

FOREST OIL CORP
Form 10-Q
August 07, 2008

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

FORM 10-Q

(Mark
One)

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

For the quarterly period ended **June 30, 2008**

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 **1-13515**

FOREST OIL CORPORATION

(Exact name of registrant as specified in its charter)

New York **25-0484900**
(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)

707 17th Street, Suite 3600 Denver, Colorado 80202
(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: **(303) 812-1400**

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, a non-accelerated filer, or a smaller reporting company. See definitions of "large accelerated filer," "accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company
(Do not check if a smaller reporting

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company)

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

As of July 31, 2008 there were 89,774,084 shares of the registrant's common stock, par value \$.10 per share, outstanding.

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June 30, 2008

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FOREST OIL CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)

(In Thousands, Except Share Data)

	June 30, 2008	December 31, 2007
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 10,811	9,685
Accounts receivable	273,270	201,617
Derivative instruments	2,391	30,006
Deferred income taxes	135,399	23,854
Other investments	29,001	34,694
Other current assets	80,747	61,518
Total current assets	531,619	361,374
Property and equipment, at cost:		
Oil and gas properties, full cost method of accounting:		
Proved, net of accumulated depletion of \$2,962,108 and \$2,742,539	4,952,318	4,414,710
Unproved	584,108	568,510
Net oil and gas properties	5,536,426	4,983,220
Other property and equipment, net of accumulated depreciation and amortization of \$33,597 and \$30,011	50,815	42,595
Net property and equipment	5,587,241	5,025,815
Goodwill	265,798	265,618
Other assets	44,831	42,741
	\$6,429,489	5,695,548
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 409,680	361,089
Accrued interest	7,908	7,693
Derivative instruments	375,064	72,675
Current portion of long-term debt		266,002
Asset retirement obligations	2,555	2,562
Other current liabilities	33,865	28,361
Total current liabilities	829,072	738,382
Long-term debt	1,997,605	1,503,035
Asset retirement obligations	91,738	87,943
Derivative instruments	152,132	38,171

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Deferred income taxes	950,432	853,427
Other liabilities	64,253	62,779
Total liabilities	4,085,232	3,283,737
Shareholders' equity:		
Preferred stock, none issued and outstanding		
Common stock, 89,767,461 and 88,379,409 shares issued and outstanding	8,977	8,838
Capital surplus	1,992,640	1,966,569
Retained earnings	224,280	306,062
Accumulated other comprehensive income	118,360	130,342
Total shareholders' equity	2,344,257	2,411,811
	\$6,429,489	5,695,548

See accompanying Notes to Condensed Consolidated Financial Statements.

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FOREST OIL CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
(In Thousands, Except Per Share Amounts)				
Revenues	\$ 515,182	254,669	891,712	437,278
Operating expenses:				
Lease operating expenses	38,413	45,027	75,978	81,067
Production and property taxes	24,148	12,808	44,199	20,718
Transportation and processing costs	4,641	5,258	9,566	9,452
General and administrative (including stock-based compensation)	19,832	13,407	39,120	26,378
Depreciation and depletion	126,584	86,126	242,151	146,585
Accretion of asset retirement obligations	1,967	1,292	3,751	2,567
Gain on sale of assets				(7,176)
Total operating expenses	215,585	163,918	414,765	279,591
Earnings from operations	299,597	90,751	476,947	157,687
Other income and expense:				
Interest expense	27,979	29,103	55,836	53,456
Unrealized losses (gains) on derivative instruments, net	319,640	(34,813)	461,853	23,025
Realized losses (gains) on derivative instruments, net	58,182	(9,270)	61,845	(34,404)
Unrealized foreign currency exchange (gains) losses	(460)	(6,271)	2,315	(6,320)
Unrealized losses on other investments, net	276		7,367	
Other (income) expense, net	(1,862)	1,122	(1,025)	234
Total other income and expense	403,755	(20,129)	588,191	35,991
Earnings (loss) before income taxes	(104,158)	110,880	(111,244)	121,696
Income tax:				
Current	4,000	2,217	3,978	3,095
Deferred	(40,140)	31,864	(42,472)	34,911
Total income tax	(36,140)	34,081	(38,494)	38,006
Net earnings (loss)	\$ (68,018)	76,799	(72,750)	83,690
Basic earnings (loss) per common share	\$ (.78)	1.11	(.83)	1.27
Diluted earnings (loss) per common share	\$ (.78)	1.08	(.83)	1.24

See accompanying Notes to Condensed Consolidated Financial Statements.

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FOREST OIL CORPORATION
CONDENSED CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY
(Unaudited)

	Common Stock		Capital Surplus	Retained Earnings	Accumulated Other Comprehensive Income	Total Shareholders' Equity
	Shares	Amount				
	(In Thousands)					
Balances at December 31, 2007	88,379	\$ 8,838	1,966,569	306,062	130,342	2,411,811
Exercise of stock options	727	73	14,217			14,290
Employee stock purchase plan	18	2	749			751
Restricted stock issued, net of cancellations	659	66	(66)			
Amortization of stock-based compensation			11,980			11,980
Adoption of EITF 06-4 and EITF 06-10				(9,032)		(9,032)
Restricted stock redeemed and other	(16)	(2)	(809)			(811)
Comprehensive loss:						
Net loss				(72,750)		(72,750)
Foreign currency translation					(11,982)	(11,982)
Total comprehensive loss						(84,732)
Balances at June 30, 2008	89,767	\$ 8,977	1,992,640	224,280	118,360	2,344,257

See accompanying Notes to Condensed Consolidated Financial Statements.

FOREST OIL CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Six Months Ended June 30,	
	2008	2007
(In Thousands)		
Operating activities:		
Net earnings (loss)	\$ (72,750)	83,690
Adjustments to reconcile net earnings (loss) to net cash provided by operating activities:		
Depreciation and depletion	242,151	146,585
Accretion of asset retirement obligations	3,751	2,567
Stock-based compensation expense	9,273	4,721
Unrealized losses on derivative instruments, net	461,853	23,025
Gain on sale of assets		(7,176)
Deferred income tax	(42,472)	34,911
Unrealized foreign currency exchange losses (gains)	2,315	(6,320)
Unrealized losses on other investments, net	7,367	
Other, net	(2,152)	(1,134)
Changes in operating assets and liabilities, net of effects of acquisitions and divestitures:		
Accounts receivable	(66,692)	32,757
Other current assets	(21,588)	726
Accounts payable	(12,781)	(20,503)
Accrued interest and other current liabilities	(18,007)	(178)
Net cash provided by operating activities	490,268	293,671
Investing activities:		
Acquisition of Houston Exploration, net of cash acquired (Note 2)		(775,960)
Capital expenditures for property and equipment:		
Exploration, development, and other acquisition costs	(789,303)	(331,983)
Other fixed assets	(12,069)	(15,539)
Proceeds from sales of assets	52,367	38,613
Other, net	1,036	
Net cash used by investing activities	(747,969)	(1,084,869)
Financing activities:		
Issuance of 7 ¹ / ₄ % senior notes, net of issuance costs	247,188	739,176
Proceeds from bank borrowings	1,360,178	963,734
Repayments of bank borrowings	(1,107,917)	(647,527)
Redemption of 8% senior notes	(265,000)	
Repurchases of 7% senior subordinated notes	(2,960)	
Repayments of term loans		(111,250)
Repayments of bank debt assumed in acquisition		(176,885)
Proceeds from the exercise of options and from employee stock purchase plan	15,041	7,056
Other, net	12,325	(1,712)
Net cash provided by financing activities	258,855	772,592
Effect of exchange rate changes on cash	(28)	1,172
Net increase (decrease) in cash and cash equivalents	1,126	(17,434)
Cash and cash equivalents at beginning of period	9,685	33,164

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Cash and cash equivalents at end of period	\$	10,811	15,730
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Cash paid during the period for:

Interest	\$	66,754	52,575
Income taxes		3,352	1,278

See accompanying Notes to Condensed Consolidated Financial Statements.

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FOREST OIL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(1) BASIS OF PRESENTATION

The Condensed Consolidated Financial Statements included herein are unaudited and include the accounts of Forest Oil Corporation and its consolidated subsidiaries (collectively, "Forest" or the "Company"). In the opinion of management, all adjustments, consisting of normal recurring accruals, have been made which are necessary for a fair presentation of the financial position of Forest at June 30, 2008, the results of its operations for the three and six months ended June 30, 2008 and 2007, and its cash flows for the six months ended June 30, 2008 and 2007. Interim results are not necessarily indicative of expected annual results because of the impact of fluctuations in prices received for liquids (oil, condensate, and natural gas liquids) and natural gas and other factors.

In the course of preparing the Condensed Consolidated Financial Statements, management makes various assumptions, judgments, and estimates to determine the reported amounts of assets, liabilities, revenues, and expenses, and in the disclosures of commitments and contingencies. Changes in these assumptions, judgments, and estimates will occur as a result of the passage of time and the occurrence of future events and, accordingly, actual results could differ from amounts previously established.

The more significant areas requiring the use of assumptions, judgments, and estimates relate to volumes of oil and gas reserves used in calculating depletion, the amount of future net revenues used in computing the ceiling test limitations, and the amount of future capital costs and abandonment obligations used in such calculations. Assumptions, judgments, and estimates are also required in determining impairments of undeveloped properties, valuing deferred tax assets, and estimating fair values of financial instruments, including derivative instruments.

Certain amounts in the prior year financial statements have been reclassified to conform to the 2008 financial statement presentation.

For a more complete understanding of Forest's operations, financial position, and accounting policies, reference is made to the consolidated financial statements of Forest, and related notes thereto, filed with Forest's Annual Report on Form 10-K for the year ended December 31, 2007, previously filed with the Securities and Exchange Commission.

(2) ACQUISITIONS AND DIVESTITURES

Acquisitions

Ark-La-Tex Properties Acquisition

On May 2, 2008, Forest acquired producing oil and natural gas properties located primarily in its core Ark-La-Tex region in East Texas and North Louisiana. Forest paid approximately \$281 million, subject to customary adjustments, for the assets using funds advanced from its credit facilities.

Acquisition of Houston Exploration

On June 6, 2007, Forest completed the acquisition of The Houston Exploration Company ("Houston Exploration") in a cash and stock transaction totaling approximately \$1.5 billion and the assumption of Houston Exploration's debt. Houston Exploration was an independent natural gas and oil producer engaged in the exploration, development, exploitation, and acquisition of natural gas and oil reserves in North America. Houston Exploration had operations in four producing regions within the United States: South Texas, East Texas, the Arkoma Basin of Arkansas, and the Uinta and DJ

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Basins in the Rocky Mountains. Pursuant to the terms and conditions of the agreement and plan of merger ("Merger Agreement"), Forest paid total merger consideration of \$750 million in cash and issued approximately 24 million common shares, valued at \$30.28 per share. The cash component of the merger consideration was financed from a private placement of \$750 million of 7¹/₄% senior notes due 2019 and borrowings under the Company's credit facilities. Immediately following the completion of the merger, Forest repaid all of Houston Exploration's outstanding bank debt totaling \$177 million.

The acquisition, which was accounted for using the purchase method of accounting, has been included in Forest's Condensed Consolidated Financial Statements since June 6, 2007, the date the acquisition closed. The following table represents the allocation of the total purchase price of Houston Exploration to the acquired assets and liabilities of Houston Exploration as of June 30, 2008. The allocation represents the estimated fair values assigned to each of the assets acquired and liabilities assumed.

	(In Thousands)
Fair value of Houston Exploration's net assets:	
Net working capital, including cash of \$3.5 million	\$ (3,739)
Proved oil and gas properties	1,741,823
Unproved oil and gas properties	448,100
Goodwill	177,428
Other assets	14,537
Derivative instruments	(45,170)
Long-term debt	(182,532)
Asset retirement obligations	(36,424)
Deferred income taxes	(590,504)
Other liabilities	(18,210)
Total fair value of net assets	\$ 1,505,309
 Consideration paid for Houston Exploration's net assets:	
Forest common stock issued	\$ 726,412
Cash consideration paid	749,694
Aggregate purchase consideration paid to Houston Exploration stockholders	1,476,106
Plus:	
Cash settlement for Houston Exploration stock options	20,075
Direct merger costs incurred	9,128
Total consideration paid	\$ 1,505,309

Goodwill of \$177.4 million has been recognized to the extent that the consideration paid exceeded the fair value of the net assets acquired and has been assigned to the U.S. geographical business segment. Goodwill is not expected to be deductible for tax purposes. The principal factors that contributed to the recognition of goodwill include the mix of complementary high-quality assets in certain of our existing core areas, lower-risk exploitation opportunities, expected increased cash flow

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FOREST OIL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(2) ACQUISITIONS AND DIVESTITURES (Continued)

from operations available for investing activities, and opportunities for cost savings through administrative and operational synergies.

Included in the working capital assumed at the acquisition date was a severance accrual of \$28.9 million for costs to involuntarily terminate employees of Houston Exploration. Management determined it would be necessary to eliminate certain overlapping positions to achieve cost savings through administrative and operational synergies. As of June 30, 2008, management has finalized its termination plan as a result of the acquisition and all severance payments have been made. The following table summarizes the activity in the severance accrual through June 30, 2008 since the acquisition date.

	(In Thousands)
Severance accrual at June 6, 2007	\$ 28,850
Cash payments ⁽¹⁾	(26,805)
Net adjustment ⁽²⁾	(2,045)
Severance accrual at June 30, 2008	\$

(1) Represents cash severance and excise tax payments to involuntarily terminated employees of Houston Exploration as well as the related employer tax payments paid by the Company.

(2) Represents the net adjustment made to the accrual as the Company continued to finalize the termination plan. This net adjustment was made to the cost of the acquired company.

The following summary pro forma combined statements of operations data of Forest for the three and six months ended June 30, 2007 has been prepared to give effect to the merger as if the merger had occurred on January 1, 2007. The pro forma financial information is not necessarily indicative of the results that might have occurred had the transaction taken place on January 1, 2007, and is not intended to be a projection of future results. Future results may vary significantly from the results reflected in the following pro forma financial information because of normal production declines, changes in commodity prices, future acquisitions and divestitures, future development and exploration activities, and other factors.

	Three Months Ended June 30, 2007	Six Months Ended June 30, 2007
	(In Thousands, Except Per Share Amounts)	
Revenues	\$ 354,429	658,235
Earnings from continuing operations	87,908	95,975
Net earnings	87,908	95,975
Basic earnings per common share:		
From continuing operations	\$ 1.01	1.11
Basic earnings per common share	1.01	1.11
Diluted earnings per common share:		
From continuing operations	\$ 1.00	1.09
Diluted earnings per common share	1.00	1.09

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FOREST OIL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(2) ACQUISITIONS AND DIVESTITURES (Continued)

*Divestitures**Sale of Alaska Assets*

On August 27, 2007, Forest sold all of its assets located in Alaska (the "Alaska Assets") to Pacific Energy Resources Ltd. ("PERL"). The total consideration received for the Alaska Assets included \$400 million in cash, 10 million shares of PERL common stock (subject to certain restrictions) (the "PERL Shares"), and a zero coupon senior subordinated note from PERL due 2014 in the principal amount at stated maturity of \$60.8 million (the "PERL Note"). A portion of the cash consideration, \$269 million, was applied to prepay all amounts due under the Alaska term loan agreements, including accrued interest and prepayment premiums. Consideration received by Forest in the form of the PERL common stock and the zero coupon senior subordinated note are being held in other investments within the Condensed Consolidated Balance Sheets. Forest accounts for these investments as trading securities in accordance with Statement of Financial Accounting Standards ("SFAS") No. 115, *Accounting for Certain Investments in Debt and Equity Securities*. Investments in debt and equity securities classified as trading securities are recorded at fair value with unrealized gains and losses recognized in "Other income and expense" in the Condensed Consolidated Statements of Operations.

(3) EARNINGS (LOSS) PER SHARE AND COMPREHENSIVE EARNINGS (LOSS)

Earnings (Loss) per Share

Basic earnings (loss) per share is computed by dividing net earnings (loss) attributable to common stock by the weighted average number of common shares outstanding during each period, excluding treasury shares. Diluted earnings per share is computed by adjusting the average number of common shares outstanding for the dilutive effect, if any, of stock options, unvested restricted stock grants, and unvested phantom stock units. Stock options, unvested restricted stock grants, and unvested phantom stock units were not included in the calculation of diluted loss per share for the three and six months ended June 30, 2008 as their inclusion would have an antidilutive effect. The following sets forth the calculation of basic and diluted earnings (loss) per share.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
	(In Thousands, Except Per Share Amounts)			
Net earnings (loss)	\$(68,018)	76,799	(72,750)	83,690
Weighted average common shares outstanding during the period	87,717	69,247	87,506	65,839
Add dilutive effects of stock options, unvested restricted stock grants, and unvested phantom stock units		1,580		1,444
Weighted average common shares outstanding, including the effects of dilutive securities	87,717	70,827	87,506	67,283
Basic earnings (loss) per share	\$ (.78)	1.11	(.83)	1.27
Diluted earnings (loss) per share	\$ (.78)	1.08	(.83)	1.24

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FOREST OIL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(3) EARNINGS (LOSS) PER SHARE AND COMPREHENSIVE EARNINGS (LOSS) (Continued)

Comprehensive Earnings (Loss)

Comprehensive earnings (loss) is a term used to refer to net earnings (loss) plus other comprehensive income (loss). Other comprehensive income (loss) is comprised of revenues, expenses, gains, and losses that under generally accepted accounting principles are reported as separate components of shareholders' equity instead of net earnings (loss). Items included in Forest's other comprehensive income (loss) for the three and six months ended June 30, 2008 and 2007 are foreign currency gains (losses) related to the translation of the assets and liabilities of Forest's Canadian operations and changes in unfunded postretirement benefits.

The components of comprehensive earnings (loss) are as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
	(In Thousands)			
Net earnings (loss)	\$ (68,018)	76,799	(72,750)	83,690
Other comprehensive income (loss):				
Foreign currency translation gains (losses)	2,308	25,921	(11,982)	28,747
Unfunded postretirement benefits, net of tax		(105)		(209)
Total comprehensive earnings (loss)	\$ (65,710)	102,615	(84,732)	112,228

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FOREST OIL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(4) STOCK-BASED COMPENSATION

The table below sets forth total stock-based compensation recorded during the three and six months ended June 30, 2008 and 2007 under the provisions of SFAS No. 123 (Revised), *Share-Based Payment* ("SFAS 123(R)") and the remaining unamortized amounts and the weighted average amortization period remaining as of June 30, 2008.

	Stock Options	Restricted Stock	Phantom Stock Units	Total ⁽¹⁾
(In Thousands)				
Three Months Ended June 30, 2008:				
Total stock-based compensation costs	\$ 694	5,756	3,165	9,615
Less: stock-based compensation costs capitalized	(301)	(2,083)	(1,948)	(4,332)
Stock-based compensation costs expensed	\$ 393	3,673	1,217	5,283
Six Months Ended June 30, 2008:				
Total stock-based compensation costs	\$ 1,529	10,192	3,818	15,539
Less: stock-based compensation costs capitalized	(648)	(3,536)	(2,341)	(6,525)
Stock-based compensation costs expensed	\$ 881	6,656	1,477	9,014
Unamortized stock-based compensation costs as of June 30, 2008	\$ 3,858	59,369	10,528 ⁽²⁾	73,755
Weighted average amortization period remaining	1.7 years	2.4 years	2.2 years	2.4 years
Three Months Ended June 30, 2007:				
Total stock-based compensation costs	\$ 1,749	1,831	568	4,148
Less: stock-based compensation costs capitalized	(329)	(600)	(366)	(1,295)
Stock-based compensation costs expensed	\$ 1,420	1,231	202	2,853
Six Months Ended June 30, 2007:				
Total stock-based compensation costs	\$ 2,682	3,264	792	6,738
Less: stock-based compensation costs capitalized	(638)	(1,020)	(504)	(2,162)
Stock-based compensation costs expensed	\$ 2,044	2,244	288	4,576

(1) The Company also maintains an employee stock purchase plan (which is not included in the table) under which \$.1 million and \$.3 million of compensation cost was recognized for the three and six months ended June 30, 2008, respectively, under the provisions of SFAS 123(R). Compensation costs for the employee stock purchase plan during the three and six months ended June 30, 2007 were each \$.1 million.

(2) Based on the closing price of the Company's common stock on June 30, 2008.

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The following table summarizes stock option activity in the Company's stock-based compensation plans for the six months ended June 30, 2008.

	Number of Shares	Weighted Average Exercise Price	Aggregate Intrinsic Value (In Thousands) ⁽¹⁾	Number of Shares Exercisable
Outstanding at January 1, 2008	2,941,506	\$ 21.35	\$ 87,816	2,275,314
Granted				
Exercised	(732,041)	19.96	29,315	
Cancelled	(28,223)	25.99		
Outstanding at June 30, 2008	2,181,242	21.76	115,318	1,779,738

(1) The intrinsic value of a stock option is the amount by which the current market value of the underlying stock exceeds the exercise price of the option.

Restricted Stock and Phantom Stock Units

The following table summarizes the restricted stock and phantom stock unit activity in the Company's stock-based compensation plans for the six months ended June 30, 2008.

	Restricted Stock Number of Shares	Weighted Average Grant Date Fair Value	Phantom Stock Units Number of Shares	Weighted Average Grant Date Fair Value
Unvested at January 1, 2008	1,281,000	\$ 43.41	164,500	\$ 42.50
Awarded	702,845	64.46	69,854	64.66
Vested	(51,100)	41.83		
Forfeited	(43,550)	44.13	(1,400)	40.91
Unvested at June 30, 2008	1,889,195	51.27	232,954	49.15

The phantom stock units can be settled in cash, shares of common stock, or a combination of both. The phantom stock units have been accounted for as a liability within the Condensed Consolidated Financial Statements.

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FOREST OIL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(5) DEBT

Components of debt are as follows:

	June 30, 2008				December 31, 2007			
	Principal	Unamortized Premium (Discount)	Other ⁽³⁾	Total	Principal	Unamortized Premium (Discount)	Other ⁽³⁾	Total
	(In Thousands)							
U.S. Credit Facility	\$ 430,000			430,000	165,000			165,000
Canadian Credit Facility	112,781			112,781	129,126			129,126
8% Senior Notes due 2008 ⁽¹⁾					265,000	(48)	1,050	266,002
8% Senior Notes due 2011	285,000	4,521	2,897	292,418	285,000	5,167	3,315	293,482
7% Senior Subordinated Notes due 2013 ⁽²⁾	2,862	(71)		2,791	5,822	(158)		5,664
7 ³ / ₄ % Senior Notes due 2014	150,000	(1,393)	10,390	158,997	150,000	(1,512)	11,275	159,763
7 ¹ / ₄ % Senior Notes due 2019 ⁽¹⁾	1,000,000	618		1,000,618	750,000			750,000
Total debt	1,980,643	3,675	13,287	1,997,605	1,749,948	3,449	15,640	1,769,037
Less: current portion of long-term debt					(265,000)	48	(1,050)	(266,002)
Long-term debt	\$ 1,980,643	3,675	13,287	1,997,605	1,484,948	3,497	14,590	1,503,035

- (1) The 8% senior notes due 2008 became due and payable on June 15, 2008. In May 2008, the Company issued an additional \$250 million in principal amount of 7¹/₄% senior notes due 2019 at 100.25% of par for proceeds of \$247.2 million (net of related offering costs) and used the net proceeds and borrowings under its credit facilities to redeem the \$265 million in principal amount outstanding of 8% senior notes that matured on June 15, 2008. The Company had previously issued \$750 million in principal amount of 7¹/₄% senior notes due 2019 at par in connection with the Houston Exploration acquisition in June 2007.
- (2) In May 2008, the Company repurchased \$3.0 million in principal amount of 7% senior subordinated notes due 2013 at 99.9375% of par value.
- (3) Represents the unamortized portion of gains realized upon termination of interest rate swaps that were accounted for as fair value hedges. The gains are being amortized as a reduction of interest expense over the terms of the notes.

Bank Credit Facilities

On May 9, 2008, Forest entered into a first amendment (the "First Amendment") to its second amended and restated combined credit agreements, which increased lender commitments to \$1.8 billion and established the global borrowing base at \$1.8 billion. The amended credit agreements consist of a \$1.65 billion U.S. credit facility through a syndicate of banks led by JPMorgan Chase Bank, N.A. (the "U.S. Credit Facility") and a \$150 million Canadian credit facility through a syndicate of banks led by JPMorgan Chase Bank, N.A., Toronto Branch (the "Canadian Credit Facility," and together with the U.S. Credit Facility, the "Credit Facilities"). The Credit Facilities will mature in June 2012.

Forest's availability under the Credit Facilities is governed by a borrowing base (the "Global Borrowing Base"), which currently is set at \$1.8 billion, with \$1.65 billion allocated to the U.S. Credit Facility and \$150 million allocated to the Canadian Credit Facility. The determination of the Global Borrowing Base is made by the lenders in their sole discretion taking into consideration the estimated value of Forest's oil and gas properties in accordance with the lenders' customary practices for oil and gas loans. The Global Borrowing Base is redetermined semi-annually,

and the available borrowing

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FOREST OIL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(5) DEBT (Continued)

amount could be increased or decreased as a result of such redeterminations. In addition, Forest and the lenders each have discretion at any time, but not more often than once during any calendar year, to have the Global Borrowing Base redetermined. In the event Forest issues senior notes after May 9, 2008, the Global Borrowing Base will immediately be reduced by an amount equal to \$0.30 of every \$1.00 principal amount of newly issued senior notes (excluding any senior notes that Forest may issue to refinance senior notes outstanding on May 9, 2008).

The Credit Facilities include terms and covenants that place limitations on certain types of activities, including restrictions or requirements with respect to additional debt, liens, asset sales, hedging activities, investments, dividends, mergers, and acquisitions, and include financial covenants.

Under certain conditions, amounts outstanding under the Credit Facilities may be accelerated. Bankruptcy and insolvency events with respect to Forest or certain of its subsidiaries will result in an automatic acceleration of the indebtedness under the Credit Facilities. Subject to notice and cure periods in certain cases, other events of default under either of the Credit Facilities will result in acceleration of the indebtedness under the facilities at the option of the lenders. Such other events of default include non-payment, breach of warranty, non-performance of obligations under the Credit Facilities (including financial covenants), default on other indebtedness, certain pension plan events, certain adverse judgments, change of control, a failure of the liens securing the Credit Facilities, and an event of default under the Canadian Credit Facility.

The Credit Facilities include provisions and conditions linked to Forest's credit ratings. For example, the Company's collateral requirements will vary based on the Company's credit ratings. In general, Forest's ability to raise funds and the cost of any financing activities may be affected by the Company's credit ratings at the time any such activities are conducted.

The Credit Facilities are collateralized by a portion of Forest's assets. The Company is also required to mortgage and grant a security interest in the greater of 75% of the present value of its consolidated proved oil and gas properties, or 1.875 multiplied by the allocated U.S. borrowing base. The Company also has pledged the stock of several subsidiaries to the lenders to secure the Credit Facilities. Under certain circumstances, the Company could be obligated to pledge additional assets as collateral. If Forest's corporate credit ratings by Moody's and S&P improve and meet pre-established levels, the collateral requirements would not apply and, at the Company's request, the banks would release their liens and security interests on its properties.

From time to time, Forest and the syndication agents, documentation agents, global administrative agent, and the other lenders party to the Credit Facilities engage in other transactions, including securities offerings where such parties or their affiliates may serve as an underwriter or initial purchaser of Forest's securities and, or serve as counterparties to Forest's derivative agreements.

7¹/₄% Senior Notes Due 2019

On May 22, 2008, Forest issued an additional \$250 million in principal amount of 7¹/₄% senior notes due in 2019 (the "7¹/₄% Notes") at 100.25% of par for net proceeds of \$247.2 million, after deducting initial purchaser discounts. The additional 7¹/₄% Notes were used to redeem a portion of the Company's 8% senior notes due 2008 that matured on June 15, 2008. The additional 7¹/₄% Notes were issued under an existing indenture (the "Indenture") dated as of June 6, 2007 among Forest, Forest Oil

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Permian Corporation, a wholly-owned subsidiary of Forest ("Forest Permian"), as subsidiary guarantor, and U.S. Bank National Association, as trustee. Forest previously issued an aggregate principal amount of \$750 million in 7¹/₄% Notes under the Indenture, and there is now a total of \$1 billion in 7¹/₄% Notes outstanding. The 7¹/₄% Notes are jointly and severally guaranteed by Forest Permian on an unsecured basis. Interest is payable on June 15 and December 15 of each year, beginning June 15, 2008. The 7¹/₄% Notes will mature on June 15, 2019.

Forest may redeem up to 35% of the 7¹/₄% Notes at any time prior to June 15, 2010, on one or more occasions, with the proceeds from certain equity offerings at a redemption price equal to 107.25% of the principal amount, plus accrued but unpaid interest. Forest may redeem the 7¹/₄% Notes at any time beginning on or after June 15, 2012 at the prices set forth below, expressed as percentages of the principal amount redeemed, plus accrued but unpaid interest:

2012	103.6%
2013	102.4%
2014	101.2%
2015 and thereafter	100.0%

Forest may also redeem the 7¹/₄% Notes, in whole or in part, at a price equal to the principal amount plus a "make whole" premium, at any time prior to June 15, 2012, using a discount rate of the Treasury rate plus 0.50%, plus accrued but unpaid interest.

Forest and its restricted subsidiaries are subject to certain negative covenants under the Indenture governing the 7¹/₄% Notes. The Indenture limits the ability of Forest and each of its restricted subsidiaries to, among other things: incur additional indebtedness, create certain liens, make certain types of "restricted payments," make investments, sell assets, enter into agreements that restrict dividends or other payments from its subsidiaries to itself, consolidate, merge or transfer all or substantially all of its assets, engage in transactions with affiliates, and pay dividends or make other distributions on capital stock or subordinated indebtedness.

7% Senior Subordinated Notes Due 2013

On May 22, 2008, Forest repurchased \$3.0 million in principal amount of 7% senior subordinated notes due in 2013 (the "7% Notes") at 99.9375% of par value. As a result of the repurchase, Forest recorded a loss of \$.1 million during the three and six months ended June 30, 2008.

8% Senior Notes Due 2008

On June 15, 2008, Forest redeemed \$265 million in principal amount of 8% senior notes due in 2008 (the "8% Notes due 2008") that matured as of that date. The Company used net proceeds received from the issuance of additional 7¹/₄% Notes and borrowings under its credit facilities to fund the redemption of the 8% Notes due 2008.

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FOREST OIL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(6) PROPERTY AND EQUIPMENT

The Company uses the full cost method of accounting for oil and gas properties. Separate cost centers are maintained for each country in which the Company has operations. During the periods presented, the Company's primary oil and gas operations were conducted in the United States and Canada. All costs incurred in the acquisition, exploration, and development of properties (including costs of surrendered and abandoned leaseholds, delay lease rentals, dry holes, and overhead related to exploration and development activities) and the fair value of estimated future costs of site restoration, dismantlement, and abandonment activities are capitalized. During the three months ended June 30, 2008 and 2007, Forest capitalized \$14.8 million and \$8.9 million of general and administrative costs (including stock-based compensation), respectively. For the six months ended June 30, 2008 and 2007, Forest capitalized \$26.9 million and \$17.1 million of general and administrative costs (including stock-based compensation), respectively. Interest costs related to significant unproved properties that are under development are also capitalized to oil and gas properties. During the three months ended June 30, 2008 and 2007, the Company capitalized \$5.5 million and \$1.4 million, respectively, of interest expense attributed to unproved properties. For the six months ended June 30, 2008 and 2007, the Company capitalized \$10.7 million and \$2.2 million, respectively, of interest expense attributed to unproved properties.

Investments in unproved properties, including capitalized interest costs, are not depleted pending determination of the existence of proved reserves. Unproved properties are assessed periodically to ascertain whether impairment has occurred. Unproved properties whose costs are individually significant are assessed individually by considering the primary lease terms of the properties, the holding period of the properties, and geographic and geologic data obtained relating to the properties. Where it is not practicable to assess individually the amount of impairment of properties for which costs are not individually significant, such properties are grouped for purposes of assessing impairment. The amount of impairment assessed is added to the costs to be amortized, or is reported as a period expense, as appropriate.

Pursuant to full cost accounting rules, the Company must perform a ceiling test each quarter on its proved oil and gas assets within each separate cost center. The ceiling test provides that capitalized costs less related accumulated depletion and deferred income taxes for each cost center may not exceed the sum of (1) the present value of future net revenue from estimated production of proved oil and gas reserves using current prices, excluding the future cash outflows associated with settling asset retirement obligations that have been accrued on the balance sheet, at a discount factor of 10%; plus (2) the cost of properties not being amortized, if any; plus (3) the lower of cost or estimated fair value of unproved properties included in the costs being amortized, if any; less (4) income tax effects related to differences in the book and tax basis of oil and gas properties. Should the net capitalized costs for a cost center exceed the sum of the components noted above, an impairment charge would be recognized to the extent of the excess capitalized costs. There were no provisions for impairment of proved oil and gas properties in 2008 or 2007, although the Company's ceiling test in each of its cost centers could be adversely impacted by declines in commodity prices.

Gain or loss is not recognized on the sale of oil and gas properties unless the sale significantly alters the relationship between capitalized costs and estimated proved oil and gas reserves attributable to a cost center.

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FOREST OIL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(6) PROPERTY AND EQUIPMENT (Continued)

Depletion of proved oil and gas properties is computed on the units-of-production method, whereby capitalized costs, as adjusted for future development costs and asset retirement obligations, are amortized over the total estimated proved reserves. Furniture and fixtures, leasehold improvements, computer hardware and software, and other equipment are depreciated on the straight-line or declining balance method, based upon estimated useful lives of the assets ranging from three to 15 years.

(7) ASSET RETIREMENT OBLIGATIONS

Forest records estimated future asset retirement obligations pursuant to the provisions of SFAS No. 143, *Accounting for Asset Retirement Obligations* ("SFAS 143"). SFAS 143 requires entities to record the fair value of a liability for an asset retirement obligation in the period in which it is incurred with a corresponding increase in the carrying amount of the related long-lived asset. Subsequent to initial measurement, the asset retirement liability is required to be accreted each period to its present value. Capitalized costs are depleted as a component of the full cost pool using the units-of-production method. Forest's asset retirement obligations consist of costs related to the plugging of wells, the removal of facilities and equipment, and site restoration on oil and gas properties.

The following table summarizes the activity for Forest's asset retirement obligations for the six months ended June 30, 2008 and 2007. The decrease in total asset retirement obligations at June 30, 2008 compared to June 30, 2007 is primarily due to the sale of the Alaska Assets in August 2007.

	Six Months Ended June 30,	
	2008	2007
	(In Thousands)	
Asset retirement obligations at beginning of period	\$90,505	64,102
Accretion expense	3,751	2,567
Liabilities incurred	6,353	1,256
Liabilities settled	(1,292)	(818)
Disposition of properties	(3,692)	
Liabilities assumed	1,096	40,073
Revisions of estimated liabilities	(1,945)	(28)
Impact of foreign currency exchange rate	(483)	1,345
Asset retirement obligations at end of period	94,293	108,497
Less: current asset retirement obligations	(2,555)	(6,232)
Long-term asset retirement obligations	\$91,738	102,265

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FOREST OIL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(8) EMPLOYEE BENEFITS*Pension Plans and Postretirement Benefits*

The following table sets forth the components of the net periodic cost of Forest's defined benefit pension plans and postretirement benefits in the United States for the three and six months ended June 30, 2008 and 2007.

	Three Months Ended June 30,				Six Months Ended June 30,			
	Pension Benefits		Postretirement Benefits		Pension Benefits		Postretirement Benefits	
	2008	2007	2008	2007	2008	2007	2008	2007
	(In Thousands)							
Service cost	\$ 57	127	102		57	254	205	
Interest cost	569	581	110	94	1,138	1,134	220	188
Expected return on plan assets	(633)	(640)			(1,266)	(1,281)		
Amortization of prior service cost		26				26		
Recognized actuarial loss (gain)	181	195	(30)	(21)	363	390	(60)	(43)
Total net periodic expense	\$ 117	219	207	175	235	326	414	350

Split Dollar Life Insurance

The Company provides life insurance benefits for certain retirees and former executives under split dollar life insurance plans. Under the life insurance plans, the Company is assigned a portion of the benefits. No current employees are covered by these plans. On January 1, 2008, the Company adopted Emerging Issues Task Force ("EITF") Issue No. 06-4, *Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements* ("EITF 06-4"), and EITF Issue No. 06-10, *Accounting for Collateral Assignment Split-Dollar Life Insurance Arrangements* ("EITF 06-10"). Pursuant to these pronouncements, the Company recognized a liability for the estimated cost of maintaining the insurance policies during the postretirement periods of the retirees and former executives in accordance with SFAS No. 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions* ("SFAS 106"). Upon adoption, Forest recorded a \$9.0 million liability as a change in accounting principle through a cumulative effect adjustment to retained earnings. The weighted average discount rate used to determine the postretirement benefit obligation and accretion expense was 5.55%. The Company's estimate of costs expected to be paid in 2008 to maintain these life insurance policies is \$1.1 million. Accretion of the discounted life insurance obligations totaled \$.1 million and \$.3 million during the three and six months ended June 30, 2008, respectively. As of June 30, 2008, the Company's liability associated with the life insurance policies was \$8.2 million. In addition, as of June 30, 2008, the Company had recorded a \$2.9 million asset representing the estimated cash surrender value of the life insurance policies.

(9) FAIR VALUE MEASUREMENTS

In September 2006, the Financial Accounting Standards Board ("FASB") issued SFAS No. 157, *Fair Value Measurements* ("SFAS 157"). This statement clarifies the definition of fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. The

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FOREST OIL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(9) FAIR VALUE MEASUREMENTS (Continued)

Company adopted the provisions of SFAS 157 as of January 1, 2008 for all financial and nonfinancial assets and liabilities recognized or disclosed at fair value on a recurring basis. We will adopt SFAS 157 as it relates to all nonfinancial assets and liabilities that are not recognized or disclosed on a recurring basis as of January 1, 2009 pursuant to the provisions of FASB Staff Position No. FAS 157-2, *Effective Date of FASB Statement No. 157*. The adoption of SFAS 157 did not materially impact the Company's financial position, results of operations, or cash flow.

SFAS 157 establishes a three-tier fair value hierarchy, which prioritizes the inputs used to measure fair value. These tiers include: Level 1, defined as inputs such as unadjusted quoted prices in active markets for identical assets or liabilities; Level 2, defined as inputs other than quoted prices in active markets that are either directly or indirectly observable; and Level 3, defined as unobservable inputs for use when little or no market data exists, therefore requiring an entity to develop its own assumptions.

As of June 30, 2008, the Company held certain financial assets and liabilities that are required to be measured at fair value on a recurring basis, including: (i) the Company's commodity derivative instruments and (ii) other investments, which are comprised of the PERL Note and the PERL Shares.

The Company used the income approach in determining the fair value of its derivative instruments, utilizing present value techniques for valuing its swaps and basis swaps and option-pricing models for valuing its collars and three-way collars. The Company's derivative instruments are included within the Level 2 fair value hierarchy. The Company also used the income approach in determining the fair value of its PERL Note and PERL Shares, utilizing present value techniques for valuing its PERL Note and an option-pricing model for valuing its PERL Shares. Because the PERL Shares are restricted and not registered for public sale, they could not be valued within the Level 1 fair value hierarchy and are instead included within the Level 2 fair value hierarchy. The PERL Note is included within the Level 3 fair value hierarchy.

The Company's assets and liabilities measured at fair value on a recurring basis at June 30, 2008, were as follows:

Description	Using Significant Other Observable Inputs (Level 2)	Using Significant Unobservable Inputs (Level 3)	Total
	(In Thousands)		
Assets:			
Derivative instruments	\$ 2,391		2,391
Other investments	12,259	16,742	29,001
Liabilities:			
Derivative instruments	(527,196)		(527,196)

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FOREST OIL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(9) FAIR VALUE MEASUREMENTS (Continued)

The following table presents a reconciliation of the beginning and ending balances of the Company's assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the three and six months ended June 30, 2008.

	Three Months Ended June 30, 2008	Six Months Ended June 30, 2008
	(In Thousands)	
Balance at beginning of period	\$ 16,069	15,023
Total gains or (losses) (realized/unrealized):		
Included in earnings	673	1,719
Included in other comprehensive income		
Purchases, sales, issuances, and settlements (net)		
Transfers in and/or out of Level 3		
Balance at end of period	\$ 16,742	16,742

The amount of total gains or (losses) for the period included in earnings attributable to the change in unrealized gains or losses relating to assets still held at end of period	\$ (193)	45
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Gains and losses (realized and unrealized) included in earnings related to the Company's assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the three and six months ended June 30, 2008 are reported in the Condensed Consolidated Statements of Operations as follows:

	Three Months Ended June 30, 2008		Six Months Ended June 30, 2008	
	Unrealized Losses on Other Investments, Net	Other (Income) Expense, Net ⁽¹⁾	Unrealized Losses on Other Investments, Net	Other (Income) Expense, Net ⁽¹⁾
	(In Thousands)			
Total losses or (gains) included in earnings for the period	\$ 193	(866)	(45)	(1,674)
Change in unrealized losses or (gains) relating to assets still held at end of period	\$ 193		(45)	

(1) Represents imputed interest income on the PERL Note.

(10) DERIVATIVE INSTRUMENTS

Commodity Derivatives

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Forest periodically enters into derivative instruments such as swap, basis swap, and collar agreements in order to provide a measure of stability to Forest's cash flows in an environment of volatile oil and gas prices and to manage the exposure to commodity price risk. Forest's commodity

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FOREST OIL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(10) DERIVATIVE INSTRUMENTS (Continued)

derivative instruments generally serve as effective economic hedges of commodity price exposure; however, the Company has elected not to account for the derivatives as cash flow hedges. As such, the Company recognizes all changes in fair value of its derivative instruments in earnings rather than deferring such amounts in accumulated other comprehensive income included in shareholders' equity as would be done if cash flow hedge accounting was utilized. Forest is exposed to risks associated with swap and collar agreements arising from movements in the prices of oil and natural gas and from non-performance by the counterparties to the swap and collar agreements.

The tables below set forth Forest's outstanding commodity swaps and collars as of June 30, 2008.

	Swaps			
	Natural Gas (NYMEX HH)		Oil (NYMEX WTI)	
	Bbtu per Day ⁽¹⁾	Weighted Average Hedged Price per MMBtu	Barrels per Day	Weighted Average Hedged Price per Bbl
Third Quarter 2008	70	\$ 9.02	6,500	\$ 69.72
Fourth Quarter 2008	70	9.02	6,500	69.72
Calendar 2009	110	9.33	4,500	69.01
Calendar 2010			1,500	72.95

(1)

10 Bbtu per day is subject to a \$6.00 written put for Calendar 2008.

	Costless Collars	
	Natural Gas (NYMEX HH)	
	Bbtu per Day	Weighted Average Hedged Floor and Ceiling Price per MMBtu
Third Quarter 2008	80	\$ 7.33/8.87
Fourth Quarter 2008	80	7.33/8.87
Calendar 2009	40	8.25/10.92

	Three-Way Costless Collars	
	Natural Gas (NYMEX HH)	
	Bbtu per Day	Weighted Average Hedged Lower Floor, Upper Floor, and Ceiling Price per MMBtu
Third Quarter 2008	30	\$ 6.00/8.00/10.00
Fourth Quarter 2008	30	6.00/8.00/10.00

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Forest also uses basis swaps in connection with natural gas swaps in order to fix the price differential between the NYMEX price and the index price at which the natural gas production is sold. As of June 30, 2008, Forest had basis swaps outstanding covering 80 Bbtu per day for the remainder of 2008.

At June 30, 2008, the fair values of Forest's commodity derivative instruments are presented within the Condensed Consolidated Balance Sheet as liabilities of \$527.2 million, of which \$375.1 million is classified as current, and assets of \$2.4 million, all of which is classified as current. Due to the volatility

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FOREST OIL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(10) DERIVATIVE INSTRUMENTS (Continued)

of oil and natural gas prices, the estimated fair values of Forest's commodity derivative instruments are subject to large fluctuations from period to period. Forest has experienced the effects of these commodity price fluctuations in prior periods and expects that this commodity price volatility will continue.

The table below summarizes the realized and unrealized gains and losses Forest incurred related to its commodity derivatives for the periods indicated.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
	(In Thousands)			
Realized losses (gains) on derivatives ⁽¹⁾	\$ 57,577	(9,140)	60,956	(34,273)
Unrealized losses (gains) on derivatives ⁽¹⁾	329,144	(33,074)	466,574	24,814
Net realized and unrealized losses (gains) recorded	\$386,721	(42,214)	527,530	(9,459)

(1) Included in "Other income and expense" in the Condensed Consolidated Statements of Operations.

Interest Rate Swaps

The Company may enter into interest rate swap agreements in an attempt to normalize the mix of fixed and floating interest rates within its debt portfolio. During the three months ended June 30, 2008, the Company terminated all of its outstanding interest rate swaps for a net gain of \$.4 million.

The table below summarizes the realized and unrealized gains and losses Forest incurred related to its interest rate swaps for the periods indicated.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
	(In Thousands)			
Realized losses (gains) on derivatives ⁽¹⁾⁽²⁾	\$ 605	(130)	889	(131)
Unrealized gains on derivatives ⁽¹⁾	(9,504)	(1,739)	(4,721)	(1,789)
Net realized and unrealized gains recorded	\$ (8,899)	(1,869)	(3,832)	(1,920)

(1)

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Included in "Other income and expense" in the Condensed Consolidated Statements of Operations.

(2)

The three and six months ended June 30, 2008 include \$.4 million of net proceeds received upon termination of the interest rate swaps.

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FOREST OIL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(11) GEOGRAPHICAL SEGMENTS

Segment information has been prepared in accordance with SFAS No. 131, *Disclosures About Segments of an Enterprise and Related Information*. At June 30, 2008, Forest conducted operations in one industry segment, that being the oil and gas exploration and production industry, and had three reportable geographical business segments: United States, Canada, and International. Forest's remaining activities were not significant and therefore were not reported as a separate segment, but have been included as a reconciling item in the information below. The segments were determined based upon the geographical location of operations in each business segment. The segment data presented below was prepared on the same basis as the Condensed Consolidated Financial Statements.

	Oil and Gas Operations							
	Three Months Ended June 30, 2008				Six Months Ended June 30, 2008			
	United States	Canada	International	Total Company	United States	Canada	International	Total Company
	(In Thousands)							
Revenue	\$433,838	81,240		515,078	749,334	142,331		891,665
Expenses:								
Lease operating expenses	29,112	9,301		38,413	58,046	17,932		75,978
Production and property taxes	23,297	851		24,148	42,471	1,728		44,199
Transportation and processing costs	2,263	2,378		4,641	4,695	4,871		9,566
Depletion	101,566	23,107		124,673	193,425	45,196		238,621
Accretion of asset retirement obligations	1,624	323	20	1,967	3,099	611	41	3,751
Earnings (loss) from operations	\$275,976	45,280	(20)	321,236	447,598	71,993	(41)	519,550
Capital expenditures ⁽¹⁾	\$567,595	31,540	1,669	600,804	763,334	102,715	2,574	868,623
Goodwill	\$248,804	16,994		265,798	248,804	16,994		265,798

(1) Includes estimated discounted asset retirement obligations of \$4.7 million and \$5.5 million related to assets placed in service during the three and six months ended June 30, 2008, respectively.

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FOREST OIL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(11) GEOGRAPHICAL SEGMENTS (Continued)

A reconciliation of segment earnings from operations to consolidated earnings (loss) before income taxes is as follows:

	Three Months Ended June 30, 2008	Six Months Ended June 30, 2008
	(In Thousands)	
Earnings from operations for reportable segments	\$ 321,236	519,550
Marketing and other	104	47
General and administrative expense (including stock-based compensation)	(19,832)	(39,120)
Administrative asset depreciation	(1,911)	(3,530)
Interest expense	(27,979)	(55,836)
Unrealized losses on derivative instruments, net	(319,640)	(461,853)
Realized losses on derivative instruments, net	(58,182)	(61,845)
Unrealized foreign currency exchange gains (losses)	460	(2,315)
Unrealized losses on other investments, net	(276)	(7,367)
Other income, net	1,862	1,025
Earnings (loss) before income taxes	\$ (104,158)	(111,244)

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FOREST OIL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(11) GEOGRAPHICAL SEGMENTS (Continued)

	Oil and Gas Operations							
	Three Months Ended June 30, 2007				Six Months Ended June 30, 2007			
	United States	Canada	International	Total Company	United States	Canada	International	Total Company
	(In Thousands)							
Revenue	\$ 201,953	51,986		253,939	339,377	97,118		436,495
Expenses:								
Lease operating expenses	36,811	8,216		45,027	65,446	15,621		81,067
Production and property taxes	12,063	745		12,808	19,283	1,435		20,718
Transportation and processing costs	2,398	2,860		5,258	4,111	5,341		9,452
Depletion	63,008	22,056		85,064	104,240	40,487		144,727
Accretion of asset retirement obligations	1,026	254	12	1,292	2,028	515	24	2,567
Earnings (loss) from operations	\$ 86,647	17,855	(12)	104,490	144,269	33,719	(24)	177,964
Capital expenditures ⁽¹⁾	\$2,222,477	24,570	2,201	2,249,248	2,321,420	81,295	2,830	2,405,545
Goodwill	\$ 322,119	16,264		338,383	322,119	16,264		338,383

(1) Includes estimated discounted asset retirement obligations of \$40.4 million and \$41.3 million related to assets placed in service during the three and six months ended June 30, 2007, respectively.

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FOREST OIL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(11) GEOGRAPHICAL SEGMENTS (Continued)

A reconciliation of segment earnings from operations to consolidated earnings before income taxes is as follows:

	Three Months Ended June 30, 2007	Six Months Ended June 30, 2007
	(In Thousands)	
Earnings from operations for reportable segments	\$ 104,490	177,964
Marketing, processing, and other	730	783
General and administrative expense (including stock-based compensation)	(13,407)	(26,378)
Administrative asset depreciation	(1,062)	(1,858)
Interest expense	(29,103)	(53,456)
Unrealized gains (losses) on derivative instruments, net	34,813	(23,025)
Realized gains on derivative instruments, net	9,270	34,404
Unrealized foreign currency exchange gains	6,271	6,320
Gain on sale of assets		7,176
Other expense, net	(1,122)	(234)
Earnings before income taxes	\$ 110,880	121,696

The following tables set forth information regarding the Company's total assets by segment and long-lived assets by geographic area.

	Total Assets	
	June 30, 2008	December 31, 2007
	(In Thousands)	
United States	\$5,516,319	4,828,582
Canada	835,841	791,714
International	77,329	75,252
Total assets	\$6,429,489	5,695,548

	Long-Lived Assets ⁽¹⁾	
	June 30, 2008	December 31, 2007
	(In Thousands)	
United States	\$5,009,472	4,487,257
Canada	767,256	730,418
International	76,311	73,758
Total long-lived assets	\$5,853,039	5,291,433

(1)

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Includes net property and equipment and goodwill.

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FOREST OIL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(12) CONDENSED CONSOLIDATING FINANCIAL INFORMATION

The Company's 8% senior notes due 2011, 7³/₄% senior notes due 2014, and 7¹/₄% senior notes due 2019 have been fully and unconditionally guaranteed by a wholly-owned subsidiary of the Company (the "Subsidiary Guarantor"). The Company's remaining subsidiaries (the "Non-Guarantor Subsidiaries") have not provided guarantees. Based on this distinction, the following presents condensed consolidating financial information as of June 30, 2008 and December 31, 2007 and for the three and six months ended June 30, 2008 and 2007 on an issuer (parent company), guarantor subsidiary, non-guarantor subsidiaries, eliminating entries, and consolidated basis. Elimination entries presented are necessary to combine the entities.

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FOREST OIL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(12) CONDENSED CONSOLIDATING FINANCIAL INFORMATION (Continued)

CONDENSED CONSOLIDATING BALANCE SHEETS

(Unaudited)

(In Thousands)

	June 30, 2008 Combined				December 31, 2007 Combined					
	Parent Company	Guarantor Subsidiary	Non-Guarantor Subsidiaries	Eliminations	Consolidated	Parent Company	Guarantor Subsidiary	Non-Guarantor Subsidiaries	Eliminations	Consolidated
ASSETS										
Current assets:										
Cash and cash equivalents	\$ 1,446	174	9,191		10,811	1,189	386	8,110		9,685
Accounts receivable	175,707	14,507	101,961	(18,905)	273,270	121,698	8,979	80,890	(9,950)	201,617
Deferred income taxes	135,399				135,399	23,854				23,854
Other current assets	101,249	146	10,744		112,139	116,898	273	9,047		126,218
Total current assets	413,801	14,827	121,896	(18,905)	531,619	263,639	9,638	98,047	(9,950)	361,374
Property and equipment, at cost										
	5,973,780	253,291	2,355,875		8,582,946	5,363,127	240,748	2,194,490		7,798,365
Less accumulated depreciation, depletion and amortization										
	2,011,911	94,214	889,580		2,995,705	1,852,033	82,743	837,774		2,772,550
Net property and equipment	3,961,869	159,077	1,466,295		5,587,241	3,511,094	158,005	1,356,716		5,025,815
Investment in subsidiaries	757,936			(757,936)		740,964			(740,964)	
Note receivable from subsidiary										
	93,053			(93,053)		73,307			(73,307)	
Goodwill	225,844		39,954		265,798	225,178		40,440		265,618
Due from (to) parent and subsidiaries										
	432,216	(16,624)	(415,592)			308,381	28,409	(336,790)		
Other assets	42,334	(1)	2,498		44,831	39,424	1	3,316		42,741
	\$ 5,927,053	157,279	1,215,051	(869,894)	6,429,489	5,161,987	196,053	1,161,729	(824,221)	5,695,548
LIABILITIES AND SHAREHOLDERS' EQUITY										
Current liabilities:										
Accounts payable	\$ 353,929	11,900	62,756	(18,905)	409,680	293,523	9,810	67,706	(9,950)	361,089
Current portion of long-term debt										
						266,002				266,002
Other current liabilities	408,326	1,078	9,988		419,392	103,288	1,012	6,991		111,291
Total current liabilities	762,255	12,978	72,744	(18,905)	829,072	662,813	10,822	74,697	(9,950)	738,382
Long-term debt	1,884,824		112,781		1,997,605	1,373,909		129,126		1,503,035
Notes payable to parent			93,053	(93,053)				73,307	(73,307)	
Other liabilities	260,824	1,766	45,533		308,123	136,362	1,690	50,841		188,893
Deferred income taxes	674,893	47,733	227,806		950,432	577,092	62,509	213,826		853,427
Total liabilities	3,582,796	62,477	551,917	(111,958)	4,085,232	2,750,176	75,021	541,797	(83,257)	3,283,737

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Shareholders' equity	2,344,257	94,802	663,134	(757,936)	2,344,257	2,411,811	121,032	619,932	(740,964)	2,411,811
	\$5,927,053	157,279	1,215,051	(869,894)	6,429,489	5,161,987	196,053	1,161,729	(824,221)	5,695,548

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FOREST OIL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(12) CONDENSED CONSOLIDATING FINANCIAL INFORMATION (Continued)

CONDENSED CONSOLIDATING STATEMENTS OF OPERATIONS

(Unaudited)

(In Thousands)

	Three Months Ended June 30,									
	2008 Combined					2007 Combined				
	Parent Company	Guarantor Subsidiary	Non-Guarantor Subsidiaries	Eliminations	Consolidated	Parent Company	Guarantor Subsidiary	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Revenues	\$ 350,896	33,664	133,169	(2,547)	515,182	131,163	16,857	107,024	(375)	254,669
Operating expenses:										
Lease operating expenses	24,667	2,906	10,805	35	38,413	16,661	3,585	24,754	27	45,027
Other direct operating costs	20,845	2,313	5,631		28,789	11,511	1,400	5,155		18,066
General and administrative (including stock-based compensation)	16,048	21	3,763		19,832	10,337	37	3,033		13,407
Depreciation and depletion	83,548	6,037	37,001	(2)	126,584	41,973	4,777	39,378	(2)	86,126
Accretion of asset retirement obligations	1,555	41	371		1,967	568	70	654		1,292
Total operating expenses	146,663	11,318	57,571	33	215,585	81,050	9,869	72,974	25	163,918
Earnings from operations	204,233	22,346	75,598	(2,580)	299,597	50,113	6,988	34,050	(400)	90,751
Equity earnings in subsidiaries	(4,361)			4,361		22,968			(22,968)	
Other income and expense:										
Interest expense	24,177		7,797	(3,995)	27,979	16,711	2	16,133	(3,743)	29,103
Unrealized losses (gains) on derivative instruments, net	232,905	46,192	40,543		319,640	(38,631)	(1,114)	4,932		(34,813)
Realized losses (gains) on derivative instruments, net	43,663	8,108	6,411		58,182	(5,193)	(1,820)	(2,257)		(9,270)
Other (income) expense, net	(4,304)	7	(366)	2,617	(2,046)	(4,095)	90	(4,910)	3,766	(5,149)
Total other income and expense	296,441	54,307	54,385	(1,378)	403,755	(31,208)	(2,842)	13,898	23	(20,129)
Earnings (loss) before income taxes	(96,569)	(31,961)	21,213	3,159	(104,158)	104,289	9,830	20,152	(23,391)	110,880
Income tax	(28,551)	(11,599)	4,010		(36,140)	27,490	3,651	2,940		34,081
Net earnings (loss)	\$ (68,018)	(20,362)	17,203	3,159	(68,018)	76,799	6,179	17,212	(23,391)	76,799

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FOREST OIL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(12) CONDENSED CONSOLIDATING FINANCIAL INFORMATION (Continued)

CONDENSED CONSOLIDATING STATEMENTS OF OPERATIONS

(Unaudited)

(In Thousands)

Six Months Ended June 30,

	2008 Combined				2007 Combined					
	Parent Company	Guarantor Subsidiary	Non-Guarantor Subsidiaries	Eliminations	Parent Company	Guarantor Subsidiary	Non-Guarantor Subsidiaries	Eliminations	Consolidated	
Revenues	\$ 604,947	59,544	227,221		891,712	212,914	31,850	194,704	(2,190)	437,278
Operating expenses:										
Lease operating expenses	48,810	6,053	21,071	44	75,978	29,479	8,100	43,530	(42)	81,067
Other direct operating costs	38,886	4,169	10,710		53,765	18,475	2,707	8,988		30,170
General and administrative (including stock-based compensation)	32,924	27	6,169		39,120	20,240	68	6,070		26,378
Depreciation and depletion	159,901	11,472	70,783	(5)	242,151	66,118	8,894	71,578	(5)	146,585
Gain on sale of assets								(7,176)		(7,176)
Accretion of asset retirement obligations	2,964	82	705		3,751	1,141	110	1,316		2,567
Total operating expenses	283,485	21,803	109,438	39	414,765	135,453	19,879	124,306	(47)	279,591
Earnings from operations	321,462	37,741	117,783	(39)	476,947	77,461	11,971	70,398	(2,143)	157,687
Equity earnings in subsidiaries	24,518			(24,518)	31,906			(31,906)		
Other income and expense:										
Interest expense	48,369		15,782	(8,315)	55,836	28,723	9	31,898	(7,174)	53,456
Unrealized losses (gains) on derivative instruments, net	372,879	66,355	22,619		461,853	(1,901)	5,869	19,057		23,025
Realized losses (gains) on derivative instruments, net	42,842	11,996	7,007		61,845	(21,952)	(5,005)	(7,447)		(34,404)
Other (income) expense, net	(855)	(27)	1,409	8,130	8,657	(7,284)	244	(6,243)	7,197	(6,086)
Total other income and expense	463,235	78,324	46,817	(185)	588,191	(2,414)	1,117	37,265	23	35,991
Earnings (loss) before income taxes	(117,255)	(40,583)	70,966	(24,372)	(111,244)	111,781	10,854	33,133	(34,072)	121,696
Income tax	(44,505)	(14,776)	20,787		(38,494)	28,091	3,924	5,991		38,006
Net earnings (loss)	\$ (72,750)	(25,807)	50,179	(24,372)	(72,750)	83,690	6,930	27,142	(34,072)	83,690

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FOREST OIL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(12) CONDENSED CONSOLIDATING FINANCIAL INFORMATION (Continued)

CONDENSED CONSOLIDATING STATEMENTS OF CASH FLOWS

(Unaudited)

(In Thousands)

	Six Months Ended June 30,							
	2008				2007			
	Parent Company	Guarantor Subsidiary	Non-Guarantor Subsidiaries	Combined Consolidated	Parent Company	Guarantor Subsidiary	Non-Guarantor Subsidiaries	Combined Consolidated
Operating activities:								
Net earnings (loss)	\$ (97,122)	(25,807)	50,179	(72,750)	49,618	6,930	27,142	83,690
Adjustments to reconcile net earnings (loss) to net cash provided by operating activities:								
Depreciation and depletion	159,901	11,472	70,778	242,151	66,118	8,894	71,573	146,585
Unrealized losses (gains) on derivative instruments, net	372,879	66,355	22,619	461,853	(1,901)	5,869	19,057	23,025
Deferred income tax	(44,350)	(14,776)	16,654	(42,472)	27,489	3,924	3,498	34,911
Other, net	15,886	82	4,586	20,554	2,371	110	(9,823)	(7,342)
Changes in operating assets and liabilities, net of effects of acquisitions and divestitures:								
Accounts receivable	(47,894)	(5,528)	(13,270)	(66,692)	29,009	959	2,789	32,757
Other current assets	(19,544)	127	(2,171)	(21,588)	8,020	(529)	(6,765)	726
Accounts payable	(8,238)	(633)	(3,910)	(12,781)	(7,195)	137	(13,445)	(20,503)
Accrued interest and other current liabilities	(16,185)	22	(1,844)	(18,007)	1,621	(136)	(1,663)	(178)
Net cash provided by operating activities	315,333	31,314	143,621	490,268	175,150	26,158	92,363	293,671
Investing activities:								
Acquisitions, net of cash acquired					(775,960)			(775,960)
Capital expenditures for property and equipment	(580,537)	(8,904)	(211,931)	(801,372)	(160,207)	(11,378)	(175,937)	(347,522)
Other, net	53,379		24	53,403	4,144	25,751	8,718	38,613
Net cash (used) provided by investing activities	(527,158)	(8,904)	(211,907)	(747,969)	(932,023)	14,373	(167,219)	(1,084,869)
Financing activities:								
Issuance of 7 ¹ / ₄ % senior notes, net of issuance costs	247,188			247,188	739,176			739,176
Proceeds from bank borrowings	1,212,000		148,178	1,360,178	875,000		88,734	963,734
Repayments of bank borrowings	(947,000)		(160,917)	(1,107,917)	(548,000)		(99,527)	(647,527)
Redemption of 8% senior notes	(265,000)			(265,000)				
Repurchases of 7% senior subordinated notes	(2,960)			(2,960)				
Repayments of debt					(176,885)		(111,250)	(288,135)
Net activity in investments from subsidiaries	(59,051)	(21,745)	80,796	(143,442)	(143,442)	(40,631)	184,073	
Other, net	26,905	(877)	1,338	27,366	11,494		(6,150)	5,344
Net cash provided (used) by financing activities	212,082	(22,622)	69,395	258,855	757,343	(40,631)	55,880	772,592
Effect of exchange rate changes on cash			(28)	(28)			1,172	1,172
Net increase (decrease) in cash and cash equivalents	257	(212)	1,081	1,126	470	(100)	(17,804)	(17,434)
Cash and cash equivalents at beginning of period	1,189	386	8,110	9,685	771	126	32,267	33,164
Cash and cash equivalents at end of period	\$ 1,446	174	9,191	10,811	1,241	26	14,463	15,730

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FOREST OIL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(13) RECENT ACCOUNTING PRONOUNCEMENTS

In December 2007, the FASB issued SFAS No. 141 (Revised), *Business Combinations* ("SFAS 141(R)"), which significantly changes the financial accounting and reporting of business combination transactions. SFAS 141(R) establishes principles and requirements for how an acquirer in a business combination: (i) recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree, (ii) recognizes and measures the goodwill acquired in the business combination or a gain from a bargain purchase, and (iii) determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. SFAS 141(R) applies prospectively to business combinations that are completed or close on or after the beginning of the first annual reporting period that begins on or after December 15, 2008. The adoption of this pronouncement may have a material impact on the accounting for any acquisition the Company may make after January 1, 2009.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements - an amendment of ARB No. 51* ("SFAS 160"). This statement amends ARB No. 51 to establish accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. SFAS 160 clarifies that a noncontrolling interest in a subsidiary, which is sometimes referred to as minority interest, is an ownership interest in the consolidated entity that should be reported as a component of equity in the consolidated financial statements. Among other requirements, SFAS 160 requires consolidated net income to be reported at amounts that include the amounts attributable to both the parent and the noncontrolling interest. It also requires disclosure, on the face of the consolidated income statement, of the amounts of consolidated net income attributable to the parent and to the noncontrolling interest. This statement is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. The Company does not expect the adoption of this pronouncement to have a material impact on the Company's financial position or results of operations.

In February 2008, the FASB issued FASB Staff Position No. 157-2, *Effective Date of FASB Statement No. 157* ("FSP 157-2"). FSP 157-2 delays the effective date of SFAS No. 157, *Fair Value Measurements*, for one year for nonfinancial assets and nonfinancial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). The Company is currently evaluating the impact the adoption of this pronouncement will have on the Company's financial position and results of operations.

In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities - an amendment of FASB Statement No. 133* ("SFAS 161"). SFAS 161 requires qualitative disclosures about objectives and strategies for using derivatives, quantitative disclosures about fair value amounts of and gains and losses on derivative instruments, and disclosures about credit-risk-related contingent features in derivative agreements. This statement is effective for fiscal years and interim periods beginning after November 15, 2008. The adoption of this pronouncement will have no impact on the Company's financial position or results of operations, but may require expanded disclosures about derivative instruments.

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

OVERVIEW

Forest Oil Corporation ("Forest") is an independent oil and gas company engaged in the acquisition, exploration, development, and production of natural gas and liquids in North America and selected international locations. Forest was incorporated in New York in 1924, as the successor to a company formed in 1916, and has been a publicly held company since 1969. Unless the context otherwise indicates, references in this quarterly report on Form 10-Q to "Forest," "we," "ours," "us," or like terms refer to Forest Oil Corporation and its subsidiaries.

We currently conduct our operations in three geographical segments and five business units. Geographical segments include: the United States, Canada, and International. Business units include: Western, Eastern, Southern, Canada, and International. We conduct exploration and development activities in each of our geographical segments; however, substantially all of our estimated proved reserves and all of our producing properties are located in onshore North America. At December 31, 2007, approximately 85% of our estimated proved oil and natural gas reserves were in the United States, approximately 12% were in Canada, and approximately 3% were in Italy. See Note 11 to the Condensed Consolidated Financial Statements for additional information about our geographical segments.

The following discussion and analysis should be read in conjunction with Forest's Condensed Consolidated Financial Statements and Notes thereto, the information under the heading "Forward-Looking Statements" below, and the information included in Forest's 2007 Annual Report on Form 10-K under the heading "Risk Factors," and "Management's Discussion and Analysis of Financial Condition and Results of Operations Critical Accounting Policies, Estimates, Judgments, and Assumptions."

Second Quarter 2008 Highlights

Revenue and Production Increase

Revenues increased 102% in the second quarter of 2008 to \$515.2 million from \$254.7 million in the second quarter of 2007 due to a 31% increase in production volumes and a 55% increase in average realized prices. These increases are discussed further in Results of Operations, *Oil and Gas Production and Revenues*, below.

Ark-La-Tex Acquisition

On May 2, 2008, Forest acquired producing oil and natural gas properties including approximately 69,000 gross acres (47,000 net acres) located primarily in its core Ark-La-Tex region in East Texas and North Louisiana. Forest estimated the proved oil and gas reserves associated with these assets, which produced an average of 13 MMcfe per day in 2007, to be approximately 110 Bcfe as of the closing date. Forest paid approximately \$281 million, subject to customary adjustments, for the assets using funds advanced under its credit facilities.

Amended Credit Facilities

On May 9, 2008, Forest entered into an amendment to its second amended and restated combined credit facilities with existing and new lenders which increased the combined commitment amount from \$1 billion to \$1.8 billion and increased the global borrowing base to \$1.8 billion.

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Senior Notes Offering

On May 22, 2008, Forest issued an additional \$250 million in principal amount of 7¹/₄% senior notes due in 2019 (the "7¹/₄% Notes") at 100.25% of par for net proceeds of \$247.2 million, after deducting initial purchaser discounts. The additional 7¹/₄% Notes were used to redeem a portion of Forest's \$265 million in principal amount of 8% senior notes that matured on June 15, 2008.

RESULTS OF OPERATIONS

Forest reported a net loss of \$68.0 million in the second quarter of 2008 compared to net earnings of \$76.8 million in the second quarter of 2007. Earnings from operations were \$299.6 million in the second quarter of 2008 compared to \$90.8 million in the second quarter of 2007. The second quarter of 2008 was negatively impacted by fair value adjustments on our derivative instruments, which primarily consisted of oil and natural gas swaps and collars. In the second quarter of 2008, we recognized unrealized losses on derivative instruments of \$319.6 million compared to gains of \$34.8 million in the second quarter of 2007.

During the first six months of 2008, Forest reported a net loss of \$72.8 million compared to net earnings of \$83.7 million during the same period of 2007. Earnings from operations were \$476.9 million during the first six months of 2008 compared to \$157.7 million in the same period of 2007. Each period was negatively impacted by fair value adjustments on our derivative instruments, which primarily consisted of oil and natural gas swaps and collars. During the first six months of 2008, we recognized unrealized losses on derivative instruments of \$461.9 million compared to \$23.0 million in the same period of 2007.

Discussion of the components of the changes in our quarterly and year to date results follows. Each period in 2008 as compared to the corresponding period in 2007 was significantly impacted by our acquisition of The Houston Exploration Company ("Houston Exploration") in June 2007, as well as the sale of our Alaska assets (the "Alaska Assets") in August 2007 to Pacific Energy Resources Ltd. ("PERL"). Details for each of these transactions are included in Note 2 to the Condensed Consolidated Financial Statements.

Oil and Gas Production and Revenues

Production volumes, revenues, and weighted average sales prices by product and location for the three and six months ended June 30, 2008 and 2007 are set forth in the tables below. These tables do

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not include miscellaneous marketing revenues of \$.1 million and \$.7 million for the three months ended June 30, 2008 and 2007, respectively, and \$.8 million for the six months ended June 30, 2007.

	Three Months Ended June 30,							
	2008				2007			
	Gas (MMcf)	Oil (MBbls)	NGLs (MBbls)	Total (MMcfe)	Gas (MMcf)	Oil (MBbls)	NGLs (MBbls)	Total (MMcfe)
Production volumes:								
United States	28,261	944	748	38,413	15,714	1,334	516	26,814
Canada	5,836	209	71	7,516	6,591	206	65	8,217
Totals	34,097	1,153	819	45,929	22,305	1,540	581	35,031
Revenues (in thousands):								
United States	\$ 276,064	115,750	42,024	433,838	102,367	81,350	18,236	201,953
Canada	53,005	23,168	5,067	81,240	38,390	11,043	2,553	51,986
Totals	\$ 329,069	138,918	47,091	515,078	140,757	92,393	20,789	253,939
Average sales price:								
United States	\$ 9.77	122.62	56.18	11.29	6.51	60.98	35.34	7.53
Canada	9.08	110.85	71.37	10.81	5.82	53.61	39.28	6.33
Totals	\$ 9.65	120.48	57.50	11.21	6.31	60.00	35.78	7.25
	Six Months Ended June 30,							
	2008				2007			
	Gas (MMcf)	Oil (MBbls)	NGLs (MBbls)	Total (MMcfe)	Gas (MMcf)	Oil (MBbls)	NGLs (MBbls)	Total (MMcfe)
Production volumes:								
United States	54,619	1,883	1,424	74,461	26,061	2,444	957	46,467
Canada	11,653	397	155	14,965	12,565	412	124	15,781
Totals	66,272	2,280	1,579	89,426	38,626	2,856	1,081	62,248
Revenues (in thousands):								
United States	\$ 469,364	205,360	74,610	749,334	166,441	141,956	30,980	339,377
Canada	93,132	39,190	10,009	142,331	71,613	21,132	4,373	97,118
Totals	\$ 562,496	244,550	84,619	891,665	238,054	163,088	35,353	436,495
Average sales price:								
United States	\$ 8.59	109.06	52.39	10.06	6.39	58.08	32.37	7.30
Canada	7.99	98.72	64.57	9.51	5.70	51.29	35.27	6.15
Totals	\$ 8.49	107.26	53.59	9.97	6.16	57.10	32.70	7.01

Net oil and gas production in the second quarter of 2008 was 45.9 Bcfe or an average of 505 MMcfe per day, a 31% increase from 35.0 Bcfe or an average of 385 MMcfe per day in the second quarter of 2007. Net oil and gas production in the first six months of 2008 was 89.4 Bcfe or an average of 491 MMcfe per day, a 44% increase from 62.2 Bcfe or an average of 344 MMcfe per day in the same period in the prior year. The net increase in oil and gas production in both periods was primarily attributable to the Houston Exploration acquisition in June 2007

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and the Ark-La-Tex acquisition in May 2008, which were partially offset by the sale of the Alaska Assets in August 2007.

Oil and natural gas revenues were \$515.1 million in the second quarter of 2008, reflecting a 103% increase as compared to \$253.9 million in the second quarter of 2007. The increase in oil and natural gas revenues between the comparable three month periods was due to the 31% increase in daily

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production and a 55% increase in average realized sales prices. Oil and natural gas revenues were \$891.7 million during the six months ended June 30, 2008, a 104% increase as compared to \$436.5 million for the same period in the prior year. The increase in oil and natural gas revenues between the comparable six month periods was due to the 44% increase in daily production and a 42% increase in average realized sales prices. No hedging gains or losses were included in the average sales prices presented given our election not to utilize cash flow hedge accounting. See *Realized and Unrealized Gains and Losses - Derivative Instruments* below for information on gains and losses recognized on derivative instruments.

Oil and Gas Production Expense

The table below sets forth the detail of oil and gas production expense for the three and six months ended June 30, 2008 and 2007.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
(In Thousands, Except Per Mcfe Data)				
Production expense:				
Lease operating expenses	\$ 38,413	45,027	75,978	81,067
Production and property taxes	24,148	12,808	44,199	20,718
Transportation and processing costs	4,641	5,258	9,566	9,452
Production expense	\$ 67,202	63,093	129,743	111,237
Production expense per Mcfe:				
Lease operating expenses	\$.84	1.29	.85	1.30
Production and property taxes	.53	.37	.49	.33
Transportation and processing costs	.10	.15	.11	.15
Production expense per Mcfe	\$ 1.46	1.80	1.45	1.79

Lease operating expenses in the second quarter of 2008 were \$38.4 million, or \$.84 per Mcfe, compared to \$45.0 million, or \$1.29 per Mcfe, in the second quarter of 2007. During the six month period ended June 30, 2008, lease operating expenses were \$76.0 million, or \$.85 per Mcfe, compared to \$81.1 million, or \$1.30 per Mcfe, in the same period in the prior year. The decrease in lease operating expense in both periods was primarily attributable to the sale of the Alaska Assets in August 2007 offset by the Houston Exploration acquisition in June 2007. On a per-Mcfe basis, the 35% decrease in both periods was primarily due to lower average per-unit lease operating expenses from the assets associated with the Houston Exploration acquisition and the divestiture of the Alaska Assets, which had higher average per-unit lease operating expenses.

Production and property taxes, which primarily consist of severance taxes paid on the value of the oil and gas produced, generally fluctuate proportionately with our oil and gas revenues. As a percentage of oil and natural gas revenue, production and property taxes were 4.7% and 5.0% for the three months ended June 30, 2008 and 2007, respectively. For the six months ended June 30, 2008 and 2007, production and property taxes were 5.0% and 4.7%, respectively, of oil and natural gas revenue. Normal fluctuations will occur between periods based on the approval of incentive tax credits in Texas, changes in tax rates, and changes in the assessed values of oil and gas reserves and other property and equipment for purposes of ad valorem taxes.

Transportation and processing costs decreased to \$4.6 million, or \$.10 per Mcfe, in the second quarter of 2008, from \$5.3 million, or \$.15 per Mcfe, in the second quarter of 2007. Transportation and processing costs were \$9.6 million, or \$.11 per Mcfe, in the six months ended June 30, 2008, compared

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to \$9.5 million, or \$.15 per Mcfe, for the corresponding 2007 period. The per-unit decrease in each period was primarily due to lower per-unit transportation costs recognized in 2008 as a result of the sale of the Alaska Assets in August 2007.

General and Administrative Expense

The following table summarizes the components of general and administrative expense incurred during the periods indicated.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
	(In Thousands, Except Per Mcfe Data)			
Stock-based compensation costs	\$ 9,748	4,220	15,798	6,883
Other general and administrative costs	24,880	18,085	50,229	36,600
General and administrative costs capitalized	(14,796)	(8,898)	(26,907)	(17,105)
General and administrative expense	\$ 19,832	13,407	39,120	26,378
General and administrative expense per Mcfe	\$.43	.38	.44	.42

General and administrative expense in the second quarter of 2008 was \$19.8 million compared to \$13.4 million in the second quarter of 2007. During the six month period ended June 30, 2008, general and administrative expense was \$39.1 million compared to \$26.4 million in the same period of 2007. The 48% increase in general and administrative expense in each period was primarily related to increased employee salary and benefit costs resulting from the acquisition of Houston Exploration in June 2007 and increased stock-based compensation. The percentage of general and administrative costs capitalized remained relatively constant between each of the periods presented, ranging from 39% to 43%.

Depreciation and Depletion

Depreciation, depletion and amortization expense ("DD&A") in the second quarter of 2008 was \$126.6 million, or \$2.76 per Mcfe, compared to \$86.1 million, or \$2.46 per Mcfe, in the second quarter of 2007. During the six months ended June 30, 2008, DD&A was \$242.2 million, or \$2.71 per Mcfe, compared to \$146.6 million, or \$2.35 per Mcfe, for the same period in 2007. The per-unit increase in both periods was primarily due to the acquisition of the Houston Exploration properties in June 2007.

Gain on Sale of Assets

In February 2007, Forest sold its overriding royalty interests in Australia for net proceeds of \$7.2 million, which resulted in a gain on the sale of \$7.2 million.

Interest Expense

Interest expense in the second quarter of 2008 totaled \$28.0 million compared to \$29.1 million in the second quarter of 2007. During the six months ended June 30, 2008, interest expense totaled \$55.8 million compared to \$53.5 million for the same period in 2007. Interest costs related to significant unproved properties that are under development are capitalized to oil and gas properties under the full cost method of accounting. Forest capitalized interest of \$5.5 million and \$1.4 million during the three months ended June 30, 2008 and 2007, respectively. During the six months ended June 30, 2008, Forest capitalized interest of \$10.7 million compared to \$2.2 million for the same period in 2007. The increase in interest capitalized was primarily due to the acquisition of Houston Exploration in June 2007, which included a large investment in unproved properties.

Table of Contents**Realized and Unrealized Gains and Losses***Derivative Instruments*

The table below sets forth realized and unrealized gains and losses on derivatives recognized under "Other income and expense" in our Condensed Consolidated Statements of Operations for the periods indicated. See Notes 9 and 10 to the Condensed Consolidated Financial Statements for more information on our derivative instruments.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
	(In Thousands)			
Realized losses (gains) on derivatives, net:				
Oil	\$ 32,104	(3,687)	48,806	(20,764)
Gas	25,473	(5,453)	12,150	(13,509)
Interest	605	(130)	889	(131)
Total	\$ 58,182	(9,270)	61,845	(34,404)
Unrealized losses (gains) on derivatives, net:				
Oil	\$ 123,602	18,182	138,361	44,043
Gas	205,542	(51,256)	328,213	(19,229)
Interest	(9,504)	(1,739)	(4,721)	(1,789)
Total	\$ 319,640	(34,813)	461,853	23,025

Other Investments

Unrealized losses on other investments totaled \$.3 million and \$7.4 million for the three and six months ended June 30, 2008, respectively. The unrealized losses on other investments relate to fair value adjustments to the shares of PERL common stock and zero coupon senior subordinated note from PERL due 2014, which were received as a portion of the total consideration for the Alaska Assets. See Note 2 and Note 9 to the Condensed Consolidated Financial Statements for more information on these investments.

Foreign Currency Exchange

Unrealized foreign currency exchange gains were \$.5 million in the second quarter of 2008 compared to \$6.3 million in the second quarter of 2007. During the six months ended June 30, 2008, unrealized foreign currency exchange losses were \$2.3 million compared to gains of \$6.3 million in the same period of 2007. The unrealized foreign currency exchange gains and losses relate to the outstanding intercompany indebtedness between Forest Oil Corporation and our Canadian subsidiary. The intercompany debt is denominated in U.S. dollars and with the recent strength in the U.S. dollar, an unrealized foreign exchange loss was recognized in the first six months of 2008.

Current and Deferred Income Tax

Our effective income tax rate was approximately 34.6% for the three and six months ended June 30, 2008. This effective rate is based primarily on the expected mix of total 2008 pre-tax earnings between the United States and Canada which have statutory rates of approximately 36% and 28%, respectively. Our effective income tax rate was 30.7% and 31.2% for the three and six months ended June 30, 2007, respectively. The increase in the effective income tax rates in each 2008 period compared to the corresponding periods in 2007 is primarily due to the effects of statutory income tax

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rate reductions in Canada in 2007 on our deferred income tax liabilities and the weighting of projected Canadian to United States earnings.

LIQUIDITY AND CAPITAL RESOURCES

In 2008, as in 2007, we expect our cash flow from operations to be our primary source of liquidity to meet operating expenses and fund capital expenditures other than large acquisitions.

The prices we receive for our oil and natural gas production have a significant impact on operating cash flows. While significant price declines would adversely affect the amount of cash flow generated from operations, we utilize a hedging program to partially mitigate that risk. As of August 1, 2008, Forest has hedged approximately 34 Bcfe of its remaining 2008 production. This level of hedging provides a measure of certainty of the cash flow we will receive for a large portion of our remaining production in 2008. Depending on changes in oil and gas futures markets and management's view of underlying oil and natural gas supply and demand trends, we may increase or decrease our current hedging positions. For further information concerning our hedging contracts, see Item 3 "Quantitative and Qualitative Disclosures about Market Risk - Commodity Price Risk," below.

Our revolving U.S. and Canadian bank credit facilities provide another source of liquidity. On May 9, 2008, we entered into an amendment to our second amended and restated combined credit facilities, which increased the commitments from \$1 billion to \$1.8 billion and established the global borrowing base at \$1.8 billion. These credit facilities, which mature in June 2012, are used to fund daily operating activities and certain acquisitions and debt refinancings in the United States and Canada as needed. See "*Bank Credit Facilities*" below for details.

The public capital markets have been our principal source of funds to finance large acquisitions and other types of large expenditures outside ordinary operating activities. We have issued debt and equity securities in both public and private offerings in the past, and we expect that these sources of capital will continue to be available to us in the future for acquisitions. For example, in May 2008 we issued an additional \$250 million principal amount of 7¹/₄% senior notes due 2019 in a private offering. Nevertheless, ready access to capital on reasonable terms can be impacted by our debt ratings assigned by independent rating agencies and are subject to many uncertainties, including restrictions contained in our bank credit facilities and indentures for our senior notes, macroeconomic factors outside of our control, the price for oil and natural gas, the value and performance of Forest's debt and equity securities, and other risks as explained in Part 1, Item 1A "Risk Factors" of our 2007 Annual Report on Form 10-K and Part II, Item 1A of this report.

In addition, during the third quarter 2008 we plan to divest additional non-core assets that are part of our Western business unit. Funds that we may receive from any divestitures, in addition to the approximate \$50 million which we have received relating to sales during the first half of 2008, may provide another source of liquidity in 2008.

We believe that our available cash, cash provided by operating activities, and funds available under our bank credit facilities will be sufficient to fund our daily operating activities, interest, and general and administrative expense, our 2008 capital expenditure budget, and our short-term contractual obligations at current levels for the foreseeable future.

Bank Credit Facilities

On May 9, 2008, we entered into a first amendment (the "First Amendment") to our second amended and restated combined credit agreements, which increased lender commitments to \$1.8 billion and established the global borrowing base at \$1.8 billion. The amended credit agreements consist of a \$1.65 billion U.S. credit facility through a syndicate of banks led by JPMorgan Chase Bank, N.A. (the "U.S. Credit Facility") and a \$150 million Canadian credit facility through a syndicate of banks led by

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JPMorgan Chase Bank, N.A., Toronto Branch (the "Canadian Credit Facility," and together with the U.S. Credit Facility, the "Credit Facilities"). The Credit Facilities will mature in June 2012.

Forest's availability under the Credit Facilities is governed by a borrowing base (the "Global Borrowing Base"), which currently is set at \$1.8 billion, with \$1.65 billion allocated to the U.S. Credit Facility and \$150 million allocated to the Canadian Credit Facility. The determination of the Global Borrowing Base is made by the lenders in their sole discretion taking into consideration the estimated value of Forest's oil and gas properties in accordance with the lenders' customary practices for oil and gas loans. The Global Borrowing Base is redetermined semi-annually, and the available borrowing amount could be increased or decreased as a result of such redeterminations. In addition, Forest and the lenders each have discretion at any time, but not more often than once during any calendar year, to have the Global Borrowing Base redetermined. In the event Forest issues senior notes after May 9, 2008, the Global Borrowing Base will immediately be reduced by an amount equal to \$0.30 of every \$1.00 principal amount of newly issued senior notes (excluding any senior notes that Forest may issue to refinance senior notes outstanding on May 9, 2008).

The Credit Facilities include terms and covenants that place limitations on certain types of activities, including restrictions or requirements with respect to additional debt, liens, asset sales, hedging activities, investments, dividends, mergers, and acquisitions, and include financial covenants.

Under certain conditions, amounts outstanding under the Credit Facilities may be accelerated. Bankruptcy and insolvency events with respect to Forest or certain of its subsidiaries will result in an automatic acceleration of the indebtedness under the Credit Facilities. Subject to notice and cure periods in certain cases, other events of default under either of the Credit Facilities will result in acceleration of the indebtedness under the facilities at the option of the lenders. Such other events of default include non-payment, breach of warranty, non-performance of obligations under the Credit Facilities (including financial covenants), default on other indebtedness, certain pension plan events, certain adverse judgments, change of control, a failure of the liens securing the Credit Facilities, and an event of default under the Canadian Credit Facility.

The Credit Facilities include provisions and conditions linked to Forest's credit ratings. For example, our collateral requirements will vary based on our credit ratings. In general, Forest's ability to raise funds and the cost of any financing activities may be affected by our credit ratings at the time any such activities are conducted.

The Credit Facilities are collateralized by a portion of Forest's assets. We are required to mortgage and grant a security interest in the greater of 75% of the present value of our consolidated proved oil and gas properties, or 1.875 multiplied by the allocated U.S. borrowing base. We also have pledged the stock of several subsidiaries to the lenders to secure the Credit Facilities. Under certain circumstances, we could be obligated to pledge additional assets as collateral. If Forest's corporate credit ratings by Moody's and S&P improve and meet pre-established levels, the collateral requirements would not apply and, at our request, the banks would release their liens and security interests on our properties.

From time to time, Forest and the syndication agents, documentation agents, global administrative agent, and the other lenders party to the Credit Facilities engage in other transactions, including securities offerings where such parties or their affiliates may serve as an underwriter or initial purchaser of Forest's securities and, or serve as counterparties to Forest's derivative agreements.

At June 30, 2008, there were outstanding borrowings of \$430.0 million under the U.S. Credit Facility at a weighted average interest rate of 3.5%, and there were outstanding borrowings of \$112.8 million under the Canadian Credit Facility at a weighted average interest rate of 4.5%. We also had used the Credit Facilities for approximately \$2.6 million in letters of credit, leaving an unused borrowing amount under the Credit Facilities of approximately \$1.25 billion at June 30, 2008. At July 31, 2008, there were outstanding borrowings of \$493.0 million under the U.S. Credit Facility at a

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weighted average interest rate of 3.6%, and there were outstanding borrowings of \$92.8 million under the Canadian Credit Facility at a weighted average interest rate of 4.5%. We also had used the Credit Facilities for approximately \$2.6 million in letters of credit, leaving an unused borrowing amount under the Credit Facilities of approximately \$1.21 billion at July 31, 2008.

Credit Ratings

Our credit risk is evaluated by two independent rating agencies based on publicly available information and information obtained during our ongoing discussions with the rating agencies. Moody's Investor Services and Standard & Poor's Rating Services currently rate each series of our senior notes and, in addition, they have assigned Forest a general credit rating. We do not have any credit rating triggers that would accelerate the maturity of amounts due under credit facilities or the debt issued under the indentures for our senior notes. Also, the indentures for the senior notes include terms that will allow us greater flexibility if our credit ratings improve to investment grade and other tests have been satisfied, in which event we would not be obligated to comply with certain restrictive covenants included in the indentures. Our ability to raise funds and the costs of any financing activities will be affected by our credit rating at the time any such financing activities are conducted.

Cash Flow

Net cash provided by operating activities, net cash used by investing activities, and net cash provided by financing activities for the six months ended June 30, 2008 and 2007 were as follows:

	Six Months Ended June 30,	
	2008	2007
	(In Thousands)	
Net cash provided by operating activities	\$ 490,268	293,671
Net cash used by investing activities	(747,969)	(1,084,869)
Net cash provided by financing activities	258,855	772,592

The increase in net cash provided by operating activities in the six months ended June 30, 2008 compared to the same period of 2007 was primarily due to higher net earnings before non-cash charges partially offset by an increased investment in net operating assets in 2008 as compared to 2007. The decrease in net cash used by investing activities in the six months ended June 30, 2008 compared to the same period of 2007 was primarily due to the acquisition of Houston Exploration in the second quarter of 2007. Net cash provided by financing activities in the six months ended June 30, 2008 included net bank proceeds of \$252.3 million; the issuance of additional 7¹/₄% senior notes, for net proceeds of \$247.2 million; proceeds from the exercise of stock options and from the employee stock purchase plan of \$15.0 million; and the redemption of our 8% senior notes of \$265.0 million. Net cash provided by financing activities in the six months ended June 30, 2007 included net bank proceeds of \$316.2 million; the issuance of 7¹/₄% senior notes, for net proceeds of \$739.2 million; proceeds from the exercise of stock options and from the employee stock purchase plan of \$7.1 million; the repayment of Houston Exploration's bank debt of \$176.9 million; and the repayment of \$111.3 million of term loans.

Table of Contents**Capital Expenditures**

Expenditures for property acquisition and exploration and development were as follows:

	Six Months Ended June 30,	
	2008	2007
	(In Thousands)	
Property acquisition costs:		
Proved properties	\$ 216,271	1,840,187
Unproved properties	93,715	251,000
	309,986	2,091,187
Exploration and development costs:		
Direct costs	521,043	295,051
Overhead capitalized	26,907	17,105
Interest capitalized	10,687	2,202
	558,637	314,358
Total capital expenditures for property acquisition and exploration and development⁽¹⁾⁽²⁾	\$ 868,623	2,405,545

(1) Total capital expenditures include cash expenditures, accrued cash expenditures, and non-cash capital expenditures including stock-based compensation capitalized under the full cost method of accounting.

(2) Includes estimated discounted asset retirement obligations of \$5.5 million and \$41.3 million for the six months ended June 30, 2008 and 2007, respectively.

For the six months ended June 30, 2008, expenditures for exploration and development activities totaled \$558.6 million. Forest's anticipated expenditures for exploration and development in 2008 are estimated to range from \$1.15 billion to \$1.25 billion. Some of the factors impacting the level of capital expenditures in 2008 include crude oil and natural gas prices, the volatility in these prices, the cost and availability of oil field services, and weather disruptions.

Forward-Looking Statements

The information in this Quarterly Report on Form 10-Q including "Management's Discussion and Analysis of Financial Condition and Results of Operations" in Item 2 of Part I of this report, contains "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. All statements, other than statements of historical facts or present facts, that address activities, events, outcomes, and other matters that Forest plans, expects, intends, assumes, believes, budgets, predicts, forecasts, projects, estimates, or anticipates (and other similar expressions) will, should, or may occur in the future are forward-looking statements. Generally, the words "expects," "anticipates," "targets," "goals," "projects," "intends," "plans," "believes," "seeks," "estimates," variations of such words, and similar expressions identify forward-looking statements, and any statements regarding Forest's future financial condition, results of operations, and business are also forward-looking statements. These forward-looking statements are based on our current expectations and assumptions about future events and are based on currently available information as to the outcome and timing of future events. When considering forward-looking statements, you should keep in mind the risk factors and other cautionary statements described under the heading "Risk Factors" included in Part I of our 2007 Annual Report on Form 10-K and the risks described in Item 1A of Part II in this report.

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These forward-looking statements appear in a number of places in this report and include statements with respect to, among other things:

estimates of our oil and gas reserves;

estimates of our future natural gas and liquids production, including estimates of any increases in oil and gas production;

the amount, nature, and timing of capital expenditures, including future development costs, and availability of capital resources to fund capital expenditures;

the amount, nature, and timing of any synergies or other benefits expected to result from acquisitions;

our outlook on oil and gas prices;

the impact of political and regulatory developments;

our future financial condition or results of operations and our future revenues and expenses; and

our business strategy and other plans and objectives for future operations.

We caution you that these forward-looking statements are subject to all of the risks and uncertainties, most of which are difficult to predict and many of which are beyond our control, incident to the exploration for and development, production, and sale of oil and gas. These risks include, but are not limited to, commodity price volatility, inflation, lack of availability of drilling and production equipment and services, environmental risks, drilling and other operating risks, regulatory changes, the uncertainty inherent in estimating proved oil and natural gas reserves and in projecting future rates of production, cash flow and access to capital, the timing of development expenditures, and the other risks described in the Form 10-K under the caption "Risk Factors." The financial results of our foreign operations are also subject to currency exchange rate risks.

Reserve engineering is a process of estimating underground accumulations of oil and natural gas that cannot be measured in an exact way. The accuracy of any reserve estimate depends on the quality of available data, the interpretation of such data, and price and cost assumptions made by reservoir engineers. In addition, the results of drilling, testing, and production activities may justify revisions of estimates that were made previously. If significant, such revisions would change the schedule of any further production and development drilling. Accordingly, reserve estimates may differ significantly from the quantities of oil and natural gas that are ultimately recovered.

Should one or more of the risks or uncertainties described above or elsewhere in this Form 10-Q occur, or should underlying assumptions prove incorrect, our actual results and plans could differ materially from those expressed in any forward-looking statements.

All forward-looking statements, expressed or implied, included in this Form 10-Q and attributable to Forest are expressly qualified in their entirety by this cautionary statement. This cautionary statement should also be considered in connection with any subsequent written or oral forward-looking statements that Forest or persons acting on its behalf may issue. Forest does not undertake to update any forward-looking statements to reflect events or circumstances after the date of filing this Form 10-Q with the Securities and Exchange Commission, except as required by law.

Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are exposed to market risk, including the effects of adverse changes in commodity prices, foreign currency exchange rates, and interest rates as discussed below.

Table of Contents**Commodity Price Risk**

We produce and sell natural gas, crude oil, and natural gas liquids for our own account in the United States and Canada. As a result, our financial results are affected when prices for these commodities fluctuate. Such effects can be significant.

Hedging Program

In order to reduce the impact of fluctuations in commodity prices, or to protect the economics of property acquisitions, we make use of an oil and gas hedging strategy. Under our hedging strategy, we enter into commodity swaps, collars, and other financial instruments with counterparties who, in general, are participants in our credit facilities. These arrangements, which are based on prices available in the financial markets at the time the contracts are entered into, are settled in cash and do not require physical deliveries of hydrocarbons.

Swaps

In a typical commodity swap agreement, we receive the difference between a fixed price per unit of production and a price based on an agreed upon published, third-party index if the index price is lower than the fixed price. If the index price is higher, we pay the difference. By entering into swap agreements, we effectively fix the price that we will receive in the future for the hedged production. Our current swaps are settled in cash on a monthly basis. As of June 30, 2008, we had entered into the following swaps:

	Swaps					
	Natural Gas (NYMEX HH)			Oil (NYMEX WTI)		
	Bbtu per Day ⁽¹⁾	Weighted Average Hedged Price per MMBtu	Fair Value (In Thousands)	Barrels per Day	Weighted Average Hedged Price per Bbl	Fair Value (In Thousands)
Third Quarter 2008	70	\$ 9.02	\$ (27,317)	6,500	\$ 69.72	\$ (42,129)
Fourth Quarter 2008	70	9.02	(30,190)	6,500	69.72	(42,141)
Calendar 2009	110	9.33	(120,151)	4,500	69.01	(112,081)
Calendar 2010				1,500	72.95	(32,117)

(1) 10 Bbtu per day is subject to a \$6.00 written put for Calendar 2008.

Costless Collars

Forest also enters into costless collar agreements with third parties. A collar agreement is similar to a swap agreement, except that we receive the difference between the floor price and the index price only if the index price is below the floor price and we pay the difference between the ceiling price and the index price only if the index price is above the ceiling price. As of June 30, 2008, we had entered into the following collars:

	Costless Collars		
	Natural Gas (NYMEX HH)		
	Bbtu per Day	Weighted Average Hedged Floor and Ceiling Price per MMBtu	Fair Value (In Thousands)
Third Quarter 2008	80	\$ 7.33/8.87	\$ (32,457)
Fourth Quarter 2008	80	7.33/8.87	(36,341)
Calendar 2009	40	8.25/10.92	(32,540)

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Forest also enters into three-way costless collars with third parties. These instruments establish two floors and one ceiling. Upon settlement, if the index price is below the lowest floor, Forest receives the difference between the two floors. If the index price is between the two floors, Forest receives the difference between the higher of the two floors and the index price. If the index price is between the higher floor and the ceiling, Forest does not receive or pay any amounts. If the index price is above the ceiling, Forest pays the excess over the ceiling price. As of June 30, 2008, we had entered into the following three-way collars:

	Three-Way Costless Collars		
	Natural Gas (NYMEX HH)		
	Weighted Average Hedged Lower Floor,		
	Bbtu per Day	Upper Floor, and Ceiling Price per MMBtu	Fair Value (In Thousands)
Third Quarter 2008	30	\$ 6.00/8.00/10.00	\$ (9,069)
Fourth Quarter 2008	30	6.00/8.00/10.00	(10,663)

Basis Swaps

Forest also uses basis swaps in connection with natural gas swaps in order to fix the price differential between the NYMEX price and the index price at which the natural gas production is sold. As of June 30, 2008, we had entered into the following basis swaps:

	Basis Swaps	
	Bbtu per Day	Fair Value (In Thousands)
Third Quarter 2008	80	\$ 275
Fourth Quarter 2008	80	2,116

Interest Rate Swaps

Forest may enter into interest rate swap agreements in an attempt to normalize the mix of fixed and floating interest rates within its debt portfolio. During the second quarter of 2008, Forest terminated all of its outstanding interest rate swaps for a net gain of \$.4 million.

Fair Value Reconciliation

The table below sets forth the changes that occurred in the fair values of our open derivative contracts during the six months ended June 30, 2008, beginning with the fair value of our derivative contracts on December 31, 2007. Due to the volatility of oil and natural gas prices, the estimated fair values of our commodity derivative instruments are subject to large fluctuations from period to period. It has been our experience that commodity prices are subject to large fluctuations and we expect this volatility to continue. Actual gains and losses recognized related to our commodity derivative

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instruments will likely differ from those estimated at June 30, 2008 and will depend exclusively on the price of the commodities on the specified settlement dates provided by the derivative contracts.

	Fair Value of Derivative Contracts		
	Commodity	Interest	
		Rate	Total
(In Thousands)			
As of December 31, 2007	\$ (76,119)	(4,721)	(80,840)
Settlements of acquired derivatives	17,888		17,888
Net (decrease) increase in fair value	(527,530)	3,832	(523,698)
Net contract losses recognized	60,956	889	61,845
As of June 30, 2008	\$ (524,805)		(524,805)

Foreign Currency Exchange Risk

We conduct business in several foreign currencies and thus are subject to foreign currency exchange rate risk on cash flows related to sales, expenses, financing, and investing transactions. In the past, we have not entered into any foreign currency forward contracts or other similar financial instruments to manage this risk. Expenditures incurred relative to the foreign concessions held by Forest outside of North America have been primarily United States dollar-denominated, as have cash proceeds related to property sales and farmout arrangements. Substantially all of our Canadian revenues and costs are denominated in Canadian dollars. While the value of the Canadian dollar does fluctuate in relation to the U.S. dollar, we believe that any currency risk associated with our Canadian operations would not have a material impact on our results of operations.

Interest Rate Risk

The following table presents principal amounts and related weighted average fixed interest rates by year of maturity for Forest's debt obligations and the fair value of our debt obligations at June 30, 2008.

	2011	2012	2013	2014	2019	Total	Fair Value
(Dollar Amounts in Thousands)							
Bank credit facilities:							
Variable rate	\$	542,781					