PETROHAWK ENERGY CORP
Form 10-Q/A
December 05, 2011

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q/A

(Amendment No. 1)

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

For the quarterly period ended March 31, 2011

Commission file number 001-33334

PETROHAWK ENERGY CORPORATION

(Exact name of registrant as specified in its charter)

Delaware	**86-0876964**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)

1000 Louisiana, Suite 5600, Houston, Texas 77002
(Address of principal executive offices including ZIP code)

(832) 204-2700
(Registrant's telephone number)

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 ý No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ý No o

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:

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

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

As of December 2, 2011 the Registrant had 100 shares of Common Stock, $.001 par value, outstanding, all of which were held by BHP Billiton Petroleum (North America) Inc., a wholly owned subsidiary of BHP Billiton Limited.

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Explanatory Note

Petrohawk Energy Corporation (Petrohawk or the Company) is filing this Amendment No. 1 to its Quarterly Report on Form 10-Q (the Amendment) to restate and amend the Company's previously issued unaudited interim financial statements and related financial information as of and for the three months ended March 31, 2011. In addition, the Company is restating and amending its Annual Report on Form 10-K, as of December 31, 2010, and its Quarterly Report on Form 10-Q, for the quarter ended June 30, 2011. The restatement relates to the accounting treatment associated with a joint venture transaction entered into on May 21, 2010 between the Company and KM Gathering LLC (Kinder Morgan), an affiliate of Kinder Morgan Energy Partners, L.P., a publicly traded master limited partnership. In this transaction, the Company contributed its Haynesville Shale gathering and treating system in Northwest Louisiana to KinderHawk Field Services LLC (KinderHawk), Kinder Morgan contributed approximately $917 million in cash, which was distributed to the Company as consideration for 50% of the Haynesville Shale gathering and treating system. In connection with the transaction the Company entered into a gathering agreement with KinderHawk, which requires the Company to deliver natural gas to the operator of the gathering and treating system, KinderHawk, from dedicated lease acreage through the Haynesville Shale gathering and treating system for the life of the dedicated lease acreage, or approximately 30 years, and includes a minimum delivery commitment over a five-year period. Upon the completion of the transaction both the Company and Kinder Morgan held a 50% membership interest in KinderHawk. The Company originally accounted for the transaction as a partial sale for which the Company deferred a gain of approximately $719.4 million and recorded its 50% membership interest in KinderHawk as an equity method investment. The deferred gain was to be recognized as commitments associated with KinderHawk, consisting of a capital commitment of approximately $200 million callable during a two-year period and a five-year delivery commitment were settled. Income and distributions related to the venture were recorded as adjustments to the Company's equity method investment.

The Company subsequently determined that the KinderHawk joint venture transaction should have been accounted for and disclosed in accordance with the Financial Accounting Standards Board's (FASB) Accounting Standards Codification (ASC) Subtopic 360-20, *Property, Plant and Equipment Real Estate Sales*, (ASC 360-20). ASC 360-20 establishes standards for recognition of profit on all real estate sales transactions other than retail land sales, without regard to the nature of the seller's business. In making the determination of whether a transaction qualifies, in substance, as a sale of real estate, the nature of the entire real estate being sold is considered, including the land plus the property improvements and the integral equipment. The Haynesville Shale gathering and treating system, consists of right of ways, pipelines and processing facilities. Due to the gathering agreement which constitutes extended continuing involvement under ASC 360-20, it has been determined that the contribution of the Company's Haynesville Shale gathering and treating system to form KinderHawk should be accounted for as a failed sale of in substance real estate. As a result of the failed sale the Company would account for the continued operations of the gas gathering system and reflect a financing obligation, representing the proceeds received, under the financing method of real estate accounting. Under the financing method, the historical cost of the Haynesville Shale gas gathering system contributed to KinderHawk should have continued to be carried at the full historical basis of the assets on the unaudited condensed consolidated balance sheets in *"Gas gathering systems and equipment"* and depreciated over the remaining useful life of the assets. The financing obligation is recorded on the unaudited condensed unaudited condensed consolidated balance sheets in *"Payable on financing arrangement,"* in the amount of approximately $917 million. Reductions to the obligation and the non cash interest on the financing obligation are tied to the gathering and treating services, as the Company delivers natural gas through the Haynesville Shale gathering and treating system. Interest and principal are determined based upon the allocable income to Kinder Morgan, and interest is limited up to an amount that is calculated based upon the Company's weighted average cost of debt as of the date of the transaction. Allocable income in excess of the calculated value will be reflected as reductions of principal. Interest is recorded in *"Interest expense and other"* on the unaudited condensed consolidated statements of operations. Any obligation remaining once the gathering agreement expires will be reversed, resulting in the recognition of a gain. Additionally, the Company records KinderHawk's revenues, net of eliminations for intercompany amounts associated with gathering and treating services provided to the Company, and expenses on the unaudited condensed consolidated statements of operations in *"Midstream revenues," "Taxes other than income," "Gathering, transportation and other," "General and administrative," "Interest expense and other"* and *"Depletion, depreciation and amortization."*

The following sections of the Form 10-Q have been revised to reflect the restatement and are set forth in their entirety in this Amendment: Part I Item 1*Condensed Consolidated Financial Statements (Unaudited)*; Item 2. *Management's Discussion and Analysis of Financial Condition and Results of Operations*; Item 4. *Controls and Procedures*; and Part II Item 6*Exhibits*. Additionally, in this Amendment, the Company is including currently dated certifications from the Company's Principal Executive Officer and Principal Financial Officer as required by Section 302 of the Sarbanes-Oxley Act of 2002 in Exhibits 31.1 and 31.2 and a currently dated certification from the Company's Principal Executive Officer and Principal Financial Officer as required by Section 906 of the Sarbanes-Oxley Act of 2002 in Exhibit 32.1. The effect of the restatement on the Company's net income for the three months ended March 31, 2011 was a reduction of approximately $30.7 million. This resulted in a reduction of net income of $0.10 per basic and diluted share for the three months ended March 31, 2011.

Except to the extent described above and set forth herein, the financial statements and other disclosures in the Form 10-Q initially filed on May 5, 2011 (the initial Form 10-Q) are unchanged and this amendment does not reflect any events that have occurred after the initial Form 10-Q was filed. Accordingly, this amendment should be read in conjunction with the Company's initial Form 10-Q and the Company's subsequent filings with the United States Securities and Exchange Commission.

In light of the restatement, readers should not rely on the Company's previously filed financial statements as of and for the fiscal year ended December 31, 2010, and unaudited interim financial statements as of and for the periods ended June 30, 2010, September 30, 2010, March 31, 2011 and June 30, 2011.

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Special note regarding forward-looking statements

This Amendment No. 1 to the Quarterly Report on Form 10-Q contains, and we may from time to time otherwise make in other public filings, press releases and presentations, forward-looking statements within the meaning of the federal securities laws. All statements, other than statements of historical facts, concerning, among other things, planned capital expenditures, potential increases in oil and natural gas production, the number and location of wells to be drilled in the future, future cash flows and borrowings, pursuit of potential acquisition opportunities, our financial position, business strategy and other plans and objectives for future operations, are forward-looking statements. These forward- looking statements are identified by their use of terms and phrases such as "may," "expect," "estimate," "project," "plan," "believe," "intend," "achievable," "anticipate," "will," "continue," "potential," "should," "could" and similar terms and phrases. Although we believe that the expectations reflected in these forward-looking statements are reasonable, they do involve certain assumptions, risks and uncertainties. Actual results could differ materially from those anticipated in these forward-looking statements. One should consider carefully the statements under the "Risk Factors" section of the previously filed Quarterly Report on Form 10-Q for the period ended March 31, 2011 and in our previously filed Annual Report on Form 10-K for the year ended December 31, 2010, and the other disclosures contained herein and therein, as well as the disclosures contained in Amendment No. 1 on Form 10-K for the period ended December 31, 2010, which describe factors that could cause our actual results to differ from those anticipated in the forward-looking statements, including, but not limited to, the following factors:

- our ability to successfully develop our large inventory of undeveloped acreage in our resource plays such as the Haynesville, Lower Bossier, and Eagle Ford Shales;
- volatility in commodity prices for oil and natural gas;
- the possibility that our industry may be subject to future regulatory or legislative actions (including any additional taxes and changes in environmental regulation);
- the presence or recoverability of estimated oil and natural gas reserves and the actual future production rates and associated costs;
- the potential for production decline rates for our wells to be greater than we expect;
- our ability to generate sufficient cash flow from operations, borrowings or other sources to enable us to fully develop our undeveloped acreage positions;
- our ability to replace oil and natural gas reserves;
- environmental risks;
- drilling and operating risks;
- exploration and development risks;
- competition, including competition for acreage in resource play areas;
- management's ability to execute our plans to meet our goals;

our ability to retain key members of senior management and key technical employees;

the cost and availability of goods and services, such as drilling rigs, fracture stimulation services and tubulars;

access to and availability of water and other treatment materials to carry out planned fracture stimulations in our resource plays;

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- access to adequate gathering systems and transportation take-away capacity, necessary to fully execute our capital program;

- our ability to secure firm transportation and other marketing outlets for the natural gas, natural gas liquids and crude oil and condensate we produce and to sell these products at market prices;

- general economic conditions, whether internationally, nationally or in the regional and local market areas in which we do business, may be less favorable than expected, including the possibility that the economic conditions in the United States will worsen and that capital markets are disrupted, which could adversely affect demand for oil and natural gas and make it difficult to access financial markets;

- social unrest, political instability, armed conflict, or acts of terrorism or sabotage in oil and natural gas producing regions, such as the Middle East, or our markets; and

- other economic, competitive, governmental, legislative, regulatory, geopolitical and technological factors that may negatively impact our business, operations or pricing.

All forward-looking statements are expressly qualified in their entirety by the cautionary statements in this paragraph and elsewhere in this document. Other than as required under the securities laws, we do not assume a duty to update these forward-looking statements, whether as a result of new information, subsequent events or circumstances, changes in expectations or otherwise.

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PART I. FINANCIAL INFORMATION

Item 1. Condensed Consolidated Financial Statements (Unaudited)

PETROHAWK ENERGY CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (Unaudited)

(In thousands, except per share amounts)

	Three Months Ended March 31, 2011 Restated(1)	2010
Operating revenues:		
Oil and natural gas	$ 350,208	$ 300,591
Marketing	140,544	130,119
Midstream	2,923	7,072
Total operating revenues	493,675	437,782
Operating expenses:		
Marketing	154,898	136,622
Production:		
Lease operating	12,611	17,395
Workover and other	4,876	2,378
Taxes other than income	12,265	12,760
Gathering, transportation and other	17,605	28,156
General and administrative	40,743	32,034
Depletion, depreciation and amortization	161,521	104,768
Total operating expenses	404,519	334,113
Income from operations	89,156	103,669
Other income (expenses):		
Net (loss) gain on derivative contracts	(50,907)	214,703
Interest expense and other	(86,046)	(62,846)
Total other income (expenses)	(136,953)	151,857
(Loss) income from continuing operations before income taxes	(47,797)	255,526
Income tax benefit (provision)	18,322	(99,234)
(Loss) income from continuing operations, net of income taxes	(29,475)	156,292
Loss from discontinued operations, net of income taxes	(2,407)	(157)
Net (loss) income	$ (31,882)	$ 156,135
Net (loss) income per share:		
Basic:		

Continuing operations	$	(0.10)	$	0.52
Discontinued operations				
Total	$	(0.10)	$	0.52
Diluted:				
Continuing operations	$	(0.10)	$	0.52
Discontinued operations				
Total	$	(0.10)	$	0.52
Weighted average shares outstanding:				
Basic		301,021		300,157
Diluted		301,021		302,668

(1) See further discussion at Note 15, *"Restatement of Quarterly Unaudited Condensed Consolidated Financial Statements"*

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

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PETROHAWK ENERGY CORPORATION

CONDENSED CONSOLIDATED BALANCE SHEETS (Unaudited)

(In thousands, except share and per share amounts)

	March 31, 2011 Restated(1)	December 31, 2010 Restated(1)
Current assets:		
Cash	$ 1,541	$ 1,591
Accounts receivable	376,045	356,597
Receivables from derivative contracts	163,111	217,018
Prepaids and other	35,568	62,831
Total current assets	576,265	638,037
Oil and natural gas properties (full cost method):		
Evaluated	8,205,478	7,520,446
Unevaluated	2,538,432	2,387,037
Gross oil and natural gas properties	10,743,910	9,907,483
Less accumulated depletion	(4,928,072)	(4,774,579)
Net oil and natural gas properties	5,815,838	5,132,904
Other operating property and equipment:		
Gas gathering systems and equipment	647,027	593,388
Other operating assets	57,671	55,315
Gross other operating property and equipment	704,698	648,703
Less accumulated depreciation	(34,631)	(27,635)
Net other operating property and equipment	670,067	621,068
Other noncurrent assets:		
Goodwill	932,802	932,802
Other intangible assets, net of amortization	86,579	89,342
Debt issuance costs, net of amortization	50,278	45,941
Deferred income taxes	306,622	316,546
Receivables from derivative contracts	36,962	41,721
Assets held for sale		74,448
Other	4,402	6,944
Total assets	$ 8,479,815	$ 7,899,753
Current liabilities:		
Accounts payable and accrued liabilities	$ 1,009,737	$ 787,238
Deferred income taxes	13,637	45,815
Liabilities from derivative contracts	32,202	5,820
Payable to KinderHawk Field Services LLC	99	976
Payable on financing arrangement	7,222	7,052
Long-term debt	14,815	14,790
Total current liabilities	1,077,712	861,691
Long-term debt	2,973,709	2,612,852
Other noncurrent liabilities:		
Liabilities from derivative contracts	36,904	13,575
Asset retirement obligations	34,368	31,741

Payable on financing arrangement		933,641		933,811
Other		563		544
Commitments and contingencies (Note 7)				
Stockholders' equity:				
Common stock: 500,000,000 shares of $.001 par value authorized; 303,748,482 and 302,489,501 shares issued and outstanding at March 31, 2011 and December 31, 2010, respectively		304		302
Additional paid-in capital		4,640,868		4,631,609
Accumulated deficit		(1,218,254)		(1,186,372)
Total stockholders' equity		3,422,918		3,445,539
Total liabilities and stockholders' equity	$	8,479,815	$	7,899,753

(1)

See further discussion at Note 15, *"Restatement of Quarterly Unaudited Condensed Consolidated Financial Statements"*

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

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PETROHAWK ENERGY CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)

(In thousands)

	Three Months Ended March 31, 2011 Restated(1)	Three Months Ended March 31, 2010
Cash flows from operating activities:		
Net (loss) income	$ (31,882)	$ 156,135
Adjustments to reconcile net (loss) income to net cash provided by operating activities:		
Depletion, depreciation and amortization	160,968	106,074
Income tax (benefit) provision	(19,805)	99,138
Loss on sale	3,950	
Stock-based compensation	6,680	4,089
Net unrealized loss (gain) on derivative contracts	114,965	(190,095)
Other operating	11,169	8,349
Change in assets and liabilities:		
Accounts receivable	(21,794)	(20,368)
Prepaids and other	27,263	(8,452)
Accounts payable and accrued liabilities	(10,343)	(21,673)
Payable to KinderHawk Field Services LLC	(877)	
Other	2,758	20,975
Net cash provided by operating activities	243,052	154,172
Cash flows from investing activities:		
Oil and natural gas capital expenditures	(682,898)	(638,999)
Proceeds received from sale of oil and natural gas properties	76,026	16,676
Proceeds received from sale of Fayetteville gas gathering systems	76,898	
Marketable securities purchased	(155,000)	(226,000)
Marketable securities redeemed	155,000	226,000
Increase in restricted cash	(295,748)	
Decrease in restricted cash	295,748	177,528
Other operating property and equipment capital expenditures	(54,315)	(72,591)
Net cash used in investing activities	(584,289)	(517,386)
Cash flows from financing activities:		
Proceeds from exercise of stock options	3,734	503
Proceeds from borrowings	1,449,500	571,000
Repayment of borrowings	(1,100,677)	(204,968)
Debt issuance costs	(7,250)	
Other	(4,120)	(3,439)
Net cash provided by financing activities	341,187	363,096
Net decrease in cash	(50)	(118)
Cash at beginning of period	1,591	1,511
Cash at end of period	$ 1,541	$ 1,393

(1) See further discussion at Note 15, *"Restatement of Quarterly Unaudited Condensed Consolidated Financial Statements"*

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

PETROHAWK ENERGY CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

1. FINANCIAL STATEMENT PRESENTATION

Petrohawk Energy Corporation (Petrohawk or the Company) is an independent oil and natural gas company engaged in the exploration, development and production of predominately natural gas properties located in the United States. The Company operates in two segments, oil and natural gas production and midstream operations. The unaudited condensed consolidated financial statements include the accounts of all majority-owned, controlled subsidiaries. All intercompany accounts and transactions have been eliminated. Certain prior year amounts have been reclassified to conform to the current year presentation. These unaudited condensed consolidated financial statements reflect, in the opinion of the Company's management, all adjustments, consisting only of normal and recurring adjustments, necessary to present fairly the financial position as of, and the results of operations for, the periods presented. During interim periods, Petrohawk follows the accounting policies disclosed in its 2010 Annual Report on Form 10-K, as amended, filed with the United States Securities and Exchange Commission (SEC). Please refer to the footnotes in the 2010 Annual Report on Form 10-K, as amended, when reviewing interim financial results.

Use of Estimates

The preparation of the Company's unaudited condensed consolidated financial statements in conformity with accounting principles generally accepted in the United States requires the Company's management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities, if any, at the date of the unaudited condensed consolidated financial statements and the reported amounts of revenues and expenses during the respective reporting periods. The Company bases its estimates and judgments on historical experience and on various other assumptions and information that are believed to be reasonable under the circumstances. Estimates and assumptions about future events and their effects cannot be perceived with certainty and, accordingly, these estimates may change as new events occur, as more experience is acquired, as additional information is obtained and as the Company's operating environment changes. Actual results may differ from the estimates and assumptions used in the preparation of the Company's unaudited condensed consolidated financial statements.

Interim period results are not necessarily indicative of results of operations or cash flows for the full year and accordingly, certain information normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States has been condensed or omitted. The Company has evaluated events or transactions through the date of issuance of these unaudited condensed consolidated financial statements.

Marketing Revenue and Expense

A subsidiary of the Company purchases and sells the Company's own and third party natural gas produced from wells which the Company and third parties operate. The revenues and expenses related to these marketing activities are reported on a gross basis as part of operating revenues and operating expenses. Marketing revenues are recorded at the time natural gas is physically delivered to third parties at a fixed or index price. Marketing expenses attributable to gas purchases are recorded as the Company takes physical title to natural gas and transports the purchased volumes to the point of sale.

Midstream Revenues

Revenues from the Company's midstream operations are derived from providing gathering and treating services for the Company and other owners in wells which the Company and third parties

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PETROHAWK ENERGY CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)

1. FINANCIAL STATEMENT PRESENTATION (Continued)

operate. Revenues are recognized when services are provided at a fixed or determinable price, collectability is reasonably assured and evidenced by a contract. The midstream operations segment does not take title to the natural gas for which services are provided, with the exception of imbalances that are monthly cash settled. The imbalances are recorded using published natural gas market prices.

The contribution of the Company's Haynesville Shale gas gathering and treating business to KinderHawk Field Services LLC (KinderHawk) on May 21, 2010 for a 50% membership interest and approximately $917 million in cash is accounted for in accordance with the Financial Accounting Standards Board's (FASB) Accounting Standards Codification (ASC) Subtopic 360-20 *Property, Plant and Equipment Real Estate Sales* (ASC 360-20). See Note 2,*"Acquisitions and Divestitures"* for more details regarding the KinderHawk joint venture arrangement and for discussion of the accounting treatment related to the arrangement. Under the financing method for a failed sale of in substance real estate, the Company records KinderHawk's revenues, net of eliminations for intercompany amounts associated with gathering and treating services provided to the Company, and expenses on the unaudited condensed consolidated statements of operations in *"Midstream revenues."*

Gas Gathering Systems and Equipment and Other Operating Assets

Gas gathering systems and equipment are recorded at cost. Depreciation is calculated using the straight-line method over a 30-year estimated useful life. Upon disposition, the cost and accumulated depreciation are removed and any gains or losses are reflected in current operations. Maintenance and repair costs are charged to operating expense as incurred. Material expenditures which increase the life of an asset are capitalized and depreciated over the estimated remaining useful life of the asset. The Company capitalized $0.7 million and $1.2 million of interest for the three months ended March 31, 2011 and 2010, respectively, related to the construction of the Company's gas gathering systems and equipment.

The contribution of the Company's Haynesville Shale gas gathering and treating business to KinderHawk on May 21, 2010 for a 50% membership interest and approximately $917 million in cash is accounted for in accordance with ASC 360-20. See Note 2, *"Acquisitions and Divestitures"* for more details regarding the KinderHawk joint venture arrangement and for discussion of the accounting treatment related to the arrangement. Under the financing method, the historical cost of the Haynesville Shale gas gathering system contributed to KinderHawk is carried at the full historical basis of the assets on the unaudited condensed consolidated balance sheets in *"Gas gathering systems and equipment"* and depreciated over the remaining useful life of the assets. Contributions to KinderHawk from the Company and the joint venture partner are recorded as increases in *"Gas gathering systems and equipment"* on the unaudited condensed consolidated balance sheets.

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PETROHAWK ENERGY CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)

1. FINANCIAL STATEMENT PRESENTATION (Continued)

Gas gathering systems and equipment as of March 31, 2011 and December 31, 2010 consisted of the following:

	March 31, 2011(1)	December 31, 2010(1)(2)
	(In thousands)	
Gas gathering systems and equipment	$ 647,027	$ 748,112
Less accumulated depreciation	(16,345)	(22,170)
Net gas gathering systems and equipment	$ 630,682	$ 725,942

(1) Under the financing method, the historical cost of the Haynesville Shale gas gathering system contributed to KinderHawk is carried at the full historical basis of the assets on the unaudited condensed consolidated balance sheets in *"Gas gathering systems and equipment"* and depreciated over the remaining useful life of the assets. As of March 31, 2011 and December 31, 2010, the table above includes approximately $430.9 million and $434.6 million, respectively, attributed to the net carrying value of the assets contributed to KinderHawk.

(2) Includes gas gathering systems and equipment of approximately $155 million and related accumulated depreciation of approximately $11 million associated with the Fayetteville Shale midstream assets, which were classified as "*Assets held for sale*" in the unaudited condensed consolidated balance sheet at December 31, 2010. "*Assets held for sale*" were recorded at the lesser of the carrying amount or the fair value less costs to sell, which resulted in a write down of approximately $69.7 million that was recorded in the year ended December 31, 2010. "*Assets held for sale*" were approximately $74 million as of December 31, 2010. The Company divested its Fayetteville Shale midstream operations on January 7, 2011.

Other operating property and equipment are recorded at cost. Depreciation is calculated using the straight-line method over the following estimated useful lives: automobiles, leasehold improvements, furniture and equipment, five years or the lesser of lease term; rental equipment, seven years; and computers, three years. Upon disposition, the cost and accumulated depreciation are removed and any gains or losses are reflected in current operations. Maintenance and repair costs are charged to operating expense as incurred. Material expenditures which increase the life of an asset are capitalized and depreciated over the estimated remaining useful life of the asset.

The Company reviews its gas gathering systems and equipment and other operating assets in accordance with ASC 360, *Property, Plant, and Equipment* (ASC 360). ASC 360 requires the Company to evaluate gas gathering systems and equipment and other operating assets as events occur or circumstances change that would more likely than not reduce the fair value below the carrying amount. If the carrying amount is not recoverable from its undiscounted cash flows, then the Company would recognize an impairment loss for the difference between the carrying amount and the current fair value. Further, the Company evaluates the remaining useful lives of its gas gathering systems and equipment and other operating assets at each reporting period to determine whether events and circumstances warrant a revision to the remaining depreciation periods.

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PETROHAWK ENERGY CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)

1. FINANCIAL STATEMENT PRESENTATION (Continued)

Payable on Financing Arrangement

The contribution of the Company's Haynesville Shale gas gathering and treating business to KinderHawk on May 21, 2010 for a 50% membership interest and approximately $917 million in cash is accounted for in accordance with ASC 360-20. Due to the gathering agreement entered into with the formation of KinderHawk, constitutes extended continuing involvement under ASC 360-20, it has been determined that the contribution of the Company's Haynesville Shale gathering and treating system to form KinderHawk is accounted for as a failed sale of in substance real estate. See Note 2, *"Acquisitions and Divestitures"* for more details regarding the KinderHawk joint venture arrangement and for discussion of the accounting treatment related to the arrangement. Under the financing method for a failed sale of in substance real estate, on May 21, 2010, the Company recorded a financing obligation on the unaudited condensed consolidated balance sheets in *"Payable on financing arrangement,"* in the amount of approximately $917 million. Reductions to the obligation and the non cash interest on the financing obligation are tied to the gathering and treating services, as the Company delivers natural gas through the Haynesville Shale gathering and treating system. Interest and principal are determined based upon the allocable income to the joint venture partner, and interest is limited up to an amount that is calculated based upon the Company's weighted average cost of debt as of the date of the transaction. Allocable income in excess of the calculated value is reflected as reductions of principal. Interest is recorded in *"Interest expense and other"* on the unaudited condensed consolidated statements of operations. The balance of the Company's financing obligation was approximately $940.9 million as of March 31, 2011 and December 31, 2010, of which approximately $7.2 million and $7.1 million was classified as current at each respective period end.

Goodwill

Goodwill represents the excess of the purchase price over the estimated fair value of the assets acquired net of the fair value of liabilities assumed in an acquisition. ASC 350, *Intangibles Goodwill and Other* (ASC 350) requires that intangible assets with indefinite lives, including goodwill, be evaluated on an annual basis for impairment or more frequently if events occur or circumstances change that could potentially result in impairment. The goodwill impairment test requires the allocation of goodwill and all other assets and liabilities to reporting units. The Company has determined that it has two reporting units: oil and natural gas production and midstream operations. All of the Company's goodwill has been allocated to its oil and natural gas production reporting unit as all of its historical goodwill relates to its acquisitions of oil and natural gas properties.

Other Intangible Assets

The Company treats the costs associated with acquired transportation contracts as other intangible assets. The initial amount recorded represents the fair value of the contract at the time of acquisition, which is amortized using the straight-line method over the life of the contract. Any unamortized balance of the Company's other intangible assets is subject to impairment testing pursuant to the *Impairment or Disposal of Long-Lived Assets Subsections* of ASC Subtopic 360-10. The Company reviews its intangible assets for potential impairment whenever events or changes in circumstances indicate that an other-than-temporary decline in the value of the investment has occurred.

Amortization expense was $2.8 million for the three months ended March 31, 2011 and 2010, and was allocated to operating expenses between *"Marketing"* and *"Gathering, transportation and other"* on

PETROHAWK ENERGY CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)

1. FINANCIAL STATEMENT PRESENTATION (Continued)

the unaudited condensed consolidated statements of operations based on the usage of the contract. The estimated amortization expense will be approximately $11.1 million per year for the remainder of the contract through 2019.

Other intangible assets subject to amortization at March 31, 2011 and December 31, 2010 are as follows:

	March 31, 2011	December 31, 2010
	(In thousands)	
Transportation contracts	$ 105,108	$ 105,108
Less accumulated amortization	(18,529)	(15,766)
Net transportation contracts	$ 86,579	$ 89,342

Assets Held for Sale

As discussed in Note 2, *"Acquisitions and Divestitures,"* the Company divested its Fayetteville Shale midstream operations on January 7, 2011 for approximately $75 million in cash, before customary closing adjustments. The Company's assets related to the Fayetteville Shale midstream operations were presented separately as "*Assets held for sale*" in the unaudited condensed consolidated balance sheet at December 31, 2010, in accordance with ASC 360. Assets held for sale were recorded at the lesser of the carrying amount or the fair value less costs to sell, which resulted in a write down of the carrying amount of approximately $69.7 million that was recorded in the year ended December 31, 2010.

Discontinued Operations

Certain amounts related to the Company's Fayetteville Shale midstream operations and other operating property and equipment have been reclassified to discontinued operations for all periods presented. Unless otherwise noted, information contained in the notes to the unaudited condensed consolidated financial statements relates to the Company's continuing operations. See Note 13, "*Discontinued Operations,"* for further discussion of the presentation of the Company's Fayetteville Shale midstream and other operating assets as discontinued operations.

Recently Issued Accounting Pronouncements

In December 2010, the FASB issued Accounting Standards Update (ASU) No. 2010-28, *When to Perform Step 2 of the Goodwill Impairment Test for Reporting Units with Zero or Negative Carrying Amounts* (ASU 2010-28). This codification update modifies Step 1 of the goodwill impairment test for reporting units with zero or negative carrying amounts and requires reporting units with such carrying amounts to perform Step 2 of the goodwill impairment test if it is more likely than not that a goodwill impairment exists. ASU 2010-28 is effective for fiscal years and interim periods beginning after December 15, 2010 and early adoption is not permitted. The Company adopted the provisions of this update for the three months ended March 31, 2011 and will apply the provisions of ASU 2010-28 when the Company's annual goodwill test is performed in 2011. The Company does not expect a material impact on its operating results, financial position, cash flows or disclosures as a result of the adoption.

In December 2010, the FASB issued ASU No. 2010-29, *Disclosure of Supplementary Pro Forma Information for Business Combinations* (ASU 2010-29). ASU 2010-29 requires a public entity who

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PETROHAWK ENERGY CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)

1. FINANCIAL STATEMENT PRESENTATION (Continued)

discloses comparative pro forma information for business combinations that occurred in the current reporting period to disclose revenue and earnings of the combined entity as though the business combination(s) occurred as of the beginning of the comparable prior annual period only. This update also expands the supplemental pro forma disclosures required to include a description of the nature and amount of material, nonrecurring pro forma adjustments directly attributable to the business combination included in the reported pro forma revenue and earnings. ASU 2010-29 is effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2010 and early adoption is permitted. The Company will apply the provisions of this update for any business combinations that occur after January 1, 2011.

2. ACQUISITIONS AND DIVESTITURES

Divestitures

Fayetteville Shale

On December 22, 2010, the Company completed the sale of its interest in natural gas properties and other operating property and equipment in the Fayetteville Shale for $575 million in cash, before customary closing adjustments. Proceeds from the sale of the interest in natural gas properties were recorded as a reduction to the carrying value of the Company's full cost pool with no gain or loss recorded. In conjunction with the sale of the other operating property and equipment, the Company recorded a loss of approximately $0.5 million in the year ended December 31, 2010. On January 7, 2011, the Company completed the sale of its midstream assets in the Fayetteville Shale for approximately $75 million in cash, before customary closing adjustments. As of December 31, 2010, the Fayetteville Shale midstream assets were classified as "*Assets held for sale"* on the Company's unaudited condensed consolidated balance sheet. "*Assets held for sale*" were recorded at the lesser of the carrying amount or the fair value less costs to sell, which resulted in a write down of the carrying amount of approximately $69.7 million in the year ended December 31, 2010. Both transactions had an effective date of October 1, 2010.

Mid-Continent Properties

On September 29, 2010, the Company completed the sale of its interest in certain Mid-Continent properties in Texas, Oklahoma and Arkansas for $123 million in cash, before customary closing adjustments. Proceeds from the sale were recorded as a reduction to the carrying value of the Company's full cost pool with no gain or loss recorded. The transaction had an effective date of July 1, 2010.

Hawk Field Services, LLC Joint Venture

On May 21, 2010, Hawk Field Services, LLC (Hawk Field Services), a wholly owned subsidiary of Petrohawk, and KM Gathering LLC (Kinder Morgan), an affiliate of Kinder Morgan Energy Partners, L.P., a publicly traded master limited partnership, formed a new joint venture pursuant to a Formation and Contribution Agreement (Contribution Agreement). The new joint venture entity, KinderHawk, engages in the natural gas midstream business in Northwest Louisiana, focused on the Haynesville and Lower Bossier Shales. Pursuant to the Contribution Agreement, Hawk Field Services contributed to KinderHawk its Haynesville Shale gathering and treating business in Northwest

PETROHAWK ENERGY CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)

2. ACQUISITIONS AND DIVESTITURES (Continued)

Louisiana, and Kinder Morgan contributed approximately $917 million in cash ($875 million for a 50% membership interest in KinderHawk and $42 million for certain closing adjustments including 2010 capital expenditures through the closing date) to KinderHawk. Each of Hawk Field Services and Kinder Morgan own a 50% membership interest in KinderHawk. KinderHawk distributed approximately $917 million to Hawk Field Services. The joint venture had an economic effective date of January 1, 2010, and Hawk Field Services continued to operate the business until September 30, 2010, at which date Hawk Field Services and Kinder Morgan terminated the transition services agreement and KinderHawk assumed operations of the joint venture. In connection with the joint venture transaction the Company entered into a gathering agreement with KinderHawk which requires the Company to deliver natural gas to KinderHawk from dedicated lease acreage for the life of the dedicated lease acreage, or approximately 30 years, and includes a minimum delivery commitment over a five-year period.

The Company is obligated to deliver to KinderHawk agreed upon minimum annual quantities of natural gas from Petrohawk operated wells producing from the Haynesville and Lower Bossier Shales with specified acreage in Northwest Louisiana through May 2015, or in the alternative, pay an annual true-up fee to KinderHawk if such minimum annual quantities are not delivered. The Company pays KinderHawk negotiated gathering and treating fees, subject to an annual inflation adjustment factor. The gathering fee is equal to $0.34 per thousand cubic feet (Mcf) of natural gas delivered at KinderHawk's receipt points. The treating fee is charged for gas delivered containing more than 2% by volume of carbon dioxide. For gas delivered containing between 2% and 5.5% carbon dioxide, the treating fee is between $0.030 and $0.345 per Mcf, and for gas containing over 5.5% carbon dioxide, the treating fee starts at $0.365 per Mcf and increases on a scale of $0.09 per Mcf for each additional 1% of carbon dioxide content.

The KinderHawk joint venture is accounted for as a failed sale of in substance real estate under the provisions of ASC 360-20. ASC 360-20 establishes standards for recognition of profit on all real estate sales transactions other than retail land sales, without regard to the nature of the seller's business. In making the determination of whether a transaction qualifies, in substance, as a sale of real estate, the nature of the entire real estate being sold is considered, including the land plus the property improvements and the integral equipment. The Haynesville Shale gathering and treating system, consists of right of ways, pipelines and processing facilities. Due to the gathering agreement which constitutes extended continuing involvement under ASC 360-20, it has been determined that the contribution of the Company's Haynesville Shale gathering and treating system to form KinderHawk should be accounted for as a failed sale of in substance real estate.

As a result of the failed sale the Company accounts for the continued operations of the gas gathering system and reflects a financing obligation, representing the proceeds received, under the financing method of real estate accounting. Under the financing method, the historical cost of the Haynesville Shale gas gathering system contributed to KinderHawk is carried at the full historical basis of the assets on the unaudited condensed consolidated balance sheets in *"Gas gathering systems and equipment"* and depreciated over the remaining useful life of the assets. The financing obligation is recorded on the unaudited condensed consolidated balance sheets in *"Payable on financing arrangement,"* in the amount of approximately $917 million. Reductions to the obligation and non cash interest on the financing obligation are tied to the gathering and treating services, as the Company delivers natural gas through the Haynesville Shale gathering and treating system. Interest and principal are determined based upon the allocable income to Kinder Morgan, and interest is limited up to an

PETROHAWK ENERGY CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)

2. ACQUISITIONS AND DIVESTITURES (Continued)

amount that is calculated based upon the Company's weighted average cost of debt as of the date of the transaction. Allocable income in excess of the calculated value is reflected as reductions of principal. Interest is recorded in *"Interest expense and other"* on the unaudited condensed consolidated statements of operations. Additionally the Company records KinderHawk's revenues, net of eliminations for intercompany amounts associated with gathering and treating services provided to the Company, and expenses on the unaudited condensed consolidated statements of operations in *"Midstream revenues," "Taxes other than income," "Gathering, transportation and other," "General and administrative," "Interest expense and other"* and *"Depletion, depreciation and amortization."*

Terryville

On May 12, 2010, the Company completed the sale of its interest in Terryville Field, located in Lincoln and Claiborne Parishes, Louisiana for $320 million in cash, before customary closing adjustments. Proceeds from the sale were recorded as a reduction to the carrying value of the Company's full cost pool with no gain or loss recorded. The transaction had an effective date of January 1, 2010. In conjunction with the closing, the Company deposited $75 million with a qualified intermediary to facilitate like-kind exchange transactions all of which had been spent as of December 31, 2010.

West Edmond Hunton Lime Unit

On April 30, 2010, the Company completed the sale of its interest in the West Edmond Hunton Lime Unit (WEHLU) Field in Oklahoma County, Oklahoma for $155 million in cash, before customary closing adjustments. Proceeds from the sale were recorded as a reduction to the carrying value of the Company's full cost pool with no gain or loss recorded. The transaction had an effective date of April 1, 2010.

3. OIL AND NATURAL GAS PROPERTIES

The Company uses the full cost method of accounting for its investment in oil and natural gas properties. Under this method of accounting, all costs of acquisition, exploration and development of oil and natural gas reserves (including such costs as leasehold acquisition costs, geological expenditures, dry hole costs, tangible and intangible development costs and direct internal costs) are capitalized as the cost of oil and natural gas properties when incurred. To the extent capitalized costs of evaluated oil and natural gas properties, net of accumulated depletion exceed the discounted future net revenues of proved oil and natural gas reserves net of deferred taxes, such excess capitalized costs are charged to expense. Beginning December 31, 2009, full cost companies use the unweighted arithmetic average first day of the month price for oil and natural gas for the 12-month period preceding the calculation date to calculate the future net revenues of proved reserves.

The Company assesses all items classified as unevaluated property on a quarterly basis for possible impairment or reduction in value. The Company assesses properties on an individual basis or as a group if properties are individually insignificant. The assessment includes consideration of the following factors, among others: intent to drill; remaining lease term; geological and geophysical evaluations; drilling results and activity; the assignment of proved reserves; and the economic viability of development if proved reserves are assigned. During any period in which these factors indicate an impairment, the cumulative drilling costs incurred to date for such property and all or a portion of the associated leasehold costs are transferred to the full cost pool and are then subject to amortization.

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PETROHAWK ENERGY CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)

3. OIL AND NATURAL GAS PROPERTIES (Continued)

At March 31, 2011 the ceiling test value of the Company's reserves was calculated based on the first day average of the 12-months ended March 31, 2011 of the West Texas Intermediate (WTI) spot price of $83.55 per barrel, adjusted by lease or field for quality, transportation fees, and regional price differentials, and the first day average of the 12-months ended March 31, 2011 of the Henry Hub price of $4.10 per million British thermal units (Mmbtu), adjusted by lease or field for energy content, transportation fees, and regional price differentials. Using these prices, the Company's net book value of oil and natural gas properties at March 31, 2011, did not exceed the ceiling amount. Changes in production rates, levels of reserves, future development costs, and other factors will determine the Company's actual ceiling test calculation and impairment analyses in future periods.

At March 31, 2010 the ceiling test value of the Company's reserves was calculated based on the first day average of the 12-months ended March 31, 2010 of the WTI posted price of $69.64 per barrel, adjusted by lease or field for quality, transportation fees, and regional price differentials, and the first day average of the 12-months ended March 31, 2010 of the Henry Hub price of $3.99 per Mmbtu, adjusted by lease or field for energy content, transportation fees, and regional price differentials. Using these prices, the Company's net book value of oil and natural gas properties at March 31, 2010, did not exceed the ceiling amount.

4. LONG-TERM DEBT

Long-term debt as of March 31, 2011 and December 31, 2010 consisted of the following:

	March 31, 2011(1)	December 31, 2010(1)
	(In thousands)	
Senior revolving credit facility	$ 364,000	$ 146,000
7.25% $1.2 billion senior notes(2)	1,232,371	825,000
10.5% $600 million senior notes(3)	564,262	562,115
7.875% $800 million senior notes	800,000	800,000
7.125% $275 million senior notes(4)		268,922
Deferred premiums on derivatives	13,076	10,815
	$ 2,973,709	$ 2,612,852

(1) Table excludes $14.6 million of deferred premiums on derivative contracts which have been classified as current at March 31, 2011 and December 31, 2010. Table also excludes $0.2 million of 9.875% senior notes due 2011 which have been classified as current at March 31, 2011 and December 31, 2010.

(2) On August 17, 2010 and January 31, 2011, the Company issued an initial $825 million principal amount and an additional $400 million principal amount, respectively, of its 7.25% senior notes due 2018. Amount includes a $7.4 million premium at March 31, 2011, recorded by the Company in conjunction with the issuance of the additional $400 million principal amount. See "7.25% Senior Notes" below for more details.

(3) Amount includes a $35.8 million and $37.9 million discount at March 31, 2011 and December 31, 2010, respectively, recorded by the Company in conjunction with the

PETROHAWK ENERGY CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)

4. LONG-TERM DEBT (Continued)

issuance of the 10.5% $600 million senior notes. See "10.5% Senior Notes" below for more details.

(4) The 7.125% $275 million senior notes were redeemed during the first quarter of 2011. Amount includes a $3.5 million discount at December 31, 2010, recorded by the Company in conjunction with the assumption of the notes. See "7.125% Senior Notes" below for more details.

Senior Revolving Credit Facility

Effective August 2, 2010, the Company amended and restated its existing credit facility dated October 14, 2009 by entering into the Fifth Amended and Restated Senior Revolving Credit Agreement (the Senior Credit Agreement), among the Company, each of the lenders from time to time party thereto (the Lenders), BNP Paribas, as administrative agent for the Lenders, Bank of America, N.A. and Bank of Montreal as co-syndication agents for the Lenders, and JPMorgan Chase Bank, N.A. and Wells Fargo Bank, N.A., as co-documentation agents for the Lenders. The Senior Credit Agreement provides for a $2.0 billion facility. As of March 31, 2011, the borrowing base was approximately $1.6 billion, $1.5 billion of which related to the Company's oil and natural gas properties and up to $100 million (currently limited as described below) related to the Company's midstream assets. The portion of the borrowing base relating to the Company's oil and natural gas properties is redetermined on a semi-annual basis (with the Company and the Lenders each having the right to one annual interim unscheduled redetermination) and adjusted based on the Company's oil and natural gas properties, reserves, other indebtedness and other relevant factors. The component of the borrowing base relating to the Company's midstream assets is limited to the lesser of $100 million or 3.5 times midstream earnings before interest, taxes, depreciation and amortization (EBITDA), and is calculated quarterly. As of March 31, 2011, the midstream component of the borrowing base was limited to approximately $95.2 million based on midstream EBITDA. At March 31, 2011, the Company had approximately $34.7 million outstanding letters of credit with various customers, vendors and others. The Company's borrowing base is subject to a reduction equal to the product of $0.25 multiplied by the stated principal amount (without regard to any initial issue discount) of any unsecured senior or senior subordinated notes that the Company may issue.

Amounts outstanding under the Senior Credit Agreement bear interest at specified margins over the London Interbank Offered Rate (LIBOR) of 2.00% to 3.00% for Eurodollar loans or at specified margins over the Alternate Base Rate (ABR) of 1.00% to 2.00% for ABR loans. Such margins will fluctuate based on the utilization of the facility. Borrowings under the Senior Credit Agreement are secured by first priority liens on substantially all of the Company's assets, including pursuant to the terms of the Fifth Amended and Restated Guarantee and Collateral Agreement, all of the assets of, and equity interests in, the Company's subsidiaries. Amounts drawn down on the facility will mature on July 1, 2014.

The Senior Credit Agreement contains customary financial and other covenants, including minimum working capital levels (the ratio of current assets plus the unused commitment under the Senior Credit Agreement to current liabilities) of not less than 1.0 to 1.0 and minimum coverage of interest expenses (as defined in the Senior Credit Agreement) of not less than 2.5 to 1.0. In addition, the Company is subject to covenants limiting dividends and other restricted payments, transactions with affiliates, incurrence of debt, changes of control, asset sales, and liens on properties. At March 31,

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PETROHAWK ENERGY CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)

4. LONG-TERM DEBT (Continued)

2011, the Company was in compliance with its financial debt covenants under the Senior Credit Agreement.

See Note 14, *"Subsequent Event"* for discussion of the amendment of the Company's Senior Credit Agreement subsequent to March 31, 2011.

7.25% Senior Notes

On August 17, 2010, the Company completed a private placement offering to eligible purchasers of an aggregate principal amount of $825 million of its 7.25% senior notes due 2018 (the initial 2018 Notes) at a purchase price of 100% of the principal amount of the initial 2018 Notes. The initial 2018 Notes were issued under and are governed by an indenture dated August 17, 2010, between the Company, U.S. Bank Trust National Association, as trustee, and the Company's subsidiaries named therein as guarantors (the 2018 Indenture). The Company applied the net proceeds from the sale of the initial 2018 Notes to redeem its 9.125% $775 million senior notes due 2013.

On January 31, 2011, the Company completed the issuance of an additional $400 million aggregate principal amount of its 7.25% senior notes due 2018 (the additional 2018 Notes) in a private placement to eligible purchasers. The additional 2018 Notes are issued under the same Indenture and are part of the same series as the initial 2018 Notes. The additional 2018 Notes together with the initial 2018 Notes are collectively referred to as the 2018 Notes.

The additional 2018 Notes were sold to Barclays Capital Inc. at 101.875% of the aggregate principal amount of the additional 2018 Notes plus accrued interest. The net proceeds from the sale of the additional 2018 Notes were approximately $400.5 million (after deducting offering fees and expenses). A portion of the proceeds of the additional 2018 Notes were utilized to redeem all of the Company's outstanding 7.125% $275 million senior notes due 2012.

Interest on the 2018 Notes is payable on February 15 and August 15 of each year, beginning on February 15, 2011. Interest on the 2018 Notes accrued from August 17, 2010, the original issuance date of the series. The 2018 Notes are senior unsecured obligations of the Company and rank equally with all of the Company's current and future senior indebtedness. The 2018 Notes are jointly and severally, fully and unconditionally guaranteed on a senior unsecured basis by the Company's subsidiaries. Petrohawk Energy Corporation, the issuer of the 2018 Notes, has no material independent assets or operations apart from the assets and operations of its subsidiaries.

On or prior to August 15, 2013, the Company may redeem up to 35% of the aggregate principal amount of the 2018 Notes with the net cash proceeds of certain equity offerings at a redemption price of 107.25% of the principal amount, plus accrued and unpaid interest to the redemption date; provided that at least 65% in aggregate principal amount of the 2018 Notes originally issued under the 2018 Indenture remain outstanding immediately after the redemption. In addition, at any time prior to August 15, 2014, the Company may redeem some or all of the 2018 Notes for the principal amount, plus accrued and unpaid interest, plus a make whole premium equal to the excess, if any of (a) the present value at such time of (i) the redemption price of such note at August 15, 2014, (ii) any required interest payments due on the notes (except for currently accrued and unpaid interest), computed using a discount rate equal to the Treasury Rate plus 50 basis points, discounted to the redemption date on a semi-annual basis, over (b) the principal amount of such note.

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PETROHAWK ENERGY CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)

4. LONG-TERM DEBT (Continued)

On or after August 15, 2014, the Company may redeem all or part of the 2018 Notes at any time or from time to time at the redemption prices (expressed as a percentage of principal amount) set forth in the following table plus accrued and unpaid interest, if any, to the applicable redemption date, if redeemed during the 12-month period beginning August 15 of the years indicated below:

Year	Percentage
2014	103.625
2015	101.813
2016 and thereafter	100.000

The Company may be required to offer to repurchase the 2018 Notes at a purchase price of 101% of the principal amount, plus accrued and unpaid interest, if any, to the redemption date, in the event of a change of control as defined in the 2018 Indenture. The 2018 Indenture contains covenants that, among other things, restrict or limit the ability of the Company and its subsidiaries to: borrow money; pay dividends on stock; purchase or redeem stock or subordinated indebtedness; make investments; create liens; enter into transactions with affiliates; sell assets; and merge with or into other companies or transfer all or substantially all of the Company's assets.

In conjunction with the issuance of the additional 2018 Notes, the Company recorded a premium of $7.5 million to be amortized over the remaining life of the notes utilizing the effective interest rate method. The remaining unamortized premium was $7.4 million at March 31, 2011.

10.5% Senior Notes

On January 27, 2009, the Company completed a private placement offering to eligible purchasers of an aggregate principal amount of $600 million of its 10.5% senior notes due 2014 (the 2014 Notes). The 2014 Notes were issued under and are governed by an indenture dated January 27, 2009, between the Company, U.S. Bank Trust National Association, as trustee, and the Company's subsidiaries named therein as guarantors (the 2014 Indenture).

The 2014 Notes bear interest at a rate of 10.5% per annum, payable semi-annually on February 1 and August 1 of each year. The 2014 Notes will mature on August 1, 2014. The 2014 Notes are senior unsecured obligations of the Company and rank equally with all of its current and future senior indebtedness. The 2014 Notes are jointly and severally, fully and unconditionally guaranteed on a senior unsecured basis by the Company's subsidiaries. Petrohawk Energy Corporation, the issuer of the 2014 Notes, has no material independent assets or operations apart from the assets and operations of its subsidiaries.

In conjunction with the issuance of the 2014 Notes, the Company recorded a discount of $52.3 million to be amortized over the remaining life of the notes utilizing the effective interest rate method. The remaining unamortized discount was $35.8 million at March 31, 2011.

7.875% Senior Notes

On May 13, 2008 and June 19, 2008, the Company issued $500 million principal amount and $300 million principal amount, respectively, of its 7.875% senior notes due 2015 (the 2015 Notes). The 2015 Notes were issued under and are governed by an indenture dated May 13, 2008, between the

PETROHAWK ENERGY CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)

4. LONG-TERM DEBT (Continued)

Company, U.S. Bank Trust National Association, as trustee, and the Company's subsidiaries named therein as guarantors.

The 2015 Notes bear interest at a rate of 7.875% per annum, payable semi-annually on June 1 and December 1 of each year. The 2015 Notes will mature on June 1, 2015. The 2015 Notes are senior unsecured obligations of the Company and rank equally with all of its current and future senior indebtedness. The 2015 Notes are jointly and severally, fully and unconditionally guaranteed on a senior unsecured basis by the Company's subsidiaries. Petrohawk Energy Corporation, the issuer of the 2015 Notes, has no material independent assets or operations apart from the assets and operations of its subsidiaries.

7.125% Senior Notes

On July 12, 2006, the date of the Company's merger with KCS Energy, Inc. (KCS), the Company assumed (pursuant to the Second Supplemental Indenture relating to the 7.125% Senior Notes, also referred to as the 2012 Notes), and subsidiaries of the Company guaranteed (pursuant to the Third Supplemental Indenture relating to such notes), all the obligations (approximately $275 million) of KCS under the 2012 Notes and the Indenture dated April 1, 2004 (the 2012 Indenture) among KCS, U.S. Bank National Association, as trustee, and the subsidiary guarantors named therein, which governs the terms of the 2012 Notes. Interest on the 2012 Notes is payable semi-annually, on each April 1 and October 1. The 2012 Notes are jointly and severally, fully and unconditionally guaranteed on a senior unsecured basis by the Company's subsidiaries. Petrohawk Energy Corporation, the issuer of the 2012 Notes, has no material independent assets or operations apart from the assets and operations of its subsidiaries.

In conjunction with the assumption of the 7.125% Senior Notes from KCS, the Company recorded a discount of $13.6 million to be amortized over the remaining life of the notes utilizing the effective interest rate method. The Company had no remaining unamortized discount at March 31, 2011 and $3.5 million at December 31, 2010.

On March 17, 2011, the Company redeemed all of the outstanding 2012 Notes with a portion of the proceeds received from the issuance of the additional 2018 Notes.

9.875% Senior Notes

On April 8, 2004, Mission Resources Corporation (Mission) issued $130 million of its 9.875% senior notes due 2011 (the 2011 Notes). The Company assumed these notes upon the closing of the Company's merger with Mission. In conjunction with the Company's merger with KCS, the Company repurchased substantially all of the 2011 Notes. There were approximately $0.2 million of the notes were not redeemed and are still outstanding and classified as current as of March 31, 2011 and December 31, 2010. In connection with the extinguishment of substantially all of the 2011 Notes, the Company requested and received from the noteholders consent to eliminate the debt covenants associated with the 2011 Notes.

On April 1, 2011, the Company repaid the $0.2 million of 2011 Notes that were outstanding.

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PETROHAWK ENERGY CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)

4. LONG-TERM DEBT (Continued)

Debt Issuance Costs

The Company capitalizes certain direct costs associated with the issuance of long-term debt. During the first quarter of 2011, the Company capitalized approximately $7.3 million in costs associated with its issuance of the additional 2018 Notes. In the first quarter of 2011, the Company wrote off $0.2 million of debt issuance costs as a result of the additional 2018 Notes issuance and the corresponding reduction of the Company's Senior Credit Agreement's borrowing base. At March 31, 2011 and December 31, 2010, the Company had approximately $50.3 million and $45.9 million, respectively, of debt issuance costs remaining that are being amortized over the lives of the respective debt.

5. FAIR VALUE MEASUREMENTS

Pursuant to ASC 820, *Fair Value Measurements and Disclosures* (ASC 820) the Company's determination of fair value incorporates not only the credit standing of the counterparties involved in transactions with the Company resulting in receivables on the Company's unaudited condensed consolidated balance sheets, but also the impact of the Company's nonperformance risk on its own liabilities. ASC 820 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (exit price). The Company utilizes market data or assumptions that market participants would use in pricing the asset or liability, including assumptions about risk and the risks inherent in the inputs to the valuation technique. These inputs can be readily observable, market corroborated, or generally unobservable. The Company classifies fair value balances based on the observability of those inputs.

The following tables set forth by level within the fair value hierarchy the Company's financial assets and liabilities that were accounted for at fair value as of March 31, 2011 and December 31, 2010. As required by ASC 820, a financial instrument's level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement. The Company's assessment of the significance of a particular input to the fair value measurement requires judgment, and may affect the valuation of fair value assets and liabilities and their placement within the fair value hierarchy levels. There were no transfers between fair value hierarchy levels for the three months ended March 31, 2011 and for the year ended December 31, 2010.

	March 31, 2011			
	Level 1	Level 2	Level 3	Total
	(In thousands)			
Assets:				
Receivables from derivative contracts	$	$ 200,073	$	$ 200,073
Liabilities:				
Liabilities from derivative contracts	$	$ 69,106	$	$ 69,106

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PETROHAWK ENERGY CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)

5. FAIR VALUE MEASUREMENTS (Continued)

	December 31, 2010			
	Level 1	Level 2	Level 3	Total
	(In thousands)			
Assets:				
Receivables from derivative contracts	$	$ 258,739	$	$ 258,739
Liabilities:				
Liabilities from derivative contracts	$	$ 19,395	$	$ 19,395

As discussed in Note 2, *"Acquisitions and Divestitures,"* the Company divested its Fayetteville Shale midstream operations on January 7, 2011 for approximately $75 million in cash, before customary closing adjustments. The Company's assets related to the Fayetteville Shale midstream operations were presented separately as "*Assets held for sale*" in the unaudited condensed consolidated balance sheet at December 31, 2010, in accordance with ASC 360. Assets held for sale were recorded at the lesser of the carrying amount or the fair value less costs to sell, which resulted in a write down of the carrying amount of approximately $69.7 million that was recorded in the year ended December 31, 2010.

Derivatives listed above include collars, swaps, and put options that are carried at fair value. The Company records the net change in the fair value of these positions in *"Net (loss) gain on derivative contracts"* in the Company's unaudited condensed consolidated statements of operations. The Company is able to value the assets and liabilities based on observable market data for similar instruments, which resulted in the Company reporting its derivatives as Level 2. This observable data includes the forward curve for commodity prices based on quoted markets prices and implied volatility factors related to changes in the forward curves.

As of March 31, 2011 and December 31, 2010, the Company's derivative contracts were with major financial institutions with investment grade credit ratings which are believed to have a minimal credit risk. As such, the Company is exposed to credit risk to the extent of nonperformance by the counterparties in the derivative contracts discussed above; however, the Company does not anticipate such nonperformance. Each of the counterparties to the Company's derivative contracts is a lender in the Company's Senior Credit Agreement. The Company did not post collateral under any of these contracts as they are secured under the Senior Credit Agreement.

The following disclosure of the estimated fair value of financial instruments is made in accordance with the requirements of ASC 825, *Financial Instruments*. The estimated fair value amounts have been determined at discrete points in time based on relevant market information. These estimates involve uncertainties and cannot be determined with precision. The estimated fair value of cash, accounts receivable and accounts payable approximates their carrying value due to their short-term nature. The estimated fair value of the Company's Senior Credit Agreement approximates carrying value because the facility's interest rate approximates current market rates. The following table presents the estimated fair values of the Company's fixed interest rate, long-term debt instruments as of March 31, 2011 and

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PETROHAWK ENERGY CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)

5. FAIR VALUE MEASUREMENTS (Continued)

December 31, 2010 (excluding premiums and discounts, deferred premiums on derivative contracts, and any amounts that have been classified as current):

Debt	March 31, 2011 Carrying Amount	March 31, 2011 Estimated Fair Value	December 31, 2010 Carrying Amount	December 31, 2010 Estimated Fair Value
	(In thousands)			
7.25% $1.2 billion senior notes	$ 1,225,000	$ 1,264,813	$ 825,000	$ 832,425
10.5% $600 million senior notes	600,000	690,000	600,000	684,000
7.875% $800 million senior notes	800,000	848,800	800,000	834,000
7.125% $275 million senior notes			272,375	273,465
	$ 2,625,000	$ 2,803,613	$ 2,497,375	$ 2,623,890

The fair values of the Company's fixed interest debt instruments were calculated using quoted market prices based on trades of such debt as of March 31, 2011 and December 31, 2010.

6. ASSET RETIREMENT OBLIGATIONS

For wells drilled, the Company records an asset retirement obligation (ARO) when the total depth of a drilled well is reached and the Company can reasonably estimate the fair value of an obligation to perform site reclamation, dismantle facilities or plug and abandon costs. For gas gathering systems and equipment, the Company records an ARO when the system is placed in service and the Company can reasonably estimate the fair value of an obligation to perform site reclamation and other necessary work. The Company records the ARO liability on the unaudited condensed consolidated balance sheets and capitalizes the cost in *"Oil and natural gas properties"* or *"Gas gathering systems and equipment"* during the period in which the obligation is incurred. The Company records the accretion of its ARO liabilities in *"Depletion, depreciation and amortization"* expense in the unaudited condensed consolidated statements of operations. The additional capitalized costs are depreciated on a unit-of-production basis or straight-line basis.

The Company recorded the following activity related to its ARO liability for the three months ended March 31, 2011 (in thousands):

Liability for asset retirement obligation as of December 31, 2010	$ 31,741
Liabilities settled and divested(1)	(465)
Additions	2,648
Accretion expense	444
Liability for asset retirement obligation as of March 31, 2011	$ 34,368

(1) Refer to Note 2, "*Acquisitions and Divestitures*" for more details on the Company's divestiture activities.

PETROHAWK ENERGY CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)

7. COMMITMENTS AND CONTINGENCIES

Commitments

The Company leases corporate office space in Houston, Texas and Tulsa, Oklahoma as well as a number of other field office locations. In addition, the Company has lease commitments related to certain vehicles, machinery and equipment under long-term operating leases. Rent expense was $1.8 million and $1.3 million for the three months ended March 31, 2011 and 2010, respectively

As of March 31, 2011, the Company had the following commitments:

	Total Obligation Amount(1) (in thousands)	Years Remaining
Gathering and transportation commitments	$ 1,928,842	18
Drilling rig commitments	261,920	3
Non-cancelable operating leases	32,278	8
Pipeline and well equipment obligations	129,372	1
Various contractual commitments (including, among other things, rental equipment obligations, obtaining and processing seismic data and fracture stimulation services)	65,680	3
Total commitments	$ 2,418,092	

(1) On May 21, 2010, the Company created a joint venture with Kinder Morgan, KinderHawk, which engages in the natural gas midstream business in Northwest Louisiana, focused on the Haynesville and Lower Bossier Shales. As part of this transaction, the Company is committed to contribute up to an additional $57.7 million, as of March 31, 2011, in capital during 2011 in the event KinderHawk requires capital to finance its planned capital expenditures. This obligation is not reflected in the amounts shown in the above table. In addition, the Company is obligated to deliver to KinderHawk agreed upon minimum annual quantities of natural gas from Petrohawk operated wells producing from the Haynesville and Lower Bossier Shales in North Louisiana through May 2015, or in the alternative, pay an annual true-up fee to KinderHawk if such minimum annual quantities are not delivered. These obligations are not reflected in the amounts shown in the table above. The Company pays to KinderHawk negotiated gathering and treating fees, subject to an annual inflation adjustment factor. See Note 2, "*Acquisitions and Divestitures*" for more details.

The contribution of the Company's Haynesville Shale gas gathering and treating business to KinderHawk is accounted for in accordance with ASC 360-20. Due to the gathering agreement which constitutes extended continuing involvement under ASC 360-20, it has been determined that the contribution of the Company's Haynesville Shale gathering and treating system to form KinderHawk is accounted for as a failed sale of in substance real estate. See Note 2, *"Acquisitions and Divestitures"* for more details regarding the KinderHawk joint venture arrangement and for discussion of the accounting treatment related to the arrangement. As a result of the failed sale, the Company recorded a financing obligation, representing the proceeds received, under the financing method of real estate accounting. The financing obligation is recorded on the unaudited condensed consolidated balance sheets in "*Payable on financing arrangement,"* in the amount of approximately $917 million. Reductions to the

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PETROHAWK ENERGY CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)

7. COMMITMENTS AND CONTINGENCIES (Continued)

obligation and the non cash interest on the obligation are tied to the gathering and treating services, as the Company delivers natural gas through the Haynesville Shale gathering and treating system. Interest and principal are determined based upon the allocable income to Kinder Morgan, and interest is limited up to an amount that is calculated based upon the Company's weighted average cost of debt as of the date of the transaction. Allocable income in excess of the calculated value is reflected as reductions of principal. Interest is recorded in *"Interest expense and other"* on the unaudited condensed consolidated statements of operations. The balance of the Company's financing obligation as of March 31, 2011, was approximately $940.9 million, of which approximately $7.2 million was classified as current. This obligation is not reflected in the amounts shown in the table above.

Contingencies

From time to time, the Company may be a plaintiff or defendant in a pending or threatened legal proceeding arising in the normal course of its business. All known liabilities are accrued based on the Company's best estimate of the potential loss. While the outcome and impact of currently pending legal proceedings cannot be determined, the Company's management and legal counsel believe that the resolution of these proceedings through settlement or adverse judgment will not have a material adverse effect on the Company's unaudited condensed consolidated operating results, financial position or cash flows. Please refer to Part II. Other Information, Item 1. *Legal Proceedings* in our Quarterly Report on Form 10-Q as filed on May 5, 2011 for further information on pending cases.

8. DERIVATIVES

The Company is exposed to certain risks relating to its ongoing business operations, such as commodity price risk and interest rate risk. Derivative contracts are utilized to economically hedge its exposure to price fluctuations and reduce the variability in the Company's cash flows associated with anticipated sales of future oil, natural gas and natural gas liquids production. The Company generally hedges a substantial, but varying, portion of anticipated oil, natural gas and natural gas liquids production for the next 12 to 36 months. Derivatives are carried at fair value on the unaudited condensed consolidated balance sheets, with the changes in the fair value included in the unaudited condensed consolidated statements of operations for the period in which the change occurs. Historically, the Company has also entered into interest rate swaps to mitigate exposure to market rate fluctuations by converting variable interest rates (such as those on the Company's Senior Credit Agreement) to fixed interest rates and may do so at some point in the future as situations present themselves.

It is the Company's policy to enter into derivative contracts, including interest rate swaps, only with counterparties that are creditworthy financial institutions deemed by management as competent and competitive market makers. Each of the counterparties to the Company's derivative contracts is a lender in the Company's Senior Credit Agreement. The Company did not post collateral under any of these contracts as they are secured under the Company's Senior Credit Agreement.

At March 31, 2011 the Company had entered into commodity collars and swaps. The Company has elected to not designate any of its derivative contracts for hedge accounting. Accordingly, the Company records the net change in the mark-to-market valuation of these derivative contracts, as well as all payments and receipts on settled derivative contracts, in *"Net (loss) gain on derivatives contracts"* on the unaudited condensed consolidated statements of operations.

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PETROHAWK ENERGY CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)

8. DERIVATIVES (Continued)

At March 31, 2011, the Company had 97 open commodity derivative contracts summarized in the tables below: two natural gas swap arrangements, 75 natural gas collar arrangements, 19 crude oil collar arrangements, and one natural gas liquids swap (which was an ethane swap). Derivative commodity contracts settle based on NYMEX WTI and Henry Hub prices, or the applicable information service for the Company's natural gas liquids contracts, which may have differed from the actual price received by the Company for the sale of its oil, natural gas and natural gas liquids production.

At December 31, 2010, the Company had 79 open commodity derivative contracts summarized in the tables below: 60 natural gas collar arrangements, two natural gas swap arrangements, 16 crude oil collar arrangements, and one natural gas liquids swap (which was an ethane swap). Derivative commodity contracts in 2010 settled based on NYMEX WTI and Henry Hub prices, or the applicable information service for the Company's natural gas liquids contracts, which may have differed from the actual price received by the Company for the sale of its oil, natural gas and natural gas liquids production.

All derivative contracts are recorded at fair market value in accordance with ASC 815 and ASC 820 and included in the unaudited condensed consolidated balance sheets as assets or liabilities. The following table summarizes the location and fair value amounts of all derivative contracts in the unaudited condensed consolidated balance sheets as of March 31, 2011 and December 31, 2010:

	Asset derivative contracts			Liability derivative contracts		
Derivatives not designated as hedging contracts under ASC 815	**Balance sheet location**	**March 31, 2011**	**December 31, 2010**	**Balance sheet location**	**March 31, 2011**	**December 31, 2010**
		(In thousands)			**(In thousands)**	
Commodity contracts	Current assets receivables from derivative contracts	$ 163,111	$ 217,018	Current liabilities liabilities from derivative contracts	$ (32,202)	$ (5,820)
Commodity contracts	Other noncurrent assets receivables from derivative contracts	36,962	41,721	Other noncurrent liabilities liabilities from derivative contracts	(36,904)	(13,575)
Total derivatives not designated as hedging contracts under ASC 815		$ 200,073	$ 258,739		$ (69,106)	$ (19,395)

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PETROHAWK ENERGY CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)

8. DERIVATIVES (Continued)

The following table summarizes the location and amounts of the Company's realized and unrealized gains and losses on derivative contracts in the Company's unaudited condensed consolidated statements of operations:

Derivatives not designated as hedging contracts under ASC 815	Location of gain or (loss) recognized in income on derivative contracts	Amount of gain or (loss) recognized in income on derivative contracts three months ended March 31, 2011	2010
		(In thousands)	
Unrealized (loss) gain on commodity contracts	Other income (expenses) net (loss) gain on derivative contracts	$ (114,965)	$ 190,095
Realized gain on commodity contracts	Other income (expenses) net (loss) gain on derivative contracts	64,058	24,608
Total net (loss) gain on derivative contracts	Other income (expenses) net (loss) gain on derivative contracts	$ (50,907)	$ 214,703

At March 31, 2011, the Company had the following open derivative contracts:

			March 31, 2011				
				Floors		Ceilings	
Period	Instrument	Commodity	Volume in Mmbtu's/ Bbl's/Gal's	Price / Price Range	Weighted Average Price	Price / Price Range	Weighted Average Price
April 2011 - December 2011	Collars	Natural gas	143,000,000	$ 5.50 - $6.00	$ 5.55	$ 9.00 - $10.30	$ 9.66
April 2011 - December 2011	Collars	Crude oil	1,512,500	75.00 - 80.00	78.00	95.00 - 101.00	98.88
April 2011 - December 2011	Swaps	Natural gas liquids	3,600,000	0.46	0.46		
January 2012 - December 2012	Collars	Natural gas	184,830,000	4.75 - 5.00	4.86	5.70 - 8.00	6.55
January 2012 - December 2012	Swaps	Natural gas	7,320,000	5.20	5.20		
January 2012 - December 2012	Collars	Crude oil	4,758,000	75.00 - 90.00	80.00	98.00 - 110.00	102.29

At December 31, 2010, the Company had the following open derivative contracts:

Period	Instrument	Commodity	Volume in Mmbtu's/ Bbl's/Gal's	Price / Price Range	Weighted Average Price	Price / Price Range	Weighted Average Price
January 2011 - December 2011	Collars	Natural gas	189,800,000	$ 5.50 - $6.00	$ 5.55	$ 9.00 - $10.30	$ 9.66
January 2011 - December 2011	Collars	Crude oil	2,007,500	75.00 - 80.00	78.00	95.00 - 101.00	98.88
January 2011 - December 2011	Swaps	Natural gas liquids	4,800,000	0.46	0.46		
January 2012 - December 2012	Collars	Natural gas	118,950,000	4.75 - 5.00	4.92	5.72 - 8.00	6.96
January 2012 - December 2012	Swaps	Natural gas	7,320,000	5.20	5.20		
	Collars	Crude oil	3,660,000	75.00 - 80.00	77.00	98.00 - 102.45	100.00

January 2012 - December 2012	

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PETROHAWK ENERGY CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)

9. STOCKHOLDERS' EQUITY

Stock Options and Stock Appreciation Rights

During the three months ended March 31, 2011, the Company granted stock options covering 2.3 million shares of common stock to employees of the Company. The stock options have exercise prices ranging from $20.57 to $20.64 with a weighted average price of $20.57. These awards vest over a three year period at a rate of one-third on the annual anniversary date of the grant and expire ten years from the grant date. At March 31, 2011, the unrecognized compensation expense related to non-vested stock appreciation rights and stock options totaled $32.1 million and will be recognized on a straight line basis over the weighted average remaining vesting period of 1.6 years.

During the three months ended March 31, 2010, the Company granted stock options covering 2.0 million shares of common stock to employees of the Company. The stock options have exercise prices ranging from $21.18 to $23.58 with a weighted average price of $21.19. These awards vest over a three year period at a rate of one-third on the annual anniversary date of the grant and expire ten years from the grant date. At March 31, 2010, the unrecognized compensation expense related to non-vested stock appreciation rights and stock options totaled $23.7 million and will be recognized on a straight line basis over the weighted average remaining vesting period of 1.6 years.

Restricted Stock

During the three months ended March 31, 2011, the Company granted 1.2 million shares of restricted stock to employees of the Company and non-employee directors. These restricted shares were granted at prices ranging from $20.57 to $20.64 with a weighted average price of $20.57. Employee shares vest over a three-year period at a rate of one-third on the annual anniversary date of the grant and the non-employee directors' shares vest six-months from the date of grant. At March 31, 2011, the unrecognized compensation expense related to non-vested restricted stock totaled $33.6 million and was to be recognized on a straight line basis over the weighted average remaining vesting period of 1.6 years.

During the three months ended March 31, 2010, the Company granted 1.1 million shares of restricted stock to employees of the Company and non-employee directors. These restricted shares were granted at prices ranging from $21.18 to $23.58 with a weighted average price of $21.20. Employee shares vest over a three-year period at a rate of one-third on the annual anniversary date of the grant and the non-employee directors' shares vest six-months from the date of grant. At March 31, 2010, the unrecognized compensation expense related to non-vested restricted stock totaled $25.7 million and was to be recognized on a straight line basis over the weighted average remaining vesting period of 1.6 years.

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PETROHAWK ENERGY CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)

9. STOCKHOLDERS' EQUITY (Continued)

Assumptions

The assumptions used in calculating the fair value of the Company's stock-based compensation are disclosed in the following table:

	Three Months Ended March 31, 2011	2010
Weighted average value per option granted during the period	$ 10.47	$ 10.31
Assumptions*(1)*:		
Stock price volatility*(2)*	58.0%	62.0%
Risk free rate of return	2.01%	2.02%
Expected term	5.0 years	4.0 years

(1) The Company's estimated future forfeiture rate is approximately 5% based on the Company's historical forfeiture rate. Calculated using the Black-Scholes fair value based method. The Company does not pay dividends on its common stock.

(2) In 2011 and 2010, the Company used a combination of implied and historic volatility.

10. EARNINGS PER SHARE

The following represents the calculation of earnings per share:

	Three Months Ended March 31, 2011	2010
	(In thousands, except per share amounts)	
Basic		
(Loss) income from continuing operations, net of income taxes	$ (29,475)	$ 156,292
Weighted average basic number of shares outstanding	301,021	300,157
Basic (loss) income from continuing operations, net of income taxes per share	$ (0.10)	$ 0.52
Diluted		
(Loss) income from continuing operations, net of income taxes	$ (29,475)	$ 156,292
Weighted average basic number of shares outstanding	301,021	300,157
Common stock equivalent shares representing shares issuable upon exercise of stock options and stock appreciation rights	Anti-dilutive	1,444
Common stock equivalent shares representing shares included upon vesting of restricted shares	Anti-dilutive	1,067
Weighted average diluted number of shares outstanding	301,021	302,668
Diluted (loss) income from continuing operations, net of income taxes per share	$ (0.10)	$ 0.52

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PETROHAWK ENERGY CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)

10. EARNINGS PER SHARE (Continued)

Common stock equivalents, including stock options and stock appreciation rights (SARS), totaling 12.2 million shares were not included in the computations of diluted earnings per share of common stock for the three months ended March 31, 2011, as the effect would have been anti-dilutive due to the net loss. Common stock equivalents, including stock options and SARS, totaling 0.1 million shares were not included in the computations of diluted earnings per share because the effect would have been anti-dilutive for the three months ended March 31, 2010 because the grant prices were greater than the average market price of the common shares.

11. ADDITIONAL FINANCIAL STATEMENT INFORMATION

Certain balance sheet amounts are comprised of the following:

	March 31, 2011	December 31, 2010
	(In thousands)	
Accounts receivable:		
Oil and natural gas revenues	$ 155,859	$ 146,823
Marketing revenues	41,186	43,462
Joint interest accounts	137,017	122,602
Income and other taxes receivable	39,669	40,016
Other	2,314	3,694
	$ 376,045	$ 356,597
Prepaids and other:		
Prepaid insurance	$ 2,464	$ 3,871
Prepaid drilling costs	29,233	55,871
Other	3,871	3,089
	$ 35,568	$ 62,831
Accounts payable and accrued liabilities:		
Trade payables	$ 24,906	$ 70,324
Revenues and royalties payable	147,451	154,559
Accrued oil and natural gas capital costs	578,533	353,280
Accrued midstream capital costs	21,133	13,703
Accrued interest expense	43,496	58,858
Prepayment liabilities	49,755	42,329
Accrued lease operating expenses	10,314	10,207
Accrued ad valorem taxes payable	13,671	8,834
Accrued employee compensation	13,885	11,401
Other	106,593	63,743
	$ 1,009,737	$ 787,238

12. SEGMENTS

In accordance with ASC 280, *Segment Reporting* (ASC 280), the Company has identified two reportable segments: oil and natural gas production and midstream operations. The oil and natural gas

PETROHAWK ENERGY CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)

12. SEGMENTS (Continued)

production segment is responsible for acquisition, exploration, development and production of oil and natural gas properties, while the midstream operations segment is responsible for gathering and treating natural gas for the Company and third parties. The Company's Chief Operating Decision Maker evaluates the performance of the reportable segments based on "*Income from continuing operations before income taxes."*

As discussed in Note 2, "*Acquisitions and Divestitures,*" on May 21, 2010, the Company contributed its Haynesville Shale gathering and treating business to form a joint venture entity with Kinder Morgan called KinderHawk. The joint venture is accounted for as a failed sale of in substance real estate in accordance with ASC 360-20. As a result of the failed sale the Company accounts for the continued operations of the gas gathering system and reflects a financing obligation, representing the proceeds received, under the financing method of real estate accounting. Under the financing method, the historical cost of the Haynesville Shale gas gathering system contributed to KinderHawk is carried at the full historical basis of the assets on the unaudited condensed consolidated balance sheets in *"Gas gathering systems and equipment"* and depreciated over the remaining useful life of the assets. The financing obligation is recorded on the unaudited condensed consolidated balance sheet in *"Payable on financing arrangement,"* in the amount of approximately $917 million. Reductions to the obligation and the non cash interest on the obligation are tied to the gathering and treating services, as the Company delivers natural gas through the Haynesville Shale gathering and treating system. Interest and principal are determined based upon the allocable income to Kinder Morgan, and interest is limited up to an amount that is calculated based upon the Company's weighted average cost of debt as of the date of the transaction. Allocable income in excess of the calculated value is reflected as reductions of principal. Interest is recorded in *"Interest expense and other"* on the unaudited condensed consolidated statements of operations. Additionally the Company records KinderHawk's revenues, net of eliminations for intercompany amounts associated with gathering and treating services provided to the Company, and expenses on the unaudited condensed consolidated statements of operations in *"Midstream revenues," "Taxes other than income," "Gathering, transportation and other," "General and administrative," "Interest expense and other"* and *"Depletion, depreciation and amortization."*

On January 7, 2011, the Company sold its midstream operations in the Fayetteville Shale. The revenues and expenses associated with the Fayetteville Shale midstream operations have been classified as discontinued operations in the unaudited condensed consolidated statements of operations for all periods presented, in the line item "*Loss from discontinued operations, net of income taxes."* See Note 13, "*Discontinued Operations,"* for further discussion of the presentation of the Company's Fayetteville Shale midstream assets as discontinued operations. The segment information presented in the tables below is amounts related to continuing operations.

The Company's oil and natural gas segment and midstream segment revenues and expenses include intersegment transactions, which are generally based on transactions made at market-related rates. Consolidated revenues and expenses reflect the elimination of all intercompany transactions. The accounting policies of the reporting segments are the same as those described in the *"Summary of Significant Events and Accounting Policies"* in Note 1 of the 2010 Annual Report on Form 10-K, as amended.

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PETROHAWK ENERGY CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)

12. SEGMENTS (Continued)

Summarized financial information concerning the Company's reportable segments is shown in the following table (in thousands):

	Oil and Natural Gas	Midstream	Intersegment Eliminations	Consolidated Total
For the three months ended March 31, 2011:				
Revenues	$ 490,752	$ 2,923	$	$ 493,675
Intersegment revenues		20,631	(20,631)	
Total revenues	$ 490,752	$ 23,554	$ (20,631)	$ 493,675
Gathering, transportation and other	(34,674)	(3,562)	20,631	(17,605)
Depletion, depreciation and amortization	(156,182)	(5,339)		(161,521)
General and administrative	(37,149)	(3,594)		(40,743)
Interest (expense) income and other	(67,528)	(18,518)		(86,046)
Loss from continuing operations before income taxes	$ (39,502)	$ (8,295)	$	$ (47,797)
Total assets*(1)*	$ 7,509,474	$ 998,200	$ (27,859)	$ 8,479,815
Payable on financing arrangement*(2)*	$	$ 940,863	$	$ 940,863
Capital expenditures	$ (691,817)	$ (45,396)	$	$ (737,213)
For the three months ended March 31, 2010:				
Revenues	$ 430,710	$ 7,072	$	$ 437,782
Intersegment revenues		22,165	(22,165)	
Total revenues	$ 430,710	$ 29,237	$ (22,165)	$ 437,782
Gathering, transportation and other	(44,454)	(5,867)	22,165	(28,156)
Depletion, depreciation and amortization	(101,885)	(2,883)		(104,768)
General and administrative	(30,535)	(1,499)		(32,034)
Interest (expense) income and other	(64,014)	1,168		(62,846)

Income from continuing operations before income taxes	$	236,081	$	19,445	$		$	255,526
Total assets	$	6,726,879	$	684,649	$	(82,538)	$	7,328,990
Capital expenditures	$	(644,372)	$	(67,218)	$		$	(711,590)

(1)

Includes gas gathering systems and equipment of approximately $155 million and related accumulated depreciation of approximately $11 million associated with the Fayetteville Shale midstream assets, which were classified as "*Assets held for sale*" in the unaudited condensed consolidated balance sheet at December 31, 2010. "*Assets held for sale*" were recorded at the lesser of the carrying amount or the fair value less costs to sell, which resulted in a write down of approximately $69.7 million that was recorded in the year ended December 31, 2010. "*Assets held for sale*" were approximately $74 million as of December 31, 2010. The Company divested its Fayetteville Shale midstream operations on January 7, 2011. See Note 1, *"Financial Statement Presentation,"* and Note 2, *"Acquisitions and Divestitures."*

(2)

Includes current portion of $7.2 million.

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PETROHAWK ENERGY CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)

13. DISCONTINUED OPERATIONS

On December 22, 2010, the Company completed the sale of its interest in natural gas properties and other operating property and equipment in the Fayetteville Shale. On January 7, 2011, the Company completed the sale of its midstream assets in the Fayetteville Shale. For all periods presented, the Company classified the operations associated with the Fayetteville Shale gas gathering systems and equipment, which are part of the Company's midstream operations segment, and the Fayetteville Shale other operating property and equipment, which are part of the Company's oil and natural gas production segment, as "*Loss from discontinued operations, net of income taxes"* in the unaudited condensed consolidated statements of operations.

On March 1, 2011, the Company completed the sale of its interest in the Buffalo Hump Ranch located in Van Buren County, Arkansas for approximately $2.1 million in cash. Proceeds from the sale were recorded as a reduction to the carrying value of the land. A loss on the sale of approximately $4.3 million was recorded during the first quarter of 2011 in *"Loss from discontinued operations, net of income taxes"* in the unaudited condensed consolidated statements of operations. The transaction had an effective date of March 1, 2011.

As of December 31, 2010, the Fayetteville Shale midstream assets were classified as "*Assets held for sale*" on the Company's unaudited condensed consolidated balance sheet. "*Assets held for sale*" were recorded at the lesser of the carrying amount or the fair value less costs to sell, which resulted in a write down of the carrying amount of approximately $69.7 million in the year ended December 31, 2010. In conjunction with the sale of the other operating property and equipment, the Company recorded a loss of approximately $0.5 million in the year ended December 31, 2010.

The following table contains summarized income statement information for the Fayetteville Shale midstream operations and other operating property and equipment for the periods indicated (in thousands):

	Three Months Ended March 31,	
	2011	**2010**
Operating revenues	$ 153	$ 2,534
Operating expenses	(13)	2,787
Loss on sale	(4,056)	
Loss from discontinued operations, before income taxes	(3,890)	(253)
Income tax benefit	1,483	96
Loss from discontinued operations, net of income taxes	$ (2,407)	$ (157)

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PETROHAWK ENERGY CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)

13. DISCONTINUED OPERATIONS (Continued)

The following table contains summarized assets held for sale information for the Fayetteville Shale midstream operations as of December 31, 2010 (as discussed above, the Company completed the sale of its midstream assets in the Fayetteville Shale on January 7, 2011).

	In thousands
Gas gathering systems and equipment	$ 154,724
Accumulated depreciation	(10,548)
Net assets	144,176
Write down of midstream assets	(69,728)
Assets held for sale	$ 74,448

14. SUBSEQUENT EVENT

During the second quarter of 2011, the Company amended its Senior Credit Agreement, the Fifth Amended and Restated Senior Revolving Credit Agreement, as amended on November 8, 2010 and December 22, 2010, by entering into the Third Amendment to the Fifth Amended and Restated Senior Revolving Credit Agreement (the Third Amendment), among the Company, each of the lenders from time to time party thereto (the Lenders), BNP Paribas, as administrative agent for the Lenders, Bank of America, N.A. and Bank of Montreal as co-syndication agents for the Lenders, and JPMorgan Chase Bank, N.A. and Wells Fargo Bank, N.A., as co-documentation agents for the Lenders. Among other things, the Third Amendment: (a) increased the Company's borrowing base to $1.9 billion, $1.8 billion of which relates to the Company's oil and natural gas properties and $100 million relates to the Company's midstream assets (limited as described below); (b) reduced interest rates such that amounts outstanding under the Senior Credit Agreement will bear interest at specified margins over the London Interbank Offered Rate of 1.50% to 2.50% for Eurodollar loans or at specified margins over the Alternate Base Rate (ABR) of 0.50% to 1.50% for ABR loans, which margins will fluctuate based on the utilization of the facility; (c) extended the maturity date of the facility from July 1, 2014 to July 1, 2016; and (d) increased the amount of the facility from $2.0 billion to $2.5 billion. Borrowings under the Senior Credit Agreement are secured by first priority liens on substantially all of the Company's assets, including pursuant to the terms of the Fifth Amended and Restated Guarantee and Collateral Agreement, all of the assets of, and equity interests in, the Company's subsidiaries. The component of the borrowing base related to the Company's midstream assets is limited to the lesser of $100 million or 3.5 times midstream EBITDA and is calculated quarterly.

15. RESTATEMENT OF QUARTERLY UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

On May 21, 2010, the Company contributed its Haynesville Shale gathering and treating business in Northwest Louisiana to a joint venture, KinderHawk, Kinder Morgan contributed approximately $917 million in cash, which was distributed to the Company as consideration for 50% of the Haynesville Shale gathering and treating system. In connection with the transaction the Company entered into a gathering agreement with KinderHawk which requires the Company to deliver natural gas to the operator of the gathering and treating system, KinderHawk, from dedicated lease acreage for the life of the dedicated lease acreage, or approximately 30 years, and includes a minimum delivery commitment over a five-year period. Upon completion of the transaction both the Company and

PETROHAWK ENERGY CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)

15. RESTATEMENT OF QUARTERLY UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Kinder Morgan held a 50% membership interest in KinderHawk. The Company originally accounted for the transaction as a partial sale for which the Company deferred a gain of approximately $719.4 million and recorded its 50% membership interest in KinderHawk as an equity method investment. The deferred gain was to be recognized as commitments associated with KinderHawk, consisting of a capital commitment of approximately $200 million callable during a two-year period and a five-year delivery commitment were settled. Income and distributions related to the venture were recorded as adjustments to the Company's equity method investment.

The Company subsequently determined that the KinderHawk joint venture transaction should have been accounted for and disclosed in accordance with ASC 360-20. ASC 360-20 establishes standards for recognition of profit on all real estate sales transactions other than retail land sales, without regard to the nature of the seller's business. In making the determination of whether a transaction qualifies, in substance, as a sale of real estate, the nature of the entire real estate being sold is considered, including the land plus the property improvements and the integral equipment. The Haynesville Shale gathering and treating system, consists of right of ways, pipelines and processing facilities. Due to the gathering agreement which constitutes extended continuing involvement under ASC 360-20, it has been determined that the contribution of the Company's Haynesville Shale gathering and treating system to form KinderHawk should be accounted for as a failed sale of in substance real estate. As a result of the failed sale the Company would account for the continued operations of the gas gathering system and reflect a financing obligation, representing the proceeds received, under the financing method of real estate accounting. Under the financing method, the historical cost of the Haynesville Shale gas gathering system contributed to KinderHawk should have continued to be carried at the full historical basis of the assets on the unaudited condensed consolidated balance sheets in *"Gas gathering systems and equipment"* and depreciated over the remaining useful life of the assets. The financing obligation is recorded on the unaudited condensed consolidated balance sheets in *"Payable on financing arrangement,"* in the amount of approximately $917 million. Reductions to the obligation and the non cash interest on the obligation are tied to the gathering and treating services, as the Company delivers natural gas through the Haynesville Shale gathering and treating system. Interest and principal are determined based upon the allocable income to Kinder Morgan, and interest is limited up to an amount that is calculated based upon the Company's weighted average cost of debt as of the date of the transaction. Allocable income in excess of the calculated value will be reflected as reductions of principal. Interest is recorded in *"Interest expense and other"* on the unaudited condensed consolidated statements of operations. Any obligation remaining once the gathering agreement expires will be reversed, resulting in the recognition of a gain. Additionally the Company records KinderHawk's revenues, net of eliminations for intercompany amounts associated with gathering and treating services provided to the Company, and expenses on the unaudited condensed consolidated statements of operations in *"Midstream revenues," "Taxes other than income," "Gathering, transportation and other," "General and administrative," "Interest expense and other"* and *"Depletion, depreciation and amortization."*

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PETROHAWK ENERGY CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)

15. RESTATEMENT OF QUARTERLY UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following table presents the line item adjustments for the unaudited condensed consolidated statement of operations for the three months ended March 31, 2011 which are impacted by the restatement (in thousands):

	Three Months Ended March 31, 2011		
	Amount as Previously Reported	Adjustments	Restated Amount
Midstream revenues	$ 972	$ 1,951	$ 2,923
Total operating revenues	491,724	1,951	493,675
Taxes other than income expense	11,735	530	12,265
Gathering, transportation and other expense	52,895	(35,290)	17,605
General and administrative expense	39,975	768	40,743
Depletion, depreciation and amortization expense	157,312	4,209	161,521
Total operating expenses	434,302	(29,783)	404,519
Amortization of deferred gain	48,468	(48,468)	
Income from operations	105,890	(16,734)	89,156
Interest expense and other	(66,803)	(19,243)	(86,046)
Equity investment income	13,571	(13,571)	
Total other income (expenses)	(104,139)	(32,814)	(136,953)
Income from continuing operations before income taxes	1,751	(49,548)	(47,797)
Income tax (provision) benefit	(571)	18,893	18,322
Income from continuing operations, net of income taxes	1,180	(30,655)	(29,475)
Loss from discontinued operations, net of income taxes	(2,408)	1	(2,407)
Net (loss) income	$ (1,228)	$ (30,654)	$ (31,882)
Net (loss) income per share:			
Basic:			
Continuing operations	$	$ (0.10)	$ (0.10)
Total	$	$ (0.10)	$ (0.10)
Diluted:			
Continuing operations	$	$ (0.10)	$ (0.10)
Total	$	$ (0.10	