

CONTANGO OIL & GAS CO
Form 10-K
August 29, 2012
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-K
(Mark One)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended June 30, 2012

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

Commission file number 001-16317

CONTANGO OIL & GAS COMPANY
(Exact name of registrant as specified in its charter)
Delaware

95-4079863

(State or other jurisdiction of
incorporation or organization)

(IRS Employer Identification No.)

3700 Buffalo Speedway, Suite 960
Houston, Texas 77098

(Address of principal executive offices)
(713) 960-1901

(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Common Stock, Par Value \$0.04 per share

NYSE MKT

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

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

No

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 No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

(Do not check if smaller reporting company)

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

At December 31, 2011, the aggregate market value of the registrant's common stock held by non-affiliates (based upon the closing sale price of shares of such common stock as reported on the NYSE MKT was \$745,499,902. As of August 24, 2012, there were 15,292,448 shares of the registrant's common stock outstanding.

Documents Incorporated by Reference

Items 10, 11, 12, 13 and 14 of Part III have been omitted from this report since registrant will file with the Securities and Exchange Commission, not later than 120 days after the close of its fiscal year, a definitive proxy statement, pursuant to Regulation 14A. The information required by Items 10, 11, 12, 13 and 14 of this report, which will appear in the definitive proxy statement, is incorporated by reference into this Form 10-K.

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CAUTIONARY STATEMENT ABOUT FORWARD-LOOKING STATEMENTS

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

- Our financial position
- Business strategy, including outsourcing
- Meeting our forecasts and budgets
- Anticipated capital expenditures
- Drilling of wells
- Natural gas and oil production and reserves
- Timing and amount of future discoveries (if any) and production of natural gas and oil
- Operating costs and other expenses
- Cash flow and anticipated liquidity
- Prospect development
- Property acquisitions and sales
- New governmental laws and regulations
- Expectations regarding oil and gas markets in the United States

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

- Low and/or declining prices for natural gas and oil
- Natural gas and oil price volatility
- Operational constraints, start-up delays and production shut-ins at both operated and non-operated production platforms, pipelines and gas processing facilities
- The risks associated with acting as the operator in drilling deep high pressure and temperature wells in the Gulf of Mexico, including well blowouts and explosions
- The risks associated with exploration, including cost overruns and the drilling of non-economic wells or dry holes, especially in prospects in which the Company has made a large capital commitment relative to the size of the Company’s capitalization structure
- The timing and successful drilling and completion of natural gas and oil wells
- Availability of capital and the ability to repay indebtedness when due
- Availability of rigs and other operating equipment
- Ability to receive Bureau of Safety and Environmental Enforcement permits on a time schedule that permits the Company to operate efficiently
- Ability to raise capital to fund capital expenditures
- Timely and full receipt of sale proceeds from the sale of our production
- The ability to find, acquire, market, develop and produce new natural gas and oil properties
- Interest rate volatility
- Zero or near-zero interest rates
- Uncertainties in the estimation of proved reserves and in the projection of future rates of production and timing of development expenditures
- Operating hazards attendant to the natural gas and oil business
 - Downhole drilling and completion risks that are generally not recoverable from third parties or insurance

- Potential mechanical failure or under-performance of significant wells, production facilities, processing plants or pipeline mishaps
 - Weather
 - Availability and cost of material and equipment
 - Delays in anticipated start-up dates
 - Actions or inactions of third-party operators of our properties
 - Actions or inactions of third-party operators of pipelines or processing facilities
 - The ability to find and retain skilled personnel
 - Strength and financial resources of competitors
 - Federal and state regulatory developments and approvals
 - Environmental risks
 - Worldwide economic conditions
 - The ability to construct and operate offshore infrastructure, including pipeline and production facilities
 - The continued compliance by the Company with various pipeline and gas processing plant specifications for the gas and condensate produced by the Company
 - Drilling and operating costs, production rates and ultimate reserve recoveries in our Eugene Island 10 (“Dutch”) and state of Louisiana (“Mary Rose”) acreage
 - Restrictions on permitting activities
 - Expanded rigorous monitoring and testing requirements
 - Legislation that may regulate drilling activities and increase or remove liability caps for claims of damages from oil spills
 - Ability to obtain insurance coverage on commercially reasonable terms
 - Accidental spills, blowouts and pipeline ruptures
 - Impact of new and potential legislative and regulatory changes on Gulf of Mexico operating and safety standards
- You should not unduly rely on these forward-looking statements in this report, as they speak only as of the date of this report. Except as required by law, we undertake no obligation to publicly release any revisions to these forward-looking statements to reflect events or circumstances occurring after the date of this report or to reflect the occurrence of unanticipated events. See the information under the heading “Risk Factors” referred to on page 13 of this report for some of the important factors that could affect our financial performance or could cause actual results to differ materially from estimates contained in forward-looking statements.

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

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PART I

Item 1. Business

Overview

Contango is a Houston-based, independent natural gas and oil company. The Company's core business is to explore, develop, produce and acquire natural gas and oil properties onshore and offshore in the Gulf of Mexico in water-depths of less than 300 feet. Contango Operators, Inc. ("COI"), our wholly-owned subsidiary, acts as operator on our properties.

Our Strategy

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

Funding exploration prospects generated by Juneau Exploration, L.P., our alliance partner. We depend primarily upon our alliance partner, Juneau Exploration, L.P. ("JEX"), for prospect generation expertise. JEX is experienced and has a successful track record in exploration.

Using our limited capital availability to increase our reward/risk potential on selective prospects. We have concentrated our risk investment capital in the exploration of i) offshore Gulf of Mexico prospects and ii) conventional and unconventional onshore plays. Exploration prospects are inherently risky as they require large amounts of capital with no guarantee of success. COI drills and operates our prospects. Should we be successful in any of our offshore prospects, we will have the opportunity to spend significantly more capital to complete development and bring the discovery to producing status.

Sale of proved properties. From time-to-time as part of our business strategy, we have sold and in the future expect to continue to sell some or a substantial portion of our proved reserves and assets to capture current value, using the sales proceeds to further our offshore exploration activities. Since its inception, the Company has sold approximately \$524 million worth of natural gas and oil properties, and views periodic reserve sales as an opportunity to capture value, reduce reserve and price risk, and as a source of funds for potentially higher rate of return natural gas and oil exploration opportunities.

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

Structuring incentives to drive behavior. We believe that equity ownership aligns the interests of our employees and stockholders. Our directors and executive officers beneficially own or have voting control over approximately 17% of our common stock.

Exploration Alliance with JEX

JEX is a private company formed for the purpose of generating offshore and onshore domestic natural gas and oil prospects. Additionally, JEX can generate offshore prospects through our 32.3% owned affiliated company, Republic Exploration LLC ("REX"). In addition to generating new prospects, JEX occasionally evaluates offshore and onshore exploration prospects generated by third-party independent companies for us to purchase. Once we have purchased a prospect from JEX, REX or a third-party, we have historically entered into participation agreements and joint operating agreements, which specify each participant's working interest, net revenue interest, and describe when such interests are earned, as well as allocate an overriding royalty interest of up to 3.33% to benefit employees of JEX. See Note 13 - Related Party Transactions for a detailed description of our transactions with JEX and REX.

On April 10, 2012, the Company announced that Mr. Brad Juneau, the sole manager of the general partner of JEX, had joined the Company's board of directors and that the Company had entered into an advisory agreement with JEX (the "Advisory Agreement"), whereby in addition to generating and evaluating offshore and onshore exploration prospects for the Company, JEX will direct Contango's staff on operational matters including drilling, completions and

production. Pursuant to the Advisory Agreement, JEX will be paid an annual fee of \$2 million and JEX, or employees of JEX, will continue to be eligible to receive overriding royalty interests, carried interests and certain back-in rights.

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Offshore Gulf of Mexico Activities

Contango, through its wholly-owned subsidiary, COI and its partially-owned affiliate, REX, conducts exploration activities in the Gulf of Mexico. COI drills, and operates our wells in the Gulf of Mexico, as well as attends lease sales and acquires leasehold acreage. Additionally, COI may acquire significant working interests in offshore exploration and development opportunities in the Gulf of Mexico, under farm-out agreements, or similar agreements, with REX, JEX and/or other third parties.

As of August 24, 2012, the Company's offshore production was approximately 83.5 million cubic feet equivalent per day ("Mmcfed"), net to Contango, which consists mainly of seven federal and five state of Louisiana wells in the shallow waters of the Gulf of Mexico. These 12 operated wells produce via the following four platforms:

Eugene Island 24 Platform

This third-party owned and operated production platform at Eugene Island 24 was designed with a capacity of 100 million cubic feet per day ("Mmcfed") and 3,000 barrels of oil per day ("bopd"). This platform services production from the Company's Dutch #1, #2 and #3 federal wells. From this platform, the gas flows through an American Midstream pipeline into a third-party owned and operated on-shore processing facility at Burns Point, Louisiana, and the condensate flows via an ExxonMobil pipeline to on-shore markets and multiple refineries. As of August 24, 2012, we were producing approximately 22.5 Mmcfed, net to Contango, from this platform.

The Company recently finished laying 6" auxiliary flowlines from the Dutch #1, #2, and #3 wells to our Eugene Island 11 Platform (see below) and is in the process of redirecting production from the Eugene Island 24 Platform to the Eugene Island 11 Platform. Our cost estimate for the installation of these three flowlines is \$2.5 million, net to Contango. As of June 30, 2012, the Company had incurred approximately \$0.8 million to install these flowlines.

Eugene Island 11 Platform

Our Company-owned and operated platform at Eugene Island 11 was designed with a capacity of 500 Mmcfed and 6,000 bopd. In September 2010 the Company installed a companion platform and two pipelines adjacent to the Eugene Island 11 platform to be able to access alternate markets. These platforms service production from the Company's five Mary Rose wells which are all located in state of Louisiana waters, as well as our Dutch #4 and Dutch #5 wells which are both located in federal waters. From these platforms, we can flow our gas to an American Midstream pipeline via our 8" pipeline and from there to a third-party owned and operated on-shore processing facility at Burns Point, Louisiana. We can flow our condensate via an ExxonMobil pipeline to on-shore markets and multiple refineries.

Alternatively, our gas and condensate can flow to our Eugene Island 63 auxiliary platform via our 20" pipeline, which has been designed with a capacity of 330 Mmcfed and 6,000 bopd, and from there to third-party owned and operated on-shore processing facilities near Patterson, Louisiana, via an ANR pipeline. As of August 24, 2012, we were producing approximately 44.6 Mmcfed, net to Contango, from this platform.

Based on production and decline rates, the Company has recently determined the need to place its Dutch and Mary Rose wells on compression in 2013. The Company is in the process of designing and building a large turbine type compressor for the platform at an estimated cost of \$6.8 million, net to Contango. This compressor will be of sufficient capacity to service all ten of the Company's Dutch and Mary Rose wells. As of June 30, 2012, the Company had incurred approximately \$2.3 million to design and build the compressor, which is expected to be installed in June 2013.

Ship Shoal 263 Platform

Our Company-owned and operated platform at Ship Shoal 263 was designed with a capacity of 40 Mmcfed and 5,000 bopd. This platform services natural gas and condensate production from our Nautilus well, which flows via the Transcontinental Gas Pipeline to onshore processing plants. As of August 24, 2012, we were producing approximately 3.0 Mmcfed, net to Contango, from this platform.

Effective October 1, 2010, the Company purchased an additional 7.5% working interest and 6.0% net revenue interest in Ship Shoal 263 for approximately \$7.5 million from JEX. The Company now owns a 100% working interest and

80% net revenue interest in this well and platform.

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Vermilion 170 Platform

Our Company-owned and operated platform at Vermilion 170 was designed with a capacity of 60 Mmcf/d and 2,000 bopd. This platform services natural gas and condensate production from our Swimmy well, which flows via the Sea Robin Pipeline to onshore processing plants. As of August 24, 2012, we were producing approximately 13.4 Mmcf/d, net to Contango, from this platform.

Based on current production and decline rates, the Company has determined the need to place its Vermilion 170 well on compression in 2013, at a cost of \$1.4 million, net to Contango. As of June 30, 2012, the Company had incurred approximately \$0.4 million to design and build a compressor to service its Swimmy well, which is expected to be completed in late 2012.

Other Activities

On July 10, 2012 we spud our South Timbalier 75 prospect ("Fang") with the Spartan 303 rig. The Company farmed-in this prospect in August 2011 from an independent third party. We have a 100% working interest in this wildcat exploration prospect, subject to back-ins if successful, and have budgeted to invest approximately \$28.0 million to drill this well. As of June 30, 2012, the Company had invested approximately \$0.4 million in Fang, which includes leasehold costs.

On July 3, 2012, we spud our Ship Shoal 134 prospect ("Eagle") with the Hercules 205 rig. The Company purchased the deep mineral rights on Ship Shoal 134 from an independent third-party effective February 24, 2011. We have a 100% working interest in this wildcat exploration prospect, subject to back-ins if successful, and have budgeted approximately \$25.0 million to drill this well. As of June 30, 2012, the Company had invested approximately \$6.5 million in Eagle, which includes leasehold costs. We expect to know the drilling results of both the Eagle and Fang wells by November 2012.

On June 20, 2012, the Company was the apparent high bidder on six lease blocks at the Central Gulf of Mexico Lease Sale 216/222. The Company bid an aggregate amount of approximately \$11 million on the following six blocks:

East Cameron 124

Eugene Island 31

Eugene Island 260

Ship Shoal 83

Ship Shoal 255

South Timbalier 110

An apparent high bid ("AHB") is subject to Outer Continental Shelf ("OCS") Bid Adequacy Review. The Bureau of Ocean Energy Management ("BOEM") (formerly the Minerals Management Service) may reject all bids for a given tract. The BOEM review process can take up to 90 days. Upon approval from the BOEM, our plan is to promptly obtain permits to drill these prospects and to drill them in 2013 and 2014. The Company will have a 100% working interest in these prospects, subject to back-ins if successful. In August 2012, the Company was notified that it had been awarded East Cameron 124, Eugene Island 31, Ship Shoal 83 and South Timbalier 110 effective September 1, 2012.

On March 1, 2012, the Company was awarded Brazos Area 543 by the BOEM, which was bid on at the Western Gulf of Mexico Lease Sale No. 218 held on December 14, 2011. As of June 30, 2012, the Company had invested approximately \$0.4 million in Brazos Area 543, which includes leasehold costs.

In June 2011, we completed a workover of our Eloise North well at a cost of approximately \$1.8 million, net to Contango, which enabled us to continue producing from the lower Rob-L sands. In October 2011, we commenced a workover of our Eloise North well to recomplete the well in the upper Rob-L sands. During the workover, the Company experienced difficulties and unexpected delays due to malfunctioning production tree valves, coiled tubing equipment failures, weather delays, and stuck equipment in the tubing. As a result, the Company plugged the Rob-L sands in January 2012 and recompleted uphole in the Cib-Op sands as our Mary Rose #5 well, at a cost of

approximately \$0.5 million, net to Contango, based on the new higher ownership percentage and inclusive of a required well cost adjustment. The Mary Rose #5 well began producing on January 26, 2012 and by mid-March 2012 had stopped again. We are currently flowing the well intermittently until we can install compression in 2013.

On December 21, 2011, the Company purchased an additional 3.66% working interest (2.67% net revenue interest) in Mary Rose #5 (previously Eloise North) for approximately \$0.2 million from an existing partner. This purchase brings the Company's working interest and net revenue interest in Mary Rose #5 to 37.80% and 27.59%, respectively.

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In July 2011, we recompleted our Eloise South well uphole in the Cib-Op sands as our Dutch #5 well, at a cost of approximately \$5.7 million, net to Contango. The Company has a 47.05% working interest (38.1% net revenue interest) in Dutch #5. In addition to this \$5.7 million, the Dutch #5 well owners purchased the Eloise South well bore from the Eloise South well owners (the "Well Cost Adjustment"). The Company invested a net of approximately \$2.3 million related to this Well Cost Adjustment.

In September 2010, we drilled our Galveston Area 277L prospect ("His Dudeness"), a wildcat exploration well in the Gulf of Mexico, and determined it was a dry hole. The Company invested approximately \$9.5 million, including leasehold costs, to drill, plug and abandon this well.

During the fiscal year ended June 30, 2010, we drilled two dry holes in the Gulf of Mexico. The first was on a farm-in we obtained on block Vermillion 155 ("Paisano"). This well had a dry hole cost of approximately \$5.3 million. The second was our Matagorda Island 617 well ("Dude"), with a dry hole cost of approximately \$14.9 million. The Company had a 100% working interest in both of these wells.

Republic Exploration LLC

In his capacity as sole manager of the general partner of JEX, Mr. Juneau also controls the activities of REX, an entity owned 34.4% by JEX, 32.3% by Contango, and 33.3% by a third party which contributed other assets to REX. REX generates and evaluates offshore exploration prospects and has historically participated with the Company in the drilling and development of certain prospects through participation agreements and joint operating agreements, which specify each participant's working interest, net revenue interest, and describe when such interests are earned, as well as allocate an overriding royalty interest ("ORRI") of up to 3.33% to benefit the employees of JEX. The Company proportionately consolidates the results of REX in its consolidated financial statements.

West Delta 36, a REX prospect, is operated by a third party. The Company depends on a third-party operator for the operation and maintenance of this production platform. As of August 24, 2012, the well was in the process of being recompleted uphole, at a cost of approximately \$0.1 million, net to Contango. REX has a 25.0% working interest ("WI"), and a 20.0% net revenue interest ("NRI"), in this well.

Contango Offshore Exploration LLC

Prior to its dissolution on June 1, 2010, in his capacity as sole manager of the general partner of JEX, Mr. Juneau controlled the activities of Contango Offshore Exploration LLC ("COE"), an entity then owned 65.63% by Contango and 34.37% by JEX. COE generated and evaluated offshore exploration prospects and had historically participated with the Company in the drilling and development of certain prospects through participation agreements and joint operating agreements, which specified each participant's working interest, net revenue interest, and described when such interests were earned, as well as allocate an overriding royalty interest ("ORRI") of up to 3.33% to benefit the employees of JEX. The Company proportionately consolidated the results of COE in its consolidated financial statements.

Immediately prior to its dissolution, COE owed the Company \$5.9 million in principal and interest under a promissory note (the "COE Note") payable on demand. In connection with the dissolution, the Company assumed its 65.6% share of the obligation under the COE Note, while JEX assumed the remaining 34.4%, or approximately \$2 million. This \$2 million was paid back to the Company during the fiscal year ended June 30, 2011.

Offshore Properties

During the fiscal year ended June 30, 2012, State Lease 19396 expired and was returned to the state of Louisiana. During the fiscal year ended June 30, 2011, the Company relinquished 12 lease blocks to the BOEM, and allowed two additional lease blocks to expire in accordance with their terms.

Producing Properties. The following table sets forth the interests owned by Contango through its affiliated entities in the Gulf of Mexico which were capable of producing natural gas or oil as of August 24, 2012:

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| Area/Block | WI | NRI | Status |
|---|---------|-------|--------------|
| Eugene Island 10 #D-1 (Dutch #1) | 47.05% | 38.1% | Producing |
| Eugene Island 10 #E-1 (Dutch #2) | 47.05% | 38.1% | Producing |
| Eugene Island 10 #F-1 (Dutch #3) | 47.05% | 38.1% | Producing |
| Eugene Island 10 #G-1 (Dutch #4) | 47.05% | 38.1% | Producing |
| Eugene Island 10 #I-1 (Dutch #5) | 47.05% | 38.1% | Producing |
| S-L 18640 #1 (Mary Rose #1) | 53.21% | 40.5% | Producing |
| S-L 19266 #1 (Mary Rose #2) | 53.21% | 38.7% | Producing |
| S-L 19266 #2 (Mary Rose #3) | 53.21% | 38.7% | Producing |
| S-L 18860 #1 (Mary Rose #4) | 34.58% | 25.5% | Producing |
| S-L 19266 #3 and S-L 19261 (Mary Rose #5) | 37.80% | 27.6% | Intermittent |
| Ship Shoal 263 (Nautilus) | 100.00% | 80.0% | Producing |
| Vermilion 170 (Swimmy) | 87.24% | 68.0% | Producing |
| West Delta 36 (via REX) | 8.1% | 6.5% | Producing |

Leases. The following table sets forth the interests owned by Contango through its related entities in leases in the Gulf of Mexico as of August 24, 2012:

| Area/Block | WI | Lease Date | Expiration Date |
|------------------------------|---------|------------|-----------------|
| Eugene Island 11 | 53.21% | Dec 07 | Dec-12 |
| East Breaks 369 (1) | (2) | Dec-03 | Dec-13 |
| South Timbalier 97 (via REX) | 32.30% | Jun-09 | Jun-14 |
| Ship Shoal 121 | 100.00% | Jul-10 | Jul-15 |
| Ship Shoal 122 | 100.00% | Jul-10 | Jul-15 |
| Brazos Area 543 | 100.00% | Mar-12 | Mar-17 |
| Ship Shoal 134 | 100.00% | (3) | (3) |
| South Timbalier 75 | 100.00% | (4) | (4) |

(1) Dry Hole

(2) Farm-out. COI retains a 2.41% ORRI

(3) Purchased deep rights. Currently drilling

(4) Farm-in. Currently drilling. Will earn lease once production begins (if successful)

Onshore Exploration and Properties

Alta Investments

On April 12, 2011, the Company announced a commitment to invest up to \$20 million over two years in Alta Energy Canada Partnership ("Alta Energy"), a venture that will acquire, explore, develop and operate onshore unconventional oil and natural gas shale assets. As of August 24, 2012, we had invested approximately \$12.3 million in Alta Energy to purchase over 60,000 acres in the Kaybob Duvernay, a liquids rich shale play in Alberta, Canada. Alta Energy has built one of the largest acreage blocks in the core of the play. Alta Energy drilled and cored its first vertical well in 17 days which is highly competitive with offset operators. Alta Energy has drilled three vertical test wells and has taken whole cores on two of those.

Offsetting activity in the Kaybob Duvernay continues to provide encouraging early results. With four horizontal well results available, initial production began with 508 barrels of oil equivalent per day ("Boed") for the first well and continuously improved to 2,123 Boed for the fourth well which tested 7.7 MMcfd and 839 Bbls per day. Condensate yields continue to rise to close to 100 bbls/MMcf plus encouraging amounts of NGL's. We expect an active summer of offsetting activity with additional information being slowly provided by competitors to the market. Alta Energy

began its summer drilling program which included spudding Alta's first horizontal well. Contango has a 2% interest in Alta Energy and a 5% interest in the Kaybob Duvernay project.

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Exaro Energy III LLC

On April 9, 2012, the Company announced that through its wholly-owned subsidiary, Contaro Company, it had entered into a Limited Liability Company Agreement (the "LLC Agreement") to form Exaro Energy III LLC ("Exaro"). Pursuant to the LLC Agreement, the Company has committed to invest up to \$82.5 million in cash in Exaro over the next five years together with other parties for an aggregate commitment of \$182.5 million. The Company owns approximately a 45% interest in Exaro, subject to terms allowing another party to acquire up to \$15 million of the Company's commitment, which would decrease the Company's interest in Exaro to approximately 37%.

As of June 30, 2012, the Company had invested approximately \$41.3 million in Exaro. Exaro has entered into an Earning and Development Agreement (the "EDA Agreement") with Encana Oil & Gas (USA) Inc. ("Encana") to provide funding of up to \$380 million to continue the development drilling program in a defined area of Encana's Jonah field asset located in Sublette County, Wyoming. This funding will be comprised of the \$182.5 million investment detailed above, debt, and cash flow from operations. Encana will continue to be the operator of the field and upon investing the full amount of the \$380 million, Exaro will have earned 32.5% of Encana's working interest in a defined joint venture area that comprises approximately 5,760 gross acres.

The Exaro-Encana venture currently has three rigs drilling, has completed five wells to date and achieved first production during mid-June 2012. The drilling project is progressing on schedule. As of June 30, 2012, there were no material natural gas or oil reserves associated with our investment in Exaro. During the period from inception to June 30, 2012, Exaro incurred a loss of approximately \$1.5 million, of which approximately \$0.5 million was recognized in the Company's consolidated statement of operations (net of \$0.2 million in taxes) for the fiscal year ended June 30, 2012.

Tuscaloosa Marine Shale

As of August 24, 2012, the Company had invested approximately \$8.7 million to lease approximately 25,000 acres in the Tuscaloosa Marine Shale ("TMS"), a shale play in central Louisiana and Mississippi. The TMS is an oil focused play and we intend to watch the play develop before we commit to drilling any exploratory wells. We do, however, plan to participate in outside operated wells with a small working interest prior to initiating an operated, high interest drilling program.

Jim Hogg County, Texas

We have entered into a letter agreement with a large south Texas mineral owner outlining the general terms and conditions of an exploration program involving acreage in Jim Hogg County, Texas. As of August 24, 2012, we had paid approximately \$1.2 million into this exploration program.

Discontinued Operations

Joint Venture Assets

In October 2009, the Company entered into a joint venture with Patara Oil & Gas LLC ("Patara") to develop proved undeveloped Cotton Valley gas reserves in Panola County, Texas. B.A. Berilgen, a member of the Company's board of directors, is the Chief Executive Officer of Patara. On May 13, 2011, the Company sold to Patara its 90% interest and 5% overriding royalty interest in the 21 wells drilled under this joint venture for approximately \$36.2 million and recognized a pre-tax loss of approximately \$0.7 million. These 21 wells had proved reserves of approximately 16.7 Bcfe, net to Contango. The Company accounted for this sale as discontinued operations as of June 30, 2011 and has included the results of the joint venture operations in discontinued operations for all periods presented.

Rexer Assets

On May 13, 2011, the Company sold to Patara 100% of its interest in Rexer #1 and 75% of its interest in Rexer-Tusa #2 for approximately \$2.5 million and recognized a pre-tax loss of approximately \$0.3 million. Rexer #1 was a wildcat exploration well that was spud in June 2010 and began producing in October 2010. This well had proved

reserves of approximately 0.5 Bcfe, net to Contango.

The remaining 25% working interest in Rexer-Tusa #2 was sold to Patara in October 2011 for \$10,000. Rexer-Tusa #2 was a wildcat exploration well that was spud in May 2011. This well had no proved reserves at the time of sale. The Company has accounted for the sale of Rexer #1 and Rexer-Tusa #2 as discontinued operations as of December 31, 2011 and has included the results of these operations in discontinued operations for all periods presented.

Contango Mining Company

Contango Mining Company (“Contango Mining”), a wholly-owned subsidiary of the Company and the predecessor to Contango ORE, Inc. (“CORE”), was initially formed on October 15, 2009 as a Delaware corporation registered to do business

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in Alaska for the purpose of engaging in exploration in the State of Alaska for (i) gold and associated minerals and (ii) rare earth elements. Contango Mining held leasehold interests in approximately 675,000 acres from the Tetlin Village Council, the council formed by the governing body for the Native Village of Tetlin, an Alaska Native Tribe, as well as additional acres in unpatented Federal and State of Alaska mining claims for the exploration of gold deposits and associated minerals and rare earth elements (collectively, the “Properties”).

On November 29, 2010, CORE, then another wholly-owned subsidiary of the Company, acquired the assets and assumed the obligations of Contango Mining, including the Properties, in exchange for its common stock which was subsequently distributed to the Company’s stockholders of record as of October 15, 2010 on the basis of one share of common stock for each ten shares of the Company’s common stock then outstanding. No fractional shares were issued, but a cash payment was made to shareholders with less than ten shares based upon the value established for CORE. The Company also contributed \$3.5 million in cash to CORE immediately prior to the distribution. The Company no longer has an ownership in CORE and has included its results of operations and gain on disposition in discontinued operations for all periods presented.

Marketing and Pricing

The Company currently derives its revenue principally from the sale of natural gas and oil. As a result, the Company’s revenues are determined, to a large degree, by prevailing natural gas and oil prices. The Company currently sells its natural gas and oil on the open market at prevailing market prices. Major purchasers of our natural gas, oil and natural gas liquids for the fiscal year ended June 30, 2012 were Shell Trading US Company (25%), NJR Energy Services (13%), ConocoPhillips Company (22%), Exxon Mobil Oil Corporation (11%), Enterprise Products Operating LLC (14%), and TransLouisiana Gas Pipeline Inc. (8%). Market prices are dictated by supply and demand, and the Company cannot predict or control the price it receives for its natural gas and oil. The Company has outsourced the marketing of its offshore natural gas and oil production volume to a privately-held third party marketing firm. Price decreases would adversely affect our revenues, profits and the value of our proved reserves. Historically, the prices received for natural gas and oil have fluctuated widely. Among the factors that can cause these fluctuations are:

- The domestic and foreign supply of natural gas and oil
- Overall economic conditions
- The level of consumer product demand
- Adverse weather conditions and natural disasters
- The price and availability of competitive fuels such as heating oil and coal
- Political conditions in the Middle East and other natural gas and oil producing regions
- The level of LNG imports
- Domestic and foreign governmental regulations
- Special taxes on production
- The loss of tax credits and deductions

Competition

The Company competes with numerous other companies in all facets of its business. Our competitors in the exploration, development, acquisition and production business include major integrated oil and gas companies as well as numerous independents, including many that have significantly greater financial resources and in-house technical expertise.

Governmental Regulations

Federal Income Tax. Federal income tax laws significantly affect the Company’s operations. The principal provisions affecting the Company are those that permit the Company, subject to certain limitations, to deduct as incurred, rather than to capitalize and amortize, its domestic “intangible drilling and development costs” and to claim depletion on a portion of its domestic natural gas and oil properties and to claim a manufacturing deduction based on qualified production activities.

Environmental Matters. Domestic natural gas and oil operations are subject to extensive federal regulation and, with respect to federal leases, to interruption or termination by governmental authorities on account of environmental and other considerations such as the Comprehensive Environmental Response, Compensation and Liability Act (“CERCLA”) also known as the “Super Fund Law”. The trend towards stricter standards in environmental legislation and regulation could increase costs to the Company and others in the industry. Natural gas and oil lessees are subject to liability for the costs of clean-up of pollution resulting from a lessee’s operations, and may also be subject to liability for pollution damages. The Company maintains insurance against costs of clean-up operations, but is not fully insured against all such risks. A serious incident of pollution may also result in the Department of the Interior requiring lessees under federal leases to suspend or cease operation in the affected area.

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The Oil Pollution Act of 1990 (the “OPA”) and regulations thereunder impose a variety of regulations on “responsible parties” related to the prevention of oil spills and liability for damages resulting from such spills in U.S. waters. The OPA assigns liability to each responsible party for oil removal costs and a variety of public and private damages. While liability limits apply in some circumstances, a party cannot take advantage of liability limits if the spill was caused by gross negligence or willful misconduct or resulted from violation of federal safety, construction or operating regulations. Few defenses exist to the liability imposed by the OPA. In addition, to the extent the Company’s offshore lease operations affect state waters, the Company may be subject to additional state and local clean-up requirements or incur liability under state and local laws. The OPA also imposes ongoing requirements on responsible parties, including proof of financial responsibility to cover at least some costs in a potential spill. The Company believes that it currently has established adequate proof of financial responsibility for its offshore facilities. However, the Company cannot predict whether financial responsibility requirements under any OPA amendments will result in the imposition of substantial additional annual costs to the Company in the future or otherwise materially adversely affect the Company. The impact, however, should not be any more adverse to the Company than it will be to other similarly situated or less capitalized owners or operators in the Gulf of Mexico.

The Company’s operations are subject to numerous federal, state and local laws and regulations controlling the discharge of materials into the environment or otherwise relating to the protection of the environment. Such laws and regulations, among other things, impose absolute liability on the lessee for the cost of clean-up of pollution resulting from a lessee’s operations, subject the lessee to liability for pollution damages, may require suspension or cessation of operations in affected areas, and impose restrictions on the injection of liquids into subsurface aquifers that may contaminate groundwater. Such laws could have a significant impact on the operating costs of the Company, as well as the natural gas and oil industry in general. Federal, state and local initiatives to further regulate the disposal of natural gas and oil wastes are also pending in certain jurisdictions, and these initiatives could have a similar impact on the Company. The Company’s operations are also subject to additional federal, state and local laws and regulations relating to protection of human health, natural resources, and the environment pursuant to which the Company may incur compliance costs or other liabilities.

Impact of Deepwater Horizon Incident. In April 2010, the deepwater Gulf of Mexico drilling rig Deepwater Horizon, engaged in drilling operations for another operator, sank after an apparent blowout and fire. The accident resulted in the loss of life and a significant oil spill and highlighted the dangers associated with exploration and production activities.

The legislative and regulatory response to the Deepwater Horizon Incident is ongoing. In 2010, the US Department of the Interior issued new rules designed to improve drilling and workplace safety, and various Congressional committees began pursuing legislation to greater regulate drilling activities and increase liability. In January 2011, the President’s National Commission on the Deepwater Horizon Oil Spill and Offshore Drilling released its report, recommending that the federal government require additional regulation and an increase in liability caps.

Additional regulatory review, slower permitting processes and increased oversight have resulted in longer development cycle time for our Gulf of Mexico projects. Cycle time is the length of time it takes for a project to progress from developing a prospect to beginning production, and longer development cycle times could result in lower rates of return on our investments.

Increased regulation impacting our activities in the Gulf of Mexico could result in extensive efforts to ensure compliance and incremental compliance costs. A significant delay or cancellation of our planned Gulf of Mexico exploratory activities will reduce our longer term ability to replace reserves, resulting in a negative impact on production over time. To the extent current exploration activities are significantly delayed, a gap could occur in our long-term production profile with a negative impact on our operating results and cash flows.

Additional legislation or regulation is being discussed which could require each company doing business in the Gulf of Mexico to establish and maintain a higher level of financial responsibility under its Certificate of Financial Responsibility ("COFR"), a certificate required under the Oil Pollution Act of 1990 which evidences a company's financial ability to pay for cleanup and damages caused by oil spills. There have also been discussions regarding the establishment of a new industry mutual fund in which companies would be required to participate and which would be available to pay for consequential damages arising from an oil spill. These and/or other legislative or regulatory changes could require us to maintain a certain level of financial strength and may reduce our financial flexibility.

Future legislation or regulation is also likely to result in substantial increases in civil or criminal fines or sanctions. Such fines or sanctions could well exceed the actual cost of containment and cleanup associated with a well incident or spill. We are monitoring legislative and regulatory developments; however, the full legislative and regulatory response to the Deepwater Horizon Incident is not yet fully known.

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Other Laws and Regulations. Various laws and regulations often require permits for drilling wells and also cover spacing of wells, the prevention of waste of natural gas and oil including maintenance of certain gas/oil ratios, rates of production and other matters. The effect of these laws and regulations, as well as other regulations that could be promulgated by the jurisdictions in which the Company has production, could be to limit the number of wells that could be drilled on the Company's properties and to limit the allowable production from the successful wells completed on the Company's properties, thereby limiting the Company's revenues.

The BOEM administers the natural gas and oil leases held by the Company on federal onshore lands and offshore tracts in the Outer Continental Shelf. The BOEM holds a royalty interest in these federal leases on behalf of the federal government. While the royalty interest percentage is fixed at the time that the lease is entered into, from time to time the BOEM changes or reinterprets the applicable regulations governing its royalty interests, and such action can indirectly affect the actual royalty obligation that the Company is required to pay. However, the Company believes that the regulations generally do not impact the Company to any greater extent than other similarly situated producers. At the end of lease operations, oil and gas lessees must plug and abandon wells, remove platforms and other facilities, and clear the lease site sea floor. The BOEM requires companies operating on the Outer Continental Shelf to obtain surety bonds to ensure performance of these obligations. As an operator, the Company is required to obtain surety bonds of \$200,000 per lease for exploration and \$500,000 per lease for developmental activities.

The Federal Energy Regulatory Commission (the "FERC") has embarked on wide-ranging regulatory initiatives relating to natural gas transportation rates and services, including the availability of market-based and other alternative rate mechanisms to pipelines for transmission and storage services. In addition, the FERC has announced and implemented a policy allowing pipelines and transportation customers to negotiate rates above the otherwise applicable maximum lawful cost-based rates on the condition that the pipelines alternatively offer so-called recourse rates equal to the maximum lawful cost-based rates. With respect to gathering services, the FERC has issued orders declaring that certain facilities owned by interstate pipelines primarily perform a gathering function, and may be transferred to affiliated and non-affiliated entities that are not subject to the FERC's rate jurisdiction. The Company cannot predict the ultimate outcome of these developments, or the effect of these developments on transportation rates. Inasmuch as the rates for these pipeline services can affect the natural gas prices received by the Company for the sale of its production, the FERC's actions may have an impact on the Company. However, the impact should not be substantially different for the Company than it would be for other similarly situated natural gas producers and sellers.

Risk and Insurance Program

In accordance with industry practice, we maintain insurance against many, but not all, potential perils confronting our operations and in coverage amounts and deductible levels that we believe to be economic. Consistent with that profile, our insurance program is structured to provide us financial protection from significant losses resulting from damages to, or the loss of, physical assets or loss of human life, and liability claims of third parties, including such occurrences as well blowouts and weather events that result in oil spills and damage to our wells and/or platforms. Our goal is to balance the cost of insurance with our assessment of the potential risk of an adverse event. We maintain insurance at levels that we believe are appropriate and consistent with industry practice and we regularly review our risks of loss and the cost and availability of insurance and revise our insurance program accordingly.

We expect the future availability and cost of insurance to be impacted by the Deepwater Horizon Incident. Impacts could include: tighter underwriting standards, limitations on scope and amount of coverage, and higher premiums, and will depend, in part, on future changes in laws and regulations regarding exploration and production activities in the Gulf of Mexico, including possible increases in liability caps for claims of damages from oil spills. We will continue to monitor the expected regulatory and legislative response and its impact on the insurance market and our overall risk profile, and adjust our risk and insurance program to provide protection at a level that we can afford considering the cost of insurance, against the potential and magnitude of disruption to our operations and cash flows.

We carry insurance protection for our net share of any potential financial losses occurring as a result of events such as the Deepwater Horizon Incident. As a result of the incident, we have increased our well control coverage from \$75 million to \$100 million on certain wells, which covers control of well, pollution cleanup and consequential damages. We have increased our general liability coverage from \$100 million to \$150 million, which covers pollution cleanup,

consequential damages coverage, and third party personal injury and death. And we have increased our Oil Spill Financial Responsibility coverage from \$35 million to \$150 million, which covers additional pollution cleanup and third party claims coverage.

Health, Safety and Environmental Program. The Company's Health, Safety and Environmental ("HS&E") Program is supervised by an operating committee of senior management to insure compliance with all state and federal regulations. In addition, to support the operating committee, we have contracted with J. Connors Consulting ("JCC") to manage our regulatory

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process. JCC is a regulatory consulting firm specializing in the offshore Gulf of Mexico regulatory process, preparation of incident response plans, safety and environmental services and facilitation of comprehensive oil spill response training and drills to oil and gas companies and pipeline operators.

For our Gulf of Mexico operations, we have a Regional Oil Spill Plan in place with the BOEM. Our response team is trained annually and is tested through annual spill drills given by the BOEM. In addition, we have in place a contract with O'Brien's Response Management ("O'Brien's"). O'Brien's maintains a 24/7 manned incident command center located in Slidell, LA. Upon the occurrence of an oil spill, the Company's spill program is initiated by notifying O'Brien's that we have an emergency. While the Company would focus on source control of the spill, O'Brien's would handle all communication with state and federal agencies as well as U.S. Coast Guard notifications.

If a spill were to occur, we have contracted with Clean Gulf Associates ("CGA") to assist with equipment and personnel needs. CGA specializes in onsite control and cleanup and is on 24 hour alert with equipment currently stored at six bases (Ingleside and Galveston, TX and Lake Charles, Houma, Venice and Pascagoula, LA), and is opening new sites in Leeville, Morgan City and Harvey, LA. The CGA equipment stockpile is available to serve member oil spill response needs including blowouts; open seas, near shore and shallow water skimming; open seas and shoreline booming; communications; dispersants; boat spray systems to apply dispersants; wildlife rehabilitation; and a forward command center. CGA has retainers with an aerial dispersant company and a company that provides mechanical recovery equipment for spill responses. CGA equipment includes:

• **HOSS Barge:** the largest purpose-built skimming barge in the United States with 4,000 barrels of storage capacity.

• **Fast Response System (FRU):** a self-contained skimming system for use on vessels of opportunity. CGA has nine of these units.

• **Fast Response Vessels (FRV):** four 46 foot FRVs with cruise speeds of 20-25 knots that have built-in skimming troughs and cargo tanks, outrigger skimming arms, navigation and communication equipment.

In addition to being a member of CGA, the Company has contracted with Wild Well Control for source control at the wellhead, if required. Wild Well Control is one of the world's leading providers of firefighting, well control, engineering, and training services.

Safety and Environmental Management System. The Company has developed and implemented a Safety and Environmental Management System ("SEMS") to address oil and gas operations in the Outer Continental Shelf ("OCS"), as required by the Bureau of Safety and Environmental Enforcement ("BSEE"). Full implementation of the following thirteen mandatory elements of the American Petroleum Institute's Recommended Practice 75 (API RP 75) was required on or before November 15, 2011:

• General provisions

• Safety and environmental information

• Hazards analyses

• Management of change

• Operating procedures

• Safe work practices

• Training

• Mechanical integrity

• Pre-startup review

• Emergency response and control

• Investigation of accidents

• Audits

• Records and documentation

Our SEMS program identifies, addresses, and manages safety, environmental hazards, and its impacts during the design, construction, start-up, operation, inspection, and maintenance of all new and existing facilities. The Company has established goals, performance measures, training, accountability for its implementation, and provides necessary

resources for an effective SEMS, as well as reviews the adequacy and effectiveness of the SEMS program. Facilities must be designed, constructed, maintained, monitored, and operated in a manner compatible with industry codes, consensus standards, and all applicable governmental regulations. We have contracted with Island Technologies Inc. to manage our SEMS program for production operations.

The BSEE will enforce the SEMS requirements through audits. We must have our SEMS program audited by either an independent third-party or our designated and qualified personnel within 2 years of the initial implementation and at least once

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every 3 years thereafter. Failure of an audit may force us to shut-in our Gulf of Mexico operations.

Employees

We have ten employees, all of whom are full time. The Company outsources its human resources function to Insperity, Inc. and all of the Company's employees are co-employees of Insperity, Inc. In addition to our employees, we use the services of independent consultants and contractors to perform various professional services, including reservoir engineering, land, legal, environmental and tax services. We are dependent on JEX for prospect generation, evaluation and prospect leasing. As a working interest owner, we rely on outside operators to drill, produce and market our natural gas and oil for our onshore prospects and certain offshore prospects where we are a non-operator. In the offshore prospects where we are the operator, we currently rely on a turn-key contractor to drill and rely on independent contractors to produce and market our natural gas and oil. In addition, we utilize the services of independent contractors to perform field and on-site drilling and production operation services and independent third party engineering firms to calculate our reserves.

Directors and Executive Officers

The following table sets forth the names, ages and positions of our directors and executive officers:

| Name | Age | Position |
|----------------------|-----|--|
| Kenneth R. Peak | 67 | Chairman and Director |
| Brad Juneau | 52 | President, Acting Chief Executive Officer and Director |
| Sergio Castro | 43 | Vice President, Chief Financial Officer, Treasurer and Secretary |
| Yaroslava Makalskaya | 43 | Vice President, Controller and Chief Accounting Officer |
| Marc L. Duncan | 59 | Vice Chairman of Operating Committee; Safety, Environmental and Regulatory Compliance Officer (SEARCO) |
| Charles A. Cambron | 45 | Vice President - Drilling |
| Michael J. Autin | 53 | Vice President - Production |
| B.A. Berilgen | 64 | Director |
| Jay D. Brehmer | 47 | Director |
| Charles M. Reimer | 67 | Director |
| Steven L. Schoonover | 67 | Director |

Kenneth R. Peak. Mr. Peak is the founder of the Company and has been Chairman and Chief Executive Officer since its formation in September 1999. In August 2012, Mr. Peak received a medical leave of absence from the Company for up to six months and Mr. Juneau was elected President and Acting Chief Executive Officer. Mr. Peak entered the energy industry in 1973 as a commercial banker and held a variety of financial and executive positions in the oil and gas industry prior to starting Contango in 1999. Mr. Peak served as an officer in the U.S. Navy from 1968 to 1971. Mr. Peak received a BS in physics from Ohio University in 1967, and an MBA from Columbia University in 1972. He currently serves as a director of Patterson-UTI Energy, Inc., a provider of onshore contract drilling services to exploration and production companies in North America, and Contango ORE, Inc., an exploration stage company involved in the exploration of gold and associated minerals and rare earth elements in the state of Alaska.

Brad Juneau. Mr. Juneau was elected a director of Contango in April 2012 and President and Acting Chief Executive Officer in August 2012. Mr. Juneau is the sole manager of the general partner of JEX, a company involved in the generation of natural gas and oil prospects. Prior to forming Juneau Exploration