Storm Cat Energy CORP
Form 10-Q
May 10, 2007

# UNITED STATES
# SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C. 20549**

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# FORM 10-Q

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

**For the quarterly period ended March 31, 2007**

**or**

o **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: 001-32628**

# STORM CAT ENERGY CORPORATION

(Exact name of registrant as specified in its charter)

| | |
|---|---|
| **British Columbia**<br>(State or other jurisdiction<br>of incorporation or organization) | **06-1762942**<br>(I.R.S. Employer<br>Identification No.) |
| **1125 17th Street, Suite 2310**<br>**Denver, Colorado**<br>(Address of principal executive offices) | **80202**<br>(Zip Code) |

(registrant s telephone number, including area code): **(303) 991-5070**

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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. x Yes o No

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

o Large accelerated filer x Accelerated filer o Non-accelerated filer

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

Indicate the number of shares outstanding of each of the issuer s classes of common shares, as of the latest practicable date:

**As of May 7, 2007, there were 80,939,820 common shares outstanding.**

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**STORM CAT ENERGY CORPORATION**

CONSOLIDATED BALANCE SHEETS

(stated in U.S. Dollars and in thousands, except share amounts)

| | March 31, 2007 (Unaudited) | December 31, 2006 |
|---|---|---|
| **ASSETS** | | |
| CURRENT ASSETS: | | |
| Cash and cash equivalents | $ 6,732 | $ 5,299 |
| Accounts receivable: | | |
| Joint interest billing | 850 | 1,932 |
| Revenue receivable | 1,765 | 2,121 |
| Fair value of derivative instruments - current | 1,932 | 2,670 |
| Subscription receivable on Series B convertible notes | 17,485 | |
| Prepaid costs and other current assets | 1,686 | 1,445 |
| Total Current Assets | 30,450 | 13,467 |
| PROPERTY AND EQUIPMENT: | | |
| Oil and gas properties: | | |
| Unproved properties, net of impairments | 57,927 | 54,873 |
| Proved properties | 54,499 | 46,446 |
| Less accumulated depreciation, depletion, and amortization | (6,262) | (4,764) |
| Oil and gas properties, net | 106,164 | 96,555 |
| Fixed assets | 1,072 | 1,057 |
| Accumulated depreciation | (484) | (408) |
| Total other property, net | 588 | 649 |
| Total property and equipment, net | 106,752 | 97,204 |
| Restricted investments | 511 | 511 |
| Debt issuance costs | 1,306 | |
| Fair value of derivative instruments - long term | | 782 |
| | 1,817 | 1,293 |
| Total Assets | $ 139,019 | $ 111,964 |
| **LIABILITIES AND STOCKHOLDERS EQUITY** | | |
| CURRENT LIABILITIES: | | |
| Accounts payable | $ 36 | $ 7,302 |
| Revenue payable | 1,584 | 2,063 |
| Accrued and other liabilities | 5,781 | 10,011 |
| Flow-through shares liability | 147 | 1,233 |
| Notes payable - current | | 7,500 |
| Interest payable | 446 | 952 |
| Total Current Liabilities | 7,994 | 29,061 |
| Asset retirement obligation | 1,977 | 1,871 |
| Fair value of derivative instruments - long term | 73 | |
| Bank debt - long term | 19,220 | 19,350 |
| Series A & B convertible notes | 50,195 | |
| | 71,465 | 21,221 |
| Total Liabilities | 79,459 | 50,282 |
| Commitments and contingencies | - | - |
| STOCKHOLDERS EQUITY | | |
| Common Shares, without par value, unlimited authorized, issued and outstanding: 80,939,820 at March 31, 2007 and 80,429,820 at December 31, 2006 | 69,695 | 69,518 |
| Contributed surplus | 5,240 | 4,910 |
| Accumulated other comprehensive income | 2,598 | 3,877 |
| Accumulated deficit | (17,973) | (16,623) |
| Total Stockholders Equity | 59,560 | 61,682 |
| Total Liabilities and Stockholders Equity | $ 139,019 | $ 111,964 |

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

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**STORM CAT ENERGY CORPORATION**

**CONSOLIDATED STATEMENTS OF OPERATIONS**

(Unaudited)

(stated in U.S. Dollars and in thousands, except share amounts)

| | Three Months Ended March 31, 2007 | 2006 |
|---|---|---|
| OPERATING REVENUES: | | |
| Oil and gas revenue | $ 3,912 | $ 1,279 |
| | | |
| OPERATING EXPENSES: | | |
| Operating costs: | | |
| Gathering and transportation | 561 | 326 |
| Operating expenses | 903 | 533 |
| General and administrative expenses | 2,662 | 1,602 |
| Depreciation, depletion, amortization and accretion | 1,634 | 503 |
| Other | | (185) |
| Total operating expenses | 5,760 | 2,779 |
| Operating loss | (1,848) | (1,500) |
| | | |
| OTHER EXPENSE (INCOME): | | |
| Interest expense | 629 | 6 |
| Interest and other miscellaneous income | (32) | (201) |
| Total other expense (income) | 597 | (195) |
| | | |
| Net loss before taxes | (2,445) | (1,305) |
| | | |
| Recovery of future income tax asset from flow-through shares | (1,095) | |
| | | |
| NET LOSS | $ (1,350) | $ (1,305) |
| Basic and diluted loss per share | $ (.02) | $ (.02) |
| Weighted average number of shares outstanding | 80,498,487 | 66,013,392 |

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

**STORM CAT ENERGY CORPORATION**

**CONSOLIDATED STATEMENT OF STOCKHOLDERS EQUITY AND COMPREHENSIVE LOSS**
**FOR THE PERIOD ENDED MARCH 31, 2007**
(Unaudited)
(stated in U.S. Dollars and in thousands, except share amounts)

| | Common Shares Shares | Amount | Share Subscription | Contributed Surplus | Other Comprehensive Income | Accumulated Deficit | Total Stockholders Equity |
|---|---|---|---|---|---|---|---|
| **BALANCE AT JANUARY 1, 2007** | **80,429,820** | **$ 69,489** | **$ 29** | **$ 4,910** | **$ 3,877** | **$ (16,623)** | **$ 61,682** |
| Issuance of stock for cash: | | | | | | | |
| -pursuant to stock options exercised | 500,000 | 169 | | | | | 169 |
| -pursuant to stock issued to consultants | 10,000 | 9 | | | | | 9 |
| Stock issuance costs | | (1) | | | | | (1) |
| Stock-based compensation | | | | 330 | | | 330 |
| Comprehensive loss: | | | | | | | |
| Net loss | | | | | | (1,350) | (1,350) |
| Unrealized loss on hedges | | | | | (1,591) | | (1,591) |
| Foreign currency translation | | | | | 312 | | 312 |
| Total comprehensive loss | | | | | | | $ (2,629) |
| **BALANCE AT MARCH 31, 2007** | **80,939,820** | **$ 69,666** | **$ 29** | **$ 5,240** | **$ 2,598** | **$ (17,973)** | **$ 59,560** |

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

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**STORM CAT ENERGY CORPORATION**

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

**(Unaudited)**

(stated in U.S. Dollars and in thousands)

| | **Three Months Ended March 31, 2007** | **2006** |
|---|---|---|
| Cash flows from operating activities: | | |
| Net Loss | $ (1,350) | $ (1,305) |
| Adjustments to reconcile net loss to net cash used in operating activities: | | |
| Recovery of future tax asset from flow-through shares | (1,090) | |
| Stock-based compensation | 454 | 758 |
| Depreciation, depletion and amortization | 1,574 | 503 |
| Asset retirement obligation | 103 | |
| Gain on disposition of properties | | 185 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | 1,437 | (552) |
| Prepaid costs and other current assets | (1,538) | (148) |
| Accounts payable | (456) | (2,296) |
| Accrued and other current liabilities | (1,736) | (3,342) |
| Net cash used in operating activities | (2,602) | (6,197) |
| Cash flows from investing activities: | | |
| Restricted investments | | (3) |
| Capital expenditures - oil and gas properties | (21,446) | (2,651) |
| Fair value of derivatives | 378 | |
| Proceeds from sale | | (1,000) |
| Other capital expenditures | (11) | (78) |
| Net cash provided by (used in) investing activities | (21,079) | (3,732) |
| Cash flows from financing activities: | | |
| Issuance of common shares for cash | 811 | 1,669 |
| Proceeds from bank debt | (7,630) | |
| Proceeds from Series A & B convertible notes | 32,950 | |
| Net cash provided by financing activities | 26,131 | 1,669 |
| Effect of exchange rate changes on cash | (1,017) | 319 |
| Net increase (decrease) in cash and cash equivalents | 1,433 | (7,941) |
| Cash and cash equivalents and beginning of period | 5,299 | 29,502 |
| Cash and cash equivalents at end of period | $ 6,732 | $ 21,561 |
| Supplemental disclosure of noncash investing and financing activities: | | |
| Cash paid for interest | $ 792 | $ |

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

**STORM CAT ENERGY CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**
**(Unaudited)**

Note 1. Basis of Presentation

Storm Cat Energy Corporation, together with its consolidated subsidiaries, ( Storm Cat or the Company ) is an independent oil and gas company focused on exploration and development of unconventional gas reserves, which are reserves from fractured shales, coal beds and tight sand formations. The Company has producing properties in Wyoming s Powder River Basin ( PRB ). Its primary exploration and development acreage is located in Canada and the United States.

The accompanying unaudited consolidated financial statements include the accounts of Storm Cat, and have been prepared in accordance with accounting principles generally accepted in the United States ( U.S. GAAP ) for the preparation of interim financial information. In the opinion of management, the accompanying unaudited condensed consolidated financial statements include all adjustments (consisting of normal and recurring accruals) considered necessary to present fairly the financial position of Storm Cat as of March 31, 2007 and results of operations and cash flows for the three months ended March 31, 2007 and 2006. Interim results are not necessarily indicative of the results that may be expected for a full year because of the impact of fluctuations in prices received for oil and natural gas and other factors.

Because a precise determination of many assets and liabilities is dependent upon future events, the timely preparation of consolidated financial statements for a period necessarily requires that management make estimates and assumptions and use judgment regarding the reported amounts of assets, liabilities, revenue and expenses and in the disclosure of commitments and contingencies. Actual results may differ from these estimates as future confirming events occur, and such differences could be significant.

For a more complete understanding of Storm Cat s operations, financial position and accounting policies, these consolidated financial statements and the notes thereto should be read in conjunction with the Company s Annual Report on Form 10-K for the fiscal year ended December 31, 2006.

Certain reclassifications have been made to prior amounts to conform to the classifications used in the current period.

Note 2. <u>Summary of Significant Accounting Policies</u>

Critical accounting estimates used in the preparation of the financial statements involve considerable judgment and are, or could be, significantly affected by factors that are out of the Company s control.

**Oil and Gas Reserves**

Storm Cat follows the full cost method of accounting whereby all costs related to the acquisition and development of oil and gas properties are capitalized into a single cost center referred to as a full cost pool. Depletion of exploration and development costs and depreciation of production equipment is computed using the units-of-production method based upon estimated proved oil and gas reserves. Under the full cost method of accounting, capitalized oil and gas property costs, less accumulated depletion and net of deferred income taxes, may not exceed an amount equal to the present value, discounted at 10%, of estimated future net revenues from proved oil and gas reserves plus the cost, or estimated fair value if lower, of unproved properties. Should capitalized costs exceed this ceiling, an impairment would be recognized.

Costs of acquiring and evaluating unproved properties are initially excluded from depletion calculations. These unproved properties are assessed periodically to ascertain whether impairment has occurred. When proved reserves are assigned, the cost of the property is added to costs subject to depletion. When property is considered to be impaired, the costs are reported as a period expense. As the Company has no proved reserves in Canada or Mongolia, the properties were expensed immediately through the recognition of an $88,000 impairment for costs related to Mongolia in 2005, and a $1.9 million impairment for Moose Mountain in Canada in the third quarter of 2006. Proceeds from sales, if any, of petroleum and natural gas properties are applied against capitalized costs, with no gain or loss recognized, unless such a sale would significantly alter the relationship between capitalized costs and the estimated proved oil and gas reserves attributable to a cost center.

Estimated reserve quantities and future net cash flows have the most significant impact on the Company because these reserve estimates are used in providing a measure of the Company s overall value. These estimates are also used in the quarterly calculations of depletion, depreciation and impairment of the Company s proved properties.

Estimating accumulations of gas and oil is complex and is not exact because of the numerous uncertainties inherent in the process. The process relies on interpretations of available geological, geophysical, engineering and production data. The extent, quality and reliability of this technical data can vary. The process also requires certain economic assumptions, some of which are mandated by the SEC, such as gas and oil prices, drilling and operating expenses, capital expenditures, taxes and availability of funds. The accuracy of a reserve estimate is a function of the quality and quantity of available data; the interpretation of that data; the accuracy of various mandated economic assumptions; and the judgment of the persons preparing the estimate.

The most accurate method of determining proved reserve estimates is based upon a decline analysis method, which consists of extrapolating future reservoir pressure and production from historical pressure decline and production data. The accuracy of the decline analysis method generally increases with the length of the production history. Since most of the Company s wells have been producing less than five years, their production history is relatively short, so other (generally less accurate) methods such as volumetric analysis and analogy to the production history of wells of other operators in the same reservoir were used in conjunction with the decline analysis method to determine the Company s estimates of proved reserves including developed producing, developed non-producing and undeveloped. As the Company s wells are produced over time and more data is available, the estimated proved reserves will be re-determined on an annual basis and may be adjusted based on that data.

Under the full cost method of accounting, capitalized oil and gas property costs, less accumulated depletion and net of related deferred income taxes, if any, may not exceed an amount referred to as the ceiling . The ceiling is the sum of the present value, discounted at 10%, of estimated future net revenues from proved oil and gas reserves plus the lower of cost or fair market value of unproved properties. The present value of estimated future net revenues is computed by pricing estimated future production of proved reserves at current period end product prices, and then deducting future expenditures estimated to be incurred in developing and producing the proved reserves assuming the continuation of existing economic conditions. If the amount of capitalized costs exceeds the ceiling, a write-down of the capitalized costs is required unless commodity prices increase subsequent to the end of the period such that the deficiency is reduced or eliminated. Once a write-down has been recorded, it may not be reversed in a subsequent period.

At March 31, 2007, the ceiling value of the Company s reserves was calculated based upon the average quoted market prices of $4.58 per Mcf for Colorado Interstate Gas ( CIG ) gas and a quoted price of $4.66 for gas delivered to the Cheyenne Hub. Using this pricing, and Storm Cat s cash flow hedges of gas production in place at March 31, 2007, the full cost pool would have exceeded the above described ceiling amount by $2.8 million.

Subsequent to quarter end on April 25, 2007, the Company entered into additional cash flow hedges for 3,689,000 MMBtu of future production (see Item 3 Quantitative and Qualitative Disclosures About Market Risk for additional discussion of the Company s hedging activities). Additionally the average of CIG and Cheyenne pricing recovered to $5.57 per MCF. As a result of the increased hedging and the recovery in CIG and Cheyenne pricing, the Company s full cost pool is below the ceiling amount by $11.1 million and therefore no write down of its oil and gas property costs is required.

Decreases in market prices from current levels, as well as changes in production rates, levels of reserves, the evaluation of costs excluded from amortization, future development costs, and service costs could result in future ceiling test impairments.

Actual future production, gas and oil prices, revenues, taxes, development expenditures, operating expenses and quantities of recoverable gas and oil reserves most likely will vary from the Company s estimates. Any significant variance could materially affect the quantities and present value of the Company s reserves. For example, a decrease in price of 10% would result in a decrease in the Company s March 31, 2007 present value of future net cash flows of approximately $2.0 million, inclusive of hedges. In addition, the Company may adjust estimates of proved reserves to reflect production history, acquisitions, divestitures, ownership interest revisions, results of exploration and development and prevailing gas and oil prices. The Company s reserves may also be susceptible to drainage by operators on adjacent properties.

**Impairment of Long-lived Assets**

The cost of the Company s unproved properties is withheld from the depletion base as described above, until such a time as the properties are either developed or abandoned. These properties are reviewed periodically for possible impairment.

**Capitalized Interest**

Pursuant to Financial Accountant Standards Board ( FASB ) Statement No. 34, the Company is required to capitalize interest costs to natural gas properties on expenditures made in connection with exploration and development projects that are not subject to current depletion. Interest is capitalized only for the period that activities are in progress to bring these projects to their intended use. $136,670 of interest cost was capitalized in the first quarter of 2007. No interest was capitalized during the same period in 2006.

**Capitalized Internal Costs**

Prior to 2007, the Company capitalized certain internal costs including salaries, bonuses and stock-based compensation on a pro-rata basis for employees directly involved in capital projects. In the first quarter of 2006, $0.3 million of internal costs were capitalized. Beginning with the first quarter of 2007, Storm Cat discontinued the capitalization of internal costs, except for two employees with direct responsibility for the supervision of capital projects in the PRB. The salaries of these employees were allocated to the properties based on a percentage of time spent on each capital project.

**Revenue Recognition**

The Company s revenue is derived from the sale of gas from its producing wells. This revenue is recognized as income when the production is produced and sold. The Company typically receives its payment for production sold one to three months subsequent to the month of the sale. For this reason, the Company must estimate the revenue that has been earned but not yet received as of the reporting date. The Company uses actual production reports to estimate the quantities sold and the CIG spot price, less marketing and transportation adjustments, to estimate the sales price of the production. Variances between estimates and the actual amounts received are recorded in the month the payment is received.

**Stock-based Compensation**

Factors affecting stock-based compensation include estimates of when stock options might be exercised, the stock price volatility, forfeiture rates, and the model used to calculate value. The timing for exercise of options is out of the Company s control and will depend, among other things, upon a variety of factors including the market value of Company shares and the financial objectives of the holders of the options. The Company calculates volatility using historical data; however, future volatility is inherently uncertain. As of March 31, 2007 the Company assumed a cumulative forfeiture rate of 10.0% based on historical forfeitures of stock-based compensation grants. The Company uses the Black-Scholes model to calculate the value of stock-based compensation. The Black-Scholes model a widely accepted mathematical model for valuing stock-based compensation, but is not the only model available.

**Accounting for Oil and Gas Properties**

The Company s recorded value of its oil and gas properties is, in all cases, based on historical costs. The Company is in an industry that is exposed to a number of risks and uncertainties, including exploration risk, development risk, commodity price risk, operating risk, ownership and political risk, funding and currency risk as well as environmental risk. The Company s financial statements have been prepared with these risks in mind. All of the assumptions set out herein are potentially subject to significant change and out of the Company s control. Such changes are not determinable at this time.

**Recent Accounting Pronouncements**

In June 2006, the FASB issued Interpretation No. 48, Accounting for Uncertainty in Income Taxes ( FIN 48 ). The interpretation clarifies the accounting for uncertainty in income taxes recognized in a company s financial statements in accordance with Statement of Financial Accounting Standards ( SFAS ) 109, Accounting for Income Taxes . Specifically, the pronouncement prescribes a recognition threshold and a measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The interpretation also provides guidance on the related derecognition, classification, interest and penalties, accounting for interim periods, disclosure and transition of uncertain tax positions. The interpretation was effective January 1, 2006 for the Company.

The Company adopted the provisions of FIN 48 on January 1, 2007. FIN 48 provides detailed guidance for the financial statement recognition, measurement and disclosure of uncertain tax positions recognized in the financial statements in accordance with SFAS 109. Tax positions must meet a more-likely-than-not recognition threshold at the effective date to be recognized upon the adoption of FIN 48 and in subsequent periods. The adoption of FIN 48 had an immaterial impact on the Company s consolidated financial position and did not result in unrecognized tax liabilities or benefits being recorded. Accordingly, no corresponding interest and penalties have been accrued. The Company files tax returns in Canada and remains in a net operating loss position. The Company is delinquent on filing its 2005 Canadian Tax return. There are no penalties or interest because of the delinquency as no tax is owed. The Company also files income tax returns in the U.S. federal jurisdiction and various states. There are currently no federal or state income tax examinations underway for these jurisdictions. Furthermore, the Company is no longer subject to U.S. federal income tax examinations by the Internal Revenue service for tax years before 2003 and for state and local tax authorities for years before 2002. The Company does, however, have prior year net operating losses which remain open for examination.

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements . This Statement defines fair value as used in numerous accounting pronouncements, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosure related to the use of fair value measures in financial statements. The Statement is to be effective for the Company s financial statements issued in 2008; however, earlier application is encouraged. The Company is currently evaluating the timing of adoption and the impact that adoption might have on its financial position or results of operations.

In September 2006, the SEC issued Staff Accounting Bulletin No. 108 Consideration of Prior Years Errors in Quantifying Current Year Misstatements ( SAB 108 ). Due to diversity in practice among registrants, SAB 108 expresses SEC staff views regarding the process by which misstatements in financial statements are evaluated for purposes of determining whether financial statement restatement is necessary. SAB 108 is effective for fiscal years ending after November 15, 2006, and early application is encouraged. The adoption of SAB 108 did not have a material impact on the Company s financial position or results from operations.

In December 2006, the FASB issued FASB Staff Position ( FSP ) EITF 00-19-2, Accounting for Registration Payment Arrangements. This FSP specifies that the contingent obligation to make future payments or otherwise transfer consideration under a registration payment arrangement should be separately recognized and measured in accordance with FASB Statement No. 5, Accounting for Contingencies . This FSP is effective immediately for registration payment arrangements and the financial instruments subject to those arrangements that are entered into or modified subsequent to December 21, 2006. For registration payment arrangements and financial instruments subject to those arrangements that were entered into prior to December 21, 2006, the guidance in the FSP is effective January 1, 2006 for the Company. The adoption of this FSP did not have a material impact on its financial position or results from operations.

On February 15, 2007, the FASB issued SFAS No. 159 The Fair Value Option for Financial Assets and Financial Liabilities. This Statement establishes presentation and disclosure requirements designed to facilitate comparisons between companies that choose different measurement attributes for similar types of assets and liabilities. SFAS No. 159 is effective for the Company s financial statements issued in 2008. The Company is currently evaluating the impact that the adoption of SFAS No. 159 might have on its financial position or results of operations.

Note 3. Basic and Diluted Loss per Share

Basic loss per share is computed by dividing the net loss by the weighted average number of common shares outstanding during the period. Diluted loss per share is calculated giving effect to the potential dilution that would occur if vested stock options and stock purchase warrants were exercised. The dilutive effect of options and warrants is computed by application of the treasury stock method which assumes that proceeds from the exercise of in-the-money options and warrants would be used to repurchase common shares at average market prices during the period. Diluted amounts are not presented when the effects of the computations are anti-dilutive due to net losses incurred. Accordingly, there is no difference in the amounts presented for basic and diluted loss per share for the three months ended March 31, 2007 and 2006. Listed below is a table showing both the basic and diluted shares outstanding at March 31, 2007 and 2006, respectively.

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| **Diluted Shares Outstanding** | **March 31, 2007** | **March 31, 2006** |
|---|---|---|
| Shares outstanding | 80,939,820 | 66,372,396 |
| Options outstanding | 4,500,000 | 4,900,000 |
| Series A convertible shares outstanding | 15,841,880 | |
| Series B convertible shares outstanding | 27,059,829 | |
| Warrants outstanding | 4,649,569 | 6,926,850 |
| Total diluted shares outstanding | 132,991,098 | 78,199,246 |

Note 4. Comprehensive Loss

Comprehensive loss consists of net loss, the effects of currency translation, and the unrealized loss on hedges. Comprehensive loss for the three months ended March 31, 2007 and 2006, respectively, is as follows:

| **Comprehensive Loss In Thousands** | **Three Months Ended March 31, 2007** | **2006** |
|---|---|---|
| Net loss | $ (1,350) | $ (1,305) |
| Effects of currency translation | 312 | 319 |
| Unrealized loss on hedges | (1,591) | |
| Total comprehensive loss | $ (2,629) | $ (986) |

Note 5. <u>Restricted Investments</u>

Storm Cat was required to post performance bonds totaling $511,000 in connection with its operations in Wyoming.  The funds are held as insured interest bearing certificates of deposit at an interest rate of 2.5%, payable annually.

Note 6. Asset Retirement Obligation

The estimated fair value of the future costs associated with dismantlement, abandonment and restoration of oil and gas properties is recorded when the assets are placed into service, generally through acquisition or completion of a well. The net estimated costs are discounted to present values using a risk-adjusted rate over the estimated economic life of the properties. Such costs are capitalized as part of the basis of the related asset and are depleted as part of the applicable full cost pool. The associated liability is recorded initially as a long-term liability. Subsequent adjustments to the initial asset and liability are recorded to reflect revisions to estimated future cash flow requirements. In addition, the liability is adjusted to reflect accretion expense as well as settlements during the period. The accretion expense is recorded as a component of depreciation, depletion and amortization expense in the accompanying condensed consolidated financial statements.

A reconciliation of the changes in the asset retirement obligation for the three months ended March 31, 2007 and 2006, respectively, is as follows:

| Asset Retirement Obligation | | |
|---|---|---|
| Balance at December 31, 2006 | $ | 1,871,393 |
| Additional liabilities incurred | 43,579 | |
| Accretion expense | 62,214 | |
| Balance at March 31, 2007 | $ | 1,977,186 |

| Asset Retirement Obligation | | |
|---|---|---|
| Balance at December 31, 2005 | $ | 793,000 |
| Additional liabilities incurred | 57,500 | |
| Accretion expense | 15,039 | |
| Balance at March 31, 2006 | $ | 865,539 |

Note 7. Stock-based Compensation

Storm Cat grants stock options at exercise prices equal to the fair market value of the Company s common shares at the date of the grant, and accounts for its options using the fair value method. The fair value is determined using a Black-Scholes option-pricing model that takes into account the common share price at the grant date, the exercise price, the expected life of the option, the volatility of the underlying shares and the expected dividends, and the risk-free interest rate over the expected life of the option.

The fair value of stock-based compensation is expensed, with a corresponding increase to contributed surplus. Upon exercise of stock options, the consideration paid upon exercise is recorded as additional value of common shares, and the amount previously recognized in capital surplus is reclassified to common shares.

The Company has reserved a total of 10,000,000 shares in the aggregate for issuance under the terms of the Storm Cat Energy Corporation Amended and Restated Share Option Plan (the Amended Option Plan ) and the Storm Cat Energy Corporation Restricted Share Unit Plan (the Restricted Share Unit Plan ), both approved by the shareholders on June 27, 2006. All options granted prior to the approval of the Amended Option Plan are included in the number of options covered under the Amended Option Plan.

A summary of the status of the options under the Amended Option Plan as of March 31, 2007 and changes during the three months then ended, is presented below:

| **Option Activity** | **Number of Shares** | **Weighted Average Exercise Price (1)** |
|---|---|---|
| Options outstanding at December 31, 2006 | 5,470,000 | $ 1.83 |
| Options granted | | |
| Options exercised | 500,000 | $ 0.39 |
| Options expired/cancelled | 470,000 | $ 1.54 |
| Options outstanding at March 31, 2007 | 4,500,000 | $ 2.03 |
| | | |
| Options exercisable at March 31, 2007 | 3,048,000 | $ 1.71 |

*(1) Exercise price is in Canadian dollars.*

Note 8. Non-cash Items

Non-cash items excluded from the cash flow are capital accrual related to oil and gas asset additions and the associated liability. These amounts totaled $5.3 million for the three-month period ended March 31, 2007 and zero for the same period in 2006.

Additionally, the Company reported subscriptions receivable related to its Series B Notes of $17.5 million as of March 31, 2007.

Note 9. Bank Credit Facility

*Senior Credit Facility*

On July 28, 2006, Storm Cat entered into a Credit Agreement, with JPMorgan Chase Bank, N.A., as Global Administrative Agent, and the Lenders party thereto (the U.S. Credit Agreement ). Additionally, on July 28, 2006, Storm Cat entered into a Credit Agreement, with JPMorgan Chase Bank, N.A., Toronto Branch as Canadian Administrative Agent, JPMorgan Chase Bank, N.A., as Global Administrative Agent, and the Lenders party thereto (the Canadian Credit Agreement and together with the U.S. Credit Agreement, the Credit Agreements ). Pursuant to these Credit Agreements, the Company is permitted to borrow up to an aggregate principal amount of $250.0 million, to be allocated between them depending on the respective borrowing base under each such agreement. The Credit Agreements were amended on January 30, 2007 pursuant to the First Amendment to Combined Credit Agreements (the Amendment and together with the Credit Agreements, the Amended Credit Agreements ) to allow for subordinated debt and to amend the current ratio requirement. A subsequent Letter

Agreement was entered into on February 16, 2007 which established the borrowing base at $20.0 million and adjusted the applicable interest rates until a re-determination on the Company s reserves and borrowing base was conducted.

Interest on borrowings under the Amended Credit Agreements and under the Letter Agreement accrues at variable interest rates at either a Eurodollar rate or an alternate base rate, at the Company s election. On loans made under the U.S. Credit Agreement, the Eurodollar rate is calculated at LIBOR plus an applicable margin 2.75%. The alternate base rate is calculated as (1) the greater of (a) the Prime Rate or (b) the Federal Funds Effective Rate plus 0.50%, plus (2) an applicable margin of 1.25%. For loans made under the Canadian Credit Agreement, the Eurodollar rate is calculated at LIBOR plus an applicable margin of 2.75%. Canadian Prime loans are the Canadian Prime Rate plus 1.25%. USBR Loans Rates are USBR plus 1.25% and the Bankers Acceptance Stamping Fee is 2.75%. Storm Cat elects the basis of the interest rate at the time of each borrowing. In addition, the Company is obligated to pay a commitment fee under the Amended Credit Agreements quarterly in arrears based on a percentage multiplied by the daily amount that the aggregate commitments exceed borrowings under the Amended Credit Agreements. The commitment fee percentage is 0.50%. Loans made under the Amended Credit Agreements are secured by mortgages on the Company s natural gas properties and guaranteed by Storm Cat s PRB assets.

The Amended Credit Agreements require the Company to comply with financial covenants as follows: (1) a ratio of current assets to current liabilities (determined at the end of each quarter) of not less than 1:1 beginning March 31, 2007; and (2) a ratio of total funded debt to EBITDA (as such terms are defined in the Amended Credit Agreement) for the most recent quarter, annualized, not to be greater than 5:1 for the fiscal quarter ending December 31, 2006, 3.5:1 fiscal quarter ending March 31, 2007, and 3:1 for each subsequent quarter. Quarterly compliance is calculated using a four quarter rolling methodology and measured against certain targets. The current assets to current liabilities ratio goes into effect March 31, 2007. The Company was in non-compliance of the EBITDA covenant as of December 31, 2006. A temporary waiver was obtained from JPMorgan for the quarter ended December 31, 2006 and, JPMorgan agreed not to test the quarter ended March 31, 2007. Pursuant to the provisions of the Emerging Issues Task Force ( EITF ) No. 86-30, *Classifications of Obligations When a Violation is Waived by the Creditor*, the Company projected future compliance with existing covenants and concluded that compliance with the same covenants at the next quarterly measurement date was probable. The temporary waiver required the Company to complete the Amendment.

The Amendment allowed the Company to move forward with its offering of subordinated convertible debt and permitted the issuance of (a) the Series A Convertible Subordinated Notes due March 31, 2012 (the Series A Notes ), and (b) the Series B Convertible Notes due March 31, 2012 (the Series B Notes ), in an aggregate principal amount not to exceed $50.2 million, a portion of the proceeds of which shall be used to repay in full the indebtedness evidenced by the Bridge Facility (as defined below), and which indebtedness (i) has a coupon rate of not greater than 9.25%, (ii) has a due date not earlier than March 31, 2012, (iii) is not subject to negative covenants, financial covenants or events of default (or other provisions which have the same effect as negative covenants, financial covenants or events of default) which have not been approved by the Global Administrative Agent, and (iv) is subordinated to the obligations on terms acceptable to the Global Administrative Agent, including, without limitation, pursuant to the terms of the Subordination Agreement.

The Company intends to enter into a Second Amendment to the Credit Agreement with JPMorgan. All the principal terms have been agreed upon and it is contemplated that the Second Amendment will be finalized early May 2007. Under the terms of the Second Amendment, the borrowing base of the Company is increased to $35.0 million of which $20.0 million is conforming. The interest on borrowing of the $35.0 million global borrowing base assuming 100% utilization are LIBOR plus 2.0% for Eurodollar loans, prime plus 1.0% for US dollar loans. A 0.50% commitment fee applies to unused portions of the $35.0 million dollar Global Borrowing Base. On March 31, 2008, the Global Borrowing Base must equal the Conforming Borrowing Base. As a requirement to entering the Second Amendment, the Company is required to hedge 80% of is current proved developed producing production as determined on January 1, 2007 for a term of three years.

As of March 31, 2007, the Company had $19.2 million outstanding on its bank credit facility. The facility was paid down by $10.0 million on April 10, 2007, leaving a balance outstanding of $9.2 million subsequent to quarter-end. At the time of the filing of this report, the Company had approximately $25.0 million available to borrow on the bank credit facility after taking into account a $0.8 million letter of credit secured by the line.

*Bridge Credit Facility*

On August 29, 2006, Storm Cat entered into an amendment (the First Amendment ) to the U.S. Credit Agreement to obtain a secured bridge note of U.S. $15.0 million (the Bridge Facility ) to help fund the PRB acquisition. On September 27, 2006, the Company used proceeds from an equity financing transaction and paid down $7.5 million under the Bridge Facility leaving a balance of $7.5 million outstanding at the end of the third quarter. The Company paid $0.9 million in fees to JPMorgan associated with the Bridge Facility ($0.8 million for an up-front fee and $0.1 million for a structuring fee). The fees were recorded as deferred financing costs in the accompanying financial statements and were amortized through January 31, 2007, at which time the Company paid off the Bridge Facility in full.

Note 10. Convertible Notes

On January 19, 2007, Storm Cat entered into a Series A Note Purchase Agreement for the private placement of the Series A Notes in a total aggregate principal amount of $18.5 million and a Series B Note Purchase Agreement for the private placement the Series B Notes in a total aggregate principal amount of $31.7 million. The Series A Notes and the Series B Notes are convertible into Storm Cat common shares at a price of $1.17 per share, as may be adjusted in accordance with the terms of the Series A Notes or the Series B Notes (as applicable), and the Company may force the conversion of the Series A Notes or the Series B Notes (as applicable) at any time 18 months after the closing date of the applicable issuance that its common shares trade above $2.05, as may be adjusted, for 20 days within a period of 30 consecutive trading days.

On January 30, 2007, Storm Cat closed the private placement of Series A Notes to qualified institutional investors in a private placement pursuant to Regulation D of the Securities Act of 1933, as amended, and exemptions from Canadian prospectus and registration requirements under National Instrument 45-106. The Series A Notes will mature on March 31, 2012, unless earlier converted, redeemed or repurchased. The Series A Notes bear interest at a rate of 9.25% per annum, commencing on January 30, 2007. Interest on the Series A Notes is payable quarterly in arrears on March 31, June 30, September 30 and December 31 of each year, beginning on June 30, 2007.

In Canada, any shares issued on conversion of the Series A Notes are subject to a four month hold period and may not be traded before May 31, 2007 unless permitted under applicable securities legislation and the rules of the Toronto Stock Exchange.

On March 30, 2007, Storm Cat closed on $31.7 million of Series B Notes to qualified institutional investors in a private placement pursuant to Regulation D of the Securities Act of 1933, as amended, and exemptions from Canadian prospectus and registration requirements under National Instrument 45-106. The Series B Notes will mature on March 31, 2012, unless earlier converted, redeemed or repurchased. The Series B Notes bear interest at a rate of 9.25% per annum, commencing on March 30, 2007. Interest on the Series A Notes is payable quarterly in arrears on March 31, June 30, September 30 and December 31 of each year, beginning on June 30, 2007. In April 2007, the Company collected $17.4 million in proceeds on the subscription receivable on its Series B Notes.

In Canada, any shares issued on conversion of the Series B Notes are also subject to a four month hold period and may not be traded before July 31, 2007 unless permitted under applicable securities legislation and the rules of the Toronto Stock Exchange.

As part of the private placements, the Company entered into a registration rights agreement with the investors requiring the Company to file with the SEC registration statements covering the common shares issuable upon conversion of the Series A Notes and the Series B Notes. Under the terms of the Series A and B registration rights agreement, the Company has thirty days from the day of closing the transaction to file a Form S-1 registration statement with the SEC. The Company has fulfilled this obligation with respect to both the Series A and B Notes. Since the SEC is under full review of the Form S-1 for the Series A Notes, the Company has 150 days from the date of closing of the Series A Notes or until June 29, 2007 to have the Form S-1 registration statement declared effective or pay liquidated damages in the amount of 1.0% of the aggregate purchase price per month ($185,350) to a maximum of 10.0% of the aggregate purchase price ($1,853,500). With respects to the Series B Notes, the registration of shares was filed as an amendment to the S-1 registration agreement filed for the Series A Notes on April 30, 2007. Should this amended Form S-1 registration statement not be declared effective by June 29, 2007, the Company will have to pay 1.0% of the aggregate purchase price per month ($316,600) to a maximum of 10.0% of the aggregate purchase price on the Series B Notes ($3,166,000) in addition to the liquidated damages on the Series A Notes. Liquidated damages can, at the option of the Company, be paid in cash or in fully paid and non-assessable common shares if all equity conditions outlined in the Form S-1 registration statement are met.

Further detail of the agreement between the Company and the Series A and B Note holders is disclosed in three separate Forms 8-K filed by the Company on January 25, February 5, and April 5, 2007.

Note 11. Derivative Financial Instruments

*Oil and Gas Commodity Hedges*

The table below summarizes derivative instrument gain (loss) activity:

| **Derivative Instrument Gain (Loss) Activity** | **Three Months Ended March 31,** | | | | | |
|---|---|---|---|---|---|---|
| **In Thousands** | **2007** | | | **2006** | | |
| Derivative contract settlements realized in oil and gas hedge gain (loss) | $ | 425 | | $ | | |
| Derivative contracts included in unrealized derivative gain (loss) | (1,591 | | ) | | | |
| Total derivative instrument gain (loss) | $ | (1,166 | ) | $ | | |

To mitigate a portion of the potential exposure to adverse market changes, the Company has entered into various derivative contracts. As of March 31, 2007, the Company had hedge contracts in place through August 2009 for a total of approximately 4,146,700 MMBtu of anticipated production. As of April 24, 2007, the Company had 3,689,000 MMBtu of additional hedge contracts in place through April 2010, for a total of approximately 7,835,700. The Company anticipates that all forecasted transactions will occur by the end of their originally specified periods. All contracts are entered into for other than trading purposes.

As of March 31, 2007, all natural gas derivative instruments qualified as cash flow hedges for accounting purposes. The estimated fair value of natural gas derivative contracts designated and qualifying as cash flow hedges under Statement of Financial Accounting Standards No. 133, Accounting for Derivative Instruments and Hedging Activities ( SFAS No. 133 ), was an unrealized loss of $1.59 million for the period ending March 31, 2007. (No hedges were in place during the first quarter of 2006). The inception-to-date estimated fair value natural gas derivative contracts designated and qualifying as cash flow hedges at March 31, 2007 was $1.86 million; $0.07 million of which was classified as a long-term liability, and $1.93 million of which was classified as a short-term asset.

Realized gains or losses from the settlement of gas derivative contracts are reported in the total operating revenues section on the consolidated statements of operations. Changes in the fair value of derivative instruments designated as cash flow hedges, to the extent they are effective in offsetting cash f