ST MARY LAND & EXPLORATION CO
Form 10-Q
August 03, 2007

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2007

Commission file number 001-31539

ST. MARY LAND & EXPLORATION COMPANY

(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	**41-0518430** (I.R.S. Employer Identification No.)
1776 Lincoln Street, Suite 700, Denver, Colorado (Address of principal executive offices)	**80203** (Zip Code)

(303) 861-8140

(Registrant s telephone number, including area code)

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

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

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

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

Indicate the number of shares outstanding of each of the issuer s classes of common stock as of the latest practicable date.

As of July 31, 2007, the registrant had 63,444,934 shares of common stock, $0.01 par value, outstanding.

ST. MARY LAND & EXPLORATION COMPANY

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

ST. MARY LAND & EXPLORATION COMPANY AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS (UNAUDITED)

(In thousands, except share amounts)

	June 30, 2007	**December 31, 2006**
ASSETS		
Current assets:		
Cash and cash equivalents	$ 26,179	$ 1,464
Short-term investments	1,143	1,450
Accounts receivable	137,333	142,721
Refundable income taxes	6,908	7,684
Prepaid expenses and other	21,587	17,485
Accrued derivative asset	29,454	56,136
Total current assets	222,604	226,940
Property and equipment (successful efforts method), at cost:		
Proved oil and gas properties	2,320,523	2,063,911
Less - accumulated depletion, depreciation, and amortization	(709,217)	(630,051)
Unproved oil and gas properties, net of impairment allowance of $9,790 in 2007 and $9,425 in 2006	110,471	100,118
Wells in progress	150,765	97,498
Other property and equipment, net of accumulated depreciation of $10,734 in 2007 and $9,740 in 2006	8,487	6,988
	1,881,029	1,638,464
Noncurrent assets:		
Goodwill	9,452	9,452
Accrued derivative asset	4,932	16,939
Other noncurrent assets	13,614	7,302
Total noncurrent assets	27,998	33,693
Total Assets	**$ 2,131,631**	**$ 1,899,097**
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable and accrued expenses	$ 226,080	$ 171,834
Short-term note payable		4,469
Accrued derivative liability	24,669	13,100
Deferred income taxes	2,713	14,667
Total current liabilities	253,462	204,070
Noncurrent liabilities:		
Long-term credit facility	96,000	334,000
Senior convertible notes	287,500	99,980
Asset retirement obligation	81,205	77,242
Net Profits Plan liability	164,388	160,583
Deferred income taxes	246,508	224,518
Accrued derivative liability	95,480	46,432

Other noncurrent liabilities	8,284	8,898
Total noncurrent liabilities	979,365	951,653
Commitments and contingencies		
Stockholders equity:		
Common stock, $0.01 par value: authorized 200,000,000 shares; issued: 63,648,218 shares in 2007 and 55,251,733 shares in 2006; outstanding, net of treasury shares: 63,424,510 shares in 2007 and 55,001,733 shares in 2006	636	553
Additional paid-in capital	156,022	38,940
Treasury stock, at cost: 223,708 shares in 2007 and 250,000 shares in 2006	(3,350)	(4,272)
Retained earnings	791,269	695,224
Accumulated other comprehensive income (loss)	(45,773)	12,929
Total stockholders equity	898,804	743,374
Total Liabilities and Stockholders Equity	**$ 2,131,631**	**$ 1,899,097**

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

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ST. MARY LAND & EXPLORATION COMPANY AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)

(In thousands, except per share amounts)

	For the Three Months Ended June 30,		**For the Six Months Ended June 30,**	
	2007	**2006**	**2007**	**2006**
Operating revenues:				
Oil and gas production revenue	$ 216,154	$ 177,957	$ 409,860	$ 362,022
Realized oil and gas hedge gain	7,303	4,875	25,987	9,980
Marketed gas system revenue	15,967	3,167	23,826	9,234
Gain on sale of proved properties		6,432		6,432
Other revenue	7,730	950	8,487	(699)
Total operating revenues	247,154	193,381	468,160	386,969
Operating expenses:				
Oil and gas production expense	50,328	43,278	102,648	84,492
Depletion, depreciation, amortization, and asset retirement obligation liability accretion	54,657	35,910	103,616	70,301
Exploration	13,643	15,319	34,412	26,106
Impairment of proved properties				1,289
Abandonment and impairment of unproved properties	1,465	1,262	2,949	2,448
General and administrative	13,697	10,429	24,838	21,215
Change in Net Profits Plan liability	(1,160)	14,059	3,805	21,080
Marketed gas system expense	14,940	2,829	22,176	8,016
Unrealized derivative loss	1,200	4,791	5,104	5,261
Other expense	401	419	1,117	990
Total operating expenses	149,171	128,296	300,665	241,198
Income from operations	97,983	65,085	167,495	145,771
Nonoperating income (expense):				
Interest income	154	540	257	1,364
Interest expense	(3,750)	(1,549)	(9,803)	(2,928)
Income before income taxes	94,387	64,076	157,949	144,207
Income tax expense	(35,152)	(23,996)	(58,764)	(53,601)
Net income	**$ 59,235**	**$ 40,080**	**$ 99,185**	**$ 90,606**
Basic weighted-average common shares outstanding	63,583	57,082	60,316	57,157
Diluted weighted-average common shares outstanding	65,120	66,950	65,015	67,145
Basic net income per common share	**$ 0.93**	**$ 0.70**	**$ 1.64**	**$ 1.59**
Diluted net income per common share	**$ 0.91**	**$ 0.61**	**$ 1.54**	**$ 1.38**

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

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ST. MARY LAND & EXPLORATION COMPANY AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY AND COMPREHENSIVE INCOME (UNAUDITED)

(In thousands, except share amounts)

	Common Stock		Additional Paid-in	Treasury Stock		Deferred Stock-Based	Retained	Accumulated Other Comprehensive Income	Total Stockholders
	Shares	**Amount**	**Capital**	**Shares**	**Amount**	**Compensation**	**Earnings**	**(Loss)**	**Equity**
Balances, December 31, 2005	**57,011,740**	**$ 570**	**$ 123,278**	**(250,000)**	**$ (5,148)**	**$ (5,593)**	**$ 510,812**	**$ (54,599)**	**$ 569,320**
Comprehensive income, net of tax:									
Net income							190,015		190,015
Change in derivative instrument fair value								87,107	87,107
Reclassification to earnings								(18,129)	(18,129)
Minimum pension liability adjustment								(180)	(180)
Total comprehensive income									258,813
SFAS No. 158 transition amount								(1,270)	(1,270)
Cash dividends, $ 0.10 per share							(5,603)		(5,603)
Treasury stock purchases				(3,319,300)	(123,108)				(123,108)
Retirement of treasury stock	(3,275,689)	(33)	(122,598)	3,275,689	122,631				
Issuance of common stock under Employee Stock Purchase Plan	26,046		814						814
Sale of common stock, including income tax benefit of stock option exercises	1,489,636	16	32,970						32,986
Adoption of Statement of Financial Accounting Standards No. 123(R)			(5,593)			5,593			
Stock-based compensation expense			10,069	43,611	1,353				11,422
Balances, December 31, 2006	**55,251,733**	**$ 553**	**$ 38,940**	**(250,000)**	**$ (4,272)**	**$**	**$ 695,224**	**$ 12,929**	**$ 743,374**

Comprehensive income, net of tax:									
Net income							99,185		99,185
Change in derivative instrument fair value								(42,380)	(42,380)
Reclassification to earnings								(16,319)	(16,319)
Minimum pension liability adjustment								(3)	(3)
Total comprehensive income									40,483
Cash dividends, $ 0.05 per share							(3,140)		(3,140)
Issuance of common stock under Employee Stock Purchase Plan	14,622		455						455
Conversion of 5.75% Senior Convertible Notes due 2022 to common stock, including income tax benefit of conversion	7,692,295	77	107,160						107,237
Issuance of common stock upon settlement of RSUs following expiration of restriction period, net of shares used for tax withholdings	302,370	3	(4,569)						(4,566)
Sale of common stock, including income tax benefit of stock option exercises	385,948	3	8,679						8,682
Stock-based compensation expense	1,250		5,357	26,292	922				6,279
Balances, June 30, 2007	**63,648,218**	**$ 636**	**$ 156,022**	**(223,708)**	**$ (3,350)**	**$**	**$ 791,269**	**$ (45,773)**	**$ 898,804**

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

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ST. MARY LAND & EXPLORATION COMPANY AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

(In thousands)

	For the Six Months Ended June 30, 2007	2006
Reconciliation of net income to net cash provided by operating activities:		
Net income	$ 99,185	$ 90,606
Adjustments to reconcile net income to net cash provided by operating activities:		
Gain on insurance settlement	(6,325)	
Gain on sale of proved properties		(6,432)
Depletion, depreciation, amortization, and asset retirement obligation liability accretion	103,616	70,301
Exploratory dry hole expense	11,220	3,640
Impairment of proved properties		1,289
Abandonment and impairment of unproved properties	2,949	2,448
Unrealized derivative loss	5,104	5,261
Change in Net Profits Plan liability	3,805	21,080
Stock-based compensation expense	6,279	6,392
Deferred income taxes	52,457	34,683
Other	(2,696)	(603)
Changes in current assets and liabilities:		
Accounts receivable	12,507	49,681
Refundable income taxes	775	(18,332)
Prepaid expenses and other	(5,120)	(8,678)
Accounts payable and accrued expenses	2,327	(20,748)
Income tax benefit from the exercise of stock options	(3,762)	(14,236)
Net cash provided by operating activities	**282,321**	**216,352**
Cash flows from investing activities:		
Proceeds from insurance settlement	7,049	
Proceeds from sale of oil and gas properties	324	182
Capital expenditures	(278,983)	(181,565)
Acquisition of oil and gas properties	(31,050)	(4,771)
Deposits to short-term investments available-for-sale	(1,138)	
Receipts from short-term investments available-for-sale	1,450	
Other	17	22
Net cash used in investing activities	**(302,331)**	**(186,132)**
Cash flows from financing activities:		
Proceeds from credit facility	292,914	108,000
Repayment of credit facility	(530,914)	(57,000)
Repayment of short-term note payable	(4,469)	
Income tax benefit from the exercise of stock options	3,762	14,236
Proceeds from issuance of convertible debt	281,194	
Proceeds from sale of common stock	5,378	14,919
Repurchase of common stock		(120,616)
Dividends paid	(3,140)	(2,859)
Net cash provided by (used in) financing activities	**44,725**	**(43,320)**
Net change in cash and cash equivalents	24,715	(13,100)
Cash and cash equivalents at beginning of period	1,464	14,925
Cash and cash equivalents at end of period	**$ 26,179**	**$ 1,825**

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

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ST. MARY LAND & EXPLORATION COMPANY AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)

Supplemental schedule of additional cash flow information and noncash investing and financing activities:

	For the Six Months Ended June 30, 2007	2006
	(In thousands)	
Cash paid for interest, net of capitalized interest	$ 11,405	$ 3,700
Cash paid for income taxes	$ 1,184	$ 29,373

As of June 30, 2007, and 2006, $110.6 million and $78.4 million, respectively, are included as additions to oil and gas properties and as increases in accounts payable and accrued expenses. These oil and gas property additions are reflected in cash used in investing activities in the periods that the payables are settled.

In May 2007 and 2006 the Company issued 26,292 and 26,076 shares, respectively, of common stock from treasury to its non-employee directors pursuant to the Company s non-employee director stock compensation plan. The Company recorded compensation expense related to these issuances of $726,000 and $195,000 for the six-month periods ended June 30, 2007, and 2006, respectively.

In March 2007, the Company called the 5.75% Senior Convertible Notes for redemption. The note holders elected to convert the 5.75% Senior Convertible Notes to common stock. As a result, the Company issued 7,692,295 shares of common stock on March 16, 2007, in exchange for the $100 million of 5.75% Senior Convertible Notes. The conversion was executed in accordance with the conversion provisions of the original indenture. Additionally, the conversion resulted in a $7.0 million decrease in non-current deferred income taxes and a corresponding increase in additional paid-in capital that is a result of the recognition of the cumulative excess tax benefit earned by the Company associated with the contingent interest feature of this note.

In June 2006 the Company hired a new senior executive. In doing so, the Company issued 13,784 shares of stock and recorded compensation expense of approximately $728,000. Additionally, in March 2007 the Company issued 1,250 shares of stock to the senior executive as the Company reached certain performance levels. The Company has recognized approximately $69,000 of expense related to this issuance as of June 30, 2007.

In February 2007 and 2006, the Company issued 78,657 and 484,351 restricted stock units, respectively, pursuant to the Company s Restricted Stock Plan. The total value of the issuances were $2.5 million and $16.4 million, respectively.

In May 2006 the Company closed a transaction whereby it exchanged oil and gas properties located in Richland County, Montana for non-core oil and gas properties. This transaction is considered a non-monetary exchange for accounting purposes with a fair value assigned to this transaction of $11.5 million.

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

ST. MARY LAND & EXPLORATION COMPANY AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

June 30, 2007

Note 1 The Company and Business

St. Mary Land & Exploration Company (St. Mary or the Company) is an independent energy company engaged in the exploration, exploitation, development, acquisition, and production of natural gas and crude oil. The Company s operations are conducted in the continental United States and offshore in the Gulf of Mexico.

Note 2 Basis of Presentation and Significant Accounting Policies

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements of St. Mary have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information. They do not include all information and notes required by generally accepted accounting principles for complete financial statements. Except as disclosed herein, there has been no material change in the information disclosed in the notes to consolidated financial statements included in St. Mary s Annual Report on Form 10-K/A for the year ended December 31, 2006. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation of the interim financial information have been included. Operating results for the periods presented are not necessarily indicative of the results that may be expected for the full year.

Other Significant Accounting Policies

The accounting policies followed by the Company are set forth in Note 1 to the Company s consolidated financial statements in the Form 10-K/A for the year ended December 31, 2006, and are supplemented throughout the footnotes of this document. It is suggested that these unaudited condensed consolidated financial statements be read in conjunction with the consolidated financial statements and notes included in the Form 10-K/A for the year ended December 31, 2006.

Note 3 Acquisitions

Catarina Field Acquisition

On June 1, 2007, the Company acquired oil and gas properties located in the Catarina Field in Webb County, Texas in exchange for $29.0 million of cash. The Company allocated $28.9 million to proved and unproved oil and gas properties. The net difference between cash exchanged and the amount allocated to oil and gas properties was allocated to other assets. The Company allocated the purchase price based on the estimated fair value of the assets and liabilities acquired. The final purchase price will be adjusted for normal net purchase price adjustments and is expected to be finalized during the fourth quarter of 2007. The acquisition was accounted for using the purchase method, and was funded with cash on hand and borrowings under the Company s credit facility.

Permian Basin, Texas Acquisition

On December 14, 2006, the Company acquired oil and gas properties in the Permian Basin in West Texas from private parties in exchange for $247.4 million of cash. After normal net purchase price

adjustments of approximately $4.3 million, $239.8 million was allocated to proved and unproved oil and gas properties and $3.0 million was allocated to intangible assets. The net difference between cash exchanged and the amount allocated to oil and gas properties and intangible assets was allocated to other assets. The Company allocated the purchase price based on the estimated fair value of the assets and liabilities acquired. The acquisition was accounted for using the purchase method, and was funded with cash on hand and borrowings under the Company s credit facility.

Richland County, Montana Acquisition

On May 15, 2006, the Company closed on a transaction whereby it exchanged oil and gas properties located in the Uinta Basin for oil and gas properties located in Richland County, Montana. The transaction was structured as an Internal Revenue Code Section 1031 tax-deferred exchange. For financial reporting purposes, the transaction is considered a non-monetary exchange and was accounted for at estimated fair value. The exchange of properties resulted in recognition of approximately $6.4 million of gain.

Note 4 Earnings per Share

Basic net income per common share of stock is calculated by dividing net income available to common stockholders by the weighted-average basic common shares outstanding during each period. The shares represented by vested restricted stock units (RSUs) are included in the calculation of the weighted-average basic common shares outstanding. The earnings per share calculations reflect the impact of any repurchases of shares of common stock made by the Company.

Diluted net income per common share of stock is calculated by dividing adjusted net income by the weighted-average of diluted common shares outstanding, which includes the effect of potentially dilutive securities. Prior to the conversion of the Company s 5.75% Senior Convertible Notes due 2022 (the 5.75% Convertible Notes) on March 16, 2007, potentially dilutive shares associated with this instrument were accounted for using the if-converted method for the determination of diluted earnings per share. Adjusted net income as used in the if-converted method was derived by adding interest expense paid on the 5.75% Convertible Notes back to net income and then adjusting for nondiscretionary items that are based on net income and would have changed had the 5.75% Convertible Notes been converted at the beginning of the period. The Company s 3.50% Senior Convertible Notes due 2027 (the 3.50% Convertible Notes) have a net-share settlement right, and the treasury stock method is used to measure the potentially dilutive impact of shares associated with the conversion feature. Year-to-date diluted earnings per share was calculated using shares associated with the 5.75% Convertible Notes, accounted for using the if-converted method as described above. Approximately 7.7 million potentially dilutive shares related to the 5.75% Convertible Notes were included in the calculation of diluted earnings per share for the three- and six-month periods ended June 30, 2006. The 5.75% Convertible Notes were called for redemption by the Company on March 16, 2007, and all of the note holders elected to convert the notes to shares of the Company s common stock. The Company issued 7,692,295 common shares in connection with the conversion of the 5.75% Convertible Notes. The diluted earnings per share calculation for the six-month period ended June 30, 2007, was adjusted for the conversion and included a time-weighted average of approximately 3.1 million potentially dilutive shares related to the 5.75% Convertible Notes. No potentially diluted shares related to the 5.75% Convertible Notes were included in the three-month period ended June 30, 2007.

Potentially dilutive securities for the year-to-date diluted earnings per share calculation consist of in-the-money outstanding stock options to purchase the Company s common stock, shares into which the 5.75% Convertible Notes were converted, shares into which the 3.50% Convertible Notes are convertible, and unvested RSUs. The shares underlying the grants of RSUs are included in the diluted earnings per share calculation beginning with grant date of the RSUs regardless of whether the shares are vested or unvested. Following the lapse of the restriction periods, the shares underlying the units will be issued and therefore will be included in the number of issued and outstanding shares.

Note 4 Earnings per Share

The dilutive effect of stock options and unvested RSUs is considered in the detailed calculations below. There were no anti-dilutive securities related to stock options or RSUs for the three-month or six-month periods ended June 30, 2006. The 3.50% Convertible Notes issued April 4, 2007 were anti-dilutive for the entire time they were outstanding during the three-month period ended June 30, 2007 and did not impact the diluted earnings per share calculation. There were no other anti-dilutive securities for the three-month or six-month periods ended June 30, 2007.

The following table sets forth the calculation of basic and diluted earnings per share:

	For the Three Months Ended June 30, 2007	For the Three Months Ended June 30, 2006	For the Six Months Ended June 30, 2007	For the Six Months Ended June 30, 2006
	(In thousands, except per share amounts)			
Net income	$ 59,235	$ 40,080	$ 99,185	$ 90,606
Adjustments to net income for dilution:				
Add: interest expense not incurred if 5.75% Convertible Notes converted		1,579	1,284	3,142
Less: other adjustments		(15)	(13)	(31)
Less: income tax effect of adjustment items		(585)	(472)	(1,157)
Net income adjusted for the effect of dilution	$ 59,235	$ 41,059	$ 99,984	$ 92,560
Basic weighted-average common shares outstanding	63,583	57,082	60,316	57,157
Add: dilutive effect of stock options and unvested restricted stock units	1,537	2,176	1,559	2,296
Add: dilutive effect of 5.75% Convertible Notes using if-converted method		7,692	3,140	7,692
Diluted weighted-average common shares outstanding	65,120	66,950	65,015	67,145
Basic earnings per common share	$ 0.93	$ 0.70	$ 1.64	$ 1.59
Diluted earnings per common share	$ 0.91	$ 0.61	$ 1.54	$ 1.38

Note 5 Compensation Plans

Cash Bonus Plan

The Company has a cash bonus plan that allows participants to receive a bonus of up to 50 percent of their aggregate base salary. Any awards under the cash bonus plan are based on a combination of Company and individual performance. The Company accrues cash bonus expense related to the current year s performance. Included in the general and administrative and exploration line items in the consolidated statements of operations are $1.2 million of cash bonus expense related to the specific performance year for each of the three-month periods ended June 30, 2007, and 2006, respectively, and $2.5 million and $2.3 million for the six-month periods ended June 30, 2007, and 2006, respectively.

Equity Incentive Compensation Plan

There are several components to the equity incentive compensation plan that are described in this section. Various types of equity awards have been granted by the Company in different periods. This section addresses the disclosure requirements for all equity awards still outstanding.

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Effective January 1, 2006, the Company adopted SFAS No. 123(R), Share Based Payment (SFAS No.123(R)) using the modified-prospective transition method. Under that transition method, compensation expense that must be recognized in periods subsequent to January 1, 2006 includes: (a) compensation cost for all share-based payments granted prior to, but not yet vested as of January 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of SFAS No. 123, and (b) compensation cost for all share-based payments granted subsequent to January 1, 2006, based on the grant date fair value estimated in accordance with the provisions of SFAS No. 123(R).

As of June 30, 2007, 2.5 million shares of common stock remained available for grant under the Company s 2006 Equity Incentive Compensation Plan (the 2006 Equity Plan). Any issuances of a direct share benefit such as an outright grant of common stock, a grant of a restricted share or a restricted stock unit counts as two shares against the amount eligible to be granted under the 2006 Equity Plan. Each stock option and similar instrument granted counts as one share against the eligible shares authorized to be issued under the 2006 Equity Plan.

The following sections describe the details of RSUs and stock options outstanding as of June 30, 2007.

Restricted Stock Incentive Program Under the 2006 Equity Incentive Compensation Plan

The Company has a long-term incentive program whereby grants of restricted stock or RSUs have been awarded to eligible employees, consultants, and members of the Board of Directors. Restrictions and vesting periods for the awards are determined at the discretion of the Board of Directors and are set forth in the award agreements. Each RSU represents a right for one share of the Company s common stock to be delivered upon settlement of the award at the end of a specified period. For employees, these grants are determined annually based on a performance formula consistent with the cash bonus plan.

St. Mary issued −−−78,657 RSUs on February 28, 2007, related to 2006 performance and 484,351 RSUs on February 28, 2006, related to 2005 performance. The total fair value associated with these issuances was $2.5 million in 2007 and $16.4 million in 2006 as measured on the respective grant dates. The granted RSUs vest 25 percent immediately upon grant and 25 percent on each of the next three anniversary dates of the grant. Compensation expense is recorded monthly over the vesting period of the award. Accordingly, the Company recorded expense in 2005 related to the awards issued in 2006, recorded expense in 2006 related to the awards issued in 2007, and is recording expense over the earning determination period in 2007 for grants that will be issued in 2008. Vested shares of common stock underlying the RSU grants will be issued on the third anniversary of the grants, at which time the shares carry no further restrictions. For all grants made subsequent to and including the 2006 grant period, the Company is using the accelerated amortization method as described in FASB Interpretation No. 28, Accounting for Stock Appreciation Rights and Other Variable Stock Option or Award Plans an interpretation of APB Opinions No. 15 and 25, whereby approximately 47 percent of the total estimated compensation expense is recognized in the first year of the vesting period. Expense for grants made for plan years prior to 2006 is being amortized under the straight-line method since this method was allowed prior to the adoption of SFAS No. 123(R).

St. Mary also issued 7,575 RSUs for various grants to specific employees during the six months ended June 30, 2007. These grants have various vesting schedules. The fair value of these awards will be recorded to compensation expense over the various vesting periods.

On June 30, 2007, the Company converted 427,059 RSUs into common stock. The Company and many of the grant participants mutually agreed to net share settle the awards for the effect of income and payroll tax withholdings as provided for in the plan document and award agreements. As a result,

the Company issued 302,370 shares of common stock. The remaining 124,689 shares were withheld to offset tax withholding obligations that occured upon the delivery of the shares underlying those RSUs.

As of June 30, 2007, there was a total of 684,856 RSUs outstanding, of which 386,367 were vested. Total compensation expense related to the RSUs for the three-month periods ended June 30, 2007, and 2006, was $2.4 million and $2.7 million respectively, and the total compensation expense related to the RSUs for the six-month periods ended June 30, 2007, and 2006, was $5.0 million and $5.3 million respectively. There is $1.9 million included in compensation expense for the six-month period ended June 30, 2007 for vesting of the estimated value of grants expected to be issued in 2008 related to the 2007 performance year. As of June 30, 2007, there was $6.4 million of total unrecognized compensation expense related to unvested restricted stock unit awards. The unrecognized compensation expense is being amortized through 2010.

In measuring compensation expense from the grant of RSUs, SFAS No. 123(R) requires companies to estimate the fair value of the award on the grant date. The fair value of the RSUs is inherently less than the market value of an unrestricted security. The fair value of RSUs has been measured using the Black-Scholes option pricing model. The Company s computation of expected volatility is based on the historic volatility of St. Mary s common stock. The Company s computation of expected life is determined based on historical experience of similar awards, giving consideration to the contractual terms of the stock-based awards, vesting schedules, and expectations of future employee behavior. The interest rate for periods within the contractual life of the award is based on the U.S. Treasury constant maturity yield at the time of grant. The fair values of granted RSUs were estimated using the following weighted-average assumptions:

	For the Six Months Ended June 30, 2007		**2006**	
Risk free interest rate:		4.6%		4.7%
Dividend yield:	0.3	%	0.2	%
Volatility factor of the market price of the Company s common stock:	33.0	%	36.6	%
Expected life of the awards (in years):	3		3	

A summary of the status and activity of non-vested RSUs for the six-month period ended June 30, 2007, is presented below.

	Non-Vested RSUs	**Weighted-Average Grant-Date Fair Value**
Non-vested, at December 31, 2006	506,161	$ 28.92
Granted	86,232	$ 32.20
Vested	(259,611)	$ 25.86
Forfeited	(34,293)	$ 31.39
Non-vested, at June 30, 2007	298,489	$ 32.24

Stock Option Grants Under the 2006 Equity Incentive Compensation Plan

The Company previously granted stock options under the St. Mary Land & Exploration Company Stock Option Plan and Incentive Stock Option Plan. The last issuance of stock options was December 31, 2004. Stock options to purchase shares of the Company s common stock had been issued

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to eligible employees and members of the Board of Directors. All options granted to date under the option plans were granted at exercise prices equal to the respective closing market price of the Company s common stock on the grant dates, which generally occurred on the last day of a fiscal period. All stock options granted under the option plans are exercisable for a period of up to ten years from the date of grant.

During the three-month periods ended June 30, 2007, and 2006, the Company recognized stock-based compensation expense of approximately $162,000 and $518,000, respectively, related to stock options that were outstanding as of January 1, 2006. During the six-month periods ended June 30, 2007, and 2006, the Company recognized stock-based compensation expense of approximately $383,000 and $1.0 million, respectively, related to stock options that were outstanding as of January 1, 2006. There was no cumulative effect adjustment from the adoption of SFAS No. 123(R).

The following table summarizes the stock options outstanding as of June 30, 2007:

	Options	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (In years)	Aggregate Intrinsic Value (In thousands)
Outstanding, beginning of period	3,121,602	$ 12.56		
Exercised	(385,948)	$ 12.75		
Forfeited	(2,452)	$ 7.34		
Outstanding, end of period	2,733,202	$ 12.54	4.83	$ 65,828
Vested, or expected to vest, end of period	2,733,202			$ 65,828
Exercisable, end of period	2,711,044	$ 12.49	4.81	$ 65,419

As of June 30, 2007, there was $78,000 of total unrecognized compensation cost related to unvested stock option awards.

The fair value of options and Employee Stock Purchase Plan (ESPP) grants was measured at the date of grant using the Black-Scholes option pricing model. For the ESPP offering period during 2007, the Company has expensed $129,000 based on the estimated fair value on the respective grant date.

Net Profits Plan

Under the Company s Net Profits Interest Bonus Plan (the Net Profits Plan), all oil and gas wells that are completed or acquired during a year are designated within a specific pool. Key employees recommended by senior management and designated as participants by the Company s Compensation Committee of the Board of Directors and employed by the Company on the last day of that year become entitled to payments under the Net Profits Plan after the Company has received net cash flows returning 100 percent of all costs associated with that pool. Thereafter, ten percent of future net cash flows generated by the pool are allocated among the participants and are distributed at least annually. The portion of net cash flows from the pool to be allocated among the participants increases to 20 percent after the Company has recovered 200 percent of the total costs for the pool, including payments made under the Net Profits Plan at the ten percent level. The Net Profits Plan has been in place since 1991. Pool years prior to and including 2005 are fully vested. Pool years beginning in 2006 carry a vesting

period of three years whereby one-third is vested at the end of the year for which participation is designated and one-third vests on each of the following two anniversary dates. Beginning with the 2006 pool, the maximum benefit to full participants from a single year s pool will be limited to 300 percent of a participating individual s adjusted base salary paid during the year to which the pool relates.

In a separate calculation, the Company records the estimated liability for future payments under the Net Profits Plan based on the discounted value of estimated future payments associated with each individual pool. The calculation of this liability is a significant management estimate. For a predominate number of the pools, a discount rate of 15 percent is used to calculate this liability and is intended to represent the best estimate of the present value of expected future payments under the Net Profits Plan. The Company s estimate of its liability is highly dependent on the oil and natural gas price and cost assumptions and discount rates used in the calculations. The commodity price assumptions are formulated by applying a price that is derived from a rolling average of actual prices realized over the prior 24 months together with adjusted NYMEX strip prices for the ensuing 12 months for a total of 36 months of data. This average is adjusted to include the effect of hedge prices for the percentage of forecasted production hedged in the relevant period. The forecasted non-cash expense associated with this significant management estimate is highly volatile from period to period due primarily to fluctuations that occur in the oil and natural gas commodity markets. The Company continually evaluates the assumptions used in this calculation in order to include the current market environment for oil and natural gas prices, costs, discount rates, and overall market conditions.

The following table presents the changes in the estimated future liability attributable to the Net Profits Plan. Reductions in the liability relate to the realized results for the periods presented from oil and gas operations for the properties associated with the respective pools that have achieved payout status.

	For the Three Months Ended June 30,		**For the Six Months Ended June 30,**	
	2007	**2006**	**2007**	**2006**
	(In thousands)		**(In thousands)**	
Liability balance for Net Profits Plan as of the beginning of the period	$ 165,548	$ 143,845	$ 160,583	$ 136,824
Increase in liability	6,652	20,992	17,523	34,894
Reduction in liability for cash payments made or accrued and recognized as compensation expense	(7,812)	(6,933)	(13,718)	(13,814)
Liability balance for Net Profits Plan as of the end of the period	$ 164,388	$ 157,904	$ 164,388	$ 157,904

The calculation of the estimated liability for the Net Profits Plan is highly sensitive to price estimates and discount rate assumptions. For example, if the commodity prices used in the calculation changed by five percent, the liability recorded at June 30, 2007, would differ by approximately $16 million. A one percentage point change in the discount rate would result in a change of the liability of approximately $8 million. Actual cash payments to be made in future periods are dependent on realized actual production, prices, and costs associated with the properties in each individual pool of the Net Profits Plan. Consequently, actual cash payments will be inherently different from the amounts estimated.

The Company records changes in the present value of estimated future payments under the Net Profits Plan as a separate item in the consolidated statements of operations. The change in the estimated liability is recorded as a non-cash expense or benefit in the current period. The amount recorded as an expense or benefit associated with the change in the estimated liability is not allocated to general and

administrative expense or exploration expense because it is associated with the future net cash flows from oil and gas properties in the respective pools rather than current period realized performance. The table below presents the estimated allocation of the change in the liability if the Company did allocate the adjustment to these specific line items:

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2007	2006	2007	2006
	(In thousands)		(In thousands)	
General and administrative expense	$ (540)	$ 5,768	$ 1,884	$ 8,964
Exploration expense	(620)	8,291	1,921	12,116
Total	$ (1,160)	$ 14,059	$ 3,805	$ 21,080

Note 6 Income Taxes

Income tax expense for the three-month and six-month periods ended June 30, 2007, and 2006, differs from the amount that would be provided by applying the statutory U.S. federal income tax rate to income before income taxes primarily due to the effect of state income taxes, percentage depletion, the estimated effect of the domestic production activities deduction, and other permanent differences.

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2007	2006	2007	2006
	(In thousands)		(In thousands)	
Current portion of income tax expense:				
Federal	$ 3,200	$ 3,389	$ 4,982	$ 18,140
State	732	(247)	1,325	778
Deferred portion of income tax expense:	31,220	20,854	52,457	34,683
Total income tax expense	$ 35,152	$ 23,996	$ 58,764	$ 53,601
Effective tax rates	37.3 %	37.4 %	37.2 %	37.2 %

A change in tax rates between reported periods will generally reflect differences in the Company s estimated highest marginal state tax rates due to changes in the composition of income between state tax jurisdictions. Differences can also reflect various effects of the Company s estimates of the domestic production activities deduction, percentage depletion, and the possible impact of permanent differences related to state income tax calculations.

The Company adopted the provisions of FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes, on January 1, 2007. There was no financial statement adjustment required as a result of adoption. At adoption the Company had a long-term liability for unrecognized tax benefit of $1.0 million and accumulated interest liability of $92,000. The entire amount of unrecognized tax benefit would affect the Company s effective tax rate if recognized. Interest expense associated with income tax is recorded as interest expense in the consolidated statements of operations. Penalties associated with income tax are recorded in general and administrative expense in the consolidated statements of operations.

The Company and its subsidiaries file income tax returns in the U.S. federal jurisdiction and in various states. With few exceptions, the Company is no longer subject to U.S. federal or state income tax examinations by these tax authorities for years before and including 2003. The Internal Revenue Service

completed an audit for the 2000, 2002 and 2003 tax years during the quarter ended March 31, 2007. There was no change to the provision for income tax as a result of these examinations.

The Company is awaiting receipt of approximately $3.8 million for income tax refunds resulting from the carry back of net operating losses and a carry over of minimum tax credits as well as accrued interest income. The entire $3.8 million receivable has been recognized by the Company.

Note 7 Long-term Debt

Revolving Credit Facility

The Company s revolving credit facility specifies a maximum loan amount of $500 million and has a maturity date of April 7, 2010. Borrowings under the facility are secured by a pledge in favor of the lenders of collateral that includes certain oil and gas properties and the common stock of the material subsidiaries of the Company. The borrowing base under the credit facility as authorized by the bank group is currently $1.1 billion and is subject to regular semi-annual redeterminations. The borrowing base redetermination process considers the value of St. Mary s oil and gas properties and other assets, as determined by the bank syndicate. The Company has elected an aggregate commitment amount of $500 million under the credit facility. The Company must comply with certain financial and non-financial covenants. Interest and commitment fees are accrued based on the borrowing base utilization percentage table below. Euro-dollar loans accrue interest at LIBOR plus the applicable margin from the utilization table, and Alternative Base Rate (ABR) loans accrue interest at Prime plus the applicable margin from the utilization table. Commitment fees are accrued on the unused portion of the aggregate commitment amount and are included in interest expense in the consolidated statements of operations.

Borrowing base utilization percentage	**<50%**	**≥50% <75%**	**≥75% <90%**	**≥90%**
Euro-dollar loans	1.000 %	1.250 %	1.500 %	1.750 %
ABR loans	0.000 %	0.000 %	0.250 %	0.500 %
Commitment fee rate	0.250 %	0.300 %	0.375 %	0.375 %

The Company had $96.0 million of Euro-dollar loans outstanding as of June 30, 2007.

5.75% Senior Convertible Notes Due 2022

The Company called for redemption of its 5.75% Convertible Notes on March 16, 2007. The call for redemption resulted in the note holders electing to convert the notes to common stock in accordance with the conversion provision in the original indenture. The 5.75% Convertible Note holders converted all $100.0 million of 5.75% Convertible Notes to common shares at a conversion price of $13.00 per share. The Company issued 7.7 million common shares in connection with the conversion.

3.50% Senior Convertible Notes Due 2027

On April 4, 2007, the Company issued $287.5 million aggregate principal amount of 3.50% Convertible Notes. The 3.50% Convertible Notes mature on April 1, 2027, unless earlier converted, redeemed, or purchased by the Company. The 3.50% Convertible Notes are unsecured senior obligations and rank equal in right of payment with all of the Company s existing and any future unsecured senior debt and senior in right of payment to any future subordinated debt.

Holders may convert their notes based on a conversion rate of 18.3757 shares of the Company s common stock per $1,000 principal amount of the 3.50% Convertible Notes (which is equal to an initial conversion price of approximately $54.42 per share), subject to adjustment, contingent upon and only under the following circumstances: (1) if the closing price of the Company s common stock reaches or

the trading price of the notes falls below specified thresholds, (2) if the notes are called for redemption, (3) if specified distributions to holders of the Company s common stock are made or specified corporate transactions occur, (4) if a fundamental change occurs, or (5) during the ten trading days prior to, but excluding, the maturity date. The notes and underlying shares have been registered under a shelf registration statement. If the Company becomes involved in a material transaction or corporate development, it may suspend trading of the 3.50% Convertible Notes under the prospectus. In the event the suspension period exceeds 45 days within any three-month period or 90 days within any twelve-month period, the Company will be required to pay additional interest to all holders of the 3.50% Convertible Notes, not to exceed a rate per annum of 0.50% of the issue price of the 3.50% Convertible Notes; provided that no such additional interest shall accrue after April 4, 2009.

Upon conversion of the 3.50% Convertible Notes, holders will receive cash or common stock, or any combination thereof as elected by the Company. At any time prior to the maturity date of the notes, the Company has the option to unilaterally and irrevocably elect to settle its obligations upon conversion of the notes in cash and, if applicable, shares of common stock. If the Company makes this election, then, for each $1,000 principal amount of notes converted, the Company will pay the following to holders in lieu of shares of common stock: (1) an amount in cash equal to the lesser of (i) $1,000 or (ii) the conversion value determined in the manner set forth in the indenture for the 3.50% Convertible Notes, and (2) if the conversion value exceeds $1,000, the Company will also deliver, at its election, cash or common stock or a combination of cash and common stock with respect to the remaining value deliverable upon conversion. Currently, it is the Company s intention to net share settle the 3.50% Convertible Notes. However, the Company has not made this a formal legal irrevocable election and thereby reserves the right to settle the 3.50% Convertible Notes in any manner allowed under the offering memorandum as business conditions warrant.

If a holder elects to convert its notes in connection with certain events that constitute a change of control before April 1, 2012, the Company will pay, to the extent described in the related indenture, a make-whole premium by increasing the conversion rate applicable to such 3.50% Convertible Notes. In addition, the Company will pay contingent interest in cash, commencing with any six-month period beginning on or after April 1, 2012, if the average trading price of a note for the five trading days ending on the third trading day immediately preceding the first day of the relevant six-month period equals 120 percent or more of the principal amount of the 3.50% Convertible Notes.

On or after April 6, 2012, the Company may redeem for cash all or a portion of the 3.50% Convertible Notes at a redemption price equal to 100 percent of the principal amount of the notes to be redeemed plus accrued and unpaid interest, if any, up to but excluding, the applicable redemption date. Holders of the 3.50% Convertible Notes may require the Company to purchase all or a portion of their notes on each of April 1, 2012, April 1, 2017, and April 1, 2022, at a purchase price equal to 100% of the principal amount of the notes to be repurchased plus accrued and unpaid interest, if any, up to but excluding, the applicable purchase date. On April 1, 2012, the Company may pay the purchase price in cash, in shares of common stock, or in any combination of cash and common stock. On April 1, 2017 and April 1, 2022, the Company must pay the purchase price in cash.

In July 2007, the Financial Accounting Standards Board (FASB) approved the preparation of a proposed FASB Staff Position (FSP) on the accounting treatment for certain convertible debt instruments that may be settled in cash, shares of common stock, or any portion thereof at the election of the issuing company. The FSP proposes that these instruments be accounted for utilizing a bifurcation model under which the value of the debt instrument would be determined without regard to the conversion feature. The difference between this calculated value and the convertible debt instrument issue price would be allocated to the option and recorded as equity as opposed to debt. Pending enactment, the changes are proposed to become effective for years beginning after December 15, 2007. The FSP does not contain a grandfather provision, thus the Company would be required to account for its

existing convertible debt instruments using the proscribed bifurcation method under the framework described by the FASB.

Weighted-average Interest Rate Paid

The weighted-average interest rates paid for the second quarters of 2007 and 2006 were 5.6 percent and 8.1 percent, respectively, including commitment fees paid on the unused portion of the credit facility aggregate commitment, amortization of deferred financing costs, amortization of the contingent interest embedded derivative associated with the 5.75% Convertible Notes, and the effects of interest rate swaps. The weighted-average interest rates paid for the six-month periods ended June 30, 2007 and 2006, were 6.3 percent and 8.2 percent, respectively. Capitalized interest costs for the Company for the three-month periods ended June 30, 2007, and 2006 were $1.2 million and $704,000, respectively, and capitalized interest costs for the six-month periods ended June 30, 2007, and 2006, were $2.6 million and $1.4 million, respectively.

Note 8 Derivative Financial Instruments

Oil and Gas Commodity Hedges

To mitigate a portion of the potential exposure to adverse market changes in oil and natural gas prices, the Company has entered into various derivative contracts. The Company s derivative contracts in place include swap and collar arrangements for the sale of oil, natural gas, and natural gas liquids. Please refer to the tables under *Summary of Oil and Gas Production Hedges in Place* in Part I, Item 2 of Management s Discussion and Analysis of Financial Condition and Results of Operations for details regarding the Company s hedged volumes and associated prices. As of June 30, 2007, the Company has hedge contracts in place through 2011 for a total of approximately 13 million Bbls of crude oil, 70 million MMBtu of natural gas, and 829,000 Bbls of natural gas liquids of anticipated production.

The Company attempts to qualify its oil and natural gas derivative instruments as cash flow hedges for accounting purposes. The Company formally documents all relationships between the derivative instruments and the hedged production, as well as the Company s risk management objective and strategy for the particular derivative contracts. This process includes linking all derivatives that are designated as cash flow hedges to the specific forecasted sale of oil or natural gas at its physical location. The Company also formally assesses (both at the derivative s inception and on an ongoing basis) whether the derivatives being utilized have been highly effective at offsetting changes in the cash flows of hedged production and whether those derivatives may be expected to remain highly effective in future periods. If it is determined that a derivative has ceased to be highly effective as a hedge, the Company will discontinue hedge accounting prospectively for that derivative instrument. If hedge accounting is discontinued and the derivative remains outstanding, the Company will recognize all subsequent changes in its fair value in the consolidated statement of operations for the period in which the change occurs. As of June 30, 2007, all oil, natural gas, and natural gas liquid derivative instruments qualified as cash flow hedges for accounting purposes. 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.

The fair value of derivative instruments is included in the balance sheets as an asset or liability. The estimated fair value of oil and natural gas derivative contracts designated and qualifying as cash flow hedges under SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, was a net liability of $85.8 million at June 30, 2007.

Gains or losses from the settlement of oil and gas derivative contracts are reported in the total operating revenues section in 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 flows attributable to the hedged risk, are recorded in other comprehensive income until the hedged item

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is recognized in earnings. Any change in fair value resulting from ineffectiveness is recognized currently in derivative loss in the consolidated statements of operations.

The Company seeks to minimize ineffectiveness by entering into oil derivative contracts indexed to NYMEX and natural gas contracts indexed to regional index prices associated with pipelines in proximity to the Company s areas of production. As the Company s derivative contracts contain the same index as the Company s sale contracts, this results in hedges that are highly correlated with the underlying hedged item.

Derivative loss for the three months ended June 30, 2007, and 2006, includes a net loss of $1.2 million and $4.9 million, respectively, from ineffectiveness related to oil and natural gas derivative contracts. Amounts for the six-month periods ended June 30, 2007, and 2006, were net losses of $5.2 million and $5.8 million, respectively.

As of June 30, 2007, the estimated amount of unrealized derivative loss net of deferred income taxes to be reclassified from accumulated other comprehensive income to realized oil and gas hedge gain in the next twelve months is $5.1 million.

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

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2007	2006	2007	2006
	(In thousands)		(In thousands)	
Derivative contract settlements realized in oil and gas hedge gain	$ 7,303	$ 4,875	$ 25,987	$ 9,980
Ineffective portion of hedges qualifying for hedge accounting included in derivative loss	(1,200)	(4,918)	(5,225)	(5,754)
Non-qualified derivative contracts included in derivative gain (loss)		127	121	493
Interest rate derivative contract settlements included in interest expense			(283)	(275)
Total gain	$ 6,103	$ 84	$ 20,600	$ 4,444

Convertible Note Derivative Instrument

The contingent interest provision of the 5.75% Convertible Notes was considered an embedded equity-related derivative that was not clearly and closely related to the fair value of an equity interest and therefore was separately accounted for as a derivative instrument. There was no derivative gain or loss recorded in the consolidated statements of operations for the three-month and six-month periods ended June 30, 2007, and there was a net loss of $4,000 recorded for the three-month period ended June 30, 2006, and a net gain of $231,000 recorded for the six-month period ended June 30, 2006, from mark-to-market adjustments for this derivative. The contingent interest provision of the 3.50% Convertible Notes is also a derivative instrument. However, the value of the derivative was determined to be de minimis at the inception of the instrument.

Note 9 Pension Benefits

The Company has a non-contributory pension plan covering substantially all employees who meet age and service requirements (the Qualified Pension Plan). The Company also has a supplemental non-contributory pension plan covering certain management employees (the Non-qualified Pension Plan).

Components of Net Periodic Benefit Cost for Both Plans

The following table presents the components of the net periodic cost for both the Qualified Pension Plan and the Non-qualified Pension Plan:

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2007	2006	2007	2006
	(In thousands)		(In thousands)	
Service cost	$ 477	$ 421	$ 955	$ 842
Interest cost	199	163	397	326
Expected return on plan assets	(135)	(107)	(270)	(190)
Amortization of net actuarial loss	54	74	109	148
Net periodic benefit cost	$ 595	$ 551	$ 1,191	$ 1,126

Prior service costs are amortized on a straight-line basis over the average remaining service period of active participants. Gains and losses in excess of ten percent of the greater of the benefit obligation and the market-related value of assets are amortized over the average remaining service period of active participants.

Contributions

The Company contributed $1.3 million to the Qualified Pension Plan during the second quarter of 2007. No further contributions to the Qualified Pension Plan are planned for the remainder of 2007.

Note 10 Asset Retirement Obligations

The Company recognizes an estimated liability for future costs associated with the abandonment of its oil and gas properties. A liability for the fair value of an asset retirement obligation and a corresponding increase to the carrying value of the related long-lived asset are recorded at the time a well is completed or acquired. The increase in carrying value is included in proved oil and gas properties in the consolidated balance sheets. The Company depletes the amount added to proved oil and gas property costs and recognizes expense in connection with the accretion of the discounted liability over the remaining estimated economic lives of the respective oil and gas properties. Cash paid to settle asset retirement obligations is included in the operating section of the Company s consolidated statements of cash flows.

The Company s estimated asset retirement obligation liability is based on historical experience in abandoning wells, estimated economic lives, estimates as to the cost to abandon the wells in the future, and federal and state regulatory requirements. The liability is discounted using a credit-adjusted risk-free rate estimated at the time the liability is incurred or revised. The credit-adjusted risk-free rates used to discount the Company s abandonment liabilities range from 6.50 percent to 7.25 percent. Revisions to the liability could occur due to changes in estimated abandonment costs or well economic lives, or if federal or state regulators enact new requirements regarding the abandonment of wells.

A reconciliation of the Company s asset retirement obligation liability is as follows:

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2007	2006	2007	2006
	(In thousands)		(In thousands)	
Beginning asset retirement obligation	$ 86,519	$ 67,196	$ 77,242	$ 66,078
Liabilities incurred	3,147	1,203	4,741	1,758
Liabilities settled	(510)	(573)	(1,298)	(1,162)
Accretion expense	1,398	1,185	2,750	2,337
Revision to estimated cash flow			7,119	
Ending asset retirement obligation	$ 90,554	$ 69,011	$ 90,554	$ 69,011

Accounts payable and accrued expenses as of June 30, 2007, contain $9.3 million related to the Company s asset retirement obligation liability. Accounts payable and accrued expenses did not contain an amount related to the Company s asset retirement obligation liability as of December 31, 2006. The amount relates to the estimated plugging and abandonment costs associated with one off-shore platform that was destroyed during Hurricane Rita. Plugging and abandonment of the platform is expected to be completed by the end of 2007.

Note 11 Repurchase of Common Stock

Stock Repurchase Program

The Company has an ongoing share repurchase program. As of the date of this filing, the Company has Board authorization to repurchase up to 6 million shares of common stock. The shares may be repurchased from time to time in open market transactions or in privately negotiated transactions, subject to market conditions and other factors, including certain provisions of St. Mary s existing credit facility agreement and compliance with securities laws. Stock repurchases may be funded with existing cash balances, internal cash flow, and borrowings under the credit facility.

During the second quarter of 2006 St. Mary repurchased 3,319,300 shares of its common stock at a weighted average price of $37.09 per share including commissions. St. Mary did not repurchase any shares of common stock under the program during the six month period ended June 30, 2007.

Note 12 Insurance Settlement

In April of 2007 the Company reached a global insurance settlement for reimbursement of damages sustained during Hurricane Rita. St. Mary s net amount of the final settlement is approximately $33 million. As a result of this settlement, the Company recorded a gain, included in other revenue in the accompanying financial statements, of $6.3 million during the second quarter of 2007. The gain calculation takes into consideration approximately $9.3 million of future costs associated with the plugging and abandonment of one offshore platform. Additionally, the Company has accrued for approximately $1.3 million of expected hurricane related damage repair costs related to its non-operated properties. The Company continues to closely monitor the activities associated with these properties. Any significant variation between actual and estimated plugging and abandonment and non-operated damage repair costs will impact the final determination of the gain associated with the insurance settlement. The Company expects adjustments to the gain to be completed by the fourth quarter of 2007.

Note 13 Subsequent Events

On August 2, 2007, the Company signed a Purchase and Sale Agreement to acquire oil and gas properties located primarily in Webb County, Texas. The purchase price for these assets is $153.1 million and the transaction is scheduled to close in the first half of October 2007. The properties target gas production in the Olmos formation. This acquisition is adjacent to the recently acquired Catarina Field assets discussed in Note 3 - Acquisitions. It is expected that the Company will pay for this acquisition with available cash flows and its existing revolving credit facility. The Company has hedged the first three years of natural gas production and the first year of associated liquids.

ITEM 2. MANAGEMENT S DIS