MARINER ENERGY INC
Form 10-Q
May 15, 2007

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-Q

þ **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**

Commission file number 1-32747

MARINER ENERGY, INC.
(Exact name of registrant as specified in its charter)

Delaware	**86-0460233**
(State or other jurisdiction of incorporation or organization)	*(I.R.S. Employer Identification Number)*

One BriarLake Plaza, Suite 2000
2000 West Sam Houston Parkway South
Houston, Texas 77042
(Address of principal executive offices and zip code)
(713) 954-5500
(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 Exchange Act 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 þ 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.

Large accelerated filer o Accelerated filer o Non-accelerated filer þ

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

As of May 10, 2007, there were 87,131,044 shares issued and outstanding of the issuer s common stock, par value $0.0001 per share.

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Certification of CEO Pursuant to Section 302
Certification of CFO Pursuant to Section 302
Certification of CEO Pursuant to Section 906
Certification of CFO Pursuant to Section 906

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PART I
Item 1. Condensed Consolidated Financial Statements

MARINER ENERGY, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands except share data)
(Unaudited)

	March 31, 2007	December 31, 2006
Current Assets:		
Cash and cash equivalents	$ 6,311	$ 9,579
Receivables, net of allowances of $1,393 and $726 as of March 31, 2007 and December 31, 2006, respectively	156,513	149,692
Insurance receivables	68,059	61,001
Derivative asset	16,544	54,488
Prepaid seismic	23,637	20,835
Prepaid expenses and other	14,458	12,846
Total current assets	285,522	308,441
Property and Equipment:		
Proved oil and gas properties, full-cost method	2,501,165	2,345,041
Unproved properties, not subject to amortization	64,405	40,246
Total Oil and Gas Properties	2,565,570	2,385,287
Other property and equipment	13,627	13,512
Accumulated depreciation, depletion and amortization	(481,177)	(386,737)
Total property and equipment, net	2,098,020	2,012,062
Restricted cash		31,830
Goodwill	288,504	288,504
Derivative asset	7,863	17,153
Other Assets, net of amortization	25,659	22,163
TOTAL ASSETS	$ 2,705,568	$ 2,680,153
Current Liabilities:		
Accounts payable	$ 2,768	$ 1,822
Accrued liabilities	85,151	74,880
Accrued capital costs	129,902	99,028
Deferred income tax	1,368	26,857
Derivative liability	8,574	
Abandonment liability	36,471	29,660
Accrued interest	12,074	7,480
Total current liabilities	276,308	239,727
Long-Term Liabilities:		
Abandonment liability	183,181	188,310
Derivative liability	183	

Deferred income tax	285,978	262,888
Long term debt, bank credit facility	314,000	354,000
Long term debt, senior unsecured notes	300,000	300,000
Other long-term liabilities	37,762	32,637
Total long-term liabilities	1,121,104	1,137,835
Commitments and Contingencies (see Note 7)		
Stockholders Equity:		
Preferred stock, $.0001 par value; 20,000,000 shares authorized, no shares issued and outstanding at March 31, 2007 and December 31, 2006		
Common stock, $.0001 par value; 180,000,000 shares authorized, 86,361,162 shares issued and outstanding at March 31, 2007; 180,000,000 shares authorized, 86,375,840 shares issued and outstanding at December 31, 2006	9	9
Additional paid-in-capital	1,045,535	1,043,923
Accumulated other comprehensive income	8,843	43,097
Accumulated retained earnings	253,769	215,562
Total stockholders equity	1,308,156	1,302,591
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	$ 2,705,568	$ 2,680,153

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

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MARINER ENERGY, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands except share data)
(Unaudited)

	Three Months Ended March 31, 2007	Three Months Ended March 31, 2006
Revenues:		
Oil	$ 60,451	$ 30,182
Natural gas	140,532	44,156
Natural gas liquids	9,149	5,234
Other revenues	1,333	688
Total revenues	211,465	80,260
Costs and Expenses:		
Lease operating expense	34,756	11,491
Severance and ad valorem taxes	2,990	1,691
Transportation expense	1,902	730
General and administrative expense	10,141	10,509
Depreciation, depletion and amortization	98,634	32,824
Total costs and expenses	148,423	57,245
OPERATING INCOME	**63,042**	**23,015**
Other Income (Expense):		
Interest income	291	115
Interest expense, net of amounts capitalized	(12,347)	(6,007)
Other	5,431	
Income before taxes	56,417	17,123
Provision for income taxes	(18,210)	(5,993)
NET INCOME	**$ 38,207**	**$ 11,130**
Earnings per share:		
Net income per share basic	$ 0.45	$ 0.22
Net income per share diluted	$ 0.45	$ 0.21
Weighted average shares outstanding basic	85,515,561	49,615,479
Weighted average shares outstanding diluted	85,704,529	51,844,610

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

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MARINER ENERGY, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
(Unaudited)

	Three Months Ended March 31, 2007	Three Months Ended March 31, 2006
Operating Activities:		
Net income	$ 38,207	$ 11,130
Adjustments to reconcile net income to net cash provided by operating activities:		
Deferred income tax	17,960	5,993
Depreciation, depletion and amortization	99,440	34,356
Ineffectiveness of derivative instruments	2,148	
Stock compensation	1,567	6,427
Changes in operating assets and liabilities:		
Receivables	(7,501)	7,251
Insurance receivables	(7,058)	
Prepaid expenses and other	(1,612)	(18,169)
Other assets	(83)	(5,900)
Accounts payable and accrued liabilities	10,561	25,419
Net cash provided by operating activities	153,629	66,507
Investing Activities:		
Additions to properties and equipment	(148,790)	(78,863)
Property conveyances	18	
Purchase price adjustment		(20,808)
Restricted cash designated for investment	31,830	
Net cash used in investing activities	(116,942)	(99,671)
Financing Activities:		
Repayment of term note		(4,000)
Credit facility (repayments) borrowings, net	(40,000)	214,200
Debt and working capital acquired from Forest Energy Resources, Inc.		(176,200)
Proceeds from exercise of stock options	45	22
Net cash (used in) provided by financing activities	(39,955)	34,022
(Decrease) Increase in Cash and Cash Equivalents	(3,268)	858
Cash and Cash Equivalents at Beginning of Period	9,579	4,556
Cash and Cash Equivalents at End of Period	$ 6,311	$ 5,414

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

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MARINER ENERGY, INC.
NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. Summary of Significant Accounting Policies

Operations Mariner Energy, Inc. (Mariner or the Company) is an independent oil and gas exploration, development and production company with principal operations in West Texas and in the Gulf of Mexico, both shelf and deepwater. Unless otherwise indicated, references to Mariner , the Company , we , our , ours and us refer to Energy, Inc. and its subsidiaries collectively.

Interim Financial Statements The accompanying unaudited consolidated financial statements have been prepared without audit pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) have been condensed or omitted, although we believe that the disclosures contained herein are adequate to make the information presented not misleading. In the opinion of management, all adjustments considered necessary for a fair presentation have been included. Operating results for interim periods are not necessarily indicative of the results that may be expected for the entire year. Our balance sheet at December 31, 2006 is derived from the December 31, 2006 audited financial statements, but does not include all disclosures required by GAAP. These unaudited condensed consolidated financial statements included herein should be read in conjunction with the Financial Statements and Notes included in the Company s Annual Report on Form 10-K for the year ended December 31, 2006.

Use of Estimates The preparation of the consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the dates of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Our most significant financial estimates are based on remaining proved natural gas and oil reserves. Estimates of proved reserves are key components of our depletion rate for natural gas and oil properties, our unevaluated properties and our full cost ceiling test. In addition, estimates are used in computing taxes, preparing accruals of operating costs and production revenues, asset retirement obligations, fair value and effectiveness of derivative instruments and fair value of stock options and the related compensation expense. Because of the inherent nature of the estimation process, actual results could differ materially from these estimates.

Principles of Consolidation Our consolidated financial statements as of March 31, 2007 and December 31, 2006 include our accounts and the accounts of our wholly-owned subsidiaries. All significant inter-company balances and transactions have been eliminated.

Reclassifications Certain prior year amounts have been reclassified to conform to current year presentation.

Income Taxes Our provision for taxes includes both federal and state taxes. The Company records its federal income taxes using an asset and liability approach which results in the recognition of deferred tax assets and liabilities for the expected future tax consequences of temporary differences between the book carrying amounts and the tax bases of assets and liabilities. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences and carryforwards are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. Valuation allowances are established when necessary to reduce deferred tax assets to the amount more likely than not to be recovered.

Recent Accounting Pronouncements During February 2007, Financial Accounting Standards Board (FASB) issued SFAS No 159, The Fair Value Option for Financial Assets and Financial Liabilities (SFAS No. 159), which permits all entities to choose, at specified election dates, to measure eligible items at fair value. SFAS No. 159 permits entities to choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value, and thereby mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. This Statement also establishes presentation and disclosure requirements designed to facilitate comparisons between entities that choose different measurement attributes for similar types of assets and liabilities. SFAS No. 159 is effective as of the beginning of an entity s first fiscal year that begins after November 15, 2007. We are evaluating the impact that this standard will have on our financial statements.

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements, which establishes guidelines for measuring fair value and expands disclosures regarding fair value measurements. SFAS No. 157 does not require any new fair value measurements but rather it eliminates inconsistencies in the guidance found in various prior accounting pronouncements. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007. Earlier adoption is encouraged, provided a company has not yet issued financial statements, including for interim periods, for that fiscal year. Although we are still evaluating the potential effects of this standard, we do not expect the adoption of SFAS No. 157 to have a material impact on our consolidated financial position, results of operation, or cash flows.

In July 2006, the FASB issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109 (FIN 48), which clarifies the accounting and disclosure for uncertainty in tax positions, as defined. FIN48 seeks to reduce the diversity in practice associated with certain aspects of the recognition and measurement related to accounting for income taxes.

The Company is subject to the provisions of FIN 48 as of January 1, 2007. As of the adoption date, Mariner did not have a gross tax-affected unrecognized tax benefit and does not reasonably estimate that to change significantly within the next 12 months. In addition, the Company did not record a cumulative effect adjustment related to the adoption of FIN 48.

The Company has analyzed filing positions in all of the federal and state jurisdictions where it is required to file income tax returns, as well as all open tax years in these jurisdictions. The Company has identified its federal tax return and its state tax return filing in Texas as major tax jurisdictions.

The periods subject to examination for the Company s federal return are the years 2003 through 2006. The tax years 1999, 2000 and 2002 are subject to adjustment to the extent of net operating losses generated in those years. In the first quarter of 2007, the Texas Comptroller of Public Accounts performed a tax audit for the years 2004 through 2006. The Company s Texas tax filing positions and deductions were sustained on audit, therefore, no reserves for uncertain income tax positions were recorded pursuant to FIN 48.

Interest on unrecognized tax benefits, if incurred, would be reported in interest expense. Penalties, if incurred, would be recorded in earnings before taxes.

2. Acquisitions and Dispositions

Forest Gulf of Mexico Operations On March 2, 2006, a subsidiary of the Company completed a merger transaction with Forest Energy Resources, Inc. (the Forest Merger). Prior to the consummation of the Forest Merger, Forest Oil Corporation (Forest) transferred and contributed the assets of, and certain liabilities associated with, its offshore Gulf of Mexico operations to Forest Energy Resources, Inc. Immediately prior to the Forest Merger, Forest distributed all of the outstanding shares of Forest Energy Resources, Inc. to Forest shareholders on a pro rata basis. Forest Energy Resources, Inc. then merged with a newly formed subsidiary of Mariner, became a new wholly owned subsidiary of Mariner and changed its name to Mariner Energy Resources, Inc. (MERI). Immediately following the Forest Merger, approximately 59% of Mariner common stock was held by shareholders of Forest and approximately 41% of Mariner common stock was held by the pre-Forest Merger stockholders of Mariner.

To acquire MERI, Mariner issued 50,637,010 shares of its common stock to the shareholders of Forest Energy Resources, Inc. The aggregate consideration was valued at $890.0 million, comprised of $3.8 million in pre-Forest Merger costs and $886.2 million in common stock, based on the closing price of the Company s common stock of $17.50 per share on September 12, 2005 (which was the date that the terms of the acquisition were announced).

The Forest Merger was accounted for using the purchase method of accounting under the accounting standards established in SFAS No. 141, Business Combinations (SFAS 141) and No. 142, Goodwill and Other Intangible

Assets. As a result, the assets and liabilities acquired by Mariner in the Forest Merger are included in the Company s December 31, 2006 balance sheet. The Company reflected the results of operations of the Forest Merger beginning March 2, 2006. The Company recorded the estimated fair values of the assets acquired and liabilities assumed at the March 2, 2006 closing date, which are summarized in the following table:

	(In millions)
Oil and natural gas properties	$ 1,211.4
Abandonment liabilities	(165.2)
Long-term debt	(176.2)
Fair value of oil and natural gas derivatives	(17.5)
Deferred tax liability	(199.4)
Other assets and liabilities	(24.5)
Goodwill	261.4
Net Assets Acquired	$ 890.0

The Forest Merger includes a large undeveloped offshore acreage position which complements the Company s large seismic database and a large portfolio of potential exploratory prospects. The initial fair value estimate of the underlying assets and liabilities acquired is determined by estimating the value of the underlying proved reserves at the transaction date plus or minus the fair value of other assets and liabilities, including inventory, unproved oil and gas properties, gas imbalances, debt (at face value), derivatives, and abandonment liabilities. The deferred tax liability recognizes the difference between the historical tax basis of the assets of Forest Energy Resources, Inc. and the acquisition cost recorded for book purposes. Goodwill represents the excess of the purchase price over the estimated fair value of the assets acquired net of the fair value of liabilities assumed in the acquisition. The entire goodwill balance is non-deductible for tax purposes.

The purchase price allocation has been finalized. In 2006, we recorded a $27.1 million goodwill adjustment primarily related to insurance receivables and deferred taxes. In April 2006, Mariner made a preliminary cash payment of $20.8 million to Forest pursuant to the distribution agreement that was part of the merger documentation. The payment reduced current liabilities. Carryover basis accounting applies for tax purposes.

On March 2, 2006, Mariner and MERI entered into a $500 million bank credit facility and an additional $40 million senior secured letter of credit. Please refer to Note 3, Long Term Debt for further discussion of the amended and restated bank credit facility.

Interest in Cottonwood On December 1, 2006, we completed the sale of our 20% interest in the Garden Banks 244 (Cottonwood) project to Petrobras America, Inc., for $31.8 million. The sale was effective November 1, 2006 and represented approximately 6.6 Bcfe of proved reserves. Proceeds from the sale were deposited in trust with a qualified intermediary to preserve our ability to reinvest them in a tax-deferred, like-kind exchange transaction for federal income tax purposes. Inasmuch as we elected not to identify replacement like-kind property to facilitate the exchange, proceeds and related interest totaling $32.0 million were disbursed to us on January 19, 2007 and used to repay borrowings under our bank credit facility. No gain was recorded on this disposition.

3. Long-Term Debt

Bank Credit Facility On March 2, 2004, the Company obtained a revolving line of credit with initial advances of $135 million from a group of banks led by Union Bank of California, N.A. and BNP Paribas. The bank credit facility initially provided up to $150 million of revolving borrowing capacity, subject to a borrowing base, and a $25 million term loan. The initial advance was made in two tranches: a $110 million Tranche A and a $25 million Tranche B. The Tranche B loan was converted to a Tranche A note in July 2004 and all subsequent advances under the bank credit facility were Tranche A advances.

The borrowing base is based upon the evaluation by the lenders of the Company s oil and gas reserves and other factors. Any increase in the borrowing base requires the consent of all lenders. Substantially all of the Company s assets are pledged to secure the bank credit facility.

Amendments of Bank Credit Facility In connection with the Forest Merger, the Company amended and restated its existing bank credit facility on March 2, 2006 to, among other things, increase maximum credit availability to $500 million for revolving loans, including up to $50 million in letters of credit, with a $400 million borrowing base as of that date; add an additional dedicated $40 million letter of credit that does not affect the borrowing base; and add MERI as a co-borrower. The bank credit facility will mature on March 2, 2010, and the $40 million letter of credit will mature on March 2, 2009. The Company used borrowings under its bank credit facility to facilitate the Forest Merger and to retire existing debt, and it may use borrowings in the future for general corporate purposes. The $40 million letter of credit was obtained in favor of Forest to secure the Company s performance of its obligations to drill and complete 150 wells under an existing drill-to-earn program and is not included as a use of the borrowing base. This letter of credit will reduce periodically by an amount equal to the product of $0.5 million times the number of wells exceeding 75 that are drilled and completed. As of March 31, 2007, 118 wells had been drilled and completed. The letter of credit balance as of March 31, 2007 was $21.9 million, and has been reduced to $17.1 million effective May 1, 2007.

At March 31, 2007, the Company had approximately $314.0 million in advances outstanding under its bank credit facility and four outstanding letters of credit totaling $16.3 million, of which $14.6 million is required for plugging and abandonment obligations at certain of its offshore fields. The outstanding principal balance of loans under the bank credit facility may not exceed the borrowing base. If the borrowing base falls below the outstanding balance under the bank credit facility, the Company will be required to prepay the deficit, pledge additional unencumbered collateral, repay the deficit and cash collateralize certain letters of credit, or effect some combination

of such prepayment, pledge and repayment and collateralization. Effective March 22, 2007, the borrowing base was reaffirmed at $450 million, subject to redetermination or adjustment.

The bank credit facility contains various restrictive covenants and other usual and customary terms and conditions, including limitations on the payment of cash dividends and other restricted payments, the incurrence of additional debt, the sale of assets, and speculative hedging. The financial covenants were modified under the amended and restated bank credit facility to require the Company to, among other things:

maintain a ratio of consolidated current assets plus the unused borrowing base to consolidated current liabilities of not less than 1.0 to 1.0; and

maintain a ratio of total debt to EBITDA, as defined in the credit agreement, of not more than 2.5 to 1.0.

The Company was in compliance with the financial covenants under the bank credit facility as of March 31, 2007.

As of March 31, 2007 and December 31, 2006, $314.0 million and $354.0 million, respectively, was outstanding under the bank credit facility, and the weighted average interest rate was 7.04% and 7.29%, respectively.

The Company must pay a commitment fee of 0.25% to 0.375% per year on the unused availability under the bank credit facility.

7^1/2% Senior Notes due 2013 On April 24, 2006, the Company sold and issued to eligible purchasers $300 million aggregate principal amount of its 7^1/2% Senior Notes due 2013 (the 7^1/2% Notes) pursuant to Rule 144A under the Securities Act of 1933, as amended. The 7^1/2% Notes were priced to yield 7.75% to maturity. Net proceeds, after deducting initial purchasers discounts and commissions and offering expenses, were approximately $287.9 million. Mariner used the net proceeds of the offering to repay debt under the bank credit facility. The issuance of the 7^1/2% Notes was a qualifying bond issuance under Mariner s bank credit facility and resulted in an automatic reduction of its borrowing base to $362.5 million as of April 24, 2006. On November 9, 2006, the Company replaced the original Notes issued in the private placement with new Notes with identical terms and tenor through an exchange offer registered under the Securities Act of 1933.

The 7^1/2% Notes are senior unsecured obligations of the Company, rank senior in right of payment to any future subordinated indebtedness, rank equally in right of payment with the Company s existing and future senior unsecured indebtedness and are effectively subordinated in right of payment to the Company s senior secured indebtedness, including its obligations under its bank credit facility, to the extent of the collateral securing such indebtedness, and to all existing and future indebtedness and other liabilities of any non-guarantor subsidiaries.

The 7^1/2% Notes are jointly and severally guaranteed on a senior unsecured basis by the Company s existing and future domestic subsidiaries. In the future, the guarantees may be released or terminated under certain circumstances. Each subsidiary guarantee ranks senior in right of payment to any future subordinated indebtedness of the guarantor subsidiary, ranks equally in right of payment to all existing and future senior unsecured indebtedness of the guarantor subsidiary and effectively subordinate to all existing and future secured indebtedness of the guarantor subsidiary, including its guarantees of indebtedness under the Company s bank credit facility, to the extent of the collateral securing such indebtedness.

Interest on the 7^1/2% Notes is payable on April 15 and October 15 of each year. The 7^1/2% Notes mature on April 15, 2013. There is no sinking fund for the 7^1/2% Notes.

The Company may redeem the 7^1/2% Notes at any time prior to April 15, 2010 at a price equal to the principal amount redeemed plus a make-whole premium, using a discount rate of the Treasury rate plus 0.50% and accrued but unpaid interest. Beginning on April 15 of the years indicated below, the Company may redeem the 7^1/2% Notes from time to time, in whole or in part, at the prices set forth below (expressed as percentages of the principal amount redeemed) plus accrued but unpaid interest:

2010 at 103.750%

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2011 at 101.875%
2012 and thereafter at 100.000%

In addition, prior to April 15, 2009, the Company may redeem up to 35% of the $7^1/2$% Notes with the proceeds of equity offerings at a price equal to 107.50% of the principal amount of the $7^1/2$% Notes redeemed. If the Company experiences a change of control (as defined in the indenture governing the $7^1/2$% Notes), subject to certain exceptions, the Company must give holders of the $7^1/2$% Notes the opportunity to sell to the Company their Notes, in whole or in part, at a purchase price equal to 101% of the principal amount, plus accrued and unpaid interest and liquidated damages to the date of purchase.

The Company and its restricted subsidiaries are subject to certain negative covenants under the indenture governing the $7^1/2$% Notes. The indenture governing the $7^1/2$% Notes limits the Company s and each of its restricted subsidiaries ability to, among other things:

make investments;

incur additional indebtedness or issue preferred stock;

create certain liens;

sell assets;

enter into agreements that restrict dividends or other payments from its subsidiaries to itself;

consolidate, merge or transfer all or substantially all of its assets;

engage in transactions with affiliates;

pay dividends or make other distributions on capital stock or subordinated indebtedness; and

create unrestricted subsidiaries.

Costs associated with the $7^1/2$% Notes offering were approximately $8.5 million, excluding discounts of $3.8 million.

JEDI Term Promissory Note On March 2, 2004, the Company issued a $10 million term promissory note to Joint Energy Development Investments Limited Partnership (JEDI) as a part of consideration in a merger that resulted in JEDI s disposition of its ownership interest in the Company s indirect parent. The note matured on March 2, 2006, and bore interest, payable in kind at our option, at a rate of 10% per annum until March 2, 2005, and 12% per annum thereafter unless paid in cash in which event the rate remained 10% per annum. We chose to pay interest in cash rather than in kind. The JEDI note was secured by a lien on three of the Company s non-proven, non-producing properties located in the Outer Continental Shelf of the Gulf of Mexico. The Company could offset against the note the amount of certain claims for indemnification that could be asserted against JEDI under the terms of the merger agreement. The JEDI term promissory note contained customary events of default, including the occurrence of an event of default under the Company s bank credit facility. In March 2005, the Company repaid $6.0 million of the note utilizing proceeds from the private equity placement in March 2005. The $4.0 million balance remaining on the JEDI note was repaid in full on its maturity date of March 2, 2006.

Cash Interest Expense Cash paid for interest was $6.7 million and $3.5 million for the three-month periods ending March 31, 2007 and 2006, respectively.

Bank Debt Issuance Costs The Company capitalizes certain direct costs associated with the issuance of long term debt. In conjunction with the Forest Merger, the Company s bank credit facility was amended and restated to, among other things, increase the borrowing capacity from $185 million to $400 million, based upon an initial borrowing base of that amount. The amendment and restatement was treated as an extinguishment of debt for accounting purposes. This treatment resulted in a charge of approximately $1.2 million in the first quarter of 2006.

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This charge is included in the interest expense line of the consolidated statement of operations.

4. Oil and Gas Properties

Oil and gas properties are accounted for using the full-cost method of accounting. All direct costs and certain indirect costs associated with the acquisition, exploration and development of oil and gas properties are capitalized. Amortization of oil and gas properties is provided using the unit-of-production method based on estimated proved oil and gas reserves. No gains or losses are recognized upon the sale or disposition of oil and gas properties unless the sale or disposition represents a significant quantity of oil and gas reserves, which would have a significant impact on the depreciation, depletion and amortization rate.

At the end of each quarter, a full-cost ceiling limitation calculation is made whereby net capitalized costs related to proved and unproved properties less related deferred income taxes may not exceed a ceiling amount equal to the present value discounted at 10% of estimated future net revenues from proved reserves plus the lower of cost or fair value of unproved properties less estimated future production and development costs and related income tax expense. The full-cost ceiling limitation is calculated using natural gas and oil prices in effect as of the balance sheet date and is adjusted for basis or location differential. Price is held constant over the life of the reserves. We use derivative financial instruments that qualify for cash flow hedge accounting under SFAS 133, Accounting for Derivative Instruments and Hedging Activities, to hedge against the volatility of natural gas prices and, in accordance with SEC guidelines, we include estimated future cash flows from our hedging program in our ceiling test calculation. If net capitalized costs related to proved properties less related deferred income taxes were to exceed the ceiling amount, the excess would be charged to expense. Additional guidance was provided in Staff Accounting Bulletin No. 47, Topic 12(D)(c)(3), primarily regarding the use of cash flow hedges, asset retirement obligations, and the effect of subsequent events on the ceiling test calculation. Once incurred, a write-down is not reversible at a later date.

5. Accrual for Future Abandonment Costs

SFAS No. 143, Accounting for Asset Retirement Obligations, addresses accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. The Company adopted SFAS No. 143 on January 1, 2003. SFAS No. 143 requires that the fair value of a liability for an asset s retirement obligation be recorded in the period in which it is incurred and the corresponding cost capitalized by increasing the carrying amount of the related long-lived asset. The liability is accreted to its then present value each period, and the capitalized cost is depreciated over the useful life of the related asset. If the liability is settled for an amount other than the recorded amount, a gain or loss is recognized.

The following roll forward is provided as a reconciliation of the beginning and ending aggregate carrying amounts of the asset retirement obligation.

	(In millions)
Abandonment liability as of December 31, 2006 (1)	$ 218.0
Liabilities Incurred	0.5
Liabilities Settled	(3.4)
Accretion Expense	4.4
Revisions to previous estimates	0.2
Abandonment Liability as of March 31, 2007 (2)	$ 219.7

(1) Includes $29.7 million classified as a current accrued liability at December 31, 2006.

(2) Includes $36.5 million classified as a current accrued liability at March 31, 2007.

6. Stockholders Equity

Equity Participation Plan We adopted an Equity Participation Plan, as amended, that provided for the one-time grant at the closing of our private equity placement on March 11, 2005 of 2,267,270 restricted shares of our common stock to certain of our employees. No further grants will be made under the Equity Participation Plan, although persons who received such a grant are eligible for future awards of restricted stock or stock options under our Stock Incentive Plan, as amended or restated from time to time, described below. We intended the grants of restricted stock under the Equity Participation Plan to serve as a means of incentive compensation for performance and not primarily as an opportunity to participate in the equity appreciation of our common stock. Therefore, Equity Participation Plan grantees did not pay any consideration for the common stock they received, and we received no remuneration for the stock. As a result of closing the Forest Merger, all shares of restricted stock granted under the Equity Participation Plan vested as follows: (i) the 463,656 shares of restricted stock held by non-executive employees vested on March 2, 2006, and (ii) the 1,803,614 shares of restricted stock held by executive officers vested on May 31, 2006 pursuant to an agreement, made in exchange for a cash payment of $1,000 to each officer, that his or her shares of restricted stock would not vest before the later of March 11, 2006 or 90 days after the effective date of the Forest Merger. The Equity Participation Plan expired upon the vesting of all shares granted thereunder. Stock could be withheld by us upon vesting to satisfy our tax withholding obligations with respect to the vesting of the restricted stock. Participants in the Equity Participation Plan had the right to elect to have us withhold and cancel shares of the restricted stock to satisfy our tax withholding obligations. In such events, we would be required to pay any tax withholding obligation in cash. As a result of such participant elections, we withheld an aggregate 807,376 shares that otherwise would have remained outstanding upon vesting of the restricted stock, reducing the aggregate outstanding vested stock grants made under the Equity Participation Plan to 1,459,894 shares. The 807,376 shares withheld became treasury shares that were retired and restored to the status of authorized and unissued shares of common stock, and the Company s capital was reduced by an amount equal to the $.0001 par value of the retired shares. We paid in cash the associated withholding taxes of $14.0 million, of which $3.3 million and $10.7 million were paid in the first and second quarter of 2006, respectively.

Stock Incentive Plan We adopted a Stock Incentive Plan that became effective March 11, 2005, was amended and restated on March 2, 2006, further amended on March 16, 2006, and amended and restated on February 6, 2007. Awards to participants under the Stock Incentive Plan may be made in the form of incentive stock options (ISOs), non-qualified stock options or restricted stock. The participants to whom awards are granted, the type or types of awards granted to a participant, the number of shares covered by each award, and the purchase price, conditions and other terms of each award are determined by the Board of Directors or a committee thereof. A total of 6,500,000 shares of Mariner s common stock is subject to the Stock Incentive Plan. No more than 2,850,000 shares issuable upon exercise of options or as restricted stock can be issued to any individual. Unless sooner terminated, no award may be granted under the Stock Incentive Plan after October 12, 2015.

During the three months ended March 31, 2007, no options or shares of restricted common stock under the Stock Incentive Plan were granted. As of March 31, 2007, 818,922 shares of unvested restricted common stock and options to purchase 707,920 shares of the Company s common stock remained outstanding under the Stock Incentive Plan, of which 526,589 were presently exercisable. As of March 31, 2007, 4,880,706 shares remained available for future issuance to participants under the Stock Incentive Plan. During the three months ended March 31, 2007, 48,608 shares of restricted stock vested, resulting in withholding tax obligations. Plan participants can elect to have us withhold and cancel shares of restricted stock to satisfy the associated tax withholding obligations. In such event, we would be required to pay any tax withholding obligation in cash. As a result of such participant elections, we withheld an aggregate 10,724 shares that otherwise would have remained outstanding upon vesting of the restricted stock. The shares withheld became treasury shares that were retired and restored to the status of authorized and unissued shares of common stock, and the Company s capital was reduced by an amount equal to the $.0001 par value of the retired shares. We paid in cash the associated withholding taxes of approximately $187,000.

Rollover Options In connection with the Forest Merger and during the 12 months ended December 31, 2006, the Company granted options to acquire 156,626 shares of its common stock to certain former employees of Forest or Forest Energy Resources, Inc. (Rollover Options). The Rollover Options are evidenced by non-qualified stock option agreements and are not covered by the Stock Incentive Plan. As of March 31, 2007, Rollover Options to purchase 90,506 shares of the Company s common stock remained outstanding, of which 27,928 were presently exercisable.

Accounting for Stock Options and Restricted Stock The Company adopted SFAS No. 123-Revised 2004 (SFAS No. 123(R)), *Share-Based Payment,* using the modified retrospective application effective January 1, 2005. As a result of the adoption of SFAS No. 123(R), we recorded compensation expense for the fair value of restricted stock that was granted pursuant to our Equity Participation Plan. We also recorded compensation expense for the value of restricted stock and options granted under the Stock Incentive Plan. In general, compensation expense will be determined at the date of grant based on the fair value of the stock or options granted. The fair value

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will then be amortized to compensation expense over the applicable vesting period. We recorded compensation expense of $1.5 million and $6.4 million for the three-month periods ended March 31, 2007 and 2006, respectively, related to restricted stock and stock options. As of May 31, 2006, the participants were fully vested in the restricted stock granted under the Equity Participation Plan and no unrecognized compensation remains. Under the Stock Incentive Plan, unrecognized compensation expense at March 31, 2007 for the unvested portion of restricted stock granted was $13.1 million and for unvested options was $0.6 million.

The following table presents a summary of stock option activity for the three months ended March 31, 2007:

	Shares	Weighted Average Exercise Price	Aggregate Intrinsic Value (1) ($000)
Outstanding at beginning of year	802,322	$ 13.77	
Granted			
Exercised	(3,896)	$ 11.59	
Forfeited			
Outstanding at March 31, 2007	798,426	$ 13.78	$ 4,272
Vested and expected to vest (2)	755,725	$ 13.78	$ 4,043
Outstanding exercisable at March 31, 2007	554,517	$ 13.89	$ 2,906
Available for future grant as options or restricted stock	4,880,706		

(1) Based upon the difference between the market price of the common stock on the last trading date of the quarter and the option exercise price of in-the-money options.

(2) The Company s estimated forfeiture rate was actualized at December 31, 2006 and was applied in the calculation of options expected to vest as of March 31, 2007.

For the three month period ended March 31, 2007, 3,896 options were exercised resulting in a $45,000 increase in cash. The following table summarizes certain information about stock options outstanding at March 31, 2007:

	Options Outstanding			Options Exercisable
Exercise Price	Shares Outstanding	Weighted Average Remaining Contractual Life (Years)	Expected Term	Weighted Average Shares Exercisable
$8.81	1,056	5.91	6.00	1,056
$9.48	5,283	6.91	6.00	2,642
$9.67	1,321	6.83	6.00	
$11.44	4,952	7.63	6.00	1,651
$11.59	67,330	7.69	6.00	19,277
$14.00	706,880	8.07	6.00	525,549
$15.50				(3,000)
$16.86	10,564	8.38	6.00	2,641
$17.00	1,040	8.47	6.00	1,040

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The following table summarizes certain information about stock options outstanding at March 31, 2006: