PETROHAWK ENERGY CORP
Form 10-Q
December 05, 2011

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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 September 30, 2011
Commission file number 001-33334

PETROHAWK ENERGY CORPORATION

(Exact name of registrant as specified in its charter)

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

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

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

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act:

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

smaller reporting company)

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

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

The registrant is a wholly owned subsidiary of BHP Billiton Limited and meets the conditions set forth in General Instruction H(1)(a) and (b) of Form 10-Q and is therefore filing this Form with a reduced disclosure format as permitted by Instruction H(2).

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Special note regarding forward-looking statements

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

- our ability to successfully integrate our business with affiliates of BHP Billiton Limited;
- our ability to retain key members of senior management and key technical employees;
- volatility in commodity prices for oil and natural gas;
- the possibility that our industry may be subject to future regulatory or legislative actions (including any additional taxes and changes in environmental regulation);
- the presence or recoverability of estimated oil and natural gas reserves and the actual future production rates and associated costs;
- the potential for production decline rates for our wells to be greater than we expect;
- our ability to replace oil and natural gas reserves;
- environmental risks;
- drilling and operating risks;
- exploration and development risks;
- competition, including competition for acreage in resource play areas;
- management's ability to execute our plans to meet our goals;

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

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

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

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

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

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

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

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

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PART I. FINANCIAL INFORMATION

Item 1. Condensed Consolidated Financial Statements (Unaudited)

PETROHAWK ENERGY CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (Unaudited)

(In thousands)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010 Restated(1)	2011	2010 Restated(1)
Operating revenues:				
Oil and natural gas	$ 491,288	$ 280,328	$ 1,285,225	$ 820,753
Marketing	5,916	122,981	295,946	360,438
Midstream	5,019	4,860	12,167	16,429
Total operating revenues	502,223	408,169	1,593,338	1,197,620
Operating expenses:				
Marketing	6,319	139,053	322,266	392,984
Production:				
Lease operating	17,333	15,794	43,670	49,573
Workover and other	2,863	2,758	12,047	6,707
Taxes other than income	18,563	(2,995)	48,142	15,025
Gathering, transportation and other	56,223	24,047	99,736	76,546
General and administrative	132,982	40,974	224,463	116,503
Depletion, depreciation and amortization	231,726	109,987	590,507	316,093
Total operating expenses	466,009	329,618	1,340,831	973,431
Income from operations	36,214	78,551	252,507	224,189
Other income (expenses):				
Net gain on derivative contracts	199,440	147,892	232,040	345,970
Interest expense and other	(108,658)	(125,858)	(283,297)	(254,945)
Total other income (expenses)	90,782	22,034	(51,257)	91,025
Income from continuing operations before income taxes	126,996	100,585	201,250	315,214
Income tax provision	(45,350)	(39,400)	(73,571)	(122,841)
Income from continuing operations, net of income taxes	81,646	61,185	127,679	192,373
Loss from discontinued operations, net of income taxes	(42)	(828)	(3,201)	(1,493)
Net income	$ 81,604	$ 60,357	$ 124,478	$ 190,880

(1) See further discussion at Note 13, *"Restatement."*

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

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PETROHAWK ENERGY CORPORATION

CONDENSED CONSOLIDATED BALANCE SHEETS (Unaudited)

(In thousands, except share amounts)

	September 30, 2011	December 31, 2010 Restated(1)
Current assets:		
Cash	$ 100,925	$ 1,591
Accounts receivable	398,052	356,597
Receivables from derivative contracts	250,663	217,018
Prepaids and other	49,536	62,831
Total current assets	799,176	638,037
Oil and natural gas properties (full cost method):		
Evaluated	9,819,839	7,520,446
Unevaluated	2,458,854	2,387,037
Gross oil and natural gas properties	12,278,693	9,907,483
Less accumulated depletion	(5,339,688)	(4,774,579)
Net oil and natural gas properties	6,939,005	5,132,904
Other operating property and equipment:		
Gas gathering systems and equipment	804,207	593,388
Other operating assets	94,893	55,315
Gross other operating property and equipment	899,100	648,703
Less accumulated depreciation	(50,151)	(27,635)
Net other operating property and equipment	848,949	621,068
Other noncurrent assets:		
Goodwill	932,802	932,802
Other intangible assets, net of amortization	81,053	89,342
Debt issuance costs, net of amortization	62,133	45,941
Deferred income taxes	281,622	316,546
Receivables from derivative contracts	46,247	41,721
Assets held for sale		74,448
Other	11,124	6,944
Total assets	$ 10,002,111	$ 7,899,753
Current liabilities:		
Accounts payable and accrued liabilities	$ 886,310	$ 787,238
Deferred income taxes	51,898	45,815
Liabilities from derivative contracts	398	5,820
Payable to KinderHawk Field Services LLC		976
Payable on financing arrangements	16,809	7,052
Long-term debt	27,285	14,790
Total current liabilities	982,700	861,691
Long-term debt	3,250,842	2,612,852
Other noncurrent liabilities:		
Liabilities from derivative contracts		13,575

Asset retirement obligations	44,075	31,741
Payable on financing arrangements	1,757,864	933,811
Other	649	544
Commitments and contingencies (Note 7)		
Stockholders' equity:		
Common stock: 100 and 500,000,000 shares of $.001 par value authorized; 100 and 302,489,501 shares issued and outstanding at September 30, 2011 and December 31, 2010, respectively		302
Additional paid-in capital	5,027,875	4,631,609
Accumulated deficit	(1,061,894)	(1,186,372)
Total stockholders' equity	3,965,981	3,445,539
Total liabilities and stockholders' equity	$ 10,002,111	$ 7,899,753

(1)

See further discussion at Note 13, *"Restatement."*

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

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PETROHAWK ENERGY CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)

(In thousands)

	Nine Months Ended September 30, 2011	Nine Months Ended September 30, 2010 Restated(1)
Cash flows from operating activities:		
Net income	$ 124,478	$ 190,880
Adjustments to reconcile net income to net cash provided by operating activities:		
Depletion, depreciation and amortization	589,160	319,919
Income tax provision	71,593	121,886
Loss on sale	3,950	
Stock-based compensation	53,203	17,038
Net unrealized gain on derivative contracts	(50,580)	(190,228)
Other operating	29,140	75,098
Change in assets and liabilities:		
Accounts receivable	(51,272)	(136,655)
Receivable from KinderHawk Field Services LLC		(780)
Prepaids and other	13,295	(28,530)
Accounts payable and accrued liabilities	(12,409)	(22,967)
Payable to KinderHawk Field Services LLC	(976)	
Other	(3,879)	16,752
Net cash provided by operating activities	765,703	362,413
Cash flows from investing activities:		
Oil and natural gas capital expenditures	(2,353,101)	(1,731,707)
Proceeds received from sale of oil and natural gas properties	86,438	613,317
Proceeds received from sale of Fayetteville gas gathering systems	76,898	
Marketable securities purchased	(896,006)	(1,091,005)
Marketable securities redeemed	896,006	1,091,005
Increase in restricted cash	(295,748)	(198,209)
Decrease in restricted cash	295,748	368,991
Other operating property and equipment capital expenditures	(236,570)	(223,111)
Net cash used in investing activities	(2,426,335)	(1,170,719)
Cash flows from financing activities:		
Proceeds from exercise of stock options	5,426	1,821
Contribution from parent	628,375	
Restricted stock awards settled	(85,904)	
Stock option awards and stock option appreciation rights settled	(224,216)	
Proceeds from borrowings	4,386,500	2,184,000
Repayment of borrowings	(3,752,157)	(2,274,888)
Increase in payable on financing arrangements	836,355	921,408
Decrease in payable on financing arrangements	(4,008)	
Debt issuance costs	(25,982)	(17,706)
Other	(4,423)	(3,688)
Net cash provided by financing activities	1,759,966	810,947

Net increase in cash		99,334		2,641
Cash at beginning of period		1,591		1,511
Cash at end of period	$	100,925	$	4,152

(1)

See further discussion at Note 13, *"Restatement."*

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

PETROHAWK ENERGY CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

1. FINANCIAL STATEMENT PRESENTATION

Petrohawk Energy Corporation (Petrohawk or the Company) is engaged in the exploration, development and production of predominately natural gas properties located in the United States. As further discussed under the heading "*Merger*" below, on August 25, 2011, BHP Billiton Limited, a corporation organized under the laws of Victoria, Australia (BHP Billiton Limited), acquired 100% of the outstanding shares of Petrohawk through the merger of a wholly owned subsidiary of BHP Billiton Petroleum (North America) Inc., a Delaware corporation (which is a wholly owned subsidiary of BHP Billiton Limited), with and into Petrohawk, with Petrohawk continuing as the surviving entity. Petrohawk remains an indirect, wholly owned subsidiary of BHP Billiton Limited. The Company operates in two segments, oil and natural gas production and midstream operations. The unaudited condensed consolidated financial statements include the accounts of all majority-owned, controlled subsidiaries of the Company. All intercompany accounts and transactions have been eliminated. Certain prior year amounts have been reclassified to conform to the current year presentation. These unaudited condensed consolidated financial statements reflect, in the opinion of the Company's management, all adjustments, consisting only of normal and recurring adjustments, necessary to present fairly the financial position as of, and the results of operations for, the periods presented. During interim periods, Petrohawk follows the accounting policies disclosed in its 2010 Annual Report on Form 10-K, as amended, filed with the United States Securities and Exchange Commission (SEC). Please refer to the footnotes in the 2010 Annual Report on Form 10-K, as amended, when reviewing interim financial results.

Merger

On July 14, 2011, the Company entered into an agreement and plan of merger (Merger Agreement) with BHP Billiton Limited (Guarantor), BHP Billiton Petroleum (North America) Inc., a Delaware corporation (Parent) and a wholly owned subsidiary of Guarantor, and North America Holdings II Inc., a Delaware corporation (Purchaser) and a wholly owned subsidiary of Parent, pursuant to which Purchaser commenced on July 25, 2011, an offer (Offer) to acquire all of the outstanding shares of the Company's common stock, par value $0.001 per share (Shares), for $38.75 per share, net to the seller in cash (the Offer Price), without interest, less any applicable withholding taxes.

On August 21, 2011, BHP Billiton Limited announced the completion of the Offer. The Offer expired at 12:00 midnight, New York City time, Friday, August 19, 2011 (the Expiration Date). According to Computershare Trust Company, N.A., the depositary (Depositary) for the Offer, as of the Expiration Date, approximately 293.9 million Shares had been validly tendered and not withdrawn pursuant to the Offer, including approximately 36.0 million Shares tendered by guaranteed delivery, which tendered shares represent approximately 97.4% of the total outstanding Shares. Purchaser accepted for payment all Shares validly tendered and not validly withdrawn pursuant to the Offer on or prior to the Expiration Date, and payment for such Shares was made in accordance with the terms of the Offer. Pursuant to the Merger Agreement, on August 25, 2011, Purchaser merged with and into Petrohawk, with Petrohawk continuing as the surviving corporation in the merger and as a wholly owned subsidiary of Parent (the BHP Merger).

At Parent's request and direction and as an inducement to Parent's willingness to enter into the Merger Agreement, the Company entered into retention agreements (Retention Agreements) with certain of the Company's executive officers contemporaneously with the execution of the Merger Agreement. The Retention Agreements became effective upon the acceptance for payment of Shares validly tendered and not withdrawn pursuant to the terms and conditions of the Offer (Acceptance

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PETROHAWK ENERGY CORPORATION

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

1. FINANCIAL STATEMENT PRESENTATION (Continued)

Time). The Retention Agreements continue the employment of each executive with the Company for a period of time following the Acceptance Time. For those executives who had employment agreements with the Company at such time, such employment agreements were superseded and replaced in their entirety by the Retention Agreements as of the effective time of such Retention Agreement. Floyd C. Wilson also entered into a consulting agreement (Consulting Agreement) with the Company beginning after the retention date specified in Mr. Wilson's Retention Agreement and ending six months thereafter under which Mr. Wilson will provide services to the Company and pursuant to which he will be entitled to separately specified compensation. Additional information regarding the Merger Agreement, Retention Agreements and Consulting Agreement is set forth in the Company's Form 8-K filed on July 20, 2011.

The company incurred approximately $89.3 million in charges related to the BHP Merger during the third quarter 2011. These costs are reported in "*General and administrative*" on the unaudited condensed consolidated statements of operations.

Use of Estimates

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

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

Marketing Revenue and Expense

Historically, for Louisiana and Arkansas production, a subsidiary of the Company purchased and sold the Company's own and third party natural gas produced from wells which the Company and third parties operated. The revenues and expenses related to these marketing activities were reported on a gross basis as part of operating revenues and operating expenses in historical periods. Marketing revenues were recorded at the time natural gas was physically delivered to third parties at a fixed or index price. Marketing expenses attributable to gas purchases were recorded as the subsidiary of the Company took physical title to natural gas and transported the purchased volumes to the point of sale. Effective July 1, 2011, the Company's marketing subsidiary ceased its marketing operations. Therefore, the Company will no longer reflect these activities on a gross basis on the unaudited condensed

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PETROHAWK ENERGY CORPORATION

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

1. FINANCIAL STATEMENT PRESENTATION (Continued)

consolidated statements of operations. As a result, certain items previously recorded to "*Marketing revenues*" will no longer be reported while others will now be recorded to "*Oil and natural gas revenues*" on the unaudited condensed consolidated statements of operations. In addition, certain charges previously reported in "*Marketing expenses*" will no longer be recorded while others will now be recorded to "*Gathering, transportation and other*" on the unaudited condensed consolidated statements of operations.

Midstream Revenues

Revenues from the Company's midstream operations are derived from providing gathering and treating services for the Company and other owners in wells which the Company and third parties operate. Revenues are recognized when services are provided at a fixed or determinable price, collectability is reasonably assured and evidenced by a contract. The midstream operations segment does not take title to the natural gas for which services are provided, with the exception of imbalances that are monthly cash settled. The imbalances are recorded using published natural gas market prices.

The contribution of the Company's Haynesville Shale gas gathering and treating business to KinderHawk Field Services LLC (KinderHawk) on May 21, 2010 for a 50% membership interest and approximately $917 million in cash is accounted for in accordance with the Financial Accounting Standards Board's (FASB) Accounting Standards Codification (ASC) Subtopic 360-20, *Property, Plant and Equipment Real Estate Sales* (ASC 360-20). Under the financing method for a failed sale of in substance real estate, the Company records KinderHawk's revenues, net of eliminations for intercompany amounts associated with gathering and treating services provided to the Company, on the unaudited condensed consolidated statements of operations in *"Midstream revenues."* On July 1, 2011, following the transfer of the Company's remaining 50% membership interest in KinderHawk to KM Gathering LLC (KM Gathering), KinderHawk's revenues are no longer recorded in the Company's unaudited condensed consolidated statements of operations in *"Midstream revenues."*

On July 1, 2011, the Company transferred a 25% interest in EagleHawk Field Services LLC (EagleHawk) to KM Eagle Gathering LLC (Eagle Gathering). The EagleHawk transaction is accounted for in accordance with ASC 360-20. Under the financing method for a failed sale of in substance real estate, the Company records EagleHawk's revenues, net of eliminations for intercompany amounts associated with gathering and treating services provided to the Company, on the unaudited condensed consolidated statements of operations in *"Midstream revenues."*

See Note 2, *"Acquisitions and Divestitures"* for more details regarding the KinderHawk and EagleHawk joint venture arrangements and for discussion of the accounting treatment related to the arrangements.

Gas Gathering Systems and Equipment and Other Operating Assets

Gas gathering systems and equipment are recorded at cost. Depreciation is calculated using the straight-line method over a 30-year estimated useful life. Upon disposition, the cost and accumulated depreciation are removed and any gains or losses are reflected in current operations. Maintenance and repair costs are charged to operating expense as incurred. Material expenditures which increase the life of an asset are capitalized and depreciated over the estimated remaining useful life of the asset. The Company capitalized $0.1 million and $1.8 million of interest for the three and nine months ended September 30, 2011, respectively, and $0.4 million and $2.9 million of interest for the three and nine

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PETROHAWK ENERGY CORPORATION

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

1. FINANCIAL STATEMENT PRESENTATION (Continued)

months ended September 30, 2010, respectively, related to the construction of the Company's gas gathering systems and equipment.

The contribution of the Company's Haynesville Shale gas gathering and treating business to KinderHawk on May 21, 2010 for a 50% membership interest and approximately $917 million in cash is accounted for in accordance with the ASC 360-20. Under the financing method, the historical cost of the Haynesville Shale gas gathering system contributed to KinderHawk is carried at the full historical basis of the assets on the unaudited condensed consolidated balance sheets in *"Gas gathering systems and equipment"* and depreciated over the remaining useful life of the assets. Contributions to KinderHawk from the Company and the joint venture partner are recorded as increases in *"Gas gathering systems and equipment"* on the unaudited condensed consolidated balance sheets. On July 1, 2011, the Company transferred its remaining 50% membership interest in KinderHawk to KM Gathering. In accordance with ASC 360-20, the historical cost of the Haynesville Shale gas gathering system is carried at the full historical basis of the assets on the unaudited condensed consolidated balance sheet and depreciated over the useful life of the assets.

The Company's transfer of a 25% interest in EagleHawk on July 1, 2011, to Eagle Gathering is accounted for in accordance with ASC 360-20. Under the financing method, the historical cost of the Eagle Ford Shale gas gathering systems contributed to EagleHawk is carried at the full historical basis of the assets on the unaudited condensed consolidated balance sheets in *"Gas gathering systems and equipment"* and depreciated over the remaining useful life of the assets. Contributions to EagleHawk from the Company and the joint venture partner are recorded as increases in *"Gas gathering systems and equipment"* on the unaudited condensed consolidated balance sheets.

See Note 2, *"Acquisitions and Divestitures"* for more details regarding the KinderHawk and EagleHawk joint venture arrangements and for discussion of the accounting treatment related to the arrangements.

Gas gathering systems and equipment as of September 30, 2011 and December 31, 2010 consisted of the following:

	September 30, 2011(1)(2)	December 31, 2010(1)(3)
	(In thousands)	
Gas gathering systems and equipment	$ 804,207	$ 748,112
Less accumulated depreciation	(26,867)	(22,170)
Net gas gathering systems and equipment	$ 777,340	$ 725,942

(1) Under the financing method, the historical cost of the Haynesville Shale gas gathering system contributed to KinderHawk is carried at the full historical basis of the assets on the unaudited condensed consolidated balance sheets in *"Gas gathering systems and equipment"* and depreciated over the remaining useful life of the assets. As of September 30, 2011 and December 31, 2010, the table above includes approximately $423.7 million and $434.6 million, respectively, attributed to the net carrying value of the assets contributed to KinderHawk.

PETROHAWK ENERGY CORPORATION

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

1. FINANCIAL STATEMENT PRESENTATION (Continued)

(2) Under the financing method, the historical cost of the Eagle Ford Shale gas gathering systems contributed to EagleHawk is carried at the full historical basis of the assets on the unaudited condensed consolidated balance sheets in *"Gas gathering systems and equipment"* and depreciated over the remaining useful life of the assets. As of September 30, 2011, the table above includes approximately $341.6 million attributed to the net carrying value of the assets contributed to EagleHawk.

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

Other operating property and equipment are recorded at cost. Depreciation is calculated using the straight-line method. Upon disposition, the cost and accumulated depreciation are removed and any gains or losses are reflected in current operations. Maintenance and repair costs are charged to operating expense as incurred. Material expenditures which increase the life of an asset are capitalized and depreciated over the estimated remaining useful life of the asset.

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

Payable on Financing Arrangements

The contribution of the Company's Haynesville Shale gas gathering and treating business to KinderHawk on May 21, 2010 for a 50% membership interest and approximately $917 million in cash is accounted for in accordance with ASC 360-20. Due to the gathering agreement entered into with the formation of KinderHawk, which constitutes extended continuing involvement under ASC 360-20, it has been determined that the contribution of the Company's Haynesville Shale gathering and treating system to form KinderHawk is accounted for as a failed sale of in substance real estate. See Note 2, *"Acquisitions and Divestitures"* for more details regarding the KinderHawk joint venture arrangement and for discussion of the accounting treatment related to the arrangement. Under the financing method for a failed sale of in substance real estate, on May 21, 2010, the Company recorded a financing obligation on the unaudited condensed consolidated balance sheets in *"Payable on financing arrangements,"* in the amount of approximately $917 million. Reductions to the obligation and the non cash interest on the financing obligation are tied to the gathering and treating services, as the Company

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PETROHAWK ENERGY CORPORATION

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

1. FINANCIAL STATEMENT PRESENTATION (Continued)

delivers natural gas through the Haynesville Shale gathering and treating system. Interest and principal are determined based upon the allocable income to the joint venture partner, and interest is limited up to an amount that is calculated based upon the Company's weighted average cost of debt as of the date of the transaction. Allocable income in excess of the calculated value is reflected as reductions of principal. Interest is recorded in *"Interest expense and other"* on the unaudited condensed consolidated statements of operations. On July 1, 2011, the Company transferred its remaining 50% membership interest in KinderHawk to KM Gathering. See further discussion in Note 2, *"Acquisitions and Divestitures."* As a result of the transfer on July 1, 2011, the Company recorded an increase in its financing obligation associated with KinderHawk of approximately $743.0 million.

The Company's transfer of a 25% interest in EagleHawk on July 1, 2011 to Eagle Gathering is accounted for in accordance with ASC 360-20. Due to the gathering agreements which constitute extended continuing involvement under ASC 360-20, it has been determined that the transfer of the Company's Eagle Ford Shale gathering and treating systems to EagleHawk is accounted for as a failed sale of in substance real estate. See Note 2, *"Acquisitions and Divestitures"* for more details regarding the EagleHawk joint venture arrangement and for discussion of the accounting treatment related to the arrangement. Under the financing method for a failed sale of in substance real estate, on July 1, 2011, the Company recorded a financing obligation on the unaudited condensed consolidated balance sheets in *"Payable on financing arrangements,"* in the amount of approximately $93 million. Reductions to the obligation and the non cash interest on the financing obligation are tied to the gathering and treating services, as the Company delivers natural gas through the Eagle Ford Shale gathering and treating systems. Interest and principal are determined based upon the allocable income to the joint venture partner, and interest is limited up to an amount that is calculated based upon the Company's weighted average cost of debt as of the date of the transaction. Allocable income in excess of the calculated value is reflected as reductions of principal. The balance of the Company's financing obligation as of September 30, 2011 and December 31, 2010, was approximately $1.8 billion and $940.9 million, respectively, of which approximately $16.8 million and $7.1 million was classified as current for the respective periods.

Goodwill

Goodwill represents the excess of the purchase price over the estimated fair value of the assets acquired net of the fair value of liabilities assumed in an acquisition. ASC 350, *Intangibles Goodwill and Other* (ASC 350) requires that intangible assets with indefinite lives, including goodwill, be evaluated on an annual basis for impairment or more frequently if events occur or circumstances change that could potentially result in impairment. The goodwill impairment test requires the allocation of goodwill and all other assets and liabilities to reporting units. The Company has determined that it has two reporting units: oil and natural gas production and midstream operations. All of the Company's goodwill has been allocated to its oil and natural gas production reporting unit as all of its historical goodwill relates to its acquisitions of oil and natural gas properties. The Company performs its goodwill test annually during the third quarter or more often if circumstances require. The Company completed its annual goodwill impairment test during the third quarter of 2011 and based on this review, no goodwill impairment was deemed necessary.

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PETROHAWK ENERGY CORPORATION

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

1. FINANCIAL STATEMENT PRESENTATION (Continued)

Other Intangible Assets

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

Amortization expense was $2.8 million and $8.3 million for the three and nine months ended September 30, 2011 and 2010, respectively. Historically, the Company allocated the amortization to operating expenses between "*Marketing*" and "*Gathering, transportation and other*" on the unaudited condensed consolidated statements of operations based on the usage of the contract. Effective July 1, 2011 and in conjunction with the elimination of the Company's marketing activities, this amortization will be included in "*Gathering, transportation and other*" only. The estimated amortization expense will be approximately $11.1 million per year for the remainder of the contract through 2019.

Other intangible assets subject to amortization at September 30, 2011 and December 31, 2010 are as follows:

	September 30, 2011	December 31, 2010
	(In thousands)	
Transportation contracts	$ 105,108	$ 105,108
Less accumulated amortization	(24,055)	(15,766)
Net transportation contracts	$ 81,053	$ 89,342

Assets Held for Sale

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

Discontinued Operations

Certain amounts related to the Company's Fayetteville Shale midstream operations and other operating property and equipment have been reclassified to discontinued operations for all periods presented. Unless otherwise noted, information contained in the notes to the unaudited condensed consolidated financial statements relates to the Company's continuing operations. See Note 12, "*Discontinued Operations,*" for further discussion of the presentation of the Company's Fayetteville Shale midstream and other operating assets as discontinued operations.

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PETROHAWK ENERGY CORPORATION

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

1. FINANCIAL STATEMENT PRESENTATION (Continued)

Recently Issued Accounting Pronouncements

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

In December 2010, the FASB issued ASU No. 2010-29, *Disclosure of Supplementary Pro Forma Information for Business Combinations* (ASU 2010-29). ASU 2010-29 requires a public entity who discloses comparative pro forma information for business combinations that occurred in the current reporting period to disclose revenue and earnings of the combined entity as though the business combination(s) occurred as of the beginning of the comparable prior annual period only. This update also expands the supplemental pro forma disclosures required to include a description of the nature and amount of material, nonrecurring pro forma adjustments directly attributable to the business combination included in the reported pro forma revenue and earnings. ASU 2010-29 is effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2010 and early adoption is permitted. The Company will apply the provisions of this update for any business combinations that occur after January 1, 2011.

In May 2011, the FASB issued ASU No. 2011-04, *Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs* (ASU 2011-04). The amendments in ASU 2011-04 are the result of the FASB's and the International Accounting Standards Board's (IASB) work to develop common requirements for measuring fair value and for disclosing information about fair value measurements in accordance with generally accepted accounting principles (GAAP) in the United States and the International Financial Reporting Standards (IFRS). ASU 2011-04 explains how to measure fair value and changes the wording used to describe many of the fair value requirements in GAAP, but does not require additional fair value measurements. The amendments in this update are to be applied prospectively to interim and annual reporting periods beginning after December 15, 2011. The Company is currently assessing the impact that the adoption of ASU 2011-04 will have on its operating results, financial position, cash flows and disclosures.

In July 2011, the FASB issued ASU No. 2011-06, *Fees Paid to the Federal Government by Health Insurers* (ASU 2011-06). This amendment discusses how health insurers should recognize and classify in their income statements the fees mandated by the Health Care and Education Reconciliation Act (the Acts). The Acts impose an annual fee upon health insurers for each calendar year on or after January 1, 2014. The annual fee imposed on the health insurance industry will be allocated to individual entities providing health insurance to employees based on a ratio, as provided for in the Acts. The health insurer's portion of the fee becomes payable to the United States Treasury once an entity provides health insurance for any United States health risk for each calendar year. ASU 2011-06

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PETROHAWK ENERGY CORPORATION

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

1. FINANCIAL STATEMENT PRESENTATION (Continued)

specifies that the liability for the entity's fee should be estimated and recorded in full once the entity has provided qualifying health insurance in the calendar year in which the fee is payable to the government. A corresponding deferred cost should be recorded and amortized on a straight line basis (unless a better amortization method is available) over the calendar year that the fee is payable. The amendments in this update are effective for calendar years beginning after December 15, 2013, once the fee is instituted. The Company is currently assessing the impact that the adoption of ASU 2011-06 will have on its operating results, financial position, cash flows and disclosures.

In September 2011, the FASB issued ASU No. 2011-08, *Testing for Goodwill Impairment* (ASU 2011-08) to simplify how companies test goodwill for impairment. ASU 2011-08 simplifies testing for goodwill impairments by allowing entities to first assess qualitative factors to determine whether the facts or circumstances lead to the conclusion that it is more likely than not that the fair value of a reporting unit is less than the carrying amount. If the entity concludes that it is not more likely than not that the fair value of a reporting unit is less than its carrying amount, then the entity does not have to perform the two-step impairment test. However, if that same conclusion is not reached, the company is required to perform the first step of the two-step impairment test. In this step, the fair value of the reporting unit is calculated and compared to the carrying amount of the reporting unit. If the carrying amount exceeds the fair value, then the entity must perform the second step of the impairment test to measure the amount of the impairment loss, if any. ASU 2011-08 allows a company to bypass the qualitative assessment and proceed directly with performing the two-step goodwill impairment test. ASU 2011-08 is effective for annual and interim goodwill impairment tests for fiscal years beginning after December 15, 2011 and early adoption is permitted. The Company adopted the provisions of ASU 2011-08 in its goodwill impairment test conducted in the third quarter of 2011. The Company opted to bypass the qualitative assessment and proceeded with the two-step goodwill impairment test. See further discussion above under the heading *"Goodwill"*.

2. ACQUISITIONS AND DIVESTITURES

Divestitures

Midstream Transactions

On July 1, 2011, the Company closed previously announced transactions with KM Gathering and Eagle Gathering, each of which is an affiliate of Kinder Morgan Energy Partners, L.P., a publicly traded master limited partnership (Kinder Morgan), in which Hawk Field Services LLC (Hawk Field Services) transferred (i) its remaining 50% membership interest in KinderHawk to KM Gathering and (ii) a 25% interest in EagleHawk to Eagle Gathering, in exchange for aggregate cash consideration of approximately $836 million. In conjunction with the closing of the transactions, the balance of the Company's capital commitment to KinderHawk, approximately $41.4 million as of July 1, 2011, was relieved. The Company's commitment to deliver certain minimum annual quantities of natural gas through the Haynesville gathering system through May 2015 was not relieved in the transfer. The effective date of the transactions is July 1, 2011. See *"Hawk Field Services, LLC Joint Venture"* below for more details regarding the initial joint venture arrangement between Hawk Field Services and Kinder Morgan and for discussion of the accounting treatment for both KinderHawk transactions.

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PETROHAWK ENERGY CORPORATION

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

2. ACQUISITIONS AND DIVESTITURES (Continued)

EagleHawk engages in the natural gas midstream business in the Eagle Ford Shale in South Texas. EagleHawk holds the Company's gathering and treating assets and business serving the Company's Hawkville and Black Hawk fields in the Eagle Ford Shale. EagleHawk has agreements with the Company covering gathering and treating of natural gas and transportation of condensate and pursuant to which the Company dedicates its production from its Eagle Ford Shale leases. Hawk Field Services manages EagleHawk's operations.

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

As a result of the failed sale the Company accounts for the continued operations of the gas gathering systems and reflects a financing obligation, representing the proceeds received, under the financing method of real estate accounting. Under the financing method, the historical cost of the Eagle Ford Shale gas gathering systems transferred to EagleHawk is carried at the full historical basis of the assets on the unaudited condensed consolidated balance sheets in *"Gas gathering systems and equipment"* and depreciated over the remaining useful life of the assets. The financing obligation is recorded on the unaudited condensed consolidated balance sheets in *"Payable on financing arrangements,"* in the amount of approximately $93 million. Reductions to the obligation and non cash interest on the financing obligation are tied to the gathering and treating services, as the Company delivers its production through the Eagle Ford Shale gathering and treating systems. Interest and principal are determined based upon the allocable income to Kinder Morgan, and interest is limited up to an amount that is calculated based upon the Company's weighted average cost of debt as of the date of the transaction. Allocable income in excess of the calculated value is reflected as reductions of principal. Interest is recorded in *"Interest expense and other"* on the unaudited condensed consolidated statements of operations. Additionally the Company records EagleHawk's revenues, net of eliminations for intercompany amounts associated with gathering and treating services provided to the Company, and expenses on the unaudited condensed consolidated statements of operations in *"Midstream revenues," "Taxes other than income," "Gathering, transportation and other," "General and administrative," "Interest expense and other"* and *"Depletion, depreciation and amortization."*

Fayetteville Shale

On December 22, 2010, the Company completed the sale of its interest in natural gas properties and related other operating property and equipment in the Fayetteville Shale for $575 million in cash, before customary closing adjustments. Proceeds from the sale of the interest in natural gas properties were recorded as a reduction to the carrying value of the Company's full cost pool with no gain or loss recorded. In conjunction with the sale of the related other operating property and equipment, the Company recorded a loss of approximately $0.5 million in the year ended December 31, 2010. On January 7, 2011, the Company completed the sale of its midstream assets in the Fayetteville Shale for

PETROHAWK ENERGY CORPORATION

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

2. ACQUISITIONS AND DIVESTITURES (Continued)

approximately $75 million in cash, before customary closing adjustments. As of December 31, 2010, the Fayetteville Shale midstream assets were classified as "*Assets held for sale*" on the Company's unaudited condensed consolidated balance sheet. "*Assets held for sale*" were recorded at the lesser of the carrying amount or the fair value less costs to sell, which resulted in a write down of the carrying amount of approximately $69.7 million in the year ended December 31, 2010. Both transactions had an effective date of October 1, 2010.

Mid-Continent Properties

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

Hawk Field Services, LLC Joint Venture

On May 21, 2010, Hawk Field Services and Kinder Morgan formed a joint venture pursuant to a Formation and Contribution Agreement (Contribution Agreement). The joint venture entity, KinderHawk, was engaged in the natural gas midstream business in Northwest Louisiana, focused on the Haynesville and Lower Bossier Shales. Pursuant to the Contribution Agreement, Hawk Field Services contributed to KinderHawk its Haynesville Shale gathering and treating business in Northwest Louisiana, and Kinder Morgan contributed approximately $917 million in cash ($875 million for a 50% membership interest in KinderHawk and $42 million for certain closing adjustments including 2010 capital expenditures through the closing date) to KinderHawk. Upon the completion of the transaction both the Company and Kinder Morgan held a 50% membership interest in KinderHawk. KinderHawk distributed approximately $917 million to Hawk Field Services. The joint venture had an economic effective date of January 1, 2010, and Hawk Field Services continued to operate the business until September 30, 2010, at which date Hawk Field Services and Kinder Morgan terminated the transition services agreement and KinderHawk assumed operations of the joint venture. On July 1, 2011, the Company transferred its remaining 50% membership interest in KinderHawk to KM Gathering.

The Company is obligated to deliver to KinderHawk agreed upon minimum annual quantities of natural gas from Petrohawk operated wells producing from the Haynesville and Lower Bossier Shales with specified acreage in Northwest Louisiana through May 2015, or in the alternative, pay an annual true-up fee to KinderHawk if such minimum annual quantities are not delivered. The Company pays KinderHawk negotiated gathering and treating fees, subject to an annual inflation adjustment factor. The gathering fee is equal to $0.34 per thousand cubic feet (Mcf) of natural gas delivered at KinderHawk's receipt points. The treating fee is charged for gas delivered containing more than 2% by volume of carbon dioxide. For gas delivered containing between 2% and 5.5% carbon dioxide, the treating fee is between $0.030 and $0.345 per Mcf, and for gas containing over 5.5% carbon dioxide, the treating fee starts at $0.365 per Mcf and increases on a scale of $0.09 per Mcf for each additional 1% of carbon dioxide content. The Company's obligation to deliver minimum annual quantities of natural gas to KinderHawk through May 2015 remained in effect following the transfer of the Company's remaining 50% membership interest in KinderHawk on July 1, 2011.

PETROHAWK ENERGY CORPORATION

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

2. ACQUISITIONS AND DIVESTITURES (Continued)

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

As a result of the failed sale the Company accounts for the continued operations of the gas gathering system and reflects a financing obligation, representing the proceeds received, under the financing method of real estate accounting. Under the financing method, the historical cost of the Haynesville Shale gas gathering system contributed to KinderHawk is carried at the full historical basis of the assets on the unaudited condensed consolidated balance sheets in *"Gas gathering systems and equipment"* and depreciated over the remaining useful life of the assets. The financing obligation is recorded on the unaudited condensed consolidated balance sheets in *"Payable on financing arrangements,"* in the amount of approximately $1.7 billion. Reductions to the obligation and non cash interest on the financing obligation are tied to the gathering and treating services, as the Company delivers natural gas through the Haynesville Shale gathering and treating system. Interest and principal are determined based upon the allocable income to Kinder Morgan, and interest is limited up to an amount that is calculated based upon the Company's weighted average cost of debt as of the date of the transaction. Allocable income in excess of the calculated value is reflected as reductions of principal. Interest is recorded in *"Interest expense and other"* on the unaudited condensed consolidated statements of operations. Additionally the Company records KinderHawk's revenues, net of eliminations for intercompany amounts associated with gathering and treating services provided to the Company, and expenses on the unaudited condensed consolidated statements of operations in *"Midstream revenues," "Taxes other than income," "Gathering, transportation and other," "General and administrative," "Interest expense and other"* and *"Depletion, depreciation and amortization."*

On July 1, 2011, the Company transferred its remaining 50% membership interest in KinderHawk to KM Gathering. The historical cost of the Haynesville Shale gas gathering system is carried at the full historical basis of the assets on the unaudited condensed consolidated balance sheet and depreciated over the useful life of the assets.

Terryville

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

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PETROHAWK ENERGY CORPORATION

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

2. ACQUISITIONS AND DIVESTITURES (Continued)

West Edmond Hunton Lime Unit

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

3. OIL AND NATURAL GAS PROPERTIES

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

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

At September 30, 2011, the ceiling test value of the Company's reserves was calculated based on the first day average of the 12-months ended September 30, 2011 of the West Texas Intermediate (WTI) spot price of $94.51 per barrel, adjusted by lease or field for quality, transportation fees, and regional price differentials, and the first day average of the 12-months ended September 30, 2011 of the Henry Hub price of $4.16 per million British thermal units (Mmbtu), adjusted by lease or field for energy content, transportation fees, and regional price differentials. Using these prices, the Company's net book value of oil and natural gas properties at September 30, 2011 did not exceed the ceiling amount. Changes in production rates, levels of reserves, future development costs, and other factors will determine the Company's actual ceiling test calculation and impairment analyses in future periods.

At September 30, 2010, the ceiling test value of the Company's reserves was calculated based on the first day average of the 12-months ended September 30, 2010 of the WTI posted price of $75.55 per barrel, adjusted by lease or field for quality, transportation fees, and regional price differentials, and the first day average of the 12-months ended September 30, 2010 of the Henry Hub price of $4.41 per Mmbtu, adjusted by lease or field for energy content, transportation fees, and regional price differentials. Using these prices, the Company's net book value of oil and natural gas properties at September 30, 2010 did not exceed the ceiling amount.

PETROHAWK ENERGY CORPORATION

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

4. LONG-TERM DEBT

Long-term debt as of September 30, 2011 and December 31, 2010 consisted of the following:

	September 30, 2011(1)	December 31, 2010(1)
	(In thousands)	
Senior revolving credit facility	$	$ 146,000
EagleHawk senior revolving credit facility	56,500	
6.25% $600 million senior notes*(2)*	600,000	
7.25% $1.2 billion senior notes*(3)*	1,231,980	825,000
10.5% $600 million senior notes*(4)*	558,376	562,115
7.875% $800 million senior notes*(5)*	799,611	800,000
7.125% $275 million senior notes*(6)*		268,922
Deferred premiums on derivatives	4,375	10,815
	$ 3,250,842	$ 2,612,852

(1) Table excludes $16.5 million and $14.6 million of deferred premiums on derivative contracts which have been classified as current at September 30, 2011 and December 31, 2010, respectively. Table also excludes $0.2 million of 9.875% senior notes due 2011 which were classified as current at December 31, 2010.

(2) On May 20, 2011, the Company issued $600 million principal amount of its 6.25% senior notes due 2019. See "6.25% Senior Notes" below for more details.

(3) On August 17, 2010 and January 31, 2011, the Company issued an initial $825 million principal amount and an additional $400 million principal amount, respectively, of its 7.25% senior notes due 2018. Amount includes a $7.0 million premium at September 30, 2011, recorded by the Company in conjunction with the issuance of the additional $400 million principal amount. See "7.25% Senior Notes" below for more details.

(4) Table excludes $10.4 million of 10.5% senior notes due 2014 that were classified as current at September 30, 2011. Table includes a $31.3 million and $37.9 million discount, at September 30, 2011 and December 31, 2010, respectively, which was recorded by the Company in conjunction with the issuance of the 10.5% senior notes due 2014. See "10.5% Senior Notes" below for more details.

(5) Table excludes $0.4 million of 7.875% senior notes due 2015 that were classified as current at September 30, 2011. See "7.875% Senior Notes" below for more details.

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

Senior Revolving Credit Facility

Effective August 2, 2010, the Company amended and restated its existing credit facility dated October 14, 2009 by entering into the Fifth Amended and Restated Senior Revolving Credit Agreement (the Senior Credit Agreement), among the Company, each of the lenders from time to time party

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PETROHAWK ENERGY CORPORATION

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

4. LONG-TERM DEBT (Continued)

thereto (the Lenders), BNP Paribas, as administrative agent for the Lenders, Bank of America, N.A. and Bank of Montreal as co-syndication agents for the Lenders, and JPMorgan Chase Bank, N.A. and Wells Fargo Bank, N.A., as co-documentation agents for the Lenders. On July 1, 2011, the Company entered into the Fourth Amendment to the Senior Credit Agreement. The Fourth Amendment was entered into to facilitate the closing of the EagleHawk joint venture. The Fourth Amendment, among other things, permitted Hawk Field Services to: convey its Eagle Ford Shale gathering and treating business in South Texas to EagleHawk; transfer a 25% equity interest in EagleHawk to Kinder Morgan; enter into and abide by the terms of the operative documents governing the formation and operation of EagleHawk, and reaffirmed the oil and gas component of the Company's borrowing base under the Senior Credit Agreement at $1.8 billion, while reducing to zero the midstream component of the Company's borrowing base. As of September 30, 2011, the Senior Credit Agreement provided for a $2.5 billion facility and the borrowing base was approximately $1.8 billion. The portion of the borrowing base relating to the Company's oil and natural gas properties is redetermined on a semi-annual basis (with the Company and the Lenders each having the right to one annual interim unscheduled redetermination) and adjusted based on the Company's oil and natural gas properties, reserves, other indebtedness and other relevant factors. At September 30, 2011, the Company had approximately $24.5 million outstanding letters of credit with various customers, vendors and others. The Company's borrowing base is subject to a reduction equal to the product of $0.25 multiplied by the stated principal amount (without regard to any initial issue discount) of any unsecured senior or senior subordinated notes that the Company may issue. Effective October 3, 2011, the Company reduced the borrowing capacity under Senior Credit Agreement from $2.5 billion to $25 million. Refer to Note 14, "*Subsequent Events*" for more details. The Company's primary sources of capital and liquidity have historically been internally generated cash flows from operations, proceeds from asset sales and availability under the Senior Credit Agreement. The Company's future capital resources and liquidity will be from internally generated cash flows from operations and funding from the Parent.

Amounts outstanding under the Senior Credit Agreement bear interest at specified margins over the London Interbank Offered Rate (LIBOR) of 1.50% to 2.50% for Eurodollar loans or at specified margins over the Alternate Base Rate (ABR) of 0.50% to 1.50% for ABR loans. Such margins will fluctuate based on the utilization of the facility. Borrowings under the Senior Credit Agreement are secured by first priority liens on substantially all of the Company's assets, including pursuant to the terms of the Fifth Amended and Restated Guarantee and Collateral Agreement, all of the assets of, and equity interests in, the Company's subsidiaries. Amounts drawn down on the facility will mature on July 1, 2016.

The Senior Credit Agreement contains customary financial and other covenants, including minimum working capital levels (the ratio of current assets plus the unused commitment under the Senior Credit Agreement to current liabilities) of not less than 1.0 to 1.0 and minimum coverage of interest expenses (as defined in the Senior Credit Agreement) of not less than 2.5 to 1.0. In addition, the Company is subject to covenants limiting dividends and other restricted payments, transactions with affiliates, incurrence of debt, changes of control, asset sales, and liens on properties. As previously reported in the Company's Form 8-K filed on August 19, 2011, a Waiver and Consent dated August 15, 2011 waived the change of control and other defaults and events of default caused by the consummation of the transactions with BHP Billiton Limited. Additionally, effective September 27, 2011, the Company's compliance obligations with respect to the aforementioned minimum working capital level and minimum coverage of interest expense covenants, as well as the Company's

PETROHAWK ENERGY CORPORATION

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

4. LONG-TERM DEBT (Continued)

compliance obligations with respect to certain other covenants in the Senior Credit Agreement including reserve report and other information delivery, were suspended until March 31, 2012.

EagleHawk Revolving Credit Facility

On July 1, 2011, EagleHawk, each of the lenders from time to time party hereto (the EagleHawk Lenders), and Wells Fargo Bank, N.A., as administrative agent for the EagleHawk Lenders, entered into a Revolving Credit Agreement (the EagleHawk Revolving Credit Agreement). The EagleHawk Revolving Credit Agreement provides for up to a $250 million credit facility with initial availability of $75 million. As of September 30, 2011, the amount of the EagleHawk Revolving Credit Agreement remained at $75 million, but could be increased to a maximum of $250 million, subject to certain conditions, including if EBITDA (as defined in the EagleHawk Revolving Credit Agreement) for the most recently completed four fiscal quarters for which financial statements are available is equal to at least one-half of the proposed aggregate commitment amount.

Amounts outstanding under the EagleHawk Revolving Credit Agreement bear interest at specified margins over the LIBOR (as adjusted pursuant to the terms of the EagleHawk Revolving Credit Agreement) of 2.00% to 2.50% for Eurodollar loans or at specified margins over the ABR of 1.00% to 1.50% for ABR loans. Such margins will fluctuate based on the Company's Leverage Ratio (as defined in the EagleHawk Revolving Credit Agreement).

The EagleHawk Revolving Credit Agreement contains customary financial and other covenants, including a maximum leverage ratio (the ratio to total debt to EBITDA for the last four fiscal quarters) of 3.0 to 1.0. In addition, EagleHawk is subject to covenants limiting restricted payments, incurrence of debt, changes of control, asset sales, and liens on properties. At September 30, 2011, EagleHawk was in compliance with its maximum leverage ratio under the EagleHawk Revolving Credit Agreement.

6.25% Senior Notes

On May 20, 2011, the Company completed a private placement offering to eligible purchasers of an aggregate principal amount of $600 million of its 6.25% senior notes due 2019 (the 2019 Notes). The 2019 Notes were issued under and are governed by an indenture dated May 20, 2011, between the Company, U.S. Bank Trust National Association, as trustee, and the Company's subsidiaries named therein as guarantors (the 2019 Indenture). The 2019 Notes were sold to investors at 100% of the aggregate principal amount of the 2019 Notes. The net proceeds from the sale of the 2019 Notes were approximately $589 million (after deducting offering fees and expenses). The proceeds were used to repay borrowings outstanding under the Company's senior revolving credit facility and for working capital for general corporate purposes.

The 2019 Notes bear interest at a rate of 6.25% per annum, payable semi-annually on June 1 and December 1 of each year, commencing on December 1, 2011. The 2019 Notes will mature on June 1, 2019. The 2019 Notes are senior unsecured obligations of the Company and rank equally with all of its current and future senior indebtedness. The 2019 Notes are jointly and severally, fully and unconditionally guaranteed on a senior unsecured basis by the Company's subsidiaries. Petrohawk Energy Corporation, the issuer of the 2019 Notes, has no material independent assets or operations apart from the assets and operations of its subsidiaries.

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PETROHAWK ENERGY CORPORATION

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

4. LONG-TERM DEBT (Continued)

On or prior to June 1, 2014, the Company may redeem up to 35% of the aggregate principal amount of the 2019 Notes with the net cash proceeds of certain equity offerings at a redemption price of 106.25% of the principal amount, plus accrued and unpaid interest to the redemption date; provided that at least 65% in aggregate principal of the 2019 Notes originally issued under the 2019 Indenture remain outstanding immediately after the redemption. In addition, on or prior to June 1, 2015, the Company may redeem all or part of the 2019 Notes at a redemption price equal to the principal amount, plus accrued and unpaid interest, plus a make whole premium equal to the excess, if any of (a) the present value at such time of (i) the redemption price of such note at June 1, 2015 plus (ii) any required interest payments due on such note through June 1, 2015 (except for currently accrued and unpaid interest), computed using a discount rate equal to the Treasury Rate plus 50 basis points, discounted to the redemption date on a semi-annual basis (assuming a 360-day year consisting of twelve 30-day months), over (b) the principal amount of such Note.

On or prior to June 1, 2015, the Company may redeem all or a part of the 2019 Notes, in whole or in part, at a redemption price equal to 100% of their principal amount plus a make-whole premium, together with accrued and unpaid interest, if any, to the redemption date. The 2019 Notes will be redeemable, in whole or in part, on or after June 1 of the years indicated below, at redemption prices equal to the principal amount multiplied by the percentage set forth below, plus accrued and unpaid interest:

Year	Percentage
2015	103.125%
2016	101.563%
2017 and thereafter	100.000%

The Company is required to offer to repurchase the 2019 Notes at a purchase price of 101% of the principal amount, plus accrued and unpaid interest, if any, to the redemption date, in the event of a change of control as defined in the 2019 Indenture that is followed by a decline within 90 days in the ratings of the 2019 Notes published by either Moody's Investor Service, Inc. (Moody's) or Standard & Poor's Rating Services (S&P). The Company's credit rating did not decline in the allotted period of time after the change of control with the closing of the BHP merger. As a result, no such offer was made. The 2019 Indenture contains covenants that, among other things, restrict or limit the ability of the Company and its subsidiaries to: borrow money; pay dividends on stock; purchase or redeem stock or subordinated indebtedness; make investments; create liens; enter into transactions with affiliates; sell assets; and merge with or into other companies or transfer all or substantially all of the Company's assets.

7.25% Senior Notes

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

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PETROHAWK ENERGY CORPORATION

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

4. LONG-TERM DEBT (Continued)

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

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

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

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

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

Year	Percentage
2014	103.625%
2015	101.813%
2016 and thereafter	100.000%

The Company is required to offer to repurchase the 2018 Notes at a purchase price of 101% of the principal amount, plus accrued and unpaid interest, if any, to the redemption date, in the event of a change of control as defined in the 2018 Indenture that is followed by a decline within 90 days in the ratings of the 2018 Notes published by either Moody's or S&P. The Company's credit rating did not

PETROHAWK ENERGY CORPORATION

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

4. LONG-TERM DEBT (Continued)

decline in the allotted period of time after the change of control with the closing of the BHP merger. As a result, no such offer was made. The 2018 Indenture contains covenants that, among other things, restrict or limit the ability of the Company and its subsidiaries to: borrow money; pay dividends on stock; purchase or redeem stock or subordinated indebtedness; make investments; create liens; enter into transactions with affiliates; sell assets; and merge with or into other companies or transfer all or substantially all of the Company's assets.

In conjunction with the issuance of the additional 2018 Notes, the Company recorded a premium of $7.5 million to be amortized over the remaining life of the notes utilizing the effective interest rate method. The remaining unamortized premium was $7.0 million at September 30, 2011.

10.5% Senior Notes

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

The 2014 Notes bear interest at a rate of 10.5% per annum, payable semi-annually on February 1 and August 1 of each year. The 2014 Notes will mature on August 1, 2014. The Company is required to offer to repurchase the 2014 Notes at a purchase price of 101% of the principal amount, plus accrued and unpaid interest, if any, to the redemption date, in the event of a change of control as defined in the 2014 Indenture. On September 16, 2011, the Company initialized an offer to repurchase the 2014 Notes, in accordance with the terms of the 2014 Indenture, due to the change of control resulting from the acquisition of the Company by BHP Billiton Limited. The holders of the 2014 Notes had until November 9, 2011 to tender their 2014 Notes. On November 14, 2011, the Company paid principal and interest of $10.8 million to repurchase a portion of the 2014 Notes at the request of the bondholders. The principal amount paid was classified as current at September 30, 2011. The 2014 Notes are senior unsecured obligations of the Company and rank equally with all of its current and future senior indebtedness. The 2014 Notes are jointly and severally, fully and unconditionally guaranteed on a senior unsecured basis by the Company's subsidiaries. Petrohawk Energy Corporation, the issuer of the 2014 Notes, has no material independent assets or operations apart from the assets and operations of its subsidiaries.

In conjunction with the issuance of the 2014 Notes, the Company recorded a discount of $52.3 million to be amortized over the remaining life of the notes utilizing the effective interest rate method. The remaining unamortized discount was $31.3 million at September 30, 2011.

7.875% Senior Notes

On May 13, 2008 and June 19, 2008, the Company issued $500 million principal amount and $300 million principal amount, respectively, of its 7.875% senior notes due 2015 (the 2015 Notes). The 2015 Notes were issued under and are governed by an indenture dated May 13, 2008, between the Company, U.S. Bank Trust National Association, as trustee, and the Company's subsidiaries named therein as guarantors (the 2015 Indenture).

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PETROHAWK ENERGY CORPORATION

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

4. LONG-TERM DEBT (Continued)

The 2015 Notes bear interest at a rate of 7.875% per annum, payable semi-annually on June 1 and December 1 of each year. The 2015 Notes will mature on June 1, 2015. The Company is required to offer to repurchase the 2015 Notes at a purchase price of 101% of the principal amount, plus accrued and unpaid interest, if any, to the redemption date, in the event of a change of control as defined in the 2015 Indenture. On September 16, 2011, the Company initialized an offer to repurchase the 2015 Notes, in accordance with the terms of the 2015 Indenture, due to the change of control resulting from the acquisition of the Company by BHP Billiton Limited. The holders of the 2015 Notes had until November 9, 2011 to tender their 2015 Notes. On November 14, 2011, the Company paid principal and interest of $0.4 million to repurchase a portion of the 2015 Notes at the request of the bondholders. The principal amount paid was classified as current at September 30, 2011. The 2015 Notes are senior unsecured obligations of the Company and rank equally with all of its current and future senior indebtedness. The 2015 Notes are jointly and severally, fully and unconditionally guaranteed on a senior unsecured basis by the Company's subsidiaries. Petrohawk Energy Corporation, the issuer of the 2015 Notes, has no material independent assets or operations apart from the assets and operations of its subsidiaries.

7.125% Senior Notes

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

In conjunction with the assumption of the 7.125% Senior Notes from KCS, the Company recorded a discount of $13.6 million to be amortized over the remaining life of the notes utilizing the effective interest rate method. The Company had no remaining unamortized discount at September 30, 2011 and $3.5 million at December 31, 2010.

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

9.875% Senior Notes

On April 8, 2004, Mission Resources Corporation (Mission) issued $130 million of its 9.875% senior notes due 2011 (the 2011 Notes). The Company assumed these notes upon the closing of the Company's merger with Mission. In conjunction with the Company's merger with KCS, the Company repurchased substantially all of the 2011 Notes. In connection with the extinguishment of substantially all of the 2011 Notes, the Company requested and received from the noteholders consent to eliminate the debt covenants associated with the 2011 Notes. There were approximately $0.2 million of the notes

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PETROHAWK ENERGY CORPORATION

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

4. LONG-TERM DEBT (Continued)

that were not redeemed and were still outstanding and classified as current as of December 31, 2010. On April 1, 2011, the Company repaid the $0.2 million of the 2011 Notes that were outstanding.

Debt Issuance Costs

The Company capitalizes certain direct costs associated with the issuance of long-term debt. During the first nine months of 2011, the Company capitalized $26.0 million in debt issuance costs associated with the issuances of the additional 2018 Notes and the 2019 Notes, as well as costs incurred for amendments to the Company's Senior Credit Agreement and the EagleHawk Revolving Credit Agreement. In the first quarter of 2011, the Company wrote off $0.2 million of debt issuance costs as a result of the additional 2018 Notes issuance and the corresponding reduction of the Company's Senior Credit Agreement. In the third quarter of 2011, the Company wrote off $0.8 million of debt issuance costs as a result of the removal of the midstream borrowing base component in the Company's Senior Credit Agreement. At September 30, 2011 and December 31, 2010, the Company had approximately $62.1 million and $45.9 million, respectively, of debt issuance costs remaining that are being amortized over the lives of the respective debt.

5. FAIR VALUE MEASUREMENTS

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

The following tables set forth by level within the fair value hierarchy the Company's financial assets and liabilities that were accounted for at fair value as of September 30, 2011 and December 31, 2010. As required by ASC 820, a financial instrument's level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement. The Company's assessment of the significance of a particular input to the fair value measurement requires judgment, and may affect the valuation of fair value assets and liabilities and their placement within the fair value hierarchy levels. There were no transfers between fair value hierarchy levels for the nine months ended September 30, 2011 and for the year ended December 31, 2010.

	September 30, 2011			
	Level 1	Level 2	Level 3	Total
	(In thousands)			
Assets:				
Receivables from derivative contracts	$	$ 296,910	$	$ 296,910
Liabilities:				
Liabilities from derivative contracts	$	$ 398	$	$ 398

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PETROHAWK ENERGY CORPORATION

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

5. FAIR VALUE MEASUREMENTS (Continued)

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

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

Derivatives listed above include collars and swaps that are carried at fair value. The Company records the net change in the fair value of these positions in "*Net gain on derivative contracts*" in the Company's unaudited condensed consolidated statements of operations. The Company is able to value the assets and liabilities based on observable market data for similar instruments, which resulted in the Company reporting its derivatives as Level 2. This observable data includes the forward curve for commodity prices based on quoted markets prices and implied volatility factors related to changes in the forward curves. For further discussion of the Company's derivatives, see Note 8, "*Derivatives.*"

As of September 30, 2011 and December 31, 2010, the Company's derivative contracts were with major financial institutions with investment grade credit ratings which are believed to have a minimal credit risk. As such, the Company is exposed to credit risk to the extent of nonperformance by the counterparties in the derivative contracts discussed above; however, the Company does not anticipate such nonperformance. Each of the counterparties to the Company's derivative contracts is a lender in the Company's Senior Credit Agreement. The Company did not post collateral under any of these contracts as they are secured under the Senior Credit Agreement.

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

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PETROHAWK ENERGY CORPORATION

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

5. FAIR VALUE MEASUREMENTS (Continued)

September 30, 2011 and December 31, 2010 (excluding premiums and discounts and deferred premiums on derivative contracts, and including certain amounts that have been classified as current):

	September 30, 2011		December 31, 2010	
Debt	**Carrying Amount**	**Estimated Fair Value**	**Carrying Amount**	**Estimated Fair Value**
	(In thousands)			
6.25% $600 million senior notes	$ 600,000	$ 675,000	$	$
7.25% $1.2 billion senior notes	1,225,000	1,422,531	825,000	832,425
10.5% $600 million senior notes(1)	600,000	675,750	600,000	684,000
7.875% $800 million senior notes(2)	800,000	856,000	800,000	834,000
7.125% $275 million senior notes			272,375	273,465
9.875% senior notes(3)			224	225
	$ 3,225,000	$ 3,629,281	$ 2,497,599	$ 2,624,115

(1) Approximately $10.4 million of the 10.5% $600 million senior notes were classified as current at September 30, 2011 and as long-term at December 31, 2010.

(2) Approximately $0.4 million of the 7.875% $800 million senior notes were classified as current at September 30, 2011 and as long-term at December 31, 2010.

(3) The 9.875% senior notes due 2011 were classified as current at December 31, 2010.

The fair values of the Company's fixed interest debt instruments were calculated using quoted market prices based on trades of such debt as of September 30, 2011 and December 31, 2010.

6. ASSET RETIREMENT OBLIGATIONS

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

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PETROHAWK ENERGY CORPORATION

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

6. ASSET RETIREMENT OBLIGATIONS (Continued)

The Company recorded the following activity related to its ARO liability for the nine months ended September 30, 2011 (in thousands):

Liability for asset retirement obligation as of December 31, 2010	$ 31,741
Liabilities settled and divested	(534)
Additions	11,333
Acquisitions	36
Accretion expense	1,499
Liability for asset retirement obligation as of September 30, 2011	$ 44,075

7. COMMITMENTS AND CONTINGENCIES

Commitments

The Company leases corporate office space in Houston, Texas and Tulsa, Oklahoma as well as a number of other field office locations. In addition, the Company has lease commitments related to certain vehicles, machinery and equipment under long-term operating leases. Rent expense was $5.9 million and $4.7 million for the nine months ended September 30, 2011 and 2010, respectively.

As of September 30, 2011, the Company had the following commitments:

	Total Obligation Amount(1) (in thousands)	Years Remaining
Gathering and transportation commitments	$ 2,363,637	18
Drilling rig commitments	332,572	4
Non-cancelable operating leases	35,350	7
Pipeline and well equipment obligations	71,080	1
Various contractual commitments (including, among other things, rental equipment obligations, obtaining and processing seismic data and fracture stimulation services)	74,650	2
Total commitments	$ 2,877,289	

(1) On May 21, 2010, the Company created a joint venture with Kinder Morgan, KinderHawk, which engages in the natural gas midstream business in Northwest Louisiana, focused on the Haynesville and Lower Bossier Shales. As part of this transaction, the Company was committed to fund up to an additional $41.4 million, as of June 30, 2011, in capital during 2011 in the event KinderHawk required capital to finance its planned capital expenditures. On July 1, 2011, in conjunction with the closing of the Company's transfer of its remaining 50% membership interest in KinderHawk, the balance of the Company's capital commitment to KinderHawk was relieved. In addition to the capital commitment, the Company is obligated to deliver to KinderHawk agreed upon minimum annual quantities of natural gas from Petrohawk operated wells producing from the Haynesville and Lower Bossier Shales in North Louisiana through May 2015, or in the alternative, pay an annual true-up fee to KinderHawk if such minimum annual

PETROHAWK ENERGY CORPORATION

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

7. COMMITMENTS AND CONTINGENCIES (Continued)

quantities are not delivered. To date, the Company has not been obligated to pay a true-up fee, as production from this acreage has exceeded the minimum annual quantities required. The minimum annual quantities commitment is not reflected in the amounts shown in the table above. The Company's obligation to deliver minimum annual quantities of natural gas to KinderHawk through May 2015 remains in effect following the transfer of the Company's remaining 50% membership interest in KinderHawk on July 1, 2011. The Company pays to KinderHawk negotiated gathering and treating fees, subject to an annual inflation adjustment factor.

The KinderHawk joint venture, as discussed above, is accounted for as a failed sale of in substance real estate in accordance with ASC 360-20. Due to the gathering agreement entered into with the formation of KinderHawk, which constitutes extended continuing involvement under ASC 360-20, it has been determined that the contribution of the Company's Haynesville Shale gathering and treating system to form KinderHawk is accounted for as a failed sale of in substance real estate. See Note 2, *"Acquisitions and Divestitures"* for more details regarding the KinderHawk joint venture arrangement and for discussion of the accounting treatment related to the arrangement. As a result of the failed sale, the Company recorded a financing obligation, representing the proceeds received, under the financing method of real estate accounting. The financing obligation is recorded on the unaudited condensed consolidated balance sheets in "*Payable on financing arrangements,"* in the amount of approximately $1.7 billion. Reductions to the obligation and the non cash interest on the obligation are tied to the gathering and treating services, as the Company delivers natural gas through the Haynesville Shale gathering and treating system. Interest and principal are determined based upon the allocable income to Kinder Morgan, and interest is limited up to an amount that is calculated based upon the Company's weighted average cost of debt as of the date of the transaction. Allocable income in excess of the calculated value is reflected as reductions of principal. Interest is recorded in *"Interest expense and other"* on the unaudited condensed consolidated statements of operations. This obligation is not reflected in the amounts shown in the table above.

The Company's transfer of a 25% interest in EagleHawk to Kinder Morgan, on July 1, 2011, is accounted for as a failed sale of in substance real estate in accordance with ASC 360-20. Due to the gathering agreements which constitute extended continuing involvement under ASC 360-20, that were either entered into in conjunction with the closing of the EagleHawk transaction or assigned to EagleHawk at the closing of the transaction, it has been determined that the transfer of the Company's Eagle Ford Shale gathering and treating systems to EagleHawk is accounted for as a failed sale of in substance real estate. See Note 2, *"Acquisitions and Divestitures"* for more details regarding the EagleHawk joint venture arrangement and for discussion of the accounting treatment related to the arrangement. As a result of the failed sale, the Company recorded a financing obligation, representing the proceeds received, under the financing method of real estate accounting. The financing obligation is recorded on the unaudited condensed consolidated balance sheets in "*Payable on financing arrangements,"* in the amount of approximately $93 million. Reductions to the obligation and the non cash interest on the obligation are tied to the gathering and treating services, as the Company delivers its production through the Eagle Ford Shale gathering and treating systems. Interest and principal are determined based upon the allocable income to Kinder Morgan, and interest is limited up to an amount that is calculated based upon the Company's weighted average cost of debt as of the date of the transaction. Allocable income in excess of the calculated value is reflected as reductions of principal. Interest is recorded in *"Interest expense and other"* on the unaudited condensed consolidated statements of operations. This obligation is not reflected in the amounts shown in the table above.

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PETROHAWK ENERGY CORPORATION

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

7. COMMITMENTS AND CONTINGENCIES (Continued)

The balance of the Company's financing obligation as of September 30, 2011, was approximately $1.8 billion, of which approximately $16.8 million was classified as current.

Contingencies

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

8. DERIVATIVES

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

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

At September 30, 2011 the Company had entered into commodity collars and swaps. The Company has elected to not designate any of its derivative contracts for hedge accounting. Accordingly, the Company records the net change in the mark-to-market valuation of these derivative contracts, as well as all payments and receipts on settled derivative contracts, in "*Net gain on derivatives contracts*" on the unaudited condensed consolidated statements of operations.

At September 30, 2011, the Company had 109 open commodity derivative contracts summarized in the tables below: 11 natural gas swap arrangements, 76 natural gas collar arrangements, 21 crude oil collar arrangements, and one natural gas liquids swap (which was an ethane swap). Derivative commodity contracts settle based on NYMEX WTI and Henry Hub prices, or the applicable information service for the Company's natural gas liquids contracts, which may have differed from the

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PETROHAWK ENERGY CORPORATION

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

8. DERIVATIVES (Continued)

actual price received by the Company for the sale of its oil, natural gas and natural gas liquids production.

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

All derivative contracts are recorded at fair market value in accordance with ASC 815 and ASC 820 and included in the unaudited condensed consolidated balance sheets as assets or liabilities. The following table summarizes the location and fair value amounts of all derivative contracts in the unaudited condensed consolidated balance sheets as of September 30, 2011 and December 31, 2010:

	Asset derivative contracts			Liability derivative contracts		
Derivatives not designated as hedging contracts under ASC 815	**Balance sheet location**	**September 30, 2011**	**December 31, 2010**	**Balance sheet location**	**September 30, 2011**	**December 31, 2010**
		(In thousands)			**(In thousands)**	
Commodity contracts	Current assets receivables from derivative contracts	$ 250,663	$ 217,018	Current liabilities liabilities from derivative contracts	$ (398)	$ (5,820)
Commodity contracts	Other noncurrent assets receivables from derivative contracts	46,247	41,721	Other noncurrent liabilities liabilities from derivative contracts		(13,575)
Total derivatives not designated as hedging contracts under ASC 815		$ 296,910	$ 258,739		$ (398)	$ (19,395)

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PETROHAWK ENERGY CORPORATION

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

8. DERIVATIVES (Continued)

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

Derivatives not designated as hedging contracts under ASC 815	Location of gain or (loss) recognized in income on derivative contracts	Amount of gain or (loss) recognized in income on derivative contracts three months ended September 30, 2011	2010	Amount of gain or (loss) recognized in income on derivative contracts nine months ended September 30, 2011	2010
		(In thousands)		(In thousands)	
Unrealized gain on commodity contracts	Other income (expenses) net gain on derivative contracts	$ 134,489	$ 87,557	$ 50,580	$ 190,228
Realized gain on commodity contracts	Other income (expenses) net gain on derivative contracts	64,951	60,335	181,460	155,742
Total net gain on derivative contracts	Other income (expe				