GASTAR EXPLORATION LTD
Form 10-Q
August 06, 2009
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2009

OR

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
FOR THE TRANSITION PERIOD FROM TO .

Commission File Number: 001-32714

GASTAR EXPLORATION LTD.

(Exact name of registrant as specified in its charter)

Alberta, Canada	**98-0570897**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
1331 Lamar Street, Suite 1080 Houston, Texas 77010	**77010**
(Address of principal executive offices)	**(ZIP Code)**

(713) 739-1800

(Registrant s telephone number, including area code)

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

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

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

Large accelerated filer	¨	Accelerated filer	x
Non-accelerated filer	¨ (Do not check if a smaller reporting company.)	Smaller reporting company	¨

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

Total number of outstanding common shares, no par value per share, as of August 4, 2009 was 49,588,093.

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GASTAR EXPLORATION LTD.

QUARTERLY REPORT ON FORM 10-Q

FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2009

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Unless otherwise indicated or required by the context, (i) Gastar, the Company, we , us , and our refer to Gastar Exploration Ltd. and its subsidiaries and predecessors, (ii) all dollar amounts appearing in this Quarterly Report on Form 10-Q as of and for the three and six months ended June 30, 2009 (Form 10-Q) are stated in United States dollars unless otherwise noted and (iii) all financial data included in this Form 10-Q have been prepared in accordance with generally accepted accounting principles in the United States of America (US GAAP).

General information about us can be found on our website at www.gastar.com. The information on our website is neither incorporated into, nor part of, this Form 10-Q. Our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q and Current Reports on Form 8-K, as well as any amendments and exhibits to those reports, will be available free of charge through our website as soon as reasonably practicable after we file or furnish them to the United States Securities and Exchange Commission (SEC). Information is also available on the SEC website at www.sec.gov for our United States filings and on SEDAR at www.sedar.com for our Canadian filings.

As of the opening of trading on August 3, 2009, a previously announced common share consolidation on the basis of one (1) common share for five (5) common shares (the 1-for-5 Reverse Split) became effective. All common share and per share amounts reported in the Form 10-Q have been reported on a post reverse split basis. See Note 17, Subsequent Events for additional information.

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GASTAR EXPLORATION LTD. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

	June 30, 2009 (Unaudited)	December 31, 2008
	(in thousands)	
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 12,499	$ 6,153
Accounts receivable, net of allowance for doubtful accounts of $607 and $560, respectively	2,943	5,296
Commodity derivative contracts	2,986	9,829
Due from related parties	1,197	2,382
Prepaid expenses	452	879
Total current assets	20,077	24,539
PROPERTY, PLANT AND EQUIPMENT:		
Natural gas and oil properties, full cost method of accounting:		
Unproved properties, not being amortized	159,182	141,860
Proved properties	327,162	309,103
Total natural gas and oil properties	486,344	450,963
Furniture and equipment	1,010	997
Total property, plant and equipment	487,354	451,960
Accumulated depreciation, depletion and amortization	(279,522)	(199,433)
Total property, plant and equipment, net	207,832	252,527
OTHER ASSETS:		
Restricted cash	533	70
Commodity derivative contracts	213	
Deferred charges, net	6,937	6,849
Drilling advances	1,999	4,352
Other	100	100
Total other assets	9,782	11,371
TOTAL ASSETS	$ 237,691	$ 288,437
LIABILITIES AND SHAREHOLDERS EQUITY		
CURRENT LIABILITIES:		
Accounts payable	$ 6,281	$ 14,256
Revenue payable	5,660	5,005
Accrued interest	2,034	1,505
Accrued drilling and operating costs	2,002	2,915
Commodity derivative contracts	1,299	1,121
Other accrued liabilities	1,732	3,131
Due to related parties	1,060	2,143
Current portion of long-term debt	168,825	151,684

Total current liabilities	188,893	181,760
LONG-TERM LIABILITIES:		
Long-term debt		
Commodity derivative contracts	273	
Asset retirement obligation	5,481	5,095
Total long-term liabilities	5,754	5,095
COMMITMENTS AND CONTINGENCIES (Note 14)		
SHAREHOLDERS EQUITY:		
Common stock, no par value, unlimited shares authorized, 49,539,093 and 41,926,494 shares issued and outstanding at June 30, 2009 and December 31, 2008, respectively	263,799	249,980
Additional paid-in capital	24,806	22,883
Accumulated other comprehensive gain fair value of commodity hedging	944	2,629
Accumulated other comprehensive gain foreign exchange	4	19
Accumulated deficit	(246,509)	(173,929)
Total shareholders equity	43,044	101,582
TOTAL LIABILITIES AND SHAREHOLDERS EQUITY	$ 237,691	$ 288,437

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

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GASTAR EXPLORATION LTD. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

	For the Three Months Ended June 30, 2009	For the Three Months Ended June 30, 2008	For the Six Months Ended June 30, 2009	For the Six Months Ended June 30, 2008
	(in thousands, except share and per share data)			
REVENUES:				
Natural gas and oil revenues	$ 11,962	$ 15,884	$ 25,423	$ 32,730
Unrealized natural gas hedge loss	(4,426)	(513)	(4,622)	(1,926)
Total revenues	7,536	15,371	20,801	30,804
EXPENSES:				
Production taxes	92	474	249	743
Lease operating expenses	1,449	2,408	3,326	3,950
Transportation and treating	325	498	818	957
Depreciation, depletion and amortization	3,361	5,890	11,360	12,299
Impairment of natural gas and oil properties			68,729	
Accretion of asset retirement obligation	88	82	175	164
General and administrative expense	3,487	4,064	6,445	8,339
Total expenses	8,802	13,416	91,102	26,452
INCOME (LOSS) FROM OPERATIONS	(1,266)	1,955	(70,301)	4,352
OTHER (EXPENSES) INCOME:				
Interest expense	(1,137)	(1,889)	(2,299)	(3,985)
Investment income and other	10	481	23	1,304
Foreign transaction loss		(1)	(3)	(38)
INCOME (LOSS) BEFORE INCOME TAXES	(2,393)	546	(72,580)	1,633
Provision for income taxes				
NET INCOME (LOSS)	$ (2,393)	$ 546	$ (72,580)	$ 1,633
NET INCOME (LOSS) PER SHARE:				
Basic	$ (0.05)	$ 0.01	$ (1.68)	$ 0.04
Diluted	$ (0.05)	$ 0.01	$ (1.68)	$ 0.04
WEIGHTED AVERAGE COMMON SHARES OUTSTANDING:				
Basic	44,854,954	41,419,714	43,163,088	41,419,714
Diluted	44,854,954	41,495,033	43,163,088	41,495,033

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

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GASTAR EXPLORATION LTD. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	For the Six Months Ended June 30, 2009	2008
	(in thousands)	
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income (loss)	$ (72,580)	$ 1,633
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation, depletion and amortization	11,360	12,299
Impairment of natural gas and oil properties	68,729	
Stock-based compensation	2,134	1,711
Net cash settlement of derivative contracts	4,622	1,926
Monetization of derivative contracts	2,465	
Amortization of other comprehensive income commodity hedging	(1,685)	
Amortization of deferred financing costs and debt discount	1,408	948
Accretion of asset retirement obligation	175	164
Changes in operating assets and liabilities:		
Restricted cash for hedging program		1,000
Accounts receivable	3,474	(4,719)
Prepaid expenses	368	225
Accounts payable and accrued liabilities	(5,068)	9,071
Net cash provided by operating activities	15,402	24,258
CASH FLOWS FROM INVESTING ACTIVITIES:		
Development and purchases of natural gas and oil properties	(33,029)	(66,190)
Drilling advances	(4,791)	(1,551)
Purchase of furniture and equipment	(13)	(131)
Other		(50)
Net cash used in investing activities	(37,833)	(67,922)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from the issuance of common shares	13,819	
Repayment of revolving credit facility	(4,975)	
Repayment of subordinated unsecured notes	(2,950)	
Proceeds from term loan	25,000	
(Increase) decrease in restricted cash	(463)	3
Deferred financing charges	(1,430)	(177)
Other	(224)	
Net cash provided by (used in) financing activities	28,777	(174)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	6,346	(43,838)
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	6,153	85,854
CASH AND CASH EQUIVALENTS, END OF PERIOD	$ 12,499	$ 42,016

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

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GASTAR EXPLORATION LTD. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Description of Business

Gastar Exploration Ltd. (the Company) is an independent energy and production company focused on finding and developing natural gas assets in North America and Australia. The Company s emphasis is on combining deep natural gas exploration and development with lower risk coal bed methane (CBM) and shale resource development. The Company owns and operates exploration and development acreage in the deep Bossier gas play of East Texas and the Marcellus Shale play in West Virginia and Pennsylvania. The Company s CBM activities are conducted within the Powder River Basin of Wyoming and Montana and concentrated on more than 6.0 million gross acres controlled by the Company in the Gunnedah Basin, located in New South Wales, Australia, with a joint venture partner. See Note 17**,** Subsequent Events for more details regarding sale of Australian assets.

2. Summary of Significant Accounting Policies

The accounting policies followed by the Company and its subsidiaries are set forth in the notes to the Company s audited condensed consolidated financial statements in its Annual Report on Form 10-K for the year ended December 31, 2008 (2008 Form 10-K) filed with the SEC. Additionally, please refer to the notes to those financial statements for additional details of the Company s financial condition, results of operations and cash flows. All material items included in those notes have not changed except as a result of normal transactions in the interim or as disclosed within this report.

The unaudited interim condensed consolidated financial statements of the Company included herein are stated in United States (U.S.) dollars unless otherwise noted and were prepared from the records of the Company by management in accordance with accounting principles generally accepted in the United States of America (US GAAP) applicable to interim financial statements, and reflect all normal and recurring adjustments which are, in the opinion of management, necessary to provide a fair presentation of the results of operations and financial position for the interim periods. Such financial statements conform to the presentation reflected in the Company s 2008 Form 10-K. The current interim period reported herein should be read in conjunction with the financial statements and summary of significant accounting policies and notes included in the Company s 2008 Form 10-K. The year end condensed balance sheet data was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America.

The preparation of financial statements in conformity with US GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Significant estimates with regard to these financial statements include the estimate of proved natural gas and oil reserve quantities and the related present value of estimated future net cash flows.

Additionally, the consolidated financial statements included in this report have been prepared on the basis of accounting principles applicable to a going concern assuming that the Company will continue as a going concern, which contemplate the realization of assets and satisfaction of liabilities in the normal course of business.

The condensed consolidated financial statements include the accounts of the Company and the consolidated accounts of all its subsidiaries. The entities included in these consolidated accounts are all wholly owned. All significant intercompany accounts and transactions have been eliminated in consolidation.

The results of operations for the three months and six ended June 30, 2009 are not necessarily indicative of the results that may be expected for the year ending December 31, 2009.

Recently Adopted Accounting Pronouncements

Determining Whether an Instrument is Indexed to an Entity s Own Stock. Effective January 1, 2009, the Company adopted the provisions of Emerging Issues Task Force (EITF) EITF 07-05, Determining Whether an

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GASTAR EXPLORATION LTD. AND SUBSIDIARIES

(NOTES TO CONSOLIDATED FINANCIAL STATEMENTS) (Continued)

Instrument (or Embedded Feature) Is Indexed to an Entity s Own Stock , (EITF 07-05). EITF 07-05 applies to any freestanding financial instruments or embedded features that have the characteristics of a derivative, as defined by Statement of Financial Accounting Standards (SFAS) SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, and to any freestanding financial instruments that are potentially settled in an entity s own common stock. The effect of adoption of EITF 07-05 in January 1, 2009 was immaterial to the Company s financial position, results of operations or cash flows.

Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement). In May 2008, the Financial Accounting Standards Board (FASB) issued FSP No. APB 14-1, Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement) (FSP APB 14-1). FSP APB 14-1 applies to convertible debt instruments that, by their stated terms, may be settled in cash (or other assets) upon conversion, including partial cash settlement, unless the embedded conversion option is required to be separately accounted for as a derivative under SFAS 133. Convertible debt instruments within the scope of FSP APB 14-1 are not addressed by the existing APB 14. FSP APB 14-1 requires that the liability and equity components of convertible debt instruments within the scope of FSP APB 14-1 be separately accounted for in a manner that reflects the entity s nonconvertible debt borrowing rate. This requires an allocation of the convertible debt proceeds between the liability component and the embedded conversion option (i.e., the equity component). The difference between the principal amount of the debt and the amount of the proceeds allocated to the liability component will be reported as a debt discount and subsequently amortized to earnings over the instrument s expected life using the effective interest method. FSP APB 14-1 was effective for the Company s fiscal year beginning January 1, 2009. The adoption of this standard did not have a material impact on the Company s financial position, results of operations, or cash flows.

Accounting for Assets Acquired and Liabilities Assumed in a Business Combination That Arise from Contingencies. In April 2009, the FASB issued FASB Staff Position (FSP) FAS 141(R)-1, Accounting for Assets Acquired and Liabilities Assumed in a Business Combination That Arise from Contingencies (FSP 141(R)-1), to amend and clarify the initial recognition and measurement, subsequent measurement and accounting, and related disclosures arising from contingencies in a business combination under SFAS 141(R). Under the new guidance, assets acquired and liabilities assumed in a business combination that arise from contingencies should be recognized at fair value on the acquisition date if fair value can be determined during the measurement period. If fair value can not be determined, companies should typically account for the acquired contingencies using existing guidance. The FSP is effective for assets or liabilities arising from contingencies in 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, 2008. The adoption of this standard did not have a material impact on the Company s financial position, results of operations, or cash flows.

Disclosures about Derivative Instruments and Hedging Activities. The Company has adopted SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities (SFAS No. 161). SFAS No. 161 requires entities that utilize derivative instruments to provide qualitative disclosures about their objectives and strategies for using such instruments, as well as any details of credit-risk-related contingent features contained within derivatives. SFAS No. 161 also requires entities to disclose additional information about the amounts and location of derivatives located within the financial statements, how the provisions of SFAS No. 133 have been applied, and the impact that hedges have on an entity s operating results, financial position or cash flows. See Note 7, Commodity Hedging Contracts for additional disclosures required by SFAS No. 161.

Subsequent Events. In May 2009, the FASB issued SFAS No. 165, Subsequent Events (SFAS 165). This statement incorporates guidance into accounting literature that was previously addressed only in auditing standards. The statement refers to subsequent events that provide additional evidence about conditions that existed at the balance-sheet date as recognized subsequent events . Subsequent events which provide evidence about conditions that arose after the balance-sheet date but prior to the issuance of the financial statements are referred to as non-recognized subsequent events . It also requires companies to disclose the date through which subsequent events have been evaluated and whether this date is the date the financial statements were issued or the date the financial statements were available to be issued. This statement is effective for interim and annual periods ending after June 15, 2009. The Company evaluated subsequent events up to immediately prior to the issuance of these financial statements. See Note 17**,** Subsequent Events for more details.

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GASTAR EXPLORATION LTD. AND SUBSIDIARIES

(NOTES TO CONSOLIDATED FINANCIAL STATEMENTS) (Continued)

Interim Reporting of Fair Value of Financial Instruments. In April 2009, the FASB issued FSP FAS 107-1 and Accounting Principles Board (APB) Opinion No. 28-1 (FSP FAS 107-1), Interim Disclosures about Fair Value of Financial Instruments. FSP FAS 107-1 amends SFAS No. 107, Disclosures about Fair Value of Financial Instruments, to require disclosures about fair value of financial instruments for interim reporting periods. The FSP FAS 107-1 also amends APB Opinion No. 28, Interim Financial Reporting, to require those disclosures about the fair value of financial instruments in summarized financial information at interim reporting periods. FSP FAS 107-1 is effective for reporting periods ending after June 15, 2009, and its adoption did not materially impact the Company s results of operations and financial condition but did require additional disclosures regarding the fair value of financial instruments. See Note 5, Fair Value of Financial Instruments for more details**.**

Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly. In April 2009, the FASB issued FSP No. FAS 157-4, Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly . The FSP provides additional guidance for estimating fair value when the market activity for an asset or liability has declined significantly. The FSP is effective for interim and annual periods ending after June 15, 2009, which is June 30, 2009 for the Company. The FSP did not have a material impact on the Company s consolidated financial statements. See Note 8, Fair Value Measurements for more details**.**

Recognition and Presentation of Other-Than-Temporary Impairments. In April 2009, the FASB issued FSP No. FAS 115-2 and FAS 124-2, Recognition and Presentation of Other-Than-Temporary Impairments , which amends the other-than-temporary impairment guidance for debt securities to make the guidance more operational and to improve the presentation and disclosure of other-than-temporary impairments on debt and equity securities in the financial statements. FSP No. FAS 115-2 and FAS 124-2 do not amend existing recognition and measurement guidance for equity securities, but do establish a new method of recognizing and reporting for debt securities. Disclosure requirements for impaired debt and equity securities have been expanded significantly and are now required quarterly, as well as annually. FSP No. FAS 115-2 and FAS 124-2 became effective for interim and annual reporting periods ending after June 15, 2009. Comparative disclosures are only required for periods ending after the initial adoption. FSP No. FAS 115-2 and FAS 124-2 did not have a material impact on the Company s financial position, results of operations or cash flows.

Newly Issued But Not Yet Effective Accounting Standards

Amendments to FASB Interpretation No. 46(R). In June 2009, the FASB issued SFAS No. 167, Amendments to FASB Interpretation No. 46(R). This Statement amends Interpretation 46(R) to require the Company to perform an analysis of our existing investments to determine whether our variable interest or interests give us a controlling financial interest in a variable interest entity. This analysis identifies the primary beneficiary of a variable interest entity as the enterprise that has both the power to direct the activities of significant impact on a variable interest entity and the obligation to absorb losses or receive benefits from the variable interest entity that could potentially be significant to the variable interest entity. It also amends Interpretation 46(R) to require ongoing reassessments of whether an enterprise is the primary beneficiary of a variable interest entity. This Statement is effective as of the beginning of each reporting entity s first annual reporting period that begins after November 15, 2009, for interim periods within that first annual reporting period, and for interim and annual reporting periods thereafter. Earlier application is prohibited. We are currently assessing the impact of adoption.

The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles-a replacement of FASB Statement No. 162. In June 2009, the FASB issued Statement No. 168, The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles-a replacement of FASB Statement No. 162 . The FASB Accounting Standards Codification is intended to be the source of authoritative U.S. generally accepted accounting principles (GAAP) and reporting standards as issued by the FASB. Its primary purpose is to improve clarity and use of existing standards by grouping authoritative literature under common topics. This Statement is effective for financial statements issued for interim and annual periods ending after September 15, 2009. The Codification does not change or alter existing GAAP and there is no expected impact on the Company s financial position, results of operations, or cash flows.

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GASTAR EXPLORATION LTD. AND SUBSIDIARIES

(NOTES TO CONSOLIDATED FINANCIAL STATEMENTS) (Continued)

Modernization of Natural Gas and Oil Reporting. In January 2009, the SEC issued revisions to the natural gas and oil reporting disclosures, Modernization of Oil and Gas Reporting; Final Rule (the Final Rule). In addition to changing the definition and disclosure requirements for natural gas and oil reserves, the Final Rule changes the requirements for determining quantities of natural gas and oil reserves. The Final Rule also changes certain accounting requirements under the full cost method of accounting for natural gas and oil activities. The amendments are designed to modernize the requirements for the determination of natural gas and oil reserves, aligning them with current practices and updating them for changes in technology. The Final Rule is effective for annual reports on Form10-K for fiscal years ending on or after December 31, 2009. The Company has not yet determined the impact the implementation of the Final Rule will have, if any, on the Company s financial position, results of operations, or cash flows.

3. Property, Plant and Equipment

The amount capitalized as natural gas and oil properties was incurred for the purchase and development of various properties in the states Montana, Pennsylvania, Texas, West Virginia and Wyoming in the United States and in New South Wales, Australia. The following schedule represents natural gas and oil property costs by country:

	United States	Australia (in thousands)	Total
From inception to June 30, 2009:			
Natural gas and oil properties, full cost method of accounting:			
Unproved properties	$ 124,500	$ 34,682	$ 159,182
Proved properties	326,558	604	327,162
Total natural gas and oil properties	451,058	35,286	486,344
Furniture and equipment	838	172	1,010
Total property and equipment	451,896	35,458	487,354
Impairment of proved natural gas and oil properties	(187,152)	(604)	(187,756)
Accumulated depreciation, depletion and amortization	(91,751)	(15)	(91,766)
Total accumulated depreciation, depletion and amortization	(278,903)	(619)	(279,522)
Total property and equipment, net	$ 172,993	$ 34,839	$ 207,832

At June 30, 2009, unproved properties not being amortized consisted of U.S. acreage acquisition costs of $107.7 million, Australian unevaluated property costs of $30.3 million and capitalized interest of $21.2 million. The U.S. unproved properties are related to our East Texas and Marcellus shale play exploration activities. The East Texas exploration is ongoing and should be completed over the next six years. The Marcellus exploration is expected to commence in late 2009 with exploration activities over the next ten years.

For the six months ended June 30, 2009, the results of management s ceiling test evaluation resulted in an impairment of the U.S. proved properties of $68.7 million. The U.S. proved property impairment was recorded at March 31, 2009 utilizing a weighted average natural gas price of $2.64 per Mcf. Management determined that an impairment was not required on the Australian properties for the six months ended June 30, 2009. There was no impairment of United States or Australian properties during the six months ended June 30, 2008.

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GASTAR EXPLORATION LTD. AND SUBSIDIARIES

(NOTES TO CONSOLIDATED FINANCIAL STATEMENTS) (Continued)

4. Long-Term Debt

The following shows the Company s long-term debt at maturity as of the dates indicated:

	June 30, 2009	December 31, 2008
	(in thousands)	
Revolving credit facility	$ 13,900	$ 18,875
Term loan	25,000	
12 3/4% senior secured notes	100,000	100,000
Convertible subordinated debentures	30,000	30,000
Subordinated unsecured notes payable	300	3,250
Total long-term debt at maturity	169,200	152,125
Current portion of long-term debt	168,825	151,684
Debt discount costs to be accreted	375	441
Total net carrying value of long-term debt	$	$

The current portion of long-term debt as of June 30, 2009 is comprised of the following:

	Amount (in thousands)
Revolving credit facility	$ 13,900
Convertible subordinated debentures	30,000
Subordinated unsecured note payable	300
Total current maturities	44,200
Term loan	25,000
12 3/4% senior secured notes	99,625
Total current portion of long-term debt	$ 168,825

Revolving Credit Facility

On November 29, 2007, concurrent with the closing of the 12 3/4% Senior Secured Notes (as defined below), Gastar Exploration USA, Inc. (Gastar USA), a wholly owned subsidiary of the Company, entered into a revolving credit facility (the Revolving Credit Facility) providing for a first priority lien borrowing base limit of $14.0 million at June 30, 2009. At June 30, 2009, the prime rate was 5.0%; the Eurodollar rates for one and three months were 0.309% and 0.595%, respectively; and the Company had no availability under the borrowing base. The borrowing base is to be re-determined at least semi-annually, using the lender s usual and customary criteria for natural gas and oil reserve valuation. The Revolving Credit Facility and related guarantees under the Revolving Credit Facility are guaranteed by the Company as the Parent (the Parent) and all its current domestic subsidiaries and all future domestic subsidiaries formed during the term of the Revolving Credit Facility, and secured by a first priority lien on all domestic natural gas and oil properties currently owned by or later acquired by Gastar USA, excluding *de minimus* value properties as determined by the lender.

On February 16, 2009, in conjunction with the Company entering into a new $25.0 million term loan (the Term Loan), described below, Gastar USA, the Parent and certain subsidiaries of the Parent entered into the Waiver and Second Amendment to the Revolving Credit Agreement (the Second Amendment) to provide for the waiver of a breach of a covenant under the Revolving Credit Facility and the additional incurrence of first lien secured debt under the Term Loan. The Second Amendment provided for a waiver of any past or present breach of the current ratio covenant requiring the Company to maintain a ratio of current assets to current liabilities of 1.0 to 1.0. The Second Amendment also affected, among other matters, the following:

Allowed for the Term Loan to rank *pari passu* with the Revolving Credit Facility on liens;

GASTAR EXPLORATION LTD. AND SUBSIDIARIES

(NOTES TO CONSOLIDATED FINANCIAL STATEMENTS) (Continued)

Borrowings bear interest at a prime rate or LIBOR rate, plus in each case an applicable margin. The applicable interest rate margin varies from 0.25% to 1.0% in the case of borrowings based on the prime rate and from 2.5% to 3.25% in the case of borrowings based on the LIBOR rate, depending on the utilization level in relation to the borrowing base subject to a minimum borrowing interest rate of 5.0%;

Annual commitment fee, ranging from 0.50% to 0.75% depending on borrowing base utilization;

Borrowing base of $18.0 million and monthly amortization of $1.0 million per month commencing March 1, 2009;

Maintenance of a maximum total net debt to earnings before interest, taxes, depreciation and amortization (EBITDA), on a rolling four quarters basis as adjusted, of not more than 4.5 to 1.0 through December 31, 2009 and 4.0 to 1.0 for all quarters thereafter; and

Automatic extension of maturity date from the current maturity date of October 15, 2009 to December 1, 2010 if requested by the Company 30 days prior to maturity of the Revolving Credit Facility provided that the Convertible subordinated debentures repayment has occurred or the lender has been provided with assurance acceptable to the lender that such payment will occur.

On March 13, 2009, Gastar USA, the Parent, certain subsidiaries of the Parent and the Revolving Credit Facility lender, as Administrative Agent, entered into the Waiver and Third Amendment to the Credit Agreement (the Third Amendment) to provide for the waiver of a breach of the current ratio test under the Revolving Credit Facility. The waiver covered the current breach as well as any future breach of the current ratio covenant as determined as of the end of any quarter of the fiscal year ending December 31, 2009. The Third Amendment also provided for the waiver of a breach of a covenant under the Revolving Credit Facility resulting from the Company s auditors issuance of a going concern statement in its report on our 2008 consolidated financial statements.

As of June 30, 2009, the Company was not in compliance with the total net indebtedness to EBITDA ratio, general and administrative expense ratio and the current ratio covenants under the Revolving Credit Facility. A waiver has been received for all defaults, including the current ratio covenant, which has been waived through December 31, 2009 as described above.

Term Loan

On February 17, 2009, Gastar USA drew $25.0 million under the Term Loan to fund current and future capital commitments and operating costs. The Term Loan bears interest at a fixed rate of 20% per annum and matures on February 15, 2012. The annual effective interest rate, after amortization of the fees paid to establish the Term Loan is 21.9% The Term Loan contains various customary covenants, including restrictions on liens, restrictions on incurring other indebtedness without the lender s consent, restrictions on dividends and other restricted payments, and maintenance of various financial ratios consistent to the Revolving Credit Facility. Amounts outstanding under the Term Loan may be prepaid prior to maturity, with a prepayment premium of 10% if repaid prior to December 31, 2009, and a prepayment premium of 5% if repaid between January 1, 2010 and December 31, 2010. Upon a Change of Control (as defined in the Term Loan), all amounts outstanding under the Term Loan will be immediately due and payable.

Amounts outstanding under the Term Loan are secured by a first priority lien on Gastar USA s and certain of the Parent s subsidiaries primary natural gas and oil assets and certain other properties. The Term Loan and other existing and future indebtedness incurred under the Company s existing Revolving Credit Facility are and remain senior to the liens securing the 12 $^{3}/4$% Senior Secured Notes.

On March 13, 2009, concurrent with the execution of the Third Amendment, the Parent and Gastar USA entered into the Waiver under Term Loan to provide for a waiver of a breach of a current ratio test under the Term Loan. The current ratio covenant under the Term Loan is similar to the covenant in the Revolving Credit Facility. The waiver covers the current breach and any future breach of the current ratio covenant as determined as of the end of any quarter of our fiscal year ending December 31, 2009.

As of June 30, 2009, the Company was not in compliance with the total net indebtedness to EBITDA ratio, general and administrative expense ratio and the current ratio covenants under the Term Loan. On July 13, 2009, the Company repaid the Term Loan in full. See Note 17, Subsequent Events for additional information.

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GASTAR EXPLORATION LTD. AND SUBSIDIARIES

(NOTES TO CONSOLIDATED FINANCIAL STATEMENTS) (Continued)

12 3/4% Senior Secured Notes

On November 29, 2007, Gastar USA sold $100.0 million aggregate principal amount of 12 3/4% senior secured notes due December 1, 2012 (12 3/4% Senior Secured Notes) at an issue price of 99.50%. The Notes are governed by an indenture, dated as of November 29, 2007 (the Indenture), by and among the Company, Gastar USA, Wells Fargo Bank, National Association, as Trustee and Collateral Agent and each of the other Guarantors party thereto The annual effective interest rate, after amortization of the debt discount and fees paid to establish the 12 3/4% Senior Secured Notes, is 15.0%. The 12 3/4% Senior Secured Notes are fully and unconditionally guaranteed jointly and severally by Gastar USA, the Parent, and all of the Parent s existing and future material domestic subsidiaries (the Guarantors). The 12 3/4% Senior Secured Notes and the guarantees are secured by a second lien on Gastar USA s principal domestic natural gas and oil properties and other assets that secure the Revolving Credit Facility and Term Loan, subject to certain exceptions. The 12 3/4% Senior Secured Notes mature on December 1, 2012.

On February 16, 2009, Gastar USA, the Parent and the Guarantors entered into a supplemental indenture amending and modifying the Indenture, with regards to, among other matters, the following:

- Allowing incurrence of up to $55.0 million of first priority indebtedness including the Revolving Credit Facility and Term Loan;

- Providing that in the event the Company or any of its subsidiaries sells assets in East Texas the net proceeds from such sale to be utilized to repay any debt outstanding under the Revolving Credit Facility and Term Loan and any remaining net proceeds to be used for the pro rata redemption of the 12 3/4% Senior Secured Notes at stated premiums;

- Allowing that net proceeds up to $60.0 million from non-East Texas asset sales before February 1, 2011 may be reinvested during the first 360 days from the closing date in existing properties with uninvested net proceeds in excess of $5.0 million after 360 days to be used for the repayment of amounts outstanding under the Revolving Credit Facility, the Term Loan, and for the pro rata redemption of the 12 3/4% Senior Secured Notes at stated premiums; and

- Continuing restrictions on Company dividends and other restricted payments.

As of June 30, 2009, the Company was in compliance with all debt covenants under the 12 3/4% Senior Secured Notes.

On July 13, 2009, Gastar USA commenced an offer (the Asset Sale Offer) to repurchase any and all of the outstanding 12 3/4% Senior Secured Notes from the holders at a price of 106.375% of par plus accrued and unpaid interest, upon the terms and subject to the conditions set forth in the Asset Sale Offer Statement. On August 6, 2009, the note holder s tendered to the Company all of the outstanding $100.0 million principal amount of the 12 3/4% Senior Secured Notes at 106.375% of the principal amounts plus accrued and unpaid interest. The Company expects to retire the 12 3/4% Senior Secured Notes in full by tendering payment of $108.7 million on August 7, 2009. See Note 17, Subsequent Events for additional information.

Convertible Subordinated Debentures

In November 2004, the Company issued $30.0 million aggregate principal amount of Convertible senior unsecured subordinated debentures (the Convertible Subordinated Debentures). The Convertible Subordinated Debentures have a term of five years, are due November 20, 2009 and bear interest at 9.75% per annum, payable quarterly. After giving effect to the 1-for-5 Reverse Split (See Note 17, Subsequent Events), the Convertible Subordinated Debentures are convertible by the holders into 1,369,863 common shares at a conversion price of $21.90 per share and are redeemable, at the option of the Company, upon notice that the average price of the Company s common shares for 20 consecutive trading days is at least 130% of the conversion price.

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GASTAR EXPLORATION LTD. AND SUBSIDIARIES

(NOTES TO CONSOLIDATED FINANCIAL STATEMENTS) (Continued)

Subordinated Unsecured Notes Payable

The Company s $3.25 million Subordinated Unsecured Notes Payable began maturing in April 2009. As of June 30, 2009, the Company had $300,000 of Subordinated Unsecured Notes Payable outstanding, which mature between July 2009 and September 2009, bear interest at 10% per annum and are callable by the Company at 101%.

5. Fair Value of Financial Instruments

The estimated fair values for financial instruments under FSP SFAS No. 107-1, Interim Disclosures about Fair Value of Financial Instruments, are 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, marketable securities, accounts receivable and accounts payable approximates their carrying value due to their short-term nature. The estimated fair values of the Company s Revolving Credit Facility and Term Loan approximate respective carrying values because the 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 June 30, 2009 and December 31, 2008:

	As of June 30, 2009		As of December 31, 2008	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
	(in thousands)			
12 3/4% Senior secured notes	$ 100,000	$ 83,560	$ 100,000	$ 79,867
Convertible subordinated debentures - 9.75%	30,000	29,236	30,000	27,884
Subordinated unsecured notes payable - 10.0%	300	298	3,250	3,144
Total	$ 130,300	$ 113,094	$ 133,250	$ 110,895

The Company accounts for its derivative activities under the provisions of SFAS 133, *Accounting for Derivative Instruments and Hedging Activities*, as amended. This statement, as amended, establishes accounting and reporting that every derivative instrument be recorded on the balance sheet as either an asset or liability measured at fair value. See Note 7, Commodity Hedging Contracts for more details.

6. Equity Compensation Plans

Share-Based Compensation Plans

At the annual meeting of shareholders held June 4, 2009 (the Annual Meeting), the Company s shareholders approved amendments to the Gastar Exploration Ltd. 2006 Long-Term Stock Incentive Plan (the 2006 Plan). The 2006 Plan was initially adopted by the Board of Directors and approved by the shareholders in 2006. Previously, the 2006 Plan authorized the Board of Directors to issue stock options, stock appreciation rights, bonus stock awards and any other type of award consistent with the 2006 Plan s purpose to directors, officers and employees of the Company and its subsidiaries covering a maximum of 1.0 million shares of common stock of the Company. The Company also maintained the 2002 Stock Option Plan of Gastar Exploration Ltd. (the 2002 Stock Option Plan) which provided for the grant of only stock options to directors, officers, employees and consultants of the Company and its subsidiaries to purchase a maximum of 5.0 million common shares. Pursuant to the amendments that were approved at the Annual Meeting and effective as of April 1, 2009, the 2002 Stock Option Plan was merged into the 2006 Plan so that all outstanding equity awards and all future equity awards to be made to employees, officers and directors will be under one plan the 2006 Plan. The merging of the 2002 Stock Option Plan with and into the 2006 Plan, resulted in the cessation of the existence of the 2002 Stock Option Plan and the transfer of all common shares previously reserved and available for issuance under for the 2002 Stock Option Plan, including any common shares subject to outstanding stock option awards previously granted under the 2002 Stock Option Plan prior to the effective date of its merger into the 2006 Plan, to the common share reserve under the 2006 Plan.

The amendments to the 2006 Plan approved at the Annual Meeting: (a) provide that the Remuneration Committee, in its discretion, may provide in an award agreement that an individual who is granted an award under

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GASTAR EXPLORATION LTD. AND SUBSIDIARIES

(NOTES TO CONSOLIDATED FINANCIAL STATEMENTS) (Continued)

the 2006 Plan (a participant) may elect to have common shares withheld from (or netted against) the total number of common shares otherwise issuable to such participant pursuant to his award in order to pay the exercise or purchase price of such award and/or to satisfy all employer tax withhold obligations with respect to the participant s award under the 2006 Plan, (b) clarify that common shares issuable under the 2006 Plan and forfeited back to the 2006 Plan will be deemed not to have been issued under the 2006 Plan and will again be available for the grant of an award under the 2006 Plan, (c) provide that common shares withheld from (or netted against) an award granted under the 2006 Plan for payment of (1) the exercise or purchase price of an award and (2) all applicable employer tax withholding obligations associated with an award will be deemed not to have been issued under the 2006 Plan and will again be available for the grant of an award under the 2006 Plan, (d) provide that the maximum number of common shares that may be subject to stock options, bonus stock awards, and stock appreciation rights granted to any one individual during any calendar year may not exceed 200,000 common shares (subject to adjustment pursuant to Section 11(a) of the 2006 Plan), and (e) provide that the definition of performance criteria in the 2006 Plan include a criteria relating to the growth of proved natural gas and oil reserves of the Company.

At June 30, 2009, 1,505,471 common shares (after giving effect to the 1-for-5 Reverse Split) were available for future stock-based compensation grants under the 2006 Plan.

Determining Fair Value under SFAS No. 123R

In determining fair value for stock option grants pursuant to SFAS No. 123R, Share Based Payments (SFAS No. 123R) the Company utilized the following assumptions:

Valuation and Amortization Method. The Company estimates the fair value of share-based awards granted using the Black-Scholes-Merton valuation model. The fair value of all awards is expensed using the graded-vesting method .

Expected Life. The expected life of awards granted represents the period of time that stock options are expected to be outstanding. The Company determined the expected life to be 6.25 years, based on historical information, for all stock options issued with a four-year vesting period and ten-year grant expiration.

Expected Volatility. Using the Black-Scholes-Merton valuation model, the Company estimates the volatility of its common shares at the beginning of the quarter in which the stock option is granted. The volatility is based on historical movements of the Company s common share price on the NYSE Amex over a period that approximates the expected life.

Risk-Free Interest Rate. The Company utilizes a risk-free interest rate equal to the rate of U.S. Treasury zero-coupon issues as of the date of grant with a term equivalent to the stock option s expected life.

Expected Dividend Yield. The Company has not paid any cash dividends on its common shares and does not anticipate paying any cash dividends in the foreseeable future. Consequently, a dividend yield of zero is utilized in the Black-Scholes-Merton valuation model.

Expected Forfeitures. Forfeitures of unvested stock option and restricted common shares are calculated at the beginning of the year as a percentage of all stock option and restricted common share grants. For 2009, the Company is utilizing a 6.5% forfeiture rate in determining compensation expense.

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GASTAR EXPLORATION LTD. AND SUBSIDIARIES

(NOTES TO CONSOLIDATED FINANCIAL STATEMENTS) (Continued)

The fair value of each stock option grant is estimated on the date of grant using the Black-Scholes-Merton valuation pricing model. The table below summarizes the number of stock options granted and the assumptions for the stock options granted for the period indicated:

	For the Six Months Ended June 30, 2009
Stock options granted during the reporting period	217,300
Expected life (in years)	6.25
Expected volatility	59.3%
Risk-free interest rate	1.97%

The weighted average grant date fair value of stock options granted and the intrinsic value of stock options exercised are shown below for the period indicated. Intrinsic value of stock options is calculated using the difference between the common share price on the date of exercise and the exercise price times the number of stock options exercised.

	For the Six Months Ended June 30, 2009 (in thousands, except per share data)	
Weighted average grant date fair value of outstanding stock options	$	5.36
Intrinsic value of stock options exercised	$	
Fair value of stock option shares vested during reporting period	$	667

Stock Option Activity

The following table summarizes certain information about stock options under the Company s 2006 Plan as of and for the six months ended June 30, 2009.

	Number of Shares Under Stock Options	Weighted Average Exercise Price	
Stock options outstanding as of December 31, 2008	1,929,750	$	13.80
Stock options granted	217,300	$	2.60
Stock options exercised		$	
Stock options cancelled/expired	(144,000)	$	15.70
Stock options outstanding as of June 30, 2009	2,003,050	$	13.00
Stock options exercisable as of June 30, 2009	1,528,283	$	14.38

The table below summarizes certain information about the stock options as of and during the six months ended June 30, 2009. Fair value calculations are as of the date of grant.

	Number of Shares Under Stock Options	Weighted Average Fair Value
Unvested stock options at December 31, 2008	359,833	$ 6.70
Unvested stock options at June 30, 2009	474,767	$ 4.16
Stock options granted during the six months ended June 30, 2009	217,300	$ 1.50
Stock options vested during the six months ended June 30, 2009	85,200	$ 7.83
Stock options canceled during the six months ended June 30, 2009	144,000	$ 5.34

As of June 30, 2009, there was no aggregate intrinsic value for outstanding stock options. The remaining weighted average contractual life of outstanding stock options was 4.5 years. As of June 30, 2009, the total fair value of exercisable stock options was $8.8 million.

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GASTAR EXPLORATION LTD. AND SUBSIDIARIES

(NOTES TO CONSOLIDATED FINANCIAL STATEMENTS) (Continued)

The following table summarizes the range of exercise prices for stock options outstanding and exercisable as of June 30, 2009:

Expiration Date	Number of Shares Under Stock Options Outstanding	Number of Shares Under Stock Options Exercisable	Exercise Prices (1)
August 4, 2009	710,750	710,750	$ 14.76
April 4, 2010	4,200	4,200	$ 18.61
June 24, 2010	65,000	65,000	$ 15.15
June 28, 2010	10,000	10,000	$ 14.71
September 7, 2010	30,000	22,500	$ 14.06
September 20, 2010	8,000	6,000	$ 17.31
October 17, 2015	15,000	11,250	$ 19.47
January 16, 2016	54,000	40,500	$ 21.68
April 5, 2016	167,600	125,700	$ 20.77
July 14, 2016	581,000	487,333	$ 11.60
March 30, 2017	40,000	20,000	$ 10.85
July 3, 2017	60,000	15,000	$ 11.00
July 7, 2017	40,000	10,000	$ 10.95
August 30, 2017	200	50	$ 8.35
March 19, 2019	217,300		$ 2.60
	2,003,050	1,528,283	

(1) Stock options granted with strike prices denominated in CDN$ have been converted to US$ by multiplying the CDN$ strike price by the exchange rate at June 30, 2009.

Restricted Share Activities

The following table summarizes the changes and grant date prices for restricted common share grants during the six months ended June 30, 2009:

	Number of Shares Under Stock Options	Weighted Average Grant Date Fair Value
Restricted common shares granted and subject to vesting as of December 31, 2008	506,780	$ 10.10
Restricted common shares granted	421,535	$ 2.60
Restricted common shares vested	(226,449)	$ 2.60
Restricted common shares forfeited/canceled	(126,225)	$ 4.41
Restricted common shares granted and subject to vesting as of June 30, 2009	575,641	$ 8.79

The following table summarizes the range expiration dates and grant date prices for restricted common shares outstanding and unvested as of June 30, 2009:

Expiration Date	Restricted Common Shares Outstanding	Grant Date Fair Value
March 19, 2011	5,000	$ 2.60
July 3, 2011	194,450	$ 11.00
January 16, 2012	2,000	$ 5.45
May 16, 2012	268,541	$ 9.55
August 18, 2012	9,000	$ 8.75
March 19, 2019	96,650	$ 2.60
Total	575,641	

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GASTAR EXPLORATION LTD. AND SUBSIDIARIES

(NOTES TO CONSOLIDATED FINANCIAL STATEMENTS) (Continued)

As of June 30, 2009, the remaining weighted average contractual life of unvested restricted common shares was 2.7 years. The following table shows the total value and weighted average fair value per share of restricted common shares outstanding as of the date indicated:

	As of June 30, 2009 (in thousands, except per share data)	
Total value of restricted common shares granted and subject to vesting (1)	$	1,151
Weighted average grant date fair value of restricted common share granted and subject to vesting	$	8.79

(1) Based on the closing price on June 30, 2009 of $2.00 per share. (adjusted for the 1-for-5 reverse split).

Stock-Based Compensation Expense

For the three months ended June 30, 2009 and 2008, the Company recorded stock-based compensation expense for stock options and restricted common shares granted using the fair-value method of $713,000 and $855,000, respectively. For the six months ended June 30, 2009 and 2008, the Company recorded stock-based compensation expense for stock options and restricted common shares granted using the fair-value method of $2.1 million and $1.7 million, respectively. Stock-based compensation expense for the six months ended June 30, 2009 includes $801,000 of compensation expense resulting from the payment of 2008 management bonuses in vested common shares in lieu of cash bonuses. All stock-based compensation costs were expensed and not tax effected, as the Company currently records no income tax expense. All common shares issued upon exercise or vesting are reserved and non-assessable.

As of June 30, 2009, the Company had approximately $3.3 million of total unrecognized compensation cost related to unvested stock options and restricted common shares, which is expected to be amortized over the following periods:

	Amount (in thousands)	
From June 30, 2009	$	1,065
2010		1,437
2011		622
2012		156
2013		9
Total	$	3,289

7. Commodity Hedging Contracts

The Company maintains a commodity price risk management strategy that uses derivative instruments to minimize significant, unanticipated earnings fluctuations that may arise from volatility in commodity prices. The Company uses costless collars, index swaps, basis swaps and put options to hedge natural gas price risk.

Effective October 1, 2008, the Company elected to discontinue hedge accounting on all existing derivative contracts and elected not to designate any derivative contracts as cash flow hedges under SFAS No. 133. Any hedge effectiveness related to the Company s previous cash flow hedging relationships will remain in Other Comprehensive Income until the underlying forecasted transactions affect earnings. As a result, for the three and six months ended June 30, 2009, gains of $0.8 million and $1.7 million, respectively, that were reclassified into earnings as a result of the discontinuance of cash flow hedge accounting treatment for the Company s derivatives. All derivative contracts are carried at their fair value on the balance sheet and all unrealized gains and losses are recorded in the statement of operations in unrealized natural gas hedge loss, while realized gains and losses related to contract settlements are recognized in natural gas and oil revenues.

The following derivative transactions were outstanding with associated notional volumes and hedge prices for the index specified as of June 30, 2009:

Date	Remaining Period	Derivative Instrument (1)	Notional Daily Volume Average (MMBtu)	Total Volume Remaining (MMBtu)	Base Fixed Price	Puts (MMBtu)	Call (MMBtu)	Index	Production Area Hedged
01/29/09	July-Dec 09	P	12,218	2,248,069		$ 5.00		Nymex-HH	TX/WY
05/12/09	July-Dec 09	CC	5,000	920,000		$ 4.50	$ 6.00	Nymex-HH	TX/WY
05/12/09	Nov-Dec 09	CC	5,000	305,000		$ 5.00	$ 7.00	Nymex-HH	TX/WY
10/15/08	July-Dec 09	B	5,000	920,000	-$ 0.3825			HSC (2)	TX
10/15/08	July-Dec 09	I	5,000	920,000				HSC (2)	TX
02/12/09	July-Dec 09	B	2,000	368,000	-$ 0.3750			HSC (2)	TX
03/16/09	July-Oct 09	B	2,000	246,000	-$ 0.2800			HSC (2)	TX
03/25/09	July-Oct 09	B	2,000	246,000	$ 0.2850			HSC (2)	TX
11/14/08	July-Dec 09	B	1,500	276,000	-$ 2.2200			CIG (3)	WY
11/21/08	July-Dec 09	B	1,000	184,000	-$ 2.0200			CIG (3)	WY
02/12/09	July-Dec 09	B	850	156,400	-$ 1.7500			CIG (3)	WY
05/05/09	Jan-Mar 10	CC	10,000	900,000		$ 5.00	$ 7.00	Nymex-HH	TX/WY
05/15/09	Apr-Oct 10	CC	2,500	535,000		$ 5.50	$ 8.50	Nymex-HH	TX/WY
06/17/09	Apr-Oct 10	CC	2,500	535,000		$ 5.50	$ 8.70	Nymex-HH	TX/WY
06/17/09	Nov-Dec 10	CC	2,500	152,500		$ 7.00	$ 9.15	Nymex-HH	TX/WY
05/15/09	Jan-Mar 10	B	7,500	675,000	-$ 0.2800			HSC (2)	TX
05/15/09	Jan-Oct 10	B	2,500	760,000	-$ 0.3900			HSC (2)	TX
04/07/09	Cal 10	B	1,000	365,000	-$ 1.3100			CIG (3)	WY
06/17/09	Jan-Mar 11	CC	2,500	225,000		$ 7.00	$ 9.15	Nymex-HH	TX/WY
04/07/09	Cal 11	B	1,000	365,000	-$ 1.2100			CIG (3)	WY

(1) CC = Costless collars.
(1) B = Basis Swaps.
(1) I = Index swaps;Gas Daily to IFERC Monthly Index.
(1) P = Put purchased.

As of June 30, 2009, all of the Company s economic derivative hedge positions were with a multinational energy company or large financial institution, which are not known to the Company to be in default on their derivative positions. Credit support for the Company s open derivatives at June 30, 2009 is provided under the Revolving Credit Facility through intercreditor agreements or under a $100,000 letter of credit. The Company is exposed to credit risk to the extent of nonperformance by the counterparties in the derivative contracts discussed above; however, the Company believes the credit risk is minimal and does not anticipate non-performance by such counterparties. None of the Company s derivative instruments contains credit-risk related contingent features.

Based on the Company s projections, approximately 84% of its remaining 2009 estimated future natural gas production was hedged as of June 30, 2009 at a weighted average NYMEX MMBtu put price of $4.87 and a call price of $6.25. The Company has approximately 2.1 Bcf of 2010 production hedged at a weighted average NYMEX MMBtu put price of $5.40 and a call price of $7.96.

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GASTAR EXPLORATION LTD. AND SUBSIDIARIES

(NOTES TO CONSOLIDATED FINANCIAL STATEMENTS) (Continued)

The Company adopted SFAS No. 161 at the beginning of the first quarter of 2009, and the expanded disclosures required by SFAS No. 161 are presented below. The table below provides data about the carrying values of derivatives that are not designated as hedge instruments under SFAS No. 133. Dollar amounts below are shown in thousands.

Derivatives not designated as hedging instruments under SFAS No. 133	**Asset Derivatives June 30, 2009**		
	Balance Sheet Location	**Fair Value**	
Current	Commodity Derivative Contracts	$	2,986
Long-term	Commodity Derivative Contracts	$	213
Total derivatives not designated as hedging instruments under SFAS 133		$	3,199

Derivatives not designated as hedging instruments under SFAS No. 133	**Liability Derivatives June 30, 2009**		
	Balance Sheet Location	**Fair Value**	
Current	Commodity Derivative Contracts	$	1,299
Long-term	Commodity Derivative Contracts	$	273
Total derivatives not designated as hedging instruments under SFAS 133		$	1,572

Derivatives not designated as hedging instruments under SFAS No. 133	**Amount of Gain or (Loss) Recognized in Income on Derivatives Three Months Ended June 30, 2009**		
	Location of Gain/(Loss) Recognized in Income on Derivatives	**Amount of Gain or (Loss) Recognized in Income on Derivatives**	
Commodity Contracts	Unrealized Natural Gas Hedges	$	(4,426)

Derivatives not designated as hedging instruments under SFAS No. 133	**Amount of Gain or (Loss) Recognized in Income on Derivatives Six Months Ended June 30, 2009**		
	Location of Gain/(Loss) Recognized in Income on Derivatives	**Amount of Gain or (Loss) Recognized in Income on Derivatives**	
Commodity Contracts	Unrealized Natural Gas Hedges	$	(4,622)

8. Fair Value Measurements

Fair Value Measurements. In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements (SFAS No. 157), which defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. SFAS No. 157 applies to other accounting pronouncements that require or permit fair value measurements; however, it does not require any new fair value measurements.

SFAS No. 157 establishes a valuation hierarchy for disclosure of the inputs to valuation used to measure fair value. This hierarchy prioritizes the inputs into three broad levels as follows:

Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities. The Company s cash equivalents consist of short-term, highly liquid investments, which have maturities of 90 days or less, including sweep investments and money market funds.

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GASTAR EXPLORATION LTD. AND SUBSIDIARIES

(NOTES TO CONSOLIDATED FINANCIAL STATEMENTS) (Continued)

Level 2 inputs are quoted prices for similar assets and liabilities in active markets or inputs that are observable for the asset or liability, either directly or indirectly through market corroboration, for substantially the full term of the financial instrument.

Level 3 inputs are measured based on prices or valuation models that require inputs that are both significant to the fair value measurement and less observable from objective sources. The Company s valuation models consider various inputs including (a) quoted forward prices for commodities, (b) time value, (c) volatility factors and (d) current market and contractual prices for the underlying instruments. Level 3 instruments are natural gas costless collars, index swaps, basis swaps and put options. Although the Company utilizes third party broker quotes to assess the reasonableness of prices and valuation techniques, the Company does not have sufficient corroborating market evidence to support classifying these instruments as Level 2.

A financial asset s or liability s classification within the hierarchy is determined based on the lowest level input that is significant to the fair value measurement. The determination of the fair values below incorporates various factors required under SFAS No. 157, including the impact of the counterparty s non-performance risk with respect to the Company s financial assets and the Company s non-performance risk with respect to the Company s financial liabilities. Under the guidance of FASB Staff Position No. FIN 39-1, Amendment of FASB Interpretation No. 39 , we have not elected to offset the fair value amounts recognized for multiple derivative instruments executed with the same counterparty, but report them gross on the Condensed Consolidated Balance Sheets. The following table provides the assets and liabilities carried at fair value measured on a recurring basis as of June 30, 2009:

	As of June 30, 2009 (in thousands)			
	Level 1	Level 2	Level 3	Total
Assets:				
Cash equivalents	$ 12,499	$	$	$ 12,499
Commodity derivatives	$	$	$ 3,199	$ 3,199
Liabilities:				
Commodity derivatives	$	$	$ 1,572	$ 1,572

The following table sets forth a reconciliation of changes in the fair value of financial assets and liabilities classified as Level 3 in the fair value hierarchy for the six months ended June 30, 2009:

	Derivatives For the Six Months Ended June 30, 2009 (in thousands)
Balance as of December 31, 2008	$ 8,708
Total gains or losses (realized or unrealized):	
Included in earnings (1)	847
Included in other comprehensive (loss) income (2)	
Purchases, issuances and settlements	(7,928)
Transfers in and out of Level 3	
Balance as of June 30, 2009	$ 1,627
Changes in unrealized loss relating to derivatives still held as of June 30, 2009	$ (1,926)

(1) This amount is included in natural gas and oil revenues on the statement of operations.
(2) None of the changes in other comprehensive income for the period related to derivatives held as of December 31, 2008 or June 30, 2009. Effective October 1, 2008, the Company discontinued hedge accounting. Any hedge effectiveness related to the Company s previous cash flow hedging relationships will remain in Other Comprehensive Income until the underlying forecasted transactions affect earnings.

GASTAR EXPLORATION LTD. AND SUBSIDIARIES

(NOTES TO CONSOLIDATED FINANCIAL STATEMENTS)   (Continued)

9. Capital Stock

Common Shares

The Company s articles of incorporation allow the Company to issue an unlimited number of common shares without par value. On July 23, 2009, the Company filed an article of amendment to its Articles of Incorporation with the Registrar of Corporations of Alberta, Canada for the purpose of affecting a reverse split of the Company s common shares on a basis of one (1) new common share for each five (5) common share outstanding. The Company s shareholders approved the reverse split at the 2008 Annual General and Special Meeting of Shareholders held on June 20, 2008 by a special resolution authorizing a reverse split of the Company s common shares on the basis of (1) new common share for up to five (5) common shares outstanding or such fewer number of commons shares as the Board of Directors may, in its sole discretion, approve at a later date. The Board of Directors approved the 1-for-5 reverse split on June 29, 2009. As of the opening of trading on August 3, 2009, the Company s common shares began trading on the NYSE Amex under the same symbol of GST on a post 1-for-5 Reverse Split basis. All common share and per share amounts reported in the Form 10-Q have been reported on a post reverse split basis.

Preferred Shares

On June 30, 2009, Company filed an article of amendment to its Articles of Incorporation to be effective as of June 30, 2009 with the Registrar of Corporations of Alberta, Canada for the purpose of creating and adding an unlimited number of preferred shares to the authorized capital of the Company. Pursuant to this amendment, the number of preferred shares which may be issued from time to time will be determined by the Board of Directors of the Company. The preferred shares will have the rights, privileges, restrictions and conditions set out in the share structure included in and forming part of the Company s amended Articles of Incorporation. The Company s shareholders approved the amendment by special resolution at the 2007 Annual General and Special Meeting of Shareholders held on June 1, 2007.

Other Share Issuances

On May 22, 2009, the Company sold 7,300,000 of its common shares in an underwritten public offering to investors in the United States pursuant to the Company s Registration Statement on Form S-3, which was declared effective by the SEC on April 27, 2007.

During the six months ended June 30, 2009, pursuant to the Company s 2006 Plan (see Note 6, Equity Compensation Plans), 421,535 restricted common shares were granted to employees, of which 226,449 vested immediately, 81,436 common shares were returned to the Company and cancelled in payment of withholding taxes, and 113,650 common shares are subject to vesting.

Shares Reserved

At June 30, 2009, the Company has reserved 5,377,149 common shares to be issued pursuant to the conversion of Convertible Subordinated Debentures (1,369,863 common shares), exercise of stock options (2,003,050 common shares) and the exercise of warrants (2,004,236 common shares).

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GASTAR EXPLORATION LTD. AND SUBSIDIARIES

(NOTES TO CONSOLIDATED FINANCIAL STATEMENTS) (Continued)

10. Warrants

The following table summarizes warrant information to purchase common shares as of June 30, 2009:

	Number of Warrants	Fair Value of Warrant (in thousands)	Warrant Price per Share Range	Weighted Average Remaining Life in Years	Weighted Average Exercise Price in US$
Warrants issued in connection with subordinated unsecured notes payable	4,236	$ 21	$14.10 - $14.20	0.1	$ 14.15
Warrant issued in connection with litigation settlement	2,000,000	$ 5,548	(1)	2.4	$ (1)

(1) The warrant is exercisable for $13.75 per share in the event that, on or before June 11, 2011, the Company sells all or substantially all of its present oil and gas interests located in Leon and Robertson Counties in East Texas for net proceeds exceeding $500.0 million. A sale or a series of sales, of all or substantially all of the Company s present East Texas properties prior to June 11, 2011 for $500.0 million or less will terminate the warrant. If the Company does not sell all or substantially all of these properties by June 11, 2011, the warrant will be exercisable for a six-month period commencing on that date at $15.00 per share. The Company is not obligated to sell any of its East Texas properties.

11. Interest Expense

The following tables summarize the components of interest expense for the periods indicated:

	For the Three Months Ended June 30, 2009	For the Three Months Ended June 30, 2008	For the Six Months Ended June 30, 2009	For the Six Months Ended June 30, 2008
	(in thousands)			
Interest expense:				
Cash and accrued	$ 5,447	$ 3,994	$ 10,273	$ 7,998
Amortization of deferred financing costs and debt discount	722	485	1,408	948
Capitalized interest	(5,032)	(2,590)	(9,382)	(4,961)
Total interest expense	$ 1,137	$ 1,889	$ 2,299	$ 3,985

12. Related Party Transactions

Chesapeake Energy Corporation

On November 4, 2005, the Company completed an integrated transaction with Chesapeake Energy Corporation (Chesapeake) whereby Chesapeake acquired 5,430,328 newly issued common shares equal to 19.9% of the Company s then outstanding common shares and acquired a 33.3% working interest in the Company s Bossier play in the Hilltop area of East Texas. As part of this transaction, Chesapeake paid an additional $7.8 million, before fees and expenses, to reimburse the Company for Chesapeake s pro rata share of leasehold interests acquired and to pay a disproportionate amount of future drilling costs in exchange for an undivided 33.3% of the Company s leasehold working interests in the deep Bossier Hilltop prospect, less and except 160 acres surrounding each existing well bore. Chesapeake agreed to pay 44.44% of the drilling costs through casing point in the first six wells drilled by the parties in the Hilltop prospect to a depth sufficient to test the deep Bossier formation (an approximate depth of 19,000 feet) in order to earn its 33.33% leasehold working interest. The leasehold reimbursement was recorded as a reduction to natural gas and oil property cost.

As a result of its purchase of common shares, Chesapeake has the right to negotiate exclusively with the Company for a period of 30 days on any proposed sale of assets in the Hilltop area of East Texas. Additionally, Chesapeake has the right, with certain exceptions, to maintain its percentage ownership of the Company, on a fully diluted basis, by participating in future stock issuances and has the right to have an observer present at meetings of the Board of Directors.

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