NEWFIELD EXPLORATION CO /DE/
Form 10-Q
October 29, 2007

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SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

(Mark One)

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

For the Quarterly Period Ended September 30, 2007

OR

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

For the Transition Period from __________to__________.

Commission File Number: 1-12534

NEWFIELD EXPLORATION COMPANY

(Exact name of Registrant as specified in its charter)

Delaware	**72-1133047**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)

363 North Sam Houston Parkway East
Suite 2020
Houston, Texas 77060
(Address and Zip Code of principal executive offices)
(281) 847-6000
(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 þ No o

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

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act).

Yes o No þ

As of October 25, 2007, there were 130,905,118 shares of the Registrant s Common Stock, par value $0.01 per share, outstanding.

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NEWFIELD EXPLORATION COMPANY
CONSOLIDATED BALANCE SHEET
(In millions, except share data)
(Unaudited)

	September 30, 2007	December 31, 2006
ASSETS		
Current assets:		
Cash and cash equivalents	$ 141	$ 80
Short-term investments	43	10
Accounts receivable	329	374
Inventories	74	44
Derivative assets	93	280
Deferred taxes	10	¾
Other current assets	36	58
Assets of discontinued operations	11	5
Total current assets	737	851
Oil and gas properties (full cost method, of which $1,190 at September 30, 2007 and $970 at December 31, 2006 were excluded from amortization)	9,349	8,689
Less accumulated depreciation, depletion and amortization	(3,802)	(3,234)
	5,547	5,455
Furniture, fixtures and equipment, net	33	28
Derivative assets	26	19
Other assets	24	20
Goodwill	62	62
Assets of discontinued operations	177	200
Total assets	$ 6,606	$ 6,635
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 49	$ 58
Current debt	124	124
Accrued liabilities	598	641
Advances from joint owners	37	90
Asset retirement obligation	4	40
Derivative liabilities	103	80
Deferred taxes	¾	63
Liabilities of discontinued operations	14	27
Total current liabilities	929	1,123

Other liabilities		32		28
Derivative liabilities		181		179
Long-term debt		1,049		1,048
Asset retirement obligation		51		225
Deferred taxes		1,098		963
Liabilities of discontinued operations		11		7
Total long-term liabilities		2,422		2,450
Commitments and contingencies (Note 6)		¾		¾
Stockholders equity:				
Preferred stock ($0.01 par value; 5,000,000 shares authorized; no shares issued)		¾		¾
Common stock ($0.01 par value; 200,000,000 shares authorized at September 30, 2007 and December 31, 2006; 132,497,291 and 131,063,555 shares issued and outstanding at September 30, 2007 and December 31, 2006, respectively)		1		1
Additional paid-in capital		1,249		1,198
Treasury stock (at cost; 1,891,535 and 1,879,874 shares at September 30, 2007 and December 31, 2006, respectively)		(31)		(30)
Accumulated other comprehensive income (loss):				
Foreign currency translation adjustment		15		14
Commodity derivatives		¾		(5)
Minimum pension liability		(3)		(3)
Retained earnings		2,024		1,887
Total stockholders equity		3,255		3,062
Total liabilities and stockholders equity	$	6,606	$	6,635

The accompanying notes to consolidated financial statements are an integral part of this statement.

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NEWFIELD EXPLORATION COMPANY
CONSOLIDATED STATEMENT OF INCOME
(In millions, except per share data)
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2007	**2006**	**2007**	**2006**
Oil and gas revenues	$ 419	$ 425	$ 1,384	$ 1,246
Operating expenses:				
Lease operating	64	36	268	155
Production and other taxes	25	12	63	43
Depreciation, depletion and amortization	162	159	539	434
General and administrative	37	33	107	89
Ceiling test writedown	¾	6	¾	6
Other	¾	(6)	¾	(11)
Total operating expenses	288	240	977	716
Income from operations	131	185	407	530
Other income (expense):				
Interest expense	(29)	(22)	(80)	(64)
Capitalized interest	13	11	35	33
Commodity derivative income (expense)	38	247	(43)	299
Other	1	2	3	7
	23	238	(85)	275
Income from continuing operations before income taxes	154	423	322	805
Income tax provision:				
Current	57	18	78	30
Deferred	5	138	47	264
	62	156	125	294
Income from continuing operations	92	267	197	511
Loss from discontinued operations, net of tax	(9)	(1)	(60)	(2)
Net income	$ 83	$ 266	$ 137	$ 509

Earnings per share:				
Basic ¾				
Income from continuing operations	$ 0.72	$ 2.11	$ 1.54	$ 4.03
Loss from discontinued operations	(0.07)	(0.01)	(0.47)	(0.01)
Net income	$ 0.65	$ 2.10	$ 1.07	$ 4.02
Diluted ¾				
Income from continuing operations	$ 0.70	$ 2.07	$ 1.51	$ 3.96
Loss from discontinued operations	(0.06)	(0.01)	(0.46)	(0.01)
Net income	$ 0.64	$ 2.06	$ 1.05	$ 3.95
Weighted average number of shares outstanding for basic earnings per share	128	126	127	127
Weighted average number of shares outstanding for diluted earnings per share	131	129	130	129

The accompanying notes to consolidated financial statements are an integral part of this statement.

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NEWFIELD EXPLORATION COMPANY
CONSOLIDATED STATEMENT OF CASH FLOWS
(In millions)
(Unaudited)

	Nine Months Ended September 30, 2007	Nine Months Ended September 30, 2006
Cash flows from operating activities:		
Net income	$ 137	$ 509
Adjustments to reconcile net income to net cash provided by continuing operating activities:		
Loss from discontinued operations, net of tax	60	2
Depreciation, depletion and amortization	539	434
Deferred taxes	47	264
Stock-based compensation	18	18
Early redemption premium	¾	8
Commodity derivative (income) expense		
Total (gains) losses	43	(299)
Realized gains	174	73
Ceiling test writedown	¾	6
Changes in operating assets and liabilities:		
(Increase) decrease in accounts receivable	(12)	82
Increase in inventories	(29)	(18)
(Increase) decrease in other current assets	18	(22)
Increase in other assets	7	12
Increase (decrease) in accounts payable and accrued liabilities	(8)	42
Decrease in commodity derivative liabilities	(2)	(13)
Increase (decrease) in advances from joint owners	(53)	40
Increase in other liabilities	4	5
Net cash provided by continuing activities	943	1,143
Net cash provided by (used in) discontinued activities	(12)	2
Net cash provided by operating activities	931	1,145
Cash flows from investing activities:		
Acquisition of oil and gas properties	(578)	¾
Additions to oil and gas properties	(1,532)	(1,126)
Insurance recoveries	¾	45
Proceeds from sale of oil and gas properties	1,281	¾
Additions to furniture, fixtures and equipment	(7)	(4)
Purchases of short-term investments	(43)	(541)
Redemption of short-term investments	24	511
Net cash used in continuing activities	(855)	(1,115)

Net cash used in discontinued activities	(41)	(118)
Net cash used in investing activities	(896)	(1,233)
Cash flows from financing activities:		
Proceeds from borrowings under credit arrangements	2,909	491
Repayments of borrowings under credit arrangements	(2,909)	(491)
Proceeds from issuance of senior subordinated notes	¾	550
Repayment of senior subordinated notes	¾	(250)
Payments to discontinued operations	(38)	(121)
Proceeds from issuances of common stock	18	9
Stock-based compensation excess tax benefit	8	3
Purchases of treasury stock	(1)	(3)
Net cash provided by (used in) continuing activities	(13)	188
Net cash provided by discontinued activities	38	121
Net cash provided by financing activities	25	309
Effect of exchange rate changes on cash and cash equivalents	1	5
Increase in cash and cash equivalents	61	226
Cash and cash equivalents from continuing operations, beginning of period	52	38
Cash and cash equivalents from discontinued operations, beginning of period	28	1
Cash and cash equivalents, end of period	$ 141	$ 265

The accompanying notes to consolidated financial statements are an integral part of this statement.

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NEWFIELD EXPLORATION COMPANY
CONSOLIDATED STATEMENT OF STOCKHOLDERS EQUITY
(In millions)
(Unaudited)

	Common Stock		Treasury Stock		Additional Paid-in	Retained	Accumulated Other Comprehensive Income	Total Stockholders
	Shares	Amount	Shares	Amount	Capital	Earnings	(Loss)	Equity
Balance, December 31, 2006	131.1	$ 1	(1.9)	$ (30)	$ 1,198	$ 1,887	$ 6	$ 3,062
Issuance of common and restricted stock	1.4				18			18
Stock-based compensation					25			25
Treasury stock, at cost				(1)				(1)
Stock-based compensation excess tax benefit					8			8
Comprehensive income:								
Net income						137		137
Foreign currency translation adjustment, net of tax of ($1)							1	1
Reclassification adjustments for settled hedging positions, net of tax of $2							(3)	(3)
Reclassification adjustments for discontinued cash flow hedges, net of tax of ($1)							2	2
Changes in fair value of outstanding hedging positions, net of tax of ($4)							6	6
Total comprehensive income								143
Balance, September 30,	132.5	$ 1	(1.9)	$ (31)	$ 1,249	$ 2,024	$ 12	$ 3,255

2007

The accompanying notes to consolidated financial statements are an integral part of this statement.

NEWFIELD EXPLORATION COMPANY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Organization and Summary of Significant Accounting Policies:

Organization and Principles of Consolidation

We are an independent oil and gas company engaged in the exploration, development and acquisition of crude oil and natural gas properties. Our domestic areas of operation include the Anadarko and Arkoma Basins of the Mid-Continent, the onshore Gulf Coast, the Uinta Basin of the Rocky Mountains and the deepwater Gulf of Mexico. Internationally, we are active offshore Malaysia and China.

Our financial statements include the accounts of Newfield Exploration Company, a Delaware corporation, and its subsidiaries. We proportionately consolidate our interests in oil and gas exploration and production ventures and partnerships in accordance with industry practice. All significant intercompany balances and transactions have been eliminated. Unless otherwise specified or the context otherwise requires, all references in these notes to Newfield, we, us or our are to Newfield Exploration Company and its subsidiaries.

These unaudited consolidated financial statements reflect, in the opinion of our management, all adjustments, consisting only of normal and recurring adjustments, necessary to state fairly our financial position as of, and results of operations for, the periods presented. These financial statements have been prepared in accordance with the instructions to Form 10-Q and, therefore, do not include all disclosures required for financial statements prepared in conformity with accounting principles generally accepted in the United States of America. Interim period results are not necessarily indicative of results of operations or cash flows for a full year.

These financial statements and notes should be read in conjunction with our audited consolidated financial statements and the notes thereto included in our annual report on Form 10-K for the year ended December 31, 2006.

On September 17, 2007, we entered into an agreement to sell all of our interests in the U.K. North Sea for $486 million. As a result of this agreement, the results of operations and financial position of our U.K. subsidiaries are reflected in our financial statements as discontinued operations. This reclassification affects not only the 2007 presentation of our financial statements, but also the presentation of all prior period financial statements. See Note 2, Discontinued Operations. Except where noted, discussions in these notes relate to our continuing operations only.

Dependence on Oil and Gas Prices

As an independent oil and gas producer, our revenue, profitability and future rate of growth are substantially dependent on prevailing prices for natural gas and oil. Historically, the energy markets have been very volatile, and there can be no assurance that oil and gas prices will not be subject to wide fluctuations in the future. A substantial or extended decline in oil or gas prices could have a material adverse effect on our financial position, results of operations, cash flows and access to capital and on the quantities of oil and gas reserves that we can economically produce.

Use of Estimates

The preparation of financial statements in accordance with accounting principles generally accepted in the United States of America requires our management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements, the reported amounts of revenues and expenses during the reporting period and the reported amounts of proved oil and gas reserves. Actual results could differ from these estimates. Our most significant financial estimates are associated with our proved oil and gas reserves.

Investments

Investments consist of highly liquid investment grade commercial paper and municipal and corporate bonds with a maturity of less than one year. These investments are classified as available-for-sale. Accordingly, unrealized gains and losses and the related deferred income tax effects are excluded from earnings and reported as a separate component of stockholders equity. Realized gains or losses are computed based on specific identification of the securities sold.

Inventories

Inventories consist primarily of tubular goods and well equipment held for use in our oil and gas operations and oil produced in our operations offshore Malaysia and China but not yet sold. Inventories are carried at the lower of cost or market. Crude oil from our operations offshore Malaysia and China is produced into floating production, storage and off-loading vessels and sold periodically as barge quantities are accumulated. The product inventory at September 30, 2007 consisted of approximately 333,000 barrels of crude oil valued at cost of $12 million. Cost for purposes of the carrying value of oil inventory is the sum of production costs and depreciation, depletion and amortization expense.

NEWFIELD EXPLORATION COMPANY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Foreign Currency

The British pound is the functional currency for our operations in the United Kingdom. Translation adjustments resulting from translating our United Kingdom subsidiaries British pound financial statements into U.S. dollars are included as accumulated other comprehensive income on our consolidated balance sheet and statement of stockholders equity. The functional currency for all other foreign operations is the U.S. dollar. Gains and losses incurred on currency transactions in other than a country s functional currency are recorded under the caption Other income (expense) Other on our consolidated statement of income.

Accounting for Asset Retirement Obligations

If a reasonable estimate of the fair value of an obligation to perform site reclamation, dismantle facilities or plug and abandon wells can be made, we record a liability (an asset retirement obligation or ARO) on our consolidated balance sheet and capitalize the asset retirement cost in oil and gas properties in the period in which the retirement obligation is incurred. In general, the amount of an ARO and the costs capitalized will be equal to the estimated future cost to satisfy the abandonment obligation assuming the normal operation of the asset, using current prices that are escalated by an assumed inflation factor up to the estimated settlement date, which is then discounted back to the date that the abandonment obligation was incurred using an assumed cost of funds for our company. After recording these amounts, the ARO is accreted to its future estimated value using the same assumed cost of funds and the additional capitalized costs are depreciated on a unit-of-production basis within the related full cost pool. Both the accretion and the depreciation are included in depreciation, depletion and amortization on our consolidated statement of income.

The changes to our ARO for the nine months ended September 30, 2007 are set forth below (in millions):

Balance as of January 1, 2007	$	264
Accretion expense		8
Additions		5
Revisions		11
Settlements [1]		(233)
Balance of ARO as of September 30, 2007	$	55

(1) $216 million relates to our Gulf of Mexico and Cherokee Basin asset sales.

Stock-Based Compensation

On January 1, 2006, we adopted Financial Accounting Standards Board (FASB) Statement (SFAS) No. 123 (revised 2004) (SFAS No. 123 (R)), *Share-Based Payment*, to account for stock-based compensation. Among other items, SFAS No. 123(R) eliminated the use of Accounting Principles Board (APB) Opinion No. 25 (APB 25), Accounting for Stock Issued to Employees, and the intrinsic value method of accounting and requires companies to recognize in their financial statements the cost of services received in exchange for awards of equity instruments based on the grant date fair value of those awards. We elected to use the modified prospective method for adoption, which requires compensation expense to be recorded for all unvested stock options and other equity-based compensation beginning in the first quarter of adoption. For all unvested options outstanding as of January 1, 2006, the previously measured but unrecognized compensation expense, based on the fair value at the original grant date, has been or will be recognized in our financial statements over the remaining vesting period. For equity-based compensation awards granted or modified subsequent to January 1, 2006, compensation expense, based on the fair value on the date of grant or modification, has been or will be recognized in our financial statements over the vesting period. We utilize the Black-Scholes option pricing model to measure the fair value of stock options and a lattice-based model for our performance and market-based restricted shares. Prior to the adoption of SFAS No. 123(R), we followed the intrinsic value method in accordance with APB 25 to account for stock-based compensation. See Note 12, Stock-Based Compensation, for a full discussion of our stock-based compensation.

Income Taxes

In July 2006, the FASB issued Interpretation No. 48 (FIN 48), Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109. FIN 48 prescribes a comprehensive model for how companies should recognize, measure, present and disclose in their financial statements uncertain tax positions taken or expected to be taken on a tax return. Under FIN 48, tax positions are recognized in our consolidated financial statements as the largest amount of tax benefit that has a greater than 50% likelihood of being realized upon ultimate settlement with tax authorities assuming full knowledge of the position and all relevant facts. These amounts are subsequently reevaluated and changes are recognized as adjustments to current period tax expense. FIN 48 also revised disclosure requirements to include an annual tabular rollforward of unrecognized tax benefits.

NEWFIELD EXPLORATION COMPANY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

We adopted the provisions of FIN 48 on January 1, 2007. The adoption did not result in a material adjustment to our tax liability for unrecognized income tax benefits. At September 30, 2007, we determined that our uncertain tax positions were immaterial.

If applicable, we would recognize interest and penalties related to uncertain tax positions in interest expense. As of September 30, 2007, we had not accrued interest related to uncertain tax positions because we have currently overpaid our 2007 estimated tax liability.

The tax years 2004-2006 remain open to examination for federal income tax purposes and by the other major taxing jurisdictions to which we are subject.

2. Discontinued Operations:

On September 17, 2007, we entered into an agreement to sell all of our interests in the U.K. North Sea for $486 million. We will recognize a gain in the fourth quarter as a result of the completion of the sale in early October 2007. The historical results of operations of our U.K. North Sea subsidiaries are reflected in our financial statements as discontinued operations. This reclassification affects not only the 2007 presentation of our financial statements, but also the presentation of all prior period financial statements.

The summarized financial results and financial position of the discontinued operations for the periods presented below are as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2007	2006	2007	2006
	(In millions)			
Revenues	$ 5	$ ¾	$ 8	$ ¾
Operating expenses [(1)]	8	1	61	3
Loss from operations	(3)	(1)	(53)	(3)
Commodity derivative expense	(3)	¾	(3)	¾
Other expense [(2)]	(3)	(1)	(4)	(1)
Loss before income taxes	(9)	(2)	(60)	(4)
Income tax benefit	¾	(1)	¾	(2)
Loss from discontinued operations	$ (9)	$ (1)	$ (60)	$ (2)

(1) Operating expenses for the nine months ended September 30, 2007 include the ceiling test writedown of $47 million recorded in the first quarter of 2007.

(2) Other expense primarily consists of U.K. withholding tax expense with respect to interest on intercompany loans.

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NEWFIELD EXPLORATION COMPANY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	September 30, 2007	December 31, 2006
	(In millions)	
Accounts receivable	$ 4	$ 4
Inventories	3	¾
Derivative assets	1	¾
Other current assets	3	1
Total current assets	11	5
Oil and gas properties, net of accumulated depreciation depletion and amortization	175	200
Furniture, fixtures and equipment, net	1	¾
Other assets	1	¾
Total other assets	177	200
Total assets	$ 188	$ 205
Accounts payable	$ 3	$ 1
Derivative liabilities	4	¾
Accrued liabilities	7	26
Total current liabilities	14	27
Deferred taxes	¾	¾
Asset retirement obligation	11	7
Total long-term liabilities	11	7
Total liabilities	$ 25	$ 34

In May 2007, we entered into several natural gas swaps related to our U.K. production. These trades are for October 2007 through September 2008 with a weighted average price of $7.55 per MMBtu. We also entered into one natural gas collar with a put price of $6.98 and a call price of $10.19 per MMBtu. The estimated fair value of these contracts at September 30, 2007 was approximately a $3 million liability.

As of September 30, 2007, we had U.K. NOL carryforwards for income tax purposes of approximately $100 million that could be used in future years to offset taxable income. Because of the sale of our U.K. assets, we will not be able to utilize these NOLs, and therefore, a valuation allowance was established for them.

3. Earnings Per Share:

Basic earnings per share (EPS) is calculated by dividing net income (the numerator) by the weighted average number of shares of common stock (other than unvested restricted stock) outstanding during the period (the denominator). Diluted earnings per share incorporates the dilutive impact of outstanding stock options and unvested restricted stock (using the treasury stock method).

NEWFIELD EXPLORATION COMPANY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following is the calculation of basic and diluted weighted average shares outstanding and EPS for the indicated periods:

	Three Months Ended September 30, 2007	Three Months Ended September 30, 2006	Nine Months Ended September 30, 2007	Nine Months Ended September 30, 2006
	(In millions, except per share data)			
Income (numerator):				
Income from continuing operations	$ 92	$ 267	$ 197	$ 511
Loss from discontinued operations, net of tax	(9)	(1)	(60)	(2)
Net income basic and diluted	$ 83	$ 266	$ 137	$ 509
Weighted average shares (denominator):				
Weighted average shares basic	128	126	127	127
Dilution effect of stock options and unvested restricted stock outstanding at end of period	3	3	3	2
Weighted average shares diluted	131	129	130	129
Earnings per share:				
Basic ¾				
Income from continuing operations	$ 0.72	$ 2.11	$ 1.54	$ 4.03
Loss from discontinued operations	(0.07)	(0.01)	(0.47)	(0.01)
Basic earnings per share	$ 0.65	$ 2.10	$ 1.07	$ 4.02
Diluted ¾				
Income from continuing operations	$ 0.70	$ 2.07	$ 1.51	$ 3.96
Loss from discontinued operations	(0.06)	(0.01)	(0.46)	(0.01)
Diluted earnings per share	$ 0.64	$ 2.06	$ 1.05	$ 3.95

There were no antidilutive shares for the three and nine months ended September 30, 2007 and 2006.

4. Oil and Gas Assets:

Oil and Gas Properties

Oil and gas properties consisted of the following at:

	September 30, 2007	December 31, 2006
	(In millions)	
Subject to amortization	$ 8,159	$ 7,719

Not subject to amortization:		
Exploration wells in progress	305	182
Development wells in progress	29	49
Capitalized interest	99	94
Fee mineral interests	23	23
Other capital costs:		
Incurred in 2007	245	
Incurred in 2006	84	88
Incurred in 2005	53	89
Incurred in 2004 and prior	352	445
Total not subject to amortization	1,190	970
Gross oil and gas properties	9,349	8,689
Accumulated depreciation, depletion and amortization	(3,802)	(3,234)
Net oil and gas properties	$ 5,547	$ 5,455

NEWFIELD EXPLORATION COMPANY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Oil and gas properties not subject to amortization represent investments in unproved properties and major development projects in which we own an interest. These unproved property costs include unevaluated leasehold acreage, geological and geophysical data costs associated with leasehold or drilling interests, costs associated with wells currently drilling and capitalized interest. We exclude these costs on a country-by-country basis until proved reserves are found or until it is determined that the costs are impaired. Unproved property costs are grouped by major prospect area where individual property costs are not significant and are assessed individually when individual costs are significant. Costs associated with exploration and development wells in progress are transferred to the amortization base upon the determination of whether proved reserves can be assigned to the properties, which is generally based on drilling results. All other costs excluded from the amortization base are reviewed quarterly to determine if impairment has occurred. The amount of any impairment is transferred to the amortization base or a charge is made against earnings for those international operations with respect to which a reserve base has not yet been established. We believe that our evaluation activities related to substantially all of the properties associated with costs not currently subject to amortization will be completed within four to ten years.

We use the full cost method of accounting for our oil and gas producing activities. Under this method, all costs incurred in the acquisition, exploration and development of oil and gas properties, including salaries, benefits and other internal costs directly attributable to these activities, are capitalized into cost centers that are established on a country-by-country basis. Capitalized costs and estimated future development and retirement costs are amortized on a unit-of-production method based on proved reserves associated with the applicable cost center. For each cost center, the net capitalized costs of oil and gas properties are limited to the lower of the unamortized cost or the cost center ceiling. A particular cost center ceiling is equal to the sum of:

- the present value (10% per annum discount rate) of estimated future net revenues from proved reserves using end of period oil and gas prices applicable to our reserves (including the effects of hedging contracts that are designated for hedge accounting); plus
- the lower of cost or estimated fair value of properties not included in the costs being amortized, if any; less
- related income tax effects.

Proceeds from the sale of oil and gas properties are applied to reduce the costs in the applicable cost center unless the sale involves a significant quantity of reserves in relation to the cost center, in which case a gain or loss is recognized.

If net capitalized costs of oil and gas properties exceed the cost center ceiling, we are subject to a ceiling test writedown to the extent of such excess. If required, a ceiling test writedown would reduce earnings and stockholders equity in the period of occurrence and result in lower depreciation, depletion and amortization expense in future periods.

The risk that we will be required to writedown the carrying value of our oil and gas properties increases when oil and gas prices decrease significantly or if we have substantial downward revisions in our estimated proved reserves. At March 31, 2007, the cost center ceiling for our U.K. oil and gas properties was calculated based upon quoted market prices of $3.74 per Mcf for gas and $55.38 per Bbl for oil, adjusted for market differentials. Using these prices, the unamortized net capitalized costs of our U.K. cost pool exceeded the full cost ceiling, resulting in a ceiling test writedown of $47 million in the first quarter of 2007. The writedown is presented in Loss from discontinued operations, net of tax on our consolidated statement of income.

Acquisition of Rocky Mountain Assets

In June 2007, we closed the $578 million acquisition of Stone Energy Corporation s Rocky Mountain assets. These assets increase our existing presence and provide an entry into large developments in many of the Rocky Mountains most attractive areas. Our consolidated financial statements include the cash flows and results of operations for these assets subsequent to June 30, 2007. This acquisition was financed through borrowings under our revolving credit agreement.

Gulf of Mexico Asset Sale

On August 6, 2007, we closed the sale of substantially all of our properties in the Gulf of Mexico to McMoRan Exploration Co. for $1.1 billion in cash and the assumption of liabilities associated with the future abandonment of wells and platforms. We retained most of our deepwater properties and interests in some exploration prospects on the shelf. The cash flows and results of operations for the assets included in the sale are included in our consolidated financial statements up to the closing date.

NEWFIELD EXPLORATION COMPANY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Cherokee Basin Asset Sale

On September 21, 2007, we closed the sale of our coal bed methane assets in the Cherokee Basin of northeastern Oklahoma for $128 million in cash. The cash flows and results of operations for these assets are included in our consolidated financial statements up to the closing date.

Pro Forma Results

The unaudited pro forma results presented below for the three months ended September 30, 2006 and nine months ended September 30, 2007 and 2006 have been prepared to give effect to the Rocky Mountain asset acquisition described above on our results of operations as if it had been consummated on January 1, 2006. The unaudited pro forma results do not purport to represent what our results of operations actually would have been if this acquisition had been completed on such date or to project our results of operations for any future date or period.

	Three Months Ended September 30,	Nine Months Ended September 30,	
	2006	2007	2006
	(Unaudited) (In millions, except per share data)		
Pro forma:			
Revenue	$ 450	$1,432	$1,318
Income from operations	195	468	557
Net income	275	198	535
Basic earnings per share	$2.18	$ 1.55	$ 4.23
Diluted earnings per share	$2.14	$ 1.52	$ 4.15

5. Debt:

As of the indicated dates, our debt consisted of the following:

	September 30, 2007	December 31, 2006
	(In millions)	
Senior unsecured debt:		
Bank revolving credit facility:		
Prime rate based loans	$ ¾	$ ¾
LIBOR based loans	¾	¾
Total bank revolving credit facility	¾	¾
Money market line of credit (1)	¾	¾
Total credit arrangements	¾	¾
$125 million 7.45% Senior Notes due 2007 (2)	125	125
Fair value of interest rate swaps (2) (3)	(1)	(1)
$175 million 7 5/8% Senior Notes due 2011	175	175
Fair value of interest rate swaps (3)	(1)	(2)

Total senior unsecured notes	298	297
Total senior unsecured debt	298	297
$325 million 6 5/8% Senior Subordinated Notes due 2014	325	325
$550 million 6 5/8% Senior Subordinated Notes due 2016	550	550
Total debt	1,173	1,172
Less: Current portion of debt [(2)]	124	124
Total long-term debt	$ 1,049	$ 1,048

(1) Because capacity under our credit facility was available to repay borrowings under our money market lines of credit as of the indicated dates, amounts outstanding under these obligations, if any, are classified as long-term.

(2) Due October 2007.

(3) We have hedged $50 million principal amount of our $125 million 7.45% Senior Notes due 2007 and $50 million principal amount of our $175 million 7 5/8% Senior Notes due 2011.

The hedges provide for us to pay variable and receive fixed interest payments.

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NEWFIELD EXPLORATION COMPANY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Credit Arrangements

In June 2007, we entered into a new revolving credit facility that matures in June 2012. This facility replaces our previous facility. The terms of the credit facility provide for initial loan commitments of $1.25 billion from a syndicate of banks, led by JPMorgan Chase as the agent bank. The loan commitments under the credit facility may be increased to a maximum aggregate amount of $1.65 billion if the lenders increase their loan commitments or new financial institutions are added to the credit facility. Loans under the credit facility bear interest, at our option, based on (a) a rate per annum equal to the higher of the prime rate announced from time to time by JPMorgan Chase Bank or the weighted average of the rates on overnight federal funds transactions with members of the Federal Reserve System during the last preceding business day plus 50 basis points or (b) a base Eurodollar rate substantially equal to the London Interbank Offered Rate, plus a margin that is based on a grid of our debt rating (87.5 basis points per annum at September 30, 2007). At September 30, 2007, we had no borrowings outstanding under the credit facility.

Under our new credit facility and our previous credit facility, we pay commitment fees on the undrawn amounts based on a grid of our debt rating (0.175% per annum at September 30, 2007). We incurred fees under these arrangements of approximately $0.5 million and $1.8 million for the three and nine months ended September 30, 2007, respectively, which are recorded in interest expense on our consolidated statement of income.

The new credit facility has restrictive covenants that include the maintenance of a ratio of total debt to book capitalization not to exceed 0.6 to 1.0; maintenance of a ratio of total debt to earnings before gain or loss on the disposition of assets, interest expense, income taxes and non-cash items (such as depreciation, depletion and amortization expense and unrealized gains and losses on commodity derivatives) of at least 3.5 to 1.0; and, so long as our debt rating is below investment grade, the maintenance of a ratio of the calculated net present value of our oil and gas properties to total debt of at least 1.75 to 1.00. At September 30, 2007, we were in compliance with all of our debt covenants.

As of September 30, 2007, we had $46 million of undrawn letters of credit outstanding under our credit facility. Letters of credit issued under our credit facility are subject to an issuance fee of 12.5 basis points and annual fees based on a grid of our debt rating (87.5 basis points at September 30, 2007).

Subject to compliance with the restrictive covenants in our credit facility, we also have a total of $135 million of borrowing capacity under money market lines of credit with various banks. At September 30, 2007, we had no borrowings outstanding under our money market lines.

6. Commitments and Contingencies:

In December 2002, a lawsuit against our Mid-Continent subsidiary was filed in Beaver County, Oklahoma and was later certified as a class action royalty owner lawsuit. The complaint alleged that we improperly reduced royalty payments for certain expenses and charges, and also claimed breach of contract and breach of fiduciary duties, among other claims. In April 2007, we entered into a settlement agreement that has recently received court approval. In the first quarter of 2007, we increased our litigation settlement reserve for the lawsuit, which resulted in a charge to earnings that was recorded under the caption General and administrative on our consolidated income statement.

We also have been named as a defendant in a number of other lawsuits arising in the ordinary course of our business. While the outcome of these lawsuits cannot be predicted with certainty, we do not expect these matters to have a material adverse effect on our financial position, cash flows or results of operations.

7. Segment Information:

While we only have operations in the oil and gas exploration and production industry, we are organizationally structured along geographic operating segments. Our current operating segments are the United States, Malaysia, China and Other International. The accounting policies of each of our operating segments are the same as those described in Note 1, Organization and Summary of Significant Accounting Policies.

The following tables provide the geographic operating segment information required by SFAS No. 131, *Disclosures about Segments of an Enterprise and Related Information,* as well as results of operations of oil and gas producing activities required by SFAS No. 69, *Disclosures about Oil and Gas Producing Activities,* as of and for the three and nine months ended September 30, 2007 and 2006 for continuing operations. Income tax allocations have been determined based on statutory rates in the applicable geographic segment.

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NEWFIELD EXPLORATION COMPANY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	United States	Malaysia	China (In millions)	Other International	Total
Three Months Ended September 30, 2007:					
Oil and gas revenues	$ 384	$ 31	$ 4	$ ¾	$ 419
Operating expenses:					
Lease operating	54	9	1	¾	64
Production and other taxes	20	5	¾	¾	25
Depreciation, depletion and amortization	153	8	1	¾	162
General and administrative	35	1	1	¾	37
Allocated income taxes	44	3	¾	¾	
Net income from oil and gas properties	$ 78	$ 5	$ 1	$ ¾	
Total operating expenses					288
Income from continuing operations					131
Interest expense, net of interest income, capitalized interest and other					(15)
Commodity derivative income					38
Income from continuing operations before income taxes					$ 154
Total long-lived assets	$ 5,159	$ 313	$ 74	$ 1	$ 5,547
Additions to long-lived assets	$ 398	$ 74	$ 5	$ ¾	$ 477

	United States	Malaysia	China (In millions)	Other International	Total
Three Months Ended September 30, 2006:					
Oil and gas revenues	$ 410	$ 13	$ 2	$ ¾	$ 425
Operating expenses:					
Lease operating	33	3	¾	¾	36

Production and other taxes		10		2		¾	¾	12
Depreciation, depletion and amortization		156		2		1	¾	159
Ceiling test writedown		¾		¾		¾	6	6
General and administrative		31		2		¾	¾	33
Other		(6)		¾		¾	¾	(6)
Allocated income taxes		67		2		¾	¾	
Net income (loss) from oil and gas properties	$	119	$	2	$	1	$ (6)	

Total operating expenses &nbs