

W&T OFFSHORE INC  
Form 10-Q  
November 14, 2006  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

WASHINGTON, D.C. 20549

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**Form 10-Q**

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

For the quarterly period ended September 30, 2006

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 1-32414

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**W&T OFFSHORE, INC.**

(Exact name of registrant as specified in its charter)

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Texas  
(State of incorporation)

72-1121985  
(IRS Employer Identification Number)

Nine Greenway Plaza, Suite 300  
Houston, Texas  
(Address of principal executive offices)

77046-0905  
(Zip Code)

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(713) 626-8525

(Registrant's telephone number, including area code)

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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  No

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

Large accelerated filer  Accelerated filer  Non-accelerated filer

Indicate by check mark whether the registrant is a shell company. Yes  No

As of November 14, 2006, there were 75,900,082 shares outstanding of the registrant's common stock, par value \$0.00001.

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<i>Unless the context requires otherwise, references in this Quarterly Report on Form 10-Q to W&amp;T, we, us, our and the Company refer to W&amp;T Offshore, Inc. and its subsidiaries.</i>	

*This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act and Section 21E of the Exchange Act that involve risks, uncertainties and assumptions. If the risks or uncertainties materialize or the assumptions prove incorrect, our results may differ materially from those expressed or implied by such forward-looking statements and assumptions. All statements other than statements of historical fact are statements that could be deemed forward-looking statements, such as those statements that address activities, events or developments that we expect, believe or anticipate will or may occur in the future. These statements are based on certain assumptions and analyses made by us in light of our experience and perception of historical trends, current conditions, expected future developments and other factors we believe are appropriate in the circumstances. Certain factors that may affect our financial condition and results of operations are discussed in Item 1A Risk Factors and Item 7A Quantitative and Qualitative Disclosures About Market Risk of our Annual Report on Form 10-K for the year ended December 31, 2005 and may be discussed from time to time in our reports filed with the Securities and Exchange Commission subsequent to this report. We assume no obligation, nor do we intend, to update these forward-looking statements.*

**Table of Contents****PART I FINANCIAL INFORMATION****Item 1. Financial Statements**

**W&T OFFSHORE, INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**

(In thousands, except share data)

(Unaudited)

	September 30, 2006	December 31, 2005
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 12,071	\$ 187,698
Receivables:		
Oil and gas sales	78,491	43,892
Joint interest and other	29,481	33,097
Insurance receivables	51,579	6,634
Total receivables	159,551	83,623
Royalty deposits	8,073	5,166
Prepaid expenses and other assets	48,225	7,337
Total current assets	227,920	283,824
Property and equipment at cost:		
Oil and gas properties and equipment (full cost method, of which \$395,886 at September 30, 2006 and \$0 at December 31, 2005 were excluded from amortization)	3,068,714	1,479,832
Furniture, fixtures and other	13,738	7,033
Total property and equipment	3,082,452	1,486,865
Less accumulated depreciation, depletion and amortization	911,635	717,583
Net property and equipment	2,170,817	769,282
Restricted deposits for asset retirement obligations	10,629	10,348
Other assets	12,459	1,066
Total assets	\$ 2,421,825	\$ 1,064,520
<b>Liabilities and Shareholders Equity</b>		
Current liabilities:		
Current maturities of long-term debt net of discount	\$ 354,640	\$
Accounts payable	169,936	143,049
Undistributed oil and gas proceeds	16,985	11,667
Asset retirement obligations	43,760	39,653
Accrued liabilities	12,037	5,714
Income taxes	51,189	31,609
Total current liabilities	648,547	231,692
Long-term debt, less current maturities net of discount	316,233	40,000

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Asset retirement obligations, less current portion	243,858	112,621
Deferred income taxes	199,964	134,395
Other liabilities	4,398	2,429
Commitments and contingencies		
Shareholders' equity:		
Common stock, \$0.00001 par value; 118,330,000 shares authorized; issued and outstanding 75,900,082 and 65,979,875 shares at September 30, 2006 and December 31, 2005, respectively	1	1
Additional paid-in capital	361,489	52,332
Retained earnings	648,080	491,050
Accumulated other comprehensive loss	(745)	
Total shareholders' equity	1,008,825	543,383
Total liabilities and shareholders' equity	\$ 2,421,825	\$ 1,064,520

See accompanying notes.

**Table of Contents****W&T OFFSHORE, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF INCOME****(In thousands, except per share data)****(Unaudited)**

	Three Months Ended		Nine Months Ended	
	September 30, 2006	September 30, 2005	September 30, 2006	September 30, 2005
<b>Revenues:</b>				
Oil and natural gas revenues	\$ 213,393	\$ 153,355	\$ 535,960	\$ 431,744
Other	38	70	122	532
<b>Total revenues</b>	<b>213,431</b>	<b>153,425</b>	<b>536,082</b>	<b>432,276</b>
<b>Operating costs and expenses:</b>				
Lease operating	34,427	18,226	66,491	52,253
Production taxes	369	184	546	631
Gathering and transportation	4,817	2,367	11,148	9,555
Depreciation, depletion and amortization	82,142	43,403	194,052	131,967
Asset retirement obligation accretion	3,324	2,203	7,840	6,829
General and administrative	9,645	6,524	30,377	19,187
Commodity derivative gain	(27,065)		(21,793)	
<b>Total costs and expenses</b>	<b>107,659</b>	<b>72,907</b>	<b>288,661</b>	<b>220,422</b>
<b>Operating income</b>	<b>105,772</b>	<b>80,518</b>	<b>247,421</b>	<b>211,854</b>
<b>Other income (expense):</b>				
Interest income	2,111	844	5,505	1,334
Interest expense	(9,876)	(263)	(10,514)	(866)
Interest capitalized	4,138		4,138	
<b>Total other income (expense)</b>	<b>(3,627)</b>	<b>581</b>	<b>(871)</b>	<b>468</b>
<b>Income before income taxes</b>	<b>102,145</b>	<b>81,099</b>	<b>246,550</b>	<b>212,322</b>
<b>Income taxes</b>	<b>35,444</b>	<b>27,997</b>	<b>85,553</b>	<b>74,156</b>
<b>Net income</b>	<b>\$ 66,701</b>	<b>\$ 53,102</b>	<b>\$ 160,997</b>	<b>\$ 138,166</b>
<b>Earnings per common share:</b>				
Basic	\$ 0.92	\$ 0.80	\$ 2.36	\$ 2.14
Diluted	0.91	0.80	2.35	2.09
Dividends declared per common share		0.02	0.06	0.06

See accompanying notes.

**Table of Contents****W&T OFFSHORE, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(In thousands)****(Unaudited)**

	<b>Nine Months Ended</b>	
	<b>September 30, 2006</b>	<b>2005</b>
<b>Operating activities:</b>		
Net income	\$ 160,997	\$ 138,166
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation, depletion, amortization and accretion	201,892	138,796
Amortization of debt issuance costs	1,097	262
Accretion of discount on long-term debt	2,141	
Share-based compensation	2,177	390
Unrealized commodity derivative gain	(15,224)	
Deferred income taxes	65,977	32,517
Changes in operating assets and liabilities:		
Oil and gas sales receivables	(34,599)	18,110
Joint interest and other receivables	3,617	906
Insurance receivables	(36,449)	
Income taxes	19,575	23,669
Prepaid expenses, royalty deposits and other assets	(39,306)	(523)
Asset retirement obligations	(20,781)	(13,573)
Accounts payable and accrued liabilities	40,354	5,174
Net cash provided by operating activities	351,468	343,894
<b>Investing activities:</b>		
Investment in oil and gas property and equipment, net	(1,449,095)	(227,464)
Investment in marketable securities		(1,822)
Purchases of furniture, fixtures and other	(6,705)	(358)
Change in restricted deposits	(280)	(187)
Net cash used in investing activities	(1,456,080)	(229,831)
<b>Financing activities:</b>		
Borrowings of long-term debt	819,732	2,550
Repayments of borrowings of long-term debt	(191,000)	(37,550)
Proceeds from equity offering, net of costs	306,980	
Dividends to shareholders	(5,947)	(2,639)
Debt issuance costs	(780)	(889)
Net cash provided by (used in) financing activities	928,985	(38,528)
(Decrease) increase in cash and cash equivalents	(175,627)	75,535
Cash and cash equivalents, beginning of period	187,698	64,975
Cash and cash equivalents, end of period	\$ 12,071	\$ 140,510

See accompanying notes.



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**W&T OFFSHORE, INC. AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

**1. Basis of Presentation**

*Operations.* W&T Offshore, Inc., together with its wholly-owned subsidiaries ( W&T or the Company ), is an independent oil and natural gas acquisition, exploitation and exploration company primarily focused in the Gulf of Mexico.

*Interim Financial Statements.* The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and the appropriate rules and regulations of the Securities and Exchange Commission ( SEC ). Accordingly, the condensed consolidated financial statements do not include all of the information and footnote disclosures required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for interim periods are not necessarily indicative of the results that may be expected for the entire year. These unaudited condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes included in the Company's annual report on Form 10-K for the year ended December 31, 2005.

*Reclassifications.* Certain reclassifications have been made to prior periods' financial statements to conform to the current presentation.

*Use of Estimates.* The preparation of financial statements in conformity with generally accepted accounting principles 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 periods. Actual results could differ from those estimates.

**2. Acquisition**

On August 24, 2006, we completed the acquisition of a wholly-owned subsidiary of Kerr-McGee Oil & Gas Corporation ( Kerr-McGee ) by merger. We own the surviving entity, which is the successor to substantially all of Kerr-McGee's Gulf of Mexico conventional shelf properties. The properties acquired include interests in approximately 100 fields on 242 offshore blocks (including 88 undeveloped blocks) spreading across the Western, Central and Eastern U.S. Gulf of Mexico, primarily in water depths of less than 1,000 feet. Based on our estimates, the total proved reserves of these properties approximated 280.5 Bcfe at June 30, 2006. This transaction was financed through a combination of cash on hand, additional debt and proceeds from the issuance of equity securities (see Notes 3 and 4).

This acquisition was accounted for as a purchase, and accordingly, the results of operations are included in our consolidated statements of income from the date of acquisition. The purchase price was allocated to the acquired assets and assumed liabilities based on their estimated fair value at the time of acquisition. We are in the process of finalizing the adjusted purchase price based on our review of results of operations of the properties from the effective date of the transaction to the closing date; therefore, the allocation of the purchase price as of September 30, 2006 is preliminary. The following summarizes the estimated fair values of assets acquired and liabilities assumed at closing (in thousands).

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Purchase price:	
Cash paid, including transaction costs	\$ 1,061,769
Plus fair market value of liabilities assumed:	
Asset retirement obligations	143,641
	<b>\$ 1,205,410</b>
Allocation of purchase price:	
Proved oil and gas properties	\$ 813,670
Unproved oil and gas properties	391,740
	<b>\$ 1,205,410</b>

The following unaudited pro forma data illustrates the effect on our historical results of operations as if the merger transaction, an offering of the Company's common stock to provide funds for the merger transaction and borrowings under the Company's \$1.3 billion senior credit facility to partially fund the merger had occurred at the beginning of each period presented. The pro forma data is a result of adjusting our statements of income for the three and nine months ended September 30, 2006 and 2005, respectively, for the pre-acquisition revenues and direct operating expenses of the Kerr-McGee acquired properties, increased depreciation, depletion, amortization and accretion resulting from the allocation of fair value to the oil and gas properties acquired and the asset retirement obligations assumed, increased general and administrative expenses due to the need for additional personnel to manage the Company after the acquisition and increased interest expense on acquisition debt. The pro forma adjustments include estimates and assumptions based on currently available information. The pro forma data does not necessarily reflect the actual operating results that would have occurred nor are they necessarily indicative of future results of operations (in thousands, except per share data).

	Three Months Ended		Nine Months Ended	
	September 30, 2006	September 30, 2005	September 30, 2006	September 30, 2005
Revenues	\$ 329,839	\$ 281,151	\$ 883,071	\$ 875,087
Net income	79,041	78,835	212,731	221,310
Earnings per share:				
Basic	\$ 1.04	\$ 1.10	\$ 2.81	\$ 2.97
Diluted	\$ 1.04	\$ 1.10	\$ 2.80	\$ 2.92

**3. Long-Term Debt**

On May 26, 2006, we entered into a credit agreement principally in connection with the funding of the Kerr-McGee transaction. Upon closing of the Kerr-McGee transaction in August 2006, our initial availability under the credit agreement was \$987.5 million. The credit agreement provides for (1) a revolving loan with an initial availability of \$300.0 million, (2) a Tranche A term loan in the amount of \$387.5 million and (3) a Tranche B term loan in the amount of \$300.0 million. The amount available under the revolving loan is subject to redetermination on March 1 and September 1 of each year commencing September 1, 2007. Additionally, the agreement provides for the availability of letters of credit for up to \$90.0 million, provided however, that its usage is subject to availability under the revolving loan.

Interest accrues either (1) at the higher of the Prime Rate, or the Federal Funds Rate plus 0.50%, plus a margin which varies from 0.0% to 1.75% depending upon the loan or (2) to the extent any loan outstanding is designated as a Eurodollar loan, at the London Interbank Offered Rate plus a margin that varies from 1.25% to 2.75% depending upon the loan. The Tranche A and Tranche B term loans are payable in installments and

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mature fifteen months from initial funding and on the fourth anniversary of initial funding, respectively. The revolving loan matures on the third anniversary of initial funding. The interest rates on the Tranche A and Tranche B term loans were 8.15% and 7.65%, respectively, at September 30, 2006.

**Table of Contents****W&T OFFSHORE, INC. AND SUBSIDIARIES****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)**

The credit agreement contains covenants that restrict the payment of cash dividends to a maximum of \$30.0 million per year, borrowings other than from the facilities, sales of assets, loans to others, investments, merger activity, hedging contracts, liens and certain other transactions without the prior consent of the lenders. We are required to maintain interest rate hedging contracts with respect to at least 50% of the aggregate principal amount outstanding of the Tranche A and Tranche B term loans at all times, as well as certain commodity derivatives. We are also subject to various financial covenants calculated as of the last day of each fiscal quarter, including a minimum current ratio beginning with the quarter ending on March 31, 2007, a minimum interest coverage ratio, a minimum asset coverage ratio and a maximum leverage ratio. We were in compliance with these covenants on September 30, 2006.

As of September 30, 2006 and December 31, 2005 our long-term debt was as follows (in thousands):

	September 30,	December 31,
	2006	2005
Revolving loan facility	\$	\$ 40,000
Tranche A term loan facility, net of unamortized discount of \$8,662	378,838	
Tranche B term loan facility, net of unamortized discount of \$7,965	292,035	
Total long-term debt	670,873	40,000
Current maturities of long-term debt	(354,640)	
Long-term debt, less current maturities	\$ 316,233	\$ 40,000

At September 30, 2006 we did not have any letters of credit outstanding. At December 31, 2005 we had \$0.3 million of letters of credit outstanding.

**4. Equity Offering**

In July 2006 the Company completed an additional equity offering of 8,500,000 shares of its common stock at an offering price of \$32.50 per share. The Underwriting Agreement also included a 30-day option to the underwriters to purchase up to an additional 1,275,000 shares at the offering price, less underwriting discounts and commissions. In August 2006 the over-allotment option was exercised in full. Net proceeds generated by the offering and the exercise of the over-allotment option were approximately \$307.0 million after underwriting discounts and commissions of approximately \$9.5 million and legal, accounting, printing and various other fees of approximately \$1.2 million. The net proceeds from the equity offering and the exercise of the over-allotment option were used in connection with the funding of the Kerr-McGee transaction.

**5. Derivative Financial Instruments**

We account for our derivative contracts in accordance with Statement of Financial Accounting Standards ( SFAS ) No. 133, *Accounting for Derivative Instruments and Hedging Activities*. SFAS No. 133, as amended, requires each derivative to be recorded on the balance sheet as an asset or a liability at its fair value. Additionally, the statement requires that changes in a derivative's fair value be recognized currently in earnings unless specific hedge accounting criteria are met at the time the derivative contract is entered into. Counterparties to our derivative contracts expose the Company to credit loss in the event of nonperformance; however, we do not anticipate nonperformance by the counterparties.

**Commodity Derivatives.** In January 2006, we entered into commodity swap and option contracts in connection with the anticipated financing related to the transaction with Kerr-McGee. While these contracts are intended to reduce the effects of volatile oil and natural gas prices, they may also limit future income from favorable price movements. Changes in the fair value of our commodity derivative contracts are recognized

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currently in earnings.

During the three and nine months ended September 30, 2006, we recorded an unrealized gain of \$22.7 million and \$15.2 million related to our open derivative contracts, respectively. For the three and nine months ended September 30, 2006, we recorded a realized gain of \$4.4 million and \$6.6 million, respectively, related to settlements of our commodity derivatives. At September 30, 2006, we had a short term asset of \$13.9 million included in prepaid expenses and other assets, a long term asset of \$5.6 million included in other assets and a long term liability of \$0.8 million included in other liabilities related to our open commodity derivatives.

**Table of Contents****W&T OFFSHORE, INC. AND SUBSIDIARIES****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)**

As of September 30, 2006, our open commodity derivatives were as follows:

Type	Commodity	Collars		Notional	NYMEX Contract Price	
		Effective	Termination		Floor	Ceiling
Zero Cost	Natural Gas	11/1/2006	12/31/2006	2,013,000 MMBtu	\$ 8.04	\$ 14.49
Funded	Natural Gas	1/1/2007	12/31/2007	8,760,000 MMBtu	7.76	16.80
Zero Cost	Oil	1/1/2007	12/31/2007	1,569,500 Bbls	61.68	76.40
Funded	Natural Gas	1/1/2008	12/31/2008	5,124,000 MMBtu	7.31	15.80
Zero Cost	Oil	1/1/2008	12/31/2008	1,024,800 Bbls	60.00	74.50

Commodity	Effective	Swaps		Notional	Price
		Termination	Quantity		
Oil	10/1/2006	12/31/2006	248,400 Bbls	\$69.85	

**Interest Rate Swaps.** In connection with the Kerr-McGee merger transaction, our credit agreement required that we enter into interest rate swap contracts. In August 2006, we entered into two interest rate swaps, which serve as a hedge of the variable LIBOR rates used to reset the floating rates of our Tranche A and Tranche B term loans. These swaps have notional amounts that equate to 50% of the aggregate outstanding principal balance of the Tranche A and Tranche B term loans, and fix the rates at 5.41% and 5.16%, respectively. These swaps have been determined to be highly effective as it relates to the variability in the LIBOR interest rate and, therefore, qualify, and are designated by management, as cash flow hedges under SFAS No. 133.

At September 30, 2006, a \$0.7 million, net of income tax, unrealized loss on hedging activity is included in accumulated other comprehensive loss resulting from the decrease in fair value of the interest rate swaps. Realized gains or losses on the swaps will be recorded to interest expense in future periods. The actual amounts that will be recorded to our consolidated statement of income could vary from this estimated amount as a result of future changes in interest rates. For the three and nine-month periods ended September 30, 2006, no amount was recognized in earnings due to ineffectiveness related to our interest rate swaps.

At September 30, 2006, we had a long term liability of \$1.2 million included in other liabilities related to our interest rate swaps.

**6. Comprehensive Income**

Our comprehensive income for the periods indicated is as follows (in thousands):

	Three Months Ended		Nine Months Ended	
	September 30, 2006	September 30, 2005	September 30, 2006	September 30, 2005
Net income	\$ 66,701	\$ 53,102	\$ 160,997	\$ 138,166
Change in the fair value of open interest rate swaps, net of income tax	(745)		(745)	

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Comprehensive income	\$ 65,956	\$ 53,102	\$ 160,252	\$ 138,166
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**Table of Contents****W&T OFFSHORE, INC. AND SUBSIDIARIES****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)**

**Accumulated Other Comprehensive Loss.** Our accumulated other comprehensive loss for the period ended September 30, 2006 is as follows (in thousands):

Balance, December 31, 2005	\$
Net change in unrealized losses on interest rate swaps	(745)
Balance, September 30, 2006	\$ (745)

**7. Asset Retirement Obligations**

Our asset retirement obligations primarily represent the estimated present value of the amount we will incur to plug, abandon and remediate our producing properties at the end of their productive lives in accordance with applicable laws. Revisions of estimated liabilities include, among other things, revisions due to timing of settling certain asset retirement obligations. A summary of our asset retirement obligations since year-end December 31, 2005 is as follows (in thousands):

Balance, December 31, 2005	\$ 152,274
Liabilities settled	(20,781)
Accretion of discount	7,840
Liabilities assumed through acquisition	143,641
Liabilities incurred	5,352
Revisions of estimated liabilities	(708)
Balance, September 30, 2006	287,618
Less current portion	43,760
Long-term	\$ 243,858

**8. Dividends**

On August 1, 2006, we paid a cash dividend of \$0.03 per common share to shareholders of record on July 14, 2006. On October 11, 2006, our board of directors declared a cash dividend of \$0.03 per common share, which was paid on November 1, 2006 to shareholders of record on October 22, 2006.

**9. Earnings Per Share**

Basic earnings per share is calculated by dividing net income applicable to common shares by the weighted average number of common shares outstanding during the periods presented. Diluted earnings per share incorporates the dilutive impact of preferred stock and nonvested restricted stock outstanding during the periods presented. In connection with our initial public offering in January 2005, all 2,000,000 shares of the Company's preferred stock were converted into a total of 13,338,350 shares of common stock.

**Table of Contents****W&T OFFSHORE, INC. AND SUBSIDIARIES****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)**

The reconciliation of basic and diluted weighted average shares outstanding and earnings per share is as follows (in thousands, except per share amounts):

	Three Months Ended		Nine Months Ended	
	September 30, 2006	September 30, 2005	September 30, 2006	September 30, 2005
Net income (basic and diluted)	\$ 66,701	\$ 53,102	\$ 160,997	\$ 138,166
Weighted average number of common shares (basic)	72,882	65,970	68,300	64,649
Weighted average common shares assumed issued upon conversion of the preferred stock				1,319
Weighted average nonvested common shares	157		112	
Weighted average number of common shares (diluted)	73,039	65,970	68,412	65,968
Earnings per share:				
Basic	\$ 0.92	\$ 0.80	\$ 2.36	\$ 2.14
Diluted	\$ 0.91	\$ 0.80	\$ 2.35	\$ 2.09

**10. Share-Based Compensation**

Effective January 1, 2006, the Company adopted SFAS No. 123 (revised 2004) ( SFAS No. 123(R) ), *Share-Based Payment*, using the modified prospective transition method. SFAS No. 123(R) supersedes Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees*, and revises guidance in SFAS No. 123, *Accounting for Stock-Based Compensation*. Under the modified prospective transition method, we are required to recognize compensation cost for share-based payments to employees over the period during which an employee is required to provide service in exchange for the award, based on the fair value of the equity instrument on the date of grant. Also, measurement and recognition of compensation cost for awards that were granted prior to, but not vested as of, the date of adoption should be based on their grant-date fair values. The new standard requires us to estimate forfeitures, resulting in the recognition of compensation cost only for those awards that actually vest. A cumulative effect of a change in accounting principle is required upon adoption to the extent that forfeitures were not estimated on share-based payments awarded prior to January 1, 2006 that were unvested on that date.

Historically, all of our share-based payments consisted of awards of unrestricted and restricted stock and were measured at their fair values on the dates of grant. As of January 1, 2006, the date we adopted SFAS No. 123(R), there were a total of 9,251 shares of restricted stock that had not vested and these shares were held by an executive officer of the Company. We estimated that the probability of forfeiture of these shares on the date of adopting SFAS No. 123(R) was remote; therefore, an adjustment to record a cumulative effect of a change in accounting principle was not required.

Shares of our common stock may be granted to employees and non-employee directors as restricted shares under our long-term incentive compensation plans. Restricted shares are subject to forfeiture restrictions and cannot be sold, transferred or disposed of during the restriction period. The holders of restricted shares generally have the same rights as a shareholder of the Company with respect to such shares, including the right to vote and receive dividends or other distributions paid with respect to the shares.

The Company generally issues new shares in connection with its share-based payment plans. During the quarter ended September 30, 2006, the Company did not issue any shares of common stock pursuant to its share-based payment plans. During the nine months ended September 30, 2006, a total of 161,784 restricted shares of our common stock were granted to employees pursuant to share-based payment plans. The restricted stock will vest in three equal increments on December 31, 2006, 2007 and 2008 and the associated compensation expense, less an allowance for estimated forfeitures, is being recognized over the requisite service period on a straight-line basis. In the second quarter of 2006, our

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non-employee directors were granted a total of 3,948 restricted shares of our common stock, with restrictions lapsing with respect to one-third of the shares on each of the first, second, and third anniversaries from the date of grant.

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At September 30, 2006, there were 2,159,152 shares of common stock available for award under our share-based payment plans. A summary of restricted share activity for the nine months ended September 30, 2006, is as follows:

		Weighted Average	
		Grant Date	
	Shares	Fair Value	
Nonvested at January 1, 2006	9,251	\$	32.43
Granted	165,732	\$	37.30
Vested	(2,087)	\$	37.17
Forfeited	(20,525)	\$	35.03
Nonvested at September 30, 2006	152,371	\$	37.31

The grant date fair value of restricted shares granted during the nine months ended September 30, 2006 was \$6.2 million. As of September 30, 2006, there was \$3.1 million of total unrecognized compensation expense related to restricted shares, which is expected to be recognized through May 31, 2009. Total compensation expensed under share-based payment arrangements was \$0.4 million and \$2.0 million during the three and nine months ended September 30, 2006, respectively. For the nine months ended September 30, 2005, total compensation expensed under share-based payment arrangements was \$0.5 million, substantially all of which was recorded in the first quarter of 2005.

**11. Long-Term Incentive Compensation**

**2005 Bonus.** In March 2006, our board of directors approved payment of a general bonus and an Extraordinary Performance Bonus under our long-term incentive compensation plan, as amended by the W&T Offshore, Inc. 2005 Annual Incentive Plan (the 2005 Plan). The 2005 Plan includes all employees of the Company except those executive officers (including our Chief Executive Officer and our Secretary) who, by written agreement, have elected not to participate. The awards consist of cash and restricted stock payable from a bonus pool equating to a maximum value of five percent of adjusted pre-tax income for 2005. Payment of the Extraordinary Performance Bonus was contingent upon the Company achieving certain performance goals in 2005; however, such goals were subject to adjustment by the Compensation Committee of our board of directors for extraordinary or unusual items or events. Although not all of the performance measures for the Extraordinary Performance Bonus were met, our board determined that substantially all of the performance measures would have been met in 2005 if not for the effects of Hurricanes Katrina and Rita. As such, in March 2006, our board awarded a 2005 Extraordinary Performance Bonus with an aggregate value of \$3.4 million to eligible employees.

Cash bonuses under the 2005 Plan (general bonus and Extraordinary Performance Bonus) were paid in March 2006 and totaled \$4.2 million. Of this amount, \$2.2 million was expensed in 2005, \$1.7 million was expensed in the first quarter of 2006 and the remainder was billed to partners under joint operating agreements.

In March 2006, a total of 160,377 restricted shares of our common stock were issued as awards under the 2005 Plan to eligible employees. The restricted stock will vest in three equal increments on December 31, 2006, 2007 and 2008 and the associated compensation expense, less an allowance for estimated forfeitures, will be recognized over the requisite service period in accordance with SFAS No. 123(R) (see Note 10).

**2006 Bonus.** In accordance with the 2005 Plan, eligible employees will be entitled to receive cash bonuses and awards of restricted stock from a bonus pool generally limited to five percent of adjusted pre-tax income for 2006. Part of the bonus will be a general bonus, consisting of cash and restricted stock. An Extraordinary Performance Bonus, also consisting of cash and restricted stock, will be paid only if the Company achieves certain performance goals which may be adjusted by the Compensation Committee



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**W&T OFFSHORE, INC. AND SUBSIDIARIES**

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

**(Unaudited)**

for extraordinary or unusual items or events. Shares of restricted stock awarded as incentive compensation for performance in 2006 will vest in three equal annual installments on December 31, 2007, 2008 and 2009. During the three and nine months ended September 30, 2006, we expensed \$1.4 million and \$4.1 million, respectively, related to the 2006 bonus.

**12. Income Taxes**

The Katrina Emergency Tax Relief Act of 2005, signed on September 23, 2005, postponed tax deadlines with a due date falling on or after August 29, 2005 until February 28, 2006 for taxpayers affected by Hurricane Katrina. On February 17 and August 25, 2006, the Internal Revenue Service further postponed tax deadlines with a due date falling on or after August 29, 2005 until August 28 and October 16, 2006, respectively, for taxpayers affected by Hurricane Katrina. Consequently, our estimated federal income tax payments due in the third and fourth quarters of 2005 and the second and third quarters of 2006 were paid on October 16, 2006 and totaled \$40.7 million.

**13. Related Party Transactions**

Virginia Boulet, who serves as special counsel to Adams and Reese LLP, was appointed to our board of directors on March 25, 2005. During the nine months ended September 30, 2006 and 2005, we paid approximately \$0.3 million and \$0.4 million, respectively, to Adams and Reese LLP for legal services.

Brooke Companies, Inc. provides personnel to fill temporary and permanent staffing needs of the Company from time to time. Susan Krohn, the wife of Tracy W. Krohn, owns 100% of Brooke Companies. Brooke Companies currently provides staffing services to our Company and we expect that it will continue to provide those services for the foreseeable future. During the nine months ended September 30, 2006 and 2005, the Company paid Brooke Companies approximately \$0.4 million and \$0.2 million, respectively.

The grandson of Jerome F. Freel, a director and our corporate Secretary, is employed by an insurance agency that arranges as a broker certain insurance coverage for the Company. We have been informed by Mr. Freel's grandson that personal commissions earned by the grandson for arranging such coverage through his employer totaled approximately \$0.1 million during the nine months ended September 30, 2006.

As part of our relocation program for employees moving from Louisiana to Texas, the Company agreed to purchase an employee's home in Louisiana that has been actively marketed and has been for sale for a period greater than 90 days. The purchase price of the home is negotiable and is based on a reasonable appraised value. During the nine months ended September 30, 2006, the Company purchased homes from two of our vice presidents for a total of approximately \$2.8 million pursuant to the relocation program, which is included in furniture, fixtures and other at September 30, 2006.

**14. Insurance Receivables**

As of September 30, 2006 we have incurred \$12.1 million of development costs and \$62.4 million of production costs (consisting primarily of repairs and maintenance and well control expenses), net to our interest, to remediate damage caused by Hurricanes Katrina and Rita that we believe are probable of reimbursement under our insurance policies. We reclassified these costs to insurance receivables and other assets and continue to process claims with our underwriters for reimbursement. As of September 30, 2006, we have received reimbursements of our claims totaling \$17.2 million. Included in insurance receivables and other assets at September 30, 2006 is \$45.7 million and \$6.1 million, respectively, which represents the estimated reimbursable hurricane remediation costs incurred in excess of our deductibles. Any differences between our insurance recoveries and insurance receivables will be recorded as adjustments to development costs or production costs, depending on how the classification of the original cost was recorded. Our estimate of total development and production costs to remediate damage caused by hurricanes Katrina and Rita is between \$90 million and \$100 million.

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**W&T OFFSHORE, INC. AND SUBSIDIARIES**

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

**(Unaudited)**

Also included in insurance receivables at September 30, 2006 is \$5.9 million related to an insurance claim to recover estimated reimbursable drilling costs on a well that experienced uncontrollable water flow in the second quarter of 2006. We believe that this amount is probable of reimbursement under our insurance policies.

**15. Recent Accounting Pronouncements**

In July 2006, the Financial Accounting Standards Board ( FASB ) issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes - an interpretation of SFAS No. 109*, ( FIN 48 ), which clarifies the accounting for uncertainty in income taxes recognized in a company's financial statements in accordance with SFAS No. 109, *Accounting for Income Taxes*. FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. It also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006. Adoption of FIN 48 is not expected to have a material effect on our consolidated financial statements.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*, which defines fair value as that term is used in many accounting pronouncements, establishes a framework for measuring the fair value of assets and liabilities as already required by generally accepted accounting principles and expands disclosures about fair value measurements. SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. We are currently evaluating the impact that SFAS No. 157 may have on our consolidated financial statements.

In September 2006, the SEC Staff issued Staff Accounting Bulletin ( SAB ) No. 108, *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements*, in an effort to address diversity in practice of quantifying misstatements and the potential for improper amounts on the balance sheet. Prior to the issuance of SAB No. 108, the roll-over and iron curtain methods were used for quantifying the effects of financial statement errors. Under the roll-over method, the primary focus was the income statement, including reversing effects of prior year misstatements. By focusing on the income statement, misstatements could accumulate on the balance sheet. Under the iron curtain method, the focus was the ending balance sheet, with less importance on the reversing effects of prior year errors in the income statement. SAB No. 108 establishes a dual approach, which requires the quantification of the effect of financial statement errors on each financial statement, as well as related disclosures. Public companies are required to record the cumulative effect of initially adopting the dual approach method in the first fiscal year ending after November 16, 2006 by recording any necessary corrections to assets and liabilities with an offsetting adjustment to the opening balance of retained earnings. The use of this cumulative effect transition method also requires detailed disclosures of the nature and amount of each error being corrected and how and when they arose. We do not expect this bulletin to have an effect on our consolidated financial statements.

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Board of Directors and Shareholders of

W&T Offshore, Inc. and Subsidiaries:

We have reviewed the condensed consolidated balance sheet of W&T Offshore, Inc. and Subsidiaries as of September 30, 2006, and the related condensed consolidated statements of income for the three-month and nine-month periods ended September 30, 2006 and 2005, and the condensed consolidated statements of cash flows for the nine-month periods ended September 30, 2006 and 2005. These financial statements are the responsibility of the Company's management.

We conducted our review in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to the condensed consolidated financial statements referred to above for them to be in conformity with U.S. generally accepted accounting principles.

We have previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of W&T Offshore, Inc. and Subsidiaries as of December 31, 2005, and the related consolidated statements of income, changes in shareholders' equity and cash flows for the year then ended (not presented herein) and in our report dated March 30, 2006, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying condensed consolidated balance sheet as of December 31, 2005, is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

/s/ ERNST & YOUNG LLP

Houston, Texas

November 13, 2006

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### **Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

The following discussion and analysis should be read in conjunction with our accompanying unaudited condensed consolidated financial statements and the notes to those financial statements included elsewhere in this quarterly report. The following discussion includes forward-looking statements that reflect our plans, estimates and beliefs. Our actual results could differ materially from those discussed in these forward-looking statements.

#### **Overview**

W&T is an independent oil and natural gas company primarily focused in the Gulf of Mexico, including exploration in the deepwater where we have developed significant technical expertise. W&T has grown through acquisitions, exploitation and exploration and currently holds working interests in over 200 fields in federal and state waters. The majority of our daily production is derived from wells we operate.

During the third quarter of 2006

We completed our previously announced acquisition of a wholly-owned subsidiary of Kerr-McGee by merger. As a result of closing adjustments provided for under the Agreement and Plan of Merger effective as of October 1, 2005 (the Merger Agreement), the amount due at closing was approximately \$1.0 billion. The final purchase price is subject to additional post-closing adjustments pursuant to and in accordance with the Merger Agreement. The properties acquired include interests in approximately 100 fields on 242 offshore blocks (including 88 undeveloped blocks) spreading across the Western, Central and Eastern U.S. Gulf of Mexico, primarily in water depths of less than 1,000 feet. Based on our estimates, the total proved reserves of these properties approximated 280.5 Bcfe at June 30, 2006.

Net income increased 26% to \$66.7 million as compared to the third quarter of 2005. Net income for the third quarter of 2006 includes an unrealized gain of \$14.8 million (after taxes) related to our open commodity derivative contracts. Without the effect of the unrealized commodity derivative gain, net income for the third quarter of 2006 would have been \$51.9 million or \$0.71 per diluted share.

We participated in drilling seven exploration wells, all of which were successful. Two of the exploration wells were on the conventional shelf, four were in the deep shelf and one was in the deepwater. We also participated in drilling one successful development well on the conventional shelf.

On August 1, 2006, we paid a cash dividend of \$0.03 per common share to shareholders of record on July 14, 2006.

**Table of Contents****Results of Operations**

The following table sets forth selected operating data for the periods indicated (all values are net to our interest unless indicated otherwise):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
Net sales:				
Natural gas (Bcf)	15.4	11.5	37.5	37.1
Oil (MMBbls)	1.8	1.0	4.3	3.4
Total natural gas and oil (Bcfe) (1)	26.2	17.5	63.3	57.4
Average daily equivalent sales (MMcfe/d)	285.1	189.7	232.0	210.3
Average realized sales prices (2):				
Natural gas (\$/Mcf)	\$ 6.58	\$ 8.64	\$ 7.35	\$ 7.31
Oil (\$/Bbl)	62.08	54.39	60.48	47.38
Natural gas equivalent (\$/Mcf)	8.14	8.79	8.46	7.52
Average per Mcfe data (\$/Mcf):				
Lease operating expenses	\$ 1.31	\$ 1.04	\$ 1.05	\$ 0.91
Gathering, transportation cost and production taxes	0.20	0.15	0.18	0.18
Depreciation, depletion, amortization and accretion	3.26	2.61	3.19	2.42
General and administrative expenses	0.37	0.37	0.48	0.33
Total number of wells drilled (gross)	8	5	28	19
Total number of productive wells drilled (gross)	8	5	24	16

- (1) One billion cubic feet equivalent (Bcfe), one million cubic feet equivalent (MMcfe) and one thousand cubic feet equivalent (Mcf) are determined using the ratio of six Mcf of natural gas to one Bbl of crude oil, condensate or natural gas liquids (totals may not add due to rounding).
- (2) Average realized prices exclude the effects of our derivative contracts that do not qualify for hedge accounting. Had we included the effect of these derivatives, our average realized sales price for natural gas would have been \$6.87 per Mcf for the third quarter of 2006 and \$7.54 per Mcf for the nine months ended September 30, 2006. Our average realized sales price for oil would have been \$62.00 per barrel for the third quarter of 2006 and \$60.33 per barrel for the nine months ended September 30, 2006. On a natural gas equivalent basis, our average realized sales price would have been \$8.30 per Mcfe for the third quarter of 2006 and \$8.57 per Mcfe for the nine months ended September 30, 2006. We did not have any derivative contracts in place during the periods ended in 2005.

**Other Financial Information (in thousands)**

	Three Months Ended	Nine Months Ended
	September 30,	Septembe