Approach Resources Inc
Form 10-Q
August 06, 2008

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UNITED STATES
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 June 30, 2008

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: 001-33801

APPROACH RESOURCES INC.
(Exact name of registrant as specified in its charter)

Delaware	51-0424817
(State or other jurisdiction of incorporation or organization)	**(I.R.S. employer identification number)**
One Ridgmar Centre 6500 W. Freeway, Suite 800 Fort Worth, Texas	76116
(Address of principal executive offices)	**(Zip Code)**

(817) 989-9000
(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, 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 o	Accelerated filer o	Non-accelerated filer þ	Smaller reporting company o
		(Do not check if a smaller reporting company)	

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

The number of shares of the registrant s common stock, $0.01 par value, outstanding as of July 31, 2008 was 20,651,591.

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PART I FINANCIAL INFORMATION

Item 1. Financial statements.

APPROACH RESOURCES INC.
UNAUDITED CONSOLIDATED BALANCE SHEETS
(In thousands, except shares and per share amounts)

	June 30, 2008	December 31, 2007
ASSETS		
CURRENT ASSETS:		
Cash	$ 140	$ 4,785
Accounts receivable:		
Joint interest owners	9,683	5,272
Oil and gas sales	12,566	5,524
Unrealized gain on commodity derivatives		793
Prepaid expenses and other current assets	2,416	773
Total current assets	24,805	17,147
PROPERTIES AND EQUIPMENT:		
Oil and gas properties, at cost, using the successful efforts method of accounting	301,798	266,905
Furniture, fixtures and equipment	794	433
	302,592	267,338
Less accumulated depletion, depreciation and amortization	(48,079)	(36,860)
Net properties and equipment	254,513	230,478
INVESTMENT	917	917
UNREALIZED GAIN ON COMMODITY DERIVATIVES		75
OTHER ASSETS	3	109
Total assets	$ 280,238	$ 248,726
LIABILITIES AND STOCKHOLDERS EQUITY		
CURRENT LIABILITIES:		
Accounts payable	$ 6,395	$ 5,459
Oil and gas sales payable	6,983	1,794
Accrued liabilities	12,170	14,764
Unrealized loss on commodity derivatives	10,266	
Total current liabilities	35,814	22,017
NON-CURRENT LIABILITIES:		
Long-term debt	7,553	
Unrealized loss on commodity derivatives	3,417	
Deferred income taxes	28,775	26,342
Asset retirement obligations	638	548

Total liabilities	76,197	48,907
COMMITMENTS AND CONTINGENCIES STOCKHOLDERS EQUITY :		
Preferred stock, $0.01 par value, 10,000,000 shares authorized none outstanding		
Common stock, $0.01 par value, 90,000,000 shares authorized, 20,675,831 and 20,622,746 shares issued and 20,651,591 and 20,622,746 shares outstanding, respectively	207	206
Additional paid-in capital	166,733	166,141
Retained earnings	37,057	33,367
Accumulated other comprehensive income	44	105
Total stockholders equity	204,041	199,819
Total liabilities and stockholders equity	$ 280,238	$ 248,726

See accompanying notes to these consolidated financial statements.

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APPROACH RESOURCES INC. AND SUBSIDIARIES
UNAUDITED CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except shares and per share amounts)

	Three Months Ended June 30, 2008	Three Months Ended June 30, 2007	Six Months Ended June 30, 2008	Six Months Ended June 30, 2007
REVENUES:				
Oil and gas sales	$ 24,144	$ 9,690	$ 43,162	$ 19,082
EXPENSES:				
Lease operating	1,856	1,043	3,253	2,023
Severance and production taxes	1,170	373	1,923	748
Exploration	987	10	1,478	633
General and administrative	1,817	1,218	3,763	2,730
Depletion, depreciation and amortization	6,025	3,017	11,241	6,108
Total expenses	11,855	5,661	21,658	12,242
OPERATING INCOME	12,289	4,029	21,504	6,840
OTHER:				
Interest expense, net	(343)	(998)	(491)	(1,954)
Realized (loss) gain on commodity derivatives	(542)	88	(481)	2,243
Unrealized (loss) gain on commodity derivatives	(9,672)	1,724	(14,551)	(2,902)
INCOME BEFORE PROVISION FOR INCOME TAXES	1,732	4,843	5,981	4,227
PROVISION FOR INCOME TAXES	804	1,853	2,291	1,818
NET INCOME	$ 928	$ 2,990	$ 3,690	$ 2,409
EARNINGS PER SHARE:				
Basic	$ 0.04	$ 0.32	$ 0.18	$ 0.25
Diluted	$ 0.04	$ 0.29	$ 0.18	$ 0.25
WEIGHTED AVERAGE SHARES OUTSTANDING:				
Basic	20,646,519	9,481,662	20,634,633	9,491,472
Diluted	20,913,832	10,261,753	20,921,994	9,866,066

See accompanying notes to these consolidated financial statements.

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APPROACH RESOURCES INC. AND SUBSIDIARIES
UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)

	Six Months Ended June 30, 2008	Six Months Ended June 30, 2007
OPERATING ACTIVITIES:		
Net income	$ 3,690	$ 2,409
Adjustments to reconcile net income to net cash provided by operating activities:		
Depletion, depreciation and amortization	11,241	6,108
Unrealized loss on commodity derivatives	14,551	2,902
Exploration expense	1,478	633
Share-based compensation expense	496	88
Deferred income taxes	2,057	1,060
Changes in operating assets and liabilities:		
Accounts receivable	(11,586)	991
Prepaid expenses and other assets	(1,537)	(607)
Accounts payable	936	(707)
Oil and gas sales payable	5,189	491
Accrued liabilities	(2,594)	(508)
Cash provided by operating activities	23,921	12,860
INVESTING ACTIVITIES:		
Additions to oil and gas properties	(35,819)	(17,360)
Investments		(917)
Additions to other property and equipment, net	(361)	(9)
Cash used in investing activities	(36,180)	(18,286)
FINANCING ACTIVITIES:		
Proceeds from issuance of common stock	97	
Loan origination fees		(143)
Borrowings under credit facility	38,503	39,419
Repayment of amounts outstanding under credit facility	(30,950)	(40,269)
Proceeds from issuance of convertible debt		20,000
Cash provided by financing activities	7,650	19,007
CHANGE IN CASH AND CASH EQUIVALENTS	(4,609)	13,581
EFFECT OF FOREIGN CURRENCY TRANSLATION ON CASH AND CASH EQUIVALENTS	(36)	
CASH AND CASH EQUIVALENTS, beginning of period	4,785	4,911
CASH AND CASH EQUIVALENTS, end of period	$ 140	$ 18,492
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Cash paid for interest	$ 124	$ 1,869

Cash paid for income taxes	$ 41	$ 1,200
SUPPLEMENTAL DISCLOSURE OF NON-CASH TRANSACTION:		
Adjustment to Neo Canyon acquisition purchase price allocation	$ 509	$
Retirement of loans to stockholders in exchange for shares of common stock	$	$ 4,184

See accompanying notes to these consolidated financial statements.

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APPROACH RESOURCES INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2008
(Unaudited)

1. Summary of significant accounting policies

Organization and nature of operations

Approach Resources Inc. (Approach, ARI, the Company, we, us or our) is an independent energy company e the exploration, development, production and acquisition of unconventional natural gas and oil properties in the United States and British Columbia. We focus on natural gas and oil reserves in tight sands and shale. We currently operate or have oil and gas properties or interests in Texas, New Mexico, Kentucky and British Columbia.

Consolidation, basis of presentation and significant estimates

The interim consolidated financial statements of the Company are unaudited and contain all adjustments (consisting primarily of normal recurring accruals) necessary for a fair statement of the results for the interim periods presented. Results for interim periods are not necessarily indicative of results to be expected for a full year or for previously reported periods due in part, but not limited to, the volatility in prices for crude oil and natural gas, future commodity prices for commodity derivative contracts, interest rates, estimates of reserves, drilling risks, geological risks, transportation restrictions, the timing of acquisitions, product demand, market competition and interruptions of production. You should read these consolidated interim financial statements in conjunction with the audited consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2007 and filed with the Securities and Exchange Commission on March 28, 2008.

The accompanying interim consolidated financial statements have been prepared in accordance with the accounting principles generally accepted in the United States of America and include the accounts of the Company and its wholly-owned subsidiaries. Intercompany accounts and transactions are eliminated. In preparing the accompanying financial statements, we have made certain estimates and assumptions that affect reported amounts in the financial statements and disclosures of contingencies. Actual results may differ from those estimates. Significant assumptions are required in the valuation of proved oil and natural gas reserves, which may affect the amount at which oil and natural gas properties are recorded, accrual of capital expenditures, asset retirement obligations and share-based compensation. It is at least reasonably possible these estimates could be revised in the near term, and these revisions could be material. Certain prior year amounts have been reclassified to conform to current year presentation. These classifications have no impact on the net income reported.

Comprehensive income

For the three and six months ended June 30, 2007, there were no elements of comprehensive income other than net income. Following is a summary of our comprehensive income for the three and six months ended June 30, 2008 (in thousands):

	Three Months Ended June 30, 2008	Six Months Ended June 30, 2008
Net income	$ 928	$ 3,690
Other comprehensive income:		
Foreign currency translation adjustments	(91)	(61)
Comprehensive income	$ 837	$ 3,629

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APPROACH RESOURCES INC. AND SUBSIDIARIES
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Earnings per common share

We report basic earnings per common share, which excludes the effect of potentially dilutive securities, and diluted earnings per common share, which includes the effect of all potentially dilutive securities unless their impact is anti-dilutive. The following are reconciliations of the numerators and denominators of our basic and diluted earnings per share (dollars in thousands, except per share amounts):

	Three Months Ended June 30, 2008		
	Income (numerator)	Shares (denominator)	Per-share amount
Basic earnings per share:			
Net income	$ 928	20,646,519	$ 0.04
Effect of dilutive securities:			
Share-based compensation, treasury method		267,313	
Net income plus assumed conversions	$ 928	20,913,832	$ 0.04

	Three Months Ended June 30, 2007		
	Income (numerator)	Shares (denominator)	Per-share amount
Basic loss per share:			
Net income	$ 2,990	9,481,662	$ 0.32
Effect of dilutive securities:			
Share-based compensation, treasury method		339,960	
Convertible debt, if-converted method(1)	23	440,131	
Net income plus assumed conversions	$ 3,013	10,261,753	$ 0.29

	Six Months Ended June 30, 2008		
	Income (numerator)	Shares (denominator)	Per-share amount
Basic earnings per share:			
Net income	$ 3,690	20,634,633	$ 0.18
Effect of dilutive securities:			
Share-based compensation, treasury method		287,361	
Net income plus assumed conversions	$ 3,690	20,921,994	$ 0.18

Six Months Ended June 30, 2007

	Income (numerator)	Shares (denominator)	Per-share amount
Basic loss per share:			
Net income	$ 2,409	9,491,472	$ 0.25
Effect of dilutive securities:			
Share-based compensation, treasury method		313,558	
Convertible debt, if-converted method(1)	13	61,036	
Net income plus assumed conversions	$ 2,422	9,866,066	$ 0.25

(1) Upon the consummation of our initial public offering in November 2007, the convertible debt was converted into shares of common stock.

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APPROACH RESOURCES INC. AND SUBSIDIARIES
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2. Contribution Agreement

On November 14, 2007, the Company acquired all of the outstanding capital stock of Approach Oil & Gas Inc. (AOG) and acquired the 30% working interest in the Ozona Northeast field (the Neo Canyon interest) that the Company did not already own from Neo Canyon Exploration, L.P. (Neo Canyon). Upon the closing of the contribution agreement, Neo Canyon and each of the stockholders of AOG received shares of Company common stock in exchange for their respective contributions. Neo Canyon received an aggregate of 4,239,243 shares of Company common stock, of which 2,061,290 shares were offered in the Company s initial public offering (IPO), 156,805 shares were subject to the over-allotment option granted to the underwriters and 2,021,148 shares were redeemed by the Company for cash. The stockholders of AOG received an aggregate of 989,157 shares of Company common stock.

The acquisition cost of the Neo Canyon interest was $60.7 million, representing 4,239,243 shares of Company common stock at $12.00 per share, our IPO price, and the assumption of related deferred income tax liabilities and asset retirement obligations at that date along with post-closing purchase price adjustments resulting from operating results of the properties acquired between the effective date and the closing date of the acquisition. The existing tax basis assumed from the acquisition was finalized during the six months ended June 30, 2008. The adjustment made during the three months ended June 30, 2008 resulted in a $376,000 increase in deferred tax liabilities, $133,000 in additional post-closing purchase price adjustments and an increase in oil and gas properties of $509,000. The following is a summary of the final purchase price and its allocation (in thousands):

Purchase price:	
Issuance of 4,239,243 shares of Approach Resources Inc. common stock valued at $12.00 per share	$ 50,871
Deferred tax liabilities assumed	9,465
Asset retirement obligations assumed	133
Post-closing purchase price adjustments	265
Total	$ 60,734
Allocation:	
Wells and equipment and related facilities	$ 59,936
Mineral interests in oil and gas properties	798
Total	$ 60,734

3. Line of credit

In January 2008 we entered into a new, $200.0 million revolving loan agreement (Loan Agreement) with the Company as borrower, AOG, Approach Oil & Gas (Canada) Inc. and Approach Resources I, LP as guarantors, and The Frost National Bank and JPMorgan Chase Bank, NA, as lenders (collectively, the Lender). The borrowing base under the Loan Agreement was initially set at $75.0 million and will be redetermined semi-annually on or before each April 1 and October 1 based on our oil and gas reserves. We or the Lender can each request one additional borrowing base redetermination each calendar year. In May 2008, the Lender increased the borrowing base to $100.0 million. The maturity date under the Loan Agreement is July 2010. The borrowings bear interest based on the bank s prime rate, or the sum of the LIBOR plus an applicable margin ranging from 1.25% to 2.00% based on the borrowings outstanding compared to the borrowing base (5.0 % at June 30, 2008), at our election. We had outstanding borrowings of $7.6 million at June 30, 2008. There were no outstanding borrowings at December 31, 2007. Principal

APPROACH RESOURCES INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2008
(Unaudited)

payments are not required until the final maturity date of the Loan Agreement, at which time any outstanding loan balances shall be due and payable in full. In addition, the Loan Agreement requires payment of a quarterly fee equal to three eighths of one percent (0.375%) of the unused portion of the borrowing base. The borrowings are collateralized by substantially all of our oil and gas properties. The Loan Agreement contains various covenants, the most restrictive of which requires us to maintain a modified current ratio of at least one. The modified current ratio represents the quotient of our current assets, less any unrealized gains on commodity derivatives plus amounts available under the Loan Agreement divided by our current liabilities less unrealized losses on commodity derivatives. We were in compliance with the covenants at June 30, 2008.

We also have outstanding unused letters of credit under the Loan Agreement totaling $400,000 at June 30, 2008, which reduce amounts available for borrowing under the Loan Agreement.

4. Income taxes

The effective income tax rate for the three and six months ended June 30, 2008 was 46.4% and 38.3%, respectively. The increase in the tax effective rate for the three months ended June 30, 2008 is due to an increase in share-based compensation expense, which is not deductible for tax purposes. Total income tax expense (benefit) differed from the amounts computed by applying the U.S. Federal statutory tax rates and estimated state rates to pre-tax income for the three and six months ended June 30, 2007 due primarily to adjustments to the valuation allowance applied to net operating loss carryforwards of AOG. At December 31, 2006, AOG provided a valuation allowance related to its deferred tax assets resulting primarily from net operating loss carryforwards, based upon our inability to assess the amount to be realized until our acquisition of all outstanding AOG capital stock in November 2007.

5. Derivatives

At June 30, 2008, we had the following commodity derivative positions outstanding:

Period	**Volume (MMBtu)**			**$/MMBtu**	
	Monthly	**Total**	**Floor**	**Ceiling**	**Fixed**
NYMEX Henry Hub					
Costless collars 2008	178,000	1,070,000	$7.50	$11.45	
Costless collars 2008 (3rd quarter)	100,000	300,000	$7.00	$ 9.10	
Costless collars 2008 (3rd - 4th quarter)	200,000	1,200,000	$9.00	$12.20	
Costless collars 2009	180,000	2,160,000	$7.50	$10.50	
Costless collars 2009	130,000	1,560,000	$8.50	$11.70	
Fixed price swaps					
4th quarter 2008	100,000	300,000			$ 8.63
WAHA differential					
Fixed price swaps 2008	178,000	1,070,000			(0.69)
Fixed price swaps 2008 (3rd - 4th quarter)	100,000	600,000			(0.67)
Fixed price swaps 2009	200,000	2,400,000			(0.61)

Unrealized gains and losses, at fair value, are included on our consolidated balance sheets as current or non-current assets or liabilities based on the anticipated timing of cash settlements under the related contracts. Changes in the fair value of our commodity derivative contracts are recorded in earnings as they occur and included in other income (expense) on our consolidated statements of operations. We estimate the fair values of swap contracts based on the present value of the difference in exchange-quoted forward price curves and contractual settlement prices multiplied by notional quantities. We internally valued the contracts and then obtained mark-to-market valuations for our collar positions from our

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counterparty and reviewed such valuations for reasonableness based on forward prices in relation to our contractual ceiling and floor prices. We use our internal valuations to determine the fair values of the contracts that are reflected on our consolidated balance sheets. Realized gains and losses are also included in other income (expense) on our consolidated statements of operations.

We are exposed to credit losses in the event of nonperformance by the counterparty on our oil and gas swaps. However, we do not anticipate nonperformance by the counterparty over the term of the swaps.

Adoption of Statement of Financial Accounting Standards No. 157 (FAS 157)

Effective January 1, 2008, we adopted FAS 157, which among other things, requires enhanced disclosures about assets and liabilities carried at fair value. As defined in FAS 157, fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (exit price). We utilize market data or assumptions that market participants would use in pricing the asset or liability, including assumptions about risk and the risks inherent in the inputs to the valuation technique. These inputs can be readily observable, market corroborated or generally unobservable. We primarily apply the market approach for recurring fair value measurements and attempt to utilize the best available information. FAS 157 establishes a fair value hierarchy that prioritizes the inputs used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurement) and lowest priority to unobservable inputs (Level 3 measurement). The three levels of fair value hierarchy defined by FAS 157 are as follows:

Level 1 Quoted prices are available in active markets for identical assets or liabilities as of the reporting date. At June 30, 2008, we had no Level 1 measurements.

Level 2 Pricing inputs are other than quoted prices in active markets included in Level 1, which are either directly or indirectly observable as of the reporting date. Level 2 includes those financial instruments that are valued using models or other valuation methodologies. These models are primarily industry-standard models that consider various assumptions, including quoted forward prices for commodities, time value, volatility factors and current market and contractual prices for the underlying instruments, as well as other relevant economic measures. Our derivatives, which consist primarily of commodity swaps and collars, are valued using commodity market data which is derived by combining raw inputs and quantitative models and processes to generate forward curves. Where observable inputs are available, directly or indirectly, for substantially the full term of the asset or liability, the instrument is categorized in Level 2. At June 30, 2008, our commodity derivatives were valued using Level 2 measurements.

Level 3 Pricing inputs include significant inputs that are generally less observable from objective sources. These inputs may be used with internally developed methodologies that result in management s best estimate of fair value. At June 30, 2008, we had no Level 3 measurements.

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APPROACH RESOURCES INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2008
(Unaudited)

6. Share-based compensation

The following is a summary of stock option activity during the six months ended June 30, 2008:

	Shares subject to stock options
Outstanding at January 1, 2008	479,991
Granted	74,345
Exercised	(28,845)
Canceled	(34,050)
Outstanding at June 30, 2008	491,441

On June 2, 2008, we granted 24,240 restricted shares of our common stock. The total fair market value of these restricted shares on the grant date was $569,000 to be expensed over a service period of three years.

7. Subsequent event

Ozona Northeast deep rights acquisition

On July 1, 2008, we acquired an additional 95% working interest in all depths below the top of the Strawn formation, compression facilities and rights to approximately 75 miles of gathering lines in our Ozona Northeast field in Crockett and Schleicher Counties, Texas. The properties were acquired from J. Cleo Thompson & James Cleo Thompson, Jr., L.P. and certain other sellers. Before the acquisition, we owned a 100% working interest above the top of the Strawn formation and a 5% working interest below the top of the Strawn formation in Ozona Northeast. As a result of the acquisition, we now own substantially all working interests in all depths of the subsurface in Ozona Northeast.

The purchase price was $12.0 million subject to post-closing adjustments. Our preliminary purchase price allocation was $9.5 million to oil and gas properties and $2.5 million to gathering system, compression facilities and related equipment. Funding was provided through borrowings under our $100.0 million revolving credit facility.

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Item 2. Management s discussion and analysis of financial condition and results of operations.

The following discussion is intended to assist in understanding our results of operations and our financial condition. This section should be read in conjunction with management s discussion and analysis contained in our Annual Report on Form 10-K for the year ended December 31, 2007 filed with the Securities and Exchange Commission (SEC) on March 28, 2008. Our consolidated financial statements and the accompanying notes included elsewhere in this Quarterly Report on Form 10-Q contain additional information that should be referred to when reviewing this material. Certain statements in this discussion may be forward-looking. These forward-looking statements involve risks and uncertainties, which could cause actual results to differ from those expressed in this report.

Cautionary statement regarding forward-looking statements

Various statements in this report, including those that express a belief, expectation or intention, as well as those that are not statements of historical fact, are forward-looking statements. The forward-looking statements may include projections and estimates concerning the timing and success of specific projects and our future reserves, production, revenues, income and capital spending. When we use the words will, believe, intend, expect, may, should, a could, estimate, plan, predict, project or their negatives, other similar expressions or the statements that include t words, it usually is a forward-looking statement.

The forward-looking statements contained in this report are largely based on our expectations, which reflect estimates and assumptions made by our management. These estimates and assumptions reflect our best judgment based on currently known market conditions and other factors. Although we believe such estimates and assumptions to be reasonable, they are inherently uncertain and involve a number of risks and uncertainties that are beyond our control. In addition, management s assumptions about future events may prove to be inaccurate. We caution all readers that the forward-looking statements contained in this report are not guarantees of future performance, and we cannot assure any reader that such statements will be realized or the forward-looking events and circumstances will occur. Actual results may differ materially from those anticipated or implied in the forward-looking statements due to the factors detailed below and discussed in our Annual Report on Form 10-K for the year ended December 31, 2007 filed with the SEC on March 28, 2008. All forward-looking statements speak only as of the date of this report. We do not intend to publicly update or revise any forward-looking statements as a result of new information, future events or otherwise. These cautionary statements qualify all forward-looking statements attributable to us, or persons acting on our behalf.

The risks, contingencies and uncertainties relate to, among other matters, the following:

- our business strategy,
- estimated quantities of gas and oil reserves,
- uncertainty of commodity prices in oil and gas,
- our financial position,
- our cash flow and liquidity,
- replacing our gas and oil reserves,
- our inability to retain and attract key personnel,

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uncertainty regarding our future operating results,

uncertainties in exploring for and producing gas and oil,

high costs, shortages, delivery delays or unavailability of drilling rigs, equipment, labor or other services,

disruptions to, capacity constraints in or other limitations on the pipeline systems which deliver our gas and other processing and transportation considerations,

our inability to obtain additional financing necessary to fund our operations and capital expenditures and to meet our other obligations,

competition in the oil and gas industry,

marketing of gas and oil,

exploitation or property acquisitions,

technology,

the effects of government regulation and permitting and other legal requirements,

plans, objectives, expectations and intentions contained in this report that are not historical, and

other factors discussed in our Annual Report on Form 10-K for the year ended December 31, 2007 filed with the SEC on March 28, 2008.

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Overview

We are an independent energy company engaged in the exploration, development, production and acquisition of unconventional natural gas and oil properties onshore in the United States and British Columbia. We focus on natural gas and oil reserves in tight sands and shale and have assembled leasehold interests aggregating approximately 278,556 gross (193,237 net) acres.

We currently operate or have interests in the following areas:

West Texas

Ozona Northeast (Wolfcamp, Canyon Sands, Strawn and Ellenburger)

Cinco Terry (Wolfcamp, Canyon Sands and Ellenburger)

East Texas

North Bald Prairie (Cotton Valley Sands, Bossier and Cotton Valley Lime)

Northeast British Columbia

Montney tight gas and Doig Shale

Northern New Mexico

El Vado East (Mancos Shale)

Southwest Kentucky

Boomerang (New Albany Shale)

At December 31, 2007, we had estimated proved reserves of approximately 180.4 billion cubic feet of natural gas equivalent. At June 30, 2008, we owned working interests in 330 producing oil and gas wells and were producing 22.4 million cubic feet of natural gas equivalent per day (MMcfe/d) (based on production for the second quarter of 2008). Our average daily net production for the month of July 2008 was 24.3 MMcfe/d.

Our financial results depend on many factors, particularly the price of oil and gas. Commodity prices are affected by changes in market demand, which is impacted by overall economic activity, weather, pipeline capacity constraints, inventory storage levels, gas price differentials and other factors. As a result, we cannot accurately predict future oil and gas prices, and therefore, we cannot determine what effect increases or decreases will have on our capital program, production volumes and future revenues. In addition to production volumes and commodity prices, finding and developing sufficient amounts of oil and gas reserves at economical costs are critical to our long-term success. Future finding and development costs are subject to changes in the industry, including the costs of acquiring, drilling and completing our projects.

Higher oil and gas prices generally increase the demand for drilling rigs and equipment, operating personnel and field supplies and services and can cause increases in the costs of those goods and services. While we have benefitted from higher commodity prices, we also have experienced an increase in operating and capital costs in the first six months of 2008 that have partially offset these higher commodity prices. We expect that our operating costs, specifically our lease operating, general and administrative and depletion, depreciation and amortization expenses will, for the foreseeable future, be higher than those historically experienced. We endeavor to increase oil and gas reserves and production while controlling costs at a level that is appropriate for long-term operations. Our future cash flow from operations will depend on our ability to manage our overall cost structure.

Like all oil and gas production companies, we face the challenge of natural production declines. Oil and gas production from any given well naturally decreases over time. Additionally, our reserves have a rapid initial decline, a characteristic of tight gas sands. We attempt to overcome this natural decline by drilling to develop and identify additional reserves, farm-ins or other drilling ventures, and by acquisitions. Our future growth will depend upon our ability to continue to add oil and gas reserves in excess of production at a reasonable cost. We intend to maintain our focus on the costs of adding reserves through drilling and acquisitions as well as the costs necessary to produce such reserves.

We also face the challenge of financing future acquisitions. After completion of the initial public offering of our common stock, we repaid all amounts outstanding on our revolving credit facility. At June 30, 2008, we had $7.6 million outstanding under our revolving credit facility. At July 31, 2008, we had $21.0 outstanding under our revolving credit facility, which we used to fund the acquisition of deep rights in Ozona Northeast discussed below. We believe we have adequate unused borrowing capacity under our revolving credit facility for possible acquisitions, temporary working capital needs and further expansion of our drilling program. Funding for future acquisitions also may require additional sources of financing, which may not be available.

Recent developments

Ozona Northeast deep rights acquisition

On July 1, 2008, we acquired an additional 95% working interest in all depths below the top of the Strawn formation, compression facilities and rights to approximately 75 miles of gathering lines in our Ozona Northeast field in Crockett and Schleicher Counties, Texas. The properties were acquired from J. Cleo Thompson & James Cleo Thompson, Jr., L.P. and certain other sellers. Before the acquisition, we owned a 100% working interest above the top of the Strawn formation and a 5% working interest below the top of the Strawn formation in Ozona Northeast. As a result of the acquisition, we now own substantially all working interests in all depths of the subsurface in Ozona Northeast.

The purchase price was $12.0 million subject to post-closing adjustments. Our preliminary purchase price allocation was $9.5 million to oil and gas properties and $2.5 million to gathering system, compression facilities and related equipment. Funding was provided through borrowings under our $100.0 million revolving credit facility.

British Columbia asset divestiture

On July 15, 2008, we announced that the operator and non-operating participants in the our British Columbia lease acquisition and drilling project engaged a financial advisor to explore the sale of the project s oil and gas interests in northeast British Columbia. The financial advisor has solicited bids for the purchase of these assets. Initial bids are due mid-August 2008. The project covers 29,954 (gross) and 28,309 (net) acres in the Monias/Charlie Lake areas. The project primarily targets Montney tight gas and Doig phosphate shale formations. We hold a 25% non-operating interest in the project.

Northern New Mexico update

On July 21, 2008, the Governor of New Mexico directed the New Mexico Oil Conservation Division and Oil Conservation Commission to propose new rules and initiate formal rulemaking for oil and gas

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operations in Eastern Rio Arriba County, including our leasehold in El Vado East. In light of the Governor s directive, we withdrew our litigation that was pending in federal district court for the District of New Mexico against Rio Arriba County. Our withdrawal of the pending litigation does not affect our ability to reinstitute proceedings against Rio Arriba County at a later date.

Results of operations

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
Revenues (in thousands):				
Gas	$ 18,572	$ 8,662	$ 33,444	$ 16,916
Oil	4,165	975	7,250	2,065
NGLs	1,407	53	2,468	101
Total oil and gas sales	24,144	9,690	43,162	19,082
Realized (loss) gain on commodity derivatives	(542)	88	(481)	2,243
Total oil and gas sales including derivative impact	$ 23,602	$ 9,778	$ 42,681	$ 21,325
Production:				
Gas (MMcf)	1,674	1,145	3,339	2,376
Oil (MBbls)	34	16	66	36
NGLs (MBbls)	26	1	47	3
Total (MMcfe)	2,036	1,251	4,016	2,608
Average prices:				
Gas (per Mcf)	$ 11.10	$ 7.57	$ 10.02	$ 7.12
Oil (per Bbl)	121.29	59.76	110.10	57.83
NGLs per (Bbl)	53.93	36.92	52.61	33.39
Total (per Mcfe)	$ 11.86	$ 7.74	$ 10.75	$ 7.32
Realized (loss) gain on commodity derivatives (per Mcfe)	(0.27)	0.07	(0.12)	0.86
Total per Mcfe including derivative impact	$ 11.59	$ 7.81	$ 10.63	$ 8.18
Costs and expenses (per Mcfe):				
Lease operating expenses	$ 0.91	$ 0.83	$ 0.81	$ 0.78
Severance and production taxes	0.57	0.30	0.48	0.29
Exploration	0.48	0.01	0.37	0.24
General and administrative	0.89	0.97	0.94	1.05
Depletion, depreciation and amortization	2.93	2.41	2.78	2.34

Equivalent amounts throughout this report are determined by using a ratio of six thousand cubic feet (Mcf) of gas to one barrel (Bbl) of oil, condensate or natural gas liquids (NGLs).

Three months ended June 30, 2008 compared to three months ended June 30, 2007

Oil and gas sales. Oil and gas sales increased $14.5 million, or 149.2%, for the three months ended June 30, 2008 to $24.1 million from $9.7 million for the three months ended June 30, 2007. The increase in oil and gas sales principally resulted from our increased ownership in the Ozona Northeast field as a result of our acquisition of the 30% working interest in Ozona Northeast (the Neo Canyon interest) that we did not already own from Neo Canyon Exploration, L.P. in the fourth quarter of 2007 and increased revenues from our Cinco Terry and North Bald Prairie fields. We now own a 100% working interest in Ozona

Northeast. Of the 2,036 million cubic feet of natural gas equivalent (MMcfe) production reported for the 2008 period, 434 MMcfe was attributable to the interest acquired from Neo Canyon. The increase in oil and gas sales also resulted from continued development of our Cinco Terry and North Bald Prairie fields. Cinco Terry production rose by 422 MMcfe compared to the prior year period. Production from North Bald Prairie accounted for 104 MMcfe for the current three-month period. Further, the average price per thousand cubic feet of natural gas equivalent (Mcfe) we received for our production increased from $7.74 to $11.86 per Mcfe as oil and gas prices rose sharply between the two periods. Of the $14.5 million increase in revenues, $9.4 million was attributable to growth in volumes with the remaining $5.1 million due to oil and gas price increases. Natural gas sales represented 76.9% of the total oil and gas sales for the three months ended June 30, 2008, compared to 89.4% for the prior year period, as our Cinco Terry field has a larger component of oil and natural gas liquids in its production.

Commodity derivative activities. Realized gains and losses from our commodity derivative activity resulted in a loss of $542,000 and a gain of $88,000 for the three months ended June 30, 2008 and 2007, respectively. Realized gains or losses are derived from the relative movement of gas prices in relation to the range of prices in our collars or the fixed notional pricing for the respective time periods. The unrealized gains or losses on commodity derivatives were a loss of $9.7 million and gain of $1.7 million for the three months ended June 30, 2008 and 2007, respectively. Both of these variances are the result of the sharp increase (for the 2008 period) or decrease (for the prior year period) in underlying gas commodity prices. As natural gas commodity prices increase, the fair value of the open portion of those positions decreases. As natural gas commodity prices decrease, the fair value of the open portion of those positions increases. Historically, we have not designated our derivative instruments as cash-flow hedges. We record our open derivative instruments at fair value on our consolidated balance sheets as either unrealized gains or losses on commodity derivatives. We record changes in such fair value in earnings on our consolidated statements of operations under the caption entitled unrealized loss on commodity derivatives.

Lease operating. Our lease operating expenses increased $813,000, or 77.9%, for the three months ended June 30, 2008 to $1.9 million ($0.91 per Mcfe) from $1.0 million ($0.83 per Mcfe) for the three months ended June 30, 2007. The primary factors in the increase in lease operating expense were the acquisition of the Neo Canyon interest and the increase in the number of wells from our ongoing development of our three producing fields. On a per Mcfe basis, the increase in lease operating expenses was primarily due to increased compression and treating costs in our Cinco Terry and North Bald Prairie projects as well as an increase in general maintenance costs in the Ozona Northeast field. We anticipate that the lease operating expenses per Mcfe for Cinco Terry and North Bald Prairie will decrease over time as production from those fields increases.

Severance and production taxes. Our production taxes increased $797,000, or 213.7%, for the three months ended June 30, 2008 to $1.2 million from $373,000 for the three months ended June 30, 2007. The increase in production taxes was a function of the increase in oil and gas sales between the two periods. Severance and productions taxes amounted to approximately 5.0% and 3.8% of oil and gas sales for the respective periods. The increase in the severance and production taxes as a percentage of oil and gas sales is due to the increase in NGL sales in Cinco Terry, which are taxed at a higher rate.

Exploration. We recorded $987,000 of exploration expense for the three months ended June 30, 2008, compared to $10,000 for the three months ended June 30, 2007. Exploration expense in the 2008 period resulted primarily from the extension of lease terms in our Ozona Northeast field. We incur these costs to maintain our leasehold positions and accordingly, we expense them as incurred.

General and administrative. Our general and administrative expenses increased $599,000, or 49.2%, to $1.8 million ($0.89 per Mcfe) for the three months ended June 30, 2008 from $1.2 million ($0.97 per

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Mcfe) for the three months ended June 30, 2007. The increase in general and administrative expense was principally due to increased staffing, salaries, professional fees, share-based compensation, insurance and travel costs in the 2008 period over the 2007 period.

Depletion, depreciation and amortization (DD&A). Our DD&A expense increased $3.0 million, or 99.7%, to $6.0 million for the three months ended June 30, 2008 from $3.0 million for the three months ended June 30, 2007. Our DD&A expense per Mcfe increased by $0.52, or 21.6%, to $2.93 per Mcfe for the three months ended June 30, 2008, compared to $2.41 per Mcfe for the three months ended June 30, 2007. The increase in DD&A was primarily attributable to increased production and higher capital costs in the 2008 period. The higher DD&A expense per Mcfe was primarily attributable to higher capital costs in North Bald Prairie and reserve revisions in Ozona Northeast at December 31, 2007. In North Bald Prairie, we paid capital costs attributable to the 50% working interest owned by our working interest partner pursuant to our farm-in agreement on the first five wells drilled.

Interest expense, net. Our interest expense decreased $655,000, or 65.6%, to $343,000 for the three months ended June 30, 2008 from $998,000 for the three months ended June 30, 2007. This decrease was substantially the result of our lower debt level in the 2008 period as well as lower interest rates during the 2008 period. We had borrowings outstanding under our revolving credit facility amounting to $7.6 million at June 30, 2008 compared to $46.8 million at June 30, 2007.

Income taxes. Our provision for income taxes decreased to $0.8 million for the three months ended June 30, 2008, from $1.9 million for the three months ended June 30, 2007. The decrease in income tax expense was due to the decrease in our income before income taxes. Our effective income tax rate for the three months ended June 30, 2008 was 46.4%, compared with 38.3% for the three months ended June 30, 2007. The higher effective tax rate for the 2008 period is a result of higher share-based compensation expense, which is not deductible for tax purposes.

Six months ended June 30, 2008 compared to six months ended June 30, 2007

Oil and gas sales. Oil and gas sales increased $24.1 million, or 126.2%, for the six months ended June 30, 2008 to $43.2 million from $19.1 million for the six months ended June 30, 2007. The increase in oil and gas sales principally resulted from our increased ownership in the Ozona Northeast field as a result of our acquisition of the Neo Canyon interest in the fourth quarter of 2007 and increased revenue from our Cinco Terry and North Bald Prairie fields. We now own a 100% working interest in Ozona Northeast. Of the 4,016 MMcfe production reported for the 2008 period, 893 MMcfe was attributable to the interest acquired from Neo Canyon. The increase in oil and gas sales also resulted from continued development of our Cinco Terry and North Bald Prairie fields. Cinco Terry production rose by 705 MMcfe compared to the prior year period. Production from North Bald Prairie accounted for 213 MMcfe in production for the current six month period. Further, the average price per Mcfe we received for our production increased from $7.32 to $10.75 per Mcfe as oil and gas prices rose sharply between the two periods. Of the $24.1 million increase in revenues, $15.3 million was attributable to growth in volumes with the remaining $8.8 million due to oil and gas price increases. Natural gas sales represented 77.5% of the total oil and gas sales for the six months ended June 30, 2008, compared to 88.7% for the prior year period, as our Cinco Terry field has a larger component of oil and NGLs in its production.

Commodity derivative activities. Realized losses and gains from our commodity derivative activity decreased our earnings by $481,000 and increased our earnings by $2.2 million for the six months ended June 30, 2008 and 2007, respectively. Realized gains and losses are derived from the relative movement of gas prices in relation to the range of prices in our collars or the fixed notional pricing for the respective time periods. The unrealized losses on commodity derivatives were $14.6 million and $2.9 million for the six months ended June 30, 2008 and 2007, respectively. Both of these losses were the result of the sharp increase in underlying gas commodity prices. As natural gas commodity prices increase, the fair value of the open portion of those positions decreases. As natural gas commodity prices decrease, the fair value of the open portion of those positions increases. Historically, we have not designated our derivative instruments as cash-flow hedges. We record our open derivative instruments at fair value on our consolidated balance sheets as either unrealized gains or losses on commodity derivatives. We record changes in such fair value in earnings on our consolidated statements of operations under the caption entitled unrealized loss on commodity derivatives.

Lease operating. Our lease operating expenses increased $1.2 million, or 60.8%, for the six months ended June 30, 2008 to $3.3 million ($0.81 per Mcfe) from $2.0 million ($0.78 per Mcfe) for the six months ended June 30, 2007. The primary factors in the increase in lease operating expense were the acquisition of the Neo Canyon interest and the increase in the number of wells from our ongoing development of our three producing fields. On a per Mcfe basis, the increase in lease operating expenses was primarily due to increased compression and treating costs in our Cinco Terry and North Bald Prairie projects as well as an increase in general maintenance costs in the Ozona Northeast field. We expect that the lease operating expenses per Mcfe for Cinco Terry and North Bald Prairie will decrease over time as production from those fields increases.

Severance and production taxes. Our production taxes increased $1.2 million, or 156.9%, for the six months ended June 30, 2008 to $1.9 million from $748,000 for the six months ended June 30, 2007. The increase in production taxes was a function of the increase in oil and gas sales between the two periods. Severance and productions taxes amounted to approximately 4.4% and 3.9% of oil and gas sales for the respective periods. The increase in the severance and production taxes as a percentage of oil and gas sales is due to the increase in NGL sales in Cinco Terry, which are taxed at a higher rate.

Exploration. We recorded $1.5 million of exploration expense for the six months ended June 30, 2008, compared to $633,000 for the six months ended June 30, 2007. Exploration expense for the 2008 period resulted from one dry hole drilled in Ozona Northeast and $965,000 of lease extensions in Ozona Northeast. We incur these costs to maintain our leasehold positions and accordingly, we expense them as incurred. Exploration expense for the 2007 period resulted from the drilling of a dry hole test well in our Boomerang project.

General and administrative. Our general and administrative expenses increased $1.0 million, or 37.8%, to $3.8 million (0.94 per Mcfe) for the six months ended June 30, 2008 from $2.7 million ($1.05 per Mcfe) for the six months ended June 30, 2007. The increase in general and administrative expense was principally due to increased staffing, salaries, professional fees, share-based compensation, insurance and travel costs in the 2008 period over the 2007 period. The 2008 period increase was partially offset by bonus payments made in the 2007 period to cover tax liabilities incurred by management in connection with the exchange of shares of common stock to repay management notes before our initial public offering and a dispute resolution payment to a former officer.

Depletion, depreciation and amortization (DD&A). Our DD&A expense increased $5.1 million, or 84.0%, to $11.2 million for the six months ended June 30, 2008 from $6.1 million for the six months ended June 30, 2007. Our DD&A expense per Mcfe increased by $0.44, or 18.8%, to $2.78 per Mcfe for the six months ended June 30, 2008, compared to $2.34 per Mcfe for the six months ended June 30, 2007. The increase in DD&A was primarily attributable to increased production and higher capital costs. The higher DD&A expense per Mcfe was primarily attributable to higher capital costs incurred in North Bald Prairie and reserve revisions in Ozona Northeast at December 31, 2007. In North Bald Prairie, we paid capital costs attributable to the 50% working interest owned by our working interest partner pursuant to our farm-in agreement on the first five wells drilled.

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Interest expense, net. Our interest expense decreased $1.5 million, or 74.9%, to $491,000 for the six months ended June 30, 2008 from $2.0 million for the six months ended June 30, 2007. This decrease was substantially the result of our lower debt level in the 2008 period as well as lower interest rates during the 2008 period. We had borrowings outstanding under our revolving credit facility amounting to $7.6 million at June 30, 2008, compared to $46.8 million at June 30, 2007.

Income taxes. Our provision for income taxes increased to $2.3 million for the six months ended June 30, 2008, from $1.8 for the six months ended June 30, 2007. The increase in income tax expense was due to the increase in our income before income taxes. Our effective income tax rate for the six months ended June 30, 2008 was 38.3%, compared with 43.0% for the six months ended June 30, 2007. The higher effective income tax rate for the 2007 period was primarily a result of changes in the valuation allowance provided against net operating loss carryovers (NOLs) for Approach Oil & Gas Inc. (AOG). We were not able to recognize a tax benefit for the NOLs until after the combination of AOG and the Company in November 2007. At such time, we determined that we would be able to realize the AOG NOLs.

Liquidity and capital resources

We rely on cash generated from operations, borrowings under our revolving credit facility and future public equity and debt offerings to satisfy our liquidity needs. Our ability to fund planned capital expenditures and to make acquisitions depends upon our future operating performance, availability of borrowings under our revolving credit facility, and more broadly, on the availability of equity and debt financing, which is affected by prevailing economic conditions in our industry and financial, business and other factors, some of which are beyond our control.

Our cash flow from operations is driven by commodity prices and production volumes. Prices for oil and gas are affected by seasonal influences of weather, national and international economic and political environments and, increasingly, from heightened demand for hydrocarbons from emerging nations, particularly China and India. Our working capital is significantly influenced by changes in commodity prices and significant declines in prices could cause a decrease in our exploration and development expenditures and production volumes. Cash flows from operations are primarily used to fund exploration and development of our mineral interests.

The following table summarizes our sources and uses of funds for the periods noted:

	Six Months Ended June 30,	
(in thousands)	**2008**	**2007**
Cash flows provided by operating activities	$ 23,921	$ 12,860
Cash flows used in investing activities	(36,180)	(18,286)
Cash flows provided by financing activities	7,650	19,007
Effect of Canadian exchange rate	(36)	
Net (decrease) increase in cash and cash equivalents	$ (4,645)	$ 13,581

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Operating activities

For the six months ended June 30, 2008, our cash flow from operations, borrowings under our credit facility and available cash were used for drilling activities. The $23.9 million in cash flow generated in the 2008 period increased $11.1 million from the same period in 2007 due primarily to an increase in oil and gas sales. Partially offsetting the increase in oil and gas sales was a $9.3 million reduction in working capital in the 2008 period as compared to the 2007 period.

Investing activities

The cash flows used in investing activities in the 2008 period were for the continued development of Ozona Northeast, Cinco Terry and North Bald Prairie. For the comparable 2007 period, the cash flows used in investing activities were for the drilling of Ozona Northeast wells, the acquisition of the Northern New Mexico leasehold, the drilling of Boomerang test wells and the drilling of Cinco Terry wells.

Future capital expenditures for 2008

Our board of directors approved an $80.0 million capital budget for 2008 in May of 2008. The following table summarizes our current estimated 2008 capital expenditures. The $80.0 million capital budget approved in May 2008 does not include the $12.0 million purchase of the deep rights in Ozona Northeast, discussed above in this report under Recent developments. We will be required to meet our capital needs from our internally generated cash flow, borrowings under our revolving credit facility, debt financings and equity financings. The estimated capital expenditures are subject to change depending upon a number of factors, including the results of our development and exploration efforts, the availability of sufficient capital resources to us and other participants for drilling prospects, economic and industry conditions at the time of drilling, including prevailing and anticipated prices for oil and gas and the availability of drilling rigs and crews, our financial results, the availability of leases on reasonable terms and our ability to obtain permits for drilling locations.

(in thousands)	**Estimated year ended December 31, 2008**
Capital expenditures:	
Ozona Northeast	$37,500
Cinco Terry	20,200
North Bald Prairie	14,400
British Columbia	3,000
El Vado East	
Boomerang	1,800
Lease acquisition, geological, geophysical and other	3,100
Total capital expenditures	$80,000

Financing activities

We borrowed $38.5 million and $39.4 million under our revolving credit facility during six months ended June 30, 2008 and 2007, respectively. We repaid $31.0 million and $40.3 million of the amounts borrowed under the revolving credit facility during the six months ended June 30, 2008 and 2007, respectively. Additionally, we borrowed $20.0 million in the 2007 period from the issuance of convertible debt.

Our goal is to actively manage our borrowings to help us maintain the flexibility to expand and invest, and to avoid the problems associated with highly leveraged companies of large interest costs and possible debt reductions restricting ongoing operations.

We believe that cash flow from operations and borrowings under our revolving credit facility will finance substantially all of our anticipated drilling, exploration and capital needs through 2008. We will also use our revolving credit facility for possible acquisitions, temporary working capital needs and any additional expansion of our drilling program through 2008. We also may determine to access the public equity or debt market for potential acquisitions, working capital or other liquidity needs, if such financing is available on acceptable terms.

Credit facility

We have a $200.0 million revolving loan agreement (Loan Agreement) with a borrowing base set at $100.0 million and which is redetermined semi-annually on or before each April 1 and October 1 based on our oil and gas reserves. We or the lenders can each request one additional borrowing base redetermination each calendar year. The maturity date under the Loan Agreement is July 2010. The borrowings bear interest based on the bank s prime rate, or the sum of the LIBOR plus an applicable margin ranging from 1.25% to 2.00% based on the borrowings outstanding compared to the borrowing base. We had outstanding borrowings of $7.6 million at June 30, 2008. There were no outstanding borrowings at December 31, 2007. The interest rate applicable to our outstanding borrowings was 5.0% and 6.6% as of June 30, 2008 and December 31, 2007, respectively. We were in compliance with the covenants in the Loan Agreement at June 30, 2008.

At July 31, 2008, we had $21.0 million outstanding under our Loan Agreement.

We also have outstanding unused letters of credit under the Loan Agreement totaling $400,000 at June 30, 2008, which reduce amounts available for borrowing under the Loan Agreement.

Contractual obligations

There have been no material changes to our contractual obligations during the six months ended June 30, 2008.

Off-balance sheet arrangements

From time to time, we enter into off-balance sheet arrangements and transactions that can give rise to off-balance sheet obligations. As of June 30, 2008, the off-balance sheet arrangements and transactions that we have entered into include undrawn letters of credit, operating lease agreements and gas transportation commitments. We do not believe that these arrangements are reasonably likely to materially affect our liquidity or availability of, or requirements for, capital resources.

Item 3. Quantitative and qualitative disclosures about market risk.

Some of the information below contains forward-looking statements. The primary objective of the following information is to provide forward-looking quantitative and qualitative information about our potential exposure to market risks. The term market risk refers to the risk of loss arising from adverse changes in oil and gas prices, and other related factors. The disclosure is not meant to be a precise indicator of expected future losses, but rather an indicator of reasonably possible losses. This forward-looking information provides an indicator of how we view and manage our ongoing market risk exposures. Our market risk sensitive instruments were entered into for commodity derivative and investment purposes, not for trading purposes.

Commodity price risk

We enter into financial swaps and collars to hedge future oil and gas production to mitigate portions of the risk of market price fluctuations. We do not designate such instruments as cash flow hedges. Accordingly, we record open commodity derivative positions on our consolidated balance sheets at fair value and recognize changes in such fair values as income (expense) on our consolidated statements of operations as they occur.

As of June 30, 2008, we had the following commodity derivative positions outstanding:

Period	**Volume (MMBtu)**			**$/MMBtu**	
	Monthly	**Total**	**Floor**	**Ceiling**	**Fixed**
NYMEX Henry Hub					
Costless collars 2008	178,000	1,070,000	$7.50	$11.45	
Costless collars 2008 (3rd quarter)	100,000	300,000	$7.00	$ 9.10	
Costless collars 2008 (3rd - 4th quarter)	200,000	1,200,000	$9.00	$12.20	
Costless collars 2009	180,000	2,160,000	$7.50	$10.50	
Costless collars 2009	130,000	1,560,000	$8.50	$11.70	
Fixed price swaps					
4th quarter 2008	100,000	300,000			$ 8.63
WAHA differential					
Fixed price swaps 2008	178,000	1,070,000			(0.69)
Fixed price swaps 2008 (3rd - 4th quarter)	100,000	600,000			(0.67)
Fixed price swaps 2009	200,000	2,400,000			(0.61)

At June 30, 2008, the fair value of our open derivative contracts was a liability of $13.7 million. At December 31, 2007, the fair value of our open derivative contracts was an asset $868,000.

We have reviewed the financial strength of our commodity derivative counterparty and believe our credit risk to be minimal. Our commodity derivative counterparty is a participant in our credit facility and the collateral for the outstanding borrowings under our revolving credit facility is used as collateral for our commodity derivatives.

Item 4T. Controls and procedures.

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934 (the Exchange Act)) as of June 30, 2008. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that, as of June 30, 2008, our disclosure controls and procedures were effective, in that they ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is (1) recorded, processed, summarized and reported within the time periods specified in the SEC s rules and forms, and (2) accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

No changes to our internal control over financial reporting occurred during the three months ended June 30, 2008 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act). The SEC s rules under Section 404 of the Sarbanes-Oxley Act of 2002 become applicable to us beginning with our Annual Report on Form 10-K for the year ending December 31, 2008 to be filed in the first quarter of 2009. We cannot give any assurance, however, that our internal controls will be effective when Section 404 becomes applicable to us. Ineffective internal controls could cause investors to lose confidence in our reported financial information and could result in a lower trading price for our securities.

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PART II OTHER INFORMATION

Item 1. Legal proceedings.

We are involved in various legal and regulatory proceedings arising in the normal course of business. We do not believe that an adverse result in any pending legal or regulatory proceeding, together or in the aggregate, would be material to our consolidated financial condition, results of operations or cash flows.

Item 1A. Risk factors.

For a discussion of our potential risks and uncertainties, see the information under the heading Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2007 filed with the SEC on March 28, 2008, which is accessible on the SEC s website at www.sec.gov. There have been no material changes to the risk factors disclosed in our Annual Report on Form 10-K for the year ended December 31, 2007.

Item 2. Unregistered sales of equity securities and use of proceeds.

None.

Item 3. Defaults upon senior securities.

None.

Item 4. Submission of matters to a vote of security holders.

On June 3, 2008, we held our annual meeting of stockholders to elect two Class I directors to our Board of Directors and to ratify the appointment of Hein & Associates LLP as our independent registered public accounting firm for the fiscal year ending December 31, 2008. At the meeting, Sheldon B. Lubar and Christopher J. Whyte were re-elected as directors.

The following is a summary of the votes cast at the annual meeting:

Results of Voting	Votes For	Withheld
1. Election of Directors		
Sheldon B. Lubar	19,393,521	44,210
Christopher J. Whyte	19,432,051	5,680

	Voted For	Against	Abstentions	Broker Non-Votes
2. Appointment of Hein & Associates LLP	19,435,191	1,940	600	

Item 5. Other information.

None.

Item 6. Exhibits.

See Index to Exhibits following the signature page of this report for a description of the exhibits filed as part of this report.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

APPROACH RESOURCES INC.

By: /s/ J. Ross Craft
J. Ross Craft
President and Chief Executive Officer

Date: August 6, 2008

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Index to Exhibits

Exhibit Number	Exhibit
3.1	Restated Certificate of Incorporation of Approach Resources Inc. (filed as Exhibit 3.1 to the Company s Quarterly Report on Form 10-Q filed December 13, 2007 and incorporated herein by reference).
3.2	Restated Bylaws of Approach Resources Inc. (filed as Exhibit 3.2 to the Company s Quarterly Report on Form 10-Q filed December 13, 2007 and incorporated herein by reference).
4.1	Specimen Common Stock Certificate (filed as Exhibit 4.1 to the Company s Registration Statement on Form S-1/A filed October 18, 2007 (File No. 333-144512) and incorporated herein by reference).
10.1	Form of Indemnity Agreement between Approach Resources Inc. and each of its directors and officers (filed as Exhibit 10.1 to the Company s Registration Statement on Form S-1/A filed September 13, 2007 (File No. 333-144512) and incorporated herein by reference).
10.2	Employment Agreement by and between Approach Resources Inc. and J. Ross Craft dated January 1, 2003 (filed as Exhibit 10.3 to the Company s Registration Statement on Form S-1 filed July 12, 2007 and incorporated herein by reference).
10.3	Employment Agreement by and between Approach Resources Inc. and Steven P. Smart dated January 1, 2003 (filed as Exhibit 10.4 to the Company s Registration Statement on Form S-1 filed July 12, 2007 and incorporated herein by reference).
10.4	Employment Agreement by and between Approach Resources Inc. and Glenn W. Reed dated January 1, 2003 (filed as Exhibit 10.5 to the Company s Registration Statement on Form S-1 filed July 12, 2007 and incorporated herein by reference).
10.5	Approach Resources Inc. 2007 Stock Incentive Plan, effective as of June 28, 2007 (filed as Exhibit 10.6 to the Company s Registration Statement on Form S-1 filed July 12, 2007 and incorporated herein by reference).
10.6	Form of Business Opportunities Agreement among Approach Resources Inc. and the other signatories thereto (filed as Exhibit 10.11 to the Company s Registration Statement on Form S-1/A filed October 18, 2007 (File No. 333-144512) and incorporated herein by reference).
10.7	Form of Option Agreement under 2003 Stock Option Plan (filed as Exhibit 10.12 to the Company s Registration Statement on Form S-1 filed July 12, 2007 and incorporated herein by reference).
10.8	Restricted Stock Award Agreement by and between Approach Resources Inc. and J. Curtis Henderson dated March 14, 2007 (filed as Exhibit 10.13 to the Company s Registration Statement on Form S-1 filed July 12, 2007 and incorporated herein by reference).

Exhibit Number	Exhibit
10.9	Form of Summary of Stock Option Grant under Approach Resources Inc. 2007 Stock Incentive Plan (filed as Exhibit 10.14 to the Company s Registration Statement on Form S-1/A filed October 18, 2007 (File No. 333-144512) and incorporated herein by reference).
10.10	Form of Stock Award Agreement under Approach Resources Inc. 2007 Stock Incentive Plan (filed as Exhibit 10.15 to the Company s Registration Statement on Form S-1/A filed October 18, 2007 (File No. 333-144512) and incorporated herein by reference).
10.11	Registration Rights Agreement dated as of November 14, 2007, by and among Approach Resources Inc. and investors identified therein (filed as Exhibit 10.1 to the Company s Current Report on Form 8-K/A filed December 3, 2007 and incorporated herein by reference).
10.12	Gas Purchase Contract dated May 1, 2004 between Ozona Pipeline Energy Company, as Buyer, and Approach Resources I, L.P. and certain other parties identified therein (filed as Exhibit 10.18 to the Company s Registration Statement on Form S-1/A filed September 13, 2007 (File No. 333-144512) and incorporated herein by reference).
10.13	Agreement Regarding Gas Purchase Contract dated May 26, 2006 between Ozona Pipeline Energy Company, as Buyer, and Approach Resources I, L.P. and certain other parties identified therein (filed as Exhibit 10.19 to the Company s Registration Statement on Form S-1/A filed September 13, 2007 (File No. 333-144512) and incorporated herein by reference).
10.14	Carry and Earning Agreement dated July 13, 2007 by and between EnCana Oil & Gas (USA) (filed as Exhibit 10.22 to the Company s Registration Statement on Form S-1/A filed September 13, 2007 (File No. 333-144512) and incorporated herein by reference).
10.15	Oil & Gas Lease dated February 27, 2007 between the lessors identified therein and Approach Oil & Gas Inc., as successor to Lynx Production Company, Inc. (filed as Exhibit 10.23 to the Company s Registration Statement on Form S-1/A filed September 13, 2007 (File No. 333-144512) and incorporated herein by reference).
10.16	Specimen Oil and Gas Lease for Boomerang prospect between lessors and Approach Oil & Gas Inc., as successor to The Keeton Group, LLC, as lessee (filed as Exhibit 10.24 to the Company s Registration Statement on Form S-1/A filed September 13, 2007 (File No. 333-144512) and incorporated herein by reference).
10.17	Lease Crude Oil Purchase Agreement dated May 1, 2004 by and between ConocoPhillips and Approach Operating LLC (filed as Exhibit 10.26 to the Company s Registration Statement on Form S-1/A filed October 18, 2007 (File No. 333-144512) and incorporated herein by reference).
10.18	Gas Purchase Agreement dated as of November 21, 2007 between WTG Benedum Joint Venture, as Buyer, and Approach Oil & Gas Inc. and Approach Operating, LLC, as Seller (filed as Exhibit 10.1 to the Company s Current Report on Form 8-K filed November 28, 2007 and incorporated herein by reference).

Exhibit Number	Exhibit
10.19	$200,000,000 Revolving Credit Agreement dated as of January 18, 2008 among Approach Resources Inc., as borrower, The Frost National Bank, as administrative agent and lender, and the financial institutions named therein (filed as Exhibit 10.1 to the Company s Current Report on Form 8-K filed January 18, 2008 and incorporated herein by reference).
10.20	Amendment dated February 19, 2008 to Credit Agreement among Approach Resources Inc., as borrower, The Frost National Bank, as administrative agent and lender, JPMorgan Chase Bank, NA, as lender, and Approach Oil & Gas Inc., Approach Oil & Gas (Canada) Inc. and Approach Resources I, LP, as guarantors, dated as of January 18, 2008 (filed as Exhibit 10.1 to the Company s Current Report on Form 8-K filed February 22, 2008 and incorporated herein by reference).
31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.