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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

**FORM 10-Q**

**QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
**For the Quarter Ended March 31, 2007**

**TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF EXCHANGE ACT**

Commission File No. 0-12185

**NGAS Resources, Inc.**

(Exact name of registrant as specified in its charter)

**Province of British Columbia**  
(State or other jurisdiction of  
incorporation or organization)

**Not Applicable**  
(I.R.S. Employer  
Identification No.)

**120 Prosperous Place, Suite 201**  
**Lexington, Kentucky**  
(Address of principal executive offices)

**40509-1844**  
(Zip Code)

**Registrant's telephone number, including area code: (859) 263-3948**

(Former name or former address, if changed since the last report)

Indicate by check mark if the registrant (1) filed all reports required to be filed by Section 13 or 15(d) of the Act during the past 12 months and (2) has been subject to those filing requirements for the past 90 days. Yes  No

Indicate by check mark if the registrant is a large accelerated filer, an accelerated filer (each as defined in Rule 12b-2) or a non-accelerated filer.

Large accelerated filer

Accelerated filer

Non-accelerated filer

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

Yes  No

Number of shares outstanding of each of the registrant's classes of common equity, as of the latest practicable date.

**Title of Class**  
**Common Stock**

**Outstanding at May 8, 2007**  
**21,798,551**

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# NGAS RESOURCES, INC.

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### Forward-Looking Statements

Some matters discussed in this report are prospective and constitute forward-looking statements within the meaning of the Private Litigation Reform Act of 1995. Other than statements of historical fact, all statements that address our future activities, events, outcomes and other matters we plan, expect, budget, intend or estimate (and other similar expressions) are forward-looking statements. While we believe these forward-looking statements are based on reasonable assumptions, they involve known and unknown risks, uncertainties and other factors that may cause future results to differ materially from those discussed or implied in this report. Additional information about issues that could cause actual results to differ from our forward-looking statements is provided in our annual report on Form 10-K for the year ended December 31, 2006.

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### Additional Information

We file annual, quarterly and other reports and information with the Securities Exchange Commission. Promptly after their filing, we provide access to these reports without charge on our website at [www.ngas.com](http://www.ngas.com).

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# NGAS RESOURCES, INC.

## CONDENSED CONSOLIDATED BALANCE SHEETS

	<u>March 31,</u> <u>2007</u>	<u>December 31,</u> <u>2006</u>
	(Unaudited)	
<b>ASSETS</b>		
Current assets:		
Cash .....	\$ 2,051,447	\$ 14,431,977
Accounts receivable.....	6,476,208	9,108,574
Prepaid expenses and other current assets .....	1,076,021	1,108,734
Loans to related parties.....	<u>7,373</u>	<u>7,147</u>
Total current assets .....	9,611,049	24,656,432
Bonds and deposits .....	558,695	533,695
Oil and gas properties .....	153,048,673	144,217,532
Property and equipment .....	3,649,515	3,342,571
Loans to related parties .....	255,361	257,430
Deferred financing costs .....	2,124,729	2,264,022
Other non-current assets.....	3,161,533	2,634,271
Goodwill .....	<u>313,177</u>	<u>313,177</u>
Total assets .....	<u>\$172,722,732</u>	<u>\$178,219,130</u>
<b>LIABILITIES</b>		
Current liabilities:		
Accounts payable .....	6,231,327	9,286,849
Accrued liabilities.....	3,336,805	3,998,978
Customers' drilling deposits.....	5,940,637	12,173,905
Long term debt, current portion.....	<u>24,000</u>	<u>24,000</u>
Total current liabilities .....	15,532,769	25,483,732
Deferred income taxes .....	8,369,185	8,035,779
Long term debt.....	71,004,957	66,922,744
Deferred compensation .....	<u>1,565,578</u>	<u>1,419,776</u>
Total liabilities.....	<u>96,472,489</u>	<u>101,862,031</u>
<b>SHAREHOLDERS' EQUITY</b>		
Capital stock		
<i>Authorized:</i>		
5,000,000 Preferred shares		
100,000,000 Common shares		
<i>Issued:</i>		
21,798,551 Common shares (2006 – 21,788,551) .....	84,572,132	84,531,832
21,100 Common shares held in treasury, at cost.....	(23,630)	(23,630)
Paid-in capital – options and warrants .....	3,268,608	3,073,287
Contributed surplus .....	1,307,861	1,396,074
<i>To be issued:</i>		
9,185 Common shares (2006 – 9,185) .....	<u>45,925</u>	<u>45,925</u>
	89,170,896	89,023,488
Deficit .....	<u>(12,920,653)</u>	<u>(12,666,389)</u>
Total shareholders' equity .....	<u>76,250,243</u>	<u>76,357,099</u>
Total liabilities and shareholders' equity .....	<u>\$172,722,732</u>	<u>\$178,219,130</u>

*See accompanying notes.*

# NGAS RESOURCES, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

	Three Months Ended March 31,	
	2007	2006
<b>REVENUE</b>		
Contract drilling .....	\$ 9,245,219	\$ 20,411,500
Oil and gas production .....	6,752,232	6,204,184
Gas transmission and compression .....	<u>1,947,941</u>	<u>703,571</u>
Total revenue .....	<u>17,945,392</u>	<u>27,319,255</u>
<b>DIRECT EXPENSES</b>		
Contract drilling .....	7,180,717	16,702,930
Oil and gas production .....	1,683,014	1,453,468
Gas transmission and compression .....	<u>1,099,593</u>	<u>632,429</u>
Total direct expenses .....	<u>9,963,324</u>	<u>18,788,827</u>
<b>OTHER EXPENSES (INCOME)</b>		
Selling, general and administrative .....	4,021,882	4,474,392
Options, warrants and deferred compensation .....	341,123	428,747
Depreciation, depletion and amortization .....	2,306,470	1,537,912
Interest expense .....	1,224,756	600,383
Interest income .....	(84,054)	(118,360)
Other, net .....	<u>92,749</u>	<u>40,948</u>
Total other expenses .....	<u>7,902,926</u>	<u>6,964,022</u>
INCOME BEFORE INCOME TAXES .....	<u>79,142</u>	<u>1,566,406</u>
DEFERRED INCOME TAX EXPENSE .....	<u>333,406</u>	<u>940,669</u>
NET INCOME (LOSS) .....	<u>\$ (254,264)</u>	<u>\$ 625,737</u>
Basic .....	<u>\$ (0.01)</u>	<u>\$ 0.03</u>
Diluted .....	<u>\$ (0.01)</u>	<u>\$ 0.03</u>
<b>WEIGHTED AVERAGE COMMON SHARES OUTSTANDING</b>		
Basic .....	<u>21,791,107</u>	<u>21,377,525</u>
Diluted .....	<u>21,791,107</u>	<u>23,177,078</u>

*See accompanying notes.*

# NGAS RESOURCES, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	Three Months Ended	
	March 31,	
	2007	2006
<b>OPERATING ACTIVITIES</b>		
Net income (loss) .....	\$ (254,264)	\$ 625,737
Adjustments to reconcile net income (loss) to net cash used in operating activities:		
Incentive bonus paid in common shares .....	--	291,032
Compensation from options and warrants .....	341,123	428,747
Depreciation, depletion and amortization .....	2,306,470	1,537,912
Gain (loss) on sale of assets .....	(5,920)	18,958
Deferred income taxes .....	333,406	940,669
Changes in assets and liabilities:		
Accounts receivable .....	2,632,366	(197,641)
Prepaid expenses and other current assets .....	32,713	1,608,781
Other non-current assets .....	(527,262)	(823,944)
Accounts payable .....	(3,055,522)	1,533,980
Accrued liabilities .....	(662,173)	2,804,756
Customers' drilling deposits .....	<u>(6,233,268)</u>	<u>(15,828,600)</u>
Net cash used in operating activities .....	<u>(5,092,331)</u>	<u>(7,059,613)</u>
<b>INVESTING ACTIVITIES</b>		
Proceeds from sale of assets .....	27,200	--
Purchase of property and equipment .....	(510,401)	(324,742)
Increase in bonds and deposits .....	(25,000)	(1,000)
Additions to oil and gas properties, net .....	<u>(10,816,141)</u>	<u>(25,521,311)</u>
Net cash used in investing activities .....	<u>(11,324,342)</u>	<u>(25,847,053)</u>
<b>FINANCING ACTIVITIES</b>		
Decrease in loans to related parties .....	1,843	20,641
Proceeds from issuance of common shares .....	40,300	168,056
Payments of deferred financing costs .....	--	(75,000)
Proceeds from issuance of long term debt .....	4,000,000	17,978,933
Payments of long term debt .....	<u>(6,000)</u>	<u>(6,000)</u>
Net cash provided by financing activities .....	<u>4,036,143</u>	<u>18,086,630</u>
Change in cash .....	(12,380,530)	(14,820,036)
Cash, beginning of period .....	14,431,977	23,944,252
Cash, end of period .....	<u>\$ 2,051,447</u>	<u>\$ 9,124,216</u>
<b>SUPPLEMENTAL DISCLOSURE</b>		
Interest paid .....	\$ 1,231,044	\$ 666,000
Income taxes paid .....	--	--

*See accompanying notes.*

# NGAS RESOURCES, INC.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

### *Note 1. Summary of Significant Accounting Policies*

(a) *General.* The accompanying condensed consolidated financial statements of NGAS Resources, Inc. (NGAS) have been prepared in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP). Our accounting policies are described in Note 1 to the consolidated financial statements in our annual report on Form 10-K for the year ended December 31, 2006. Except as noted below, our accounting policies and their method of application in the accompanying condensed consolidated financial statements are consistent with those described in the annual report.

(b) *Basis of Presentation.* The accompanying condensed consolidated financial statements include the accounts of NGAS, our wholly owned subsidiary, Daugherty Petroleum, Inc. (DPI), and its wholly owned subsidiaries. The condensed consolidated financial statements also reflect DPI's interests in a total of 35 drilling programs sponsored to participate in its drilling operations. We account for those interests using the proportionate consolidation method, with all material inter-company accounts and transactions eliminated on consolidation. References to the *Company, we, our or us* include DPI, its subsidiaries and interests in sponsored drilling programs. These interim consolidated financial statements are unaudited but reflect all normal recurring adjustments that, in the opinion of our management, are necessary to fairly present our financial position at March 31, 2007 and results of operations and cash flows for the three months ended March 31, 2007 and 2006.

(c) *Estimates.* The preparation of financial statements in conformity with U.S. GAAP requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities as of the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting periods. The most significant estimates pertain to proved oil and gas reserves and related cash flow estimates used in impairment tests of goodwill and other long-lived assets, estimates of future development, dismantlement and abandonment costs and estimates relating to future oil and gas revenues and expenses. We also make estimates and assumptions in maintaining allowances for doubtful accounts when deemed appropriate to reflect losses that could result from failures by customers or other parties to make payments on our trade receivables. The evaluations required for all of these estimates involve significant uncertainties, and actual results could differ from the estimates.

### *Note 2. Oil and Gas Properties*

All of our oil and gas development and producing activities are conducted within the continental United States. Capitalized costs and accumulated depreciation, depletion and amortization (DD&A) for our oil and gas properties, gathering facilities and well equipment as of March 31, 2007 and December 31, 2006 are summarized below.

	<u>March 31,</u> <u>2007</u>	<u>December 31,</u> <u>2006</u>
Proved oil and gas properties.....	\$118,693,664	\$110,169,303
Unproved oil and gas properties .....	3,325,397	3,000,465
Gathering facilities and well equipment .....	<u>48,336,706</u>	<u>46,369,858</u>
	170,355,767	159,539,626
Accumulated DD&A .....	<u>(17,307,094)</u>	<u>(15,322,094)</u>
Net oil and gas properties and equipment .....	<u>\$153,048,673</u>	<u>\$144,217,532</u>

### **Note 3. Property and Equipment**

The following table presents the capitalized costs and accumulated depreciation for our other property and equipment as of March 31, 2007 and December 31, 2006.

	<b>March 31, 2007</b>	<b>December 31, 2006</b>
Land.....	\$ 12,908	\$ 12,908
Building improvements .....	60,731	48,350
Machinery and equipment .....	2,980,384	2,680,174
Office furniture and fixtures .....	160,802	129,031
Computer and office equipment .....	598,194	569,877
Vehicles .....	<u>1,699,714</u>	<u>1,607,554</u>
	5,512,733	5,047,894
Accumulated depreciation .....	<u>(1,863,218)</u>	<u>(1,705,323)</u>
Net other property and equipment.....	<u>\$ 3,649,515</u>	<u>\$ 3,342,571</u>

### **Note 4. Deferred Financing Costs**

Financing costs for our convertible note private placements and secured credit facility are initially capitalized and amortized at rates based on the terms of the underlying debt instruments. These costs include \$354,819 incurred in the third quarter of 2006 for our new credit facility. See Note 7 – Long Term Debt. Upon conversion of convertible notes, the principal amount converted is added to equity, net of a proportionate amount of the original financing costs. Unamortized deferred financing costs for our outstanding notes and credit facility aggregated \$2,124,729 at March 31, 2007 and \$2,264,022 at December 31, 2006, net of accumulated amortization totaling \$1,061,617 and \$922,324, respectively.

### **Note 5. Goodwill**

Goodwill of \$1,789,564 was recorded in connection with our acquisition of DPI in 1993 and was amortized over ten years on a straight-line basis until 2002, when we adopted the Canadian equivalent of SFAS No. 142, *Goodwill and Other Intangible Assets*. Under the adopted standard, goodwill is no longer amortized but is instead tested for impairment at least annually. Our annual analyses indicated that no impairment charges were required. Accordingly, accumulated amortization of goodwill remained at \$1,476,387 as of March 31, 2007 and December 31, 2006, with unamortized goodwill of \$313,177.

### **Note 6. Customer Drilling Deposits**

We sponsor and manage drilling programs to participate in our drilling initiatives, in which we maintain non-promoted interests ranging from 12.5% to 75%. Historically, we conducted drilling operations under turnkey contracts with our sponsored drilling programs, requiring us to drill and complete wells at specified prices and entitling us to any surplus if the contract price exceeded our costs. In 2006, we changed the structure of our new drilling programs from turnkey pricing to cost plus, with a view to reducing our exposure to price volatility for drilling services, equipment and steel casing requirements. Under both structures, net proceeds received under drilling contracts with sponsored programs are recorded as customers' drilling deposits at the time of receipt. We recognize revenues from drilling operations on the completed contract method as the wells are drilled, rather than when funds are received. Customer drilling deposits aggregating \$5,940,637 as of March 31, 2007 and \$12,173,905 at December 31, 2006 represent unapplied drilling contract payments for wells that were not yet drilled as of the balance sheet dates.

### **Note 7. Long Term Debt**

(a) *Convertible Notes.* We issued several series of convertible notes in private placements to finance part of our drilling and acquisition activities. During 2005, the notes of all prior series were converted by their holders, either voluntarily or in response to our redemption calls, resulting in our issuance of 3,439,478 common shares

during the year. In December 2005, we completed an institutional private placement of a new series of 6% convertible notes due December 15, 2010 in the aggregate principal amount of \$37 million, all of which remained outstanding at March 31, 2007, with a conversion price of \$14.34, subject to adjustment for certain dilutive issuances of common stock. We also issued warrants in the transaction, which expired unexercised in August 2006. See Note 8 – Capital Stock.

The purchase agreement for our outstanding 6% notes provides holders with certain participation rights in future financing transactions. It also provides for a holder electing to convert a note before the second anniversary of the issuance date to a payment equal to the difference between two years' interest on the converted note and the interest already paid on the note, unless the prevailing market price of our common stock exceeds 160% of the conversion price, payable at our option in cash or in common shares. After that date, if the prevailing market price of the common stock exceeds 160% of the conversion price, we may redeem any unconverted notes at a redemption price equal to their principal amount plus accrued and unpaid interest. Any notes that are neither redeemed nor converted prior to maturity will be repayable in cash or in common shares. Any common shares issued for interest payments on converted notes or upon redemption at their maturity will generally be valued for that purpose at 92.5% of their prevailing market price.

(b) *Credit Facility.* In September 2006, we entered into a credit agreement with KeyBank National Association, as agent and primary lender. The credit agreement provides DPI with a senior secured revolving credit facility that replaces its prior credit facility with KeyBank, which had a scheduled maturity date of July 31, 2007 and a borrowing base of \$35 million. The new facility has a five-year maturity for revolving term loans and letters of credit in an aggregate amount up to \$125 million, with a borrowing base of \$50 million at March 31, 2007. Under the terms of the credit agreement, outstanding borrowings bear interest at fluctuating rates ranging from the agent's prime rate to 0.75% above that rate, depending on the amount of borrowing base utilization. Alternatively, we may elect Eurodollar based pricing from 1.5% to 2.5% above quoted LIBOR rates, depending on our borrowing base utilization. The credit agreement also provides for commitment fees ranging from 0.375% to 0.5% of the unused borrowing base. As of March 31, 2007, outstanding borrowings under the facility aggregated \$35 million, with \$2 million in letters of credit. The facility is secured by liens on our interests in most of our producing wells. Obligations under the facility are guaranteed by NGAS.

(c) *Acquisition Debt.* We issued a note for \$854,818 to finance our 1986 acquisition of mineral property on Unga Island, Alaska. The debt is repayable without interest in monthly installments of \$2,000 and is secured by liens on the acquired property, buildings and equipment. Although the acquisition agreement provides for royalties at 4% of net smelter returns or other production revenues, the property has remained inactive. The remaining acquisition debt was \$336,818 at March 31, 2007 and \$342,818 at December 31, 2006.

(d) *Total Long Term Debt and Maturities.* The following tables summarize our total long term debt at March 31, 2007 and December 31, 2006 and the principal payments due each year through 2010 and thereafter.

	<u>Principal Amount Outstanding</u>	
	<u>March 31,</u> <u>2007</u>	<u>December 31,</u> <u>2006</u>
Total long term debt (including current portion) <sup>(1)</sup> .....	\$ 71,028,957	\$ 66,946,744
Less current portion .....	24,000	24,000
Total long term debt <sup>(1)</sup> .....	<u>\$ 71,004,957</u>	<u>\$ 66,922,744</u>

**Maturities of Debt**

Remainder of 2007 .....	\$ 18,000
2008 .....	24,000
2009 .....	24,000
2010 .....	35,716,139
2011 and thereafter .....	35,246,818

(1) Reflects allocations of \$1,307,861 at March 31, 2007 and \$1,396,074 at December 31, 2006 from our 6% convertible notes in the principal amount of \$37,000,000 based on equity components of their conversion features and related warrants.

**Note 8. Capital Stock**

(a) Preferred Shares. We have 5,000,000 authorized shares of preferred stock, none of which were outstanding at March 31, 2007 or December 31, 2006.

(b) Common Shares. The following tables reflect transactions involving our common stock during the periods presented.

	<u>Number of Shares</u>	<u>Amount</u>
<u>Common Shares Issued</u>		
Balance, December 31, 2005 .....	21,357,628	\$ 82,371,189
Issued to employees as incentive bonus .....	65,945	468,612
Issued upon exercise of stock options and warrants .....	336,106	1,472,026
Issued for contract settlement .....	<u>28,872</u>	<u>220,005</u>
Balance, December 31, 2006 .....	21,788,551	84,531,832
Issued upon exercise of stock options and warrants .....	<u>10,000</u>	<u>40,300</u>
Balance, March 31, 2007 .....	<u>21,798,551</u>	<u>\$ 84,572,132</u>
<u>Paid In Capital – Options and Warrants</u>		
Balance, December 31, 2005 .....		\$ 2,743,806
Recognized .....		975,468
Expired .....		(565,946)
Accreted <sup>(1)</sup> .....		<u>(80,041)</u>
Balance, December 31, 2006 .....		3,073,287
Recognized .....		<u>195,321</u>
Balance, March 31, 2007 .....		<u>\$ 3,268,608</u>
<u>Contributed Surplus</u>		
Balance, December 31, 2005 .....		\$ 1,748,926
Accreted <sup>(1)</sup> .....		<u>(352,852)</u>
Balance, December 31, 2006 .....		1,396,074
Accreted <sup>(1)</sup> .....		<u>(88,213)</u>
Balance, March 31, 2007 .....		<u>1,307,861</u>
<u>Common Shares to be Issued</u>		
Balance, March 31, 2007 and December 31, 2006 .....	<u>9,185</u>	<u>\$ 45,925</u>

(1) Reflects accretion of the equity components allocated to our 6% convertible notes and related warrants issued in 2005.

(c) Stock Options and Awards. We maintain three stock plans for the benefit of our directors, officers, employees and, in the case of the second and third plans, certain consultants or advisors. The plans provide for the grant of options to purchase up to 3,600,000 common shares and, in the case of our most recent plan, either stock awards or options for an aggregate of up to 4,000,000 common shares. Option grants under all the plans must be at prevailing market prices and may be subject to vesting requirements over a period of up to ten years from the date of grant. Stock awards under the third plan may be subject to vesting conditions and trading restrictions specified at the time of grant. During 2006, stock awards and option grants were made under the third plan for a total of 65,945 shares. There were no awards or grants in the first quarter of 2007. The following table shows transactions and vesting in stock options during the reported periods.

	<u>Issued</u>	<u>Exercisable</u>	<u>Weighted Average Exercise Price</u>
Balance, December 31, 2005 .....	2,985,000	571,250	\$ 4.67
Vested .....	--	509,583	4.26
Exercised .....	(135,000)	(135,000)	4.05
Forfeited .....	<u>(35,000)</u>	--	6.02
Balance, December 31, 2006 .....	2,815,000	945,833	4.68
Vested .....	--	<u>292,500</u>	4.03
Balance, March 31, 2007 .....	<u>2,815,000</u>	<u>1,238,333</u>	4.68

At March 31, 2007, the exercise prices of options outstanding under our stock option plans ranged from \$1.02 to \$7.04 per share, and their weighted average remaining contractual life was 2.64 years. The following table provides additional information on the terms of stock options outstanding at March 31, 2007.

<u>Options Issued and Outstanding</u>			<u>Options Exercisable</u>		
<u>Exercise Price or Range</u>	<u>Number</u>	<u>Weighted Average Remaining Life (years)</u>	<u>Weighted Average Exercise Price</u>	<u>Number</u>	<u>Weighted Average Exercise Price</u>
\$ 1.02	145,000	0.76	\$ 1.02	145,000	\$ 1.02
4.03 4.09	1,845,000	2.50	4.05	1,045,000	4.06
6.02 7.04	<u>825,000</u>	3.31	6.74	<u>48,333</u>	6.02
	<u>2,815,000</u>			<u>1,238,333</u>	

In accounting for stock options, we apply the fair value recognition provisions of SFAS No. 123(R), *Share-Based Payment*, which we adopted retroactively under its Canadian GAAP equivalent in 2004. We use the Black-Scholes pricing model to determine the fair value of each stock option at the grant date, and we recognize the compensation cost ratably over the vesting period. For the periods presented in the interim consolidated financial statements, the fair value estimates for each option grant assumed a risk free interest rate ranging from 4.5% to 6%, no dividend yield, a theoretical volatility ranging from 0.30 to 0.85 and an expected life ranging from six months to five years based on the option's vesting provisions. This resulted in non-cash charges for options and warrants of \$975,468 in 2006 and \$195,321 in the first three months of 2007.

(d) *Common Stock Purchase Warrants.* We have issued common stock purchase warrants in various financing transactions. At December 31, 2006, we had outstanding warrants for the purchase of 10,000 common shares at \$4.03 per share, which were fully exercised in the first quarter of 2007.

**Note 9. Income (Loss) Per Share**

The following table shows the computation of basic and diluted earnings (loss) per share (*EPS*) for the reporting periods.

	<b>Three Months Ended March 31,</b>	
	<b>2007</b>	<b>2006</b>
<b><u>Numerator:</u></b>		
Net income (loss) as reported for basic EPS.....	\$ (254,264)	\$ 625,737
Adjustments to income (loss) for diluted EPS.....	--	--
Net income (loss) for diluted EPS.....	<u>\$ (254,264)</u>	<u>\$ 625,737</u>
<b><u>Denominator:</u></b>		
Weighted average shares for basic EPS.....	21,791,107	21,377,525
Effect of dilutive securities:		
Stock options.....	--	1,584,900
Warrants.....	--	214,653
Adjusted weighted average shares for dilutive EPS.....	<u>21,791,107</u>	<u>23,177,078</u>
Basic EPS.....	<u>\$ (0.01)</u>	<u>\$ 0.03</u>
Diluted EPS.....	<u>\$ (0.01)</u>	<u>\$ 0.03</u>

**Note 10. Segment Information**

We have two reportable segments based on management responsibility and key business operations. The following table presents summarized financial information on these business segments.

	<b>Three Months Ended March 31,</b>	
	<b>2007</b>	<b>2006</b>
<b><u>Revenue:</u></b>		
Oil and gas development.....	\$ 17,945,392	\$ 27,319,255
Corporate.....	--	--
Total.....	<u>17,945,392</u>	<u>27,319,255</u>
<b><u>DD&amp;A:</u></b>		
Oil and gas development.....	2,142,426	1,386,745
Corporate.....	164,044	151,167
Total.....	<u>2,306,470</u>	<u>1,537,912</u>
<b><u>Interest expense:</u></b>		
Oil and gas development.....	669,756	45,383
Corporate.....	555,000	555,000
Total.....	<u>1,224,756</u>	<u>600,383</u>
<b><u>Net income (loss):</u></b>		
Oil and gas development.....	521,481	1,470,653
Corporate.....	(775,745)	(844,916)
Total.....	<u>(254,264)</u>	<u>625,737</u>
<b><u>Capital expenditures:</u></b>		
Oil and gas development.....	11,198,942	25,764,868
Corporate.....	127,600	81,185
Total.....	<u>\$ 11,326,542</u>	<u>\$ 25,846,053</u>
<b><u>Identifiable assets:</u></b>		
Oil and gas development.....	\$ 169,397,604	\$ 174,750,803
Corporate.....	3,325,128	3,468,327
Total.....	<u>\$ 172,722,732</u>	<u>\$ 178,219,130</u>

### Note 11. Commitments

We incurred lease rental expenses of \$1,727,982 in 2006 and \$565,538 in the first three months of 2007. As of March 31, 2007, we have contractual obligations for periodic future payments under leases for field equipment and instruments governing its other commercial commitments in the amounts listed below.

<u>Year</u>	<u>Commercial Commitments</u>		
	<u>Operating Leases</u>	<u>Other Commitments</u>	<u>Total</u>
Remainder of 2007 .....	\$ 1,244,800	\$ 240,000 <sup>(1)</sup>	\$ 1,484,800
2008.....	1,410,410	100,000 <sup>(2)</sup>	1,510,410
2009.....	1,310,502	2,045,000 <sup>(2)</sup>	3,355,502
2010.....	1,211,834	--	1,211,834
2011 and thereafter.....	<u>1,112,654</u>	<u>--</u>	<u>1,112,654</u>
Total .....	<u>\$ 6,290,200</u>	<u>\$ 2,385,000</u>	<u>\$ 8,675,200</u>

(1) Reflects obligations under a guaranty secured by a certificate of deposit provided for bank debt of Galax Energy Concepts, LLC, a limited liability company in which DPI previously held a minority interest.

(2) Reflects commitments under a purchase contract for an airplane.

### Note 12. Recent Accounting Standards

**SFAS No. 159.** In February 2007, the Financial Accounting Standards Board (FASB) issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*. SFAS No. 159 permits fair value accounting for many financial instruments and related items that are not currently required to be measured at fair value. The objective is to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. We will adopt SFAS No. 159 at the beginning of 2008 and do not expect its adoption to have a material impact on our consolidated financial condition or results of operations.

**SAB No. 108.** In September 2006, the staff of the Securities and Exchange Commission issued Staff Accounting Bulletin (SAB) No. 108, *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements*. SAB No. 108 provides interpretive guidance on how the effects of the carryover or reversal of prior year financial statement errors should be considered in quantifying a current year misstatement. Beginning in 2007, prior year errors must be quantified using both a balance sheet and income statement approach and evaluated based on relevant quantitative and qualitative factors in determining their materiality for disclosure purposes. Application of this guidance has not had a material affect on our consolidated financial statements.

**SFAS No. 158.** In September 2006, the FASB issued SFAS No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans*. SFAS No. 158 requires the employer to recognize the overfunded or underfunded status of any defined benefit postretirement plan as an asset or liability on its balance sheet and to recognize changes in that status through adjustments to comprehensive income. It also requires an employer to measure the funded status of a plan as of the date of its year-end balance sheet. These requirements are effective for fiscal years ending after December 15, 2006. The adoption of SFAS No. 158 has not had a material impact on our consolidated financial position, results of operations or cash flows.

**SFAS No. 157.** In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*, which defines fair value, establishes a framework for measuring fair value and expands disclosure requirements about fair value measurements. The guidance in SFAS No. 157 applies to fair value measurements for derivatives and other financial instruments at initial recognition and in all subsequent periods. SFAS No. 157 is generally effective for all reporting periods during fiscal years beginning after November 15, 2007. We do not expect any material impact on our consolidated financial position or results of operations from adoption of this new standard.

FSP AUG AIR-1. In September 2006, the FASB issued FSP AUG AIR-1, *Accounting for Planned Major Maintenance Activities*. FSP AUG AIR-1 prohibits companies from accruing the future costs of periodic major overhauls and maintenance of plant and equipment as a liability. The provisions of FSP AUG AIR-1 are effective for fiscal years beginning after December 15, 2006. The implementation of these provisions has not had a material impact on our consolidated financial statements.

FIN No. 48. In July 2006, the FASB issued FASB Interpretation (*FIN*) No. 48, *Accounting for Uncertainty in Income Taxes – Interpretation of FASB No. 109*. FIN No. 48 requires us to recognize the impact of a tax position on our financial statements if that position is more likely than not to be sustained on audit, based on the technical merits of the position. The provisions of FIN No. 48 are effective at the beginning of 2007, with the cumulative effect of any resulting change in accounting principles recorded as an adjustment to opening retained earnings. The adoption of FIN No. 48 has not had a material affect on our consolidated financial position.

# NGAS RESOURCES, INC.

## Item 2.

### MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

#### *General*

We are an independent exploration and production company focused on unconventional natural gas basins in the eastern United States that support multiple, repeatable drilling, principally in the southern portion of the Appalachian basin. We specialize in generating our own geological prospects in this region, where we have established expertise and recognition. We also control the gas gathering and transmission facilities for our core Appalachian properties, providing deliverability directly from the wellhead to interstate pipelines serving major east coast natural gas markets. We believe our extensive geological, geophysical, engineering and operating experience in this region, coupled with our midstream assets, infrastructure position and relationships with partners, suppliers and mineral interest owners, gives us competitive advantages in developing these resources to achieve annual volumetric growth and strong financial returns on a long term basis.

We develop our prospects through our operating subsidiaries and our interests in sponsored drilling programs. Our combined interest as both general partner and an investor in these programs ranges from 12.5% to 75%, and we earn additional reversionary interests after targeted distribution thresholds are reached. Our principal and administrative offices are located in Lexington, Kentucky. Our common stock is traded on the Nasdaq National Market under the symbol *NGAS*. Unless otherwise indicated, references in this report to *we*, *our* or *us* include NGAS Resources, Inc., our direct and indirect wholly owned subsidiaries and our interests in sponsored drilling programs. As used in this report, *Dth* means decatherm, *Mcf* means thousand cubic feet, *Bcf* means billion cubic feet, *Mcfe* means thousand cubic feet of gas equivalents and *Bcfe* means billion cubic feet of gas equivalents.

#### *Strategy*

Our business is structured to achieve capital appreciation through growth in our natural gas reserves, production, cash flow and earnings per share. During 2006, we achieved record production of 2.9 Bcfe, up 57% from 2005, contributing to 28% growth in our total revenue to \$79.8 million. We also increased our estimated proved reserves by 34% to 100.9 Bcfe at the end of 2006, of which 42% are proved developed, with a reserve life index over 32 years based on annualized fourth quarter production. We achieved these benchmarks primarily through drilling success and a larger net position in new wells on our core properties. Our strategy for continuing to realize our operational and financial objectives for 2007 and beyond emphasizes several components.

- *Acceleration of Drilling Operations.* Development drilling is our mainstay for production and reserve growth. We believe our long and successful operating history in the Appalachian basin and proven ability to drill a large number of wells year after year have positioned us as a leading player in this region. We participated in 226 gross (65.4577 net) wells during 2006 and an additional 57 gross (23.6000 net) wells in the first quarter of 2007. We have identified over 1,100 additional drilling locations on our Appalachian properties for future development, including 550 locations in our key Leatherwood field, where we plan to continue our focus over the next few years. We are also accelerating development of our Fonde field and other complementary Appalachian plays to consolidate our position in the region, while diversifying our asset base through targeted expansion in other unconventional natural gas basins.
- *Investment in Midstream Assets.* We operate a strategically located open-access gas gathering system spanning 116 miles in southeastern Kentucky and southwestern Virginia. We acquired these midstream assets in March 2006 through our NGAS Gathering subsidiary for \$18 million. We operated this system since October 2004 and augmented it after the acquisition through two high-pressure lateral upgrades. Ownership of these facilities compliments our field-wide Appalachian gathering systems, expanding our total gathering position to 544 miles as of March 31, 2007. We currently move production from our Leatherwood, Straight Creek and SME fields for delivery through the NGAS Gathering system, with daily gross throughput of over 19,000 Dth. In addition to generating gas transmission and compression revenues from third-party throughput and cost savings for our own Appalachian production, ownership of these assets gives us control over gas flow from our connected fields and enhances our competitive position in the region.

- *Extension of Infrastructure.* We construct and operate field-wide gas gathering and compression facilities for our Appalachian properties, which we continually upgrade to keep pace with our expanding production base. Because we control third-party access to these facilities, our 100% ownership of this infrastructure provides us with competitive advantages in acquiring and developing nearby acreage. Our field-wide systems spanned 428 miles at March 31, 2007, including 103 miles of production lines installed in 2006 and 14 miles in the first quarter this year. Recent additions to our infrastructure include facilities that enabled us to bring a backlog of unconnected wells in our Leatherwood field on line sequentially for compression into the NGAS Gathering system. We are currently upgrading the main suction line for this field to enhance flow rates from new Leatherwood wells. We are also extending our infrastructure to provide deliverability from our Fonde field through a 17-mile, six-inch steel line to our midstream system. Production in Fonde has historically been limited by pipeline capacity constraints. Our new system, scheduled for completion in the third quarter of 2007, will connect over 60 Fonde wells and open nearly 50,000 acres to development in this field.
- *Repeatable Drilling.* As of March 31, 2007, we had interests in a total of 1,067 wells. Most of our wells are drilled to relatively shallow total depths up to 5,000 feet, generally encountering several predictable natural gas pay zones. We focus on repeatable prospects to reduce drilling risks, as reflected in our success rate. Historically, over 99% of our Appalachian development wells have been completed as producers. The primary pay zone for most of these wells is the Devonian shale formation. This is considered an unconventional target due to its low permeability, and natural fracturing is often enhanced by effective acidizing or other treatments. While this typically results in modest initial volumes and pressures, it also accounts for the low annual decline rates demonstrated by our wells in the region, many of which are expected to produce for 25 years or more.
- *Drilling Program Financings.* Our ability to attract outside capital through our sponsored drilling programs has enabled us to capitalize on natural gas development opportunities and long range pricing expectations for this commodity. Beginning in 2006, we changed the structure of our new drilling programs from turnkey to cost-plus pricing, with a view to reducing our exposure to price volatility for drilling services, equipment and steel casing requirements. We also tailored our new drilling programs for tiered participation on a field-wide basis, retaining program interests between 45% to 75% in Leatherwood development and from 12.5% to 60% in our other drilling initiatives.
- *Acquisition of Additional Drilling Prospects.* We follow a disciplined capital allocation process in selecting opportunities to build our substantial inventory of drilling prospects that meet our criteria for predictable, long-lived reserves. During 2006, we expanded our position in several of our major Appalachian fields. We also implemented initiatives to leverage our core expertise with evolving technologies in horizontal and directional drilling, which may provide advantages in extracting tight gas from unconventional formations. The initial programs are being conducted in the Arkoma basin on a coalbed methane (CBM) project, in the Illinois basin on acreage we acquired in western Kentucky to test the New Albany shale formation and in West Virginia on acreage controlled by a joint venture partner. We plan to continue capitalizing on opportunities to assemble or acquire interests in large tracts with significant development potential. Our goal is to consolidate our position in the Appalachian basin, while also diversifying our prospect inventory with similar unconventional plays.

### ***Regional Advantages***

Our proved reserves, both developed and undeveloped, are concentrated in the southern portion of the Appalachian basin. This is one of the oldest and most prolific natural gas producing areas in the United States. Typically, natural gas wells in this part of the Appalachian basin recover between 100 to 500 Mmcf of reserves per drilling unit. The natural gas production, known as sweet gas, is environmentally friendly because it is substantially free of sulfur compounds, carbon dioxide or other chemical impurities. In addition, most of these wells produce no water with the gas production. This helps us minimize production (lifting) costs. Appalachian gas also has the advantage of high energy (Dth) content, ranging from 1.1 to 1.3 Dth per Mcf. Our gas sales contracts provide upward adjustments to index based pricing for throughput with an energy content above 1 Dth per Mcf, resulting in realized premiums averaging 17% over normal pipeline quality gas. Our proximity to major east coast markets generates further realization premiums above Henry Hub spot prices, contributing to enhanced cash flows and long term returns on investment.

## ***Drilling Programs***

*Drilling Program Structure.* Most of our drilling operations are conducted through sponsored programs structured to share development costs, risks and returns on repeatable prospects and optimize tax advantages for private investors. To develop exploratory prospects with higher risk profiles, we generally rely on smaller, specialized drilling programs with strategic and industry partners or other suitable investors. Historically, we have conducted program operations under turnkey drilling contracts, requiring us to bear any drilling and completion costs exceeding the contract price. In response to increased demand and price volatility for drilling services and equipment, we changed the structure of our drilling programs to cost-plus pricing, beginning in 2006, with a view to sharing this exposure with our outside investors and stabilizing our margins for contract drilling operations.

*Drilling Program Benefits.* Our structure for drilling program participation in our development initiatives helps us attract outside capital from private investors. This addresses the high capital costs of our business, enabling us to accelerate the development of our properties, generally without relinquishing control over drilling and operating decisions. The structure also provides economies of scale with operational benefits at several levels.

- Expanding our drilling budget with outside capital from program investors enables us to compete for attractive properties by increasing our drilling commitments and to maintain a larger and more capable staff than we could otherwise support if we were operating solely for our own account. It also leverages our buying power for drilling services and materials, resulting in lower overall development costs.
- Accelerating the pace of development activities through our drilling programs expands the production capacity we can make available to gas purchasers, contributing to higher and more stable sales prices for our production.
- By conducting exploratory operations through specially tailored programs, we expand our inventory of developmental locations with lower risk profiles for subsequent programs, while adding to our proved reserves, both developed and undeveloped.
- Our drilling program strategy substantially increases the number of wells we could drill solely for our own account, diversifying the risks of drilling operations.

*Drilling Program Investments.* In addition to managing program operations, we invest in each drilling program on substantially the same terms as outside investors. We contribute capital to each program in proportion to our initial ownership interest, and we share program distributions in the same ratio until program distributions reach payout, which ranges from 100% to 110% of partners' investment. After payout, we are entitled to specified increases in our distributive share, up to 15% of the total program interests. In 2006 and the first quarter of 2007, we sponsored a total of five new drilling programs under our cost-plus pricing structure. They include three programs for up to 184 wells in our major Appalachian fields, including 83 wells in Leatherwood, where we maintained a 75% interest in our 2006 programs and 45% in our first program this year. Our 2006 initiatives also included programs for 40 natural gas wells on acreage controlled by a joint venture partner in West Virginia and six horizontal CBM wells drilled by another joint venture partner in the Arkoma basin. We have a 25% stake in the West Virginia program and a 12.5% share of the Arkoma program.

## ***Drilling Operations***

*Exploratory Initiatives.* We sponsored a specialized exploratory drilling program late in 2005 on acquired tracts in the Illinois basin spanning approximately 15,500 acres in western Kentucky to test the New Albany shale formation, which has similar geologic characteristics to the Devonian shale in the Appalachian basin. The initial phase of the project targeted the shallow New Albany shale on the eastern rim of the basin. There were 30 test wells for this phase, including five wells drilled with horizontal legs averaging 2,500 feet. Although we drilled and tested all the wells in this phase below budget, we were not encouraged by the results, and we expensed the suspended well costs for three of the wells during 2006. Late in the year, we began a five-well test phase for our own account in the central portion of the Illinois basin, targeting the New Albany shale at greater depths through traditional vertical drilling. Treatment and flow testing on these wells were promising, and we plan to continue this phase of the central Illinois basin project at a pace determined by ongoing results.

**Participation Rights.** The leases and farmouts for some of our acreage in the Appalachian basin, primarily the Leatherwood field, are subject to third-party participation rights for up to 50% of the working interests in new wells. We had third-party participation in our Leatherwood wells for average working interests of 25.4% in 2006 and 10.9% during the first quarter of 2007.

**Drilling Results.** The following table shows the number of gross and net development and exploratory wells we drilled during 2006 and the first three months of 2007. Gross wells are the total number of wells in which we have a working interest. Net wells reflect our working interests in wells, without giving effect to any reversionary interest we may subsequently earn in wells drilled through our drilling programs.

	Development Wells			Exploratory Wells		
	Productive		Dry	Productive		Dry
	Gross	Net	Gross	Gross	Net	Gross
Year ended December 31, 2006.....	193	56.3007	--	30	8.5330	3
Three months ended						
March 31, 2007 .....	52	18.6000	--	5	5.0000	--

**Production Volumes and Sales Prices.** The following table shows our total net oil and gas production volumes and average sales prices for the three months ended March 31, 2007 and 2006 and for the year ended December 31, 2006. We also had extracted liquids and condensates that contributed \$44,560 to our production revenues in the first three months of 2007 and \$44,832 in 2006.

	Three Months Ended		Year Ended
	March 31,		December 31,
	2007	2006	2006
Production volumes:			
Oil (Bbl).....	15,611	9,211	40,938
Natural gas (Mcf).....	684,649	608,898	2,622,474
Equivalentents (Mcf).....	778,312	664,164	2,868,102
Average sales price:			
Natural gas (per Mcf).....	\$ 8.62	\$ 9.35	\$ 8.23
Oil (per Bbl).....	51.44	50.73	59.60

**Results of Operations – Three Months Ended March 31, 2007 and 2006**

**Revenues.** The following table shows the components of our revenues for the three months ended March 31, 2007 and 2006, together with their percentages of total revenue in the current period and percentage change on a period-over-period basis.

	Three Months Ended March 31,			
	2007	% of Revenue	2006	% Change
Contract drilling.....	\$ 9,245,219	51%	\$20,411,500	(55)%
Oil and gas production.....	6,752,232	38	6,204,184	9
Gas transmission and compression.....	1,947,941	11	703,571	177
Total.....	<u>\$17,945,392</u>	<u>100%</u>	<u>\$27,319,255</u>	(34)

Our revenue mix for the first quarter of 2007 reflects our ongoing strategy for transitioning to a production based business, with oil and gas sales accounting for 38% of total revenues, compared to 23% of total revenues for the year-earlier quarter and 30% for 2006 as a whole. We expect this trend to continue as we execute our initiatives for long term production growth by expanding our infrastructure and acreage position in core fields and accelerating our development of these properties.

Contract drilling revenues reflect the size and timing of our drilling program financing, as well as our percentage interest in drilling initiatives. Although we receive the proceeds from program financings as customers' drilling deposits under our drilling contracts with sponsored programs, we recognize revenues from drilling operations on the completed contract method as the wells are drilled, rather than when funds are received. We participated in 57 gross (23.6000 net) wells in the first quarter of 2007, including five exploratory wells for our own account, compared to 79 gross (18.6535 net) wells in the same quarter last year. The contraction in third-party contract drilling revenues reflects this reduction in gross wells, coupled with lower third-party participation levels resulting from our increased net position in current drilling initiatives.

Our growth in production revenues on a period-over period basis reflects an increase of 17% in production volumes to 778,312 Mmcfe in the first quarter of 2007, with an 8% decline in our average sales price of natural gas (before certain transportation charges) to \$8.62 per Mcf. Our volumetric growth was driven by added production from new wells brought on line in the last twelve months. We anticipate ongoing production gains as we continue to upgrade our infrastructure and bring wells in Leatherwood and other key fields on stream. Principal purchasers of our production are gas marketers and customers with transmission facilities near our producing properties. Approximately 45% of our natural gas production in the first quarter of 2007 was sold under fixed-price contracts, and the balance primarily at prices determined monthly under formulas based on prevailing market indices.

Gas transmission and compression revenues were driven by fees totaling \$894,080 for moving third-party gas through our NGAS Gathering system, which we acquired in March 2006. This component of revenues also reflects additional fees for gathering and compression of third-party gas production through our field-wide facilities, together with contributions of \$137,996 from gas utility sales and \$60,720 from our minority interest in the gathering system that services our Arkoma CBM project.

*Expenses.* The following table shows the components of our direct and other expenses for the three months ended March 31, 2007 and 2006. Percentages listed in the table reflect margins for each component of direct expenses and percentages of total revenue for each component of other expenses.

	<b>Three Months Ended March 31,</b>			
	<u>2007</u>	<u>Margin</u>	<u>2006</u>	<u>Margin</u>
Contract drilling.....	\$ 7,180,717	22%	\$ 16,702,930	18%
Oil and gas production.....	1,683,014	75	1,453,468	77
Gas transmission and compression.....	<u>1,099,593</u>	44	<u>632,429</u>	10
Total direct expenses.....	<u>9,963,324</u>	44	<u>18,788,827</u>	31
		<b><u>% Revenue</u></b>		<b><u>% Revenue</u></b>
Selling, general and administrative.....	4,021,882	22%	4,474,392	16%
Options, warrants and deferred compensation.....	341,123	2	428,747	2
Depreciation, depletion and amortization.....	2,306,470	13	1,537,912	6
Interest expense, net of interest income.....	1,140,702	6	482,023	2
Other, net.....	<u>92,749</u>	1	<u>40,948</u>	--
Total other expenses.....	<u>\$ 7,902,926</u>		<u>\$ 6,964,022</u>	

Contract drilling expenses reflect the substantial level and complexity of our drilling initiatives. In the first quarter of 2007, these expenses were 78% of contract drilling revenues, compared to 82% in the first quarter of 2006. The margins for this sector reflect our transition from turnkey to cost-plus pricing for our new drilling programs, which we implemented in 2006 with a view to reducing our exposure to price volatility for drilling services, equipment and steel casing requirements. We expect these margins to stabilize from ongoing cost-plus drilling program operations.

Production expenses for the current quarter were driven by our substantial volumetric growth. In addition to lifting costs, production expenses include field operating and maintenance costs, related overhead, third-party transportation fees and lease operating expenses. The increase in our production expenses was significantly offset by cost savings realized from ownership of the NGAS Gathering system acquired in March 2006, eliminating transportation fees for our share of Leatherwood, Straight Creek and SME production delivered through the system. As a percentage of oil and gas production revenues, our production expenses increased to 25% in the first quarter of 2007 from 23% in the year-earlier period.

Gas transmission and compression expenses in the first quarter of 2007 were 56% of associated revenues, compared to 90% in the same quarter last year. The improvement in margins for this part of our business reflects substantial revenue growth from third-party fees generated by the NGAS Gathering system acquired in March 2006. Our gas transmission and compression expenses do not reflect our acquisition costs for that system or capitalized costs for extensions of our field-wide gas gathering systems and additions to dehydration and compression capacity required to bring new wells on line.

Selling, general and administrative (*SG&A*) expenses primarily reflect the timing and extent of our selling and promotional costs for sponsored drilling programs. On a period-over-period basis, *SG&A* expenses also reflect higher costs for supporting expanded operations as a whole, including additions to our staff and technology infrastructure as well as increased salary and other employee related expenses.

Non-cash charges for options, warrants and deferred compensation reflect the fair value method of accounting for employee stock options, which we adopted in 2004. Under this method, employee stock options are valued at the grant date using the Black-Scholes valuation model, and the compensation cost is recognized ratably over the vesting period. We also recognized an accrual of \$145,802 for deferred compensation cost.

Depreciation, depletion and amortization (*DD&A*) is recognized under the units-of-production method, based on the estimated proved developed reserves of the underlying oil and gas properties and on a straight-line basis over the useful life of other property and equipment. The increase in *DD&A* charges reflects substantial additions to our oil and gas properties, gas gathering systems and related equipment, including our acquisition of the NGAS Gathering transmission system for \$18 million in March 2006.

Interest expense for the first quarter of 2007 increased from higher overall bank borrowings, primarily to support our ongoing drilling and gas gathering initiatives, including capitalized costs of approximately \$2.0 million for extensions and enhancements of our field-wide gas gathering systems during the current quarter.

Deferred income tax expense recognized in the first quarter of 2007 represents future tax liability at the operating company level. Although we have no current tax liability due to the utilization of intangible drilling costs allocated from our active drilling programs, our consolidated income tax expense is negatively impacted by the non-recognition of tax benefits at the parent company level.

*Net Income and EPS.* We recognized a net loss of \$254,264 in the first quarter of 2007, compared to net income of \$625,737 in the same quarter last year, reflecting the foregoing factors. Basic earnings (loss) per share (*EPS*) was \$(0.01) based on 21,791,107 weighted average common shares outstanding in the current quarter, compared to *EPS* of \$0.03 based on 21,377,525 weighted average common shares outstanding in the first quarter of 2006.

The results of operations for the three months ended March 31, 2007 are not necessarily indicative of results to be expected for the full year.

### ***Liquidity and Capital Resources***

*Liquidity.* Net cash of \$5,092,331 was used by operating activities in the first three months of 2007. During the quarter, we used \$11,324,342 in investing activities, most of which reflects net additions to our oil and gas properties and gathering systems. These investments were funded in part with net cash of \$4,036,143 from financing activities. As a result of these activities, net cash decreased from \$14,431,977 at December 31, 2006 to \$2,051,447 at March 31, 2007.

As of March 31, 2007, we had a working capital deficit of \$5,921,720. This reflects wide fluctuations in our current assets and liabilities from the timing of customers' deposits and expenditures under drilling contracts with our sponsored programs. Since these fluctuations are normalized over relatively short time periods, we generally do not consider working capital to be a reliable measure of liquidity. The working capital deficit at the end of the reported period is not expected to have an adverse effect on our financial condition or results of operations in future periods.

*Capital Resources.* Our business involves significant capital requirements. The rate of production from oil and gas properties declines as reserves are depleted. Without successful development activities, our proved reserves would decline as oil and gas is produced from our proved developed reserves. Our long term performance and profitability is dependent not only on developing existing oil and gas reserves, but also on our ability to find or acquire additional reserves on terms that are economically and operationally advantageous. To fund our ongoing reserve development and acquisition activities, we have relied on a combination of cash flows from operations, bank borrowings and private placements of our convertible notes and equity securities, as well as participation by outside investors in our sponsored drilling programs.

In December 2005, we completed an institutional private placement of our 6% convertible notes due December 15, 2010 in the aggregate principal amount of \$37 million. We also issued warrants in the transaction, which expired unexercised in August 2006. At March 31, 2007, all of the notes remained outstanding but were recorded at \$35,692,139, reflecting an initial allocation of \$2,394,913 for their equity components, which was ratably accreted by \$432,893 in 2006 and \$88,213 in the first quarter of 2007, along with \$565,946 reallocated to debt upon expiration of the warrants last year.

The notes are convertible by their holders into our common stock at a conversion price of \$14.34 per share, subject to adjustments for certain dilutive issuances of common stock. If a holder elects to convert a note before the second anniversary of the issuance date, unless the prevailing market price of our common stock exceeds 160% of the conversion price, the holder will be entitled to a payment equal to the difference between two years' interest on the converted note and the interest already paid on the note, payable at our option in cash or in common shares. After that date, if the prevailing market price of our common stock exceeds 160% of the conversion price, we may redeem any unconverted notes at a redemption price equal to their principal amount plus accrued and unpaid interest. Upon any event of default or any change of control, the notes are redeemable at the option of the holders in cash at a default rate equal to 125% of their principal amount or at a change of control rate equal to the greater of 110% of their principal amount or 110% of the consideration that would be received by the holder for the underlying shares in the change of control transaction. Any notes that are neither redeemed nor converted prior to maturity will be repayable in cash or in common shares. Any common shares issued for interest payments on converted notes or upon redemption at their maturity will generally be valued for that purpose at 92.5% of their prevailing market price.

In September 2006, we entered into a credit agreement with KeyBank National Association, as agent and primary lender. The credit agreement provides us with a senior secured revolving credit facility that replaces our prior credit facility with KeyBank, which had a scheduled maturity date of July 31, 2007 and a borrowing base of \$35 million. The new facility has a five-year maturity for revolving term loans and letters of credit in an aggregate amount up to \$125 million, with a current borrowing base of \$50 million. The facility is secured by liens on our interests in most of our Appalachian wells. Outstanding borrowings under the facility bear interest at fluctuating rates ranging from 1.5% to 2.5% above quoted LIBOR rates, depending on the amount of borrowing base utilization, plus commitment fees ranging from 0.375% to 0.5% of the unused borrowing base. As of March 31, 2007, our outstanding borrowings under the facility aggregated \$35 million.

Our ability to repay our bank debt and convertible notes will be subject to our future performance and prospects as well as market and general economic conditions. We will likely be dependent on additional financings to repay our outstanding long term debt at maturity.

Our future revenues, profitability and rate of growth will continue to be substantially dependent on the demand and market price for natural gas. Future market prices for natural gas will also have a significant impact on our ability to maintain or increase our borrowing capacity, to obtain additional capital on acceptable terms and to continue attracting investment capital for drilling programs. The market price for natural gas is subject to wide fluctuations in response to relatively minor changes in supply and demand, market uncertainty and a variety of other factors that are beyond our control.

We expect our cash reserves, cash flows from operations and anticipated borrowing base availability under our credit facility to provide adequate working capital to meet our short-term capital expenditure objectives. To fully realize our financial goals for growth in revenues and reserves, we will continue to be dependent on the capital markets or other financing alternatives as well as continued participation by investors in future drilling programs.

### ***Contractual Obligations and Commercial Commitments***

We are parties to leases for office facilities and various types of equipment. We are also obligated to make payments at specified times and amounts under instruments governing our long term debt and other commercial commitments. The following table lists our minimum annual commitments as of March 31, 2007 under these instruments.

<b><u>Year</u></b>	<b><u>Operating Leases</u></b>			<b><u>Other Commitments</u></b>	<b><u>Long Term Debt</u></b>
	<b><u>Equipment</u></b>	<b><u>Premises</u></b>	<b><u>Total</u></b>		
Remainder of 2007 .....	\$ 1,055,726	\$ 189,074	\$ 1,244,800	\$ 240,000 <sup>(1)</sup>	\$ 18,000
2008 .....	1,389,402	21,008	1,410,410	100,000 <sup>(2)</sup>	24,000
2009 .....	1,310,502	--	1,310,502	2,045,000 <sup>(2)</sup>	24,000
2010 .....	1,211,834	--	1,211,834	--	35,716,139 <sup>(3)</sup>
2011 and thereafter .....	<u>1,112,654</u>	<u>--</u>	<u>1,112,654</u>	<u>--</u>	<u>35,246,818</u>
Total .....	<u>\$ 6,080,118</u>	<u>\$ 210,082</u>	<u>\$ 6,290,200</u>	<u>\$ 2,385,000</u>	<u>\$71,028,957</u>

- (1) Reflects obligations under a guaranty secured by a certificate of deposit provided for bank debt of Galax Energy Concepts, LLC, a limited liability company in which DPI previously held a minority interest.
- (2) Reflects commitments under a purchase contract for an airplane.
- (3) Excludes an allocation of \$1,307,861 from our 6% convertible notes in the principal amount of \$37,000,000 based on equity components of their conversion features.

### ***Critical Accounting Policies and Estimates***

***General.*** The preparation of financial statements requires management to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses and related disclosure of contingent assets and liabilities. On an ongoing basis, management evaluates its estimates, including evaluations of any allowance for doubtful accounts and impairment of long-lived assets. Management bases its estimates on historical experience and on various other assumptions it believes to be reasonable under the circumstances. The results of these evaluations form a basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Although actual results may differ from these estimates under different assumptions or conditions, management believes that its estimates are reasonable and that actual results will not vary significantly from the estimated amounts.

***Allowance for Doubtful Accounts.*** We maintain an allowance for doubtful accounts when deemed appropriate to reflect losses that could result from failures by customers or other parties to make payments on our trade receivables. The estimates of this allowance, when maintained, are based on a number of factors, including historical experience, aging of the trade accounts receivable, specific information obtained on the financial condition of customers and specific agreements or negotiated amounts with customers.

***Impairment of Long-Lived Assets.*** Our long-lived assets include property and equipment and goodwill. Long-lived assets with an indefinite life are reviewed at least annually for impairment, while other long-lived assets are reviewed whenever events or changes in circumstances indicate that carrying values of these assets are not recoverable.

### ***Forward Looking Statements and Risk Factors***

Some statements made by us in this report are prospective and constitute forward-looking statements within the meaning of the Private Litigation Reform Act of 1995. Other than statements of historical fact, all statements that address future activities, outcomes and other matters we plan, expect, budget, intend or estimate (and other similar expressions) are forward-looking statements. The forward-looking statements involve known and unknown

risks, uncertainties and other factors, many of which are beyond our control. They include subsurface risks on the recoverability of hydrocarbons, operating risks involving logistical, infrastructure and regulatory issues and commercial risks stemming from the volatility of natural gas prices. Our annual report on Form 10-K for the year ended December 31, 2006 includes a discussion of these risk factors. There were no material changes in these risk factors during the interim period covered by this report.

### **Item 3. Quantitative and Qualitative Disclosures about Market Risk**

Not applicable.

### **Item 4. Controls and Procedures**

Our management, with the participation or under the supervision of our Chief Executive Officer and Chief Financial Officer, is responsible for establishing and maintaining disclosure controls and procedures and internal control over financial reporting for the Company in accordance with the requirements of the Securities Exchange Act of 1934. Our disclosure controls and procedures are intended to provide a framework for making sure that all information required to be disclosed in our current and periodic reports under the Exchange Act is processed and publicly reported by us within the prescribed time periods for our filing of those reports. Our internal controls over financial reporting are designed to ensure the reliability of our financial reporting and the preparation of our financial statements for external purposes in accordance with generally accepted accounting principles. They include policies and procedures for maintaining reasonably detailed records that accurately and fairly reflect all our business transactions and dispositions of assets, for ensuring that receipts and expenditures are made only in accordance with management authorizations and for preventing or timely detecting any unauthorized acquisition, use or disposition of our assets that could have a material effect on our financial statements.

Our Chief Executive Officer and Chief Financial Officer have evaluated the effectiveness of the design and operation of our disclosure controls and procedures and our internal control over financial reporting as of March 31, 2007. Based on their evaluation, they have concluded that our disclosure controls and procedures are effective to ensure that material information about our business and operations is recorded, processed, summarized and publicly reported within the time period required under the Exchange Act. They have also concluded that our internal controls over financial reporting are effective to ensure the reliability of our financial reporting and the preparation of our publicly reported financial statements in accordance with generally accepted accounting principles. There were no changes in our controls or procedures during the three months ended March 31, 2007 that have materially affected or are reasonably likely to materially affect our internal control of financial reporting.

## **PART II. OTHER INFORMATION**

### **Item 6. Exhibits**

#### ***Exhibit***

<b><u>Number</u></b>	<b><u>Description of Exhibit</u></b>
3.1	Notice of Articles, certified on June 3, 2004 by the Registrar of Corporations under the British Columbia Business Corporations Act (incorporated by reference to Exhibit 3.1 to Current Report on Form 8-K [File No. 0-12185], filed June 29, 2004).
3.2	Alteration to Notice of Articles, certified on June 25, 2004 by the Registrar of Corporations under the British Columbia Business Corporations Act (incorporated by reference to Exhibit 3.2 to Current Report on Form 8-K [File No. 0-12185], filed June 29, 2004).
3.3	Articles dated June 25, 2004, as amended and restated for corporate transition under the British Columbia Business Corporations Act (incorporated by reference to Exhibit 3.3 to Current Report on Form 8-K [File No. 0-12185], filed June 29, 2004).
10.1	1997 Stock Option Plan (incorporated by reference to Exhibit 10[a] to Annual Report on Form 10-KSB [File No. 0-12185] for the year ended December 31, 2002).

- 10.2 2001 Stock Option Plan (incorporated by reference to Exhibit 10[b] to Annual Report on Form 10-KSB [File No. 0-12185] for the year ended December 31, 2002).
- 10.3 2003 Incentive Stock and Stock Option Plan (incorporated by reference to Exhibit 10.3 to Quarterly Report on Form 10-QSB [File No. 0-12185] for the quarter ended March 31, 2004).
- 10.4 Asset Purchase and Sale Agreement dated as of January 17, 2006 among Duke Energy Gas Services, LLC, NGAS Gathering, LLC and Daugherty Resources, Inc. (incorporated by reference to Exhibit 10.1 to current report on Form 8-K [File No. 0-12185] dated January 19, 2006).
- 10.5 Securities Purchase Agreement dated as of December 13, 2005 among NGAS Resources, Inc. and the investors named therein (incorporated by reference to Exhibit 10.1 to current report on Form 8-K [File No. 0-12185] dated December 14, 2005).
- 10.6 Form of 6% convertible notes issued pursuant to the Securities Purchase Agreement dated as of December 13, 2005 among NGAS Resources, Inc. and the investors named therein (incorporated by reference to Exhibit 10.2 to current report on Form 8-K [File No. 0-12185] dated December 14, 2005).
- 10.7 Credit Agreement dated as of September 8, 2006 among NGAS Resources, Inc., Daugherty Petroleum, Inc. and KeyBank National Association, as agent for the lenders named therein (incorporated by reference to Exhibit 10.1 to current report on Form 8-K [File No. 0-12185] dated September 8, 2006).
- 10.8 Form of Change of Control Agreement dated as of February 25, 2004 (incorporated by reference to Exhibit 10.9 to quarterly report on Form 10-QSB [File No. 0-12185] for the quarter ended March 31, 2004).
- 10.9 Form of Indemnification Agreement dated as of February 25, 2004 (incorporated by reference to Exhibit 10.10 to quarterly report on Form 10-QSB [File No. 0-12185] for the quarter ended March 31, 2004).
- 10.10 Form of Long Term Incentive Agreement dated as of February 25, 2004 (incorporated by reference to Exhibit 10.11 to quarterly report on Form 10-QSB [File No. 0-12185] for the quarter ended March 31, 2004).
- 11.1 Computation of Earnings Per Share (included in Note 9 to the accompanying consolidated financial statements)
- 21.0 Subsidiaries (incorporated by reference to Exhibit 21.1 to annual report on Form 10-K [File No. 0-12185] for the year ended December 31, 2006).
- 24.1 Power of Attorney.
- 31.1 Certification of Chief Executive Officer pursuant to Exchange Act Rule 13a-14(a), as adopted under Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of Chief Financial Officer pursuant to Exchange Act Rule 13a-14(a), as adopted under Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification of Chief Executive Officer pursuant to Exchange Act Rule 13a-14(b), as adopted under Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification of Chief Financial Officer pursuant to Exchange Act Rule 13a-14(b), as adopted under Section 906 of the Sarbanes-Oxley Act of 2002.

**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.

**NGAS RESOURCES, INC.**

Date: May 10, 2007

By:           /s/ William S. Daugherty            
William S. Daugherty  
Chief Executive Officer  
(Duly Authorized Officer)  
(Principal Executive Officer)

**CERTIFICATION OF CHIEF EXECUTIVE OFFICER  
PURSUANT TO RULE 13A-14(A) OR 15D-14(A) UNDER THE SECURITIES EXCHANGE ACT OF 1934**

In connection with the quarterly report of NGAS Resources, Inc. on Form 10-Q for the quarter ended March 31, 2007, as filed with the Securities Exchange Commission on the date hereof under the Securities Exchange Act of 1934, as amended, the undersigned, William S. Daugherty, Chairman, Chief Executive Officer and President of NGAS Resources, Inc., certifies pursuant to Rule 13a-14(a) or 15d-14(a) under the Exchange Act that:

1. I have reviewed this quarterly report on Form 10-Q of NGAS Resources, Inc.
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report.
3. Based on my knowledge, the consolidated financial statements and other financial information included in this report fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of and for the periods presented in this report.
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rule 13a-15(e) and 15d-15(e)) for the registrant and internal control over financial reporting (as defined in Exchange Act Rule 13a-15(f) and 15d-15(f)) for the registrant, and we have:
  - (a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) designed such internal controls over financial reporting, or caused such internal controls over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the reported fiscal quarter that has materially affected or is reasonably likely to materially affect the registrant's internal control over financial reporting.
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors:
  - (a) all significant deficiencies and material weaknesses in the design or operation of internal controls over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

*/s/ William S. Daugherty*

William S. Daugherty  
Chairman, Chief Executive Officer and President  
May 10, 2007

**CERTIFICATION OF CHIEF FINANCIAL OFFICER  
PURSUANT TO RULE 13A-14(A) OR 15D-14(A) UNDER THE SECURITIES EXCHANGE ACT OF 1934**

In connection with the quarterly report of NGAS Resources, Inc. on Form 10-Q for the quarter ended March 31, 2007, as filed with the Securities Exchange Commission on the date hereof under the Securities Exchange Act of 1934, as amended, the undersigned, Michael P. Windisch, Chief Financial Officer of the NGAS Resources, Inc., certifies pursuant to Rule 13a-14(a) or 15d-14(a) under the Exchange Act that:

1. I have reviewed this quarterly report on Form 10-Q of NGAS Resources, Inc.
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report.
3. Based on my knowledge, the consolidated financial statements and other financial information included in this report fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of and for the periods reported in this report.
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Rule 13a-15(e) and 15d-15(e) under the Exchange Act) for the registrant and internal control over financial reporting (as defined in Rule 13a-15(f) and 15d-15(f) under the Exchange Act) for the registrant, and we have:
  - (a) designed such disclosure controls and procedures, or caused such disclosure control and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) designed such internal controls over financial reporting, or caused such disclosure control and procedures to be designed under our supervision, to provide reasonable assurances regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of those disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) disclosed in the Report any change in the registrant's internal control over financial reporting that occurred during the reported fiscal quarter that has materially affected or is reasonably likely to materially affect the registrant's internal control over financial reporting.
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors:
  - (a) all significant deficiencies and material weaknesses in the design or operation of internal controls over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

*/s/ Michael P. Windisch*

Michael P. Windisch  
Chief Financial Officer  
May 10, 2007

**CERTIFICATION OF CHIEF EXECUTIVE OFFICER  
PURSUANT TO RULE 13A-14(B) OR 15D-14(B) UNDER THE SECURITIES EXCHANGE ACT OF 1934**

In connection with the quarterly report of NGAS Resources, Inc. on Form 10-Q for the quarter ended March 31, 2007, as filed with the Securities Exchange Commission on the date hereof under the Securities Exchange Act of 1934, as amended, the undersigned, William S. Daugherty, Chairman, Chief Executive Officer and President of NGAS Resources, Inc., certifies pursuant to Rule 13a-14(b) or 15d-14(b) under the Exchange Act that:

1. The report fully complies with the requirements of Section 13(a) or 15(d) of the Exchange Act; and
2. The information contained in the report fairly presents, in all material respects, the financial condition and results of operations of NGAS Resources, Inc. as of the date and for the periods reported therein.

*/s/ William S. Daugherty*

William S. Daugherty  
Chairman, Chief Executive Officer and President  
May 10, 2007

**CERTIFICATION OF CHIEF FINANCIAL OFFICER  
PURSUANT TO RULE 13A-14(B) OR 15D-14(B) UNDER THE SECURITIES EXCHANGE ACT OF 1934**

In connection with the quarterly report of NGAS Resources, Inc. on Form 10-Q for the quarter ended March 31, 2007, as filed with the Securities Exchange Commission on the date hereof under the Securities Exchange Act of 1934, as amended, the undersigned, Michael P. Windisch, Chief Financial Officer of NGAS Resources, Inc., certifies pursuant to Rule 13a-14(b) or 15d-14(b) under the Exchange Act that:

1. The report fully complies with the requirements of Section 13(a) or 15(d) of the Exchange Act; and
2. The information contained in the report fairly presents, in all material respects, the financial condition and results of operations of NGAS Resources, Inc. as of the date and for the periods reported therein.

*/s/ Michael P. Windisch*

Michael P. Windisch  
Chief Financial Officer  
May 10, 2007