CRIMSON EXPLORATION INC.
Form DEFR14A
April 13, 2007

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

SCHEDULE 14A

(RULE 14a-101)

(Amendment No. 1)

SCHEDULE 14A INFORMATION

Proxy Statement Pursuant to Section 14(a) of the Securities Exchange Act of 1934

Filed by Registrant x

Filed by a Party other than the Registrant o

Check the appropriate box:

o	Preliminary Proxy Statement
o	Confidential, for use of the Commission Only (as permitted by Rule 14a-6(e)(2))
x	Definitive Proxy Statement
o	Definitive Additional Materials
o	Soliciting Material Pursuant to §240.1a-11(c) or §240.1a-12

CRIMSON EXPLORATION INC.

(Name of Registrant as Specified In Its Charter)

Payment of Filing Fee (Check the appropriate box):

x No fee required.

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(1) Title of each class of securities to which transaction applies:

(2) Aggregate number of securities to which transaction applies:

(3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (set forth the amount on which the filing is calculated and state how it was determined):

(4) Proposed maximum aggregate value of transaction:

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o Fee paid previously with preliminary materials.

o Check box if any part of the fee is offset as provided by Exchange Act Rule 0-11(a)(2) and identify the filing for which the offsetting fee was paid previously. Identify the previous filing by registration statement number, or the form or schedule and the date of its filing.

(1) Amount previously paid:
(2) Form, Schedule or Registration Statement No.:
(3) Filing Party:
(4) Date Filed:

Explanatory Note

On April 11, 2007, Crimson Exploration Inc. filed with the Securities and Exchange Commission its definitive proxy statement for its Annual Meeting of Stockholder to be held on May 10, 2007. After the filing of the proxy statement but prior to the mailing of the proxy statement to its stockholders, the Company discovered certain typographical errors relating to calendar dates and share numbers in the following sections: Proposal 2 - Ratification of the Appointment of Our Independent Auditors and the table titled Security Ownership of Certain Beneficial Owners and Management . The company is amending and restating the proxy statement to correct those errors.

CRIMSON EXPLORATION INC.

717 Texas, Suite 2900

Houston, Texas 77002

NOTICE OF ANNUAL MEETING OF STOCKHOLDERS

To Be Held on May 10, 2007

NOTICE IS HEREBY GIVEN that the annual meeting of stockholders of Crimson Exploration Inc. will be held on Thursday, May 10, 2007 at 9:30 a.m. CDT, at 717 Texas, Suite 2900, Houston, Texas 77002, (713) 236-7400, for the following purposes:

(1) To elect five directors to hold office until the next annual meeting of stockholders and until their successors are duly elected and qualified.
(2) To ratify the appointment of Grant Thornton LLP as our independent auditors for the fiscal year ending December 31, 2007; and
(3) To consider and act upon such other business as may properly come before the meeting or any adjournments or postponement thereof.

The close of business on April 3, 2007 has been fixed as the record date for determining stockholders entitled to notice of, and to vote at, the meeting or any adjournments or postponement thereof. For at least 10 days prior to the meeting, a complete list of stockholders entitled to vote at the meeting will be open to any stockholder s examination during ordinary business hours at our offices at 717 Texas, Suite 2900, Houston, Texas 77002.

A proxy for the meeting and a proxy statement with information concerning the matters to be acted upon is enclosed herewith.

By Order of the Board of Directors

/s/ Allan D. Keel

Allan D. Keel

President and Chief Executive Officer

Houston, Texas

April 10, 2007

Your vote is important no matter how large or small your holdings may be. If you do not expect to be present at the meeting in person, you are urged to immediately complete, date, sign, detach and return the enclosed proxy in the accompanying envelope, which requires no postage if mailed in the United States. In the alternative, you may elect to vote by internet or by phone by following the instructions set forth in the enclosed proxy.

CRIMSON EXPLORATION INC.

717 Texas, Suite 2900

Houston, Texas 77002

PROXY STATEMENT

For

ANNUAL MEETING OF STOCKHOLDERS

To Be Held on May 10, 2007

The Board of Directors (the ***Board***) of Crimson Exploration Inc. (the ***Company*** or ***Crimson***) is furnishing this proxy statement to stockholders beginning on or about April 16, 2007 in connection with a solicitation of proxies for use at the annual meeting of stockholders to be held on Thursday, May 10, 2007, at 9:30 a.m. CDT, at 717 Texas, Suite 2900, Houston, Texas 77002, (713) 236-7400, and at all adjournments or postponements thereof (the ***Annual Meeting***), for the purposes set forth in the attached Notice of Annual Meeting of Stockholders.

All shares represented by a valid proxy, properly executed, duly returned to us and not revoked will be voted in accordance with the instructions contained therein. The shares represented by executed but unmarked proxies will be voted (i) FOR the nominees for election as directors named herein under Election of Directors, and (ii) FOR the ratification of the appointment of Grant Thornton LLP as our independent auditors for the fiscal year ending December 31, 2007, and at the discretion of the person named as proxy with regard to any other matter that may properly come before the Annual Meeting.

Executing a proxy given in response to this solicitation will not affect a stockholder s right to attend the Annual Meeting and to vote in person. Presence at the Annual Meeting of a stockholder who has signed a proxy does not in itself revoke a proxy. Any stockholder giving a proxy may revoke it at any time by giving written notice thereof to Crimson Exploration Inc., 480 N. Sam Houston Parkway E., Suite 300, Houston, Texas 77060, Attention: Stephen W. Schoppe.

RECORD DATE AND VOTING SECURITIES

The record date for determining the stockholders entitled to vote at the Annual Meeting is the close of business on April 3, 2007 (the ***Record Date***). On that date, 3,335,031 shares of our Common Stock, par value $.001 per share (***Common Stock***), were outstanding and entitled to vote. In deciding all questions and other matters, a holder of Common Stock on the Record Date may cast one vote for each share of Common Stock registered in his or her name. Shares of our Series G Convertible Preferred Stock, par value $.01 per share (the ***Series G Preferred Stock***), and shares of our Series H Convertible Preferred Stock, par value $.01 per share (the ***Series H Preferred Stock***), may vote on an as-converted basis with the Common Stock with respect to matters on which approval of our stockholders may be required. However, with respect to the election of directors, the Series G Preferred Stock is entitled to elect a majority of our directors, but not the remaining directors, which the holders of the Common Stock and Series H Preferred Stock are entitled to elect. On the Record Date, 81,000 shares of Series G Preferred Stock, representing the voting power of 5,252,895 shares of Common Stock, and 5,210 shares of

Series H Preferred Stock, representing the voting power of 744,288 shares of Common Stock, were outstanding. Our Series D Preferred Stock (the ***Series D Preferred Stock***) and Cumulative Convertible Preferred Stock, Series E (the ***Series E Preferred Stock***), $.01 par value per share, of which 8,000 and 9,000 shares, respectively, are outstanding, do not have voting rights unless required by law or as set forth in their respective Certificates of Designation.

Effective September 15, 2006, the Company completed a reverse stock split of its Common Stock pursuant to which any ten shares of issued and outstanding Common Stock was combined into one share of Common Stock. This action was taken pursuant to Board resolutions adopted on July 28, 2006, which authorized an amendment to Crimson s certificate of incorporation effecting a reverse split of our Common Stock. The resolutions were approved by written consent of OCM GW Holdings, LLC, the Company s principal stockholder which at the time held approximately 55.0% of the voting power of the outstanding capital stock entitled to vote on such matters. References in this proxy to shares of Common Stock and the number of shares of Common Stock that may be issued upon conversion of preferred shares and upon the exercise of stock option grants and warrants have been revised to reflect the effect of such reverse stock split.

A significant portion of our capital stock s voting power is held by one investor and by our management. See Security Ownership of Certain Beneficial Owners and Management.

QUORUM AND VOTING

To be validly approved by the stockholders, two of the director nominees (as indicated in Proposal No. 1) must be elected by a plurality of votes cast by holders of the Common Stock and Series H Preferred Stock entitled to vote at the Annual Meeting; the remaining three director nominees (as indicated in Proposal No. 1) must be elected by a majority of votes cast by holders of the Series G Preferred Stock entitled to vote at the Annual Meeting. The proposal to ratify our appointment of Grant Thornton LLP for the fiscal year ended December 31, 2007, must be approved by the affirmative vote of a majority of votes that are actually voted at the Annual Meeting with respect to shares of Common Stock, Series G Preferred Stock and Series H Preferred Stock. Each share of Common Stock is entitled to one vote per share. Each share of Series G Preferred Stock votes on an as-converted basis with the Common Stock on the second proposal, the ratification of Grant Thornton LLP as our independent auditors for the fiscal year ending December 31, 2007. With respect to the first proposal regarding the election of directors, each share of Series G Preferred Stock is not entitled to vote except as a separate class for the three Series G Preferred Stock director nominees (as indicated in Proposal No. 1), in which case each share is entitled to one vote. The Series G Preferred Stock currently has a conversion price of $9.00 a share; on a fully converted basis the 81,000 shares of Series G Preferred Stock (including accrued and unpaid dividends to April 3, 2007) would convert into 5,252,895 shares of Common Stock. Each share of Series H Preferred Stock votes on an as-converted basis with the Common Stock on the proposals described in this statement. The Series H Preferred Stock currently has a conversion price of $3.50 a share; on a fully converted basis the 5,210 shares of Series H Preferred Stock would convert into 744,288 shares of Common Stock.

Only votes cast FOR a matter constitute affirmative votes. A majority of the issued and outstanding shares of Common Stock and Series G Preferred Stock and Series H Preferred

Stock (on an as-converted basis) are necessary to constitute a quorum to transact business. Each share represented at the Annual Meeting in person or by Proxy will be counted towards a quorum. Votes withheld or abstaining from voting will be counted for quorum purposes.

Proposal 1

Election of Directors

The Board consists of five directors, a majority of which the Series G Preferred Stock, voting as a class, is entitled to elect. The two director nominees indicated below which the holders of the Common Stock and Series H Preferred Stock are entitled to vote on as a single class (the ***Common/Series H Nominees***) have been nominated by the Board for re-election to serve until the next Annual Meeting of Stockholders and until their successors have been elected and qualified. The three director nominees indicated below which the holders of the Series G Preferred Stock are entitled to vote on as a class (the ***Series G Nominees*** ; cumulatively, the ***Nominees***) have been nominated by the Board members elected by holders of the Series G Preferred Stock at our last annual meeting for re-election to serve until the next Annual Meeting of Stockholders and until their successors have been elected and qualified.

It is expected that the five Nominees named below will be able to accept such nominations. If any Nominee for any reason is unable or is unwilling to serve at the time of the Annual Meeting, the Proxy holder may vote the Proxy for a substitute nominee or nominees to the extent such holder is entitled to vote on such nominee. The following sets forth information as to the five Nominees for election at the Annual Meeting, including their ages, present principal occupations, business experience, and directorships in other publicly-held companies.

THE BOARD RECOMMENDS THE STOCKHOLDERS VOTE FOR THE ELECTION OF EACH OF THE NOMINEES LISTED BELOW.

DIRECTORS AND NOMINEES

SERIES G NOMINEES

Name	**Age**	**Position**	**Year First Elected Director**
Allan D. Keel	47	President, Chief Executive Officer and Director	2005
B. James Ford	38	Director	2005
Skardon F. Baker	37	Director	2005

COMMON/SERIES H NOMINEES

Name	**Age**	**Position**	**Year First Elected Director**
Lee B. Backsen	66	Director	2005
Lon McCain	59	Director	2005

Allan D. Keel was appointed Chief Executive Officer and President and joined the Company s Board of Directors on February 28, 2005. Before joining Crimson, Mr. Keel was Vice President/General Manager of Westport Resources, Houston office, during 2004. In this role he was responsible for their Gulf of Mexico operations including acquisitions, development and exploration. In 2003, Mr. Keel served as a consultant to both domestic and international companies in building their presence in the Gulf of Mexico. From mid-2000 until mid-2001, Mr.

Keel served as a Vice President at Enron Energy Finance where he worked on private equity transactions and volumetric production payments. From mid-2001 through 2002, Mr. Keel served as President and CEO of Mariner Energy Company (Mariner), a majority owned affiliate of Enron. Subsequent to Enron s bankruptcy and its decision to sell Mariner, Mr. Keel partnered with Oaktree Capital Management, LLC in an effort to acquire Mariner. From 1996 until mid-2000, Mr. Keel was Vice President/General Manager for Westport Resources, where he built the Gulf of Mexico division from the grassroots. From 1984 to 1996, Mr. Keel was with Energen Resources where he directed the company s exploration, joint venture and acquisition activities. He received BS and MS degrees in geology from the University of Alabama and an MBA from the Owen School of Management at Vanderbilt University. Mr. Keel was appointed pursuant to the terms of the Series G Preferred Stock, the majority of which is held by OCM GW Holdings, LLC, whose ultimate parent is Oaktree Capital Management, LLC.

B. James Ford became a member of the Company s Board of Directors on February 28, 2005. Mr. Ford is a Managing Director of Oaktree Capital Management, LLC. Before joining Oaktree in June 1996, Mr. Ford was a consultant with McKinsey & Co., and a financial analyst in the Investment Banking Department of PaineWebber Incorporated. Mr. Ford earned a Bachelor of Arts in Economics from the University of California at Los Angeles and an MBA from the Stanford University Graduate School of Business. He currently serves as a director of Cequel Communications; HydroChem Holdings, Inc.; Triton Media and Red Technology Alliance, LLC. Mr. Ford was appointed pursuant to the terms of the Series G Preferred Stock, the majority of which is held by OCM GW Holdings, LLC, whose ultimate parent is Oaktree Capital Management, LLC.

Skardon F. Baker became a member of the Company s Board of Directors on February 28, 2005. Mr. Baker is a Senior Vice President of Oaktree Capital Management, LLC s Principal Activities Group. Prior to joining Oaktree in 2004, Mr. Baker spent four years at J.P. Morgan Chase & Co. and its predecessor organizations, serving most recently as a Vice President in the Mergers and Acquisitions group responsible for identifying and executing leveraged transactions for the firm s financial sponsor client base. During his time at J.P. Morgan Chase, Mr. Baker worked on several advisory assignments in Asia and also served as Executive Aide to Geoff Boisi and Don Layton, co-CEOs of JP Morgan s Global Investment Banking operations. Prior to J.P. Morgan Chase, Mr. Baker was a Director and Associate at The Beacon Group, LLC, a merger advisory and private investment firm. Mr. Baker received an MBA from Harvard Business School and a JD from the University of Texas School of Law, where he was Associate Editor of The Texas Law Review. Prior to graduate school, Mr. Baker served as Chief Speechwriter and Special Assistant for the Office of Governor George W. Bush. Prior to that, he was a Lieutenant in the United States Army. Mr. Baker received an A.B. degree magna cum laude in Government from Harvard University. Mr. Baker was appointed pursuant to the terms of the Series G Preferred Stock, the majority of which is held by OCM GW Holdings, LLC, whose ultimate parent is Oaktree Capital Management, LLC.

Lee B. Backsen became a member of the Company s Board of Directors on June 1, 2005. Mr. Backsen is Vice President Exploration for Andex Resources, LLC, a private oil and gas producing company, with responsibility for sourcing exploration joint ventures. From 2000 until joining Andex in 2004, Mr. Backsen was a consulting geologist for Continental Land & Fur Co., Inc. and Grant Geophysical, Inc., for whom he screened exploratory prospects in the Texas and Louisiana Gulf Coast Basins. Prior to establishing his consulting practice in 2000, Mr. Backsen spent over 35 years in the industry in senior exploration management positions with Burlington Resources Inc., UMC Petroleum Corporation, General Atlantic Gulf Coast Inc., Kerr McGee Corporation, Pelto Oil Company, Spectrum Oil and Gas Company and Shell Oil Company. Mr. Backsen earned Bachelor of Science degree and Masters of Science degree in Geology from Iowa State University.

Lon McCain became a member of the Company s Board of Directors on June 1, 2005. Mr. McCain was Vice President, Treasurer and Chief Financial Officer of Westport Resources Corporation, a large, publicly traded exploration and production company, from 2001 until the sale of that company to Kerr McGee Corporation in 2004. From 1992 until joining Westport, Mr. McCain was Senior Vice President and Principal of Petrie Parkman & Co., an investment banking firm specializing in the oil and gas industry. From 1978 until joining Petrie Parkman, Mr. McCain held senior financial management positions with Presidio Oil Company and Petro-Lewis Corporation and Ceres Capital. He currently serves as a director of Transzap Inc. and Cheniere Energy Partners. Mr. McCain received a B.S. of Business Administration and a Masters of Business Administration/Finance from the University of Denver. Mr. McCain has also been an Adjunct Professor of Finance at the University of Denver since 1982.

Directors are elected annually and hold office until the next annual meeting or until their successors are duly elected and qualified. The Board met four times during 2006. No director during the last fiscal year attended fewer than 75% of the total number of meetings of the Board and committees on which that director served during that year.

Stockholders desiring to communicate with the Board may do so by mail addressed as follows: Board of Directors, Crimson Exploration Inc., 480 N. Sam Houston Parkway E., Suite 300, Houston, Texas 77060. We believe our responsiveness to stockholder communications to the Board has been excellent.

The Company encourages, but does not require, directors to attend annual meetings of stockholders. At the Company s 2006 stockholder meeting, all members of the Board at the time of the meeting attended.

BOARD MEETINGS AND COMMITTEES

Our Board has established an audit committee and a compensation committee. Although our Board has not made a formal determination on the matter, under current NASDAQ listing standards (which we are not currently subject to), we believe that Lee B. Backsen and Lon McCain would be considered independent directors including, with respect to Mr. McCain, under applicable standards for audit committee members. Because of his employment with us, Allan D. Keel would not be considered independent. B. James Ford may not be considered an independent director because of his senior position with Oaktree Capital Management, LLC, the parent of our controlling stockholder. Also, Skardon F. Baker may not be considered independent because of his senior position with Oaktree Capital Management, LLC s Principal Activities Group.

The Audit Committee was established to review and appraise the audit efforts of our independent auditors, and monitor our accounts, procedures and internal controls. Our Audit Committee consists of Messrs. McCain and Baker. The committee met four times in 2006. The Board has determined that Mr. McCain is an audit committee financial expert as defined under applicable rules and regulations of the Securities and Exchange Commission (the ***SEC***). Our Audit Committee has adopted a charter which is posted on our website www.crimsonexploration.com under Corporate Governance.

The function of the Compensation Committee is to fix the annual salaries and other compensation for our executive officers and key employees. Our Compensation Committee consists of Messrs. Ford and Backsen. The committee met once in 2006. Our Compensation Committee has adopted a written charter which is posted on our website www.crimsonexploration.com under Corporate Governance. The Compensation Committee has the following authority and responsibilities:

- To establish and review our overall compensation philosophy;
- To review and approve corporate goals and objectives relevant to our executive officers compensation, evaluate the performance of such officers and recommend for approval by the Board, the benefits, direct and indirect, of our executive officers based on this evaluation;
- To review and recommend to the Board for approval all our equity compensation plans that are not otherwise subject to the approval of the stockholders;
- To review and make recommendations to the Board for approval all equity awards;
- To review and monitor all employee pension, profit-sharing and benefit plans, if any; and
- To make recommendations to the Board with regard to our compensation and benefit programs and practices for all employees.

While the Compensation Committee is not prohibited from delegating its functions, the Compensation Committee has not done so in the past, although it may consider senior management s recommendations as to appropriate compensation for members of management reporting to them, as discussed under Compensation Discussion and Analysis below.

The Board does not have a nominating committee. We believe that the entire Board is able to fulfill the functions of a nominating committee. In any event, the directors elected solely by the Series G Preferred Stock, constituting a majority of directors, are entitled to nominate the directors to be elected by the holders of the Series G Preferred Stock or, if there are no such directors, holders of a majority of the Series G Preferred Stock may nominate the nominees for election as such directors, and the following discussion is so qualified by the rights of the holders of the Series G Preferred Stock and their elected directors. We do not have a charter addressing director nominations.

The Board believes that candidates for director should have certain minimum qualifications, including being able to read and understand financial statements and having the highest personal integrity and ethics. The Board also considers such factors as relevant expertise and experience, ability to devote sufficient time to the affairs of the Company, demonstrated excellence in his or her field, the ability to exercise sound business judgment and the commitment to rigorously represent the long-term interests of the Company s stockholders. Candidates for director will be reviewed in the context of the current composition of the Board, the operating requirements of the Company and the long-term interests of stockholders.

The Board does not have a formal process for identifying and evaluating nominees for directors. Instead, it uses its network of contacts to identify potential candidates. The Board will conduct any appropriate and necessary inquiries into the backgrounds and qualifications of possible candidates after considering the function and needs of the Board. The Board will meet to discuss and consider such candidates qualifications and then select a nominee for recommendation to the Board by majority vote, subject to the rights of the holders of the Series G Preferred Stock and their elected directors to nominate and elect a majority of directors.

The Board has not established procedures for considering nominees recommended by stockholders.

We have adopted a code of ethics as defined by the applicable rules of the SEC, and it has been posted on our website: www.crimsonexploration.com.

EXECUTIVE OFFICERS

The following table sets forth information on our executive officers, except for Allan D. Keel whose information is included with the above information regarding the Company s directors:

Name	Age	Position	Year First Elected Officer
E. Joseph Grady	54	Senior Vice President and Chief Financial Officer	2005
Tracy Price	48	Senior Vice President Land/Business Development	2005
Thomas H. Atkins	48	Senior Vice President Exploration	2005
Jay S. Mengle	53	Senior Vice President Engineering	2005

E. Joseph Grady was appointed Vice President and Chief Financial Officer on February 28, 2005. E. Joseph Grady is managing director of Vision Fund Advisors, Inc., a financial advisory firm he co-founded in 2001 and serves as an advisor to the Board for the firm s privately-held advisory clients. Mr. Grady has over twenty-five years of financial, operational and administrative experience, including seventeen years in the oil and gas industry. He was formerly Senior Vice President Finance and Chief Financial Officer of Texas Petrochemicals Holdings, Inc. from April 2003 to July 2004 and Vice President Chief Financial Officer and Treasurer of Forcenergy Inc. from 1995 to 2001.

Tracy Price was appointed Senior Vice President Land/Business Development on April 1, 2005. Mr. Price joined the Company after serving as the Senior Vice President Land/Business Development for The Houston Exploration Company from 2001 until joining the Company. Prior to his tenure at The Houston Exploration Company, Mr. Price served as Manager of Land and Business Development for Newfield Exploration Company between 1990 and 2001. From 1986 to 1990 Mr. Price was Land Manager for Apache Corporation. Prior to Apache, Mr. Price has also served in similar land management capacities at Challenger Minerals Inc. and Phillips Petroleum Company. Mr. Price received his BBA in Petroleum Land Management from the University of Texas.

Thomas H. Atkins was appointed Senior Vice President Exploration on April 1, 2005. Mr. Atkins joined the Company after serving as the General Manager Gulf of Mexico for Newfield Exploration Company where he was employed from 1998 until joining the Company. Prior to his tenure at Newfield, Mr. Atkins served in various exploration capacities with EOG Resources and its predecessor companies from 1984 to 1998, including prospect generator, development geologist and finally as Exploration Manager. Mr. Atkins also worked at the Superior Oil Company from 1981 through 1984. Mr. Atkins received a BS in Geology from the University of Oklahoma.

Jay S. Mengle was appointed Senior Vice President Engineering on April 1, 2005, after serving as the Shelf Asset Manager Gulf of Mexico for Kerr McGee Corporation subsequent to its 2004 merger with Westport Resources. Mr. Mengle was with Westport Resources from 1998 to 2004, where he started Westport s Gulf Coast/Gulf of Mexico drilling and production operations. Prior to joining Westport, Mr. Mengle also served in various drilling, production and marketing management capacities at Norcen Energy Resources, Kirby Exploration and Mobil Oil Corp. Mr. Mengle received his BS in Petroleum Engineering from the University of Texas.

EXECUTIVE COMPENSATION

Compensation Discussion and Analysis

The Compensation Committee of the Board is empowered to review and approve, or in some cases recommend for the approval of the full Board of Directors, the annual compensation and compensation procedures for the five executive officers of the Company: the President - Chief Executive Officer; Senior Vice President - Chief Financial Officer; Senior Vice President - Land and Business Development; Senior Vice President - Engineering and Senior Vice President - Exploration.

Philosophy and Objectives of the Compensation Program

The primary objective of our executive officer compensation program is to attract and retain key employees, and to provide motivation and reward for achieving the Company s financial and non-financial goals and objectives. We believe that compensation of our executive officers should reflect their success as a management team as well as rewarding them for individual accomplishments. The philosophy of the Compensation Committee is that compensation to executive officers, specifically including the President and Chief Executive Officer, should be directly and materially linked to the Company s achievement of specific annual, long-term and strategic goals of the Company and to their individual contribution to the attainment of those goals. The overall compensation strategy of the Company is to maximize stockholder return by offering a balanced combination of annual and long-term compensation to executive officers based upon corporate and individual performance.

What Our Compensation Program is Designed to Reward

Our compensation program is designed to reward our executive officers contribution to the Company s achievement of its financial and non-financial goals and objectives. In measuring their contribution, the Compensation Committee considers numerous factors including the Company s overall growth and financial performance. All executive officers participate in a performance based incentive compensation plan that is based on the Company s success in meeting or exceeding key financial and business objectives including meeting pre-determined financial and operating goals.

2006 Executive Compensation Components

For the fiscal year ending December 31, 2006, the principal compensation components for the executive officers were:

- Base salary;
- Performance based incentive compensation;

Long term equity incentive compensation;

Overriding royalty interest plan compensation; and

Perquisites and other personal benefits.

The Compensation Committee has not retained a compensation consultant to review our policies and procedures with respect to executive compensation. The Compensation Committee utilizes energy industry compensation surveys to conduct a benchmark review of the aggregate level and mix of our executive compensation against companies in our industry.

Base Salary

Annual compensation is generally paid in the form of base salary. All of our executive officers are subject to employment agreements that provide for a fixed base salary with a discretionary bonus component. These salaries were determined by our Board of Directors which took into account competitive factors and the historic salary structure for various levels of responsibility within the Company, level and scope of responsibility, individual and corporate performance and salaries paid for comparable positions at similarly situated companies. In the future, base salary determinations will be based on recommendations from the Compensation Committee. The Compensation Committee will consider senior management s recommendations as to appropriate compensation for members of management reporting to them. At the time the employment agreements were entered into, we set base salaries at the base salary comparables for each position, and the Compensation Committee will continue to do so in the future.

Performance Based Incentive Compensation

The executive officers were paid annual incentive bonuses in March 2007 that were determined based upon the Company s success in meeting certain minimum financial and operating performance goals for calendar year 2006. Incentive bonuses paid to the executive officers for 2006 were approximately 30% to 40% of their respective base salary.

The Compensation Committee approves, on an annual basis, individual quantitative performance goals for each of the following performance categories: (i) oil and gas production levels (Production), (ii) Earnings Before Interest, Taxes, Depreciation, Amortization and Exploration Expenses (EBITDAX), (iii) replacement of oil and natural gas reserves depleted by production (Reserve Replacement), (iv) Finding and Development Costs (F&DC), and (v) Return on Invested Capital (ROIC).

Definitions of Performance Categories

Production. The production goal is based on targeted increases in true production levels for the year, established prior to the beginning of the year.

EBITDAX. EBITDAX is a non-GAAP measure we use as an approximation of cash flow from operations before tax. Our definition of EBITDAX may differ from that of other companies and excludes Exploration (Geological & Geophysical) expenses and Dry Hole Costs (DHC).

Reserve Replacement. Reserve Replacement is a measure of the Company s ability to replace oil and gas reserves over and above equivalent reserves depleted by oil and gas production during the fiscal year.

F&DC. Finding and Development Costs are the measure of the cost ($/mcfe) to locate prospects, acquire production rights, drill and complete wells and install or construct production equipment and facilities.

ROIC. ROIC is a measure of earnings before tax but excludes certain expenses, including Exploration Costs and Dry Hole Costs, SFAS 123 expenses, gains/losses from mark to market on derivatives and gains/losses from asset impairment, divided by stockholders equity (consisting of the par value of preferred stock and Common Stock plus Additional Paid-In Capital).

Determining Bonuses To Be Paid

Bonuses are typically paid out in cash and/or restricted stock in the first quarter of the year following the year in which they are earned. For each executive officer, the Compensation Committee determines the appropriate percentage allocation to be assigned each of the five performance categories. In most cases, when determining an executive officer s bonus, the Compensation Committee gives equal weight to each category except when a particular performance category bears a more direct relationship to the executive officer s areas of responsibility, in which case a particular performance category may be more heavily weighted.

As respects the method for calculating the individual executive officer s annual bonus, should the Company s financial and operating results meet or exceed either the pre-determined Minimum , Target and Maximum values assigned a particular performance category, then the executive officer is paid an annual bonus that is a percentage of their annual salary. The actual percentage of annual salary that is paid as an annual incentive bonus ranges from 20% to 100% of the annual salary paid Messrs. Keel and Grady and from 20% to 70% of the annual salary paid Messrs. Price, Mengle and Atkins. The actual percentage of annual salary paid an executive officer is dependent upon the extent to which the Company meets or exceeds the Company s pre-determined performance goals. Payment of annual incentive bonuses to our executive officers is not guaranteed and is based upon actual Company performance during the fiscal year.

The Compensation Committee has the ability to award additional discretionary bonuses to our executive officers, even if performance goals are not met, should their individual performance or contribution during the year merit a bonus. During 2006, such discretionary bonuses were awarded to Messrs. Price and Mengle for $11,600 and $20,000, respectively.

Long Term Equity Compensation

The Company makes stock option grants from time-to-time as a mechanism for providing long-term, non-cash compensation to the executive officers. The Board believes that stock options are an effective incentive for executive officers and managers to create value for the Company and the stockholders since the value of an option bears a direct relationship to appreciation in the Company s stock price. By using stock-based compensation, the Company can focus much needed cash flow, which would otherwise be paid out as compensation, back into the daily operations of the business. Individual stock option grants are subjectively determined based upon a number of factors, including individual and Company performance and prior year grants. The majority of shares granted under our 2005 Stock Incentive Plan were to newly hired executive officers during 2005 as an incentive to join the Company and to improve the long-term performance and success of the Company. The grants are discussed in the Executive Compensation section below under Option Awards.

Our 2005 Stock Incentive Plan also permits the granting of other equity-based awards, which the Company may issue from time to time. For example, in 2006 the Company granted restricted stock awards to certain executive officers in lieu of 50% of their cash bonus for 2005, at the executive officers election. These restricted stock awards vested one year from the date of grant.

Grants under our 2005 Stock Incentive Plan are intended to qualify as performance based compensation and thus are not subject to the limits of Section 162(m). In 2006, the Company issued no stock options to executive officers, but during this period did issue to non-executive employees options to purchase 51,000 shares of Common Stock. Options to acquire 100,000 shares of Common Stock were forfeited by the resignation in 2006 of a former executive officer of the Company.

All option grants by the Company are made at an exercise price equal to or greater than the fair market value of the underlying stock on the date of grant. Currently, approximately 2,191,000 of the outstanding options have an exercise price greater than $6.25, the closing price of the underlying Common Stock on December 29, 2006.

We do not have any program, plan or practice in place for selecting grant dates for awards under our 2005 Stock Incentive Plan in coordination with the release of material non-public information. We are not prohibited from granting options at times when our executives are in possession of material non-public information. However, no inside information was taken into account in determining the number of options previously awarded or the exercise price for those awards, and we did not time the release of any material non-public information to affect the value of those awards.

Overriding Royalty Interest Plan

This plan is designed to reward the efforts of those Company employees who are successful in exploring for oil and natural gas on behalf of the Company. The program is available only to those company employees that are directly involved in oil and natural gas exploration efforts, including the Senior Vice President-Exploration who is the only named executive officer entitled to benefits under this plan. No benefits were paid under this plan during 2006. In order to be able to participate in the Plan, a potential candidate must be recommended for participation by the Company s President and approved by the Compensation Committee. Under this plan the participants share a portion of the net revenue interest held by the Company in certain oil and natural gas producing properties generated by the exploration program.

Perquisites and Other Personal Benefits

In certain circumstances, the Company provides certain perquisites and other personal benefits to its executive officers and other employees. We believe these perquisites are reasonable, competitive and consistent with the overall compensation program to enable the Company to attract and retain qualified employees for key positions.

The Company offers a variety of health and welfare programs to all eligible employees. The executive officers are eligible for the same benefit programs on the same basis as the rest of the broad-based employees. The health and welfare programs are intended to protect employees against catastrophic loss. Our programs include medical, pharmacy, dental, vision, life insurance and accidental death and disability. The Compensation Committee periodically reviews the perquisites and other benefits offered the Company s employees.

Tax Treatment

We consider the anticipated tax treatment of our executive compensation program when setting levels and types of compensation. Section 162(m) of the Internal Revenue Code generally disallows a tax deduction to public companies for compensation paid to a company s chief executive officer or any of its other four most highly compensated executive officers in excess of $1 million in any year, with certain performance-based compensation being specifically exempt from this deduction limit. During 2006, none of our employees subject to this limit received Section 162(m) compensation in excess of $1 million. Consequently, the requirements of Section 162(m) should not affect the tax deductions available to us in connection with our senior executive compensation program for 2006.

COMPENSATION COMMITTEE REPORT

The Compensation Committee of the Company has reviewed and discussed the Compensation Discussion and Analysis required by Item 402(b) of the Regulation S-K with management and, based on such review and discussions, the Compensation Committee recommended to the Board that the Compensation Discussion and Analysis be included in this Proxy Statement.

THE COMPENSATION COMMITTEE

B. James Ford

Lee B. Backsen

EXECUTIVE COMPENSATION

Summary Compensation Table

The following table sets forth information regarding compensation paid to the chief executive officer, chief financial officer and our three other executive officers for the fiscal year ending December 31, 2006.

Summary Compensation Table

Name and Principal Position	Year End	Salary ($)	Bonus[(1)] ($)	Stock Awards ($)	Option Awards ($) [(3)]	Non-Equity Incentive Plan Compensation [(1)] ($)	Change In Pension Value And Non-Qualified Deferred Compensation Earnings ($)	All Other Compensation [(4)] ($)		Total ($)
Allan D. Keel *Chief Executive Officer and President*	2006	240,000			2,009,700	72,000		2,400		312,000
E. Joseph Grady *Senior Vice President and Chief Financial Officer*	2006	220,000			669,900	66,000		29,641	(2)	313,441
Tracy Price *Senior Vice President -Land/Business Development*	2006	185,000	11,600		522,448	44,400		1,850		241,000
Jay S. Mengle *Senior Vice President Engineering*	2006	180,000	20,000		261,224	54,000		1,800		254,000
Tommy H. Atkins *Senior Vice President Exploration*	2006	180,000			222,524	75,600		1,800		255,000

(1) The following incentive bonuses were paid to executive officers in March 2007, for 2006 calendar year performance: Mr. Keel received an incentive bonus of $72,000; Mr. Grady received an incentive bonus of $66,000; Mr. Price received an incentive bonus of $44,400 and a discretionary bonus of $11,600; Mr. Mengle received an incentive bonus of $54,000 and a discretionary bonus of $20,000 and Mr. Atkins received an incentive bonus of $75,600. All executive bonuses for 2006 were paid in cash.

(2) Pursuant to his employment contract, Mr. Grady was reimbursed a total of $27,441 in 2006 for commuting costs prior to his relocation to Houston, Texas in late 2006. Reimbursements were for housing and air fare. In addition, the Company contributed $2,200 to Mr. Grady s 401(K) plan during 2006.

(3) No options were granted to our executive officers in 2006. Included in this column is the amount recognized in accordance with FAS 123(R) for financial statement reporting purposes for the fiscal year ending December 31, 2006. Assumptions underlying these valuations can be found in Note 6 to our financial statements included with our Annual Report on Form 10-K for the year ended December 31, 2006.

(4)

Except as otherwise noted in footnote (2) regarding reimbursement for commuting costs incurred by Mr. Grady, these amounts represent 401(K) plan contributions by the Company during 2006.

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Employment Agreements

The Company has entered into employment agreements with all its executive officers. The agreements entered with Mr. Keel (Chief Executive Officer and President) and Mr. Grady (Senior Vice President and Chief Financial Officer) each provide for a term of three years with automatic yearly extensions unless the Company or the officer elects not to extend the agreement. For calendar year 2006, and thereafter, each agreement provides for a base salary and an annual discretionary bonus of 0% to 100% of each officer s base salary to be established by the Board or by the Compensation Committee. For calendar year ending December 31, 2006, Mr. Keel received a base salary of $240,000 and an incentive cash bonus of $72,000. For this same period, Mr. Grady received a base salary of $220,000 and an incentive cash bonus of $66,000.

Employment agreements have also been entered into with Mr. Price (Senior Vice President Land/Business Development); Mr. Atkins (Senior Vice President Exploration); and Mr. Mengle (Senior Vice President Engineering). For calendar year 2006 and thereafter, each agreement provides for a base salary and an annual discretionary bonus of 0% to 70% of each officer s base salary to be established by our Board or by the Compensation Committee. For the calendar year ending December 31, 2006, Mr. Price received a base salary of $185,000, an incentive cash bonus of $44,400 and a discretionary cash bonus of $11,600. For this same period Mr. Atkins received a base salary of $180,000 and an incentive cash bonus of $75,600 and Mr. Mengle received a base salary of $180,000, an incentive cash bonus of $54,000 and a discretionary cash bonus of $20,000.

Each of the employment agreements provides for severance and change-in-control payments in the event we terminate an officer s employment without Cause or if the officer terminates for Good Reason.

Cause generally means (i) continued failure by the executive officer to perform substantially his duties and responsibilities (other than a failure resulting from permanent disability) that remains uncorrected for ten days after receipt of appropriate written notice from the Board of Directors; (ii) engagement by the executive officer in willful, reckless or grossly negligent misconduct that is materially injurious to Company or any of its affiliates, monetarily or otherwise; (iii) except as provided by (iv), the charging of the executive officer with a crime involving moral turpitude or a felony, provided that if the criminal charge is dismissed with prejudice or if the executive is acquitted at trial or on appeal, the executive officer will be deemed to have been terminated without Cause; (iv) the charging of the executive officer with an act of criminal fraud, misappropriation or personal dishonesty, provided that if the criminal charge is subsequently dismissed with prejudice or the executive officer is acquitted at trial or on appeal then the executive officer will be deemed to have been terminated without Cause; or (v) a material breach by the executive officer of any provision of the employment agreement that remains uncorrected for 10 days following written notice of such breach by the Company to the executive officer identifying the provision of the employment agreement that the Company determined was breached.

Good Reason generally means (i) a material breach by the Company of any provision of the employment agreement that remains uncorrected for 10 days following written notice of such breach by the executive officer to the Company identifying the provision of the employment agreement that the executive officer determined has been breached; (ii) assignment by the Board of Directors to the executive officer of any duties that materially and adversely alter the nature or status of his position, job descriptions, duties, title or responsibilities from those of such executive officer s position, or eligibility for Company compensation plans; (iii) requirement by the Company for the executive officer to relocate anywhere other than the greater Houston, Texas metropolitan area, except for required travel on Company business to an extent substantially consistent with his obligations under their employment agreement; (iv) reduction in the executive officer s base salary in effect at the relevant time; or (v) exclusion of the executive officer from eligibility for the Company's bonus plan as described above.

A Change of Control is deemed to occur when less than 10% of our Common Stock is beneficially owned by Oaktree Capital Management, LLC or its affiliates.

The employment agreements also contain provisions for payment of severance benefits upon termination of employment. A discussion of applicable severance benefits is set forth in the section titled Potential Payments Upon Termination or Change of Control .

Option Awards

On February 28, 2005, the Company entered into Stock Option Agreements with Messrs. Keel and Grady in conjunction with their commencement of employment with the Company. Mr. Keel received options to purchase 270,000 shares of the Company s Common Stock at an exercise price of $9.70 per share, options to purchase 405,000 shares of the Company s Common Stock at an exercise price of $12.50 per share, and options to purchase 540,000 shares of the Company s Common Stock at an exercise price of $17.00 per share. Mr. Grady received options to purchase 90,000 shares of the Company s Common Stock at an exercise price of $9.70 per share, options to purchase 135,000 shares of the Company s Common Stock at an exercise price of $12.50 per share, and options to purchase 180,000 shares of the Company s Common Stock at an exercise price of $17.00 per share.

On April 1, 2005, the Company entered into Stock Option Agreements with Messrs. Price, Mengle, and Atkins in conjunction with their commencement of employment with the Company. Mr. Price received options to purchase 90,000 shares of the Company s Common Stock at an exercise price of $11.60 per share and options to purchase 180,000 shares of the Company s Common Stock at an exercise price of $17.00 per share. Mr. Mengle received options to purchase 45,000 shares of the Company s Common Stock at an exercise price of $11.60 per share and options to purchase 90,000 shares of the Company s Common Stock at an exercise price of $17.00 per share. Mr. Atkins received options to purchase 38,300 shares of the Company s Common Stock at an exercise price of $11.60 per share and options to purchase 76,700 shares of the Company s Common Stock at an exercise price of $17.00 per share.

Each set of options granted will become vested and exercisable with respect to 15% of the shares on the first anniversary of the date granted and thereafter at the end of each full succeeding year from the date granted according to the following: 25% on the second anniversary, an additional 25% on the third anniversary and 35% on the fourth anniversary at which time each set of granted options will be fully vested and exercisable.

During 2005 there were options issued to purchase 2,240,000 shares of our Common Stock, all of which were issued to executive officers. No awards were made in 2006 to our executive officers.

Grants of Plan-Based Awards

	Estimated Possible Payouts Under Non-Equity Incentive Plan Awards[1]		
Name	Threshold [2]	Target	Maximum
Allan D. Keel	48,000	120,000	240,000
E. Joseph Grady	44,000	120,000	220,000
Tracy Price	18,500	92,500	129,500
Jay S. Mengle	18,000	90,000	126,000
Thomas H. Atkins	18,000	90,000	126,000

(1) See the Compensation Discussion and Analysis provision titled Determining Bonuses To Be Paid for explanation of method used to determine non-equity incentive compensation actually paid during 2006.

(2) Under the Company s executive officer performance based incentive compensation plan this category is referred to as the Minimum payout level.

Bonus

See Executive Compensation, Compensation Discussion and Analysis 2006 Executive Compensation Components Performance Based Incentive Compensation for a discussion of our incentive bonus plan. Actual amounts paid for fiscal year 2006 are disclosed in the Summary Compensation Table above.

Outstanding Equity Awards at Fiscal Year-End

Name	**Number of Securities Underlying Unexercised Options (#) Exercisable(1)**	**Number of Securities Underlying Unexercised Options (#) Unexercisable (2)**	**Option Exercise Price ($)**	**Option Expiration Date**	**Number of Shares or Units of Stock That Have Not Vested ($)(3)**	**Market Value of Shares or Units of Stock That Have Not Vested ($)**
Allan D. Keel	182,250	229,500	9.70	2/28/2015	8,000	50,000
		344,250	12.50	2/28/2015		
		459,000	17.00	2/28/2015		
E. Joseph Grady	60,750	76,500	9.70	2/28/2015	7,333	45,831
		114,750	12.50	2/28/2015		
		153,000	17.00	2/28/2015		
Tracy Price	40,500	76,500	11.60	4/1/2015	3,700	23,125
		153,000	17.00	4/1/2015		
Jay S. Mengle	20,250	38,250	11.60	4/1/2015	3,600	22,500
		76,500	17.00	4/1/2015		
Thomas H. Atkins	17,250	32,555	11.60	4/1/2015	3,600	22,500
		65,195	17.00	4/1/2015		

(1) The exercisable but unexercised options vested on the first anniversary date of the date of grant. For Messrs. Keel and Grady the vesting date was February 28, 2006 and for Messrs. Price, Mengle and Atkins the vesting date was April 1, 2006.

(2) As respects the unexercisable and unexercised options, the underlying securities vest according to the following schedule: 25% on the second anniversary of the date of grant, 25% on the third anniversary of the date of grant and 35% on the fourth anniversary of the date of grant. For Messrs. Keel and Grady the initial date of grant was February 28, 2005 and for Messrs. Price, Mengle and Atkins the initial date of grant was April 1, 2005.

(3) The restricted stock awards reflected in this column vested on March 1, 2007.

Option Exercises and Stock Vesting

For the fiscal year ending December 31, 2006, no executive officer exercised a stock option award nor did a restricted stock award vest during this period.

Nonqualified Deferred Compensation

No executive officer participated in a Nonqualified Deferred Compensation Plan during the fiscal year ending December 31, 2006.

Pension Benefits

The Company does not provide a pension plan for its executive officers and non-executive employees.

Potential Payments Upon Termination or Change of Control.

Payments that would have been payable to executive officers upon a termination or change of control, assuming such event had occurred during the fiscal year ending December 31, 2006, are set forth in the respective employment agreement between the executive officer and the Company. Each employment agreement contains similar but not identical provisions regarding payments upon termination or change in control and relevant provisions of those agreements are described above under the Summary Compensation Table, as well as below.

Severance Payments

Regarding Messrs. Keel and Grady, if their employment is terminated by the Company without Cause or by them for Good Reason, and subject to their observance of certain non-compete and release of liability agreements, they will receive a severance payment consisting of (i) a cash amount equal to the greater of (a) two times the sum of their respective base salaries for the current calendar year plus their prior year s annual bonus and (b) $600,000 and (ii) health insurance benefits for two years from the termination date. Had the employment of Messrs. Keel and Grady been terminated by the Company without Cause or by them for Good Reason in 2006, they would have been paid $600,000 plus the value of health insurance benefits for two years from the termination date, estimated at $12,669 each per year.

With respect to Messrs. Price, Mengle and Atkins, if their employment is terminated by the Company without Cause or by them for Good Reason, and subject to their observance of certain non-compete and release of liability agreements, they will receive a severance payment consisting of (i) a cash amount equal to the greater of (a) two times the sum of their respective base salaries for the current calendar year plus their prior year s annual bonus and (b) $500,000 and (ii) health insurance benefits for two years from the termination date. Had the employment of Messrs. Price, Mengle and Atkins been terminated by the Company without Cause or by them for Good Reason in 2006, they would have been paid $500,000 plus the value of health insurance benefits for two years from the termination date, estimated at $12,669 each per year for Messrs. Price and Atkins and estimated at $9,192 per year for Mr. Mengle.

If no annual bonus was paid to an executive officer during the year before the year in which their employment was terminated, the officer is entitled to the greater of (i) the amount of the annual bonus most recently paid to such executive officer and (ii) their target bonus for the calendar year in which termination occurs.

If not in connection with a Change of Control, the Company terminates the executive officer without Cause or the officer terminates their employment for Good Reason, the executive officer will receive half of the cash severance amount in a lump sum within 15 days of termination. The executive officer will not be entitled to the remainder of the cash severance payment, or the second year of health insurance benefits, unless they give notice to the Company within 30 days of the conclusion of the 12 month period following their termination date that they agree to comply with the non-compete and non-solicitation provisions of their respective employment agreements for an additional 12 month period. In such event, the executive officer will receive the remainder of their severance payment and an extension of their health insurance benefits for an additional year and the remainder of the cash severance payment, payable monthly over the second 12 month period following their termination.

If an executive officer s employment is terminated because of death or permanent disability, the family members covered by the Company s group health plan will be reimbursed for the group health plan continuation coverage they elect to receive under the Consolidated Omnibus Budget Reconciliation Act (COBRA) for up to 18 months, provided a member of the executive officer s family provides timely notice to the health plan administrator of the executive officer s death or permanent disability.

Under each executive officer s stock option agreements and restricted stock awards under the 2005 Stock Incentive Plan, in the event of a Change of Control, termination by the Company without Cause or termination by the executive officer for Good Reason, each executive officer s unvested options and unvested restricted stock will become fully vested and, in the case of options, exercisable with respect to 100% of such shares, resulting in the vesting of 1,032,750 shares for Mr. Keel, 344,250 shares for Mr. Grady, 229,500 shares for Mr. Price, 114,750 shares for Mr. Mengle and 97,750 shares for Mr. Atkins. As of December 31, 2006, the aggregate value of option shares held by the executive officers was $0.00, as the closing price of the Company s Common Stock on that date was less than the exercise price of the stock options.

With regard to unvested restricted stock held by the executive officers as of December 31, 2006, Mr. Keel held 8,000 shares, Mr. Grady held 7,334 shares, and Mr. Price held 3,700 shares and Messrs. Mengle and Atkins each held 3,600 shares. The aggregate value of such shares was $50,000 for Mr. Keel, $45,838 for Mr. Grady, $23,125 for Mr. Price and $22,500 for both Messrs. Mengle and Atkins. All such restricted stock shares vested on March 1, 2007. However, had the employment of an executive officer been terminated by the Company without Cause prior to such date, then the vesting date of such restricted stock would have been automatically accelerated as of the date of termination.

In the event of death or disability during 2007, each executive officer will be deemed to have served until the next anniversary of the option grant date following the date of their death or permanent disability, resulting in the vesting of 607,500 shares for Mr. Keel, 202,500 shares for Mr. Grady, 135,000 shares for Mr. Price, 67,500 shares for Mr. Mengle and 57,500 shares for Mr. Atkins. As of December 31, 2006, the aggregate value of these option shares was $0.00, as the closing price of the Company s Common Stock on that date was less than the exercise price of the stock options.

Change of Control

If the severance payment is made as a result of termination by the Company without Cause or by the Employee for Good Reason within 90 days before or 12 months after a Change of Control, the Company will pay the entire cash severance amount in a lump sum upon the earlier to occur of (i) the date on which the Change of Control occurs and (ii) the executive officer s effective date of termination.

Non-Compete and Non-Solicitation Provisions

The agreements generally require that each executive officer not engage in competition with the Company in any geographic area in which the Company owns a material amount of oil, gas or other mineral properties, during the period commencing with executive officer s initial date of hire and ending: (i) except as contemplated by (ii) or (iii), 12 months following the date of termination of their employment by the Company without Cause or by the executive officer for Good Reason, (ii) 24 months following the date of termination of the executive officer s employment with the Company (a) by the Company for Cause, or (b) if the executive officer gives notice of their desire to accept the extension of such period to receive additional severance benefits, as discussed above, and the executive officer s employment has been terminated by the Company without Cause or by the executive officer for Good Reason, and (iii) 12 months, if the executive officer s employment is terminated by the Company without Cause or the executive officer terminates their employment for Good Reason within 12 months following a Change of Control. Each executive officer is also subject to non-solicitation provisions during the term of the non-compete provisions prohibiting the executive officer from inducing or soliciting any other employee or officer of the Company to terminate their employment with the Company.

Gross Up Payments

Pursuant to their respective employment agreements, if it is determined that any payment, award, benefit or distribution (or an acceleration of any payment, award, benefit or distribution) to an executive officer by the Company or by another entity in the event of a Change in Control is subject to the imposition of an excise tax imposed by Section 4999 of the Internal Revenue Code of 1986, as amended, or any interest or penalties are incurred by the executive officer with respect to such excise tax (***Excise Tax***), the Company will pay the executive officer an additional payment (a ***Gross Up Payment***) in an amount equal to such Excise Tax.

Compensation of Directors

Name	Year	Fees Earned or Paid in Cash ($)	Stock Awards ($)	Option Awards ($)	Non-Equity Incentive Plan Compensation ($)	Change in Pens
Skardon F. Baker	2006	18,000				
B. James Ford	2006	21,000				
Lon McCain	2006	29,667	10,000			
Lee B. Backsen	2006	20,000	10,000			

On June 1, 2005, the Board approved a compensation plan for non-employee directors (the ***Plan***) providing for a $10,000 annual retainer, with a $2,000 meeting attendance fee ($1,000 if by telephone) for a maximum of $8,000 per director per year, with an additional fee payable for attendance of committee meetings held on days other than those on which the Board meets. The chairman of the Audit and Compensation Committee is entitled to receive an annual retainer of $5,000 and $2,500, respectively.

Under the Plan, each non-employee director receives $15,000 of restricted Common Stock for his first year of service subject to a two year vesting schedule. Upon re-election, each non-employee director receives $10,000 in restricted Common Stock, subject to a one year stock vesting requirement. The number of shares to be awarded is determined based on the fair market value of the Company s Common Stock as of the close of trading on the date of grant.

In addition, the Plan provides for reimbursement of expenses for all directors in the performance of their duties, including reasonable travel expenses incurred attending meetings.

STATUS OF EQUITY COMPENSATION PLANS

The following table shows the Company s stockholder approved and non-stockholder approved equity compensation plans as of December 31, 2006:

Plan Category	**Number of securities to be issued upon exercise of outstanding options, warrants and rights**	**Weighted-average exercise price of outstanding options, warrants and rights**	**Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))**
	(a)	(b)	(c)
Equity compensation plans approved by security holders	2,326,800	$13.71	661,250
Equity compensation plans not approved by security holders	3,000	$ 0.10	0
Total	2,329,800	$ 13.71	661,250

Our three equity compensation plans with outstanding options that have been approved by the Company s shareholders to-date are our (i) amended and restated 1994 Employee Stock Option Plan, which terminated in February 2004, (ii) 2004 Stock Option and Compensation Plan and (iii) 2005 Stock Incentive Plan. Although we sought and obtained stockholder approval of the 2004 Stock Option and Compensation Plan, neither the plan itself nor the outstanding grants were contingent on stockholder approval.

We have issued options for 2,176,000 shares of Common Stock at a weighted-average exercise price of $14.28 per share under the 2005 Stock Incentive Plan (***2005 Plan***). The aggregate number of shares of our Common Stock that may be issued and outstanding pursuant to the exercise of awards under the 2005 Plan may not exceed 2,852,500 shares, reduced by 152,250 shares (the number of shares of outstanding options and awards granted under the 2004 Plan). Options covering a total of 661,250 shares of Common Stock are available to be issued under the 2005 Plan.

Additionally, in prior years warrants were occasionally issued to lenders or guarantors on loans to the Company as additional consideration for entering into the loans or guaranties. All currently outstanding warrants were issued to Mr. Keel as consideration for a loan by him to the Company. The loan has subsequently been repaid. The warrants have an exercise price of $.10 per share and entitle the warrant holder to purchase up to 3,000 shares of Common Stock. Their expiration date is January 10, 2008.

The weighted-average exercise price per share of our outstanding options under the amended and restated 1994 Employee Stock Option Plan and 2004 Stock Option and Compensation Plan is $9.02 and $4.74, respectively.

COMPENSATION COMMITTEE INTERLOCKS AND INSIDER PARTICIPATION

There are no relationships required to be disclosed under this section.

CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

Related Party Transactions

Transactions with our directors, executive officers, principal stockholders or affiliates must be at terms that are no less than favorable to us than those available from third parties and must be approved in advance by a majority of disinterested members of the Board of Directors.

There were no related party transactions during the fiscal year ending December 31, 2006.

VOTE REQUIRED AND BOARD RECOMMENDATION

Each of the two Common/Series H Nominees must be elected by a plurality of votes cast by holders of the Common Stock and Series H Preferred Stock entitled to vote at the Annual Meeting.

Each of the three Series G Nominees must be elected by a majority of votes cast by holders of the Series G Preferred Stock entitled to vote at the Annual Meeting.

THE BOARD UNANIMOUSLY RECOMMENDS A VOTE FOR THE RE-ELECTION OF THE FIVE NOMINEES TO THE BOARD OF DIRECTORS. PROXY CARDS EXECUTED AND RETURNED WILL BE SO VOTED UNLESS CONTRARY INSTRUCTIONS ARE INDICATED THEREON.

Proposal 2

Ratification of the Appointment of Our Independent Auditors

With authority granted by our Board of Directors, the Audit Committee of our Board of Directors has appointed Grant Thornton LLP (***Grant Thornton***) as our independent auditors to audit our consolidated financial statements for the fiscal year ending December 31, 2007, and our Board of Directors recommends that our stockholders vote FOR ratification of such appointment.

The Audit Committee of the Board of Directors of the Company had previously recommended and approved the selection of the accounting firm of Grant Thornton to replace the firm of Weaver and Tidwell, L.L.P. (***Weaver and Tidwell***) as the Company s independent accountants for the calendar years ended December 31, 2005 and December 31, 2004.

Weaver and Tidwell did not resign or decline to stand for reelection, but was dismissed effective July 19, 2005, to allow the appointment of Grant Thornton as the Company s principal accountants as of this date. Weaver and Tidwell s opinion regarding the financial statements of the Company for the last two fiscal years did not contain an adverse opinion or disclaimer of opinion, nor was it qualified or modified as to uncertainty, audit scope or accounting principles, except its report dated March 19, 2004, included in the Company s Annual Report on Form 10-K for the year ended December 31, 2003, which raised substantial doubt regarding the Company s ability to continue as a going concern. The Company is not aware of any disagreements with the Company s former accountant during the past two most recent fiscal years and the subsequent interim period up to the date of dismissal on any matter of accounting principals or practices, financial statement disclosure or auditing scope or procedure which disagreements, if not resolved to the satisfaction of Weaver and Tidwell, would have caused it to make reference to the subject matter of the disagreements in connection with its report. Additionally, there were no reportable events pursuant to Item 304(a)(v) of Regulation S-K under the Securities Act of 1933.

During the Company s last two fiscal years and the subsequent interim period up to the date of engagement, the Company did not consult with Grant Thornton regarding (i) the application of accounting principles to a specific transaction, either completed or proposed, or the type of audit opinion that might be rendered on the Company s financial statements, in each case where written or oral advice was provided, that Grant Thornton concluded was an important factor considered by the Company in reaching a decision as to the accounting, auditing or financial reporting issue or (ii) any matter that was either the subject of a disagreement or reportable event, as those terms are described in Item 304(a)(iv) and Item 304(a)(v), respectively, of Regulation S-K under the Securities Act of 1933.

The Company has provided Weaver and Tidwell with a copy of the disclosures the Company is making in this proxy statement, which were initially made in a Current Report on Form 8-K filed on July 21, 2005, in response to the disclosures required by Regulation S-K, Item 304(a), under the Securities Act of 1933. The former accountant has been provided an opportunity to furnish the Company with a letter addressed to the SEC expressing its agreement and absence of any disagreement with the statements made by the Company in response to this Item. A letter to such effect was attached as Exhibit 99.2 to such Current Report on Form 8-K.

A representative of Grant Thornton is expected to be present at the Annual Meeting, will have an opportunity to make a statement if he or she so desires and is expected to be available to respond to appropriate questions from our stockholders.

Grant Thornton LLP s fees for professional services totaled $171,200 for 2006 and $257,456 for 2005. Grant Thornton LLP s fees for professional services included the following:

Audit Services fees for audit services, which relate to the fiscal year consolidated audit, quarterly reviews, registration statements, comfort letters, statutory and regulatory audits, and accounting consultations were $171,200 in 2006 and $257,456 in 2005. These fees include audit fees for the performance of annual audits of our financial statements for both the fiscal years ending December 31, 2006 and December 31, 2005.

Audit-Related Services - No fees for audit-related services were incurred in 2006 or 2005.

Tax Services there were no tax services or other fees incurred and payable to Grant Thornton in 2006 or 2005.

Weaver and Tidwell s fees for professional services totaled $6,600 for 2006 and $32,026 in 2005. Weaver and Tidwell s fees for professional services included the following:

Audit Services During 2006 and 2005, Weaver and Tidwell issued consent letters approving the use of the results of an audit conducted by them covering audited consolidated statement of operations, stockholders equity and cash flows of the Company for the year ended December 31, 2003. The fees charged by Weaver & Tidwell to issue these consent letters were $4,200 in 2006 and $8,200 in 2005.

Audit-Related Services fees for audit-related services, consisting of reviews of registration statements were $2,400 in 2006 and $23,826 in 2005. These fees were incurred in connection with their review of our Registration Statement on Form S-1 filed for the benefit of certain selling shareholders, which was initially filed in June 2004.

Tax Services there were no tax services or other fees incurred and payable to Weaver & Tidwell in fiscal years 2006 and 2005.

The Audit Committee has considered whether the non-audit services provided to the Company by Grant Thornton impaired the independence of Grant Thornton and concluded that they did not.

All of Grant Thornton s fees for 2006 and 2005, and Weaver and Tidwell s fees for 2005, were pre-approved by the Audit Committee through formal engagement letters with those entities. The policy of the Audit Committee and the Board, as applicable, is to pre-approve all services by the Company s independent accountants. The Audit Committee has adopted a pre-approval policy that provides guidelines for the audit, audit-related, tax and other non-audit services that may be provided by the Company s independent accountants to the Company. The policy (a) identifies the guiding principles that must be considered by the Audit Committee in approving services to ensure that the independent accountants independence is not impaired; (b) describes the audit, audit-related, tax and other services that may be provided and the non-audit services that are prohibited; and (c) sets forth pre-approval requirements for all permitted services. Under the policy, all services to be provided by our independent accountants must be pre-approved by the Audit Committee.

VOTE REQUIRED AND BOARD RECOMMENDATION

Stockholder ratification of the appointment of our independent auditors is not required by the Company s bylaws or otherwise. However, we are submitting this proposal to the stockholders as a matter of good corporate practice. Approval of this proposal requires the affirmative vote of a majority of the votes cast on the proposal. If the appointment of Grant Thornton is not ratified, the Audit Committee will reconsider the appointment. Even if the appointment is ratified, the Audit Committee in its discretion may direct the appointment of a different independent audit firm at any time during the year if it is determined that such change would be in best interests of the Company and its stockholders.

THE BOARD RECOMMENDS THAT YOU VOTE FOR THE RATIFICATION OF THE APPOINTMENT OF GRANT THORNTON LLP AS THE COMPANY S INDEPENDENT AUDITORS FOR THE YEAR 2007.

REPORT REGARDING AUDITED FINANCIAL STATEMENTS

The Audit Committee has reviewed and discussed with management, and our independent auditors, our audited financial statements contained in our Annual Report on Form 10-K for the year ended December 31, 2006.

The Audit Committee has received and reviewed the written disclosures and the letter from our independent auditors required by Independence Standards Board Standard No. 1 (titled, Independence Discussions with Audit Committees). The Audit Committee has discussed with the independent auditors the matters to be discussed by SAS 61 (Codification of Statements of Auditing Standards AU § 380), and has discussed with the independent accountant the independent accountant s independence.

Based on the review and discussions referred to above, the Audit Committee has determined that the audited financial statements be included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2006, to be filed with the SEC.

Lon McCain

Skardon F. Baker

SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The following table sets forth information as of April 3, 2007 regarding the beneficial ownership of Common Stock by each person known to us to own beneficially 5% or more of the outstanding Common Stock, each director, each director nominee, certain named executive officers, and the directors and executive officers as a group. The persons named in the table have sole voting and investment power with respect to all shares of Common Stock owned by them, unless otherwise noted.

Beneficial ownership is determined in accordance with the rules of the SEC. For the purpose of calculating the number of shares beneficially owned by a stockholder and the percentage ownership of that stockholder, shares of Common Stock subject to options that are currently exercisable or exercisable within 60 days of the date of this prospectus by that stockholder are deemed outstanding.

Name and Address of Beneficial Owner	Title of Class	Amount and Nature of Beneficial Ownership	Percent %
Allan D. Keel[1, 2]	Common	539,916	13.93
	Series G	600	*
E. Joseph Grady[2, 3]	Common	169,334	4.83
Tracy Price[2, 12]	Common	111,700	3.24
Thomas H. Atkins[2, 13]	Common	49,600	1.47
Jay S. Mengle[2, 14]	Common	79,650	2.33
B. James Ford[4,5]	Common	0	*
Skardon F. Baker[4,5]	Common	0	*
Lee B. Backsen[2, 15]	Common	2,905	*
Lon McCain[2, 15]	Common	2,905	*
All current directors and officers as a group (9 persons)[6]	Common	956,260	22.26
	Series G	600	*
Oaktree Capital Management, LLC[5, 7]	Common	5,273,000	61.26
	Series G	76,700	94.70
	Series H	2,000	38.39
J. Virgil Waggoner[8,9]	Common	1,637,700	32.93
	Series H	3,000	57.58
	Series E	9,000	100.00
Gregory P. Pipkin[10]	Common	360,154	9.75
	Series G	500	*

* Denotes less than 1% of class beneficially owned

1. Reported Common Stock includes 12,000 shares held directly, 38,916 shares underlying convertible preferred stock, 3,000 shares underlying warrants to purchase Common Stock and options to acquire 182,250 shares of Common Stock that vested on February 28, 2006 and 303,750 shares that vested on February 28, 2007.
2. Shareholder s current address is 480 N. Sam Houston Parkway East, Suite 300, Houston, Texas 77060.
3. Reported Common Stock includes 7,334 shares held directly and options to acquire 60,750 that vested on February 28, 2006 and 101,250 shares that vested on February 28, 2007.

4. Excludes shares held by OCM GW Holdings, LLC, of which the Messrs. Ford and Baker both disclaim beneficial ownership.
5. Shareholder s address is c/o Oaktree Capital Management, LLC, 333 South Grand Avenue, Los Angeles, California 90071.
6. Includes 58,094 shares held directly; 859,950 shares subject to currently exercisable options; 3,000 shares subject to currently exercisable warrants, and 38,916 shares underlying convertible preferred stock.
7. Reported Common Stock includes 5,260,359 shares underlying Series G and Series H convertible preferred stock (including accrued dividends on the Series G Preferred Stock) and 12,667 shares in each case held directly by OCM GW Holdings, LLC. OCM Principal Opportunities Fund III, L.P. (Fund) and OCM Principal Opportunities Fund IIIA, L.P. (Fund IIIA) are the direct beneficial owners of OCM GW Holdings, LLC. Fund is the managing member of Holdings and Oaktree Capital Management LLC (Oaktree) is the managing member of OCM Principal Opportunities Fund III GP, LLC (Fund GP), the general partner of the Fund and Fund IIIA. Although each of Fund, Fund IIIA, Fund GP and Oaktree may be deemed an indirect beneficial owner of the securities, each of them disclaims beneficial ownership of those shares except to the extent of its pecuniary interest in them.
8. Reported Common Stock includes 919,333 held directly, 428,572 shares underlying Series H convertible preferred stock, 287,795 shares underlying Series E convertible preferred stock (including accrued dividends thereon), and 2,000 shares subject to currently exercisable options. The shareholder granted OCM GW Holdings, LLC an irrevocable proxy and entered into Share Restriction Agreement on February 28, 2005, which currently applies only to class votes of the Series H Preferred Stock.
9. Shareholder s address is 6605 Cypresswood Drive, Suite 250, Spring, Texas 77379.
10. Shareholder s address is 11227 Smithdale Road, Houston, Texas 77024. Reported Common Stock includes 327,724 shares held directly, 32,430 shares of Common Stock that may be received upon conversion of Series G Convertible Preferred Stock beneficially owned by the reporting person, including shares of Common Stock that may be received upon conversion of accrued and unpaid dividends on the Series G Convertible Preferred Stock, and 3,236 shares of Common Stock owned by Core Natural Resources GP, LLC, of which reporting person is the sole member.
12. Reported Common Stock includes 3,700 shares held directly and 40,500 shares that vested on April 1, 2006 and 67,500 shares that vested on April 1, 2007.
13. Reported Common Stock includes 3,600 shares held directly and 17,250 shares that vested on April 1, 2006 and 28,750 shares that vested on April 1, 2007.
14. Reported Common Stock includes 22,150 shares directly held by Mr. Mengle, 3,500 shares held by his wife and 20,250 shares that vested on April 1, 2006 and 33,750 shares that vested on April 1, 2007.
15. Reported Common Stock includes 2,905 shares each held directly by Messrs. McCain and Backsen.

SECTION 16(a) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE

Section 16(a) of the Securities Exchange Act of 1934, as amended, requires our officers and directors, and persons who own more than 10% of a registered class of our equity securities, to file initial reports of ownership and reports of changes in ownership with the SEC. Such persons are required by SEC regulation to furnish us with copies of all Section 16(a) forms they file.

Based solely on our review of the copies of such forms received by us with respect to 2006, or written representations from certain reporting persons, we believe that our officers, directors and persons who own more than 10% of a registered class of our equity securities have complied with all applicable filing requirements, except that Mr. Waggoner was late in filing for one transaction by one day involving the sale of Common Stock. An executive officer, Mr. Mengle, was late filing a report by four days covering a purchase of Common Stock.

STOCKHOLDERS PROPOSALS

Stockholders may submit proposals on matters appropriate for stockholder action at our subsequent annual meetings consistent with Rule 14a-8 promulgated under the Securities Exchange Act of 1934, as amended. For such proposals to be considered in the Proxy Statement and Proxy relating to the 2008 Annual Meeting of Stockholders they must be received by us not later than December 13, 2007. Such proposals should be directed to Crimson Exploration Inc., 717 Texas, Suite 2900, Houston, Texas 77002, and Attention: Stephen W. Schoppe, Acting Secretary.

OTHER BUSINESS

The Board knows of no matter other than those described herein that will be presented for consideration at the Annual Meeting. However, should any other matters properly come before the Meeting or any adjournments thereof, it is the intention of the person(s) named in the accompanying Proxy to vote in accordance with their best judgment in the interest of the Company.

MISCELLANEOUS

We will bear all costs incurred in the solicitation of Proxies. In addition to solicitation by mail, our officers and employees may solicit Proxies by telephone, telegraph or personally, without additional compensation. We may also make arrangements with brokerage houses and other custodians, nominees and fiduciaries for the forwarding of solicitation materials to the beneficial owners of shares of Common Stock held of record by such persons, and we may reimburse such brokerage houses and other custodians, nominees and fiduciaries for their out-of-pocket expenses incurred in connection therewith. We have not engaged a proxy solicitor.

The SEC has adopted rules that permit companies and intermediaries such as brokers to satisfy delivery requirements for proxy statements with respect to two or more stockholders sharing the same address by delivering a single proxy statement addressed to those stockholders. This process, which is commonly referred to as householding, potentially provides extra convenience for stockholders and cost savings for companies. The Company and some brokers may household proxy materials, delivering a single proxy statement to multiple stockholders sharing an address unless contrary instructions have been received from the affected stockholders. Once you have received notice from your broker or the Company that they or the Company will be householding materials to your address, householding will continue until you are notified otherwise or until you revoke your consent. If, at any time, you no longer wish to participate in householding and would prefer to receive a separate proxy statement, please notify your broker if your shares are held in a brokerage account or the Company if you hold registered shares. You can notify the Company by sending a written request to Stephen W. Schoppe, Acting Secretary, 717 Texas, Suite 2900, Houston, Texas 77002, by registered, certified or express mail.

Our Annual Report to Stockholders, including financial statements for the year ended December 31, 2006, accompanies this Proxy Statement. The Annual Report is not to be deemed part of this Proxy Statement.

Houston, Texas

April 10, 2007
By Order of the Board of Directors

/s/ Allan D. Keel

Allan D. Keel,

President and Chief Executive Officer

CRIMSON EXPLORATION INC.

C/O PROXY SERVICES

P.O. BOX 9142

FARMINGTON, NY 11735

VOTE BY INTERNET www.proxyvote.com

Use the Internet to transmit your voting instructions and for electronic delivery of information up until 11:59 P.M. Eastern Time the day before the cut-off date or meeting date. Have your proxy card in hand when you access the web site and follow the instructions to obtain your records and to create an electronic voting instruction form.

ELECTRONIC DELIVERY OF FUTURE SHAREHOLDER COMMUNICATIONS

If you would like to reduce the costs incurred by CRIMSON EXPLORATION INC. in mailing proxy materials, you can consent to receiving all future proxy statements, proxy cards and annual reports electronically via e-mail or the internet. To sign up for electronic delivery, please follow the instructions above to vote using the Internet and, when prompted, indicate that you agree to receive or access shareholder communications electronically in future years.

VOTE BY PHONE 1-800-690-6903

Use any touch-tone telephone to transmit your voting instructions up until 11:59 P.M. Eastern Time the day before the cut-off date or meeting date. Have your proxy card in hand when you call and then follow the instructions.

VOTE BY MAIL

Mark, sign and date your proxy card and return it in the postage-paid envelope we have provided or return it to CRIMSON EXPLORATION INC, c/o ADP, 51 Mercedes Way, Edgewood, NY 11717.

TO VOTE, MARK BLOCKS BELOW IN BLUE OR BLACK INK AS FOLLOWS:

KEEP THIS PORTION FOR YOUR RECORDS
DETACH AND RETURN THIS PORTION ONLY

THIS PROXY CARD IS VALID ONLY WHEN SIGNED AND DATED.

CRIMSON EXPLORATION INC.

THE BOARD OF DIRECTORS RECOMMEND A VOTE

FOR ITEMS 1 AND 2.

Vote on Directors

		For All	Withhold All	For All Except	To withhold authority to vote for any individual nominee(s), mark For All Except and write the number(s) of the nominee(s) on the line below.
1. ELECTION OF DIRECTORS					
Series G Nominees	Common/Series H Nominees				
1)Allan D. Keel	4)Lee B. Backsen	o	o	o	
2)B. James Ford	5)Lon McCain				
3)Skardon F. Baker					

Vote on Proposals

	For	Against	Abstain
2. To ratify the appointment of Grant Thornton LLP as our independent auditors for the fiscal year ending 12/31/2007.	o	o	o
3. In the discretion of the Proxy holder, on any other matter that may properly come before the meeting or any adjournments or postponements thereof.			

The shares represented by this Proxy will be voted as directed. **Where no direction is given, the shares will be voted FOR matters 1 and 2 above.** If any other matters properly come before the meeting, or if cumulative voting is required, the person named in this proxy will vote in their discretion.

For address changes and/or comments, please check this box and write them on the back where indicated. o

	Yes	No	
Please indicate if you plan to attend this meeting.	o	o	Please sign your name exactly as it appears hereon. When signing as attorney, executor, administrator, trustee or guardian, please add your title as such. When signing as joint tenants, all parties in the joint tenancy must sign. If a signer is a corporation, please sign in full corporate name by duly authorized officer.
HOUSEHOLD ELECTION Please indicate if you consent to receive certain future investor communications in a single package per household.	o	o	

Signature [PLEASE SIGN WITHIN BOX]	Date	Signature (Joint Owners)	Date

CRIMSON EXPLORATION INC.
THIS PROXY IS SOLICITED ON BEHALF OF THE BOARD OF DIRECTORS
ANNUAL MEETING OF STOCK HOLDERS

MAY 10, 2007

The stockholder(s) hereby appoint(s) Stephen W. Schoppe, as proxy, with the power to appoint his substitute, and hereby authorizes him to represent and to vote, as designated on the reverse side of this ballot, all of the shares of Common and Preferred Stock of Crimson Exploration Inc. that the stockholder(s) is/are entitled to vote at the Annual Meeting of Stockholders to be held at 9:30 a.m. central daylight time on May 10, 2007, at 717 Texas, Suite 2900, Houston, TX 77002, and any adjournment or postponement thereof.

THIS PROXY, WHEN PROPERLY EXECUTED, WILL BE VOTED AS DIRECTED BY THE STOCKHOLDER(S). IF NO SUCH DIRECTIONS ARE MADE, THIS PROXY WILL BE VOTED FOR THE ELECTION OF THE NOMINEES LISTED ON THE REVERSE SIDE FOR THE BOARD OF DIRECTORS AND FOR EACH PROPOSAL.
PLEASE MARK, SIGN, DATE AND RETURN THIS PROXY CARD PROMPTLY USING THE ENCLOSED REPLY ENVELOPE.

Address Changes/Comments:

t none #D9D9D9 ;border-bottom:1pt none #D9D9D9 ;border-right:1pt none #D9D9D9 ;background-color: #C6D9F1;height:9.75pt;padding:0pt;">

Net income

$

52,163

$

45,692

$

156,000

$

144,557

Other comprehensive income, net of tax:

Foreign currency translation adjustments

(19,003)

9,418

(15,524)

(2,115)

Unrealized (loss) gain on investments, net of tax (benefit) expense of ($23) and ($19) in 2014 and $51 and $84 in 2013

(37)

86

(32)

142

Unrealized gain (loss) on derivative instruments:

Unrealized gain (loss), net of tax expense (benefit) of $2,809 and $1,796 in 2014 and ($1,512) and $1,278 in 2013

6,204

(3,601)

4,027

3,066

Less: reclassification adjustment for gains included in net income, net of tax expense (benefit) of $67 and ($24) in 2014 and $329 and $542 in 2013

(205)

(834)

(103)

(1,485)

Unrealized gain (loss) on derivative instruments

5,999

(4,435)

3,924

1,581

Other comprehensive (loss) income, net of tax

(13,041)

5,069

(11,632)

(392)

Comprehensive income

39,122

50,761

144,368

144,165

Less: comprehensive income attributable to noncontrolling interest

21

4

55

15

Comprehensive income attributable to IDEXX Laboratories, Inc.

$

39,101

$

50,757

$

144,313

$

144,150

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

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IDEXX LABORATORIES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(Unaudited)

	For the Nine Months Ended September 30, 2014	2013
Cash Flows from Operating Activities:		
Net income	$ 156,000	$ 144,557
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	43,610	41,130
Provision for uncollectible accounts	1,678	1,226
Benefit of deferred income taxes	(6,729)	(984)
Share-based compensation expense	13,463	12,265
Other	(79)	446
Tax benefit from share-based compensation arrangements	(9,581)	(7,438)
Changes in assets and liabilities:		
Accounts receivable	(8,464)	(12,795)
Inventories	(12,638)	(10,216)
Other assets	(3,375)	4,717
Accounts payable	6,876	3,958
Accrued liabilities	16,216	(335)
Deferred revenue	11,566	4,050
Net cash provided by operating activities	208,543	180,581
Cash Flows from Investing Activities:		
Purchases of property and equipment	(42,504)	(61,459)
Proceeds from disposition of pharmaceutical product lines	-	3,500
Proceeds from sale of equity investment	5,400	-
Acquisitions of a business, net of cash acquired	(7,516)	(10,101)
Acquisitions of intangible assets	(175)	(1,024)
Net cash used by investing activities	(44,795)	(69,084)
Cash Flows from Financing Activities:		
Borrowings on revolving credit facilities, net	98,000	185,200
Issuance of long-term debt	200,000	-
Debt issue costs	(1,357)	-
Payment of notes payable	(1,394)	(858)
Repurchases of common stock	(468,968)	(282,910)
Proceeds from exercises of stock options and employee stock purchase plans	18,361	21,734
Tax benefit from share-based compensation arrangements	9,581	7,438

Net cash used by financing activities	(145,777)	(69,396)
Net effect of changes in exchange rates on cash	(4,294)	(1,276)
Net increase in cash and cash equivalents	13,677	40,825
Cash and cash equivalents at beginning of period	279,058	223,986
Cash and cash equivalents at end of period	$ 292,735	$ 264,811

The accompanying notes are an integral part of these condensed consolidated financial statements.
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IDEXX LABORATORIES, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

NOTE 1. BASIS OF PRESENTATION AND PRINCIPLES OF CONSOLIDATION

The accompanying condensed consolidated financial statements of IDEXX Laboratories, Inc. and its subsidiaries have been prepared in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP") for interim financial information and with the requirements of Regulation S-X, Rule 10-01 for financial statements required to be filed as a part of this Quarterly Report on Form 10-Q. Unless the context requires otherwise, references in this Quarterly Report on Form 10-Q to "IDEXX," the "Company," "we," "our" or "us" refer to IDEXX Laboratories, Inc. and its subsidiaries.

The accompanying condensed consolidated financial statements include the accounts of IDEXX Laboratories, Inc. and our wholly-owned and majority-owned subsidiaries. We do not have any variable interest entities for which we are the primary beneficiary. All intercompany transactions and balances have been eliminated in consolidation.

The accompanying condensed consolidated financial statements reflect, in the opinion of our management, all adjustments necessary for a fair statement of our financial position and results of operations. All such adjustments are of a recurring nature. The consolidated balance sheet data at December 31, 2013 was derived from audited financial statements, but does not include all disclosures required by U.S. GAAP. The results of operations for the three and nine months ended September 30, 2014 are not necessarily indicative of the results to be expected for the full year or any future period. These condensed consolidated financial statements should be read in conjunction with this Quarterly Report on Form 10-Q for the quarter ended September 30, 2014 and our Annual Report on Form 10-K for the year ended December 31, 2013 (the "2013 Annual Report") filed with the Securities and Exchange Commission.

Reclassifications and Revisions

Certain prior year amounts have been reclassified to conform with the current year presentation. Such reclassifications had no material impact on previously reported results of operations, financial position or cash flows.

Revisions were made to the condensed consolidated statement of cash flows for the nine months ended September 30, 2013 to correctly reflect non-cash investing activities impacting accounts payable, accrued liabilities and inventory on the condensed consolidated balance sheets at September 30, 2013 and December 31, 2012. These revisions increased the operating cash flows related to the change in accounts payable, accrued liabilities and inventory for the nine months ended September 30, 2013 by $0.9 million from the amounts previously reported, and decreased investing cash flows related to purchases of property and equipment by the same amount. The revisions to the condensed consolidated statements of cash flows noted above represent an error that is not deemed to be material, individually or in the aggregate, to the prior period condensed consolidated financial statements.

Note 2. ACCOUNTING POLICIES

The significant accounting policies used in preparation of these condensed consolidated financial statements for the three and nine months ended September 30, 2014 are consistent with those discussed in Note 2 to the consolidated financial statements in our 2013 Annual Report.

Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board ("FASB") issued an amendment which will replace most of the existing revenue recognition guidance within U.S. GAAP. The core principle of this guidance is that an entity should recognize revenue for the transfer of goods or services to customers in an amount that it expects to be entitled to receive for those goods or services. In doing so, companies will be required to make certain judgments and estimates, including identifying contract performance obligations, estimating the amount of variable consideration to include in the transaction price and allocating the transaction price among separate performance obligations. Additionally, the amendment requires disclosure about the nature, amount, timing and uncertainty of revenue and cash flows arising from customer contracts, significant judgments reached in the application of the guidance and assets recognized from the costs to obtain or fulfill a contract. Effective for the Company beginning on January 1, 2017, the amendment allows for two methods of adoption, a full retrospective method or a modified retrospective approach with the cumulative effect recognized at the date of initial application. Early adoption is not permitted. We are in the process of determining the method of adoption and the impact of this amendment on our consolidated financial statements.

In August 2014, the FASB issued an amendment that requires management to assess an entity's ability to continue as a going concern by incorporating and expanding upon certain principles that are currently in U.S. auditing standards. The amendments in this update provide guidance about management's responsibility to evaluate whether there is substantial doubt about an entity's ability to continue as a going concern for one year after the date that the financial statements are issued and to provide related footnote disclosures. In doing so, the amendments should reduce diversity in the timing and content of footnote disclosures. The amendments in this update apply to all entities and are effective for the annual period ending after December 15, 2016, and for annual periods and interim periods thereafter. Early application is permitted. This amendment is not expected to have a material impact on our financial statements.

NOTE 3. SHARE-BASED COMPENSATION

The fair value of options, restricted stock units, deferred stock units and employee stock purchase rights awarded during the three and nine months ended September 30, 2014 totaled $1.0 million and $23.8 million, respectively, as compared to $0.3 million and $18.9 million for the three and nine months ended September 30, 2013, respectively. The total unrecognized compensation expense, net of estimated forfeitures, for unvested share-based compensation awards outstanding at September 30, 2014 was $41.2 million, which will be recognized over a weighted average period of approximately 1.8 years.

We determine the assumptions used in the valuation of option awards as of the date of grant. Differences in the expected stock price volatility, expected term or risk-free interest rate may necessitate distinct valuation assumptions at each grant date. As such, we may use different assumptions for options granted throughout the year. Option awards are granted with an exercise price equal to the closing market price of our common stock at the date of grant. We have never paid any cash dividends on our common stock, and we have no intention to pay such a dividend at this time; therefore, we assume that no dividends will be paid over the expected terms of option awards. The weighted averages of the valuation assumptions used to determine the fair value of each option award on the date of grant and the weighted average estimated fair values were as follows:

	For the Nine Months Ended September 30,			
	2014		2013	
Expected stock price volatility	28	%	33	%
Expected term, in years1	5.7		4.7	
Risk-free interest rate	1.5	%	0.9	%

Weighted average fair value of options granted	$ 36.14	$ 26.36

1 Options granted after May 8, 2013 have a contractual term of ten years. Options granted between January 1, 2013 and May 8, 2013 have a contractual term of seven years.

note 4. acquisitions and disposition of strategic investment

During the three months ended September 30, 2014, we paid an aggregate of $3.0 million in cash and recorded contingent consideration of $0.8 million upon the acquisition of substantially all of the assets of a business that offers a cloud-based software solution that supports veterinary preventive care plans. As part of this business acquisition, we recorded $3.1 million in amortizable intangible assets and $0.7 million in goodwill. Amortizable intangible assets primarily consisted of software which was assigned a useful life of 7 years. All assets acquired in connection with this business acquisition were assigned to our Companion Animal Group segment. Pro forma information has not been presented for this business acquisition because such information is not material to the financial statements.

In July 2014, we paid an aggregate of $3.0 million in cash and recorded contingent consideration of $1.1 million upon the acquisition of certain assets of a veterinary reference laboratory testing business, including a customer list in the U.S. Amortizable intangible assets primarily consisted of the aforementioned customer list, which was assigned a useful life of 14 years and was assigned to our Companion Animal Group segment. Pro forma information has not been presented for this business acquisition because such information is not material to the financial statements.

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In June 2014, we divested our investment in a company that owns and operates veterinary hospitals. Upon the closing date, we received proceeds of $5.4 million in exchange for two outstanding promissory notes of the company and its subsidiaries and our 11% equity interest in the company. This investment has been accounted for under the equity method of accounting since acquisition in the fourth quarter of 2010. Upon the disposition of this strategic investment, we realized a $0.7 million gain, which has been reflected as a reduction to general and administrative expense.

Note 5. Inventories

Inventories, which are stated at the lower of cost (first-in, first-out) or market, include material, conversion costs and inbound freight charges. The components of inventories were as follows (in thousands):

	September 30, 2014	December 31, 2013
Raw materials	$ 26,372	$ 23,766
Work-in-process	16,194	14,359
Finished goods	113,441	95,302
	$ 156,007	$ 133,427

Note 6. Goodwill and Intangible Assets, NET

The decrease in goodwill during the nine months ended September 30, 2014 resulted primarily from changes in foreign currency exchange rates. The increase in intangible assets other than goodwill during the nine months ended September 30, 2014 resulted primarily from intangibles recognized in connection with the acquisition of businesses, partly offset by the continued amortization of our intangible assets and, to a lesser extent, changes in foreign currency exchange rates. See Note 4 for information regarding amortizable intangible assets recognized in connection with the acquisition of businesses during the nine months ended September 30, 2014.

NOTE 7. Other NONCURRENT ASSETS

Other noncurrent assets consisted of the following (in thousands):

	September 30, 2014	December 31, 2013
Investment in long-term product supply arrangements	$ 11,078	$ 13,075
Customer acquisition costs, net	23,742	21,199
Other assets	25,743	22,957
	$ 60,563	$ 57,231

Note 8. Accrued liabilities

Accrued liabilities consisted of the following (in thousands):

	September 30, 2014	December 31, 2013
Accrued expenses	$ 47,502	$ 44,274
Accrued employee compensation and related expenses	70,521	62,474
Accrued taxes	17,314	16,508
Accrued customer programs	32,112	25,663
	$ 167,449	$ 148,919

Note 9. DEBT

In June 2014, we refinanced our existing $450.0 million unsecured revolving credit facility by entering into an amended and restated credit agreement relating to a five-year unsecured revolving credit facility in the principal amount of $700 million with a syndicate of multinational banks, which matures on June 18, 2019 (the new credit facility and the previous credit facility are referred to collectively as the “Credit Facility”) and requires no scheduled prepayments before that date. Although the Credit Facility does not mature until June 18, 2019, all amounts borrowed under the terms of the Credit Facility are reflected in the current liabilities section in the accompanying condensed consolidated balance sheets because the Credit Facility contains a subjective material adverse event clause, which allows the debt holders to call the loans under the Credit Facility if we fail to provide prompt written notice to the syndicate of such an event. At September 30, 2014 and December 31, 2013, we had $375.0 million and $277.0 million, respectively, outstanding under the Credit Facility with a weighted average effective interest rate of 1.6%. The funds available under the Credit Facility at September 30, 2014 and December 31, 2013 reflect a further reduction due to the issuance of a letter of credit for $1.0 million, which was issued in connection with our workers' compensation policy.

Applicable interest rates on borrowings under the Credit Facility generally range from 0.875 to 1.375 percentage points (“Credit Spread”) above the London interbank offered rate or the Canadian Dollar-denominated bankers' acceptance rate, based on our leverage ratio, or the prevailing prime rate plus a maximum spread of up to 0.375%, based on our leverage ratio. We have entered into forward fixed interest rate swap agreements to manage the economic effect of the first $80 million of variable interest rate borrowings. As such, we continue to designate the existing interest rate swaps as cash flow hedges. See Note 17 for a discussion of our derivative instruments and hedging activities. Under the Credit Facility, we pay quarterly commitment fees of 0.15% to 0.35%, based on our leverage ratio, on any unused commitment.

The obligations under the Credit Facility may be accelerated upon the occurrence of an event of default under the Credit Facility, which includes customary events of default, including payment defaults, defaults in the performance of the affirmative, negative and financial covenants, the inaccuracy of representations or warranties, bankruptcy and insolvency related defaults, defaults relating to judgments, certain events related to employee pension benefit plans under the Employee Retirement Income Security Act of 1974, the failure to pay specified indebtedness and a change of control default. The Credit Facility contains affirmative, negative and financial covenants customary for financings of this type. The negative covenants include restrictions on liens, indebtedness of subsidiaries of the Company, fundamental changes, investments, transactions with affiliates and certain restrictive agreements. The financial covenant is a consolidated leverage ratio test that requires our ratio of debt to earnings before interest, taxes, depreciation, amortization and share-based compensation, defined as the consolidated leverage ratio under the terms of the Credit Facility, not to exceed 3.5-to-1. At September 30, 2014, we were in compliance with the covenants of the Credit Facility.

In December 2013, we issued and sold through a private placement an aggregate principal amount of $150 million of senior notes consisting of $75 million of 3.94% Series A Senior Notes due December 11, 2023 (the “2023 Notes”) and $75 million of 4.04% Series B Senior Notes due December 11, 2025 (the “2025 Notes” and together with the 2023 Notes, the “December Notes”) under a Note Purchase Agreement among the Company, New York Life Insurance Company and the accredited institutional purchasers named therein (the “December 2013 Note Agreement”).

In July 2014, we issued and sold through a private placement an aggregate principal amount of $125 million of senior notes consisting of $75 million of 3.76% Series B Senior Notes due July 21, 2024 (the "2024 Notes") and $50 million of 3.32% Series A Senior Notes due July 21, 2021 (the "2021 Notes" and together with the 2024 Notes, the "Prudential Notes") under a Note Purchase and Private Shelf Agreement among the Company, Prudential Investment Management, Inc. and the accredited institutional purchasers named therein (the "July 2014 Note Agreement").

In September 2014, we issued and sold through a private placement an aggregate principal amount of $75 million of 3.72% Senior Notes due September 4, 2026 (the "2026 Notes" and together with the Prudential Notes and the December Notes, the "Senior Notes") under a Note Purchase Agreement dated as of July 22, 2014 among the Company, New York Life Insurance Company and the accredited institutional purchasers named therein (such agreement, together with July 2014 Note Agreement and December 2013 Note Agreement, the "Senior Note Agreements").

The Senior Note Agreements contain affirmative, negative and financial covenants customary for agreements of this type. The negative covenants include restrictions on liens, indebtedness of our subsidiaries, priority indebtedness, fundamental changes, investments, transactions with affiliates, certain restrictive agreements and violations of laws and regulations. The financial covenant is a consolidated leverage ratio test that requires our ratio of debt to earnings before interest, taxes, depreciation, amortization and share-based compensation, as defined in the Senior Note Agreements, not to exceed 3.5-to-1. At September 30, 2014, we were in compliance with the covenants of the Senior Note Agreements.

Should we elect to prepay the Senior Notes, such aggregate prepayment will include the applicable make-whole amount(s), as defined within the applicable Senior Note Agreements. Additionally, in the event of a change in control of the Company or upon the disposition of certain assets of the Company the proceeds of which are not reinvested (as defined in the Senior Note Agreements), we may be required to prepay all or a portion of the Senior Notes. The obligations under the Senior Notes may be accelerated upon the occurrence of an event of default under the applicable Senior Note Agreement, each of which includes customary events of default including payment defaults, defaults in the performance of the affirmative, negative and financial covenants, the inaccuracy of representations or warranties, bankruptcy and insolvency related defaults, defaults relating to judgments, certain events related to employee pension benefit plans under the Employee Retirement Income Security Act of 1974 and the failure to pay specified indebtedness.

In June 2014, we paid off the remaining outstanding principal balance on the mortgage related to our worldwide headquarters in Westbrook, Maine.

Note 10. Repurchases of common STOCK

The following is a summary of our open market common stock repurchases for the three and nine months ended September 30, 2014 and 2013 (in thousands, except per share amounts):

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2014	2013	2014	2013
Shares repurchased	2,197	801	3,746	3,139
Total cost of shares repurchased	$ 272,342	$ 76,575	$ 468,968	$ 282,910
Average cost per share	$ 123.98	$ 95.52	$ 125.18	$ 90.12

We primarily acquire shares by means of repurchases in the open market. However, we also acquire shares that are surrendered by employees in payment for the minimum required withholding taxes due on the vesting of restricted stock units and the settlement of deferred stock units, otherwise referred to herein as employee surrenders. The number of shares acquired through employee surrenders during both the three months ended September 30, 2014 and 2013 was not material. We acquired 42,742 shares having a total cost of $5.3 million in connection with such employee surrenders during the nine months ended September 30, 2014, as compared to 47,483 shares having a total cost of $4.3 million during the nine months ended September 30, 2013.

We issue shares of treasury stock upon the vesting of certain restricted stock units and upon the exercise of certain stock options. The number of shares of treasury stock issued during both the nine months ended September 30, 2014 and 2013 was not material.

Note 11. Income Taxes

Our effective income tax rates were 23.5% and 28.0% for the three and nine months ended September 30, 2014, respectively, as compared to 29.1% and 28.9% for the three and nine months ended September 30, 2013, respectively.

The decrease in our effective income tax rate for the three months ended September 30, 2014, as compared to the same period of the prior year, was related to a non-recurring benefit related to the deferral of intercompany profits that were included in prior year tax provisions in error, which is not material to current or prior interim or annual periods, and higher relative earnings subject to international tax rates that are lower than domestic tax rates. These favorable factors were partly offset by the U.S. research and development ("R&D") tax credit which was not available during the three months ended September 30, 2014 because the legislation expired as of January 1, 2014.

The decrease in our effective income tax rate for the nine months ended September 30, 2014, as compared to the same period of the prior year, was related to higher relative earnings subject to international tax rates that are lower than domestic tax rates, a non-recurring benefit related to the deferral of intercompany profits that were included in prior year tax provisions in error, which is not material to current or prior interim or annual periods, and the resolution of domestic and international tax audits, which resulted in a net reduction in our provision for uncertain tax positions. These favorable factors were partly offset by the R&D tax credit, which expired as of January 1, 2014. During the three months ended March 31, 2013, legislation in the U.S. retroactively allowed the R&D tax credit for all of 2012 and extended the R&D tax credit through the year ending December 31, 2013. Because this legislation was enacted during the three months ended March 31, 2013, the full benefit of the credit related to the prior years' activities was recognized within that quarter.

Note 12. ACCUMULATED OTHER Comprehensive Income

The changes in accumulated other comprehensive income ("AOCI"), net of tax, for the nine months ended September 30, 2014 consisted of the following (in thousands):

For the Nine Months Ended September 30, 2014	Unrealized Gain on Investments, Net of Tax	Unrealized (Loss) Gain on Derivative Instruments, Net of Tax	Cumulative Translation Adjustment	Total
Balance as of December 31, 2013	$ 108	$ (179)	$ 13,693	$ 13,622
Other comprehensive (loss) income before reclassifications	(32)	4,027	(15,524)	(11,529)
Gains reclassified from accumulated other comprehensive income	-	(103)	-	(103)
Balance as of September 30, 2014	$ 76	$ 3,745	$ (1,831)	$ 1,990

The following is a summary of reclassifications out of AOCI for the three and nine months ended September 30, 2014 and 2013 (in thousands):

Details about AOCI Components	Affected Line Item in the Statement Where Net Income is Presented	Amounts Reclassified from AOCI For the Three Months Ended September 30, 2014	2013
Gains (losses) on derivative instruments classified as cash flow hedges included in net income:			
Foreign currency exchange contracts	Cost of revenue	$ 540	$ 1,294
Interest rate swaps	Interest expense	(268)	(131)
	Total gains before tax	272	1,163
	Tax expense	67	329
	Gains, net of tax	$ 205	$ 834

Details about AOCI Components	Affected Line Item in the Statement Where Net Income is Presented	Amounts Reclassified from AOCI For the Nine Months Ended September 30,

		2014	2013
Gains (losses) on derivative instruments classified as cash flow hedges included in net income:			
Foreign currency exchange contracts	Cost of revenue	$ 874	$ 2,659
Interest rate swaps	Interest expense	(795)	(632)
	Total gains before tax	79	2,027
	Tax (benefit) expense	(24)	542
	Gains, net of tax	$ 103	$ 1,485

Note 13. Earnings per Share

Basic earnings per share is computed by dividing net income attributable to IDEXX Laboratories, Inc. stockholders by the weighted average number of shares of common stock and vested deferred stock units outstanding during the year. The computation of diluted earnings per share is similar to the computation of basic earnings per share, except that the denominator is increased for the assumed exercise of dilutive options and assumed issuance of unvested restricted stock units and unvested deferred stock units using the treasury stock method unless the effect is anti-dilutive. The treasury stock method assumes that proceeds, including cash received from the exercise of employee stock options, the total unrecognized compensation expense for unvested share-based compensation awards and the excess tax benefits resulting from share-based compensation tax deductions in excess of the related expense recognized for financial reporting purposes, would be used to purchase our common stock at the average market price during the period. Vested deferred stock units outstanding are included in shares outstanding for basic and diluted earnings per share because the associated shares of our common stock are issuable for no cash consideration, the number of shares of our common stock to be issued is fixed and issuance is not contingent. See Note 4 to the consolidated financial statements in our 2013 Annual Report for additional information regarding deferred stock units.

The following is a reconciliation of shares outstanding for basic and diluted earnings per share for the three and nine months ended September 30, 2014 and 2013 (in thousands):

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2014	2013	2014	2013
Shares outstanding for basic earnings per share	49,745	52,450	50,821	53,562
Shares outstanding for diluted earnings per share:				
Shares outstanding for basic earnings per share	49,745	52,450	50,821	53,562
Dilutive effect of share-based payment awards	655	792	701	829
	50,400	53,242	51,522	54,391

Certain options to acquire shares have been excluded from the calculation of shares outstanding for diluted earnings per share because they were anti-dilutive. The following table presents information concerning those anti-dilutive options for the three and nine months ended September 30, 2014 and 2013 (in thousands):

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2014	2013	2014	2013
Weighted average number of shares underlying anti-dilutive options	365	561	311	530

Note 14. Commitments, Contingencies and Guarantees

Significant commitments, contingencies and guarantees at September 30, 2014 are consistent with those discussed in Note 14 to the consolidated financial statements in our 2013 Annual Report, with the exception of $200 million of long-term debt issued during the nine months ended September 30, 2014.

Note 15. Segment Reporting

Operating segments are defined as components of an enterprise about which separate financial information is available that is evaluated regularly by the chief operating decision-maker, or decision-making group, in deciding how to allocate resources and in assessing performance. Our chief operating decision-maker is our Chief Executive Officer. Our reportable segments include diagnostic and information technology-based products and services for the veterinary market, which we refer to as the Companion Animal Group ("CAG"), water quality products ("Water") and diagnostic tests for livestock and poultry health and to ensure the quality and safety of milk and food, which we refer to as Livestock, Poultry and Dairy ("LPD"). Our Other operating segment combines and presents products for the human point-of-care medical diagnostics market with our pharmaceutical product line and our out-licensing arrangements because they do not meet the quantitative or qualitative thresholds for reportable segments.

Items that are not allocated to our operating segments are as follows: a portion of corporate support function and personnel-related expenses; certain manufacturing costs; corporate research and development expenses that do not align with one of our existing business or service categories; the difference between estimated and actual share-based compensation expense; and certain foreign currency exchange gains and losses. These amounts are shown under the caption "Unallocated Amounts."

We estimate our share-based compensation expense, corporate support function expenses and certain personnel-related costs and allocate the estimated expenses to the operating segments. This allocation differs from actual expense and consequently yields a difference that is reported under the caption "Unallocated Amounts."

With respect to manufacturing costs, the costs reported in our operating segments include our standard cost for products sold and any variances from standard cost for products purchased or manufactured within the period. We capitalize these variances for inventory on hand at the end of the period to record inventory in accordance with U.S. GAAP. We then record these variances as cost of product revenue as that inventory is sold. The impact to cost of product revenue resulting from this variance capitalization and subsequent recognition is reported within the caption "Unallocated Amounts."

Additionally, in certain geographies where we maintain inventories in currencies other than the U.S. dollar, the product costs reported in our operating segments include our standard cost for products sold, which is stated at the budgeted currency exchange rate from the beginning of the fiscal year. In these geographies, the variances from standard cost for products sold related to changes in currency exchange rates are reported within the caption "Unallocated Amounts."

The following is a summary of segment performance for the three and nine months ended September 30, 2014 and 2013 (in thousands):

	For the Three Months Ended September 30,					
	CAG	Water	LPD	Other	Unallocated Amounts	Consolidated Total
2014						
Revenue	$ 320,724	$ 25,747	$ 29,648	$ 7,404	$ -	$ 383,523
Income (loss) from operations	$ 62,608	$ 11,367	$ 3,886	$ 794	$ (6,466)	$ 72,189
Interest expense, net						(3,981)
Income before provision for income taxes						68,208
Provision for income taxes						16,045
Net income						52,163
Less: Net income attributable to noncontrolling interest						21
Net income attributable to IDEXX Laboratories, Inc. stockholders						$ 52,142
2013						
Revenue	$ 283,843	$ 23,247	$ 25,131	$ 6,076	$ -	$ 338,297
Income from operations	$ 52,711	$ 10,414	$ 1,125	$ 612	$ 623	$ 65,485
Interest expense, net						(1,007)
Income before provision for income taxes						64,478
Provision for income taxes						18,786
Net income						45,692
Less: Net income attributable to noncontrolling interest						4
Net income attributable to IDEXX Laboratories, Inc. stockholders						$ 45,688

	For the Nine Months Ended September 30,					
	CAG	Water	LPD	Other	Unallocated Amounts	Consolidated Total
2014						
Revenue	$ 949,009	$ 71,655	$ 93,738	$ 19,446	$ -	$ 1,133,848
Income (loss) from operations	$ 188,820	$ 29,547	$ 17,669	$ 1,134	$ (11,716)	$ 225,454
Interest expense, net						(8,761)

Income before provision for income taxes						216,693
Provision for income taxes						60,693
Net income						156,000
Less: Net income attributable to noncontrolling interest						55
Net income attributable to IDEXX Laboratories, Inc. stockholders						$ 155,945
2013						
Revenue	$ 856,617	$ 66,297	$ 81,448	$ 18,623	$ -	$ 1,022,985
Income (loss) from operations	$ 167,377	$ 28,682	$ 9,176	$ 1,888	$ (1,689)	$ 205,434
Interest expense, net						(2,132)
Income before provision for income taxes						203,302
Provision for income taxes						58,745
Net income						144,557
Less: Net income attributable to noncontrolling interest						15
Net income attributable to IDEXX Laboratories, Inc. stockholders						$ 144,542

The following is a summary of revenue by product and service category for the three and nine months ended September 30, 2014 and 2013 (in thousands):

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2014	2013	2014	2013
CAG segment revenue:				
CAG Diagnostics recurring revenue:	$ 277,957	$ 242,163	$ 818,327	$ 734,989
IDEXX VetLab® consumables	90,971	76,080	264,405	230,637
VetLab service and accessories	13,716	12,749	40,332	37,312
Rapid assay products	46,777	43,042	139,329	133,182
Reference laboratory diagnostic and consulting services	126,493	110,292	374,261	333,858
CAG Diagnostics capital - instruments	18,040	19,115	55,508	55,702
Customer information management and digital imaging systems	24,727	22,565	75,174	65,926
CAG segment revenue	320,724	283,843	949,009	856,617
Water segment revenue	25,747	23,247	71,655	66,297
LPD segment revenue	29,648	25,131	93,738	81,448
Other segment revenue	7,404	6,076	19,446	18,623
Total revenue	$ 383,523	$ 338,297	$ 1,133,848	$ 1,022,985

Note 16. FAIR VALUE MEASUREMENTS

U.S. GAAP defines fair value as 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. U.S. GAAP requires an entity to maximize the use of observable inputs, where available, and minimize the use of unobservable inputs when measuring fair value.

The Company has certain financial assets and liabilities that are measured at fair value on a recurring basis, certain nonfinancial assets and liabilities that may be measured at fair value on a nonrecurring basis and certain financial assets and liabilities that are not measured at fair value in our condensed consolidated balance sheets but for which we disclose the fair value. The fair value disclosures of these assets and liabilities are based on a three-level hierarchy, which is defined as follows:

Level 1	Quoted prices in active markets for identical assets or liabilities that the entity can access at the measurement date.
Level 2	Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3	Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

Assets and liabilities measured at fair value are classified in their entirety based on the lowest level of input that is significant to the fair value measurement. Our assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment and considers factors specific to the asset or liability. We did not have any transfers between Level 1 and Level 2 or transfers in or out of Level 3 of the fair value hierarchy during the nine months ended September 30, 2014.

Our foreign currency exchange contracts and interest rate swap agreements are measured at fair value on a recurring basis in our accompanying condensed consolidated balance sheets. We measure the fair value of our foreign currency exchange contracts classified as derivative instruments using an income approach, based on prevailing market forward rates less the contract rate multiplied by the notional amount. The product of this calculation is then adjusted for counterparty risk. We measure the fair value of our interest rate swaps classified as derivative instruments using an income approach, utilizing a discounted cash flow analysis based on the terms of the contract and the interest rate curve adjusted for counterparty risk.

The amount outstanding under our Credit Facility, notes receivable and long-term debt are measured at carrying value in our accompanying condensed consolidated balance sheets though we disclose the fair value of these financial instruments. We determine the fair value of the amount outstanding under our Credit Facility, notes receivable and long-term debt using an income approach, utilizing a discounted cash flow analysis based on current market interest rates for debt issues with similar remaining years to maturity, adjusted for applicable credit risk. Our Credit Facility and long-term debt are valued using Level 2 inputs. The estimated fair value of our Credit Facility approximates its carrying value. At September 30, 2014, the estimated fair value and carrying value of our long-term debt were $361.7 million and $350.0 million, respectively. As of December 31, 2013, the carrying value of our long-term debt approximated its fair value. During the nine months ended September 30, 2014, we disposed of notes receivable representing a strategic investment in a privately held company. As of December 31, 2013, these notes receivable had a carrying value that approximated their fair value of $5.1 million and were valued using Level 3 inputs. See Note 4 for further information regarding the disposition of the notes receivable during June 2014.

The following tables set forth our assets and liabilities that were measured at fair value on a recurring basis at September 30, 2014 and at December 31, 2013 by level within the fair value hierarchy (in thousands):

As of September 30, 2014	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance at September 30, 2014
Assets				
Money market funds(1)	$ 164,740	$ -	$ -	$ 164,740
Equity mutual funds(2)	2,671	-	-	2,671
Foreign currency exchange contracts(3)	-	7,292	-	7,292
Liabilities				
Foreign currency exchange contracts(3)	-	1,091	-	1,091
Deferred compensation(4)	2,671	-	-	2,671
Interest rate swaps(5)	-	1,242	-	1,242

As of December 31, 2013	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance at December 31, 2013
Assets				
Money market funds(1)	$ 153,109	$ -	$ -	$ 153,109
Equity mutual funds(2)	2,847	-	-	2,847
Foreign currency exchange contracts(3)	-	4,044	-	4,044

Liabilities				
Foreign currency exchange contracts(3)	-	3,096	-	3,096
Deferred compensation(4)	2,847	-	-	2,847
Interest rate swaps(5)	-	1,821	-	1,821

(1) Money market funds are included within cash and cash equivalents. The remaining balance of cash and cash equivalents as of September 30, 2014 and December 31, 2013 consisted of demand deposits.
(2) Equity mutual funds relate to a deferred compensation plan that was assumed as part of a previous business combination. This amount is included within other long-term assets, net. See number (4) below for a discussion of the related deferred compensation liability.
(3) Foreign currency exchange contracts are included within other current assets; other long-term assets, net; accrued liabilities; or other long-term liabilities depending on the gain (loss) position and anticipated settlement date.
(4) A deferred compensation plan assumed as part of a previous business combination is included within other long-term liabilities. The fair value of our deferred compensation plan is indexed to the performance of the underlying equity mutual funds discussed in number (2) above.
(5) Interest rate swaps are included within accrued liabilities.

The estimated fair value of certain financial instruments, including cash and cash equivalents, accounts receivable and accounts payable, approximate carrying value due to their short maturity.

Note 17. Derivative Instruments and Hedging

Disclosure within this footnote is presented to provide transparency about how and why we use derivative instruments, how the instruments and related hedged items are accounted for, and how the instruments and related hedged items affect our financial position, results of operations and cash flows.

We are exposed to certain risks related to our ongoing business operations. The primary risks that we manage by using derivative instruments are foreign currency exchange risk and interest rate risk. Our subsidiaries enter into foreign currency exchange contracts to manage the exchange risk associated with their forecasted intercompany inventory purchases and sales for the next year. From time to time, we may also enter into foreign currency exchange contracts to minimize the impact of foreign currency fluctuations associated with specific, significant transactions. We enter into interest rate swaps to minimize the impact of interest rate fluctuations associated with our variable-rate Credit Facility.

The primary purpose of our foreign currency hedging activities is to protect against the volatility associated with foreign currency transactions, including transactions denominated in euro, British pound, Japanese yen, Canadian dollar, Australian dollar and Swiss franc. We also utilize natural hedges to mitigate our transaction and commitment exposures. Our corporate policy prescribes the range of allowable hedging activity. We enter into foreign currency exchange contracts with large multinational financial institutions and we do not hold or engage in transactions involving derivative instruments for purposes other than risk management.

We recognize all derivative instruments, including our foreign currency exchange contracts and interest rate swap agreements, on the balance sheet at fair value at the balance sheet date. Derivative instruments that do not qualify for hedge accounting treatment must be recorded at fair value through earnings. To qualify for hedge accounting treatment, cash flow hedges must be highly effective in offsetting changes to expected future cash flows on hedged transactions. If a derivative instrument qualifies for hedge accounting, changes in the fair value of the derivative instrument from the effective portion of the hedge are deferred in AOCI, net of tax, and reclassified into earnings in the same period or periods during which the hedged transaction affects earnings. We immediately record in earnings the extent to which a hedge instrument is not effective in achieving offsetting changes in fair value. We de-designate derivative instruments from hedge accounting when the likelihood of the hedged transaction occurring becomes less than probable. For de-designated instruments, the gain or loss from the time of de-designation through maturity of the instrument is recognized in earnings. Any gain or loss in AOCI at the time of de-designation is reclassified into earnings in the same period or periods during which the hedged transaction affects earnings. See Note 12 for further information regarding the effect of derivative instruments designated as cash flow hedges on the condensed consolidated statements of operations for the three and nine months ended September 30, 2014 and 2013.

We enter into master netting arrangements with the counterparties to our derivative transactions which permit outstanding receivables and payables to be offset in the event of default. Our derivative contracts do not require either party to post cash collateral. We elect to present our derivative assets and liabilities in the accompanying condensed consolidated balance sheets on a gross basis. All cash flows related to our foreign currency exchange contracts and interest rate swaps are classified as operating cash flows, which is consistent with the cash flow treatment of the underlying items being hedged.

Cash Flow Hedges

We have designated our foreign currency exchange contracts and variable-to-fixed interest rate swaps as cash flow hedges as these derivative instruments mitigate the exposure to variability in the cash flows of forecasted transactions attributable to foreign currency exchange and interest rates. Unless noted otherwise, we have also designated our derivative instruments as qualifying for hedge accounting treatment.

We did not de-designate any instruments from hedge accounting treatment during the three and nine months ended September 30, 2014 or 2013. Gains or losses related to hedge ineffectiveness recognized in earnings during the three and nine months ended September 30, 2014 and 2013 were not material. At September 30, 2014, the estimated amount of net gains, net of income tax expense, which are expected to be reclassified out of AOCI and into earnings within the next 12 months, is $3.0 million if exchange and interest rates do not fluctuate from the levels at September 30, 2014.

We enter into foreign currency exchange contracts for amounts that are less than the full value of forecasted intercompany inventory purchases and sales. Our hedging strategy related to intercompany inventory purchases and sales is to employ the full amount of our hedges for the succeeding year at the conclusion of our budgeting process for that year. We primarily utilize foreign currency exchange contracts with durations of less than 24 months. Quarterly, we enter into contracts to hedge incremental portions of anticipated foreign currency transactions for the current and following year. As a result, our risk with respect to foreign currency exchange rate fluctuations and the notional value of foreign currency exchange contracts may vary throughout the year. The U.S. dollar is the currency purchased or sold in all of our foreign currency exchange contracts. The notional amount of foreign currency exchange contracts to hedge forecasted intercompany inventory purchases and sales totaled $216.0 million and $168.3 million at September 30, 2014 and December 31, 2013, respectively.

We have entered into forward fixed interest rate swap agreements to manage the economic effect of variable interest obligations on amounts borrowed under the terms of our Credit Facility. The variable interest rate associated with $40 million of borrowings outstanding under the Credit Facility is effectively fixed at 1.36% plus the Credit Spread through June 30, 2016. Additionally, the variable interest rate associated with an additional $40 million of borrowings outstanding under the Credit Facility is effectively fixed at 1.64% plus the Credit Spread through June 30, 2016.

The fair values of derivative instruments and their respective classification on the condensed consolidated balance sheets and amounts subject to offset under master netting arrangements consisted of the following (in thousands):

		Asset Derivatives	
		September 30, 2014	December 31, 2013
Derivatives designated as hedging instruments	Balance Sheet Classification		
Foreign currency exchange contracts	Other current assets	$ 6,015	$ 4,044
Foreign currency exchange contracts	Other long-term assets, net	1,277	-
Total derivative instruments presented on the balance sheet		7,292	4,044
Gross amounts subject to master netting arrangements not offset on the balance sheet		1,091	2,965
Net amount		$ 6,201	$ 1,079

		Liability Derivatives	
		September 30, 2014	December 31, 2013
Derivatives designated as hedging instruments	Balance Sheet Classification		
Foreign currency exchange contracts	Accrued liabilities	$ 933	$ 3,096
Foreign currency exchange contracts	Other long-term liabilities	158	-
Interest rate swaps	Accrued liabilities	1,242	1,821
Total derivative instruments presented on the balance sheet		2,333	4,917
Gross amounts subject to master netting arrangements not offset on the balance sheet		1,091	2,965
Net amount		$ 1,242	$ 1,952

The effect of derivative instruments designated as cash flow hedges on the condensed consolidated balance sheets consisted of the following (in thousands):

	Gain (Loss) Recognized in AOCI on Derivative Instruments (Effective Portion)			
	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
Derivative instruments	2014	2013	2014	2013
Foreign currency exchange contracts, net of tax	$ 5,775	$ (4,380)	$ 3,560	$ 1,117
Interest rate swaps, net of tax	224	(55)	364	464
Total derivative instruments, net of tax	$ 5,999	$ (4,435)	$ 3,924	$ 1,581

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Item 2.Management’s Discussion and Analysis of Financial Condition and Results of Operations.

This Quarterly Report on Form 10-Q contains statements which, to the extent they are not statements of historical fact, constitute “forward-looking statements.” Such forward-looking statements about our business and expectations within the meaning of the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, include statements relating to future revenue growth rates, earnings and other measures of financial performance; the effect of economic conditions on our business performance; demand for our products; realizability of assets; future cash flow and uses of cash; future repurchases of common stock; future levels of indebtedness and capital spending; interest expense; warranty expense; share-based compensation expense; and competition. Forward-looking statements can be identified by the use of words such as “expects,” “may,” “anticipates,” “intends,” “would,” “will,” “plans,” “believes,” “estimates,” “should,” and simi expressions. These forward-looking statements are intended to provide our current expectations or forecasts of future events, are based on current estimates, projections, beliefs, and assumptions, and are not guarantees of future performance. Actual events or results may differ materially from those described in the forward-looking statements. These forward-looking statements involve a number of risks and uncertainties described in our Annual Report on Form 10-K for the year ended December 31, 2013 (the “2013 Annual Report”) and this Quarterly Report on Form 10-Q, as well as those described from time to time in our other periodic reports filed with the Securities and Exchange Commission (the “SEC”).

Any forward-looking statements represent our estimates only as of the day this Quarterly Report on Form 10-Q was first filed with the SEC and should not be relied upon as representing our estimates as of any subsequent date. From time to time, oral or written forward-looking statements may also be included in other materials released to the public. While we may elect to update forward-looking statements at some point in the future, we specifically disclaim any obligation to do so, even if our estimates or expectations change.

You should read the following discussion and analysis in conjunction with our 2013 Annual Report that includes additional information about us, our results of operations, our financial position and our cash flows, and with our unaudited condensed consolidated financial statements and related notes included in Part I, Item 1 of this Quarterly Report on Form 10-Q.

§ Business Overview and Trends

Operating Segments. We operate primarily through three business segments: diagnostic and information technology-based products and services for the veterinary market, which we refer to as the Companion Animal Group (“CAG”), water quality products (“Water”) and diagnostic tests for livestock and poultry health and to ensure the quality and safety of milk and food, which we refer to as Livestock, Poultry and Dairy (“LPD”). Our Other operating segment combines and presents products for the human point-of-care medical diagnostics market (“OPTI Medical”) with our pharmaceutical product line and our out-licensing arrangements because they do not meet the quantitative or qualitative thresholds for reportable segments.

CAG develops, designs, manufactures and distributes products and performs services for veterinarians and the bioresearch market, primarily related to diagnostics and information management. Water develops, designs, manufactures and distributes a range of products used in the detection of various microbiological parameters in water. LPD develops, designs, manufactures and distributes diagnostic tests and related instrumentation that are used to detect a wide range of diseases and monitor the health status in livestock and poultry, as well as products that ensure the quality and safety of milk and food. OPTI Medical develops, designs, manufactures and distributes point-of-care electrolyte and blood gas analyzers and related consumable products for the human medical diagnostics market.

Effects of Certain Factors on Results of Operations

Distributor Purchasing and Inventories. The instrument consumables and rapid assay products in our CAG segment are sold in the U.S. and certain other geographies by third party distributors, who purchase products from us and sell them to veterinary practices, which are the end users. As a result, distributor purchasing dynamics have an impact on our reported sales of these products. Distributor purchasing dynamics may be affected by many factors and in a given period may not be directly related to underlying end-user demand for our products. Consequently, reported results may reflect fluctuations in inventory levels held at distributors and may not necessarily reflect changes in underlying end-user demand. Therefore, we believe it is important to track distributor sales to end users by our significant distributors and to distinguish between the impact of end-user demand and the impact of distributor purchasing dynamics on reported revenue. We are unable to obtain data for sales to end users from certain less significant third party distributors internationally. We do not believe the impact of changes in these distributors' inventories would have a material impact on our growth rates.

Where growth rates are affected by changes in end-user demand, we refer to this as the impact of practice-level sales on growth. Where growth rates are affected by distributor purchasing dynamics, we refer to this as the impact of changes in distributors' inventories on growth. If during the current year, distributors' inventories grew by less than those inventories grew in the comparable period of the prior year, then changes in distributors' inventories have an unfavorable impact on our reported sales growth in the current period. Conversely, if during the current year distributors' inventories grew by more than those inventories grew in the comparable period of the prior year, then changes in distributors' inventories have a favorable impact on our reported sales growth in the current period.

We believe that our U.S. CAG distributors typically hold inventory equivalent to approximately three to four weeks of the anticipated end-user demand for VetLab consumables and rapid assay products at the end of a quarter.

Effective January 1, 2015, we plan to be fully transitioned to an all-direct sales strategy in the U.S. and will not renew our current annual contracts with our U.S. distribution partners. Under this approach, we intend to take orders, ship product, invoice and receive payment for all rapid assay test kits and instrument consumables in the U.S., aligning with our direct model for instruments, reference laboratory services, and other CAG products and services.

We have incurred and will continue to incur transition costs to implement this all-direct sales strategy in the U.S. We incurred approximately $0.4 million during the third quarter of 2014 in incremental expense as we ramped up sales and operating resources. We now anticipate full year 2014 incremental expenses of approximately $6 million related to the ramp of sales and operating resources, which is a reduction from our previous estimate of $8 million reflecting the timing of resource additions. We also incurred $4.3 million in non-recurring expenses during the third quarter of 2014 associated with project management and other one-time costs required to implement this new strategy. We continue to anticipate full year 2014 non-recurring expenses of $10 million to $12 million related to the all-direct transition.

Previously, we noted that further transitional impacts related to the drawdown of inventory held by distributors would occur primarily in the first quarter of 2015 and we would incur $2 million to $3 million in remaining project management expenses in early 2015. Given our progress in advancing operational plans to support the transition, we now expect one-time transitional impacts related to the drawdown of distributor inventory will occur primarily in the fourth quarter of 2014 and will result in a reduction in revenue and operating profit of $18 million to $23 million and $15 million to $19 million, respectively, which represents a decrease from our previous estimates of $30 million to $35 million, and $23 million to $27 million, respectively. The higher end of the estimated impact range corresponds with the full estimated impact of the inventory drawdown impact. To the degree that impacts are below the high end of the estimated impact range in 2014, there may be limited carryover revenue and operating profit impact in the first quarter of 2015. We now expect to incur limited additional project management expenses in early 2015.

On January 1, 2015, we will begin recognizing revenue on rapid assay kits and instrument consumables upon delivery to end users in the U.S., instead of at distribution. We continue to expect to capture an additional $50 million to $55 million in annual revenue on these direct sales. We estimate that annual operating profit associated with this incremental revenue stream will increase approximately $5 million to $8 million in 2015 and will continue to provide accretive benefits that will scale over time based on our expected future growth rates.

Also as a result of the transition to an all-direct sales strategy in the U.S., we anticipate increased working capital demands of approximately $15 million to $20 million, including inventory costs previously held by our distributors and incremental accounts receivable resulting from a potentially longer elapsed time to collect our receivables.

Currency Impact. For the three and nine months ended September 30, 2014, approximately 26% and 27%, respectively, of our consolidated revenue was derived from products manufactured in the U.S. and sold internationally in local currencies. For the three and nine months ended September 30, 2013, approximately 25% and 26%, respectively, of our consolidated revenue was derived from products manufactured in the U.S. and sold internationally in local currencies. Strengthening of the rate of exchange for the U.S. dollar relative to other currencies has a negative impact on our revenues derived in currencies other than the U.S. dollar and on profits of products manufactured in the U.S. and sold internationally, and a weakening of the U.S. dollar has the opposite effect. Similarly, to the extent that the U.S. dollar is stronger in current or future periods relative to the exchange rates in effect in the corresponding prior periods, our growth rate will be negatively affected. The impact of foreign currency denominated operating expenses and foreign currency denominated supply contracts partly offsets this exposure. Additionally, our designated hedges of intercompany inventory purchases and sales help delay the impact of certain exchange rate fluctuations on non-U.S. denominated revenues.

The impact on revenue resulting from changes in foreign currency exchange rates is not a measure defined by accounting principles generally accepted in the United States of America (“U.S. GAAP”), otherwise referred to herein as a non-GAAP financial measure. As exchange rates are an important factor in understanding period-to-period comparisons, we believe the presentation of results normalized for changes in currency in addition to reported results helps improve investors’ ability to understand our operating results and evaluate our performance in comparison to prior periods.

Effective January 1, 2014, we calculate the impact on revenue resulting from changes in foreign currency exchange rates by applying the difference between the weighted average exchange rates during the current year period and the comparable previous year period to foreign currency denominated revenues for the prior year period. Prior to January 1, 2014, we calculated this impact by applying the difference between the weighted average exchange rates during the current year period and the comparable previous year period to foreign currency denominated revenues for the current year period. This change in methodology, which was implemented to achieve operational efficiencies, has not had a material impact on organic revenue growth. See the subsection below titled “Results of Operations” for the definition of and other information regarding organic revenue growth.

During the three months ended September 30, 2014, as compared to the three months ended September 30, 2013, total company revenue attributable to changes in foreign currency exchange rates remained relatively consistent, as the weakening of the U.S. dollar against the British pound was almost entirely offset by the strengthening of the U.S. dollar against the Canadian dollar and Japanese yen.

During the nine months ended September 30, 2014, as compared to the nine months ended September 30, 2013, changes in foreign currency exchange rates increased total company revenue by approximately $1.7 million, due primarily to the weakening of the U.S. dollar against the euro and British pound, partly offset by the strengthening of the U.S. dollar against the Canadian dollar, Australian dollar and Japanese yen.

Effects of Economic Conditions. Demand for our products and services is vulnerable to changes in the economic environment, including slow economic growth, high unemployment and credit availability. Negative or cautious consumer sentiment can lead to reduced or delayed consumer spending, resulting in a decreased number of patient visits to veterinary clinics. Unfavorable economic conditions can impact sales of instruments, digital radiography and practice management systems, which are larger capital purchases for veterinarians. Additionally, economic turmoil can cause our customers to remain sensitive to the pricing of our products and services. We monitor patient visits and clinic revenue data provided by a subset of our CAG customers. Although limited and susceptible to short-term impacts such as weather, we believe that this data provides a fair and meaningful long-term representation of the trend in patient visit activity in the U.S., providing us insight regarding demand for our products and services. We believe the overall trends in patient visits and capital investments since the beginning of the economic downturn in 2008 have had a slightly negative impact on our CAG segment revenue growth rates. Although the rate of growth has not been steady, we have seen an improvement in growth of patient visits since 2012.

Economic conditions can also affect the purchasing decisions of our Water and LPD business customers. In the past, water testing volumes have been susceptible to declines in discretionary testing and in mandated testing as a result of decreases in home and commercial construction. Fiscal difficulties can also reduce government funding for water and livestock testing programs.

We believe that the diversity of our products and services and the geographic diversity of our markets partially mitigate the effects of the economic environment and negative consumer sentiment on our revenue growth rates.

Effects of Patent Expiration. Some of our patents and licenses of patents and technologies from third parties expired during the nine months ended September 30, 2014, and we expect other patents and licenses to expire prior to the end of 2015. However, the expiration of these patents and licenses, individually or in the aggregate, is not expected to have a material effect on our financial position or future operations due to a range of factors, including our brand strength and reputation in the marketplace; the breadth, quality and integration of our product offerings; our existing customer relationships and our customer support; our sales force; the applicable regulatory approval status for certain products; our continued investments in innovative product improvements that often result in new technologies and/or additional patents; and our significant know-how, scale and investments related to manufacturing processes of associated product offerings.

§ Critical Accounting Policies and Estimates

The discussion and analysis of our financial condition and results of operations is based upon our condensed consolidated financial statements, which have been prepared in accordance with U.S. GAAP. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. We evaluate our estimates on an ongoing basis. We base our estimates on historical experience and on various assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates. The significant accounting policies used in preparation of these condensed consolidated financial statements for the three and nine months ended September 30, 2014 are consistent with those discussed in Note 2 to the consolidated financial statements in our 2013 Annual Report. The critical accounting policies and the significant judgments and estimates used in the preparation of our condensed consolidated financial statements for the three and nine months ended September 30, 2014 are consistent with those discussed in our 2013 Annual Report in the section under the heading "Part II, Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations—Critical Accounting Policies and Estimates."

§ Results of Operations

The following revenue analysis and discussion focuses on organic revenue growth. Organic revenue growth is a non-GAAP financial measure and represents the percentage change in revenue during the three and nine months ended September 30, 2014, as compared to the same period for the prior year, net of the effect of changes in foreign currency exchange rates and acquisitions. Organic revenue growth should be considered in addition to, and not as a replacement for or as a superior measure to, revenues reported in accordance with U.S. GAAP, and may not be comparable to similarly titled measures reported by other companies. Management believes that reporting organic revenue growth provides useful information to investors by facilitating easier comparisons of our revenue performance with prior and future periods and to the performance of our peers. We exclude the effect of changes in foreign currency exchange rates because changes in foreign currency exchange rates are not under management's control, are subject to volatility and can obscure underlying business trends. We exclude the effect of acquisitions because the nature, size and number of acquisitions can vary dramatically from period to period and therefore can also obscure underlying business trends.

Organic revenue growth and the percentage changes in revenue from foreign currency exchange rates and acquisitions are non-GAAP financial measures. See the subsection above titled "Effects of Certain Factors on Results of Operations – Currency Impact" for a description of the calculation of the percentage change in revenue resulting from changes in foreign currency exchange rates. The percentage change in revenue resulting from acquisitions represents incremental revenues attributable to acquisitions that have occurred since the beginning of the prior year period.

Three Months Ended September 30, 2014 Compared to Three Months Ended September 30, 2013

Revenue

Total Company. The following table presents revenue by operating segment:

Net Revenue (dollars in thousands)	For the Three Months Ended September 30, 2014	For the Three Months Ended September 30, 2013	Dollar Change	Percentage Change	Percentage Change from Currency	Percentage Change from Acquisitions	Organic Revenue Growth
CAG	$ 320,724	$ 283,843	$ 36,881	13.0%	-	0.2%	12.8%
Water	25,747	23,247	2,500	10.8%	0.5%	1.3%	9.0%
LPD	29,648	25,131	4,517	18.0%	0.1%	4.0%	13.9%
Other	7,404	6,076	1,328	21.9%	0.1%	-	21.8%
Total	$ 383,523	$ 338,297	$ 45,226	13.4%	-	0.6%	12.8%

U.S. and International Revenue. The following table provides further analysis of total company revenue by U.S. markets and non-U.S., or international, markets:

Net Revenue (dollars in thousands)	For the Three Months Ended September 30, 2014	For the Three Months Ended September 30, 2013	Dollar Change	Percentage Change	Percentage Change from Currency	Percentage Change from Acquisitions	Organic Revenue Growth
United States	$ 225,310	$ 200,408	$ 24,902	12.4%	-	0.1%	12.3%
International	158,213	137,889	20,324	14.7%	-	1.3%	13.4%
Total	$ 383,523	$ 338,297	$ 45,226	13.4%	-	0.6%	12.8%

The increase in both U.S. and international revenues was driven primarily by CAG Diagnostics recurring revenue. The increase in international revenues was driven by strong growth in Europe and Asia-Pacific markets, most significantly from the United Kingdom, Germany, Australia, France and China. The impact of changes in distributors' inventory levels increased reported U.S. revenue growth by 3%. The impact of changes in distributors' inventory levels did not have a significant impact on international revenue growth.

Companion Animal Group. The following table presents revenue by product and service category for CAG:

Net Revenue (dollars in thousands)	For the Three Months Ended September 30, 2014	For the Three Months Ended September 30, 2013	Dollar Change	Percentage Change	Percentage Change from Currency	Percentage Change from Acquisitions	Organic Revenue Growth
CAG Diagnostics recurring revenue:	$ 277,957	$ 242,163	$ 35,794	14.8%	0.1%	0.3%	14.4%
VetLab consumables	90,971	76,080	14,891	19.6%	0.3%	-	19.3%
VetLab service and accessories	13,716	12,749	967	7.6%	(0.3%)	-	7.9%
Rapid assay products	46,777	43,042	3,735	8.7%	(0.1%)	-	8.8%
Reference laboratory diagnostic and consulting services	126,493	110,292	16,201	14.7%	-	0.7%	14.0%
CAG Diagnostics capital - instruments	18,040	19,115	(1,075)	(5.6%)	(0.9%)	-	(4.7%)
Customer information							

management and digital imaging systems	24,727	22,565	2,162	9.6%	(0.3%)	-	9.9%
Net CAG revenue	$ 320,724	$ 283,843	$ 36,881	13.0%	-	0.2%	12.8%

The increase in CAG Diagnostics recurring revenue was due primarily to increased volumes and higher realized prices in both our reference laboratory diagnostic services and our VetLab consumables. The impact of changes in distributors' inventory levels increased reported CAG Diagnostics recurring revenue growth by 2%.

VetLab consumables revenue growth was due primarily to higher unit volumes. The increase in unit volumes resulted primarily from growth of our installed base of Catalyst Dx® and ProCyte Dx® instruments as a result of new customer acquisitions, as well as an increase in testing from existing customers, including those who upgraded to these instruments. Additionally, VetLab consumables revenue benefited from higher average unit sales prices resulting from price increases. The impact of changes in distributors' inventory levels increased reported consumables revenue growth by 5%.

VetLab service and accessories revenue growth was primarily a result of the increase in our installed base of instruments.

The increase in rapid assay revenue was due primarily to higher sales of both our canine and feline testing products resulting from an increase in U.S. practice-level sales volumes and price increases. The impact of changes in distributors' inventory levels increased reported rapid assay revenue growth by 4%.

The increase in reference laboratory diagnostic and consulting services revenue was due primarily to the impact of higher volumes throughout our worldwide network of laboratories resulting from increased testing from existing customers and the acquisition of new customers. Additionally, the increase in revenue was the result of higher average unit sales prices due to price increases.

The decrease in CAG Diagnostics capital instruments revenue was due primarily to the unfavorable impact of deferred revenue associated with preorders for our upcoming Catalyst OneTM analyzer and the impact of lower realized prices. Under our Catalyst One introductory offer, customers are provided with the right to use a Catalyst Dx instrument through the Catalyst One release date. As a result, we do not recognize instrument revenue for preorders relating to the Catalyst One introductory offer until the Catalyst One is delivered. These unfavorable impacts were partly offset by higher placements of our ProCyte hematology instrument in Europe and the U.S. For the three months ended September 30, 2014, nearly all of SNAP Pro® Mobile Device placements were made under a reagent rental program for which instrument revenue will be recognized with the future sale of consumables.

The increase in customer information management and digital imaging systems revenue was due primarily to higher support revenue, resulting from an increase in our installed base of practice management and digital imaging systems, and a growing Pet Health Network® Pro subscriber base.

Water. The increase in Water revenue resulted from higher sales volumes of our Colilert® products, due primarily to the acquisition of new customers in Europe and the United States.

Livestock, Poultry and Dairy. The increase in LPD revenue was due primarily to higher sales volumes of bovine test products worldwide. To a lesser extent, higher revenues also resulted from increased sales volumes of poultry tests in Europe. We continue to anticipate lower sales volumes of bovine test products in Europe resulting from the success of certain eradication programs and changes in Bovine Spongiform Encephalopathy (“BSE”) testing requirements, though we expect that these revenue declines will not be realized until 2015. The acquisition of a Brazilian distributor of our LPD products in the third quarter of 2013 added 4% to reported revenue growth for the three months ended September 30, 2014 as compared to the same period of the prior year.

Other. The increase in Other revenue resulted from higher sales volumes of consumables used with our OPTI Medical instruments and milestone revenue from our pharmaceutical out-licensing arrangements earned during the three months ended September 30, 2014.

Gross Profit

Total Company. The following table presents gross profit and gross profit percentages by operating segment:

Gross Profit	For the Three Months Ended	Percent of	For the Three Months Ended	Percent of	Dollar	Percentage

(dollars in thousands)	September 30, 2014	Revenue	September 30, 2013	Revenue	Change	Change
CAG	$ 176,036	54.9%	$ 152,359	53.7%	$ 23,677	15.5%
Water	17,341	67.4%	15,598	67.1%	1,743	11.2%
LPD	17,970	60.6%	13,140	52.3%	4,830	36.8%
Other	3,986	53.8%	2,978	49.0%	1,008	33.8%
Unallocated amounts	(1,997)	N/A	1,708	N/A	(3,705)	(216.9%)
Total Company	$ 213,336	55.6%	$ 185,783	54.9%	$ 27,553	14.8%

Companion Animal Group. Gross profit for CAG increased due to higher sales and an increase in the gross profit percentage to 55% from 54%. The increase in gross profit percentage was due primarily to lower overall VetLab product costs, price increases across our CAG Diagnostics recurring revenue portfolio and efficiencies realized throughout our reference laboratory operations.

Water. Gross profit for Water increased due primarily to higher sales. The slight increase in the gross profit percentage was due primarily to a decrease in overall manufacturing costs resulting from higher production volumes and a more favorable product mix consisting of higher relative sales of our Colilert products. These favorable impacts were partly offset by lower average unit sales prices in Latin America and Australia, and the unfavorable impact of currency resulting from lower relative hedging gains during the three months ended September 30, 2014 as compared to the same period of the prior year.

Livestock, Poultry and Dairy. Gross profit for LPD increased due primarily to an improvement in the gross profit percentage to 61% from 52% and higher sales. The increase in the gross profit percentage was due primarily to lower overall manufacturing costs driven by higher production volumes and, to a lesser extent, higher realized prices resulting from the acquisition of our distributor in Brazil in the third quarter of 2013.

Other. Gross profit for Other increased due to higher sales and an improvement in the gross profit percentage to 54% from 49%. The increase in the gross profit percentage was due primarily to milestone revenue related to our pharmaceutical out-licensing arrangements, for which there is no associated cost of revenue, and lower overall product costs in our OPTI Medical business. These favorable impacts were partly offset by lower average unit sales prices realized on our OPTI Medical instruments.

Unallocated Amounts. Gross profit for Unallocated Amounts decreased due primarily to an increase in certain manufacturing costs and changes in certain currency exchange rates.

The manufacturing costs reported in our operating segments include our standard cost for products sold and any variances from standard cost for products purchased or manufactured within the period. We capitalize these variances for inventory on hand at the end of the period to record inventory in accordance with U.S. GAAP. We then record these variances as cost of product revenue as that inventory is sold. The impact to cost of product revenue resulting from this variance capitalization and subsequent recognition is reported within the caption “Unallocated Amounts.” The net unfavorable impact to gross profit as a result of increased manufacturing costs was due to the capitalization of favorable manufacturing variances, primarily in our LPD business, during the three months ended September 30, 2014.

In certain geographies where we maintain inventories in currencies other than the U.S. dollar, the product costs reported in our operating segments include our standard cost for products sold, which is stated at the budgeted currency exchange rate from the beginning of the fiscal year. In these geographies, the variances from standard cost for products sold related to changes in currency exchange rates are reported within the caption “Unallocated Amounts.” The U.S. dollar strengthened significantly against the Japanese yen from the beginning of the prior fiscal year through September 30, 2013. The strengthening in the value of the U.S. dollar relative to the Japanese yen from the beginning of the current fiscal year through September 30, 2014 was less significant as compared to the same period of the prior year, resulting in a lower favorable variance within Unallocated Amounts relating to the cost of products sold in Japanese yen.

Operating Expenses and Operating Income

Total Company. The following tables present operating expenses and operating income by operating segment:

Operating Expenses (dollars in thousands)	For the Three Months Ended September 30, 2014	Percent of Revenue	For the Three Months Ended September 30, 2013	Percent of Revenue	Dollar Change	Percentage Change

CAG	$ 113,428	35.4%	$ 99,648	35.1%	$ 13,780	13.8%
Water	5,974	23.2%	5,184	22.3%	790	15.2%
LPD	14,084	47.5%	12,015	47.8%	2,069	17.2%
Other	3,192	43.1%	2,366	38.9%	826	34.9%
Unallocated amounts	4,469	N/A	1,085	N/A	3,384	311.9%
Total Company	$ 141,147	36.8%	$ 120,298	35.6%	$ 20,849	17.3%

Operating Income (dollars in thousands)	For the Three Months Ended September 30, 2014	Percent of Revenue	For the Three Months Ended September 30, 2013	Percent of Revenue	Dollar Change	Percentage Change
CAG	$ 62,608	19.5%	$ 52,711	18.6%	$ 9,897	18.8%
Water	11,367	44.1%	10,414	44.8%	953	9.2%
LPD	3,886	13.1%	1,125	4.5%	2,761	245.4%
Other	794	10.7%	612	10.1%	182	29.7%
Unallocated amounts	(6,466)	N/A	623	N/A	(7,089)	(1,137.9%)
Total Company	$ 72,189	18.8%	$ 65,485	19.4%	$ 6,704	10.2%

We incurred transition costs to implement an all-direct sales strategy within our CAG segment of approximately $4.8 million during the third quarter of 2014. For the three months ended September 30, 2014, Total Company operating income adjusted for the aforementioned transition costs was approximately $76.9 million and 20.1% of revenue, which represents an increase in operating income adjusted for transition costs of approximately $11.5 million and 17.5%, as compared to the three months ended September 30, 2013. Operating income adjusted for transition costs is a non-GAAP financial measure and should be considered in addition to, and not as a replacement for or as a superior measure to, operating income reported in accordance with U.S. GAAP. Management believes that reporting operating income excluding transition costs provides useful information to investors by facilitating easier comparisons of our operating income performance with prior and future periods and to the performance of our peers.

See the subsection above titled “Effects of Certain Factors on Results of Operations – Distributor Purchasing and Inventories” for details regarding anticipated transitional costs related to moving to an all-direct sales strategy for VetLab consumables and rapid assay products and services within our CAG segment in the U.S.

Companion Animal Group. The following table presents CAG operating expenses by functional area:

Operating Expenses (dollars in thousands)	For the Three Months Ended September 30, 2014	Percent of Revenue	For the Three Months Ended September 30, 2013	Percent of Revenue	Dollar Change	Percentage Change
Sales and marketing	$ 60,737	18.9%	$ 51,932	18.3%	$ 8,805	17.0%
General and administrative	34,874	10.9%	32,067	11.3%	2,807	8.8%
Research and development	17,817	5.6%	15,649	5.5%	2,168	13.9%
Total operating expenses	$ 113,428	35.4%	$ 99,648	35.1%	$ 13,780	13.8%

The increase in sales and marketing expense resulted from non-recurring consulting costs related to the aforementioned implementation of an all-direct sales strategy in the U.S., as well as higher personnel-related costs across all major regions, including our North American sales force transformation beginning in the second half of 2013 and increased commissions resulting from improved sales performance. The increase in general and administrative expense resulted primarily from higher personnel-related costs and, to a lesser extent, depreciation of internal-use software. The increase in research and development expense resulted primarily from higher personnel-related costs and increased materials costs, partly offset by lower external consulting and development costs.

Water. The following table presents Water operating expenses by functional area:

Operating Expenses (dollars in thousands)	For the Three Months Ended September 30, 2014	Percent of Revenue	For the Three Months Ended September 30, 2013	Percent of Revenue	Dollar Change	Percentage Change
Sales and marketing	$ 2,896	11.2%	$ 2,443	10.5%	$ 453	18.5%
General and administrative	2,336	9.1%	2,114	9.1%	222	10.5%
Research and development	742	2.9%	627	2.7%	115	18.3%
Total operating expenses	$ 5,974	23.2%	$ 5,184	22.3%	$ 790	15.2%

The increase in sales and marketing expense was due primarily to higher personnel-related costs, including commissions related to improved sales performance, and incremental costs associated with the acquisition of our distributor in South Africa in the fourth quarter of 2013. The increase in general and administrative expense resulted primarily from higher personnel-related costs. The increase in research and development expense was due primarily to higher materials costs.

Livestock, Poultry and Dairy. The following table presents LPD operating expenses by functional area:

Operating Expenses (dollars in thousands)	For the Three Months Ended September 30, 2014	Percent of Revenue	For the Three Months Ended September 30, 2013	Percent of Revenue	Dollar Change	Percentage Change
Sales and marketing	$ 6,380	21.5%	$ 5,071	20.2%	$ 1,309	25.8%
General and administrative	4,564	15.4%	3,945	15.7%	619	15.7%
Research and development	3,140	10.6%	2,999	11.9%	141	4.7%
Total operating expenses	$ 14,084	47.5%	$ 12,015	47.8%	$ 2,069	17.2%

The increase in sales and marketing expense resulted from higher personnel-related costs, including incremental costs associated with the acquisition of a Brazilian distributor in the third quarter of 2013 and commercial team investments worldwide, most significantly in the Asia-Pacific region. The increase in general and administrative expense resulted from the impairment of an intangible asset and incremental costs associated with the acquisition of the Brazilian distributor, consisting primarily of amortization of the acquired intangible assets and higher personnel-related costs. Research and development expense for the three months ended September 30, 2014 was generally consistent with the same period of the prior year.

Other. Operating expenses for Other increased $0.8 million to $3.2 million for the three months ended September 30, 2014, as compared to the same period of the prior year, due primarily to higher external development and consulting costs and an increase in personnel-related costs in our OPTI Medical business.

Unallocated Amounts. Operating expenses that are not allocated to our operating segments increased by $3.4 million to $4.5 million for the three months ended September 30, 2014, as compared to the same period of the prior year, due primarily to an increase in certain personnel-related costs and certain foreign exchange losses. In September 2014, the U.S. dollar experienced a continued and persistent strengthening relative to the euro, resulting in realized and unrealized losses on monetary assets, partly offset by gains on liabilities denominated in a currency other than the U.S. dollar. These favorable impacts were partly offset by a tax credit received under a state employment tax reimbursement program. We estimate certain personnel-related costs and allocate the estimated expenses to the operating segments. This allocation differs from actual expense and consequently yields a difference that is reported under the caption “Unallocated Amounts.”

Interest Income and Interest Expense

Interest income was $0.3 million and $0.5 million for the three months ended September 30, 2014 and 2013, respectively. The decrease in interest income was the result of our disposition of a debt investment and repayment of the related notes receivable in June 2014. See Note 4 to the condensed consolidated financial statements included in this Quarterly Report on Form 10-Q for additional information regarding the disposition of this strategic investment.

Interest expense was $4.3 million for the three months ended September 30, 2014, as compared to $1.5 million for the same period of the prior year. The increase in interest expense was due primarily to senior notes that we issued and sold through three private placements between December 2013 and September 2014 in an aggregate principal amount of $350 million. Interest rates on the senior notes range from 3.32% to 4.04%. See Note 9 to the condensed consolidated financial statements included in this Quarterly Report on Form 10-Q for additional information regarding our senior notes.

Provision for Income Taxes

Our effective income tax rates were 23.5% and 29.1% for the three months ended September 30, 2014 and 2013, respectively. The decrease in our effective income tax rate for the three months ended September 30, 2014, as compared to the same period of the prior year, was related to a non-recurring benefit related to the deferral of intercompany profits that were included in prior year tax provisions in error, which is not material to current or prior interim or annual periods, and higher relative earnings subject to international tax rates that are lower than domestic tax rates. These favorable factors were partly offset by the U.S. research and development (“R&D”) tax credit which was not available during the three months ended September 30, 2014 because the legislation expired as of January 1, 2014.

Nine Months Ended September 30, 2014 Compared to Nine Months Ended September 30, 2013

Revenue

Total Company. The following table presents revenue by operating segment:

Net Revenue (dollars in thousands)	For the Nine Months Ended September 30, 2014	For the Nine Months Ended September 30, 2013	Dollar Change	Percentage Change	Percentage Change from Currency	Percentage Change from Acquisitions	Organic Revenue Growth
CAG	$ 949,009	$ 856,617	$ 92,392	10.8%	-	0.2%	10.6%
Water	71,655	66,297	5,358	8.1%	0.4%	1.3%	6.4%
LPD	93,738	81,448	12,290	15.1%	1.2%	5.7%	8.2%
Other	19,446	18,623	823	4.4%	0.2%	-	4.2%
Total	$ 1,133,848	$ 1,022,985	$ 110,863	10.8%	0.1%	0.7%	10.0%

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U.S. and International Revenue. The following table provides further analysis of total company revenue by U.S. markets and non-U.S., or international, markets:

Net Revenue (dollars in thousands)	For the Nine Months Ended September 30, 2014	For the Nine Months Ended September 30, 2013	Dollar Change	Percentage Change	Percentage Change from Currency	Percentage Change from Acquisitions	Organic Revenue Growth
United States	$ 658,240	$ 602,332	$ 55,908	9.3%	0.1%	-	9.2%
International	475,608	420,653	54,955	13.1%	0.3%	1.6%	11.2%
Total	$ 1,133,848	$ 1,022,985	$ 110,863	10.8%	0.1%	0.7%	10.0%

The increase in both U.S. and international revenues was primarily driven by CAG Diagnostics recurring revenue. The increase in international revenues was driven by strong growth in Europe and Asia-Pacific markets, most significantly from the United Kingdom, Germany, Australia, China and France. The impact of changes in distributors' inventory levels did not have a significant impact on reported U.S. or international revenue growth.

Companion Animal Group. The following table presents revenue by product and service category for CAG:

Net Revenue (dollars in thousands)	For the Nine Months Ended September 30, 2014	For the Nine Months Ended September 30, 2013	Dollar Change	Percentage Change	Percentage Change from Currency	Percentage Change from Acquisitions	Organic Revenue Growth
CAG Diagnostics recurring revenue:	$ 818,327	$ 734,989	$ 83,338	11.3%	-	0.2%	11.1%
VetLab consumables	264,405	230,637	33,768	14.6%	0.2%	-	14.4%
VetLab service and accessories	40,332	37,312	3,020	8.1%	0.5%	-	7.6%
Rapid assay products	139,329	133,182	6,147	4.6%	(0.2%)	-	4.8%
Reference laboratory diagnostic and consulting services	374,261	333,858	40,403	12.1%	(0.1%)	0.4%	11.8%
CAG Diagnostics capital - instruments	55,508	55,702	(194)	(0.3%)	0.5%	-	(0.8%)
Customer information management and digital imaging systems	75,174	65,926	9,248	14.0%	(0.5%)	-	14.5%

Net CAG revenue	$ 949,009	$ 856,617	$ 92,392	10.8%	-	0.2%	10.6%

The increase in CAG Diagnostics recurring revenue was due primarily to increased volumes and higher realized prices in both our reference laboratory diagnostic services and our VetLab consumables. The impact of changes in distributors' inventory levels did not have a significant impact on reported CAG Diagnostics recurring revenue.

VetLab consumables revenue growth was due primarily to higher unit volumes. The increase in unit volumes resulted primarily from growth of our installed base of Catalyst Dx and ProCyte Dx instruments as a result of new customer acquisitions, as well as an increase in testing from existing customers, including those who upgraded to these instruments. Additionally, VetLab consumables revenue benefited from higher average unit sales prices resulting from price increases. These favorable impacts were partly offset by lower consumables volumes from our VetTest® chemistry instrument as customers continue to upgrade from our VetTest instrument to our Catalyst instruments. The impact of changes in distributors' inventory levels did not have a significant impact on reported consumables revenue growth.

VetLab service and accessories revenue growth was primarily a result of the increase in our installed base of instruments.

The increase in rapid assay revenue was due primarily to higher sales of both our canine and feline testing products, resulting from both higher average unit sales prices and an increase in U.S. practice-level sales volumes. These favorable factors were partly offset by the impact of changes in distributors' inventory levels, which reduced reported rapid assay revenue growth by 2%.

The increase in reference laboratory diagnostic and consulting services revenue was due primarily to the impact of higher volumes throughout our worldwide network of laboratories resulting from increased testing from existing customers, the acquisition of new customers and improved customer retention. Additionally, the increase in revenue was the result of higher average unit sales prices due to price increases.

The decrease in CAG Diagnostics capital instruments revenue was due primarily to the unfavorable impact of deferred revenue associated with preorders for our upcoming Catalyst One analyzer and the impact of lower realized prices. Under our Catalyst One introductory offer, customers are provided with the right to use a Catalyst Dx instrument through the Catalyst One release date. As a result, we do not recognize instrument revenue for preorders relating to the Catalyst One introductory offer until the Catalyst One is delivered. These unfavorable impacts were partly offset by higher placements of our Catalyst Dx and ProCyte Dx instruments, primarily in Europe and the Asia-Pacific region. For the nine months ended September 30, 2014, the majority of SNAP Pro Mobile Device placements were made under a reagent rental program for which instrument revenue will be recognized with the future sale of consumables.

The increase in customer information management and digital imaging systems revenue was due primarily to a growing Pet Health Network Pro subscriber base, higher support revenue resulting from an increase in our installed base of practice management and digital imaging systems and higher revenue from hardware upgrades as a result of Microsoft ending support for Windows XP.

Water. The increase in Water revenue resulted from higher revenue from our Colilert products and related accessories, due primarily to higher sales volumes in North America, Europe and the Asia-Pacific region resulting from the acquisition of new customers.

Livestock, Poultry and Dairy. The increase in LPD revenue was due primarily to higher sales of certain bovine test products in the Asia-Pacific region, higher volumes in Europe of our milk-based bovine pregnancy test, and higher sales in China of Dairy SNAP® tests used for the detection of antibiotic residues in milk. We continue to anticipate lower sales volumes of bovine test products in Europe resulting from the success of certain eradication programs and changes in BSE testing requirements, though we expect that these revenue declines will not be realized until 2015. The acquisition of a Brazilian distributor of our LPD products in the third quarter of 2013 added 6% to reported revenue growth for the nine months ended September 30, 2014 as compared to the same period of the prior year.

Other. The increase in Other revenue was due primarily to higher sales volumes associated with our OPTI Medical consumables and pharmaceutical product line. These favorable impacts were partly offset by lower sales of our OPTI Medical instruments in Latin America.

Gross Profit

Total Company. The following table presents gross profit and gross profit percentages by operating segment:

Gross Profit (dollars in thousands)	For the Nine Months Ended September 30, 2014	Percent of Revenue	For the Nine Months Ended September 30, 2013	Percent of Revenue	Dollar Change	Percentage Change
CAG	$ 522,908	55.1%	$ 464,301	54.2%	$ 58,607	12.6%
Water	47,379	66.1%	44,136	66.6%	3,243	7.3%
LPD	58,612	62.5%	44,270	54.4%	14,342	32.4%
Other	10,130	52.1%	9,235	49.6%	895	9.7%
Unallocated amounts	(5,078)	N/A	5,511	N/A	(10,589)	(192.1%)
Total Company	$ 633,951	55.9%	$ 567,453	55.5%	$ 66,498	11.7%

Companion Animal Group. Gross profit for CAG increased due to higher sales and an increase in the gross profit percentage to 55% from 54%. The increase in gross profit percentage was due primarily to lower overall VetLab product costs and price increases across our CAG Diagnostics recurring revenue portfolio.

Water. Gross profit for Water increased due primarily to higher sales, partly offset by a decrease in the gross profit percentage to 66% from 67%. The decrease in gross profit percentage was due primarily to the unfavorable impact of currency resulting from hedging losses during the nine months ended September 30, 2014 as compared to hedging gains during the same period of the prior year, partly offset by a more favorable product mix consisting of higher relative sales of our Colilert products.

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Livestock, Poultry and Dairy. Gross profit for LPD increased due to an improvement in the gross profit percentage to 63% from 54% and higher sales. The increase in the gross profit percentage resulted from lower overall manufacturing costs driven by higher production volumes and a decrease in royalty expense. The decrease in royalty expense was due primarily to an agreement executed in the first quarter of 2014 with a licensor of patents related to the sale of certain swine tests. A portion of the favorability resulting from this agreement will not recur.

Other. Gross profit for Other increased due to an improvement in the gross profit percentage to 52% from 50% and higher sales. The increase in the gross profit percentage was due primarily to our OPTI Medical business, resulting from favorable product mix due to higher relative sales of consumables and lower overall manufacturing costs.

Unallocated Amounts. Gross profit for Unallocated Amounts decreased due primarily to an increase in certain manufacturing costs and changes in certain currency exchange rates.

The manufacturing costs reported in our operating segments include our standard cost for products sold and any variances from standard cost for products purchased or manufactured within the period. We capitalize these variances for inventory on hand at the end of the period to record inventory in accordance with U.S. GAAP. We then record these variances as cost of product revenue as that inventory is sold. The impact to cost of product revenue resulting from this variance capitalization and subsequent recognition is reported within the caption “Unallocated Amounts.” The net unfavorable impact to gross profit as a result of increased manufacturing costs was due to the capitalization of favorable manufacturing variances, primarily within our LPD business, during the nine months ended September 30, 2014.

In certain geographies where we maintain inventories in currencies other than the U.S. dollar, the product costs reported in our operating segments include our standard cost for products sold, which is stated at the budgeted currency exchange rate from the beginning of the fiscal year. In these geographies, the variances from standard cost for products sold related to changes in currency exchange rates are reported within the caption “Unallocated Amounts.” The U.S. dollar strengthened significantly against the Japanese yen from the beginning of the prior fiscal year through September 30, 2013. The strengthening in the value of the U.S. dollar relative to the Japanese yen from the beginning of the current fiscal year through September 30, 2014 was less significant, as compared to the same period of the prior year, resulting in a lower favorable variance within Unallocated Amounts relating to the cost of products sold in Japanese yen.

Operating Expenses and Operating Income

Total Company. The following tables present operating expenses and operating income by operating segment:

Operating Expenses (dollars in thousands)	For the Nine Months Ended September 30, 2014	Percent of Revenue	For the Nine Months Ended September 30, 2013	Percent of Revenue	Dollar Change	Percentage Change
CAG	$ 334,088	35.2%	$ 296,924	34.7%	$ 37,164	12.5%
Water	17,832	24.9%	15,454	23.3%	2,378	15.4%
LPD	40,943	43.7%	35,094	43.1%	5,849	16.7%
Other	8,996	46.3%	7,347	39.5%	1,649	22.4%
Unallocated amounts	6,638	N/A	7,200	N/A	(562)	(7.8%)
Total Company	$ 408,497	36.0%	$ 362,019	35.4%	$ 46,478	12.8%

Operating Income (dollars in thousands)	For the Nine Months Ended September 30, 2014	Percent of Revenue	For the Nine Months Ended September 30, 2013	Percent of Revenue	Dollar Change	Percentage Change
CAG	$ 188,820	19.9%	$ 167,377	19.5%	$ 21,443	12.8%
Water	29,547	41.2%	28,682	43.3%	865	3.0%
LPD	17,669	18.8%	9,176	11.3%	8,493	92.6%
Other	1,134	5.8%	1,888	10.1%	(754)	(39.9%)
Unallocated amounts	(11,716)	N/A	(1,689)	N/A	(10,027)	(593.7%)
Total Company	$ 225,454	19.9%	$ 205,434	20.1%	$ 20,020	9.7%

We incurred transition costs to implement an all-direct sales strategy in the U.S. within our CAG segment of approximately $4.8 million during the third quarter of 2014. For the nine months ended September 30, 2014, Total Company operating income adjusted for the aforementioned transition costs was approximately $230.2 million and 20.3% of revenue, which represents an increase in adjusted operating income of $20.7 million and 10.1%, as compared to the nine months ended September 30, 2013, which is adjusted for the 2013 bankruptcy of a third-party service provider of approximately $4.1 million. Adjusted operating income is a non-GAAP financial measure and should be considered in addition to, and not as a replacement for or as a superior measure to, operating income reported in accordance with U.S. GAAP. Management believes that reporting adjusted operating income provides useful information to investors by facilitating easier comparisons of our operating income performance with prior and future periods and to the performance of our peers.

See the subsection above titled “Effects of Certain Factors on Results of Operations – Distributor Purchasing and Inventories” for details regarding anticipated transitional costs related to moving to an all-direct sales strategy for VetLab consumables and rapid assay products and services within our CAG segment in the U.S.

Companion Animal Group. The following table presents CAG operating expenses by functional area:

Operating Expenses (dollars in thousands)	For the Nine Months Ended September 30, 2014	Percent of Revenue	For the Nine Months Ended September 30, 2013	Percent of Revenue	Dollar Change	Percentage Change
Sales and marketing	$ 177,442	18.7%	$ 154,765	18.1%	$ 22,677	14.7%
General and administrative	104,159	11.0%	94,858	11.1%	9,301	9.8%
Research and development	52,487	5.5%	47,301	5.5%	5,186	11.0%
Total operating expenses	$ 334,088	35.2%	$ 296,924	34.7%	$ 37,164	12.5%

The increase in sales and marketing expense resulted from higher personnel-related costs across all major regions, including our North American sales force transformation started in the second half of 2013 and increased commissions resulting from improved sales performance; and non-recurring consulting costs related to the aforementioned implementation of an all-direct sales strategy in the U.S. The increase in general and administrative expense resulted primarily from higher personnel-related costs and, to a lesser extent, depreciation of internal-use software. The increase in research and development expense resulted primarily from higher personnel-related costs and increased materials costs, partly offset by lower external consulting and development costs.

Water. The following table presents Water operating expenses by functional area:

Operating Expenses (dollars in thousands)	For the Nine Months Ended September 30, 2014	Percent of Revenue	For the Nine Months Ended September 30, 2013	Percent of Revenue	Dollar Change	Percentage Change
Sales and marketing	$ 8,572	12.0%	$ 7,262	11.0%	$ 1,310	18.0%
General and administrative	6,942	9.7%	6,298	9.5%	644	10.2%
Research and development	2,318	3.2%	1,894	2.9%	424	22.4%
Total operating expenses	$ 17,832	24.9%	$ 15,454	23.3%	$ 2,378	15.4%

The increase in sales and marketing expense was due primarily to higher personnel-related costs, including commissions related to improved sales performance, and incremental costs associated with the acquisition of our distributor in South Africa in the fourth quarter of 2013. The increase in general and administrative expense resulted primarily from higher personnel-related costs. The increase in research and development expense was due primarily to higher materials costs.

Livestock, Poultry and Dairy. The following table presents LPD operating expenses by functional area:

Operating Expenses (dollars in thousands)	For the Nine Months Ended September 30, 2014	Percent of Revenue	For the Nine Months Ended September 30, 2013	Percent of Revenue	Dollar Change	Percentage Change
Sales and marketing	$ 18,413	19.6%	$ 14,953	18.4%	$ 3,460	23.1%
General and administrative	12,776	13.6%	10,855	13.3%	1,921	17.7%
Research and development	9,754	10.4%	9,286	11.4%	468	5.0%
Total operating expenses	$ 40,943	43.7%	$ 35,094	43.1%	$ 5,849	16.7%

The increase in sales and marketing expense resulted from higher personnel-related costs, including incremental costs associated with the acquisition of a Brazilian distributor in the third quarter of 2013 and commercial team investments worldwide, most significantly in the Asia-Pacific region. The increase in general and administrative expense resulted from incremental costs associated with the acquisition of the Brazilian distributor, primarily personnel-related costs and higher amortization of the acquired intangible assets, the impairment of an intangible asset and the unfavorable impact of changes in foreign currency exchange rates. The increase in research and development expense was due primarily to higher personnel-related costs and the unfavorable impact of changes in foreign currency exchange rates.

Other. Operating expenses for Other increased $1.6 million to $9.0 million for the nine months ended September 30, 2014, as compared to the same period of the prior year due primarily to higher external development and consulting costs and an increase in personnel-related costs in our OPTI Medical line of business.

Unallocated Amounts. Operating expenses that are not allocated to our operating segments decreased by $0.6 million to $6.6 million for the nine months ended September 30, 2014, as compared to the same period of the prior year, due primarily to the absence of a $4.1 million loss incurred during the nine months ended September 30, 2013 resulting from the bankruptcy of a freight payment and audit service provider and by a tax credit received under a state employment tax reimbursement program. These favorable factors were partly offset by an increase in certain personnel-related costs and certain foreign exchange losses. In September 2014, the U.S. dollar experienced a continued and persistent strengthening relative to the euro, resulting in realized and unrealized losses on monetary assets, partly offset by gains on liabilities denominated in a currency other than the U.S. dollar.

Interest Income and Interest Expense

Interest income was $1.3 million for both the nine months ended September 30, 2014 and 2013. For the remainder of 2014, we anticipate a reduction in interest income as a result of our June 2014 disposition of a debt investment and repayment of the related notes receivable. See Note 4 to the condensed consolidated financial statements included in this Quarterly Report on Form 10-Q for additional information regarding the disposition of this strategic investment.

Interest expense was $10.0 million for the nine months ended September 30, 2014, as compared to $3.5 million for the same period of the prior year. The increase in interest expense was due primarily to senior notes that we issued and sold through three private placements between December 2013 and September 2014 in an aggregate principal amount of $350 million. Interest rates on the senior notes range from 3.32% to 4.04%. See Note 9 to the condensed consolidated financial statements included in this Quarterly Report on Form 10-Q for additional information regarding our senior notes.

Provision for Income Taxes

Our effective income tax rates were 28.0% and 28.9% for the nine months ended September 30, 2014 and 2013, respectively. The decrease in our effective income tax rate for the nine months ended September 30, 2014, as compared to the same period of the prior year, was related to higher relative earnings subject to international tax rates that are lower than domestic tax rates, a non-recurring benefit related to the deferral of intercompany profits that were included in prior year tax provisions in error and the resolution of domestic and international tax audits, which resulted in a net reduction in our provision for uncertain tax positions. These favorable factors were partly offset by the R&D tax credit, which expired as of January 1, 2014. During the three months ended March 31, 2013, legislation in the U.S. retroactively allowed the R&D tax credit for all of 2012 and extended the R&D tax credit through the year ending December 31, 2013. Because this legislation was enacted during the three months ended March 31, 2013, the full benefit of the credit related to the prior years' activities was recognized within that quarter.

§ Recent Accounting Pronouncements

A discussion of recent accounting pronouncements is included in Note 2 to the condensed consolidated financial statements included in this Quarterly Report on Form 10-Q.

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§ Liquidity and Capital Resources

Liquidity

We fund the capital needs of our business through cash on hand, funds generated from operations, and amounts available under our unsecured revolving credit facility, which we refinanced in June 2014 by entering into an amended and restated five-year unsecured revolving credit facility in the principal amount of $700 million (the amended and restated credit facility and the previous credit facility are referred to collectively as the “Credit Facility”). In addition, we issued $150 million, $125 million and $75 million of our senior notes in December 2013, July 2014 and September 2014, respectively. At September 30, 2014 and December 31, 2013, we had $292.7 million and $279.1 million, respectively, of cash and cash equivalents, and working capital of $72.4 million and $174.4 million, respectively. Additionally, at September 30, 2014, we had remaining borrowing availability of $324.0 million under our Credit Facility. We believe that, if necessary, we could obtain additional borrowings at prevailing market interest rates to fund our growth objectives. We further believe that current cash and cash equivalents, funds generated from operations and available borrowings will be sufficient to fund our operations, capital purchase requirements and strategic growth needs for the next twelve months. We believe that these resources, coupled with our ability, as needed, to obtain additional financing on favorable terms will be sufficient in the long term to fund our business as currently conducted.

We consider the majority of the operating earnings of certain non-U.S. subsidiaries to be indefinitely invested outside the U.S. No provision has been made for the payment of U.S. federal and state or international taxes that may result from future remittances of these undistributed earnings of non-U.S. subsidiaries. Changes to this position could have adverse tax consequences. A determination of the related tax liability that would be paid on these undistributed earnings if repatriated is not practicable. We manage our worldwide cash requirements considering available funds among all of our subsidiaries. Our foreign cash balances are generally available without restrictions to fund ordinary business operations outside the U.S. Of our total cash and cash equivalents at September 30, 2014, approximately $282.6 million was held by our foreign subsidiaries and was subject to material repatriation tax effects. As of September 30, 2014, 56% of the cash and cash equivalents held by our non-U.S. subsidiaries was invested in money market funds restricted to U.S. government and agency securities and 44% was held as bank deposits. As of September 30, 2014, approximately 60% of the cash and cash equivalents held by our foreign subsidiaries was held in U.S. dollars.

Should we require more capital in the U.S. than is generated by our operations domestically, for example to fund significant discretionary activities, we could elect to repatriate future earnings from foreign jurisdictions or raise capital in the U.S. through debt or equity issuances. These alternatives could result in higher effective tax rates or increased interest expense and other dilution of our earnings. We have borrowed funds domestically and continue to have the ability to borrow funds domestically at reasonable interest rates.

The following table presents additional key information concerning working capital:

	For the Three Months Ended				
	September 30, 2014	June 30, 2014	March 31, 2014	December 31, 2013	September 30, 2013
Days sales outstanding(1)	39.2	40.8	42.8	39.9	41.9
Inventory turns(2)	1.8	1.8	1.8	1.9	1.7

(1) Days sales outstanding represents the average of the accounts receivable balances at the beginning and end of each quarter divided by revenue for that quarter, the result of which is then multiplied by 91.25 days.
(2) Inventory turns represent inventory-related cost of product revenue for the twelve months preceding each quarter-end divided by the inventory balance at the end of the quarter.

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Sources and Uses of Cash

The following table presents cash provided (used):

(dollars in thousands)	For the Nine Months Ended September 30, 2014	2013 1	Dollar Change
Net cash provided by operating activities	$ 208,543	$ 180,581	$ 27,962
Net cash used by investing activities	(44,795)	(69,084)	24,289
Net used by financing activities	(145,777)	(69,396)	(76,381)
Net effect of changes in exchange rates on cash	(4,294)	(1,276)	(3,018)
Net increase in cash and cash equivalents	$ 13,677	$ 40,825	$ (27,148)

1 Revisions were made to the condensed consolidated statement of cash flows for the nine months ended September 30, 2013 to correctly reflect $0.9 million of net non-cash activities embedded in accounts payable, accrued liabilities and inventory on the condensed consolidated balance sheets at September 30, 2013 and December 31, 2012. See Note 1 to the condensed consolidated financial statements included in this Quarterly Report on Form 10-Q for additional information about this revision.

Operating Activities. Cash provided by operating activities was $208.5 million for the nine months ended September 30, 2014, as compared to $180.6 million for the same period of the prior year. The total of net income and net non-cash charges, excluding the impact of reclassifying the tax benefit from share-based compensation arrangements to a financing activity, was $207.9 million for the nine months ended September 30, 2014, as compared to $198.6 million for the same period of the prior year, resulting in an increase in operating cash flows of $9.3 million driven primarily by an increase in net income, partly offset by the impact of deferred income taxes. The total of changes in operating assets and liabilities and the tax benefit from share-based compensation arrangements increased cash by $0.6 million and decreased cash by $18.1 million for the nine months ended September 30, 2014 and 2013, respectively, resulting in an incremental increase in cash of $18.7 million.

The following table presents cash flows from changes in operating assets and liabilities and the tax benefit from share-based compensation arrangements:

(dollars in thousands)	For the Nine Months Ended September 30, 2014	2013 1	Dollar Change
Accounts receivable	$ (8,464)	$ (12,795)	$ 4,331
Inventories	(12,638)	(10,216)	(2,422)

Other assets	(3,375)	4,717	(8,092)
Accounts payable	6,876	3,958	2,918
Accrued liabilities	16,216	(335)	16,551
Deferred revenue	11,566	4,050	7,516
Tax benefit from share-based compensation arrangements	(9,581)	(7,438)	(2,143)
Total	$ 600	$ (18,059)	$ 18,659

1 Revisions were made to the condensed consolidated statement of cash flows for the nine months ended September 30, 2013 to correctly reflect $0.9 million of non-cash activities embedded in accounts payable, accrued liabilities and inventory on the condensed consolidated balance sheets at September 30, 2013 and December 31, 2012. See Note 1 to the condensed consolidated financial statements included in this Quarterly Report on Form 10-Q for additional information about this revision.

The increase in the cash provided by accrued liabilities was due primarily to lower relative taxes paid relating to the 2013 tax year, as compared to the 2012 tax year, and higher personnel-related accruals at September 30, 2014, primarily resulting from improved business performance. The incremental cash provided by deferred revenue for the nine months ended September 30, 2014, as compared to the same period of the prior year was due primarily to sales under our Catalyst One introductory offer launched in the first quarter of 2014. Similarly, the incremental cash used by other assets during the nine months ended September 30, 2014, as compared to the same period of the prior year was due to the deferred cost of Catalyst instrument placements under our Catalyst One introductory offer.

We historically have experienced proportionally lower net cash flows from operating activities during the first quarter and proportionally higher cash flows from operating activities for the remainder of the year and for the annual period driven primarily by payments related to annual employee incentive programs in the first quarter following the year for which the bonuses were earned and the seasonality of vector-borne disease testing, which has historically resulted in significant increases in accounts receivable balances during the first quarter of the year.

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Investing Activities. Cash used by investing activities was $44.8 million for the nine months ended September 30, 2014, as compared to $69.1 million for the same period of the prior year. The decrease in cash used by investing activities was due primarily to the completion of our headquarters facility expansion in August 2013.

Our total capital expenditure plan for 2014 is estimated to be approximately $75 million, which includes investments in information technology infrastructure and software for internal use, capital investments in manufacturing equipment and investments in our reference laboratory equipment and facilities.

Financing Activities. Cash used by financing activities was $145.8 million for the nine months ended September 30, 2014, as compared to $69.4 million for the same period of the prior year. The increase in cash used to repurchase common stock and lower relative net borrowings under the Credit Facility was partly offset by $200 million provided from the issuance of long-term debt during the nine months September 30, 2014.

Cash used to repurchase shares of our common stock increased by $186.1 million during the nine months ended September 30, 2014, as compared to the same period of the prior year. From the inception of our share repurchase program in August 1999 to September 30, 2014, we have repurchased 52.8 million shares. During the nine months ended September 30, 2014, we purchased 3.7 million shares for an aggregate cost of $469.0 million, as compared to purchases of 3.1 million shares for an aggregate cost of $282.9 million during the nine months ended September 30, 2013. We believe that the repurchase of our common stock is a favorable means of returning value to our shareholders, and we also repurchase our stock to offset the dilutive effect of our share-based compensation programs. Repurchases of our common stock may vary depending upon the level of other investing activities and the share price. See Note 10 to the condensed consolidated financial statements included in this Quarterly Report on Form 10-Q for additional information about our share repurchases.

As noted above, in June 2014, we refinanced our existing $450 million Credit Facility and increased the principal amount thereunder to $700 million. The Credit Facility matures on June 18, 2019 and requires no scheduled prepayments before that date. Although the Credit Facility does not mature until June 18, 2019, all amounts borrowed under the terms of the Credit Facility are reflected in the current liabilities section in the accompanying condensed consolidated balance sheets because the Credit Facility contains a subjective material adverse event clause, which allows the debt holders to call the loans under the Credit Facility if we fail to notify the syndicate of such an event. Applicable interest rates on borrowings under the Credit Facility generally range from 0.875 to 1.375 percentage points above the London interbank offered rate or the Canadian Dollar-denominated bankers' acceptance rate, based on our leverage ratio, or the prevailing prime rate plus a maximum spread of up to 0.375%, based on our leverage ratio.

Net borrowing and repayment activity under the Credit Facility resulted in incremental cash used, as compared to the same period of the prior year, of $87.2 million during the nine months ended September 30, 2014. At September 30, 2014, we had $375.0 million outstanding under the Credit Facility. The general availability of funds under the Credit Facility was further reduced by $1.0 million for a letter of credit that was issued in connection with claims under our workers' compensation policy. The Credit Facility contains affirmative, negative and financial covenants customary for financings of this type. The negative covenants include restrictions on liens, indebtedness of subsidiaries of the Company, fundamental changes, investments, transactions with affiliates and certain restrictive agreements. The financial covenant is a consolidated leverage ratio test that requires our ratio of debt to earnings before interest, taxes, depreciation, amortization and share-based compensation not to exceed 3.5-to-1. At September 30, 2014, we were in compliance with the covenants of the Credit Facility. The obligations under the Credit Facility may be accelerated upon the occurrence of an event of default under the Credit Facility, which includes customary events of default including payment defaults, defaults in the performance of the affirmative, negative and financial covenants, the inaccuracy of representations or warranties, bankruptcy and insolvency related defaults, defaults relating to judgments, certain events related to employee pension benefit plans under the Employee Retirement Income Security Act of 1974, the failure to pay specified indebtedness and a change of control default.

In December 2013, we issued and sold through a private placement an aggregate principal amount of $150 million of senior notes consisting of $75 million of 3.94% Series A Senior Notes due December 11, 2023 (the “2023 Notes”) and $75 million of 4.04% Series B Senior Notes due December 11, 2025 (the “2025 Notes” and together with the 2023 Notes, the “December Notes”) under a Note Purchase Agreement among the Company, New York Life Insurance Company and the accredited institutional purchasers named therein (the “December 2013 Note Agreement”).

In July 2014, we issued and sold through a private placement an aggregate principal amount of $125 million of senior notes consisting of $75 million of 3.76% Series B Senior Notes due July 21, 2024 (the “2024 Notes”) and $50 million of 3.32% Series A Senior Notes due July 21, 2021 (the “2021 Notes” and together with the 2024 Notes, the “Prudential Notes”) under a Note Purchase and Private Shelf Agreement among the Company, Prudential Investment Management, Inc. and the accredited institutional purchasers named therein (the “July 2014 Note Agreement”).

In September 2014, we issued and sold through a private placement an aggregate principal amount of $75 million of 3.72% Senior Notes due September 4, 2026 (the “2026 Notes” and together with the Prudential Notes and the December Notes, the “Senior Notes”) under a Note Purchase Agreement dated as of July 22, 2014 among the Company, New York Life Insurance Company and the accredited institutional purchasers named therein (such agreement, together with July 2014 Note Agreement and December 2013 Note Agreement, the “Senior Note Agreements”).

The Senior Note Agreements contain affirmative, negative and financial covenants customary for agreements of this type. The negative covenants include restrictions on liens, indebtedness of our subsidiaries, priority indebtedness, fundamental changes, investments, transactions with affiliates, certain restrictive agreements and violations of laws and regulations. The financial covenant is a consolidated leverage ratio test that requires our ratio of debt to earnings before interest, taxes, depreciation, amortization and share-based compensation, as defined in the Senior Note Agreements, not to exceed 3.5-to-1. At September 30, 2014, we were in compliance with the covenants of the Senior Note Agreements.

Should we elect to prepay the Senior Notes, such aggregate prepayment will include the applicable make-whole amount(s), as defined within the applicable Senior Note Agreements. Additionally, in the event of a change in control of the Company or upon the disposition of certain assets of the Company the proceeds of which are not reinvested (as defined in the Senior Note Agreements), we may be required to prepay all or a portion of the Senior Notes. The obligations under the Senior Notes may be accelerated upon the occurrence of an event of default under the applicable Senior Note Agreement, each of which includes customary events of default including payment defaults, defaults in the performance of the affirmative, negative and financial covenants, the inaccuracy of representations or warranties, bankruptcy and insolvency related defaults, defaults relating to judgments, certain events related to employee pension benefit plans under the Employee Retirement Income Security Act of 1974 and the failure to pay specified indebtedness.

Other Commitments, Contingencies and Guarantees

Significant commitments, contingencies and guarantees at September 30, 2014 are consistent with those discussed in the section under the heading “Part II, Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources” and in Note 14 to the consolidated financial statements in our 2013 Annual Report, with the exception of $200 million of long-term debt issued during the nine months ended September 30, 2014. See Note 9 to the condensed consolidated financial statements included in this Quarterly Report on Form 10-Q for additional information regarding our senior notes.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

For quantitative and qualitative disclosures about market risk affecting us, see the section under the heading "Part II, Item 7A. Quantitative and Qualitative Disclosures About Market Risk" in our 2013 Annual Report. As of the date of this Quarterly Report on Form 10-Q, there have been no material changes to the market risks described in our 2013 Annual Report.

Item 4. Controls and Procedures

Disclosure Controls and Procedures

Our management is responsible for establishing and maintaining disclosure controls and procedures, as defined by the SEC in its Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act"). The term "disclosure controls and procedures," as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act, means controls and other procedures of an issuer that are designed to ensure that information required to be disclosed by the issuer in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company's management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure. Management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives and management necessarily applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Based on the evaluation of our disclosure controls and procedures at September 30, 2014, our Chief Executive Officer and Chief Financial Officer have concluded that, as of such date, our disclosure controls and procedures were effective at the reasonable assurance level.

Changes in Internal Control Over Financial Reporting

There were no changes in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the three months ended September 30, 2014 that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II — OTHER INFORMATION

Item 1. Legal Proceedings

Due to the nature of our activities, we are at times subject to pending and threatened legal actions that arise out of the ordinary course of business. In the opinion of management, based in part upon advice of legal counsel, the disposition of any such currently pending matters is not expected to have a material effect on our results of operations, financial condition or cash flows. However, the results of legal actions cannot be predicted with certainty. Therefore, it is possible that our results of operations, financial condition or cash flows could be materially adversely affected in any particular period by the unfavorable resolution of one or more legal actions.

Item 1A. Risk Factors

In addition to the other information set forth in this Quarterly Report on Form 10-Q, you should carefully consider the factors discussed in "Part I, Item 1A. Risk Factors" in our 2013 Annual Report, which could materially affect our business, financial condition or future results. There have been no material changes from the risk factors previously disclosed in the 2013 Annual Report, except for the additional risk factor set forth below. The risks described in this Quarterly Report on Form 10-Q and in our 2013 Annual Report are not the only risks facing our Company. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition or future results.

Uncertainties in Executing a Recently Announced All-Direct Sales Strategy in the U.S. Could Negatively Impact Our Results of Operations, and this New Strategy May Not Be Successful

On July 25, 2014, we announced our plan to transition to an all-direct sales strategy for our rapid assay test kits and instrument consumables ("kits and consumables") in the U.S. effective January 1, 2015. Successfully executing this plan will require us to concurrently achieve a number of key objectives in a relatively short period of time, including, among other things, successfully recruiting, retaining and training additional personnel in key positions (such as sales, marketing and customer support) and developing or enhancing the necessary operational, logistics and systems support for an all-direct sales strategy in the U.S. Implementation of the new strategy will require us to incur additional transitional cost and expense in 2014 and will result in the drawdown of distributor inventory in 2014 and potentially in early 2015. These transitional costs and expenses and inventory drawdown are expected to negatively affect our earnings during these periods. In addition, there can be no assurance that we will be wholly successful in our efforts, and if we are delayed or otherwise unable to effectively implement and support the new strategy, our results of operations may be negatively impacted. We also cannot assure you that the new strategy will result in growth of practice-level sales of our kits and consumables from historical levels.

In connection with executing this plan, we are not renewing our existing contracts with our key U.S. distribution partners after their expiration at the end of 2014. In October 2014, three of our previously exclusive U.S. distribution partners announced that they would begin carrying competitive products in the fourth quarter of 2014, before we have completed our transition to an all-direct sales strategy in the U.S. for our kits and consumables. We have historically sold significant amounts of our kits and consumables through our U.S. distribution partners, and the change in our existing relationships with these distribution partners and the transition of previously exclusive distributors to promoting and selling competitive products may adversely affect the retention of our customers for our kits and consumables and the sales and distribution of our products, which could have an adverse effect on our results of operations.

Item 2.Unregistered Sales of Equity Securities and Use of Proceeds

During the three months ended September 30, 2014, we repurchased shares of common stock as described below:

Period	Total Number of Shares Purchased (a)		Average Price Paid per Share (b)	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (1) (c)	Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs (d)
July 1 to July 31, 2014	280,063		$ 132.60	280,020	6,132,313
August 1 to August 31, 2014	937,354		125.83	937,354	5,194,959
September 1 to September 30, 2014	980,151		119.75	979,336	4,215,623
Total	2,197,568	(2)	$ 123.98	2,196,710	4,215,623

(1)As of September 30, 2014, our Board of Directors had approved the repurchase of up to 57 million shares of our common stock in the open market or in negotiated transactions pursuant to the Company's share repurchase program. The program was approved and announced on August 13, 1999, and the maximum number of shares that may be purchased under the program was subsequently increased on October 4, 1999, November 16, 1999, July 21, 2000, October 20, 2003, October 12, 2004, October 12, 2005, February 14, 2007, February 13, 2008, February 10, 2010, October 12, 2011, May 7, 2013 and again on July 16, 2014, when the Board of Directors authorized the repurchase by the Company of up to an additional five million shares of our common stock. There is no specified expiration date for this repurchase program. There were no other repurchase programs outstanding during the three months ended September 30, 2014, and no repurchase programs expired during the period. Repurchases of 2,196,710 shares were made during the three months ended September 30, 2014 in transactions made pursuant to our repurchase program.

(2)During the three months ended September 30, 2014, we received 858 shares of our common stock that were surrendered by employees in payment for the minimum required withholding taxes due on the vesting of restricted stock units and settlement of deferred stock units. In the above table, these shares are included in columns (a) and (b), but excluded from columns (c) and (d). These shares do not reduce the number of shares that may yet be purchased under the repurchase program.

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Item 6.Exhibits

Exhibit No.	Description
10.1	Note Purchase and Private Shelf Agreement, dated as of July 21, 2014, among the Company, as issuer, Prudential Investment Management, Inc., Pruco Life Insurance Company, The Prudential Insurance Company of America, Prudential Investment Japan Co., Ltd., as investment manager, and Prudential Investment Management, Inc., as sub-adviser for The Gibraltar Life Insurance Co., Ltd., Prudential Arizona Reinsurance Universal Company, as grantor, and Prudential Investment Management, Inc., as investment manager for PAR U Hartford Life Insurance Comfort Trust, Prudential Private Placement Investors, L.P., as investment advisor, and Prudential Private Placement Investors, Inc., as general partner to each of, The Independent Order of Foresters, Zurich American Insurance Company, Globe Life and Accident Insurance Company, Family Heritage Life Insurance Company of America, MTL Insurance Company, The Lincoln National Life Insurance Company, William Penn Life Insurance Company of New York, Farmers Insurance Exchange and Mid Century Insurance Company, as purchasers (filed as Exhibit 99.1 to Form 8-K filed July 25, 2014, File No. 00-19271, and incorporated herein by reference).
10.2	Note Purchase Agreement, dated as of July 22, 2014, among the Company, as issuer, New York Life Insurance Company, and NYL Investors LLC, as investment manager for New York Life Insurance and Annuity Corporation and New York Life Insurance and Annuity Corporation Institutionally Owned Life Insurance Separate Account (BOLI 30C), as purchasers (filed as Exhibit 99.2 to Form 8-K filed July 25, 2014, File No. 00-19271, and incorporated herein by reference).
31.1	Certification of Principal Executive Officer pursuant to Rules 13a-14(a) and 15d-14(a) under the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Principal Financial Officer pursuant to Rules 13a-14(a) and 15d-14(a) under the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS	XBRL Instance Document.
101.SCH	XBRL Taxonomy Extension Schema Document.
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document.

101.DEF	XBRL Taxonomy Extension Definition Linkbase Document.
101.LAB	XBRL Taxonomy Extension Label Linkbase Document.
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document.

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.

	IDEXX LABORATORIES, INC.
	/s/ Brian P. McKeon
Date: October 24, 2014	Brian P. McKeon
	Executive Vice President, Chief Financial Officer
	and Treasurer
	(Duly Authorized Officer, Principal Financial Officer)

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Exhibit Index

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