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

FORM 10-Q

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

For the Quarterly Period Ended March 31, 2006

Commission File Number 001-14039

CALLON PETROLEUM COMPANY

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of
incorporation or organization)

64-0844345

(I.R.S. Employer
Identification No.)

**200 North Canal Street
Natchez, Mississippi 39120**

(Address of principal executive offices)(Zip code)

(601) 442-1601

(Registrant's telephone number,
including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

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

As of May 5, 2006, there were 20,313,141 shares of the Registrant's Common Stock, par value \$0.01 per share, outstanding.

CALLON PETROLEUM COMPANY

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Callon Petroleum Company
Consolidated Balance Sheets
(In thousands, except share data)

	March 31, 2006 <u>(Unaudited)</u>	December 31, 2005 <u>(Note 1)</u>
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 5,139	\$ 2,565
Accounts receivable	30,683	33,195
Deferred tax asset	37,788	26,770
Restricted investments	4,152	4,110
Fair market value of derivatives	2,165	889
Other current assets	1,077	1,998
Total current assets	<u>81,004</u>	<u>69,527</u>
Oil and gas properties, full-cost accounting method:		
Evaluated properties	985,614	937,698
Less accumulated depreciation, depletion and amortization	<u>(553,235)</u>	<u>(539,399)</u>
	432,379	398,299
Unevaluated properties excluded from amortization	55,013	49,065
Total oil and gas properties	<u>487,392</u>	<u>447,364</u>
Other property and equipment, net	1,618	1,605
Long-term gas balancing receivable	723	403
Restricted investments-long-term	1,877	1,858
Investment in Medusa Spar LLC	11,835	11,389
Other assets, net	1,515	1,630
Total assets	<u>\$ 585,964</u>	<u>\$ 533,776</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 44,798	\$ 39,323
Fair market value of derivatives	653	1,247
Undistributed oil and gas revenues	1,176	721
Asset retirement obligations	27,040	21,660
Current maturities of long-term debt	236	263
Total current liabilities	<u>73,903</u>	<u>63,214</u>
Long-term debt	194,218	188,813
Asset retirement obligations-long-term	25,298	16,613
Deferred tax liability	49,018	31,633
Accrued liabilities to be refinanced	—	5,000
Other long-term liabilities	458	455
Total liabilities	<u>342,895</u>	<u>305,728</u>
Stockholders' equity:		
Preferred Stock, \$.01 par value, 2,500,000 shares authorized;	—	—
Common Stock, \$.01 par value, 30,000,000 shares authorized; 20,293,779 and 19,357,138 shares outstanding at March 31, 2006 and December 31, 2005, respectively	203	194
Capital in excess of par value	217,996	220,360
Unearned compensation restricted stock	—	(3,334)
Other comprehensive income (loss)	944	(331)
Retained earnings	23,926	11,159
Total stockholders' equity	<u>243,069</u>	<u>228,048</u>
Total liabilities and stockholders' equity	<u>\$ 585,964</u>	<u>\$ 533,776</u>

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

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Callon Petroleum Company
Consolidated Statements of Operations
(Unaudited)
(In thousands, except per share amounts)

	Three Months Ended	
	March 31,	
	2006	2005
Operating revenues:		
Oil sales	\$ 27,799	\$ 24,009
Gas sales	17,782	19,003
Total operating revenues	<u>45,581</u>	<u>43,012</u>
Operating expenses:		
Lease operating expenses	5,905	6,536
Depreciation, depletion and amortization	13,836	15,408
General and administrative	1,726	1,694
Accretion expense	1,419	861
Derivative expense	90	379
Total operating expenses	<u>22,976</u>	<u>24,878</u>
Income from operations	<u>22,605</u>	<u>18,134</u>
Other (income) expenses:		
Interest expense	4,148	4,569
Other (income) expense	(330)	(202)
Total other (income) expenses	<u>3,818</u>	<u>4,367</u>
Income before income taxes	18,787	13,767
Income tax expense	<u>6,550</u>	<u>4,818</u>
Income before Medusa Spar LLC	12,237	8,949
Income from Medusa Spar LLC, net of tax	<u>530</u>	<u>526</u>
Net income	12,767	9,475
Preferred stock dividends	—	318
Net income available to common shares	<u>\$ 12,767</u>	<u>\$ 9,157</u>
Net income per common share:		
Basic	<u>\$ 0.66</u>	<u>\$ 0.52</u>
Diluted	<u>\$ 0.60</u>	<u>\$ 0.46</u>
Shares used in computing net income:		
Basic	19,396	17,671
Diluted	<u>21,329</u>	<u>20,678</u>

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

Callon Petroleum Company
Consolidated Statements of Cash Flows
(Unaudited)
(In thousands)

	Three Months Ended	
	March 31, 2006	March 31, 2005
Cash flows from operating activities:		
Net income	\$ 12,767	\$ 9,475
Adjustments to reconcile net income to cash provided by operating activities:		
Depreciation, depletion and amortization	14,018	15,543
Accretion expense	1,419	861
Amortization of deferred financing costs	546	490
Non-cash derivative expense	90	379
Income from investment in Medusa Spar LLC	(530)	(526)
Deferred income tax expense	6,550	4,818
Non-cash charge related to compensation plans	115	374
Excess tax benefits from share-based payment arrangements	(1,195)	—
Changes in current assets and liabilities:		
Accounts receivable	1,212	(6,965)
Other current assets	922	265
Current liabilities	5,483	(3,334)
Change in gas balancing receivable	(320)	88
Change in gas balancing payable	(2)	(68)
Change in other long-term liabilities	5	4
Change in other assets, net	(64)	(73)
Cash provided by operating activities	<u>41,016</u>	<u>21,331</u>
Cash flows from investing activities:		
Capital expenditures	(39,507)	(16,206)
Distribution from Medusa Spar LLC	370	116
Cash used by investing activities	<u>(39,137)</u>	<u>(16,090)</u>
Cash flows from financing activities:		
Change in accrued liabilities to be refinanced	(5,000)	—
Increase in debt	14,000	3,000
Payments on debt	(9,000)	(8,000)
Issuance of common stock	—	1
Equity issued related to employee stock plans	(418)	(87)
Excess tax benefits from share-based payment arrangements	1,195	—
Capital leases	(82)	(208)
Cash dividends on preferred stock	—	(318)
Cash provided (used) by financing activities	<u>695</u>	<u>(5,612)</u>
Net increase (decrease) in cash and cash equivalents	2,574	(371)
Cash and cash equivalents:		
Balance, beginning of period	2,565	3,266
Balance, end of period	<u>\$ 5,139</u>	<u>\$ 2,895</u>

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

CALLON PETROLEUM COMPANY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
March 31, 2006

1. General

The financial information presented as of any date other than December 31 has been prepared from the books and records of Callon Petroleum Company (the "Company" or "Callon") without audit. Financial information as of December 31, 2005 has been derived from the audited financial statements of the Company, but does not include all disclosures required by U.S. generally accepted accounting principles. In the opinion of management, all adjustments, consisting only of normal recurring adjustments, necessary for the fair presentation of the financial information for the periods indicated, have been included. For further information regarding the Company's accounting policies, refer to the Consolidated Financial Statements and related notes for the year ended December 31, 2005 included in the Company's Annual Report on Form 10-K filed March 15, 2006. The results of operations for the three-month period ended March 31, 2006 are not necessarily indicative of future financial results.

2. Stock-Based Compensation

The Company has various stock plans ("Plans") under which employees of the Company and its subsidiaries and non-employee members of the Board of Directors of the Company have been or may be granted certain equity compensation. The Company has compensatory stock option plans in place whereby participants have been or may be granted rights to purchase shares of common stock of Callon. For further discussion of the Company's Plans, refer to Note 11 of the Consolidated Financial Statements for the year ended December 31, 2005 included in the Company's Annual Report on Form 10-K filed March 15, 2006.

Effective January 1, 2006, the Company adopted Statement of Financial Accounting Standard No. 123 (revised 2004), ("SFAS 123R") "Share-Based Payment," utilizing the modified prospective approach. Prior to the adoption of SFAS 123R we accounted for stock option grants in accordance with Accounting Principals Board Opinion No. 25, "Accounting for Stock Issued to Employees" (the intrinsic value method) and, accordingly, recognized no compensation expense for stock option grants.

Under the modified prospective approach, SFAS 123R applies to new awards, unvested awards as of January 1, 2006 and awards that were outstanding on January 1, 2006 that are subsequently modified, repurchased or cancelled. Under the modified prospective approach, compensation cost recognized in the first quarter of 2006 includes compensation cost for all share-based payments granted prior to, but not yet vested as of January 1, 2006, based on the grant-date fair value estimated in accordance with the original provisions of Statement of Financial Accounting Standard No. 123 ("SFAS 123") "Accounting for Stock-Based Compensation," and compensation cost for all share-based payments granted subsequent to January 1, 2006, based on the grant-date fair value estimated in accordance with the provisions of SFAS 123R. Prior periods were not restated to reflect the impact of adopting the new standard.

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As a result of most of the Company's stock-based compensation being in the form of restricted stock, the impact of the adoption of SFAS 123R on income before taxes, net income and basic and diluted earnings per share for the three-month period ended March 31, 2006 was immaterial.

We receive a tax deduction for certain stock option exercises during the period the options are exercised, generally for the excess of the price at which the options are sold over the exercise prices of the options. In accordance with SFAS 123R, for the three months ended March 31, 2006, we revised our consolidated statements of cash flows presentation to report the tax benefits from the exercise of stock options as financing cash flows. For the three months ended March 31, 2006, \$1.2 million of tax benefits were reported as financing cash flows rather than operating cash flows. There were no cash proceeds from the exercise of stock options for the three months ended March 31, 2006 due to the fact that all options were exercised through net-share settlements.

For the three month period ended March 31, 2006, we recorded compensation expense of \$217,000, \$108,000 of which was included in general and administrative expenses and \$109,000 of which was capitalized to oil and gas properties. Shares available for future stock option or restricted stock grants to employees and directors under existing plans were 916,974 at March 31, 2006.

The following table illustrates the effect on operating results and per share information had the Company accounted for stock-based compensation in accordance with SFAS 123 for the three months ended March 31, 2005 (in thousands, except per share amounts):

	Three Months Ended March 31, 2005
Net income available to common shares as reported	\$ 9,157
Add: Stock-based compensation expense included in net income as reported, net of tax	191
Deduct: Total stock-based compensation expense under fair value based method, net of tax	(230)
Net income available to common shares pro forma	<u>\$ 9,118</u>
Net income per share available to common:	
Basic-as reported	\$ 0.52
Basic-pro forma	\$ 0.52
Diluted-as reported	\$ 0.46
Diluted-pro forma	\$ 0.46

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Stock Options

The Company uses the Black-Scholes option pricing model to estimate the fair value of stock-based awards with the following weighted-average assumptions for the indicated periods.

	Three Months Ended March 31,	
	2006	2005
Dividend yield	—	—
Expected volatility	38.9%	42.4%
Risk-free interest rate	4.6%	4.4%
Expected life of option (in years)	5	4
Weighted-average grant-date fair value	7.72	6.19
Forfeiture rate	7.5%	—

The assumptions above are based on multiple factors, including historical exercise patterns of employees with respect to exercise and post-vesting employment termination behaviors, expected future exercising patterns and the historical volatility of our stock price.

At March 31, 2006, there was \$284,000 of unrecognized compensation cost related to stock option share-based payments, which is expected to be recognized over a weighted-average period of 2.8 years.

The following table represents stock option activity for the three months ended March 31, 2006:

	Number of Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contract Life
Outstanding options at beginning of period	1,205,558	\$ 10.11	
Granted	15,000	18.69	
Exercised	(384,650)	10.65	
Forfeited	—	—	
Outstanding options at end of period	835,908	10.02	4.48 Yrs.
Outstanding exercisable at end of period	787,908	\$ 9.55	4.17 Yrs.

The aggregate intrinsic value of options outstanding was \$9.2 million and the aggregate intrinsic value of options exercisable was \$9.0 million. Total intrinsic value of options exercised was \$3.4 million for the three months ended March 31, 2006.

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The following table summarizes our nonvested stock option activity for the three months ended March 31, 2006.

	Number of Shares	Weighted-Average Exercise Price
Nonvested stock options at beginning of period	39,000	\$ 16.94
Granted	15,000	18.69
Vested	(6,000)	15.21
Forfeited	—	—
Nonvested stock options at end of period	48,000	\$ 17.70

Restricted Stock

The Plans allow for the issuance of restricted stock awards. The unearned stock-based compensation related to these awards is being amortized to compensation expense over the vesting period, which ends in the third quarter of 2009. The share based expense for these awards was determined based on the market price of our stock at the date of grant applied to the total numbers of shares that were anticipated to fully vest. As of March 31, 2006, we have unearned stock-based compensation of \$3.1 million associated with these awards.

The following table represents restricted stock activity for the three months ended March 31, 2006.

	Number of Shares	Weighted-Average Grant Price
Outstanding shares at beginning of period	272,000	\$ 13.66
Granted	—	—
Vested	—	—
Forfeited	—	—
Outstanding shares at end of period	272,000	\$ 13.66

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3. Per Share Amounts

Basic net income per common share was computed by dividing net income by the weighted average number of shares of common stock outstanding during the period. Diluted net income per common share was determined on a weighted average basis using common shares issued and outstanding adjusted for the effect of common stock equivalents computed using the treasury stock method. In addition, an adjustment was included in 2005 for the effect of the convertible preferred stock.

A reconciliation of the basic and diluted earnings per share computation is as follows (in thousands, except per share amounts):

	Three Months Ended	
	March 31,	
	2006	2005
(a) Net income available to common shares	\$ 12,767	\$ 9,157
Preferred dividends assuming conversion of preferred stock (if dilutive)	—	318
(b) Income available to common shares assuming conversion of preferred stock (if dilutive)	\$ 12,767	\$ 9,475
(c) Weighted average shares outstanding	19,396	17,671
Dilutive impact of stock options	342	315
Dilutive impact of warrants	1,491	1,267
Dilutive impact of restricted stock	100	69
Convertible preferred stock (if dilutive)	—	1,356
(d) Total diluted shares	21,329	20,678
Basic income per share (a, c)	\$ 0.66	\$ 0.52
Diluted income per share (b, d)	\$ 0.60	\$ 0.46

Stock options and warrants excluded due to the exercise price being greater than the stock price (in thousands)

15 25

4. Derivatives

The Company periodically uses derivative financial instruments to manage oil and gas price risk. Settlements of gains and losses on commodity price contracts are generally based upon the difference between the contract price or prices specified in the derivative instrument and a NYMEX price or other cash or futures index price.

The Company's derivative contracts that are accounted for as cash flow hedges under Statement of Financial Accounting Standards No. 133 ("SFAS No. 133"), "Accounting for Derivative Instruments and Hedging Activities," are recorded at fair market value and the

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changes in fair value are recorded through other comprehensive income (loss), net of tax, in stockholders' equity. The cash settlements on these contracts are recorded as an increase or decrease in oil and gas sales. The changes in fair value related to ineffective derivative contracts are recognized as derivative expense (income). The cash settlements on these contracts are also recorded within derivative expense (income).

Cash settlements on effective cash flow hedges during the three-month periods ended March 31, 2006 and 2005 resulted in an increase in oil and gas sales of \$724,000 and a reduction of oil and gas sales of \$2.9 million, respectively. Derivative expense of \$90,000 and \$379,000 for the three-month periods ended March 31, 2006 and 2005, respectively, represents the amortization of derivative contract premiums.

As of March 31, 2006, the fair value of the outstanding gas derivative contracts was a current asset of \$2.2 million and the fair value of the outstanding oil contracts was a current liability of \$653,000.

Listed in the table below are the outstanding derivative contracts as of March 31, 2006:

Swaps

Product	Volumes per Month	Quantity Type	Average Price	Period
Oil	15,000	Bbls	\$55.00	04/06-06/06

Collars

Product	Volumes per Month	Quantity Type	Average Floor Price	Average Ceiling Price	Period
Oil	30,000	Bbls	\$60.00	\$77.10	04/06-12/06
Oil	30,000	Bbls	\$60.00	\$81.75	04/06-12/06
Natural Gas	100,000	MMBtu	\$ 8.00	\$10.40	04/06-06/06
Natural Gas	100,000	MMBtu	\$ 8.00	\$10.30	07/06-09/06
Natural Gas	600,000	MMBtu	\$ 8.00	\$ 9.30	04/06-12/06

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5. Long-Term Debt

Long-term debt consisted of the following at:

	<u>March 31,</u> <u>2006</u>	<u>December 31,</u> <u>2005</u>
	(In thousands)	
Senior Secured Credit Facility (matures July 31, 2007)	\$ 5,000	\$ —
9.75% Senior Notes (due 2010), net of discount	188,401	187,941
Capital lease	<u>1,053</u>	<u>1,135</u>
Total debt	194,454	189,076
Less current portion:		
Capital lease	<u>236</u>	<u>263</u>
Long-term debt	<u>\$194,218</u>	<u>\$ 188,813</u>

On June 15, 2004, the Company closed on a three-year senior secured credit facility underwritten by Union Bank of California, N.A. The credit facility had an initial borrowing base of \$60 million, which was increased to \$70 million in the second quarter of 2005. The borrowing base is reviewed and redetermined semi-annually and can be increased to a maximum of \$175 million. Borrowings under the credit facility are secured by mortgages covering the Company's five largest fields. As of March 31, 2006, there was \$5 million outstanding under the facility with a weighted average interest rate of 6.38% and \$65 million available for future borrowings.

6. Comprehensive Income

A summary of the Company's comprehensive income (loss) is detailed below (in thousands):

	<u>Three Months Ended</u> <u>March 31,</u>	
	<u>2006</u>	<u>2005</u>
Net income	\$ 12,767	\$ 9,475
Other comprehensive income (loss):		
Change in fair value of effective cash flow hedges	<u>1,275</u>	<u>(4,849)</u>
Total comprehensive income	<u>\$ 14,042</u>	<u>\$ 4,626</u>

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7. Asset Retirement Obligations

The following table summarizes the activity for the Company's asset retirement obligation for the three-month period ended March 31, 2006:

	Three Months Ended March 31, 2006
Asset retirement obligation at beginning of period	\$ 38,273
Accretion expense	1,419
Liabilities incurred	1,109
Liabilities settled	—
Revisions to estimate	<u>11,537</u>
Asset retirement obligation at end of period	52,338
Less: current asset retirement obligation	<u>(27,040)</u>
Long-term asset retirement obligation	<u>\$ 25,298</u>

The upward revisions to estimate were primarily due to a sharp increase in industry service cost for the Gulf of Mexico region experienced in the first quarter of 2006, principally as a result of the weather patterns during the second half of 2005.

Assets, primarily U.S. Government securities, of approximately \$6.0 million at March 31, 2006, are recorded as restricted investments. These assets are held in abandonment trusts dedicated to pay future abandonment costs for several of the Company's oil and gas properties.

Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Forward-Looking Statements

This report includes "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. All statements other than statements of historical facts included in this report, including statements regarding our financial position, adequacy of resources, estimated reserve quantities, business strategies, plans, objectives and expectations for future operations and covenant compliance, are forward-looking statements. We can give no assurances that the assumptions upon which such forward-looking statements are based will prove to have been correct. Important factors that could cause actual results to differ materially from our expectations ("Cautionary Statements") are disclosed in the section entitled "Risk Factors" included in our Annual Report on Form 10-K for our most recent fiscal year, elsewhere in this report and from time to time in other filings made by us with the Securities and Exchange Commission. All subsequent written and oral forward-looking statements attributable to us or persons acting on our behalf are expressly qualified by the Cautionary Statements.

General

Our revenues, profitability, future growth and the carrying value of our oil and gas properties are substantially dependent on prevailing prices of oil and gas, our ability to find, develop and acquire additional oil and gas reserves that are economically recoverable and our ability to develop existing proved undeveloped reserves. Our ability to maintain or increase our borrowing capacity and to obtain additional capital on attractive terms is also influenced by oil and gas prices. Prices for oil and gas are subject to large fluctuations in response to relatively minor changes in the supply of and demand for oil and gas, market uncertainty and a variety of additional factors beyond our control. These factors include weather conditions in the United States, the condition of the United States economy, the actions of the Organization of Petroleum Exporting Countries, governmental regulations, political stability in the Middle East and elsewhere, the foreign supply of oil and gas, the price of foreign imports and the availability of alternate fuel sources. Any substantial and extended decline in the price of oil or gas would have an adverse effect on the carrying value of our proved reserves, borrowing capacity, revenues, profitability and cash flows from operations. We use derivative financial instruments for price protection purposes on a limited amount of our future production, but do not use derivative financial instruments for trading purposes.

The following discussion is intended to assist in an understanding of our historical financial position and results of operations. Our historical financial statements and notes thereto included elsewhere in this quarterly report contain detailed information that should be referred to in conjunction with the following discussion.

Liquidity and Capital Resources

Our primary sources of capital are cash flows from operations, borrowings from financial institutions and the sale of debt and equity securities. On March 31, 2006, we had net cash and cash equivalents of \$5 million and \$65 million of availability under our senior secured credit facility. Cash provided from operating activities during the three-month period ended March 31, 2006 totaled \$41 million. Cash provided by operating activities during the first quarter of 2006 increased 92% compared to 2005, due to increased oil and gas prices. Net capital expenditures from the cash flow statement for the three-month period ended March 31, 2006 totaled \$40 million.

Production of our reserves during 2006, without weather-related downtime, is projected to be higher than 2005 due to 10 new discoveries scheduled to commence initial production during 2006 which are expected to offset traditional declines from our current producing properties. Given the current pricing environment for oil and natural gas and the higher production volumes, our cash provided by operating activities for 2006 should exceed 2005.

Our capital expenditure plans for 2006, including capitalized interest and general and administrative expenses, will require \$150 million of funding. We expect that cash flow generated from operations during 2006 and current availability under our senior secured credit facility, if necessary, will provide the \$177 million of capital necessary to fund these planned capital expenditures as well as our asset retirement obligations. See the Capital Expenditures section below for a more detailed discussion of our capital expenditures for 2006.

The Indentures governing our 9.75% Senior Notes due 2010 and our senior secured credit facility contain various covenants, including restrictions on additional indebtedness and payment of cash dividends. In addition, our senior secured credit facility contains covenants for maintenance of certain financial ratios. We were in compliance with these covenants at March 31, 2006. See Note 5 of the Consolidated Financial Statements for the year ended December 31, 2005 included in our Annual Report on Form 10-K filed March 15, 2006 for a more detailed discussion of long-term debt.

The following table describes our outstanding contractual obligations (in thousands) as of March 31, 2006:

Contractual Obligations	Total	Less Than One Year	One-Three Years	Four-Five Years	After-Five Years
Senior Secured Credit Facility	\$ 5,000	\$ —	\$ 5,000	\$ —	\$ —
9.75% Senior Notes	200,000	—	—	200,000	—
Capital Lease (future minimum payments)	1,581	401	542	449	189
Throughput Commitments:					
Medusa Spar	11,776	3,772	5,160	2,844	—
Medusa Oil Pipeline	555	181	172	110	92
	<u>\$218,912</u>	<u>\$ 4,354</u>	<u>\$ 10,874</u>	<u>\$203,403</u>	<u>\$ 281</u>

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Capital Expenditures

Capital expenditures from the cash flow statement for exploration and development costs related to oil and gas properties totaled approximately \$40 million for the three months ended March 31, 2006. We incurred approximately \$27 million in costs in the Gulf of Mexico Shelf Area related primarily to the drilling of five wells, four successful and one in progress, and completion and development of seven discoveries. In the Onshore Louisiana area we incurred \$5 million, which was associated with the drilling and beginning stage of completion for our Prairie Beach discovery. Interest of approximately \$2 million and general and administrative costs allocable directly to exploration and development projects of approximately \$2 million were capitalized for the first three months of 2006. The remainder of the capital expended includes the acquisition of seismic and leases and costs incurred in our Gulf of Mexico deepwater area.

Capital expenditures for the remainder of 2006 are forecast to be approximately \$110 million and include:

- the completion and development of our 2005 and 2006 discoveries;
- the non-discretionary drilling of exploratory wells;
- the acquisition of seismic and leases; and
- capitalized interest and general and administrative costs.

In addition, we are projecting to spend \$27 million for asset retirement obligations.

Off-Balance Sheet Arrangements

In December 2003, we announced the formation of a limited liability company, Medusa Spar LLC, which now owns a 75% undivided ownership interest in the deepwater Spar production facilities on our Medusa Field in the Gulf of Mexico. We contributed a 15% undivided ownership interest in the production facility to Medusa Spar LLC in return for approximately \$25 million in cash and a 10% ownership interest in the LLC. The LLC will earn a tariff based upon production volume throughput from the Medusa area. We are obligated to process our share of production from the Medusa Field and any future discoveries in the area through the Spar production facilities. This arrangement allows us to defer the cost of the Spar production facility over the life of the Medusa Field. Our cash proceeds were used to reduce the balance outstanding under our senior secured credit facility. The LLC used \$83.7 million of cash proceeds from non-recourse financing and a cash contribution by one of the LLC owners to acquire its 75% interest in the Spar. The balance of Medusa Spar LLC is owned by Oceaneering International, Inc. (NYSE:OII) and Murphy Oil Corporation (NYSE:MUR). We are accounting for our 10% ownership interest in the LLC under the equity method.

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Results of Operations

The following table sets forth certain unaudited operating information with respect to the Company's oil and gas operations for the periods indicated:

	Three Months Ended March 31,	
	2006	2005
Net production :		
Oil (MBbls)	515	641
Gas (MMcf)	1,950	2,748
Total production (MMcfe)	5,042	6,593
Average daily production (MMcfe)	56.0	73.3
Average sales price:		
Oil (Bbls) (a)	\$ 53.95	\$ 37.46
Gas (Mcf)	9.12	6.92
Total (Mcf)	9.04	6.52
Oil and gas revenues:		
Oil revenue	\$ 27,799	\$ 24,009
Gas revenue	17,782	19,003
Total	<u>\$ 45,581</u>	<u>\$ 43,012</u>
Oil and gas production costs:		
Lease operating expense	\$ 5,905	\$ 6,536
Additional per Mcfe data:		
Sales price	\$ 9.04	\$ 6.52
Lease operating expense	1.17	0.99
Operating margin	<u>\$ 7.87</u>	<u>\$ 5.53</u>
Depletion, depreciation and amortization	\$ 2.74	\$ 2.34
General and administrative	\$ 0.34	\$ 0.26

(a) Below is a reconciliation of the average NYMEX price to the average realized sales price per barrel of oil:

Average NYMEX oil price	\$ 63.48	\$ 49.85
Basis differential and quality adjustments	(7.52)	(6.33)
Transportation	(1.27)	(1.31)
Hedging	(0.74)	(4.75)
Average realized oil price	<u>\$ 53.95</u>	<u>\$ 37.46</u>

Comparison of Results of Operations for the Three Months Ended March 31, 2006 and the Three Months Ended March 31, 2005.

Oil and Gas Production and Revenues

Total oil and gas revenues increased 6% to \$45.6 million in the first quarter of 2006 from \$43.0 million in the first quarter of 2005. The increase was due to higher product prices. Total production on an equivalent basis for the first quarter of 2006 decreased by 24% versus the first quarter of 2005.

Gas production during the first quarter of 2006 totaled 2.0 Bcf and generated \$17.8 million in revenues compared to 2.7 Bcf and \$19.0 million in revenues during the same period in 2005. The average gas price after hedging impact for the first quarter of 2006 was \$9.12 per Mcf compared to \$6.92 per Mcf for the same period last year. The decrease in production was primarily due to normal and expected decline in production from our Habanero, High Island Block 119, and Mobile Bay area fields and older properties. The decrease was partially offset by production from our new well at East Cameron 90. In addition, initial production from several of our new discoveries was delayed until the second quarter due to weather and equipment availability.

Oil production during the first quarter of 2006 totaled 515,000 barrels and generated \$27.8 million in revenues compared to 641,000 barrels and \$24.0 million in revenues for the same period in 2005. The average oil price received after hedging impact in the first quarter of 2006 was \$53.95 per barrel compared to \$37.46 per barrel in the first quarter of 2005. The decrease in production for the first quarter of 2006 compared to the first quarter of 2005 was primarily due to normal and expected decline in production from our Habanero Field and older properties.

Lease Operating Expenses

Lease operating expenses were \$5.9 million for the three-month period ended March 31, 2006, a decrease of \$600,000 compared to the same period in 2005. The decrease was primarily due to the shut-in of our Main Pass 163 Field after the first quarter of 2005, which became uneconomic and is awaiting plugging and abandonment, and a decrease in through-put charges for Habanero resulting from lower production.

Depreciation, Depletion and Amortization

Depreciation, depletion and amortization for the three months ended March 31, 2006 and 2005 was \$13.8 million and \$15.4 million, respectively. The 10% decrease was primarily due to lower production volumes for the first quarter of 2006 compared to the same period last year. The decrease was partially offset by a higher depletion rate.

Accretion Expense

Accretion expense for the three-month period ended March 31, 2006 and 2005 of \$1.4 million and \$861,000, respectively, represents accretion of our asset retirement obligations. The increase was due to the addition of plugging and abandonment obligations associated with new discoveries. See Note 8 to the Consolidated Financial Statements.

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General and Administrative

General and administrative expenses, net of amounts capitalized, were \$1.7 million for both three-month periods ended March 31, 2006 and 2005.

Interest Expense

Interest expense decreased by 9% to \$4.1 million during the three months ended March 31, 2006 from \$4.6 million during the three months ended March 31, 2005. This decrease is primarily attributable to an increase in capitalized interest resulting from an increase in our investment in unevaluated properties over the last year due to an increase in our exploration program activities.

Income Taxes

Income tax expense was \$6.6 million and \$4.8 million for the three-month periods ended March 31, 2006 and 2005, respectively. The increase was due to an increase in income before income taxes.

Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company's revenues are derived from the sale of its crude oil and natural gas production. The prices for oil and gas remain extremely volatile and sometimes experience large fluctuations as a result of relatively small changes in supply, weather conditions, economic conditions and government actions. From time to time, the Company enters into derivative financial instruments to manage oil and gas price risk.

The Company utilizes fixed price "swaps", which reduce the Company's exposure to decreases in commodity prices and limit the benefit the Company might otherwise have received from any increases in commodity prices.

The Company utilizes price "collars" to reduce the risk of changes in oil and gas prices. Under these arrangements, no payments are due by either party so long as the market price is above the floor price and below the ceiling price set in the collar. If the price falls below the floor, the counter-party to the collar pays the difference to the Company, and if the price rises above the ceiling, the counter-party receives the difference from the Company.

Callon has purchased "puts" as another form of derivative financial instrument which reduces the Company's exposure to decreases in oil and gas prices while allowing realization of the full benefit from any increases in oil and gas prices. If the price falls below the puts, the counter-party pays the difference to the Company.

The Company enters into these various agreements from time to time to reduce the effects of volatile oil and gas prices and does not enter into derivative transactions for speculative purposes. However, certain of the Company's derivative positions may not be designated as hedges for accounting purposes.

See Note 4 to the Consolidated Financial Statements for a description of the Company's outstanding derivative contracts at March 31, 2006. There have been no significant changes in market risks faced by the Company since the end of 2005.

Item 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures. The Company's principal executive and financial officer has concluded that the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934 (the "Exchange Act")) were effective as of March 31, 2006 to ensure that information required to be disclosed by the Company in reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission.

There were no changes in the Company's internal control over financial reporting that occurred during the Company's last fiscal quarter that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

CALLON PETROLEUM COMPANY

PART II. OTHER INFORMATION

Item 6. EXHIBITS

Exhibits

3. Articles of Incorporation and By-Laws
 - 3.1 Certificate of Incorporation of the Company, as amended (incorporated by reference from Exhibit 3.1 of the Company's Annual Report on Form 10-K for the year ended December 31, 2003 filed March 15, 2004, File No. 001-14039)
 - 3.2 Bylaws of the Company (incorporated by reference from Exhibit 3.2 of the Company's Registration Statement on Form S-4, filed August 4, 1994, Reg. No. 33-82408)
4. Instruments defining the rights of security holders, including indentures
 - 4.1 Specimen Common Stock Certificate (incorporated by reference from Exhibit 4.1 of the Company's Registration Statement on Form S-4, filed August 4, 1994, Reg. No. 33-82408)
 - 4.2 Rights Agreement between Callon Petroleum Company and American Stock Transfer & Trust Company, Rights Agent, dated March 30, 2000 (incorporated by reference from Exhibit 99.1 of the Company's Registration Statement on Form 8-A, filed April 6, 2000, File No. 001- 14039)
 - 4.3 Warrant dated as of June 29, 2001 entitling Duke Capital Partners, LLC to purchase common stock from the Company (incorporated by reference to Exhibit 4.11 of the Company's Quarterly Report on Form 10-Q for the period ended June 30, 2001, File No. 001-14039)

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- 4.4 Form of Warrant entitling certain holders of the Company's 10.125% Senior Subordinated Notes due 2002 to purchase common stock from the Company (incorporated by reference to Exhibit 4.13 of the Company's Form 10-Q for the period ended June 30, 2002, File No. 001-14039)
- 4.5 Form of Warrants dated December 8, 2003 and December 29, 2003 entitling lenders under the Company's \$185 million amended and restated Senior Unsecured Credit Agreement, dated December 23, 2003, to purchase common stock from the Company (incorporated by reference to Exhibit 4.14 of the Company's Annual Report on Form 10-K for the year ended December 31, 2003, File No. 001-14039)
- 4.6 Indenture for the Company's 9.75% Senior Notes due 2010, dated March 15, 2004, between Callon Petroleum Company and American Stock Transfer & Trust Company (incorporated by reference to Exhibit 4.16 of the Company's Quarterly Report on Form 10-Q for the period ended March 31, 2004, File No. 001-14039)
- 10. Material Contracts
 - 10.1 2006 Stock Incentive Plan
- 31. Certifications
 - 31.1 Certification of Chief Executive and Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 32. Section 1350 Certifications
 - 32.1 Certification of Chief Executive and Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

SIGNATURES

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

CALLON PETROLEUM COMPANY

Date: May 8, 2006

By: /s/ Fred L. Callon

Fred L. Callon, President and Chief Executive Officer (on behalf of the registrant and as the principal financial officer)

Exhibit Index

<u>Exhibit Number</u>	<u>Title of Document</u>
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CALLON PETROLEUM COMPANY
2006 Stock Incentive Plan
(Effective May 4, 2006)

SECTION 1
General Provisions Relating to
Plan Governance, Coverage and Benefits

1.1 Establishment and Purpose

Callon Petroleum Company, a Delaware corporation, (the “*Company*”) hereby establishes the Callon Petroleum Company 2006 Stock Incentive Plan effective as of May 4, 2006 (the “*Effective Date*”) (the “*Plan*”) for the benefit of the Company and the participants in the Plan.

The purpose of the Plan is to foster and promote the long-term financial success of the Company and to increase stockholder value by: (a) encouraging the commitment and retention of selected key Employees and Outside Directors, (b) motivating superior performance of key Employees and Outside Directors by means of long-term incentives, (c) encouraging and providing key Employees and Outside Directors with a program for obtaining ownership interests in the Company that link and align their personal interests to those of the Company’s stockholders, (d) maintaining competitive compensation levels, thereby attracting and retaining key Employees and Outside Directors by providing competitive compensation opportunities, and (e) enabling key Employees and Outside Directors to share in the long-term growth and success of the Company.

The Plan will remain in effect, subject to the right of the Board to amend or terminate the Plan at any time pursuant to Section 6.7, until the earlier of the date that (a) all Shares subject to the Plan have been purchased or acquired according to its provisions or (b) the Plan terminates pursuant to Section 6.18. However, in no event may an Incentive Stock Option be granted under the Plan after the expiration of ten (10) years from the Effective Date.

1.2 Definitions

The following terms shall have the meanings set forth below:

- (a) *Authorized Officer*. The Chairman of the Board, the CEO or any other senior officer of the Company to whom either of them delegate the authority to execute any Incentive Agreement for and on behalf of the Company. No officer or director shall be an Authorized Officer with respect to any Incentive Agreement for himself.
 - (b) *Board*. The Board of Directors of the Company.
-

- (c) *Cause*. Unless otherwise provided in the applicable Incentive Agreement, when used in connection with the termination of a Grantee's Employment, "Cause" shall mean the termination of the Grantee's Employment by the Company or any Subsidiary by reason of:
- (i) the conviction of the Grantee by a court of competent jurisdiction as to which no further appeal can be taken of a crime involving moral turpitude or a felony or entering the plea of *nolo contendere* to such crime by Grantee;
 - (ii) the commission by the Grantee of a material act of fraud upon the Company or any Parent or Subsidiary;
 - (iii) the material misappropriation by the Grantee of any funds or other property of the Company or any Parent or Subsidiary;
 - (iv) the knowing engagement by the Grantee without the written approval of the Board, in any material activity which directly competes with the business of the Company or any Parent or Subsidiary, or which would directly result in a material injury to the business or reputation of the Company or any Parent or Subsidiary; or
 - (v) with respect to any Grantee who is an Employee (A) a material breach by Employee during his employment period of any of the restrictive covenants set out in his employment agreement with the Company or any Parent or Subsidiary, if applicable, or (B) the willful, material and repeated nonperformance of Employee's duties to the Company or any Parent or Subsidiary (other than by reason of Employee's illness or incapacity), but Cause shall not exist under this clause; or (v) (A) or (v)(B) until after written notice from the Board has been given to Employee of such material breach or nonperformance (which notice specifically identifies the manner and sets forth specific facts, circumstances and examples in which the Board believes that Employee has breached the agreement or not substantially performed his duties) and Employee has failed to cure such alleged breach or nonperformance within the time period set by the Board, but in no event less than thirty (30) business days after his receipt of such notice; and, for purposes of this clause (v), no act or failure to act on Employee's part shall be deemed "willful" unless it is done or omitted by Employee not in good faith and without his reasonable belief that such action or omission was in the best interest of the Company (assuming disclosure of the pertinent facts, any action or omission by Employee after consultation with, and in accordance with the advice of, legal counsel reasonably acceptable to the Company shall be deemed to have been taken in good faith and to not be willful for purposes of this definition of "Cause").
- (d) *CEO*. The Chief Executive Officer of the Company.

- (e) *Change in Control.* Any of the events described in and subject to Section 5.8.
- (f) *Code.* The Internal Revenue Code of 1986, as amended, and the regulations and other authority promulgated thereunder. References herein to any provision of the Code shall refer to any successor provision thereto.
- (g) *Committee.* A committee appointed by the Board to administer the Plan. The Plan shall be administered by the Compensation Committee appointed by the Board consisting of not less than three directors who fulfill the “non-employee director” requirements of Rule 16b-3 under the Exchange Act and the “outside director” requirements of Code Section 162(m). The Compensation Committee of the Board may appoint a subcommittee provided that, in all events, the members of the Committee for purposes of the Plan satisfy the requirements of the previous provisions of this paragraph.

The Board shall have the power to fill vacancies on the Committee arising by resignation, death, removal or otherwise. The Board, in its sole discretion, may divide the powers and duties of the Committee among one or more separate committees, or retain all powers and duties of the Committee in a single Committee. The members of the Committee shall serve at the discretion of the Board.

Notwithstanding the preceding paragraphs of this Section 1.2(g), the term “Committee” as used in the Plan with respect to any Incentive Award for an Outside Director shall refer to the entire Board. In the case of an Incentive Award for an Outside Director, the Board shall have all the powers and responsibilities of the Committee hereunder as to such Incentive Award, and any actions as to such Incentive Award may be acted upon only by the Board (unless it otherwise designates in its discretion). When the Board exercises its authority to act in the capacity as the Committee hereunder with respect to an Incentive Award for an Outside Director, it shall so designate with respect to any action that it undertakes in its capacity as the Committee.

- (h) *Common Stock.* The common stock of the Company, no par value per share and any class of common stock into which such common shares may hereafter be converted, reclassified or recapitalized.
- (i) *Company.* Callon Petroleum Company and any successor in interest thereto.
- (j) *Covered Employee.* A named executive officer who is one of the group of covered employees, as defined in Code Section 162(m) and Treasury Regulation § 1.162-27(c) (or its successor), during any period that the Company is a Publicly Held Corporation.
- (k) *Disability.* Disability means that the Grantee, because of ill health, physical or mental disability or any other reason beyond his control, is unable to perform his

employment duties for a period of six (6) continuous months, as determined in good faith by the Committee. With respect to any Incentive Stock Option, however, “Disability” means permanent and total disability as defined in Code Section 22(e)(3). A determination of Disability may be made by a physician selected or approved by the Committee and, in this respect, the Grantee shall submit to any reasonable examination(s) required by such physician upon request. Notwithstanding the foregoing provisions of this paragraph, in the event any Incentive Award is subject to Code Section 409A, then, in lieu of the foregoing definition and to the extent necessary to comply with the requirements of Code Section 409A, the definition of “Disability” for purposes of such Incentive Award shall be the definition of “disability” provided for under Code Section 409A and the regulations or other guidance issued thereunder.

- (l) *Employee.* Any employee of the Company within the meaning of Code Section 3401(c) who, in the opinion of the Committee, is in a position to contribute to the growth, development or financial success of the Company, including, without limitation, officers who are members of the Board.
- (m) *Employment.* Employment means that the individual is employed as an Employee, or engaged as an Outside Director, by the Company, or by any corporation issuing or assuming an Incentive Award in any transaction described in Code Section 424(a). In this regard, neither the transfer of a Grantee from Employment by the Company to Employment by any Parent or Subsidiary, nor the transfer of a Grantee from Employment by any Parent or Subsidiary to Employment by the Company, shall be deemed to be a termination of Employment of the Grantee. Moreover, the Employment of a Grantee shall not be deemed to have been terminated because of an approved leave of absence from active Employment on account of temporary illness, authorized vacation or granted for reasons of professional advancement, education, or health, or during any period required to be treated as a leave of absence by virtue of any applicable statute, Company personnel policy or written agreement. All determinations regarding Employment, and the termination of Employment hereunder, shall be made by the Committee.

The term “Employment” for all purposes of the Plan shall include (i) active performance of agreed services by an employee and (ii) current membership on the Board by an Outside Director.

Notwithstanding anything in the Plan to the contrary, in the event an Incentive Award issued under the Plan is subject to Code Section 409A, then, to the extent necessary to comply with Code Section 409A, no Employee or Outside Director shall be deemed to have suffered a termination of Employment, unless such termination of Employment constitutes a “separation from service” as defined under Code Section 409A and the regulations or other guidance issued thereunder.

- (n) *Exchange Act.* The Securities Exchange Act of 1934, as amended.

- (o) *Fair Market Value.* While the Company is a Publicly Held Corporation, the Fair Market Value of one Share of Common Stock on the date in question is deemed to be the average of the opening and closing prices of a Share on the date as of which Fair Market Value is to be determined, or if no such sales were made on such date, the closing sales price on the immediately preceding business day of a Share as reported on the New York Stock Exchange or other principal securities exchange on which Shares are then listed or admitted to trading.

If the Company is not a Publicly Held Corporation at the time a determination of the Fair Market Value of the Common Stock is required to be made hereunder, the determination of Fair Market Value for purposes of the Plan shall be made by the Committee in its sole and absolute discretion and using a reasonable valuation method in accordance with the requirements of Code Section 409A and the regulations and other guidance issued thereunder. In this respect, the Committee may rely on such financial data, appraisals, valuations, experts, and other sources as, in its sole and absolute discretion, it deems advisable under the circumstances.

- (p) *Grantee.* Any Employee or Outside Director who is granted an Incentive Award under the Plan.
- (q) *Immediate Family.* With respect to a Grantee, the Grantee's child, stepchild, grandchild, parent, stepparent, grandparent, spouse, former spouse, sibling, mother-in-law, father-in-law, son-in-law, daughter-in-law, brother-in-law, or sister-in-law, including adoptive relationships.
- (r) *Incentive Agreement.* The written agreement entered into between the Company and the Grantee setting forth the terms and conditions pursuant to which an Incentive Award is granted under the Plan, as such agreement are further defined in Section 5.1.
- (s) *Incentive Award or Award.* A grant of an award under the Plan to a Grantee, including any Non-statutory Stock Option, Incentive Stock Option, Stock Appreciation Right (SAR), or Restricted Stock Award.
- (t) *Incentive Stock Option or ISO.* A Stock Option granted by the Committee to an Employee under Section 2 which is designated by the Committee as an Incentive Stock Option and is intended to qualify as an Incentive Stock Option under Code Section 422.
- (u) *Insider.* If the Company is a Publicly Held Corporation, an individual who is, on the relevant date, an officer, director or ten percent (10%) beneficial owner of any class of the Company's equity securities that is registered pursuant to Section 12 of the Exchange Act, all as defined under Section 16 of the Exchange Act.
- (v) *Non-statutory Stock Option.* A Stock Option granted by the Committee to a Grantee under Section 2 that is not designated by the Committee as an Incentive Stock Option.

- (w) *Option Price*. The exercise price at which a Share may be purchased by the Grantee of a Stock Option.
- (x) *Other Stock-Based Award*. An award granted by the Committee to a Grantee under Section 4.1 that is valued in whole or in part by reference to, or is otherwise based upon, Common Stock.
- (y) *Outside Director*. A member of the Board who is not at the time of grant of an Incentive Award, an Employee.
- (z) *Parent*. Any corporation (whether now or hereafter existing) which constitutes a “parent” of the Company, as defined in Code Section 424(e).
- (aa) *Plan*. The Callon Petroleum Company 2006 Stock Incentive Plan, as set forth herein and as it may be amended from time to time.
- (bb) *Publicly Held Corporation*. A corporation issuing any class of common equity securities required to be registered under Section 12 of the Exchange Act.
- (cc) *Restricted Stock*. Shares of Common Stock issued or transferred to a Grantee pursuant to Section 3.
- (dd) *Restricted Stock Award*. An authorization by the Committee to issue or transfer Restricted Stock to a Grantee pursuant to Section 3.
- (ee) *Restriction Period*. The period of time determined by the Committee and set forth in the Incentive Agreement during which the transfer of Restricted Stock by the Grantee is restricted.
- (ff) *Retirement*. The voluntary termination of Employment from the Company constituting retirement for age (i) on any date after the Employee attains the normal retirement age of 62 years, or (ii) an earlier retirement date for age as expressly agreed to by the Committee and designated by the Committee in the Employee’s individual Incentive Agreement.
- (gg) *Share*. A share of the Common Stock of the Company.
- (hh) *Share Pool*. The number of shares authorized for issuance under Section 1.4, as adjusted for awards and payouts under Section 1.5 and as adjusted for changes in corporate capitalization under Section 5.6.
- (ii) *Spread*. The difference between the exercise price per Share specified in a SAR grant and the Fair Market Value of a Share on the date of exercise of the SAR.
- (ij) *Stock Appreciation Right or SAR*. A Stock Appreciation Right as described in Section 2.5.

- (kk) *Stock Option or Option.* Pursuant to Section 2, (i) an Incentive Stock Option granted to an Employee or (ii) a Non-statutory Stock Option granted to an Employee or Outside Director, which Option provides the Grantee with the right to purchase Shares of Common Stock upon specified terms. In accordance with Code Section 422, only an Employee may be granted an Incentive Stock Option.
- (ll) *Subsidiary.* Any (i) corporation in an unbroken chain of corporations beginning with the Company, if each of the corporations other than the last corporation in the unbroken chain owns stock possessing a majority of the total combined voting power of all classes of stock in one of the other corporations in the chain, (ii) limited partnership, if the Company or any corporation described in item (i) above owns a majority of the general partnership interest and a majority of the limited partnership interests entitled to vote on the removal and replacement of the general partner, and (iii) partnership or limited liability company, if the partners or members thereof are composed only of the Company, any corporation listed in item (i) above or any limited partnership listed in item (ii) above, except that with respect to the issuance of Incentive Stock Options, the term “Subsidiary” shall have the same meaning as the term “subsidiary corporation” as defined in Code Section 424(f) as required by Code Section 422.

1.3 Plan Administration

- (a) *Authority of the Committee.* Except as may be limited by law and subject to the provisions herein, the Committee shall have full power to (i) select Grantees who shall participate in the Plan; (ii) determine the sizes, duration and types of Incentive Awards; (iii) determine the terms and conditions of Incentive Awards and Incentive Agreements; (iv) determine whether any Shares subject to Incentive Awards will be subject to any restrictions on transfer; (v) construe and interpret the Plan and any Incentive Agreement or other agreement entered into under the Plan; and (vi) establish, amend, or waive rules for the Plan’s administration. Further, the Committee shall make all other determinations which may be necessary or advisable for the administration of the Plan.
- (b) *Meetings.* The Committee shall designate a chairman from among its members who shall preside at its meetings, and shall designate a secretary, without regard to whether that person is a member of the Committee, who shall keep the minutes of the proceedings and all records, documents, and data pertaining to its administration of the Plan. Meetings shall be held at such times and places as shall be determined by the Committee and the Committee may hold telephonic meetings. The Committee may take any action otherwise proper under the Plan by the affirmative vote, taken with or without a meeting, of a majority of its members. The Committee may authorize any one or more of its members or any officer of the Company to execute and deliver documents on behalf of the Committee.
- (c) *Decisions Binding.* All determinations and decisions of the Committee shall be made in its discretion pursuant to the terms and provisions of the Plan, and shall

be final, conclusive and binding on all persons including the Company, its stockholders, Employees, Grantees, and their estates and beneficiaries. The Committee's decisions with respect to any Incentive Award need not be uniform and may be made selectively among Incentive Awards and Grantees, whether or not such Incentive Awards are similar or such Grantees are similarly situated.

- (d) *Modification of Outstanding Incentive Awards.* Subject to the stockholder approval requirements of Section 6.7 if applicable, upon a Grantee's death, Disability, Retirement or termination of Employment without Cause, or upon a Change in Control, the Committee may, in its discretion, provide for the extension of the exercisability of an Incentive Award, accelerate the vesting or exercisability of an Incentive Award (except for an Incentive Award that is a SAR), eliminate or make less restrictive any restrictions contained in an Incentive Award, waive any restriction or other provisions of an Incentive Award, or otherwise amend or modify an Incentive Award in any manner that is either (i) not adverse to the Grantee to whom such Incentive Award was granted, (ii) is consented to by such Grantee, and (iii) does not cause the Incentive Award to provide for the deferral of compensation subject to Code Section 409A (unless otherwise determined by the Committee). With respect to an Incentive Award that is an ISO, no adjustment thereto shall be made to the extent constituting a "modification" within the meaning of Code Section 424(h)(3) unless otherwise agreed to by the Grantee in writing. Notwithstanding the above provisions of this subsection, no amendment or modification of an Incentive Award shall be made to the extent such modification results in any Stock Option with an exercise price less than 100% of the Fair Market Value per Share on the date of grant.
- (e) *Delegation of Authority.* The Committee may delegate to designated officers or other employees of the Company any of its duties and authority under the Plan pursuant to such conditions or limitations as the Committee may establish from time to time; provided, however, the Committee may not delegate to any person the authority to grant Incentive Awards or (ii) to take any action which would contravene the requirements of Rule 16b-3 under the Exchange Act.
- (f) *Expenses of Committee.* The Committee may employ legal counsel, including, without limitation, independent legal counsel and counsel regularly employed by the Company, and other agents as the Committee may deem appropriate for the administration of the Plan. The Committee may rely upon any opinion or computation received from any such counsel or agent. All expenses incurred by the Committee in interpreting and administering the Plan, including, without limitation, meeting expenses and professional fees, shall be paid by the Company.
- (g) [Reserved]

(h) *Indemnification.* Each person who is or was a member of the Committee shall be indemnified by the Company against and from any damage, loss, liability, cost and expense that may be imposed upon or reasonably incurred by him in connection with or resulting from any claim, action, suit, or proceeding to which he may be a party or in which he may be involved by reason of any action taken or failure to act under the Plan, except for any such act or omission constituting willful misconduct or gross negligence. Each such person shall be indemnified by the Company for all amounts paid by him in settlement thereof, with the Company's approval, or paid by him in satisfaction of any judgment in any such action, suit, or proceeding against him, provided he shall give the Company an opportunity, at its own expense, to handle and defend the same before he undertakes to handle and defend it on his own behalf. The foregoing right of indemnification shall not be exclusive of any other rights of indemnification to which such persons may be entitled under the Company's Articles or Certificate of Incorporation or Bylaws, pursuant to any separate indemnification or hold harmless agreement with the Company, as a matter of law, or otherwise, or any power that the Company may have to indemnify them or hold them harmless.

1.4 Shares of Common Stock Available for Incentive Awards

Subject to adjustment under Section 5.6, there shall be available for Incentive Awards that are granted wholly or partly in Common Stock (including rights or Stock Options that may be exercised for or settled in Common Stock) five hundred thousand (500,000) Shares of Common Stock. The number of Shares of Common Stock that are the subject of Incentive Awards under this Plan, which are forfeited or terminated, expire unexercised, lapse, or are settled in cash in lieu of Common Stock or in another manner such that all or some of the Shares covered by the Incentive Award are either not issued to a Grantee or are exchanged for Incentive Awards that do not involve Common Stock, shall again, in each case, immediately become available for Incentive Awards to be granted under the Plan. The aggregate number of Shares of Common Stock which may be issued upon exercise of ISOs shall be five hundred thousand (500,000) of the Shares reserved pursuant to the first sentence of this paragraph. For purposes of counting Shares against the ISO maximum, only the net number of Shares issued pursuant to the exercise of an ISO shall be counted. The Committee may from time to time adopt and observe such procedures concerning the counting of Shares against the Plan maximum as it may deem appropriate.

During any period that the Company is a Publicly Held Corporation, then unless and until the Committee determines that a particular Incentive Award granted to a Covered Employee is not intended to comply with the "performance-based exception" under Code Section 162(m), the following rules shall apply to grants of Incentive Awards to Covered Employees:

- (a) Subject to adjustment as provided in Section 5.6, the maximum aggregate number of Shares of Common Stock attributable to Incentive Awards (including Stock Options, SARs, and Restricted Stock) that may be granted (in the case of Stock Options and SARs) or that may vest (in the case of Restricted Stock), as applicable, in any calendar year pursuant to any Incentive Award held by any individual Covered Employee shall be two hundred thousand (200,000) Shares.
- (b) Subject to the limitation of paragraph (a) above, the maximum aggregate number of Shares issuable to any one person pursuant to Incentive Awards shall be five percent (5%) of the number of Shares of Common Stock outstanding at the time of the grant of an Incentive Award.
- (c) [Reserved]

1.5 Share Pool Adjustments for Awards and Payouts

The following Incentive Awards and payouts shall reduce, on a one Share for one Share basis, the number of Shares authorized for issuance under the Share Pool:

- (a) Stock Option;
- (b) SAR;
- (c) Restricted Stock Award; and
- (d) A payout of an Other Stock-Based Award in Shares.

The following transactions shall restore, on a one Share for one Share basis, the number of Shares authorized for issuance under the Share Pool:

- (a) A cancellation, termination, expiration, forfeiture, or lapse for any reason of any Shares subject to an Incentive Award; and
- (b) Payment of an Option Price by withholding Shares which otherwise would be acquired on exercise (i.e., the Share Pool shall be increased by the number of Shares withheld in payment of the Option Price).

Notwithstanding any provisions of the Plan to the contrary, only shares forfeited back to the Company, shares canceled on account of termination, expiration or lapse of an Incentive Award, shares surrendered in payment of the exercise price of an option or shares withheld for payment of applicable employment taxes and/or withholding obligations resulting from the exercise of an option shall again be available for grant of

Incentive Stock Options under the Plan, but shall not increase the maximum number of shares described in Section 1.4 above as the maximum number of Shares that may be delivered pursuant to Incentive Stock Options.

1.6 Common Stock Available

The Common Stock available for issuance or transfer under the Plan shall be made available from Shares now or hereafter (a) held in the treasury of the Company, (b) authorized but unissued shares, or (c) shares to be purchased or acquired by the Company. No fractional shares shall be issued under the Plan; payment for fractional shares shall be made in cash.

1.7 Participation

(a) *Eligibility.* The Committee shall from time to time designate those Employees and/or Outside Directors to be granted Incentive Awards under the Plan, the type of Incentive Awards granted, the number of Shares, Stock Options, rights or units, as the case may be, which shall be granted to each such person, and any other terms or conditions relating to the Incentive Awards as it may deem appropriate to the extent consistent with the provisions of the Plan. A Grantee, who has been granted an Incentive Award may, if otherwise eligible, be granted additional Incentive Awards at any time.

No Insider shall be eligible to be granted an Incentive Award that is subject to Rule 16a-3 under the Exchange Act unless and until such Insider has granted a limited power of attorney to those officers of the Company who have been designated by the Committee for purposes of future required filings under the Exchange Act.

(b) *Incentive Stock Option Eligibility.* No individual shall be eligible for the grant of any Incentive Stock Option except an Employee. However, no Employee shall be eligible for the grant of any ISO who owns or would own immediately before the grant of such ISO, directly or indirectly, stock possessing more than ten percent (10%) of the combined voting power of all classes of stock of the Company, or any Parent or Subsidiary. This restriction does not apply if, at the time such ISO is granted, the ISO exercise price is at least one hundred and ten percent (110%) of the Fair Market Value on the date of grant and the ISO by its terms is not exercisable after the expiration of five (5) years from the date of grant. For the purpose of the immediately preceding sentence, the attribution rules of Code Section 424(d) shall apply from the purpose of determining an Employee's percentage ownership in the Company or any Parent or Subsidiary. This paragraph shall be construed consistent with the requirements of Code Section 422.

1.8 Types of Incentive Awards

The types of Incentive Awards under the Plan are Stock Options, Stock Appreciation Rights, Restricted Stock and Other Stock-Based Awards (as described in Section 4), or any combination of the foregoing.

SECTION 2 Stock Options and Stock Appreciation Rights

2.1 Grant of Stock Options

The Committee is authorized to grant (a) Non-statutory Stock Options to Employees and Outside Directors and (b) Incentive Stock Options to Employees only in accordance with the terms and conditions of the Plan, and with such additional terms and conditions, not inconsistent with the Plan, as the Committee shall determine in its discretion. Successive grants may be made to the same Grantee regardless of whether any Stock Option previously granted to such person remains unexercised.

2.2 Stock Option Terms

- (a) *Written Agreement.* Each grant of a Stock Option shall be evidenced by a written Incentive Agreement. Among its other provisions, each Incentive Agreement shall set forth the extent to which the Grantee shall have the right to exercise the Stock Option following termination of the Grantee's Employment. Such provisions shall be determined in the discretion of the Committee, shall be included in the Grantee's Incentive Agreement, and need not be uniform among all Stock Options issued pursuant to the Plan.
- (b) *Number of Shares.* Each Stock Option shall specify the number of Shares of Common Stock to which it pertains.
- (c) *Exercise Price.* The exercise price per Share of Common Stock under each Stock Option shall be determined by the Committee; provided however, that such exercise price shall not be less than 100% of the Fair Market Value per Share on the date the Stock Option is granted. Each Stock Option shall specify the method of exercise which shall be consistent with the requirements of Section 2.4(a).
- (d) *Term.* In the Incentive Agreement, the Committee shall fix the term of each Stock Option, not to exceed ten (10) years from the date of grant for ISO grants or five (5) years for ISO grants to 10% or greater stockholders pursuant to Section 1.7(b). In the event no term is fixed, such term shall be ten (10) years from the date of grant.
- (e) *Exercise.* The Committee shall determine the time or times at which a Stock Option may be exercised, in whole or in part. Each Stock Option may specify the required period of continuous Employment before the Stock Option or portion

thereof will become exercisable. All such terms and conditions shall be set forth in the Incentive Agreement.

- (f) *\$100,000 Annual Limit on Incentive Stock Options.* Notwithstanding any contrary provision in the Plan, to the extent that the aggregate Fair Market Value (determined as of the time the Incentive Stock Option is granted) of the Shares of Common Stock with respect to which ISOs are exercisable for the first time by any Grantee during any single calendar year (under the Plan and any other stock option plans of the Company and its Subsidiaries or Parent) exceeds the sum of \$100,000, such ISO shall automatically be deemed to be a Non-statutory Stock Option but only to the extent in excess of the \$100,000 limit, and not an ISO. In such event, all other terms and provisions of such Stock Option grant shall remain unchanged. This paragraph shall be applied by taking ISOs into account in the order in which they were granted and shall be construed in accordance with Code Section 422(d).

2.3 Stock Option Exercises

- (a) *Method of Exercise and Payment.* Stock Options shall be exercised by the delivery of a signed written notice of exercise to the Company as of a date set by the Company in advance of the effective date of the proposed exercise. The notice shall set forth the number of Shares with respect to which the Option is to be exercised, accompanied by full payment for the Shares.

The Option Price upon exercise of any Stock Option shall be payable to the Company in full either: (i) in cash or its equivalent; or (ii) subject to prior approval by the Committee in its discretion, by tendering previously acquired Shares having an aggregate Fair Market Value at the time of exercise equal to the Option Price (provided that the Shares which are tendered must have been held by the Grantee for at least six (6) months prior to their tender to satisfy the Option Price); or (iii) subject to prior approval by the Committee in its discretion, by withholding Shares which otherwise would be acquired on exercise having an aggregate Fair Market Value at the time of exercise equal to the total Option Price; or (iv) subject to prior approval by the Committee in its discretion, by a combination of (i), (ii), and (iii) above.

Any payment in Shares shall be effected by the surrender of such Shares to the Company in good form for transfer and shall be valued at their Fair Market Value on the date when the Stock Option is exercised. Unless otherwise permitted by the Committee in its discretion, the Grantee shall not surrender, or attest to the ownership of, Shares in payment of the Option Price if such action would cause the Company to recognize compensation expense (or additional compensation expense) with respect to the Stock Option for financial accounting reporting purposes.

The Committee, in its discretion, also may allow the Option Price to be paid with such other consideration as shall constitute lawful consideration for the issuance

of Shares (including, without limitation, effecting a “cashless exercise” with a broker of the Option), subject to applicable securities law restrictions and tax withholdings, or by any other means which the Committee determines to be consistent with the Plan’s purpose and applicable law. At the direction of the Grantee, the broker will either (i) sell all of the Shares received when the Option is exercised and pay the Grantee the proceeds of the sale (minus the Option Price, withholding taxes and any fees due to the broker); or (ii) sell enough of the Shares received upon exercise of the Option to cover the Option Price, withholding taxes and any fees due the broker and deliver to the Grantee (either directly or through the Company) a stock certificate for the remaining Shares. Dispositions to a broker affecting a cashless exercise are not exempt under Section 16 of the Exchange Act if the Company is a Publicly Held Corporation. Moreover, in no event will the Committee allow the Option Price to be paid with a form of consideration, including a loan or a “cashless exercise,” if such form of consideration would violate the Sarbanes-Oxley Act of 2002, as determined by the Committee in its sole discretion.

As soon as practicable after receipt of a written notification of exercise and full payment, the Company shall deliver, or cause to be delivered, to or on behalf of the Grantee, in the name of the Grantee or other appropriate recipient, evidence of ownership for the number of Shares purchased under the Stock Option.

Subject to Section 5.4, during the lifetime of a Grantee, each Option granted to him shall be exercisable only by the Grantee (or his legal guardian in the event of his Disability) or by a broker-dealer acting on his behalf pursuant to a cashless exercise under the foregoing provisions of this Section 2.4(a).

- (b) *Restrictions on Share Transferability.* The Committee may impose such restrictions on any grant of Stock Options or on any Shares acquired pursuant to the exercise of a Stock Option as it may deem advisable, including, without limitation, restrictions under (i) any stockholders’ agreement, buy/sell agreement, right of first refusal, non-competition, and any other agreement between the Company and any of its securities holders or employees; (ii) any applicable federal securities laws; (iii) the requirements of any stock exchange or market upon which such Shares are then listed and/or traded; or (iv) any blue sky or state securities law applicable to such Shares. Any certificate issued to evidence Shares issued upon the exercise of an Incentive Award may bear such legends and statements as the Committee shall deem advisable to assure compliance with federal and state laws and regulations.

Any Grantee or other person exercising an Incentive Award shall be required, if requested by the Committee, to give a written representation that the Incentive Award and the Shares subject to the Incentive Award will be acquired for investment and not with a view to public distribution; provided, however, that the Committee, in its discretion, may release any person receiving an Incentive Award from any such representations either prior to or subsequent to the exercise of the Incentive Award.

- (c) *Notification of Disqualifying Disposition of Shares from Incentive Stock Options.* Notwithstanding any other provision of the Plan, a Grantee who disposes of Shares of Common Stock acquired upon the exercise of an Incentive Stock Option by a sale or exchange either (i) within two (2) years after the date of the grant of the Incentive Stock Option under which the Shares were acquired or (ii) within one (1) year after the transfer of such Shares to him pursuant to exercise, shall promptly notify the Company of such disposition, the amount realized and his adjusted basis in such Shares.
- (d) *Proceeds of Option Exercise.* The proceeds received by the Company from the sale of Shares pursuant to Stock Options exercised under the Plan shall be used for general corporate purposes.

2.4 Stock Appreciation Rights

- (a) *Grant.* The Committee may grant Stock Appreciation Rights that are independent of Non-statutory Stock Options (“SARs”), but only with respect to Shares that are traded on an established securities exchange. All SARs granted under the Plan are intended to satisfy the requirements for stock appreciation rights to be exempt from the requirements of Code Section 409A, and therefore not provide for any deferral of compensation subject to Code Section 409A.
- (b) *General Provisions.* The terms and conditions of each SAR shall be evidenced by an Incentive Agreement. The exercise price per Share shall never be less than one hundred percent (100%) of the Fair Market Value of a Share on the grant date of the SAR. The term of the SAR shall be determined by the Committee. The Committee cannot include any feature for the deferral of compensation other than the deferral of recognition of income until exercise of the SAR.
- (c) *Exercise.* SARs shall be exercisable subject to such terms and conditions as the Committee shall specify in the Incentive Agreement for the SAR grant, provided that such terms and conditions are not inconsistent with the Plan. No SAR granted to an Insider may be exercised prior to six (6) months from the date of grant, except in the event of his death or Disability which occurs prior to the expiration of such six-month period if so permitted under the Incentive Agreement.
- (d) *Settlement.* Upon exercise of the SAR, the Grantee shall receive an amount equal to the Spread. The Spread, less applicable withholdings, shall be payable only in Shares within 30 calendar days of the exercise date. In no event shall any SAR be settled in any manner other than by delivery of Shares that are traded on an established securities market. In addition, the Incentive Agreement under which such SARs are awarded, or any other agreements or arrangements, shall not provide that the Company will purchase any Shares delivered to the Grantee as a result of the exercise or vesting of a SAR.

SECTION 3
Restricted Stock

3.1 Award of Restricted Stock

- (a) *Grant.* With respect to a Grantee who is an Employee or Outside Director, Shares of Restricted Stock may be awarded by the Committee with such restrictions during the Restriction Period as the Committee shall designate in its discretion. Any such restrictions may differ with respect to a particular Grantee. Restricted Stock shall be awarded for no additional consideration or such additional consideration as the Committee may determine, which consideration may be less than, equal to, or more than the Fair Market Value of the shares of Restricted Stock on the grant date. Subject to Section 3.2.(c), the terms and conditions of each grant of Restricted Stock shall be evidenced by an Incentive Agreement and, during the Restriction Period, such Shares of Restricted Stock must remain subject to a “substantial risk of forfeiture” within the meaning given to such term under Code Section 83.
- (b) *Immediate Transfer Without Immediate Delivery of Restricted Stock.* Unless otherwise specified in the Grantee’s Incentive Agreement, each Restricted Stock Award shall not constitute an immediate transfer of the record and beneficial ownership of the Shares of Restricted Stock to the Grantee in consideration of the performance of services as an Employee or Outside Director, as applicable, and shall not entitle such Grantee to any voting and other ownership rights in such Shares until the date the Restriction Period ends.

As specified in the Incentive Agreement, a Restricted Stock Award may limit the Grantee’s dividend rights during the Restriction Period in which the shares of Restricted Stock are subject to a “substantial risk of forfeiture” (within the meaning given to such term under Code Section 83) and restrictions on transfer. In the Incentive Agreement, the Committee may apply any restrictions to the dividends that the Committee deems appropriate. In the event that any dividend constitutes a derivative security or an equity security pursuant to the rules under Section 16 of the Exchange Act, if applicable, such dividend shall be subject to a vesting period equal to the remaining vesting period of the Shares of Restricted Stock with respect to which the dividend is paid.

Shares awarded pursuant to a grant of Restricted Stock may be issued in the name of the Grantee and held, together with a stock power endorsed in blank, by the Committee or Company (or their delegates) or in trust or in escrow pursuant to an agreement satisfactory to the Committee, as determined by the Committee, until such time as the restrictions on transfer have expired. All such terms and conditions shall be set forth in the particular Grantee’s Incentive Agreement. The Company or Committee (or their delegates) shall issue to the Grantee a receipt evidencing the certificates held by it which are registered in the name of the Grantee.

3.2 Restrictions

- (a) *Forfeiture of Restricted Stock.* Restricted Stock awarded to a Grantee may be subject to the following restrictions until the expiration of the Restriction Period: (i) a restriction that constitutes a “substantial risk of forfeiture” (as defined in Code Section 83), or a restriction on transferability; (ii) unless otherwise specified by the Committee in the Incentive Agreement, the Restricted Stock that is subject to restrictions which are not satisfied shall be forfeited and all rights of the Grantee to such Shares shall terminate; and (iii) any other restrictions that the Committee determines in advance are appropriate, including, without limitation, rights of repurchase or first refusal in the Company or provisions subjecting the Restricted Stock to a continuing substantial risk of forfeiture in the hands of any transferee. Any such restrictions shall be set forth in the particular Grantee’s Incentive Agreement.
- (b) *Issuance of Certificates.* Reasonably promptly after the date of grant with respect to Shares of Restricted Stock, the Company shall cause to be issued a stock certificate, registered in the name of the Grantee to whom such Shares of Restricted Stock were granted, evidencing such Shares; provided, however, that the Company shall not cause to be issued such a stock certificate unless it has received a stock power duly endorsed in blank with respect to such Shares. Each such stock certificate shall bear the following legend or any other legend approved by the Company:

The transferability of this certificate and the shares of stock represented hereby are subject to restrictions, terms and conditions (including forfeiture and restrictions against transfer) contained in the Callon Petroleum Company 2006 Stock Incentive Plan and an Incentive Agreement entered into between the registered owner of such shares and Callon Petroleum Company 2006 Stock Incentive Plan a copy of the Plan and Incentive Agreement are on file in the main corporate office of Callon Petroleum Company.

Such legend shall not be removed from the certificate evidencing such Shares of Restricted Stock unless and until such Shares vest pursuant to the terms of the Incentive Agreement.

- (c) *Removal of Restrictions.* The Committee, in its discretion, shall have the authority to remove any or all of the restrictions on the Restricted Stock if it determines that, by reason of a change in applicable law or another change in circumstance arising after the grant date of the Restricted Stock, such action is necessary or appropriate; provided, however, that the Committee may only accelerate the vesting of Restricted Stock upon a Grantee’s death, Disability, Retirement, or termination of Employment without Cause, or upon a Change in Control. Except as otherwise provided by Section 1.3(d), notwithstanding

anything to the contrary herein, in no event shall the Restriction Period for a grant of Restricted Stock expire earlier than (i) one year from the date of grant for Restricted Stock for which the Restriction Period expires upon the attainment of Performance Goals (as described in Section 3.4) or (ii) ratably over three years from the grant date for Restricted Stock for which the Restriction Period expires upon the performance of services over time.

3.3 Delivery of Shares of Common Stock. Subject to withholding taxes under Section 6.3 and to the terms of the Incentive Agreement, a stock certificate evidencing the Shares of Restricted Stock with respect to which the restrictions in the Incentive Agreement have been satisfied shall be delivered to the Grantee or other appropriate recipient free of restrictions.

3.4 Performance Goals. Awards of Restricted Stock and Other Stock-Based Awards under the Plan may be made subject to the attainment of any of this goals described in this Section 3.4 (“*Performance Goals*”) relating to one or more business criteria which, where applicable, shall be within the meaning of Code Section 162(m) and consist of one or more or any combination of the following criteria: cash flow; cost; revenues; sales; ratio of debt to debt plus equity; net borrowing, credit quality or debt ratings; profit before tax; economic profit; earnings before interest and taxes; earnings before interest, taxes, depreciation and amortization; gross margin; earnings per share (whether on a pre-tax, after-tax, operational or other basis); operating earnings; capital expenditures; expenses or expense levels; economic value added; ratio of operating earnings to capital spending or any other operating ratios; free cash flow; net profit; net sales; net asset value per share; the accomplishment of mergers, acquisitions, dispositions, public offerings or similar extraordinary business transactions; sales growth; price of the Company’s Common Stock; return on assets, equity or stockholders’ equity; market share; inventory levels, inventory turn or shrinkage; or total return to stockholders (“*Performance Criteria*”). Any Performance Criteria may be used to measure the performance of the Company as a whole or any business unit of the Company and may be measured relative to a peer group or index. Any Performance Criteria may include or exclude (i) extraordinary, unusual and/or non-recurring items of gain or loss, (ii) gains or losses on the disposition of a business, (iii) changes in tax or accounting regulations or laws, or (iv) the effect of a merger or acquisition, as identified in the Company’s quarterly and annual earnings releases. In all other respects, Performance Criteria shall be calculated in accordance with the Company’s financial statements, under generally accepted accounting principles, or under a methodology established by the Committee prior to the issuance of an Award which is consistently applied and identified in the audited financial statements, including footnotes, or the Management Discussion and Analysis section of the Company’s annual report. However, to the extent Section 162(m) of the Code is applicable, the Committee may not in any event increase the amount of compensation payable to an individual upon the attainment of a Performance Goal.

SECTION 4
Other Stock-Based Awards

4.1 Grant of Other Stock-Based Awards

Other Stock-Based Awards may be awarded by the Committee to selected Grantees that are payable in Shares or in cash, as determined in the discretion of the Committee to be consistent with the goals of the Company. Other types of Stock-Based Awards that are payable in Shares include, without limitation, purchase rights, Shares of Common Stock awarded that are not subject to any restrictions or conditions, convertible or exchangeable debentures, and other rights convertible into Shares. As is the case with other types of Incentive Awards, Other Stock-Based Awards may be awarded either alone or in addition to or in conjunction with any other Incentive Awards. Other Stock-Based Awards that are payable in Shares are not intended to be deferred compensation that is subject to Code Section 409A unless otherwise determined and provided by the Committee.

4.2 Other Stock-Based Award Terms

- (a) *Written Agreement.* The terms and conditions of each grant of an Other Stock-Based Award shall be evidenced by an Incentive Agreement.
- (b) *Purchase Price.* Except to the extent that an Other Stock-Based Award is granted in substitution for an outstanding Incentive Award or is delivered upon exercise of a Stock Option, the amount of consideration required to be received by the Company shall be either (i) no consideration other than services actually rendered (in the case of authorized and unissued shares) or to be rendered, or (ii) as otherwise specified in the Incentive Agreement.
- (c) *Other Terms.* All terms and conditions of Other Stock-Based Awards shall be determined by the Committee and set forth in the Incentive Agreement, provided that such terms and conditions are consistent with the Plan. Except as otherwise provided by Section 1.3(d), notwithstanding anything to the contrary herein, in no event shall a grant of an Other Stock-Based Award vest earlier than (i) one year from the date of grant for an Other Stock-Based Award which is subject to the attainment of Performance Goals (as described in Section 3.4) or (ii) ratably over three years from the date of grant for an Other Stock-Based Award which vests upon the performance of services over time.
- (d) *Payment.* Other Stock-Based Awards shall be paid in Shares, in a single payment or in installments on such dates as determined by the Committee; all as specified in the Incentive Agreement.

SECTION 5
Provisions Relating to Plan Participation

5.1 Incentive Agreement

Each Grantee to whom an Incentive Award is granted shall be required to enter into an Incentive Agreement with the Company, in such a form as is provided by the Committee. The Incentive Agreement shall contain specific terms as determined by the Committee, in its discretion, with respect to the Grantee's particular Incentive Award. Such terms need not be uniform among all Grantees or any similarly situated Grantees. The Incentive Agreement may include, without limitation, vesting, forfeiture and other provisions particular to the particular Grantee's Incentive Award, as well as, for example, provisions to the effect that the Grantee (a) shall not disclose any confidential information acquired during Employment with the Company, (b) shall abide by all the terms and conditions of the Plan and such other terms and conditions as may be imposed by the Committee, (c) shall not interfere with the employment or other service of any employee, (d) shall not compete with the Company or become involved in a conflict of interest with the interests of the Company, (e) shall forfeit an Incentive Award if terminated for cause, (f) shall not be permitted to make an election under Code Section 83(b) when applicable, and (g) shall be subject to any other agreement between the Grantee and the Company regarding Shares that may be acquired under an Incentive Award including, without limitation, a stockholders' agreement, buy-sell agreement, or other agreement restricting the transferability of Shares by Grantee. An Incentive Agreement shall include such terms and conditions as are determined by the Committee, in its discretion, to be appropriate with respect to any individual Grantee. The Incentive Agreement shall be signed by the Grantee to whom the Incentive Award is made and by an Authorized Officer.

5.2 No Right to Employment

Nothing in the Plan or any instrument executed pursuant to the Plan shall create any Employment rights (including without limitation, rights to continued Employment) in any Grantee or affect the right of the Company to terminate the Employment of any Grantee at any time without regard to the existence of the Plan.

5.3 Securities Requirements

The Company shall be under no obligation to affect the registration pursuant to the Securities Act of 1933 of any Shares to be issued hereunder or to effect similar compliance under any state laws. Notwithstanding anything herein to the contrary, the Company shall not be obligated to cause to be issued or delivered any certificates evidencing Shares pursuant to the Plan unless and until the Company is advised by its counsel that the issuance and delivery of such certificates is in compliance with all applicable laws, regulations of governmental authorities, and the requirements of any securities exchange on which Shares are traded. The Committee may require, as a condition of the issuance and delivery of certificates evidencing Shares pursuant to the terms hereof, that the recipient of such Shares make such covenants, agreements and

representations, and that such certificates bear such legends, as the Committee, in its discretion, deems necessary or desirable.

The Committee may, in its discretion, defer the effectiveness of any exercise of an Incentive Award in order to allow the issuance of Shares to be made pursuant to registration or an exemption from registration or other methods for compliance available under federal or state securities laws. The Committee shall inform the Grantee in writing of its decision to defer the effectiveness of the exercise of an Incentive Award. During the period that the effectiveness of the exercise of an Incentive Award has been deferred, the Grantee may, by written notice to the Committee, withdraw such exercise and obtain the refund of any amount paid with respect thereto.

If the Shares issuable on exercise of an Incentive Award are not registered under the Securities Act of 1933, the Company may imprint on the certificate for such Shares the following legend or any other legend which counsel for the Company considers necessary or advisable to comply with the Securities Act of 1933:

THE SECURITIES REPRESENTED BY THIS CERTIFICATE HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMENDED ("ACT"), OR THE SECURITIES LAWS OF ANY STATE. THE SECURITIES MAY NOT BE TRANSFERRED EXCEPT PURSUANT TO AN EFFECTIVE REGISTRATION STATEMENT UNDER SUCH ACT AND APPLICABLE STATE SECURITIES LAWS OR PURSUANT TO ANY APPLICABLE EXEMPTION FROM THE REGISTRATION REQUIREMENTS OF SUCH ACT AND SUCH LAWS OR PURSUANT TO A WRITTEN OPINION OF COUNSEL REASONABLY SATISFACTORY TO THE COMPANY THAT SUCH REGISTRATION IS NOT REQUIRED.

5.4 Transferability

Incentive Awards granted under the Plan shall not be transferable or assignable other than: (a) by will or the laws of descent and distribution or (b) pursuant to a qualified domestic relations order (as defined under Code Section 414(p)); provided, however, only with respect to Incentive Awards consisting of Non-statutory Stock Options, the Committee may, in its discretion, authorize all or a portion of the Non-statutory Stock Options to be granted on terms which permit transfer by the Grantee to (i) the members of the Grantee's Immediate Family, (ii) a trust or trusts for the exclusive benefit of Immediate Family members, (iii) a partnership in which such Immediate Family members are the only partners, or (iv) any other entity owned solely by Immediate Family members; provided that (A) there may be no consideration for any such transfer, (B) the Incentive Agreement pursuant to which such Non-statutory Stock Options are granted must be approved by the Committee, and must expressly provide for transferability in a manner consistent with this Section 5.4, (C) subsequent transfers of transferred Non-statutory Stock Options shall be prohibited except in accordance with clauses (a) and (b) (above) of this sentence, and (D) there may be no transfer of any Incentive Award in a listed transaction as described in IRS Notice 2003-47. Following

any permitted transfer, the Non-statutory Stock Option shall continue to be subject to the same terms and conditions as were applicable immediately prior to transfer, provided that the term “Grantee” shall be deemed to refer to the transferee. The events of termination of employment, as set out in Section 5.7 and in the Incentive Agreement, shall continue to be applied with respect to the original Grantee, and the Incentive Award shall be exercisable by the transferee only to the extent, and for the periods, specified in the Incentive Agreement.

Except as may otherwise be permitted under the Code, in the event of a permitted transfer of a Non-statutory Stock Option hereunder, the original Grantee shall remain subject to withholding taxes upon exercise. In addition, the Company and the Committee shall have no obligation to provide any notices to any Grantee or transferee thereof, including, for example, notice of the expiration of an Incentive Award following the original Grantee’s termination of employment.

The designation by a Grantee of a beneficiary of an Incentive Award shall not constitute transfer of the Incentive Award. No transfer by will or by the laws of descent and distribution shall be effective to bind the Company unless the Committee has been furnished with a copy of the deceased Grantee’s enforceable will or such other evidence as the Committee deems necessary to establish the validity of the transfer. Any attempted transfer in violation of this Section 5.4 shall be void and ineffective. All determinations under this Section 5.4 shall be made by the Committee in its discretion.

5.5 Rights as a Stockholder

- (a) *No Stockholder Rights.* Except as otherwise provided in Section 3.1(b) for grants of Restricted Stock, a Grantee of an Incentive Award (or a permitted transferee of such Grantee) shall have no rights as a stockholder with respect to any Shares of Common Stock until the issuance of a stock certificate or other record of ownership for such Shares.
- (b) *Representation of Ownership.* In the case of the exercise of an Incentive Award by a person or estate acquiring the right to exercise such Incentive Award by reason of the death or Disability of a Grantee, the Committee may require reasonable evidence as to the ownership of such Incentive Award or the authority of such person. The Committee may also require such consents and releases of taxing authorities as it deems advisable.

5.6 Change in Stock and Adjustments

- (a) *Changes in Law or Circumstances.* Subject to Section 5.8 (which only applies in the event of a Change in Control), in the event of any change in applicable law or any change in circumstances which results in or would result in any dilution of the rights granted under the Plan, or which otherwise warrants an equitable adjustment because it interferes with the intended operation of the Plan, then, if the Board or Committee should so determine, in its absolute discretion, that such change equitably requires an adjustment in the number or kind of shares of stock

or other securities or property theretofore subject, or which may become subject, to issuance or transfer under the Plan or in the terms and conditions of outstanding Incentive Awards, such adjustment shall be made in accordance with such determination. Such adjustments may include changes with respect to (i) the aggregate number of Shares that may be issued under the Plan, (ii) the number of Shares subject to Incentive Awards, and (iii) the Option Price or other price per Share for outstanding Incentive Awards, but shall not result in the grant of any Stock Option with an exercise price less than 100% of the Fair Market Value per Share on the date of grant. The Board or Committee shall give notice to each applicable Grantee of such adjustment which shall be effective and binding.

- (b) *Exercise of Corporate Powers.* The existence of the Plan or outstanding Incentive Awards hereunder shall not affect in any way the right or power of the Company or its stockholders to make or authorize any or all adjustments, recapitalization, reorganization or other changes in the Company's capital structure or its business or any merger or consolidation of the Company, or any issue of bonds, debentures, preferred or prior preference stocks ahead of or affecting the Common Stock or the rights thereof, or the dissolution or liquidation of the Company, or any sale or transfer of all or any part of its assets or business, or any other corporate act or proceeding whether of a similar character or otherwise.
- (c) *Recapitalization of the Company.* Subject to Section 5.8 (which only applies in the event of a Change in Control), if while there are Incentive Awards outstanding, the Company shall effect any subdivision or consolidation of Shares of Common Stock or other capital readjustment, the payment of a stock dividend, stock split, combination of Shares, recapitalization or other increase or reduction in the number of Shares outstanding, without receiving compensation therefore in money, services or property, then the number of Shares available under the Plan and the number of Incentive Awards which may thereafter be exercised shall (i) in the event of an increase in the number of Shares outstanding, be proportionately increased and the Option Price or Fair Market Value of the Incentive Awards awarded shall be proportionately reduced; and (ii) in the event of a reduction in the number of Shares outstanding, be proportionately reduced, and the Option Price or Fair Market Value of the Incentive Awards awarded shall be proportionately increased. The Board or Committee shall take such action and whatever other action it deems appropriate, in its discretion, so that the value of each outstanding Incentive Award to the Grantee shall not be adversely affected by a corporate event described in this Section 5.6(c).
- (d) *Issue of Common Stock by the Company.* Except as hereinabove expressly provided in this Section 5.6 and subject to Section 5.8 in the event of a Change in Control, the issue by the Company of shares of stock of any class, or securities convertible into shares of stock of any class, for cash or property, or for labor or services, either upon direct sale or upon the exercise of rights or warrants to subscribe therefore, or upon any conversion of shares or obligations of the Company convertible into such shares or other securities, shall not affect, and no adjustment by reason thereof shall be made with respect to, the number of, or

Option Price or Fair Market Value of, any Incentive Awards then outstanding under previously granted Incentive Awards; provided, however, in such event, outstanding Shares of Restricted Stock shall be treated the same as outstanding unrestricted Shares of Common Stock.

- (e) *Assumption under the Plan of Outstanding Stock Options.* Notwithstanding any other provision of the Plan, the Board or Committee, in its discretion, may authorize the assumption and continuation under the Plan of outstanding and unexercised stock options or other types of stock-based incentive awards that were granted under a stock option plan (or other type of stock incentive plan or agreement) that is or was maintained by a corporation or other entity that was merged into, consolidated with, or whose stock or assets were acquired by, the Company as the surviving corporation. Any such action shall be upon such terms and conditions as the Board or Committee, in its discretion, may deem appropriate, including provisions to preserve the holder's rights under the previously granted and unexercised stock option or other stock-based incentive award; such as, for example, retaining an existing exercise price under an outstanding stock option. Any such assumption and continuation of any such previously granted and unexercised incentive award shall be treated as an outstanding Incentive Award under the Plan and shall thus count against the number of Shares reserved for issuance pursuant to Section 1.4. In addition, any Shares issued by the Company through the assumption or substitution of outstanding grants from an acquired company shall reduce the Shares available for grants under Section 1.4.
- (f) *Assumption of Incentive Awards by a Successor.* Subject to the accelerated vesting and other provisions of Section 6.8 that apply in the event of a Change in Control, in the event of a Corporate Event (defined below), each Grantee shall be entitled to receive, in lieu of the number of Shares subject to Incentive Awards, such shares of capital stock or other securities or property as may be issuable or payable with respect to or in exchange for the number of Shares which Grantee would have received had he exercised the Incentive Award immediately prior to such Corporate Event, together with any adjustments (including, without limitation, adjustments to the Option Price and the number of Shares issuable on exercise of outstanding Stock Options). For this purpose, Shares of Restricted Stock shall be treated the same as unrestricted outstanding Shares of Common Stock. A "Corporate Event" means any of the following: (i) a dissolution or liquidation of the Company, (ii) a sale of all or substantially all of the Company's assets, or (iii) a merger, consolidation or combination involving the Company (other than a merger, consolidation or combination (A) in which the Company is the continuing or surviving corporation and (B) which does not result in the outstanding Shares being converted into or exchanged for different securities, cash or other property, or any combination thereof). The Board or Committee shall take whatever other action it deems appropriate to preserve the rights of Grantees holding outstanding Incentive Awards.

Notwithstanding the previous paragraph of this Section 5.6(f), but subject to the accelerated vesting and other provisions of Section 5.8 that apply in the event of a Change in Control, in the event of a Corporate Event (described in the previous paragraph), the Board or Committee, in its discretion, shall have the right and power to:

- (i) cancel, effective immediately prior to the occurrence of the Corporate Event, each outstanding Incentive Award (whether or not then exercisable) and, in full consideration of such cancellation, pay to the Grantee an amount in cash equal to the excess of (A) the value, as determined by the Board or Committee, of the property (including cash) received by the holders of Common Stock as a result of such Corporate Event over (B) the exercise price of such Incentive Award, if any; provided, however, this subsection (i) shall be inapplicable to an Incentive Award granted within six (6) months before the occurrence of the Corporate Event if the Grantee is an Insider and such disposition is not exempt under Rule 16b-3 (or other rules preventing liability of the Insider under Section 16(b) of the Exchange Act) and, in that event, the provisions hereof shall be applicable to such Incentive Award after the expiration of six (6) months from the date of grant; or
- (ii) provide for the exchange or substitution of each Incentive Award outstanding immediately prior to such Corporate Event (whether or not then exercisable) for another award with respect to the Common Stock or other property for which such Incentive Award is exchangeable and, incident thereto, make an equitable adjustment as determined by the Board or Committee, in its discretion, in the Option Price or exercise price of the Incentive Award, if any, or in the number of Shares or amount of property (including cash) subject to the Incentive Award; or
- (iii) provide for assumption of the Plan and such outstanding Incentive Awards by the surviving entity or its parent.

The Board or Committee, in its discretion, shall have the authority to take whatever action it deems to be necessary or appropriate to effectuate the provisions of this Section 5.6(f).

5.7 Termination of Employment, Death, Disability and Retirement

- (a) *Termination of Employment.* Unless otherwise expressly provided in the Grantee's Incentive Agreement or the Plan, if the Grantee's Employment is terminated for any reason other than due to his death, Disability, Retirement or for Cause, any non-vested portion of any Stock Option or other Incentive Award at the time of such termination shall automatically expire and terminate and no further vesting shall occur after the termination date. In such event, except as otherwise expressly provided in his Incentive Agreement, the Grantee shall be entitled to exercise his rights only with respect to the portion of the Incentive

Award that was vested as of his termination of Employment date for a period that shall end on the earlier of (i) the expiration date set forth in the Incentive Agreement or (ii) ninety (90) days after the date of his termination of Employment.

- (b) *Termination of Employment for Cause.* Unless otherwise expressly provided in the Grantee's Incentive Agreement or the Plan, in the event of the termination of a Grantee's Employment for Cause, all vested and non-vested Stock Options and other Incentive Awards granted to such Grantee shall immediately expire, and shall not be exercisable to any extent, as of 12:01 a.m. (CST) on the date of such termination of Employment.
- (c) *Retirement.* Unless otherwise expressly provided in the Grantee's Incentive Agreement or the Plan, upon the termination of Employment due to the Grantee's Retirement:
 - (i) any non-vested portion of any outstanding Option or other Incentive Award shall immediately terminate and no further vesting shall occur; and
 - (ii) any vested Option or other Incentive Award shall expire on the earlier of (A) the expiration date set forth in the Incentive Agreement for such Incentive Award; or (B) the expiration of (1) one year after the date of his termination of Employment due to Retirement in the case of any Incentive Award other than an Incentive Stock Option or (2) three months after his termination date in the case of an Incentive Stock Option.
- (d) *Disability or Death.* Unless otherwise expressly provided in the Grantee's Incentive Agreement or the Plan, upon termination of Employment as a result of the Grantee's Disability or death:
 - (i) any non-vested portion of any outstanding Option or other Incentive Award shall immediately terminate upon termination of Employment and no further vesting shall occur; and
 - (ii) any vested Incentive Award shall expire on the earlier of either (A) the expiration date set forth in the Incentive Agreement or (B) the one year anniversary date of the Grantee's termination of Employment date.

In the case of any vested Incentive Stock Option held by an Employee following termination of Employment, notwithstanding the definition of "Disability" in Section 1.2, whether the Employee has incurred a "Disability" for purposes of determining the length of the Option exercise period following termination of Employment under this Section 5.7(d) shall be determined by reference to Code Section 22(e)(3) to the extent required by Code Section 422(c)(6). The Committee shall determine whether a Disability for purposes of this Section 5.7(d) has occurred.

- (e) *Continuation.* Subject to the conditions and limitations of the Plan and applicable law and regulation in the event that a Grantee ceases to be an Employee or Outside Director, as applicable, for whatever reason, the Committee and Grantee may mutually agree with respect to any outstanding Option or other Incentive Award then held by the Grantee (i) for an acceleration or other adjustment in any vesting schedule applicable to the Incentive Award; (ii) for a continuation of the exercise period following termination for a longer period than is otherwise provided under such Incentive Award; or (iii) to any other change in the terms and conditions of the Incentive Award. In the event of any such change to an outstanding Incentive Award, a written amendment to the Grantee's Incentive Agreement shall be required. Notwithstanding the foregoing, no amendment to a Grantee's Incentive Award shall be made to the extent compensation payable pursuant thereto as a result of such amendment would be considered deferred compensation subject to Code Section 409A, unless otherwise determined and provided by the Committee.

5.8 Change in Control

Notwithstanding any contrary provision in the Plan, in the event of a Change in Control (as defined below), the following actions shall automatically occur as of the day immediately preceding the Change in Control date unless expressly provided otherwise in the individual Grantee's Incentive Agreement:

- (a) all of the Stock Options and Stock Appreciation Rights then outstanding shall become 100% vested and immediately and fully exercisable;
- (b) all of the restrictions and conditions of any Restricted Stock and any Other Stock-Based Awards then outstanding shall be deemed satisfied, and the Restriction Period with respect thereto shall be deemed to have expired, and thus each such Incentive Award shall become free of all restrictions and fully vested; and
- (c) all of the Performance-Based Stock-Based Awards and any Other Stock-Based Awards shall become fully vested, deemed earned in full, and promptly paid within thirty (30) days to the affected Grantees without regard to payment schedules and notwithstanding that the applicable performance cycle, retention cycle or other restrictions and conditions have not been completed or satisfied.

For all purposes of this Plan, a "Change in Control" of the Company means the occurrence of any one or more of the following events:

- (a) any consolidation, merger or share exchange of the Company in which the Company is not the continuing or surviving corporation or pursuant to which Shares would be converted into cash, securities or other property, other than a consolidation, merger or share exchange of the Company in which the holders of the Common Stock immediately prior to such transaction have the same proportionate ownership of Common Stock of the surviving corporation immediately after such transaction;

- (b) any sale, lease, exchange or other transfer (excluding transfer by way of pledge or hypothecation) in one transaction or a series of related transactions, of all or substantially all of the assets of the Company;
- (c) the stockholders of the Company approve any plan or proposal for the liquidation or dissolution of the Company;
- (d) the cessation of control (by virtue of their not constituting a majority of directors) of the Board by the individuals (the **“Continuing Directors”**) who (x) at the date of this Plan were directors or (y) become directors after the effective date of the Plan and whose election or nomination for election by the Company’s stockholders, was approved by a vote of at least two-thirds of the directors then in office who were directors at the effective date of the Plan or whose election or nomination for election was previously so approved;
- (e) the acquisition of beneficial ownership (within the meaning of Rule 13d-3 under the Exchange Act) of an aggregate of 20% of the voting power of the Company’s outstanding voting securities by any person or group (as such term is used in Rule 13d-5 under the Exchange Act) who beneficially owned less than 15% of the voting power of the Company’s outstanding voting securities on the effective date of the Plan, or the acquisition of beneficial ownership of an additional 5% of the voting power of the Company’s outstanding voting securities by any person or group who beneficially owned at least 15% of the voting power of the Company’s outstanding voting securities on the effective date of the Plan; provided, however, that notwithstanding the foregoing, an acquisition shall not constitute a Change of Control hereunder if the acquirer is (x) a trustee or other fiduciary holding securities under an employee benefit plan of the Company and acting in such capacity, (y) a Subsidiary of the Company or a corporation owned, directly or indirectly, by the stockholders of the Company in substantially the same proportions as their ownership of voting securities of the Company or (z) any other person whose acquisition of shares of voting securities is approved in advance by a majority of the Continuing Directors; or
- (f) in a Title 11 bankruptcy proceeding, the appointment of a trustee or the conversion of a case involving the Company to a case under Chapter 7.

Notwithstanding the occurrence of any of the foregoing events set out in this [Section 5.8](#) which would otherwise result in a Change in Control, the Board may determine in its discretion, if it deems it to be in the best interest of the Company, that an event or events otherwise constituting or reasonably leading to a Change in Control shall not be deemed a Change in Control hereunder. Such determination shall be effective only if it is made by the Board (a) prior to the occurrence of an event that otherwise would be, or reasonably lead to, a Change in Control, or (b) after such event only if made by the Board a majority of which is composed of directors who were members of the Board immediately prior to the event that otherwise would be, or reasonably lead to, a Change in Control.

Notwithstanding the foregoing provisions of this Section 5.8, to the extent that any payment or acceleration hereunder is subject to Code Section 409A for deferred compensation, Change in Control shall have the meaning set forth in Code Section 409A(2)(A)(v) and any regulations issued thereunder, which are incorporated herein by reference, but only to the extent inconsistent with the foregoing provisions as determined in the discretion of the Committee.

5.9 Financing

Subject to the requirements of the Sarbanes-Oxley Act of 2002, the Company may extend and maintain, or arrange for and guarantee, the extension and maintenance of financing to any Grantee to purchase Shares pursuant to exercise of an Incentive Award upon such terms as are approved by the Committee in its discretion.

SECTION 6 General

6.1 Effective Date and Grant Period

This Plan is adopted by the Board effective as of the Effective Date, subject to the approval of the stockholders of the Company within one year from the Effective Date. Incentive Awards may be granted under the Plan at any time prior to receipt of such stockholder approval; provided, however, if the requisite stockholder approval is not obtained then any Incentive Awards granted hereunder shall automatically become null and void and of no force or effect. Notwithstanding the foregoing, any Incentive Award that is intended to satisfy the “performance-based exception” under Code Section 162(m) shall not be granted until the terms of the Plan are disclosed to, and approved by, the stockholders of the Company in accordance with the requirements of the “performance-based exception” under Code Section 162(m).

6.2 Funding and Liability of Company

No provision of the Plan shall require the Company, for the purpose of satisfying any obligations under the Plan, to purchase assets or place any assets in a trust or other entity to which contributions are made, or otherwise to segregate any assets. In addition, the Company shall not be required to maintain separate bank accounts, books, records or other evidence of the existence of a segregated or separately maintained or administered fund for purposes of the Plan. Although bookkeeping accounts may be established with respect to Grantees who are entitled to cash, Common Stock or rights thereto under the Plan, any such accounts shall be used merely as a bookkeeping convenience. The Company shall not be required to segregate any assets that may at any time be represented by cash, Common Stock or rights thereto. The Plan shall not be construed as providing for such segregation, nor shall the Company, the Board or the Committee be deemed to be a trustee of any cash, Common Stock or rights thereto. Any liability or obligation of the Company to any Grantee with respect to an Incentive Award shall be based solely upon any contractual obligations that may be created by this Plan and any

Incentive Agreement, and no such liability or obligation of the Company shall be deemed to be secured by any pledge or other encumbrance on any property of the Company. The Company, the Board or the Committee shall be required to give any security or bond for the performance of any obligation that may be created by the Plan.

6.3 Withholding Taxes

- (a) *Tax Withholding.* The Company shall have the power and the right to deduct or withhold, or require a Grantee to remit to the Company, an amount sufficient to satisfy federal, state, and local taxes, domestic or foreign, required by law or regulation to be withheld with respect to any taxable event arising as a result of the Plan or an Incentive Award hereunder. Upon the lapse of restrictions on Restricted Stock, the Committee, in its discretion, may elect to satisfy the tax withholding requirement, in whole or in part, by having the Company withhold Shares having a Fair Market Value on the date the tax is to be determined equal to the minimum withholding taxes which could be imposed on the transaction as determined by the Committee.
- (b) *Share Withholding.* With respect to tax withholding required upon the exercise of Stock Options or SARs, upon the lapse of restrictions on Restricted Stock, or upon any other taxable event arising as a result of any Incentive Awards, Grantees may elect, subject to the approval of the Committee in its discretion, to satisfy the withholding requirement, in whole or in part, by having the Company withhold Shares having a Fair Market Value on the date the tax is to be determined equal to the minimum withholding taxes which could be imposed on the transaction as determined by the Committee. All such elections shall be made in writing, signed by the Grantee, and shall be subject to any restrictions or limitations that the Committee, in its discretion, deems appropriate.
- (c) *Incentive Stock Options.* With respect to Shares received by a Grantee pursuant to the exercise of an Incentive Stock Option, if such Grantee disposes of any such Shares within (i) two years from the date of grant of such Option or (ii) one year after the transfer of such shares to the Grantee, the Company shall have the right to withhold from any salary, wages or other compensation payable by the Company to the Grantee an amount sufficient to satisfy the minimum withholding taxes which could be imposed with respect to such disqualifying disposition.
- (d) *Loans.* To the extent permitted by the Sarbanes-Oxley Act of 2002 or other applicable law, the Committee may provide for loans, on either a short term or demand basis, from the Company to a Grantee who is an Employee to permit the payment of taxes required by law.

6.4 No Guarantee of Tax Consequences

Neither the Company nor the Committee makes any commitment or guarantee that any federal, state or local tax treatment will apply or be available to any person participating or eligible to participate hereunder.

6.5 Designation of Beneficiary by Participant

Each Grantee may, from time to time, name any beneficiary or beneficiaries (who may be named contingently or successively) to whom any benefit under the Plan is to be paid in case of his death before he receives any or all of such benefit. Each such designation shall revoke all prior designations by the same Grantee, shall be in a form prescribed by the Committee, and will be effective only when filed by the Grantee in writing with the Committee during the Grantee's lifetime. In the absence of any such designation, benefits remaining unpaid at the Grantee's death shall be paid to the Grantee's estate.

6.6 Deferrals

The Committee shall not permit a Grantee to defer such Grantee's receipt of the payment of cash or the delivery of Shares that would, otherwise be due to such Grantee by virtue of the lapse or waiver of restrictions with respect to Restricted Stock, or the satisfaction of any requirements or goals with respect to Performance-Based Stock-Based Awards or Other Stock-Based Awards.

6.7 Amendment and Termination

The Board shall have the power and authority to terminate or amend the Plan at any time; provided, however, the Board shall not, without the approval of the stockholders of the Company within the time period required by applicable law:

- (a) except as provided in Section 5.6, increase the maximum number of Shares which may be issued under the Plan pursuant to Section 1.4;
- (b) amend the requirements as to the class of Employees eligible to purchase Common Stock under the Plan;
- (c) extend the term of the Plan; or,
- (d) if the Company is a Publicly Held Corporation (i) increase the maximum limits on Incentive Awards to Covered Employees as set for compliance with the "performance-based exception" under Code Section 162(m) or (ii) decrease the authority granted to the Committee under the Plan in contravention of Rule 16b-3 under the Exchange Act.

No termination, amendment, or modification of the Plan shall adversely affect in any material way any outstanding Incentive Award previously granted to a Grantee under the Plan, without the written consent of such Grantee or other designated holder of such Incentive Award.

In addition, to the extent that the Committee determines that (a) the listing for qualification requirements of any national securities exchange or quotation system on which the Company's Common Stock is then listed or quoted, if applicable, or (b) the

Code (or regulations promulgated thereunder), require stockholder approval in order to maintain compliance with such listing requirements or to maintain any favorable tax advantages or qualifications, then the Plan shall not be amended in such respect without approval of the Company's stockholders.

6.8 Requirements of Law

- (a) *Governmental Entities and Securities Exchanges.* The granting of Incentive Awards and the issuance of Shares under the Plan shall be subject to all applicable laws, rules, and regulations, and to such approvals by any governmental agencies or national securities exchanges as may be required. Certificates evidencing shares of Common Stock delivered under this Plan (to the extent that such shares are so evidenced) may be subject to such stop transfer orders and other restrictions as the Committee may deem advisable under the rules and regulations of the Securities and Exchange Commission, any securities exchange or transaction reporting system upon which the Common Stock is then listed or to which it is admitted for quotation, and any applicable federal or state securities law, if applicable. The Committee may cause a legend or legends to be placed upon such certificates (if any) to make appropriate reference to such restrictions.
- (b) *Securities Act Rule 701.* If no class of the Company's securities is registered under Section 12 of the Exchange Act, then unless otherwise determined by the Committee, grants of Incentive Awards to "Rule 701 Grantees" (as defined below) and issuances of the underlying shares of Common Stock, if any, on the exercise or conversion of such Incentive Awards are intended to comply with all applicable conditions of Securities Act Rule 701 ("Rule 701"), including, without limitation, the restrictions as to the amount of securities that may be offered and sold in reliance on Rule 701, so as to qualify for an exemption from the registration requirements of the Securities Act. Any ambiguities or inconsistencies in the construction of an Incentive Award or the Plan shall be interpreted to give effect to such intention. In accordance with Rule 701, each Grantee shall receive a copy of the Plan on or before the date an Incentive Award is granted to him, as well as the additional disclosure required by Rule 701(e) if the aggregate sales price or amount of securities sold during any consecutive 12-month period exceeds \$5,000,000 as determined under Rule 701(e). If Rule 701 (or any successor provision) is amended to eliminate or otherwise modify any of the requirements specified in Rule 701, then the provisions of this Section 6.8(b) shall be interpreted and construed in accordance with Rule 701 as so amended. For purposes of this Section 6.8(b), as determined in accordance with Rule 701, "Rule 701 Grantees" shall mean any Grantee other than a director of the Company, the Company's chairman, CEO, president, chief financial officer, controller and any vice president of the Company, and any other key employee of the Company who generally has access to financial and other business related information and possesses sufficient sophistication to understand and evaluate such information.

6.9 Rule 16b-3 Securities Law Compliance for Insiders

If the Company is a Publicly Held Corporation, transactions under the Plan with respect to Insiders are intended to comply with all applicable conditions of Rule 16b-3 under the Exchange Act. Any ambiguities or inconsistencies in the construction of an Incentive Award or the Plan shall be interpreted to give effect to such intention, and to the extent any provision of the Plan or action by the Committee fails to so comply, it shall be deemed null and void to the extent permitted by law and deemed advisable by the Committee in its discretion.

6.10 Compliance with Code Section 162(m) for Publicly Held Corporation

If the Company is a Publicly Held Corporation, unless otherwise determined by the Committee with respect to any particular Incentive Award, it is intended that the Plan shall comply fully with the applicable requirements so that any Incentive Awards subject to Section 162(m) that are granted to Covered Employees shall qualify for the “performance-based exception” under Code Section 162(m), except for grants of Non-statutory Stock Options with an Option Price set at less than the Fair Market Value of a Share on the date of grant. If any provision of the Plan or an Incentive Agreement would disqualify the Plan or would not otherwise permit the Plan or Incentive Award to comply with the “performance-based exception” under Code Section 162(m) as so intended, such provision shall be construed or deemed to be amended to conform to the requirements of the “performance-based exception” under Code Section 162(m) to the extent permitted by applicable law and deemed advisable by the Committee; provided, however, no such construction or amendment shall have an adverse effect on the prior grant of an Incentive Award or the economic value to a Grantee of any outstanding Incentive Award.

6.11 Notices

- (a) *Notice From Insiders to Secretary of Change in Beneficial Ownership.* Within two business days after the date of a change in beneficial ownership of the Common Stock issued or delivered pursuant to this Plan, an Insider should report to the Secretary of the Company any such change to the beneficial ownership of Common Stock that is required to be reported with respect to such Insider under Rule 16(a)-3 promulgated pursuant to the Exchange Act. Whenever reasonably feasible, Insiders will provide the Committee with advance notification of such change in beneficial ownership.
- (b) *Notice to Insiders and Securities and Exchange Commission.* The Company shall provide notice to any Insider, as well as to the Securities and Exchange Commission, of any “blackout period,” as defined in Section 306(a)(4) of the Sarbanes-Oxley Act of 2002, in any case in which Insider is subject to the requirements of Section 304 of said Act in connection with such “blackout period.”

6.12 Pre-Clearance Agreement with Brokers

Notwithstanding anything in the Plan to the contrary, no shares of Common Stock issued pursuant to this Plan will be delivered to a broker or dealer that receives such shares for the account of an Insider unless and until the broker or dealer enters into a written agreement with the Company whereby such broker or dealer agrees to report immediately to the Secretary of the Company (or other designated person) a change in the beneficial ownership of such shares.

6.13 Successors to Company

All obligations of the Company under the Plan with respect to Incentive Awards granted hereunder shall be binding on any successor to the Company, whether the existence of such successor is the result of a direct or indirect purchase, merger, consolidation, or otherwise, of all or substantially all of the business and/or assets of the Company.

6.14 Miscellaneous Provisions

- (a) No Employee, Outside Director, or other person shall have any claim or right to be granted an Incentive Award under the Plan. Neither the Plan, nor any action taken hereunder, shall be construed as giving any Employee or Outside Director any right to be retained in the Employment or other service of the Company or any Parent or Subsidiary.
- (b) The expenses of the Plan shall be borne by the Company.
- (c) By accepting any Incentive Award, each Grantee and each person claiming by or through him shall be deemed to have indicated his acceptance of the Plan.

6.15 Severability

In the event that any provision of this Plan shall be held illegal, invalid or unenforceable for any reason, such provision shall be fully severable, but shall not affect the remaining provisions of the Plan, and the Plan shall be construed and enforced as if the illegal, invalid, or unenforceable provision was not included herein.

6.16 Gender, Tense and Headings

Whenever the context so requires, words of the masculine gender used herein shall include the feminine and neuter, and words used in the singular shall include the plural. Section headings as used herein are inserted solely for convenience and reference and constitute no part of the interpretation or construction of the Plan.

6.17 Governing Law

The Plan shall be interpreted, construed and constructed in accordance with the laws of the State of Delaware without regard to its conflicts of law provisions, except as may be superseded by applicable laws of the United States.

6.18 Term of the Plan

Unless terminated earlier pursuant to Section 6.7 hereof, the Plan shall terminate as of the close of business on May 3, 2016, and no Incentive Award may be granted under the Plan thereafter, but such termination shall not affect any Incentive Award issued or granted on or prior to such termination date.

IN WITNESS WHEREOF, the Company has caused this Plan to be duly executed in its name and on its behalf by its duly authorized officer, effective as of May 4, 2006.

CALLON PETROLEUM COMPANY

By: _____
Name: Fred L. Callon
Title: President & Chief Executive Officer

CERTIFICATIONS

I, Fred L. Callon, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Callon Petroleum Company;
 2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
 3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
 4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
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5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 8, 2006

By: /s/ Fred L. Callon

Fred L. Callon, President and Chief Executive Officer

(Principal Executive and Financial Officer)

**CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350**

In connection with the Quarterly Report of Callon Petroleum Company (the "**Company**") on Form 10-Q for the quarterly period ended March 31, 2006, as filed with the Securities and Exchange Commission on the date hereof (the "**Report**"), I, Fred L. Callon, Chief Executive Officer and Principal Financial Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to my knowledge:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: May 8, 2006

/s/ Fred L. Callon

Fred L. Callon, Chief Executive Officer and Principal Financial Officer