CIMAREX ENERGY CO
Form 10-K/A
March 12, 2004

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D C 20549

Form 10-K/A

Amendment No.1

(Mark One)

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

For the fiscal year ended December 31, 2003

OR

o	**Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

Commission file number 001-31446

CIMAREX ENERGY CO.

(Exact name of registrant as specified in its charter)

Delaware	**45-0466694**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

707 Seventeenth Street, Suite 3300, Denver, Colorado 80202

(Address of principal executive offices including ZIP code)

(303) 295-3995

(Registrant s telephone number)

Securities Registered Pursuant to Section 12(b) of the Act:

Title of Each Class	**Name of each exchange on which registered**
Common Stock ($.01 par value)	New York Stock Exchange

Securities Registered Pursuant to Section 12(g) of the Act: **None**

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 ý NO o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K/A or any amendment to this Form 10-K/A.

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Securities Exchange Act of 1934.
YES ý NO o

Aggregate market value of the voting stock held by non-affiliates of Cimarex Energy Co. as of June 30, 2003 was approximately $971,834,366.

Number of shares of Cimarex Energy Co. common stock outstanding as of February 29, 2004 was 41,317,563.

Documents Incorporated by Reference: Portions of the Registrant s Proxy Statement for its 2004 Annual Meeting of Stockholders are incorporated by reference into Part III of this Form 10-K/A

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DESCRIPTION

Glossary

Bbls Barrels (of oil)

Bcf Billion cubic feet

Bcfe Billion cubic feet equivalent

MBbls Thousand barrels

Mcf Thousand cubic feet (of natural gas)

Mcfe Thousand cubic feet equivalent

MMBbls Million barrels

MMBtu Million British Thermal Units

MMcf Million cubic feet

MMcfe Million cubic feet equivalent

Net Acres Gross acreage multiplied by working interest percentage

Net Production Gross production multiplied by net revenue interest

NGL Natural gas liquids

One barrel of oil is the energy equivalent of six Mcf of natural gas.

PART I

Forward-Looking Statements

Throughout this Form 10-K/A we make statements that may be deemed 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, that address activities, events, outcomes and other matters that Cimarex plans, expects, intends, assumes, believes, budgets, predicts, forecasts, projects, estimates or anticipates (and other similar expressions) will, should or may occur in the future are forward-looking statements. These forward-looking statements are based on management s current belief, based on currently available information, as to the outcome and timing of future events. When considering forward-looking statements, you should keep in mind the risk factors and other cautionary statements in this Form 10-K/A. Forward-looking statements include statements with respect to, among other things:

amount, nature and timing of capital expenditures;

drilling of wells;

reserve estimates;

timing and amount of future production of oil and natural gas;

operating costs and other expenses;

cash flow and anticipated liquidity;

estimates of proved reserves, exploitation potential or exploration prospect size; and

marketing of oil and natural gas.

We caution you that these forward-looking statements are subject to all of the risks and uncertainties, many of which are beyond our control, incident to the exploration for and development, production and sale of oil and gas. These risks include, but are not limited to, commodity price volatility, inflation, lack of availability of goods and services, environmental risks, drilling and other operating risks, regulatory changes, the uncertainty inherent in estimating proved oil and natural gas reserves and in projecting future rates of production and timing of development expenditures and other risks described herein.

Reserve engineering is a subjective process of estimating underground accumulations of oil and natural gas that cannot be measured in an exact way. The accuracy of any reserve estimate depends on the quality of available data and the interpretation of such data by our engineers. As a result, estimates made by different engineers often vary from one another. In addition, the results of drilling, testing and production activities may justify revisions of estimates that were made previously. If significant, such revisions could change the schedule of any future production and development drilling. Accordingly, reserve estimates are generally different from the quantities of oil and natural gas that are ultimately recovered.

Should one or more of the risks or uncertainties above or elsewhere in this Form 10-K/A occur, or should underlying assumptions prove incorrect, our actual results and plans could differ materially from those expressed in any forward-looking statements.

All forward-looking statements, express or implied, included in this Form 10-K/A and attributable to Cimarex are qualified in their entirety by this cautionary statement. This cautionary statement should also be considered in connection with any subsequent written or oral forward-looking statements that Cimarex or persons acting on its behalf may issue. Cimarex does not undertake any obligation to update any forward-looking statements to reflect events or circumstances after the date of filing this Form 10-K/A with the Securities and Exchange Commission, except as required by law.

ITEM 1. BUSINESS

General

Cimarex Energy Co. is an independent oil and gas exploration and production company. Our principal areas of operations are located in Oklahoma, Texas, Kansas, and Louisiana.

At December 31, 2003, proved reserves totaled 422.2 Bcfe consisting of 337.3 Bcf of gas and 14.1 million barrels of oil. Of total proved reserves, 80 percent are gas and more than 99 percent are classified as proved developed. We operate the wells that account for 65 percent of our total proved reserves and production.

Approximately 39 percent of our proved reserves are located in Oklahoma. Properties situated in Texas and Kansas comprised 25 percent and 20 percent of total proved reserves, respectively. We have active exploration and development programs underway in each of those states as well as in Mississippi, Louisiana, New Mexico, California, and North Dakota.

The estimated present value using a 10 percent discount rate of the future net cash flow before income taxes from year-end 2003 proved reserves is $1.03 billion. The standardized measure of discounted future net cash flow after tax is $711.6 million. In accordance with standardized measure guidelines established by the Securities and Exchange Commission (SEC), we used an average gas price of $5.54 per Mcf and an average oil price of $30.49 per barrel over the life of the properties to determine these amounts.

Cimarex was formed in February 2002 as a wholly owned subsidiary of Helmerich & Payne, Inc. (H&P). In July 2002, H&P contributed its oil and gas exploration and production assets and the common stock of its gas marketing subsidiary to Cimarex. On September 30, 2002, H&P distributed in the form of a dividend to H&P stockholders approximately 26.6 million shares of Cimarex common stock. As a result, Cimarex was spun off and became a stand-alone company. Also on September 30, Cimarex acquired Key Production Company, Inc. (Key) in a stock-for-stock transaction whereby each of Key s 14.1 million outstanding common shares were exchanged for Cimarex common stock on a one-for-one basis. Key continues to conduct exploration and development activities as a wholly owned subsidiary of Cimarex.

Because the merger with Key was a tax-free reorganization that was accounted for as a purchase business combination, the financial and operating results presented in this report on Form 10-K/A, unless expressly noted otherwise, include Key only for the period subsequent to the merger on September 30, 2002.

On September 30, 2002, Cimarex changed its fiscal year from September 30 to December 31. As a consequence, financial statements included in this report show results of operations for the years ended December 31, 2003 and 2002, the three months ended December 31, 2001 and the fiscal year ended September 30, 2001.

Cimarex is comprised primarily of an exploration and production segment, but because we market third party gas incidental to the sale of our own production, we also report in our footnotes segment information for natural gas marketing. For a discussion of financial information about the two segments of Cimarex, see Note 13 of Notes to Consolidated Financial Statements contained herein.

Corporate headquarters are located at 707 Seventeenth Street, Suite 3300, Denver, Colorado 80202, telephone (303) 295-3995. Principal operations offices are at 15 East 5th Street, Suite 1000, Tulsa, Oklahoma 74103, telephone (918) 585-1100. Our common stock is listed on the New York Stock Exchange and trades under the symbol XEC.

Business Approach

Our approach to the business is fundamentally driven by seeking to achieve consistent profitable growth in proved reserves and production by conducting a continually expanding drilling program. To supplement our growth, from time to time we also consider acquisitions and mergers but do not view these activities as being our primary growth drivers. To implement these strategies, we seek to:

Generate our own drilling inventory by maintaining a highly qualified staff of geoscientists;

Maintain a balanced portfolio of prospects that is underpinned by a predominant mixture (70-90 percent of total capital) of low-to-moderate risk drilling prospects combined with a smaller proportion of higher risk/higher potential projects;

Mitigate exploration risk by operating in multiple basins, which provides both geologic and geographic diversification to our drilling program;

Maintain operational control of our drilling and production activities;

Closely monitor the production performance of our existing properties and constantly evaluate the potential to increase production rates and enhance ultimate recoveries through workovers, recompletions and operational efficiencies;

Evaluate the economic and strategic attractiveness of acquisition and merger opportunities; and

Maintain financial flexibility and an appropriate capital structure.

Exploration and Development

Exploration and development activities are primarily focused in western Oklahoma and the upper Gulf Coast areas of Texas and Louisiana. We also have smaller projects underway in Kansas, the Hardeman Basin of north Texas, the Permian Basin of west Texas and southeast New Mexico, the Mississippi Salt Basin, the northern San Joaquin Valley of California, the Williston Basin of North Dakota and Montana, and the

Gulf of Mexico.

For each of our core exploration areas we have assembled integrated teams of landmen, geoscientists and petroleum engineers, who base their drilling decisions on detailed analysis of the potential reserves, expected costs, future net cash flow and risks associated with individual wells and programs. Through our centralized exploration management system, we measure actual results and provide continuous feedback about them to the respective exploration teams in order to help them improve and refine future investment decisions.

Company-wide, we participated in drilling 178 gross wells during 2003, with an overall success rate of 81 percent. On a net basis, 73 of 97 total wells drilled during 2003 were successful.

Our 2003 exploration and development expenditures, excluding leasehold costs, totaled $151.3 million and resulted in 78.2 Bcfe of proved reserve additions. Including lease acquisition costs, we invested nearly $161 million. Of total expenditures, 60 percent ($97 million) was invested in projects located in the mid-continent area of the U.S., including Kansas, Oklahoma and north Texas. Approximately 30 percent, or $48 million, was directed toward prospects located along the Texas and Louisiana Gulf Coast and adjacent shallow waters in the Gulf of Mexico.

One of our most notable discoveries during 2003 was the Mauboules #1 well on the West Gueydan prospect in Vermilion Parish, Louisiana. As of year-end 2003, the well was awaiting completion operations. First sales occurred on February 20, 2004 and by month end had risen to daily production of 18.0 MMcf of gas and 280 barrels of oil.

The new well was drilled to a total depth of 18,300 feet and found two gas-bearing intervals in the Miogyp formation. During testing operations, it produced nearly 19 MMcfe per day from the upper interval. A second well, the Mauboules #2, is situated approximately 2,000 feet north of the #1 well and is being drilled to develop the lower zone. We operate both wells with a 64.5 percent working interest and have a 46.4 percent revenue interest. We also plan to drill during 2004 one to three additional exploratory wells on separate geologic features in the immediately surrounding area.

Elsewhere in the upper Gulf Coast area, we drilled six wells in Liberty County, Texas, three of which were productive in the the Yegua and Cook Mountain formations. The two best wells were the Henderson #1 (82 percent working interest) and the Brookhollow #1 (50 percent working interest), that tested at gross rates of 7.8 MMcfe per day and 6.8 MMcfe per day, respectively. We plan to drill another seven to nine wells in this area during 2004.

We continue to have a high level of drilling activity in western Oklahoma, primarily targeting the Red Fork and Granite Wash formations in the Anadarko Basin. During 2003, we completed 78 of 81 gross wells in this area, and we anticipate drilling over 100 wells there during 2004.

In the Mountain Front play of southwestern Oklahoma, each of the six wells drilled were completed as producers. The larger discoveries in this area produced gas at high initial rates when they were brought on line during November 2003, helping boost our aggregate fourth-quarter 2003 volumes to 187 MMcfe per day. Of particular importance were the Gwendolyn #3-29, with net production of 9.4 MMcf per day; the Buddy #3-32, producing a net 6.7 MMcf per day; and the Lisa #4-30, with net production of 4.8 MMcf per day. We plan to drill 13 more wells in this area during 2004.

In the Arkoma basin of eastern Oklahoma, we drilled and completed twelve wells during 2003, and have a similar level of activity planned for 2004. In the Hardeman Basin, we completed nine of 21 wells. We own approximately 400 square miles of 3-D seismic survey data in the Hardeman and plan to drill an additional six to eight wells on our acreage during 2004.

We completed four of seven wells drilled in the Permian Basin during 2003. Primarily targeting Pennsylvanian-age, gas-bearing formations, we have identified as many as 25 potential drilling locations for 2004.

Acquisitions

As noted earlier, on September 30, 2002 in connection with the spin off of Cimarex from H&P, Cimarex acquired 100 percent of the common stock of Key. Key s oil and gas properties were valued at $297 million and resulted in the addition of 149.4 Bcfe of proved reserves (98 percent proved developed) principally in Oklahoma, Texas, Mississippi and Louisiana.

In 2003, we added to our ownership interest primarily in certain Texas and Louisiana properties by acquiring incremental interests for $2 million. The property interests acquired had associated proved reserves of 1.6 Bcfe.

Production

Production volumes during 2003 averaged 180 MMcfe per day versus 132 MMcfe per day in 2002. Gas production was 138.5 MMcf per day, compared to 113.2 MMcf per day during 2002. Oil production was 6,859 barrels per day in 2003 versus 3,209 barrels per day in 2002. The increase in volumes primarily stems from the acquisition of Key and favorable drilling results. Because of natural production declines from the wells we own, our production would typically decrease by 20-25 percent year-to-year if we did not conduct successful drilling operations or acquire existing producing properties.

The weighted-average gas price we received during 2003 was $4.96 per Mcf , which was 60 percent higher than the $3.10 per Mcf average price we received during 2002. Our annual average realized oil price during 2003 increased by 17 percent to $29.30 per barrel from $24.97 per barrel in 2002. The increase in the prices we received during 2003 was the result of tighter market conditions for oil and gas.

Our largest producing area was western Oklahoma, providing nearly 64 MMcfe per day, or 36 percent of our total production during 2003. We operated 67 percent of this production, of which 93 percent was gas.

Production from Kansas, primarily from the Hugoton Field, totaled 28 MMcfe per day or 16 percent of our total production, with 84 percent being gas. We operated 93 percent of the related volumes.

The areas along the Gulf Coast of Texas, Louisiana and Mississippi yielded approximately 30 MMcfe per day of output, which was 17 percent of our total production. Of these volumes, 70 percent was gas and 42 percent was operated.

The Permian basin provided another 22 MMcfe per day or 12 percent of total production, with 80 percent of the related volumes being gas and 68 percent from properties that we operate.

We have implemented management systems over our production operations that monitor actual results against plan and measure controllable costs. We have field offices located near our major concentrations of operated properties in Kansas, Oklahoma and Texas and have a centralized production management team in our Tulsa office. Overall, approximately 65 percent of both our production and oil and gas reserves are from properties that we operate.

Marketing

Our oil and gas production is sold under various short-term arrangements at market-responsive prices. We sell our oil at various prices directly or indirectly tied to field postings, posted platts, as well as daily front-month contract prices on the New York Mercantile Exchange (NYMEX). Our gas is generally sold under pricing mechanisms related to either monthly index prices on pipelines where we deliver our gas or the spot market.

We sell our oil and gas to a broad portfolio of customers. Our largest customer, OGE Energy Resources, Inc., accounted for 10.3 percent of 2003 revenues. Because approximately two-thirds of our gas production is from wells in Kansas and Oklahoma, most of our customers are from those states or other Midwest market centers. We regularly monitor the credit worthiness of all our customers and may require parental guarantees, letters of credit or prepayments when we deem such security is necessary.

We have a wholly owned subsidiary, Cimarex Energy Services, Inc. (CESI), through which we conduct a majority of our gas marketing activity. Like Cimarex, CESI enters into sales transactions with various purchasers under a variety of short-term arrangements and supplies these sales with equity gas (gas produced by Cimarex) or gas purchased from third parties. Certain gathering systems and related equipment are held and operated by Cimarex and its subsidiaries. CESI operates most of the gas gathering systems and processing plants incidental to our production. Non-equity gas handled by CESI is predominantly comprised of gas owned by our royalty interest owners and working interest partners who have elected to have us sell their gas for them. Gas purchased from other third parties, such as marketing companies and owners of production from wells that we do not have an interest in, is generally limited to activity associated with supplying gas sales arrangements under which our equity gas is also being sold. Approximately 56 percent of the gas sold through CESI was Cimarex equity gas.

CESI has no employees and is not considered an autonomous operating unit. Neither Cimarex nor CESI has any long-term sales contracts nor any marketing arrangements that would be considered derivative instruments within the scope of Statement of Financial Accounting Standard No. 133, *Accounting for Derivative Instruments and Hedging Activities*.

Employees

We employed 315 people on December 31, 2003. None of our employees are subject to collective bargaining agreements.

Web Site Access

Our Web site address is www.cimarex.com. There you will find our news releases, annual reports and proxy statements, 10-Ks, 10-Qs, 8-Ks, insider (Section 16) filings and all other SEC filings. We have also posted our Code of Ethics, Code of Business Conduct, Corporate Governance Guidelines, Audit Committee Charter and Governance Committee Charter. Copies of these documents are also available in print upon a written or telephone request to our Assistant Corporate Secretary.

Competition

The oil and gas industry is highly competitive. Competition is particularly intense for prospective undeveloped leases and purchases of proved oil and gas reserves. There is also competition for the rigs and related equipment we use to drill for and produce oil and gas. Our competitive position is also highly dependent on our ability to recruit and retain geological, geophysical and engineering expertise. We compete for prospects, proved reserves, oil-field services and qualified oil and gas professionals with major and diversified energy companies and other independent operators that have larger financial, human and technological resources than we do.

We compete with majors, independents and other energy companies for the sale and transportation of oil and gas to marketing companies and end users. The oil and gas industry competes with other energy industries that supply fuel and power to industrial, commercial and residential consumers. Many of these competitors have financial and human resources substantially larger than those of Cimarex. The effect of these competitive factors on Cimarex cannot be predicted.

Title to Oil and Gas Properties

We undertake title examination and perform curative work at the time we lease undeveloped acreage, prepare for the drilling of a prospect or acquire proved properties. We believe that the titles to our properties are good and defensible, and are in accordance with industry standards. Our oil and gas properties are subject to customary royalty interests contracted for in connection with the acquisition of title, liens incidental to operating agreements, tax liens and other burdens and minor encumbrances, easements and restrictions.

Government Regulation

Oil and gas production and transportation is subject to many varying and complex Federal and state regulations. In recent years, we have been most directly affected by Federal and state environmental regulations and energy conservation rules. We are indirectly affected by Federal and state regulation of pipeline and other oil and gas transportation systems. Compliance with such laws and regulations increases our overall cost of business, but has not had a material adverse effect on our operations or financial condition.

Most of the states in which we conduct operations regulate the size of well spacing units, drilling density within productive formations and the unitization or pooling of properties. In addition, state conservation laws establish limits on the maximum rate of production from wells, generally prohibit the venting or flaring of natural gas and impose certain requirements regarding the ratability of production. The effect of these regulations is to often limit the amounts of oil and natural gas that we can produce from our wells and to limit the number of wells or locations at which we can drill.

Environmental Regulation. Various Federal, state and local laws and regulations covering the discharge of materials into the environment, or otherwise relating to the protection of the environment, affect our operations and costs as a result of their effect on natural gas and crude oil exploration, development and production operations and could cause us to incur remediation or other corrective action costs in connection with a release of regulated substances, including crude oil, into the environment. In addition, we have acquired certain oil and gas properties from third parties whose actions with respect to the management and disposal or release of hydrocarbons or other wastes were not under our control. Under environmental laws and regulations, we could be required to remove or remediate wastes disposed of or released by prior owners or operators. It is not anticipated, based on current laws and regulations, that we will be required in the near future to expend amounts that are material in relation to our exploration and development expenditure program in order to comply with environmental laws and regulations, but inasmuch as such laws and regulations are frequently changed, we are unable to predict the ultimate cost of compliance. We also could incur costs related to the clean up of sites to which we sent regulated substances for disposal and for damages to natural resources or other claims related to releases of regulated substances at such sites.

Gas Gathering and Transportation. The Federal Energy Regulatory Commission (FERC) requires interstate gas pipelines to provide open access transportation. Interstate pipelines have implemented this requirement by modifying their tariffs and implementing new services and rates. These changes have provided us with additional market access and more fairly applied transportation services and rates. FERC continues to review and modify its open access and other regulations applicable to interstate pipelines.

Under the Natural Gas Policy Act (NGPA), natural gas gathering facilities are expressly exempt from FERC jurisdiction. What constitutes gathering under the NGPA has evolved through FERC decisions and judicial review of such decisions. We believe that our gathering systems meet the test for non-jurisdictional gathering systems under the NGPA and that our facilities are not subject to Federal regulations. Although exempt from Federal regulatory oversight, our natural gas gathering systems and services may receive regulatory scrutiny by state agencies.

Additional proposals and proceedings that might affect the oil and gas industry are pending before the U.S. Congress, FERC, state legislatures, state agencies and the courts. We cannot predict when or whether any such proposals may become effective and what effect they will have on our operations. We do not anticipate that compliance with existing Federal, state and local laws, rules or regulations will have a material adverse effect upon our capital expenditures, earnings or competitive position.

In addition to using our own gathering facilities, we may use third-party gathering services or interstate transmission facilities (owned and operated by interstate pipelines) to ship our gas to markets.

Federal and State Income Taxation

Cimarex and the petroleum industry in general are affected by both Federal and state income tax laws. We have considered the effects of these provisions on our operations and do not anticipate that there will be any undisclosed impact on our capital expenditures, earnings or competitive position.

Certain Risks

The following risks and uncertainties, together with other information set forth in this Form 10-K/A, should be carefully considered by current and future investors in our securities. If any of the following risks and uncertainties develop into actual events, this could have a material adverse affect on our business, financial condition or results of operations and could negatively impact the value of our common stock.

Low oil and gas prices could adversely affect our financial results and future rate of growth in proved reserves and production.

Our revenues and results of operations are highly dependent on oil and gas prices. The prices we receive for our production are based on prevailing market conditions and are influenced by many factors that are beyond our control. Historically, oil and gas prices have fluctuated widely. For example, in 2003 we sold our gas at an average price of $4.96 per Mcf, which was 60 percent higher than our 2002 average sales price of $3.10 per Mcf. Similarly, our average 2003 oil price of $29.30 per barrel was 17 percent higher than the price we received in 2002 of $24.97 per barrel. As a result, our combined 2003 oil and gas sales increased by 106 percent to $324 million from $157 million in 2002, versus a 36 percent increase in our aggregate production volumes.

Petroleum prices could continue to be volatile in the future. In recent years, oil prices have responded to changes in supply and demand stemming from actions taken by the Organization of Petroleum Exporting Countries, worldwide economic conditions, growing transportation and power generation needs, and other events. Factors affecting gas prices have included declining domestic supplies; the level and price of natural gas imports into the U.S.; weather conditions; and the price and level of alternative sources of energy such as nuclear power, hydroelectric power, coal, and other petroleum products.

Our proved oil and gas reserves and production volumes will decrease in quantity unless we successfully replace the reserves we produce with new discoveries or acquisitions. For the foreseeable future, we expect to make substantial capital investments for the exploration and development of new oil and gas reserves to replace the reserves we produce and to increase our total proved reserves. Historically, we have paid for these types of capital expenditures with cash flow provided by our production operations. Because low oil and gas prices would negatively affect the amount of cash flow available to fund these capital investments, they could also affect our future rate of growth. Low prices may also reduce the amount of oil and gas that we can economically produce and may cause us to curtail, delay or defer certain exploration and development projects. Moreover, our ability to borrow under our bank credit facility and to raise additional debt or equity capital to fund acquisitions would also be impacted.

Failure of our exploration and development program to find commercial quantities of new oil and gas reserves could negatively affect our financial results and future rate of growth.

Most of our wells produce from reservoirs characterized by high levels of initial production and declines which stabilize within three to five years. In order to replace the reserves depleted by production and to maintain or grow our total proved reserves and overall production levels, we must locate and develop new oil and gas reserves or acquire producing properties from others. While we may from time to time seek to acquire proved reserves, our main business strategy is to grow through drilling. Without successful exploration and development, our reserves, production and revenues could decline rapidly, which would negatively impact our results of operations and reduce our ability to raise capital.

Exploration and development involves numerous risks, including the risk that no commercially productive oil or gas reservoirs will be discovered. Exploration and development can also be unprofitable, not only from dry wells, but from productive wells that do not produce sufficient reserves to return a profit.

We often are uncertain as to the future cost or timing of drilling, completing and producing wells. Our drilling operations may be curtailed, delayed or canceled as a result of several factors, including unforeseen poor drilling conditions, title problems, unexpected pressure or irregularities in formations, equipment failures, accidents, adverse weather conditions, compliance with environmental and other governmental requirements, and the cost of, or shortages or delays in the availability of, drilling rigs and related equipment.

Our proved reserve estimates may be inaccurate and future net cash flows are uncertain.

Estimates of proved oil and gas reserves and their associated future net cash flow necessarily depend on a number of variables and assumptions. Among others, changes in any of the following factors may cause estimates to vary considerably from actual results:

- production rates, reservoir pressure, and other subsurface information;
- future oil and gas prices;
- assumed effects of governmental regulation;
- future operating costs;
- future property, severance, excise and other taxes incidental to oil and gas operations;
- capital expenditures;
- workover and remedial costs; and
- Federal and state income taxes.

Estimates of proved reserves and future net cash flow prepared by different engineers or by the same engineers at different times may vary substantially. Our proved oil and gas reserve estimates are prepared by Cimarex engineers in accordance with guidelines established by the Securities and Exchange Commission (SEC). Ryder Scott Company, L.P., independent petroleum engineers, reviewed our reserve estimates for properties that comprised 80 percent of the discounted future net cash flows before income taxes, using a 10 percent discount rate, as of December 31, 2003.

The net present values referred to in this report should not be construed as the current market value of our proved reserves. In accordance with SEC guidelines, the estimated discounted net cash flow from proved reserves is based on prices and costs as of the date of the estimate, whereas actual future prices and costs may be materially different.

The marketability of our production depends in part upon the availability, proximity and capacity of pipelines.

We deliver oil and gas through pipelines that we do not own. The marketability of our production depends in part upon the availability, proximity and capacity of these pipelines. These facilities may not always be available to us in the future. The lack of availability of these facilities for an extended period of time could negatively affect revenues.

Competition in our industry is intense and many of our competitors have greater financial and technological resources.

We operate in the competitive area of oil and gas exploration and production. Many of our competitors are large, well-established companies that have larger operating staffs and greater capital resources than we do. These companies may be able to pay more for exploratory prospects and productive oil and gas properties and may be able to define, evaluate, bid for and purchase a greater number of properties and prospects than our financial or human resources permit.

We are subject to complex laws and regulations that can adversely affect the cost, manner or feasibility of doing business.

Exploration, development, production and sale of oil and gas are subject to extensive Federal, state and local laws and regulations, including complex environmental laws. We may be required to make large expenditures to comply with environmental and other governmental regulations. Failure to comply with these