

CIMAREX ENERGY CO  
Form 10-Q  
November 07, 2005

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

**FORM 10-Q**

(Mark One)

☒ **Quarterly Report Pursuant To Section 13 or 15(d) of the Securities Exchange Act of 1934**

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

**For the Quarterly Period ended September 30, 2005**  
**Commission File No. 001-31446**

## **CIMAREX ENERGY CO.**

**1700 Lincoln Street, Suite 1800**

**Denver, Colorado 80203-4518**

**(303) 295-3995**

**Incorporated in the  
State of Delaware**

**Employer Identification  
No. 45-0466694**

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 an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes ☒ No ☐.

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

The number of shares Cimarex Energy Co. common stock outstanding as of September 30, 2005 was 82,395,826.

**CIMAREX ENERGY CO.**

Table of Contents

**PART I**

<u>Item 1</u>	<u>Financial Statements</u>
	<u>Consolidated balance sheets (unaudited)</u> <u>as of September 30, 2005 and December 31, 2004</u>
	<u>Consolidated statements of operations (unaudited)</u> <u>for the three and nine months ended September 30, 2005 and 2004</u>
	<u>Consolidated statements of cash flows (unaudited)</u> <u>for the nine months ended September 30, 2005 and 2004</u>
	<u>Notes to consolidated financial statements</u>
<u>Item 2</u>	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>
<u>Item 3</u>	<u>Qualitative and Quantitative Disclosures About Market Risk</u>
<u>Item 4</u>	<u>Controls and Procedures</u>

**PART II**

<u>Item 6</u>	<u>Exhibits and Reports on Form 8-K</u>
---------------	---

*In this report, we use terms to discuss oil and gas producing activities as defined in Rule 4-10(a) of Regulation S-X. We express quantities of natural gas in terms of thousand cubic feet (Mcf), million cubic feet (MMcf) or billion cubic feet (Bcf). Oil is quantified in terms of barrels (Bbls), thousands of barrels (MBbls) and millions of barrels (MMBbls). Oil is compared to natural gas in terms of equivalent thousand cubic feet (Mcfe) or equivalent million cubic feet (MMcfe). One barrel of oil is the energy equivalent of six Mcf of natural gas. Information relating to our working interest in wells or acreage, net oil and gas wells or acreage is determined by multiplying gross wells or acreage by our working interest therein. Unless otherwise specified, all references to wells and acres are gross.*

---

**PART I****ITEM 1 - Financial Statements****CIMAREX ENERGY CO.**

## Consolidated Balance Sheets

(Unaudited)

	September 30, 2005 (In thousands, except share data)	December 31, 2004
Assets		
Current assets:		
Cash and cash equivalents	\$ 27,473	\$ 115,746
Receivables, net	250,193	103,989
Inventories	32,520	9,742
Deferred income taxes	16,098	2,149
Other current assets	25,462	4,821
Total current assets	351,746	236,447
Oil and gas properties at cost, using the full cost method of accounting:		
Proved properties	3,450,018	1,596,704
Unproved properties and properties under development, not being amortized	408,406	72,249
	3,858,424	1,668,953
Less accumulated depreciation, depletion and amortization	(1,032,735)	(866,660)
Net oil and gas properties	2,825,689	802,293
Fixed assets, net	85,112	16,109
Goodwill	716,818	44,967
Other assets, net	69,140	5,630
	\$ 4,048,505	\$ 1,105,446
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	\$ 61,113	\$ 26,511
Accrued liabilities	190,102	77,362
Derivative fair value	94,124	
Revenue payable	82,515	39,129
Total current liabilities	427,854	143,002
Long-term debt	438,396	
Deferred income taxes	633,057	225,285
Other liabilities	122,257	36,447
Stockholders' equity:		
Preferred stock, \$0.01 par value, 15,000,000 shares authorized, no shares issued		
Common stock, \$0.01 par value, 200,000,000 shares authorized, 84,871,551 and 41,729,280 shares issued, respectively	849	417
Treasury stock, at cost, 2,475,725 shares held	(93,236)	
Paid-in capital	1,916,505	250,248
Unearned compensation	(17,205)	(10,072)
Retained earnings	619,948	460,031
Accumulated other comprehensive income	80	88
	2,426,941	700,712

\$ 4,048,505 \$ 1,105,446

See accompanying notes to consolidated financial statements.

**CIMAREX ENERGY CO.**

## Consolidated Statements of Operation

(Unaudited)

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2005	2004	2005	2004
	(In thousands, except per share data)			
<b>Revenues:</b>				
Gas sales	\$ 245,010	\$ 91,333	\$ 488,043	\$ 256,529
Oil sales	98,459	28,299	177,829	73,927
Gas gathering, marketing, and processing	64,833	49,329	183,784	139,921
Other, net	(3,925)	1,312	(1,114)	6,008
	404,377	170,273	848,542	476,385
<b>Costs and expenses:</b>				
Depreciation, depletion and amortization	82,826	32,048	172,493	89,220
Asset retirement obligation accretion	1,331	319	2,266	913
Transportation	4,237	2,696	10,319	7,544
Production	40,473	8,648	68,056	27,536
Taxes other than income	21,418	9,736	45,913	27,565
Gas gathering, marketing, and processing	58,958	48,495	176,172	138,081
General and administrative	8,418	5,398	23,967	15,040
Stock compensation	1,225	502	3,663	1,454
Expenses related to merger	1,402		8,087	
Loss on derivative instruments	81,946		83,976	
	302,234	107,842	594,912	307,353
<b>Operating income</b>	<b>102,143</b>	<b>62,431</b>	<b>253,630</b>	<b>169,032</b>
<b>Other income and expense:</b>				
Interest expense	8,280	290	12,239	866
Amortization of fair value of debt	(771)		(1,187)	
Capitalized interest	(4,978)		(6,157)	
Interest income and other	(469)	(232)	(1,814)	(421)
<b>Income before income tax expense</b>	<b>100,081</b>	<b>62,373</b>	<b>250,549</b>	<b>168,587</b>
<b>Income tax expense</b>	<b>36,006</b>	<b>23,191</b>	<b>90,632</b>	<b>63,070</b>
<b>Net income</b>	<b>\$ 64,075</b>	<b>\$ 39,182</b>	<b>\$ 159,917</b>	<b>\$ 105,517</b>
<b>Earnings per share:</b>				
Basic	\$ 0.78	\$ 0.94	\$ 2.72	\$ 2.55
Diluted	\$ 0.76	\$ 0.91	\$ 2.63	\$ 2.47
<b>Weighted average shares outstanding:</b>				
Basic	82,284	41,511	58,815	41,399
Diluted	84,840	42,885	60,767	42,687

See accompanying notes to consolidated financial statements.





**CIMAREX ENERGY CO.**

## Consolidated Statements of Cash Flows

(Unaudited)

	<b>For the Nine Months Ended September 30,</b>		
	<b>2005</b>		<b>2004</b>
	<b>(In thousands)</b>		
Cash flows from operating activities:			
Net income	\$	159,917	\$ 105,517
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation, depletion and amortization		172,493	89,220
Asset retirement obligation accretion		2,266	913
Deferred income taxes		32,644	42,899
Stock compensation		3,663	1,454
Loss on derivative instruments		66,538	
Other		12,870	59
Changes in operating assets and liabilities, net of effects of the acquisition of Magnum Hunter:			
Increase in receivables, net		(23,765)	(12,922)
Increase in other current assets		(24,420)	(2,447)
Increase in accounts payable and accrued liabilities		15,081	29,083
Increase in other non-current liabilities		188	1,330
Net cash provided by operating activities		417,475	255,106
Cash flows from investing activities:			
Oil and gas expenditures		(398,191)	(205,925)
Acquisition of proved oil and gas properties		(1,973)	(102)
Merger related costs		(12,405)	
Cash received in connection with acquisition of MHR		33,407	
Proceeds from sale of assets		70,576	766
Other expenditures		(19,798)	(8,078)
Net cash used by investing activities		(328,384)	(213,339)
Cash flows from financing activities:			
Borrowing (payments) on long-term debt, net		(188,422)	
Financing costs		(1,414)	
Common stock reacquired and retired		(2,130)	(714)
Proceeds from issuance of common stock		14,602	10,724
Net cash (used in) provided by financing activities		(177,364)	10,010
Net change in cash and cash equivalents		(88,273)	51,777
Cash and cash equivalents at beginning of period		115,746	40,420
Cash and cash equivalents at end of period	\$	27,473	\$ 92,197

See accompanying notes to consolidated financial statements.

**CIMAREX ENERGY CO.**

Notes to Consolidated Financial Statements

September 30, 2005

(Unaudited)

**1. Basis of Presentation**

## Edgar Filing: CIMAREX ENERGY CO - Form 10-Q

The accompanying financial statements are unaudited and were prepared from the records of Cimarex Energy Co. (Cimarex or the Company). We believe these financial statements include all adjustments necessary for a fair presentation of our financial position and results of operations. We prepared these statements on a basis consistent with the annual audited statements and Regulation S-X. Regulation S-X allows us to omit some of the footnote and policy disclosures required by accounting principles generally accepted in the United States of America and normally included in annual reports on Form 10-K. These interim financial statements should be read in conjunction with the financial statements and notes in our Annual Report on Form 10-K for the year ended December 31, 2004.

Cimarex was formed in February 2002 as a wholly-owned subsidiary of Helmerich & Payne, Inc. (H&P). As a result of a dividend declared and paid by H&P on September 30, 2002, in the form of Cimarex common stock, Cimarex was spun-off and became a stand-alone company. Also on September 30, 2002, Cimarex acquired 100 percent of the outstanding common stock of Key Production Company, Inc. (Key) in a tax-free exchange.

In June 2005, Cimarex acquired Magnum Hunter Resources, Inc. Terms of the merger agreement provided that Magnum Hunter stockholders receive 0.415 shares of Cimarex common stock for each share of Magnum Hunter common stock. As a result of the merger, Cimarex issued 39.7 million common shares to Magnum Hunter's common stockholders (excluding 2.5 million shares held in treasury). At September 30, 2005, the combined company had 82.4 million shares outstanding. The merger was accounted for as a purchase of Magnum Hunter by Cimarex.

The accounts of Cimarex and its subsidiaries are presented in the accompanying consolidated financial statements. All intercompany accounts and transactions were eliminated in consolidation.

We make certain estimates and assumptions to prepare our financial statements in conformity with accounting principles generally accepted in the United States of America. Those estimates and assumptions affect the reported amounts of assets and liabilities and the reported amounts of revenues and expenses during the reporting period and in disclosures of commitments and contingencies. Changes in facts and circumstances may result in revised estimates and actual results could differ from those estimates.

The more significant areas requiring the use of management's estimates and judgments relate to the estimation of proved oil and gas reserves, the use of these oil and gas reserves in calculating depletion, depreciation and amortization, the use of the estimates of future net revenues in computing ceiling test limitations and estimates of future abandonment obligations used in recording asset retirement obligations. Estimates and judgments are also required in determining reserves for bad debt, impairments of undeveloped properties, the purchase price allocation, assessment of goodwill and valuation of deferred tax assets.

Certain amounts in the accompanying consolidated financial statements for prior periods have been reclassified to conform to the current year presentation.

## 2. Business Combination

On June 7, 2005, Cimarex completed the acquisition of Magnum Hunter Resources, Inc, an independent oil and gas exploration and production company with operations concentrated in the Permian Basin of West Texas and New Mexico and in the Gulf of Mexico. Terms of the merger agreement provided that Magnum Hunter stockholders receive 0.415 shares of Cimarex common stock for each share of Magnum Hunter common stock. As a result of the merger, Cimarex issued 39.7 million common shares to Magnum Hunter's common stockholders (excluding 2.5 million shares held in treasury).

We believe that the merger provides the opportunity to expand our existing core areas and to add new projects, without jeopardizing our strong financial position; a substantial footprint in the Permian Basin from which we can grow; complementary operations in the Mid-Continent and Gulf Coast areas; measured exposure to high potential projects in the Gulf of Mexico; and the ability to greatly expand our balanced-risk drilling program underpinned by a strong balance sheet.

The consolidated balance sheet at September 30, 2005, includes the estimated fair value of assets and liabilities of Magnum Hunter on June 7, 2005, as well as the adjustments required to record the acquisition in accordance with the purchase method of accounting. The results of operations of Magnum Hunter are included in our consolidated statements of operations for the period since the acquisition on June 7, 2005.

The purchase price of Magnum Hunter's assets was based on the value of Cimarex common stock issued to the Magnum Hunter stockholders and the fair value of assumed liabilities. The value of the common stock issued is based on the weighted average price of Cimarex's common stock for the period beginning two days before and ending two days after the announcement of the merger, or \$37.66 per share. The purchase price also includes merger costs incurred, which include employee severance costs, investment banking expenses, legal and accounting fees, printing expenses and other related costs.

<b>Purchase Price (in millions):</b>	
Shares of Cimarex common stock issued to Magnum Hunter stockholders	39.7
Average Cimarex stock price	\$ 37.66
<b>Fair value of common stock issued</b>	
	\$ 1,495.4
Plus: Merger costs incurred	30.5
<b>Total purchase price</b>	<b>1,525.9</b>
<b>Plus: Liabilities assumed by Cimarex:</b>	
Current liabilities	156.2
Fair value of long-term debt	633.0
Other non-current liabilities	72.9
Deferred income taxes	425.8
Fair Value of common stock associated with convertible debt	49.6
<b>Total purchase price plus liabilities assumed</b>	<b>\$ 2,863.4</b>
<b>Allocation of Purchase Price:</b>	
Current assets	\$ 177.3
Proved oil and gas properties	1,521.4
Unproved oil and gas properties	297.7
Investments	61.2
Other property and equipment	52.8
Other non-current assets	67.6
Goodwill	685.4
	\$ 2,863.4



The allocation of the purchase price to oil and gas properties utilized prevailing oil and gas prices at the time of negotiations and announcement of the merger. The overall allocation of the purchase price is preliminary because certain items such as the determination of the final fair value of certain assets and liabilities as of the acquisition date have not been finalized. The goodwill amount related to the purchase as of September 30, 2005 has been adjusted to \$671.9 million, as the finalization process continues.

Included in current assets on the acquisition date of June 7, 2005 were assets available for sale of approximately \$8.4 million acquired in the Magnum Hunter merger. These assets were sold in the third quarter for approximately \$8.1 million.

The following unaudited pro forma information has been prepared to give effect to the Magnum Hunter acquisition as if it had occurred at the beginning of the periods presented. The unaudited pro forma data is presented for illustrative purposes only, based on estimates and assumptions deemed appropriate by management, and should not be relied upon as an indication of the operating results that Cimarex would have achieved if the transaction had occurred on January 1, 2004. The pro forma information also should not be used as an indication of future results or trends.

(Thousands of dollars, except per share data)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
<b>Pro Forma Statement of Operations Data</b>				
Revenues	\$ 365,489	299,418	1,084,747	816,865
Net income	64,075	32,971	235,516	117,212
Net income per share:				
Basic	\$ 0.78	0.41	2.86	1.45
Diluted	0.76	0.40	2.78	1.42

3. Derivatives

SFAS No.133, *Accounting for Derivative Instruments and Hedging activities*, requires that all derivatives be recorded on the balance sheet at fair value. We generally determine the fair value of commodity futures and swap contracts based on the difference between the fixed contract price and the underlying market price at the determination date. Realized and unrealized gains and losses on derivatives that are not designated as hedges are recorded as an expense. In connection with the Magnum Hunter merger, Cimarex recognized a \$39.3 million liability associated with Magnum Hunter's existing commodity derivatives at the merger date (June 7, 2005). These derivative instruments have not been designated for hedge accounting treatment. As a result, Cimarex recognized a net loss during the third quarter of \$82 million. The charge includes both non-cash mark-to-market derivative losses as well as cash settlements. Cash payments related to these contracts that settled in the third quarter totaled \$15.6 million. The derivative liability at September 30, 2005 equals \$106.5 million. Cimarex will continue to recognize gains and losses in future earnings as the remaining derivative instruments expire through December 31, 2006. Actual gains and losses to be recognized may differ materially from current fair value estimates. The following is a summary of the company's open derivative contracts as of September 30, 2005:

Commodity	Type	Volume/Day	Duration		Weighted Average Price	Fair Value (000 \$)
Natural Gas	Collar	40,000 MMBTU	Oct 05	Dec 05	\$4.00 - \$6.25	\$ 27,610,144
Natural Gas	Collar	10,000 MMBTU	Oct 05	Dec 05	\$4.25 - \$6.60	6,857,865
Natural Gas	Collar	10,000 MMBTU	Oct 05	Dec 05	\$5.00 - \$9.50	4,218,657
Natural Gas	Swap	20,000 MMBTU	Oct 05	Dec 05	\$6.25	14,360,346
Crude Oil	Swap	1,000 BBL	Oct 05	Dec 05	\$34.90	2,874,805
Crude Oil	Collar	1,000 BBL	Oct 05	Dec 05	\$35.00 - \$55.00	1,076,867
Natural Gas	Collar	20,000 MMBTU	Jan 06	Dec 06	\$5.25 - \$6.30	38,529,822
Crude Oil	Collar	1,000 BBL	Jan 06	Dec 06	\$30.00 - \$35.85	10,970,818
						\$ 106,499,324

Of the \$106.5 million of total derivative liabilities, \$94.1 million is classified as current and \$12.4 million is included in other long-term liabilities on our consolidated balance sheet at September 30, 2005. The weighted average NYMEX prices at September 30 for fourth quarter 2005 approximate \$14.09 per Mcf of gas and \$66.33 per barrel of oil. Weighted average NYMEX prices at September 30, 2005 for the year 2006 approximate \$11.71 per Mcf of gas and \$66.83 per barrel of oil.



4. Stock Options

## Edgar Filing: CIMAREX ENERGY CO - Form 10-Q

Cimarex's 2002 Stock Incentive Plan reserves 12.7 million shares of common stock for issuance to directors and employees, including officers. Options granted under the plan after December 5, 2002, expire ten years from the grant date and vest in one-fifth increments on each of the first five anniversaries of the grant date. All grants are made at the average of the high and low prices of our common stock as reported on the New York Stock Exchange on the date of grant.

Upon the exercise of the options for shares of common stock, the employee is required to hold at least 50 percent of the profit shares, as defined in the plan, until the eighth anniversary of the grant date. The incentive plan provides for accelerated vesting if there is a change in control (as defined in the plan).

For periods prior to January 1, 2005, we applied Accounting Principles Board (APB) Opinion 25, *Accounting for Stock Issued to Employees*, and related interpretations to account for all stock option grants. No compensation cost had been recognized for stock options granted, as the option prices were equal to the market price of the underlying common stock on the date of grant.

Effective January 1, 2005, we adopted the provisions of Statement of Financial Accounting Standards (SFAS) No. 123R, *Share Based Payment* on a prospective basis. SFAS No. 123R requires companies to recognize in the income statement the grant-date fair value of stock options and other equity-based compensation to employees. For the quarter and nine months ended September 30, 2005 amortization of compensation expense related to stock options was approximately \$0.5 million and \$1.9 million or \$0.3 million and \$1.2 million after tax (\$.01 and \$.02 per diluted share respectively).

As discussed more fully in the notes to the financial statements of our annual report on form 10-K for the year ended December 31, 2004, the merger with Magnum Hunter constituted a change of control event under the incentive plan. As a result, all participants became entitled to acceleration of vesting of their options. Cimarex obtained waivers of the accelerated vesting from certain option holders including the company's CEO and other senior officers. Option holders who were not requested to or did not choose to execute a waiver became fully vested in their options on June 7, 2005. Compensation expense related to the accelerated vesting of options was approximately \$1.1 million or \$.7 million after tax.

The fair value of each option award was estimated as of the date of grant using the Black-Scholes option-pricing model. Expected volatilities were based on the historical volatility of our common stock. The risk free interest rate is based on U.S. Treasury Securities at a constant five year fixed maturity in effect at the date of the grant. Historical data was also used to estimate the probability of option exercise, expected years until exercise and employee termination within the valuation model.

Had compensation cost for the plan been determined based on the fair value at the grant dates for awards to employees under the plan, consistent with the methodology of SFAS No. 123R for the quarter and nine months ended September 30, 2004, such compensation expense would have been approximately \$0.9 million and \$2.6 million, respectively. Pro forma net income for the quarter and nine months ended September 30, 2004 would have been as indicated below:

Edgar Filing: CIMAREX ENERGY CO - Form 10-Q

	Three Months Ended, September 30, 2004		Nine Months Ended September 30, 2004	
Net income, as reported	\$	39,182	\$	105,517
Less: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects		(536)		(1,611)
Pro forma net income	\$	38,646	\$	103,906
Earnings per share:				
Basic as reported	\$	.94	\$	2.55
Basic pro forma				