JONES SODA CO
Form 10-Q
November 13, 2018


UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

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Form 10-Q

June

30, 2014

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the Quarterly Period Ended September 30, 2018
OR
TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to
Commission File Number: 000-28820

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JONES SODA CO.

(Exact name of registrant as specified in its charter)

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| | |
|---|---|
| Washington<br>(State or other jurisdiction of<br>incorporation or organization) | 52-2336602<br>(I.R.S. Employer<br>Identification No.) |
| 66 South Hanford Street, Suite 150<br>Seattle, Washington<br>(Address of principal executive offices) | <br>98134<br>(Zip Code) |

(206) 624-3357

(Registrant’s telephone number, including area code)

Indicate by checkmark 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 checkmark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes No

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

| | |
|---|---|
| Large accelerated filer | Accelerated filer |
| Non-accelerated filer | Smaller reporting company |
| Emerging growth company | |

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

As of November 13, 2018, there were 41,464,373 shares of the registrant's common stock issued and outstanding.

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JONES SODA CO.

FORM 10-Q

FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2018

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## EXPLANATORY NOTE

Unless otherwise indicated or the context otherwise requires, all references in this Quarterly Report on Form 10-Q (this "Report") to "we," "us," "our," "Jones," "Jones Soda," and the "Company" are to Jones Soda Co., a Washington corporati and our wholly-owned subsidiaries, Jones Soda Co. (USA) Inc. and Jones Soda (Canada) Inc.

In addition, unless otherwise indicated or the context otherwise requires, all references in this Annual Report to "Jones Soda" refer to our premium beverages, including Jones® Soda and Lemoncocco® sold under the trademarked brand name "Jones Soda Co.®"

## CAUTIONARY NOTICE REGARDING FORWARD LOOKING STATEMENTS

We desire to take advantage of the "safe harbor" provisions of the Private Securities Litigation Reform Act of 1995. This Report contains a number of forward-looking statements that reflect management's current views and expectations with respect to our business, strategies, products, future results and events, and financial performance. All statements made in this Report other than statements of historical fact, including statements that address operating performance, the economy, events or developments that management expects or anticipates will or may occur in the future, including statements related to case sales, revenues, profitability, distributor channels, new products, adequacy of funds from operations, cash flows and financing, our ability to continue as a going concern, potential strategic transactions, statements regarding future operating results and non-historical information, are forward-looking statements. In particular, the words such as "believe," "expect," "intend," "anticipate," "estimate," "may," "will," "can," "plan, "could," "future," "continue," variations of such words, and similar expressions identify forward-looking statements, but are not the exclusive means of identifying such statements and their absence does not mean that the statement is not forward-looking.

Readers should not place undue reliance on these forward-looking statements, which are based on management's current expectations and projections about future events, are not guarantees of future performance, are subject to risks, uncertainties and assumptions and apply only as of the date of this Report. Our actual results, performance or achievements could differ materially from historical results as well as from the results expressed in, anticipated or implied by these forward-looking statements. Except as required by law, we undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

In particular, our business, including our financial condition and results of operations and our ability to continue as a going concern may be impacted by a number of factors, including, but not limited to, the following:

- Our ability to successfully execute on our growth strategy and operating plans;
- Our ability to establish, maintain and expand distribution arrangements with independent distributors, retailers, brokers and national retail accounts, most of whom sell and distribute competing products, and upon whom we rely to employ sufficient efforts in managing and selling our products, including re-stocking the retail shelves with our products;
- Our ability to respond to any changes in, and to maintain, our private label relationship with 7-Eleven;
- The timing and amount of reorders for 7-Select®, including the impact on our inventory, revenue and cash flow;
- Competition in the fountain business, particularly from Coke and Pepsi;
- Entrance into and increased focus on the craft beverage segment by Coke and Pepsi;
- Our ability to compete successfully against much larger, well-funded, established companies currently operating in the beverage industry generally;
- Our ability to respond to changes in the consumer beverage marketplace, including potential reduced consumer demand due to health concerns (including obesity) and legislative initiatives against sweetened beverages;

- Our ability to successfully develop and launch new products that match consumer beverage trends and;
- Consumer response to such new products and new initiatives;
- Imposition of new taxes, including potential taxes on sugar-sweetened beverages;
- Our ability to manage our operating expenses and generate cash flow from operations, along with our ability to secure additional financing if our case sales goals take longer to achieve than anticipated;
- Our ability to manage our inventory levels and to predict the timing and amount of our sales;
- Our reliance on third-party contract manufacturers of our products and the geographic locations of their facilities, which could make management of our distribution efforts inefficient or unprofitable;
- Our ability to secure a continuous supply and availability of raw materials, as well as other factors affecting our supply chain including increases in raw material costs and shortages of glass in the supply chain;

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- Fluctuations in fuel and freight costs;
- Fluctuations in currency exchange rates, particularly between the United States and Canadian dollars;
- Our ability to source our flavors on acceptable terms from our key flavor suppliers;
- Our ability to attract and retain key personnel, including retaining the services of our CEO, the loss of whom would directly affect our efficiency and operations and could materially impair our ability to execute our growth strategy;
- Our ability to protect our trademarks and trade secrets, the failure of which may prevent us from successfully marketing our products and competing effectively;
- Our ability to create and maintain brand name recognition and acceptance of our products, which is critical to our success in our competitive, brand-conscious industry;
- Our ability to maintain brand image and product quality and avoid risks from other product issues such as product recalls;
- Litigation or legal proceedings, which could expose us to significant liabilities and damage our reputation;
- Our ability to maintain effective disclosure controls and procedures and internal control over financial reporting;
- Our ability to maintain an effective information technology infrastructure;
- Dilutive and other adverse effects on our existing shareholders and our stock price arising from future securities issuances;
- Our ability to access the capital markets for any future equity financing, and any actual or perceived limitations to our common stock by being traded on the OTCQB Marketplace, including the level of trading activity, volatility or market liquidity;
- Regional, national or global economic conditions that may adversely impact our business and results of operations; and
- Our ability to comply with the many regulations to which our business is subject.

For a discussion of some of the factors that may affect our business, results and prospects, see “Item 1A. Risk Factors” in our Annual Report on Form 10-K for the year ended December 31, 2017 filed with the Securities and Exchange Commission on March 29, 2018. Readers are also urged to carefully review and consider the various disclosures made by us in this Report and in our other reports we file with the Securities and Exchange Commission, including our periodic reports on Forms 10-Q and current reports on Form 8-K, and those described from time to time in our press releases and other communications, which attempt to advise interested parties of the risks and factors that may affect our business, prospects and results of operations.

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PART 1 – FINANCIAL INFORMATION

ITEM 1.FINANCIAL STATEMENTS

JONES SODA CO.

CONDENSED CONSOLIDATED BALANCE SHEETS

| | September 30, 2018 (Unaudited) | December 31, 2017 |
|---|---|---|
| | (In thousands, except share amounts) | |
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | $ 1,237 | $ 397 |
| Accounts receivable, net of allowance for doubtful accounts of $16 and $7 | 1,865 | 1,247 |
| Inventory | 1,459 | 1,557 |
| Prepaid expenses and other current assets | 103 | 141 |
| Total current assets | 4,664 | 3,342 |
| Fixed assets, net of accumulated depreciation of $480 and $568 | 98 | 39 |
| Other assets | 33 | 8 |
| Total assets | $ 4,795 | $ 3,389 |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Accounts payable | $ 1,007 | $ 949 |
| Line of credit | 432 | 858 |
| Accrued expenses | 706 | 626 |
| Taxes payable | - | 1 |
| Total current liabilities | 2,145 | 2,434 |
| Convertible subordinated notes payable, net | 2,497 | - |
| Deferred rent | 9 | 12 |
| Shareholders' equity: | | |
| Common stock, no par value: | | |
| Authorized — 100,000,000; issued and outstanding shares — 41,464,373 shares | 53,822 | 53,822 |
| Additional paid-in capital | 9,339 | 8,861 |
| Accumulated other comprehensive income | 371 | 391 |
| Accumulated deficit | (63,388) | (62,131) |
| Total shareholders' equity | 144 | 943 |
| Total liabilities and shareholders' equity | $ 4,795 | $ 3,389 |

See accompanying notes to condensed consolidated financial statements.

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JONES SODA CO.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

| | Three months ended September 30, | | Nine months ended September 30, | |
|---|---|---|---|---|
| | 2018 | 2017 | 2018 | 2017 |
| | (In thousands, except share amounts) | | | |
| Revenue | $ 3,454 | $ 3,648 | $ 10,218 | $ 11,116 |
| Cost of goods sold | 2,667 | 2,749 | 7,902 | 8,303 |
| Gross profit | 787 | 899 | 2,316 | 2,813 |
| Operating expenses: | | | | |
| Selling and marketing | 644 | 588 | 1,859 | 1,680 |
| General and administrative | 477 | 474 | 1,550 | 1,505 |
| | 1,121 | 1,062 | 3,409 | 3,185 |
| Loss from operations | (334) | (163) | (1,093) | (372) |
| Interest expense | (87) | (22) | (185) | (57) |
| Other income (expense), net | 2 | (20) | 42 | (13) |
| Loss before income taxes | (419) | (205) | (1,236) | (442) |
| Income tax expense, net | (6) | (6) | (21) | (21) |
| Net loss | $ (425) | $ (211) | $ (1,257) | $ (463) |
| Net loss per share - basic and diluted | $ (0.01) | $ (0.01) | $ (0.03) | $ (0.01) |
| Weighted average basic and diluted common shares outstanding | 41,464,373 | 41,449,373 | 41,464,373 | 41,409,512 |

See accompanying notes to condensed consolidated financial statements.

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JONES SODA CO.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(Unaudited)

| | Three months ended September 30, | | Nine months ended September 30, | |
|---|---|---|---|---|
| | 2018 | 2017 | 2018 | 2017 |
| | (In thousands) | | | |
| Net loss | $ (425) | $ (211) | $ (1,257) | $ (463) |
| Other comprehensive income (loss): | | | | |
| Foreign currency translation adjustment | 24 | 64 | (20) | 103 |
| Total comprehensive loss | $ (401) | $ (147) | $ (1,277) | $ (360) |

See accompanying notes to condensed consolidated financial statements.

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JONES SODA CO.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

| | Nine months ended September 30, | |
|---|---|---|
| | 2018 | 2017 |
| | (In thousands) | |
| OPERATING ACTIVITIES: | | |
| Net loss | $ (1,257) | $ (463) |
| Adjustments to reconcile net loss to net cash used in operating activities: | | |
| Gain on insurance claim | (36) | - |
| Depreciation and amortization | 83 | 9 |
| Stock-based compensation | 128 | 122 |
| Change in allowance for doubtful accounts | 9 | 4 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | (635) | 349 |
| Inventory | 89 | (414) |
| Prepaid expenses and other current assets | 55 | (7) |
| Other assets | (25) | - |
| Accounts payable | 61 | 904 |
| Accrued expenses | 81 | (249) |
| Taxes payable | (19) | (21) |
| Other liabilities | (3) | - |
| Net cash (used in) provided by operating activities | (1,469) | 234 |
| INVESTING ACTIVITIES: | | |
| Purchase of fixed assets | (78) | (27) |
| Proceeds from insurance claim on property damage | 36 | - |
| Net cash used in investing activities | (42) | (27) |
| FINANCING ACTIVITIES: | | |
| Proceeds from issuance of convertible notes, net | 2,783 | - |
| Repayments on line of credit | (426) | (280) |
| Proceeds from exercise of stock options | - | 46 |
| Net cash provided by (used in) financing activities | 2,357 | (234) |
| Net increase (decrease) in cash and cash equivalents | 846 | (27) |
| Effect of exchange rate changes on cash | (6) | 39 |
| Cash and cash equivalents, beginning of period | 397 | 733 |
| Cash and cash equivalents, end of period | $ 1,237 | $ 745 |
| Supplemental disclosure: | | |
| Cash paid during period for: | | |

| | | |
|---|---|---|
| Interest | $ 32 | $ 53 |
| Income taxes | 10 | 25 |
| Supplemental disclosure of non-cash transactions: | | |
| Beneficial conversion feature on convertible notes | $ 350 | $ - |

See accompanying notes to condensed consolidated financial statements.

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JONES SODA CO.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. Nature of Operations and Summary of Significant Accounting Policies

Jones Soda Co. develops, produces, markets and distributes premium beverages which it sells and distributes primarily in the United States and Canada through its network of independent distributors and directly to its national and regional retail accounts.

We are a Washington corporation and have two operating subsidiaries, Jones Soda Co. (USA) Inc. and Jones Soda (Canada) Inc. (together, our "Subsidiaries").

Basis of presentation and consolidation

The accompanying condensed consolidated balance sheet as of December 31, 2017, which has been derived from our audited consolidated financial statements, and unaudited interim condensed consolidated financial statements as of September 30, 2018, have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") and the Securities and Exchange Commission ("SEC") rules and regulations applicable to interim financial reporting. The condensed consolidated financial statements include our accounts and the accounts of our Subsidiaries. All intercompany transactions between us and our Subsidiaries have been eliminated in consolidation.

In the opinion of management, the accompanying unaudited condensed consolidated financial statements contain all material adjustments, consisting only of those of a normal recurring nature, considered necessary for a fair presentation of our financial position, results of operations and cash flows at the dates and for the periods presented. The operating results for the interim periods presented are not necessarily indicative of the results expected for the full year. These financial statements should be read in conjunction with the audited financial statements and notes thereto included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2017.

Liquidity

As of September 30, 2018, we had cash and cash-equivalents of approximately $1.2 million and working capital of approximately $2.5 million. Cash used in operations during the nine months ended September 30, 2018 totaled approximately $1.5  million compared to $234,000 provided by operations for the same period a year ago. The increase in cash used in operations compared to the same period a year ago is primarily due to timing of the collection of receivables. We reported a net loss of approximately $1.3 million for the nine months ended September 30, 2018, compared to a net loss of approximately $463,000 for the same period a year ago.

We have experienced recurring losses from operations and negative cash flows from operating activities.  This situation creates uncertainties about our ability to execute our business plan, finance operations, and indicates substantial doubt about the Company's ability to continue as a going concern.

We continue to experience negative cash flows from operations, as well as an ongoing requirement for additional capital to support working capital needs. Therefore, currently, based upon the Company's near term anticipated level of operations and expenditures, management believes that cash on hand, excluding cash available under the Company's line of credit, is not sufficient to enable the Company to fund operations for twelve months from the date the financial statements included in this Report are issued. Our line of credit is not included in this assessment due to the ability of the bank to terminate the line of credit upon 120 days' notice as discussed in Note 3 below. In view of these conditions, the ability of the Company to continue as a going concern is in substantial doubt and dependent upon achieving a profitable level of operations and on the ability of the Company to obtain necessary financing to fund ongoing operations. The consolidated financial statements included in this Report do not give effect to any adjustments which will be necessary should the Company be unable to continue as a going concern and therefore be required to realize its assets and discharge its liabilities in other than the normal course of business and at amounts different from those reflected in the accompanying consolidated financial statements.

We have a revolving secured credit facility with CapitalSource Business Finance Group (the "Loan Facility"). The Loan Facility allows us to borrow a maximum aggregate amount of up to $3.2 million based on eligible accounts receivable and inventory. As of September 30 2018, our accounts receivable and inventory eligible borrowing base was approximately $1.8 million, of which we had drawn down $432,000. See Note 3 below for further information.

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We may require additional financing to support our working capital needs in the future. The amount of additional capital we may require, the timing of our capital needs and the availability of financing to fund those needs will depend on a number of factors, including our strategic initiatives and operating plans, the performance of our business and the market conditions for available debt or equity financing. Additionally, the amount of capital required will depend on our ability to meet our sales goals and otherwise successfully execute our operating plan. We believe it is imperative that we meet these sales objectives in order to lessen our reliance on external financing in the future. We intend to continually monitor and adjust our operating plan as necessary to respond to developments in our business, our markets and the broader economy. Although we believe various debt and equity financing alternatives will be available to us to support our working capital needs, financing arrangements on acceptable terms may not be available to us when needed. Additionally, these alternatives may require significant cash payments for interest and other costs or could be highly dilutive to our existing shareholders. Any such financing alternatives may not provide us with sufficient funds to meet our long-term capital requirements. If necessary, we may explore strategic transactions that we consider to be in the best interest of the Company and our shareholders, which may include, without limitation, public or private offerings of debt or equity securities, a rights offering, and other strategic alternatives; however, these options may not ultimately be available or feasible when needed.

Seasonality and other fluctuations

Our sales are seasonal and we experience fluctuations in quarterly results as a result of many factors. We historically have generated a greater percentage of our revenues during the warm weather months of April through September. Sales may fluctuate materially on a quarter to quarter basis or an annual basis when we launch a new product or fill the “pipeline” of a new distribution partner or a large retail partner such as 7-Eleven. Sales results may also fluctuate based on the number of SKUs selected or removed by our distributors and retail partners through the normal course of serving consumers in the dynamic, trend-oriented beverage industry. As a result, management believes that period-to-period comparisons of results of operations are not necessarily meaningful and should not be relied upon as any indication of future performance or results expected for the fiscal year.

Revenue Recognition

The Company recognizes revenue under ASC 606, Revenue from Contracts with Customers. The core principle of the revenue standard is that a company should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. The Company only applies the five-step model to contracts when it is probable that the Company will collect the consideration it is entitled to in exchange for the goods and services transferred to the customer. The following five steps are applied to achieve that core principle:

Step 1: Identify the contract with the customer

Step 2: Identify the performance obligations in the contract

Step 3: Determine the transaction price

Step 4: Allocate the transaction price to the performance obligations in the contract

Step 5: Recognize revenue when the company satisfies a performance obligation

See Note 6, Segment information, for information on revenue disaggregated by geographic area.

Because the Company’s agreements generally have an expected duration of one year or less, the Company has elected the practical expedient in ASC 606-10-50-14(a) to not disclose information about its remaining performance obligations.

The Company’s performance obligations are satisfied at the point in time when products are received by the customer, which is when the customer has title and the significant risks and rewards of ownership. Therefore, the Company’s contracts have a single performance obligation (shipment of product). The Company primarily receives fixed consideration for sales of product. Shipping and handling amounts paid by customers are primarily for online orders, and are included in revenue, and totaled  $44,000 and $43,000 for the three months ended September 30, 2018 and 2017, respectively. Shipping and handling amounts paid by customers are primarily for online orders, and are included in revenue, and totaled  $137,000 and $143,000 for the nine months ended September 30, 2018 and 2017, respectively. Sales tax and other similar taxes are excluded from revenue.

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Revenue is recorded net of provisions for discounts, slotting fees payable by us to retailers to stock our products and promotion allowances, which are typically agreed to upfront with the customer and do not represent variable consideration. Discounts, slotting fees and promotional allowances vary the consideration the Company is entitled to in exchange for the sale of products to distributors. The Company estimates these discounts, slotting fees and promotional allowances in the same period that the revenue is recognized for products sales to customers. The amount of revenue recognized represents the amount that will not be subject to a significant future reversal of revenue. The liability for promotional allowances is included in accrued expenses on the consolidated balance sheets. Amounts paid for slotting fees are recorded as prepaid expenses on the consolidated balance sheets and amortized over the corresponding term. For the quarters ended September 30, 2018 and 2017, our revenue was reduced by $458,000 and $420,000 respectively, for slotting fees and promotion allowances. For the nine months ended September 30, 2018 and 2017, our revenue was reduced by approximately $1.1 million and approximately $1.2 million, respectively, for slotting fees and promotion allowances.

All sales to distributors and customers are generally final. In limited instances the Company may accept returned product due to quality issues or distributor terminations and in such situations the Company would have variable consideration. To date, returns have not been material. The Company's customers generally pay within 30 days from the receipt of a valid invoice. The Company offers prompt pay discounts of up to 2% to certain customers typically for payments made within 15 days. Prompt pay discounts are estimated in the period of sale based on experience with sales to eligible customers. Early pay discounts are recorded as a deduction to the accounts receivable balance presented on the consolidated balance sheets.

The accounts receivable balance primarily includes balances from trades sales to distributors and retail customers. The allowance for doubtful accounts is the best estimate of the amount of probable credit losses in existing accounts receivable. The Company determines the allowance for doubtful accounts based primarily on historical write-off experience. Account balances that are deemed uncollectible are charged off against the allowance after all means of collection have been exhausted and the potential for recovery is considered remote. Allowances for doubtful accounts of $16 and $7 as of September 30, 2018 and December 31, 2017, respectively, were netted against accounts receivable. No impairment losses were recognized as of September 30, 2018 and December 31, 2017, respectively. Changes in accounts receivable are primarily due to the timing and magnitude of orders of products, the timing of when control of products is transferred to distributors and the timing of cash collections.

Deferred financing costs

We defer costs related to the issuance of debt which are included on the accompanying balance sheets as a deduction from the debt liability. Deferred financing costs are amortized over the term of the related loan and are included as a component of interest expense on the accompanying consolidated statements of operations.

Use of estimates

The preparation of the condensed consolidated financial statements requires management to make a number of estimates and assumptions relating to the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the condensed consolidated financial statements and the reported amounts of revenue and expenses during the reporting period. Significant items subject to such estimates and assumptions include, but are not limited to, inventory valuation, depreciable lives and valuation of capital assets, valuation allowances for receivables, trade promotion liabilities, stock-based compensation expense, valuation allowance for deferred income tax assets, contingencies, and forecasts supporting the going concern assumption and related disclosures. Actual results could differ from those estimates.

Recent accounting pronouncements

In July 2017, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2017-11 ("ASU 2017-11"), which allows companies to exclude a down round feature when determining whether a financial instrument is considered indexed to the entity's own stock. As a result, financial instruments with down round features are no longer classified as liabilities and embedded conversion options with down round features are no longer bifurcated. For equity-classified freestanding financial instruments, such as warrants, an entity will treat the value of the effect of the down round, when triggered, as a dividend and a reduction of income available to common shareholders in computing basic earnings per share. For convertible instruments with embedded conversion options that have down round features, an entity will recognize the intrinsic value of the feature only when the feature becomes beneficial. The guidance in ASU 2017-11 is effective for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. We early adopted ASU 2017-11 effective January 1, 2018 without a material impact on our consolidated financial statements.

In May 2014, the FASB issued ASU No. 2014-09, "Revenue from Contracts with Customers (Topic 606)," ("ASU 2014-09"). ASU 2014-09 supersedes the revenue recognition requirements in ASC 605 - Revenue Recognition ("ASC 605") and most industry-specific guidance throughout ASC 605. The FASB haand in each case until their respective successors are duly elected and qualified.

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None of our directors currently serves as a director of any other company which is required to file periodic reports under the Securities Exchange Act of 1934.

**Board Committees**

Our board of directors has established an audit committee, whose principal functions are to assist the board in monitoring the integrity of our financial statements, the independent auditor s qualifications and independence, the performance of our independent auditors and our compliance with legal and regulatory requirements. The audit committee has the sole authority to retain and terminate our independent auditors and to approve the compensation paid to our independent auditors. The audit committee is also responsible for overseeing our internal audit function. The audit committee is comprised of two independent directors, consisting of Messrs. Kemendo and Woodrum, with Mr. Kemendo acting as the chairman. Our board of directors has determined that each member of the audit committee qualifies as an audit committee financial expert under the rules of the SEC adopted pursuant to requirements of the Sarbanes-Oxley Act of 2002 (see the biographical information for each of Messrs. Kemendo and Woodrum, infra, in this discussion of Directors and Executive Officers. Each of Messrs. Kemendo and Woodrum further qualifies as independent in accordance with the applicable regulations adopted by the SEC and American Stock Exchange.

We currently do not have a separate compensation committee. However, in accordance with the rules of the American Stock Exchange (on which our shares are listed), the compensation of our chief executive officer is recommended to the Board (in a proceeding in which the chief executive officer does not participate) by a majority of the independent directors serving on the Board. Compensation for all other officers is determined, or recommended to the Board for determination, by a majority of the independent directors.

We currently do not have a nominating committee.

Our board may establish other committees from time to time to facilitate our management.

**Director Compensation**

All outside directors are currently compensated with a stipend of $500 per month. No director receives a salary as a director.

**Compensation Committee Interlocks and Insider Participation**

As noted above, we currently do not have a compensation committee. As a result, the majority of our independent members of our board, consisting of Messrs. Crawford, Kemendo and Woodrum, are responsible for fixing the compensation to be paid to our executive officers. None of our executive officers serve as a member of the board of directors or compensation committee of any entity that has one or more of its executive officers serving as a member of our board of directors or compensation committee.

**Section 16(a) Beneficial Ownership Reporting Compliance**

Based solely upon a review of Forms 4 furnished to us during our most recent fiscal year, we know of no director, officer or beneficial owner of more than ten percent of our common stock who failed to file on a timely basis reports of beneficial ownership of the our common stock as required by Section 16(a) of the Securities Exchange Act of 1934, as amended.

**Code of Ethics**

The Company has adopted a code of ethics that applies to its principal executive officer, principal financial officer and principal accounting officer or persons performing similar functions (as well as its other employees and directors). The Company undertakes to provide any person without charge, upon request, a copy of such code of ethics. Requests may be directed to Arena Resources, Inc., 4920 S. Lewis Ave., Suite 107, Tulsa, Oklahoma 74105, attention William R. Broaddrick, or by calling (918) 747-6060.

**Item 10:**

**Executive Compensation**

The following table sets forth information concerning the compensation paid by us for the three most recent fiscal years to our chief executive officer and our other two executive officers.

**Summary Compensation Table**

| | | Annual Compensation | | Long-Term |
|---|---|---|---|---|
| **Name and Principal Position** | **Year** | **Salary** | **Bonus** | **Compensation Awards** |
| | | **($)[1]** | **($)** | |

| | | | | Securities Underlying Options[2] |
|---|---|---|---|---|
| Lloyd T. Rochford | | | | |
| *President and Chief Executive Officer* | 2001 | $24,500 | -- | -- |
| | 2002 | $36,000 | -- | -- |
| | 2003 | $36,000 | -- | $229,742 |
| Stanley M. McCabe | | | | |
| *Chairman of the Board* | 2001 | $24,500 | -- | -- |
| | 2002 | $36,000 | -- | -- |
| | 2003 | $36,000 | -- | $229,742 |
| William R. Broaddrick | | | | |
| *Vice President, Chief Financial Officer* | 2001 | $16,334 | $3,000 | -- |
| | 2002 | $45,000 | $6,000 | -- |
| | 2003 | $47,927 | -- | $459,484 |

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(1) Mr. Broaddrick s salary for 2003 reflects a raise that occurred in mid-year to increase his annual salary to $50,000. There are no current plans to change any officers salary from their level at December 31, 2003.

(2) The fair value of the options is estimated on the dates granted using the Black-Scholes option pricing model with the following weighted average assumptions: dividend yield of 0%; expected volatility of 36.2%; risk-free interest rate of 2.9% and expected lives of 5.0 years. The weighted average remaining contractual life of the options at December 31, 2003 was 4.2 years.



**Employee Benefit Plans**

*Equity Incentive Plan.* In March 2003, our board of directors adopted an executive stock option plan which was subsequently approved by our shareholders at our annual meeting in July 2003. The executive stock option plan is intended to promote continuity of management and to provide increased incentive and personal interest in our welfare by those key employees who are primarily responsible for shaping and carrying out our long-range plans and securing our continued growth and financial success. In addition, by encouraging stock ownership by directors who are not our employees, the executive stock option plan is intended to attract and retain qualified directors.

The plan is administered by Messrs. Rochford and McCabe, and they have the authority to select the key employees and non-employee directors to be participants in the plan, to determine the awards to be granted to participants and the number of shares covered by such awards, to set the terms and conditions of such awards and to establish, amend or waive rules for the administration of the plan.

Any of our key employees, including any of our executive officers or directors, is eligible to be granted awards by plan administrators. The plan authorizes the grant of stock options to key employees, all of which have been non-qualified stock options. Our non-employee directors are only eligible to be granted non-qualified stock options under the plan.

The plan provides that up to a total of 1,000,000 shares of common stock, subject to adjustment to reflect stock dividends and other capital changes, are available for granting of awards under the executive stock option plan. All of the shares available for grant under the plan have been reserved for issuance pursuant to options granted during 2003, as shown in the table below.

| **Name** | **Number of Securities Underlying Options/SARs Granted** | **Percent of Total Options/SARs Granted to Employees in Fiscal Year** | **Exercise Of Base Price ($/Sh)** | **Market Price per Share on Date of Grant** | **Expiration Date** |
|---|---|---|---|---|---|
| Lloyd T. Rochford | 125,000 | 12.5% | $3.70 | $4.35 | 10/1/08 |
| Stanley M. McCabe | 125,000 | 12.5% | $3.70 | $4.35 | 10/1/08 |
| William R. Broaddrick | 250,000 | 25.0% | $3.70 | $4.35 | 10/1/08 |
| Charles M. Crawford | 50,000 | 5.0% | $3.70 | $4.35 | 10/1/08 |
| Chris V. Kemendo, Jr. | 50,000 | 5.0% | $3.70 | $4.35 | 10/1/08 |
| Clayton E. Woodrum | 50,000 | 5.0% | $4.80 | $5.64 | 02/12/09 |
| Phillip W. Terry | 250,000 | 25.0% | $3.70 | $4.35 | 10/1/08 |
| Raymond H. Estep | 100,000 | 10.0% | $3.70 | $4.35 | 10/1/08 |

Each of the options identified above vests at the rate of 20% each year over five years beginning one year from the date of grant. All of the options identified above, with the exception of options granted to Mr. Woodrum, were issued on April 1, 2003. Mr. Woodrum s options were granted on August 12, 2003. Therefore, no options were capable of being exercised during our fiscal year ending December 31, 2003. The exercise price of each option was 85% of the closing market price of our common stock on the date the option was issued. The options for 50,000 shares granted to Mr. Woodrum, were originally granted to a former director on April 1, 2003; however, upon such director s resignation, in accordance with the terms of the options, those options were forfeited. Mr. Woodrum s options were granted in connection with his appointment to fill the vacant board position.



The following table provides information regarding option exercises and fiscal year-end option values calculated by determining the difference between the closing price of our common stock at December 31, 2003 and the exercise price of the options.

| **Name** | **Shares Acquired on Exercise** | **Value Realized ($)** | **Number of Unexercised Securities Underlying Options/SARs at FY-End (#) Exercisable/ Unexercisable** | **Value of Unexercisable In-The-Money Options/SARs at FY-End ($) Exercisable/ Unexercisable** |
|---|---|---|---|---|
| Lloyd T. Rochford | 0 | 0 | 0/125,000 | $0/$291,250 |
| Stanley M. McCabe | 0 | 0 | 0/125/000 | $0/$291,250 |
| William R. Broaddrick | 0 | 0 | 0/250,000 | $0/$582,500 |
| Charles M. Crawford | 0 | 0 | 0/50,000 | $0/$116,500 |
| Chris V. Kemendo, Jr. | 0 | 0 | 0/50,000 | $0/$116,500 |
| Clayton E. Woodrum | 0 | 0 | 0/50,000 | $0/$61,500 |
| Phillip W. Terry | 0 | 0 | 0/250,000 | $0/$582,500 |
| Raymond H. Estep | 0 | 0 | 0/100,000 | $0/$233,000 |

The following table sets forth information concerning our executive stock option plan as of December 31, 2003.

| | Number of securities to be issued upon exercise of outstanding options | Weighted average exercise price of outstanding options | Number of securities remaining available for future issuance under equity compensation plans (excluding securities in column (a)) |
|---|---|---|---|
| | (a) | (b) | (c) |
| Equity compensation plans | 1,000,000 | $3.76 | -0- |

| | | | |
|---|---|---|---|
| approved by security holders | | | |
| Equity compensation plans not approved by security holders | -- | -- | -- |
| Total | 1,000,000 | $3.76 | 1,000,000 |

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**Item 11:**

**Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters**

The following table sets forth, as March 10, 2004, information regarding the beneficial ownership of our common stock: (i) by each of our directors and executive officers; (ii) by all directors and executive officers as a group; and (iii) by all persons known to us to own 5% or more of our outstanding shares of common stock. The table also reflects what their ownership will be assuming completion of the sale of all shares in this offering (without taking into account the exercise of any warrants).  The mailing address for each of the persons indicated is our corporate headquarters.

Beneficial ownership is determined under the rules of the Securities and Exchange Commission. In general, these rules attribute beneficial ownership of securities to persons who possess sole or shared voting power and/or investment power with respect to those securities and includes, among other things, securities that an individual has the right to acquire within 60 days. Unless otherwise indicated, the stockholders identified in the following table have sole voting and investment power with respect to all shares shown as beneficially owned by them.

| | Shares of Common Stock Beneficially Owned | |
|---|---|---|
| **Name** | **Number** | **Percent** |
| Lloyd T. Rochford | 1,312,600 [(1)] | 18.3% |
| Stanley M. McCabe | 1,163,000 [(2)] | 16.2% |

| | | |
|---|---|---|
| William R. Broaddrick | 54,500 (3) | * |
| Charles M. Crawford | 10,000 (4) | * |
| Chris V. Kemendo, Jr. | 10,100 (5) | * |
| Clayton E. Woodrum | -- | * |
| All directors and executive officers as a group (6 persons) | 2,550,200 (6) | 35.6% |

(1)

Includes 25,000 shares issuable upon the exercise of stock options that are exercisable within 60 days.

(2)

Includes 25,000 shares issuable upon the exercise of stock options that are exercisable within 60 days.

(3)

Includes 50,000 shares issuable upon the exercise of stock options that are exercisable within 60 days.

(4)

Includes 10,000 shares issuable upon the exercise of stock options that are exercisable within 60 days.

(5)

Includes 10,000 shares issuable upon the exercise of stock options that are exercisable within 60 days.

(6)

Includes 120,000 shares issuable upon the exercise of stock options that are exercisable within 60 days by all executive officers and directors.

*

Represents beneficial ownership of less than 1%

Percentage ownership calculations for any stockholder listed above are based on 7,163,097 shares of our common stock outstanding as of March 10, 2004,

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**Item 12:**

**Certain Relationships and Related Transactions**

The initial capital assets that were contributed to us were provided by Messrs. Rochford and McCabe. In contributing these assets to us in September 2000, no independent determination was made regarding the value of the oil and gas properties and related interests contributed in exchange for stock. In exchange for the initial 1,300,000 shares of common stock issued to each of Messrs. Rochford and McCabe, each contributed $33,695 in cash and a carried working interest obligation with future development costs estimated by an independent oil and gas engineer of approximately $134,000. Of the cash contributed, $61,174 was used to acquire our three initial leases. The estimated future development costs were accounted for as a receivable from Messrs. Rochford and McCabe. Total actual costs incurred by them in relation to the carried working interest were $121,274. The difference of $12,726 was charged against additional paid in capital.

In July 2002, we borrowed $200,000 from each of Messrs. Rochford and McCabe, which debts are evidenced by notes payable which mature on January 1, 2005. The notes bear interest at a rate of 10% per annum, and are secured by our assets (although such notes are subordinate to our credit facility with our primary commercial lender).

In 2001 and 2002 we acquired certain lease interests and had other business dealings with Petro Consultants, Inc. One of the principals of Petro Consultants, Inc., Mr. Robert J. Morley, was appointed our Vice President of Investor Relations in July 2002 and served as a member of the Board of Directors from February 2003, until his resignation of all positions as an officer and director in August 2003. Therefore, any transactions involving Petro Consultant between July 2002 and August 2003 could be deemed to have been entered into with an affiliate. Because we anticipated that we may continue to transact business with Petro Consultants, to avoid future issues that might arise due to such affiliation, Mr. Morley resigned his position as an officer and member of our board and forfeited all stock options (none of which had vested) which he had been granted by reason of his position as a board member.

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**Item 13:**

Exhibits and Reports on Form 8-K

**Reports on Form 8-K**:

None

**Exhibit Index**:

3.1

Articles of Incorporation of Arena Resources, Inc. (i)

3.2

By-Laws of Arena Resources, Inc. (i)

10.1

Business Loan Agreement, dated as of December 31, 2003, among Arena Resources, Inc. and Bank of Oklahoma, N.A. (ii)

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Consent of Lee Keeling and Associates, Inc., Independent Petroleum Engineers

31.1

Certification of CEO

31.2

Certification of CFO

32.1

Section 1350 Certification - CEO

32.2

Section 1350 Certification CFO

(i) Incorporated herein by reference to the exhibits to Arena Resources, Inc. s Form SB-1 filed January 2, 2001 (SEC File No. 333-46164).

(ii) Incorporated herein by reference to the exhibits to Arena Resources, Inc. s Form 10-KSB filed March 19, 2004.

**Item 14:**

**Principal Accountant Fees and Services**

Hansen, Barnett & Maxwell served as our independent accountants for the years ended December 31, 2002 and 2003, and is expected to serve in that capacity for the current year. Principal accounting fees for professional services rendered for us by Hansen, Barnett & Maxwell for the years ended December 31, 2002 and 2003 are summarized as follows:

| | **2002**(1) | **2003**(1) |
|---|---|---|
| Audit | $12,265 | $ 29,617 |
| Audit related | 2,083 | 888 |
| Tax | 747 | 1,052 |
| All other | - | - |
| Total | $ 15,095 | $ 31,557 |

[1] The aggregate fees included in Audit are fees billed for the fiscal years for the audit of the Company s annual financial statements, review of the financial statements and statutory and regulatory filings or engagements. The aggregate fees included in each of the other categories are for fees billed in the fiscal years.

*Audit Fees.* Audit fees were for professional services rendered in connection with audits and quarterly reviews of financial statements of the Company and review of and preparation of consents for this registration statement for filing with the Securities and Exchange Commission.

*Audit Related Fees.* Audit related fees were for consultations regarding financial accounting and reporting standards primarily related to acquisitions of oil and gas properties.

*Tax Fees.* Tax fees related to services for tax compliance and consulting.

*Audit Committee Pre-Approval Policies and Procedures.* At its regularly scheduled and special meetings, the Audit Committee of the Board of Directors, which is comprised of independent directors knowledgeable of financial reporting, considers and pre-approves any audit and non-audit services to be performed by the Company s independent accountants. The Audit Committee has the authority to grant pre-approvals of non-audit services. That procedure was put into place promptly after July 30, 2002, the effective date of the Sarbanes-Oxley Act of 2002. At that time, the Audit Committee approved all non-audit services being performed at that time by the Company s independent accountants and adopted its pre-approval policies and procedures as set forth above. From the date of that meeting, there were no non-audit services performed by the Company s independent accountants that were not per-approved. Accordingly, the de minimus exception under Section 202 of the Sarbanes-Oxley Act of 2002 was applicable.

The Company s Audit Committee has considered whether the provision of the non-audit services provided by Hansen, Barnett & Maxwell is compatible with maintaining the accountant s independence.

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**SIGNATURES**

In accordance with Section 13 or 15(d) of the Exchange Act, the registrant caused this report to be signed on behalf by the undersigned, thereunto duly authorized.

ARENA RESOURCES, INC.

By:

/s/ Lloyd T. Rochford

Mr. Lloyd T. Rochford, President,

Chief Executive Officer

Date: August 5, 2004

By:

/s/ Stanley McCabe

Mr. Stanley McCabe

Treasurer, Secretary

Date:

August 5, 2004

By:

/s/ William R. Broaddrick

Mr. William R. Broaddrick

Chief Financial Officer

Date:

August 5, 2004

In accordance with the Exchange Act, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the date indicated.

By:

/s/ Lloyd T. Rochford

Mr. Lloyd T. Rochford, President,

Chief Executive Officer

Date:  August 5, 2004

By:

/s/ Stanley McCabe

Mr. Stanley McCabe

Treasurer, Secretary

Date:

August 5, 2004

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By:

/s/ Charles Crawford

Mr. Charles Crawford

Director

Date:

August 5, 2003

By:

/s/ Chris V. Kemendo, Jr.

Mr. Chris V. Kemendo, Jr.

Director

Date:

August 5, 2003

By:

/s/  Clayton E. Woodrum

Mr. Clayton E. Woodrum

Director

Date:

August 5, 2004

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**ARENA RESOURCES, INC.**

**INDEX TO FINANCIAL STATEMENTS**

**Page**

**HANSEN, BARNETT & MAXWELL**

A Professional Corporation

CERTIFIED PUBLIC ACCOUNTANTS

5 Triad Center, Suite 750

Salt Lake City, UT 84180-1128

Phone: (801) 532-2200

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**REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS**

To the Board of Directors and the Stockholders

Arena Resources, Inc.

We have audited the accompanying balance sheets of Arena Resources, Inc. as of December 31, 2003 and 2002, and the related statements of operations, stockholders' equity, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Arena Resources, Inc. as of December 31, 2003 and 2002, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 1, the accompanying financial statements have been restated for the effects of changing estimated depreciation, depletion and amortization.

**HANSEN, BARNETT & MAXWELL**

Salt Lake City, Utah

January 20, 2004

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**ARENA RESOURCES, INC.**
**CONDENSED BALANCE SHEETS**

| | December 31, 2003 | December 31, 2002 |
|---|---|---|
| **ASSETS** | | |
| **Current Assets** | | |
| Cash | $ 1,076,676 | $ 796,915 |
| Account receivable | 388,910 | 269,436 |
| Short-term investments | 25,234 | - |

| | | |
|---|---|---|
| Subscription receivable | - | 157,500 |
| Prepaid expenses | 28,935 | 1,128 |
| **Total Current Assets** | 1,519,755 | 1,224,979 |
| **Property and Equipment,** Using Full Cost Accounting | | |
| Oil and gas properties subject to amortization | 8,463,400 | 4,884,804 |
| Drilling advances | 351,000 | - |
| Equipment | 48,480 | 21,794 |
| Office equipment | 18,978 | 14,672 |
| **Total Property and Equipment** | 8,881,858 | 4,921,270 |
| Less: Accumulated depreciation and amortization | (559,229) | (195,608) |
| **Net Property and Equipment** | 8,322,629 | 4,725,662 |
| **Deferred Offering Costs** | 130,872 | - |
| **Long-Term Deposits** | - | 76,502 |
| **Total Assets** | $ 9,973,256 | $ 6,027,143 |
| **LIABILITIES AND STOCKHOLDERS' EQUITY** | | |
| **Current Liabilities** | | |
| Accounts payable | $ 229,522 | $ 173,174 |
| Accrued liabilities | 18,440 | - |
| Put option | 2,905 | - |
| Accrued preferred dividends | - | 114,685 |
| **Total Current Liabilities** | 250,867 | 287,859 |
| **Long-Term Liabilities** | | |
| Put option | - | 50,604 |
| Notes payable to officers | 400,000 | 400,000 |
| Asset retirement liability | 607,200 | - |
| Deferred income taxes | 656,759 | 179,488 |
| **Total Long-Term Liabilities** | 1,663,959 | 630,092 |
| **Stockholders' Equity** | | |
| Preferred stock - $0.001 par value; 10,000,000 shares | | |

| | | |
|---|---|---|
| authorized; | | |
| no shares issued or outstanding | - | - |
| Common stock - $0.001 par value; 100,000,000 shares authorized; | | |
| 7,162,097 shares and 6,282,056 shares outstanding, respectively | 7,162 | 6,282 |
| Additional paid-in capital | 6,994,925 | 5,287,189 |
| Options and warrants outstanding | 813,164 | 382,040 |
| Retained earnings | 243,179 | (566,319) |
| **Total Stockholders' Equity** | 8,058,430 | 5,109,192 |
| **Total Liabilities and Stockholders' Equity** | $ 9,973,256 | $ 6,027,143 |

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

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**ARENA RESOURCES, INC.**
**CONDENSED STATEMENTS OF OPERATIONS**

| | For the Twelve Months Ended December 31, | |
|---|---|---|
| | **2003** | **2002** |
| **Oil and Gas Revenues** | $ 3,665,477 | $ 1,657,037 |
| **Costs and Operating Expenses** | | |
| Oil and gas production costs | 1,149,136 | 594,863 |
| Oil and gas production taxes | 269,563 | 117,164 |
| Depreciation, depletion and amortization | 360,282 | 151,197 |
| General and administrative expense | 557,576 | 248,018 |

| | | |
|---|---|---|
| **Total Costs and Operating Expenses** | 2,336,557 | 1,111,242 |
| **Other Income (Expense)** | | |
| Gain from change in fair value of put options | 47,699 | 36,665 |
| Accretion expense | (32,212) | - |
| Interest expense | (38,798) | (15,923) |
| **Net Other Income (Expense)** | (23,311) | 20,742 |
| **Income Before Provision for Income Taxes and Cumulative Effect of Change in Accounting Principle** | 1,305,609 | 566,537 |
| **Provision for Deferred Income Taxes** | 484,298 | 179,488 |
| **Income Before Cumulative Effect of Change in Accounting Principle** | 821,311 | 387,049 |
| **Cumulative Effect of Change in Accounting Principle** | (11,813) | - |
| **Net Income** | 809,498 | 387,049 |
| **Preferred Stock Dividends** | - | 798,018 |
| **Income (Loss) Attributable to Common Shares** | $ 809,498 | $ (410,969) |
| **Basic Income (Loss) Per Common Share** | | |
| Before cumulative effect of change in accounting principle | $ 0.12 | $ (0.09) |
| Cumulative effect of change in accounting principle | - | - |
| **Net Income (Loss) Attributable to Common Shares** | $ 0.12 | $ (0.09) |
| **Diluted Income (Loss) Per Common Share** | | |
| Before cumulative effect of change in accounting principle | $ 0.11 | $ (0.09) |
| Cumulative effect of change in accounting principle | - | - |
| **Net Income (Loss) Attributable to Common Shares** | $ 0.11 | $ (0.09) |

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

**ARENA RESOURCES, INC.**

**STATEMENT OF STOCKHOLDERS' EQUITY**

| | Preferred Stock | | Common Stock | | Additional | Options and | Receivable | |
|---|---|---|---|---|---|---|---|---|
| | Shares | Amount | Shares | Amount | Paid-in Capital | Warrants Outstanding | from Shareholders | D |
| **Balance December 31, 2001** | 857,573 | $ 1,274,021 | 3,604,500 | $ 3,605 | $ 817,811 | $ 103,600.00 | $ (5,733) | $ |
| Issuance for cash | 1,028,786 | 1,214,582 | - | - | 114,402 | 254,889 | - | |
| Issuance for cash to a related party | - | - | 70,000 | 70 | 88,130 | - | - | |
| Issuance for property acquisitions | - | - | 149,885 | 150 | 525,260 | - | - | |
| Preferred stock beneficial conversion dividends | - | 114,402 | - | - | - | - | - | |
| Preferred stock cash dividends accrued | - | - | - | - | - | - | - | |
| Preferred stock dividends paid with common stock | - | - | 199,526 | 199 | 408,828 | - | - | |
| Conversion of preferred stock to common stock | (1,886,359) | (2,603,005) | 1,886,359 | 1,886 | 2,601,119 | - | - | |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Issuance upon exercise of warrants | - | - | 74,786 | 75 | 215,565 | (84,764) | - | |
| Issuance for cash | - | - | 286,000 | 286 | 493,535 | 108,315 | - | |
| Issuance for services | - | - | 11,000 | 11 | 22,539 | - | - | |
| Collection of receivable from shareholder | - | - | - | - | - | - | 5,733 | |
| Net Income | - | - | - | - | - | - | - | |
| **Balance December 31, 2002** | - | - | 6,282,056 | 6,282 | 5,287,189 | 382,040 | - | |
| Issuance for cash | - | - | 790,294 | 790 | 1,274,256 | 436,154 | - | |
| Issuance of warrants as consulting fee for 2002 offering | - | - | - | - | (15,922) | 15,922 | - | |
| Cancellation of shares for extension of lock up | - | - | (500) | (0) | 0 | - | - | |
| Issuance of common stock for services | - | - | 13,847 | 14 | 75,026 | - | - | |
| Warrant exercise | - | - | 19,400 | 19 | 54,883 | (20,952) | - | |
| Issuance of common stock in property acquisitions | - | - | 57,000 | 57 | 319,493 | - | - | |
| Net Income | - | - | - | - | - | - | - | |
| **Balance December 31, 2003** | - | $ - | 7,162,097 | $ 7,162 | $ 6,994,925 | $ 813,164 | $ - | $ |

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

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**ARENA RESOURCES, INC.**
**CONDENSED STATEMENTS OF CASH FLOWS**

| *For the Year Ended December 31* | | **2003** | | **2002** |
|---|---|---|---|---|
| **Cash Flows From Operating Activities** | | | | |
| Net income | $ | 809,498 | $ | 387,049 |
| Adjustments to reconcile net income to net cash | | | | |
| provided by operating activities: | | | | |
| Shares issued for services | | 75,040 | | - |
| Depreciation and depletion | | 360,282 | | 151,197 |
| Services and use of office space contributed by officers | | - | | 22,550 |
| Gain from change in fair value of put option | | (47,699) | | (36,665) |
| Cumulative effect of change in accounting principle | | 11,813 | | - |
| Accretion of discounted liabilities | | 32,212 | | - |
| Changes in assets and liabilities: | | | | |
| Accounts receivable | | (119,474) | | (258,730) |
| Prepaid expenses | | (27,807) | | (222) |
| Interest capitalized on certificates of deposit | | - | | (1,502) |
| Accounts payable and accrued liabilities | | 74,787 | | 127,583 |
| Deferred income tax payable | | 484,298 | | 179,488 |
| **Net Cash Provided by Operating Activities** | | 1,652,950 | | 570,748 |
| **Cash Flows from Investing Activities** | | | | |
| Purchase of oil and gas properties | | (3,050,558) | | (2,603,279) |
| Purchase of office equipment | | (4,306) | | (7,594) |
| Increase in long-term investments | | - | | (25,000) |
| Maturity of long term investment | | 51,268 | | - |

| | | | | |
|---|---|---|---|---|
| Purchase of property, plant & equipment | | (26,686) | | (21,794) |
| **Net Cash Used in Investing Activities** | | (3,030,282) | | (2,657,667) |
| **Cash Flows From Financing Activities** | | | | |
| Proceeds from issuance of common stock and warrants, net of offering costs | | 1,580,328 | | 532,836 |
| Proceeds from warrant exercise | | 33,950 | | 130,876 |
| Collection of common stock subscription receivable | | 157,500 | | - |
| Payment from issuance of note payable | | - | | 400,000 |
| Proceeds from issuance of preferred stock, net of offering costs | | - | | 1,589,606 |
| Payment on note payable | | - | | (18,000) |
| Payment of dividends to preferred stockholders | | (114,685) | | (196,048) |
| **Net Cash Provided by Financing Activities** | | 1,657,093 | | 2,439,270 |
| **Net Increase in Cash** | | 279,761 | | 352,351 |
| **Cash at Beginning of Period** | | 796,915 | | 444,564 |
| **Cash at End of Period** | $ | 1,076,676 | $ | 796,915 |
| **Supplemental Cash Flows Information** | | | | |
| Cash paid for interest | $ | 38,798 | $ | 17,425 |
| **Non-Cash Investing and Financing Activities** | | | | |
| Common stock issued for properties less call options granted | $ | 319,550 | $ | 525,410 |
| Asset retirement obligation incurred in property acquisition | | 338,271 | | - |
| Accrual of preferred stock dividends | | - | | 274,589 |
| Receivable from shareholders related to stock offerings | | - | | 157,500 |
| Preferred stock dividends paid with common stock | | - | | 409,027 |
| Beneficial conversion feature on convertible preferred stock | | - | | 114,402 |
| Settlement of receivable in property acquisition | | - | | 23,027 |
| Value of put option included in cost to acquire properties | | - | | 87,269 |

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

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**ARENA RESOURCES, INC.**

**NOTES TO FINANCIAL STATEMENTS**

**DECEMBER 31, 2003 AND 2002**

**NOTE 1 ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

***Organization and Nature of Operations*** Arena Resources, Inc. (the Company ) is a Nevada corporation that owns interests in oil and gas properties located in Oklahoma, Texas, Kansas and New Mexico. The Company is engaged primarily in the acquisition, exploration and development of oil and gas properties and the production and sale of oil and gas.

***Use of Estimates*** The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

***Cash Equivalents and Short-term investments*** Cash and cash equivalents include investments in highly-liquid debt instruments with original maturities of three months or less. The Company has deposits with a bank that are $976,676 in excess of federally insured limits at December 31, 2003. Short-term investments consist of certificates of deposit totaling $25,234 which are assigned as collateral under standby letters of credit.

***Oil and Gas Properties*** The Company uses the full cost method of accounting for oil and gas properties. Under this method, all costs associated with acquisition, exploration, and development of oil and gas properties are capitalized. Costs capitalized include acquisition costs, geological and geophysical expenditures, lease rentals on undeveloped properties and costs of drilling and equipping productive and non-productive wells. Drilling costs include directly related overhead costs. Capitalized costs are categorized either as being subject to amortization or not subject to amortization.

All capitalized costs of oil and gas properties, including the estimated future costs to develop proved reserves and estimated future costs of site restoration, are amortized on the unit-of-production method using estimates of proved reserves as determined by independent engineers. Investments in unproved properties and major development projects are not amortized until proved reserves associated with the projects can be determined or until impairment occurs. If the results of an assessment indicate that the properties are impaired, the amount of the impairment is added to the capitalized costs to be amortized. Depletion and amortization expense for the year ended December 31, 2003, was $360,282, based on depletion at the rate of $2.79 per barrel-of-oil-equivalent and for the year ended December 31, 2002, was $151,197, based on depletion at the rate of $2.27 per barrel-of-oil-equivalent.

In addition, capitalized costs are subject to a ceiling test, which limits such costs to the aggregate of the estimated present value, discounted at a 10-percent interest rate of future net revenues from proved reserves, based on current economic and operating conditions, plus the lower of cost or fair market value of unproved properties.

***Support and Office Equipment*** Depreciation of support and office equipment is computed using the straight-line method over the estimated useful life of the assets which is currently seven years. Depreciation expense was $9,950 and $3,456 for the years ended December 31, 2003 and 2002, respectively.

***Income Taxes*** Provisions for income taxes are based on taxes payable or refundable for the current year and deferred taxes on temporary differences between the amount of taxable income and pretax financial income and between the tax bases of assets and liabilities and their reported amounts in the financial statements. Deferred tax assets and liabilities are included in the financial statements at currently enacted

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income tax rates applicable to the period in which the deferred tax assets and liabilities are expected to be realized or settled. As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through the provision for income taxes.

***Basic and Diluted Income (Loss) Per Share*** Basic income (loss) per common share is computed by dividing income (loss) attributable to common shareholders by the weighted-average number of common shares outstanding during the period. Diluted income (loss) per share is calculated to give effect to potentially issuable common shares except during loss periods when those potentially issuable common shares would decrease loss per common share. There were 507,200 warrants outstanding at December 31, 2002 that were excluded from the calculation of diluted loss per common share during the year ended December 31, 2002 because they were anti-dilutive.

***Major Customers*** During the year ended December 31, 2003, sales to three customers represented 51%, 19% and 11% of total sales, respectively. At December 31, 2003, these three customers made up 46%, 16% and 17% of accounts receivable, respectively. During the year ended December 31, 2002, sales to two customers represented 47% and 31% of total sales. At December 31, 2002, these customers made up 56% and 19% of accounts receivable, respectively.

***Stock-Based Employee Compensation*** On April 1, 2003 and on August 12, 2003, the Company issued stock options to directors and employees, which are described more fully in Note 7. The Company applies the recognition and measurement principles of Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees* (APB 25) and related interpretations in accounting for its stock-based compensation awards to employees. Under APB 25, no stock-based compensation expense was charged to earnings, as all options granted had an exercise price equal to or greater than the adjusted fair value of the underlying common stock on the grant date.

Alternately, Statement on Financial Accounting Standards (SFAS) No. 123, *Accounting for Stock-Based Compensation* (SFAS No. 123), allows companies to recognize compensation expense over the related service period based on the grant date fair value of the stock option awards. The following table illustrates the effect on net income and basic and diluted income (loss) per common share if the Company had applied the fair value recognition provisions of SFAS No. 123 to stock-based employee compensation:

| ***For the Years Ended December 31,*** | | **2003** | | **2002** |
|---|---|---|---|---|
| Net income, as reported | $ | 809,498 | $ | 387,049 |
| Deduct: Total stock-based employee compensation expense determined under the fair value based method for all awards, net of related tax effects | | (391,683) | | - |
| **Pro Forma Net Income** | $ | 417,815 | $ | 387,049 |
| **Income (Loss) Per Common Share** | | | | |
| Basic, as reported | $ | 0.12 | $ | (0.09) |
| Basic, pro forma | $ | 0.06 | $ | (0.09) |
| Diluted, as reported | $ | 0.11 | $ | (0.09) |
| Diluted, pro forma | $ | 0.06 | $ | (0.09) |

The pro forma estimated after-tax stock-based compensation expense under SFAS 123 for the years ending December 31, 2004, 2005 and 2006 relating to options outstanding at December 31, 2003, will be approximately $362,000, $214,000 and $126,000, respectively.

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***Cumulative Effect of Change in Accounting Principle*** The Company adopted SFAS No. 143, *Accounting for Asset Retirement Obligations*, on January 1, 2003. In accordance with the transition provisions of SFAS No. 143, on that date the Company recorded asset retirement costs and liabilities and recorded an adjustment for the cumulative effect on prior years of adopting SFAS No. 143 in the amount of $11,813 as a reduction in earnings, which had no effect on basic or diluted income per common share.

***Recent Accounting Pronouncements*** In July 2002, the FASB issued SFAS No. 146, *Accounting for Costs Associated with Exit or Disposal activities*. The statement requires companies to recognize costs associated with exit or disposal activities when they are incurred rather than at the date of a commitment to an exit or disposal plan. The Company has not been involved in any exit or disposal activities; therefore the adoption of the statement on January 1, 2003 did not have an impact on the Company s financial position or results of operations.

In November 2002, the FASB issued Interpretation No. 45, *Guarantor s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others*. The interpretation requires that a liability measured at fair value be recognized for guarantees. The Company has not provided any guarantees and therefore the adoption of the interpretation had no impact on the Company s financial statements.

In December 2002, the FASB issued SFAS No. 148, *Accounting for Stock-Based Compensation-Transition and Disclosure*. Under the requirements of this statement, the Company has disclosed the effects on reported net of the Company s accounting policy with respect to stock-based employee compensation.

In January 2003, the FASB issued Interpretation No. 46, *Consolidation of Variable Interest Entities*. This interpretation establishes the requirement for a primary beneficiary to consolidate certain entities in which equity investors do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. The Company does not have an interest in a variable interest entity and the adoption of the statement did not have an impact on the Company s financial statements.

In May 2003, the FASB issued SFAS No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity*. This statement was effective for the Company in July 2003. The statement requires financial instruments to be classified as liabilities if the financial instruments are issued in the form of shares that are mandatorily redeemable or embody an obligation to repurchase equity shares. The Company issued a put option in exchange for oil and gas property interests in August 2002. The put option was originally classified as a liability; therefore, the adoption of the statement did not have an impact on the Company s financial statements.

***Restatement of Financial Statements*** The Company revised its estimates of oil and gas reserves and estimated future development costs. The revision of those estimates resulted in an increase in depreciation, depletion and amortization for the years ended December 31, 2003 and 2002. The accompanying financial statements have been restated as a result of the change in depreciation, depletion and amortization. The effects of the restatement were as follows:



| | As Previously Reported | Effect of Restatement | As Restated |
|---|---|---|---|
| **For the Year Ended December 31, 2003** | | | |
| Depreciation and amortization | $ 338,157 | $ 22,125 | $ 360,282 |
| Income before provision for income taxes and cumulative effect of change in accounting principle | 1,327,734 | (22,125) | 1,305,609 |
| Provision for deferred income taxes | 491,599 | (7,301) | 484,298 |
| Income before cumulative effect of change in accounting principle | 836,135 | (14,824) | 821,311 |
| Net income | 824,322 | (14,824) | 809,498 |
| Basic income per common share | 0.12 | - | 0.12 |
| Diluted income per common share | 0.12 | (0.01) | 0.11 |
| **For the Year Ended December 31, 2002** | | | |
| Depreciation and amortization | $ 127,847 | $ 23,350 | $ 151,197 |
| Income before provision for income taxes | 589,887 | (23,350) | 566,537 |
| Provision for deferred income taxes | 187,193 | (7,705) | 179,488 |
| Net income | 402,694 | (15,645) | 387,049 |
| Basic loss per common share | (0.09) | - | (0.09) |
| Diluted loss per common share | (0.09) | - | (0.09) |

| | | | |
|---|---|---|---|
| **As of December 31, 2003** | | | |
| Property and equipment, net | $ 8,368,104 | $ (45,475) | $ 8,322,629 |
| Total assets | 10,018,731 | (45,475) | 9,973,256 |
| Deferred income taxes | 671,765 | (15,006) | 656,759 |
| Total long-term liabilities | 1,678,965 | (15,006) | 1,663,959 |
| Retained earnings | 273,648 | (30,469) | 243,179 |
| Total stockholders' equity | 8,088,899 | (30,469) | 8,058,430 |
| **As of December 31, 2002** | | | |
| Property and equipment, net | $ 4,749,012 | $ (23,350) | $ 4,725,662 |
| Total assets | 6,050,493 | (23,350) | 6,027,143 |
| Deferred income taxes | 187,193 | (7,705) | 179,488 |
| Total long-term liabilities | 637,797 | (7,705) | 630,092 |
| Retained earnings | (550,674) | (15,645) | (566,319) |
| Total stockholders' equity | 5,124,837 | (15,645) | 5,109,192 |

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**NOTE 2 EARNING PER SHARE INFORMATION**

| ***For the Years Ended December 31,*** | **2003** | **2002** |
|---|---|---|
| Income before cumulative effect of change in accounting principle | $ 821,311 | $ 387,049 |
| Less: Preferred stock dividends | - | (798,018) |
| Income (loss) before cumulative effect of change in accounting principle | 821,311 | (410,969) |
| Cumulative effect of change in accounting principle | (11,813) | - |
| Income (Loss) Attributable to Common Shares | $ 809,498 | $ (410,969) |
| Basic weighted-average common shares outstanding | 6,759,858 | 4,553,232 |
| Effect of dilutive securities | | |
| Warrants | 231,476 | - |
| Stock options | 250,342 | - |
| Diluted Weighted-Average Common Shares Outstanding | 7,241,676 | 4,553,232 |
| Basic Income (Loss) Per Common Share | | |

| | | | | |
|---|---|---|---|---|
| Before cumulative effect of change in accounting principle | $ | 0.12 | $ | (0.09) |
| Cumulative effect of change in accounting principle | | - | | - |
| Net Income (Loss) Attributable to Common Shares | $ | 0.12 | $ | (0.09) |
| Diluted Income (Loss) Per Common Share | | | | |
| Before cumulative effect of change in accounting principle | $ | 0.11 | $ | (0.09) |
| Cumulative effect of change in accounting principle | | - | | - |
| Net Income (Loss) Attributable to Common Shares | $ | 0.11 | $ | (0.09) |

**NOTE 3 ACQUISITION OF OIL AND GAS PROPERTIES**

***Koehn Property*** On March 12, 2002, the Company entered into a farm-out agreement relating to certain oil and gas property in Haskell and Gray Counties, Kansas referred to as the Koehn Property. Under the terms of the agreement, the Company agreed to drill one well and could drill additional wells on the property. In exchange for each well drilled, the Company will be assigned 100% of the working interest (80% of the net revenue interest) in the well and related oil and gas until payout of all costs of drilling, equipping, completing and operating the well. After payout, the Company s working interest in the wells and related oil and gas will decrease to 75% (60% of the net revenue interest). The Company successfully drilled one well at a cost of approximately $127,000. The well found proved gas reserves but is currently shut-in pending a pipeline connection.

On March 20, 2002, the Company entered into an agreement with Petro Consultants, Inc. ( Petro ), a related-party shareholder of the Company, which agreement created a joint venture between the two companies to drill and operate the well on the above-mentioned property. Under the terms of the agreement, Petro purchased 27% of the working interest in the well for $88,200. On May 20, 2002, after the well was successfully drilled, the Company issued 70,000 shares of common stock to Petro to repurchase the 27% working interest in the well. The transactions with Petro have been recognized as a financing arrangement and have been accounted for as the issuance of 70,000 shares of common stock for $88,200 in cash, or $1.26 per share, without other rights to the property.



***Dodson*** On April 26, 2002, the Company purchased a working interest in a mineral lease located in Montague County, Texas in exchange for a cash payment of $200,000. In addition, the Company issued 25,000 shares of common stock to Petro as a finder s fee, valued at $2.50 per share, or $62,500, based on the market value of the common stock on the date issued. The finder s fee was capitalized as a cost of the mineral lease.

***Ona Morrow*** On June 18, 2002, the Company purchased a working interest in a mineral lease located in Texas County, Oklahoma for a cash payment of $735,000.

***Eva South*** On July 16, 2002, the Company purchased a working interest in a mineral lease located in Texas County, Oklahoma in exchange for a cash payment of $827,500. In addition, the Company issued 25,000 shares of common stock to Petro as a finder s fee, valued at $4.00 per share, or $100,000, based on the market value of the common stock on the date issued. The finder s fee was capitalized as a cost of the mineral lease.

***Midwell, Appleby, Smalts and Hanes*** On August 23, 2002, the Company entered into an agreement to purchase a working interest in mineral leases located in Cimarron County, Oklahoma. The cost of mineral interests acquired was $550,179 with the consideration given consisting of a cash payment of $100,000, the issuance of 99,885 shares of common stock valued at $399,540 or $4.00 per share based on the market value of the common stock on the date issued, the issuance of a put option to the seller valued at $87,269, less a call option received from the seller valued at $36,630.

Under the terms of the put option, the seller has the right on September 1, 2004, to require the Company to repurchase the 99,885 common shares at $4.00 per share. The issuance of the put option was recorded as a liability based on the holder s ability to require the Company to pay cash to redeem the common stock and was recorded at its fair value of $87,269 on the date issued. The fair value of the put option was computed using the Black-Scholes option pricing model with the following assumptions: 2.2% risk-free interest rate; 43% expected volatility; two years expected life and 0% dividend yield.

The call option received by the Company granted the Company the option to repurchase 50,000 of the common shares at $5.00 per share from the date issued through September 11, 2004. The call option is exercisable at the Company s discretion and was therefore recorded as a reduction of additional paid-in capital based on its fair value of $36,630 on the date received. The fair value of the call option was determined using the Black-Scholes option pricing model with the following assumptions: 2.2% risk-free interest rate; 43% expected volatility; two year expected life and 0% dividend yield. The call option is part of permanent equity and will not be revalued at any future date.

**Seven Rivers Queen Unit -** On April 4, 2003, the Company entered into an agreement to purchase a 70.60% working interest, representing a 56.48% net revenue interest, in the Seven Rivers Queen Unit mineral lease located in Lea County, New Mexico. Total consideration provided by the Company was a cash payment of $900,000. The Company also issued 10,000 shares of common stock as a finder s fee relating to this acquisition to an unrelated third party, which were valued at $5.20 per share, or $52,000. The value of the shares was based on the market value of the Company s common stock on the date issued.



**Beals Prospect -** On July 2, 2003, the Company entered into an agreement to purchase a 100% working interest, representing a 80.5% net revenue interest, in the Beals Prospect mineral lease located in Comanche County, Kansas.

Total consideration provided by the Company was a cash payment of $60,000 and the issuance of 15,000 shares of common stock as a finder s fee to an unrelated third party, which were valued at $5.80 per share, or $87,000. The value of the shares was based on the market value of the Company s common stock on the date issued. The prospect was unproven, undeveloped acreage. The Company entered into an agreement with Petro Consultants, Inc., a shareholder of the Company, whereby Petro paid the Company $180,000 for a 35% working interest in an explorative well that the Company agreed to drill on the prospect. The cost of the well and the carrying value of the property were reduced by the proceeds received from Petro. When the well was drilled, it was unsuccessful and was plugged and abandoned.

***North Benson Queen Unit*** Effective October 1, 2003, the Company acquired a 100% working interest, representing a 78.15% net revenue interest, in the North Benson Queen Unit in Eddy County New Mexico. Total consideration provided by the Company was a cash payment of $500,000 and the issuance of 25,000 shares of common stock as a finder s fee to an unrelated third party, which were valued at $5.64 per share, or $141,000. The value of the shares was based on the market value of the Company s common stock on the date issued.

***West San Andres Unit*** Effective October 1, 2003, the Company acquired a 100% working interest, representing a 79.60% net revenue interest, in the West San Andres Unit in Yoakum County, Texas. Total consideration provided by the Company was a cash payment of $500,000 and the issuance of 7,000 shares of common stock as a finder s fee to an unrelated third party, which were valued at $5.65 per share, or $39,550. The value of the shares was based on the market value of the Company s common stock on the date issued.

**NOTE 4 NOTES PAYABLE AND PUT OPTION**

On February 3, 2003, the Company established a $10,000,000 revolving credit facility with a bank with an initial borrowing base of $2,000,000. The interest rate is a floating rate equal to the JP Morgan Chase prime rate plus 1% with interest payable monthly. Annual fees for the facility are 1/2 of one percent of the unused portion of the borrowing base. Amounts borrowed under the revolving credit facility will be due in February 2005. The revolving credit facility is secured by the Company s principal mineral interests. In order to obtain the revolving credit facility, loans from two officers were subordinated to the position of the bank and the credit facility was guaranteed by two of the Company s officers. The Company is required under the terms of the credit facility to maintain a tangible net worth of $4,000,000, maintain a 5-to-1 ratio of income before interest, taxes, depreciation, depletion and amortization to interest expense and maintain a current asset to current liability ratio of 1-to-1. The Company is presently current on its undertakings to the bank necessary to maintain this credit facility. As of December 31, 2003, no amounts are owed under this credit facility.

On December 31, 2003, the Company entered into an agreement that increased it s revolving credit facility to $20,000,000 and increased the initial borrowing base to $4,000,000. Additionally, the agreement extended the maturity date to December 31, 2005, annual fees for the facility have been decreased to ¼ of 1% of the unused portion of the borrowing base, the Company is now required to maintain a tangible net worth of $6,000,000 and the personal guaranties of the two Company officers are released. All other terms and conditions of the credit facility remain unchanged.

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On July 1, 2002, the Board of Directors authorized the Company to borrow up to $500,000 from its officers. On July 26, 2002, the Company borrowed $400,000 from two of its officers. The related notes payable bear interest at 10% per annum payable monthly with principal and interest due December 31, 2002. The notes are secured by all mineral interests, rights and equipment of the Company but have been subordinated to the bank revolving credit facility. On December 30, 2002, the Company and the officers agreed to an 18 month extension to the notes payable, extending the maturity date to June 30, 2004. On August 1, 2003, the Board of Directors and the officers agreed to an additional extension of the notes to January 1, 2005, under the same terms as the original notes. Based on the borrowing rates available to the Company for bank loans, the fair value of the notes payable to officers was $400,000 at both December 31, 2003 and 2002.

The Company granted a put option in connection with the acquisition of oil and gas properties in August 2002. Under the terms of the put option, the seller has the right on September 1, 2004, to require the Company to repurchase the 99,885 common shares at $4.00 per share. The put option is a derivative and as such, the liability has been revalued to its fair value at each balance sheet date with adjustments to fair value being recognized as gain on change in fair value of put options. At December 31, 2003 and 2002, the fair value of the liability was $2,905 and $50,604, respectively, calculated using the Black-Scholes option pricing model with the following assumptions: 1.1% and 1.8% risk-free interest rate; 32% and 36% volatility; 0.67 years and 1.7 years expected life; and 0% and 0% dividend yield.

**NOTE 5 ASSET RETIREMENT OBLIGATION**

Effective January 1, 2003, the Company adopted SFAS No. 143, *Accounting for Asset Retirement Obligations*, which requires entities to record the fair value of a liability for an asset retirement obligation when it is incurred which, for the Company, is typically when an oil or gas well is drilled or purchased. The standard applies to legal obligations associated with the retirement of long-lived assets that result from the acquisition, construction, development or normal use of the asset. The Company s asset retirement obligations relate primarily to the obligation to plug and abandon oil and gas wells and support wells at the conclusion of their useful lives.

SFAS No. 143 requires that the fair value of a liability for an asset retirement obligation be recognized in the period in which it is incurred, if a reasonable estimate of fair value can be made. When the liability is initially recorded, the related cost is capitalized by increasing the carrying amount of the related oil and gas property. Over time, the liability is accreted upward for the change in its present value each period until the obligation is settled. The initial capitalized cost is amortized as a component of oil and gas properties as described in Note 1.

At January 1, 2003, the implementation of SFAS No. 143 resulted in a net increase in property and equipment of $217,878. Liabilities increased by $236,718, which represents the establishment of an asset retirement obligation liability. The cumulative effect on prior years of the change in accounting principle of $11,813, net of $7,027 of related tax effects, was recorded in the first quarter of 2003 as a reduction in earnings. The effect of adopting this accounting principle was a $24,873 after-tax decrease in net income during the year ended December 31, 2003.

The following present pro forma net income and basic and diluted income (loss) per common share as if SFAS No. 143 had been applied retroactively for the year ended December 31, 2003 and 2002:



| *For the Years Ended December 31,* | | **2003** | | **2002** |
|---|---|---|---|---|
| Net Income | $ | 809,498 | $ | 377,396 |
| Income (Loss) Per Common Share | | | | |
| Basic | $ | 0.12 | $ | 0.08 |
| Diluted | $ | 0.11 | $ | 0.08 |

The pro forma amount of the liability for the asset retirement obligation was $80,140 at December 31, 2001 and $236,718 at December 31, 2002. The asset retirement obligation is adjusted each quarter for any liabilities incurred or settled during the period, accretion expense and any revisions made to the estimated cash flows. The reconciliation of the asset retirement obligation for the year ended December 31, 2003 is as follows:

| | | |
|---|---|---|
| Balance, January 1, 2003 | $ | 236,718 |
| Liabilities incurred | | 338,270 |
| Accretion expense | | 32,212 |
| Balance, December 31, 2003 | $ | 607,200 |

**NOTE 6 STOCKHOLDERS EQUITY**

The Company is authorized to issue 100,000,000 common shares, with a par value of $0.001 per share, and 10,000,000 Class A convertible preferred shares, with a par value of $0.001 per share.

***Preferred Stock*** In June 2001, Arena commenced a Private Placement Offering of 10% convertible preferred shares to accredited investors to raise between $525,000 and $3,500,000 for drilling and completions, as well as additional acquisitions. The offering closed June 30, 2002 with gross proceeds of $3,301,128 and net proceeds of $2,961,495, after cash offering costs totaling $339,633.

During the year ended December 31, 2002, the Company collected $5,733 of subscriptions receivable that were outstanding at December 31, 2001. From January 1, 2002 through July 1, 2002, the Company issued 1,028,786 shares of Class A convertible preferred stock at $1.75 per share under the terms of the private placement offering and realized gross proceeds during that period of $1,800,376 before cash offering costs of $216,503. Offering costs included a 10% cash commission paid to the placement agents on shares they placed. The Company issued the placement agents warrants to purchase 236,786 shares of common stock at $1.75 per share for a period of three years. The Company valued the warrants issued to the placement agents at $254,889 and accounted for the warrants as an additional offering cost. The fair value of the warrants was determined using the Black-Scholes option-pricing model with the following weighted-average assumptions: risk free interest rate of 3.4%, volatility of 47%, expected life of 3 years and expected dividend yield of 0%.

The Company determined that the issuance of Class A preferred stock issued in 2002 resulted in the related shareholders receiving a beneficial conversion option at the dates the preferred stock was issued. This beneficial conversion option was valued at $114,402 based on the difference between the effective conversion price and the market value of the Company s common stock on the dates issued. Since the preferred shares were immediately convertible into common stock, the Company recognized the beneficial conversion option as preferred stock dividends on the dates the preferred stock was issued.



The Class A preferred stock was convertible into common shares from the date of issuance on a 1-for-1 ratio. The Class A preferred shares were automatically convertible into common shares if the price of the common shares was equal to or greater than $4.00 for 20 consecutive days. After one year, the Class A preferred shares were redeemable by the Company, subject to a 30-day notice, at $1.84 per share plus payment of any accrued dividends. The Class A preferred shares accrued dividends at the rate of $0.175 per share annually and were payable quarterly. The Class A preferred shares were non-voting and were entitled to priority over the common shares in the payment of dividends and in liquidation.

On July 30, 2002, the Company s common stock was priced at or above $4.00 per share for the twentieth consecutive day. Accordingly, the 1,886,359 shares of Class A preferred stock were converted into 1,886,359 shares of common stock on July 30, 2002.

The provisions of the preferred stock dictate that dividends will be paid up to the date of conversion or for one year from the date of issuance, whichever is later; accordingly, the Company accrued all remaining cash dividends that were payable in connection with the Series A preferred stock conversion on July 30, 2002. The total Series A preferred stock 2002 dividends payable in cash were $274,589. The Company paid $114,685 in preferred dividends during the year ended December 31, 2003 and $196,048 during the same period of 2002. All accrued dividends have been paid.

On October 1, 2002, the Company offered all former Class A preferred shareholders additional restricted common shares equal to 10% of the common shares issued upon conversion of the preferred stock in exchange for their agreement and consent not to engage in any sales, assignments or rights related to the common stock issued for a period of twelve months from the earliest date the common stock could otherwise be traded under existing restricted stock agreements or federal securities regulations. Under that offer, the Company issued 181,387 common shares to the former Class A preferred shareholders. In addition, the Company issued the placement agents 18,139 common shares as compensation for obtaining the related lock up agreements. The Company recognized the common shares issued as preferred stock dividends and valued them at $409,027 or $2.05 per share based on the market value of the common stock on the dates the offer was accepted.

***Common Stock*** On August 22, 2002, the Company initiated a $3,000,000 private placement offering of the Company s common stock at $2.50 per share with a detachable warrant exercisable at $5.00 per share through September 30, 2005. Through December 31, 2002, the Company had issued 286,000 shares of common stock and warrants under the terms of the private placement offering for gross proceeds of $715,000 before cash offering costs of $112,864 and were allocated to the common stock issued and the warrants based upon their relative fair value. Accordingly, $493,821 was allocated to the 286,000 shares of common stock, and $108,315 was allocated to the 286,000 warrants. Although the amount allocated to the warrants was less than their fair value, the fair value of the warrants was $278,015 determined using the Black-Scholes option pricing model with the following assumptions: risk free interest rate of 1.8%, expected dividend yield of 0%, volatility of 36.5%, and expected lives of 2.8 years.

From January 1, 2003 to July 15, 2003, the Company issued 790,294 shares of common stock and 790,294 warrants for $1,711,200 in net cash proceeds (net of cash offering costs of $264,535). In addition, 105,196 warrants exercisable at $5.00 per share through September 30, 2005 were issued to placement agents. The net proceeds received were allocated to the common stock and the warrants based upon their relative fair values, with $1,275,046 allocated to the common stock and $436,154 allocated to the warrants. The fair value of the warrants issued was $1,192,626, or $1.37 per warrant, which was determined using the Black-Scholes option pricing model with the following weighted-average assumptions: risk-free interest rate of 1.32%, expected dividend yield of 0%, volatility of 34.7% and an expected life of 2.21 years.

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In addition, during the year ended December 31, 2003, Arena issued 2,433 additional warrants, with the same terms to placement agents, and 50,000 additional warrants exercisable at $3.00 per share through July 15, 2006, as consulting fees, relating to the shares of common stock and warrants issued during 2002. During the year ended December 31, 2003, $15,922 of the proceeds from the 2002 cash offering proceeds were allocated to the additional warrants, based upon their relative fair value. The offering closed July 15, 2003. The Company issued a total of 1,076,294 units of common stock and warrants to investors under the offering for $ 2,313,336 in net cash proceeds (net of cash offering costs of $377,399) and issued 157,629 warrants as consulting fees and for services to placement agents.

During the years ended December 31, 2003 and 2002, warrant holders exercised 19,400 warrants for $33,950 or $1.75 per share and exercised 74,786 warrants for $130,876 or $1.75 per share, respectively. Additionally, the Company issued 70,847 shares of common stock for services, which the Company valued at an aggregate total of $394,590 or 5.57 per share. The Company capitalized as part of oil and gas properties $319,550 and the remaining $75,040 was charged to expense.

Stock purchase warrants issued and exercised during the years ended December 31, 2003 and 2002 are summarized as follows:

| | 2003 | | 2002 | |
|---|---|---|---|---|
| | **Warrants** | **Weighted-Average Exercise Price** | **Warrants** | **Weighted-Average Exercise Price** |
| Outstanding at beginning of year | 507,200 | $3.58 | 59,200 | $1.75 |
| Issued | 947,923 | 4.89 | 522,786 | 3.53 |
| Exercised | (19,400) | 1.75 | (74,786) | 1.75 |
| Outstanding at End of Year | 1,435,723 | $4.47 | 507,200 | $3.58 |

Stock purchase warrants outstanding at December 31, 2003 are as follows:

| **Warrants Outstanding** | **Exercise Price** | **Weighted-Average Remaining Contractual Life** |
|---|---|---|
| 201,800 | $1.75 | 1.5 years |
| 50,000 | 3.00 | 2.5 |
| 1,183,923 | 5.00 | 1.7 |
| 1,435,723 | | |

***Call Option*** The Company received a call option in August 2002 in connection with the purchase of oil and gas properties. The option permits the Company to repurchase 50,000 shares of its common stock at $5.00 per share through September 11, 2004. The call option is exercisable at the Company s discretion and was recorded as a reduction of additional paid-in capital based on its fair value of $36,630 on the date received. The fair value of the call option was determined using the Black-Scholes option pricing model with the following assumptions: 2.2% risk-free interest rate; 43% expected volatility; two year expected life and 0% dividend yield. The call option is part of permanent equity and will not be revalued.

**NOTE 7 EMPLOYEE STOCK OPTIONS**

On April 1, 2003 and on August 12, 2003, the Company granted nonqualified stock options to directors and employees to purchase 1,000,000 shares and 50,000 shares of common stock at $3.70 per share and $4.80 per share through April 1, 2008 and August 12, 2008, respectively. Effective July 31, 2003, 50,000 of the options with an exercise price of $3.70 per share were forfeited. The options vest at the rate of 20% each year over five years beginning one year from the date granted. The exercise price was 85% of the market value of the Company s common stock on the dates issued. In accordance with FASB Interpretation No. 44, *Accounting for Certain Transactions Involving Stock Compensation*, the 15% discount from the market price of the Company s common stock used in determining the fair value of the common stock is considered reasonable and the options are not compensatory. Accordingly, the Company did not recognize any compensation expense from the grant of these stock options. A summary of the status of the stock options as of December 31, 2003 and changes during the year then ended is as follows:

| | Options | Weighted-Average Exercise Price |
|---|---|---|
| Granted | 1,050,000 | $3.75 |
| Forfeited | (50,000) | 3.70 |
| Outstanding at End of Year | 1,000,000 | $3.76 |
| Options exercisable at end of year | - | |

The fair value of the options granted, net of forfeitures, was $1,862,864, or $1.86 per share, and was estimated on the dates granted using the Black-Scholes option-pricing model with the following weighted-average assumptions: dividend yield of 0% percent, expected volatility of 36.2%, risk-free interest rate of 2.9% and expected lives of 5.0 years. The weighted-average remaining contractual life of the stock options at December 31, 2003 was 4.2 years.

**NOTE 8 RELATED PARTY TRANSACTIONS**

In July 2002, the Company borrowed $400,000 from two of its officers under the terms of secured, 10% promissory notes, as more fully described in Note 4.

In 2002, the Company issued common stock to Petro Consultants, Inc. for cash and as compensation for finding and arranging for the purchase of oil and gas properties, as described in Note 3. Petro Consultants, Inc. was a related party shareholder of the Company due to an officer of Petro Consultants, Inc. serving as a director and a consultant to the Company from July 1, 2002 to July 2003. Due to the resignation from that position and relationship, Petro Consultants, Inc. is no longer considered a related party. In August 2003, the Company sold an interest in an explorative well to Petro Consultants, Inc for $180,000 as described in Note 3.

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**NOTE 9 COMMITMENTS**

***Operating Leases*** Effective January 1, 2004, the Company entered into a two-year extension to an existing operating lease agreement for office space. Under terms of the lease, the Company pays $1,700 per month through December 31, 2005. The Company incurred lease expense of $10,640 for the year ended December 31, 2003. The future minimum lease payments under the operating lease agreement as of December 31, 2003 consist of $20,400 due during the year ending December 31, 2004 and $20,400 due during the year ending December 31, 2005.

***Standby Letters of Credit*** A commercial bank has issued standby letters of credit on behalf of the Company to the states of Texas, Oklahoma and New Mexico totaling $256,529 to allow the Company to do business in those states. The standby letters of credit are collateralized by an assignment of certificates of deposit totaling $25,000 and by the credit facility with a bank. The Company intends to renew the standby letters of credit for as long as the Company does business in those states. No amounts have been drawn under the standby letters of credit.

**NOTE 10 INCOME TAXES**

The provision for income taxes consisted of the following:

| ***For the Years Ended December 31,*** | **2003** | **2002** |
|---|---|---|
| Current before benefit of operating loss carry forwards | $ 83,686 | $ - |
| Current benefit of operating loss carry forwards | (83,686) | - |

| | | | | |
|---|---|---|---|---|
| Deferred | | 484,298 | | 179,488 |
| Provision for Income Taxes | $ | 484,298 | $ | 179,488 |

The following is a reconciliation of income taxes computed using the U.S. federal statutory rate to the provision for income taxes:

| ***For the Years Ended December 31,*** | | **2003** | | **2002** |
|---|---|---|---|---|
| Tax at federal statutory rate (34%) | $ | 443,907 | $ | 192,623 |
| Income not subject to tax | | (17,364) | | (22,168) |
| State tax, net of federal benefit | | 57,255 | | 19,700 |
| Benefit of operating loss carry forwards | | - | | (10,667) |
| Provision for Income Taxes | $ | 484,298 | $ | 179,488 |

As of December 31, 2003, the Company had net operating loss carry forwards for federal income tax reporting purposes of $39,471 which, if unused, will expire in 2022. The net deferred tax liability consisted of the following:

| ***December 31,*** | | **2003** | | **2002** |
|---|---|---|---|---|
| Deferred tax liabilities | | | | |
| Depreciation and amortization | $ | 41,152 | $ | (7,705) |
| Intangible drilling costs | | 648,126 | | 264,851 |
| Asset retirement costs | | 208,690 | | - |
| Total deferred tax liabilities | | 897,968 | | 257,146 |
| Deferred tax assets | | | | |
| Asset retirement liability | | 226,486 | | - |
| Operating loss carry forwards | | 14,723 | | 77,658 |
| Total deferred tax assets | | 241,209 | | 77,658 |
| Net Deferred Income Taxes | $ | 656,759 | $ | 179,488 |

**NOTE 11 SUBSEQUENT EVENTS**

Subsequent to December 31, 2003, the Company has drilled and completed the Rexford #1-30 well in Haskell County, Kansas, on the acreage covered by the farm-out agreement entered into on March 12, 2002 as part of the Koehn lease. The well was successful, but has not yet been connected. It is anticipated to be connected later this year.

Subsequent to December 31, 2003, warrants to acquire 5,000 shares of common stock have been exercised (unaudited).

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**ARENA RESOURCES, INC.**

**SUPPLEMENTAL INFORMATION ON OIL AND GAS PRODUCING ACTIVITIES**

**(Unaudited)**

**Capitalized Costs Relating to Oil and Gas Producing Activities**

| ***December 31,*** | **2003** | **2002** |
|---|---|---|
| Unproved oil and gas properties | $ 128,694 | $ - |
| Proved oil and gas properties | 8,334,706 | 4,884,804 |
| Drilling advances on uncompleted projects | 351,000 | - |
| Support and office equipment | 67,458 | 36,466 |
| Total capitalized costs | 8,881,858 | 4,921,270 |
| Less accumulated depreciation and amortization | (559,229) | (195,608) |
| **Net Capitalized Costs** | $ 8,322,629 | $ 4,725,662 |

**Costs Incurred in Oil and Gas Producing Activities**

| ***For the Years Ended December 31,*** | **2003** | **2002** |
|---|---|---|
| Acquisition of proved properties | $ 2,470,821 | $ 2,659,832 |
| Acquisition of unproved properties | 147,000 | - |
| Exploration costs | 326,410 | - |
| Development costs | 849,864 | 579,153 |
| Acquisition of support and office equipment | - | 29,388 |
| Asset retirement costs recognized upon adoption of SFAS No. 143 | 221,218 | - |
| **Total Costs Incurred** | $ 4,015,313 | $ 3,268,373 |

**Results of Operations from Oil and Gas Producing Activities** The Company s results of operations from oil and gas producing activities exclude interest expense, accretion expense, gain from change in fair value of put options and the cumulative effect of change in accounting principle. Income taxes are based on statutory tax rates, reflecting allowable deductions.

| ***For the Years Ended December 31,*** | **2003** | **2002** |
|---|---|---|
| Oil and gas revenues | $ 3,665,477 | $ 1,657,037 |
| Production costs | (1,149,136) | (594,863) |
| Production taxes | (269,563) | (117,164) |
| Depreciation and amortization | (360,282) | (151,197) |
| General and administrative expense | (557,576) | (248,018) |
| Results before income taxes | 1,328,920 | 545,795 |
| Provision for income taxes | (484,298) | (179,488) |
| **Results of Oil and Gas Producing Operations** | $ 844,622 | $ 366,307 |

**Reserve Quantities Information** The following estimates of proved and proved developed reserve quantities and related standardized measure of discounted net cash flow are estimates only, and do not purport to reflect realizable values or fair market values of the Company s reserves. The Company emphasizes that reserve estimates are inherently imprecise and that estimates of new discoveries are more imprecise than those of producing oil and gas properties. Accordingly, these estimates are expected to change as future information becomes available. All of the Company s reserves are located in the United States of America.

Proved reserves are estimated reserves of crude oil (including condensate and natural gas liquids) and natural gas that geological and engineering data demonstrate with reasonable certainty to be recoverable in future years from known reservoirs under existing economic and operating conditions. Proved developed reserves are those expected to be recovered through existing wells, equipment and methods.

The standardized measure of discounted future net cash flows is computed by applying year-end prices of oil and gas to the estimated future production of proved oil and gas reserves, less estimated future expenditures (based on year-end costs) to be incurred in developing and producing the proved reserves, less estimated future income tax expenses (based on year-end statutory tax rates) to be incurred on pretax net cash flows less tax basis of the properties and available credits, and assuming continuation of existing economic conditions. The estimated future net cash flows are then discounted using a rate of 10 percent per year to reflect the estimated timing of the future cash flows.

| ***For the Years Ended December 31,*** | **2003** | | **2002** | |
|---|---|---|---|---|
| | **Oil [1]** | **Gas [1]** | **Oil [1]** | **Gas [1]** |
| **Proved Developed and Undeveloped Reserves** | | | | |
| Beginning of year | 4,113,936 | 3,187,757 | 494,823 | 2,960,373 |
| Purchases of minerals in place | 3,175,357 | 570,924 | 3,597,156 | 1,676,706 |
| Improved recovery | 18,066 | 229,626 | - | - |
| Production | (117,646) | (67,329) | (58,717) | (46,819) |
| Revision of previous estimates | (139,546) | (512,224) | 80,674 | (1,402,503) |
| End of Year | 7,050,167 | 3,408,754 | 4,113,936 | 3,187,757 |
| **Proved Developed Reserves at End of Year** | 1,580,531 | 1,612,738 | 750,464 | 1,151,985 |

[1] Oil reserves are stated in barrels; gas reserves are stated in thousand cubic feet.

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**Standardized Measure of Discounted Future Net Cash Flows**

| *December 31,* | **2003** | **2002** |
|---|---|---|
| Future cash inflows | $ 218,026,254 | $ 109,145,883 |
| Future production costs | (64,157,199) | (28,850,909) |
| Future development costs | (13,609,384) | (6,218,000) |
| Future income taxes | (45,778,941) | |

(23,701,042)

Future net cash flows

94,480,730

50,375,932

10% annual discount for estimated timing of cash flows

(49,474,633)

(22,378,108)

**Standardized Measure of Discounted Future Net Cash Flows**

$ 45,006,097

$ 27,997,824

**Changes in Standardized Measure of Discounted Future Net Cash Flows**

***For the Years Ended December 31,***

**2003**

**2002**

Beginning of the year

$ 27,997,824

$ 5,203,372

Purchase of minerals in place

21,333,720

34,477,311

Extensions, discoveries and improved recovery, less related costs

691,469

-

Development costs incurred during the year

320,102

215,433

Sales of oil and gas produced, net of production costs

(2,302,405)

(1,057,366)

Accretion of discount

3,012,793

3,525,683

| | | |
|---|---|---|
| Net changes in prices and production costs | 8,222,075 | 6,456,827 |
| Net change in estimated future development costs | 39,219 | (142,491) |
| Revision of previous quantity estimates | (53,098) | (2,497,666) |
| Revision in estimated timing of cash flows | (5,468,732) | - |
| Net change in income taxes | (8,786,870) | (18,183,279) |
| **End of the Year** | | |

$ 45,006,097

$ 27,997,824

**Exhibit Index**

3.1

Articles of Incorporation of Arena Resources, Inc. (i)

3.2

By-Laws of Arena Resources, Inc. (i)

10.1

Business Loan Agreement, dated as of December 31, 2003, among Arena Resources, Inc. and Bank of Oklahoma, N.A. (ii)

10.2

Arena Resources, Inc. Stock Option Plan (ii)

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Consent of Lee Keeling and Associates, Inc., Independent Petroleum Engineers

31.1

Certification of CEO

31.2

Certification of CFO

32.1

Section 1350 Certification - CEO

32.2

Section 1350 Certification  CFO

(i) Incorporated herein by reference to the exhibits to Arena Resource, Inc. s Form SB-1 filed January 2, 2001 (SEC File No. 333-46164)].

(ii) Incorporated herein by reference to the exhibits to Arena Resource, Inc. s Form 10-KSB filed March 19, 2004



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**Exhibit 23.1**

Consent of Lee Keeling and Associates, Inc. - Independent Petroleum Engineers

We consent to the reference to our Appraisal of Oil and Gas Properties dated January 1, 2004 in the Annual Report (Form 10-KSB), as amended, of Arena Resources, Inc. for the year ended December 31, 2003.

Lee Keeling and Associates, Inc.

Tulsa, Oklahoma

August 4, 2004

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**Exhibit 31.1**

CERTIFICATION

I, Lloyd T. Rochford, certify that:

1.

I have reviewed this Annual Report on Form 10-KSB/A of Arena Resources, Inc.

2.

Based on my knowledge, this annual 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 annual report;

3.

Based on my knowledge, the financial statements, and other financial information included in this annual 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 annual report;

4.

The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:

a) designed such disclosure controls and procedures 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 annual report is being prepared;

b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of the end of the period covered by this annual report (the "Evaluation Date"); and

c) presented in this annual report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5.

The registrant's other certifying officer and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):

a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6.

The registrant's other certifying officer and I have indicated in this annual report whether there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

/s/ Lloyd T. Rochford

Lloyd T. Rochford

Chief Executive Officer

August 5, 2004

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**Exhibit 31.2**

CERTIFICATION

I, William R. Broaddrick, certify that:

1.

I have reviewed this Annual Report on Form 10-KSB/A of Arena Resources, Inc.

2.

Based on my knowledge, this annual 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 annual report;

3.

Based on my knowledge, the financial statements, and other financial information included in this annual 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 annual report;

4.

The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:

a) designed such disclosure controls and procedures 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 annual report is being prepared;

b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of the end of the period covered by this annual report (the "Evaluation Date"); and

c) presented in this annual report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5.

The registrant's other certifying officer and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):

a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6.

The registrant's other certifying officer and I have indicated in this annual report whether there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

<u>/s/ William R. Broaddrick</u>

William R. Broaddrick

Chief Financial Officer

August 5, 2004



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**Exhibit 32.1**

CERTIFICATION PURSUANT TO

18 U.S.C. SECTION 1350,

AS ADOPTED PURSUANT TO

SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Annual Report of Arena Resources, Inc. (the "Company"), on Form 10-KSB/A for the year ended December 31, 2003, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Lloyd T. Rochford, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

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

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

/s/ Lloyd T. Rochford

Lloyd T. Rochford

Chief Executive Officer

August 5, 2004

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**Exhibit 32.2**

CERTIFICATION PURSUANT TO

18 U.S.C. SECTION 1350,

AS ADOPTED PURSUANT TO

SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Annual Report of Arena Resources, Inc. (the "Company"), on Form 10-KSB/A for the year ended December 31, 2003, as filed, I, William R. Broaddrick, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

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

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

/s/ William R. Broaddrick

William R. Broaddrick

Chief Financial Officer

August 5, 2004