CIMAREX ENERGY CO
Form 10-Q
November 06, 2013
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

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

For the Quarterly Period ended September 30, 2013

Commission File No. 001-31446

CIMAREX ENERGY CO.

1700 Lincoln Street, Suite 1800

Denver, Colorado 80203-4518

(303) 295-3995

Incorporated in the State of Delaware	**Employer Identification No. 45-0466694**

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer, and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer x	Accelerated filer o	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

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

The number of shares of Cimarex Energy Co. common stock outstanding as of September 30, 2013 was 86,838,423.

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GLOSSARY

Bbl/d Barrels (of oil or natural gas liquids) per day

Bbls Barrels (of oil or natural gas liquids)

Bcf Billion cubic feet

Bcfe Billion cubic feet equivalent

Btu British thermal unit

MBbls Thousand barrels

Mcf Thousand cubic feet (of natural gas)

Mcfe Thousand cubic feet equivalent

MMBbls Million barrels

MMBtu Million British Thermal Units

MMcf Million cubic feet

MMcf/d Million cubic feet per day

MMcfe Million cubic feet equivalent

MMcfe/d Million cubic feet equivalent per day

Net Acres Gross acreage multiplied by Cimarex s working interest percentage

Net Production Gross production multiplied by Cimarex s net revenue interest

NGL or NGLs Natural gas liquids

Tcf Trillion cubic feet

Tcfe Trillion cubic feet equivalent

WTI West Texas Intermediate

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

CAUTIONARY INFORMATION ABOUT FORWARD-LOOKING STATEMENTS

Throughout this Form 10-Q, we make statements that may be deemed forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities and Exchange Act of 1934. These forward-looking statements include, among others, statements concerning our outlook with regard to timing and amount of future production of oil and gas, price realizations, amounts, nature and timing of capital expenditures for exploration and development, plans for funding operations and capital expenditures, drilling of wells, operating costs and other expenses, marketing of oil, gas, and NGLs and other statements of expectations, beliefs, future plans and strategies, anticipated events or trends, and similar expressions concerning matters that are not historical facts. The forward-looking statements in this report are subject to risks and uncertainties that could cause actual results to differ materially from those expressed in or implied by the statements.

These risks and uncertainties include, but are not limited to, fluctuations in the price we receive for our oil and gas production, reductions in the quantity of oil and gas sold due to decreased industry-wide demand and/or curtailments in production from specific properties or areas due to mechanical, transportation, marketing or other problems, operating and capital expenditures that are either significantly higher or lower than anticipated because the actual cost of identified projects varied from original estimates and/or from the number of exploration and development opportunities being greater or fewer than currently anticipated, and increased financing costs due to a significant increase in interest rates. In addition, exploration and development opportunities that we pursue may not result in economic, productive oil and gas properties. There are also numerous uncertainties inherent in estimating quantities of proved reserves, projecting future rates of production and the timing of development expenditures. These and other risks and uncertainties affecting us are discussed in greater detail in this report and in our other filings with the Securities and Exchange Commission.

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PART I

ITEM 1 - Financial Statements

CIMAREX ENERGY CO.

Condensed Consolidated Balance Sheets

	September 30, 2013 (Unaudited)	December 31, 2012
	(In thousands, except share data)	
Assets		
Current assets:		
Cash and cash equivalents	$ 4,531	$ 69,538
Restricted cash	818	
Receivables, net	391,105	302,974
Oil and gas well equipment and supplies	69,517	81,029
Deferred income taxes	13,902	8,477
Derivative instruments	7,168	
Prepaid expenses	5,750	7,420
Other current assets	4,082	699
Total current assets	496,873	470,137
Oil and gas properties at cost, using the full cost method of accounting:		
Proved properties	12,466,073	11,258,748
Unproved properties and properties under development, not being amortized	597,526	645,078
	13,063,599	11,903,826
Less accumulated depreciation, depletion and amortization	(7,318,137)	(6,899,057)
Net oil and gas properties	5,745,462	5,004,769
Fixed assets, net	137,455	152,605
Goodwill	620,232	620,232
Derivative instruments	2,717	
Other assets, net	51,625	57,409
	$ 7,054,364	$ 6,305,152
Liabilities and Stockholders Equity		
Current liabilities:		
Accounts payable	$ 111,082	$ 103,653
Accrued liabilities	403,413	392,909
Derivative instruments	4,320	
Revenue payable	187,065	149,300
Total current liabilities	705,880	645,862
Long-term debt	900,000	750,000
Deferred income taxes	1,338,623	1,121,353
Other liabilities	293,576	313,201
Total liabilities	3,238,079	2,830,416
Stockholders equity:		
Preferred stock, $0.01 par value, 15,000,000 shares authorized, no shares issued		
Common stock, $0.01 par value, 200,000,000 shares authorized, 86,838,423 and 86,595,976 shares issued, respectively	868	866

Paid-in capital		1,959,160		1,939,628
Retained earnings		1,855,382		1,533,768
Accumulated other comprehensive income		875		474
		3,816,285		3,474,736
	$	7,054,364	$	6,305,152

See accompanying notes to consolidated financial statements.

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CIMAREX ENERGY CO.

Consolidated Statements of Income and Comprehensive Income

(Unaudited)

	For the Three Months Ended September 30, 2013	For the Three Months Ended September 30, 2012	For the Nine Months Ended September 30, 2013	For the Nine Months Ended September 30, 2012
	(In thousands, except per share data)			
Revenues:				
Gas sales	$ 118,824	$ 83,208	$ 346,492	$ 238,102
Oil sales	371,881	263,315	933,879	759,609
NGL sales	58,922	50,860	168,106	154,160
Gas gathering, processing and other	11,380	10,054	32,951	31,940
Gas marketing, net	329	(525)	21	(741)
	561,336	406,912	1,481,449	1,183,070
Costs and expenses:				
Depreciation, depletion and amortization	159,182	135,987	442,851	375,486
Asset retirement obligation	1,797	3,512	7,080	9,478
Production	76,166	62,699	214,985	192,818
Transportation and other operating	25,838	14,481	66,494	40,966
Gas gathering and processing	6,970	5,496	18,310	15,302
Taxes other than income	31,104	24,095	84,039	72,738
General and administrative	19,003	14,742	57,416	41,523
Stock compensation	3,347	8,301	10,459	17,519
(Gain) loss on derivative instruments, net	10,824	5,329	(1,233)	(661)
Other operating, net	2,507	2,236	7,804	7,295
	336,738	276,878	908,205	772,464
Operating income	224,598	130,034	573,244	410,606
Other (income) and expense:				
Interest expense	13,954	13,223	41,272	35,570
Capitalized interest	(7,286)	(9,231)	(23,868)	(26,154)
Loss on early extinguishment of debt				16,214
Other, net	(2,263)	(6,159)	(13,637)	(18,714)
Income before income tax	220,193	132,201	569,477	403,690
Income tax expense	81,823	47,939	211,615	149,019
Net income	$ 138,370	$ 84,262	$ 357,862	$ 254,671
Earnings per share to common stockholders:				
Basic				
Distributed	$ 0.14	$ 0.12	$ 0.42	$ 0.36
Undistributed	1.45	0.85	3.70	2.58
	$ 1.59	$ 0.97	$ 4.12	$ 2.94
Diluted				
Distributed	$ 0.14	$ 0.12	$ 0.42	$ 0.36
Undistributed	1.45	0.85	3.70	2.57
	$ 1.59	$ 0.97	$ 4.12	$ 2.93
Comprehensive income:				

Net income	$	138,370	$	84,262	$	357,862	$	254,671
Other comprehensive income:								
Change in fair value of investments, net of tax		302		238		401		502
Total comprehensive income	$	138,672	$	84,500	$	358,263	$	255,173

See accompanying notes to consolidated financial statements.

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CIMAREX ENERGY CO.

Condensed Consolidated Statements of Cash Flows

(Unaudited)

	For the Nine Months Ended September 30, 2013	2012
	(In thousands)	
Cash flows from operating activities:		
Net income	$ 357,862	$ 254,671
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation, depletion and amortization	442,851	375,486
Asset retirement obligation	7,080	9,478
Deferred income taxes	211,615	150,648
Stock compensation	10,459	17,519
Gain on derivative instruments	(1,233)	(661)
Settlements on derivative instruments	(4,332)	
Loss on early extinguishment of debt		16,214
Changes in non-current assets and liabilities	9,102	7,930
Other, net	(685)	3,354
Changes in operating assets and liabilities:		
Receivables, net	(88,131)	24,398
Other current assets	9,799	8,763
Accounts payable and accrued liabilities	(13,639)	(31,652)
Net cash provided by operating activities	940,748	836,148
Cash flows from investing activities:		
Oil and gas expenditures	(1,165,555)	(1,181,742)
Sales of oil and gas assets	37,707	12,167
Sales of other assets	31,252	550
Other expenditures	(34,657)	(42,913)
Net cash used by investing activities	(1,131,253)	(1,211,938)
Cash flows from financing activities:		
Net bank debt borrowings	150,000	25,000
Proceeds from other long-term debt		750,000
Other long-term debt payments		(363,595)
Financing costs incurred	(100)	(13,821)
Dividends paid	(34,570)	(29,199)
Issuance of common stock and other	10,168	10,410
Net cash provided by financing activities	125,498	378,795
Net change in cash and cash equivalents	(65,007)	3,005
Cash and cash equivalents at beginning of period	69,538	2,406
Cash and cash equivalents at end of period	$ 4,531	$ 5,411

See accompanying notes to consolidated financial statements.

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Notes to Consolidated Financial Statements

September 30, 2013

(Unaudited)

1. Basis of Presentation

The accompanying unaudited financial statements have been prepared by Cimarex Energy Co. (Cimarex , we , or us) pursuant to rules and regulations of the Securities and Exchange Commission (SEC). Accordingly, certain disclosures required by accounting principles generally accepted in the United States and normally included in annual reports on Form 10-K have been omitted. Although management believes that our disclosures in these interim financial statements are adequate, they should be read in conjunction with the financial statements, summary of significant accounting policies, and footnotes included in our 2012 Annual Report on Form 10-K.

In the opinion of management, the accompanying financial statements reflect all adjustments necessary to present fairly our financial position, results of operations, and cash flows for the periods and as of the dates shown. Certain amounts in prior years financial statements have been reclassified to conform to the 2012 financial statement presentation. We have evaluated subsequent events through the date of this filing.

Restricted Cash

At December 31, 2012, we had restricted cash of $811 thousand included in our non-current other assets which consisted of monies from third parties that were being held by Cimarex, as operator of a property in Oklahoma, until the ownership disputes among the third parties could be resolved. As of September 30, 2013, the ownership disputes have been resolved and we have transferred the restricted cash and the related liability from non-current to current.

Oil and Gas Properties

We use the full cost method of accounting for our oil and gas operations. Accounting rules require us to perform a quarterly ceiling test calculation to test our oil and gas properties for possible impairment. The primary components impacting this calculation are commodity prices, reserve quantities added and produced, overall exploration and development costs, depletion expense, and tax effects. If the net capitalized cost of our oil and gas properties subject to amortization (the carrying value) exceeds the ceiling limitation, the excess would be charged to expense. The ceiling limitation is equal to the sum of the present value discounted at 10% of estimated future net cash flows from proved reserves, the cost of properties not being amortized, the lower of cost or estimated fair value of unproven properties included in the costs being amortized, and all related tax effects.

At September 30, 2013, the calculated value of the ceiling limitation exceeded the carrying value of our oil and gas properties subject to the test, and no impairment was necessary. Our ceiling limitation has improved since December 31, 2012. However, a decline of 5% in the value of the ceiling limitation would have resulted in an impairment. If pricing conditions decline, or if there is a negative impact on one or more of the other components of the calculation, we may incur a full cost ceiling impairment related to our oil and gas properties in future quarters.

Use of Estimates

The more significant areas requiring the use of management s estimates and judgments relate to the estimation of proved oil and gas reserves, the use of these oil and gas reserves in calculating depletion, depreciation, and amortization (DD&A), the use of the estimates of future net revenues in computing ceiling test limitations and estimates of future abandonment obligations used in recording asset retirement obligations, and the assessment of goodwill. Estimates and judgments are also required in determining

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Notes to Consolidated Financial Statements (Continued)

September 30, 2013

(Unaudited)

allowance for bad debt, impairments of undeveloped properties and other assets, purchase price allocation, valuation of deferred tax assets, fair value measurements, and commitments and contingencies.

Accounts Receivable, Accounts Payable, and Accrued Liabilities

The components of our receivable accounts, accounts payable, and accrued liabilities are shown below:

(in thousands)	**September 30, 2013**	**December 31, 2012**
Receivables, net of allowance		
Trade	$ 87,069	$ 55,528
Oil and gas sales	289,673	239,106
Gas gathering, processing, and marketing	14,363	7,901
Other		439
Receivables, net	$ 391,105	$ 302,974
Accounts payable		
Trade	$ 84,152	$ 88,168
Gas gathering, processing, and marketing	26,930	15,485
Accounts payable	$ 111,082	$ 103,653
Accrued liabilities		
Exploration and development	$ 173,066	$ 155,002
Taxes other than income	29,022	29,179
Other	201,325	208,728
Accrued liabilities	$ 403,413	$ 392,909

Recently Issued Accounting Standards

No significant accounting standards applicable to Cimarex have been issued during the quarter ended September 30, 2013.

2. Derivative Instruments/Hedging

We periodically enter into derivative instruments to mitigate a portion of our potential exposure to a decline in commodity prices and the corresponding negative impact on cash flow available for reinvestment. While the use of these instruments limits the downside risk of adverse price changes, their use may also limit future revenues from favorable price changes.

The following tables summarize our outstanding hedging contracts as of September 30, 2013:

Oil Contracts

					Weighted Average Price			Fair Value
Period		**Type**	**Volume/Day**	**Index(1)**	**Floor**	**Ceiling**	**Swap**	**(in thousands)**
Oct 13	Dec 13	Collars	6,000 Bbls	WTI	$ 85.00	$ 102.31	N/A	$ (1,311)
Oct 13	Dec 13	Swaps	6,000 Bbls	WTI	N/A	N/A	$ 96.13	$ (2,987)
Jan 14	Dec 14	Collars	6,000 Bbls	WTI	$ 85.00	$ 105.68	N/A	$ 1,477

(1) WTI refers to West Texas Intermediate price as quoted on the New York Mercantile Exchange.

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Notes to Consolidated Financial Statements (Continued)

September 30, 2013

(Unaudited)

Gas Contracts

Period		Type	Volume/Day	Index(1)	Weighted Average Price Floor		Ceiling		Fair Value (in thousands)	
Oct 13	Dec 14	Collars	80,000 MMBtu	PEPL	$	3.51	$	4.57	$	8,386

(1) PEPL refers to Panhandle Eastern Pipe Line, Tex/OK Mid-Continent Index as quoted in Platt s Inside FERC.

Under a collar agreement, we receive the difference between the published index price and a floor price if the index price is below the floor. We pay the difference between the ceiling price and the index price only if the index price is above the contracted ceiling price. No amounts are paid or received if the index price is between the floor and ceiling prices. For a swap contract, the counterparty is required to make a payment to us if the settlement price for any settlement period is less than the swap price. We are required to make a payment to the counterparty if the settlement price for the settlement period is greater than the swap price.

Depending on changes in oil and gas futures markets and management s view of underlying supply and demand trends, we may increase or decrease our hedging positions.

We have elected not to account for our derivatives as cash flow hedges. Therefore, we recognize settlements and changes in the assets or liabilities relating to our open derivative contracts in earnings. Cash settlements of our contracts are included in cash flows from operating activities in our statements of cash flows.

The following table summarizes the net gains and (losses) from settlements and changes in fair value of our derivative contracts as presented in our accompanying financial statements.

(in thousands)	Three Months Ended September 30, 2013		2012		Nine Months Ended September 30, 2013		2012	
Gain (loss) on derivative instruments, net								
Natural gas contracts	$	376	$		$	9,575	$	

Oil contracts		(11,200)		(5,329)		(8,342)		661
Gain (loss) on derivative instruments, net	$	(10,824)	$	(5,329)	$	1,233	$	661
Gains (losses) from settlement of derivative instruments:								
Natural gas contracts	$	1,189	$		$	1,189	$	
Oil contracts		(7,286)				(5,521)		
Settlement gains (losses)	$	(6,097)	$		$	(4,332)	$	

Our derivative contracts are carried at their fair value on our balance sheet using Level 2 inputs. We estimate the fair value with internal risk-adjusted discounted cash flow calculations. Cash flows are based on published forward commodity price curves for the underlying commodity as of the date of the estimate. For collars, we estimate the option value of the contract floors and ceilings using an option pricing model which takes into account market volatility, market prices, and contract terms.

The fair value of our derivative instruments in an asset position includes a measure of counterparty credit risk and the fair value of instruments in a liability position includes a measure of our own non-performance risk. These credit risks are based on current published credit default swap rates.

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Notes to Consolidated Financial Statements (Continued)

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(Unaudited)

Due to the volatility of commodity prices, the estimated fair value of our derivative instruments is subject to fluctuation from period to period, which could result in significant differences between the current estimated fair value and the ultimate settlement price.

Our derivative instruments are subject to enforceable master netting arrangements, which allow us to offset recognized asset and liability fair value amounts on contracts with the same counterparty. Our policy is to not offset asset and liability positions in our accompanying balance sheets.

The following table presents the amounts and classifications of our derivative assets and liabilities as of September 30, 2013, as well as the potential effect of netting arrangements on contracts with the same counterparty. At December 31, 2012, we had no outstanding derivative contracts.

September 30, 2013: **(in thousands)**	**Balance Sheet Location**		**Asset**		**Liability**
Oil contracts	Current assets Derivative instruments	$	303	$	
Natural gas contracts	Current assets Derivative instruments	$	6,865	$	
Oil contracts	Non-current assets Derivative instruments	$	1,196	$	
Natural gas contracts	Non-current assets Derivative instruments	$	1,521	$	
Oil contracts	Current liabilities Derivative instruments	$		$	4,320
Total gross amounts presented in accompanying balance sheet		$	9,885	$	4,320
Less: gross amounts not offset in the accompanying balance sheet		$	(3,995)	$	(3,995)
Net amount:		$	5,890	$	325

We are exposed to financial risks associated with our derivative contracts from non-performance by our counterparties. We have mitigated our exposure to any single counterparty by contracting with a number of financial institutions, each of which has a high credit rating and is a member of our bank credit facility. Our member banks do not require us to post collateral for our hedge liability positions.

3. Fair Value Measurements

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (exit price). The Financial Accounting Standards Board (FASB) has established a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. This hierarchy consists of three broad levels. Level 1 inputs are the highest priority and consist of unadjusted quoted prices in active markets for identical assets and liabilities. Level 2 are inputs other than quoted prices that are observable for the asset or liability, either directly or indirectly. Level 3 are unobservable inputs for an asset or liability.

The following tables provide fair value measurement information for certain assets and liabilities as of September 30, 2013 and December 31, 2012:

September 30, 2013: **(in thousands)**		**Carrying Amount**		**Fair Value**
Financial Assets (Liabilities):				
Bank debt	$	(150,000)	$	(150,000)
5.875% Notes due 2022	$	(750,000)	$	(765,000)
Derivative instruments assets	$	9,885	$	9,885
Derivative instruments liabilities	$	(4,320)	$	(4,320)

(in thousands) **December 31, 2012:**		**Carrying Amount**		**Fair Value**
Financial (Liabilities):				
5.875% Notes due 2022	$	(750,000)	$	(825,750)

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Notes to Consolidated Financial Statements (Continued)

September 30, 2013

(Unaudited)

Assessing the significance of a particular input to the fair value measurement requires judgment, including the consideration of factors specific to the asset or liability. The following methods and assumptions were used to estimate the fair value of the assets and liabilities in the table above.

Debt (Level 1)

The fair value of our bank debt at September 30, 2013 was estimated to approximate the carrying amount because the floating rate interest paid on such debt was set for periods of three months or less.

The fair value for our 5.875% fixed rate notes was based on their last traded value before period end.

Derivative Instruments (Level 2)

The fair value of our derivative instruments was estimated using internal discounted cash flow calculations. Cash flows are based on the stated contract prices and current and published forward commodity price curves, adjusted for volatility. The cash flows are risk adjusted relative to non-performance for both our counterparties and our liability positions. Please see Note 2 for further information on the fair value of our derivative instruments.

Other Financial Instruments

The carrying amounts of our cash, cash equivalents, restricted cash, accounts receivable, accounts payable, and accrued liabilities approximate fair value because of the short-term maturities and/or liquid nature of these assets and liabilities.

Most of our accounts receivable balances are uncollateralized and result from transactions with other companies in the oil and gas industry. Concentration of customers may impact our overall credit risk because our customers may be similarly affected by changes in economic or other conditions within the industry.

We routinely assess the recoverability of all material accounts receivable to determine their collectability. We accrue a reserve to the allowance for doubtful accounts when, based on the judgment of management, it is probable that a receivable will not be collected and the amount of the reserve may be reasonably estimated. At September 30, 2013 and December 31, 2012, the allowance for doubtful accounts was $6.0 and $6.5 million, respectively.

4. Capital Stock

Authorized capital stock consists of 200 million shares of common stock and 15 million shares of preferred stock. At September 30, 2013, there were no shares of preferred stock outstanding. A summary of our common stock activity for the nine months ended September 30, 2013 follows:

Issued and outstanding as of December 31, 2012	86,596
Restricted shares issued under compensation plans, net of reacquired stock and cancellations	41
Option exercises, net of cancellations	201
Issued and outstanding as of September 30, 2013	86,838

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Notes to Consolidated Financial Statements (Continued)

September 30, 2013

(Unaudited)

Dividends

In September 2013, the Board of Directors declared a cash dividend of $0.14 per share. The dividend is payable on December 2, 2013 to stockholders of record on November 15, 2013. Future dividend payments will depend on our level of earnings, financial requirements, and other factors considered relevant by the Board of Directors.

5. *Stock-based Compensation*

Our 2011 Equity Incentive Plan (the 2011 Plan) was approved by stockholders in May 2011 and our previous plan was terminated at that time. Outstanding awards under the previous plan were not impacted. The 2011 Plan provides for grants of stock options, restricted stock, restricted stock units, performance stock and performance stock units. A total of 5.3 million shares of common stock may be issued under the 2011 Plan.

We have recognized non-cash stock-based compensation cost as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
(in thousands)	**2013**	**2012**	**2013**	**2012**
Restricted stock	$ 5,329	$ 10,769	$ 17,252	$ 24,319
Stock options	940	692	2,355	2,117
	6,269	11,461	19,607	26,436
Less amounts capitalized to oil and gas properties	(2,922)	(3,160)	(9,148)	(8,917)
Compensation expense	$ 3,347	$ 8,301	$ 10,459	$ 17,519

Historical amounts may not be representative of future amounts as additional awards may be granted.

Restricted Stock and Units

The following tables provide information about restricted stock awards granted during the three and nine months ended September 30, 2013 and 2012.

	Three Months Ended September 30, 2013		Three Months Ended September 30, 2012	
	Number of Shares	Weighted Average Grant-Date Fair Value	Number of Shares	Weighted Average Grant-Date Fair Value
Performance-based stock awards	26,000	$ 56.85	24,000	$ 48.24
Service-based stock awards	228,200	$ 72.83	238,100	$ 53.19
Total restricted stock awards	254,200	$ 71.20	262,100	$ 52.73

	Nine Months Ended September 30, 2013		Nine Months Ended September 30, 2012	
	Number of Shares	Weighted Average Grant-Date Fair Value	Number of Shares	Weighted Average Grant-Date Fair Value
Performance-based stock awards	26,000	$ 56.85	262,770	$ 43.22
Service-based stock awards	277,236	$ 72.49	294,198	$ 54.03
Total restricted stock awards	303,236	$ 71.15	556,968	$ 48.93

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Notes to Consolidated Financial Statements (Continued)

September 30, 2013

(Unaudited)

From time to time, performance-based awards are granted to eligible executives and are subject to market condition-based vesting determined by our stock price performance relative to a defined peer group s stock price performance. After three years of continued service, an executive will be entitled to vest in 50% to 100% of the award. In accordance with Internal Revenue Code Section 162(m), certain of the amounts awarded may not be deductible for tax purposes. Service-based stock awards granted to other eligible employees and non-employee directors have vesting schedules of three to five years.

Compensation cost for the performance-based stock awards is based on the grant-date fair value of the award utilizing a Monte Carlo simulation model. Compensation cost for the service-based vesting restricted shares is based upon the grant-date market value of the award. Such costs are recognized ratably over the applicable vesting period.

The following table reflects the non-cash compensation cost related to our restricted stock:

	Three Months Ended September 30,		Nine Months Ended September 30,	
(in thousands)	**2013**	**2012**	**2013**	**2012**
Performance-based stock awards	$ 2,710	$ 7,719	$ 7,963	$ 15,390
Service-based stock awards	2,619	3,050	9,289	8,929
	5,329	10,769	17,252	24,319
Less amounts capitalized to oil and gas properties	(2,491)	(2,912)	(8,229)	(8,081)
Restricted stock compensation expense	$ 2,838	$ 7,857	$ 9,023	$ 16,238

The 2012 compensation cost for the performance-based awards includes $3.9 million of accelerated compensation expense related to the death of our former Chairman, F.H. Merelli.

Unrecognized compensation cost related to unvested restricted shares at September 30, 2013 was $52.7 million, which we expect to recognize over a weighted average period of approximately 2.5 years.

The following table provides information on restricted stock and unit activity as of September 30, 2013 and changes during the year. A restricted unit held by an employee represents a right to an unrestricted share of common stock upon completion of defined vesting and holding periods. A restricted unit held by a non-employee director represents an election to defer payment of director fees until the time specified by the director in his deferred compensation agreement. The remaining outstanding restricted units shown below represent restricted units held by a non-employee director who has elected to defer payment of common stock represented by the units until termination of his service on the Board of Directors.

	Restricted Stock	Restricted Units
Outstanding as of January 1, 2013	1,838,736	33,838
Vested	(383,175)	N/A
Converted to stock	N/A	(25,000)
Granted	303,236	
Canceled	(133,530)	
Outstanding as of September 30, 2013	1,625,267	8,838
Vested included in outstanding	N/A	8,838

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CIMAREX ENERGY CO.

Notes to Consolidated Financial Statements (Continued)

September 30, 2013

(Unaudited)

Stock Options

The following table provides information about stock options granted in 2013 and 2012:

	Three and Nine Months Ended September 30, 2013	Three and Nine Months Ended September 30, 2012
Options	144,400	152,800
Weighted average grant-date fair value	$ 21.64	$ 20.55
Weighted average exercise price	$ 72.25	$ 51.92

Options granted under our 2011 and previous plans expire seven to ten years from the grant date and have service-based vesting schedules of three to five years. The plans provide that all grants have an exercise price of the average of the high and low prices of our common stock as reported by the New York Stock Exchange on the date of grant.

Compensation cost related to stock options is based on the grant-date fair value of the award, recognized ratably over the applicable vesting period. We estimate the fair value using the Black-Scholes option-pricing model. Expected volatilities are based on the historical volatility of our common stock. We also use historical data to estimate the probability of option exercise, expected years until exercise and potential forfeitures. We use U.S. Treasury bond rates in effect at the grant date for our risk-free interest rates.

Non-cash compensation cost related to our stock options is reflected in the following table:

	Three Months Ended September 30,		Nine Months Ended September 30,	
(in thousands)	**2013**	**2012**	**2013**	**2012**
Stock option awards	$ 940	$ 692	$ 2,355	$ 2,117
Less amounts capitalized to oil and gas properties	(431)	(248)	(919)	(836)
Stock option compensation expense	$ 509	$ 444	$ 1,436	$ 1,281

As of September 30, 2013, there was $5.1 million of unrecognized compensation cost related to non-vested stock options. We expect to recognize that cost pro rata over a weighted-average period of approximately 2.0 years.

Information about outstanding stock options is summarized below:

	Options		Weighted Average Exercise Price	Weighted Average Remaining Term		Aggregate Intrinsic Value (in thousands)
Outstanding as of January 1, 2013	687,459	$	54.51			
Granted	144,400	$	72.25			
Exercised	(201,295)	$	50.51			
Canceled	(2,663)	$	86.00			
Forfeited	(15,443)	$	65.51			
Outstanding as of September 30, 2013	612,458	$	59.59	5.6 Years	$	21,721
Exercisable as of September 30, 2013	262,776	$	53.98	5.1 Years	$	10,796

The following table provides information regarding the options exercised and the grant-date fair value of options vested:

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CIMAREX ENERGY CO.

Notes to Consolidated Financial Statements (Continued)

September 30, 2013

(Unaudited)

	Nine Months Ended September 30,			
(dollars in thousands)		**2013**		**2012**
Number of options exercised		201,295		505,057
Cash received from option exercises	$	10,168	$	10,410
Intrinsic value of options exercised	$	6,811	$	20,232
Grant-date fair value of options vested	$	2,521	$	2,466

The following summary reflects the status of non-vested stock options as of September 30, 2013 and changes during the year:

	Options		Weighted Average Grant-Date Fair Value		Weighted Average Exercise Price
Non-vested as of January 1, 2013	317,062	$	23.22	$	60.58
Granted	144,400	$	21.64	$	72.25
Vested	(96,337)	$	26.17	$	65.54
Forfeited	(15,443)	$	25.96	$	65.51
Non-vested as of September 30, 2013	349,682	$	21.63	$	63.82

6. Asset Retirement Obligations

We recognize the fair value of liabilities for retirement obligations associated with tangible long-lived assets in the period in which there is a legal obligation associated with the retirement of such assets and the amount can be reasonably estimated. The associated asset retirement costs are capitalized as part of the carrying amount of the long-lived asset. This liability includes costs related to the abandonment of wells, the removal of facilities and equipment, and site restorations. Subsequent to initial measurement, the asset retirement liability is required to be accreted each period. If the fair value of a recorded asset retirement obligation changes, a revision is recorded to both the asset retirement obligation and the asset retirement capitalized cost. Capitalized costs are included as a component of the DD&A calculations.

The following table reflects the components of the change in the carrying amount of the asset retirement obligation for the nine months ended September 30, 2013:

(in thousands)		
Asset retirement obligation at January 1, 2013	$	185,138

Liabilities incurred		4,272
Liability settlements and disposals		(41,540)
Accretion expense		5,987
Revisions of estimated liabilities		2,502
Asset retirement obligation at September 30, 2013		156,359
Less current obligation		(49,435)
Long-term asset retirement obligation	$	106,924

7. Long-Term Debt

Debt at September 30, 2013 and December 31, 2012 consisted of the following:

(in thousands)		**September 30, 2013**		**December 31, 2012**
Bank debt	$	150,000	$	
5.875% Senior Notes due 2022		750,000		750,000
Total long-term debt	$	900,000	$	750,000

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CIMAREX ENERGY CO.

Notes to Consolidated Financial Statements (Continued)

September 30, 2013

(Unaudited)

Bank Debt

We have a five-year senior unsecured revolving credit facility (Credit Facility), which matures July 14, 2016. The Credit Facility provides for a borrowing base of $2.25 billion with aggregate commitments of $1 billion from our lenders. The borrowing base under the Credit Facility is determined at the discretion of the lenders based on the value of our proved reserves. The next regular annual redetermination date is scheduled for April 15, 2014.

As of September 30, 2013, we had $150 million of bank debt outstanding at a weighted average interest rate of 2.28%. We also had letters of credit outstanding under the Credit Facility of $2.5 million, leaving an unused borrowing availability of $847.5 million.

At our option, borrowings under the Credit Facility may bear interest at either (a) LIBOR plus 1.75-2.5%, based on our leverage ratio, or (b) the higher of (i) a prime rate, (ii) the federal funds effective rate plus 0.50%, or (iii) adjusted one-month LIBOR plus 1.0% plus, in each case, an additional 0.75-1.5%, based on our leverage ratio.

The Credit Facility also has financial covenants that include the maintenance of current assets (including unused bank commitments) to current liabilities of greater than 1.0 to 1.0. We also must maintain a leverage ratio of total debt to earnings before interest expense, income taxes and non-cash items (such as depreciation, depletion and amortization expense, unrealized gains and losses on commodity derivatives, ceiling test write-downs, and goodwill impairments) of not more than 3.5 to 1.0. Other covenants could limit our ability to incur additional indebtedness, pay dividends, repurchase our common stock, or sell assets. As of September 30, 2013, we were in compliance with all of the financial and non-financial covenants.

5.875% Notes due 2022

In April 2012, we issued $750 million of 5.875% senior notes due May 1, 2022, with interest payable semiannually in May and November. The notes were sold to the public at par. The notes are governed by an indenture containing certain covenants, events of default and other restrictive provisions. We may redeem the notes in whole or in part, at any time on or after May 1, 2017, at redemption prices of 102.938% of the principal amount as of May 1, 2017, declining to 100% on May 1, 2020 and thereafter.

7.125% Notes due 2017

In May 2007, we issued $350 million of 7.125% senior unsecured notes at par that were scheduled to mature May 1, 2017. On March 22, 2012, we commenced a cash tender offer (Tender Offer) to purchase all of the outstanding 7.125% senior notes. The Tender Offer was completed in the second quarter of 2012. We recognized a $16.2 million loss on early extinguishment of debt during the second quarter of 2012.

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CIMAREX ENERGY CO.

Notes to Consolidated Financial Statements (Continued)

September 30, 2013

(Unaudited)

8. *Income Taxes*

The components of our provision for income taxes are as follows:

(in thousands)	Three Months Ended September 30, 2013	Three Months Ended September 30, 2012	Nine Months Ended September 30, 2013	Nine Months Ended September 30, 2012
Current benefit	$	$ (1,629)	$	$ (1,629)
Deferred taxes	81,823	49,568	211,615	150,648
	$ 81,823	$ 47,939	$ 211,615	$ 149,019

At December 31, 2012, we had a U.S. net tax operating loss carryforward of approximately $480.7 million, which would expire between 2031 and 2032. We believe that the carryforward will be utilized before it expires. We also had an alternative minimum tax credit carryforward of approximately $4.4 million.

At September 30, 2013, we had no unrecognized tax benefits that would impact our effective rate and we have made no provisions for interest or penalties related to uncertain tax positions. The tax years 2009-2012 remain open to examination by the Internal Revenue Service of the United States. We file tax returns with various state taxing authorities, which remain open to examination for the 2008-2012 tax years.

Our provision for income taxes differed from the U.S. statutory rate of 35% primarily due to state income taxes and non-deductible expenses. The effective income tax rates for the nine months ended September 30, 2013 and September 30, 2012 were 37.2% and 36.9%, respectively.

9. Supplemental Disclosure of Cash Flow Information:

(in thousands)	Three Months Ended September 30, 2013	Three Months Ended September 30, 2012	Nine Months Ended September 30, 2013	Nine Months Ended September 30, 2012
Cash paid during the period for:				
Interest expense (including capitalized amounts)	$ 1,932	$ 1,017	$ 27,158	$ 15,374
Interest capitalized	$ 394	$ 432	$ 15,706	$ 11,304

Income taxes	$		$		$	205	$	375
Cash received for income taxes	$	213	$	57	$	450	$	49,293

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CIMAREX ENERGY CO.

Notes to Consolidated Financial Statements (Continued)

September 30, 2013

(Unaudited)

10. Earnings per Share

The calculations of basic and diluted net earnings per common share under the two-class method are presented below:

(in thousands, except per share data)		**Three Months Ended September 30, 2013**		**2012**		**Nine Months Ended September 30, 2013**		**2012**
Basic:								
Net income	$	138,370	$	84,262	$	357,862	$	254,671
Participating securities share in earnings		(2,375)		(1,628)		(6,049)		(4,929)
Net income applicable to common shareholders	$	135,995	$	82,634	$	351,813	$	249,742
Diluted:								
Net income	$	138,370	$	84,262	$	357,862	$	254,671
Participating securities share in earnings		(2,371)		(1,622)		(6,041)		(4,910)
Net income applicable to common shareholders	$	135,999	$	82,640	$	351,821	$	249,761
Shares:								
Basic shares outstanding		85,213		84,681		85,213		84,681
Incremental shares from assumed exercise of stock options		134		316		117		340
Fully diluted common stock		85,347		84,997		85,330		85,021
Excluded (1)		232		400		254		408
Earnings per share to common shareholders: (2)								
Basic	$	1.59	$	0.97	$	4.12	$	2.94
Diluted	$	1.59	$	0.97	$	4.12	$	2.93

(1) Inclusion of certain outstanding stock options would have an anti-dilutive effect.

(2) Earnings per share are based on actual figures rather than the rounded figures presented.

11. Commitments and Contingencies

Commitments

We have commitments of $176.9 million to finish drilling and completing wells in progress at September 30, 2013.

In New Mexico and Texas, we are constructing gathering facilities and pipelines. At September 30, 2013, we had commitments of $4.1 million relating to these construction projects.

At September 30, 2013, we had firm sales contracts to deliver approximately 25 Bcf of natural gas over the next 11 months. If this gas is not delivered, our financial commitment would be approximately $82.8 million. This commitment will fluctuate due to price volatility and actual volumes delivered. However, we believe no financial commitment will be due based on our current proved reserves and production levels.

We have other various transportation and delivery commitments in the normal course of business, which approximate $3.5 million over the next four years.

We have various commitments for office space and equipment under operating lease arrangements totaling $130.7 million for the next five years and beyond.

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CIMAREX ENERGY CO.

Notes to Consolidated Financial Statements (Continued)

September 30, 2013

(Unaudited)

All of the noted commitments were routine and were made in the normal course of our business.

Litigation

In the normal course of business, we have various litigation matters. We assess the probability of estimable amounts related to litigation matters in accordance with guidance established by the FASB and adjust our accruals accordingly. Though some of the related claims may be significant, we believe the resolution of them, individually or in the aggregate, would not have a material adverse effect on our financial condition or results of operations after consideration of current accruals.

Hitch Enterprises, Inc. et al. v. Cimarex Energy Co. et al.

On December 11, 2012, Cimarex entered into a preliminary resolution of the *Hitch Enterprises, Inc., et al. v. Cimarex Energy Co., et al.* (*Hitch*) litigation matter for $16.4 million. *Hitch* is a statewide royalty class action pending in the Federal District Court in Oklahoma City, Oklahoma. The settlement was reached at a mediation, which occurred after the parties began to exchange information, including damage analyses, on November 16, 2012. On July 2, 2013, the Court entered a judgment approving the parties settlement. The judgment became final and unappealable on August 2, 2013. Cimarex distributed the settlement proceeds pursuant to the Court s order in September 2013 and the administration of the settlement is ongoing. In the fourth quarter of 2012, we accrued $16.4 million for this matter.

H.B. Krug, et al versus H&P

In January 2009, the Tulsa County District Court issued a judgment totaling $119.6 million in the *H.B. Krug, et al. v. Helmerich & Payne, Inc.* (H&P) case. This lawsuit originally was filed in 1998 and addressed H&P s conduct pertaining to a 1989 take-or-pay settlement, along with potential drainage and other related issues. Pursuant to the 2002 spin-off transaction to shareholders of H&P, by which Cimarex became a publicly-traded entity, Cimarex assumed the assets and liabilities of H&P s exploration and production business, including this lawsuit. In 2008, we recorded a litigation expense of $119.6 million for this lawsuit. We have accrued additional post-judgment interest and costs during the appeal of the District Court s judgment.

On August 18, 2011, the Oklahoma Court of Appeals reversed and remanded the $112.7 million disgorgement of profits award, holding the District Court erred in failing to make the required findings of fact and conclusions of law. In all other respects, the Court of Appeals affirmed the District Court s judgment, including damages of $6.845 million. On February 13, 2012, the Oklahoma Supreme Court granted Cimarex s Petition for Certiorari, which requested a review of the affirmed portion of the judgment. We are awaiting a ruling from the Oklahoma Supreme Court, and the final outcome cannot be determined at this time. If the District Court s original judgment is ultimately affirmed in its entirety, the $119.6 million, plus the then-determined amount of post-judgment interest and costs would become payable.

The following table reflects the change in the non-current accrued liability for this lawsuit for the nine months ended September 30, 2013:

(in thousands)		
Outstanding at January 1, 2013	$	155,374
Accrued post-judgment interest and costs		7,070
Outstanding at September 30, 2013	$	162,444

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CIMAREX ENERGY CO.

Notes to Consolidated Financial Statements (Continued)

September 30, 2013

(Unaudited)

12. Property Sales and Acquisitions

We sold interests in various oil and gas properties for $37.7 million during the first nine months of 2013. There were $12.2 million of oil and gas property sales during the first nine months of 2012. During the second quarter of 2013, we also sold a 50% interest in our Culberson County, Texas Triple Crown gas gathering and processing system for approximately $31 million.

During the first nine months of 2013 and 2012, we had property acquisitions of $6.2 million and $11.3 million, respectively.

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

OVERVIEW

Cimarex is an independent oil and gas exploration and production company. Our operations are entirely located in the United States, mainly in Oklahoma, Texas, New Mexico, and Kansas.

Our principal business objective is to profitably grow proved reserves and production for the long-term benefit of our shareholders through a diversified drilling portfolio. Our strategy centers on maximizing cash flow from producing properties and profitably reinvesting that cash flow in exploration and development. We occasionally consider property acquisitions and mergers to enhance our competitive position.

In order to achieve a consistent rate of growth and mitigate risk, we have historically maintained a blended portfolio of low, moderate, and higher risk exploration and development projects. We seek geologic and geographic diversification by operating in multiple basins. In recent years, we have shifted our capital expenditures to oil and liquids-rich gas projects because of strong oil prices relative to gas prices.

Our operations are currently focused in two main areas: the Permian Basin and the Mid-Continent region. Our Permian Basin region encompasses west Texas and southeast New Mexico. The Mid-Continent region consists of Oklahoma, the Texas Panhandle, and southwest Kansas. We also have operations in the Gulf Coast area, primarily in southeast Texas.

Growth is generally funded with cash flow provided by operating activities together with bank borrowings, sale of non-strategic assets and occasional public financing. Conservative use of leverage and maintaining a strong balance sheet have long been part of our financial strategy.

Our revenue, profitability and future growth are highly dependent on the commodity prices we receive. Prices impact the amount of cash flow available for capital expenditures, our ability to raise additional capital and the fair market value of our assets. We use the full cost method of accounting for oil and gas activities. An extended decline in oil and/or gas prices could have an adverse effect on our financial position and results of operations, including the determination of full cost accounting ceiling test write-downs.

The preparation of our financial statements in conformity with generally accepted accounting principles requires us to make estimates and assumptions that impact reported results of operations and the amount of reported assets, liabilities, equity and proved reserves.

Third quarter 2013 summary of operating and financial results:

- Net income increased 64% to $138.4 million, or $1.59 per diluted share.

- Oil, gas and NGL sales for the third quarter of 2013 were $549.6 million, 38% higher than a year earlier.

- Our overall production volumes increased 13% to a record 716.8 MMcfe per day.

- Oil production grew 21%, to a record 39,292 barrels per day.

- NGL volumes increased by 16% and gas volumes were up 7%.

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- Year-to-date cash flow provided by operating activities was $940.7 million versus $836.1 million for the same period of 2012.

- Year-to-date exploration and development expenditures totaled $1.187 billion.

- Total debt at September 30, 2013 was $900 million, up $150 million from year-end 2012.

Revenues

Most of our revenues are derived from the sales of oil, gas and NGL production. While revenues are a function of both production and prices, wide swings in commodity prices have had the greatest impact on our results of operations. Prices we receive are determined by prevailing market conditions. Regional and worldwide economic and geopolitical activity, weather and other variable factors influence market conditions, which often result in significant volatility in commodity prices.

The following table presents our average realized commodity prices. Realized prices do not include settlements of our commodity hedging contracts, which are financial instruments.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	**2012**	**2013**	**2012**
Oil Prices:				
Average WTI Cushing price ($/Bbl)	$ 105.81	$ 92.22	$ 98.14	$ 96.21
Average realized sales price ($/Bbl)	$ 102.88	$ 88.18	$ 93.81	$ 91.67
Gas Prices:				
Average Henry Hub price ($/Mcf)	$ 3.58	$ 2.80	$ 3.67	$ 2.58
Average realized sales price ($/Mcf)	$ 3.72	$ 2.79	$ 3.73	$ 2.71
NGL Prices:				
Average realized sales price ($/Bbl)	$ 28.63	$ 28.55	$ 28.57	$ 31.35

On an energy equivalent basis, 51% of our aggregate 2013 production was crude oil and NGLs. A $1.00 per barrel change in our average realized sales price would have resulted in a $15.8 million change in our combined oil and NGL revenues. Similarly, 49% of our production was natural gas. A $0.10 per Mcf change in our average realized gas sales price would have resulted in a $9.3 million change in our gas revenues.

See **RESULTS OF OPERATIONS** below for a discussion of the impact changes in realized prices had on our 2013 revenues.

Production and other operating expenses

Costs associated with producing oil and gas are substantial. Some of these costs vary with commodity prices, some trend with the type and volume of production and some are a function of the number of wells we own. At the end of 2012, we owned interests in 13,127 gross wells.

Production expense generally consists of the cost of water disposal, power and fuel, direct labor, third-party field services, compression and certain maintenance activity (workovers) necessary to produce oil and gas from existing wells.

Transportation and other operating costs include expenditures to prepare and move oil and gas from the wellhead to a specified sales point. In some cases we receive a payment from purchasers which

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is net of these costs, and in other instances we separately pay for transportation. If costs are netted in the proceeds received, both the gross revenues and gross costs are shown in sales and expenses, respectively.

Depreciation, depletion and amortization (DD&A) of our producing properties is computed using the units-of-production method. The economic life of each producing well depends upon the estimated proved reserves for that well which in turn depend upon the assumed price for future sales of production. Therefore, fluctuations in oil and gas prices will impact the level of proved reserves used in the calculation. Higher prices generally have the effect of increasing reserves, which reduces depletion expense. Conversely, lower prices generally have the effect of decreasing reserves, which increases depletion expense. The cost of replacing production also impacts our DD&A rate. In addition, changes in estimates of reserve quantities, estimates of operating and future development costs, and reclassifications of properties from unproved to proved will impact depletion expense.

We use the full cost method of accounting for our oil and gas operations. Accounting rules require us to perform a quarterly ceiling test calculation to test our oil and gas properties for possible impairment. The primary components impacting this analysis are commodity prices, reserve quantities added and produced, overall exploration and development costs, depletion expense, and tax effects. If the net capitalized cost of our oil and gas properties subject to amortization (the carrying value) exceeds the ceiling limitation, the excess would be expensed. The ceiling limitation is equal to the sum of (a) the present value discounted at 10% of estimated future net cash flows from proved reserves, (b) the cost of properties not being amortized, (c) the lower of cost or estimated fair value of unproven properties included in the costs being amortized, and (d) all related tax effects.

At September 30, 2013, the calculated value of the ceiling limitation exceeded the carrying value of our oil and gas properties subject to the test, and no impairment was necessary. Our ceiling limitation has improved since December 31, 2012. However, a decline of 5% in the value of the ceiling limitation would have resulted in an impairment. If pricing conditions decline, or if there is a negative impact on one or more of the other components of the calculation, we may incur a full cost ceiling impairment related to our oil and gas properties in future quarters.

General and administrative (G&A) expenses consist primarily of salaries and related benefits, office rent, legal fees, consultants, systems costs and other administrative costs incurred in our offices and not directly associated with exploration, development or production activities. Our G&A expense is reported net of amounts reimbursed to us by working interest owners of the oil and gas properties we operate and net of amounts capitalized pursuant to the full cost method of accounting.

See **RESULTS OF OPERATIONS** below for a discussion of changes in production and other operating expenses.

Derivative Instruments/Hedging

We periodically enter into derivative instruments to mitigate a portion of our potential exposure to a decline in oil and/or gas prices and the corresponding negative impact on cash flow available for reinvestment. While the use of these instruments limits the downside risk of adverse price changes, their use may also limit future revenues from favorable price changes.

For 2012, we hedged about half of our anticipated oil production. We did not hedge any of our gas or NGL production. All of the oil contracts expired during 2012 without any cash settlements and we did not have any hedges in place at year-end.

In the first nine months of 2013, we hedged approximately 32% of our anticipated 2013 oil production, and 23% of our anticipated gas production. We have also hedged a portion of our 2014 oil

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and gas production. For contracts that have settled through September 30, 2013, we have paid net cash settlements of $5.5 million on oil contracts and received $1.2 million of cash settlements on our gas contracts.

The following tables summarize our outstanding contracts as of September 30, 2013:

Oil Contracts

Period		Type	Volume/Day	Index(1)	Weighted Average Price Floor		Ceiling		Swap	
Oct 13	Dec 13	Collars	6,000 Bbls	WTI	$	85.00	$	102.31		N/A
Oct 13	Dec 13	Swaps	6,000 Bbls	WTI		N/A		N/A	$	96.13
Jan 14	Dec 14	Collars	6,000 Bbls	WTI	$	85.00	$	105.68		N/A

(1) WTI refers to West Texas Intermediate price as quoted on the New York Mercantile Exchange.

Gas Contacts

Period		Type	Volume/Day	Index(1)	Weighted Average Price Floor		Ceiling	
Oct 13	Dec 14	Collars	80,000 MMBtu	PEPL	$	3.51	$	4.57

(1) PEPL refers to Panhandle Eastern Pipe Line, Tex/OK Mid-Continent Index as quoted in Platt s Inside FERC.

Depending on changes in oil and gas futures markets and management s view of underlying supply and demand trends, we may increase or decrease our hedging positions.

Since 2009, we have chosen not to apply hedge accounting treatment to our derivative contracts. As a result, any settlements on the contracts are shown as a component of operating costs and expenses as either a net gain or loss on derivative instruments. See the discussion of our net gain/loss on hedging activities below, in **RESULTS OF OPERATIONS.** Also, see Note 2 to the Consolidated Financial Statements and Item 3 of this report for additional information regarding our derivative instruments.

RESULTS OF OPERATIONS

Third Quarter and Nine Months Ended September 30, 2013 vs. September 30, 2012

Net income for the third quarter of 2013 was $138.4 million ($1.59 per diluted share), up 64% from $84.3 million ($0.97 per diluted share) for the same period of 2012. For the first nine months of 2013, net income of $357.9 million ($4.12 per diluted share) was 41% higher than net income of $254.7 million ($2.93 per diluted share) for 2012. The increases in net income for the 2013 periods were primarily a result of higher revenues from increased production volumes and higher realized commodity prices, which were partially offset by higher operating expenses. In addition, the first nine months of 2012 included a loss on early extinguishment of debt. These changes are discussed further in the analysis that follows.

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Commodity Sales (in thousands or as indicated)	2013	2012	Percent Change Between 2013/2012	Price/Volume Change Price	Volume	Total
For the Three Months Ended September 30,						