VINTAGE PETROLEUM INC
Form 10-K
March 12, 2004
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SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

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

For the fiscal year ended December 31, 2003

OR

¨ **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 1-10578

VINTAGE PETROLEUM, INC.

(Exact name of registrant as specified in its charter)

Delaware	**73-1182669**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

110 West Seventh Street	
Tulsa, Oklahoma	**74119-1029**
(Address of principal executive offices)	**(Zip Code)**

Registrant s telephone number, including area code: (918) 592-0101

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, $0.005 Par Value	New York Stock Exchange
Preferred Share Purchase Rights	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: None

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

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

Indicate by check mark whether the Registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2). Yes x No ¨

As of June 30, 2003, the aggregate market value of the Registrant s Common Stock held by non-affiliates was approximately $579,700,000.

As of February 27, 2004, 64,317,208 shares of the Registrant s Common Stock were outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Registrant s Proxy Statement for the Annual Meeting of Stockholders to be held May 11, 2004, are incorporated by reference into Part III of this Form 10-K.

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VINTAGE PETROLEUM, INC.

FORM 10-K

YEAR ENDED DECEMBER 31, 2003

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Certain Definitions

As used in this Form 10-K:

Unless the context requires otherwise, all references to Vintage, Company, we, our, ours, and us refer to Vintage Petroleum, Inc., its consolidated subsidiaries and its proportionately consolidated general partner and limited partner interests in various joint ventures.

Oil means crude oil, condensate and natural gas liquids. Condensate means hydrocarbons which are in a gaseous state under reservoir conditions but which become liquid at the surface and may be recovered by conventional separators. Natural gas liquids means hydrocarbons found in natural gas which may be extracted as liquified petroleum gas and natural gasoline. Gas means natural gas.

Mcf means thousand cubic feet, MMcf means million cubic feet, and Bcf means billion cubic feet. Btu means British thermal units, the quantity of heat required to raise the temperature of one pound of water by one degree Fahrenheit, and MMBtu means million British thermal units. Bbl means barrel, or 42 U.S. gallons liquid volume, MBbls means thousand barrels and MMBbls means million barrels. BOE means equivalent barrels of oil, MBOE means thousand equivalent barrels of oil and MMBOE means million equivalent barrels of oil. Unless otherwise indicated in this Form 10-K, gas volumes are stated at the legal pressure base of the state or area in which the reserves are located and at 60° Fahrenheit. BOE are determined using the ratio of six Mcf of gas to one Bbl of oil.

Working interest means the operating interest that gives the owner the right to drill, produce and conduct operating activities on the property and to receive a share of production, subject to all royalties, overriding royalties and other burdens and to all costs of exploration, development and operations and all risks in connection therewith. Royalty interest means an interest in an oil and gas property entitling the owner to a share of oil and gas production free of cost of production.

The term gross refers to the total acres or wells in which Vintage has a working interest, and net refers to gross acres or wells multiplied by the percentage working interest owned by Vintage. Net production means production that is owned by Vintage less royalties and production due others.

Development well means a well drilled within the proved area of an oil or gas reservoir, as indicated by reasonable interpretation of available data, to the depth of a stratigraphic horizon known to be productive. Exploratory well means a well drilled to find and produce oil or gas in an unproved area, to find a new reservoir in a field previously found to be productive of oil or gas in another reservoir, or to extend the proved limits of a known reservoir. Dry hole means a well found to be incapable of producing either oil or gas in sufficient quantities to justify completion of the well. Productive well means a well that is producing oil or gas or that is capable of production including gas wells awaiting pipeline connections to commence deliveries and oil wells awaiting connection to production facilities.

Infill drilling means drilling of an additional well or wells provided for by an existing spacing order to more adequately drain a reservoir. Recompletion means the completion for production of an existing wellbore in a different formation or producing horizon, either deeper or shallower, from that in which the well was previously completed. Workover means remedial operations on a well with the intention of restoring or increasing production from the same zone, including plugging back, squeeze cementing, reperforating, cleanout and acidizing.

Proved oil and gas reserves are the estimated quantities of crude oil, natural gas and natural gas liquids which 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 oil and gas reserves are reserves that can be expected to be recovered through existing wells with existing equipment and operating methods. Proved undeveloped oil and gas reserves are reserves that are expected to be recovered from new wells on undrilled acreage, or from existing wells where a relatively major expenditure is required for recompletion.

Developed acreage means the number of acres which are allocated or assignable to producing wells or wells capable of production. Undeveloped acreage means the number of acres on which wells have not been drilled or completed to a point that would permit the production of commercial quantities of oil and gas regardless of whether such acreage contains proved oil and gas reserves.

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Forward-Looking Statements

This Form 10-K includes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. All statements, other than statements of historical facts, included in this Form 10-K which address activities, events or developments which we expect, believe or anticipate will or may occur in the future are forward-looking statements. The words believes, intends, expects, anticipates, projects, estimates, predicts and similar expr are also intended to identify forward-looking statements.

These forward-looking statements include, among others, such things as:

- **amounts and nature of future capital expenditures;**
- **wells to be drilled or reworked;**
- **oil and gas prices and demand;**
- **exploitation and exploration prospects;**
- **estimates of proved oil and gas reserves;**
- **reserve potential;**
- **development and infill drilling potential;**
- **expansion and other development trends of the oil and gas industry;**
- **business strategy;**
- **production of oil and gas reserves;**
- **expansion and growth of our business and operations; and**
- **events or developments in foreign countries, including estimates of oil export levels.**

These statements are based on certain assumptions and analyses we made in light of our experience and our perception of historical trends, current conditions and expected future developments as well as other factors we believe are appropriate in the circumstances.

However, whether actual results and developments will conform with our expectations and predictions is subject to a number of risks and uncertainties which could cause actual results to differ materially from our expectations, including:

- **risk factors discussed in this Form 10-K and listed from time to time in our filings with the Securities and Exchange Commission;**
- **oil and gas prices;**
- **exploitation and exploration successes;**
- **actions taken and to be taken by the foreign governments as a result of economic conditions;**
- **continued availability of capital and financing;**
- **general economic, market or business conditions;**
- **acquisitions and other business opportunities (or lack thereof) that may be presented to and pursued by us;**
- **changes in laws or regulations; and**
- **other factors, most of which are beyond our control.**

Consequently, all of the forward-looking statements made in this Form 10-K are qualified by these cautionary statements and there can be no assurance that the actual results or developments anticipated by us will be realized or, even if substantially realized, that they will have the expected consequences to or effects on us or our business or operations. We assume no obligation to update publicly any such forward-looking statements, whether as a result of new information, future events or otherwise.

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PART I

Items 1 and 2. Business and Properties.

Website Access to Reports

Our public internet site is http://www.vintagepetroleum.com. We make available free of charge through our internet site, via a link to the EDGAR database of the Securities and Exchange Commission (SEC), our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, as soon as reasonably practicable after we electronically file such material with, or furnish it to, the SEC.

In addition, we make available on http://www.vintagepetroleum.com our annual report to stockholders. You will need the Adobe Acrobat Reader software installed on your computer to view this document, which is in PDF format. If you do not have Adobe Acrobat Reader installed, a link to Adobe Systems Incorporated s internet site, where you can download the software, is provided.

General

We are an independent energy company with operations primarily in the exploration and production, gas marketing and oil and gas gathering and processing segments of the oil and gas industry. We are focused on the acquisition of oil and gas properties which contain the potential for increased value through exploitation and exploration. Through our experienced management and technical staff, we have been successful in realizing such potential on prior acquisitions through workovers, recompletions, secondary recovery operations, operating cost reductions and the drilling of development or exploratory wells. In addition to our exploration and development activities associated with acquisitions, we continue to build an inventory of exploration prospects in North America that may impact production in the near term as well as high potential frontier prospects that may impact production in the longer term.

At December 31, 2003, we owned and operated producing properties in nine states in the U.S., with our proved reserves in the U.S. located primarily in four core areas: West Coast, Gulf Coast, East Texas and Mid-Continent. During 2001, we significantly expanded our North American operations in Canada through the acquisition of 100 percent of Genesis Exploration Ltd. (Genesis, now Vintage Petroleum Canada, Inc.). See Acquisitions. Additionally, we have international core areas located in Argentina and Bolivia. In Argentina, we own 21 oil concessions, 18 of which we operate. Fourteen of these operated concessions are located in the south flank of the San Jorge Basin in southern Argentina. We expanded our Argentina core area into the Cuyo Basin in western Argentina with the purchase of the Piedras Colorados and Cachueta concessions in 2000, and the purchase of the La Ventana and Rio Tunuyan concessions in 2001. See Acquisitions. In Bolivia, we own and operate three concessions in the Chaco Plains area of southern Bolivia and the Naranjillos concession located in the Santa Cruz Province. We have exploration activities currently ongoing in Yemen, Italy and Bulgaria. Initial production in Yemen is expected to begin late in the first quarter of 2004. We also previously operated three blocks in the Oriente Basin in Ecuador. However, on January 31, 2003, we sold all of our operations in Ecuador. See Divestitures.

As of December 31, 2003, we owned interests in 2,660 gross (2,323 net) productive wells in the U.S., of which approximately 92 percent are operated by us, 645 gross (420 net) productive wells in Canada, of which approximately 58 percent are operated by us, 1,518 gross (1,371 net) productive wells in Argentina, of which approximately 84 percent are operated by us, 14 gross (13 net) productive wells in Bolivia, all of which are operated by us and three gross (two net) productive wells in Yemen, all of which are operated by us. As of December 31, 2003, our properties had proved reserves of 447.1 MMBOE, comprised of 292.8 MMBbls of oil and 926.0 Bcf of gas, with a present value of estimated future net revenues before income taxes (utilizing a 10 percent discount rate) of $3.5 billion and a standardized measure of discounted future net cash flows of $2.4 billion. From the first quarter of 1999 through the fourth quarter of 2003, we increased our average net daily production from continuing operations from 40,800 Bbls of oil to 48,400 Bbls of oil and from 120.9 MMcf of gas to 155.1 MMcf of gas.

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Financial information relating to our industry segments is set forth in Note 10 Segment Information to our consolidated financial statements included elsewhere in this Form 10-K.

We were incorporated in Delaware on May 31, 1983. Our principal office is located at 110 West Seventh Street, Tulsa, Oklahoma 74119-1029, and our telephone number is (918) 592-0101.

Business Strategy

Our overall goal is to maximize value through profitable growth in oil and gas reserves and production. We have been successful at achieving this goal through an ongoing strategy of (a) acquiring producing oil and gas properties with significant upside potential at favorable prices, (b) focusing on exploitation, development and exploration activities to maximize production and ultimate reserve recovery on existing properties and undeveloped properties, (c) maintaining efficient operations and (d) maintaining financial flexibility. Key elements of our strategy include:

Acquisitions of Producing Properties. We have an experienced management and technical team which focuses on acquisitions of operated producing properties that meet our selection criteria, which include (a) significant potential for increasing reserves and production through exploitation, development and exploration, (b) favorable purchase price and (c) opportunities for improved operating efficiency. Our emphasis on property acquisitions reflects our belief that continuing consolidation and restructuring activities on the part of major integrated, large independent and national oil companies has afforded in the past, and should afford in the future, favorable opportunities to purchase domestic and international properties. This acquisition strategy has allowed us to rapidly grow our reserves at favorable acquisition prices. From January 1, 1999, through December 31, 2003, we spent $865.9 million acquiring 190.4 MMBOE of proved oil and gas reserves at an average acquisition cost of $4.55 per BOE. We replaced, through acquisitions, approximately 128 percent of our production of 148.6 MMBOE during the same period. For additional information, see Acquisitions. Although we made no significant acquisitions in 2002 and 2003, primarily as a result of our debt reduction program, we are continually identifying and evaluating acquisition opportunities, including acquisitions that would be significantly larger than many of those we have consummated to date. No assurance can be given that any such acquisitions will be successfully consummated.

Exploration and Development. We pursue workovers, recompletions, secondary recovery operations and other production optimization techniques on our properties, as well as development and infill drilling, with the goals of offsetting normal production declines and replacing our annual production. Our overall exploration strategy balances high potential international prospects with lower risk drilling in known formations in North America and Argentina. We make extensive use of geophysical studies, including 3-D seismic data, which reduces the cost of our exploration program by increasing our success rate. From January 1, 1999, through December 31, 2003, we spent approximately $778.5 million on exploration and development activities. As a result of all of these activities, including the impact of reserve revisions, during the five-year period ended December 31, 2003, we succeeded in adding 192.9 MMBOE to proved reserves, replacing approximately 130 percent of production during the same period at a cost of $4.04 per BOE. During 2003, we spent $181.3 million on exploration and development activities and added 27.0 MMBOE to proved reserves (excluding Canadian additions and revisions), replacing approximately 97 percent of 2003 production at a cost of $6.72 per BOE. Substantial negative net additions and revisions in Canada, however, totaled 26.3 MMBOE, negating almost all of the net additions generated from our operations in other countries. For additional information, see Exploration and Development. We continue to maintain an extensive inventory of exploration and development opportunities. The total 2004 non-acquisition capital budget has been set at $225 million, a 27 percent increase over 2003 spending. The exploration portion of the 2004 capital budget of approximately $60 million will focus primarily on North America, with other projects planned for Yemen, Italy and Bulgaria.

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Efficient Operations. We believe we are an efficient operator and capitalize on our lower cost structure in evaluating acquisition opportunities. We have generally achieved substantial reductions in labor and other field level costs from those experienced by the previous operators. In addition, we target acquisition candidates that are located in our core areas and provide opportunities for cost efficiencies through consolidation with our other operations. The lower cost structure has generally allowed us to substantially improve the cash flows of newly acquired properties.

Financial Flexibility. We are committed to maintaining financial flexibility, which we believe is important for the successful execution of our acquisition, exploitation and exploration strategy. Since 1990, we have completed five public equity offerings, two public debt offerings and three Rule 144A private debt offerings, all of which have provided us with aggregate net proceeds of approximately $1.2 billion. In early 2002 we announced plans to reduce debt by $200 million through a combination of asset sales and cash flows in excess of planned capital expenditures. The sale of our operations in Trinidad and our heavy oil properties in California in 2002, along with our operations in Ecuador in January 2003 and cash flows in excess of our capital expenditures, allowed us to exceed our $200 million debt reduction goal. Our debt, less cash on hand, at December 31, 2003, was $645.1 million, compared to approximately $1.0 billion at December 31, 2001. Cash on hand, internally generated cash flows, the borrowing capacity under our revolving credit facility and our ability to adjust our level of capital expenditures are our major sources of liquidity. In addition, we may use other sources of capital, including the issuance of additional debt securities or equity securities, to fund any major acquisitions we might secure in the future and maintain our financial flexibility. For further information, see Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations - Capital Resources and Liquidity included elsewhere in this Form 10-K.

Acquisitions

Historically, we have allocated a substantial portion of our capital expenditures to the acquisition of producing oil and gas properties. Our continuing emphasis on reserve additions through property acquisitions reflects our belief that consolidation and restructuring activities on the part of major integrated, large independent and national oil companies have afforded in recent years, and should afford in the future, favorable opportunities to purchase domestic and international producing properties.

Since our incorporation in May 1983, we have been actively engaged in the acquisition of producing oil and gas properties, primarily in the West Coast, Gulf Coast, East Texas and Mid-Continent areas of the U.S. In 1995, we made a series of acquisitions that established a new core area in the San Jorge Basin in southern Argentina. In late 1996, we expanded our South American operations into Bolivia and, in 1998, into Ecuador. In 1999, we entered into a farm-in agreement for the S-1 Damis exploration block in Yemen and in December 2000, we made our initial entrance into Canada and Trinidad with the purchase of 100 percent of Cometra Energy (Canada), Ltd. (Cometra), a privately-held Canadian company. We significantly expanded our Canadian operations in 2001 with the purchase of 100 percent of Genesis, a publicly-traded Canadian company. We also extended our Argentine operations in 2000 with our acquisition of two concessions from Perez Companc and in 2001 with our purchase of the La Ventana and Rio Tunuyan concessions from Shell C.A.P.S.A., a wholly-owned affiliate of Royal Dutch Shell. Although we made no significant acquisitions in 2002 and 2003, primarily due to our debt reduction program, we are constantly identifying and evaluating additional acquisition opportunities which may lead to our expansion into new domestic core areas or other countries which we believe are politically and economically stable.

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From January 1, 1999, through December 31, 2003, we made oil and gas reserve acquisitions with costs totaling approximately $865.9 million. As a result of these acquisitions, we acquired approximately 190.4 MMBOE of proved oil and gas reserves. The following table summarizes our acquisition experience during the periods indicated:

	Acquisition Costs	Proved Reserves When Acquired Oil (MBbls)	Gas (MMcf)	MBOE	Cost Per BOE When Acquired
	(In thousands)				
North America Acquisitions:					
1999	$ 31,662	10,343	14,947	12,834	$ 2.47
2000	53,962	2,854	41,166	9,715	5.55
2001	564,950	27,493	207,701	62,110	9.10
2002					
2003	463	90	258	133	3.48
Total North America Acquisitions	651,037	40,780	264,072	84,792	7.68
South America Acquisitions:					
1999	135,125	67,733	81,072	81,245	1.66
2000	37,486	11,970	2,278	12,350	3.04
2001	42,267	11,724	1,636	11,997	3.52
2002					
2003					
Total South America Acquisitions	214,878	91,427	84,986	105,592	2.03
Total Acquisitions	$ 865,915	132,207	349,058	190,384	$ 4.55

Divestitures

We have historically sold properties that were either marginally economical or non-strategic to our areas of operations. In 2001 and early 2002, we received proceeds of $47.1 million for properties sold primarily through public auctions in the U.S. These sales resulted in gains of $26.9 million ($16.7 million net of tax). Through these sales of 780 wells and over 600 leases in 85 fields, we significantly reduced our domestic well and lease count while reducing net U.S. production by only six percent and total net production by three percent.

In 2002, we determined that the level of investment and time horizon required to continue the development of our interests in Ecuador and Trinidad were inconsistent with the timing of our desire to reduce leverage. These assets, along with our remaining heavy oil properties in the Santa Maria area of southern California, were identified for sale. Our heavy oil properties in the Santa Maria area were sold in June 2002 for $9.5 million in cash and a note receivable for $6 million bearing monthly payments of $360,000, plus interest, with final maturity in June 2003. We received a cash payment as final settlement of this note in October 2002. On July 30, 2002, we completed the sale of our operations in Trinidad. We received $40 million in cash and recorded a gain of approximately $31.9 million ($14.9 million after income taxes).

On January 31, 2003, we completed the sale of our operations in Ecuador. We received $137.4 million in cash and recorded a gain of approximately $47.3 million ($9.5 million after income taxes). Also in 2003, we sold certain U.S. Mid-Continent gas properties for $30.0 million and certain non-strategic oil and gas assets in Saskatchewan and West Central Alberta, Canada for $27.9 million. We recorded losses of $1.7 million ($1.0 million after income taxes) on these sales. Combined, we estimate that the properties we sold in North America in 2003 accounted for proved reserves of 1.0 MMBbls of oil and 53.1 Bcf of gas as of the closing date of the sales and the Ecuador properties accounted for 45.3 MMBbls of oil. In total, these sales represented approximately 10 percent of our total proved reserves at the beginning of 2003.

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Exploration and Development

We concentrate our acquisition efforts on proved producing properties that demonstrate a potential for significant additional development through workovers, recompletions, secondary recovery operations, the drilling of development, infill or exploratory wells and other exploitation opportunities. We have pursued an active workover, recompletion and development drilling program on the properties we have acquired and intend to continue these activities in the future. Our exploitation staff focuses on maximizing the value of the properties within our reserve base and striving to offset normal production declines and our annual production.

Our exploration program is designed to contribute significantly to our growth. We divide the strategic objectives of our exploration program into two parts. First, in North America and Argentina, our exploration focus is in our core areas where our geological and engineering expertise and experience are greatest. We use state-of-the-art technology, including 3-D seismic data, to identify prospects. Exploration in North America is designed to generate reserve growth in this core area in combination with our exploitation activities. In recent years, we have increased the magnitude of this program and we plan to continue this effort in the future with a goal of achieving yearly production replacement through core area exploration. Such exploration is characterized by numerous individual projects with medium to low risk. Secondly, international exploration targets significant long-term reserve growth and value creation. Our international exploration projects currently underway in Yemen, Italy and Bulgaria are characterized by higher potential and higher risk.

In 2003, we spent $22.6 million on workovers, recompletions and other projects. A measure of the overall success of our recompletion and workover operations during 2003 (excluding minor equipment repair and replacement) was that improved production or operating efficiencies were achieved from approximately 77 percent of such operations, which is consistent with the average of 80 percent for the last three years.

Development drilling activity is generated both through our exploration efforts and as a result of obtaining undeveloped acreage in connection with producing property acquisitions. In addition, there are many opportunities for infill drilling on our leases currently producing oil and gas. We intend to continue to pursue development drilling opportunities which offer us potentially significant returns.

During 2003, we participated in the drilling of 124 gross (108 net) development wells, of which 117 gross (102 net) were productive. At December 31, 2003, our proved reserves included approximately 137 development or infill drilling locations on our U.S. acreage, three locations on our Canadian acreage, 463 locations on our Argentine acreage, 13 locations on our Bolivian acreage and six locations on our acreage in Yemen. In addition, we have an extensive inventory of development and infill drilling locations on our existing properties which is not included in proved reserves. Included in our 2003 development drilling was approximately $33.8 million in the U.S., $10.9 million in Canada, $46.5 million in Argentina and $1.0 million in Ecuador. We also spent approximately $6.4 million on the acquisition of development seismic data and other development activities in 2003.

We spent approximately $52.2 million on exploration activities in 2003, participating in the drilling of 12 gross (eight net) exploratory wells, of which six gross (three net) were productive. Exploration spending for 2003 included $36.1 million in North America, $12.4 million in Yemen, $1.4 million in Bulgaria, $1.3 million in Bolivia and $1.0 million in Italy. We also spent approximately $7.8 million on the acquisition of unproved acreage in 2003, primarily in North America.

Our total 2004 non-acquisition capital budget has been set at $225 million, which represents a 24 percent increase over 2003 exploration and development spending. Planned development expenditures for 2004 are $165 million, consisting of $55 million in North America, $84 million in

Argentina and $26 million in Yemen, including $17 million for the start of the construction of facilities near our An Nagyah light oil discovery and a pipeline necessary to connect into neighboring infrastructure. The exploration portion of the 2004 capital budget of approximately $60 million includes $51 million in North America and $9 million on various international projects.

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Exploration and development activities for 2003 were concentrated mainly in our U.S., Canada and Argentina core areas. The following is a brief description of significant developments in our recent exploration and development activities:

United States. We increased our United States oil and gas capital expenditures in 2003, spending a total of $74.5 million, compared to $29.5 million in 2002. Capital expenditures in 2002 were limited as a result of our decision to use a portion of cash flow and proceeds from asset sales to execute our debt reduction program during 2002.

Our U.S. development program for 2003 included the drilling of 31 gross (26 net) development wells, of which 26 gross (23 net) were successful, representing an 84 percent success rate. Exploitation drilling in the West Ranch, Luling and Darst Creek fields in south central Texas resulted in 19 gross (19 net) horizontal completions with an initial production buildup of over 2,700 net Bbls of oil per day. Development drilling in the Gilmer and Loma Blanca fields in Texas and the Strong City field in Oklahoma resulted in three gross (three net) wells with an initial net production buildup of 5.6 MMcf of gas and 200 Bbls of oil per day. High angle drilling of one gross (one net) well in the Pleito Ranch field in California developed an initial net production buildup of 260 Bbls of oil and 100 Mcf of gas per day. Our 2003 U.S. development program also included 80 gross (74 net) workovers and recompletions (excluding minor equipment repair and replacement), of which 55 gross (52 net) resulted in improved production or operating efficiencies, for a 69 percent success rate.

During the fourth quarter of 2003, we drilled the Galveston Bay State Tract 65-2R well, in which we have a 50 percent working interest. This is a replacement well for the State Tract 65-2 which ceased production in June 2003 due to a mechanical problem. The State Tract 65-2R well has been completed and is testing with a daily flow rate of six MMcf gross (three MMcf net) of gas.

Our 2004 development budget includes $46 million targeted towards U.S. projects. We will focus on impact projects along the Texas and Louisiana Gulf Coast, expanding on our successes of 2003 and pursuing new opportunities as well. Several additional horizontal drilling locations are planned in the Darst Creek and Luling fields for 2004. We plan to drill 32 exploitation wells and workovers are planned for approximately 55 wells, principally in Texas and California.

We spent approximately $2.6 million during the fourth quarter of 2003 and returned to production 2,800 BOE per day lost due to the California fires in October 2003. We now estimate that we will complete the remaining fire damage repair at an additional cost of approximately $3.4 million dollars. The volumes from remaining wells are planned to be returned to production by the end of the first quarter of 2004.

We anticipate spending $38 million on our U.S. exploration activities in 2004, focusing our efforts on the Gulf Coast, the Permian basin and California. We are pursuing Oligocene and Miocene exploration prospects that we generated in the Texas Gulf Coast based on 3-D seismic and geochemical surveys. Within these targeted play concepts, we have acquired leases covering four shallow water prospects. Three wells have been successfully drilled on the Tres prospect, High Island #55-L, which was based on a Miocene gas exploration target coupled with the redevelopment of additional Miocene oil and gas sands. Facility and pipeline construction is underway, with initial net daily production estimated to be in the range of 20 to 30 MMcf gross (10 to 15 MMcf net) beginning in mid-2004. We are the operator and have a 65 percent working interest in this prospect. We currently plan to commence drilling on the Wesson prospect, Mustang Island #775, by the third quarter of 2004. The target is a four-way dip anticline with potentially stacked pays at depths from 16,000 to 18,000 feet. We presently own a 100 percent working interest in the Wesson prospect, but we anticipate securing other partners prior to drilling.

We have an interest in over 19,500 gross acres in the Permian basin encompassing three multi-well exploration prospects targeting known tight carbonate gas reservoirs. These prospects are predicated on an established play concept which utilizes horizontal drilling and fracture stimulation technology to significantly improve production and economics over the historical results obtained utilizing vertical well bores. We recently drilled the Wilbanks 53 #2-H in the Rosehill prospect in Martin County, Texas, and the Hannah 17 State #2-H in the Austin prospect in Lea County, New Mexico, with both horizontal wells successfully penetrating the targeted Mississippian formation. The wells are undergoing completion and long-term testing. If these tests are successful, we may drill additional wells on these prospects in 2004. We have a 100 percent working interest in both the Rosehill and Austin prospects.

In California, we are preparing to drill a 12,500 foot oil prospect in the San Joaquin basin. If this prospect is successful, production could commence by the third quarter of 2004 and multiple offset locations could be drilled before year end. We have a 50 percent working interest in this prospect. Further, we plan to spend approximately 15 percent of our domestic exploration budget of $38 million assessing the potential of unconventional resource projects in various locations in the U.S.

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Canada. In 2003, we continued exploitation and exploration activity with the drilling of 32 gross (19 net) wells, of which 26 gross (14 net), or 81 percent, were successful. Drilling in 2003 focused on the Sturgeon Lake, West Central and Peace River Arch operating areas of Alberta and the foothills trend of northeastern British Columbia.

Overall, the results in Canada during 2003 were disappointing, leading to significant downward reserve revisions at year end 2003. Results of our work programs and production performance of certain producing properties during the latter part of 2003 resulted in revisions to reserves previously booked to specific wells or to reserves associated with future activities. Due to these disappointing results, in connection with our normal year end reserve estimation process, we performed a critical review to revise or re-validate all remaining future activities on our Canadian proved reserve base. As a result of this review, we determined that previously planned exploration and development activities would be scaled back or eliminated. We continue to employ independent third party engineering firms to prepare estimates of our reserves in all of our operating areas.

The Sturgeon Lake area exploitation program targeted attic oil accumulations in Devonian age Leduc reef structures and shallow gas accumulations in the Cretaceous Badheart formation. During 2003, 11 gross (9 net) wells were drilled in the area. Results of the 2003 exploitation program were well below expectations resulting in downward revisions in reserves previously booked to specific wells drilled, as well as downward revisions to reserves associated with remaining future activities. No drilling activity is planned in the Sturgeon Lake area for 2004.

In the West Central operating area, we participated in the drilling of eight gross (three net) wells targeting Cretaceous Cardium and Gething gas accumulations in the Oldman and Bigstone areas at an overall success rate of 100 percent. Aggregate initial net daily production from this program was approximately 2.1 MMcf of gas. Additional drilling in this area is scheduled for 2004.

Consistent with the strategy that led to our entry into Canada, we are intensifying our efforts in generating impact exploration prospects within the country. The majority of these prospects will target gas, consistent with our overall business plan to focus our North American exploration endeavor on gas prospects with significant reserve potential. In the Cypress area of northeast British Columbia, we are targeting multi-horizon gas potential in Triassic and Mississippian age thrust features. During 2003 and early 2004, three gross (one net) wells have been drilled with one gross (one net) successful well waiting on a pipeline connection. During 2003, we acquired an additional 25,200 gross (10,775 net) acres in this prospect area. We remain encouraged about the high impact potential in this area and additional drilling is planned for 2004.

We have set our 2004 Canadian exploration and development budget at $22 million. Exploitation spending has been reduced to $9 million in favor of other opportunities we have in other areas. We anticipate drilling 15 gross (7 net) development and extensional wells in Canada with activity concentrated in the West Central and Peace River Arch areas. Exploration spending is budgeted at $13 million with 12 gross (9 net) wells planned in the foothills of northeast British Columbia and the Peace River Arch of Alberta.

Argentina. During 2003, as a result of increased political stability and favorable oil prices, we successfully reinitiated our aggressive growth program in Argentina with a significantly expanded capital budget. Our operational activity, in terms of rigs, reflects the highest activity level since we began operations in Argentina in 1995. As a result of the revitalized campaign, our gross operated oil production in Argentina has now reached 30,000 Bbls per day, the highest level since early 2002. Drilling activity in 2003 increased significantly from one rig operating at the beginning of the year to four rigs operating by the third quarter. We drilled a total of 68 gross (67 net) wells during the year with a success rate of 99 percent. An additional 11 wells were either under completion or in the process of drilling by year end 2003. A similar increase in activity was also seen with the number of workover rigs working, from two rigs at the beginning of 2003 to the current level of seven rigs. We performed a total of 78 gross (73 net) workovers in 2003 with a success rate of 88 percent.

We expect the business outlook for Argentina in 2004 to continue to be favorable and as a result, we anticipate additional production growth from Argentina in 2004. This expectation is supported by a capital budget of $84 million, which is a 44 percent increase over 2003 actual spending. Our 2004 budget includes drilling 92 development wells and performing 84 workovers. Our budget also includes the implementation of four waterflood projects which are targeted to contribute to production in 2005 and beyond.

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Additionally, since our drilling program relies heavily on the interpretation of 3-D seismic data to aid in the optimum placement of wells, we plan to significantly expand our program to record 3-D seismic data for 2004. We believe this will allow us to considerably expand our areas of operations. During 2003, a new 3-D survey in Las Heras and Piedra Clavada was completed with an additional 176 square kilometers (68 square miles) of data recorded. In December 2003 the Cerro Wenceslao seismic program began with 77 square kilometers (30 square miles) of data recorded by the end of 2003 and an additional 137 square kilometers (53 square miles) of data recorded in January 2004.

We have additional 3-D seismic surveys already underway in 2004. We have recorded 139 square kilometers (54 square miles) of data in Canadon Leon and 110 square kilometers (42 square miles) of data in Tres Picos. We have a project underway in Cerro Overo that will cover 171 square kilometers (66 square miles). By the middle of 2004 additional surveys are anticipated to be completed in Block 127 and Canadon Minerales that will cover 78 square kilometers (30 square miles) and 192 square kilometers (74 square miles), respectively. Once these programs are completed, approximately 59 percent of our total acreage in the San Jorge basin will be covered by 3-D seismic data. We also have areas in the Cuyo basin with 29 percent 3-D seismic coverage and the Neuquen basin with no 3-D seismic coverage to date. Upon completion of the 2004 activity in progress, we will have 3-D data covering approximately 51 percent of all of our operated acreage in Argentina.

The number of development drilling locations in Argentina has increased substantially in recent years, from 331 at December 31, 2001, to 463 at December 31, 2003, due to a combination of development drilling and workover results integrated with interpretation of 3-D seismic data.

Bolivia. The focus for our operations in Bolivia continues to be on maximizing gas sales to existing markets and the development of new gas markets. During 2003, we signed two gas sales agreements and continued selling and swapping gas on the spot market. In addition, our only remaining work obligation in Bolivia was completed by performing an aeromagnetic and geochemical study of the Chaco Concession. We do not anticipate any significant capital expenditures in Bolivia during 2004.

Italy. We had originally expected to spud the first of two planned exploration wells in the Po Valley in late 2003. However, due to delays in obtaining the required permits, spudding of the first well has been delayed until the second quarter of 2004. The initial drilling campaign will target shallow gas sands in a stratigraphic trap at a depth of approximately 4,800 feet. The play was defined by 2-D seismic and a geochemical survey. We operate two exploration blocks with a 70 percent working interest. These blocks encompass an area of approximately 275,000 gross acres in the north of Italy which has a well-developed gas market and pipeline infrastructure.

Yemen. On October 15, 2003 the Republic of Yemen s Ministry of Oil and Minerals approved our S-1 Damis block development plan covering 285,000 acres for a term of 20 years. This plan follows the Lam sand discovery made by the An Nagyah #2 well in December 2002, which was further delineated in 2003 with the drilling of the An Nagyah #3 and #4 wells. Operations are currently underway to begin development of the discovery in 2004. We are preparing to commence drilling of the An Nagyah #5 well to appraise the western side of the An Nagyah structure. Following this well, drilling will proceed on the first development well, the An Nagyah #6. In 2004, we plan to drill a total of six wells in Yemen to delineate and develop the An Nagyah structure. In addition to the Lam development, we plan to drill the first appraisal well to the Harmel oil discovery, which was drilled in the 2001 drilling campaign.

We are currently installing early production facilities which will allow production of oil before the central production facility and pipeline are in place. Initial production with the early production facility will be limited to 2,500 Bbls of oil per day (approximately 1,300 Bbls net) and should start late in the first quarter of 2004. Work is underway to design the permanent production facility and pipeline necessary to transport the oil to existing export infrastructure, with construction expected to commence in late 2004. Approximately one-third of our 2004 planned capital expenditures in Yemen of $27 million will be allocated to drilling, with the remainder for the design and construction of production facilities and pipeline.

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Bulgaria. We have been awarded an exploration permit for the Bourgas-Deep Sea block in the exclusive economic zone of the Republic of Bulgaria in the western Black Sea. The permit s initial exploration period expires in December 2005 and has provisions for extension. We have a 100 percent working interest and are the operator of this unexplored block that encompasses nearly two million acres (7,958 square kilometers). We acquired 1,575 kilometers of 2-D seismic data in 2003, which will aid us in the detailed mapping of an identified large structural lead. After completion of additional geological and geophysical work, we expect to secure participation by an industry partner with deep water experience to drill and operate this prospect.

Oil and Gas Properties

At December 31, 2003, we owned and operated domestic producing properties in nine states, with our U.S. proved reserves located primarily in four core areas: West Coast, Gulf Coast, East Texas and Mid-Continent. In addition, we established core areas in Argentina during 1995, Bolivia during 1996 and Canada in 2000. As of December 31, 2003, we operated 4,111gross (3,913 net) productive wells and also owned non-operating interests in 729 gross (216 net) productive wells. We continuously evaluate the profitability of our oil, gas and related activities and we have a policy of divesting ourselves of unprofitable leases or areas of operations that are not consistent with our operating philosophy. See Divestitures.

The following table sets forth estimates of our proved oil and gas reserves at December 31, 2003, as estimated by the independent petroleum consultants of Netherland, Sewell & Associates, Inc. for the U.S., Argentina and Yemen, as estimated by the independent petroleum consultants of DeGolyer and MacNaughton for Bolivia and as estimated by the independent petroleum consultants of Outtrim Szabo Associates Ltd. for Canada:

	Oil (MBbls)			Gas (MMcf)			MBOE
	Developed	Undeveloped	Total	Developed	Undeveloped	Total	Total
West Coast	48,171	4,331	52,502	92,391	4,198	96,589	68,600
Gulf Coast	20,777	6,591	27,368	60,518	37,045	97,563	43,629
East Texas	5,950	730	6,680	61,141	16,011	77,152	19,539
Mid-Continent	647	407	1,054	14,385	1,842	16,227	3,758
Total U.S.							