

MARINER ENERGY INC  
Form 10-Q  
August 14, 2001

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549**

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**FORM 10-Q**

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

For the quarterly period ended June 30, 2001

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Commission file number 333-12707

**Mariner Energy, Inc.**

(Exact name of registrant as specified in its charter)

Internal Revenue Service - Employer Identification No. 86-0460233  
State of other jurisdiction of incorporation or organization - Delaware

**580 WestLake Park Blvd., Suite 1300  
Houston, Texas 77079**  
(Address of principal executive offices including Zip Code)

**(281) 584-5500**  
(Registrant's telephone number)

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 requirement for the past 90 days. Yes [ ] No [X]

Note: The Company is not subject to the filing requirements of the Securities Exchange Act of 1934. This quarterly report is filed pursuant to contractual obligations imposed on the Company by an Indenture, dated as of August 1, 1996, under which the Company is the issuer of certain debt.

As of August 3, 2001, there were 1,380 shares of the registrant's common stock outstanding.

**MARINER ENERGY, INC.**  
**Form 10-Q**  
**June 30, 2001**

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**MARINER ENERGY, INC.**  
**BALANCE SHEETS**  
(in thousands)

|                           | <b>June 30,<br/>2001</b> | <b>December 31,<br/>2000</b> |
|---------------------------|--------------------------|------------------------------|
|                           | (Unaudited)              |                              |
| <b><u>ASSETS</u></b>      |                          |                              |
| <b>CURRENT ASSETS:</b>    |                          |                              |
| Cash and cash equivalents | \$ 50,047                | \$ 2,389                     |
| Receivables               | 32,352                   | 33,534                       |
| Hedge receivable          | 7,748                    | --                           |

**MARINER ENERGY, INC.**  
**BALANCE SHEETS**  
(in thousands)

|  |           |           |
|--|-----------|-----------|
| Prepaid expenses and other                           | 11,535    | 5,991     |
|  | <hr/>     | <hr/>     |
| Total current assets                                 | 101,682   | 41,914    |
|  | <hr/>     | <hr/>     |
| <b>PROPERTY AND EQUIPMENT:</b>                       |           |           |
| Oil and gas properties, at full cost:                |           |           |
| Proved   | 508,038   | 478,596   |
| Unproved, not subject to amortization                | 74,845    | 61,068    |
|  | <hr/>     | <hr/>     |
| Total  | 582,883   | 539,664   |
| Other property and equipment                         | 5,293     | 4,592     |
| Accumulated depreciation, depletion and amortization | (287,926) | (254,396) |
|  | <hr/>     | <hr/>     |
| Total property and equipment, net                    | 300,250   | 289,860   |
|  | <hr/>     | <hr/>     |
| OTHER ASSETS, Net of amortization                    | 3,550     | 3,653     |
| HEDGE RECEIVABLE                                     | 4,363     | --        |
|  | <hr/>     | <hr/>     |
| TOTAL ASSETS   | \$409,845 | \$335,427 |
|  | <hr/>     | <hr/>     |
| <b><u>LIABILITIES AND STOCKHOLDER'S EQUITY</u></b>   |           |           |
| <b>CURRENT LIABILITIES:</b>                          |           |           |
| Accounts payable                                     | \$ 77,232 | \$ 37,600 |
| Accrued liabilities                                  | 34,835    | 15,144    |
| Accrued interest                                     | 4,423     | 4,522     |
|  | <hr/>     | <hr/>     |
| Total current liabilities                            | 116,490   | 57,266    |
|  | <hr/>     | <hr/>     |
| OTHER LIABILITIES                                    | 7,666     | 6,552     |
| <b>LONG-TERM DEBT:</b>                               |           |           |
| Revolving credit facility                            | --        | 30,000    |
| Senior Subordinated Notes                            | 99,747    | 99,722    |
|  | <hr/>     | <hr/>     |
| Total long-term debt                                 | 99,747    | 129,722   |
|  | <hr/>     | <hr/>     |
| <b>STOCKHOLDER'S EQUITY:</b>                         |           |           |
|  | 1         | 1         |

**MARINER ENERGY, INC.**  
**BALANCE SHEETS**  
(in thousands)

|   |                  |                  |
|---|------------------|------------------|
| Common stock, \$1 par value; 2,000 shared authorized,<br>1,380 issued and outstanding |                  |                  |
| Additional paid-in-capital  | 227,318          | 227,318          |
| Other comprehensive income  | 12,111           | --               |
| Accumulated deficit   | (53,488)         | (85,432)         |
|   | <hr/>            | <hr/>            |
| Total stockholder's equity  | 185,942          | 141,887          |
|   | <hr/>            | <hr/>            |
| <b>TOTAL LIABILITIES AND STOCKHOLDER'S EQUITY</b>                                     | <b>\$409,845</b> | <b>\$335,427</b> |
|   | <hr/>            | <hr/>            |

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

**MARINER ENERGY, INC.**  
**STATEMENTS OF OPERATIONS**  
(Unaudited, in thousands)

|  | <b>Three-Months Ended<br/>June 30</b> |               | <b>Six-Months Ended<br/>June 30</b> |               |
|--|---------------------------------------|---------------|-------------------------------------|---------------|
|  | <b>2001</b>                           | <b>2000</b>   | <b>2001</b>                         | <b>2000</b>   |
|  | <hr/>                                 | <hr/>         | <hr/>                               | <hr/>         |
| <b>REVENUES:</b>                         |                                       |               |                                     |               |
| Oil sales                                | \$ 18,200                             | \$ 10,538     | \$ 37,962                           | \$17,961      |
| Gas sales                                | 23,553                                | 26,705        | 53,705                              | 43,478        |
|  | <hr/>                                 | <hr/>         | <hr/>                               | <hr/>         |
| Total revenues                           | 41,753                                | 37,243        | 91,667                              | 61,439        |
|  | <hr/>                                 | <hr/>         | <hr/>                               | <hr/>         |
| <b>COSTS AND EXPENSES:</b>               |                                       |               |                                     |               |
| Lease operating expenses                 | 5,281                                 | 4,277         | 10,410                              | 8,470         |
| Transportation                           | 3,916                                 | 2,214         | 7,386                               | 3,131         |
| Depreciation, depletion and amortization | 16,697                                | 16,055        | 34,196                              | 28,982        |
| General and administrative expenses      | 1,674                                 | 1,526         | 3,705                               | 3,254         |
|  | <hr/>                                 | <hr/>         | <hr/>                               | <hr/>         |
| Total costs and expenses                 | 27,568                                | 24,072        | 55,697                              | 43,837        |
|  | <hr/>                                 | <hr/>         | <hr/>                               | <hr/>         |
| <b>OPERATING INCOME</b>                  | <b>14,185</b>                         | <b>13,171</b> | <b>35,970</b>                       | <b>17,602</b> |
| <b>INTEREST EXPENSE, NET:</b>            | <b>1,644</b>                          | <b>2,729</b>  | <b>4,026</b>                        | <b>6,106</b>  |

**MARINER ENERGY, INC.**  
**STATEMENTS OF OPERATIONS**  
(Unaudited, in thousands)

| INCOME BEFORE TAXES        | 12,541    | 10,442    | 31,944   | 11,496   |
|----------------------------|-----------|-----------|----------|----------|
| PROVISION FOR INCOME TAXES | --        | --        | --       | --       |
| NET INCOME                 | \$ 12,541 | \$ 10,442 | \$31,944 | \$11,496 |

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

**MARINER ENERGY, INC.**  
**STATEMENTS OF CASH FLOWS**  
(unaudited, in thousands)

|  | <b>Six-Months Ended<br/>June 30,</b> |             |
|--|--------------------------------------|-------------|
|  | <b>2001</b>                          | <b>2000</b> |
| <b>OPERATING ACTIVITIES:</b>   |                                      |             |
| Net Income   | \$31,944                             | \$11,496    |
| Adjustments to reconcile net income to<br>net cash provided by (used in) operating activities: |                                      |             |
| Depreciation, depletion and amortization   | 34,664                               | 29,272      |
| Changes in operating assets and liabilities:   |                                      |             |
| Receivables  | 1,182                                | (20,728)    |
| Other current assets   | (5,543)                              | (1,962)     |
| Other assets   | 103                                  | (356)       |
| Accounts payable and accrued liabilities   | 59,230                               | 5,322       |
| Net cash provided by operating activities  | 121,580                              | 23,044      |
| <b>INVESTING ACTIVITIES:</b>   |                                      |             |
| Additions to oil and gas properties  | (82,721)                             | (53,866)    |
| Proceeds from property conveyances   | 39,500                               | 29,002      |
| Additions to other property and equipment  | (701)                                | (100)       |

**MARINER ENERGY, INC.**  
**STATEMENTS OF CASH FLOWS**  
**(unaudited, in thousands)**

|   |          |          |
|---|----------|----------|
| Net cash used in investing activities                 | (43,922) | (24,964) |
|   | <hr/>    | <hr/>    |
| <b>FINANCING ACTIVITIES:</b>                          |          |          |
| Proceeds from (payments to) revolving credit facility | (30,000) | (22,600) |
| Capital contribution from parent                      | --       | 55,000   |
| Proceeds from (payments to) senior credit facility    | --       | (25,000) |
|   | <hr/>    | <hr/>    |
| Net cash provided by (used in) financing activities   | (30,000) | 7,400    |
|   | <hr/>    | <hr/>    |
| INCREASE IN CASH AND CASH EQUIV.                      | 47,658   | 5,480    |
| CASH AND CASH EQUIV. AT BEGINNING OF PERIOD           | 2,389    | 123      |
|   | <hr/>    | <hr/>    |
| CASH AND CASH EQUIV. AT END OF PERIOD                 | \$50,047 | \$5,603  |
|   | <hr/>    | <hr/>    |

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

**MARINER ENERGY, INC.**  
**Notes to Financial Statements**  
**(unaudited)**

**1. BASIS OF PRESENTATION**

The financial statements of Mariner Energy, Inc. (the "Company") included herein have been prepared, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC"). Accordingly, they reflect all adjustments (consisting only of normal, recurring accruals) which are, in the opinion of management, necessary for a fair presentation of the financial results for the interim periods. Certain information and notes normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to such rules and regulations, although the Company believes that the disclosures are adequate to make the information presented not misleading. These financial statements should be read in conjunction with the financial statements and notes thereto included in the Company's Form 10-K for the year ended December 31, 2000. The results of operations for the three and six-months ended June 30, 2001 and the cash flows for the six-months ended June 30, 2001 are not necessarily indicative of the results for the full year.

**2. OIL AND GAS PROPERTIES**

Under the full cost method of accounting for oil and gas properties, the net carrying value of proved oil and gas properties is limited to an estimate of the future net revenues, discounted at 10%, from proved oil and gas reserves based on period-end prices and costs plus the lower of cost or estimated fair value of unproved properties.

### 3. HEDGING PROGRAM

On January 1, 2001, the Company adopted SFAS 133 "Accounting for Derivative Instruments and Hedging Activities" as amended by SFAS 137 and SFAS 138. Under SFAS 133, all derivative instruments are recorded on the balance sheet at fair value. If the derivative does not qualify as a hedge or is not designated as a hedge, the gain or loss on the derivative is recognized currently in earnings. To qualify for hedge accounting, the derivative must qualify either as a fair value hedge, cash flow hedge or foreign currency hedge. Currently, the Company uses only cash flow hedges and the remaining discussion will relate exclusively to this type of derivative instrument. If the derivative qualifies for hedge accounting, the gain or loss on the derivative is deferred in Other Comprehensive Income, a component of Stockholder's Equity, to the extent the hedge is effective.

The relationship between the hedging instrument and the hedged item must be highly effective in achieving the offset of changes in cash flows attributable to the hedged risk both at the inception of the contract and on an ongoing basis. The Company measures effectiveness on a period basis. Hedge accounting is discontinued prospectively when a hedge instrument becomes ineffective. Gains and losses deferred in accumulated Other Comprehensive Income related to cash flow hedges that become ineffective remain unchanged until the related production is delivered. If the Company determines that it is probable that a hedged forecasted transaction will not occur, deferred gains or losses on the hedging instrument are recognized in earnings immediately.

Gains and losses on hedging instruments when settled are included in natural gas or crude oil production revenues in the period that the related production is delivered.

The following table sets forth the Company's position as of June 30, 2001:

| <u>Time Period</u>            | <u>Notional<br/>Quantities</u> | <u>Price</u> |                |              | <u>Fair Value</u><br><br>(in millions) |
|-------------------------------|--------------------------------|--------------|----------------|--------------|--|
|                               |                                | <u>Floor</u> | <u>Ceiling</u> | <u>Fixed</u> |  |
| <b>Natural Gas (MMMBtu)</b>   |                                |              |                |              |  |
| July 1 - September 30, 2001   |                                |              |                |              |  |
| Collar purchased              | 1,291                          | 3.50         | \$ 4.92        |              | 0.4                                    |
| Put floor purchased           | 1,291                          | 3.50         |                |              | 0.4                                    |
| Fixed price swap purchased    | 1,100                          |              |                | \$ 2.18      | (1.1)                                  |
| Fixed price swap purchased    | 1,283                          |              |                | 4.43         | 1.6                                    |
| October 1 - December 31, 2001 |                                |              |                |              |  |
| Fixed price swap purchased    | 774                            |              |                | 2.18         | (1.0)                                  |
| Fixed price swap purchased    | 3,218                          |              |                | 4.43         | 2.9                                    |
| January 1 - December 31, 2002 |                                |              |                |              |  |
| Fixed price swap purchased    | 1,831                          |              |                | 2.18         | (2.4)                                  |
| Fixed price swap purchased    | 12,134                         |              |                | 4.43         | 10.3                                   |
| <b>Crude Oil (MBbl)</b>       |                                |              |                |              |  |
| July 1 - December 31, 2001    |                                |              |                |              |  |
| Fixed price swap purchased    | 497                            |              |                | \$27.75      | 0.8                                    |
| January 1 - December 31, 2002 |                                |              |                |              |  |

### 3. HEDGING PROGRAM

|                            |     | <u>Price</u> |         |
|----------------------------|-----|--------------|---------|
| Fixed price swap purchased | 365 | 25.48        | 0.2     |
|                            |     |              | <hr/>   |
| Total                      |     |              | \$ 12.1 |
|                            |     |              | <hr/>   |

Subsequent to June 30, 2001 we entered into an additional natural gas fixed price swap for the year 2003 for a notional quantity of 120 MMBtu at \$3.74 per MMBtu. We also entered into a crude oil fixed price swap for the period August 1, 2001 through July 1, 2002 for a notional quantity of 334 MBbl at \$25.15 per barrel.

On January 1, 2001, in accordance with the transition provisions of SFAS 133, the Company recorded \$32.9 million in Other Comprehensive Income representing the cumulative effect of an accounting change to recognize at fair value all cash flow derivatives. The Company recorded cash flow hedge derivative liabilities of \$32.9 million on that date. There is no tax effect on the cumulative effect.

During the six-months of 2001, hedging losses of \$14.1 million were transferred from Other Comprehensive Income to revenue and the fair value of outstanding hedges was \$12.1 million. As of June 30, 2001, the ineffective portion of the cash flow hedges were not material for the quarter.

As of June 30, 2001, \$12.1 million of deferred gains on derivative instruments were recorded in Other Comprehensive Income, of which \$7.0 million are expected to be reclassified to earnings during the next twelve-month period.

All hedge transactions are subject to the Company's risk management policy, approved by the Board of Directors, which does not permit speculative positions. The Company formally documents all relationships between hedging instruments and hedged items, as well as its risk management objectives and strategy for undertaking the hedge. This process includes specific identification of the hedging instrument and the hedge transaction, the nature of the risk being hedged and how the hedging instrument's effectiveness will be assessed. Both at the inception of the hedge and on an ongoing basis, the Company assesses whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in cash flows of hedged items.

The fair value of our hedging instruments was determined based on a broker's forward price quote and a NYMEX forward price quote. As of June 30, 2001, a commodity price increase of 10% would have resulted in an unfavorable change in fair value of \$10.5 million and a commodity price decrease of 10% would have resulted in a favorable change in fair value of \$10.5 million.

#### 4. COMMITMENTS AND CONTINGENCIES

**Litigation** - The Company, in the ordinary course of business, is a claimant and/or a defendant in various legal proceedings, including proceedings as to which the Company has insurance coverage. The Company does not consider its exposure in these proceedings, individually and in the aggregate, to be material.

#### 5. OTHER COMPREHENSIVE INCOME

Other Comprehensive Income includes net income and certain items recorded directly to Stockholder's Equity and classified as Other Comprehensive Income. The Company recorded Other Comprehensive Income for the first time in the first quarter of 2001. Following the adoption of SFAS 133, the Company recorded an Other Comprehensive Income of \$12.1 million related to the change in fair value of certain derivative financial instruments that has qualified for cash flow hedge accounting. The following table illustrates the calculation of Other Comprehensive Income for the



six-months ended June 30, 2001:

|   | <b>Six-Months Ended<br/>June 30, 2001<br/>(In thousands)</b> |   |
|---|--|---|
|   | <b>Comprehensive<br/>Income</b>                              | <b>Accumulated<br/>Comprehensive<br/>Income</b> |
|   | <hr/>  | <hr/>   |
| Other comprehensive income - December 31, 2000                        |  | \$ -  |
| Net income  | \$31,944   |   |
|   | <hr/>  |   |
| Other comprehensive loss  |  |   |
| Cumulative effect of change in accounting principle - January 1, 2001 | (32,976)   |   |
| Reclassification adjustment for settled contracts                     | 14,145   |   |
| Changes in fair value of outstanding hedging positions                | 30,942   |   |
|   | <hr/>  |   |
| Other comprehensive loss  | 12,111   | 12,111  |
|   | <hr/>  |   |
| Comprehensive income  | \$44,055   |   |
|   | <hr/>  |   |
| Other comprehensive loss  |  | \$12,111  |
|   |  | <hr/>   |

There were no items in Other Comprehensive Income/Loss other than the Company's hedging activity.

## 6. RECENT ACCOUNTING PRONOUNCEMENTS

In June 2001, the Financial Accounting Standards Board issued SFAS No. 141, Business Combinations (effective July 1, 2001) and SFAS No. 142, Goodwill and Other Intangible Assets (effective on January 1, 2002). SFAS No. 141 prohibits pooling-of-interests accounting for acquisitions. SFAS No. 142 specifies that goodwill and some intangible assets will no longer be amortized but instead will be subject to periodic impairment testing. We do not believe the adoption of this statement will have an impact on our financial statements.

### Independent Accountants Report

Board of Directors and Stockholder  
Mariner Energy, Inc.  
Houston, Texas

We have reviewed the accompanying balance sheet of Mariner Energy, Inc. as of June 30, 2001 and the related statements of operations for the three-months and six-months ended June 30, 2001 and 2000 and the related statements of cash flows for the six-months ended June 30, 2001 and 2000. These financial statements are the responsibility of the Company's management.

## 5. OTHER COMPREHENSIVE INCOME

We conducted our review in accordance with standards established by the American Institute of Certified Public Accountants. A review of interim financial information consists primarily of applying analytical procedures to financial data and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with auditing standards generally accepted in the United States of America, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to the accompanying consolidated financial statements for them to be in conformity with accounting principles generally accepted in the United States of America.

We have previously audited, in accordance with auditing standards generally accepted in the United States of America, the balance sheet as of December 31, 2000, and the related statements of operations, stockholder's equity, and cash flows for the year ended December 31, 2000 (not presented herein), and in our report dated April 2, 2001, we expressed an unqualified opinion on those financial statements. In our opinion, the information set forth in the accompanying balance sheet as of December 31, 2000 is fairly stated, in all material respects, in relation to the balance sheet from which it has been derived.

/s/ DELOITTE & TOUCHE LLP

**DELOITTE & TOUCHE LLP**

Houston, Texas  
August 9, 2001

**Part I, Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.**

The following review of operations for the three-month and six-month periods ended June 30, 2001 and 2000 should be read in conjunction with the financial statements of the Company and Notes thereto included elsewhere in this Form 10-Q and with the Financial Statements, Notes, and Management's Discussion and Analysis of Financial Condition and Results of Operations included in the Company's Annual Report on Form 10-K for the year ended December 31, 2000, filed with the Securities and Exchange Commission on April 2, 2001.

**Information Regarding Forward Looking Statements**

All statements other than statements of historical fact included in this quarterly report on Form 10-Q, including, without limitation, statements contained in this "Management's Discussion and Analysis of Financial Condition and Results of Operations" regarding the Company's financial position, business strategy, plans and objectives of management of the Company for future operations, and industry conditions, are forward-looking statements. Although the Company believes that the expectations reflected in such forward-looking statements are reasonable, it can give no assurance that such expectations will prove to have been correct, and actual results could differ materially from the Company's expectations. Factors that could influence these results include, but are not limited to, oil and gas price volatility, results of future drilling, availability of drilling rigs, future production and costs, capital resources, liquidity and other factors described in the Company's annual report on Form 10-K for the year ended December 31, 2000, filed with the Securities and Exchange Commission on April 2, 2001.

**Results of Operations**

The following table sets forth certain information regarding results of operations for the periods shown:

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|                                    | Three-Months Ended<br>June 30 |               | Six-Months Ended<br>June 30 |                |
|------------------------------------|-------------------------------|---------------|-----------------------------|----------------|
|                                    | 2001                          | 2000          | 2001                        | 2000           |
| Total revenue, \$MM                | \$41.8                        | \$37.2        | \$91.7                      | \$61.4         |
| EBITDA(1), \$MM                    | 30.9                          | 29.3          | 70.2                        | 46.6           |
| Net income (loss), \$MM            | 12.5                          | 10.4          | 31.9                        | 11.5           |
| Production:                        |                               |               |                             |                |
| Oil and condensate (Mbbls)         | 757                           | 459           | 1,542                       | 828            |
| Natural Gas (Mmcf)                 | 5,499                         | 8,262         | 10,924                      | 14,983         |
| Natural Gas equivalents (Mmcfe)    | 10,041                        | 11,016        | 20,174                      | 19,951         |
| Average realized sales prices:     |                               |               |                             |                |
| Oil and condensate (\$/Bbl)        | \$24.04                       | \$22.94       | \$24.62                     | \$21.68        |
| Natural Gas (\$/Mcf)               | 4.28                          | 3.23          | 4.92                        | 2.90           |
| Natural Gas equivalents (\$/Mcf)   | 4.16                          | 3.38          | 4.54                        | 3.08           |
| Cash Margin(2) per Mcfe:           |                               |               |                             |                |
| Revenue (pre-hedge)                | \$4.51                        | \$4.10        | \$5.25                      | \$3.71         |
| Hedging impact                     | (0.35)                        | (0.72)        | (0.71)                      | (0.63)         |
| Lease operating expenses           | (0.53)                        | (0.38)        | (0.52)                      | (0.42)         |
| Transportation                     | (0.39)                        | (0.20)        | (0.37)                      | (0.16)         |
| Gross G&A costs                    | (0.35)                        | (0.31)        | (0.39)                      | (0.37)         |
|                                    | <u>\$2.89</u>                 | <u>\$2.49</u> | <u>\$3.26</u>               | <u>\$2.13</u>  |
| Capital Expenditures(3), \$MM:     |                               |               |                             |                |
| Exploration:                       |                               |               |                             |                |
| Leasehold and G&G costs            | \$12.6                        | \$(12.9)      | \$8.5                       | \$(10.2)       |
| Drilling                           | 15.5                          | 1.4           | 30.8                        | 2.8            |
| Development & other                | 18.5                          | 15.3          | (1.2)                       | 27.3           |
| Capitalized G&A and interest costs | 2.7                           | 2.4           | 5.8                         | 5.1            |
|                                    | <u>\$ 49.3</u>                | <u>\$ 6.2</u> | <u>\$ 43.9</u>              | <u>\$ 25.0</u> |

1. EBITDA equals earnings before interest, income taxes, depreciation, depletion, and amortization. EBITDA should be used as a supplement to, and not as a replacement for, net earnings and cash provided by operating activities (as disclosed in the financial statements) in analyzing the Company's results of operations and liquidity.

2. Cash margin measures the net cash generated by a company's operations during a given period, without regard to the period such cash is physically received or spent by the company.
3. Net of \$39.5 million of proceeds from property conveyances for the six-month period ended June 30, 2001. There were no conveyances made during the second quarter 2001.

## Results of Operations for the Second Quarter of 2001

**Net production** was 10.0 Bcfe for the second quarter of 2001 compared to 11.0 Bcfe for the second quarter of 2000. Our Deepwater Gulf of Mexico production was 8.1 Bcfe in the second quarter of 2001, compared to the 8.0 Bcfe produced in the second quarter of 2000. Anticipated production declines from our producing properties more than offset a production increase from the Black Widow field located in Ewing Banks 966. We anticipate production for 2001 to be approximately 36 Bcfe with production from the Black Widow project offsetting anticipated production decline from other properties. First production from the King Kong / Yosemite project is anticipated in late 2001.

**Hedging activities** for the second quarter of 2001 decreased our average realized natural gas sales price received by \$0.65 per Mcf and revenues by \$3.5 million. Hedging activities for the second quarter 2000 reduced our average realized natural gas and crude oil prices by \$0.58 per Mcf and \$6.92 per Bbl, resulting in reductions in revenue of \$4.8 million and \$3.2 million, respectively.

**Oil and gas revenues** increased 12% to \$41.8 million for the second quarter of 2001 from \$37.2 million for the second quarter of 2000. The revenue increase reflected a 23% increase in realized prices, to \$4.16 per Mcfe for the second quarter from \$3.18 per Mcfe in the same period of 2000, offset in part by a 9% decrease in production.

**Lease operating expenses** increased 24% to \$5.3 million for the second quarter of 2001, from \$4.3 million for the second quarter of 2000, due to the addition of our Black Widow field located in Ewing Bank 966.

**Transportation expenses** increased 77% to \$3.9 million for the second quarter of 2001, from \$2.2 million for the second quarter of 2000, due to the addition of our Black Widow field located in Ewing Bank 966 and a flowline loss contract recorded in the second quarter of 2001.

**Depreciation, depletion, and amortization expense (DD&A)** increased 4% to \$16.7 million for the second quarter of 2001 from \$16.1 million for the second quarter of 2000, as a result of an increase in the unit-of-production depreciation, depletion, and amortization rate to \$1.66 per Mcfe from \$1.46 per Mcfe. The higher rate does not include the effect of reserves currently not considered proved which are expected to be reclassified in future periods.

**General and administrative expenses**, which are net of overhead reimbursements received by us from other working interest owners, increased 10% to \$1.7 million for the second quarter of 2001 from \$1.5 million for the second quarter of 2000, due primarily to increased personnel-related costs required for us to pursue our Deepwater Gulf exploration and development plan.

**Interest expense** for the second quarter of 2001 decreased 31% to \$1.9 million from \$2.8 million in the second quarter of 2000, due to the repayment of our revolving credit facility with proceeds for our property conveyance.

**Income before income taxes** was \$12.5 million for the second quarter of 2001 compared to \$10.4 million in the second quarter of 2000, as a result of the oil and gas revenue increase, offset in part by increased expenses as discussed above.

## Results of Operations for the First Six Months of 2001

**Net production** was 20.2 Bcfe for the first six months of 2001 compared to 20.0 Bcfe for the same period of 2000. Production from our Deepwater Gulf of Mexico properties increased to 16.4 Bcfe in the six-month period ending June 30, 2001 from 13.5 Bcfe in the same period of 2000, primarily as a result of production commencing from our Black Widow field located in Ewing Bank 966. This increase was offset in part by anticipated production declines in our other fields. Total production for the full year of 2001 is expected to be approximately 36 Bcfe, with production from the Black Widow project, located in Ewing Bank 966, offsetting anticipated production declines from other properties. First production from the King Kong / Yosemite project is anticipated in late 2001.

**Oil and gas revenues** increased 49% to \$91.7 million for the first six months of 2001 from \$61.4 million for the comparable period of 2000, primarily due to a 47% increase in realized prices to \$4.54 per Mcfe in the first six months of 2001 from \$3.08 per Mcfe in the same period last year, and the production increase discussed above.

**Hedging activities** for the first six months of 2001 decreased our average realized natural gas sales price received by \$1.29 per Mcf and revenues by \$14.2 million. Hedging activities for the first six months of 2000 reduced our average realized natural gas and crude oil prices by \$0.43 per Mcf and \$7.46 per Bbl, resulting in reductions in revenue of \$6.4 million and \$6.2 million, respectively.

**Lease operating expenses** increased 24% to \$10.4 million for the first six months of 2001, from \$8.4 million for the comparable period of 2000, primarily due to the higher offshore production discussed above.

**Transportation expenses** increased 136% to \$7.4 million for the first six months of 2001, from \$3.1 million for the same period of 2000, due to the addition of our Black Widow field located in Ewing Bank 966 and a flowline loss contract recorded in the second quarter of 2001.

**Depreciation, depletion, and amortization expense (DD&A)** increased 18% to \$34.2 million for the first six months of 2001 from \$28.9 million for the comparable period of 2000, as a result of the increase in the unit-of-production depreciation, depletion, and amortization rate to \$1.70 per Mcfe from \$1.45 per Mcfe, and a slight increase in equivalent volumes produced. The higher rate does not include the effect of reserves currently not considered proved which are expected to be reclassified in future periods.

**General and administrative expenses**, which are net of overhead reimbursements received by us from other working interest owners, increased 14% to \$3.7 million for the first six months of 2001 from \$3.3 million for the comparable period of 2000, due primarily to increased personnel-related costs required for us to pursue our Deepwater Gulf exploration and development plan.

**Interest expense** for the first six months of 2001 decreased 29% to \$4.4 million from \$6.2 million for the comparable period of 2000, primarily due to the repayment of our revolving credit agreement with proceeds from property conveyances.

**Income (loss) before income taxes** was an \$31.9 million income for the first six months of 2001 compared to \$11.5 million for the same period of 2000, primarily as a result of oil and gas revenue increases, partially offset by increased expenses discussed above.

## Liquidity, Capital Expenditures and Capital Resources

As of June 30, 2001, we had a working capital deficit of approximately \$14.8 million, compared to a working capital deficit of \$15.4 million at December 31, 2000. We expect our 2001 capital expenditures, excluding capitalized general, administrative and interest costs and after proceeds from property conveyances, to be approximately \$147 million, which would exceed expected cash flow from operations. We believe there will be adequate cash flow and

borrowing capacity to allow us to fund our remaining planned activities in 2001. However, there can be no assurance that our access to capital will be sufficient to meet our needs for capital. As such, we may be required to reduce our planned capital expenditures and forego planned exploratory drilling or monetize portions of our proved reserves or undeveloped inventory if additional capital resources are not available to us on terms we consider reasonable.

Net cash provided by operating activities was \$121.6 million in the first six months of 2001, an increase of \$98.5 million from the same period of 2000. A period to period increase of approximately \$25.9 million in operating cash flow before changes in operating assets and liabilities was due primarily to higher production and higher commodity prices. An increase of \$72.7 million in net cash used for changes in working capital was caused by increased oil and gas receivables and the timing of payments made on accounts payable.

Cash used in investing activities in the first six months of 2001 increased to \$43.9 million from \$25.0 million for the same period in 2000 due primarily to higher development expenditures.

Cash used by financing activities was \$30 million for the first six months of 2001 compared to cash provided of \$7.4 million for the same period in 2000. In addition to cash from operating activities, our primary source of cash for the first six months of 2001 was \$39.5 million in proceeds from property conveyances, offset in part by \$30 million of payments on our Revolving Credit Facility.

The energy markets have historically been very volatile, and there can be no assurance that oil and natural gas prices will not be subject to wide fluctuations in the future. To reduce the effects of the volatility of the price of oil and natural gas on our operating cash flow, management has adopted a policy of hedging oil and natural gas prices from time to time through the use of commodity futures, options and swap agreements. While the use of these hedging arrangements limits the downside risk of adverse price movements, it may also limit future gains from favorable movements.

The following table sets forth the increase (decrease) in our oil and natural gas sales as a result of hedging transactions and the effects of hedging transactions on prices during the periods indicated.

|   | <b>Six-Months<br/>Ended<br/>June 30,</b> |             |
|---|--|-------------|
|   | <b>2001</b>                              | <b>2000</b> |
| Decrease in natural gas sales (in thousands)                                | \$(14,162)                               | \$(6,393)   |
| Decrease in oil sales (in thousands)  | 17                                       | (6,178)     |
| Effect of hedging transactions on average natural gas sales price (per Mcf) | (1.29)                                   | (0.43)      |
| Effect of hedging transactions on average oil sales price (per Bbl)         | 0.01                                     | (7.46)      |

A table setting forth our open hedging positions as of June 30, 2001 is contained in footnote 3. Commitments and Contingencies in the footnotes to the financial statements in Item 1 of this report.

Hedging arrangements for 2001, including hedge positions entered into subsequent to June 30, 2001, cover approximately 62% of our anticipated equivalent production for the year. Hedging arrangements for 2002 and 2003 cover approximately 36% and 6% of our anticipated equivalent production for those years, respectively.

Capital expenditures for the first six months of 2001 were \$43.9 million including \$5.8 million of capitalized general, administrative and interest costs and a deduction of \$39.5 million for proceeds received from property conveyances, which was allocated to development expenditures.

During the remainder of 2001, we expect to conduct drilling operations on two to four exploratory wells, all in the Deepwater Gulf, and expanding our Deepwater Gulf 3-D seismic data. Total capital expenditures for 2001, net of proceeds from property conveyances and before capital interest, are now expected to be \$147 million. Development activities will include completing the King Kong / Yosemite project, continued development of the Aconcagua discovery and drilling several development wells in producing fields.

Debt outstanding as of June 30, 2001 was approximately \$99.8 million of senior subordinated notes. Following the semi-annual borrowing base redetermination, in May 2001, the borrowing base under the Revolving Credit Facility was increased from \$70 million to \$80 million.

There can be no assurance that funds available to us under the Revolving Credit Facility will be sufficient for us to fund our currently planned capital expenditures. We may be required to reduce our planned capital expenditures and forego planned exploratory drilling or to monetize portions of our proved reserves or undeveloped inventory if additional capital resources are not available to us on terms we consider reasonable.

We believe there will be adequate cash flow in order for us to fund our remaining planned activities in 2001. Our capital resources still may not be sufficient to meet our anticipated future requirements for working capital, capital expenditures and scheduled payments of principal and interest on our indebtedness. There can be no assurance that anticipated growth will be realized, that our business will generate sufficient cash flow from operations or that future borrowings or equity capital will be available in an amount sufficient to enable us to service our indebtedness or make necessary capital expenditures. In addition, depending on the levels of our cash flow and capital expenditures (the latter of which are, to a large extent, discretionary), we may need to refinance a portion of the principal amount of our senior subordinated debt at or prior to maturity. However, there can be no assurance that we would be able to obtain financing on acceptable terms to complete a refinancing.

### **Part I, Item 3. Quantitative and Qualitative Disclosures about Market Risk.**

See Part I, Item 2. "Management's Discussion and Analysis of Financial Condition and Results of Operations".

### **Part II. Other Information**

#### **Item 1. Legal Proceedings**

None.

#### **Item 2. Changes in Securities and Use of Proceeds**

None.

#### **Item 3. Defaults Upon Senior Securities**

None.

#### **Item 4. Submission of Matters to a Vote of Security Holders**

None.

**Item 5. Other Information**

None.

**Item 6. Exhibits and Reports on Form 8-K**

(a) None.

(b) The Company filed no Current Reports on Form 8-K during the quarter ended June 30, 2001.

**SIGNATURE**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

**MARINER ENERGY, INC.**

Date: May 14, 2001

/s/ Frank A. Pici

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Frank A. Pici  
Vice President of Finance and  
Chief Financial Officer  
(Principal Financial Officer  
and  
Officer Duly Authorized to  
Sign  
on Behalf of the Registrant)