

CONTANGO OIL & GAS CO  
Form DEFM14A  
December 07, 2004  
Table of Contents

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**WASHINGTON, DC 20549**

**SCHEDULE 14A**  
**(RULE 14a-101)**

**INFORMATION REQUIRED IN PROXY STATEMENT**  
**SCHEDULE 14A INFORMATION**

**Proxy Statement Pursuant to Section 14(A) of The**  
**Securities Exchange Act of 1934**  
**(Amendment No.    )**

Filed by the Registrant  Filed by a Party other than the Registrant

Check the appropriate box:

Preliminary proxy statement

**Confidential, for use of the Commission only (as permitted by Rule 14a-6(e)(2)).**

Definitive proxy statement

Definitive additional materials

.. Soliciting material pursuant to Rule 14a-11(c) or Rule 14a-12

**CONTANGO OIL & GAS COMPANY**

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(Name of Registrant as Specified in its Charter)

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(Name of Person(s) Filing Proxy Statement if other than the Registrant)

Payment of filing fee (check the appropriate box):

- .. No fee required.
- .. Fee computed on table below per Exchange Act Rules 14a-6(i)(1) and 0-11.

(1) Title of each class of securities to which transaction applies:

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(2) Aggregate number of securities to which transaction applies:

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(3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (set forth the amount on which the filing fee is calculated and state how it was determined):

1/50 (.01) (50,000,000)

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(4) Proposed maximum aggregate value of transaction:

\$50,000,000

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(5) Total fee paid:

\$10,000

x Fee paid previously with preliminary materials.

.. Check box if any part of the fee is offset as provided by Exchange Act Rule 0-11(a)(2) and identify the filing for which the offsetting fee was paid previously. Identify the previous filing by registration statement number, or the form or schedule and the date of its filing.

(1) Amount previously paid:

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(2) Form, schedule or registration statement no.:

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(3) Filing party:

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(4) Date filed:

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**Table of Contents**

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(4) Date filed:

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Table of Contents

**CONTANGO OIL & GAS COMPANY**

**3700 Buffalo Speedway, Suite 960**

**Houston, Texas 77098**

**NOTICE OF SPECIAL MEETING OF STOCKHOLDERS**

**DECEMBER 29, 2004**

Dear Stockholder,

You are cordially invited to a special meeting of stockholders of Contango Oil & Gas Company, which will be held at 3700 Buffalo Speedway, Suite 960, Houston, Texas 77098, on Wednesday, December 29, 2004 at 9:00 a.m., Central Time.

We have agreed to sell substantially all of our interests in natural gas and oil properties in south Texas to Edge Petroleum Exploration Company, if our stockholders authorize the proposed sale. Edge's parent, Edge Petroleum Corporation, is a publicly-held independent natural gas and oil company engaged in the exploration, development, acquisition, and production of natural gas and oil properties in the United States. In exchange for the interests, Edge has agreed to pay us a total of \$50 million, subject to specific adjustments. The proposed sale of assets to Edge would take place under an asset purchase agreement, dated as of October 7, 2004. The full text of the asset purchase agreement is included as Annex A to the proxy statement that accompanies this letter. The sale of a portion of these assets is subject to rights of first refusal held by the lessors of these interests under various leases. In the event such lessors exercise any of their first refusal rights, the interests subject thereto would be sold to such lessors on substantially the same terms as set forth in the asset purchase agreement between us and Edge.

It is not clear under Delaware law whether the proposed sale of assets to Edge requires the authorization of our stockholders. To avoid uncertainty, we are seeking the authorization of our stockholders. The sale will not be completed unless and until it is authorized by the holders of a majority of our outstanding shares of common stock voting together as a single class with holders of our Series C preferred stock, who will vote as if their shares were converted into shares of common stock. We have scheduled a special meeting of our stockholders for this vote on December 29, 2004. **YOUR VOTE IS VERY IMPORTANT.**

**OUR BOARD OF DIRECTORS HAS UNANIMOUSLY DETERMINED THAT THE PROPOSED SALE OF ASSETS IS IN THE BEST INTERESTS OF US AND OUR STOCKHOLDERS. THE BOARD OF DIRECTORS UNANIMOUSLY APPROVED THE PROPOSED SALE AND THE ASSET PURCHASE AGREEMENT AND RECOMMENDS THAT YOU VOTE FOR THE PROPOSED SALE.**

Holders of our common stock and holders of our Series C convertible preferred stock at the close of business on November 16, 2004 are entitled to attend and vote at the meeting. You have two options in submitting your vote prior to the special meeting date:

(1) You may sign and return the enclosed proxy card in the accompanying envelope; or

(2) If your shares are held in street name, you can vote over the Internet at the address shown on your proxy card.

**Whether or not you plan to attend the special meeting in person, please date, sign, and return the enclosed proxy card promptly or vote over the Internet.** A postage-paid return envelope is enclosed for your convenience. If you decide to attend the special meeting, you can, if you wish, revoke your proxy and vote in person. If you have any questions, please contact us through our website at [www.contango.com](http://www.contango.com), send us an e-mail at [contango@contango.com](mailto:contango@contango.com) or write us at 3700 Buffalo Speedway, Suite 960, Houston, Texas 77098.

By order of the Board of Directors,

/s/ KENNETH R. PEAK

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**Kenneth R. Peak Chairman,**

*Chief Executive Officer, Chief Financial Officer and*

*Secretary*

Houston, Texas

December 6, 2004

**Table of Contents**

**CONTANGO OIL & GAS COMPANY**

**3700 Buffalo Speedway, Suite 960**

**Houston, Texas 77098**

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**SPECIAL MEETING OF STOCKHOLDERS**

**DECEMBER 29, 2004**

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The Board of Directors of Contango Oil & Gas Company, a Delaware corporation, is furnishing you with this proxy statement in connection with its solicitation of your proxy, in the form enclosed, for use at a special meeting of stockholders to be held at 3700 Buffalo Speedway, Suite 960, Houston, Texas 77098, on Wednesday, December 29, 2004 at 9:00 a.m., Central Time.

The purpose of the special meeting is to:

1. Consider and vote upon a proposal to sell substantially all of our interests in natural gas and oil properties in south Texas to (a) Edge Petroleum Exploration Company pursuant to the terms of an asset purchase agreement, dated as of October 7, 2004 and/or (b) the lessors of a portion of these interests on substantially the same terms as set forth in such asset purchase agreement, in the event and to the extent such lessors exercise their rights of first refusal covering the sale of any of these interests. We anticipate that we will obtain waivers from these lessors of their rights of first refusal. A copy of the asset purchase agreement is attached as Annex A to the accompanying proxy statement.

2. Transact such other business as may properly come before the special meeting and any adjournment thereof. The Board of Directors is not aware of any other business that will be presented for consideration at the special meeting.

**OUR BOARD OF DIRECTORS HAS UNANIMOUSLY DETERMINED THAT THE TERMS OF THE PROPOSED SALE ARE IN THE BEST INTERESTS OF US AND OUR STOCKHOLDERS AND RECOMMENDS THAT YOU VOTE FOR THE PROPOSED SALE.**

Only holders of our common stock and holders of our Series C preferred stock as of the close of business on November 16, 2004 are entitled to notice of and to vote at the special meeting.

The proposed sale will not be completed unless it is authorized by the affirmative vote of a majority of our stockholders entitled to vote at the special meeting.



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We are mailing this proxy statement to you on or about December 9, 2004, together with the accompanying proxy card.

We cordially invite you to attend the special meeting. Whether or not you plan to attend, please complete, date, and sign the proxy card and return it promptly in the return envelope provided. If your shares are owned in street name and you prefer to vote over the internet, please follow the instructions on the proxy card or other enclosed proxy material.

**Table of Contents**

**TABLE OF CONTENTS**

	<u>Page</u>
<u>SUMMARY TERM SHEET</u>	1
<u>QUESTIONS AND ANSWERS ABOUT THE PROPOSED SALE</u>	4
<u>CAUTIONARY STATEMENT ABOUT FORWARD-LOOKING STATEMENTS</u>	7
<u>RISK FACTORS</u>	9
<u>THE PROPOSED SALE</u>	10
<u>General</u>	10
<u>Description of the Assets to be Sold</u>	10
<u>Background of the Proposed Sale</u>	10
<u>Reasons for the Proposed Sale</u>	11
<u>Summary of Reserve Report</u>	12
<u>Recommendation of Our Board of Directors</u>	13
<u>Use of Proceeds</u>	13
<u>Accounting Treatment for the Proposed Sale</u>	15
<u>TERMS OF THE ASSET PURCHASE AGREEMENT</u>	16
<u>Purchase Price and Adjustments</u>	16
<u>The Closing</u>	18
<u>Representations and Warranties</u>	18
<u>Covenants</u>	18
<u>No Solicitation</u>	18
<u>Closing Conditions</u>	19
<u>Abandonment</u>	19
<u>Break-Up Fees</u>	19
<u>Indemnification: Survival Of Indemnification Obligations</u>	19
<u>Fees and Expenses</u>	20
<u>MARKET PRICE DATA; DIVIDENDS</u>	21
<u>SELECTED CONSOLIDATED HISTORICAL AND PRO FORMA FINANCIAL DATA</u>	22
<u>UNAUDITED PRO FORMA CONDENSED CONSOLIDATED FINANCIAL STATEMENTS</u>	25
<u>NOTES TO UNAUDITED PRO FORMA CONDENSED CONSOLIDATED FINANCIAL STATEMENTS</u>	29
<u>Basis of Presentation</u>	29
<u>Pro Forma Adjustments</u>	29
<u>SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT</u>	30
<u>DEADLINE FOR RECEIPT OF STOCKHOLDER PROPOSALS FOR THE ANNUAL MEETING OF STOCKHOLDERS IN 2005</u>	31
<u>ADVANCE NOTICE PROCEDURES FOR NEXT YEAR'S ANNUAL MEETING</u>	31
<u>OTHER PROPOSED ACTIONS</u>	31
<u>WHERE YOU CAN FIND MORE INFORMATION</u>	32
<u>FORM OF PROXY</u>	

**Table of Contents**

**SUMMARY TERM SHEET**

This summary term sheet highlights selected information regarding the proposed sale and may not contain all of the information that is important to you. All references in this proxy statement to we, us, or our are to Contango Oil & Gas Company and its subsidiaries. To understand the proposed sale more fully and for a complete description of the legal terms of the proposed sale, you should carefully read this entire document and the documents we refer you to. Also see *Where You Can Find More Information* on page 27. We have included page references parenthetically to direct you to the page of this document where you can find a more complete discussion of the topic.

**THE ASSETS (SEE PAGE 8).** Through a wholly-owned subsidiary, we own interests in natural gas and oil producing properties in south Texas. The interests are in various natural gas and oil leases, wells, equipment, contracts, and seismic rights. Throughout this proxy statement, we will refer to these assets collectively as our south Texas natural gas and oil interests. We drilled our first successful exploratory well on these properties in June 2000. We subsequently drilled 51 wells, of which 38 were successful. In addition in 2002 and 2003, we increased our working and net revenue interests in our south Texas properties through a series of acquisitions that resulted in the purchase of 14.0 Bcfe. As of June 30, 2004, we held an average 68% net working interest and a 52% net revenue interest in our south Texas natural gas and oil interests and owned approximately 16.0 Bcfe of total proved reserves, all of which were classified as proved developed producing. The pre-tax net present value of these proved reserves using a 10% discount rate as of June 30, 2004 was \$54.3 million. The sale of these assets to Edge is subject to approval by a majority of our stockholders, rights of first refusal held by lessors of a portion of these interests, and rights to prohibit assignment held by lessors of a portion of these interests. Other than as described below, all of the lessors have waived their rights of first refusal with respect to the sale to Edge and consented to the assignment of the interests to Edge, to the extent they hold such rights. Six lessors of interests having an aggregate allocated value of approximately \$25 million hold rights to prohibit assignment of such interests and have not yet consented to assignment of the interests to Edge. Two lessors of interests having an aggregate allocated value of approximately \$900,000 hold rights of first refusal and rights to prohibit assignment of such interests and have not yet consented to the sale and assignment of such interests of Edge. We have notified these eight lessors of the pending sale, and we anticipate that we will obtain waivers and consents from these lessors. In the event one of these lessors exercises its right of first refusal, we would sell the applicable interest to the lessor on substantially the same terms as set forth in the asset purchase agreement with Edge. Subject to the conditions of Edge's obligations under its asset purchase agreement, described below, including that we have obtained consents to assign interest in wells that have an aggregate allocated value equal to at least 80% of the purchase price, Edge would be obligated to purchase the remainder of the interests. In the event one of these lessors prohibits the assignment of an interest to Edge, Edge would not purchase the applicable interest.

**THE PROPOSED SALE OF THE ASSETS (SEE PAGE 8).** We have agreed to sell our south Texas natural gas and oil interests to Edge Petroleum Exploration Company. Specifically, we will sell all of the interests to Edge for \$50 million, subject to adjustment to reflect, among other items, title defects, environmental remediation costs, and the net proceeds we derive from the interests between July 1, 2004 and the date on which the proposed sale is completed. Assuming the sale is completed on December 31, 2004, we estimate we will have received approximately \$7 million in net revenues for production during the four months of July, August, September, and October. We thus would anticipate receiving approximately \$43 million in pre-tax proceeds, with estimated taxes owed as a result of this sale of approximately \$9 million. We anticipate net proceeds after tax and before debt repayment of approximately \$34 million. We currently anticipate closing this transaction by December 31, 2004. The transaction does not require the parties to obtain any regulatory approval or comply with any federal or state regulatory requirement.

**USE OF PROCEEDS (SEE PAGE 12).** Assuming the sale is completed on December 31, 2004, we will have net after tax and after debt repayment proceeds of approximately \$34 million. Initially, we

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**Table of Contents**

expect to invest these proceeds in short-term U.S. government securities. These funds will provide working capital for ongoing operations and allow us to continue investing in our existing onshore exploration programs and to maintain our 10% limited partnership interest in the Freeport LNG plant, including a possible expansion in the plant's capacity. As a result of our increased liquidity from this sale, we will consider acquiring direct working interests, on a prospect by prospect basis, of between 5% and 20% in offshore Gulf of Mexico prospects being pursued by our two partially owned subsidiaries. While we intend to use the proceeds to fund our offshore and onshore exploration prospects and develop the LNG terminal, we do not yet know the precise prospects and actual expenditures. We will determine the precise prospects and actual expenditures as opportunities arise and we assess the risks and rewards related to each opportunity. We intend to remain an independent natural gas and oil company engaged in the exploration, production, and acquisition of natural gas and oil.

**OUR REASONS FOR THE PROPOSED SALE (SEE PAGE 10).** Our core belief and strategy is that the value creation event in the natural gas and oil exploration industry is the drilling and discovery of natural gas and oil reserves. We, thus, routinely review our assets with the objective of maximizing the exploration opportunities and returns available to us. In Contango's five year history, we have attempted to be opportunistic and have previously both purchased and sold reserves. For instance, in fiscal years 2002 and 2003, we purchased 14.0 Bcfe of our south Texas proved reserves for \$26 million. In fiscal year 2003, we offered our south Texas properties for sale but did not receive any acceptable offers and decided not to pursue the sale. In fiscal year 2004, we sold natural gas and oil assets for approximately \$11 million and used the proceeds to reduce debt and invest in our onshore and offshore exploration programs and in our Freeport LNG plant. We believe Edge has offered us a fair and attractive price from a financial perspective for our properties. We believe our increased liquidity as a result of this sale will enable us to expand our offshore exploration opportunities.

**OUR BOARD OF DIRECTORS' RECOMMENDATION (SEE PAGE 12).** Our Board of Directors believes that the proposed sale is in the best interests of us and our stockholders and unanimously recommends that you vote in favor of the proposed sale.

**THE ASSET PURCHASE AGREEMENT (SEE PAGE 13).** The asset purchase agreement, dated as of October 7, 2004, is attached as Annex A to this proxy statement. We encourage you to read the agreement as it is the legal document that governs the proposed sale.

**CONDITIONS TO THE ASSET PURCHASE AGREEMENT (SEE PAGE 17).** The completion of the proposed sale depends upon meeting a number of conditions, including the following:

Lessor's failure to exercise its right of first refusal with respect to the assets,

Consent of the lessor to assignment of the assets,

Authorization by a majority vote of our stockholders,

There being no material adverse change in the value of the assets, and

The transactions contemplated by the asset purchase agreement not having been abandoned, as described below.

**ABANDONMENT OF THE TRANSACTIONS CONTEMPLATED BY THE ASSET PURCHASE AGREEMENT (SEE PAGE 17).** If net adjustments to the purchase price with respect to title defects and environmental matters exceed \$5 million, either we or Edge may abandon the transactions contemplated by the asset purchase agreement at any time prior to the completion of the sale. In addition, either party may abandon the transactions contemplated by the asset purchase agreement if (1) a court or other governmental authority prohibits the proposed sale, or (2) the closing conditions have not been met and the proposed sale has not been completed on or before the earlier of February 28, 2005 and the date that follows December 31, 2004 by the number of days equal to

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the number of days between the date the SEC notified us that it would review our proxy statement, which was October 18, 2004, and the date the SEC's review process is completed. This date when either party may abandon the transactions if the closing conditions have not been met is the last permitted closing date.

**Table of Contents**

**BREAK-UP FEES (SEE PAGE 17).** If the closing conditions set forth in the asset purchase agreement are satisfied and Edge fails to fulfill its obligations necessary to purchase our assets pursuant to the agreement by the last permitted closing date, then we may terminate the agreement, and Edge will owe us \$2 million. If the closing conditions set forth in the asset purchase agreement are satisfied and we fail to fulfill our obligations necessary to sell our assets pursuant to the agreement by the last permitted closing date or our Board of Directors amends its recommendation of Edge's offer and recommends a superior proposal, then either we or Edge may terminate the agreement, and we will owe Edge \$2 million. If our stockholders fail to approve the proposed sale, we will owe Edge \$1 million.

**ACCOUNTING TREATMENT (SEE PAGE 13).** Under accounting principles generally accepted in the United States of America, upon stockholder approval of the proposed transaction, we expect to reflect the results of operations of the south Texas natural gas and oil interests sold as discontinued operations, including the related gain on the sale, net of any applicable taxes commencing with the quarter during which the proposed sale closes. For further information, see the pro forma financial information.

**UNITED STATES FEDERAL INCOME TAX CONSEQUENCES.** The proposed sale of our south Texas natural gas and oil interests will not result in any United States federal income tax consequences to you. If completed, the proposed sale will, however, be a taxable event to us for United States federal income tax purposes.

**NO APPRAISAL RIGHTS.** Under Delaware law, our stockholders are not entitled to appraisal rights in connection with the proposed sale.

**Table of Contents**

**QUESTIONS AND ANSWERS ABOUT THE PROPOSED SALE**

**Q: WHY ARE WE SELLING OUR NATURAL GAS AND OIL INTERESTS IN THE SOUTH TEXAS PROPERTIES?**

A: Throughout Contango's five year history, we have attempted to be both an opportunistic purchaser and seller of reserves. Natural gas and crude oil prices are currently near their historic highs, and we think this is an opportune time to sell. Edge recently submitted an unsolicited offer to purchase substantially all of our south Texas natural gas and oil interests, and we have accepted Edge's offer, subject to conditions contained in the asset purchase agreement, including the approval of our stockholders. Our Board of Directors believes that the price Edge will pay for the interests is both fair and attractive from a financial point of view.

**Q: WHAT ARE THE EXPECTED PROCEEDS FROM THE SALE?**

A: The effective time of the sale will be July 1, 2004. Assuming the sale is completed on December 31, 2004, we estimate will have received approximately \$7 million in net revenues for production during the four months of July, August, September, and October. We thus would anticipate receiving approximately \$43 million in pre-tax proceeds, with estimated taxes owed as a result of this sale of approximately \$9 million. We anticipate net proceeds after tax and before debt repayment of approximately \$34 million.

**Q: WHAT ARE WE PLANNING TO DO WITH THE NET PROCEEDS FROM THE SALE?**

A: Initially, we expect to invest the proceeds from the sale in short-term U.S. government securities. These funds will provide working capital for ongoing operations and allow us to continue investing in our existing onshore exploration programs and to maintain our 10% limited partnership interest in the Freeport LNG plant, including any expansion in the plant's capacity.

The additional liquidity will give us the ability to consider taking a 5% to 20% working interest position in the offshore Gulf of Mexico exploration opportunities being developed by our two partially owned subsidiaries, Republic Exploration, LLC and Contango Offshore Exploration, LLC. Our offshore Gulf of Mexico prospects are focused on the deep shelf portion of the Gulf of Mexico. The deep shelf refers to the depth of the prospect, which is greater than 15,000 feet, not the depth of the water. Deep shelf prospects are expensive, with dry hole costs in the range of \$10 to \$20 million, and costs can be considerably greater if adverse weather conditions or down hole problems develop. Deep shelf prospects are risky, as 3-D seismic data are not as effective an exploration tool as depth increases below 15,000 feet. Deep shelf discoveries, however, are typically considerably larger than onshore discoveries. We can offer no assurances that any deep shelf prospects in which we invest will be successful.

While we intend to use the proceeds to fund our offshore and onshore exploration prospects and develop the LNG terminal, we do not yet know the precise prospects and actual expenditures. We will determine the precise uses and actual expenditures as opportunities arise and we assess the risks and rewards related to each opportunity. We intend to remain an independent natural gas and oil company engaged in the exploration, production, and acquisition of natural gas and oil.

**Q: WHEN DO YOU EXPECT THE PROPOSED SALE TO BE COMPLETED?**

A: We are working to complete the proposed sale as quickly as practicable. If all necessary approvals, including stockholder approval and third party consents, have been obtained, we hope to complete the sale shortly after the special meeting scheduled for December 29, 2004.

**Q: WHY ARE WE ASKING FOR A STOCKHOLDER VOTE? WHAT VOTE IS REQUIRED?**

A: The proposed sale may constitute the sale of substantially all of our assets under Delaware corporate law. If so, the proposed sale requires authorization by the holders of a majority of our outstanding common stock voting together as a class with holders of our Series C preferred stock, who will vote as if their shares had been converted into shares of common stock. Because it is not clear whether the proposed sale requires stockholder authorization, we are making the sale subject to a stockholder vote to avoid any uncertainty, and



**Table of Contents**

we will not complete the sale unless and until it is authorized by the affirmative vote of holders of a majority of our common stock and Series C preferred stock voting as a single class as described below.

**Q: WHO IS ENTITLED TO VOTE?**

A: Record holders of our capital stock as of November 16, 2004 are entitled to vote at the special meeting.

**Q: HOW MANY SHARES MAY VOTE AT THE SPECIAL MEETING?**

A: Holders of common stock and holders of Series C preferred stock will vote as one class at the special meeting. Each record holder of common stock is entitled to one vote per share of common stock. Each record holder of Series C preferred stock is entitled to one vote for each share of common stock into which each share of Series C preferred stock is convertible. Currently, each holder of Series C preferred stock on the record date is entitled to 833 votes per share of Series C preferred stock owned. As of the record date of November 16, 2004, we had outstanding 13,004,950 shares of common stock and 1,400 shares of Series C preferred stock, which were convertible into 1,166,662 shares of common stock. The total number of shares eligible to vote is thus 14,171,612. The affirmative vote of a majority of these shares is required for approval.

**Q: WHAT WILL HAPPEN IF THE PROPOSED ASSET SALE IS NOT APPROVED?**

A: If our stockholders fail to approve the proposed sale, then either we or Edge may terminate the agreement, and we will owe Edge \$1 million as liquidated damages.

We would continue to invest in our onshore exploration programs and invest as necessary to maintain our 10% limited partnership interest in our Freeport LNG plant. We would have to increase our debt or sell equity to have the liquidity needed to invest in as many or take as large a working interest in Republic Exploration's and Contango Offshore Exploration's prospects if this sale were not to occur.

**Q: WHAT DO I NEED TO DO NOW?**

A: Just complete, sign, and mail your signed proxy card in the enclosed return envelope as soon as possible so that your shares may be represented at the special meeting. The meeting will take place on December 29, 2004. Our Board of Directors unanimously recommends that you vote in favor of the proposed sale.

**Q: CAN I CHANGE MY VOTE AFTER I HAVE MAILED IN MY SIGNED PROXY CARD?**

A: Yes. You can change your vote at any time before we vote your proxy at the special meeting. You can do so in one of three ways. First, you can send a written notice stating that you would like to revoke your proxy to our Secretary at the address given below. Second, you can request a new proxy card and complete and send it to our Secretary at the address given below. Third, you can attend the special meeting and vote in person.

You should send any written notice or request for a new proxy card to the attention of the Secretary, Contango Oil & Gas Company, 3700 Buffalo Speedway, Suite 960, Houston, Texas 77098.

**Q: IF MY SHARES ARE HELD IN STREET NAME BY MY BROKER, WILL MY BROKER VOTE MY SHARES FOR ME?**

A: Your broker will vote your shares only if you provide instructions on how to vote. Following the directions provided by your broker, you should instruct your broker to vote your shares. Without your instructions, your shares will not be voted, which will have the same effect as a vote against the proposed sale.

**Q: WHAT IS THE EFFECT OF AN ABSTENTION OR A BROKER NON-VOTE?**

A: Abstentions and broker non-votes are counted for purposes of determining the presence or absence of a quorum for the transaction of business. A broker non-vote occurs when a nominee holding shares of our common stock for a beneficial owner does not vote on a particular proposal because the nominee does not

**Table of Contents**

have discretionary voting power with respect to that item and has not received instructions from the beneficial owner. Abstentions are counted in tabulations of the votes cast on proposals presented to stockholders as a vote against, whereas broker non-votes are not counted for purposes of determining whether a proposal has been approved.

**Q: HOW WILL WE SOLICIT PROXIES?**

A: Proxies may be solicited in person, by telephone, facsimile, mail or e-mail by our directors, officers and employees without additional compensation. Brokers, nominees, fiduciaries, and other custodians have been requested to forward soliciting material to the beneficial owners of shares of our common stock held of record by them, and we will reimburse such custodians for their reasonable expenses.

**Q: WHO CAN ANSWER FURTHER QUESTIONS?**

A: If you have more questions about the proposed sale, you should contact:

Contango Oil & Gas Company

3700 Buffalo Speedway, Suite 960

Houston, Texas 77098

(713) 960-1901

Attention: Kenneth R. Peak, Chairman and Chief Executive Officer

**Table of Contents**

**CAUTIONARY STATEMENT ABOUT FORWARD-LOOKING STATEMENTS**

Some of the statements made in this proxy statement may contain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, and Section 21E of the Securities Exchange Act of 1934, as amended. The words and phrases should be , will be , believe , expect , anticipate , estimate , forecast , goal , and similar expressions identify forward-looking statements and express our expectations about future events. These include such matters as:

The closing of the proposed asset sale;

Our use of proceeds from the proposed asset sale;

Our financial position;

Business strategy and budgets;

Anticipated capital expenditures;

Drilling of wells;

Natural gas and oil reserves;

Timing and amount of future production of natural gas and oil;

Operating costs and other expenses;

Cash flow and anticipated liquidity;

Prospect development;

Property acquisitions and sales; and

Development and financing of our LNG receiving terminal.

Although we believe the expectations reflected in such forward-looking statements are reasonable, we cannot assure you that such expectations will occur. These forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause our actual results, performance or achievements to be materially different from actual future results expressed or implied by the forward-looking statements. These factors include among others:

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The satisfaction of closing conditions to the asset purchase agreement, including approval of the sale by our stockholders;

Receipt of required third party consents;

Potential adjustments to the purchase price we may receive for the sale of the assets;

Our indemnification obligations to the purchaser of the assets;

Risks associated with our use of the proceeds from the proposed asset sale, including the drilling of dry holes and the attendant higher costs and risks associated with taking a working interest position in deep shelf prospects;

Low and/or declining prices for natural gas and oil;

Natural gas and oil price volatility;

The risks associated with exploration, including cost overruns and the drilling of non-economic wells or dry holes;

Availability of capital and the ability to repay indebtedness when due;

Ability to raise capital to fund capital expenditures;

The ability to find, acquire, market, develop and produce new natural gas and oil properties;

**Table of Contents**

Uncertainties in the estimation of proved reserves and in the projection of future rates of production and timing of development expenditures;

Operating hazards attendant to the natural gas and oil business;

Downhole drilling and completion risks that are generally not recoverable from third parties or insurance;

Potential mechanical failure or under-performance of significant wells or pipeline mishaps;

Weather;

Availability and cost of material and equipment;

Delays in anticipated start-up dates;

Actions or inactions of third-party operators of our properties;

Ability to find and retain skilled personnel;

Strength and financial resources of competitors;

Federal and state regulatory developments and approvals;

Environmental risks;

Worldwide economic conditions;

Operational and financial risks associated with foreign exploration and production;

Ability of LNG to become a competitive energy supply in the United States; and

Ability to fund our LNG project, cost overruns, and third party performance.

You should not unduly rely on these forward-looking statements in this proxy statement, as they speak only as of the date of this proxy statement. Except as required by law, we undertake no obligation to publicly release any revisions to these forward-looking statements to reflect events or circumstances occurring after the date of this proxy statement or to reflect the occurrence of unanticipated events. All references in this proxy statement to we, us, or our are to Contango Oil & Gas Company and its subsidiaries. Unless otherwise noted, all information in this proxy statement relating to natural gas and oil reserves and the estimated future net cash flows attributable to those reserves are based on estimates prepared by independent engineers and are net to our interest.



**Table of Contents**

**RISK FACTORS**

In considering whether to authorize the proposed sale, you should consider, in addition to the other information contained in this document, the following risks:

*The sale of the natural gas and oil interests will reduce revenue and income from operations by approximately 80%.*

The south Texas natural gas and oil interests we are selling constitute 80% of our estimated revenues and 80% of estimated income for our July, August, September and October operations. Following the sale, we will have remaining production of approximately 3.0 MMcfe per day. Based on current prices and production rates, this level of production will result in monthly net production revenues prior to interest, income taxes, depreciation, depletion and amortization, impairment, expenses, exploration expenses, including gains (losses) from hedging activities and sales of assets of \$400,000 to \$500,000 per month, a level believed to be sufficient to pay our on-going cash general and administrative expenses of \$175,000 to \$200,000 per month. Our stockholders will be exposed to the reinvestment risk of the sales proceeds. To the extent we are unsuccessful in our onshore and offshore exploration programs or our Freeport LNG receiving terminal is not successfully developed, your investment in us will suffer.

*There is no plan to distribute any of the proceeds of the asset sale to our stockholders, and exploration drilling involves significant risks.*

We do not intend to distribute any portion of the proceeds from the asset sale to our stockholders. Our intention is to use the net proceeds of the sale to attempt to maximize shareholder value. Initially, the net proceeds will be invested in short-term U.S. government securities. We intend to continue to pursue natural gas and oil exploration, both onshore and offshore. These opportunities involve significant risks. Our future investments may be illiquid and could result in a total loss to us and our stockholders if our exploration efforts prove unsuccessful.

**You should also consider the risk factors set forth in our Form 10-K for the year ended June 30, 2004 that relate to our intended use of proceeds, particularly those regarding the risks involved in natural gas and oil exploration.**



**Table of Contents**

**THE PROPOSED SALE**

**General**

Pursuant to the terms of the asset purchase agreement, we propose to sell to Edge all of our south Texas natural gas and oil interests located in south Texas. The purchase price is \$50 million, subject to adjustment as described below.

**Description of the Assets to be Sold**

We are selling our working and net revenue interests in natural gas and oil leases, wells, equipment, contracts, and seismic rights related to properties located in south Texas. Current net production from the south Texas properties is approximately 11 million cubic feet of natural gas per day and 150 barrels of condensate per day. Total proved producing reserves attributable to the properties as of June 30, 2004 totaled approximately 14.4 Bcf of natural gas and 266,000 barrels of oil. Based on relevant spot prices at June 30, 2004 of \$5.90 per MMBtu for natural gas at the Houston Ship Channel (which equates to a NYMEX price of \$6.16 per MMBtu) and to a NYMEX oil price of \$37.05 per barrel, in each case before adjusting for basis, transportation, and BTU content, the proved producing reserves had a present value of approximately \$54.3 million, assuming a 10% discount rate. The south Texas natural gas and oil interests represent 93% of our proved onshore reserves and 80% of our current estimated production. The interests are held by a limited partnership. Two of our wholly-owned subsidiaries are the sole general partner and sole limited partner of the limited partnership.

On a consolidated basis, revenues attributable to the south Texas natural gas and oil interests equaled 95% of our total revenues and 100% of our operating income as of June 30, 2004. The south Texas natural gas and oil interests constituted approximately 55% of our assets as of June 30, 2004.

Historical financial information is set forth in our consolidated financial statements, which are included in our annual report on Form 10-K for the year ended June 30, 2004.

**Background of the Proposed Sale**

On an ongoing basis our management reviews various alternatives to enhance stockholder value. As part of this process, in late 2002, we began to look at the feasibility of selling our south Texas natural gas and oil interests. We believed that we would receive a better return on our capital by engaging in a more active prospect generation and exploration effort.

In October 2002, we engaged Randall & Dewey Inc. to assist us in conducting a possible sale. Randall & Dewey contacted numerous potential buyers regarding their possible interest in acquiring those interests. In December of 2002, prior to receiving any indications of interest from prospective buyers, we determined that it was in the best interests of our stockholders not to proceed with a proposed sale at that time, and we ended our efforts to sell the south Texas natural gas and oil interests. We anticipated that we would negotiate a purchase price with potential purchasers and did not seek a particular purchase price. Our relationship with Randall & Dewey Inc. ended in 2002, and Randall & Dewey Inc.

has had no involvement with our proposed asset sale to Edge.

In August of 2004, Michael Long, Edge's Chief Financial Officer, and C.W. MacLeod, Edge's Senior Vice President of Business Development and Planning, requested a meeting on August 26, 2004 with Kenneth R. Peak, our Chairman and Chief Financial Officer. Messrs. Long and MacLeod did not state a purpose for the meeting. Mr. Peak knew that Edge was a company engaged in the energy industry and agreed to meet with Edge's officers. At the August 26, 2004 meeting, Messrs. Long and MacLeod indicated Edge's interest in our natural gas and oil properties in south Texas. Mr. Peak stated that Contango was continually reviewing its assets and would be interested in selling its south Texas properties at a price of \$50 million. Mr. Peak arrived at the \$50 million price due to his familiarity as our Chairman and Chief Executive Officer with the daily production from

## **Table of Contents**

our properties, the market for reserves, and the extent of our proved reserves. After the initial meeting, Edge indicated that it would be interested in performing due diligence with respect to our south Texas natural gas and oil interests.

On September 1, 2004 through September 3, 2004, our Board of Directors held its annual retreat. The Board of Directors was not previously aware of Edge's indication of interest in potentially purchasing our south Texas natural gas and oil interests. At the annual retreat, Mr. Peak advised the Board of Directors of his meeting with Edge's officers. The Board of Directors directed Mr. Peak to pursue the potential asset sale, but did not authorize a sale or approve a purchase price. On September 21, 2004, after receiving additional confirmation of Edge's interest, Mr. Peak advised our Board of Directors of Edge's continued interest, and after further discussing the possible consequences of the asset sale, our Board of Directors recommended that Mr. Peak continue to pursue the potential asset sale. Again, the Board of Directors did not authorize a sale or approve a purchase price.

On September 8, 2004, we entered into a confidentiality agreement with Edge. On September 9, 2004 and again on September 14, 2004, senior executives of Edge visited our offices to perform due diligence. On September 23, 2004, Edge's Chief Financial Officer and Senior Vice President advised Mr. Peak that Edge was prepared to offer \$50 million for all of our south Texas natural gas and oil interests, subject to negotiation of definitive documentation and receipt of required third party consents and approvals. Mr. Peak discussed the proposal with each other member of our Board of Directors, and each member encouraged Mr. Peak to negotiate the terms of an asset purchase agreement on our behalf.

Over the course of the next two weeks, we negotiated the terms and conditions of the asset purchase agreement with Edge, including terms relating to purchase price adjustments, representations and warranties, indemnification for breaches of the agreement and related indemnification threshold and liquidated damage amounts. Our Board of Directors unanimously approved the proposed sale on October 6, 2004 and directed our officers to conclude the negotiation of, and execute, a definitive version of the asset purchase agreement. Contango, Edge, and Contango STEP, L.P., our limited partnership that directly owns the assets, executed the definitive asset purchase agreement on October 7, 2004.

The Board of Directors relied in part on a reserve report prepared by independent third-party reservoir engineers. The reserve report was prepared to enable us to present the estimated value of our reserves to our stockholders in our annual report. The report was not prepared in anticipation of the proposed sale. A summary of the reserve report is set forth on pages 11 and 12 of this proxy statement. The engineers prepared the report during August of 2004 and delivered the report to us on September 10, 2004. The engineers were aware that we had considered selling our south Texas natural gas and oil interests in 2002 but were not aware that we were considering the sale of the interests in 2004.

## **Reasons for the Proposed Sale**

In reaching its decision to recommend and approve the proposed sale and the asset purchase agreement, our Board of Directors considered the following material factors:

Our strategy for maximizing stockholder value is based on our core belief that the value creation event in our industry is the drilling of successful exploration wells. The increased liquidity and financial flexibility provided by this sale will allow us to drill more exploration wells.

Natural gas and crude oil prices are currently near their historic highs, and we think this is an opportune time to sell.

In the last several years, we have invested approximately \$20 million in offshore Gulf of Mexico 3-D seismic data, a sophisticated 3-D seismic reprocessing center, and 42 offshore leases through our two partially owned subsidiaries, Republic Exploration, LLC and Contango Offshore Exploration, LLC. Through Republic Exploration and Contango Offshore Exploration, we now own 3-D seismic data in over 4,000 blocks and 42 leases. Our strategy to date has been to farm-out our prospects to others and

## **Table of Contents**

keep an overriding royalty interest or carried back-in working interest. As a result of our increased liquidity, we intend to consider investing, on a prospect by prospect basis, a 5% to 20% working interest position in our deep shelf offshore prospects. Deep shelf prospects are risky and expensive, but typically have potential for greater reserves and production than the onshore prospects available to us.

Based on a reserve report prepared by our independent third-party reservoir engineers, as summarized immediately below, our south Texas natural gas and oil interests, using relevant spot prices at June 30, 2004 of \$5.90 per MMBtu for natural gas at the Houston Ship Channel (which equates to a NYMEX price of \$6.16 per MMBtu) and to a NYMEX oil price of \$37.05 per barrel, in each case before adjusting for basis, transportation, and BTU content, the proved producing reserves had a present value of approximately \$54.3 million, assuming a 10% discount rate. Our reserves are 90% natural gas. Natural gas prices are both cyclical and volatile, and we believe this is an attractive price.

The consideration to be paid by Edge consists entirely of cash.

The asset purchase agreement does not contain a financing condition and, accordingly, we are not assuming the risk that Edge will be unable to obtain financing.

Other terms of the asset purchase agreement, which is the product of extensive arm's-length negotiations are believed to be reasonable and commercially attractive.

Its determination that the consideration to be received for the south Texas natural gas and oil interests is fair based on an assessment of our business and financial results.

The risk and uncertainty associated with our south Texas natural gas and oil interests being concentrated in one area.

Our south Texas properties included in the proposed sale constitute the bulk of the collateral used to secure our existing bank line, which recently was reviewed and approved at \$21 million. The amount of borrowings under the existing line is limited to a hydrocarbon borrowing base. The revolving line of credit currently available to us declines at approximately \$600,000 per month and at December 1, 2004 is projected to be \$19.8 million. After completion of the proposed transaction, we will have sold almost all of our hydrocarbon assets used to collateralize our bank revolver, and our remaining bank credit line, if any, will be less than \$2 million.

We will pay federal income taxes as a result of this sale. The increased liquidity provided by this sale, however, gives us the ability to acquire 5% to 20% working interests in available Gulf of Mexico prospects. Drilling these prospects can provide us with significant intangible drilling costs (IDC), which are immediately deductible for income tax purposes.

Our Board of Directors did not find it practical to and did not quantify or attempt to attach relative weight to any of the specific factors considered by it. Our Board of Directors, however, did find that the positive factors listed above outweighed the potential risks of the proposed sale and found the opportunity to generate increased stockholder value through completion of the proposed sale compelling from a financial perspective. Notwithstanding expectations of our management regarding the benefits to be realized from the proposed sale, no assurance can be given that we will be able to realize such benefits.

## **Summary of Reserve Report**

## Edgar Filing: CONTANGO OIL & GAS CO - Form DEFM14A

In recommending the proposed sale, our Board of Directors considered a report prepared by the engineering firm W.D. Von Gonten & Co. The report assesses our proved reserves and future net revenue as of July 1, 2004. The report was prepared as an independent assessment to enable us to present the estimated value of our reserves to our stockholders in our annual report for the year ended June 30, 2004. The report was not prepared in anticipation of the sale of our south Texas natural gas and oil interests and does not assess the fairness of the consideration we may receive for the interests in the proposed asset sale. W.D. Von Gonten & Co. has prepared annual and quarterly reports for us regarding our proved reserves and future net revenue since 2000, and the reserve report our Board of Directors considered was the most recent reserve report available.

**Table of Contents**

W.D. Von Gonten & Co. is composed of experienced engineers familiar with reserves located in south Texas. We selected W.D. Von Gonten & Co. to prepare our reserve reports because of its expertise and our satisfaction with its prior services. From time to time, we have also engaged the firm to prepare evaluations of selected properties that we have considered purchasing. During the past two years, we have paid approximately \$103,000 to the firm as consideration for annual and quarterly reserve reports. During the past two years, we have paid approximately \$37,000 to the firm for evaluations of certain properties included in other unrelated projects. We intend to obtain future reports and evaluations from W.D. Von Gonten & Co.

In preparing the reserve report our Board of Directors considered, W.D. Von Gonten & Co. projected production rates and timing of development expenditures and analyzed available geological, geophysical, production and engineering data. Estimates of natural gas and oil reserves are inherently imprecise. The process requires various assumptions, including natural gas and oil prices, drilling and operating expenses, capital expenditures, taxes, and availability of funds. Actual future production, natural gas and oil prices, revenues, taxes, development expenditures, operating expenses and quantities of recoverable natural gas and oil reserves most likely will vary from estimates. Any significant variance could materially affect the estimated quantities and net present value of reserves. Because the reserve estimate was not based on a lengthy production history and was calculated using volumetric analysis, estimates are less reliable than estimates based on a lengthy production history. As we have each quarter for the past four years, we instructed W.D. Von Gonten & Co. to generate a report of our reserves to enable us to present the estimated value of our reserves. We did not limit the scope of or vary our instructions for the report our Board of Directors used to evaluate the proposed sale.

The W.D. Von Gonten & Co. reserve report concluded that our estimated net proved natural gas and oil reserves and the pre-tax net present value of our reserves at June 30, 2004, was as set forth in the following table. The pre-tax present value is not intended to represent the current market value of the estimated natural gas and oil reserves we own. The pre-tax net present value of future cash flows attributable to our proved reserves prepared in accordance with SEC guidelines as of June 30, 2004 was based on \$5.90 per MMBtu for natural gas at the Houston Ship Channel (which equated to a NYMEX price of \$6.16 per MMBtu) and to a NYMEX oil price of \$37.05 per barrel of oil, in each case before adjusting for basis, transportation costs and Btu content. For further information concerning the present value of future net cash flows from these proved reserves, see the discussion titled "Supplemental Oil and Gas Disclosures" in our Form 10-K for the year ended June 30, 2004.

	Total Proved Reserves as of June 30, 2004			Total
	Producing	Behind Pipe	Undeveloped	
Natural Gas (MMcf)	15,543	91		15,634
Oil and condensate (MBbls)	295	2		297
Total proved reserves (MMcfe)	17,313	103		17,416
Pre-tax net present value (\$000)	\$ 59,537	\$ 230	\$	\$ 59,767

**Recommendation of Our Board of Directors**

At a special meeting held on October 6, 2004 to consider the asset purchase agreement, our Board of Directors unanimously approved the proposed sale as being in the best interests of us and our stockholders. FOR THE REASONS DISCUSSED ABOVE, OUR BOARD OF DIRECTORS UNANIMOUSLY RECOMMENDS THAT OUR STOCKHOLDERS VOTE FOR THE PROPOSED SALE.

**Use of Proceeds**

## Edgar Filing: CONTANGO OIL & GAS CO - Form DEFM14A

*Background.* Natural gas and oil prices have been exceptionally strong over the past year. While oil prices are expected to continue to remain strong, they will also likely remain volatile, with large swings due to supply tightness stemming from strong world demand combined with political unrest in major crude producing regions. Natural gas prices will likely be subject to wide swings due to weather, growing demand and the industry's overall difficulty in replacing and growing reserves and production. In the current macro-industry environment, we believe this is an excellent time to harvest our existing cash flow and direct the proceeds into drilling an



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**Table of Contents**

increased number of wells in which we have exposure in the offshore Gulf of Mexico. While we have ample borrowing capacity under our bank line, we do not think it is prudent to drill deep shelf exploration wells with increased debt. The price we expect to receive for substantially all of our interests in natural gas and oil properties in south Texas is considered fair from a financial perspective.

Assuming our sale is completed on December 31, 2004, we anticipate net after tax and before debt repayment proceeds of approximately \$34 million. Initially, we expect to invest these proceeds in short-term U.S. government securities. These funds will provide working capital for ongoing operations and allow us to continue investing in our existing onshore exploration programs and to maintain our 10% limited partnership interest in the Freeport LNG plant, including any possible expansion in the plant's capacity. As a result of our increased liquidity from this sale, we will consider acquiring direct working interests, on a prospect by prospect basis, of between 5% and 20% in Republic Exploration's and Contango Offshore Exploration's Gulf of Mexico prospects. While we intend to use the proceeds to fund our offshore and onshore exploration prospects and develop the LNG terminal, we do not yet know the precise prospects and actual expenditures. We will determine the precise uses and actual expenditures as opportunities arise and we assess the risks and rewards related to each opportunity. We intend to remain an independent natural gas and oil company engaged in the exploration, production, and acquisition of natural gas and oil.

*Onshore Exploration Efforts.* We expect to use the proceeds from the proposed sale of our south Texas natural gas and oil interests to continue to fund our onshore exploration efforts. Our onshore exploration efforts are primarily conducted through our three onshore alliance partners. We and one of our partners completed a 3-D seismic shoot covering approximately 40 square miles in southern Duval County, Texas. The shoot identified two prospects, both of which commenced production in September of 2004. We expect to drill two additional shallow prospects in December of 2004 at the latest. We recently participated in an unsuccessful exploratory Queen City well in Jim Hogg County, Texas. Our 45% share of the dry hole cost is estimated at \$400,000. In addition, we have agreed to participate in an exploratory well in Bandera County, Texas. We expect to drill this prospect by July of 2005. Our 50% share of the dry hole cost is estimated at \$600,000. In February of 2004, we agreed to explore prospects with another alliance partner. The alliance partner identified eight prospect areas, and has successfully drilled an 11,400-foot Wilcox test in one prospect area in Zapata County, Texas. We have a 14% net revenue interest in this well. Another Wilcox test is planned for a second prospect area in Zapata County next year. Our 18.8% share of the dry hole cost is estimated at approximately \$800,000. In September of 2004, we entered into an agreement with another alliance partner to generate prospects in Jim Hogg County using available 3-D seismic data. We have agreed to reimburse the partner \$100,000 for geological and geophysical costs. If drillable prospects are identified, we will pay all of the prospect leasehold costs and carry the partner on a portion of the drilling costs on a specified number of wells.

*Offshore Exploration Efforts.* We conduct our exploration activities in the Gulf of Mexico directly and through affiliated companies. We and our affiliates have interests in 42 offshore leases. We own interests in two limited liability companies formed to generate exploration opportunities in the Gulf of Mexico. These companies have collectively licensed approximately 4,000 blocks of this 3-D seismic data and have focused on using 3-D seismic data reprocessed in our reprocessing center to identify prospects, acquire leases at federal and state lease sales, and then sell the prospects to third parties, subject to timed drilling obligations plus retained reversionary interests in our favor. Our increased liquidity will give us the financial flexibility on a prospect by prospect basis to consider acquiring a direct 5% to 20% working interest under the same arms-length terms available to industry partners.

*Development of an LNG terminal.* One potential use of proceeds is to maintain our 10% limited partnership interest in the limited partnership formed to develop a 1.5 billion cubic feet per day LNG receiving terminal in Freeport, Texas. We invested \$2.3 million to acquire our 10% limited partnership interest, and we expect the LNG terminal to commence commercial operations as early as 2007. Dow Chemical Company has entered into agreements providing for Dow's potential long-term use of the LNG terminal and Dow's firm commitment for the use of 500 million cubic feet per day of regasification capacity. In June of 2004, the Federal Energy Regulatory Commission issued an order authorizing the limited partnership to site, construct, and operate the

## **Table of Contents**

LNG terminal, and in September of 2004, FERC extended the time the limited partnership has to place the LNG terminal into service until 2009. In July of 2004, ConocoPhillips entered into agreements providing for the construction and use of the LNG receiving terminal. ConocoPhillips acquired 1.0 billion cubic feet per day of regasification capacity, purchased a 50% interest in the general partner of the limited partnership, and agreed to provide substantial construction funding. The limited partnership and ConocoPhillips are negotiating the engineering, procurement, and construction contract for the LNG terminal. The current management of Freeport LNG will remain in place and will oversee the commercial activities of the partnership, while ConocoPhillips will manage the construction of the facility and oversee its operations. Although we believe that ConocoPhillips will provide a majority of the construction financing, we anticipate that we will, from time-to-time, be required to provide funds to the project. Moreover, if the plant's capacity were to be expanded beyond its current anticipated 1.5 Bcf per day, we would likely be required to provide our pro rata 10% equity participation to help secure the funds required for expanding the plant's capacity. We intend to use, as necessary to satisfy our potential capital contribution obligations as a limited partner, a portion of the proceeds from the sale of the south Texas natural gas and oil interests to provide funds for developing the Freeport LNG plant and any potential expansion of its capacity.

## **Accounting Treatment for the Proposed Sale**

Under accounting principles generally accepted in the United States of America, upon stockholder approval of the proposed sale, we expect to reflect the results of operations of the south Texas natural gas and oil interests sold as discontinued operations, including the related gain on the sale, net of any applicable taxes commencing with the quarter during which the proposed sale closes. For further information, see the pro forma financial information.

**Table of Contents**

**TERMS OF THE ASSET PURCHASE AGREEMENT**

The following discussion of the terms and conditions of the asset purchase agreement, while materially complete, is qualified in its entirety by reference to the provisions of the asset purchase agreement, which is attached to this proxy statement as Annex A and incorporated by reference in this proxy statement.

**Purchase Price and Adjustments**

The base purchase price for our south Texas natural gas and oil interests is \$50 million in cash, subject to adjustment. The base purchase price will be adjusted to account for revenue attribution, title defects, third-party consents, and environmental matters. The adjustments to the purchase price are not limited by a collar or any other limitation.

*Adjustments due to revenue attribution.* Although the asset purchase agreement is dated as of October 7, 2004, the effective time of the sale is July 1, 2004. Accordingly, the purchase price will be increased by certain taxes, assessments, and expenses, if any, related to the purchased assets that we pay but are attributable to the period subsequent to July 1, 2004. Similarly, the purchase price will be decreased by certain unpaid taxes, assessments, and expenses related to the purchased assets that are attributable to the period prior to July 1, 2004. Purchase price adjustments with respect to revenues may occur in two stages. We and Edge will jointly prepare an initial closing statement reflecting any net revenue produced from the assets we received after July 1, 2004 and up to a date as close as reasonably practicable to the anticipated closing date. Both parties will then have 30 days to agree to the initial closing statement. If we and Edge fail to agree, both parties will seek to agree pending a final closing statement. Depending on the agreement, the purchase price may be increased or decreased. Within 90 days after the closing, we and Edge will jointly prepare a final closing statement. The final closing statement will reflect any net revenue produced after the date of the initial closing statement from the assets Edge receives that is attributable to the operation of the assets after the date of the initial closing statement. Both parties will then have 30 days to agree to the final closing statement. If we and Edge fail to agree, both parties will submit to binding arbitration. Depending on the agreement or the outcome of the arbitration, the purchase price may be adjusted again.

*Adjustments due to title defects.* Our title to the south Texas natural gas and oil interests we sell to Edge is presumed to be defensible. If Edge notifies us that our title is defective prior to the closing of the asset sale, we may be required to reduce the purchase price, indemnify Edge against the title defect, or retain the applicable well or lease. Defensible title means that our title in and to each lease and well, subject to permitted encumbrances (1) entitles us to receive not less than the net revenue interest for the hydrocarbons and proceeds thereof produced from each well, (2) obligates us to bear costs and expenses relating to the maintenance, development, operation and production of hydrocarbons from each well, in an amount not greater than the working interest for each well, and (3) is free and clear of encumbrances, liens and defects that materially impair the use of or constitute a loss of interest in the well and the lease. Our title is presumed defensible unless Edge submits a title defect notice. A title defect notice would state that our interest is subject to a lien, encumbrance (other than a permitted encumbrance), or objection that would constitute a material loss of interest in the respective property. The asset purchase agreement attached hereto defines permitted encumbrances and excludes certain defects from constituting title defects. Together with Edge, we have allocated values to each well included in the purchased assets, and together with Edge, we will determine the value of each title defect. Once we receive timely notice of a title defect from Edge prior to the closing, we will have several options. We may cure the title defect prior to closing, indemnify Edge for all liabilities and obligations associated with the title defect until cured, or contest the title defect or the value of the title defect. We may also sell the respective interest to Edge but reduce the purchase price by the agreed-upon value of the title defect and no longer be liable for the title defect; however, we will not be required to adjust the purchase price unless the aggregate value of all title defects equals or exceeds \$1 million, and our liabilities will be the sum of the aggregate value of all title defects in excess of \$500,000. Or, if the value of the title defect exceeds 10% of the respective well's allocated value, we also have the option not to sell the interest in the well to Buyer, which would reduce the purchase price by the allocated value of the interest in the well. In this case, we may elect to cure the title defect and convey the



**Table of Contents**

interest to Edge before the date of the final closing statement and increase the purchase price, or we may elect to convey the well with the title defect before the date of the final closing statement and indemnify Edge for the title defect.

*Adjustments due to third-party consents.* A portion of our natural gas and oil interests are subject to transfer restrictions. Third-parties have rights to prohibit the assignment of our interests unless we obtain their consent. Other parties may have preferential rights to purchase our interests that would supersede Edge's rights pursuant to the asset purchase agreement. We have agreed to use our reasonable efforts to obtain third-party consents and provide required notices with respect to preferential purchase rights before and after closing. If Edge identifies a contractually-required third-party consent that has not been obtained prior to closing, Edge may either (1) purchase the applicable interest and require us to indemnify Edge against any loss due to the failure to obtain the required consent, or (2) exclude the interest affected by the required consent from the assets to be purchased at closing and reduce the purchase price accordingly. If we obtain the required consent by the date of the final closing statement, we will convey the interest affected by the required consent to Edge and increase the purchase price accordingly. If a third-party exercises its right to purchase one of the interests to be transferred to Edge or such a right remains exercisable at the closing, then the affected interest will be excluded from the assets to be purchased and the purchase price will be reduced accordingly. If (1) the third-party exercises its preferential right to purchase but fails to consummate the transaction before the date of the final closing statement, (2) the holder's option to exercise a preferential right expires after closing but before the date of the final closing statement, or (3) the holder has waived the preferential right after the closing but before the date of the final closing statement, we will convey that portion of the affected interest to Edge, and Edge will, on the date of the final closing statement, pay us the amount by which the purchase price was previously reduced with respect to the affected interest. If any other preferential right to purchase that is identified after closing is subsequently exercised, Edge has agreed to convey the affected interest to the third-party and will receive all consideration related thereto.

Other than as described below, all of the lessors have waived their rights of first refusal with respect to the sale to Edge and consented to the assignment of the interests to Edge, to the extent they hold such rights. Six lessors of interests having an aggregate allocated value of approximately \$25 million hold rights to prohibit assignment of such interests and have not yet consented to assignment of the interests to Edge. Two lessors of interests having an aggregate allocated value of approximately \$900,000 hold rights of first refusal and rights to prohibit assignment of such interests and have not yet consented to the sale and assignment of such interests of Edge. We have notified these eight lessors of the pending sale, and we anticipate that we will obtain waivers and consents from these lessors. In the event one of these lessors exercises its right of first refusal, we would sell the applicable interest to the lessor on substantially the same terms as set forth in the asset purchase agreement with Edge. Subject to the conditions of Edge's obligations under its asset purchase agreement, described below, including that we have obtained consents to assign interest in wells that have an aggregate allocated value equal to at least 80% of the purchase price, Edge would be obligated to purchase the remainder of the interests. In the event one of these lessors prohibited the assignment of an interest to Edge, Edge would not purchase the applicable interest.

*Adjustments due to environmental matters.* We have agreed with Edge to apportion environmental liabilities related to the assets. Upon closing, Edge will indemnify us against liabilities relating to environmental liabilities, except for liabilities relating to the remediation of environmental defects Edge has notified us of prior to closing. We will indemnify Edge for such remediation obligations, except for claims relating to the remediation obligations arising out of events occurring after July 1, 2004 that are within Edge's control or that are attributable to the acts of Edge or its contractors. We have agreed to use our reasonable efforts to obtain consents from third parties to allow Edge to conduct initial environmental assessments on the south Texas properties. If Edge notifies us no later than 10 days prior to the closing of the asset sale that (1) a condition exists that causes a well or the lands covered by a lease or upon which a well is situated to be in violation of an environmental law and (2) the condition existed prior to July 1, 2004, then we may be required to reduce the purchase price, remediate the environmental condition, or retain the applicable well or lease. If Edge provides us with valid notice of an environmental condition, we may elect to remediate the environmental condition at our expense within 90 days after the closing, in which case we will no longer be required to indemnify Edge for costs related to the environmental condition. Alternatively, we may contest the existence of the environmental condition or the

## **Table of Contents**

allocated value Edge estimates as the cost of remediating the environmental condition. We may also reduce the purchase price by the value Edge estimates as the costs of remediating the environmental condition; however, we will not be required to adjust the purchase price unless the aggregate value of all estimated remediation costs equals or exceeds \$1 million, and our liabilities will be the sum of the aggregate value of all estimated remediation costs in excess of \$500,000. Or, if the cost of remediating the environmental condition exceeds 10% of the respective interest's allocated value, we also have the option to not sell the interest in the well to Edge, which would reduce the purchase price by the allocated value of the interest in the well.

## **The Closing**

The terms of the asset purchase agreement provide that the sale and purchase of the assets will occur on a date agreeable to both us and Edge on or prior to the earlier of February 28, 2005 and the date that follows December 31, 2004 by the number of days equal to the number of days between the date the SEC notified us that it would review our proxy statement, which was October 18, 2004, and the date the SEC's review process is completed.

## **Representations and Warranties**

The asset purchase agreement contains various representations and warranties by us, Edge, and Edge's parent corporation. These include representations and warranties by us as to (1) our organization and good standing, (2) proper authority, (3) title to the assets, (4) requisite approvals, (5) no conflicts or violations, (6) material litigation, (7) brokers, finders and fees, (8) contracts and leases, (9) environmental matters, (10) compliance with laws, (11) oil and gas agreements, (12) gas balances and related contracts, (13) payout balances, (14) transactions with related parties, and (15) our status as a non-operator with respect to the assets.

The asset purchase agreement also contains representations and warranties of Edge and Edge's parent corporation, including representations and warranties as to: (1) their organization and good standing, (2) proper corporate authority, (3) no conflicts or violations, (4) requisite approvals, (5) brokers, finders and fees, and (6) knowledge of the natural gas and oil business and investment intent.

For a description of the survivability of the representations and warranties and related indemnification, see [Indemnification; Survival of Indemnification Obligations](#) beginning on page 17.

## **Covenants**

The asset purchase agreement contains various covenants. During the period from the date of the asset purchase agreement to the closing date, we agree to maintain the assets, pay costs and expenses related to the operation of the assets, notify Edge of certain actions we take and expenses we incur with respect to the assets, and generally conduct our business and operations with respect to the assets in the ordinary course. We also agree to (1) not alter existing marketing contracts or enter into certain types of new marketing contracts, (2) provide financial statements and reserve information to Edge, and (3) request comfort letters from our accountants and independent reserve engineers to Edge in connection with filings Edge may make with the SEC, and (4) allow Edge and its representatives to perform additional due diligence with respect to the assets. We also agree to convene the special meeting of stockholders described in this proxy statement for the purpose of obtaining stockholder authorization of the proposed sale.

**No Solicitation**

In the asset purchase agreement, we and our affiliates agree not to pursue, solicit, or enter into any sale, trade, exchange, joint venture, lease, farmout, or similar transaction prior to closing, involving the assets that are subject to the asset purchase agreement, including any sale, merger, or business combination involving the partnership interests of our wholly-owned limited partnership that directly owns the assets. Our Board of Directors, however, may consider an unsolicited proposal involving such assets and/or the partnership interests of

## **Table of Contents**

our wholly-owned limited partnership owning such assets. Our Board of Directors may determine that the new proposal is superior to Edge's and, after providing notice to Edge, change its recommendation regarding Edge's proposal and instead recommend the unsolicited proposal. Our Board of Directors may only do so if, in its good faith opinion and after consultation with legal counsel and analysis of any counteroffer by Edge, our Board of Directors concludes that its failure to do so could be reasonably likely to be inconsistent with its fiduciary obligations to you.

## **Closing Conditions**

The respective obligations of each party to effect the purchase and sale of the assets are subject to the satisfaction or waiver at or prior to the closing date of various conditions, including the following: (1) we have obtained waivers from third-parties regarding preferential rights to purchase interests in wells that have an aggregate allocated value equal to 80% of the purchase price, or such parties have failed to exercise their preferential purchase rights, (2) we have obtained consents to assign interests in wells that have an aggregate allocated value equal to 80% of the purchase price, or such consents are not applicable, (3) we have performed our covenants and obligations and our representations and warranties are true and correct, (4) no material adverse change has occurred that causes the value of our interests in a well or group of wells to be reduced by more than \$500,000 and we are unable or unwilling to compensate Edge for such reduction, (5) Edge has performed its covenants and obligations and its representations and warranties are true and correct, and (6) our stockholders have authorized the proposed sale.

## **Abandonment**

By providing notice to the other party no later than three business days prior to the closing date, either we or Edge may abandon the transactions contemplated by the asset purchase agreement at any time prior to the completion of the sale, if net adjustments to the purchase price with respect to title defects and environmental matters exceed \$5 million. In addition, either party may abandon the transactions contemplated by the asset purchase agreement if (1) a court or other governmental authority prohibits the proposed sale, or (2) the closing conditions have not been met and the proposed sale has not been completed on or before the earlier of February 28, 2005 and the date that follows December 31, 2004 by the number of days equal to the number of days between October 18, 2004 and the date we file a definitive proxy statement. This date when either party may abandon the transactions if the closing conditions have not been met is the last permitted closing date.

## **Break-Up Fees**

If the closing conditions set forth in the asset purchase agreement are met or waived and Edge fails to fulfill its obligations necessary to purchase our assets pursuant to the agreement by the last permitted closing date, then we may terminate the agreement, and Edge will owe us \$2 million. If the closing conditions set forth in the asset purchase agreement are met or waived and we fail to fulfill our obligations necessary to sell our assets pursuant to the agreement by the last permitted closing date, or our Board of Directors amends its recommendation of Edge's offer or we enter into an agreement to consummate a transaction we consider superior to the proposed asset sale to Edge, then either we or Edge may terminate the agreement, and we will owe Edge \$2 million. If our stockholders fail to approve the proposed sale, we will owe Edge \$1 million. The payments would be due within five business days of termination and would constitute liquidated damages.

## **Indemnification; Survival Of Indemnification Obligations**

After closing the proposed sale, we have agreed to indemnify, defend and save Edge and its affiliates harmless from and against losses and liabilities incurred by Edge and its affiliates arising out of any misrepresentation or breach of representations and warranties by us; our failure to



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perform any of our covenants or obligations; certain liabilities and obligations related to the purchased assets attributable to events occurring prior to July 1, 2004; and certain obligations related to title defects, failure to obtain third-party consents, and environmental remediation matters. Except with respect to losses relating to title defects, failure to obtain

**Table of Contents**

third-party consents, and environmental remediation matters, we will not have to reimburse Edge for losses unless the aggregate amount of such losses exceeds \$500,000 and, in that event, our total aggregate reimbursement is limited to \$25 million.

Edge and Edge's parent corporation have agreed to indemnify, defend and save us and our affiliates harmless from and against losses we incur because of any misrepresentation or breach of representations and warranties by Edge or its parent, any failure by Edge or its parent to perform their covenants and obligations, liabilities and obligations related to the purchased assets and attributable to events occurring subsequent to July 1, 2004.

Our indemnification obligations will survive for twelve months after the closing date except that our indemnification obligations relating to losses in connection with title defects, failure to obtain third-party consents, and environmental remediation matters will survive indefinitely. The parties agree that no claims or causes of action may be brought against either party based upon, directly or indirectly, any of the representations, warranties or agreements contained in the asset purchase agreement after the applicable survival period or, except as otherwise provided in the agreement.

**Fees And Expenses**

Whether or not the proposed sale is completed, all costs and expenses incurred in connection with the asset purchase agreement and the consummation of the transactions contemplated by the agreement will be paid by the party incurring those expenses, except as specifically provided in the asset purchase agreement.

**Table of Contents****MARKET PRICE DATA; DIVIDENDS**

Our common stock is listed on the American Stock Exchange under the symbol MCF . The table below sets forth, for the calendar periods indicated, the high and low closing prices per share of our common stock.

	<u>High</u>	<u>Low</u>
Quarter ended September 30, 2004	\$ 7.27	\$ 6.05
Fiscal year ended June 30, 2004:		
Quarter ended June 30, 2004	\$ 7.82	\$ 5.45
Quarter ended March 31, 2004	\$ 8.48	\$ 6.42
Quarter ended December 31, 2003	\$ 7.03	\$ 4.03
Quarter ended September 30, 2003	\$ 4.59	\$ 3.88
Fiscal year ended June 30, 2003:		
Quarter ended June 30, 2003	\$ 4.10	\$ 2.86
Quarter ended March 31, 2003	\$ 3.44	\$ 2.80
Quarter ended December 31, 2002	\$ 3.39	\$ 2.56
Quarter ended September 30, 2002	\$ 3.39	\$ 2.59

On October 6, 2004, the last full trading day before the public announcement of the proposed sale, the high sales price per share of our common stock, as quoted by the AMEX, was \$6.94 and the low sales price per share was \$6.80.

The closing sales price for the shares of our common stock as reported by the AMEX on December 3, 2004 (the latest practicable date prior to mailing this proxy statement) was \$7.70. As of the close of business on the record date, there were approximately 133 holders of record of our common stock.

We have not paid cash dividends on our common stock. We currently intend to retain our earnings and do not anticipate paying any cash dividends in the foreseeable future.

**Table of Contents****SELECTED CONSOLIDATED HISTORICAL AND PRO FORMA FINANCIAL DATA**

We are providing the following financial data to aid you in your analysis of the financial aspects of the proposed sale. With the exception of the pro forma data as of June 30, 2004, we derived the information from our historical consolidated financial statements. Our consolidated financial statements have been audited by Grant Thornton LLP, independent auditors, and are included in our annual report on Form 10-K for the year ended June 30, 2004.

The selected pro forma data are derived from the unaudited pro forma consolidated financial statements and accompanying notes appearing elsewhere in this proxy statement. The selected financial data should be read in conjunction with the accompanying notes appearing elsewhere in this proxy statement and with our consolidated financial statements and accompanying notes and the information contained in Management's Discussion and Analysis of Financial Condition and Results of Operations contained in our annual report on Form 10-K for the year ended June 30, 2004.

**Selected Historical Financial Data**

	Year Ended June 30,				
	2004	2003	2002	2001	2000 (1)
(Dollar amounts in 000s, except per share amounts)					
<b>Financial Data:</b>					
Revenues:					
Natural gas and oil sales	\$ 27,630	\$ 33,919	\$ 23,902	\$ 24,549	\$ 298
Gain (loss) from hedging activities	58	(5,709)	5,016	(558)	
<b>Total revenues</b>	<b>\$ 27,688</b>	<b>\$ 28,210</b>	<b>\$ 28,918</b>	<b>\$ 23,991</b>	<b>\$ 298</b>
Net income (loss)	\$ 7,700	\$ (4,336)	\$ 6,577	\$ 7,737	\$ (1,847)
Preferred stock dividends	620	600	600	475	
<b>Net income (loss) attributable to common stock</b>	<b>\$ 7,080</b>	<b>\$ (4,936)</b>	<b>\$ 5,977</b>	<b>\$ 7,262</b>	<b>\$ (1,847)</b>
Net income (loss) per share:					
Basic	\$ 0.68	\$ (0.54)	\$ 0.55	\$ 0.64	\$ (0.37)
Diluted	\$ 0.58	\$ (0.54)	\$ 0.48	\$ 0.54	\$ (0.37)
Weighted average shares outstanding:					
Basic	10,484	9,129	10,842	11,287	4,954
Diluted	13,280	9,129	13,712	14,381	4,954
<b>EBITDAX (2)</b>	<b>\$ 28,986</b>	<b>\$ 20,901</b>	<b>\$ 22,486</b>	<b>\$ 19,002</b>	<b>\$ (481)</b>
Working capital (deficit)	\$ 3,356	\$ (1,676)	\$ 3,928	\$ 4,782	\$ 4,930
Capital expenditures	\$ 12,384	\$ 22,769	\$ 31,651	\$ 22,769	\$ 2,957
Long term debt	\$ 7,089	\$ 16,460	\$ 17,620	\$	\$
Stockholders' equity	\$ 36,117	\$ 20,738	\$ 25,098	\$ 25,020	\$ 6,405
Total assets	\$ 45,511	\$ 46,305	\$ 51,840	\$ 31,722	\$ 6,643



**Table of Contents**

	Year Ended June 30,				
	2004	2003	2002	2001	2000
<b>Production Data:</b>					
Natural gas (million cubic feet)	4,329	6,016	6,982	3,570	28
Oil and condensate (thousand barrels)	99	139	186	122	6
Total (million cubic feet equivalent)	4,923	6,850	8,098	4,302	64
Natural gas (thousand cubic feet per day)	11,827	16,483	19,129	9,781	77
Oil and condensate (barrels per day)	272	380	510	335	17
Total (thousand cubic feet equivalent per day)	13,459	18,763	22,189	11,791	179
Average sales price:					
Natural gas (per thousand cubic feet)	\$ 5.65	\$ 5.00	\$ 2.94	\$ 5.92	\$ 4.16
Oil and condensate (per barrel)	\$ 31.99	\$ 27.90	\$ 21.44	\$ 27.95	\$ 28.43
Selected data per Mcfe:					
Production and severance taxes	\$ 0.16	\$ 0.35	\$ 0.20	\$ 0.39	\$ 0.12
Lease operating expenses	\$ 0.63	\$ 0.48	\$ 0.28	\$ 0.22	\$ 1.16
General and administrative expenses	\$ 0.55	\$ 0.30	\$ 0.36	\$ 0.55	\$ 11.50
Depreciation, depletion and amortization of natural gas and oil properties	\$ 1.39	\$ 1.24	\$ 1.05	\$ 0.92	\$ 5.15
Proved Reserve Data:					
Total proved reserves (Mmcf)	17,422	23,592	27,939	18,144	4
Pre-tax net present value (SEC at 10%)	\$ 59,767	\$ 69,627	\$ 53,349	\$ 42,626	\$ 12,260

- (1) We commenced natural gas and oil operations in July 1999.
- (2) EBITDAX represents earnings before interest, income taxes, depreciation, depletion and amortization, impairment expenses, exploration expenses, including gain (loss) from hedging activities, and sale of assets and other. We have reported EBITDAX because we believe EBITDAX is a measure commonly reported and widely used by investors as an indicator of a company's operating performance and ability to incur and service debt. We believe EBITDAX assists investors in comparing a company's performance on a consistent basis without regard to depreciation, depletion and amortization, impairment of natural gas and oil properties and exploration expenses, which can vary significantly depending upon accounting methods. EBITDAX is not a calculation based on U.S. generally accepted accounting principles and should not be considered an alternative to net income (loss) in measuring our performance or used as an exclusive measure of cash flow because it does not consider the impact of working capital growth, capital expenditures, debt principal reductions and other sources and uses of cash, which are disclosed in our statements of cash flows. Investors should carefully consider the specific items included in our computation of EBITDAX. While we have disclosed our EBITDAX to permit a more complete comparative analysis of our operating performance and debt servicing ability relative to other companies, investors should be cautioned that EBITDAX as reported by us may not be comparable in all instances to EBITDAX as reported by other companies. EBITDAX amounts may not be fully available for management's discretionary use, due to requirements to conserve funds for capital expenditures, debt service, preferred stock dividends and other commitments.

**Table of Contents**

A reconciliation of EBITDAX to income (loss) from operations for the periods indicated is presented below.

	Year ended June 30,				
	2004	2003	2002	2001	2000
	(\$000)				
Income (loss) from operations	\$ 4,199	\$ (6,481)	\$ 10,297	\$ 10,511	\$ (2,048)
Exploration expenses	9,873	17,922	2,694	4,167	604
Depreciation, depletion and amortization	6,989	8,788	8,594	4,024	345
Impairment of natural gas and oil properties	43	181	527	300	548
Gain on sale of marketable securities	710	452			
Gain on sale of assets and other	7,172	39	374		70
<b>EBITDAX</b>	<b>\$ 28,986</b>	<b>\$ 20,901</b>	<b>\$ 22,486</b>	<b>\$ 19,002</b>	<b>\$ (481)</b>

**Table of Contents**

**UNAUDITED PRO FORMA CONDENSED CONSOLIDATED  
FINANCIAL STATEMENTS**

The following unaudited pro forma condensed consolidated financial statements and related notes are presented to show effects of the sale of the working and net revenue interests of south Texas properties.

The pro forma consolidated statements of operations for the year ended June 30, 2004 and for the three months ended September 30, 2004 are presented to show net income attributable to common stock as if the sale occurred effective July 1, 2003. The pro forma condensed consolidated balance sheets are based on the assumption that the sale occurred effective September 30, 2004.

Pro forma data are based on assumptions and include adjustments as explained in the notes to the unaudited pro forma condensed consolidated financial statements. The pro forma data are not necessarily indicative of the financial results that would have been attained had the sale occurred on the dates referenced above and should not be viewed as indicative of operations in future periods. The unaudited pro forma condensed consolidated financial statements should be read in conjunction with the notes thereto and our annual report on Form 10-K for the year ended June 30, 2004 and our quarterly report on Form 10-Q for the quarter ended September 30, 2004.



**Table of Contents****CONTANGO OIL & GAS COMPANY AND SUBSIDIARIES****UNAUDITED PRO FORMA CONSOLIDATED STATEMENTS OF OPERATIONS****For the Year Ended June 30, 2004**

	<u>Contango Historical</u>	<u>Pro Forma Adjustments</u>	<u>Pro Forma After Sale</u>
<b>REVENUES:</b>			
Natural gas and oil sales	\$ 27,629,814	\$ (26,377,248)(a)	\$ 1,252,566
Gain from hedging activities	58,171		58,171
	<u>27,687,985</u>	<u>(26,377,248)</u>	<u>1,310,737</u>
<b>EXPENSES:</b>			
Operating expenses	3,888,185	(3,640,161)(b)	248,024
Exploration expenses	9,873,164	(1,019,114)(c)	8,854,050
Depreciation, depletion and amortization	6,989,428	(6,721,304)(d)	268,124
Impairment of natural gas and oil properties	42,995		42,995
General and administrative expense	2,695,592		2,695,592
	<u>23,489,364</u>	<u>(11,380,579)</u>	<u>12,108,785</u>
<b>INCOME (LOSS) FROM CONTINUING OPERATIONS</b>	<b>4,198,621</b>	<b>(14,996,669)</b>	<b>(10,798,048)</b>
Interest expense	(362,127)	362,127(e)	
Interest income	38,182		38,182
Gain on sale of marketable securities	710,322		710,322
Gain on sale of assets and other	7,171,704		7,171,704
	<u>11,756,702</u>	<u>(14,634,542)</u>	<u>(2,877,840)</u>
<b>INCOME (LOSS) FROM CONTINUING OPERATIONS BEFORE INCOME TAXES</b>	<b>11,756,702</b>	<b>(14,634,542)</b>	<b>(2,877,840)</b>
Provision (benefit) for income taxes	4,056,353	(5,122,090)(g)	(1,065,737)
	<u>7,700,349</u>	<u>(9,512,452)</u>	<u>(1,812,103)</u>
<b>NET INCOME (LOSS) FROM CONTINUING OPERATIONS</b>	<b>7,700,349</b>	<b>(9,512,452)</b>	<b>(1,812,103)</b>
<b>DISCONTINUED OPERATIONS:</b>			
Earnings from discontinued operations			
Gain on disposal of discontinued operations		21,365,168(f)	21,365,168
Provision for income taxes		(7,477,809)(g)	(7,477,809)
		<u>13,887,359</u>	<u>13,887,359</u>
<b>GAIN ON DISCONTINUED OPERATIONS</b>		<b>13,887,359</b>	<b>13,887,359</b>
<b>NET INCOME</b>	<b>7,700,349</b>	<b>4,374,907</b>	<b>12,075,256</b>
Preferred stock dividends	620,000		620,000
	<u>\$ 7,080,349</u>	<u>\$ 4,374,907</u>	<u>\$ 11,455,256</u>
<b>NET INCOME ATTRIBUTABLE TO COMMON STOCK</b>	<b>\$ 7,080,349</b>	<b>\$ 4,374,907</b>	<b>\$ 11,455,256</b>
<b>NET INCOME (LOSS) PER SHARE:</b>			
<b>BASIC:</b>			
Continuing operations	\$ 0.68		\$ (0.23)

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Discontinued operations		1.32
Total	\$ 0.68	\$ 1.09
<b>DILUTED:</b>		
Continuing operations	\$ 0.58	\$ (0.23)
Discontinued operations		1.32
Total	\$ 0.58	\$ 1.09
<b>WEIGHTED AVERAGE COMMON SHARES OUTSTANDING:</b>		
Basic	10,484,078	10,484,078
Diluted	13,279,862	13,279,862

The accompanying notes to unaudited pro forma condensed consolidated  
financial statements are an integral part of these statements.

**Table of Contents****CONTANGO OIL & GAS COMPANY AND SUBSIDIARIES****UNAUDITED PRO FORMA CONSOLIDATED STATEMENTS OF OPERATIONS****For the Three Months Ended September 30, 2004**

	<u>Contango Historical</u>	<u>Pro Forma Adjustments</u>	<u>Pro Forma After Sale</u>
<b>REVENUES:</b>			
Natural gas and oil sales	\$ 6,672,242	\$ (6,092,629)(a)	\$ 579,613
<b>Total revenues</b>	<b>6,672,242</b>	<b>(6,092,629)</b>	<b>579,613</b>
<b>EXPENSES:</b>			
Operating expenses	851,862	(773,985)(b)	77,877
Exploration expenses	810,905		810,905
Depreciation, depletion and amortization	1,729,903	(1,567,872)(d)	162,031
Impairment of natural gas and oil properties	112,000		112,000
General and administrative expense	812,473		812,473
<b>Total expenses</b>	<b>4,317,143</b>	<b>(2,341,857)</b>	<b>1,975,286</b>
<b>INCOME (LOSS) FROM OPERATIONS</b>	<b>2,355,099</b>	<b>(3,750,772)</b>	<b>(1,395,673)</b>
Interest expense	(48,976)	48,976(e)	
Interest income	17,853		17,853
Gain on sale of assets and other	(40,506)		(40,506)
<b>INCOME (LOSS) FROM OPERATIONS BEFORE INCOME TAXES</b>	<b>2,283,470</b>	<b>(3,701,796)</b>	<b>(1,418,326)</b>
Provision (benefit) for income taxes	800,570	(1,295,629)(g)	(495,059)
<b>NET INCOME (LOSS)</b>	<b>1,482,900</b>	<b>(2,406,167)</b>	<b>(923,267)</b>
Preferred stock dividend	105,000		105,000
<b>NET INCOME (LOSS) ATTRIBUTABLE TO COMMON STOCK</b>	<b>1,377,900</b>	<b>(2,406,167)</b>	<b>(1,028,267)</b>
<b>NET INCOME (LOSS) PER SHARE:</b>			
<b>BASIC:</b>	<b>\$ 0.11</b>		<b>\$ (0.08)</b>
<b>DILUTED:</b>	<b>\$ 0.10</b>		<b>\$ (0.08)</b>
<b>WEIGHTED AVERAGE COMMON SHARES OUTSTANDING:</b>			
Basic	12,867,906		12,867,906
Diluted	14,580,970		14,580,970

The accompanying notes to unaudited pro forma condensed consolidated

financial statements are an integral part of these statements.

**Table of Contents**

**CONTANGO OIL & GAS COMPANY AND SUBSIDIARIES**

**UNAUDITED PRO FORMA**

**CONDENSED CONSOLIDATED BALANCE SHEETS**

**As of September 30, 2004**

	<b>Contango Historical</b>	<b>Pro Forma Adj. (1)</b>	<b>Pro Forma Adj. (2)</b>	<b>Pro Forma Adj. (3)</b>	<b>Pro Forma After Sale</b>
<i>Assets</i>		&nbs			