ARENA RESOURCES INC
Form 10KSB
March 17, 2005

United States Securities and Exchange Commission

Washington, D.C. 20549

Form 10-KSB

(Mark One)

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

For the fiscal year ended December 31, 2004
Or

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

For the transition period from ___________to ___________

Commission file number 001-31657

Arena Resources, Inc.
(Name of small business issuer in its charter)

Nevada	**73-1596109**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)
4920 South Lewis Avenue, Suite 107	
Tulsa, Oklahoma	**74105**
(Address of Principal Executive Offices)	(Zip Code)

(918) 747-6060

(Issuer s Telephone Number, Including Area Code

Securities registered under Section 12(b) of the Exchange Act:

Title of Each Class	**Name of Each Exchange On Which Registered**
Common - $0.001 Par Value	American Stock Exchange

Securities registered under Section 12(g) of the Exchange Act: None

Check whether the issuer: (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes **þ** No ¨

Check if there is no disclosure of delinquent filers in response to Item 405 of Regulation S-B is not contained in this form, and no disclosure will be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-KSB or any amendment to this Form 10-KSB. **þ**

State issuer’s revenues for its most recent fiscal year. $8,453,739

As of March 10, 2005, the aggregate market value of the common voting stock held by non-affiliates of the issuer, based upon the closing stock price of $12.61 per share, was approximately $97,905,351. As of March 10, 2005, the issuer had outstanding 10,194,304 shares of common stock ($0.001 par value).

Transitional Small Business Disclosure Format (check one): Yes ¨ No **þ**

TABLE OF CONTENTS

PART I

PART II

PART III

Forward Looking Statements

All statements, other than statements of historical fact included in this Annual Report on Form 10-KSB (herein, Annual Report) regarding our strategy, future operations, financial position, estimated revenues and losses, projected costs, prospects, plans and objectives of management are forward-looking statements. When used in this Annual Report, the words could, believe, anticipate, intend, estimate, expect, project and similar expressions are identify forward-looking statements, although not all forward-looking statements contain such identifying words. All forward-looking statements speak only as of the date of this Annual Report. You should not place undue reliance on these forward-looking statements. Although we believe that our plans, intentions and expectations reflected in or suggested by the forward-looking statements we make in this Annual Report are reasonable, we can give no assurance that these plans, intentions or expectations will be achieved. We disclose important factors that could cause our actual results to differ materially from our expectations under Risk Factors, Management s Discussion and Analysis of Financial Condition and Results of Operations and elsewhere in this Annual Report. These cautionary statements qualify all forward-looking statements attributable to us or persons acting on our behalf.

Unless the context otherwise requires, references in this Annual Report to Arena, we, us, our or ours refer to Resources, Inc.

PART I

Item 1:

Description of Business

General

Arena Resources, Inc. was incorporated in Nevada on August 31, 2000. Our principal executive offices are located at 4920 South Lewis Avenue, Suite 107, Tulsa, Oklahoma 74105, and our telephone number is (918) 747-6060.

We are engaged in oil and natural gas acquisition, exploration, development and production, with activities currently in Oklahoma, Texas, New Mexico and Kansas. Our focus will be on developing our existing properties, while continuing to pursue acquisitions of oil and gas properties with upside potential.

Business Development

Since our inception in August 2000, we have built our asset base and achieved growth primarily through property acquisitions. From our inception through December 31, 2004, we have increased our proved reserves to approximately 21.2 million Boe (barrel of oil equivalent), through the acquisition of interests in 12 leases, which have net revenue interests ranging from 24.5% to 81.32%. As of December 31, 2004, our estimated proved reserves had a pre-tax PV10 (present value of future net revenues before income taxes discounted at 10%) of approximately $302 million. We spent approximately $29.4 million on acquisitions and capital projects during 2003 and 2004.

We have a portfolio of oil and natural gas reserves, with approximately 92% of our proved reserves consisting of oil and approximately 8% consisting of natural gas. Approximately 24.1% of our proved reserves are classified as proved developed producing, or PDP. Approximately 1.7% of our proved reserves are classified as proved developed non-producing, or PDNP, and approximately 74.2% are classified as proved undeveloped, or PUD.

Competitive Business Conditions

We operate in a highly competitive environment for acquiring properties, marketing oil and natural gas and securing trained personnel. The majority of our competitors possess and employ financial, technical and personnel resources substantially greater than ours, which can be particularly important in the areas in which we operate. Those companies may be able to pay more for productive oil and natural gas properties and exploratory prospects and to evaluate, bid for and purchase a greater number of properties and prospects than our financial or personnel resources permit. Our ability to acquire additional prospects and to find and develop reserves in the future will depend on our ability to evaluate and select suitable properties and to consummate transactions in a highly competitive environment. Also, there is substantial competition for capital available for investment in the oil and natural gas industry

Current competitive factors in the domestic oil and gas industry are unique. The actual price range of crude oil is largely established by major international producers. Pricing for natural gas is more regional. Because the current domestic demand for oil and gas exceeds supply, we believe there is little risk that all current production will not be sold at relatively fixed prices. To this extent we do not believe we are directly competitive with other producers, nor is there any significant risk that we could not sell all our current production at current prices with a reasonable profit margin. The risk of domestic overproduction at current prices is not deemed significant. However, more favorable prices can usually be negotiated for larger quantities of oil and/or gas product. In this respect, while we believe we have a price disadvantage when compared to larger producers, we view our primary pricing risk to be related to a potential decline in international prices to a level which could render our current production uneconomical.

We are presently committed to use the services of the existing gathering companies in our present areas of production. This potentially gives such gathering companies certain short-term relative monopolistic powers to set gathering and transportation costs, because obtaining the services of an alternative gathering company would require substantial additional costs (since an alternative gathering would be required to lay new pipeline and/or obtain new rights of way to any lease from which we are selling production).

Major Customers

We principally sell our oil and natural gas production to end users, marketers and other purchasers that have access to nearby pipeline facilities. In areas where there is no practical access to pipelines, oil is trucked to storage facilities. Our marketing of oil and natural gas can be affected by factors beyond our control, the effects of which cannot be accurately predicted. For fiscal year 2004, two customers were responsible for generating 74% or more of our total oil and natural gas sales. These two customers were Plains Marketing, L.P., accounting for approximately 31% of total sales and Navajo Refining Company, accounting for approximately 43% of total sales. However, we believe that the loss of either of these customers would not materially impact our business, because we could readily find other purchasers for our oil and gas as produced.

Governmental Regulations

Regulation of Transportation of Oil

Sales of crude oil, condensate and natural gas liquids are not currently regulated and are made at negotiated prices. Nevertheless, Congress could reenact price controls in the future.

Our sales of crude oil are affected by the availability, terms and cost of transportation. The transportation of oil in common carrier pipelines is also subject to rate regulation. The Federal Energy Regulatory Commission, or the FERC, regulates interstate oil pipeline transportation rates under the Interstate Commerce Act. Intrastate oil pipeline transportation rates are subject to regulation by state regulatory commissions. The basis for intrastate oil pipeline regulation, and the degree of regulatory oversight and scrutiny given to intrastate oil pipeline rates, varies from state to state.

Insofar as effective interstate and intrastate rates are equally applicable to all comparable shippers, we believe that the regulation of oil transportation rates will not affect our operations in any way that is of material difference from those of our competitors. Further, interstate and intrastate common carrier oil pipelines must provide service on a non-discriminatory basis. Under this open access standard, common carriers must offer service to all shippers requesting service on the same terms and under the same rates. When oil pipelines operate at full capacity, access is governed by pro-rationing provisions set forth in the pipelines published tariffs. Accordingly, we believe that access to oil pipeline transportation services generally will be available to us to the same extent as to our competitors.

Regulation of Transportation and Sale of Natural Gas

Historically, the transportation and sale for resale of natural gas in interstate commerce have been regulated pursuant to the Natural Gas Act of 1938, the Natural Gas Policy Act of 1978 and regulations issued under those Acts by the FERC. In the past, the federal government has regulated the prices at which natural gas could be sold. While sales by producers of natural gas can currently be made at uncontrolled market prices, Congress could reenact price controls in the future.

Since 1985, the FERC has endeavored to make natural gas transportation more accessible to natural gas buyers and sellers on an open and non-discriminatory basis. The FERC has stated that open access policies are necessary to improve the competitive structure of the interstate natural gas pipeline industry and to create a regulatory framework that will put natural gas sellers into more direct contractual relations with natural gas buyers by, among other things, unbundling the sale of natural gas from the sale of transportation and storage services. Although the FERC s orders do not directly regulate natural gas producers, they are intended to foster increased competition within all phases of the natural gas industry.

We cannot accurately predict whether the FERC s actions will achieve the goal of increasing competition in markets in which our natural gas is sold. Therefore, we cannot provide any assurance that the less stringent regulatory approach recently established by the FERC will continue. However, we do not believe that any action taken will affect us in a way that materially differs from the way it affects other natural gas producers.

Intrastate natural gas transportation is subject to regulation by state regulatory agencies. The basis for intrastate regulation of natural gas transportation and the degree of regulatory oversight and scrutiny given to intrastate natural gas pipeline rates and services varies from state to state. Insofar as such regulation within a particular state will generally affect all intrastate natural gas shippers within the state on a comparable basis, we believe that the regulation of similarly situated intrastate natural gas transportation in any states in which we operate and ship natural gas on an intrastate basis will not affect our operations in any way that is of material difference from those of our competitors.

Regulation of Production

The production of oil and natural gas is subject to regulation under a wide range of local, state and federal statutes, rules, orders and regulations. Federal, state and local statutes and regulations require permits for drilling operations, drilling bonds and reports concerning operations. All of the states in which we own and operate properties have regulations governing conservation matters, including provisions for the unitization or pooling of oil and natural gas properties, the establishment of maximum allowable rates of production from oil and natural gas wells, the regulation of well spacing, and plugging and abandonment of wells. The effect of these regulations is to limit the amount of oil and natural gas that we can produce from our wells and to limit the number of wells or the locations at which we can drill, although we can apply for exceptions to such regulations or to have reductions in well spacing. Moreover, each state generally imposes a production or severance tax with respect to the production and sale of oil, natural gas and natural gas liquids within its jurisdiction.

The failure to comply with these rules and regulations can result in substantial penalties. Our competitors in the oil and natural gas industry are subject to the same regulatory requirements and restrictions that affect our operations

Environmental Compliance and Risks

Our oil and natural gas exploration, development and production operations are subject to stringent federal, state and local laws and regulations governing the discharge of materials into the environment or otherwise relating to environmental protection. Historically, most of the environmental regulation of oil and gas production has been left to state regulatory boards or agencies in those jurisdictions where there is significant gas and oil production, with limited direct regulation by such federal agencies as the Environmental Protection Agency. However, while we believe this generally to be the case for our production activities in Oklahoma, Texas, New Mexico and Kansas, there are various regulations issued by the Environmental Protection Agency (EPA) and other governmental agencies that would govern significant spills, blow-outs, or uncontrolled emissions.

In Oklahoma, Texas, New Mexico and Kansas specific oil and gas regulations apply to the drilling, completion and operations of wells, and the disposal of waste oil and salt water. There are also procedures incident to the plugging and abandonment of dry holes or other non-operational wells, all as governed by the applicable governing state agency.

At the federal level, among the more significant laws and regulations that may affect our business and the oil and gas industry are: The Comprehensive Environmental Response, Compensation and Liability Act of 1980, also known as CERCLA or Superfund; the Oil Pollution Act of 1990; the Resource Conservation and Recovery Act, also known as RCRA, ; the Clean Air Act; Federal Water Pollution Control Act of 1972, or the Clean Water Act; and the Safe Drinking Water Act of 1974.

Compliance with these regulations may constitute a significant cost and effort for us. No specific accounting for environmental compliance has been maintained or projected by us at this time. We are not presently aware of any environmental demands, claims, or adverse actions, litigation or administrative proceedings in which either us or our acquired properties are involved or subject to, or arising out of any predecessor operations.

In the event of a breach of environmental regulations, these environmental regulatory agencies have a broad range of alternative or cumulative remedies which include: ordering a clean-up of any spills or waste material and restoration of the soil or water to conditions existing prior to the environmental violation; fines; or enjoining further drilling, completion or production activities. In certain egregious situations the agencies may also pursue criminal remedies against us or our principal officers.

Current Employees

As of December 31, 2004, we had ten full-time employees, including one petroleum engineer. Our employees are not represented by any labor union. We consider our relations with our employees to be satisfactory and have never experienced a work stoppage or strike.

We retain certain engineers, geologists, landmen, pumpers and other personnel on a contract or fee basis as necessary for our operations.

Item 2:

Description of Property

General Background

Since our inception in late August 2000, we have begun to build a solid asset base and achieved steady growth, primarily through property acquisitions, but with some exploitation activities. From our inception through December 31, 2004, our proved reserves have grown to 21,217,254 Boe, at an average acquisition/drilling cost of $1.56 per Boe. As of December 31, 2004, our estimated proved reserves had a pre-tax PV10 value of approximately $302 million, approximately 44% of which came from properties located in New Mexico, approximately 42% from our properties in Texas, approximately 12% from our properties in Oklahoma and approximately 2% from our properties in Kansas. We spent approximately $28.3 million on capital projects during 2003 and 2004. We expect to further develop these properties through additional drilling. Our capital budget for 2005 is approximately $15 million for development of existing properties. Although our focus will be on development of our existing properties, we also intend to continue seeking acquisition opportunities which compliment our current portfolio. We intend to fund our development activity primarily through use of cash flow from operations and cash on hand, while potential drawings on our credit facility and proceeds from future equity transactions would also be available for development projects or future acquisitions. We believe that our acquisition expertise, together with our operating experience and efficient cost structure, provides us with the potential to continue our growth.

We have a portfolio of oil and natural gas reserves, with approximately 92% of our proved reserves consisting of oil and approximately 8% consisting of natural gas. Approximately 24.1% of our proved reserves are classified as proved developed producing properties. Approximately 1.7% of our proved reserves are classified as proved developed nonproducing, and approximately 74.2% are classified as proved undeveloped.

The following table summarizes our total net proved reserves and pre-tax PV10 value as of December 31, 2004.

	Oil	Natural Gas	Total		
Geographic Area	**(Bbl)**	**(Mcf)**	**(Boe)**	**Pre-Tax PV10 Value**	
New Mexico	8,659,448	4,165,346	9,353,672	$	132,918,983
Texas	7,777,328	2,204,548	8,144,753		127,273,059
Oklahoma	3,113,888	168,756	3,142,014		36,583,892

Kansas	-	3,460,891	576,815		5,680,048
Total	19,550,664	9,999,541	21,217,254	$	302,455,982

Proved Reserves

Our 21,217,254 Boe of proved reserves, which consist of approximately 92% oil and 8% natural gas, are summarized below as of December 31, 2004, on a net pre-tax PV10 value basis. Our reserve estimates have not been filed with any Federal authority or agency (other than the SEC).

As of December 31, 2004, New Mexico proved reserves had a net pre-tax PV10 value of $132,9 million, our proved reserves in Texas had a net pre-tax PV10 value of $127.2 million, our proved reserves in Oklahoma had a net pre-tax PV10 value of $36.6 million and and our proved reserves in Kansas had a net pre-tax PV10 value of $5.7 million.

As of December 31, 2004, approximately 24.1% of the 21.2 million Boe of proved reserves have been classified as proved developed producing, or PDP . Proved developed non-producing, or PDNP , and proved undeveloped, or PUD reserves constitute 1.7% and 74.2%, respectively, of the proved reserves as of December 31, 2004.

Total proved reserves had a net pre-tax PV10 value as of December 31, 2004 of approximately $302 million, 18.6% or $56.1 million of which is associated with the PDP reserves. An additional $4.7 million is associated with the PDNP reserves ($60.8 million for total proved developed reserves, or 20.1% of total proved reserves pre-tax PV10 value) and $241.6 million is associated with PUD reserves.

Our proved reserves as of December 31, 2004 are summarized in the table below.

	Oil (Bbl)	Gas (Mcf)	Total (Boe)	% of Total Proved	Pre-tax PV10 (In thousands)	Future Capital Expenditures (in thousands)
New Mexico:						
PDP	2,273,402	2,070,556	2,618,495	12%	$ 31,268	$ -
PDNP	326,902	250,734	368,691	2%	4,696	-
PUD	6,059,144	1,844,056	6,366,487	30%	96,955	11,541
Total Proved:	8,659,448	4,165,346	9,353,672	44%	$ 132,919	$ 11,541
Texas:						
PDP	1,661,082	584,328	1,758,470	8%	$ 17,293	$ -
PDNP	-	-	-	0%	-	-
PUD	6,116,246	1,620,220	6,386,283	30%	109,980	44,684
Total Proved:	7,777,328	2,204,548	8,144,753	38%	$ 127,273	$ 44,684
Oklahoma:						
PDP	459,907	168,756	488,033	3%	$ 4,731	$ -
PDNP	-	-	-	0%	-	-
PUD	2,653,981	-	2,653,981	12%	31,853	5,375
Total Proved:	3,113,888	168,756	3,142,014	15%	$ 36,584	$ 5,375

Kansas:								
PDP	-	1,540,891	256,815	1%		2,818	$	-
PDNP	-	-	-	0%		-		-
PUD	-	1,920,000	320,000	2%		2,862		375
Total Proved:	-	3,460,891	576,815	3%	$	5,680	$	375
Total:								
PDP	4,394,391	4,364,531	5,121,813	24%	$	56,110	$	-
PDNP	326,902	250,734	368,691	2%		4,696		-
PUD	14,829,371	5,384,276	15,726,750	74%		241,650		61,975
Total Proved:	19,550,664	9,999,541	21,217,254	100%	$	302,456	$	61,975

Estimated Costs Related to Conversion of Proved Undeveloped Reserves to Proved Developed Reserves

The following table indicates projected reserves that we currently estimate will be converted from proved undeveloped to proved developed, as well as the estimated costs per year involved in such development.

Year	Estimated Oil Reserves Developed (Bbls)	Estimated Gas Reserves Developed (Mcf)	Total Boe		Estimated Development Costs [1]
2005	3,108,084	2,159,540	3,468,007	$	12,406,208
2006	6,041,222	1,832,581	6,346,652		22,620,434
2007	4,517,791	1,056,016	4,693,794		16,532,000
	13,667,097	5,048,137	14,508,453	$	51,558,642

(1) The amount shown for 2005 differs from the Capital Expenditures budgeted as described elsewhere in this document. The difference is the result of Arena owning less than 100% of the working interest in all of the properties which are being developed. The amount shown here and in our reserve analysis constitutes the portion attributable to our working interest. However, if our working interest partners elected not to participate in the development planned, we would be responsible for the full $15 million.

Production

Our estimated average daily production for the month of December, 2004, is summarized below. These tables indicate the percentage of our estimated December 2004 average daily production of 999 Boe/d attributable to each state and to oil versus natural gas production.

Average Daily Production (December 2004): 999 Boe We identified no specific instances of noncompliance with District policy or any other internal control errors. The financial secretary should be highly commended for this achievement. We encourage the school to maintain its high standard of record keeping.

State	Average Daily Production	Oil	Natural Gas

New Mexico	48.99%	43.15%	5.84%
Texas	24.40%	22.99%	1.41%
Oklahoma	22.21%	20.15%	2.06%
Kansas	4.40%	0.00%	4.40%
Total	100%	86%	14%

Summary of Oil and Natural Gas Properties and Projects

Significant New Mexico Operations

Seven Rivers Queen Unit Lea County, New Mexico. We acquired a 70.6% working interest and a 56.48% net revenue interest in this property in May 2003. This lease was acquired from Permian Resources Holding, Inc., an unaffiliated company, for a cash payment of $900,000. The remaining working interest is owned by unaffiliated parties. There are currently 43 producing wells on this lease, and we believe it can support six to eight possible infill wells (additional wells within the spacing requirements of the unit), as well as some untested formations in shallow sand. This lease consists of approximately 2,240 acres and is held by production.

North Benson Queen Unit Eddy County, New Mexico. In October 2003 we acquired a 100% working interest and a 78.15% net revenue interest in this lease, which currently has 21 producing wells. This lease was acquired from United Resources, L.P., an unaffiliated company, for a cash payment of $500,000. The lease covers approximately 1,800 acres, and we currently anticipate it can support up to 23 additional wells, which are included in our estimate of PUD. This lease is held by production.

The North Benson Queen Unit Waterflood will require additional volumes of water to support the waterflood expansion. A sufficient and economical source of water has been identified. A water line of approximately four miles in length will be constructed across Bureau of Land Management lands to transport the water to the North Benson Queen Unit. Permit applications must be submitted to the Bureau of Land Management and are usually granted within ninety days of application submittal. The construction of the water line should require approximately thirty days at a cost of $250,000. The permit application will be submitted in the second quarter 2005 with construction slated for the summer of 2005. The development of the North Benson Queen Unit waterflood is scheduled for 2006 at estimated costs of $5,732,000.

East Hobbs Unit Lea County, New Mexico. In May 2004 we acquired a 82.24% working interest and a 67.6% net revenue interest in this lease primarily from EnerQuest Oil and Gas, Ltd., an unaffiliated company, for a cash payment of $10,008,440. Although the Purchase and Sales Agreement transferred the revenue and the related operating costs from East Hobbs to us beginning March 1, 2004, Arena did not control the property interests until May 7, 2004. As a result, the acquisition date for accounting purposes was May 7, 2004 and the operations of East Hobbs operations were included in our results of operations from May 7, 2004. Revenues and operating costs for the months of March and April were estimated and treated as adjustments to the purchase price. This lease covers approximately 920 acres. At the date of acquisition, there were 20 operating oil and gas wells. We drilled an additional six wells, all of which were successfully completed, and washed down one other well during 2004. We believe this property can support up to six additional wells, which are included in our estimate of PUD. This lease is held by production.

Significant Texas Operations

Y6 Lease Fisher County, Texas. We acquired a 100% working interest and an 80% net revenue interest in this lease in June 2001. This lease was acquired from Durango Operating Company, Inc. an unaffiliated company, for a cash payment of $750,000. There are currently 12 producing wells on this lease. A portion of this property has been waterflooded, and when we begin our future development operations on this property, we plan to waterflood the remaining acreage. A waterflood operation is a method of secondary recovery in which water is injected into the reservoir formation to displace residual oil. The water from injection wells physically sweeps the displaced oil to adjacent production wells. This potential waterflood project (and the estimated $1 million cost thereof) is included as PUD in our reserve report. This lease consists of approximately 1,697 acres and is held by production.

Dodson Lease Montague County, Texas. We purchased a 100% working interest and an 81.25% net revenue interest in this lease in June 2002. This lease was acquired from Nocona minerals Partnership, an unaffiliated company, for a cash payment of $200,000. There are currently three producing wells and nine other wells on this approximately 570 acre lease, all of which is held by production.

West San Andres Unit Yoakum County, Texas. In October 2003 we acquired a 100% working interest and a 79.60% net revenue interest in this lease from Permian Resources, Inc. an unaffiliated company, for a cash payment of $500,000. The lease covers approximately 1,200 acres, and currently has 10 producing wells. We believe it can support up to four additional wells, which are included in our estimate of PUD. This lease is held by production. In 2004 we contracted for the drilling of one well on this property, which was not commenced until January 2005.

Fuhrman-Mascho leases   Andrews County, Texas. In December 2004 we acquired a 100% working interest and a 75% net revenue interest in these leases from four entities; Paul D. Friemel & Assoc, Inc., Compostella Oil Company, Redco Oil & Gas Inc. and Terry N. Stevens, Inc., all unaffiliated companies. The purchase price, including acquisition costs, was $10,966,495 and consisted of $9,667,381 of cash paid to the sellers, $44,421 in cash acquisition costs, 180,013 shares of the Company s common stock, valued at $1,260,091, or $7.00 per share, and the issuance of put and call options with a net value of $24,602. These leases cover approximately 11,300 acres. We believe it can support up to 130 additional wells, which are included in our estimate of PUD. These leases are held by production.

Significant Oklahoma Operations

Casey Lease   Muskogee County, Oklahoma. The Casey Lease originally consisted of a 40% working interest contributed by our two principal shareholders. We subsequently acquired additional interests in this lease, so that presently we have a 94% working interest, and an approximately 74.48% net revenue interest in the well on this property. Net revenue interest is the owner s percentage share of the monthly income realized from the sale of a well s produced oil and gas. The net revenue interest is a lesser number as compared to the working interest, due to the mineral owner royalty and other overriding royalties on the well.

In May 2001, we acquired an additional 30% working interest in the lease from a group of interest holders represented by Petro Consultants, Inc. The additional working interest was valued at $300,000 and was acquired by the issuance of 80,000 shares of common stock valued at $1.75 per share totaling $140,000, the assumption of a $50,000 obligation of the seller and the issuance of a note payable for $110,000. This note was subsequently settled through cash payments of $45,000 and the issuance of an additional 37,143 shares of common stock valued at $1.75 per share totaling $65,000. The $50,000 liability assumed from the seller related to the seller s previous obligation to the operator of the properties and has been paid.

In October 2001, we acquired an additional 24% working interest and a 2½% overriding royalty interest in the Casey lease from a group of interest holders represented by Petro Consultants, Inc. The acquired interests were valued at $266,250 and were purchased by the issuance of 81,857 shares of common stock valued at $1.75 per share totaling $143,250, a cash payment of $90,000 and the issuance of a note payable for $33,000. The note was subsequently paid.

The remaining working interest in the Casey lease is owned by an unaffiliated party. This lease consists of approximately 160 acres. In December 2003 we temporarily shut-in this gas well. Subsequent to December 31, 2004, we sold the Casey lease to an unrelated party.

Ona Morrow Sand Unit   Cimarron and Texas Counties, Oklahoma. We own a 100% working interest and an 81.32% net revenue interest in this lease which has been producing since our acquisition in July 2002. This lease was acquired from Bass Petroleum, Inc., an unaffiliated company, for a cash payment of $735,000. This lease has approximately 2,120 acres and seven producing wells. We believe up to five additional locations may be suitable for drilling, which are included in our estimate of our PUD. This lease is held by production.

Eva South Morrow Sand Unit Texas County, Oklahoma. We own a 100% working interest and an 85.41% net revenue interest in this lease which was also acquired in July 2002. This lease was acquired from Ensign Operating Company, an unaffiliated company, for a cash payment of $827,500. The lease consists of approximately 489 acres and has seven producing wells, with a possibility for two additional wells, which have been included in our estimate of our PUD. This lease is held by production.

Midwell, Appleby, Smaltz and Hanes Leases Cimarron County, Oklahoma. We own 100% of the working interest and an 80% net revenue interest in these four leases acquired in September 2002. All have been producing leases since the date of our acquisition. The Midwell Appleby and Smaltz leases consist of approximately 1,640 acres with five producing wells, and we believe there are up to three additional drilling locations on these leases. The Hanes lease contains approximately 640 acres and four producing wells, with a possibility of up to two additional wells, which are included in our estimate of PUD. All of these leases are held by production.

Roy Hanes Lease Texas County, Oklahoma. We own a 24.5% working interest and a 21.44% net revenue interest in this lease, which is a property operated by XTO Energy, Inc, an unaffiliated company, who also owns the remaining working interest. The interest in this lease was acquired at the same time we acquired our interests in the Midwell, Appleby, Smaltz and Hanes leases, and there has been production on this lease since that time. This lease consists of approximately 640 acres, and is currently held by production.

The Midwell, Appleby, Smaltz, Hanes and Roy Hanes leases were acquired from Burk Royalty Co., Ltd. R.A. Kimball Property Co., Ltd. and Kimball Family Resources, Ltd., all unaffiliated companies. The cost of these leases was $550,179, with $100,000 paid in cash and the balance paid through our issuance of 99,885 shares of our common stock valued at $4.00 per share (the then current market value), and the issuance of put and call options with a net value to the sellers of $50,639.

Significant Kansas Operations

Koehn/Rexford Unit Haskell & Gray County, Kansas. This lease consists of approximately 640 acres. After entering into a farmout agreement with Bird Creek Resources, Inc., an unaffiliated company, we drilled and completed an initial gas well on this lease. Under the terms of this agreement, we agreed to drill one well and could drill additional wells on the property. In exchange for each well drilled, we will be assigned 100% of the working interest (80% of the net revenue interest) in the well and related oil and gas until payout of all costs of drilling, equipping and operating the well. After payout, our working interest in the wells and related oil and gas will decrease to 75% (60% of the net revenue interest).

In 2002, we successfully drilled one well at a cost of approximately $153,000 to drill, complete and connect to the pipeline and thus will have reached payout when we recover this amount from production. After payout, Bird Creek Resources, Inc. will own the remaining 25% working interest.

On March 20, 2002, we entered into a joint venture agreement with Petro Consultants, Inc., to drill and operate the well on the above-mentioned property. Under the terms of the agreement, Petro purchased 27% of the working interest in the well for $88,200. On May 20, 2002, after the well was successfully drilled, we issued 70,000 shares of common stock (valued at $1.26 per share) to Petro to repurchase the 27% working interest in the well.

In February 2004, we successfully drilled one additional well on this acreage at a cost of approximately $159,000 to drill, complete and connect to the pipeline and thus will have reached payout when we recover this amount from production. After payout, Bird Creek Resources, Inc. will own the remaining 25% working interest.

In November 2004, we completed the installation of a pipeline from our Koehn lease to a gatherer/purchased pipeline. Total cost on installation of the pipeline was approximately $144,000. The installation of this pipeline was necessary to be able to begin producing from our wells in that area. Production started on December 11, 2004.

Schmidt Unit Gray County, Kansas. During 2004 we leased an additional 640 acres offsetting our Koehn/Rexford Unit for a total of approximately $8,582. In November 2004, we successfully drilled one well on this acreage at a cost of approximately $183,520 to drill, complete and connect to the pipeline. We began producing from this well on December 23, 2004.

Beals Prospect Comanche County, Kansas. In July 2003 we acquired a 100% working interest and an 80.5% net revenue interest in this lease, consisting of 1,560 acres. This lease was acquired from Bengalia Land and Cattle Company., an unaffiliated party, for a cash payment of $60,000. During August 2003 we drilled one well on this acreage, which was unsuccessful and was plugged and abandoned. This lease will expire in April 2006 if not then held by production.

Acreage

The following table summarizes gross and net developed and undeveloped acreage at December 31, 2004 by region (net acreage is our percentage ownership of gross acreage). Acreage in which our interest is limited to royalty and overriding royalty interests is excluded.

	Developed Acreage		**Undeveloped Acreage**		**Total Acreage**	
	Gross	**Net**	**Gross**	**Net**	**Gross**	**Net**
New Mexico	4,960	3,294	--	--	4,960	3,294
Texas	14,767	11,251	--	--	14,767	11,251
Oklahoma	5,689	4,242	--	--	5,689	4,242
Kansas	1,280	1,024	1,560	1,256	2,840	2,280
Total	26,696	19,811	1,560	1,256	28,256	21,067

Production History

The following table presents the historical information about our produced natural gas and oil volumes.

	Year Ended December 31, 2002	2003	2004
Oil production (Bbls)	58,717	117,646	195,166
Natural gas production (Mcf)	46,819	67,329	169,002
Total production (Boe)	66,520	128,868	223,333
Daily production (Boe/d)	182	353	612
Average sales price:			
Oil (per Bbl)	$ 26.09	$ 29.06	$ 39.26
Natural gas (per Mcf)	2.67	3.67	4.93
Total (per Boe)	24.91	28.44	38.09
Average production cost (per Boe)	$ 8.94	$ 8.92	$ 8.90

Productive Wells

The following table presents our ownership at December 31, 2004, in productive oil and natural gas wells by region (a net well is our percentage ownership of a gross well).

	Oil Wells		Gas wells		Total Wells	
	Gross	Net	Gross	Net	Gross	Net
New Mexico	93	60	-	-	93	60
Texas	182	138	-	-	182	138
Oklahoma	23	19	-	-	23	19
Kansas	-	-	3	2	3	2
Total	298	217	3	2	301	219

Drilling Activity

During 2004 we completed the drilling of nine wells, completed a wash down on one well and had contracted for the drilling of one additional well that was not commenced until January 2005. Two of the wells were drilled and completed in Gray County, Kansas, offsetting the Koehn well that was drilled in 2002. Both of these wells were placed into production in December 2004. The third newly drilled well is on our Dodson property in Montague County, Texas. This well has been completed but has not yet been placed into production. The remaining six newly drilled wells and the one washed down well are in on our East Hobbs San Andres Unit property in Lea County, New Mexico. All seven wells were completed have been placed into production. The well for which we had contracted for drilling that was commenced in January 2005 is on our West San Andres Unit property in Yoakum County, Texas. This well was drilled in January 2005 and completed in March 2005, but has not yet been placed into production.

Cost Information

We conduct our oil and natural gas activities entirely in the United States. Our average production costs, per Boe, were $8.94 in 2002, $8.92 in 2003 and $8.90 in 2004. Net costs capitalized during the years ended December 31, 2002, 2003 and 2004, related to our oil and natural gas producing activities are shown below.

	For the Years Ended December 31,		
	2002	**2003**	**2004**

Acquisition of proved properties	$ 2,659,832	$ 2,470,821	$ 21,063,816
Acquisition of unproved properties		147,000	43,082
Exploration costs		326,410	216805
Development costs	579,153	849,864	4,027,754
Acquisition of support and office equipment	29,388		19,629
Asset retirement costs recognized upon			
adoption of SFAS No. 143		221,218	607,133
Total Costs Incurred	$ 3,268,373	$ 4,015,313	$ 25,978,219

Reserve Quantity Information

Our estimates of proved reserves and related valuations were based on reports prepared by Lee Keeling and Associates, Inc., independent petroleum and geological engineers, in accordance with the provisions of SFAS 69, Disclosures About Oil and Gas Producing Activities. The estimates of proved reserves are inherently imprecise and are continually subject to revision based on production history, results of additional exploration and development, price changes and other factors.

Our oil and natural gas reserves are attributable solely to properties within the United States. A summary of the changes in quantities of proved (developed and undeveloped) oil and natural gas reserves is shown below.

	Oil (Bbls)	Natural Gas (Mcf)
Balance, December 31, 2001	494,823	2,960,373
Purchase of minerals in place	3,597,156	1,676,706
Extensions and discoveries	--	--
Production	(58,717)	(46,819)
Revisions of estimates	80,674	(1,402,503)
Balance, December 31, 2002	4,113,937	3,187,757
Purchase of minerals in place	3,175	570,924
Extensions and discoveries	18,066	229,626
Production	(117,646)	(67,329)
Revisions of estimates	(139,546)	(512,224)
Balance, December 31, 2003	7,050,167	3,408,751
Purchase of minerals in place	8,764,087	6,431,440
Extensions and discoveries	-	640,000
Production	(195,167)	(169,002)
Revisions of estimates	3,931,577	(311,648)
Balance, December 31, 2004	19,550,664	9,999,541

Our proved oil and natural gas reserves are shown below.

	For the Years Ended December 31,		
	2002	**2003**	**2004**
Oil (Bbls)			
Developed	750,463	1,580,521	4,721,293
Undeveloped	3,363,473	5,469,646	14,829,371
Total	4,113,936	7,050,167	19,550,664
Natural Gas (Mcf)			

Developed	1,160,639	1,612,738	4,615,265
Undeveloped	2,027,118	1,796,016	5,384,276
Total	3,187,757	3,408,754	9,999,541
Total (Boe)			
Developed	943,904	1,849,311	5,490,504
Undeveloped	3,701,326	5,768,972	15,726,750
Total	4,645,230	7,618,283	21,217,254

Standardized Measure of Discounted Future Net Cash Flows

Our standardized measure of discounted future net cash flows relating to proved oil and natural gas reserves and changes in the standardized measure as described below were prepared in accordance with the provisions of SFAS 69. Future cash inflows were computed by applying year-end prices to estimated future production. Future production and development costs are computed by estimating the expenditures to be incurred in producing and developing the proved oil and natural gas reserves at year end, based on year-end costs and assuming continuation of existing economic conditions.

Future income tax expenses are calculated by applying appropriate year-end tax rates to future pre-tax net cash flows relating to proved oil and natural gas reserves, less the tax basis of properties involved. Future income tax expenses give effect to permanent differences, tax credits and loss carryforwards relating to the proved oil and natural gas reserves. Future net cash flows are discounted at a rate of 10 percent annually to derive the standardized measure of discounted future net cash flows. This calculation procedure does not necessarily result in an estimate of the fair market value or the present value of our oil and natural gas properties.

The standardized measure of discounted future net cash flows relating to the proved oil and natural gas reserves are shown below.

		December 31,		
		2003		**2004**
Future cash inflow	$	218,026,254	$	814,346,791
Future production costs		(64,157,199)		(171,518,828)
Future development costs		(13,609,584)		(61,975,106)
Future income tax expense		(45,778,941)		(187,392,403)
Future net cash flows		94,480,730		393,460,454
10% annual discount for estimated timing of cash flows		(49,474,633)		(188,219,704)
Standardized measure of discounted future net cash flows	$	45,006,097		205,240,750

The changes in the standardized measure of discounted future net cash flows relating to the proved oil and natural gas reserves are shown below.

For the Years Ended December 31,

		2003		2004
Beginning of the year	$	27,997,824	$	45,006,097
Purchase of minerals in place		21,333,720		142,824,938
Extensions, discoveries and improved recovery, less related costs		691,469		347,652
Development costs incurred during the year		320,102		5,387,638
Sales of oil and gas produced, net of production costs		(2,302,405)		(5,876,333)
Accretion of discount		3,012,793		4,882,064
Net change in prices and production costs		8,222,075		74,777,221
Net change in estimated future development costs		39,219		(3,187,159)
Revision of previous quantity estimates		(53,098)		42,149,044
Revision of estimated timing of cash flows		(5,468,732)		(27,509,967)
Net change in income taxes		(8,786,869)		(73,560,445)
End of the Year	$	45,006,097	$	205,240,750

Management s Business Strategy Related to Properties

Our goal is to increase stockholder value by investing in oil and gas projects with attractive rates of return on capital employed. We plan to achieve this goal by exploiting and developing our existing oil and natural gas properties and pursuing acquisitions of additional properties. Specifically, we have focused, and plan to continue to focus, on the following:

Developing and Exploiting Existing Properties. We believe that there is significant value to be created by drilling the identified undeveloped opportunities on our properties. We own interests in a total of 26,696 gross (19,810 net) developed acres and operate essentially all of the net pre-tax PV10 value of our proved undeveloped reserves. In addition, as of December 31, 2004, we owned interests in approximately 1,560 gross undeveloped acres (1,256 net). We believe that our current and future cash flow will enable us to undertake the exploitation of our properties through additional drilling activities. Our expected capital budget for development of existing properties in 2005 is approximately $15 million.

Pursuing Profitable Acquisitions. We have historically pursued acquisitions of properties that we believe to have exploitation and development potential comparable to our existing inventory of drilling locations. We have developed and refined an acquisition program designed to increase reserves and complement our existing core properties. We have an experienced team of management and engineering professionals who identify and evaluate acquisition opportunities, negotiate and close purchases and manage acquired properties. From August 2000 through December 31, 2004, we acquired 12 leases at an aggregate acquisition and enhancement cost of approximately $33 million, representing approximately 21.2 million Boe of proved reserves (at an average cost of $1.56 per Boe). While our emphasis in 2005 and beyond is anticipated to focus on the further development our existing properties, we will continue to look for properties with both existing cash flow from production and future development potential.

Controlling Costs through Efficient Operation of Existing Properties. We operate essentially 100% of the pre-tax PV10 value of our total proved reserves, which we believe enables us to better manage expenses, capital allocation and the decision-making processes related to our exploitation and exploration activities. For the year ended December 31, 2004, our lease operating expense per Boe averaged $8.90 and general and administrative costs averaged $3.02 per Boe produced.

Other Properties and Commitments

We currently lease our principal executive offices in Tulsa, Oklahoma. At December 31, 2004, the lease was for approximately 2,352 square feet of office space, at an annual rental of $20,400. Subsequent to December 31, 2004 and effective March 1, 2005, we leased an additional 385 square feet of office space at the same location and extended the lease through January 1, 2006. Our annual rental for 2005 will be $24,400. The current facilities are believed adequate for our current operations.

Item 3:

Legal Proceedings

In the ordinary course of business, we may be, from time to time, a claimant or a defendant in various legal proceedings. We do not presently have any litigation pending or threatened.

Item 4:

Submission of Matters to a Vote of Security Holders

Our annual shareholders meeting was held on December 21, 2004. The shareholder s re-elected Messrs. Stanley M. McCabe, Lloyd T. Rochford, Charles M. Crawford, Chris V. Kemendo, Jr. and Clayton E. Woodrum as Directors with terms ending in 2005. The shareholders further approved an amendment to the Company s executive stock option plan to increase the number of shares of Common Stock that may be granted under the plan from 1,000,000 to 1,500,000, and to provide discretionary acceleration of vesting of options previously granted. Following is a chart reflecting the votes cast for each of the elected directors, as well as for the amendment to the stock option plan:

	Votes for	Votes against	Abstain
Lloyd T. Rochford	5,556,002	-	11,001
Stanley M. McCabe	5,556,002	-	11,001
Charles M. Crawford	5,556,002	-	11,001
Chris V. Kemendo, Jr.	5,545,002	-	22,001
Clayton E. Woodrum	5,556,002	-	11,001
Amendment to option plan	5,473,992	93,011	438,038

PART II

Item 5:

Market for Registrant s Common Stock, Related Stockholder Matters and Issuer Purchases of Equity Securities

Market for our Common Stock

Since April 15, 2003, our common stock has been traded on the American Stock Exchange, under the symbol ARD . Prior to that time, our common stock traded on the OTC Bulletin Board. The following table shows the high and low sales prices for each quarter since listing on the American Stock Exchange, and the high and low bid prices prior to such time, during the last two years.

Period	High Sale or Bid	Low Sale or Bid
1st Quarter 2003	$ 4.35	$ 4.25
2nd Quarter 2003	5.99	4.35

3rd Quarter 2003		5.82		5.45
4th Quarter 2003		6.10		5.40
1st Quarter 2004	$	7.08	$	5.85
2nd Quarter 2004		9.65		6.98
3rd Quarter 2004		7.46		5.98
4th Quarter 2004		8.79		6.80
1st Quarter 2005 (through March 10, 2005)	$	13.40	$	8.35

Record Holders

As of March 1, 2005, there are approximately 1,481 holders of record of our common stock. Approximately 24%, or 2,430,200 shares of the 10,194,304 shares issued and outstanding as of such date are held by management or affiliated parties.

Dividend Policy

We have not paid any dividends on our common stock during the last two years, and we do not anticipate paying any cash dividends on our common stock in the foreseeable future. We currently intend to retain future earnings, if any, to finance the expansion of our business. Our future dividend policy is within the discretion of our board of directors and will depend upon various factors, including our results of operations, financial condition, capital requirements and investment opportunities. In addition, our credit facility prohibits us from paying dividends.

Securities Authorized for Issuance Under Equity Compensation Plans

In March 2003, our board of directors adopted an executive stock option plan which was subsequently approved by our shareholders at our annual meeting in July 2003, and which was amended by our shareholders at our annual meeting in 2004. Information regarding this plan and the options that have been granted under this plan may be found in this Annual Report under Part III, Items 10 and 11.

Recent Sales of Unregistered Securities

Throughout 2004, we issued 78,300 shares of our common stock upon the exercise of previously issued warrants at either $1.75 per share or $5.00 per share. These shares were issued in a transaction not involving a public offering and were issued in reliance upon the exemption from registration provided by Section 4(2) of the Securities Act of 1933. The persons to whom the shares were issued had access to full information concerning us and represented that he acquired the shares for his own account and not for the purpose of distribution. The certificates for the shares contain a restrictive legend advising that the shares may not be offered for sale, sold or otherwise transferred without having first been registered under the 1933 Act or pursuant to an exemption from registration under the 1933 Act. There was no underwriter involved in these transactions.

In August 2004, we issued 40,000 shares of common stock valued at $5.11 per share, or $204,533, as compensation to a consultant utilized in connection with our acquisition of the East Hobbs San Andres Unit in Eddy County, New Mexico. The shares were issued in a transaction not involving a public offering and were issued in reliance upon the exemption from registration provided by Section 4(2) of the Securities Act of 1933. The person to whom the shares were issued had access to full information concerning us and represented that he acquired the shares for his own account and not for the purpose of distribution. The certificates for the shares contain a restrictive legend advising that the sh