

EVERGREEN RESOURCES INC  
Form 10-Q  
August 03, 2004

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

Washington, DC 20549

**Form 10-Q**

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

For the quarterly period ended: **June 30, 2004.**

**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: **001-13171**

**EVERGREEN RESOURCES, INC.**

(Exact name of registrant as specified in its charter)

**Colorado**  
(State or Other Jurisdiction of  
Incorporation or Organization)

**84-0834147**  
(I.R.S. Employer  
Identification Number)

**1401 17th Street Suite 1200**  
**Denver, Colorado**  
(Address of Principal Executive Offices)

**80202**  
(Zip Code)

**(303) 298-8100**

(Registrant's Telephone Number, Including Area Code)

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

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

As of July 31, 2004, 43,158,047 shares of the Registrant's Common Stock, no par value, were outstanding.

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EVERGREEN RESOURCES, INC.

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## PART I. FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS

EVERGREEN RESOURCES, INC.  
CONSOLIDATED BALANCE SHEETS

|   | June 30,<br>2004    | December 31,<br>2003 |
|---|---------------------|----------------------|
|   | (unaudited)         |                      |
|   | (in thousands)      |                      |
| <b>ASSETS</b>   |                     |                      |
| Current:  |                     |                      |
| Cash and cash equivalents   | \$ 28,700           | \$ 3,820             |
| Accounts receivable   | 35,329              | 25,708               |
| Other current assets  | 1,499               | 2,817                |
|   | <u>65,528</u>       | <u>32,345</u>        |
| Property and equipment, at cost:  |                     |                      |
| Oil and gas properties, full cost method of accounting:   |                     |                      |
| Proved, net of accumulated depletion of \$91,376 and \$74,671   | 650,317             | 575,026              |
| Unproved  | 63,305              | 85,841               |
|   | <u>713,622</u>      | <u>660,867</u>       |
| Net oil and gas properties  | 713,622             | 660,867              |
| Other property and equipment, net of accumulated depreciation and amortization of \$33,684 and \$28,448 | 232,091             | 201,771              |
|   | <u>945,713</u>      | <u>862,638</u>       |
| Net property and equipment  | 945,713             | 862,638              |
| Other assets  | 17,012              | 10,103               |
|   | <u>\$ 1,028,253</u> | <u>\$ 905,086</u>    |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>   |                     |                      |
| Current liabilities:  |                     |                      |
| Accounts payable  | \$ 9,390            | \$ 4,697             |
| Amounts payable to oil and gas property owners  | 14,269              | 10,557               |
| Production and property taxes payable   | 10,394              | 9,407                |
| Derivative instruments  | 32,941              | 17,821               |
| Accrued liabilities and other   | 22,713              | 14,214               |
|   | <u>89,707</u>       | <u>56,696</u>        |
| Total current liabilities   | 89,707              | 56,696               |
| Revolving credit facilities   |                     | 149,373              |
| Senior convertible notes  | 100,000             | 100,000              |
| Senior subordinated notes, net of discount  | 198,474             |                      |
| Deferred income taxes   | 100,701             | 92,355               |
| Production taxes payable  | 2,771               | 6,221                |
| Derivative instruments  | 4,102               |                      |

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|   | June 30,<br>2004    | December 31,<br>2003 |
|---|---------------------|----------------------|
| Asset retirement obligation   | 14,370              | 12,876               |
| <b>Total liabilities</b>  | <b>510,125</b>      | <b>417,521</b>       |
| Minority interest in subsidiaries   | 5,607               | 4,637                |
| Stockholders' equity:   |                     |                      |
| Preferred stock, \$1.00 par value; shares authorized, 24,900; none outstanding                                  |                     |                      |
| Common stock, \$0.005 stated value; shares authorized, 100,000; shares issued and outstanding 43,152 and 42,937 | 216                 | 215                  |
| Additional paid-in capital  | 374,973             | 370,352              |
| Retained earnings   | 161,587             | 123,099              |
| Accumulated other comprehensive loss  | (24,255)            | (10,738)             |
| <b>Total stockholders' equity</b>   | <b>512,521</b>      | <b>482,928</b>       |
|   | <b>\$ 1,028,253</b> | <b>\$ 905,086</b>    |

See accompanying notes to consolidated financial statements.

**EVERGREEN RESOURCES, INC.**  
**CONSOLIDATED STATEMENTS OF INCOME**  
**(Unaudited)**

|  | <b>Three Months Ended<br/>June 30,</b>           |                  |
|--|--|------------------|
|  | <b>2004</b>                                      | <b>2003</b>      |
|  | <b>(in thousands, except per<br/>share data)</b> |                  |
| <b>Revenues:</b>                         |  |                  |
| Oil and natural gas revenues             | \$ 66,297  | \$ 53,010        |
| Interest and other                       | 255  | 278              |
| <b>Total revenues</b>                    | <b>66,552</b>                                    | <b>53,288</b>    |
| <b>Expenses:</b>                         |  |                  |
| Lease operating expenses                 | 7,332  | 5,292            |
| Transportation costs                     | 3,459  | 3,556            |
| Production and property taxes            | 3,142  | 2,972            |
| Depreciation, depletion and amortization | 11,136   | 6,187            |
| General and administrative expenses      | 5,742  | 3,269            |
| Interest expense                         | 3,691  | 2,074            |
| Merger expenses                          | 2,649  |                  |
| Other expense                            | 1,022  | 935              |
| <b>Total expenses</b>                    | <b>38,173</b>                                    | <b>24,285</b>    |
| <b>Income before income taxes</b>        | <b>28,379</b>                                    | <b>29,003</b>    |
| <b>Income tax provision:</b>             |  |                  |
| Current                                  | 369  |                  |
| Deferred                                 | 9,935  | 10,586           |
| <b>Total income tax provision</b>        | <b>10,304</b>                                    | <b>10,586</b>    |
| <b>Net income</b>                        | <b>\$ 18,075</b>                                 | <b>\$ 18,417</b> |
| <b>Basic income per common share</b>     | <b>\$ 0.42</b>                                   | <b>\$ 0.48</b>   |
| <b>Diluted income per common share</b>   | <b>\$ 0.39</b>                                   | <b>\$ 0.46</b>   |

See accompanying notes to consolidated financial statements.

**EVERGREEN RESOURCES, INC.**  
**CONSOLIDATED STATEMENTS OF INCOME**  
**(Unaudited)**

|  | <b>Six Months Ended<br/>June 30,</b>         |                |
|--|--|----------------|
|  | <b>2004</b>                                  | <b>2003</b>    |
|  | <b>(in thousands, except per share data)</b> |                |
| <b>Revenues:</b>   |  |                |
| Oil and natural gas revenues   | \$ 130,196                                   | \$ 101,986     |
| Interest and other   | 496  | 423            |
|  | <b>130,692</b>                               | <b>102,409</b> |
| <b>Expenses:</b>   |  |                |
| Lease operating expenses   | 14,579                                       | 10,008         |
| Transportation costs   | 7,322  | 6,922          |
| Production and property taxes  | 6,192  | 5,952          |
| Depreciation, depletion and amortization   | 21,040                                       | 11,716         |
| General and administrative expenses  | 10,269                                       | 5,876          |
| Interest expense   | 6,041  | 4,274          |
| Merger expenses  | 2,649  |                |
| Other expense  | 1,960  | 859            |
|  | <b>70,052</b>                                | <b>45,607</b>  |
| Income before income taxes and cumulative effect of change in accounting principle | 60,640                                       | 56,802         |
| <b>Income tax provision:</b>   |  |                |
| Current  | 937  |                |
| Deferred   | 21,215                                       | 20,733         |
|  | <b>22,152</b>                                | <b>20,733</b>  |
| Income before cumulative effect of change in accounting principle                  | 38,488                                       | 36,069         |
| Cumulative effect of change in accounting principle, net of tax                    |  | (713)          |
|  | <b>38,488</b>                                | <b>35,356</b>  |
| <b>Basic income per common share:</b>  |  |                |
| Income before cumulative effect of change in accounting principle                  | \$ 0.89                                      | \$ 0.94        |
| Cumulative effect of change in accounting principle, net of tax                    |  | (0.02)         |
|  | <b>\$ 0.89</b>                               | <b>\$ 0.92</b> |
| <b>Diluted income per common share:</b>  |  |                |
| Income before cumulative effect of change in accounting principle                  | \$ 0.82                                      | \$ 0.91        |

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Six Months Ended  
June 30,

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|   |  |  |        |
|---|--|--|--------|
| Cumulative effect of change in accounting principle, net of tax |  |  | (0.02) |
|---|--|--|--------|

|            |    |      |    |      |
|------------|----|------|----|------|
| Net income | \$ | 0.82 | \$ | 0.89 |
|------------|----|------|----|------|

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See accompanying notes to consolidated financial statements.

## EVERGREEN RESOURCES, INC.

## CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

|   | Six Months Ended June 30, |                 |
|---|---------------------------|-----------------|
|   | 2004                      | 2003            |
| (in thousands)  |                           |                 |
| <i>Increase in Cash and Cash Equivalents</i>                                      |                           |                 |
| Operating activities:   |                           |                 |
| Net income  | \$ 38,488                 | \$ 35,356       |
| Adjustments to reconcile net income to net cash provided by operating activities: |                           |                 |
| Depreciation, depletion and amortization  | 21,040                    | 11,716          |
| Cumulative effect of change in accounting principle, net of tax                   |                           | 713             |
| Deferred income taxes   | 21,215                    | 20,733          |
| Non-cash compensation and other   | 3,083                     | 1,307           |
| Changes in operating assets and liabilities:                                      |                           |                 |
| Accounts receivable   | (9,620)                   | (8,078)         |
| Other current assets  | 1,507                     | (2,415)         |
| Accounts payable  | (270)                     | (3,037)         |
| Amounts payable to oil and gas property owners                                    | 3,712                     | 2,905           |
| Production and property taxes payable   | (2,462)                   | 1,220           |
| Accrued liabilities and other   | 539                       | (843)           |
| <i>Net cash provided by operating activities</i>                                  | <u>77,232</u>             | <u>59,577</u>   |
| Investing activities:   |                           |                 |
| Investment in property and equipment  | (98,182)                  | (58,493)        |
| Other   | 925                       | 1,943           |
| <i>Net cash used in investing activities</i>                                      | <u>(97,257)</u>           | <u>(56,550)</u> |
| Financing activities:   |                           |                 |
| Proceeds from issuance of senior subordinated notes, net of discount              | 198,426                   |                 |
| Net payments on revolving credit facilities                                       | (149,373)                 | (6,000)         |
| Debt issue costs  | (5,265)                   |                 |
| Proceeds from issuance of common stock, net                                       | 2,128                     | 3,177           |
| Other   | (1,011)                   | 3,571           |
| <i>Net cash provided by financing activities</i>                                  | <u>44,905</u>             | <u>748</u>      |
| Increase in cash and cash equivalents   | 24,880                    | 3,775           |
| Cash and cash equivalents, beginning of the period                                | 3,820                     | 871             |
| Cash and cash equivalents, end of the period                                      | <u>\$ 28,700</u>          | <u>\$ 4,646</u> |

See accompanying notes to consolidated financial statements.





## EVERGREEN RESOURCES, INC.

## CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited)

|   | Three Months Ended June 30, |           | Six Months Ended June 30, |           |
|---|-----------------------------|-----------|---------------------------|-----------|
|   | 2004                        | 2003      | 2004                      | 2003      |
|   | (in thousands)              |           |                           |           |
| Net income  | \$ 18,075                   | \$ 18,417 | \$ 38,488                 | \$ 35,356 |
| Derivative instruments:                                       |                             |           |                           |           |
| Change in fair value  | (18,393)                    | (10,072)  | (31,668)                  | (30,074)  |
| Reclassification adjustment for losses included in operations | 8,057                       | 2,852     | 12,637                    | 14,823    |
| Derivative instruments, before taxes                          | (10,336)                    | (7,220)   | (19,031)                  | (15,251)  |
| Related income tax effect                                     | 3,783                       | 2,635     | 6,983                     | 5,594     |
| Derivative instruments, net of tax                            | (6,553)                     | (4,585)   | (12,048)                  | (9,657)   |
| Available for sale securities:                                |                             |           |                           |           |
| Change in fair value  |                             | 611       |                           | 611       |
| Reclassification adjustment for gains included in operations  |                             | (950)     |                           | (950)     |
| Available for sale securities, before taxes                   |                             | (339)     |                           | (339)     |
| Related income tax effect                                     |                             | 135       |                           | 135       |
| Available for sale securities, net of tax                     |                             | (204)     |                           | (204)     |
| Foreign currency translation adjustments:                     |                             |           |                           |           |
| Unrealized loss   | (1,487)                     |           | (1,469)                   |           |
| Reclassification adjustment for gains included in operations  |                             |           |                           | (996)     |
|   | (1,487)                     |           | (1,469)                   | (996)     |
| Comprehensive income  | \$ 10,035                   | \$ 13,628 | \$ 24,971                 | \$ 24,499 |

See accompanying notes to consolidated financial statements.

**EVERGREEN RESOURCES, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**As of June 30, 2004**

**(Unaudited)**

**1. Nature of Operations and Basis of Presentation**

Evergreen Resources, Inc. ("Evergreen" or "the Company") is a Colorado corporation organized on January 14, 1981. Evergreen is an independent energy company engaged primarily in the operation, development, production, exploration and acquisition of North American unconventional natural gas properties. Evergreen is one of the leading developers of coal bed methane reserves in the United States. Evergreen's current operations are principally focused on developing and expanding its coal bed methane project located in the Raton Basin in southern Colorado. The Company is also expanding its conventional and unconventional projects in the Piceance Basin in western Colorado, the Uintah Basin in eastern Utah and the Western Canada Sedimentary Basin in south-central Alberta. Evergreen has also initiated coal bed methane projects in the Cook Inlet-Susitna Basin in Alaska and the Forest City Basin in eastern Kansas. Evergreen's common stock is traded on the New York Stock Exchange under the symbol "EVG."

In the opinion of management, the accompanying unaudited financial statements include all adjustments, consisting only of normal recurring items, necessary to present fairly the Company's financial position as of June 30, 2004 and December 31, 2003 and the results of its operations for the three and six months ended June 30, 2004 and 2003, and its cash flows for the six months ended June 30, 2004 and 2003. Certain reclassifications have been made to prior periods to conform to the classifications used in the current period. These reclassifications did not have an impact on previously reported results of operations. The results of operations for interim periods are not necessarily indicative of results to be expected for a full year. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted in this Form 10-Q pursuant to the rules and regulations of the United States Securities and Exchange Commission ("SEC"). The accompanying financial statements should be read in conjunction with the Company's audited consolidated financial statements for the year ended December 31, 2003.

All common stock and per-share amounts reported in the consolidated financial statements and notes thereto reflect the two-for-one split of Evergreen common stock which was effective as of September 16, 2003.

**2. Pioneer Natural Resources Company Merger**

On May 3, 2004, Evergreen and Pioneer Natural Resources Company ("Pioneer") entered into an Agreement and Plan of Merger (the "Merger Agreement") providing, among other things, that holders of Evergreen common stock will have the right to receive an aggregate of 25 million shares of Pioneer common stock (with related stockholders rights) and a total of \$850 million in cash. Holders of Evergreen common stock will have the option to elect among three types of consideration for each share of Evergreen common stock: (1) 1.1635 shares of Pioneer common stock; (2) \$39.00 cash; or (3) 0.58175 shares of Pioneer common stock and \$19.50 in cash. All holders of unvested restricted stock under Evergreen's stock-based employee plans will be deemed to have elected to receive Pioneer common stock. Holders who elect all stock consideration or all cash consideration (other than holders of unvested restricted stock) will be subject to allocation of stock and cash so that the aggregate amounts of stock and cash will be as set forth above. The Merger Agreement provides for a merger by which Evergreen will become a subsidiary of Pioneer (the "Proposed Merger").

Evergreen will also seek to sell its Kansas assets before the closing date of the merger. The Merger Agreement provides for an additional cash payment to Evergreen shareholders equal to the greater of: (1) \$0.35 per share (approximately \$15 million total) as consideration from Pioneer for the Kansas properties in the merger; or (2) the gross proceeds less transaction costs from the sale of the Kansas properties to a third party that closes before the closing date of the Proposed Merger. The Company has not received an acceptable offer for the Company's interests in the Forest City Basin in eastern Kansas. Evergreen's objective has been to sell these interests prior to the completion of the merger. The Company is pursuing other alternatives to monetize these interests. In the event that Evergreen is unable to sell the Kansas properties, Pioneer will acquire them pursuant to the terms of the Merger Agreement, previously noted.

The merger is subject to approval at meetings of the stockholders of Evergreen and Pioneer and other customary closing conditions. The merger was approved by the board of directors of Evergreen and Pioneer. The merger agreement may also be terminated in certain circumstances, including if Evergreen receives and decides to accept an unsolicited, superior offer. The merger is expected to be completed in September 2004.

### **3. Oil and Gas Properties**

The Company follows the full cost method of accounting for oil and gas properties. Under this method, all productive and nonproductive costs incurred in connection with the exploration for and development of oil and gas reserves are capitalized. Such capitalized costs include lease acquisition, geological and geophysical work, delay rentals, drilling, completing and equipping oil and gas wells, including salaries, benefits and other internal costs directly attributable to these activities. For the six months ended June 30, 2004 and 2003, Evergreen capitalized \$3.5 million and \$2.2 million of general and administrative costs, respectively. Costs associated with production and general corporate activities are expensed in the period incurred. Interest costs related to unproved properties and properties under development are also capitalized to oil and gas properties. Approximately \$1.7 million and \$0.5 million of interest was capitalized during the six months ended June 30, 2004 and 2003, respectively.

If the net investment in oil and gas properties, as adjusted for asset retirement obligations, exceeds an amount equal to the sum of: (1) the standardized measure of discounted future net cash flows from proved reserves and (2) the lower of cost or fair market value of properties in the process of development and unexplored acreage, the excess is charged to expense as additional depletion. The standardized measure is calculated using a 10% discount rate and is based on unescalated prices in effect at quarter-end with effect given to the Company's cash flow hedge positions. Normal dispositions of oil and gas properties are accounted for as adjustments of capitalized costs, with no gain or loss recognized.

Depreciation and depletion of proved oil and gas properties is computed on the units-of-production method based upon estimates of proved reserves with oil and gas being converted to a common unit of measure based on the relative energy content. Unproved oil and gas properties, including any related capitalized interest expense, are not amortized, but are assessed for impairment either individually or on an aggregate basis. The costs of certain unevaluated leasehold acreage and wells drilled are also not being amortized. Costs not being amortized are periodically assessed for possible impairments or reductions in value. If a reduction in value has occurred, costs being amortized are increased or a charge is made against earnings for those operations where a reserve base is not yet established.

Gas collection and support equipment are stated at cost. Depreciation and amortization for the gas collection system, with the exception of the gas compressor facilities, is computed on the units-of-production method based upon total reserves of the field. Gas compressor facilities and other

support equipment are depreciated using the straight-line method over the estimated useful lives of the assets of three to 30 years.

#### 4. Indebtedness

##### *5.875% Senior Subordinated Notes*

In March 2004, the Company issued \$200 million of 5.875% Senior Subordinated Notes for proceeds of \$198.4 million, net of a \$1.6 million discount. The notes are due on March 15, 2012 with interest payable on March 15 and September 15 of each year. The notes are unsecured senior subordinated indebtedness, are subordinated in right of payment to all of the Company's existing and future senior indebtedness, will rank equally in right of payment with all of the Company's future senior unsecured subordinated indebtedness and will be senior in right of payment to all of the Company's future subordinated obligations. The indenture contains covenants restricting the ability of the Company to, among other things, incur additional indebtedness, pay dividends or sell significant assets or subsidiaries. The Company was in compliance with all of these covenants at June 30, 2004.

Prior to March 15, 2007, the Company may redeem up to 35% of the original principal amount of the notes with the net cash proceeds of one or more equity offerings at a redemption price of 105.875% of the principal amount of the notes, plus accrued and unpaid interest. On or after March 15, 2008, the Company may redeem all or a portion of the notes at redemption prices ranging from 102.938% to 100% of the principal amount, as provided by the indenture. The notes also contain provisions for mandatory redemption upon the occurrence of certain future events, including a change in control.

At June 30, 2004, the carrying amount of the notes was \$198.5 million net of an unamortized discount of \$1.5 million.

The Merger Agreement with Pioneer discussed in Note 2 provides that upon the request of Pioneer, and in exchange for Pioneer's agreement to cause the subordination provisions of the notes to be eliminated and to assume the notes, the Company will use commercially reasonable efforts to solicit consents from the holders of the notes to amend the notes in order to eliminate or amend certain covenants of the notes, effective as of the effective time of the merger.

##### *Senior Convertible Notes*

The Company also has \$100 million in senior unsecured convertible notes which are due in 2021 and bear interest at a fixed annual rate of 4.75%, which is to be paid in cash on June 15 and December 15 of each year. In addition to the fixed interest, the Company will pay contingent interest to the holders of the notes if the average trading price of the notes for an established number of days exceeds 120% or more of the principal amount of the notes. The rate of contingent interest payable in respect to any six-month period will equal the greater of (1) a per annum rate equal to 5% of the Company's estimated per annum borrowing rate for senior non-convertible fixed-rate debt with a maturity date comparable to the notes or (2) 0.30% per annum. In no event may the contingent interest rate exceed 0.40% per annum. The Company paid \$0.2 million in contingent interest on June 15, 2004 and will be required to pay contingent interest equal to \$0.2 million on December 15, 2004.

The notes are general unsecured obligations, ranking on a parity in right of payment with all of Evergreen's existing and future senior indebtedness, and senior in right of payment with all of Evergreen's future subordinated indebtedness. The notes are due on December 15, 2021 but are redeemable at either the Company's option or the holder's option on other specified dates. The Company may redeem the notes at its option in whole or in part beginning on December 20, 2006, at 100% of their principal amount plus accrued and unpaid interest (including contingent interest).

Holders of the notes may require the Company to repurchase the notes if a change in control of the Company occurs. Holders may also require the Company to repurchase all or part of the notes on December 20, 2006, December 15, 2011 and December 15, 2016 at a repurchase price of 100% of the principal amount of the notes plus accrued and unpaid interest (including contingent interest). On December 20, 2006, the Company may pay the repurchase price in cash, in shares of common stock, or in any combination of cash and common stock. On December 15, 2011 and December 15, 2016, the Company must pay the repurchase price in cash.

The notes are convertible into shares of common stock of Evergreen under certain circumstances as discussed below at a conversion price of \$25 per share, subject to certain adjustments. The notes can be converted at the option of the holder if for a specified period of time, the closing price of the Company's common stock exceeds 110% of the \$25 conversion price, which occurred in November 2003, January 2004 and in April 2004, or if the average trading value of the notes for a specified period of time is less than 105% of an average conversion value as defined by the indenture governing the notes. The notes are eligible for conversion and are currently considered potential common shares in the computation of diluted shares outstanding. The notes may also be converted into shares of common stock of the Company at the election of the holders upon notice of redemption, or at any time the notes are rated by either Moody's Investors Service, Inc. or Standard & Poor's Rating Group and the credit rating initially assigned to the notes by either such rating agency is reduced by two or more ratings levels, or upon the occurrence of certain corporate transactions including a change in control or the distribution to current Company stockholders of certain purchase rights or any other asset that has a value exceeding 10% of the sale price of the common stock on the day preceding the declaration date of the distribution of such assets.

### ***Revolving Credit Facilities***

The Company currently has a \$200 million revolving credit facility with a bank group. The credit facility is available through July 1, 2005. Advances pursuant to this credit facility are limited to a borrowing base, as defined by the credit facility, which was \$200 million at June 30, 2004. The Company may elect to use either the LIBO rate plus a margin of 1.125% to 1.50% or the prime rate plus a margin of 0% to 0.25%, with margins on both rates determined by the average outstanding borrowings under the credit facility. The borrowing base is redetermined semi-annually by the bank group based upon reserve evaluations of Evergreen's oil and gas properties. An annual commitment fee of 0.375% is charged quarterly for any unused portion of the credit line. The agreement is collateralized by substantially all domestic oil and gas properties and guaranteed by substantially all of the Company's subsidiaries. The credit agreement also contains certain net worth, leverage and ratio requirements and limits the payment of dividends. At June 30, 2004, Evergreen had no outstanding borrowings under this credit facility and the Company was in compliance with all loan covenants.

## 5. Earnings per Share

The following tables set forth the computation of basic and diluted weighted average shares outstanding for the three and six months ended June 30, 2004 and 2003:

|  | Three Months Ended June 30,           |                 |                  |           |                 |                  |
|--|---------------------------------------|-----------------|------------------|-----------|-----------------|------------------|
|  | 2004                                  |                 |                  | 2003      |                 |                  |
|  | Income                                | Weighted Shares | Per Share Amount | Income    | Weighted Shares | Per Share Amount |
|  | (in thousands, except per share data) |                 |                  |           |                 |                  |
| Basic income per common share                      | \$ 18,075                             | 43,122          | \$ 0.42          | \$ 18,417 | 38,750          | \$ 0.48          |
| Effect of dilutive securities:                     |                                       |                 |                  |           |                 |                  |
| Stock options and unvested restricted stock grants |                                       | 1,645           |                  |           | 1,290           |                  |
| Assumed conversion of senior convertible notes     | 800                                   | 4,000           |                  |           |                 |                  |
| Diluted income per common share                    | \$ 18,875                             | 48,767          | \$ 0.39          | \$ 18,417 | 40,040          | \$ 0.46          |
|  | Six Months Ended June 30,             |                 |                  |           |                 |                  |
|  | 2004                                  |                 |                  | 2003      |                 |                  |
|  | Income                                | Weighted Shares | Per Share Amount | Income    | Weighted Shares | Per Share Amount |
|  | (in thousands, except per share data) |                 |                  |           |                 |                  |
| Basic income per common share                      | \$ 38,488                             | 43,074          | \$ 0.89          | \$ 35,356 | 38,438          | \$ 0.92          |
| Effect of dilutive securities:                     |                                       |                 |                  |           |                 |                  |
| Stock options and unvested restricted stock grants |                                       | 1,548           |                  |           | 1,323           |                  |
| Assumed conversion of senior convertible notes     | 1,601                                 | 4,000           |                  |           |                 |                  |
| Diluted income per common share                    | \$ 40,089                             | 48,622          | \$ 0.82          | \$ 35,356 | 39,761          | \$ 0.89          |

As of and for the three and six months ended June 30, 2004, the Company's \$100 million senior convertible notes were convertible into four million shares of Evergreen common stock at \$25 per share due to the average market price of the Company's common stock surpassing \$27.50 for an established period of time as prescribed by the indenture. The notes were not convertible at any time during the first six months of 2003.

See Note 8 for discussion of stock based compensation.

## 6. Derivatives and Hedging Activities

The Company may use derivative instruments to manage exposures to commodity prices, foreign currency and interest rate risks. The Company's objectives for holding derivatives are to achieve a consistent level of cash flow to support its capital budgeting and expenditure plans and to maximize internal rates of return for capital projects including property acquisition investments.

The Company periodically enters into fixed-price physical delivery contracts and commodity derivative contracts to manage price risk with regard to a portion of its natural gas production. The table below summarizes the natural gas swaps the Company had in place as of June 30, 2004 by region





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and contract period. The weighted average prices of the swaps have been adjusted for anticipated fuel use and regional price differentials.

| Remaining Contract Period |        | Market                     | Volume in Mcf/day | Weighted Average \$/Mcf | Unrealized Gains (Losses) at June 30, 2004 |
|---------------------------|--------|----------------------------|-------------------|-------------------------|--|
| (in thousands)            |        |                            |                   |                         |  |
| Jul 04                    | Oct 04 | Midcontinent               | 65,000            | \$ 4.86                 | \$ (5,901)                                 |
| Jul 04                    | Dec 04 | Midcontinent               | 50,000            | 4.20                    | (14,412)                                   |
| Jul 04                    | Dec 04 | Northwest Pipeline Rockies | 3,000             | 4.33                    | (713)                                      |
| Jul 04                    | Dec 04 | AECO Canada                | 4,739             | 4.63                    | (912)                                      |
|                           | Oct 04 | Midcontinent               | 10,000            | 5.79                    | 94   |
| Nov 04                    | Dec 04 | Midcontinent               | 50,000            | 5.88                    | (275)                                      |
| Jan 05                    | Dec 05 | Midcontinent               | 100,000           | 5.14                    | (14,394)                                   |
|                           |        |                            |                   |                         | \$ (36,513)                                |

The net unrealized loss of \$36.5 million as reflected in the table above is presented on the Consolidated Balance Sheet as a current liability of \$32.9 million, a non-current liability of \$4.1 million and a current asset of \$0.5 million. During the three and six months ended June 30, 2004, the Company recognized approximately \$8.1 million and \$12.6 million in hedging losses, respectively, related to natural gas derivative contracts designated as cash flow hedges. Net hedging losses of \$2.9 million and \$14.8 million were recognized related to natural gas derivative contracts designated as cash flow hedges during the three and six months ended June 30, 2003. These net losses are included in oil and natural gas revenues in the Consolidated Statements of Income and are included in cash flows from operations in the Consolidated Statements of Cash Flows.

#### 7. Supplemental Disclosures of Cash Flow Information

Cash paid during the six months ended June 30, 2004 and 2003 for interest was approximately \$4.1 million and \$4.6 million, respectively. The Company paid \$0.7 million for cash income taxes during the six months ended June 30, 2004.

#### 8. Stock Based Compensation

Financial Accounting Standards Board ("FASB") Statement of Financial Accounting Standards ("SFAS") No. 123, "Accounting for Stock-Based Compensation," as amended by SFAS No. 148, "Accounting for Stock-Based Compensation Transition and Disclosure" an Amendment to SFAS No. 123" requires the Company to provide pro forma information regarding net income as if the compensation cost for the Company's stock option plans had been determined in accordance with the fair value based method prescribed in SFAS No. 123. To provide the required pro forma information, the Company estimates the fair value of each stock option at the grant date by using the Black-Scholes option pricing model. The following table represents the pro forma effect on net income and earnings

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per share as if the Company had applied the fair value based method and recognition provisions of SFAS No. 123 to stock-based employee compensation:

|   | Three Months Ended<br>June 30,        |           | Six Months Ended<br>June 30, |           |
|---|---------------------------------------|-----------|------------------------------|-----------|
|   | 2004                                  | 2003      | 2004                         | 2003      |
|   | (in thousands, except per share data) |           |                              |           |
| Net income, as reported   | \$ 18,075                             | \$ 18,417 | \$ 38,488                    | \$ 35,356 |
| Add: Stock-based employee compensation included in reported net income, net of tax  | 347                                   | 84        | 561                          | 174       |
| Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of tax | (783)                                 | (490)     | (1,371)                      | (986)     |
| Pro forma net income  | \$ 17,639                             | \$ 18,011 | \$ 37,678                    | \$ 34,544 |
| <b>Earnings per share:</b>  |                                       |           |                              |           |
| Basic earnings per common share:  |                                       |           |                              |           |
| As reported   | \$ 0.42                               | \$ 0.48   | \$ 0.89                      | \$ 0.92   |
| Pro forma   | \$ 0.41                               | \$ 0.46   | \$ 0.87                      | \$ 0.90   |
| <b>Diluted earnings per common share:</b>   |                                       |           |                              |           |
| As reported   | \$ 0.39                               | \$ 0.46   | \$ 0.82                      | \$ 0.89   |
| Pro forma   | \$ 0.38                               | \$ 0.45   | \$ 0.81                      | \$ 0.87   |

*Stock Awards*

Under the Company's 2000 Stock Incentive Plan, shares of common stock may be granted to key employees and directors under terms and conditions determined by management. These stock grants vest over a period of three to six years and are distributed to the employees and directors as the shares vest. The Company determines employee and director compensation based on the market price of its common stock on the date of grant. Unearned compensation arising from the stock grants is shown as a reduction in stockholders' equity on the consolidated balance sheets and is amortized using the straight-line method as additional compensation over the vesting period. During the six months ended June 30, 2004, the Company granted approximately 320,000 shares of common stock to certain employees that vest over two to four years. These shares were valued at approximately \$11.2 million at the grant dates (representing a weighted average fair value of approximately \$35 per share) and recorded as deferred compensation in stockholders' equity. During the three and six months ended June 30, 2004, the Company amortized deferred compensation of \$1.1 million and \$1.8 million, respectively, for all stock grants, including those granted in prior periods.

**9. Recent Accounting Pronouncements**

Effective January 1, 2003, Evergreen adopted FASB SFAS No. 143, "Accounting for Asset Retirement Obligations." SFAS No. 143 requires the fair value of a liability for an asset retirement obligation to be recognized in the period in which it is incurred if a reasonable estimate of fair value can be made. The associated asset retirement costs are capitalized as part of the carrying amount of the long-lived asset. The adoption of SFAS No. 143 required Evergreen to record a non-cash expense, net of tax, of approximately \$0.7 million as a cumulative effect of change in accounting principle in the first quarter of 2003.

In March 2004, the FASB issued an exposure draft entitled "Share-Based Payment, an Amendment of FASB Statements No. 123 and 95." This proposed statement addresses the accounting for



share-based payment transactions in which an enterprise receives employee services in exchange for: (1) equity instruments of the enterprise or (2) liabilities that are based on the fair value of the enterprise's equity instruments or that may be settled by the issuance of such equity instruments. The proposed statement would eliminate the ability to account for share-based compensation transactions using APB Opinion No. 25, "Accounting for Stock Issued to Employees" and generally would require instead that such transactions be accounted for using a fair value-based method. As proposed, this statement would be effective for the Company on January 1, 2005. The Company is currently unable to determine what effect this statement will have on the Company's financial position or results of operations.

In March 2004, the Emerging Issues Task Force ("EITF") reached a consensus that mineral rights, as defined in EITF Issue No. 04-2, "Whether Mineral Rights Are Tangible or Intangible Assets," are tangible assets and that they should be removed as examples of intangible assets in SFAS No. 141, "Business Combinations" and No. 142, "Goodwill and Other Intangible Assets." The FASB has recently ratified this consensus and directed the FASB staff to amend SFAS Nos. 141 and 142 through the issuance of FASB Staff Position ("FSP") FAS Nos. 141-1 and 142-1. In addition, proposed FSP 142-b confirms that SFAS 142 does not change the balance sheet classification or disclosures of mineral rights of oil and gas producing enterprises. Historically, Evergreen has included the costs of such mineral rights as tangible assets, which is consistent with the EITF's consensus. As such, EITF 04-02 and the related FSPs have not affected the Company's consolidated financial statements.

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

This report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (the "Securities Act"), and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), including statements regarding, among other items, (1) the Company's growth strategies, (2) anticipated trends in the Company's business and its future results of operations, (3) market conditions in the oil and gas industry, (4) the ability of the Company to make and integrate acquisitions, (5) the outcome of litigation and the impact of governmental regulation, (6) financial market conditions, (7) wars and acts of terrorism or sabotage, (8) the risks associated with integration of acquired companies and (9) the proposed merger with Pioneer Natural Resources Company. These forward-looking statements are based largely on the Company's expectations and are subject to a number of risks and uncertainties, many of which are beyond the Company's control. Actual results could differ materially from those implied by these forward-looking statements as a result of, among other things, (1) a decline in oil and natural gas production, (2) a decline in oil and natural gas prices, (3) incorrect estimations of required capital expenditures, (4) increases in the cost of drilling, (5) completion and gas collection, (6) an increase in the cost of production and operations, (7) an inability to meet growth projections, or (8) changes in general economic conditions. These and other risks and uncertainties as well as the Company's critical accounting policies are described in more detail in the Company's most recent Annual Report on Form 10-K filed with the Securities and Exchange Commission. In light of these and other risks and uncertainties of which the Company may be unaware or which the Company currently deems immaterial, there can be no assurance that actual results will be as projected in the forward-looking statements.

Evergreen is an independent energy company engaged primarily in the operation, development, production, exploration and acquisition of North American unconventional natural gas properties. Evergreen is one of the leading developers of coal bed methane reserves in the United States. Evergreen's current operations are principally focused on developing and expanding its coal bed methane project located in the Raton Basin in southern Colorado. The Company is also expanding its conventional and unconventional projects in the Piceance Basin in western Colorado, the Uintah Basin in eastern Utah and the Western Canada Sedimentary Basin in south-central Alberta. Evergreen has also initiated coal bed methane projects in the Cook Inlet-Susitna Basin in Alaska and the Forest City Basin in eastern Kansas.

*Pioneer Merger*

On May 3, 2004, Evergreen and Pioneer Natural Resources Company ("Pioneer") entered into an Agreement and Plan of Merger (the "Merger Agreement") providing, among other things, that holders of Evergreen common stock will have the right to receive an aggregate of 25 million shares of Pioneer common stock (with related stockholders rights) and a total of \$850 million in cash. Holders of Evergreen common stock will have the option to elect among three types of consideration for each share of Evergreen common stock: (1) 1.1635 shares of Pioneer common stock; (2) \$39.00 cash; or (3) 0.58175 shares of Pioneer common stock and \$19.50 in cash. All holders of unvested restricted stock under Evergreen's stock-based employee plans will be deemed to have elected to receive Pioneer common stock. Holders who elect all stock consideration or all cash consideration (other than holders of unvested restricted stock) will be subject to allocation of stock and cash so that the aggregate amounts of stock and cash will be as set forth above. The Merger Agreement provides for a merger by which Evergreen will become a subsidiary of Pioneer (the "Proposed Merger").

Evergreen also will seek to sell its Kansas assets before the closing date of the merger. The Merger Agreement provides for an additional cash payment to Evergreen shareholders equal to the greater of: (1) \$0.35 per share (approximately \$15 million total) as consideration from Pioneer for the

Kansas properties in the merger, or (2) the gross proceeds less transaction costs from the sale of the Kansas properties to a third party that closes before the closing date of the Proposed Merger. The Company has not received an acceptable offer for the Company's interests in the Forest City Basin in eastern Kansas. Evergreen's objective has been to sell these interests prior to the completion of the merger. The Company is pursuing other alternatives to monetize these interests. In the event that Evergreen is unable to sell the Kansas properties, Pioneer will acquire them pursuant to the terms of the Merger Agreement, previously noted.

The merger is subject to approval at meetings of the stockholders of Evergreen and Pioneer and other customary closing conditions. The merger was approved by the board of directors of Evergreen and Pioneer. The Merger Agreement may also be terminated in certain circumstances, including if Evergreen receives and decides to accept an unsolicited, superior offer. The merger is expected to be completed in September 2004.

#### *Second Quarter 2004 Overview*

Oil and natural gas revenues increased 25% to \$66.3 million in the second quarter of 2004 from \$53.0 million in the corresponding period in 2003, due primarily to increased production in the Raton Basin and additional production provided by the properties acquired in the Piceance, Uintah and Western Canada Sedimentary Basins in conjunction with the Company's acquisition of Carbon Energy Corporation ("Carbon") in the fourth quarter of 2003. Total production volumes increased 23% to 13.7 Bcfe in the second quarter of 2004 from 11.2 Bcfe during the same period in the prior year.

Despite higher oil and natural gas revenues, net earnings for the second quarter of 2004 of \$18.1 million, or \$0.39 per diluted share, were slightly lower than the corresponding period in 2003 of \$18.4 million, or \$0.46 per diluted share. The decrease was primarily due to higher operating costs, as discussed in detail under "Results of Operations" below.

Evergreen drilled a total of 82 wells in the second quarter of 2004, bringing its year-to-date total to 150 wells. Of the 150 well total, 107 were drilled in the Raton Basin, 22 in the Forest City Basin, 10 in the Piceance Basin and 11 in the Western Canada Sedimentary Basin.

Evergreen expects that the remainder of 2004 will continue to be a period of accelerated development and expansion into newly acquired areas. Evergreen plans to continue to focus on its core area in the Raton Basin with 200 wells expected to be drilled by year-end. Evergreen's plans for the recently acquired areas in the Piceance and Uintah Basins include a 2004 drilling program of 55 gross wells, and its plans for the Western Canada Sedimentary Basin include a 2004 drilling program of 65 gross wells. Due to the pending merger with Pioneer, the Company has deferred the drilling of additional wells in the Forest City Basin of eastern Kansas due to the proposed sale of these properties as discussed above.

**Results of Operations****Three and Six Months Ended June 30, 2004 compared to the Three and Six Months Ended June 30, 2003.**

The following table sets forth certain unaudited operating data of the Company for the periods presented:

|  | Three Months Ended<br>June 30, |         | Six Months Ended<br>June 30, |         |
|--|--------------------------------|---------|------------------------------|---------|
|  | 2004                           | 2003    | 2003                         | 2004    |
| Oil and natural gas production (MMcfe)   | 13,721                         | 11,174  | 26,802                       | 21,689  |
| Average daily production (MMcfe)         | 150.8                          | 122.8   | 147.3                        | 119.8   |
| Average realized sales price per Mcfe(1) | \$ 4.83                        | \$ 4.74 | \$ 4.86                      | \$ 4.70 |
| Costs per Mcfe:                          |                                |         |                              |         |
| Lease operating expenses                 | \$ 0.53                        | \$ 0.47 | \$ 0.54                      | \$ 0.46 |
| Transportation costs                     | \$ 0.25                        | \$ 0.32 | \$ 0.27                      | \$ 0.32 |
| Production and property taxes            | \$ 0.23                        | \$ 0.27 | \$ 0.23                      | \$ 0.27 |
| Depreciation, depletion and amortization | \$ 0.81                        | \$ 0.55 | \$ 0.79                      | \$ 0.54 |
| General and administrative expenses      | \$ 0.42                        | \$ 0.29 | \$ 0.38                      | \$ 0.27 |
| Interest expense                         | \$ 0.27                        | \$ 0.19 | \$ 0.23                      | \$ 0.20 |

(1) Includes effects of hedging activities

Net oil and gas production in the second quarter of 2004 increased to 13,721 MMcfe or an average of 150.8 MMcfe per day, from 11,174 MMcfe or an average of 122.8 MMcfe per day in the second quarter of 2003. Net oil and gas production in the first six months of 2004 increased to 26,802 MMcfe or an average of 147.3 MMcfe per day, from 21,689 MMcfe or an average of 119.8 MMcfe per day in the first half of 2003.

Oil and natural gas revenues were \$66.3 million and \$130.2 million during the three and six months ended June 30, 2004 as compared to \$53.0 and \$102.0 million for the same periods in the prior year. The increase in oil and natural gas revenues for the three-month period was primarily due to a 23% increase in oil and gas production as well as a 2% increase in the average realized sales price per Mcfe from \$4.74 in 2003 to \$4.83 in 2004. Likewise, the increase in oil and natural gas revenues for the six-month period was primarily due to a 24% increase in oil and gas production as well as a 3% increase in the average realized sales price per Mcfe.

The average realized sales prices for the periods presented include hedging losses recognized on the Company's derivative instruments. For the three and six months ended June 30, 2004, the Company recognized hedging losses of \$8.1 million and \$12.6 million, respectively, compared to hedging losses of \$2.9 million and \$14.8 million during the same periods in the prior year.

The tables below set forth oil and natural gas production and oil and natural gas revenues by region for the three and six months ended June 30, 2004 and 2003. The Company did not own oil and

gas properties in the Piceance, Uintah and Western Canada Sedimentary Basins until its acquisition of Carbon in the fourth quarter of 2003.

**Oil and Natural Gas Production**

|                                  | Three Months Ended June 30, |               |              | Six Months Ended June 30, |               |              |
|----------------------------------|-----------------------------|---------------|--------------|---------------------------|---------------|--------------|
|                                  | 2004                        | 2003          | Change       | 2004                      | 2003          | Change       |
|                                  | (MMcfe)                     |               |              |                           |               |              |
| Raton Basin                      | 12,067                      | 11,174        | 893          | 23,777                    | 21,689        | 2,088        |
| Piceance and Uintah Basins       | 606                         |               | 606          | 1,146                     |               | 1,146        |
| Western Canada Sedimentary Basin | 1,048                       |               | 1,048        | 1,879                     |               | 1,879        |
| <b>Total</b>                     | <b>13,721</b>               | <b>11,174</b> | <b>2,547</b> | <b>26,802</b>             | <b>21,689</b> | <b>5,113</b> |

**Oil and Natural Gas Revenues**

|                                  | Three Months Ended June 30, |                  |                  | Six Months Ended June 30, |                   |                  |
|----------------------------------|-----------------------------|------------------|------------------|---------------------------|-------------------|------------------|
|                                  | 2004                        | 2003             | Change           | 2004                      | 2003              | Change           |
|                                  | (in thousands)              |                  |                  |                           |                   |                  |
| Raton Basin                      | \$ 57,168                   | \$ 53,010        | \$ 4,158         | \$ 113,930                | \$ 101,986        | \$ 11,944        |
| Piceance and Uintah Basins       | 3,169                       |                  | 3,169            | 5,717                     |                   | 5,717            |
| Western Canada Sedimentary Basin | 5,960                       |                  | 5,960            | 10,549                    |                   | 10,549           |
| <b>Total</b>                     | <b>\$ 66,297</b>            | <b>\$ 53,010</b> | <b>\$ 13,287</b> | <b>\$ 130,196</b>         | <b>\$ 101,986</b> | <b>\$ 28,210</b> |

Lease operating expenses for the three months ended June 30, 2004 were \$7.3 million or \$0.53 per Mcfe compared to \$5.3 million or \$0.47 per Mcfe for the same period in 2003. During the six months ended June 30, 2004, lease operating expenses were \$14.6 million or \$0.54 per Mcfe as compared to \$10.0 million or \$0.46 per Mcfe for the same period in the prior year. The increases of \$2.0 million and \$4.6 million for the three and six months ended June 30, 2004 from 2003 were primarily attributable to the properties acquired in the Piceance, Uintah and Western Canada Sedimentary Basins in the fourth quarter of 2003 which accounted for all of the quarter-over-quarter increase and \$3.8 million of the \$4.6 million six-month period increase. On a per Mcfe basis, the acquired properties' lease operating expenses were \$1.24 per Mcfe for the first six months of 2004 compared to \$0.46 per Mcfe for the properties located in the Raton Basin. The per unit lease operating expenses are higher for these properties because the properties (1) include more costly third party contractor costs and (2) these basins are in the early stages of development and therefore have fewer economies of scale.

Production and property taxes for the three months ended June 30, 2004 were \$3.1 million compared to \$3.0 million for the same period in 2003. For the six months ended June 30, 2004, production and property taxes were \$6.2 million as compared to \$6.0 million for the same period in the prior year. The net increases in production taxes for each period were primarily due to higher natural gas revenues offset almost entirely by decreases in the effective Colorado severance tax rate.

Depreciation, depletion and amortization expense for the three months ended June 30, 2004 was \$11.1 million compared to \$6.2 million for the same period in 2003. On an equivalent Mcf basis, depreciation, depletion and amortization expense was \$0.81 per Mcfe for three months ended June 30, 2004 compared to \$0.55 per Mcfe for the same period in the prior year. During the six months ended June 30, 2004, depreciation, depletion and amortization expense was \$21.0 million or \$0.79 per Mcfe as compared to \$11.7 million or \$0.54 per Mcfe for the same period in the prior year. The increases of \$0.26 per Mcfe and \$0.25 per Mcfe for the three and six months ended June 30, 2004 as compared to the corresponding periods in the prior year are primarily due to the acquisition of the oil and gas properties in the Piceance, Uintah and Western Canada Sedimentary Basins in the fourth quarter of 2003.



General and administrative expenses were \$5.7 million during the three months ended June 30, 2004, as compared to \$3.3 million during the same period in 2003. For the six months ended June 30, 2004, general and administrative expenses were \$10.3 million as compared to \$5.9 million for the same period in the prior year. The increase in general and administrative expense was primarily related to an increase in salaries and related burdens which was due primarily to hiring additional employees in conjunction with the Company's fourth quarter 2003 acquisition of oil and gas properties, which have also added additional rental and office expenses. Professional services and public ownership expenses have also increased primarily due to costs associated with the Company's compliance with the Sarbanes-Oxley Act of 2002.

Interest expense in the second quarter of 2004 totaled \$3.7 million compared to \$2.1 million in the second quarter of 2003. Interest expense for the first six months of 2004 was \$6.0 million compared to \$4.3 million in the first half of 2003. The increase in interest expense is due primarily to higher average debt balances during each period in 2004 compared to the corresponding periods in 2003 as well as higher average interest rates. In March 2004, the Company issued \$200 million of 5.875% Senior Subordinated Notes to provide the Company more financial flexibility and to take advantage of historically low fixed-rate interest rates. The proceeds from the Notes were used to pay down lower variable interest rate debt, which has resulted in higher effective interest rates for each period in 2004 compared to the corresponding periods in 2003.

Merger expenses of \$2.6 million for the three and six months ended June 30, 2004 are related to costs incurred in conjunction with the Pioneer merger as discussed above.

The Company's income tax provision was based on effective income tax rates of 36.6% and 36.5% for its U.S. operations for each period in 2004 and 2003, respectively. The effective income tax rates used for the Company's Canadian operations for the three and six months ended June 30, 2004 were 35.9% for deferred income taxes and 39.5% for current income taxes payable.

Provisions for income taxes include deferred taxes resulting primarily from temporary differences due to different reporting methods for oil and gas properties for financial reporting purposes and income tax purposes. For financial reporting purposes, all exploratory and development expenditures, including future abandonment costs related to evaluated projects, are capitalized and depreciated, depleted and amortized on the units-of-production method. For United States income tax purposes, leasehold costs relative to unsuccessful wells and intangible drilling costs are charged to expense as incurred, whereas tangible well equipment and leasehold costs relative to successful wells are capitalized and are recovered through depreciation and depletion, respectively. Other significant income tax reporting differences include: (1) gas compressor facilities and other support equipment are generally depreciated over an accelerated time period with a useful life less than the corresponding financial accounting method; (2) the compensatory value of certain stock options exercised during the year is expensed for U.S. tax purposes; and (3) a deduction for original issue discount related to the senior convertible notes is also expensed for U.S. tax purposes. For Canadian income tax purposes, exploratory, development and certain acquisition expenditures are capitalized and deducted on a declining balance basis ranging from 10% to 100% of the balance annually.

## **Liquidity and Capital Resources**

### *Sources and Uses*

The Company's primary sources of liquidity are cash provided by operations and debt financing. Capital markets have also been utilized in order to maintain the Company's indebtedness at moderate levels in order to provide sufficient financial flexibility to react to future opportunities. The Company's primary needs for cash are for the operation, development, production, exploration and acquisition of oil and gas properties and working capital obligations.

In March 2004, the Company issued \$200 million of 5.875% Senior Subordinated Notes for proceeds of \$198.4 million, net of a \$1.6 million discount. The Notes are due on March 15, 2012 with interest payable on March 15 and September 15 of each year. The notes are unsecured senior subordinated indebtedness, are subordinated in right of payment to all of the Company's existing and future senior indebtedness, will rank equally in right of payment with all of the Company's future unsecured senior subordinated indebtedness and will be senior in right of payment to all of the Company's future subordinated obligations. The indenture contains covenants restricting the ability of the Company to, among other things, incur additional indebtedness, pay dividends or sell significant assets or subsidiaries. The Company was in compliance with all of these covenants at June 30, 2004. The notes contain provisions for mandatory redemption upon the occurrence of certain future events, including a change in control.

The proceeds from the issuance of the notes were utilized to completely discharge outstanding indebtedness under the Company's \$200 million revolving credit facility (described below) and to provide funding for future development expenditures and for general corporate purposes.

The Merger Agreement with Pioneer discussed in Note 2 to the consolidated financial statements provides that upon the request of Pioneer, and in exchange for Pioneer's agreement to cause the subordination provisions of the notes to be eliminated and to assume the notes, the Company will use commercially reasonable efforts to solicit consents from the holders of the notes to amend the notes in order to eliminate or amend certain covenants of the notes, effective as of the effective time of the merger.

The Company currently has a \$200 million revolving credit facility with a bank group. The credit facility is available through July 1, 2005. Advances pursuant to this credit facility are limited to a borrowing base, which is presently \$200 million. The Company may elect to use either LIBO rate plus a margin of 1.125% to 1.50% or the prime rate plus a margin of 0% to 0.25%, with margins on both rates determined by the average outstanding borrowings under the credit facility. The borrowing base is redetermined semi-annually by the bank group based upon reserve evaluations of Evergreen's oil and gas properties. An annual commitment fee of 0.375% is charged quarterly for any unused portion of the credit line. The agreement is collateralized by substantially all domestic oil and gas properties and guaranteed by substantially all of the Company's subsidiaries. The credit agreement also contains certain net worth, leverage and ratio requirements and limits the payment of dividends. The Company was in compliance with all loan covenants for all periods presented. At June 30, 2004, Evergreen had no outstanding borrowings under this credit facility.

The Company believes it is well positioned to finance its cash requirements as needed through cash on hand, cash flow from operations or current credit facilities.

#### *Cash Flows and Capital Expenditures*

Cash flows provided by operating activities were \$77.2 million for the six months ended June 30, 2004, compared to \$59.6 million for the same period in 2003. The \$17.6 million increase is primary due to a \$14.0 million increase in net income before non cash expenses consisting of depreciation, depletion and amortization, deferred income taxes, and non-cash compensation and other.

Cash flows used in investing activities were \$97.3 million during the six months ended June 30, 2004, versus \$56.6 million in the first half of 2003. The increase over 2003 of \$40.7 million is primarily due to increased investment in property and equipment during the first half of 2004 compared to the

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first half of 2003. The table below sets forth the Company's capital expenditures during the first six months of 2004 by region, including accrued capital expenditures:

|                                      | <b>Exploration<br/>and<br/>Development</b> | <b>Gas<br/>Collection</b> | <b>Well Service<br/>Equipment</b> | <b>Lease<br/>Acquisition</b> | <b>Total</b>      |
|--------------------------------------|--|---------------------------|-----------------------------------|------------------------------|-------------------|
| (in thousands)                       |  |                           |                                   |                              |                   |
| <b>Oil and Gas Operations:</b>       |  |                           |                                   |                              |                   |
| Raton Basin                          | \$ 48,791                                  | \$ 16,096                 | \$ 4,466                          | \$ 611                       | \$ 69,964         |
| Piceance and Uintah Basins           | 7,666                                      | 317                       |                                   | 920                          | 8,903             |
| Western Canada Sedimentary Basin     | 5,145                                      | 1,832                     | 109                               | 7,676                        | 14,762            |
| Kansas                               | 6,679                                      | 969                       | 1,914                             | 2,679                        | 12,241            |
| Alaska                               | 2,279                                      |                           |                                   | 346                          | 2,625             |
|                                      | <b>\$ 70,560</b>                           | <b>\$ 19,214</b>          | <b>\$ 6,489</b>                   | <b>\$ 12,232</b>             | <b>108,495</b>    |
| Other corporate capital expenditures |  |                           |                                   |                              | 2,178             |
|                                      |  |                           |                                   |                              | <b>\$ 110,673</b> |

Cash flows provided by financing activities during the first six months of 2004 were \$44.9 million compared to cash provided by financing activities of \$0.7 million during the first half of 2003. The increase of \$44.2 million was primarily associated with the issuance of the Senior Subordinated Notes resulting in net proceeds of \$193.2 million (net of related issue costs and discounts). The net proceeds were used to completely discharge the outstanding indebtedness under the Company's \$200 million revolving credit facility.

*Hedging Transactions*

The Company may use derivative instruments to manage exposures to commodity prices, foreign currency and interest rate risks. The Company's objectives for holding derivatives are to achieve a consistent level of cash flow to support its capital budgeting and expenditure plans and to maximize internal rates of return for capital projects including property acquisition investments.

The Company periodically enters into fixed-price physical delivery contracts and commodity derivative contracts to manage price risk with regard to a portion of its natural gas production. The table below summarizes the natural gas swaps the Company had in place as of June 30, 2004 by region and contract period. The weighted average prices of the swaps have been adjusted for anticipated fuel use and regional price differentials.

| <b>Remaining<br/>Contract Period</b> | <b>Market</b>              | <b>Volume in<br/>Mcf/day</b> | <b>Weighted<br/>Average<br/>\$/Mcf</b> | <b>Unrealized<br/>Gains<br/>(Losses) at<br/>June 30, 2004</b> |
|--------------------------------------|----------------------------|------------------------------|--|---|
| (in thousands)                       |                            |                              |  |   |
| Jul 04 Oct 04                        | Midcontinent               | 65,000                       | \$ 4.86                                | \$ (5,901)  |
| Jul 04 Dec 04                        | Midcontinent               | 50,000                       | 4.20                                   | (14,412)  |
| Jul 04 Dec 04                        | Northwest Pipeline Rockies | 3,000                        | 4.33                                   | (713)   |
| Jul 04 Dec 04                        | AECO Canada                | 4,739                        | 4.63                                   | (912)   |
| Oct 04                               | Midcontinent               | 10,000                       | 5.79                                   | 94  |
| Nov 04 Dec 04                        | Midcontinent               | 50,000                       | 5.88                                   | (275)   |
| Jan 05 Dec 05                        | Midcontinent               | 100,000                      | 5.14                                   | (14,394)  |
|                                      |                            |                              |  | <b>\$ (36,513)</b>  |

| <b>Remaining<br/>Contract Period</b> | <b>Market</b> | <b>Volume in<br/>Mcf/day</b> | <b>Weighted<br/>Average<br/>\$/Mcf</b> | <b>Unrealized<br/>Gains<br/>(Losses) at<br/>June 30, 2004</b> |
|--------------------------------------|---------------|------------------------------|--|---|
|                                      |               |                              |  |   |

### Recent Accounting Pronouncements

In March 2004, the Financial Accounting Standards Board ("FASB") issued an exposure draft entitled "Share-Based Payment, an Amendment of FASB Statements No. 123 and 95." This proposed statement addresses the accounting for share-based payment transactions in which an enterprise receives employee services in exchange for (1) equity instruments of the enterprise or (2) liabilities that are based on the fair value of the enterprise's equity instruments or that may be settled by the issuance of such equity instruments. The proposed statement would eliminate the ability to account for share-based compensation transactions using APB Opinion No. 25, "Accounting for Stock Issued to Employees" and generally would require instead that such transactions be accounted for using a fair-value-based method. As proposed, this statement would be effective for the Company on January 1, 2005. The Company is currently unable to determine what effect this statement will have on the Company's financial position or results of operations.

In March 2004, the Emerging Issues Task Force ("EITF") reached a consensus that mineral rights, as defined in EITF Issue No. 04-2, "Whether Mineral Rights Are Tangible or Intangible Assets," are tangible assets and that they should be removed as examples of intangible assets in SFAS No. 141, "Business Combinations" and No. 142, "Goodwill and Other Intangible Assets." The FASB has recently ratified this consensus and directed the FASB staff to amend SFAS Nos. 141 and 142 through the issuance of FASB Staff Position ("FSP") FAS Nos. 141-1 and 142-1. In addition, proposed FSP 142-b confirms that SFAS 142 does not change the balance sheet classification or disclosures of mineral rights of oil and gas producing enterprises. Historically, Evergreen has included the costs of such mineral rights as tangible assets, which is consistent with the EITF's consensus. As such, EITF 04-02 and the related FSPs have not affected the Company's consolidated financial statements.

### ITEM 3. QUANTATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company measures its exposure to market risk at any point in time by comparing its open positions to a market risk of fair value. The market prices the Company uses to determine fair value are based on management's best estimates, which consider various factors including closing exchange prices, volatility factors and the time value of money. At June 30, 2004, the Company was exposed to some market risk with respect to natural gas prices, long-term debt and foreign currency; however, management did not believe such risk to be material.

**Commodity Risk.** The Company's major market risk exposure is in the pricing applicable to its unhedged oil and natural gas production. Realized pricing is primarily driven by the prevailing price for crude oil and spot prices applicable to Evergreen's oil and natural gas production. Historically, prices received for gas production have been volatile and unpredictable. Pricing volatility is expected to continue.

The Company periodically enters into agreements to hedge its oil and natural gas production when market conditions are deemed favorable in order to manage price fluctuations and achieve a more predictable cash flow. The Company may use fixed-price physical delivery contracts and derivative instruments to manage exposures to commodity prices. The Company does not enter into derivative instruments for trading or speculative purposes.

Assuming production, the percent of oil and gas hedged, and the average realized market price of the unhedged oil and gas sold remained unchanged from the quarter ended June 30, 2004, a hypothetical 10% decline in the average market price the Company realized during the six months ended June 30, 2004 on unhedged production would reduce the Company's oil and natural gas revenues by approximately \$3.9 million on an annual basis.

**Interest Rate Risk.** At June 30, 2004, Evergreen had only fixed rate long-term debt totaling \$298.5 million outstanding. The \$100 million convertible notes due 2021 have a fixed interest rate of

4.75%; however, up to an additional 0.40% may be paid as contingent interest if certain conditions are met. Accordingly, the Company's annual interest payment on the \$100 million 4.75% convertible notes due 2021 will be a minimum of \$4.75 million and a maximum of \$5.15 million.

**Foreign Currency Risk.** Evergreen conducts business in Canada through its Canadian subsidiary where the Canadian dollar has been designated as the functional currency. As such, the Company is subject to foreign currency exchange risk on cash flows relating to sales, expenses, financing and investing transactions. Evergreen's net assets, revenue and expense accounts from its foreign operations in Canada are based on the U.S. dollar equivalent of such amounts measured in the Canadian dollar. Assets and liabilities of these foreign operations are translated to U.S. dollars using the applicable exchange rate as of the end of a reporting period. Revenues, expenses and cash flow are translated using the average exchange rates during the reporting period. Currently, the Company has no financial instruments in place to hedge its foreign currency risk.

#### **ITEM 4. CONTROLS AND PROCEDURES**

- (a) Evaluation of disclosure controls and procedures

The Company's Chief Executive Officer and the Chief Financial Officer evaluated the effectiveness of the Company's disclosure controls and procedures as of June 30, 2004 in accordance with Rule 13a-15 under the Exchange Act. Based on their evaluation, the Chief Executive Officer and the Chief Financial Officer concluded that the Company's disclosure controls and procedures enable the Company to:

record, process, summarize and report within the time periods specified in the Securities and Exchange Commission's rules and forms information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act; and

accumulate and communicate to management, as appropriate to allow timely decisions regarding required disclosure, information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act.

- (b) Changes in internal control over financial reporting

There were no changes in the Company's internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act) that occurred during the quarter ended June 30, 2004 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

**PART II. OTHER INFORMATION****ITEM 1. LEGAL PROCEEDINGS**

Except as provided below, Evergreen is not engaged in any material legal proceedings to which the Company or its subsidiaries are a party or to which any of its property is subject.

On May 13, 2004, after the Company announced the merger with Pioneer, certain Evergreen shareholders filed a class action lawsuit against the Company and its directors in the Denver County District Court. The lawsuit alleges that the Company and its directors breached their fiduciary duties to the Company's shareholders by, among other things, agreeing to unfair and inadequate consideration for the shares of Evergreen common stock held by the Company's shareholders. The plaintiffs in the lawsuit are seeking injunctive relief. This lawsuit and any other similar lawsuits could result in different merger consideration being paid to the holders of Evergreen common stock who are plaintiffs in such suits than the consideration paid to other Evergreen shareholders. In addition, the combined company may have to indemnify its directors for damages levied against the directors as a result of such lawsuits.

**ITEM 2. CHANGES IN SECURITIES, USE OF PROCEEDS AND ISSUER PURCHASES OF EQUITY SECURITIES**

During the period covered by this report, the Board of Directors of Evergreen amended the Shareholder Rights Agreement, dated July 7, 1997, between Evergreen and Computershare Trust Company, Inc., as successor to American Securities Transfer & Trust, Inc., as Rights Agent, to allow for the merger of Evergreen and Pioneer and to cause the purchase rights under the Shareholder Rights Agreement to expire immediately prior to the effective time of the merger.

The table below sets forth information regarding repurchases by Evergreen of its Common Shares during the periods indicated.

**Issuer Purchases of Equity Securities**

| Period     | (a)<br>Total number of<br>shares<br>purchased(1) | (b)<br>Average<br>price paid<br>per share | (c)<br>Total number of shares<br>purchased as part of<br>publicly announced plans<br>or programs(2) | (d)<br>Maximum number of<br>shares that may be<br>purchased under the<br>plans or programs(2) |
|------------|--|---|---|---|
| April 2004 |  | \$  |   |   |
| May 2004   | 19,048   | 37.40                                     |   |   |
| June 2004  |  |   |   |   |
|            | 19,048   | \$ 37.40                                  |   |   |

- (1) The purchases reflected in the table above reflect acquisitions of common shares in connection with the transfer of common shares to the Company by a participant in the company's stock incentive plans for payment of the exercise price of stock options and the repurchase of shares held by an employee of the Company.
- (2) The Company did not repurchase any of its equity securities during the period covered by this report pursuant to any publicly announced plan or program, and no such plan or program was in effect during the period covered by this report.

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

Not applicable.





**ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

The following summarizes the votes at the Company's Annual Meeting of Shareholders held on May 6, 2004:

*Election of Directors* with terms expiring at the Annual Meeting of Shareholders in 2007:

| <b>Name</b>       | <b>Term to Expire</b> | <b>For</b> | <b>Withheld</b> |
|-------------------|-----------------------|------------|-----------------|
| Dennis R. Carlton | 2007                  | 27,487,115 | 11,600,119      |
| Mark S. Sexton    | 2007                  | 27,646,192 | 11,441,042      |
| Arthur L. Smith   | 2007                  | 27,131,769 | 11,955,465      |

The terms of office of the following directors continued after the meeting: Alain G. Blanchard, Robert J. Clark, Scott D. Sheffield, Larry D. Estridge, Andrew D. Lundquist and John J. Ryan III.

*Ratification of the appointment of BDO Seidman, LLP as independent auditors for the year ending December 31, 2004:*

| <b>For</b> | <b>Against</b> | <b>Abstain</b> |
|------------|----------------|----------------|
| 38,639,029 | 437,330        | 10,875         |

**ITEM 5. OTHER INFORMATION**

Not applicable.

**ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K****(a) Exhibits.**

- 2.1 Agreement and Plan of Merger dated as May 3, 2004 by and among Pioneer Natural Resources Company, BC Merger Sub, Inc. and Evergreen Resources, Inc: Incorporated by reference to Exhibit 2.1 to the Company's Current Report on Form 8-K dated May 5, 2004.
- 4.1 Amendment No. 1 to Shareholder Rights Agreement dated as of May 3, 2004 between Evergreen Resources, Inc. and Computershare Trust Company, Inc., as Rights Agent: Incorporated by reference to Exhibit 4.1 to the Company's Current Report on Form 8-K dated May 5, 2004.
- 31.1 Certification Pursuant to Rule 13a-14(a) or 15d-14(a) of the Exchange Act, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification Pursuant to Rule 13a-14(a) or 15d-14(a) of the Exchange Act, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

**(b) Reports on Form 8-K.**

On May 5, 2004, Evergreen Resources, Inc. filed a Form 8-K under Item 5 announcing that Evergreen and Pioneer Natural Resources Company had entered into a definitive merger agreement.

On May 21, 2004, Evergreen Resources, Inc. furnished a Form 8-K under Item 9 to report that Mark S. Sexton, President and Chief Executive Officer of Evergreen Resources, Inc. sent a letter to the Wall Street Journal in which some of the terms of the proposed merger of the company with a wholly-owned subsidiary of Pioneer Natural Resources Company were discussed.

On June 7, 2004, Evergreen Resources, Inc. furnished a Form 8-K under Item 12 to report its financial results for its first quarter ended March 31, 2004.



**SIGNATURES**

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

**EVERGREEN RESOURCES, INC.**

(Registrant)

**Date:** August 2, 2004

By: /s/ KEVIN R. COLLINS

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Kevin R. Collins

*Executive Vice President Finance, Chief Financial Officer and  
Secretary (Principal Financial and Accounting Officer)*

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