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CHENIERE ENERGY INC  
Form 10-K/A  
November 30, 2001

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

FORM 10-K/A

(AMENDMENT NO. 1)

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

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES  
EXCHANGE ACT OF 1934

FOR THE YEAR ENDED DECEMBER 31, 2000

Commission File No. 0-9092

CHENIERE ENERGY, INC.

(Exact name of registrant as specified in its charter)

DELAWARE  
(State or other jurisdiction of  
incorporation or organization)

95-4352386  
(I.R.S. Employer  
Identification No.)

333 CLAY STREET, SUITE 3400  
HOUSTON, TEXAS  
(Address of principal executive offices)

77002-4102  
(Zip code)

Registrant's telephone number, including area code: (713) 659-1361

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

Securities registered pursuant to Section 12(g) of the Act:  
COMMON STOCK, \$ 0.003 PAR VALUE  
(Title of Class)

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 IF DISCLOSURE OF DELINQUENT FILERS PURSUANT TO ITEM 405 OF REGULATION S-K IS NOT CONTAINED HEREIN, AND WILL NOT BE CONTAINED, TO THE BEST OF THE REGISTRANT'S KNOWLEDGE, IN DEFINITIVE PROXY OR INFORMATION STATEMENTS INCORPORATED BY REFERENCE IN PART III OF THIS FORM 10-K/A OR ANY AMENDMENT TO THIS FORM 10-K/A.

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THE AGGREGATE MARKET VALUE OF THE REGISTRANT'S COMMON STOCK HELD BY NON-AFFILIATES OF THE REGISTRANT WAS APPROXIMATELY \$25,260,770 AS OF MARCH 30, 2001 (BASED UPON THE MARCH 30, 2001 CLOSING MARKET PRICE OF SUCH COMMON STOCK AS REPORTED ON THE AMERICAN STOCK EXCHANGE). 12,797,393 SHARES OF THE REGISTRANT'S COMMON STOCK WERE OUTSTANDING AS OF MARCH 30, 2001.

DOCUMENTS INCORPORATED BY REFERENCE: PROXY STATEMENT FOR THE REGISTRANT'S ANNUAL MEETING OF STOCKHOLDERS (TO BE FILED WITHIN 120 DAYS OF THE CLOSE OF THE REGISTRANT'S FISCAL YEAR) IS INCORPORATED BY REFERENCE INTO PART III.

CHENIERE ENERGY, INC.  
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### PART I

#### ITEMS 1. AND 2. BUSINESS AND PROPERTIES

##### GENERAL

Cheniere Energy, Inc., a Delaware corporation, is a Houston-based company engaged in oil and gas exploration, development and exploitation. The terms Cheniere and Company refer to Cheniere Energy, Inc. and its subsidiaries. The Company evaluates and generates drilling prospects using a regional and integrated approach with a large seismic database as a platform.

Cheniere has been publicly traded since July 3, 1996 under the name Cheniere Energy, Inc. The Company's principal executive offices are located at 333 Clay Street, Suite 3400, Houston, Texas 77002, and its telephone number is (713) 659-1361. Cheniere's internet website is located at [www.cheniere.com](http://www.cheniere.com).

On October 16, 2000 the Company's stockholders approved a one-for-four reverse stock split. The reverse stock split became effective on October 18, 2000 and reduced Cheniere's issued and outstanding shares from 43,989,572 shares to approximately 10,997,393 shares. All historical share and per share data appearing in this document have been restated to reflect the reverse stock

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split.

As used in this Report, Mcf means thousand cubic feet, Mmcf means million cubic feet, Bcf means billion cubic feet, Bbl means barrel or 42 U.S. gallons liquid volume, Mbbl means thousand barrels, Mcfe means thousand cubic feet of natural gas equivalent using the ratio of six Mcf of natural gas to one Bbl of crude oil, condensate and natural gas liquids, Mmcfe means million cubic feet of natural gas equivalent, Bcfe means billion cubic feet of natural gas equivalent, and Mmbtu means million British thermal units. This Report includes various other capitalized terms that are defined when first used.

### GENERAL DEVELOPMENT OF BUSINESS

Cheniere Energy Operating Co., Inc. (Cheniere Operating) was incorporated in Delaware in February 1996 for the purpose of engaging in the oil and gas exploration business, initially on the Louisiana Gulf Coast. On July 3, 1996, Cheniere Operating underwent a reorganization whereby Bexy Communications, Inc., a publicly held Delaware corporation (Bexy), received 100% of the outstanding shares of Cheniere Operating, and the former stockholders of Cheniere Operating received approximately 93% of the issued and outstanding Bexy shares. As a result of the share exchange, a change in the control of the Company occurred. The transaction was accounted for as a recapitalization of Cheniere Operating. Bexy spun off its existing assets and liabilities to its original stockholders and changed its name to Cheniere Energy, Inc. Cheniere Operating became a wholly-owned subsidiary of the Company.

Cameron Project. In 1996, Cheniere entered into an exploration agreement with an industry partner to acquire and process proprietary seismic data along the transition zone in Cameron Parish, Louisiana, covering a 228-square-mile area (the Cameron Project). The 228-square-mile survey was acquired jointly by Cheniere and an industry partner, and initial processing was completed in 1997. Interpretation of the data yielded drilling prospects located onshore and in the state and federal waters of offshore Louisiana. Leasing activity occurred over identified prospects throughout these areas and five prospects were drilled during 1999. Leasing over additional prospects began in 2000 and continues. See --Exploration Programs.

Offshore Louisiana Area. In an effort to provide continued access to high quality drilling prospects, the Company expanded beyond the Cameron Project and into the shallow waters of the Gulf of Mexico. In 1999, Cheniere licensed 8,800 square miles of seismic data from Fairfield Industries (the Offshore Louisiana Area). The Company also made the commitment to reprocess the entire 8,800 square-mile seismic database. On March 10, 2000, the Company entered into a Joint Exploration Agreement with Samson Offshore Company (Samson), whereby Samson acquired an option to participate at a 50% working interest level in any prospects Cheniere generates within an area of mutual interest in the Gulf of Mexico through September 2001.

On September 15, 2000 Cheniere reached an agreement (the Gryphon Transaction) with Warburg, Pincus Equity Partners, L.P. (Warburg), a global private equity fund based in New York, to fund exploration and development in the Offshore Louisiana Area through a newly formed private corporation, Gryphon Exploration Company (Gryphon). The Company contributed to Gryphon: (i) the Company's license from Fairfield Industries to seismic data covering the Offshore Louisiana Area; (ii) the Company's interest in the Joint Exploration Agreement with Samson, (iii) certain offshore leases, including its Shark prospect on West Cameron Block 49, and

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(iv) certain other assets and liabilities, all in exchange for 100% of the common stock of the subsidiary and cash. Warburg invested \$25,000,000 and received preferred stock, with an 8% accruing dividend, convertible into 63.2% of Gryphon's common stock. Cheniere and Warburg have also agreed, under certain circumstances, to contribute to Gryphon their respective shares of an additional \$75,000,000 investment. The Gryphon Transaction was consummated on October 11, 2000. See --Investment in Gryphon Exploration Company.

Offshore Texas Project Area. Between June 2000 and October 2000, Cheniere acquired licenses to approximately 6,800 miles of seismic data primarily in the shallow waters offshore Texas and also in the West Cameron area in the Gulf of Mexico (the Offshore Texas Project Area) in separate transactions with Seitel Data Ltd., a division of Seitel Inc., and JEBCO Seismic, L.P. Cheniere has committed to reprocess all of the data from the Offshore Texas Project Area at a cost of approximately \$8,500,000, payable in installments beginning in October 2000 and continuing through the final delivery of reprocessed data, which is expected to occur by December 2001. See --Exploration Programs.

Cheniere's existing data set covering the Cameron Project and the reprocessed data set covering the Offshore Texas Project Area, as it is delivered, provide the Company the framework with which to identify potential drilling prospects which may then be acquired through leasing at the area-wide federal and state lease sales, through farm-ins (agreements whereby a third party owner of lease interests grants to the Company the right to earn an assignment of an interest in the lease, typically by drilling one or more wells), and through participation in industry prospects. Cheniere has added exploration staff and infrastructure and plans to engage an exploration partner with the intent of commencing exploration drilling of the Offshore Texas Project Area during 2001.

As a part of its plans to add exploration staff, in December 2000, Cheniere entered into an agreement with Aurora Exploration, LLC (Aurora) to assist Cheniere in the interpretation of the Company's seismic data sets and in the Company's prospect generation activities. The initial term of the agreement is through March 2001, but it is anticipated that the agreement will be extended for an additional two years. Aurora, based in Lafayette, LA, will focus its efforts on the Mustang Island, Matagorda and West Cameron areas of the Gulf of Mexico shelf, using a portion of Cheniere's recently licensed seismic data from the Offshore Texas Project Area.

### BUSINESS STRATEGY

The Company's objective is to expand the net value of its assets by building an oil and gas reserve base in a cost-efficient manner. Cheniere's exploration program combines the use of regional seismic data in shallow water areas of the Gulf of Mexico, advanced analytical technologies, a methodology that integrates geoscience and engineering disciplines, and a core of experienced staff.

### Seismic Data

Cheniere has acquired two significant seismic database assets: 1) a 228 square-mile proprietary seismic program covering the transition zone in Cameron Parish (the Cameron Project described above), and 2) a 6,800 square-mile seismic database comprising several seismic surveys in the shallow waters offshore Texas (the Offshore Texas Project Area described above). The offshore Texas database has been available previously to the industry and was processed using a technique called dip move out (DMO). Cheniere has acquired the DMO data and is underwriting the reprocessing of the data utilizing another technology known as prestack time migration (PSTM). Both DMO and PSTM are processing techniques which improve seismic data quality to more accurately image subsurface features. Of the two techniques, PSTM is more advanced and technically accurate. The

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regional PSTM data is the technology tool which management believes gives Cheniere a competitive advantage and is being processed at the rate of approximately 600-800 square-miles (70-80 blocks) per month.

### Analysis

Cheniere has built a prospect generation infrastructure capable of detailed analyses of large volumes of seismic, geological, and engineering data. At the center of the analytical capabilities is a UNIX workstation network, which allows large databases to be shared by the technical staff. Geological and geophysical interpretation, modeling, and mapping software packages are available on the network for use by each of the geoscientists to generate and refine drilling opportunities. A thorough analysis of the various technical factors, utilizing some of these advanced evaluation capabilities, is essential to accurately quantify reserve potential and risks.

### Methodology

Cheniere employs a rigorous methodology which includes: 1) the detailed analyses of existing fields to identify geological and geophysical attributes for use as analogs, 2) regional trend mapping to extend prolific plays into under-explored areas, 3) the use of workstation interpretation techniques to rapidly identify prospects with attributes similar to those identified in the analog fields, 4) the integration of seismic interpretation, well control, structure, stratigraphy, timing, sourcing factors, and production data to quantify prospect potential, and 5) the integration of the above sciences with experience and conservative economic evaluation to focus the exploration program on highly commercial projects. By conducting a thorough analysis of the data and strict adherence to the methodology, Cheniere believes it can reduce the risk of dry holes and achieve significant growth, while maintaining a competitive

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cost of finding and development.

### Experience

Cheniere has built a technical and management team that is experienced in the Gulf of Mexico and in various technical specialties required for its exploration program. The technical staff averages 20 years of experience exploring for oil and gas in the Gulf Coast, and each individual has a proven track record of discoveries. The Company believes this experienced team allows it to be very productive in the generation and acquisition of prospects and drilling of exploratory wells.

### EXPLORATION PROGRAMS

The Company's current oil and gas exploration and development activities are focused on two areas: (i) the Cameron Project, which covers an area extending roughly three to five miles on either side of the westernmost 28 miles of Louisiana coastline; and (ii) the Offshore Texas Project Area, which covers approximately 6,800 square miles in the shallow waters offshore Texas. Substantial infrastructure along the Gulf Coast and in the shallow Gulf of Mexico should permit Cheniere to lower its development costs compared to those in other geographic regions and facilitate timely development of oil and gas discoveries. The Company's officers and technical staff have extensive experience both onshore and offshore in the Gulf Coast and believe the Company is well-positioned to evaluate, explore and develop properties in these areas.

Proprietary Seismic Exploration Program in Cameron Project

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Under the terms of an exploration agreement with an industry partner covering the Cameron Project, Cheniere paid for certain seismic costs and earned a 50% interest in seismic data covering the Cameron Project. Neither party to the exploration agreement may sell or license the acquired seismic data without the other party's approval.

In addition to ownership of the seismic data, under the exploration agreement, Cheniere has the right to acquire a 50% working interest in prospects generated by its partner within the Cameron Project. In addition to its right to participate in prospects generated by its partner, Cheniere has elected to reprocess and interpret the seismic data itself in order to generate its own prospects. Under the exploration agreement, leases acquired by either Cheniere or its partner within the Cameron Project may be subject to an area of mutual interest, under which the other party would have the right to acquire a 50% interest in acquired leases. The area of mutual interest will expire May 15, 2001.

### Seismic Exploration Program in Offshore Texas Project Area

In June 2000, Cheniere acquired a license to approximately 1,900 square miles of seismic data from Seitel Data Ltd., a division of Seitel Inc. In October 2000, Cheniere exercised its option to expand the agreement with Seitel Data Ltd. to cover an additional 1,900 square miles of seismic data. Together, the licenses acquired from Seitel represent coverage over 433 Outer Continental Shelf blocks in the shallow waters offshore Texas and Louisiana in the Gulf of Mexico.

In October 2000, Cheniere negotiated a Master Data Users Agreement with the Houston-based firm, JEBCO Seismic L.P., to acquire 3,000 square miles (333 blocks) of seismic data in both state and federal waters offshore Texas, bringing Cheniere's total data set in the shallow waters offshore Texas and Louisiana to approximately 6,800 square miles of seismic coverage. Cheniere has added exploration staff and infrastructure and plans to engage an exploration partner with the intent of commencing exploration drilling of the Offshore Texas Project Area during 2001. Cheniere has committed to reprocess all of the data from the Offshore Texas Project Area at a cost of approximately \$8,500,000, payable in installments beginning in October 2000 and continuing through the final delivery of reprocessed data, which is expected to occur in October 2001.

### Drilling Activities

In 1999, the Company drilled and completed two discovery wells located in adjacent fault blocks on West Cameron Block 49 in Louisiana state waters: the Redfish well and the Stingray well. The wells were tied into a common platform and began production during September 1999. During 2000, the wells produced 1.5 bcfe. Both wells are located in shallow waters of approximately 25 feet and were drilled into the Lower Miocene formation from 9,000 to 11,000 feet. Cheniere owns a 30% working interest in the Redfish well and a 45% working interest in the Stingray well.

During 2000, the Company commenced drilling an additional exploration well on West Cameron Block 49, known as the Shark well. In connection with the Gryphon Transaction, Cheniere assigned its interest in the Shark well, which was then being drilled, to Gryphon. Gryphon subsequently completed the well in February 2001. Production of natural gas from the Shark well is handled through a common platform which, since September 1999, has also handled production from the Company's Stingray and Redfish

wells. Further drilling in the Cameron Project is scheduled for 2001 on leased

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prospects, and leasing on additional prospects is ongoing.

### Investment in Gryphon Exploration Company

Cheniere has a 36.8% interest in Gryphon, after giving effect to the conversion of all shares of Gryphon's convertible preferred stock to shares of Gryphon common stock, but does not participate in the day-to-day management of Gryphon, does not exercise control over Gryphon, and cannot effect a change in the management of Gryphon.

In the Gryphon Transaction, the Company contributed the license to 8,800 square miles of seismic data that it had originally licensed from Fairfield Industries. The data covered more than 1,100 outer continental shelf blocks in the shallow waters of the Gulf of Mexico (the Offshore Louisiana Area). Cheniere also assigned its rights in its Joint Exploration Agreement with Samson. Under that agreement, Samson has the option to participate as a 50% working interest owner in any drilling prospect generated or acquired by Cheniere in a designated area of mutual interest coincident with the Offshore Louisiana Area within the Gulf of Mexico.

The Company also assigned to Gryphon its rights in certain leases, including the Shark Prospect on West Cameron Block 49. Gryphon has initiated production from the Shark well in February 2001, and by month-end, the well was flowing at a rate of 11 mmcf/day. Gryphon has a 29% working interest in the Shark well.

Gryphon has developed an inventory of more than 40 leads and prospects. As of March 26, 2001, Gryphon had two wells for which drilling was in progress. Depending on rig availability, Gryphon anticipates drilling up to twelve exploration wells during 2001. Gryphon is also engaged in acquiring drilling prospects through leasing at area-wide federal and state lease sales and through farm-ins of leased acreage.

### PRODUCTION AND SALES

The following table presents certain information with respect to oil and natural gas production attributable to the Company, average sales prices received and average production costs during 2000 and 1999. The Company commenced oil and gas production on September 9, 1999.

	Year Ended December 31, 2000
Production:	
Oil (bbls)	3,703
Gas (mmcf)	1,459,897
Gas equivalents (mmcfe)	1,482,117
Average sales prices:	
Oil (per barrel)	\$ 29.78
Gas (per mcf)	\$ 3.79
Selected data per mcfe:	
Average sales price	\$ 3.59
Production costs	\$ 0.26
Oil and gas depreciation, depletion and amortization	\$ 2.04

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### ACREAGE AND WELLS

The following table sets forth certain information with respect to the Company's developed and undeveloped leased acreage as of December 31, 2000.

	DEVELOPED ACRES		UNDEVELOPED ACRES (1)	
	GROSS	NET	GROSS	NET
Louisiana	1,366	513	1,466	1,352
Texas	--	--	--	--
Total	1,366	513	1,466	1,352
	-----	-----	-----	-----

(1) The Company has no leases which expire in 2001.

At December 31, 2000, the Company had working interests in 2 gross (0.75 net) producing gas wells.

### DRILLING ACTIVITIES

All of Cheniere's drilling activities are conducted through arrangements with independent contractors. Cheniere owns no drilling equipment. Certain information with regard to the Company's drilling activities, during the years ended December 31, 2000 and December 31, 1999, is set forth below:

	YEAR ENDED DECEMBER 31, 2000		DEC
	GROSS	NET WORKING INTEREST	GROSS
Development wells	--	--	--
Exploratory wells:			
Oil	--	--	--
Gas	--	--	2
Nonproductive	--	--	4
Total	--	--	6
Total wells	--	--	6
	-----	-----	-----

Cheniere drilled no wells prior to 1999. All of the Company's wells are located in the United States. Although the Company commenced drilling the Shark well during 2000, the Company assigned its interest in the Shark well to Gryphon, its unconsolidated affiliate, in connection with the Gryphon Transaction in October 2000. At December 31, 2000, the Company was not participating in the drilling of



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any wells.

### OIL AND GAS RESERVES

All information herein regarding estimates of Cheniere's proved reserves, related future net revenues and PV-10 is taken from reports generated by Ryder Scott Company, the Company's independent petroleum engineers, in accordance with the rules and regulations of the SEC. The independent engineers' estimates were based upon a review of production histories and other geologic, economic, ownership and engineering data provided by the Company.

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	DECEMBER 31, 2000		
	-----		
	PROVED RESERVES		
	-----		
	OIL (BBLS)	GAS (MCF)	MCFE
	-----		
West Cameron Block 49	19,874	4,568,000	4,687,244
	-----		
Proved Reserves - Consolidated	19,874	4,568,000	4,687,244
	=====		
Proved Reserves - Total (2)	22,514	6,242,000	6,377,084
	=====		
Proved Developed Reserves - Consolidated	16,913	3,982,000	4,083,478
	=====		
Proved Developed Reserves - Total (2)	19,553	5,656,000	5,773,318
	=====		

(1) The PV-10 amount (present value of estimated future net revenues discounted at 10%) is calculated using year-end prices of \$29.72 per barrel of oil and \$10.71 per mcf of gas.

(2) Includes Cheniere's proportional share, based on its 100% common stock ownership, of the proved reserves, proved developed reserves and PV-10 value of Gryphon ( 2,640 barrels of oil, 1,674,000 mcf of gas and PV-10 of \$9,138,920). Such proportional share of Gryphon reserves and PV-10 value is based upon Cheniere's ownership of 100% of Gryphon's common stock and will be reduced to 36.8% upon the conversion of Gryphon's preferred shares. See --General Development of Business.

There are numerous uncertainties inherent in estimating quantities of proved reserves and in projecting future rates of production and future amounts and timing of development expenditures, including many factors beyond the control of the Company. Reserve engineering is a subjective process of estimating underground accumulations of crude oil and natural gas that cannot be measured in an exact manner, and the accuracy of any reserve estimate is a function of the quality of available data and of engineering and geological interpretation and judgment. Estimates of proved undeveloped reserves are inherently less certain than estimates of proved developed reserves. The quantities of oil and gas that are ultimately recovered, production and operating costs, the amount and timing of future development expenditures, geologic success and future oil and gas sales prices may all differ from those assumed in these estimates. In

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addition, the Company's reserves may be subject to downward or upward revision based upon production history, purchases or sales of properties, results of future development, prevailing oil and gas prices and other factors. Therefore, the present value shown above should not be construed as the current market value of the estimated oil and gas reserves attributable to the Company's properties.

In accordance with SEC guidelines, the independent engineers' estimates of future net revenues from the Company's proved reserves and the present value thereof are made using oil and gas sales prices in effect as of the dates of such estimates and are held constant throughout the life of the properties except where such guidelines permit alternate treatment, including, in the case of gas contracts, the use of fixed and determinable contractual price escalations. The Company may receive amounts different than the independent engineers' estimates for a number of reasons, including changes in prices. See Supplemental Information to Consolidated Financial Statements. Estimates of the Company's proved oil and gas reserves were not filed with or included in reports to any other federal authority or agency other than the SEC during the fiscal year ended December 31, 2000.

### COMPETITION AND MARKETS

Competition in the industry is intense, particularly with respect to the acquisition of producing properties and proved undeveloped acreage. The Company competes with the major oil companies and other independent producers of varying sizes, all of which are engaged in the exploration, development and acquisition of producing and non-producing properties. Many of the Company's competitors have financial resources and exploration and development budgets that are substantially greater than those of the Company, which may adversely affect the Company's ability to compete.

The Company anticipates selling a portion of its interest in certain prospects as a means of funding its participation in the development of these properties. The Company anticipates that competition will arise from other companies seeking drilling funds from potential working interest partners. There can be no assurance that the Company will be successful in securing funds in this manner.

The availability of a ready market for and the price of any hydrocarbons produced by the Company will depend on many factors beyond the control of the Company, including the extent of domestic production and imports of foreign oil, the marketing of competitive fuels, the proximity and capacity of natural gas pipelines, the availability of transportation and other market facilities, the

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demand for hydrocarbons, the political conditions in international oil-producing regions, the effect of federal and state regulation of allowable rates of production, taxation, the conduct of drilling operations, and federal regulation of natural gas. In the past, as a result of excess deliverability of natural gas, many pipeline companies curtailed the amount of natural gas taken from producing wells, shut in some producing wells, significantly reduced gas taken under existing contracts, refused to make payments under applicable take-or-pay provisions, and have not contracted for gas available from some newly completed wells. The Company can give no assurance that such conditions will not arise again.

In addition, the restructuring of the natural gas pipeline industry has eliminated the gas purchasing activity of traditional interstate gas transmission pipeline buyers. Producers of natural gas, therefore, have been required to develop new markets among gas marketing companies, end-users of

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natural gas, and local distribution companies. All of these factors, together with economic factors in the marketing area, generally may affect the supply and/or demand for oil and gas and thus the prices available for sales of oil and gas.

### GOVERNMENT REGULATION

The Company's oil and gas exploration, production, and related operations are subject to federal and state statutes and extensive rules and regulations promulgated by federal and state agencies. Failure to comply with such laws can result in substantial penalties. The regulatory burden on the oil and gas industry increases the Company's cost of doing business and affects its profitability. Because such laws are frequently amended or reinterpreted, the Company is unable to predict the future cost or impact of complying with them.

### Production

In most, if not all, areas in which the Company conducts activities, statutes concerning the production of oil and natural gas authorize administrative agencies to adopt rules which, among others matters, (i) regulate the operation of, and production from, both oil and gas wells, (ii) determine the reasonable market demand for oil and gas, and (iii) establish allowable rates of production. Such regulation may restrict the rate at which the Company's wells may produce oil or gas, with the result that the amount or timing of the Company's revenues could be adversely affected.

### MMS Regulation

The Company may conduct certain activities on federal oil and gas leases which the Minerals Management Service (MMS) administers. The MMS grants leases through competitive bidding. These leases contain relatively standardized terms and require compliance with detailed MMS regulations and orders pursuant to The Outer Continental Shelf Lands Act (OCSLA) (which regulations and orders are subject to change by the MMS). For offshore operations, lessees must obtain MMS approval for exploration plans and development and production plans prior to the commencement of such operations. In addition to permits which may be required from other agencies (such as the Coast Guard, the Army Corps of Engineers and the Environmental Protection Agency), lessees must obtain a permit from the MMS prior to the commencement of drilling. The MMS has adopted regulations requiring offshore production facilities located on the Outer Continental Shelf (OCS) to meet stringent engineering and construction specifications. The MMS also has regulations restricting the flaring or venting of natural gas, and has amended such regulations to prohibit the flaring of liquid hydrocarbons and oil without prior authorization except under certain limited circumstances. Also, the MMS has promulgated other regulations governing the plugging and abandonment of wells located offshore and the removal of all production facilities. To cover the various obligations of lessees on the OCS, the MMS generally requires that lessees post substantial bonds or other acceptable assurances that such obligations will be met. The cost of such bonds or other surety can be substantial and there is no assurance that the Company will be able to obtain such bonds or other surety in all cases.

In March 2000, the MMS amended its regulations governing the calculation of royalties and the valuation of crude oil produced from federal leases. This rule modifies the valuation procedures for both arm's length and non-arm's length crude oil transactions to decrease reliance on oil posted prices and assign a value to crude oil that better reflects its market value. The Company cannot predict how it will be affected by this regulation.

In April 1997, after two years of study, the MMS withdrew proposed changes to the way it values natural gas for royalty payments and requested comment on two alternative options for natural gas valuation. The changes as originally

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proposed would have established an alternative market-based method to calculate royalties on certain natural gas sold to affiliates or pursuant to non-arm's length sales contracts. Informal discussions among the MMS and industry officials are continuing, although it is uncertain whether, and what, changes may be proposed regarding gas royalty valuation.

### Bonding and Financial Responsibility Requirements

The Company is required to obtain bonding, or otherwise demonstrate financial responsibility, at varying levels by governmental agencies in connection with obtaining state or federal leases or acting as an owner or operator on such leases or of exploration and production related facilities. These bonds may cover such obligations as plugging and abandonment of unproductive wells, removal

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and closure of related exploration, production facilities, and pollution liabilities. The costs of such bonding and financial responsibility requirements can be substantial, and there can be no assurance that the Company will be able to obtain such bonds and/or otherwise demonstrate financial responsibility in all cases.

### Natural Gas Marketing and Transportation

The Federal Energy Regulatory Commission (FERC) regulates the transportation and sale for resale of natural gas in interstate commerce pursuant to the Natural Gas Act of 1938 (NGA) and the Natural Gas Policy Act of 1978 (the NGPA). In the past, the federal government has regulated the prices at which natural gas could be sold. Deregulation of wellhead sales of natural gas began with the enactment of the NGPA in 1978. In 1989, Congress enacted the Natural Gas Wellhead Decontrol Act (the Decontrol Act) which removed all NGA and NGPA price and nonprice controls affecting wellhead sales of natural gas effective January 1, 1993. While sales by producers of natural gas can currently be made at uncontrolled market prices, Congress could reenact price controls in the future.

Commencing in April 1992, the FERC issued its Order No. 636 and related clarifying orders (Order No. 636), which, among other things, restructured the interstate natural gas industry and required interstate pipelines to provide transportation services separate, or unbundled, from the pipelines' sales of natural gas. Order No. 636 and certain related proceedings have been the subject of a number of judicial appeals and orders on remand by the FERC. Order No. 636 has largely been upheld on appeal. The Company cannot predict when these remaining appeals will be completed or their impact on the Company. The FERC continues to address Order 636-related issues (including capacity brokering, alternative and negotiated ratemaking and transportation policy matters) in a number of pending proceedings. It is unclear what impact, if any, increased competition within the natural gas industry under Order Nos. 636, et al., will have on the Company's activities. Although Order No. 636 could provide the Company with additional market access and more fairly applied transportation service rates, Order No. 636 could also subject the Company to more restrictive pipeline imbalance tolerances and greater penalties for violations of these tolerances.

The FERC has announced its intention to re-examine certain of its transportation-related policies, including the appropriate manner in which interstate pipelines release transportation capacity under Order No. 636, and the use of market-based rates for interstate gas transmission. While any resulting FERC action would affect the Company only indirectly, the FERC's current rules and policy statements may have the effect of enhancing competition in natural gas markets by, among other things, encouraging non-producer natural

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gas marketers to engage in certain purchase and sale transactions. The Company cannot predict what action the FERC will take on these matters, nor can it accurately predict whether the FERC's actions will achieve the goal of increasing competition in markets in which the Company's natural gas is sold. However, the Company does not believe that it will be treated materially differently than other natural gas producers and marketers with which it competes.

OCSLA requires that all pipelines operating on or across the OCS provide open-access, non-discriminatory service. Although the FERC has opted not to impose the regulations of Order No. 509, in which the FERC implemented OCSLA, on gatherers and other non-jurisdictional entities, the FERC has retained the authority to exercise jurisdiction over those entities if necessary to permit non-discriminatory access to service on OCS. In this regard, the FERC issued a Statement of Policy (Policy Statement) regarding the application of its jurisdiction under the NGA and OCSLA over natural gas facilities and service on OCS. In the Policy Statement, the FERC concluded that facilities located in water depths of 200 meters or more shall be presumed to have a primary purpose of gathering up to the point of interconnection with the interstate pipeline grid. The FERC has determined that gathering facilities are outside of its jurisdiction, and thus, it will no longer regulate the rates and services of such OCS facilities under the NGA. While it is not possible to determine what the actual impact of this new policy will be, it is possible that the Company could experience an increase in transportation costs associated with its OCS natural gas production and, possibly, reduced access to OCS transmission capacity.

The FERC has also issued numerous orders approving the sale and abandonment of natural gas gathering facilities previously owned by interstate pipelines and has acknowledged that if the FERC does not have jurisdiction over services provided thereon, then such facilities and services may be subject to regulation by state authorities in accordance with state law. A number of states have either enacted new laws or are considering the inadequacy of existing laws affecting gathering rates and/or services. In addition, the FERC's approval of transfers of previously regulated gathering systems to independent or pipeline-affiliated gathering companies that are not subject to FERC regulation may affect both the costs and the nature of gathering services that will be available to interested producers or shippers in the future. The effects, if any, of state and federal gathering policies on the Company's operations are uncertain.

### Oil Sales and Transportation Rates

Sales of crude oil, condensate, and gas liquids by the Company are not currently regulated under federal or state law and are made at market prices. The FERC regulates the transportation of oil in interstate commerce pursuant to the Interstate Commerce Act. However, the price a Company receives from the sale of these products is affected by the cost of transporting the products to market. Effective as of January 1, 1995, the FERC implemented regulations establishing an indexing system for transportation rates for oil pipelines, which would generally index such rates to inflation, subject to certain conditions and limitations. Over time, these

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regulations could increase the cost of transporting crude oil, liquids, and condensate by pipeline. The Company is not able to predict with certainty what effect, if any, these regulations will have on it; but other factors being equal, these regulations may tend to increase transportation costs or reduce wellhead prices for such commodities.

### Operating Hazards and Environmental Matters

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The oil and gas business involves a variety of operating risks, including the risk of fire, explosions, blow-outs, pipe failure, casing collapse, abnormally pressured formations and environmental hazards such as oil spills, natural gas leaks, ruptures and discharge of toxic gases, the occurrence of any of which could result in substantial losses to the Company due to injury or loss of life, severe damage to or destruction of property, natural resources and equipment, pollution or other environmental damage, clean-up responsibilities, regulatory investigation and penalties and suspension of operations. Such hazards may hinder or delay drilling, development and on-line production operations.

Extensive federal, state and local laws and regulations applicable to oil and gas operations regulate the discharge of substances into the environment or otherwise relate to the protection of the environment. These laws and regulations may require the acquisition of a permit before drilling commences, restrict or prohibit the types, quantities and concentration of substances that can be released into the environment or wastes that can be disposed of in connection with drilling and production activities, prohibit drilling activities on certain lands lying within wetlands or other protected areas and impose substantial liabilities for pollution or releases of hazardous substances resulting from drilling and production operations. Failure to comply with these laws and regulations may also result in civil and criminal fines and penalties. Moreover, state and federal environmental laws and regulations may become more stringent.

The Comprehensive Environmental Response, Compensation and Liability Act (CERCLA), also known as the Superfund law, imposes liability, without regard to fault or the original conduct, on certain classes of persons who are considered to be responsible for the release of a hazardous substance into the environment. These persons include the owner or operator of the disposal site or sites where the release occurred and companies that disposed or arranged for the disposal of the hazardous substances. Under CERCLA, such persons may be subject to joint and several liability for the costs of cleaning up the hazardous substances that have been released into the environment, for damages to natural resources and for the costs of certain health studies, and it is not uncommon for neighboring landowners and other third parties to file claims for personal injury and property damage allegedly caused by the release of hazardous substances.

The Company's operations may be subject to the Clean Air Act (CAA) and comparable state and local requirements. Amendments to the CAA were adopted in 1990 and contain provisions that may result in the gradual imposition of certain pollution control requirements with respect to air emissions from the operations of the Company. The EPA and states have been developing regulations to implement these requirements. The Company may be required to incur certain capital expenditures in the next several years for air pollution control equipment in connection with maintaining or obtaining permits and approvals addressing other air emission-related issues. The Company does not believe, however, that its operations will be materially adversely affected by any such requirements.

In addition, the U.S. Oil Pollution Act (OPA) requires owners and operators of facilities that could be the source of an oil spill into waters of the United States (a term defined to include rivers, creeks, wetlands, and coastal waters) to adopt and implement plans and procedures to prevent any spill of oil into any waters of the United States. OPA also requires affected facility owners and operators to demonstrate that they have at least \$35 million in financial resources to pay for the costs of cleaning up an oil spill and compensating any parties damaged by an oil spill. Such financial assurances may be increased to as much as \$150 million if a formal assessment indicates such an increase is warranted.

Operations of the Company are also subject to the federal Clean Water Act (CWA) and analogous state laws. In accordance with the CWA, the state of Louisiana has

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issued regulations prohibiting discharges of produced water in state coastal waters, effective July 1, 1997. Producers may be required to incur certain capital expenditures in the next several years in order to comply with the prohibition against the discharge of produced waters into Louisiana coastal waters or increase operating expenses in connection with offshore operations in Louisiana coastal waters. Pursuant to other requirements of the CWA, the EPA has adopted regulations concerning discharges of storm water runoff. This program requires covered facilities to obtain individual permits, participate in a group permit or seek coverage under an EPA general permit. The Company believes that it will be able to obtain, or be included under, such storm water discharge permits, where necessary.

In addition, the disposal of wastes containing naturally occurring radioactive material, which are commonly generated during oil and gas production, is regulated under state law. Typically, wastes containing naturally occurring radioactive material can be managed on-site or disposed of at facilities licensed to receive such waste at costs that are not expected to be material.

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### OPERATIONAL RISKS AND INSURANCE

The Company anticipates that any wells established by it will be drilled by proven industry contractors. Based on financial considerations, the Company may choose to utilize turnkey drilling contracts that limit its financial and legal exposure. Under a turnkey drilling contract, a negotiated price is agreed upon and the money is placed in escrow. The drilling contractor then assumes all of the risk and expense, including any cost overruns, of drilling a well to contract depth and completing any agreed upon evaluation of the wellbore. Upon performance of all these items, the escrowed money is released to the contractor. Circumstances may arise where the Company is unable to secure a turnkey contract on satisfactory terms. In this case, the Company may decide to drill, or cause to be drilled, the applicable test well(s) on either a footage or day-rate basis. Under a footage drilling contract, the operator pays to the drilling contractor an agreed sum per foot drilled. Under a day-rate drilling contract, the operator pays an agreed sum for each day of drilling required to reach contract depth. All risk and expense, including cost overruns, of drilling a well to total depths lies with the operator in both footage and day-rate contracts. The drilling of such test wells will be subject to the usual drilling hazards such as cratering, explosions, uncontrollable flows of oil, gas or well fluids, fires, pollution, and other environmental risks. The Company's activities are also subject to perils specific to marine operations, such as capsizing, collision, and damage or loss from severe weather. These hazards can cause personal injury and loss of life, severe damage to and destruction of property and equipment, pollution or environmental damage, and suspension of operations. In accordance with customary industry practices, the Company intends to maintain insurance against some, but not all, of such risks, and some, but not all, of such losses. The occurrence of a significant event not fully insured or indemnified against could materially and adversely affect the Company's financial condition and operations. Moreover, no assurance can be given that the Company will be able to maintain adequate insurance in the future at rates considered reasonable by the Company.

### EMPLOYEES

The Company had 12 full-time employees as of March 30, 2001.

### FORWARD-LOOKING STATEMENTS AND RISK FACTORS

This annual report contains certain statements that may be deemed forward-

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looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (Securities Act), and Section 21E of the United States Securities Exchange Act of 1934, as amended (Exchange Act). Readers of this annual report are cautioned that such forward-looking statements are not guarantees of future performance and that actual results, developments and business decisions may differ from those envisaged by such forward-looking statements.

All statements, other than statements of historical facts so included in this annual report that address activities, events or developments that the Company intends, expects, projects, believes, or anticipates will or may occur in the future, including, without limitation: statements regarding the Company's business strategy, plans and objectives; statements expressing beliefs and expectations regarding the ability of the Company to successfully raise the additional capital necessary to meet its obligations, the ability of the Company to secure the leases necessary to facilitate anticipated drilling activities and the ability of the Company to attract additional working interest owners to participate in the exploration and development of oil and gas reserves, and statements about non-historical Year 2000 information, are forward-looking statements within the meaning of the Act. These forward-looking statements are, and will be, based on management's then-current views and assumptions regarding future events.

The following are some of the important factors that could affect the Company's financial performance or could cause actual results to differ materially from estimates contained in the Company's forward-looking statements. The important factors are not exclusive.

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THE COMPANY HAS A LIMITED OPERATING HISTORY DURING WHICH IT HAS INCURRED LOSSES, AND IT MAY CONTINUE TO INCUR LOSSES.

The Company has a limited operating history with respect to its oil and gas exploration activities, which were commenced in April 1996. From the Company's inception until the quarter ended June 30, 2000 and subsequently, it has incurred losses and may continue to incur losses, depending on whether it generates sufficient revenue from producing reserves acquired either through acquisitions or drilling activities.

THE COMPANY HAS LIMITED CURRENT OIL AND GAS PRODUCTION AND LIMITED PROVED RESERVES, WHICH MEANS THAT ITS SUCCESS IS HIGHLY DEPENDENT ON THE SUCCESS OF ITS EXPLORATION PROGRAM.

Cheniere established its initial oil and gas production in September 1999. Through its drilling in 1999, the Company established proved reserves, which means that it has identified oil and gas reserves that geological and engineering data demonstrate with reasonable certainty to be recoverable in future years from known reservoirs under existing economic and operating conditions. The focus of Cheniere's business is exploratory drilling. Because almost all of the Company's assets are represented by investments to date in its exploration program, and the Company anticipates investing additional amounts in the program, the Company is highly dependent on the success of its exploration program.

THE COMPANY MAY NEED ADDITIONAL FINANCING AND MAY NOT BE ABLE TO OBTAIN IT ON TERMS THAT ARE ACCEPTABLE TO THE COMPANY, WHICH COULD HARM ITS ABILITY TO CONDUCT BUSINESS.

Cheniere presently has limited operating revenues. As of December 31, 2000, Cheniere had \$2,838,800 of current assets and working capital of \$1,234,390.



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Because of its low level of current assets, the Company may need additional capital for a number of purposes, and if the Company were unable to obtain additional financing it could significantly harm Cheniere's ability to conduct its business, including its ability to take advantage of opportunities that come from its exploration program. Cheniere's needs for additional financing include the following:

- . Additional capital will be required to pay for Cheniere's share of costs relating to the drilling of prospects and development of those that are successful, to exercise lease options, and to acquire additional oil and gas leases. The total amount of the Company's capital needs will be determined in part by the number of prospects generated within its exploration program and by the working interest that the Company retains in those prospects.

- . The Company will need funds for the payment of approximately \$8,000,000 related to future deliveries of reprocessed seismic data through December 2001.

- . The Company may need capital to fund its pro-rata share of the capital calls by Gryphon that are approved by Gryphon's Board of Directors. The Company's share of such future capital calls could total up to \$27,600,000. If the Company elects not to fund its pro-rata portion of such capital calls, and Warburg funds its portion, as they would be entitled, the Company will suffer dilution of its holdings in Gryphon. If the Company subscribes to its pro-rata portion of such capital calls but fails to fund, it would lose its ability to subscribe to any future capital calls and would suffer dilution of its holdings in Gryphon. It is anticipated that Gryphon will make cash calls for additional funds during 2001.

- . The Company will need funds for the payment of a transfer fee related to the assignment to Gryphon of its seismic license over the Offshore Louisiana Project Area. Cheniere is obligated to pay a transfer fee of up to \$2,500,000, in ten installments of \$250,000, which would become payable after one month of production from each of ten separate successful wells completed by Gryphon within the data set.

- . Should the Company choose to make an acquisition of producing oil and gas properties, it is likely that such an acquisition would require that some portion of the purchase price be paid in cash, and thus would create the need for additional capital.

Additional capital could be obtained from a combination of funding sources. These potential funding sources include:

- . cash flow from operating activities,
- . borrowings from financial institutions,

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- . debt offerings, which would increase the Company's leverage and add to its need for cash to service such debt,

- . additional offerings of the Company's equity securities, which would cause dilution of its common stock,

- . sales of portions of its working interest in the prospects within its exploration program, which would reduce future revenues from its exploration program,

- . sale to an industry partner of a participation in the Company's exploration program, including sale of a license to the approximate 6,800 square miles of seismic data in the Offshore Texas Project Area, which would reduce future

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revenues from its exploration program, and

- . sale of all or a portion of the Company's producing oil and gas properties, which would reduce future revenues.

Cheniere's ability to raise additional capital will depend on the results of its operations and the status of various capital and industry markets at the time such additional capital is sought. Accordingly, there can be no assurances that capital will be available to the Company from any source or that, if available, it will be on terms acceptable to the Company.

BECAUSE OF THE COMPANY'S LACK OF DIVERSIFICATION, FACTORS HARMING THE OIL AND GAS INDUSTRY IN GENERAL, INCLUDING DOWNTURNS IN PRICES FOR OIL AND GAS, WOULD BE ESPECIALLY HARMFUL TO IT.

As an independent energy company, Cheniere's revenues and profits will be substantially dependent on the oil and gas industry in general and the prevailing prices for oil and gas in particular. Circumstances that harm the oil and gas industry in general will have an especially harmful effect on Cheniere. Oil and gas prices have been and are likely to continue to be volatile and subject to wide fluctuations in response to any of the following factors:

- . relatively minor changes in the supply of and demand for oil and gas;
- . political conditions in international oil producing regions;
- . the extent of domestic production and importation of oil in relevant markets;
- . the level of consumer demand;
- . weather conditions;
- . the competitive position of oil or gas as a source of energy as compared with other energy sources;
- . the refining capacity of oil purchasers; and
- . the effect of federal and state regulation on the production, transportation and sale of oil and gas.

It is likely that adverse changes in the oil market or the regulatory environment would have an adverse effect on the Company's ability to obtain capital from lending institutions, industry participants, private or public investors or other sources.

THE COMPANY EXPERIENCES COMPETITION IN THE OIL AND GAS INDUSTRY, WHICH MAY MAKE IT DIFFICULT FOR THE COMPANY TO SUCCEED.

The oil and gas industry is highly competitive. If Cheniere is unable to compete effectively, it will not succeed. A number of factors may give the Company's competitors advantages over Cheniere. For example, most of the Company's current and potential competitors have significantly greater financial resources and a significantly greater number of experienced and trained managerial and technical personnel than the Company does. There can be no assurance that Cheniere will be able to compete effectively with such companies. Moreover, the oil and gas industry competes with other industries in supplying the energy and fuel needs of industrial, commercial and other consumers. Increased competition causing over supply and depressed prices could greatly affect Cheniere's operating revenues.

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THE COMPANY IS SUBJECT TO SIGNIFICANT OPERATING HAZARDS AND UNINSURED RISKS, ONE OR MORE OF WHICH MAY CREATE SIGNIFICANT LIABILITIES FOR IT.

The Company's oil and gas operations are subject to all of the risks and hazards typically associated with the exploration for, and the development and production of, oil and gas. In accordance with customary industry practices, the Company intends to maintain insurance against some, but not all, of these risks and losses. The occurrence of a significant event not fully insured or indemnified against could seriously harm the Company. Moreover, no assurance can be given that the Company will be able to maintain adequate insurance in the future at rates it considers reasonable. Risks in drilling operations include cratering, explosions, uncontrollable flows of oil, gas or well fluids, fires, pollution and other environmental risks. The Company's activities are also subject to perils specific to marine operations, such as capsizing, collision and damage or loss from severe weather. These hazards can cause personal injury and loss of life, severe damage to and destruction of property and equipment, pollution or environmental damage and suspension of operations.

THE COMPANY IS SUBJECT TO SIGNIFICANT EXPLORATION RISKS, INCLUDING THE RISK THAT IT MAY NOT BE ABLE TO FIND OR PRODUCE ENOUGH OIL AND GAS TO GENERATE ANY PROFITS.

The Company's exploration activities involve significant risks, including the risk that it may not be able to find or produce enough oil and gas to generate any profits. There can be no assurance that the use of technical expertise as applied to geophysical or geological data will ensure that any well the Company drills will discover oil or gas. Further, there is no way to know in advance of drilling and testing whether any prospect will yield oil or gas in sufficient quantities to make money for the Company. In addition, the Company is highly dependent on seismic activity and the related application of new technology as a primary exploration methodology. This methodology, however, requires greater pre-drilling expenditures than traditional drilling strategies. Even when fully used and properly interpreted, seismic data can only assist the Company in identifying subsurface reservoirs and hydrocarbon indicators, and will not allow the Company to determine conclusively if hydrocarbons will in fact be present and recoverable. There can be no assurance that the Company's exploration efforts will be successful.

THE COMPANY MAY NOT BE ABLE TO ACQUIRE THE OIL AND GAS LEASES IT NEEDS TO SUSTAIN PROFITABLE OPERATIONS.

There can be no assurance that Cheniere will be successful in acquiring farmouts (agreements whereby the Company, as owner of lease interests, grants to a third party the right to earn an assignment of an interest in the lease, typically by drilling one or more wells), seismic permits, lease options, leases or other rights to explore for or recover oil and gas. Consequently, the area covered by Cheniere's seismic data that could be explored through drilling could be reduced if these leases, permits, options and the like are not acquired. The United States department of the interior and the states of Texas and Louisiana award oil and gas leases on a competitive bidding basis. Further, non-governmental owners of the onshore mineral interests within the area covered by the Company's exploration program are not obligated to lease their mineral rights to the Company except where the Company has already obtained lease options. Other major and independent oil and gas companies with financial resources significantly greater than Cheniere's may bid against Cheniere for the purchase of oil and gas leases.

IF THE COMPANY IS UNABLE TO OBTAIN SATISFACTORY TURNKEY CONTRACTS, IT MAY HAVE TO ASSUME ADDITIONAL RISKS AND EXPENSES WHEN DRILLING WELLS.

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Cheniere anticipates that any wells drilled in which it has an interest will be drilled by established industry contractors under turnkey contracts that limit its financial and legal exposure. Circumstances may arise, however, where a turnkey contract is not economically beneficial to the Company or is otherwise unobtainable from proven industry contractors. In such instances, the Company may decide to drill wells on a day-rate basis, subjecting it to the usual drilling hazards such as cratering, explosions, uncontrollable flows of oil, gas or well fluids, fires, pollution and other environmental risks. The Company would also be liable for any cost overruns attributable to drilling problems that otherwise would have been covered by a turnkey contract.

Under a turnkey drilling contract, a negotiated price is agreed upon and the money is placed in escrow. The drilling contractor then assumes all of the risk and expense, including any cost overruns, of drilling a well to contract depth and completing any agreed upon evaluation of the wellbore. Upon performance of all these items, the escrowed money is released to the contractor. On a non-turnkey basis, all risk and expense, including cost overruns, of drilling a well to total depths lies with the operator.

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EXISTING AND FUTURE UNITED STATES GOVERNMENTAL REGULATION, TAXATION AND PRICE CONTROLS COULD SERIOUSLY HARM THE COMPANY.

Oil and gas production and exploration are subject to comprehensive federal, state and local laws and regulations controlling the exploration for and production and sale of oil and gas and the possible effects of such activities on the environment. Failure to comply with such rules and regulations can result in substantial penalties and may harm the Company. Present as well as future legislation and regulations could cause additional expenditures, restrictions and delays in the Company's business, the extent of which cannot be predicted and which may require the Company to limit substantially, delay or cease operations in some circumstances. In most areas where the Company plans to conduct activities, there are statutory provisions regulating the production of oil and natural gas which may restrict the rate of production and adversely affect revenues. The Company plans to acquire oil and gas leases in the Gulf of Mexico, which will be granted by the federal government and administered by the U.S. Department of Interior minerals management service. The department strictly regulates the exploration, development and production of oil and gas reserves in the Gulf of Mexico. Such regulations could seriously harm the Company's operations in the Gulf of Mexico. The federal government regulates the interstate transportation of oil and natural gas, through the Federal Energy and Regulatory Commission (FERC). The FERC has in the past regulated the prices at which oil and gas could be sold. Federal reenactment of price controls or increased regulation of the transport of oil and natural gas could seriously harm the Company. In addition, the Company's operations are subject to numerous laws and regulations governing the discharge of oil and hazardous materials into the environment or otherwise relating to environmental protection, including the Oil Pollution Act of 1990. These laws and regulations have continually imposed increasingly strict requirements for water and air pollution control, solid waste management, and strict financial responsibility and remedial response obligations relating to oil spill protection. The cost of complying with such environmental legislation could have a general harmful effect on the Company's operations.

THERE IS ONLY LIMITED TRADING IN THE COMPANY'S COMMON STOCK, WHICH MAKES ITS STOCK MORE DIFFICULT TO SELL THAN THE STOCK OF COMPANIES WITH MORE ACTIVE MARKETS.

Historically, there has been only limited trading in Cheniere's common stock,

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which makes its stock more difficult to sell than the stock of companies with more active markets. For the year 2000, the average trading volume of Cheniere's common stock was approximately 72,000 shares per day.

THE COMPANY HAS NOT PAID DIVIDENDS AND DOES NOT EXPECT TO DO SO IN THE FORESEEABLE FUTURE, SO ITS STOCKHOLDERS WILL NOT BE ABLE TO RECEIVE A RETURN ON THEIR INVESTMENT WITHOUT SELLING THEIR SHARES.

The Company has not paid dividends since its inception and does not expect to in the foreseeable future, so Cheniere's stockholders will not be able to receive a return on their investments without selling their shares. The Company presently anticipates that all earnings, if any, will be retained for development of its business. Any future dividends will be subject to the discretion of the Company's board of directors and will depend on, among other things, future earnings, the Company's operating and financial condition, its capital requirements and general business conditions.

THE COMPANY'S STOCKHOLDERS COULD EXPERIENCE DILUTION IN THE VALUE OF THEIR SHARES BECAUSE OF ADDITIONAL ISSUANCES OF SHARES.

Any issuance of common stock by the Company may result in a reduction in the book value per share or market price per share of its outstanding shares of common stock and will reduce the proportionate ownership and voting power of such shares. The Company has 125,000,000 authorized shares of stock, consisting of 120,000,000 shares of common stock, and 5,000,000 shares of preferred stock. As of December 31, 2000, approximately 90% of the shares of the common stock remained unissued. The board of directors has the power to issue any and all of such shares without shareholder approval. It is likely that the Company will issue shares of common stock in order to raise capital to sustain operations, and/or to finance future oil and gas exploration projects. In addition, the Company has reserved 2,758,621 shares of the common stock for issuance upon the exercise of outstanding warrants and 1,500,000 shares of the common stock for issuance upon the exercise of stock options. As of December 31, 2000, there are 884,236 issued and outstanding options to purchase common stock. To the extent that outstanding warrants and options are exercised, the percentage ownership of common stock of the Company's stockholders will be diluted. Moreover, the terms upon which the Company will be able to obtain additional equity capital may be adversely affected because the holders of outstanding warrants and options can be expected to exercise them at a time when the Company would, in all likelihood, be able to obtain any needed capital on terms more favorable than the exercise terms provided by such outstanding securities. In the event of the exercise of a substantial number of warrants and options, within a reasonably short period of time after the right to exercise commences, the resulting increase in the amount of the Company's common stock in the trading market could substantially adversely affect the market price of the common stock or the Company's ability to raise money through the sale of equity securities.

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THE COMPANY DEPENDS ON KEY PERSONNEL AND COULD BE SERIOUSLY HARMED IF IT LOST THEIR SERVICES.

Cheniere depends on its executive officers for various activities. The Company does not maintain key person life insurance policies on any of its personnel. The loss of the services of any of these individuals could seriously harm the Company. In addition, the Company's future success will depend in part on its ability to attract and retain additional qualified personnel. Cheniere currently has 12 full-time employees.

THE COMPANY DEPENDS ON INDUSTRY PARTNERS AND COULD BE SERIOUSLY HARMED IF THEY DO NOT PERFORM SATISFACTORILY, WHICH IS USUALLY NOT WITHIN THE COMPANY'S

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CONTROL.

Because the Company has limited financial resources, it will be largely dependent on industry partners for the success of its oil and gas exploration projects for the foreseeable future. Cheniere could be seriously harmed if its industry partners do not perform satisfactorily on projects that affect it. The Company often has no control over factors that influence the performance of its partners.

THE COMPANY IS CONTROLLED BY A SMALL NUMBER OF PRINCIPAL STOCKHOLDERS WHO MAY EXERCISE A PROPORTIONATELY LARGER INFLUENCE ON CHENIERE THAN ITS STOCKHOLDERS WITH SMALLER HOLDINGS.

Cheniere is controlled by a small number of principal stockholders who may do things that are not in the interests of the Company's stockholders with smaller holdings. BSR Investments, Ltd. (BSR) owns approximately 11% of the outstanding common stock. BSR is controlled by the mother of Charif Souki, chairman of Cheniere's board of directors. Accordingly, it is likely that BSR will have significant influence on the election of Cheniere's directors and on its management, operations and affairs, including the ability to prevent or cause a change in control of the Company.

ANTI-TAKEOVER PROVISIONS OF THE CERTIFICATE OF INCORPORATION, BYLAWS AND DELAWARE LAW COULD ADVERSELY IMPACT A POTENTIAL ACQUISITION BY THIRD PARTIES THAT MAY ULTIMATELY BE IN THE FINANCIAL INTERESTS OF THE COMPANY'S SHAREHOLDERS.

Cheniere's certificate of incorporation, bylaws and the Delaware general corporation law contain provisions that may discourage unsolicited takeover proposals. These provisions could have the effect of inhibiting fluctuations in the market price of the Company's shares that could result from actual or rumored takeover attempts, preventing changes in its management or limiting the price that investors may be willing to pay for shares of common stock. These provisions, among other things, authorize the board of directors to designate the terms of and to issue new series of preferred stock, to limit the personal liability of directors, to require the Company to indemnify directors and officers to the fullest extent permitted by applicable law and to impose restrictions on business combinations with some interested parties.

A SIGNIFICANT PORTION OF THE VALUE OF THE COMPANY IS DERIVED FROM ITS OWNERSHIP INTEREST IN GRYPHON, OVER WHICH THE COMPANY EXERCISES NO DAY-TO-DAY CONTROL.

Cheniere owns 100% of the common stock of Gryphon (36.8% effective ownership after conversion of Gryphon's preferred stock), and a significant portion of the Company's value is derived from this investment. However, Cheniere is a passive investor; it does not participate in the day-to-day management of Gryphon and has no ability to effect a change of control of Gryphon. Accordingly, Gryphon's management team could make business decisions without Cheniere's consent that could impair the value of Cheniere's investment in Gryphon.

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### ITEM 3. LEGAL PROCEEDINGS

There are no material legal proceedings currently pending against the Company.

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

The Company held a special meeting of its stockholders on October 16, 2000. The purpose of the meeting was to take a vote of the stockholders concerning a proposed one-for-four reverse stock split. Information concerning the proposal was distributed to all stockholders of record as of September 11, 2000 in a

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proxy statement dated September 18, 2000. There were 43,989,572 pre-stock split shares of common stock outstanding and eligible to vote as of the record date of September 11, 2000. The results of voting on the reverse stock split is summarized as follows:

Votes for the reverse split	29,161,146
Votes against the reverse stock split	431,671
Abstentions	25,707

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### PART II

#### ITEM 5. MARKET PRICE OF AND DIVIDENDS ON THE REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

Beginning on March 5, 2001, the common stock of the Company has traded on The American Stock Exchange under the symbol CXY. Between December 14, 2000 and March 2, 2001, Cheniere's common stock traded on the OTC Bulletin Board under the symbol CHEX.

Between April 11, 1997 and December 13, 2000, the common stock of the Company traded on The Nasdaq SmallCap Market under the symbol CHEX. From the time the Company first traded publicly until April 11, 1997, the Company's common stock traded on the OTC Bulletin Board. The table below presents the high and low daily closing sales prices of the common stock, as reported by the Nasdaq SmallCap Market and the OTC Bulletin Board, for each quarter during 1999 and 2000, and for a portion of the Company's current quarter, as reported by the OTC Bulletin Board and The American Stock Exchange.

	High	Low
Three Months Ended		
March 31, 1999	\$8.00	\$3.50
June 30, 1999	\$7.00	\$3.50
September 30, 1999	\$8.50	\$4.75
December 31, 1999	\$5.63	\$1.63
Three Months Ended		
March 31, 2000	\$4.57	\$3.91
June 30, 2000	\$4.00	\$2.13
September 30, 2000	\$3.30	\$2.91
December 31, 2000	\$2.27	\$1.98
Three Months Ended		
March 31, 2001	\$3.38	\$2.09

As of March 30, 2001, there were 12,797,393 shares of the Company's common stock outstanding held by approximately 2,800 beneficial owners.

The Company has never paid a cash dividend on its common stock. The Company currently intends to retain earnings to finance the growth and development of its business and does not anticipate paying any cash dividends on the common stock in the foreseeable future. Any future change in the Company's dividend

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policy will be made at the discretion of the Company's board of directors in light of the financial condition, capital requirements, earnings and prospects of the Company, and any restrictions under any credit agreements, as well as other factors the board of directors deems relevant.

With respect to equity securities sold by the Company during the fourth quarter of 2000 that were not registered under the Securities Act of 1933, as amended (Securities Act), see Liquidity and Capital Resources - Private Placements of Equity under Item 7 of this report.

### ITEM 6. SELECTED FINANCIAL DATA

Selected financial data set forth below are derived from the Company's audited Consolidated Financial Statements for the periods indicated, except for the data as of December 31, 1996 and for the four months ended December 31, 1996, which is derived from the Company's unaudited financial data. The financial data should be read in conjunction with the Management's Discussion and Analysis of Financial Condition and Results of Operations and the Company's Consolidated Financial Statements and Notes thereto included elsewhere in this report.

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	FOR THE YEAR ENDED DECEMBER 31,			FOR
	2000	1999	1998	1
Revenues	\$ 5,320,432	\$ 1,614,055	\$ --	\$
Production Costs	388,637	128,859	--	
Depreciation, depletion and amortization	3,371,383	1,361,644	39,171	
General and administrative expenses	1,938,659	1,908,805	1,619,307	
Loss from operations	(378,247)	(1,785,253)	(1,658,478)	
Interest income (expense)	23,916	31,530	20,634	
Equity in net loss of affiliate (2)	(426,649)	--	--	
Net loss	(780,980)	(1,753,723)	(1,637,844)	
Net loss per share (basic and diluted) (3)	(0.07)	(0.27)	(0.41)	
Cash dividends per share	\$ --	\$ --	\$ --	\$
Weighted average shares outstanding (3)	10,732,678	6,449,104	4,003,864	3

	FOR THE PERIOD ENDED AUGUST 31,	
	1997	1996
Revenues	\$ --	\$ --
Production Costs	--	--
Depreciation, depletion and amortization	8,268	3,603
General and administrative expenses	1,705,193	100,211
Loss from operations	(1,713,461)	(103,814)
Interest income (expense)	36,993	(18,033)
Equity in net loss of affiliate (2)	--	--
Net loss	(1,676,468)	(121,847)
Net loss per share (basic and diluted) (3)	(0.55)	(0.06)
Cash dividends per share	\$ --	\$ --



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Weighted average shares outstanding (3) 3,035,980 2,152,735

	DECEMBER 31,			
	2000	1999	1998	1997
Cash	\$ 1,888,562	\$ 1,175,950	\$ 143,868	\$ 1,093,180
Oil and gas properties, proved, net	6,727,613	9,459,041	--	--
Oil and gas properties, unproved	18,253,731	20,648,923	20,000,425	4,000,000
Total assets	34,665,618	34,481,275	20,840,474	5,145,310
Long-term notes payable	--	--	2,025,020	--
Total liabilities	1,604,410	6,735,537	4,523,144	718,855
Total stockholders' equity	33,061,208	27,745,738	16,317,330	4,426,455

	AUGUST 31,	
	1997	1996
Cash	\$ 234,764	\$ 1,093,180
Oil and gas properties, proved, net	--	--
Oil and gas properties, unproved	13,500,000	4,000,000
Total assets	13,841,712	5,145,310
Long-term notes payable	--	--
Total liabilities	888,291	718,855
Total stockholders' equity	12,953,421	4,426,455

(1) On April 7, 1998, the Company's board of directors approved a change in fiscal year-end. The change in year-end resulted in a transition period from September 1, 1997 to December 31, 1997.

(2) Represents the Company's equity in the net loss of Gryphon. See Note 6 to the Company's Consolidated Financial Statements.

(3) Net loss per share and weighted average shares outstanding have been restated to give effect to the one-for-four reverse stock split which was effective in October 2000. See Note 2 to Consolidated Financial Statements.

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ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

GENERAL

Cheniere Operating was incorporated in Delaware in February 1996 for the purpose of engaging in the oil and gas exploration business, initially on the Louisiana Gulf Coast. On July 3, 1996, Cheniere Operating underwent a reorganization whereby Bexy Communications, Inc., a publicly held Delaware corporation (Bexy), received 100% of the outstanding shares of Cheniere Operating, and the former stockholders of Cheniere Operating received approximately 93% of the issued and outstanding Bexy shares. As a result of the share exchange, a change in the control of the Company occurred. The transaction was accounted for as a recapitalization of Cheniere Operating. Bexy spun off its existing assets and liabilities to its original stockholders and changed its name to Cheniere Energy, Inc.

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On April 7, 1998, the Company's board of directors approved a change in fiscal year-end. The change in year-end resulted in a transition period from September 1, 1997 to December 31, 1997.

### PRODUCTION AND PRODUCT PRICES

Information concerning the Company's production and average prices received for the years ended December 31, 2000 and 1999 is presented in the following table. Cheniere commenced its production of oil and gas on September 9, 1999.

	YEAR ENDED DECEMBER 31,	
	2000	1999
Production		
Oil (Bbls)	3,703	2,975
Gas (Mcf)	1,459,897	633,432
Gas equivalents (Mcfe)	1,482,117	651,282
Average sales prices:		
Oil (per Bbl)	\$ 29.78	\$ 23.18
Gas (per Mcf)	\$ 3.79	\$ 2.59

### RESULTS OF OPERATIONS - COMPARISON OF THE FISCAL YEARS ENDED DECEMBER 31, 2000 AND 1999

The Company's financial results for the year ended December 31, 2000, reflect a loss of \$780,980 or \$0.07 per share (both basic and diluted), as compared to a loss of \$1,753,723, or \$0.27 per share (both basic and diluted), for the fiscal year ended December 31, 1999.

Cheniere commenced production of oil and gas on September 9, 1999. Accordingly, oil and gas revenues and related costs and expenses include a full year of production in 2000, compared to approximately four months of production in 1999. As a result, revenues totaled \$5,320,432 for the year ended December 31, 2000, compared to \$1,614,055 in 1999; production costs were \$388,637 in 2000 compared to \$128,859 in 1999; and depreciation, depletion and amortization (DD&A) increased to \$3,371,383 in 2000 from \$1,361,644 in 1999.

Gross general and administrative (G&A) expenses totaled \$4,366,207 in 2000, compared to \$2,868,805 in 1999. In mid-1999, Cheniere licensed 8,800 square miles of seismic data (the Fairfield Database) and doubled the number of its employees, adding management and exploration professionals to exploit its expanded database. In October 2000, Cheniere transferred to Gryphon the Fairfield Database, other assets and liabilities and substantially all of the management and technical team assembled in mid-1999 to exploit the Fairfield Database. As a result, salaries, benefits and consulting expenses increased to \$2,735,337 for 2000, compared to \$1,674,200 for 1999. In connection with the October 2000 Gryphon Transaction, Cheniere issued its financial advisers warrants to purchase 125,000 shares of common stock, valued at \$165,000. Also in 2000, Cheniere received management fees totaling \$1,684,193, of which \$988,548 was recorded as a recovery of G&A expenses. The management fees were received from the Company's industry partner, Samson, beginning in March 2000 and running through October 11, 2000, at which time the related exploration agreement was assigned to Gryphon. G&A expenses, net of recoveries, were \$3,377,659 in 2000 compared with \$2,868,805 in 1999. Cheniere capitalizes as oil and gas property costs that portion of G&A expenses directly related to its exploration

and development activities. Cheniere capitalized \$1,439,000 in 2000 compared to \$960,000 in 1999, the change being a direct result of the increased level of exploration activity. G&A expenses, net of recoveries and amounts capitalized, were \$1,938,659 and \$1,908,805 in 2000 and 1999, respectively.

Cheniere accounts for its investment in Gryphon using the equity method of accounting. Cheniere does not participate in the day-to-day management of Gryphon, does not exercise control over Gryphon and cannot effect a change in the management of Gryphon. Cheniere's equity share of Gryphon's earnings (losses) for the period from October 11, 2000 through December 31, 2000 was \$426,649, calculated by applying Cheniere's 100% common stock ownership interest to Gryphon's net income of \$19,003 and reducing such result for Gryphon's preferred dividend arrearages (\$445,652). At such time as Warburg converts its preferred shares to common shares, Cheniere's equity share of Gryphon's earnings will be calculated at 36.8%.

#### RESULTS OF OPERATIONS - COMPARISON OF THE FISCAL YEARS ENDED DECEMBER 31, 1999 AND 1998

The Company's financial results for the year ended December 31, 1999, reflect a loss of \$1,753,723 or \$0.27 per share (both basic and diluted), as compared to a loss of \$1,637,844, or \$0.41 per share (both basic and diluted), for the fiscal year ended December 31, 1998. The Company began its initial production of oil and gas in September 1999. Oil and gas revenues totaled \$1,614,055 for 1999, and related production costs were \$128,859.

DD&A increased to \$1,361,644 in 1999 from \$39,171 in 1998 principally due to the inclusion in 1999 of \$1,200,186 related to proved oil and gas properties.

G&A expenses increased to \$1,908,805 in 1999 compared to \$1,619,307 in 1998. During 1999, Cheniere licensed 8,800 additional square miles of seismic data and doubled the number of its employees, adding management and exploration professionals to exploit its expanded database. As a result, salaries, benefits and consulting expenses increased to \$1,674,200 for 1999 compared with \$773,485 in 1998. Additionally, the related expansion of office facilities increased office rent and occupancy expenses to \$264,971 in 1999 from \$52,558 in 1998. Legal and professional fees decreased to \$286,716 in 1999 from \$938,766 in 1998, largely due to the inclusion in 1998 of \$817,870 of nonrecurring expenses related to arbitration proceedings. Investor relations and travel expenses increased to \$293,623 in 1999 from \$49,691 in 1998 as Cheniere engaged outside consultants to assist in broadening investor interest in the Company; approximately \$100,000 of the 1999 expenses relate to the non-cash issuance of warrants to the Company's outside consultants. Cheniere capitalizes as oil and gas property costs that portion of G&A related to its exploration and development activities. Cheniere capitalized \$960,000 of such G&A expenses in 1999 and \$444,000 in 1998.

At December 31, 1999, the cost of Cheniere's oil and gas properties exceeded its ceiling test limitation by \$1,888,912. Increases in the prices of oil and gas subsequent to year-end were significant enough to fully eliminate the need for a write-down of the Company's oil and gas properties. For further discussion, see Note 2 - Summary of Significant Accounting Policies.

#### LIQUIDITY AND CAPITAL RESOURCES

The Company anticipates that future liquidity requirements will be met by cash balances, cash flows from operating activities, borrowings from financial institutions, debt offerings, additional offerings of the Company's equity securities, sales of portions of its working interest in the prospects within

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its exploration program, sale to an industry partner of a participation in the Company's exploration program, including sale of a license to the approximate 6,800 square miles of seismic data in the Offshore Texas Project Area, and/or sale of all or a portion of the Company's producing oil and gas properties.

### Cash Flow from Operating Activities

Cheniere commenced production of oil and gas in September 1999. Cash flow from operations (before changes in operating assets and liabilities) for the year ended December 31, 2000 totaled \$3,151,302. In October 2000, Cheniere paid in full the \$1,047,514 balance outstanding under its platform financing facility. Cash flows from Cheniere's producing oil and gas properties, which were previously dedicated to the repayment of this obligation, are now available to the Company for the funding of its operations.

### Private Placements of Equity

Since its inception, Cheniere's primary source of financing for operating expenses and investments in its exploration program has been the sale of its equity securities. Through December 31, 2000, the Company has issued 12,547,393 shares of its common stock, generating net proceeds of \$38,597,631. During 2000, the Company raised \$5,373,650, net of offering costs, from the sale of units (common stock and warrants) to accredited investors pursuant to Regulation D, through the exercise of warrants, and through the issuance of common stock in exchange for a short-term note payable. Proceeds of the offerings were used for the acquisition of leases and other exploration costs, for the repayment of short-term notes payable and for general corporate purposes.

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In February and March 2000, the Company issued to three investors 373,000 units at a price of \$3.00 per unit, each unit representing one share of common stock and one warrant to purchase a share of common stock. Warrants issued in connection with these sales of units are exercisable at a price of \$4.00 per share on or before the second anniversary of the date the units were sold. These issuances were made in reliance on the exemption from registration provided by Section 506 of Regulation D. Net proceeds were \$1,020,000 after payment of \$99,000 in selling commissions.

In March 2000, the Company issued to nine investors 234,375 shares pursuant to the exercise of warrants at an exercise price of \$4.00 per share. These issuances were made in reliance on the exemption from registration provided by Section 506 of Regulation D. Net proceeds were \$937,500.

Also in March 2000, Cheniere issued 16,667 shares of common stock to one Company in exchange for \$50,000 of geophysical consulting services. In April 2000, Cheniere issued 50,000 shares to a drilling Company in connection with an adjustment to the price of shares previously issued for drilling services rendered. These issuances were made in reliance on the exemption from registration provided by Section 4(2) of the Securities Act of 1933.

In April 2000, Cheniere issued 20,233 units to ten existing stockholders pursuant to price adjustment provisions of their subscription agreements. These units represented 20,233 shares of common stock and warrants to purchase 10,117 shares of common stock at an exercise price of \$6.00 per share on or before April 13, 2003. These issuances were made in reliance on the exemption from registration provided by Section 506 of Regulation D.

As a selling commission related to a 1999 private placement of securities, Cheniere issued to an individual in April 2000 warrants to purchase 25,000 shares of common stock at an exercise price of \$6.00 per share on or before June

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30, 2002.

In September 2000, the Company issued to the holder of its bridge notes warrants to purchase 250,000 shares of common stock at an exercise price of \$4.00 per share on or before September 6, 2003. Cheniere also issued 250,000 shares to the note holder in September 2000, at a price of \$2.00 per share, in satisfaction of \$500,000 of the bridge notes.

In December 2000, the Company consummated a private placement of 1,550,000 units consisting of one share of common stock, \$.003 par value per share, and one warrant to purchase one-sixth of a share of common stock at an exercise price of \$3.00 per share. The units were sold pursuant to Regulation D to approximately twenty-six accredited investors, including members of the Company's management and affiliates who purchased an aggregate of \$475,000. The total purchase price of the units sold was \$3,100,000. Proceeds of the offering, net of offering costs, were approximately \$2,866,150 and will be used to fund exploration activities and for other general corporate purposes. Petrie Parkman & Co. acted as financial advisor to the Company in connection with the private placement, and principals of Petrie Parkman & Co. purchased an aggregate of \$500,000 in the offering. The holders of the shares of common stock issued in this offering were granted certain registration rights.

### Short-Term Promissory Notes

At December 31, 2000, Cheniere had no outstanding debt obligations. At December 31, 1999, Cheniere had outstanding short-term notes payable of \$4,963,213. Three financing facilities comprised the balance: platform financing of \$3,090,643, well services financing of \$1,117,570 and December 1997 bridge financing notes of \$755,000. The terms of each of these facilities and of others that were utilized within the three years ended December 31, 2000, are described in the following paragraphs.

April 2000 - \$2,000,000 Bridge Financing - In April 2000, the Company established a bridge financing facility which provided for: borrowings of up to \$2,000,000 bearing interest at a rate equal to LIBOR plus 2%, a placement fee equal to 2% of the commitment amount, the issuance of warrants to purchase 250,000 shares of common stock at an exercise price of \$4.00 per share on or before September 6, 2003, and conversion of the notes payable into common stock, at Cheniere's election, at a price per share equal to \$2.00 per share. Cheniere borrowed an aggregate of \$2,000,000 under the facility during 2000. In September 2000, the Company repaid \$500,000 in cash and issued 250,000 shares to satisfy an additional \$500,000. In December 2000, Cheniere repaid the remaining balance of \$1,000,000 plus accrued interest.

September 1999 - \$3,100,000 Platform Financing - On September 1, 1999, Cheniere established a \$3,100,000 financing facility to fund a production platform and other exploration and development costs in the West Cameron Block 49 area. Borrowings under the facility were repaid from Cheniere's share of net cash flow from production through the West Cameron Block 49 platform. The note was secured by Cheniere's oil and gas properties and had a maturity date of June 30, 2000. Financing costs included interest at 10% per annum and a 5% net profit interest in the initial two wells producing through the platform. At December 31, 1999, the outstanding balance under the facility was \$3,090,643. During 2000, the Company borrowed an additional \$605,000 under the same facility and repaid all principal and interest due under the facility.

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December 1999 - \$1,117,570 Well Services Financing - In December 1999, Cheniere entered into a financing agreement with a supplier of well services to consolidate and convert trade accounts payable balances into a short-term

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secured note payable. Interest was payable at 10% per annum. The note was secured by Cheniere's oil and gas properties and matured on July 5, 2000. At December 31, 1999, the outstanding balance was \$1,117,570, which balance and all related interest were repaid during 2000.

December 1997 - \$4,000,000 Bridge Financing - In December 1997, Cheniere completed the private placement of a \$4,000,000 bridge financing. The notes payable issued by Cheniere had an initial maturity date of March 15, 1998, which was extended ultimately to March 15, 2000, when the then-remaining balance was paid. In connection with the issuance of the notes payable and with various extensions in the maturity dates, the Company has issued 70,273 shares of common stock and warrants to purchase 925,809 shares of common stock at prices ranging from \$4.00 to \$7.00 per share. The notes bore interest at rates ranging from LIBOR plus 4% to LIBOR plus 6% (approximately 12.14% at December 31, 1999).

### Exploration Agreement

On March 10, 2000, Cheniere entered into an exploration agreement with an industry partner. Under the terms of the agreement, Cheniere's exploration partner acquired an option to participate at a 50% working interest level in any drilling prospects generated by Cheniere over the subsequent eighteen-month period within a defined area of mutual interest in the Gulf of Mexico. Pursuant to the exploration agreement, Cheniere receives a management fee of \$230,000 per month over the eighteen-month term of the agreement. In addition, Cheniere's partner pays a disproportionate share of the cost of leasing and of the initial test well on each prospect. In October 2000, Cheniere assigned its rights and obligations under this agreement to Gryphon in connection with the Gryphon Transaction.

### Exploration Funding

On October 11, 2000, Cheniere completed a transaction with Warburg to fund its exploration program on approximately 8,800 square miles of seismic data in the Gulf of Mexico (the Louisiana Data Set) through a newly formed affiliated company, Gryphon. Cheniere contributed selected assets and liabilities in exchange for 100% of the common stock of Gryphon and \$2,000,000 in cash (36.8% effective interest after conversion of preferred stock). Such assets include: the Louisiana Data Set, certain offshore leases, a prospect then being drilled, its exploration agreement with an industry partner and certain other assets and liabilities. The net book value of the assets and liabilities contributed was \$7,065,919, which consisted of assets of \$9,115,963, which primarily consisted of unproved oil and gas properties and liabilities of \$2,050,044, which primarily consisted of account payable. Warburg contributed \$25,000,000 and received preferred stock, with an 8% cumulative dividend, convertible into 63.2% of Gryphon's common stock.

Cheniere and Warburg also have the option, in connection with subsequent capital calls made by Gryphon, to contribute up to an additional \$75,000,000 to Gryphon, proportionate to their respective ownership interests. Under the terms of the agreement governing these additional contributions, in the event that either Cheniere or Warburg elects not to participate in any additional contribution, the other investor has the option to purchase the non-participating investor's proportionate share. Assuming (i) that Gryphon makes subsequent capital calls for an aggregate of \$75,000,000, (ii) that Cheniere elects not to participate in any of the capital calls and (iii) that Warburg elects to purchase all of Cheniere's proportionate share, the Company's effective interest in Gryphon, after giving effect to the conversion of Gryphon's preferred stock, will be reduced to 12.7%. Cheniere accounted for the contribution of net assets at its historical cost, whereby the net amount of such assets and liabilities less the \$2,000,000 in cash was reclassified to investment in affiliate. No gain or loss was recognized at the time of contribution, primarily due to Cheniere's commitment to provide additional funding described above.

Cheniere accounts for its investment in Gryphon using the equity method of accounting. Cheniere does not participate in the day-to-day management of Gryphon, does not exercise control over Gryphon and cannot effect a change in the management of Gryphon. Cheniere's equity share of Gryphon's earnings (losses) for the period from October 11, 2000 through December 31, 2000 was \$426,649, calculated by applying Cheniere's 100% common stock ownership interest to Gryphon's net income of \$19,003 and reducing such result for Gryphon's preferred dividend arrearages (\$445,652). At such time as Warburg converts its preferred shares to common shares, Cheniere's equity share of Gryphon's earnings will be calculated at 36.8%.

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#### Seismic Reprocessing

Between June 2000 and October 2000, Cheniere acquired licenses to approximately 6,800 miles of seismic data primarily in the shallow waters offshore Texas and also in the West Cameron area in the Gulf of Mexico (the Offshore Texas Project Area) in separate transactions with Seitel Data Ltd., a division of Seitel Inc., and JEBCO Seismic, L.P. Cheniere has committed to reprocess all of the data from the Offshore Texas Project Area at a cost of approximately \$8,500,000, payable in installments beginning in October 2000 and continuing through the final delivery of reprocessed data, which is expected to occur by December 2001.

#### Recoverability of Investment in Oil and Gas Properties

The recoverability of the Company's unevaluated oil and gas properties is dependent on future events, including obtaining adequate financing for its exploration and development program, the successful reprocessing of the 3D seismic data in the Offshore Texas Project Area, the successful completion of its planned drilling program, and the achievement of a level of operating revenues that is sufficient to support the Company's cost structure. At various times during the life of the Company to date, it has been necessary for the Company to raise additional capital through private placements of debt or equity financing. When such a need has arisen, the Company has met it successfully. It is management's belief that it will continue to be able to meet its needs for additional capital as such needs arise in the future.

Cheniere's needs for additional financing include the following:

- . Additional capital will be required to pay for Cheniere's share of costs relating to the drilling of prospects and development of those that are successful, to exercise lease options, and to acquire additional oil and gas leases. The total amount of the Company's capital needs will be determined in part by the number of prospects generated within its exploration program and by the working interest that the Company retains in those prospects.

- . The Company will need funds for the payment of approximately \$8,000,000 related to future deliveries of reprocessed seismic data through December 2001.

- . The Company may need capital to fund its pro-rata share of the capital calls by Gryphon that are approved by Gryphon's Board of Directors. The Company's share of such future capital calls could total up to \$27,600,000. If the Company elects not to fund its pro-rata portion of such capital calls, and Warburg funds its portion, as they would be entitled, the Company will suffer dilution of its holdings in Gryphon. If the Company subscribes to its pro-rata portion of such capital calls but fails to fund, it would lose its ability to subscribe to any future capital calls and would suffer dilution of its holdings in Gryphon. It is anticipated that Gryphon will make cash calls for additional funds during 2001.

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. The Company will need funds for the payment of a transfer fee related to the assignment to Gryphon of its seismic license over the Offshore Louisiana Project Area. Cheniere is obligated to pay a transfer fee of up to \$2,500,000, in ten installments of \$250,000, which would become payable after one month of production from each of ten separate successful wells completed by Gryphon within the data set.

. Should the Company choose to make an acquisition of producing oil and gas properties, it is likely that such an acquisition would require that some portion of the purchase price be paid in cash, and thus would create the need for additional capital.

Additional capital could be obtained from a combination of funding sources. These potential funding sources include:

- . cash flow from operating activities,
- . borrowings from financial institutions,
- . debt offerings, which would increase the Company's leverage and add to its need for cash to service such debt,
- . additional offerings of the Company's equity securities, which would cause dilution of its common stock,
- . sales of portions of its working interest in the prospects within its exploration program, which would reduce future revenues from its exploration program,

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. sale to an industry partner of a participation in the Company's exploration program, including sale of a license to the approximate 6,800 square miles of seismic data in the Offshore Texas Project Area, which would reduce future revenues from its exploration program, and

. sale of all or a portion of the Company's producing oil and gas properties, which would reduce future revenues.

Cheniere's ability to raise additional capital will depend on the results of its operations and the status of various capital and industry markets at the time such additional capital is sought. Accordingly, there can be no assurances that capital will be available to the Company from any source or that, if available, it will be on terms acceptable to the Company.

### New Accounting Pronouncements

In June 1998, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 133, Accounting for Derivative Instruments and Hedging Activities. In June 1999, the FASB extended the adoption date of SFAS 133 until January 1, 2001, through the issuance of SFAS No. 137, Deferral of the Effective Date of SFAS 133. In June 2000, the FASB issued SFAS No. 138, Accounting for Certain Derivative Instruments and Certain Hedging Activities, which also amended SFAS 133. SFAS 133, as amended requires that companies recognize all derivative instruments as either assets or liabilities on the balance sheet and measure those instruments at fair value. Changes in the fair value of derivatives are recorded each period in current earnings or other comprehensive income depending on their designation, their intended use, or their ability to qualify as hedges. The Company adopted SFAS 133 in the first quarter of 2001; such adoption did not have a material impact on its financial



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statements.

In December 1999, the Securities and Exchange Commission issued Staff Accounting Bulletin (SAB) No. 101, Revenue Recognition in Financial Statements. SAB No. 101 was implemented in 2000 and did not have a material effect on the Company's financial statements.

### OTHER DEVELOPMENTS

Cheniere received notice on May 15, 2000 from The Nasdaq Stock Market stating that the Company was not in compliance with certain requirements related to the listing of its shares on The Nasdaq SmallCap Market. Specifically, the market price of the Company's common stock had fallen below \$1.00 per share. On September 21, 2000, Cheniere appeared before a Nasdaq Listing Panel and requested an exception to the requirement. Nasdaq granted such an exception, specifying that Cheniere must achieve a minimum bid price of \$1.00 per share by October 23, 2000 and maintain such a bid price for at least 10 consecutive trading days thereafter. At a special meeting of the Company's stockholders held on October 16, 2000, the stockholders approved a one-for-four reverse stock split. The reverse stock split became effective on October 18, 2000 and reduced Cheniere's issued and outstanding shares from 43,989,572 shares to approximately 10,997,393 shares. The closing bid price exceeded \$1.00 per share every day following the reverse split.

Nevertheless, on December 13, 2000, Nasdaq notified the Company that its common stock would be delisted from the Nasdaq SmallCap Market effective at the open of business on December 14, 2000. Effective December 14, 2000, the Company's common stock began trading on the OTC Bulletin Board under the symbol CHEX. The Company appealed Nasdaq's ruling, and contemporaneously with the appeal, applied for listing on The American Stock Exchange. When the Company's listing application was accepted by The American Stock Exchange, it discontinued the appeals process with Nasdaq. Cheniere's common stock began trading on The American Stock Exchange on March 5, 2001 under the symbol CXY.

### ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company produces and sells natural gas, crude oil and condensate. As a result, the Company's financial results can be significantly affected as these commodity prices fluctuate widely in response to changing market forces. The Company has not entered into any derivative transactions.

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### ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

#### INDEX TO FINANCIAL STATEMENTS

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REPORT OF INDEPENDENT ACCOUNTANTS

To the Board of Directors and  
Stockholders of Cheniere Energy, Inc:

In our opinion, the consolidated financial statements listed in the index appearing under Item 14(a)(1) on page 55 present fairly, in all material respects, the financial position of Cheniere Energy, Inc. and its subsidiaries at December 31, 2000 and 1999, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2000 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As more fully described in Note 13, the recoverability of the Company's unevaluated oil and gas properties is dependent on future events, including obtaining additional funding for its completion and development program, its successful reprocessing of 3D seismic data and the successful completion of its planned development program. Management's plans in regard to this matter are also described in Note 13.

PRICEWATERHOUSECOOPERS LLP

Houston, Texas  
March 30, 2001

CHENIERE ENERGY, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEET

ASSETS  
-----

December 31,  
2000  
-----

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CURRENT ASSETS	
Cash	\$ 1,888,5
Accounts Receivable	851,7
Debt Issuance Costs, net	--
Prepaid Expenses	98,5
	-----
Total Current Assets	2,838,8
OIL AND GAS PROPERTIES, full cost method	
Proved Properties, net	6,727,6
Unproved Properties, not subject to amortization	18,253,7
	-----
Total Oil and Gas Properties	24,981,3
FIXED ASSETS, net	206,2
INVESTMENT IN UNCONSOLIDATED AFFILIATE	6,639,2
	-----
Total Assets	\$ 34,665,6
	=====
LIABILITIES AND STOCKHOLDERS' EQUITY	
CURRENT LIABILITIES	
Accounts Payable	\$ 1,472,2
Accrued Liabilities	132,1
Notes Payable	
	-----
Total Current Liabilities	1,604,4
COMMITMENTS AND CONTINGENCIES (NOTE 12)	
STOCKHOLDERS' EQUITY	
Common Stock, \$.003 par value	
Authorized: 120,000,000 shares	
Issued and Outstanding: 12,547,393 shares at December 31, 2000	
and 10,053,118 shares at December 31, 1999	37,6
Preferred Stock, \$.0001 par value	
Authorized: 5,000,000 shares	
Issued and Outstanding: none	
Additional Paid-in-Capital	39,382,7
Accumulated Deficit	(6,359,2)
	-----
Total Stockholders' Equity	33,061,2
	-----
Total Liabilities and Stockholders' Equity	\$ 34,665,6
	=====

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

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	2000
Revenues	
Oil and Gas Sales	\$ 5,320,432
	-----
Total Revenues	5,320,432
	-----
Operating Costs and Expenses	
Production Costs	388,637
Depreciation, Depletion and Amortization	3,371,383
General and Administrative Expenses	1,938,659
	-----
Total Operating Costs and Expenses	5,698,679
	-----
Income/(Loss) from Operations Before Interest, Income Taxes and Equity in Net Loss of Unconsolidated Affiliate	(378,247)
Interest Income	23,916
Provision for Income Taxes	--
Equity in Net Loss of Unconsolidated Affiliate	(426,649)
	-----
Net Loss	\$ (780,980)
	=====
Net Loss Per Share - Basic and Diluted	\$ (0.07)
	=====
Weighted Average Number of Shares Outstanding - Basic and Diluted	10,732,678
	=====

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

CHENIERE ENERGY, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY

	Common Stock		Additional Paid-In Capital
	Shares	Amount	
Balance - December 31, 1997	3,614,466	\$ 10,843	\$ 15,595,8
Issuances of Stock	1,128,971	3,387	4,380,2
Expenses Related to Offerings	--	--	(168,0
Issuance of Warrants	--	--	319,4
Net Loss	--	--	
Balance - December 31, 1998	4,743,437	14,230	20,127,6
Issuance of Shares in Exchange for Notes	792,590	2,378	2,243,7
Issuance of Warrants	--	--	200,0
Repricing of Warrants to Extend Bridge Notes	--	--	35,7
Issuance of Shares in Exchange for Production Payment	146,119	438	399,5
Issuances of Stock	4,370,972	13,113	11,001,5
Expenses Related to Offerings	--	--	(714,3
Net Loss	--	--	
Balance - December 31, 1999	10,053,118	30,159	33,293,8
Issuance of Shares in Exchange for Note	250,000	750	499,2
Issuance of Warrants	--	--	722,8
Issuances of Stock	2,244,275	6,733	5,199,7
Expenses Related to Offerings	--	--	(332,8
Net Loss	--	--	

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	-----	-----	-----
Balance - December 31, 2000	12,547,393	\$ 37,642	\$ 39,382,7
	=====	=====	=====

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

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CHENIERE ENERGY, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENT OF CASH FLOWS

	Year
	----- 2000 -----
CASH FLOWS FROM OPERATING ACTIVITIES:	
Net Loss	\$ (780,980)
Adjustments to Reconcile Net Loss to	
Net Cash Provided by (Used in) Operating Activities:	
Depreciation, Depletion and Amortization	3,371,383
Compensation Paid in Common Stock	--
Non-Cash Expense (Issuance of Warrants)	134,250
Equity in Net Loss of Unconsolidated Affiliate	426,649
	----- 3,151,302
Changes in Operating Assets and Liabilities	
Accounts Receivable	54,863
Subscriptions Receivable	--
Prepaid Expenses	(16,787)
Accounts Payable and Accrued Liabilities	2,014,028
	-----
NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES	5,203,406
	-----
CASH FLOWS FROM INVESTING ACTIVITIES:	
Purchases of Fixed Assets	(320,362)

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Proceeds from Sales of Oil and Gas Seismic Data	--
Oil and Gas Property Additions	(6,561,169)
Proceeds from Contribution of Assets to Unconsolidated Affiliate	2,000,000
	-----
NET CASH USED IN INVESTING ACTIVITIES	(4,881,531)
	-----
CASH FLOWS FROM FINANCING ACTIVITIES:	
Proceeds from Issuance of Notes Payable or Advances	2,605,000
Repayment of Notes Payable or Advances	(7,068,213)
Sale of Common Stock	5,156,500
Offering Costs	(302,550)
Debt Issuance Costs	--
	-----
NET CASH PROVIDED BY FINANCING ACTIVITIES	390,737
	-----
NET INCREASE (DECREASE) IN CASH	712,612
CASH - BEGINNING OF PERIOD	1,175,950
	-----
CASH - END OF PERIOD	\$ 1,888,562
	=====

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

CHENIERE ENERGY, INC. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1-ORGANIZATION AND NATURE OF OPERATIONS

Cheniere Energy, Inc., a Delaware corporation, is engaged in exploration for oil and gas reserves. The terms Cheniere and Company refer to Cheniere Energy, Inc. and its subsidiaries. Cheniere is a Houston-based company formed for the purpose of oil and gas exploration, development and exploitation. The Company is currently engaged in the exploration for oil and natural gas along the Gulf Coast of Texas and Louisiana, onshore and in the shallow waters of the Gulf of Mexico. The Company commenced operations in April 1996 by entering into an exploration agreement with an industry partner to acquire and process seismic

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data. Cheniere has acquired two significant seismic database assets: 1) the Cameron Project and 2) the Offshore Texas Project.

### NOTE 2-SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

#### Basis of Presentation

The consolidated financial statements include the accounts of Cheniere Energy, Inc. and its wholly-owned subsidiaries. Cheniere also owns an effective 36.8% interest in an affiliated company, Gryphon Exploration Company, and accounts for this investment using the equity method of accounting. All significant intercompany accounts and transactions have been eliminated in consolidation.

#### Oil and Gas Properties

The Company follows the full cost method of accounting for its oil and gas properties. Under this method, all productive and nonproductive exploration and development costs incurred for the purpose of finding 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, together with internal costs directly attributable to property acquisition, exploration and development activities. Interest is capitalized on oil and gas properties not subject to amortization and in the process of development. The Company capitalized interest totaling \$1,154,099, \$415,262 and \$1,058,595 and general and administrative expenses, net of reimbursements, totaling \$743,355, \$960,000 and \$444,000 for the years 2000, 1999 and 1998, respectively.

The costs of the Company's oil and gas properties, including the estimated future costs to develop proved reserves, are depreciated using a composite units-of-production rate based on estimates of proved reserves. Investments in unproved properties and major development projects are not amortized until proved reserves associated with the projects can be determined or until impairment occurs. If the results of an assessment indicate that the properties are impaired, the amount of the impairment is added to the capitalized costs to be amortized. Net capitalized costs are limited to a capitalization ceiling, calculated on a quarterly basis as the aggregate of the present value, discounted at 10%, of estimated future net revenues from proved reserves, based on current economic and operating conditions, plus the lower of cost or fair market value of unproved properties, less related income tax effects.

The Company's allocation of seismic exploration costs to proved properties involves an estimate of the total reserves to be discovered in the project. It is reasonably possible, based on the results obtained from future drilling, that revisions to this estimate could occur within the next twelve months, which could affect the Company's capitalization ceiling.

Sales of proved and unproved properties are accounted for as adjustments of capitalized costs with no gain or loss recognized, unless such adjustments would significantly alter the relationship between capitalized costs and proved oil and gas reserves.

#### Revenue Recognition



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Revenues from the sale of oil and gas production are recognized upon passage of title, net of royalty interests. When sales volumes differ from the Company's entitled share, an underproduced or overproduced imbalance occurs. To the extent an overproduced imbalance exceeds the Company's share of the remaining estimated proved natural gas reserves for a given property, the Company records a liability. At December 31, 2000 and 1999, the Company had no gas imbalances.

### Debt Issuance Costs

Costs incurred in connection with the issuance of debt are capitalized and amortized into interest expense using the straight line method which approximates the interest method. (which is then capitalized as a cost of oil and gas properties) over the term of the related debt. Accumulated amortization was \$849,249 as of December 31, 2000 and \$24,382 as of December 31, 1999.

### Fixed Assets

Fixed assets are recorded at cost. Repairs and maintenance costs are charged to operations as incurred. Depreciation is computed using the straight-line method calculated to amortize the cost of assets over their estimated useful lives, which range from three to seven years. Upon retirement or other disposition of property and equipment, the cost and related depreciation is removed from the accounts and the resulting gains or losses are recorded.

### Offering Costs

Offering costs consist primarily of placement fees, professional fees and printing costs. These costs are charged against the related proceeds from the sale of common stock in the periods in which they occur.

### Income Taxes

Provisions for income taxes are based on taxes payable or refundable for the current year and deferred taxes on temporary differences between the amount of taxable income and pretax financial income and between the tax bases of assets and liabilities and their reported amounts in the financial statements. Deferred tax assets and liabilities are included in the financial statements at currently enacted income tax rates applicable to the period in which the deferred tax assets and liabilities are expected to be realized or settled as prescribed in Statement of Financial Accounting Standards (SFAS) No. 109, Accounting for Income Taxes. As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through the current period's provision for income taxes.

### Stock-Based Compensation

SFAS No. 123, Accounting for Stock-Based Compensation, encourages, but does not require, companies to record compensation cost for stock-based employee compensation plans at fair value. The Company has chosen to continue to account for stock-based compensation issued to employees using the intrinsic value method prescribed in Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations. Accordingly, compensation cost for stock options is measured as the excess, if any, of the quoted market price of the Company's stock at the date of the grant over the amount an employee must pay to acquire the stock. The Company grants options at or above the market price of its common stock at the date of each grant. The Company accounts for stock-based compensation issued to non-employees using SFAS No. 123.

### Earnings (Loss) Per Share

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Earnings (loss) per share (EPS) is computed in accordance with the requirements of SFAS No. 128, Earnings Per Share. Basic EPS excludes dilution and is computed by dividing net income (loss) by the weighted average number of shares outstanding during the period. Diluted EPS reflects potential dilution and is computed by dividing net income (loss) by the weighted average number of common shares outstanding during the period increased by the number of additional common shares that would have been outstanding if the potential common shares had been issued. Potential dilutive common stock equivalents include stock options from employee benefit plans and warrants to purchase common stock. Basic and diluted EPS for all periods presented are the same since the effect of the Company's options and warrants is antidilutive to its net loss per share under SFAS No. 128.

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### CHENIERE ENERGY, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

#### Reverse Stock Split

On October 16, 2000, the Company's stockholders approved a one-for-four reverse stock split, which became effective on October 18, 2000. All per share amounts and numbers of shares in the financial statements have been restated for the effect of this reverse stock split.

#### Cash Equivalents

The Company classifies all investments with original maturities of three months or less as cash equivalents.

#### Fair Value of Financial Instruments

The carrying amounts of cash and cash equivalents, accounts receivable and accounts payable approximate fair value because of the short maturity of those instruments. The carrying value of the Company's notes payable as of December 31, 1999 is considered to approximate its fair value due to the short-term nature of the notes.

#### Commodity Price Risk

The Company produces and sells natural gas, crude oil and condensate. As a result, the Company's financial results can be significantly affected as these commodity prices fluctuate widely in response to changing market forces. The Company has not entered into any hedging transactions. The Company's market risk with respect to its fixed-rate, short-term notes payable is considered to be immaterial due to the short-term nature of these instruments.

#### Concentration of Credit Risk

All of the Company's revenues are derived from a single customer. The Company's products are commodities and constantly have a readily available market for sale.

#### Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires that the Company make estimates and assumptions that affect the amounts reported in the financial statements and the

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accompanying notes. Actual results could differ from those estimates. Management believes its estimates are reasonable.

### Reclassifications

Certain prior period amounts have been reclassified to conform to the current period presentation. These reclassifications had no effect on the Company's net income or stockholder's equity.

### New Accounting Pronouncements

In June 1998, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 133, Accounting for Derivative Instruments and Hedging Activities. In June 1999, the FASB extended the adoption date of SFAS 133 until January 1, 2001, through the issuance of SFAS No. 137, Deferral of the Effective Date of SFAS 133. In June 2000, the FASB issued SFAS No. 138, Accounting for Certain Derivative Instruments and Certain Hedging Activities, which also amended SFAS 133. SFAS 133, as amended requires that companies recognize all derivative instruments as either assets or liabilities on the balance sheet and measure those instruments at fair value. Changes in the fair value of derivatives are recorded each period in current earnings or other comprehensive income depending on their designation, their intended use, or their ability to qualify as hedges. The Company adopted SFAS 133 in the first quarter of 2001; such adoption did not have a material impact on its financial statements.

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### CHENIERE ENERGY, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

In December 1999, the Securities and Exchange Commission issued Staff Accounting Bulletin (SAB) No. 101, Revenue Recognition in Financial Statements. SAB No. 101 was implemented in 2000 and did not have a material effect on the Company's financial statements.

#### NOTE 3-FIXED ASSETS

Fixed assets consist of the following:

	December 31,	
	2000	1999
	-----	-----
Furniture and Fixtures	\$ 43,391	\$ 133,588
Computers and Office Equipment	132,673	544,925
Other	60,977	464,939
	-----	-----
	237,041	1,143,452
Less Accumulated Depreciation	(30,837)	(215,433)
	-----	-----
Fixed Assets, Net	\$ 206,204	\$ 928,019
	=====	=====

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Depreciation expense related to the Company's fixed assets totaled \$347,865 in 2000, \$161,458 in 1999 and \$39,171 in 1998.

NOTE 4-OIL AND GAS PROPERTIES

Investments in oil and gas properties were as follows:

	December 31,	
	2000	1999
Oil and gas properties:	-----	-----
Proved	\$ 10,951,317	\$ 10,659,227
Unproved	18,253,731	20,648,923
	-----	-----
	29,205,048	31,308,150
Less accumulated depreciation, depletion and amortization	(4,223,704)	(1,200,186)
	-----	-----
	\$ 24,981,344	\$ 30,107,964
	=====	=====

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CHENIERE ENERGY, INC. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Depreciation, depletion and amortization of oil and gas property costs, which commenced in 1999, totaled \$3,023,518 for the year 2000 and \$1,200,186 for the year 1999. Depreciation, depletion and amortization per equivalent Mcf (using an Mcf-to-barrel conversion factor of 6 to 1) was \$2.04 for the year 2000 and \$1.84 for the year 1999. All of Cheniere's oil and gas properties are located within the United States or its territorial waters.

Costs incurred for unproved oil and gas properties were \$6,603,296 in 2000 and \$648,498 in 1999.

Subsequent to December 31, 1999, prices for oil and gas increased to levels at which the Company's capitalized costs did not exceed its capitalization ceiling at that date. If the capitalization ceiling had been limited to a value calculated using prices in effect at December 31, 1999, the Company's capitalized costs would have exceeded its capitalization ceiling by \$1,888,912.

The Company has made substantial investments in acquiring, processing and reprocessing its seismic databases covering a 6,800-square-mile project area offshore Texas and Louisiana and a 228-square-mile project area onshore and

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offshore Louisiana. The costs of these projects become subject to amortization on a ratable basis as the oil and gas reserves expected to be recovered from the projects are discovered. The Company began drilling prospects identified within its seismic databases in 1999. Interpretation of this data is ongoing.

### NOTE 5-EXPLORATION AGREEMENT

On March 10, 2000, Cheniere entered into an exploration agreement with an industry partner. Under the terms of the agreement, Cheniere's exploration partner acquired an option to participate at a 50% working interest level in any drilling prospects generated by Cheniere over the subsequent eighteen-month period within a defined area of mutual interest in the Gulf of Mexico. Pursuant to the exploration agreement, Cheniere receives a fixed management fee of \$230,000 per month over the eighteen-month term of the agreement. In addition, Cheniere's partner pays a disproportionate share of the cost of leasing and of the initial test well on each prospect. Cheniere is the operator of the drilling program. Management fees received by Cheniere in 2000 totaled \$1,684,193 and were reported as a \$988,548 recovery of general and administrative expenses attributable to generating the management fee and a \$695,645 reduction to the amount of general and administrative expenses which were capitalized as oil and gas property costs. Each such portion of the management fee was allocated based on the historical cost and expense structure of the Company. In October 2000, Cheniere assigned its rights and obligations under this agreement to Gryphon, its unconsolidated affiliate, in connection with the Company's investment in Gryphon, as described in Note 6.

### NOTE 6-INVESTMENT IN UNCONSOLIDATED AFFILIATE

On October 11, 2000, Cheniere completed a transaction with Warburg to fund its exploration program on approximately 8,800 square miles of seismic data in the Gulf of Mexico (the Louisiana Data Set) through a newly formed affiliated company, Gryphon. Cheniere contributed selected assets and liabilities in exchange for 100% of the common stock of Gryphon (36.8% voting interest after conversion of preferred stock) and \$2,000,000 in cash. Such assets include: the Louisiana Data Set, certain offshore leases, a prospect then being drilled, its exploration agreement with an industry partner and certain other assets and liabilities. The net book value of the assets and liabilities contributed was \$7,065,919, which consisted of assets of \$9,115,963, which primarily consisted of unproved oil and gas properties and liabilities of \$2,050,044, which primarily consisted of account payable. Warburg contributed \$25,000,000 and received preferred stock, with an 8% accrued dividend, convertible into 63.2% of Gryphon's common stock.

Cheniere and Warburg also have the option, in connection with subsequent capital calls made by Gryphon, to contribute up to an additional \$75,000,000 to Gryphon, proportionate to their respective ownership interests. Under the terms of the agreement governing these additional contributions, in the event that either Cheniere or Warburg elects not to participate in any additional contribution, the other investor has the option to purchase the non-participating investor's proportionate share. Assuming (i) that Gryphon makes subsequent capital calls for an aggregate of \$75,000,000, (ii) that Cheniere elects not to participate in any of the capital calls and (iii) that Warburg elects to purchase all of Cheniere's proportionate share, the Company's effective interest in Gryphon, after giving effect to the conversion of Gryphon's preferred stock, will be reduced to 12.7%. Cheniere accounted for the contribution of net assets at its historical cost, whereby the net amount of such assets and liabilities less the \$2,000,000 in cash was reclassified to investment in affiliate. No gain or loss was recognized at the time of contribution, primarily due to Cheniere's commitment to provide additional funding described above and due to the uncertainty of realization of the carrying value of the contributed unproved oil

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and gas properties.

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CHENIERE ENERGY, INC. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Cheniere accounts for its investment in Gryphon using the equity method of accounting. Cheniere does not participate in the day-to-day management of Gryphon, does not exercise control over Gryphon and cannot effect a change in the management of Gryphon. Cheniere's equity share of Gryphon's earnings (losses) for the period from October 11, 2000 through December 31, 2000 was \$426,649, calculated by applying Cheniere's 100% common stock ownership interest to Gryphon's net income of \$19,003 and reducing such result for Gryphon's preferred dividend arrearages (\$445,652). At such time as Warburg converts its preferred shares to common shares, Cheniere's equity share of Gryphon's earnings (losses) will be calculated at 36.8% and will not be reduced by preferred dividends. Gryphon's preferred stock is convertible at the option of the holder at a rate of \$100 per share of common stock at any time after the holders of a majority of the preferred stock execute a written consent permitting a conversion of the preferred stock or, if earlier, at any time after August 31, 2010. In the event the holders of a majority of the preferred stock vote to convert all of their shares of preferred stock into common stock, all shares of preferred stock shall automatically be converted, without further action by Gryphon or its shareholders. In addition, Gryphon has the right, at its option, to convert shares of preferred stock into common stock upon Gryphon's closing of a firm commitment qualified public offering.

Summarized financial information relative to Gryphon is set forth below:

	December 31, 2000 -----
Current assets	\$ 24,041,892
Oil and gas properties, full cost method	18,196,153
Noncurrent cash deposits	2,607,648
Fixed assets	651,453
Current liabilities	11,124,538
Long-term liabilities	--
Deferred tax liability	1,183,789
	Year Ended December 31,

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	2000
	-----
Revenues	\$ --
Net income	19,003
Cheniere's equity in earnings (loss) from unconsolidated affiliate	(426,649)

As of December 31, 2000 Cheniere's share of the underlying equity in the net assets of Gryphon exceeded its investment balance by approximately \$2.0 million. Cheniere will amortize this basis difference over the estimated useful lives of the assets contributed to Gryphon.

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CHENIERE ENERGY, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 7-NOTES PAYABLE

At December 31, 2000, Cheniere had no outstanding debt obligations. At December 31, 1999, Cheniere had outstanding short-term notes payable of \$4,963,213. Three financing facilities comprised the balance: platform financing of \$3,090,643, well services financing of \$1,117,570 and December 1997 bridge financing notes of \$755,000. The terms of each of these facilities and of others that were utilized within the three years ended December 31, 2000, are described in the following paragraphs.

April 2000 - \$2,000,000 Bridge Financing

In April 2000, the Company established a bridge financing facility which provided for: borrowings of up to \$2,000,000 bearing interest at a rate equal to LIBOR plus 2%, a placement fee equal to 2% of the commitment amount, the issuance of warrants to purchase 250,000 shares of common stock at an exercise price of \$4.00 per share on or before September 6, 2003, and conversion of the notes payable into common stock, at Cheniere's election, at a price per share equal to \$2.00 per share. Cheniere borrowed an aggregate of \$2,000,000 under the facility during 2000. In September 2000, the Company repaid \$500,000 in cash and issued 250,000 shares to satisfy an additional \$500,000. In December 2000, Cheniere repaid the remaining balance of \$1,000,000 plus accrued interest.

September 1999 - \$3,100,000 Platform Financing

On September 1, 1999, Cheniere established a \$3,100,000 financing facility to fund a production platform and other exploration and development costs in the West Cameron Block 49 area. Borrowings under the facility were repaid from Cheniere's share of net cash flow from production through the West Cameron Block 49 platform. The note was secured by Cheniere's oil and gas properties and had a maturity date of June 30, 2000. Financing costs included interest at 10% per annum and a 5% net profit interest in the initial two wells producing through the platform. At December 31, 1999, the outstanding balance under the facility was \$3,090,643. During 2000, the Company borrowed an additional \$605,000 under the same facility and repaid all principal and interest due under the facility.

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December 1999 - \$1,117,570 Well Services Financing

In December 1999, Cheniere entered into a financing agreement with a supplier of well services to consolidate and convert trade accounts payable balances into a short-term secured note payable. Interest was payable at 10% per annum. The note was secured by Cheniere's oil and gas properties and matured on July 5, 2000. At December 31, 1999, the outstanding balance was \$1,117,570, which balance and all related interest were repaid during 2000.

December 1997 - \$4,000,000 Bridge Financing

In December 1997, Cheniere completed the private placement of a \$4,000,000 bridge financing. The notes payable issued by Cheniere had an initial maturity date of March 15, 1998, which was extended ultimately to March 15, 2000, when the then-remaining balance was paid. In connection with the issuance of the notes payable and with various extensions in the maturity dates, the Company has issued 70,273 shares of common stock and warrants to purchase 925,809 shares of common stock at prices ranging from \$4.00 to \$7.00 per share. The notes bore interest at rates ranging from LIBOR plus 4% to LIBOR plus 6% (approximately 12.14% at December 31, 1999).

### NOTE 8-INCOME TAXES

From its inception the Company has recorded losses for both financial reporting purposes and for federal income tax reporting purposes. Accordingly, the Company is not presently a taxpayer and has not recorded a provision for income taxes in any of the periods presented in the accompanying financial statements.

At December 31, 2000, the Company had net operating loss (NOL) carryforwards for tax reporting purposes of approximately \$16,937,000. In accordance with SFAS No. 109, a valuation allowance equal to the net tax benefit for deferred taxes has been established due to the uncertainty of realizing the benefit of such NOL carryforwards.

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### CHENIERE ENERGY, INC. AND SUBSIDIARIES

#### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Deferred tax assets and liabilities reflect the net tax effect of temporary differences between the carrying amount of assets and liabilities for financial reporting purposes and amounts used for income tax purposes. Significant components of the Company's deferred tax assets and liabilities at December 31, 2000 and 1999 are as follows:

	December 31,	
	2000	1999
Deferred tax assets		
NOL carryforwards	\$ 6,267,000	\$ 4,400,000

Deferred tax liabilities



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Oil and gas properties and fixed assets	971,880	1,425,714
Investment in unconsolidated affiliate	1,642,160	-
	-----	-----
	2,614,040	1,425,714
	-----	-----
Net deferred tax assets	3,652,960	2,974,286
	-----	-----
Less: valuation allowance	(3,652,960)	(2,974,286)
	-----	-----
	\$ -	\$ -
	=====	=====

NOL carryforwards expire starting in 2006 extending through 2020. NOLs incurred prior to July 3, 1996 (approximately \$747,000) are subject to per year availability under Internal Revenue Code Section 382 change of ownership limitations. Certain of the Company's NOLs incurred after July 3, 1996 are also subject to an annual limitation of approximately \$2,000,000 under Section 382.

The gross change in the valuation allowance for deferred tax assets increased approximately \$679,000, \$1,420,000 and \$557,000 during the years ended December 31, 2000, 1999 and 1998, respectively.

NOTE 9-WARRANTS

As of December 31, 2000, Cheniere has issued and outstanding 2,758,621 warrants for the purchase of its common stock. The Company has reserved an equal number of shares of common stock for issuance upon the exercise of its outstanding warrants. Warrants issued by the Company do not confer upon the holders thereof any voting or other rights of a stockholder of the Company. The Company grants warrants in connection with certain of its debt or equity financings and as compensation for services. In instances where warrants were granted in connection with financings, the valuation of such warrants was calculated in accordance with the provisions of APB Opinion No. 14, incorporating the estimated fair market value of the stock at the time. Where warrants were issued for services, fair value was calculated using the Black-Scholes pricing model. The terms of warrants outstanding at December 31, 2000 range from two years to five years, with a weighted average remaining life of 2.5 years at December 31, 2000. All outstanding warrants are fully exercisable. Prices at which the warrants are exercisable range from \$1.75 to \$11.50 per share, with a weighted average exercise price of \$4.52 per share at December 31, 2000. Information related to Cheniere's issuances of warrants is summarized in the following table:

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CHENIERE ENERGY, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

December

-----  
2000

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Outstanding at beginning of period	2,116,951	1,20
Warrants issued	1,291,462	94
Warrants exercised	(234,375)	(2
Warrants canceled	(415,417)	
	-----	-----
Outstanding at end of period	2,758,621	2,11
	=====	=====
Weighted average exercise price of warrants outstanding	\$ 4.52	\$
	=====	=====
Weighted average remaining contractual life of warrants outstanding	2.5 years	3.0

The following table summarizes information about warrants outstanding at December 31, 2000:

Exercise Prices	Number Outstanding	Weighted Average Years Remaining Contractual Life
-----	-----	-----
\$9.50-\$11.50	25,000	3.7
\$7.00-\$8.00	313,542	2.9
\$5.00-\$6.00	794,384	1.9
\$4.00	992,350	2.0
\$3.00	258,345	3.0
\$1.75	375,000	4.5
	-----	
	2,758,621	

NOTE 10-STOCK-BASED COMPENSATION

In 1997 the Company established the Cheniere Energy, Inc. 1997 Stock Option Plan (the Option Plan), which allows for the issuance of options to purchase up to 1,500,000 shares of Cheniere common stock. The Company has reserved 1,500,000 shares of common stock for issuance upon the exercise of options which have been granted or which may be granted. The term of options granted under the Option Plan is generally five years. Vesting varies, but generally occurs over three or four years, in increments of 33% or 25%, respectively, on each anniversary of the grant date.

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

A summary of the status of the Company's stock options as of December 31, 2000, 1999 and 1998 is presented below:

	2000	1999
Outstanding at beginning of period	540,299	171,000
Options granted at an exercise price of \$12.00 per share	--	8,000
Options granted at an exercise price of \$6.00 per share	83,750	368,000
Options granted at an exercise price of \$2.75 per share	450,875	--
Options granted at an exercise price of \$1.94 per share	380,000	--
Options canceled	(570,688)	(8,000)
Outstanding at end of period	884,236	540,000
Exercisable at end of period	220,799	190,000
Weighted average exercise price of options outstanding	\$ 3.45	\$ 3.45
Weighted average exercise price of options exercisable	\$ 5.03	\$ 5.03
Weighted average fair value of options granted during the period	\$ 1.39	\$ 1.39
Weighted average remaining contractual life of options outstanding	4.3 years	4.7 years

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The following table summarizes information about fixed options outstanding at December 31, 2000:

Options Outstanding			Options Exercisable
Exercise Prices	Number Outstanding	Weighted Average Years Remaining Contractual Life	Number Outstanding
\$ 12.00	17,500	2.8	17,500
\$ 7.20	4,861	2.9	4,861
\$ 6.00	228,750	3.5	107,813
\$ 2.75	253,125	4.4	53,125
\$ 1.94	380,000	4.9	37,500
	----- 884,236 =====		----- 220,799 =====

The fair value of options is calculated using the Black-Scholes option-pricing model. Assumptions used in the pricing model and pro forma effects on the Company's net losses had it adopted the optional recognition provisions of SFAS No. 123 for the years ended December 31, 2000, 1999 and 1998 are summarized in the following table. The effects of applying SFAS No. 123 in this pro forma disclosure are not indicative of future amounts.

	Year Ended De	
	2000	1999
Dividend yield	0.0%	0.0%
Weighted average volatility	82.0%	124.0%
Risk-free interest rate	5.8%	6.3%
Expected lives of options	4.0 years	3.0 years
Net loss	\$ (780,980)	\$ (1,753,723)
Net loss per share (both basic and diluted)	\$ (0.07)	\$ (0.27)

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Pro forma net loss	\$ (1,019,208)	\$ (3,184,723)
Pro forma net loss per share (both basic and diluted)	\$ (0.09)	\$ (0.49)

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### CHENIERE ENERGY, INC. AND SUBSIDIARIES

#### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

On December 11, 1998, the Company adjusted the exercise price from \$12.00 to \$6.00 per share for the 143,750 options then issued and outstanding to management and employees. On September 30, 1999, all options then outstanding to management and employees were extended to September 30, 2004.

In June 1999, the Company issued 250,000 warrants to its president and chief executive officer and 50,000 warrants to another member of its board of directors, both of whom were instrumental in negotiating the Company's license of 8,800 square miles of 3-D seismic data in the Gulf of Mexico. Warrants issued in connection with this transaction are exercisable on or before the fifth anniversary of the date the transaction closed at an exercise price of \$6.00 per share. The 250,000 warrants issued to Cheniere's president and chief executive officer were canceled in October 2000, when he resigned from Cheniere to become president and chief executive officer of Gryphon. An additional 250,000 warrants were issued to Cheniere's new president and chief executive officer in October 2000, pursuant to the terms of his employment agreement. The fair value of these warrants is included in the above pro forma net loss calculated under SFAS No. 123.

#### NOTE 11-RELATED PARTY TRANSACTIONS

Under the terms of the Contribution and Subscription Agreement dated October 11, 2000 by and among the Company, Gryphon and the other investors listed therein, Gryphon provided office space to Cheniere at no cost from the closing date of October 11, 2000 until Cheniere relocated in December 2000, and Cheniere is providing accounting and cash management services to Gryphon without charge for six months following the closing date. The values of the office space and the accounting and cash management services offset and were not significant to the Company.

Cheniere served as contract operator throughout 2000 for the well contributed to Gryphon on which drilling was underway at the date of Gryphon's inception. Cheniere received industry standard overhead reimbursements from all working interest owners, including Gryphon, in accordance with the terms of the joint interest operating agreement.

BSR Investments, Ltd., a major stockholder of the Company controlled by the mother of Charif Souki, Chairman of Cheniere, purchased \$2,000,000 of the notes issued in the Company's \$4,000,000 December 1997 Bridge Financing and pledged a portion of its investment in Cheniere common stock to fund its participation. In conjunction with the financing, BSR received warrants to purchase 41,667 shares of the Company's common stock. On September 15, 1998, BSR received warrants to purchase an additional 100,000 shares of common stock as consideration for extending the maturity of the notes to that date. Also in September 1998, the exercise price of the warrants held by BSR was reduced from \$9.50 to \$6.00 per share as consideration to extend the maturity date of the notes to January 15, 1999. In March 1999, BSR exchanged notes payable of \$2,000,000 for 694,445 shares of Cheniere common stock (\$2.88 per share).

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In May 1999, BSR purchased from another noteholder \$240,000 in short-term notes payable by Cheniere. In July 1999, the Company repaid \$120,000 to BSR at the time it repaid 50% of the outstanding balances on all of the notes issued in the December 1997 Bridge Financing. On September 30, 1999, BSR exchanged its remaining \$120,000 note payable and \$1,000 in accrued interest for 27,500 units (\$4.40 per unit), each unit representing one share of common stock and one half warrant to purchase a share of common stock at an exercise price of \$6.00 per share on or before September 30, 2002.

In conjunction with certain of the Company's private placements of equity, placement fees have been paid to Investors Administration Services, Limited (IAS), a company in which the brother of Charif Souki, Cheniere's chairman, is a principal. Placement fees paid to IAS totaled \$99,000 for 2000, \$562,372 for 1999 and \$138,000 for 1998. Such payments were recorded as offering costs and reflected as a reduction of additional paid-in capital. In addition, in connection with the sale of 2,620,758 units (of common stock and warrants), Cheniere granted to IAS, or its assigns, warrants to purchase 161,250 shares of common stock at an exercise price of \$4.00 per share on or before December 30, 2002.

During June 1998, the Company received and repaid short-term advances from then co-chairman of the board, William D. Forster, and members of his family or entities under their control, totaling \$592,000. Interest was paid at LIBOR plus 4% and totaled \$1,622. In addition, non-interest bearing, short-term advances totaling \$105,000 were made to the Company by co-chairman Forster (\$75,000) and BSR (\$30,000) in October and November 1998. Such advances were repaid by the Company in October and November 1998.

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### CHENIERE ENERGY, INC. AND SUBSIDIARIES

#### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

##### NOTE 12-COMMITMENTS AND CONTINGENCIES

In November 2000, the Company entered into an office lease agreement with a term which runs through March 31, 2003. Future minimum lease payments are \$112,607, \$112,607 and \$28,152 for the years ended December 31, 2001, 2002 and 2003, respectively. Effective in October 2000, Cheniere assigned its rights and obligations under its previous office lease agreement to Gryphon. Cheniere's total rental expense for office space for the years ended December 31, 2000, 1999 and 1998 was \$222,394, \$229,381 and \$42,741, respectively. Cheniere has no other leasing commitments.

In June 1999, Cheniere entered into a master license agreement covering the license of approximately 8,800 square miles of seismic data in the Gulf of Mexico. In connection with the license agreement, the Company made a commitment to reprocess certain of the seismic data and to pay a fee for such reprocessing as the reprocessed data are delivered. In October 2000, Cheniere's rights and obligations arising from this license agreement were assigned to Gryphon. Related to the assignment of this license, Cheniere is obligated to pay a transfer fee of up to \$2,500,000, payable in ten installments of \$250,000, which will become payable after one month of production from each of ten separate successful wells completed by Gryphon within the data set.

In June 2000, Cheniere entered into agreements whereby Cheniere acquired a license to seismic data covering 1,900 square miles in the Gulf of Mexico in exchange for its commitment to fund the reprocessing of the data. The Company

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had a commitment to fund approximately \$4,108,000 for the processing of such data. As of December 31, 2000, the Company made payments of \$500,000 with the remainder of the commitment to be recorded as an obligation and paid as the work is completed and the data delivered. The Company expects the data to be delivered in 2001. In the event the reprocessing is not completed, the Company would retain the data in the existing format and would not be required to pay any additional amounts. In October 2000, Cheniere exercised its option to expand the agreement to cover an additional 1,900 square miles.

In November 2000, Cheniere acquired from another company a license to seismic data covering an additional 3,000 square miles in the Gulf of Mexico in exchange for its commitment to fund the reprocessing of the data. The Company had a commitment to fund approximately \$4,324,000 for the processing of such data. As of December 31, 2000, the Company made payments of \$150,000 with the remainder of the commitment to be recorded as an obligation and paid as the work is completed and the data delivered. The Company expects the data to be delivered in 2001. In the event the reprocessing is not completed, the Company would retain the data in the existing format and would not be required to pay any additional amounts.

Under the terms of the Contribution and Subscription Agreement dated October 11, 2000 by and among the Company, Gryphon and the other investors listed therein, Cheniere and the other investors have committed under certain circumstances to contribute their pro rata shares of as much as an additional \$75,000,000 to Gryphon. The amount of such contributions, if any, will depend on the future cash requirements of Gryphon. Cheniere may choose to make such contributions to maintain its 36.8% voting ownership interest in Gryphon or it may choose to contribute a lesser amount or zero, in which case its ownership interest in Gryphon would be reduced.

### NOTE 13-LIQUIDITY

The recoverability of the Company's unevaluated oil and gas properties is dependent on future events, including obtaining adequate financing for its exploration and development program, the successful reprocessing of the 3D seismic data in the Offshore Texas Project Area, the successful completion of its planned drilling program, and the achievement of a level of operating revenues that is sufficient to support the Company's cost structure. At various times during the life of the Company to date, it has been necessary for the Company to raise additional capital through private placements of debt or equity financing. When such a need has arisen, the Company has met it successfully. It is management's belief that it will continue to be able to meet its needs for additional capital as such needs arise in the future.

Cheniere's needs for additional financing include the following:

- . Additional capital may be required to pay for Cheniere's share of costs relating to the drilling of prospects and development of those that are successful, to exercise lease options, and to acquire additional oil and gas leases. The total amount of the Company's capital needs will be determined in part by the number of prospects generated within its exploration program and by the working interest that the Company retains in those prospects.

- . The Company will need funds for the payment of approximately \$8,000,000 related to future deliveries of reprocessed seismic data through December 2001. (Note 12)

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CHENIERE ENERGY, INC. AND SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

. The Company may need capital to fund its pro-rata share of the capital calls by Gryphon that are approved by Gryphon's Board of Directors. (Note 12)

. The Company will need funds for the payment of any transfer fee related to the assignment to Gryphon of its seismic license over the Offshore Louisiana Project Area. (Note 12)

. Should the Company choose to make an acquisition of producing oil and gas properties, it is likely that such an acquisition would require that some portion of the purchase price be paid in cash, and thus would create the need for additional capital.

Additional capital could be obtained from a combination of funding sources. These potential funding sources include:

- . cash flow from operating activities,
- . borrowings from financial institutions,
- . debt offerings, which would increase the Company's leverage and add to its need for cash to service such debt,
- . additional offerings of the Company's equity securities, which would cause dilution of its common stock,
- . sales of portions of its working interest in the prospects within its exploration program, which would reduce future revenues from its exploration program,
- . sale to an industry partner of a participation in the Company's exploration program, including sale of a license to the approximate 6,800 square miles of seismic data in the Offshore Texas Project Area, which would reduce future revenues from its exploration program, and
- . sale of all or a portion of the Company's producing oil and gas properties, which would reduce future revenues.

Cheniere's ability to raise additional capital will depend on the results of its operations and the status of various capital and industry markets at the time such additional capital is sought. Accordingly, there can be no assurances that capital will be available to the Company from any source or that, if available, it will be on terms acceptable to the Company.

#### NOTE 14-SUPPLEMENTAL DISCLOSURES OF NON-CASH TRANSACTIONS

In conjunction with its December 1997 Bridge Financing, the Company issued at closing 25,000 shares of common stock (valued at \$237,500) and upon extension of the maturity date 12,500 shares of common stock (valued at \$33,500), which were recorded as debt issuance costs. In the same financing, the Company issued warrants to purchase 333,334 shares of its common stock (valued at \$101,000) and warrants to purchase 496,875 shares of its common stock (valued at \$315,833) related to extensions of the maturity dates. In conjunction with a short-term bridge financing in June 1998, the Company issued warrants to purchase 20,834 shares of common stock (valued at \$3,661). The value of the warrants related to these financings was recorded as debt issue costs and the amortization of such warrant costs was included in interest expense, which was capitalized as a cost



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of oil and gas properties.

In 1998, the Company issued 17,500 shares of common stock (valued at \$98,000) in settlement of invoices for previously rendered legal services.

In 1999, the Company issued 703,132 shares of common stock in exchange for \$2,025,020 in notes payable and 56,250 shares of common stock in exchange for \$75,000 in notes payable. The Company also issued 36,047 units (each unit representing one share of common stock and one half of a warrant to purchase one share of common stock) in exchange for notes payable and accrued interest totaling \$158,608. In March 1999, the Company adjusted the exercise price for certain warrants (valued at \$35,702) in connection with the extension of the maturity dates of notes payable. In the fourth quarter of 1999, the Company issued 32,773 shares of common stock and warrants to purchase 95,600 shares of common stock (collectively valued at \$98,197) in connection with the extension of maturity dates of notes payable. The Company issued 514,366 shares of common stock to purchase oil and gas services and seismic data valued at \$2,828,210. In October 1999, the Company issued warrants to purchase 50,000 shares of common stock (valued at \$200,000) in payment for investor relations consulting services and recorded within general and administrative expenses over the six-

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### CHENIERE ENERGY, INC. AND SUBSIDIARIES

#### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

month term of the consulting agreement. The Company issued 37,500 shares (valued at \$37,500) in connection with the employment of one of its executives. The Company issued a short-term note payable for oil and gas services valued at \$1,117,570.

In 2000, Cheniere issued 16,667 shares of common stock in exchange for seismic data reprocessing services valued at \$50,000. The Company issued 50,000 shares of common stock as a price adjustment to shares issued in 1999 for oil and gas drilling services. Cheniere issued warrants to purchase 25,000 shares of common stock (valued at \$30,300) as a placement fee in connection with the sale of securities. The Company issued warrants to purchase 250,000 shares of common stock (valued at \$528,000) in connection with the establishment of a bridge financing facility. Cheniere issued 250,000 shares of common stock in satisfaction of \$500,000 in short-term notes payable issued under the bridge financing facility. Cheniere also issued warrants to purchase 250,000 shares of common stock to its president and chief executive officer in October 2000, pursuant to his employment agreement. The Company issued its financial advisers warrants to purchase 125,000 shares of common stock, valued at \$164,500, as consideration for assistance in the capitalization of Gryphon.

The values of securities issued by the Company in connection with the transactions described above are based on third party arms-length negotiated prices.

In connection with the Gryphon transaction, Cheniere contributed to Gryphon certain assets and liabilities with a net book value of \$7,065,919 for its 36.8% ownership interest in the company.

#### NOTE 15-SUBSEQUENT EVENTS

In February 2001, the Company completed a private placement of units (common stock and warrants) at a price of \$2.00 per unit, generating net proceeds of

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\$500,000. In connection with the offering, the Company issued 250,000 shares of common stock and 41,667 warrants to purchase common stock exercisable at a price of \$3.00 per share on or before December 31, 2003.

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CHENIERE ENERGY, INC. AND SUBSIDIARIES  
 SUPPLEMENTAL INFORMATION TO CONSOLIDATED FINANCIAL STATEMENTS  
 OIL AND GAS RESERVES AND RELATED FINANCIAL DATA  
 (unaudited)

COSTS INCURRED IN OIL AND GAS PRODUCING ACTIVITIES

Presented below are costs incurred in oil and gas property acquisition, exploration and development activities:

	Years Ended December 31,		
	2000	1999	1998
Acquisition of properties:			
Proved properties	\$ --	\$ 1,364,809	\$ --
Unproved properties	6,603,296	648,498	3,466,371
Exploration costs	--	7,675,809	--
Development costs	673,136	1,618,609	--
Subtotal	7,276,432	11,307,725	3,466,371
Amounts contributed to			
unconsolidated affiliate	(9,379,534)	--	--
Total	\$ (2,103,102)	\$11,307,725	\$ 3,466,371

Included in the above amounts for the years ended December 31, 2000, 1999 and 1998 were \$1,897,454, \$1,375,262 and \$1,502,595, respectively, of capitalized general and administrative expenses and capitalized interest expense directly related to property acquisition, exploration and development.

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CHENIERE ENERGY, INC. AND SUBSIDIARIES  
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### OIL AND GAS RESERVES AND RELATED FINANCIAL DATA (unaudited)

#### Capitalized Costs Related to Oil and Gas Producing Activities

The following table presents total capitalized costs of proved and unproved properties and accumulated depreciation, depletion and amortization related to oil and gas producing operations:

	December 31	
	2000	1999
Proved properties	\$ 10,951,317	\$ 10,659,220
Unproved properties	18,253,731	20,648,920
	29,205,048	31,308,140
Accumulated depreciation, depletion and amortization	(4,223,704)	(1,200,180)
	\$ 24,981,344	\$ 30,107,960

#### RESULTS OF OPERATIONS FROM OIL AND GAS PRODUCING ACTIVITIES

The results of operations from oil and gas producing activities are as follows:

	Year ended December 31	
	2000	1999
Revenues	\$ 5,320,432	\$ 1,600,000
Production costs	(388,637)	(1,000,000)
Depreciation, depletion and amortization	(3,023,518)	(1,200,000)
Income tax benefit (expense)	-	-
Results of operations from oil and gas producing activities	\$ 1,908,277	\$ 400,000

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(excluding corporate overhead and interest costs)

\$ 1,908,277

\$ 2

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RESERVE QUANTITIES

Estimates of proved reserves of Cheniere and the related standardized measure of discounted future net cash flow information are based on the reports generated by the Company's independent petroleum engineers in accordance with the rules and regulations of the SEC. The independent engineers' estimates were based upon a review of production histories and other geologic, economic, ownership and engineering data provided by the Company. These estimates represent the Company's interest in the reserves associated with its properties. All of the Company's oil and gas reserves are located within the United States or its territorial waters.

The Company's estimates of its proved reserves and proved developed reserves of oil and gas as of December 31, 2000 and 1999 and the changes in its proved reserves are as follows:

	2000		
	Oil	Gas	Oil
	(Bbls)	(Mcf)	(Bbl)
Proved reserves:			
Beginning of year - consolidated	27,816	5,796,000	
Revisions of prior estimates	(7,200)	(354,103)	
Production	(3,703)	(1,459,897)	(2,
Extensions, discoveries and other additions	2,961	586,000	30,
End of year - consolidated	19,874	4,568,000	27,
Proportional Interest in proved reserves of			
unconsolidated affiliate - end of year (1)	2,640	1,674,000	
End of year - total	22,514	6,242,000	27,

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	=====	=====	=====
Proved developed reserves:			
Beginning of year	27,816	5,796,000	
	=====	=====	=====
End of year - consolidated	16,913	3,982,000	27,
Interest in proved developed reserves of			
unconsolidated affiliate - end of year (1)	2,640	1,674,000	
	-----	-----	-----
End of year - total	19,553	5,656,000	27,
	=====	=====	=====

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CHENIERE ENERGY, INC. AND SUBSIDIARIES  
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(1) Represents Cheniere's proportional share, based on its 100% common stock ownership, of the proved reserves and proved developed reserves of Gryphon. Such proportional share of Gryphon reserves will be reduced to 36.8% upon the conversion of Gryphon's preferred shares.

There are numerous uncertainties inherent in estimating quantities of proved reserves and in projecting future rates of production and future amounts and timing of development expenditures, including many factors beyond the control of the Company. Reserve engineering is a subjective process of estimating underground accumulations of crude oil and natural gas that cannot be measured in an exact manner, and the accuracy of any reserve estimate is a function of the quality of available data and of engineering and geological interpretation and judgment. Estimates of proved undeveloped reserves are inherently less certain than estimates of proved developed reserves. The quantities of oil and gas that are ultimately recovered, production and operating costs, the amount and timing of future development expenditures, geologic success and future oil and gas sales prices may all differ from those assumed in these estimates. In addition, the Company's reserves may be subject to downward or upward revision based upon production history, purchases or sales of properties, results of future development, prevailing oil and gas prices and other factors.

STANDARDIZED MEASURE OF DISCOUNTED FUTURE NET CASH FLOWS

The standardized measure of discounted future net cash flows was calculated by applying year-end prices to estimated future production, less future expenditures (based on year-end costs) to be incurred in developing and producing the Company's proved reserves and the estimated effect of future income taxes based on the current tax law. The resulting future net cash flows were discounted using a rate of 10% per annum.

The standardized measure of discounted future net cash flow amounts contained in the following tabulation does not purport to represent the fair market value of

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oil and gas properties. No value has been given to unproved properties. There are significant uncertainties inherent in estimating quantities of proved reserves and in projecting rates of production and the timing and amount of future costs. Future realization of oil and gas prices over the remaining reserve lives may vary significantly from current prices. In addition, the method of valuation utilized, based on year-end prices and costs and the use of a 10% discount rate, is not necessarily appropriate for determining fair value.

The standardized measure of discounted future net cash flows relating to proved oil and gas reserves is as follows:

	2000	1999
	-----	-----
Future gross revenues	\$ 48,989,932	\$ 13,651,000
Less - future costs:		
Production	(5,853,817)	(2,050,000)
Development and dismantlement	(2,823,300)	(1,516,000)
	-----	-----
Future net cash flows before income taxes	40,312,815	10,084,000
Less - 10% annual discount for estimated timing of cash flows	(14,632,097)	(2,514,000)
	-----	-----
Present value of future net cash flows before income taxes	25,680,718	7,570,000
Less - present value of future income taxes	(5,062,716)	
	-----	-----
Standardized measure of discounted future net cash flows	\$ 20,618,002	\$ 7,570,000
	=====	=====

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CHENIERE ENERGY, INC. AND SUBSIDIARIES  
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The following table summarizes the principal sources of change in the standardized measure of discounted future net cash flows:

	Year Ended December 31, 2000	Year Ended December 31, 1999
	-----	-----
	2000	1999

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Standardized measure - beginning of period	\$ 7,570,129	\$
Sales of oil and gas produced, net of production costs	(4,931,795)	(1,485,
Extensions, discoveries and other additions	3,537,975	9,055,
Revisions to previous quantity estimates, timing and other	(2,349,930)	
Net changes in prices and production costs	20,424,190	
Development costs incurred	673,136	
Net changes in income taxes	(5,062,716)	
Accretion of discount	757,013	
Standardized measure - end of period - consolidated	\$ 20,618,002	\$ 7,570,
Standardized measure - end of period - proportional interest in reserves of unconsolidated affiliate (1)	9,138,920	
Standardized measure - end of period - total	\$ 29,756,922	\$ 7,570,
Current prices at year-end, used in standardized measure		
Oil (per barrel)	\$ 29.72	\$ 25
Gas (per mcf)	10.71	2

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CHENIERE ENERGY, INC. AND SUBSIDIARIES  
SUPPLEMENTAL INFORMATION TO CONSOLIDATED FINANCIAL STATEMENTS  
OIL AND GAS RESERVES AND RELATED FINANCIAL DATA  
(unaudited)

(1) Represents Cheniere's proportional share, based on its 100% common stock ownership, of the standardized measure of Gryphon's proved oil and gas reserves. Such proportional share of Gryphon's standardized measure will be reduced to 36.8% upon the conversion of Gryphon's preferred shares.

(2) The Company may receive amounts different than those incorporated into the standardized measure of discounted cash flow for a number of reasons, including changes in prices. Therefore, the present value shown above should not be construed as the current market value of the estimated oil and gas reserves

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attributable to the Company's properties.

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CHENIERE ENERGY, INC. AND SUBSIDIARIES  
 SUPPLEMENTAL INFORMATION TO CONSOLIDATED FINANCIAL STATEMENTS  
 SUMMARIZED QUARTERLY FINANCIAL DATA  
 (unaudited)

	First Quarter	Second Quarter	Third Quarter	
Year ended December 31, 2000:				
Revenues (1)	\$ 1,173,605	\$1,731,078	\$1,198,052	\$
Gross profit (2)	165,923	546,680	176,474	
Income (loss) from operations	(311,086)	353,925	(86,036)	
Net income (loss)	(302,377)	358,135	(81,131)	
Net loss per share - basic and diluted	\$ (0.03)	\$ 0.03	\$ (0.01)	\$
Year ended December 31, 1999:				
Revenues	\$ -	\$ -	\$ 421,268	\$
Gross profit (2)	(10,344)	(10,982)	134,147	
Loss from operations	(334,043)	(360,139)	(347,522)	
Net loss	(329,105)	(354,885)	(333,999)	
Net loss per share - basic and diluted	\$ (0.07)	\$ (0.06)	\$ (0.05)	\$

(1) Revenues for the first three quarters of 2000 have been revised by \$230,000, \$373,333 and \$373,334 to present management fees as a reduction of general and administrative expenses instead of as revenues as reported in the quarterly financial statements. These reclassifications had no effect on net income.

(2) Revenues less operating expenses other than general and administrative.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

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In accordance with paragraph (3) of General Instruction G to form 10-K, Part III of this Report is omitted because the Company will file with the Securities and Exchange Commission not later than 120 days after the end of the fiscal year ended December 31, 2000 a definitive proxy statement pursuant to Regulation 14A involving the election of directors, which proxy statement is incorporated herein by reference (with the exception of certain portions noted therein that are not so incorporated by reference).

### PART IV

#### ITEM 14. EXHIBITS, FINANCIAL STATEMENT SCHEDULES AND REPORTS ON FORM 8-K

##### (a) Financial Statements, Schedules and Exhibits

##### (1) Financial Statements - Cheniere Energy, Inc and Subsidiaries

Report of Independent Accountants.....	28
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##### (2) Financial Statement Schedule

All consolidated financial statement schedules have been omitted because they are not required, are not applicable, or the required information has been included elsewhere within this Form 10-K/A.

The financial statements of Gryphon Exploration Company, for which Cheniere uses the equity method of accounting have been filed as part of this report on Form 10-K/A. (See Item 14 (d).)

##### (3) Exhibits

Exhibit No.	Description
-----	-----

- |     |   |
|-----|---|
| 3.1 | Amended and Restated Certificate of Incorporation of Cheniere Energy, Inc. (Cheniere) (Incorporated by reference to Exhibit 3.1 of the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 1999 (File No. 0-9092))         |
| 3.2 | Certificate of Amendment to the Amended and Restated Certificate of Incorporation of Cheniere (Incorporated by reference to Exhibit 3.2 of the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 1999 (File No. 0-9092)) |

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- 3.3 By-laws of Cheniere as amended through April 7, 1997 (Incorporated by reference to Exhibit 3.2 of the Company's Annual Report on Form 10-K for the year ended December 31, 1998 (File No. 0-9092))
- 4.1 Specimen Common Stock Certificate of Cheniere (Incorporated by reference to Exhibit 4.1 of the Company's Registration Statement on Form S-1 filed on August 27, 1996 (File No. 333-10905))

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- 10.1 Exploration Agreement between FX Energy, Inc. (now known as Cheniere Energy Operating Co., Inc. (Cheniere Operating)) and Zydeco Exploration, Inc. (Zydeco) (Incorporated by reference to Exhibit 10.1 of the Company's Registration Statement under the Securities Act of 1933 on Form S-1 filed on August 27, 1996 (File No. 333-10905))
- 10.2 First Amendment to the Exploration Agreement between FX Energy, Inc. (now known as Cheniere Operating) and Zydeco (Incorporated by reference to Exhibit 10.2 of the Company's Registration Statement on Form S-1 filed on August 27, 1996 (File No. 333-10905))
- 10.3 Second Amendment to the Exploration Agreement between FX Energy, Inc. (now known as Cheniere Operating) and Zydeco (Incorporated by reference to Exhibit 10.3 of the Company's Registration Statement on Form S-1 filed on August 27, 1996 (File No. 333-10905))
- 10.4 Third Amendment to the Exploration Agreement between FX Energy, Inc. (now known as Cheniere Operating) and Zydeco (Incorporated by reference to Exhibit 10.4 of the Annual Report on Form 10-K for the year ended August 31, 1996 (File No. 2-63115))
- 10.5 Form of Warrant Agreement between Cheniere and each of C.M. Blair, W.M. Foster & Co., Inc. and Redliw Corp. (Incorporated by reference to Exhibit 10.8 of the Company's Registration Statement on Form S-1 filed on August 27, 1996 (File No. 333-10905))
- 10.6 Fourth Amendment to the Exploration Agreement between FX Energy, Inc. (now known as Cheniere Operating) and Zydeco (Incorporated by reference to Exhibit 10.12 of the Company's Registration Statement on Form S-1 filed on March 17, 1997 (File No. 333-23421))
- 10.7 Fifth Amendment to the Exploration Agreement between FX Energy, Inc. (now known as Cheniere Operating) and Zydeco (Incorporated by reference to Exhibit 10.18 of the Annual Report on Form 10-K for the year ended August 31, 1997 (File No. 0-9092))
- 10.8 Sixth Amendment to the Exploration Agreement between FX Energy, Inc. (now known as Cheniere Operating) and Zydeco (Incorporated by reference to Exhibit 10.19 of the Annual Report on Form 10-K for the year ended August 31, 1997 (File No. 0-9092))
- 10.9 Seventh Amendment to the Exploration Agreement between FX Energy, Inc. (now known as Cheniere Operating) and Zydeco (Incorporated by reference to Exhibit 10.23 of the Annual Report on Form 10-K for the year ended August 31, 1997 (File No. 0-9092))
- 10.10 Cheniere Energy, Inc. 1997 Stock Option Plan (Incorporated by

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reference to Exhibit 10.25 of the Quarterly on Form 10-Q for the quarter ended November 31, 1997 (File No. 0-9092))

- 10.11 Eighth Amendment to the Exploration Agreement between FX Energy, Inc. (now known as Cheniere Operating) and Zydeco (Incorporated by reference to Exhibit 10.26 of the Transition Report on Form 10-K for the period from September 1, 1997 to December 31, 1997 (File No. 0-9092))
- 10.12 Form of Securities Purchase Agreement dated December 15, 1997 (Incorporated by reference to Exhibit 10.27 of the Transition Report on Form 10-K for the period from September 1, 1997 to December 31, 1997 (File No. 0-9092))

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- 10.13 Form of First Amendment to Securities Purchase Agreement dated December 15, 1997 (Incorporated by reference to Exhibit 10.28 of the Transition Report on Form 10-K for the period from September 1, 1997 to December 31, 1997 (File No. 0-9092))
- 10.14 Securities Purchase Agreement among Cheniere, Arabella S.A., Alba Limited and Scorpion Energy Partners dated December 15, 1997 (Incorporated by reference to Exhibit 10.29 of the Transition Report on Form 10-K for the period from September 1, 1997 to December 31, 1997 (File No. 0-9092))
- 10.15 Letter Agreement between Cheniere and Zydeco dated December 31, 1997 (Incorporated by reference to Exhibit 10.30 of the Transition Report on Form 10-K for the period from September 1, 1997 to December 31, 1997 (File No. 0-9092))
- 10.16 Services Agreement dated October 1, 1998 between Cheniere and Charif Souki (Incorporated by reference to Exhibit 10.22 of the Annual Report on Form 10-K for the year ended December 31, 1998 (File No. 0-9092))
- 10.17 Form of Second Amendment to Securities Purchase Agreement dated December 15, 1997 (Incorporated by reference to Exhibit 10.23 of the Annual Report on Form 10-K for the year ended December 31, 1998 (File No. 0-9092))
- 10.18 Form of Third Amendment to Securities Purchase Agreement dated December 15, 1997 (Incorporated by reference to Exhibit 10.24 of the Annual Report on Form 10-K for the year ended December 31, 1998 (File No. 0-9092))
- 10.19 Form of Fourth Amendment to Securities Purchase Agreement dated December 15, 1997 (Incorporated by reference to Exhibit 10.25 of the Annual Report on Form 10-K for the year ended December 31, 1998 (File No. 0-9092))
- 10.20 Form of Fifth Amendment to Securities Purchase Agreement dated December 15, 1997 (Incorporated by reference to Exhibit 10.26 of the Annual Report on Form 10-K for the year ended December 31, 1998 (File No. 0-9092))

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- 10.21 Exchange Agreement between Cheniere and BSR Investments, Ltd. (Incorporated by reference to Exhibit 10.27 of the Annual Report on Form 10-K for the year ended December 31, 1998 (File No. 0-9092))
- 10.22 Master License Agreement dated June 9, 1999 between Fairfield Industries Incorporated and Cheniere. Certain information in this exhibit has been omitted and filed separately with the Commission. Confidential treatment has been requested with respect to the omitted portions. (Incorporated by reference to Exhibit 10.28 of the Quarterly Report on Form 10-Q for the quarter ended June 30, 1999 (File No. 0-9092))
- 10.23 Supplement Agreement No. 1 to Master License Agreement dated June 9, 1999 between Fairfield Industries Incorporated and Cheniere. Certain information in this exhibit has been omitted and filed separately with the Commission. Confidential treatment has been requested with respect to the omitted portions. (Incorporated by reference to Exhibit 10.29 of the Quarterly Report on Form 10-Q for the quarter ended June 30, 1999 (File No. 0-9092))
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- 10.24 Credit Agreement between Cheniere as Borrower and EnCap Energy Capital Fund III, L.P. as Lender for \$3,100,000 dated as of September 1, 1999 (Incorporated by reference to Exhibit 10.30 of the Quarterly Report on Form 10-Q for the quarter ended September 30, 1999 (File No. 0-9092))
- 10.25 Conveyance of Net Profits Overriding Royalty Interest from and by Cheniere Energy, Inc. to and in favor of EnCap Energy Capital Fund III, L.P. dated as of September 1, 1999 (Incorporated by reference to Exhibit 10.31 of the Quarterly Report on Form 10-Q for the quarter ended September 30, 1999 (File No. 0-9092))
- 10.26 First Amendment to Cheniere Energy, Inc. 1997 Stock Option Plan. (Incorporated by reference to Exhibit 10.26 of the Annual Report on Form 10-K for the year ended December 31, 1999 (File No. 0-9092))
- 10.27 Exploration Agreement dated as of March 31, 2000 between Cheniere and Samson Offshore Company. Certain information in this exhibit has been omitted and filed separately with the Commission. Confidential treatment has been requested with respect to the omitted portions. (Incorporated by reference to Exhibit 10.28 of the Annual Report on Form 10-K for the year ended December 31, 1999 (File No. 0-9092))
- 10.28 First Amendment to Credit Agreement between Cheniere and EnCap Energy Capital Fund III, L.P. dated December 31, 1999. (Incorporated by reference to Exhibit 10.29 of the Annual Report on Form 10-K for the year ended December 31, 1999 (File No. 0-9092))
- 10.29 Three Party Agreement dated January 4, 2000 between Cheniere, EnCap Energy Capital Fund III, L.P., and Schlumberger Technology Corporation. (Incorporated by reference to Exhibit 10.30 of the Annual Report on Form 10-K for the year ended December 31, 1999 (File No. 0-9092))
- 10.30 Subordination Agreement dated January 4, 2000 between Cheniere,

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EnCap Energy Capital Fund III, L.P., and Schlumberger Technology Corporation. (Incorporated by reference to Exhibit 10.31 of the Annual Report on Form 10-K for the year ended December 31, 1999 (File No. 0-9092))

- 10.31 Debt Restructure Agreement dated January 4, 2000 between Cheniere and Schlumberger Technology Corporation. (Incorporated by reference to Exhibit 10.32 of the Annual Report on Form 10-K for the year ended December 31, 1999 (File No. 0-9092))
- 10.32 Second Amendment to Credit Agreement between Cheniere and EnCap Energy Capital Fund III, L.P. dated February 29, 2000. (Incorporated by reference to Exhibit 10.33 of the Annual Report on Form 10-K for the year ended December 31, 1999 (File No. 0-9092))
- 10.33 Form of Sixth Amendment to Securities Purchase Agreement dated December 15, 1997. (Incorporated by reference to Exhibit 10.34 of the Annual Report on Form 10-K for the year ended December 31, 1999 (File No. 0-9092))
- 10.34 Form of Seventh Amendment to Securities Purchase Agreement dated December 15, 1997. (Incorporated by reference to Exhibit 10.35 of the Annual Report on Form 10-K for the year ended December 31, 1999 (File No. 0-9092))
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- 10.35 Form of Eighth Amendment to Securities Purchase Agreement dated December 15, 1997. (Incorporated by reference to Exhibit 10.36 of the Annual Report on Form 10-K for the year ended December 31, 1999 (File No. 0-9092))
- 10.36 Form of Ninth Amendment to Securities Purchase Agreement dated December 15, 1997. (Incorporated by reference to Exhibit 10.37 of the Annual Report on Form 10-K for the year ended December 31, 1999 (File No. 0-9092))
- 10.37 Form of Tenth Amendment to Securities Purchase Agreement dated December 15, 1997. (Incorporated by reference to Exhibit 10.38 of the Annual Report on Form 10-K for the year ended December 31, 1999 (File No. 0-9092))
- 10.38 Seismic Data Purchase Agreement dated June 21, 2000 between Seitel Data and Cheniere. (Incorporated by reference to Exhibit 10.39 of the Quarterly Report on Form 10-Q for the quarter ended June 30, 2000 (File No. 0-9092))
- 10.39 Contribution and Subscription Agreement dated October 11, 2000, by and among the Company, Gryphon Exploration Company and the other investors listed therein. (Incorporated by reference to Exhibit 10.1 of the Company's Current Report on Form 8-K filed on October 20, 2000) (File No. 0-9092))
- 10.40 Stockholders Agreement dated October 11, 2000. (Incorporated by reference to Exhibit 10.2 of the Company's Current Report on Form 8-K filed on October 20, 2000 (File No. 0-9092))

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- 10.41 Certificate of Designations, Preferences and Rights of Series A Convertible Preferred Stock of Gryphon Exploration Company. (Incorporated by reference to Exhibit 10.3 of the Company's Current Report on Form 8-K filed on October 20, 2000 (File No. 0-9092))
- 21.1 Subsidiaries of Cheniere Energy, Inc. (Incorporated by reference to Exhibit 21.1 of the Annual Report on Form 10-K filed on October 14, 1997 (File No. 0-9092))
- 23.1 Consent of PricewaterhouseCoopers LLP

(b) Reports On Form 8-K

. The Company filed a Current Report on Form 8-K on October 20, 2000 (File No. 0-9092) to report (i) the closing of a \$25,000,000 agreement with Warburg, Pincus Equity Partners, L.P., a global private equity fund based in New York, to fund its exploration program on the Louisiana Data Set through a newly formed affiliate Gryphon Exploration Company; (ii) the election of Charles M. Reimer as President and Chief Executive Officer of the Company; and (iii) the approval of the stockholders of the four-for-one reverse stock split at a special meeting of the stockholders.

The Company filed a Current Report on Form 8-K on December 15, 2000 to report that the Nasdaq Listing Qualifications Panel had notified the Company that its common stock had been delisted from the Nasdaq SmallCap Market effective December 14, 2000, and that its common stock would trade on the OTC Bulletin Board effective December 14, 2000.

(c) Not applicable.

(d) Gryphon Exploration Company Financial Statements, for which Cheniere uses the equity method of accounting, are filed as a part of this report on page 61.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

CHENIERE ENERGY, INC.

By: /s/ DON A. TURKLESON

-----  
Don A. Turkleson  
Vice President, Chief Financial  
Officer, Secretary and Treasurer  
Date: November 29, 2001

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REPORT OF INDEPENDENT ACCOUNTANTS

To the Board of Directors and Stockholders of Gryphon Exploration Company

In our opinion, the accompanying balance sheet and the related statements of operations, stockholders' equity and cash flows present fairly, in all material respects, the financial position of Gryphon Exploration Company at December 31, 2000, and the results of its operations and its cash flows for the period from inception (October 11, 2000 through December 31, 2000 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit of these statements in accordance with auditing standards generally accepted in the United States of America, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

PRICEWATERHOUSECOOPERS LLP

Houston, Texas  
March 30, 2001

GRYPHON EXPLORATION COMPANY  
BALANCE SHEET

ASSETS

CURRENT ASSETS

Cash and Short-Term Investments

Dece

-----

\$

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Restricted Cash Deposits	
Receivables from Joint Interest Owners	
Prepaid Expenses	
	-----
Total Current Assets	
OIL AND GAS PROPERTIES, full cost method	
Proved Properties, net	
Unproved Properties, not subject to amortization	
	-----
Total Oil and Gas Properties	
NONCURRENT RESTRICTED CASH DEPOSITS	
FIXED ASSETS, net	
	-----
Total Assets	=====
	\$
	=====
LIABILITIES AND STOCKHOLDERS' EQUITY	
CURRENT LIABILITIES	
Accounts Payable	
Trade Accounts	
Advances from Joint Interest Owners	
Other	
	-----
Total Current Liabilities	-----
DEFERRED TAX LIABILITY	
	-----
COMMITMENTS AND CONTINGENCIES (NOTE 10)	
STOCKHOLDERS' EQUITY	
Common Stock, \$.01 par value	
Authorized: 4,000,000 shares; Issued and Outstanding: 145,600 shares	
Preferred Stock, \$.01 par value	
Authorized: 100,000 shares; Issued and Outstanding: 25,000 shares	
Additional Paid-in-Capital	
Retained Earnings	
	-----
Total Stockholders' Equity	-----
	-----
Total Liabilities and Stockholders' Equity	=====
	\$
	=====

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



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December 31, 2000

Revenues	\$ --
Operating Costs and Expenses	
Depreciation, Depletion and Amortization	112,503
General and Administrative Expenses	119,165
Total Operating Costs and Expenses	231,668
Loss from Operations Before Interest Income and Income Taxes	(231,668)
Interest Income	260,460
Income From Operations Before Income Taxes	28,792
Provision for Income Taxes	(9,789)
Net Income	\$ 19,003

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

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GRYPHON EXPLORATION COMPANY  
STATEMENT OF STOCKHOLDERS' EQUITY

	Common Stock		Preferred Stock		Additional Paid-In Capital
	Shares	Amount	Shares	Amount	
Balance - Date of Inception (October 11, 2000)	-	\$ -	-	\$ -	\$ -
Issuance of Common Stock	145,600	1,456			9,064,463
Issuance of Preferred Stock			25,000	250	24,999,750
Expenses Related to Issuance	-	-	-	-	(896,103)
Net Income	-	-	-	-	-
Balance - December 31, 2000	145,600	\$ 1,456	25,000	\$ 250	\$ 33,168,110

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

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GRYPHON EXPLORATION COMPANY  
STATEMENT OF CASH FLOWS

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	Ince (October Th Decembe -----
CASH FLOWS FROM OPERATING ACTIVITIES:	
Net Income	\$ 1
Adjustments to Reconcile Net Income to	
Net Cash Provided by (Used in) Operating Activities:	
Depreciation, Depletion and Amortization	11
Non-Cash Expense	1
Deferred Income Taxes	
	-----
Changes in Operating Assets and Liabilities	15
Restricted Cash Deposits	(7, 17
Accounts Receivable	(1, 69
Prepaid Expenses	(18
Accounts Payable	10, 96
	-----
NET CASH PROVIDED BY OPERATING ACTIVITIES	2, 07
	-----
CASH FLOWS FROM INVESTING ACTIVITIES:	
Purchases of Fixed Assets	(6
Oil and Gas Property Additions	(9, 54
Noncurrent Restricted Cash Deposits	(2, 60
	-----
NET CASH USED IN INVESTING ACTIVITIES	(12, 22
	-----
CASH FLOWS FROM FINANCING ACTIVITIES:	
Sale of Preferred Stock	25, 00
Offering Costs	(89
	-----
NET CASH PROVIDED BY FINANCING ACTIVITIES	24, 10
	-----
NET INCREASE IN CASH	13, 95
CASH - BEGINNING OF PERIOD	
	-----
CASH - END OF PERIOD	\$ 13, 95
	=====

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

GRYPHON EXPLORATION COMPANY  
NOTES TO FINANCIAL STATEMENTS  
DECEMBER 31, 2000

NOTE 1-ORGANIZATION AND NATURE OF OPERATIONS

Gryphon Exploration Company, a Delaware corporation, (Gryphon or the Company) is a non-public, Houston-based company formed for the purpose of oil and gas

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exploration, development and exploitation. The Company is currently engaged in the exploration for oil and natural gas along the Gulf Coast of Louisiana, in the shallow waters of the Gulf of Mexico. The Company began its oil and gas activities in October 2000.

On October 11, 2000, Gryphon completed a transaction with Warburg, Pincus Equity Partners, L.P., (Warburg) a global private equity fund based in New York, and Cheniere Energy, Inc. (Cheniere) to fund an exploration program on approximately 8,800 square miles of seismic data in the Gulf of Mexico (the Louisiana Data Set). Cheniere contributed selected net assets and liabilities in exchange for 100% of the common stock of Gryphon and \$2,000,000 in cash (36.8% voting interest after conversion of Gryphon's preferred stock). Such assets include: the Louisiana Data Set, certain offshore leases, a prospect then being drilled, an exploration agreement with an industry partner (described in Note 5) and certain other assets and liabilities. The net assets received from Cheniere were recorded at their estimated fair value at the date of the transaction. Warburg contributed \$25,000,000 and received Gryphon preferred stock, with an 8% cumulative dividend, convertible into 63.2% of Gryphon's common stock. Cheniere and Warburg also agreed, under certain circumstances, to contribute an additional \$75,000,000 to Gryphon, proportionate to their respective ownership interests.

### NOTE 2-SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

#### Basis of Presentation

The financial statements include the accounts of Gryphon Exploration Company.

#### Oil and Gas Properties

The Company follows the full cost method of accounting for its oil and gas properties. Under this method, all productive and nonproductive exploration and development costs incurred for the purpose of finding 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, together with internal costs directly attributable to property acquisition, exploration and development activities.

The costs of the Company's oil and gas properties, including the estimated future costs to develop proved reserves, are depreciated (upon commencement of production) using a composite units-of-production rate based on estimates of proved reserves. Investments in unproved properties and major development projects are not amortized until proved reserves associated with the projects can be determined or until impairment occurs. If the results of an assessment indicate that the properties are impaired, the amount of the impairment is added to the capitalized costs to be amortized. Net capitalized costs are limited to a capitalization ceiling, calculated on a quarterly basis as the aggregate of the present value, discounted at 10%, of estimated future net revenues from proved reserves, based on current economic and operating conditions, plus the lower of cost or fair market value of unproved properties, less related income tax effects.

The Company's allocation of 3D seismic exploration costs to proved properties involves an estimate of the total reserves to be discovered in the project. It is reasonably possible, based on the results obtained from future drilling, that revisions to this estimate could occur within the next twelve months, which could affect the Company's capitalization ceiling.

Sales of proved and unproved properties are accounted for as adjustments of capitalized costs with no gain or loss recognized, unless such adjustments would significantly alter the relationship between capitalized costs and proved oil

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and gas reserves.

### Revenue Recognition

Revenues from the sale of oil and gas produced are recognized upon passage of title, net of royalty interests. When sales volumes differ from the Company's entitled share, an overproduced or underproduced imbalance occurs. To the extent the overproduced imbalance exceeds the Company's share of the remaining estimated proved natural gas reserves for a given property, the Company records a liability. At December 31, 2000 the Company had no gas imbalances.

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### GRYPHON EXPLORATION COMPANY NOTES TO FINANCIAL STATEMENTS--(Continued) DECEMBER 31, 2000

### Fixed Assets

Fixed assets are recorded at cost. Repairs and maintenance costs are charged to operations as incurred. Depreciation is computed using the straight-line method calculated to amortize the cost of assets over their estimated remaining useful lives, which are estimated as 9-17 months for software and computer equipment, 18 months for office furnishings and 3 years for leasehold improvements. Upon retirement or other disposition of property and equipment, the cost and related depreciation is removed from the accounts and the resulting gains or losses are recorded.

### Offering Costs

Offering costs consist primarily of placement fees, professional fees and printing costs. These costs are charged against the related proceeds from the sale of equity securities in the periods in which they occur.

### Income Taxes

Provisions for income taxes are based on taxes payable or refundable for the current year and deferred taxes on temporary differences between the amount of taxable income and pretax financial income and between the tax bases of assets and liabilities and their reported amounts in the financial statements. Deferred tax assets and liabilities are included in the financial statements at currently enacted income tax rates applicable to the period in which the deferred tax assets and liabilities are expected to be realized or settled as prescribed in Statement of Financial Accounting Standards (SFAS) No. 109, Accounting for Income Taxes. As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through the current period's provision for income taxes.

### Stock-Based Compensation

SFAS No. 123, Accounting for Stock-Based Compensation, encourages, but does not require, companies to record compensation cost for stock-based employee compensation plans at fair value. The Company has chosen to continue to account for stock-based compensation issued to employees using the intrinsic value method prescribed in Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations. Accordingly, compensation cost for stock options is measured as the excess, if any, of the market price of the Company's stock at the date of the grant over the amount an employee must pay to acquire the stock. The Company grants options

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at or above the market price of its common stock at the date of each grant.

### Cash Equivalents

The Company classifies all investments with original maturities of three months or less as cash equivalents.

### Restricted Cash Deposits

Restricted cash deposits represent deposits reserved for the funding of contractual drilling costs on behalf of the Company and its working interest partners.

### Fair Value of Financial Instruments

The carrying amounts of cash and cash equivalents, accounts receivable and accounts payable approximate fair value because of the short maturity of those instruments.

### Commodity Price Risk

The Company produces and sells natural gas, crude oil and condensate. As a result, the Company's financial results can be significantly affected as these commodity prices fluctuate widely in response to changing market forces. The Company has not entered into any hedging or derivative transactions.

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GRYPHON EXPLORATION COMPANY  
NOTES TO FINANCIAL STATEMENTS--(Continued)  
DECEMBER 31, 2000

### Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires that the Company make estimates and assumptions that affect the amounts reported in the financial statements and the accompanying notes. Actual results could differ from those estimates. Management believes its estimates are reasonable.

### New Accounting Pronouncements

In June 1998, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 133, Accounting for Derivative Instruments and Hedging Activities. In June 1999, the FASB extended the adoption date of SFAS 133 until January 1, 2001, through the issuance of SFAS No. 137, Deferral of the Effective Date of SFAS 133. In June 2000, the FASB issued SFAS No. 138, Accounting for Certain Derivative Instruments and Certain Hedging Activities, which also amended SFAS 133. SFAS 133, as amended requires that companies recognize all derivative instruments as either assets or liabilities on the balance sheet and measure those instruments at fair value. Changes in the fair value of derivatives are recorded each period in current earnings or other comprehensive income depending on their designation, their intended use, or their ability to qualify as hedges. The Company adopted SFAS 133 in the first quarter of 2001; such adoption did not have a material impact on its financial statements.

In December 1999, the Securities and Exchange Commission issued Staff Accounting Bulletin (SAB) No. 101, Revenue Recognition in Financial Statements. SAB No. 101 was implemented in 2000 and did not have a material effect on the Company's financial statements.

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NOTE 3-FIXED ASSETS

Fixed assets consist of the following:

	December 31, 2000
	-----
Furniture and Fixtures	\$ 71,024
Computers and Office Equipment	597,217
Other	95,715
	-----
	763,956
Less Accumulated Depreciation	(112,503)
	-----
Fixed Assets, Net	\$ 651,453
	=====

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GRYPHON EXPLORATION COMPANY  
NOTES TO FINANCIAL STATEMENTS--(Continued)  
DECEMBER 31, 2000

NOTE 4-OIL AND GAS PROPERTIES

Investments in oil and gas properties were as follows at December 31, 2000:

	December 31, 2000
	-----
Oil and gas properties:	
Proved	\$ 2,727,143
Unproved	15,469,010
	-----
	18,196,153
Less accumulated depreciation, depletion and amortization	-
	-----
	\$ 18,196,153
	=====

There was no production from the Company's proved reserves as of December 31, 2000. The Company capitalized as oil and gas property costs \$98,032 of general administrative expenses directly related to its exploration and development activities in 2000. Noncurrent restricted cash deposits represent amounts advanced by the Company into escrow or deposit accounts related to its portion of drilling costs under contractual arrangements.

The Company has made a substantial investment in acquiring, processing and reprocessing its 3D seismic database covering an 8,800-square-mile project area in the Gulf of Mexico. The costs of this project become subject to amortization on a ratable basis as the oil and gas reserves expected to be recovered from the project are discovered. The Company commenced drilling exploratory wells in December 2000 related to its unproved properties and anticipates completing

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drilling activities sufficient to fully evaluate the properties within three to five years. Interpretation of this data is ongoing.

### NOTE 5-EXPLORATION AGREEMENT

The Company is party to an exploration agreement with an industry partner. This exploration agreement was contributed by Cheniere (Note 1). Under the terms of the agreement, Gryphon's exploration partner acquired an option to participate at a 50% working interest level in any drilling prospect generated by Gryphon through August 2001 within a defined area of mutual interest in the Gulf of Mexico. Gryphon receives a fixed management fee of \$230,000 per month from its partner, representing partial reimbursement of general and administrative expenses over the term of the agreement (through August 31, 2001). In addition, Gryphon's partner pays a disproportionate share of the cost of leasing and of the initial test well on each prospect. Gryphon is the operator of the drilling program. The management fee payments were credited as a recovery of general and administrative expenses. Management fees received by Gryphon in 2000 totaled \$615,807.

### NOTE 6-INCOME TAXES

From its inception through December 31, 2000, the Company has recorded a loss for federal income tax reporting purposes and deferred income taxes of \$9,789. At December 31, 2000, the Company had net operating loss (NOL) carryforwards for tax reporting purposes of approximately \$2,032,000.

Deferred tax assets and liabilities reflect the net tax effect of temporary differences between the carrying amount of assets and liabilities for financial reporting purposes and amounts used for income tax purposes. The Company recorded a deferred tax liability of approximately \$1,174,000 to account for the difference between the tax basis of assets contributed by Cheniere and the estimated fair value of those assets at the date of inception.

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GRYPHON EXPLORATION COMPANY  
NOTES TO FINANCIAL STATEMENTS--(Continued)  
DECEMBER 31, 2000

Significant components of the Company's deferred tax assets and liabilities at December 31, 2000 are as follows:

Deferred Tax Asset (Liability)	December 31, 2000
NOL	\$ 751,671
Oil and gas properties and fixed assets	(1,935,460)
	-----
Net deferred tax liability	\$(1,183,789)
	=====

Net operating loss carryforwards expire in 2020.

### NOTE 7-PREFERRED STOCK

At December 31, 2000, the Company had 25,000 shares of its 8% convertible preferred stock issued and outstanding. The preferred stock is convertible at the option of the holder at a rate of \$100 per share of common stock at any time

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after the holders of a majority of the preferred stock execute a written consent permitting a conversion of the preferred stock or, if earlier, at any time after August 31, 2010. In the event the holders of a majority of the preferred stock vote to convert all of their shares of preferred stock into common stock, all shares of preferred stock shall automatically be converted, without further action by the Company or its shareholders. In addition, the Company has the right, at its option, to convert shares of preferred stock into common stock upon the closing of a firm commitment qualified public offering. Holders of preferred stock are entitled to vote, on an as converted basis, on all matters as to which holders of common stock are entitled to vote, in the same manner and with the same effect as such holders of common stock, voting together with the holders of common stock as one class. Each share of preferred stock has a liquidation preference of \$1,000. Dividends accrue at a rate of 8% per annum, become payable quarterly as declared, and are cumulative and payable in the event of liquidation of the Company. At December 31, 2000, there were \$445,652 in undeclared dividends in arrears.

### NOTE 8-STOCK-BASED COMPENSATION

In 2000, the Company established the Gryphon Exploration Company 2000 Stock Option Plan (the Option Plan). The Option Plan allows for the issuance of options to purchase up to 64,400 shares of Gryphon common stock at an exercise price of \$100.00 per share during 2000 and 2001. The Company has reserved 64,400 shares of common stock for issuance upon the exercise of options which have been granted or which may be granted. The term of options granted under the Option Plan is generally ten years. Vesting occurs over a three-year period, one third on each anniversary of the grant date. Grants made by the Company during 2000 are summarized in the following table:

	December 31, 2000
	-----
Outstanding at beginning of period	-
Options granted at an exercise price of \$100.00 per share	39,750
Options canceled	(350)
	-----
Outstanding at end of period	39,400
	=====
Exercisable at end of period	-
	=====
Weighted average exercise price of options outstanding	\$ 100.00
	=====
Weighted average exercise price of options exercisable	N/A
	=====
Weighted average fair value of options granted during the period	\$ 0.24
	=====
Weighted average remaining contractual life of options outstanding	9.8 years

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GRYPHON EXPLORATION COMPANY  
NOTES TO FINANCIAL STATEMENTS--(Continued)  
DECEMBER 31, 2000

The following table summarizes information about fixed options outstanding at December 31, 2000.



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Exercise Price	Number Outstanding	Weighted Average Remaining Contractual Life (Years)
-----	-----	-----
\$100.00	39,400	9.8
	-----	
	39,400	
	=====	

The fair value of options is calculated using the Black-Scholes option pricing model. Assumptions used for the period from inception (October 11, 2000) through December 31, 2000, were: no dividend yield, no volatility, risk-free interest rate of 5.6%, and expected life of the options of 5.0 years. The pro forma effect on the Company's net income had it adopted the optional recognition provisions of SFAS No. 123 for 2000 would be to decrease the reported net income by \$580.

NOTE 9-RELATED PARTY TRANSACTIONS

Under the terms of the Contribution and Subscription Agreement dated October 11, 2000 by and among the Company, Cheniere and the other investors listed therein, Gryphon provided office space to Cheniere at no cost from the closing date of October 11, 2000 until Cheniere relocated in December 2000, and Cheniere is providing accounting and cash management services to Gryphon without charge for six months following the closing date. The values of the office space and the accounting and cash management services offset and were not significant to the Company.

Cheniere served as contract operator throughout 2000 for the well contributed to Gryphon on which drilling was underway at the date of Gryphon's inception. Cheniere received industry standard overhead reimbursements from all working interest owners, including Gryphon, in accordance with the terms of the joint interest operating agreement.

NOTE 10-COMMITMENTS AND CONTINGENCIES

The Company has entered into an office lease agreement with a non-cancelable term which runs through January 2003. Future minimum lease payments are \$236,259, \$236,259 and \$19,688 for the years ended December 31, 2001, 2002 and 2003, respectively. Total rental expense for office space for the period from inception (October 11, 2000) through December 31, 2000 was \$56,519.

At the time of its inception, Gryphon acquired a master license agreement covering the license of approximately 8,800 square miles of 3-D seismic data in the Gulf of Mexico. In connection with the license agreement, the Company has made a commitment to reprocess certain of the seismic data and to pay a fee for such reprocessing as the reprocessed data are delivered. At December 31, 2000, the Company had contingent commitments of approximately \$800,000 related to future deliveries of reprocessed data.

NOTE 11-SUPPLEMENTAL DISCLOSURES OF NON-CASH TRANSACTIONS

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At the time of its inception, the Company received a contribution of net assets which were recorded at their estimated fair value and which are summarized as follows:

	Inception (October 11, 2000)
Prepaid expenses	\$ 1,042,119
Unproved oil and properties	9,379,534
Fixed assets	694,310
Accounts payable	(2,050,044)
	-----
Net assets contributed at inception	\$ 9,065,919
	=====

Additionally, the Company recorded a deferred tax liability of approximately \$1,174,000 to account for the difference between the tax basis of assets contributed by Cheniere and the estimated fair value of those assets at the date of inception.

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### GRYPHON EXPLORATION COMPANY SUPPLEMENTAL INFORMATION TO FINANCIAL STATEMENTS OIL AND GAS RESERVES AND RELATED FINANCIAL DATA (unaudited)

#### COSTS INCURRED IN OIL AND GAS PRODUCING ACTIVITIES

Presented below are costs incurred in oil and gas property acquisition, exploration and development activities:

	December 31, 2000
Acquisition of properties:	
Proved properties	\$ -
Unproved properties	7,875,590
Exploration costs	2,018,442
Development costs	728,866
	-----
	10,622,898
Assets contributed at inception	7,573,255
	-----
Total	\$18,196,153
	=====

The above amounts include \$98,032 of capitalized general and administrative expenses directly related to property acquisition, exploration and development.

#### CAPITALIZED COSTS RELATED TO OIL AND GAS PRODUCING ACTIVITIES

The following table presents total capitalized costs of proved and unproved properties and accumulated depreciation, depletion and amortization related to oil and gas producing operations:

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	December 31, 2000
	-----
Proved properties	\$ 2,727,143
Unproved properties	15,469,010
	-----
	18,196,153
Accumulated depreciation, depletion and amortization	-
	-----
	\$18,196,153
	=====

The Company commenced drilling exploratory wells in December 2000 related to its unproved properties and anticipates completing drilling activities sufficient to fully evaluate the properties within three to five years. Interpretation of this data is ongoing.

RESULTS OF OPERATIONS FROM OIL AND GAS PRODUCING ACTIVITIES

Oil and gas producing activities had not yet commenced as of December 31, 2000.

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GRYPHON EXPLORATION COMPANY SUPPLEMENTAL INFORMATION TO FINANCIAL STATEMENTS OIL AND GAS RESERVES AND RELATED FINANCIAL DATA  
(unaudited)

RESERVE QUANTITIES

Estimates of proved reserves of the Company and the related standardized measure of discounted future net cash flow information are based on the reports generated by independent petroleum engineers in accordance with the rules and regulations of the SEC. The independent engineers' estimates were based upon a review of production histories and other geologic, economic, ownership and engineering data provided by the Company. These estimates represent the Company's interest in the reserves associated with its properties. All of the Company's oil and gas reserves are located within the United States and its territorial waters.

The Company's estimates of its proved reserves and proved developed reserves of oil and gas as of December 31, 2000 and the changes in its proved reserves are as follows:

	2000	
	-----	-----
	Oil	Gas
	(Bbls)	(Mcf)
	-----	-----
Proved reserves:		
Beginning of year	-	-
Extensions, discoveries and other additions	2,640	1,674,000
	-----	-----
End of year	2,640	1,674,000
	=====	=====
Proved developed reserves:		
Beginning of year	-	-
End of year	2,640	1,674,000

=====

There are numerous uncertainties inherent in estimating quantities of proved reserves and in projecting future rates of production and future amounts and timing of development expenditures, including many factors beyond the control of the Company. Reserve engineering is a subjective process of estimating underground accumulations of crude oil and natural gas that cannot be measured in an exact manner, and the accuracy of any reserve estimate is a function of the quality of available data and of engineering and geological interpretation and judgment. Estimates of proved undeveloped reserves are inherently less certain than estimates of proved developed reserves. The quantities of oil and gas that are ultimately recovered, production and operating costs, the amount and timing of future development expenditures, geologic success and future oil and gas sales prices may all differ from those assumed in these estimates. In addition, the Company's reserves may be subject to downward or upward revision based upon production history, purchases or sales of properties, results of future development, prevailing oil and gas prices and other factors.

STANDARDIZED MEASURE OF DISCOUNTED FUTURE NET CASH FLOWS

The standardized measure of discounted future net cash flows was calculated by applying year-end prices to estimated future production, less future expenditures (based on year-end costs) to be incurred in developing and producing such proved reserves and the estimated effect of future income taxes based on the current tax law. The resulting future net cash flows were discounted using a rate of 10% per annum.

The standardized measure of discounted future net cash flow amounts contained in the following tabulation does not purport to represent the fair market value of oil and gas properties. No value has been given to unproved properties. There are significant uncertainties inherent in estimating quantities of proved reserves and in projecting rates of production and the timing and amount of future costs. Future realization of oil and gas prices over the remaining reserve lives may vary significantly from current prices. In addition, the method of valuation utilized, based on year-end prices and costs and the use of a 10% discount rate, is not necessarily appropriate for determining fair value.

The standardized measure of discounted future net cash flows relating to proved oil and gas reserves is as follows:

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GRYPHON EXPLORATION COMPANY SUPPLEMENTAL INFORMATION TO FINANCIAL STATEMENTS OIL AND GAS RESERVES AND RELATED FINANCIAL DATA  
(unaudited)

	December 31, 2000
	-----
Future gross revenues	\$ 17,645,344
	=====
Less - future costs:	
Production	(900,581)
Development and dismantlement	(1,205,810)
	-----
Future net cash flows before income taxes	15,538,953
Less - 10% annual discount for estimated timing of cash flows	(2,471,729)
	-----
Present value of future net cash flows before income taxes	13,067,224
Less - present value of future income taxes	(3,928,304)

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Standardized measure of discounted future net cash flows	----- \$ 9,138,920 =====
--	--------------------------------

The following table summarizes the principal sources of change in the standardized measure of discounted future net cash flows:

	December 31, 2000 -----
Standardized measure - beginning of period	\$ -
Extensions, discoveries and other additions	9,138,920 -----
Standardized measure - end of period	\$9,138,920 =====

The standardized measure amounts are based on year-end prices of \$29.72 per barrel of oil and \$10.60 per mcf of gas. The Company had not commenced production of oil and gas as of December 31, 2000. The Company may receive amounts different than those incorporated into the standardized measure of discounted cash flow for a number of reasons, including changes in prices. Therefore, the present value shown above should not be construed as the current market value of the estimated oil and gas reserves attributable to the Company's properties.