HARKEN ENERGY CORP
Form 10-Q
August 12, 2004
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SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

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

For the quarterly period ended June 30, 2004

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

For the transition period from ______ to ______

Commission file number 1-10262

HARKEN ENERGY CORPORATION

(Exact name of registrant as specified in its charter)

Delaware	**95-2841597**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

180 State Street, Suite 200 Southlake, Texas	**76092**
(Address of principal executive offices)	**(Zip Code)**

Registrant s telephone number, including area code (817) 424-2424

Former Name or Former Address, if Changed Since Last Report:

580 Westlake Park Boulevard, Suite 600, Houston, Texas 77079

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 x No ¨

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No x

The number of shares of Common Stock, par value $0.01 per share, outstanding as of August 2, 2004 was 205,763,106.

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HARKEN ENERGY CORPORATION

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June 30, 2004

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PART I FINANCIAL INFORMATION

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ITEM 1. CONDENSED FINANCIAL STATEMENTS

HARKEN ENERGY CORPORATION AND SUBSIDIARIES

CONSOLIDATED CONDENSED BALANCE SHEETS

	December 31, 2003	June 30, 2004
	(audited)	(unaudited)
Assets		
Current Assets:		
Cash and temporary investments	$ 12,173,000	$ 22,439,000
Accounts receivable, net	2,307,000	5,237,000
Prepaid expenses and other current assets	1,160,000	889,000
Investment in equity securities	1,209,000	
Total Current Assets	16,849,000	28,565,000
Property and Equipment, net	62,834,000	63,528,000
Other Assets, net	1,329,000	1,118,000
	$ 81,012,000	$ 93,211,000
Liabilities and Stockholders Equity		
Current Liabilities:		
Trade payables	$ 963,000	$ 1,939,000
Accrued liabilities and other	5,166,000	2,375,000
Revenues and royalties payable	1,166,000	1,694,000
Convertible notes payable	1,667,000	1,667,000
Total Current Liabilities	8,962,000	7,675,000
Convertible Notes Payable	3,673,000	2,500,000
Senior Secured Notes	2,020,000	
Accrued Preferred Stock Dividends	3,239,000	195,000
Asset Retirement Obligation	6,305,000	6,422,000
Global Warrant Liability	651,000	13,132,000
Commitments and Contingencies (Note 17)		
Minority Interest in Consolidated Subsidiary	3,401,000	3,625,000
Series J Preferred Stock, $1.00 par value; $5,000,000 liquidation value; 65,000 shares authorized; 50,000 shares outstanding		4,675,000
Series L Preferred Stock, $1.00 par value; $5,000,000 liquidation value; 65,000 shares authorized; 50,000 shares outstanding		3,526,000
Stockholders Equity:		

Series G1 Preferred Stock, $1.00 par value; $29,537,200 liquidation value; 700,000 shares authorized; 325,312 and 295,372 shares outstanding, respectively	325,000	295,000
Series G2 Preferred Stock, $1.00 par value; $2,715,000 liquidation value; 100,000 shares authorized; 61,650 and 27,150 shares outstanding, respectively	62,000	27,000
Series G3 Preferred Stock, $1.00 par value; $0 liquidation value; 150,000 shares authorized; 76,700 and 0 shares outstanding, respectively,	77,000	
Series G4 Preferred Stock, $1.00 par value; $7,800,000 liquidation value; 150,000 shares authorized; 77,517 shares outstanding		78,000
Common stock, $0.01 par value; 325,000,000 shares authorized; 185,405,471 and 206,370,916 shares issued, respectively	1,854,000	2,064,000
Additional paid-in capital	432,027,000	439,283,000
Accumulated deficit	(380,872,000)	(388,953,000)
Accumulated other comprehensive income	740,000	119,000
Treasury stock, at cost, 605,700 shares held	(1,452,000)	(1,452,000)
Total Stockholders Equity	52,761,000	51,461,000
	$ 81,012,000	$ 93,211,000

The accompanying Notes to Consolidated Condensed Financial Statements

are an integral part of these Statements.

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HARKEN ENERGY CORPORATION AND SUBSIDIARIES

CONSOLIDATED CONDENSED STATEMENTS OF OPERATIONS

(Unaudited)

	Three Months Ended June 30, 2003	Three Months Ended June 30, 2004	Six Months Ended June 30, 2003	Six Months Ended June 30, 2004
Revenues:				
Oil and gas operations	$ 6,667,000	$ 7,995,000	$ 14,045,000	$ 14,438,000
Interest and other income	(63,000)	163,000	(387,000)	397,000
	6,604,000	8,158,000	13,658,000	14,835,000
Costs and Expenses:				
Oil and gas operating expenses	2,537,000	2,178,000	4,564,000	4,055,000
General and administrative expenses, net	2,440,000	2,080,000	4,916,000	3,647,000
Depreciation and amortization	2,157,000	2,948,000	4,197,000	5,583,000
Interest expense and other, net	1,011,000	138,000	3,323,000	350,000
Loss from increase in Global warrant liability		12,481,000		12,481,000
	8,145,000	19,825,000	17,000,000	26,116,000
Gain from extinguishments of debt	751,000		5,282,000	325,000
Gain from sale of equity investment				990,000
Income/(loss) before income taxes	(790,000)	(11,667,000)	1,940,000	(9,966,000)
Income tax (expense)/benefit	451,000	(231,000)	351,000	(323,000)
Income/(loss) before cumulative effect of change in accounting principle and minority interest	(339,000)	(11,898,000)	2,291,000	(10,289,000)
Minority interest of subsidiary	(61,000)	(127,000)	(30,000)	(225,000)
Income/(loss) before cumulative effect of change in accounting principle	$ (400,000)	$ (12,025,000)	$ 2,261,000	$ (10,514,000)
Cumulative effect of change in accounting principle			(813,000)	
Net income/(loss)	$ (400,000)	$ (12,025,000)	$ 1,448,000	$ (10,514,000)
Accrual of dividends related to preferred stock	(1,010,000)	(877,000)	(1,996,000)	(1,643,000)
Exchange of preferred stock		337,000		337,000
Payment of preferred stock dividends		1,074,000	7,044,000	3,738,000
Net income/loss attributed to common stock	$ (1,410,000)	$ (11,491,000)	$ 6,496,000	$ (8,082,000)
Basic income per common share:				
	$ (0.01)	$ (0.06)	$ 0.10	$ (0.04)

Net income/loss per common share before cumulative effect of change in accounting principle				
Cumulative effect of change in accounting principle			(0.01)	
Net income/loss per common share	$ (0.01)	$ (0.06)	$ 0.09	$ (0.04)
Weighted average common shares outstanding	108,460,068	201,391,524	72,810,323	194,714,427
Diluted income per common share:				
Net income/loss per common share before cumulative effect of change in accounting principle	$ (0.01)	$ (0.06)	$ 0.03	$ (0.04)
Cumulative effect of change in accounting principle			(0.01)	
Net income/loss per common share	$ (0.01)	$ (0.06)	$ 0.02	$ (0.04)
Weighted average common shares outstanding	108,460,068	201,391,524	72,905,996	194,714,427

The accompanying Notes to Consolidated Condensed Financial Statements

are an integral part of these Statements.

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HARKEN ENERGY CORPORATION AND SUBSIDIARIES

CONSOLIDATED CONDENSED STATEMENT OF STOCKHOLDERS EQUITY

(Unaudited)

	G1 Preferred Stock	G2 Preferred Stock	G3 Preferred Stock	G4 Preferred Stock	Common Stock	Additional Paid-In Capital	Treasury Stock	Accumulated Deficit	Accumulated Other Comprehensive Income (Loss)	Total
Balance, December 31, 2003	$ 325,000	$ 62,000	$ 77,000	$	$ 1,854,000	$ 432,027,000	$ (1,452,000)	$ (380,872,000)	$ 740,000	$ 52,761,000
Conversion of convertible notes					7,000	311,000				$ 318,000
Issuance of common stock and warrants					36,000	3,193,000				$ 3,229,000
Conversion of preferred stock	(29,000)	(12,000)	(77,000)		162,000	47,000				$ 91,000
Issuance of preferred stock dividends					5,000	460,000		3,885,000		$ 4,350,000
Accrual of preferred stock dividends								(1,643,000)		$ (1,643,000)
Issuance of Common Stock Warrants and Unit Purchase Warrants						1,365,000		(146,000)		$ 1,219,000
Issuance and exchange of Preferred Stock	(1,000)	(23,000)		78,000		1,880,000		337,000		$ 2,271,000
Comprehensive income:										
Realized holding gain on sale of equity investment									(606,000)	
Reclass of derivative fair value into earnings									(15,000)	
Net loss								(10,514,000)		
Total comprehensive loss										(11,135,000)
Balance, June 30, 2004	$ 295,000	$ 27,000	$	$ 78,000	$ 2,064,000	$ 439,283,000	$ (1,452,000)	$ (388,953,000)	$ 119,000	$ 51,461,000

The accompanying Notes to Consolidated Condensed Financial Statements are

an integral part of these Statements.

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HARKEN ENERGY CORPORATION AND SUBSIDIARIES

CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS

(Unaudited)

	Six Months Ended June 30,	
	2003	**2004**
Cash flows from operating activities:		
Net income (loss)	$ 1,448,000	$ (10,514,000)
Adjustment to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	4,197,000	5,583,000
Accretion of asset retirement obligation	236,000	207,000
Amortization of issuance costs	1,089,000	75,000
Minority interest	30,000	225,000
Cumulative effect of change in accounting principle	813,000	
Loss on investment	488,000	
Gain on extinguishments of notes	(5,282,000)	(325,000)
Gain on sale of available for sale equity investment		(990,000)
Loss from increase in Global warrant liability		12,481,000
Other	(8,000)	(183,000)
Change in assets and liabilities:		
Increase in accounts receivable	(1,432,000)	(2,930,000)
Decrease in trade payables and other	(705,000)	(741,000)
Net cash provided by operating activities	874,000	2,888,000
Cash flows from investing activities:		
Proceeds from sales of assets and equity investment	887,000	1,376,000
Capital expenditures	(4,704,000)	(6,205,000)
Net cash used in investing activities	(3,817,000)	(4,829,000)
Cash flows from financing activities:		
Repayments of debt and convertible notes	(11,101,000)	(2,503,000)
Proceeds from issuances of common stock, net	4,426,000	3,229,000
Proceeds from issuances of preferred stock, net	5,847,000	11,643,000
Proceeds from issuances of European Notes, net	3,278,000	
Payment of preferred stock dividends		(162,000)
Purchase of preferred stock	(53,000)	
Net cash provided by financing activities	2,397,000	12,207,000
Net increase (decrease) in cash and temporary investments	(546,000)	10,266,000
Cash and temporary investments at beginning of period	6,377,000	12,173,000
Cash and temporary investments at end of period	$ 5,831,000	$ 22,439,000

Supplemental disclosures of cash flow information:				
Cash paid during the period for:				
Interest	$	282,000	$	106,000
Income taxes		167,000	$	124,000

The accompanying Notes to Consolidated Condensed Financial Statements

are an integral part of these Statements.

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HARKEN ENERGY CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

June 30, 2003 and 2004

(Unaudited)

(1) BASIS OF PRESENTATION

The accompanying unaudited consolidated condensed financial statements of Harken Energy Corporation (Harken) have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). Certain information and note disclosures normally included in annual financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to these rules and regulations, although Harken believes that the disclosures made are adequate to make the information presented not misleading. In the opinion of Harken, these financial statements contain all adjustments necessary to present fairly its financial position as of December 31, 2003 and June 30, 2004 and the results of its operations and changes in its cash flows for all periods presented as of June 30, 2003 and 2004. See Note 11 - Stockholders Equity for discussion of reporting for the payment of the preferred stock dividends. All other adjustments represent normal recurring items. These condensed financial statements should be read in conjunction with the financial statements and the notes thereto included in Harken s Annual Report on Form 10-K for the year ended December 31, 2003. Certain prior year amounts have been reclassified to conform with the 2004 presentation.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reported period. Actual results could differ from these estimates.

The results of operations for the three month and six month periods ended June 30, 2004 are not necessarily indicative of the results to be expected for the full year.

Comprehensive Income (Loss) Comprehensive income (loss) includes changes in stockholders equity during the periods that do not result from transactions with stockholders. Harken s total comprehensive income (loss) is as follows:

	Six Months Ended June 30,	
	2003	**2004**
	(in thousands)	
Net income (loss)	$ 1,448	$ (10,514)
Reclassification of derivative into earnings		(15)
Realized gain on sale of available for sale equity investment		(606)

Total comprehensive income (loss)	$ 1,448	$ (11,135)

Recently Issued Accounting Pronouncements - In May 2003, the FASB issued SFAS No. 150, Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity. SFAS No. 150 establishes standards for how an issuer measures certain financial instruments with characteristics of both liabilities and equity and requires that an issuer classify a financial instrument within its scope as a liability (or asset in some circumstances). SFAS No. 150 was effective for financial instruments entered into or modified after May 31, 2003 and otherwise was effective and adopted by Harken on July 1, 2003. As Harken s Series G1, Series G2, Series G4, Series J and Series L Preferred stock do not qualify as liabilities under SFAS No. 150, the adoption of this statement did not have an impact on Harken s financial condition or results of operations.

In March 2004, The Emerging Issues Task Force (EITF) reached a consensus that mineral rights, as defined in EITF Issue No. 04-2, Whether Mineral Rights Are Tangible or Intangible Assets, are tangible assets and that they should be removed as examples of intangible assets in SFAS Nos. 141 and 142. The FASB has recently ratified this consensus and directed the FASB staff to amend SFAS Nos. 141 and 142 through the issuance of FASB Staff Positions FSP FAS 141-1 and FSP FAS 142-1. Historically, Harken has included the costs of such mineral rights as tangible assets, which is consistent with the EITF s consensus.

(2) ACQUISITIONS AND DISPOSITIONS

Sale of Certain Panhandle Oil and Gas Properties In the fourth quarter of 2003, Harken sold the majority of its oil and gas properties located in the Panhandle region of Texas for a gross sales price of approximately $7.0 million, subject to certain adjustments. No gain or loss was recognized on this transaction as the entire amount of the proceeds (including any subsequent purchase price adjustments), was recorded as a reduction to the domestic full cost pool. In the first quarter of 2004, Harken paid approximately $229,000, and subsequent to June 30, 2004, Harken received approximately $136,000 in purchase price adjustments related to the sale of certain Panhandle oil and gas properties.

(3) INVESTMENTS

On December 16, 2002, Harken exchanged 2,000,000 of its shares of common stock of Global Energy Development PLC (Global), for 1,232,742 of the redeemable ordinary common shares of New Opportunities Investment Trust PLC (NOIT), an investment trust organized under the laws of the United Kingdom (a public limited company admitted for trading on the Alternative Investment Market of the London Stock Exchange). This transaction reduced Harken s ownership in Global from 92.77% to 85.62%. Harken s interest in Global may be further reduced in certain circumstances, see Note 7 Global Warrants and Stock Options for further discussion. Harken accounted for the 1,232,742 ordinary shares of NOIT as an investment in available for sale securities in accordance with Statement of Financial Accounting Standards No. 115, *Accounting for Certain Investment in Debt and Equity Transactions,* and reflected the fair value of the investment as an asset included as Investment in Equity Securities at December 31, 2003.

At December 31, 2003, the fair market value of the investment in NOIT had increased to approximately $1.2 million, based on the underlying market price of NOIT common stock. The unrealized holding gain of $606,000 was included as a separate component of Other Comprehensive Income in stockholders equity in the Consolidated Condensed Balance Sheet at December 31, 2003. In March 2004, Harken sold all 1,232,742 ordinary shares of NOIT on the Alternative Investment Market of the London Stock Exchange for cash proceeds of approximately $1.6 million and recorded a realized gain on sale of equity investment of approximately $1.0 million in the Consolidated Condensed Statement of Operations for the six months ended June 30, 2004.

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(4) PROPERTY AND EQUIPMENT

A summary of property and equipment follows:

	December 31, 2003	June 30, 2004
Unevaluated oil and gas properties:		
Unevaluated Peru properties	$ 701,000	$ 705,000
Unevaluated Panama properties	488,000	489,000
Unevaluated domestic properties	1,923,000	772,000
Evaluated oil and gas properties:		
Evaluated Colombian properties	188,219,000	190,686,000
Evaluated domestic properties	153,866,000	158,642,000
Facilities and other property	25,913,000	26,088,000
Less accumulated depreciation and Amortization	(308,276,000)	(313,854,000)
	$ 62,834,000	$ 63,528,000

(5) ASSET RETIREMENT OBLIGATION

Effective January 1, 2003, Harken changed its method of accounting for asset retirement obligations in accordance with FASB Statement No. 143, *Accounting for Asset Retirement Obligations* (SFAS 143). Prior to the effective date of SFAS 143, Harken reflected asset retirement obligations for acquired assets net of related estimated salvage values to be realized at the time of retirement. Under the new accounting method, Harken recognizes the full amount of asset retirement obligations beginning in the period in which they are incurred if a reasonable estimate of a fair value can be made. The associated asset retirement costs are capitalized as part of the carrying amount of the long-lived asset. The net of tax cumulative effect of the change in accounting method on prior years resulted in a charge to income of $813,000 (($0.01) per share) in the first quarter of 2003.

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A summary of Harken s assets with required asset retirement obligations as of June 30, 2004 is as follows:

Asset Category	Asset Retirement Liability	Estimated Life
North American oil and gas producing properties	$ 3,508,000	2-55 years
North American facilities and other property	2,347,000	12-29 years
Colombian oil producing properties	567,000	4-23 years
Colombian facilities and other property		
	$ 6,422,000	

Harken reflects no asset retirement obligation for Global s Colombian facilities as upon the expiration of the related Association Contract, the ownership of such facilities reverts to Empresa Colombiana de Petroleos (Ecopetrol).

The following table describes all changes to Harken s asset retirement obligation liability during the six months ended June 30, 2004.

Asset retirement obligation at December 31, 2003	$ 6,305,000
Additions during the six months ended June 30, 2004	20,000
Change in estimates	(45,000)
Deletions during the six months ended June 30, 2004	(65,000)
Accretion expense	207,000
Asset retirement obligation at June 30, 2004	$ 6,422,000

Accretion expense related to SFAS 143 is included in Interest and Other Expense in the Consolidated Condensed Statement of Operations. Accretion expense was $105,000 and $207,000 for the three months and six months ended June 30, 2004 in the Consolidated Condensed Statement of Operations.

(6) MIDDLE AMERICAN OPERATIONS

Harken s Middle American operations are conducted through its ownership in Global. Global s ordinary shares are listed for trading on the Alternative Investment Market of the London Stock Exchange. At June 30, 2004, Harken owns 85.62% of Global s common shares, which may be subject to reduction under certain circumstances, as further described in Note 7 Global Warrants and Stock Options.

Colombian Operations Global s Colombian operations are conducted through Harken de Colombia, Ltd., a wholly owned subsidiary of Global, which held three exclusive Colombian Association Contracts with Ecopetrol as of June 30, 2004. Terms of each of the Association Contracts originally committed Global to perform certain activities, such as seismic activities and/or the drilling of wells, in accordance with a prescribed timetable. Global has satisfied these requirements of each of the Association Contracts.

Peru Operations In April 2001, Global, through a wholly owned subsidiary, signed a Technical Evaluation Agreement (Peru TEA) with Perupetro, the national oil company of Peru. The Peru TEA covered an area of approximately 6.8 million gross acres in northeastern Peru. Under the terms of the Peru TEA, Global had the option to convert the Peru TEA to a Production Sharing Contract with a seven year exploration term and a twenty-two year production period. Terms of the Peru TEA allowed Global to conduct a study of the area that included the reprocessing of seismic data and evaluation of previous well data. In April 2003, Global received an extension from Perupetro of the Peru TEA to July 2003. In June of 2003 Global submitted a final report and completed all obligations required under the TEA. Prior to the expiration of the Peru TEA in July 2003, Global exercised its option under the Peru TEA and entered into negotiations with Perupetro for a Production Sharing Contract. All work requirements under the Peru TEA were satisfied prior to its expiration. As of August 12, 2004, the negotiations with Perupetro for a Production Sharing Contract are still in progress and are expected to be completed during late 2004.

Panama Operations In September 2001, Global, through a wholly owned subsidiary, signed a Technical Evaluation Agreement (Panama TEA) with the Ministry of Commerce and Industry for the Republic of Panama. The Panama TEA covered an area approximately 1.4 million gross acres divided into three blocks in and offshore Panama. Under the terms of this Panama TEA, Global performed certain work program procedures and studies and submitted them to the Panamanian government. The Panama TEA provided Global with an option to negotiate and enter into one or more Contracts for the Exploration and Exploitation of Hydrocarbons with the Ministry of Commerce and Industry. Global completed all of its obligations under the Panama TEA and exercised its option to negotiate an Exploration and Exploitation Contract. As of August 12, 2004, the negotiations with the Panamanian government are still in progress and are expected to be completed in early 2005.

(7) GLOBAL WARRANTS AND STOCK OPTIONS

Global Warrants held by Lyford - In July and August 2002, Harken issued a 10% Term Loan Payable (the Investor Term Loan) in the total principal amount of $5,000,000 to Lyford Investments Enterprises Ltd. (Lyford), in exchange for cash in the principal amount of the Investor Term Loan. The principal of Lyford is Phyllis Quasha, whose son, Alan G. Quasha, is a member of Harken s board of directors and the Chairman of Harken. Harken s indebtedness to Lyford under the Investor Term Loan was repaid in full in March 2003.

As additional consideration for the Investor Term Loan, as amended, Harken issued to Lyford warrants (the Lyford Warrants) to purchase up to 7,000,000 shares held by Harken of Global at a price of 50 UK pence per share. The warrants will expire on October 13, 2005, 90 days after the originally scheduled maturity date of the Investor Term Loan. These warrants constitute approximately 29% of Harken s holdings of Global shares.

Global Warrants held by Global s Minority Interest Owners - In August, 2002, Global issued to its minority shareholders warrants to purchase up to 505,407 shares of Global stock at UK 60 pence per share.

Harken is required to account for the Global Warrants held by Global s Minority Owners and the Lyford Warrants (collectively referred to as Global Warrants held by Outside Parties) as derivatives in accordance with the Statement of Financial Accounting Standard No. 133, *Accounting for Derivative Instruments and Hedging Activities* (SFAS 133). SFAS 133 requires Harken to record the estimated fair value of the warrants as a liability at issuance and to adjust the liability to estimated fair value each period with any changes in value reflected in earnings.

Historically, Global s stock has been thinly traded and changes in value of the shares has been insignificant. However, following Global s announcement of year-end results and the successful drilling results of the Estero #4 well in the second quarter of 2004, there was a 190% increase in Global s common share price from approximately 50 UK pence at December 31, 2003 and March 31, 2004 to 145 UK pence at June 30, 2004. As a result of this increase in share price, the fair value of the Global Warrants held by Outside Parties increased $12,431,000 during the second quarter of 2004 to $13,132,000 at June 30, 2004. The fair value of the warrants is calculated by a third party firm based on the underlying market price of the Global common stock. Accordingly, Harken recorded a loss related to the change in fair value of the Global warrants of $12,431,000 during the three month period ended June 30, 2004.

Global Warrants held by Harken - In August 2002, Global issued to Harken warrants to purchase 6,487,481 of Global shares at UK 60 pence per share. Since Global is a consolidated subsidiary, this warrant issuance is not reflected in the consolidated condensed financial statements. The estimated fair market value of these warrants at June 30, 2004 was approximately $10.3 million, as calculated by a third-party firm.

Global Stock Options - In addition to the warrants described above, certain employees and directors of Global hold options to purchase 3,390,000 of Global at 50 pence per share.

If all Global warrants and stock options were exercised, Harken s ownership in Global would decrease from 85.62% to 61.11%.

(8) SENIOR SECURED NOTES

In May 2003, Harken issued $2,020,000 principal amount of Increasing Rate Senior Secured Notes Due 2008 (Senior Secured Notes) in exchange for $2,020,000 principal amount of 5% European Notes. Prior to maturity, the principal balance in its entirety, plus accrued and unpaid interest, of the Senior Secured Notes could be prepaid, upon not less than 30 days notice to the noteholders, at a discount with a combination of cash and freely tradable shares of Harken common stock, as defined in the Senior Secured Note agreement. In December 2003, Harken exercised its rights, under the terms of the notes, to prepay the principal balance in its entirety, plus accrued and unpaid interest, at the stated discount with cash. Harken provided the required notice to the noteholders in December 2003. Subsequently, in accordance with the terms of the notes, in January 2004, Harken repaid the principal amount of the Senior Secured Notes, at a discount equal to approximately 18%, plus accrued and unpaid interest, with cash and recorded a gain on extinguishment of the notes of approximately $325,000 in January 2004 in the Consolidated Condensed Statement of Operations. Harken s indebtness under the Senior Secured Notes was repaid in full in January 2004.

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(9) CONVERTIBLE NOTES PAYABLE

A summary of convertible notes payable is as follows:

	December 31, 2003	June 30, 2004
7% European Notes	$ 340,000	$
4.25% Convertible Notes	5,000,000	4,167,000
	5,340,000	4,167,000
Less: Current portion	1,667,000	1,667,000
	$ 3,673,000	$ 2,500,000

7% European Notes At December 31, 2003, Harken had outstanding a total of approximately $340,000 principal amount of its 7% European Notes, which were to mature on March 31, 2007. In February 2004, in accordance with the terms of the 7% European Notes, Harken mandatorily converted the remaining outstanding principal amounts of $340,000, plus accrued and unpaid interest of its 7% European Notes into approximately 696,000 shares of Harken common stock. No gain or loss was recorded for the mandatory conversions of the 7% European Notes as this transaction did not qualify as debt extinguishment.

4.25% Convertible Notes In December 2003, Harken issued to qualified investors a total of $5 million principal amount of its 4.25% Convertible Notes due 2006 (the 4.25% Convertible Notes), which mature on December 14, 2006, in exchange for $5 million cash. Both principal and accrued interest on the 4.25% Convertible Notes are payable semi-annually in six equal installments of each year in cash beginning June 2004. The 4.25% Convertible Notes are unsecured and rank equal to all other present and future unsecured indebtedness of Harken. The first principal installment payment along with accrued interest was paid in cash as of June 30, 2004. At December 31, 2003 and June 30, 2004, respectively, based on the scheduled principal installments, approximately $1.7 million of the 4.25% Convertible Notes are classified as current debt in the Consolidated Condensed Balance Sheet.

Pursuant to the terms of the 4.25% Convertible Notes, Harken is required to maintain unencumbered assets such that the ratio of (a) the fair market value of the unencumbered assets to (b) the outstanding principal amount of the 4.25% Convertible Notes, is equal to or greater than 1.5 to 1.0. At June 30, 2004, Harken was in compliance with the asset coverage ratio under the 4.25% Convertible Notes.

(10) REDEEMABLE PREFERRED STOCKS

Issuance of Series J Convertible Preferred Stock and Warrants

In March 2004, Harken s Board of Directors approved the authorization and issuance of up to 65,000 shares of a new series of convertible preferred stock, the Series J Preferred. In April 2004, in exchange for $5.0 million in cash, Harken issued

50,000 shares of Series J Preferred Stock,

2,873,563 warrants to purchase Harken common stock; and

10,000 unit purchase warrants

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The Series J Preferred has a liquidation value of $100 per share, is non-voting and is convertible at the holders option into common stock at an original conversion price of $0.87 per share, subject to adjustments in certain circumstances. The Series J Preferred is also convertible by Harken, into freely tradable shares of Harken common stock at the conversion price, if for any period of twenty consecutive calendar days the average closing price of Harken common stock has equaled or exceeded 150% of the conversion price.

Dividends - The holders of the Series J Preferred are entitled to receive dividends at an annual rate equal to 5% per share. All dividends on the Series J Preferred stock are payable quarterly in arrears, beginning on September 30, 2004 in cash or, at Harken s option, in shares of Harken common stock. The Series J Preferred dividend and liquidation rights rank junior to all claims of creditors, including holders of outstanding debt securities, but senior to the holders of Harken common stock and pari passu to the holders of any other series of Harken preferred stock, unless otherwise provided.

Warrants - The common stock warrants issued in connection with the Series J Preferred have a term of one year and an original exercise price of $0.98. Upon the effective registration of the underlying shares, Harken may call the warrants if the closing price of Harken s common stock over five consecutive days closes at or above 150% of the exercise price.

Unit Purchase Warrants - The unit purchase warrants issued in connection with the Series J Preferred have an exercise price of $100 per unit. Each unit consists of one share of Series J Preferred and one warrant to purchase that number of shares of common stock that equals 50% of the number of shares of Harken common stock into which one share of the Series J Preferred that is purchased, by exercise of the unit purchase warrant, may be converted. The warrants provide for an initial exercise price of $0.98 per share.

Additional Dividend Feature If an additional dividend event occurs while the Series J Preferred is outstanding, the holders will have the right to an annual additional dividend calculated at a rate of 6.0% per annum of the issue price of any outstanding Series J Preferred, payable in cash, until such additional dividend event has been remedied. Additional dividend events include the failure of Harken common stock to be listed for trading on any principal market, Harken s failure to declare or pay in full any dividend payable on the shares of Series J Preferred on the applicable dividend payment date, as well as other additional dividend events that are defined in the terms of the Series J Preferred.

Optional Redemption Event - If an optional redemption event occurs while the Series J Preferred is outstanding, each holder will have the right to require Harken to repurchase all or any portion of such holder s Series J Preferred at the greater of (x) 115% of the stated value of the Series J Preferred, or (y) the market value of Harken common stock as if the Series J Preferred were converted at the then prevailing conversion price at the time of redemption. An optional redemption event includes the failure to declare and pay dividends on the Series J Preferred, voluntary liquidation, a fundamental change in the ownership of Harken, failure of Harken to generally pay its debts as they become due, as well as other events defined in the terms of the Series J Preferred.

Accounting for the Series J Preferred Stock and Warrants In accordance with APB Opinion No.14 Accounting for Convertible Debt and Debt Issued with Stock Purchase Warrants (APB 14), the net proceeds received of $5 million, less fees, must be allocated between the Series J Preferred, the common stock warrants and the unit purchase warrants based on the relative fair value of each instrument. The valuation of the Series J Preferred is supported by a third-party appraisal and is based on, among other things, an analysis of comparable publicly traded convertible preferred stock issuances, the rights and privileges associated with the Series J Preferred, and the combined (i) conversion value and (ii) excess dividend value of the Series J Preferred. In accordance with EITF Topic D-98 Classification and Measurement of Redeemable Securities (EITF D-98), the Optional Redemption Event for the Series J Preferred contains certain provisions whereby redemption is deemed to be out of Harken s control. Therefore the fair value of the Series J Preferred of approximately $4.7 million, is classified as temporary equity.

In accordance with EITF 00-19 Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company s Own Stock (EITF 00-19), the common stock warrants were initially measured at fair value of $287,000 by an independent third party and classified as permanent equity in the Consolidated Condensed Balance Sheet at June 30, 2004. The fair value allocated to the unit purchase warrants, approximately $38,000, is also classified as permanent equity in the Consolidated Condensed Balance Sheet at June 30, 2004.

After allocating the net proceeds between the Series J Preferred, the common stock warrants, and the unit purchase warrants, Harken determined no beneficial conversion feature existed.

Adjustment of Series J Conversion Price and Warrant Exercise Price In May 2004, as a result of Harken s issuance of its Series L Convertible Preferred Stock (the Series L Preferred), the conversion price of the Series J Preferred was adjusted from $0.87 to $0.85. In accordance with EITF Issue 00-27, Issue 7, the number of the additional shares issuable upon conversion of the Series J Preferred multiplied by Harken s stock price on the date of the original transaction is recorded as a Dividend Related to Preferred Stock of approximately $135,000 which is presented as a decrease to Net Income Attributed to Common Stock in the Consolidated Condensed Statement of Operations for the six months ended June 30, 2004. In addition, the original exercise price of the common stock warrants issued with the Series J Preferred was adjusted from $0.98 to $0.95. In conjunction with SFAS 123 Accounting for Stock Based Compensation (SFAS 123), the incremental increase in the fair value of the warrant of approximately $11,000 was recorded as a dividend related to preferred stock which is presented as a decrease to Net Income Attributed to Common Stock in the Consolidated Condensed Statement of Operations for the six months ended June 30, 2004. If Harken continues to issue shares of its common stock or any common stock equivalent at a price per share less than the conversion price of the Series J Preferred, the conversion price of the Series J Preferred is subject to continued adjustment.

Issuance of Series L Convertible Preferred Stock and Warrants

In March 2004, Harken s Board of Directors approved the authorization and issuance of up to 65,000 shares of a new series of convertible preferred stock, the Series L Preferred. In May 2004, Harken issued 50,000 shares of Series L Preferred stock and 3,676,471 warrants to purchase shares of Harken common stock in exchange for $5 million in cash. Shares of the Series L Preferred have a liquidation value of $100 per share, are non-voting and are convertible at the holders option into Harken common stock at a conversion price of $0.72 per share, subject to adjustments in certain circumstances. If for any period of thirty consecutive days the average closing price of Harken common stock trades above $0.90 per share, up to 25,000 shares of the Series L Preferred are convertible by Harken, into freely tradable shares of Harken common stock at $0.72 per share. If the average daily volume weighted average price of Harken common stock during a period of thirty trading days equals or exceeds $1.08, Harken may convert all the Series L Preferred stock into freely tradable shares of Harken common stock at $0.72 per share.

Dividends - The holders of the Series L Preferred are entitled to receive dividends at an increasing rate starting at 4% per share. On the third anniversary from the date of issuance (May 28, 2007), the dividend rate increases to 8% per share with 1% annual increases thereafter to a maximum of 12% annually. All dividends on the Series L Preferred are payable semi-annually on June 30 and December 30, beginning on June 30, 2004. Dividends may be paid in cash or, at Harken s option, in freely tradable shares of Harken common stock, until May 28, 2007 and in cash thereafter. The dividend rate may escalate to 12% under certain events of default, including failure to declare and pay dividends.

The dividend and liquidation rights of the Series L Preferred shall rank junior to all claims of creditors, including holders of outstanding debt securities, but senior to holders of Harken common stock and pari passu to any other series of Harken preferred stock, unless otherwise provided.

Warrants The common stock warrants issued in connection with the Series L Preferred are exercisable for two years from issuance and have an exercise price of $0.68.

Redemption Feature Harken may redeem the Series L Preferred stock for cash, in whole or in part, anytime after May 28, 2007, for liquidation value of $100 per share. The Series L preferred stock is redeemable at the option of the holder, only in the event of default. An event of default includes a change of control, either planned or pending, or other event of default, including failure to declare and pay dividends, that remains uncured for a period of 20 days after notification by the holders. If redemption is required as a result of an event of default, the Series L Preferred stock is redeemable at the holder s option, in cash at $120 per share.

Accounting for the Series L Preferred Stock and Warrants In accordance with APB 14, the net proceeds received of $5 million, less fees, must be allocated between the Series L Preferred and the common stock warrants based on the relative fair value of each instrument. Based on an internal valuation of the Series L Preferred Stock, using the market value of the underlying common stock, a discounted value associated with an assumed dividend yield, along with a valuation by an independent third party of the common stock warrants issued in conjunction with the Series L Preferred, Harken assigned relative fair values to the Series L Preferred and the warrants based on the total consideration received of $5 million in cash. In accordance with EITF D-98, events of default for the Series L Preferred contain certain provisions whereby redemption is deemed to be out of Harken s control. Therefore the fair value of the Series L Preferred of approximately $4.0 million was classified as temporary equity. In accordance with EITF 00-19, the fair value allocated to the common stock warrants of approximately $978,000 is classified as permanent equity in the Consolidated Condensed Balance Sheet at June 30, 2004.

The proceeds allocated to the Series L Preferred represented a discount to the market value of the underlying common stock. The discount of approximately $421,000 was treated as a beneficial conversion feature and was recorded as a reduction of the value of the Series L Preferred as of June 30, 2004 and will be recognized as a dividend related to preferred stock and presented as a decrease to Net Income Attributed to Common Stock in the third quarter of 2004.

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(11) STOCKHOLDERS EQUITY

Common Stock At each of its stockholders meetings held in February and May 2004, Harken received stockholder approval to increase Harken s authorized shares of common stock by 50 million shares at each meeting, increasing total authorized shares from 225 million shares at December 31, 2003 to 325 million shares of common stock as of June 30, 2004. At December 31, 2003 and June 30, 2004, 185,405,471 and 206,370,916 shares of Harken common stock, respectively, were issued.

Treasury Stock At December 31, 2003 and June 30, 2004, Harken had 605,700 shares of treasury stock. During 2003 and the six months ended June 30, 2004, Harken did not purchase any shares of its common stock.

Series G1 Convertible Preferred Stock The Series G1 Convertible Preferred Stock (the Series G1 Preferred), which was issued in October 2000, has a liquidation value of $100 per share, is non-voting, and is convertible at the holder s option into Harken common stock at a conversion price of $12.50 per share, subject to adjustment in certain circumstances.

The Series G1 Preferred holders are entitled to receive dividends at an annual rate equal to $8 per share when, as and if declared by Harken s Board of Directors. All dividends on the Series G1 Preferred are cumulative and payable semi-annually in arrears, payable on June 30 and December 30. At Harken s option, dividends may also be payable in Harken common stock valued at $12.50 per share. The dividend and liquidation rights of the Series G1 Preferred rank junior to all claims of creditors, including holders of outstanding debt securities, but senior to Harken common stockholders and to any subsequent series of Harken preferred stock, unless otherwise provided, except for Harken s Series G2 Convertible Preferred Stock (the Series G2 Preferred), Series G4 Convertible Preferred Stock (the Series G4 Preferred), the Series J Preferred and the Series L Preferred, which rank equal to the Series G1 Preferred.

As of December 31, 2003, Harken had accrued approximately $2.6 million of dividends in arrears related to the Series G1 Preferred or approximately $8.00 per share of such preferred stock outstanding. During 2003, Harken s Board of Directors declared that a dividend be paid on all accrued and unpaid dividends as of December 31, 2003 payable to holders of the Series G1 Preferred and the Series G2 Preferred. The dividend was paid with shares of Harken common stock. As of the record date for those dividends, December 30, 2003, there were 325,312 shares of the Series G1 Preferred outstanding. During January and February 2004, a total of approximately 208,000 shares of Harken common stock were issued to holders of the Series G1 Preferred.

During April 2004, Harken s Board of Directors declared that a dividend be paid on all accrued and unpaid dividends as of June 30, 2004 payable to holders of Harken s Series G1 and Series G2 Preferred. The dividend was paid with shares of common stock. As of the record date for such dividends, May 3, 2004, there were 295,372 shares of the Series G1 Preferred outstanding. In June 2004, Harken had accrued approximately $1.2 million of dividends in arrears related to the Series G1 Preferred, or approximately $4.00 per share of such preferred stock outstanding. In June 2004, a total of approximately 94,500 shares of Harken common stock were paid to holders of the Series G1 Preferred.

During the six months ended June 30, 2004, holders of 28,940 shares of the Series G1 Preferred elected to exercise their conversion option, and such holders were issued 231,651 shares of Harken common stock.

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Series G2 Convertible Preferred Stock In July 2001, Harken issued 95,800 shares of a new series of convertible preferred stock, the Series G2 Preferred, in exchange for 5% European Notes in the face amount of $9,580,000. Harken s Board of Directors approved the authorization and issuance of up to 100,000 shares of the Series G2 Preferred, which has a liquidation value of $100 per share, is non-voting, and is convertible at the holder s option into Harken common stock at a conversion price of $3.00 per share, subject to adjustment in certain circumstances. The Series G2 Preferred is also convertible by Harken into shares of Harken common stock if for any period of twenty consecutive calendar days, the average of the closing prices of Harken common stock during such period shall have equaled or exceeded $3.75 per share.

The Series G2 Preferred holders are entitled to receive dividends at an annual rate equal to $8 per share when, as and if declared by the Harken Board of Directors. All dividends on the Series G2 Preferred are cumulative and payable semi-annually in arrears, payable on June 30 and December 30. At Harken s option, dividends may also be payable in Harken common stock at $3.00 per share of Harken common stock. The Series G2 Preferred dividend and liquidation rights rank junior to all claims of creditors, including holders of outstanding debt securities, but senior to Harken common stockholders and to any subsequent series of Harken preferred stock, unless otherwise provided.

At December 31, 2003, Harken had accrued approximately $493,000 of dividends in arrears related to the Series G2 Preferred or approximately $8.00 per share of such preferred stock outstanding. During 2003, Harken s Board of Directors declared that a dividend be paid for all accrued and unpaid dividends payable as of December 31, 2003 to holders of the Series G1 Preferred and the Series G2 Preferred, such dividend to be paid with shares of Harken common stock. As of the record date for such dividends, December 30, 2003, there were 61,650 shares of the Series G2 Preferred outstanding. During January and February 2004, a total of approximately 164,000 shares of Harken common stock were issued to holders of the Series G2 Preferred.

During April 2004, Harken s Board of Directors declared that a dividend be paid as of June 30, 2004 to holders of the Series G1 Preferred and the Series G2 Preferred, such dividend to be paid with shares of common stock. As of the record date for such dividends, May 3, 2004, there were 27,150 shares of the Series G2 Preferred outstanding. In June 2004, Harken had accrued approximately $108,600 of dividends in arrears related to the Series G2 Preferred or approximately $4.00 per share of such preferred stock outstanding. In June 2004, a total of approximately 36,200 shares of Harken common stock were paid to holders of the Series G2 Preferred.

During the six months ended June 30, 2004, holders of 11,500 shares of the Series G2 Preferred elected to exercise their conversion option, and such holders were issued 386,141 shares of Harken common stock.

Accounting for Payment of Series G1 and Series G2 Preferred Stock Dividends Harken accounts for the payment of the Series G1 Preferred and the Series G2 Preferred stock dividends with shares of Harken common stock as a liability extinguishment in accordance with APB 26. Net Income Attributable to Common

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Stock, as previously reported in Harken s Form 10-Q for the three and six months ended June 30, 2003, has been changed since Harken determined it is necessary to account for the January 2003 payment of dividends on the Series G1 Preferred and the Series G2 Preferred with shares of Harken common stock to reflect, in accordance with APB 26, the difference between the carrying value of the preferred stock dividend liability of approximately $7.4 million and the fair market value of the shares of Harken common stock of approximately $227,000 issued by Harken in payment of the liability. The difference was recognized as a Payment of Preferred Stock Dividends of approximately $7.0 million in the Consolidated Condensed Statement of Operations for the period ended March 31, 2003 as an increase, net of income taxes paid on behalf of the preferred shareholders, to Net Income Attributed to Common Stock. Harken had previously accounted for the payment of dividends of the Series G1 Preferred and the Series G2 Preferred with shares of Harken common stock as a conversion transaction, pursuant to the terms of the respective preferred stock agreement, with the difference between the carrying amount of the preferred stock dividend liability and the par value of the common stock issued recorded to Additional Paid-in Capital. This accounting treatment had no effect on Harken s revenues, net income, net working capital, or cash flow for the periods in question. Basic earnings per share increased from a loss per share of $(0.01) to earnings per share of $0.09, and diluted earnings per share increased from a loss per share of $(0.01) to earnings per share of $0.02 for the six months ended June 30, 2003 as a result of the increase to Income Attributable to Common Stock. Additionally, none of Harken s debt compliance covenants were affected by this accounting treatment.

In January and February 2004, Harken paid the dividend on the Series G1 Preferred and the Series G2 Preferred accrued at December 31, 2003 with approximately 372,000 shares of Harken common stock. Accordingly, the difference between the carrying value of the preferred stock dividend liability at December 31, 2003, approximately $3.1 million, and the fair market value of the shares of Harken common stock issued by Harken in payment of the liability in January and February 2004, approximately $425,000, was recognized as a Payment of Preferred Stock Dividends in the Consolidated Condensed Statement of Operations for the six months ended June 30, 2004 as a $2.7 million increase to Net Income Attributed to Common Stock.

In June 2004, Harken paid the dividends on the Series G1 Preferred and the Series G2 Preferred accrued at June 30, 2004 with approximately 130,700 shares of Harken common stock. The difference between the carrying value of the preferred stock dividend liability at June 30, 2004, approximately $1.3 million and the fair market value of the shares of Harken common stock issued by Harken in payment of the liability in June 2004, approximately $69,000, was recognized as a Payment of Preferred Stock Dividends in the Consolidated Condensed Statement of Operations as of June 30, 2004 as a $1.2 million increase to Net Income Attributed to Common Stock.

Series G3 Convertible Preferred Stock During the six months ended June 30, 2004, holders of the remaining 77,000 shares of Harken s Series G3 Preferred stock elected to exercise their conversion option, and these remaining holders were issued a total of approximately 15.5 million shares of Harken common stock. At June 30, 2004, the Series G3 Preferred is no longer outstanding.

Issuance of Series G4 Convertible Preferred Stock In March 2004, Harken s Board of Directors approved the authorization and issuance of up to 150,000 shares of a new series of convertible preferred stock, the Series G4 Preferred. In April 2004, Harken issued 77,517 shares of the Series G4 Preferred in exchange for approximately 1,000 shares of the Series G1 Preferred and 23,000 shares of the Series G2 Preferred and $2.4 million in cash. The Series G4 Preferred has a liquidation value of $100 per share, is non-voting and is convertible at the holders option into Harken common stock at a conversion price of $2.00 per share, subject to adjustments in certain circumstances. The Series G4 Preferred is also convertible by Harken into freely tradable shares of Harken common stock if for any period of twenty consecutive calendar days the average of

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the closing prices of Harken common stock has equaled or exceeded $2.20 per share, initially. This target price will be reduced by 10 percent of the immediately preceding target price in December of each year, commencing December 31, 2004.

The holders of the Series G4 Preferred are entitled to receive dividends, when as and if declared by the Board of Directors, at an annual rate equal to $8.00 per share. All dividends on the Series G4 Preferred are payable semi-annually in arrears, in cash or, at Harken s option, in shares of Harken common stock, payable on June 30 and December 31, commencing December 31, 2004. At Harken s option, the dividends can be paid in shares of common stock valued at $2.00 per share. The Series G4 Preferred dividend and liquidation rights rank junior to all claims of creditors, including holders of outstanding debt securities, but senior to Harken common stockholders and pari passu to any other series of Harken preferred stock, unless otherwise provided.

Harken may also redeem the Series G4 Preferred in whole or in part for cash at any time at $100 per share plus any accrued and unpaid dividends. In addition, on or after January 1, 2006, Harken may further elect, in any six month period, to redeem up to 50% of the outstanding Series G4 Preferred with shares of Harken common stock valued at an average market price, and using a redemption value of the Series G4 Preferred that includes a 5% premium based on Harken s market capitalization at the time of redemption.

Accounting for the Series G4 Preferred Stock Issuance Harken has reflected the difference between the face amount of the Series G1 Preferred and the Series G2 Preferred, plus the $2.4 million in cash, less transaction fees, and the fair value of the Series G4 Preferred shares issued as Exchange on Preferred Stock of approximately $337,000 in the Consolidated Condensed Statement of Operations for the six months ended June 30, 20004, as an increase to Net Income Attributed to Common Stock. The valuation of the Series G4 Preferred stock is supported by an appraisal, performed by RP&C International Inc. (RP&C), and is based on the market value of the underlying conversion shares of Harken common stock as of the date of the exchange along with a discounted value associated with an assumed dividend yield.

Accumulated Other Comprehensive Income During 2003, Harken recorded unrealized holding gains of $606,000 on its available for sale investment in NOIT in Other Comprehensive Income in stockholders equity in the Consolidated Condensed Balance Sheet at December 31, 2003. In February 2004, upon the sale of Harken s investment in NOIT, the accumulated holding gain of $606,000 in Other Comprehensive Income was realized into earnings. Harken recorded a total gain on sale of the NOIT investment of approximately $1 million in the Consolidated Condensed Statement of Operations as of June 30, 2004. See Note 3 Investments for further discussion of Harken s former investment in NOIT.

Private Placement of Common Stock - In March 2004, Harken issued 3.6 million shares of Harken common stock in a private placement offering to two institutional investors for a total of $3.5 million in cash, less transaction costs. In connection with this private placement common stock offering, in March 2004, Harken issued to those investors, warrants to purchase 1.75 million shares of Harken s common stock. The warrants are exercisable, at a price of $1.056 per share, at any time prior to March 8, 2005. The warrants also contain a call option whereby at any time during the exercise period, Harken has the right to call the warrants at $0.05 per warrant provided that Harken s market price of its common stock is equal to or greater than 125% of the exercise price for at least 15 consecutive trading days following March 8, 2004, along with certain other provisions.

In accordance with EITF 00-19, these warrants were initially measured at fair value and are classified as permanent equity in the Consolidated Condensed Balance Sheet at June 30, 2004.

(12) STOCK OPTION PLAN

Harken has elected to follow Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees (APB 25) and related Interpretations in accounting for its employee stock options because, as discussed below, the alternative fair value accounting provided for under SFAS 123 requires use of option valuation models that were not developed for use in valuing employee stock options. Under APB 25, because the exercise price of Harken s employee stock options equals or exceeds the market price of the underlying stock on the date of grant, no compensation expense is recognized.

Harken s 1993 Stock Option and Restricted Plan authorized the grant of options to Harken employees and directors for up to 400,000 shares of Harken common stock. Harken s 1996 Stock Option and Restricted Stock Plan authorized the grant of 1,852,500 shares of Harken common stock. All options granted had 10-year terms, vested and became fully exercisable at the end of 4 years of continued employment. At June 30, 2004, all of Harken s previously issued and/or outstanding employee stock options had expired or were previously voluntarily surrendered, therefore no pro-forma information regarding net income and net income per share is required. As of June 2004 and after duly authorized action by Harken s Board of Directors, all of Harken s stock option plans have been terminated. See Note 7 Global Warrants and Stock options for discussion on Global stock options.

(13) RELATED PARTY TRANSACTIONS

In November 2001, Global elected to its Board of Directors a director who is also a director of RP&C. RP&C has historically provided financial and transaction consulting services to Harken. In addition, RP&C has served as a financial advisor in connection with Harken s restructuring of its international assets, obligations and operations through its Global subsidiary. Also, RP&C currently serves as Global s nominated advisor for the AIM Exchange in London. During the three months and the six months ended June 30, 2004, Harken paid to RP&C approximately $206,000 and $350,000, respectively, for transaction costs associated with transaction consulting services. In connection with these services provided, RP&C may continue to earn such fees in the future.

(14) DERIVATIVE INSTRUMENTS

Harken holds certain commodity derivative instruments which are effective in mitigating commodity price risk associated with a portion of its future monthly natural gas production and related cash flows. Harken s oil and gas operating revenues and cash flows are impacted by changes in commodity product prices, which are volatile and cannot be accurately predicted. Harken s objective for holding these commodity derivatives is to protect the operating revenues and cash flows related to a portion of its future natural gas sales and crude oil from the risk of significant declines in commodity prices.

During the six months ended June 30, 2004, Harken held a natural gas collar contract consisting of a fixed price floor option of $3.00 per MMBTU and a fixed price cap option of $4.95 per MMBTU covering 70,000 MMBTUs per month. Harken had not designated the above derivative as a hedge under SFAS No. 133, therefore the derivative was marked to market each period. The changes in the fair value of the derivative of approximately $150,000 and $303,000, respectively, for the three months and the six months ended June 30, 2004 are reflected as an increase to Other Income in the Consolidated Condensed Statement of Operations. Such natural gas collar contract was settled at fair value in June 2004.

In December 2003, Harken purchased a crude oil floor contract with a strike price of $27.00 per barrel for a notional amount of 6,000 barrels per month over a period of the contract from January 1, 2004 through December 31, 2004. In March 2004, Harken terminated this crude oil floor contract and replaced it with a crude oil floor contract with a strike price of $28.00 per barrel for a notional amount of 6,000 barrels per month over a period of the contract from April 1, 2004 through December 31, 2004. In June 2004, Harken terminated this crude oil floor contract and replaced it with a crude oil floor contract with a strike price of $30.00 per barrel for a notional amount of 6,000 barrels per month over a contract period from July through December 2004. Such crude oil floor contract is reflected in Prepaid Expenses and Other Assets in the Consolidated Condensed Balance Sheet at June 30, 2004 with a market value of approximately $33,000.

In January 2004, Harken purchased a natural gas floor contract with a strike price of $4.00 per MMBTU for a notional amount of 90,000 MMBTUs per month over the period of the contract from July 1, 2004 through December 31, 2004. Such natural gas floor contract is reflected in Prepaid Expenses and Other Assets in the Consolidated Condensed Balance at June 30, 2004 with a market value of approximately $18,000.

Each of the above option floor contracts have been designated as cash flow hedges of the exposure from the variability of cash flows from future specified production from certain of Harken s domestic property operations. Gains and losses from commodity derivative instruments are reclassified into earnings when the associated hedged production occurs. Harken holds no derivative instruments which are designated as either fair value hedges or foreign currency hedges. Settlements of oil and gas commodity derivatives are based on the difference between fixed option prices and the New York Mercantile Exchange closing prices for each month during the life of the contracts. Harken monitors its crude oil and natural gas production prices compared to New York Mercantile Exchange prices to assure its commodity derivatives are effective hedges in mitigating its commodity price risk.

(15) SEGMENT INFORMATION

Harken s accounting policies for each of its operating segments are the same as those for its consolidated financial statements. There are no intersegment sales or transfers. Revenues and expenses not directly identifiable with either segment, such as certain general and administrative expenses, are allocated by Harken based on various internal and external criteria including an assessment of the relative benefit to each segment. During the periods presented below, none of Harken s Middle American segment operating revenues related to Costa Rica, Peru or Panama.

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Harken s financial information for each of its operating segments is as follows for the periods ended June 30, 2003 and 2004:

	Three Months Ended June 30, 2003			Six Months Ended June 30, 2003		
	North America	Middle America	Total	North America	Middle America	Total
Operating revenues	$ 4,725,000	$ 1,942,000	$ 6,667,000	$ 10,258,000	$ 3,787,000	$ 14,045,000
Interest and other income	(73,000)	10,000	(63,000)	(421,000)	34,000	(387,000)
Depreciation and amortization	1,422,000	735,000	2,157,000	2,882,000	1,315,000	4,197,000
Interest expense and other, net	1,019,000	(8,000)	1,011,000	3,302,000	21,000	3,323,000
Gains on repurchases of convertible notes	751,000		751,000	5,282,000		5,282,000
Income tax expense		(451,000)	(451,000)		(351,000)	(351,000)
Segment income (loss) before cumulative effect of change in accounting principle	(831,000)	431,000	(400,000)	1,849,000	412,000	2,261,000
Segment income (loss)	(831,000)	431,000	(400,000)	1,236,000	212,000	1,448,000
Capital expenditures	290,000	1,648,000	1,938,000	749,000	2,987,000	3,736,000
Total assets at end of period	58,470,00	26,312,000	84,782,000	58,470,000	26,312,000	84,782,000

	Three Months Ended June 30, 2004			Six Months Ended June 30, 2004		
	North America	Middle America	Total	North America	Middle America	Total
Operating revenues	$ 4,998,000	$ 2,997,000	$ 7,995,000	$ 8,914,000	$ 5,524,000	$ 14,438,000
Interest and other income	149,000	14,000	163,000	368,000	29,000	397,000
Depreciation and amortization	2,035,000	913,000	2,948,000	3,798,000	1,785,000	5,583,000
Interest expense and other, net	135,000	3,000	138,000	349,000	1,000	350,000
Gains on extinguishments of notes				325,000		325,000
Loss on increase in warrant liability	12,481,000		12,481,000	12,481,000		12,481,000
Gain on sale of equity investment				990,000		990,000
Income tax expense	15,000	216,000	231,000	15,000	308,000	323,000
Segment income (loss)	(12,906,000)	881,000	(12,025,000)	(12,074,000)	1,560,000	(10,514,000)
Capital expenditures	1,851,000	1,898,000	3,749,000	3,781,000	2,424,000	6,205,000
Total assets at end of period	64,820,000	28,391,000	93,211,000	64,820,000	28,391,000	93,211,000

(16) EARNINGS PER SHARE

Basic earnings per share includes no dilution and is computed by dividing income or loss attributed to common stockholders by the weighted-average number of common shares outstanding for the period. Diluted earnings per share reflects the potential dilution that could occur if security interests were exercised or converted into common stock.

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The following table sets forth the computation of basic and diluted earnings per share for the six months ended June 30, 2003 and 2004.

	2003			2004		
(in thousands, except per share data)	**Net Income Attributed to Common Stock**	**Weighted-Average Shares**	**Per-Share earnings**	**Net Loss Attributed to Common Stock**	**Weighted-Average Shares**	**Per-Share Loss**
Basic earnings per share	$ 6,496	72,810	$ 0.09	$ (8,082)	194,714	$ (0.04)
Effect of dilutive securities:						
5% European Notes (A)	(5,254)	96	(0.07)			
Diluted earnings per share	1,242	72,906	$ 0.02	$ (8,082)	194,714	$ (0.04)

(A) Represents 5% European Notes extinguished during the six months ended June 30, 2003. Gains on these transactions have been treated as a reduction to income attributed to common stock as such gains would not have occurred had these securities been converted by the holder.

Not included in the calculation for diluted earnings per share were employee stock options outstanding during the six months ended June 30, 2003. The inclusion of these options would have been antidilutive since they were not in the money during the six months ended June 30, 2003. Harken s 7% European Notes, Benz Convertible Notes and Series G-1 and G-2 Preferred Stock were also excluded from the calculation of diluted earnings per share as their effect would have been antidilutive.

(17) COMMITMENTS AND CONTINGENCIES

As previously reported in Harken s Annual Report on Form 10-K for the year ended December 31, 2003, D.E. Rice and Karen Rice, as Trustees for the Rice Family Living Trust, filed a lawsuit in state court in August 2002 alleging damages from alleged spills on the Rice s property. In December 2003, the parties agreed to formal mediation of this matter which took place in January 2004. Following mediation, the parties reached a settlement agreement, whereby Harken and Harken s insurers agreed to pay to Rice the total sum of $1.9 million in return for a full and final release for all disputes and claims alleged by Rice against Harken. The insurers agreed to contribute $775,000 of this settlement amount. Based on the settlement agreement and the contribution from the insurers, Harken accrued and expensed $1.125 million in December 2003. Harken s insurers, pursuant to a separate Fifth Circuit Court of Appeals order, have covered Harken s legal costs of defense in the litigation. In April 2004 the trial court, upon joint motion of parties, dismissed the Rice lawsuit in its entirety with prejudice to refiling.

420 Energy Investment, Inc. and ERI Investments, Inc. (collectively 420 Energy) filed a lawsuit against XPLOR Energy, Inc., a wholly-owned subsidiary of Harken (XPLOR), on December 21, 1999 in the New Castle County Court of Chancery of the State of Delaware. 420 Energy alleges that they are entitled to appraisal and payment of the fair value of their common stock in XPLOR as of the date XPLOR merged with Harken. Harken has relied on an indemnity provision in the XPLOR merger agreement to tender the costs of defense in this matter to former stockholders of XPLOR. In April 2004, 420 Energy voluntarily dismissed this lawsuit in its entirety.

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In May 2002, Henry C. Magee III (Magee) filed a complaint against XPLOR Energy SPV-I, Inc. and XPLOR Energy Operating Company, as the successor in Interest to Araxas SPV-I, Inc. and Araxas Exploration, Inc. in the United States District Court for the Eastern District of Louisiana. In his complaint, Magee alleges that Xplor breached a contractual obligation relating to a royalty interest assignment from XPLOR s predecessor in interest, Araxas Exploration, Inc. The court granted Magee s motion for summary judgment as to a disputed interpretation of the assignment clause but reserved for trial XPLOR s reformation claim. Subsequent to the summary judgment, Magee has asserted additional claims relating to his purported royalty interest assignment. Trial on the reformation claim, the additional claims asserted by Magee and the remaining issues in this case is currently scheduled to take place on October 24, 2004. Trial preparations are ongoing including the deposition of material fact and expert witnesses. XPLOR will continue to vigorously dispute these claims and retains the right to appeal the summary judgment granted by the court. While the results of the trial and any appeals related to the trial or summary judgment remain uncertain, Harken believes the ultimate outcome will not have a material adverse effect on Harken s financial conditions and results of operations. Based on Harken s reasonable estimate of the most likely outcome of this matter, Harken has accrued a reserve of $220,000 at June 30, 2004 related to this claim.

In October 2003, Xplor was served with a complaint filed by Apache Corporation in the Harris County District Court. Apache sought payment of $219,000 plus interest and attorneys fees. Apache alleged that the amount demanded was due pursuant to the terms of a 1998 purchase and sale agreement between Apache and Xplor. In March 2004, Apache and Xplor entered into a compromise and settlement agreement resolving all disputes between the parties, resulting in the dismissal with prejudice to refiling of this case.

Harken and its subsidiaries currently are involved in various other lawsuits and other contingencies, which in management s opinion, will not result in a material adverse effect upon Harken s financial condition or operations taken as a whole.

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