

CLAYTON WILLIAMS ENERGY INC /DE

FORM 10-K (Annual Report)

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Industry	Oil & Gas Operations
Sector	Energy
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FORM 10-K

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

(Mark One)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 1997

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 0-20838

CLAYTON WILLIAMS ENERGY, INC.

(Exact name of registrant as specified in its charter)

DELAWARE	75-2396863
----- (State or other jurisdiction of incorporation or organization)	----- (I.R.S. Employer Identification No.)
SIX DESTA DRIVE - SUITE 6500 MIDLAND, TEXAS	79705-5510
----- (Address of principal executive offices)	----- (Zip code)

Registrant's telephone number, including area code: (915) 682-6324

Securities registered pursuant to Section 12(b) of the Act:

None

Securities registered pursuant to Section 12(g) of the Act:

Common Stock - \$.10 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 X 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 registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. []

The aggregate market value of the outstanding Common Stock, \$.10 par value, of the registrant held by non-affiliates of the registrant as of March 19, 1998, based on the closing price as quoted on the Nasdaq Stock Market's National Market as of the close of business on said date, was \$40,679,232.

There were 8,891,263 shares of Common Stock, \$.10 par value, of the registrant outstanding as of March 19, 1998.

Documents incorporated by reference:

(1) The information required by Part III of Form 10-K is found in the registrant's definitive Proxy Statement which will be filed with the Commission not later than April 30, 1998. Such portions of the registrant's definitive Proxy Statement are incorporated herein by reference.

PART I

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

Certain statements in this Form 10-K under "Item 1. Business," "Item 3. Legal Proceedings," "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations," and elsewhere in this Form 10-K constitute "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. All statements, other than statements of historical facts, included in this Form 10-K that address activities, events or developments that Clayton Williams Energy, Inc. and its subsidiaries (the "Company") expects, projects, believes or anticipates will or may occur in the future, including such matters as oil and gas reserves, future drilling and operations, future production of oil and gas, future net cash flows, future capital expenditures and other such matters, are forward-looking statements. Such forward-looking statements involve known and unknown risks, uncertainties, and other factors which may cause the actual results, performance, or achievements of the Company to be materially different from any future results, performance, or achievements expressed or implied by such forward-looking statements. Such factors include, among others, the following: the volatility of oil and gas prices, the Company's drilling results, the Company's ability to replace short-lived reserves, the availability of capital resources, the reliance upon estimates of proved reserves, operating hazards and uninsured risks, competition, government regulation, the ability of the Company to implement its business strategy, and other factors referenced in this Form 10-K.

ITEM 1 - BUSINESS

SPECIAL NOTE: CERTAIN STATEMENTS SET FORTH BELOW UNDER THIS CAPTION CONSTITUTE "FORWARD-LOOKING STATEMENTS." SEE "SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS" FOR ADDITIONAL FACTORS RELATING TO SUCH STATEMENTS.

GENERAL

Clayton Williams Energy, Inc. and its subsidiaries (the "Company") are primarily engaged in the exploration for and development and production of oil and natural gas. The Company commenced operations in May 1993 following the consolidation into the Company (the "Consolidation") of substantially all of the oil and gas and gas gathering operations previously conducted by various companies controlled by Clayton W. Williams, Jr. (collectively, the "Williams Companies") and the completion of the Company's initial public offering of Common Stock (the "Initial Public Offering").

Since 1988, the Company and its predecessors have concentrated their drilling activities in the Cretaceous Trend (the "Trend"), which extends from south Texas through east Texas, Louisiana and other southern states and includes the Austin Chalk, Buda, and Georgetown formations. The Company believes that it has been one of the leaders in horizontal drilling in the Trend. From January 1, 1990 through December 31, 1997, the Company drilled or participated in 269 gross (218.7 net) horizontal wells in the Trend. The Company also has operations in the Jalmat Field located in southeastern New Mexico and in the Texas Gulf Coast.

In 1997, the Company initiated several exploratory projects designed to reduce its dependence on Trend drilling for future production and reserve growth. These new areas include other formations in the vicinity of its core properties in east central Texas, as well as south Texas, Louisiana and Mississippi.

As of December 31, 1997, the Company had estimated proved reserves totaling 8,410 MBbls of oil and 32.9 Bcf of gas with \$99.9 million of estimated future net revenues before income taxes (discounted at 10%). During 1997, the Company added 3,720 MBOE of estimated proved reserves through extensions and discoveries, substantially all of which were derived from Trend drilling activities. Reserve additions for 1997

were 99% of production for the same period, while production for 1997 was approximately 20% higher on an MBOE basis than in 1996. The Company held interests in 507 gross (373.7 net) oil and gas wells and owned leasehold interests in approximately 359,079 gross (200,974 net) undeveloped acres at December 31, 1997.

DRILLING AND EXPLORATION ACTIVITIES

Following is a discussion of the Company's significant drilling and exploration activities during 1997, together with its plans for capital and exploratory expenditures in 1998.

TREND DRILLING ACTIVITIES

The Company has assembled a 122,000 net acre lease block (the "North Giddings Block") in the updip area of the Giddings Field in Burleson, Robertson and Milam Counties, Texas where the Company has drilled 105 gross (101.7 net) horizontal oil wells through December 31, 1997. In addition, the Company has the right to earn acreage in this same area under two continuous-drilling farm-in agreements covering approximately 52,000 net acres, having drilled 5 gross (3.5 net) wells on this acreage in 1997.

The economic viability of the Company's Trend drilling activities is highly dependent upon the price of oil expected to be realized during the early years of a well's productive life due to high initial production rates and steep decline rates which are characteristic of most Trend wells. Prior to the recent deterioration in oil prices, the Company had planned to spend approximately \$18 million on Trend leasing and drilling activities in 1998, as compared to \$44.1 million in 1997. This reduction in planned expenditures was attributable to a decrease in the number of Trend drilling locations that could meet the Company's risk-adjusted economic parameters.

However, since oil prices are presently at their lowest levels in four years, the Company plans to indefinitely suspend its Trend drilling activities beginning in April 1998 pending an improvement in oil prices. The suspension of Trend drilling activities for an extended period of time may have a significant adverse effect on the Company's oil and gas production and cash flows from operating activities in 1998 and future periods unless the Company can offset the negative impact of such suspension through favorable drilling results from its emerging exploration program or through acquisitions of proved properties. See "MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS."

COTTON VALLEY EXPLORATORY PROJECT

During 1997, the Company completed a 3-D seismic survey covering approximately 55,000 net acres in its North Giddings Block to explore for gas reserves in the prolific Cotton Valley Pinnacle Reef play. As opposed to Trend formations, which are encountered at depths of 5,500 to 7,000 feet in this area, the Cotton Valley formation is encountered at depths of 15,000 to 16,000 feet. The Company has interpreted approximately one-third of the survey and has identified 11 Cotton Valley Pinnacle Reef anomalies to date. The northern edge of the North Giddings Block is approximately 24 miles southwest of the nearest producing Cotton Valley Pinnacle Reef. Project costs from inception of the project in 1996 through December 31, 1997 have aggregated \$4.6 million.

During 1998, the Company plans to spend approximately \$9 million to complete the interpretation of the seismic survey, extend and renew existing leases as required, and drill an exploratory well to determine if the identified reefs are gas-bearing. Drilling on an initial test well is expected to begin in the second or third quarter of 1998. The Company has revoked its previous policy of limiting expenditures on the Cotton Valley Exploratory Project to 25% of its planned annual capital expenditures. This policy change was necessitated by the Company's decision to suspend Trend drilling activities in 1998 pending an improvement in oil prices. See "TREND DRILLING ACTIVITIES."

OTHER EXPLORATION ACTIVITIES

Following is a discussion of other areas where the Company conducted significant seismic, leasing and exploratory drilling activities in 1997, together with its plans for 1998. During 1997, the Company spent an aggregate of \$3.7 million on seismic surveys and \$10.1 million on leasing in areas other than the Trend and the Cotton Valley Exploratory Project. Presently, the Company plans to spend approximately \$9 million in 1998 on other exploration projects, substantially all of which are targeting gas reserves due to currently depressed oil prices. However, the nature and extent of exploration activities may change significantly during the year depending upon several factors, including seismic interpretations, drilling results, rig availability, product prices, and the availability of capital resources.

GLEN ROSE

Beginning in 1997, the Company has assembled a 50,000 net acre lease block in Grimes, Walker and Madison Counties, Texas and plans to drill a horizontal exploratory well on this prospect in 1998. The Company believes that its experience in horizontal drilling can be used to find and develop significant gas reserves from the Glen Rose Limestone formation in this area. Depending upon drilling results, the Company may drill one or more additional wells on this prospect in 1998.

EAST TEXAS HORIZONTAL

The Company is presently evaluating an exploratory horizontal gas well in the Haynesville Limestone formation in Freestone County, Texas. The Company began drilling the well in January 1998, and completed drilling in March 1998 after penetrating a total of 8,000 feet of the target formation through two opposing laterals. Although initial indications are disappointing, the Company has placed the well on production and may conduct one or more stimulation procedures. In addition, the Company may attempt to complete the well in shallower zones. If the well is ultimately determined to be uneconomical, the Company will record a charge against earnings of approximately \$3.5 million in the period of such determination.

SOUTH TEXAS

During 1997, the Company completed a 3-D seismic survey covering approximately 12,000 net acres in Duval County, Texas. During 1998, the Company plans to drill an exploratory gas well to test one of the eight Wilcox prospects generated by the survey. In addition, the Company initiated a 3-D seismic survey in 1998 covering 3,150 net acres in Jim Hogg County, Texas targeting the Queen City formation and may initiate a 3-D seismic survey in Goliad County, Texas targeting the Wilcox formation.

LOUISIANA

During 1997, the Company drilled an exploratory well on its Mamou Prospect in Evangeline Parish, Louisiana that was completed as a field discovery well in the Upper Wilcox formation in March 1998. The Company plans to evaluate geological and geophysical data on three other prospects generated in 1997 targeting the Sparta and Miocene formations to determine the nature and extent of further exploration activities in these areas.

MISSISSIPPI

During 1997, the Company began a multi-pay exploration program targeting hydrocarbons trapped by salt domes in Mississippi. The Company acquired approximately 19,000 net acres based on 2-D seismic data, and conducted a 3-D seismic survey on one of the salt domes. During 1998, the Company plans to complete the leasing and seismic activities begun in 1997 and evaluate the data to determine the nature and extent of further exploration activities in Mississippi.

ACQUISITIONS OF PROVED PROPERTIES

Although no specified amounts of capital expenditures have been designated for acquisitions of proven properties in 1998, the Company believes that the purchase of long-lived oil and gas reserves would effectively compliment its emerging exploration program. Therefore, the Company plans to actively seek and evaluate acquisition opportunities during 1998.

PRINCIPAL PRODUCING AREAS

THE TREND

The Company's current production of oil and gas in the Trend is derived principally from the Austin Chalk formation in the Giddings Field. At December 31, 1997, the Company had interests in 264 gross (201.1 net) producing wells in the Giddings Field, including 192 horizontal and 72 vertical wells. For the year ended December 31, 1997, the Company's daily net production in the Giddings Field averaged approximately 7,405 Bbls of oil and 6,749 Mcf of gas. The Company drilled 35 wells in the Giddings Field during 1997, all of which were completed as productive wells. The Company operates 82% of its wells in the Giddings Field. Since May 1994, the Company has concentrated its Trend drilling activities in the North Giddings Block. Wells producing from the Austin Chalk formation in this updip portion of the Giddings Field are more prone to produce oil than gas.

The Company's wells in the Austin Chalk formation are routinely subjected to cyclic water stimulation. Cyclic water stimulation involves pumping large volumes of water at high injection rates into a well, shutting-in the well for ten days to two weeks, and then returning the well to production. Water is pumped into the reservoir in several stages and is absorbed into the micro-pore spaces of the rock, thereby displacing oil into the fractures where it may be more readily produced and, in some cases, extending the fracture system. The Company has used the cyclic water stimulation method since 1987. The Company generally uses this treatment technique during the well completion process and repeats the process 12 to 18 months after a well has been placed in production. During 1997, 34 horizontal wells received an initial treatment and 2 horizontal wells received a subsequent treatment.

JALMAT FIELD

The Company owns interests in 132 gross (106.7 net) operated wells in the Jalmat Field, located in Lea County, New Mexico. For the year ended December 31, 1997, the Company's daily net production from this field averaged approximately 101 Bbls of oil and 3,474 Mcf of gas.

TEXAS GULF COAST

The Company owns interests in 27 gross (10.8 net) non-operated wells in Wharton and Matagorda Counties in the Gulf Coast region of Texas. The Company's daily net production from this area during the year ended December 31, 1997 averaged approximately 83 Bbls of oil and 1,556 Mcf of gas.

MARKETING ARRANGEMENTS

The Company sells substantially all of its oil production under short-term contracts based on prices quoted on the New York Mercantile Exchange ("NYMEX") for spot West Texas Intermediate ("WTI") contracts, less agreed-upon deductions which vary by grade of crude oil. The majority of the Company's gas production is sold under short-term contracts based on pricing formulae which are generally market responsive.

The Company believes that the loss of any of its oil and gas purchasers would not have a material adverse effect on its results of operations due to the availability of other purchasers.

NATURAL GAS SERVICES

The Company owns an interest in and operates seven gas gathering systems and three gas processing plants in the states of Texas and Mississippi. These natural gas service facilities consist of interests in approximately 70 miles of pipeline, two amine treating plants, one liquids extraction plant and three compressor stations. The Company does not derive a significant portion of its consolidated operating income from natural gas services and does not consider this business to be a strategic part of its business plan.

COMPETITION AND MARKETS

Competition in all areas of the Company's operations is intense. The oil and gas industry as a whole also competes with other industries in supplying the energy and fuel requirements of industrial, commercial and individual consumers. Major and independent oil and gas companies and oil and gas syndicates actively bid for desirable oil and gas properties, as well as for the equipment and labor required to operate and develop such properties. A number of the Company's competitors have financial resources and acquisition, exploration and development budgets that are substantially greater than those of the Company, which may adversely affect the Company's ability to compete with these companies. Such companies may be able to pay more for productive oil and gas properties and exploratory prospects and to define, evaluate, bid for and purchase a greater number of properties and prospects than the Company's financial or human resources permit.

The market for oil, gas and natural gas liquids produced by the Company depends on factors beyond its control, including domestic and foreign political conditions, the overall level of supply of and demand for oil, gas and natural gas liquids, the price of imports of oil and gas, weather conditions, the price and availability of alternative fuels, the proximity and capacity of gas pipelines and other transportation facilities and overall economic conditions.

REGULATION

The Company's oil and gas exploration, production and related operations are subject to extensive rules and regulations promulgated by federal, state and local agencies. Failure to comply with such rules and regulations 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 rules and regulations are frequently amended or reinterpreted, the Company is unable to predict the future cost or impact of complying with such laws.

The State of Texas and many other states require permits for drilling operations, drilling bonds and reports concerning operations and impose other requirements relating to the exploration and production of oil and gas. Such states also have statutes or regulations addressing conservation matters, including provisions for the unitization or pooling of oil and gas properties, the establishment of maximum rates of production from oil and gas wells and the spacing, plugging and abandonment of such wells. The statutes and regulations of certain states limit the rate at which oil and gas can be produced from the Company's properties.

The Federal Energy Regulatory Commission ("FERC") regulates interstate natural gas transportation rates and service conditions, which affect the marketing of gas produced by the Company, as well as the revenues received by the Company for sales of such production. Since the mid-1980s, the FERC has issued a series of orders, culminating in Order Nos. 636, 636-A and 636-B ("Order 636"), that have significantly altered

the marketing and transportation of gas. Order 636 mandates a fundamental restructuring of interstate pipeline sales and transportation services, including the unbundling by interstate pipelines of the sales, transportation, storage and other components of the city-gate sales services such pipelines previously performed. One of the FERC's purposes in issuing the orders is to increase competition within all phases of the gas industry. Order 636 and subsequent FERC orders on rehearing have been appealed and are pending judicial review. It is difficult to predict the ultimate impact of the orders on the Company and its gas marketing efforts. Generally, Order 636 has eliminated or substantially reduced the interstate pipelines' traditional role as wholesalers of natural gas, and has substantially increased competition and volatility in natural gas markets. While significant regulatory uncertainty remains, Order 636 may ultimately enhance the Company's ability to market and transport its gas, although it may also subject the Company to greater competition, more restrictive pipeline imbalance tolerances and greater associated penalties for violation of such tolerances.

Sales of oil and natural gas liquids by the Company are not regulated and are made at market prices. The price the Company receives from the sale of those 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, generally, would index such rate to inflation, subject to certain conditions and limitations. These regulations could increase the cost of transporting oil and natural gas liquids by pipeline. The Company is not able to predict with any certainty what effect, if any, these regulations will have on it, but, other factors being equal, the regulations may, over time, tend to increase transportation costs or reduce wellhead prices for oil and natural gas liquids.

ENVIRONMENTAL MATTERS

Operations of the Company pertaining to oil and gas exploration, production and related activities are subject to numerous and constantly changing federal, state and local laws governing the discharge of materials into the environment or otherwise relating to environmental protection. Numerous governmental agencies issue regulations to implement and enforce such laws which are often difficult and costly to comply with and which carry substantial civil and criminal penalties for failure to comply. These laws and regulations may require the acquisition of certain permits prior to or in connection with drilling activities, restrict or prohibit the types, quantities and concentration of substances that can be released into the environment in connection with drilling and production, restrict or prohibit drilling activities that could impact wetlands, endangered or threatened species or other protected areas or natural resources, require some degree of remedial action to mitigate pollution from former operations, such as pit cleanups and plugging abandoned wells, and impose substantial liabilities for pollution resulting from the Company's operations. Such laws and regulations may substantially increase the cost of exploring for, developing, producing or processing oil and gas and may prevent or delay the commencement or continuation of a given project and thus generally could have a material adverse effect upon the capital expenditures, earnings, or competitive position of the Company. Management of the Company believes it is in substantial compliance with current applicable environmental laws and regulations, and the cost of compliance with such laws and regulations has not been material and is not expected to be material during the next fiscal year. Nevertheless, changes in existing environmental laws and regulations or in the interpretations thereof could have a significant impact on the operating costs of the Company, as well as the oil and gas industry in general. For instance, legislation has been proposed in Congress from time to time that would reclassify certain oil and gas production wastes as "hazardous wastes," which reclassification would make exploration and production wastes subject to much more stringent handling, disposal and clean-up requirements. State initiatives to further regulate the disposal of oil and gas wastes and naturally occurring radioactive materials could have a similar impact on the Company.

The Comprehensive Environmental Response, Compensation, and Liability Act ("CERCLA"), also known as the "Superfund" law, imposes liability, without regard to fault or the legality of the original conduct, on certain classes of persons that are considered to have contributed to the release of a "hazardous substance" into the environment. These persons include the owner or operator of the disposal site or the site where the

release occurred and companies that disposed or arranged for the disposal of the hazardous substances at the site where the release occurred. 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 and for damages to natural resources, 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 hazardous substances released into the environment. The Company is able to control directly the operation of only those wells with respect to which it acts as operator. Notwithstanding the Company's lack of direct control over wells operated by others, the failure of an operator other than the Company to comply with applicable environmental regulations may, in certain circumstances, be attributed to the Company. Management of the Company believes that it has no material commitments for capital expenditures to comply with existing environmental requirements.

State water discharge regulations and federal waste discharge permitting requirements adopted pursuant to the Federal Water Pollution Control Act prohibit or are expected to prohibit, within the next several months, the discharge of produced water and sand, and some other substances related to the oil and gas industry, to coastal waters. Although the costs to comply with zero discharge mandates under state or federal law may be significant, the entire industry will experience similar costs and the Company believes that these costs will not have a material adverse impact on the Company's financial condition and operations.

TITLE TO PROPERTIES

As is customary in the oil and gas industry, the Company performs a minimal title investigation before acquiring undeveloped properties. A title opinion is obtained prior to the commencement of drilling operations on such properties. The Company has obtained title opinions on substantially all of its producing properties and believes that it has satisfactory title to such properties in accordance with standards generally accepted in the oil and gas industry. The Company's properties are subject to customary royalty interests, liens incident to operating agreements, liens for current taxes and other burdens which the Company believes do not materially interfere with the use of or affect the value of such properties. Substantially all of the Company's oil and gas properties are currently mortgaged to secure borrowings under the Company's secured bank credit facility and may be mortgaged under any future credit facilities entered into by the Company.

OPERATIONAL HAZARDS AND INSURANCE

The Company's operations are subject to the usual hazards incident to the drilling and production of oil and gas, such as blowouts, cratering, explosions, uncontrollable flows of oil, gas or well fluids, fires and pollution and other environmental risks. 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 operation.

The Company maintains insurance of various types to cover its operations. The limits provided under its general liability policies total \$32 million. In addition, the Company maintains operator's extra expense coverage which provides for care, custody and control of selected wells during drilling operations. The occurrence of a significant adverse event, the risks of which are not fully covered by insurance, could have a material adverse effect on the Company's financial condition and results of operations. Moreover, no assurances can be given that the Company will be able to maintain adequate insurance in the future at rates it considers reasonable.

EMPLOYEES

At December 31, 1997, the Company had 109 full-time employees. None of the Company's employees is subject to a collective bargaining agreement. The Company considers its relations with its employees to be good.

OFFICES

The Company leases approximately 40,000 square feet of office space in Midland, Texas and approximately 1,400 square feet of office space in Houston, Texas.

ITEM 2 - PROPERTIES

The Company's properties consist primarily of oil and gas wells and its ownership in leasehold acreage, both developed and undeveloped. At December 31, 1997, the Company had interests in 507 gross (373.7 net) oil and gas wells and owned leasehold interests in 359,079 gross (200,974 net) undeveloped acres.

RESERVES

The following table sets forth certain information as of December 31, 1997 with respect to the Company's estimated proved oil and gas reserves and the present value of estimated future net revenues therefrom, discounted at 10% ("PV-10 Value").

	PROVED DEVELOPED	PROVED UNDEVELOPED	TOTAL
Oil (Mbbbls).....	7,826	584	8,410
Gas (Mmcf).....	27,392	5,469	32,861
MBOE.....	12,392	1,495	13,887
PV-10 Value:			
Before income taxes.....	\$94,831	\$5,087	\$99,918
After income taxes.....			\$92,403

The following table sets forth certain information as of December 31, 1997 regarding the Company's proved oil and gas reserves in each of its principal producing areas.

AREA OR FIELD	PROVED RESERVES			PERCENT OF TOTAL OIL EQUIVALENT	PV-10 VALUE BEFORE INCOME TAXES	PERCENTAGE OF PV-10 VALUE BEFORE INCOME TAXES
	OIL (MMBLS)	GAS (MMCF)	TOTAL OIL EQUIVALENT (MBOE)			
					(in thousands)	
Trend.....	7,803	11,611	9,738	70.1%	\$73,687	73.7%
Jalmat.....	308	13,747	2,599	18.7	14,264	14.3
Texas Gulf Coast.....	165	4,521	919	6.6	9,688	9.7
Other.....	134	2,982	631	4.6	2,279	2.3
Total.....	8,410	32,861	13,887	100.0%	\$99,918	100.0%

The estimates as of December 31, 1997 of proved reserves, future net revenues from proved reserves and the PV-10 Value before income taxes set forth in this Form 10-K were based on a report prepared by Williamson Petroleum Consultants, Inc. (the "Independent Engineers"). For purposes of preparing such estimates, the Independent Engineers reviewed production data through October 31, 1997 for properties representing 84% of the estimated present value of the Company's proved developed producing reserves and through earlier dates for the balance of the Company's properties. In order to calculate the proved reserve estimates as of December 31, 1997, the Independent Engineers assumed that production for each of the Company's properties since the date of the last production data reviewed was in accordance with the production decline curve for such property.

In accordance with applicable guidelines of the Commission, the estimates of the Company's proved reserves and future net revenues therefrom set forth herein are made using oil and gas sales prices estimated to be in effect as of the date of such reserve estimates and are held constant throughout the life of the properties. Estimated quantities of proved reserves and future net revenues therefrom are affected by changes in oil and gas prices. Oil and gas prices decreased substantially from December 31, 1996 to December 31, 1997, resulting in significant decreases in the Company's estimated future net revenues and, to a lesser extent, decreases in

estimated reserve quantities. The weighted average of the sales prices utilized for the purposes of estimating the Company's proved reserves and the future net revenues therefrom as of December 31, 1997 were \$17.00 per Bbl of oil and \$2.33 per Mcf of gas, as compared to \$25.01 per Bbl and \$3.63 per Mcf as of December 31, 1996. Subsequent to December 31, 1997, oil and gas prices have continued to decline, and are expected to remain volatile. The Company estimates that a \$1 decline in the price per Bbl of oil would result in a \$5.9 million reduction in PV-10 Value (before income taxes), and that a \$.25 decline in the price per Mcf of gas would result in a \$5.2 million reduction in PV-10 Value (before income taxes).

Also in accordance with Commission guidelines, the estimates of the Company's proved reserves and future net revenues therefrom are made using current lease and well operating costs estimated by the Company. Lease operating expenses for oil wells operated by the Company in the Austin Chalk, Buda and Georgetown formations were estimated using a combination of fixed and variable-by-volume costs consistent with the Company's experience in operating such wells. For purposes of calculating future net revenues and PV-10 Value, operating costs exclude accounting and administrative overhead expenses attributable to the Company's working interest in wells operated by it under joint operating agreements, but include administrative costs associated with production offices.

The Independent Engineers report relies upon various assumptions, including assumptions required by the Commission as to oil and gas prices, drilling and operating expenses, capital expenditures, taxes and availability of funds. The process of estimating oil and gas reserves is complex, requiring significant decisions and assumptions in the evaluation of available geological, geophysical, engineering and economic data for each reservoir. As a result, such estimates are inherently imprecise. Actual future production, oil and gas prices, revenues, taxes, development expenditures, operating expenses and quantities of recoverable oil and gas reserves may vary substantially. Any significant variance in these assumptions could materially affect the estimated quantity and value of reserves set forth herein. In addition, the Company's reserves may be subject to downward or upward revision based upon production history, results of future development and exploration, prevailing oil and gas prices and other factors, many of which are beyond the Company's control. Actual production, revenues, taxes, development expenditures and operating expenses with respect to the Company's reserves will likely vary from the estimates used, and such variances may be material.

Approximately 11% of the Company's total proved reserves at December 31, 1997 were undeveloped, which are by their nature less certain. Recovery of such reserves will require significant capital expenditures and successful drilling operations. The reserve data set forth in the Independent Engineers' report as of December 31, 1997 assumes, based on the Company's estimates, that aggregate capital expenditures by the Company of approximately \$6.8 million through 2000 will be required to develop such reserves. Although cost and reserve estimates attributable to the Company's oil and gas reserves have been prepared in accordance with industry standards, no assurance can be given that the estimated costs are accurate, that development will occur as scheduled or that the results will be as estimated.

The PV-10 Value referred to herein 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 applicable requirements of the Commission, the PV-10 Value from proved reserves is generally based on prices and costs as of the date of the estimate, whereas actual future prices and costs may be materially higher or lower. Actual future net revenues also will be affected by changes in consumption and changes in governmental regulations or taxation. The timing of actual future net revenues from proved reserves, and thus their actual present value, will be affected by the timing of both the production and the incurrence of expenses in connection with development and production of oil and gas properties. In addition, the 10% discount factor, which is required by the Commission to be used in calculating discounted future net revenues for reporting purposes, is not necessarily the most appropriate discount factor based on interest rates in effect from time to time and risks associated with the Company or the oil and gas industry in general.

The Company must develop or acquire new oil and gas reserves to replace those being depleted by production. Without successful drilling and exploration or acquisition activities, the Company's reserves and revenues will decline rapidly. In particular, the Company's producing properties in the Trend are characterized by a high initial production rate, followed by a steep decline in production. The Company's properties in the Trend may be susceptible to hydrocarbon drainage from production on adjacent properties by other operators, particularly from horizontal wells. The Company has a relatively low reserve-to-production ratio of approximately 3.7 years (based upon the estimated quantities of proved oil and gas reserves as of December 31, 1997, divided by production volumes for 1997). The 1997 ratio is down from 4.6 years at December 31, 1996 due to a combination of downward reserve revisions caused primarily by lower product prices and higher than average initial production rates on wells completed in 1997. Accordingly, the Company believes that its future success will depend to a significant extent upon the results of its emerging exploration program and, to a lesser extent, acquisitions of proved properties. See "ITEM 7 - MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS."

Since January 1, 1997, the Company has not filed an estimate of its net proved oil and gas reserves with any federal authority or agency other than the Commission.

EXPLORATION AND DEVELOPMENT ACTIVITIES

The Company drilled, or participated in the drilling of, the following numbers of wells during the periods indicated.

	YEAR ENDED DECEMBER 31,					
	1997		1996		1995	
	GROSS	NET	GROSS	NET	GROSS	NET
DEVELOPMENT WELLS:						
Oil.....	33	28.0	23	20.9	24	21.0
Gas.....	1	.2	-	-	1	.5
Dry.....	-	-	-	-	-	-
Total.....	34	28.2	23	20.9	25	21.5
EXPLORATORY WELLS:						
Oil.....	8	7.5	4	4.0	2	2.0
Gas.....	-	-	-	-	-	-
Dry.....	5	1.9	2	.6	-	-
Total.....	13	9.4	6	4.6	2	2.0
TOTAL WELLS:						
Oil.....	41	35.5	27	24.9	26	23.0
Gas.....	1	.2	-	-	1	.5
Dry.....	5	1.9	2	.6	-	-
Total.....	47	37.6	29	25.5	27	23.5

The information contained in the foregoing table should not be considered indicative of future drilling performance, nor should it be assumed that there is any necessary correlation between the number of productive wells drilled and the amount of oil and gas that may ultimately be recovered by the Company.

The Company does not own any drilling rigs and all of its drilling activities are conducted by independent contractors on a day rate basis under standard drilling contracts. At March 19, 1998, the Company had one drilling rig under contract in the Trend.

PRODUCTIVE WELL SUMMARY

The following table sets forth certain information regarding the Company's ownership as of December 31, 1997, of productive wells in the areas indicated.

	OIL		GAS		TOTAL	
	GROSS	NET	GROSS	NET	GROSS	NET
Trend.....	289	223.6	23	16.1	312	239.7
Jalmat.....	37	30.0	95	76.7	132	106.7
Texas Gulf Coast.....	1	.4	26	10.4	27	10.8
Other.....	19	12.9	17	3.6	36	16.5
Total.....	346	266.9	161	106.8	507	373.7

The Company seeks to act as operator of the wells in which it owns a significant interest. As operator of a well, the Company is able to manage drilling and production operations as well as other matters affecting the production and sale of oil and gas. In addition, the Company receives fees from other working interest owners for the operation of the wells. At December 31, 1997, the Company was the operator of 408 wells, or approximately 80% of the 507 total wells in which it has a working interest. Production from these operated wells represented approximately 92% of the Company's total net production for 1997.

VOLUMES, PRICES AND PRODUCTION COSTS

The following table sets forth certain information regarding the production volumes of, average sales prices received from, and average production costs associated with the Company's sales of oil and gas for the periods indicated.

	YEAR ENDED DECEMBER 31,		
	1997	1996	1995
OIL AND GAS PRODUCTION DATA:			
Oil (MMbbls).....	2,903	2,203	1,831
Gas (MMcf).....	5,091	5,584	6,845
Total (MBOE).....	3,752	3,134	2,972
AVERAGE OIL AND GAS SALES PRICE (1):			
Oil (\$/Bbl).....	\$19.80	\$20.85	\$17.35
Gas (\$/Mcf)(2).....	\$ 2.64	\$ 2.65	\$ 1.77
AVERAGE PRODUCTION COSTS			
Lease operations (\$/BOE)(3).....	\$ 4.32	\$ 4.71	\$ 4.55

(1) Includes effects of hedging transactions.

(2) Includes natural gas liquids.

(3) Includes direct lifting costs (labor, repairs and maintenance, materials and supplies), workover costs and the administrative costs of production offices, insurance and property and severance taxes.

DEVELOPMENT, EXPLORATION AND ACQUISITION EXPENDITURES

The following table sets forth certain information regarding the costs incurred by the Company in its development, exploration and acquisition activities during the periods indicated.

	YEAR ENDED DECEMBER 31,		
	1997	1996	1995
	(IN THOUSANDS)		
Property Acquisitions:			
Proved.....	\$ -	\$ 1,375	\$ -
Unproved.....	14,042	5,002	2,254
Developmental Costs.....	32,656	20,931	16,823
Exploratory Costs.....	13,813	6,306	1,407
Total.....	\$60,511	\$33,614	\$20,484

ACREAGE

The following table sets forth certain information regarding the Company's developed and undeveloped leasehold acreage as of December 31, 1997 in the areas indicated. Acreage in which the Company's interest is limited to royalty, overriding royalty and similar interests is excluded.

	DEVELOPED		UNDEVELOPED		TOTAL	
	GROSS	NET	GROSS	NET	GROSS	NET
Trend.....	111,296	96,575	107,896	91,034	219,192	187,609
Jalmat.....	9,481	8,023	-	-	9,481	8,023
Texas Gulf Coast.....	8,735	3,963	562	163	9,297	4,126
Other (a).....	16,602	2,596	250,621	109,777	267,223	112,373
Total.....	146,114	111,157	359,079	200,974	505,193	312,131

(a) Net undeveloped acres are attributable to the following areas:

Glen Rose - 50,505; Mississippi - 18,771; Louisiana - 5,828; Alabama - 13,596; Wyoming - 10,253; and other - 10,824.

ITEM 3 - LEGAL PROCEEDINGS

SPECIAL NOTE: CERTAIN STATEMENTS SET FORTH BELOW UNDER THIS CAPTION CONSTITUTE "FORWARD-LOOKING STATEMENTS." SEE "SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS" FOR ADDITIONAL FACTORS RELATING TO SUCH STATEMENTS.

The Company is a defendant in a suit styled The State of Texas, et al v. Union Pacific Resources Company et al, presently pending in Lee County, Texas. The suit attempts to establish a class action consisting of unidentified royalty and working interest owners throughout the State of Texas. Among other things, the plaintiffs are seeking actual and exemplary damages for alleged violation of various statutes relating to common carriers and common purchasers of crude oil including discrimination in the purchase of oil by giving preferential treatment to defendants' own oil and conspiring to keep the posted price or sales price of oil below market value. A general denial has been filed. Because the Company is neither a common purchaser nor common carrier of oil, management of the Company believes there is no merit to the allegations as they relate to the Company or its operations.

In addition, the Company is a defendant or codefendant in minor lawsuits that have arisen in the ordinary course of business. While the outcome of these lawsuits cannot be predicted with certainty, management does

not expect any of these to have a material adverse effect on the Company's consolidated financial condition or results of operations.

ITEM 4 - SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

No matter was submitted to a vote of the security holders of the Registrant during the fourth quarter of its fiscal year ended December 31, 1997.

PART II

ITEM 5 - MARKET FOR THE REGISTRANT'S COMMON STOCK AND RELATED STOCKHOLDER

MATTERS

The Company's Common Stock is quoted on the Nasdaq Stock Market's National Market under the symbol "CWEI". As of December 31, 1997, there were approximately 1,400 beneficial and record stockholders. The following table sets forth, for the periods indicated, the high and low sales prices for the Common Stock, as reported on the National Market:

	High	Low
	-----	-----
Year Ended December 31, 1997:		
Fourth Quarter.....	\$ 18 7/8	\$ 12 1/2
Third Quarter.....	17 1/4	9 7/8
Second Quarter.....	15 3/4	10 1/2
First Quarter.....	19 7/8	11 3/4
Year Ended December 31, 1996:		
Fourth Quarter.....	\$ 17 7/8	\$ 9 5/8
Third Quarter.....	12	7 3/8
Second Quarter.....	10 7/8	3 3/4
First Quarter.....	4 3/8	2 5/8

The quotations in the table above reflect inter-dealer prices without retail markups, markdowns or commissions. On March 19, 1998, the last reported sale price for the Common Stock on the National Market was \$9 1/8.

The Company has not paid any cash dividends on its Common Stock, and the Board of Directors does not anticipate paying any cash dividends in the foreseeable future. The terms of the Company's secured bank credit facility limit the payment of cash dividends by the Company during any fiscal year to a maximum of 50% of the Company's net income during such period, assuming compliance with other terms thereof. Subject to the restrictions imposed by the Company's lenders, future dividend policy will depend on a number of factors, including future earnings, capital requirements, the financial condition and future prospects of the Company and such other factors as the Board of Directors may deem relevant.

ITEM 6 - SELECTED FINANCIAL DATA

The following table sets forth selected consolidated financial data for the Company as of the dates and for the periods indicated. The consolidated financial data for each of the years in the five-year period ended December 31, 1997 was derived from audited financial statements of the Company. The data set forth in this table should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the Consolidated Financial Statements.

	YEAR ENDED DECEMBER 31,				
	1997	1996	1995	1994	1993
(IN THOUSANDS, EXCEPT PER SHARE DATA)					
STATEMENT OF OPERATIONS DATA:					
Revenues:					
Oil and gas sales.....	\$70,929	\$60,610	\$ 43,883	\$ 43,617	\$ 55,041
Natural gas services.....	4,559	4,281	5,388	5,868	4,554
Total revenues.....	75,488	64,891	49,271	49,485	59,595
Costs and expenses:					
Lease operations.....	16,205	14,776	13,533	12,775	12,788
Exploration:					
Abandonments and impairments.....	2,692	597	1,472	6,227	4,244
Seismic and other.....	7,629	1,036	83	912	1,954
Natural gas services.....	3,955	3,437	3,714	3,510	2,518
Depreciation, depletion and amortization.....	31,273	23,758	25,110	25,248	26,751
Impairment of property and equipment (1).....	236	1,186	10,259	-	-
General and administrative.....	4,181	3,266	3,708	5,659	6,876
Total costs and expenses.....	66,171	48,056	57,879	54,331	55,131
Operating income (loss).....	9,317	16,835	(8,608)	(4,846)	4,464
Other income (expense):					
Interest expense.....	(1,767)	(3,440)	(5,493)	(4,461)	(4,003)
Other income (expense) (2).....	217	335	6,022	759	149
Total other income (expense).....	(1,550)	(3,105)	529	(3,702)	(3,854)
Income (loss) before income taxes.....	7,767	13,730	(8,079)	(8,548)	610
Income tax expense (3).....	-	-	-	-	207
Net income (loss).....	\$ 7,767	\$13,730	\$ (8,079)	\$ (8,548)	\$ 403
Net income (loss) per common share:					
Basic.....	\$.87	\$ 1.80	\$ (1.31)	\$ (1.50)	\$.09
Diluted.....	\$.85	\$ 1.76	\$ (1.31)	\$ (1.50)	\$.09
Weighted average common shares outstanding:					
Basic.....	8,888	7,624	6,165	5,700	4,700
Diluted.....	9,094	7,800	6,165	5,700	4,700
OTHER DATA:					
Net cash provided by operating activities.....	\$39,324	\$40,306	\$ 24,203	\$ 23,672	\$ 29,716
Discretionary cash flow (4):					
Total.....	\$49,597	\$40,307	\$ 28,845	\$ 23,839	\$ 33,352
Per diluted common share.....	\$ 5.45	\$ 5.17	\$ 4.68	\$ 4.18	\$ 7.10
DECEMBER 31,					
(IN THOUSANDS)					
BALANCE SHEET DATA:					
Working capital (deficit).....			\$ (6,369)	\$ (3,422)	\$(13,717)
Total assets.....			134,562	103,598	93,161
Long-term debt.....			35,700	18,000	33,538
Stockholders' equity.....			73,074	66,214	34,996

(1) The Company adopted the provisions of Statement of Financial Accounting Standards No. 121 "Accounting for Impairment of Long-Lived

Assets" effective October 1, 1995.

(2) The 1995 period includes a \$6 million non-recurring gain on sale of two principal gas gathering and processing systems.

(3) Prior to the Consolidation, income taxes were computed at the applicable federal statutory rate.

(4) Discretionary cash flow refers to net income (loss) before exploration costs, depreciation, depletion and amortization and impairments of property and equipment.

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

SPECIAL NOTE: CERTAIN STATEMENTS SET FORTH BELOW UNDER THIS CAPTION CONSTITUTE "FORWARD-LOOKING STATEMENTS." SEE "SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS" FOR ADDITIONAL FACTORS RELATING TO SUCH STATEMENTS.

The following discussion is intended to assist in understanding the Company's historical consolidated financial position at December 31, 1997, 1996 and 1995, and results of operations and cash flows for each of the three years in the period ended December 31, 1997. The Company's historical Consolidated Financial Statements and notes thereto included elsewhere in this Form 10-K contain detailed information that should be referred to in conjunction with the following discussion.

OVERVIEW

The Company commenced operations in May 1993, following the Consolidation and completion of the Company's Initial Public Offering. Since 1988, the Company and its predecessors have concentrated their drilling activities in the Trend. Oil and gas production in the Trend is generally characterized by a high initial production rate, followed by a steep rate of decline. In order to maintain its oil and gas reserve base, production levels and cash flow from operations, the Company has been required to maintain or increase its level of drilling activity and achieve comparable or improved results from such activities.

Beginning in 1997, the Company initiated several exploratory projects designed to reduce its dependence on Trend drilling for future production and reserve growth. These new areas include other formations in the vicinity of its core properties in east central Texas, as well as south Texas, Louisiana and Mississippi. During 1998, the Company plans to devote a substantial portion of its capital expenditures to these new areas and also intends to actively seek and evaluate opportunities to acquire proven properties. See "LIQUIDITY AND CAPITAL RESOURCES - CAPITAL EXPENDITURES."

The Company follows the successful efforts method of accounting for its oil and gas properties, whereby costs of productive wells, developmental dry holes and productive leases are capitalized and amortized using the unit-of-production method based on estimated proved reserves. Costs of unproved properties are initially capitalized. Those properties with significant acquisition costs are periodically assessed and any impairment in value is charged to expense. The amount of impairment recognized on unproved properties which are not individually significant is determined by amortizing the costs of such properties within appropriate groups based on the Company's historical experience, acquisition dates and average lease terms. Exploration costs, including geological and geophysical expenses and delay rentals, are charged to expense as incurred. Exploratory drilling costs, including the cost of stratigraphic test wells, are initially capitalized but charged to expense if and when the well is determined to be unsuccessful.

RESULTS OF OPERATIONS

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

	YEAR ENDED DECEMBER 31,		
	1997	1996	1995
OIL AND GAS PRODUCTION DATA:			
Oil (MBbls).....	2,903	2,203	1,831
Gas (MMcf).....	5,091	5,584	6,845
Total (MBOE) (1).....	3,752	3,134	2,972
AVERAGE OIL AND GAS SALES PRICES (2):			
Oil (\$/Bbl).....	\$19.80	\$20.85	\$17.35
Gas (\$/Mcf).....	\$ 2.64	\$ 2.65	\$1.77
OPERATING COSTS AND EXPENSES (\$/BOE PRODUCED):			
Lease operations.....	\$ 4.32	\$ 4.71	\$ 4.55
Oil and gas depletion.....	\$ 8.10	\$ 7.32	\$ 8.16
General and administrative.....	\$ 1.11	\$ 1.04	\$ 1.25
NET WELLS DRILLED:			
Horizontal Wells.....	33.3	24.4	23.5
Vertical Wells.....	4.3	1.1	-

(1) Gas is converted to barrel of oil equivalents (BOE) at the ratio of six Mcf of gas to one Bbl of oil.

(2) Includes effects of hedging transactions.

1997 COMPARED TO 1996

REVENUES

Oil and gas sales increased 17% from \$60.6 million in 1996 to \$70.9 million in 1997 due primarily to a 32% increase in oil production. The effect of higher oil production was partially offset by a 5% decrease in oil prices and a 9% decline in gas production. Production from wells completed subsequent to December 31, 1996 accounted for approximately 42% of total oil production for the 1997 period, which more than offset the effects of steep production declines from previously existing Trend wells. The Company plans to discontinue Trend drilling in April 1998 pending an improvement in oil prices, which have fallen to their lowest levels in four years. The suspension of Trend drilling activities for an extended period of time may adversely affect the Company's production and revenues in 1998.

COSTS AND EXPENSES

Lease operations expenses increased 9% from \$14.8 million in 1996 to \$16.2 million in 1997 while oil and gas production on a BOE basis increased 20%, resulting in a decrease in lease operations expenses on a BOE basis from \$4.71 per BOE in 1996 to \$4.32 per BOE in 1997. Higher initial rates of production on several of the wells completed during 1997 contributed materially to the decline in lease operations expenses per BOE.

Exploration costs increased from \$1.6 million in 1996 to \$10.3 million in 1997 due primarily to costs incurred during 1997 in connection with exploration projects initiated during the fourth quarter of 1996. The Company plans to spend approximately \$17 million in 1998 on exploratory prospects. Because the Company follows the successful efforts method of accounting, the Company's results of operations may be adversely affected during any accounting period in which seismic costs, exploratory dry hole costs, and unproved property impairments are expensed.

Depreciation, depletion and amortization ("DD&A") expense increased 32% from \$23.8 million in 1996 to \$31.3 million in 1997 due primarily to a 20% increase in oil and gas production on a BOE basis, combined with an 11% increase in the Company's average depletion rate per BOE. Under the successful efforts method of accounting, costs of oil and gas properties are amortized on a unit-of-production method based on estimated proved reserves. The average depletion rate per BOE was \$8.10 in the 1997 period compared to \$7.32 in the 1996 period.

General and administrative ("G&A") expenses increased 27% from \$3.3 million in 1996 to \$4.2 million in 1997 due primarily to increased personnel costs. In response to an increase in demand for skilled technical and managerial personnel in the oil and gas industry and an increase in the Company's level of exploration and development activities, the Company has hired additional personnel and increased salaries of existing personnel.

INTEREST EXPENSE

Interest expense decreased 47% from \$3.4 million in 1996 to \$1.8 million in 1997 due primarily to lower average levels of indebtedness on the Company's secured credit facility (the "Credit Facility") and, to a much lesser extent, lower average interest rates. The average daily principal balance outstanding on such facility during the 1997 period was \$24 million compared to \$36.9 million in 1996. The effective annual interest rate on bank debt, including bank fees, during the 1997 period was 8.7% compared to 9.4% in 1996

1996 COMPARED TO 1995

REVENUES

Oil and gas sales increased 38% from \$43.9 million in 1995 to \$60.6 million in 1996 due primarily to a 20% increase in oil production, a 20% increase in oil prices (net of hedging losses), and a 50% increase in gas prices. These benefits were offset in part by an 18% decline in gas production since most of the wells drilled since 1995 have been predominately oil wells. Production from wells completed subsequent to December 31, 1995 accounted for approximately 37% of total oil production for the 1996 period, which more than offset the effects of steep production declines from previously existing Trend wells.

Revenues from natural gas services decreased 20% from \$5.4 million in 1995 to \$4.3 million in 1996 due primarily to the sale of the Company's two principal gas gathering and processing systems in August 1995, and offset in part by additional revenues generated in 1996 related to a gas plant and three gathering systems acquired in the first quarter of 1996.

COSTS AND EXPENSES

Lease operations expenses increased 10% from \$13.5 million in 1995 to \$14.8 million in 1996 while production on a BOE basis increased 5%, resulting in an increase in lease operations expenses on a BOE basis from \$4.55 per BOE in 1995 to \$4.71 per BOE in 1996. Such increase was due primarily to higher production taxes resulting from the increase in oil and gas sales prices in 1996 as compared to 1995.

Although exploration costs were relatively insignificant in 1996 and 1995, the Company expects exploration costs to increase significantly during 1997 due to the initiation of the Cotton Valley Exploratory Project and other exploration activities outside the Trend. To date, the Company has committed to spend approximately \$4 million to conduct and evaluate a 3-D seismic survey covering approximately 50,000 acres in the North Giddings Block in 1997. The Company may continue to expand the area covered by the survey and may drill one or more exploratory wells on any prospects which result from such survey. In addition, the Company plans to spend approximately \$8 million on other exploration activities, a significant portion of which will be classified as exploration costs. Because the Company follows the successful efforts method of

accounting, the Company's results of operations may be adversely affected during any accounting period in which such costs are incurred and expensed.

DD&A expense decreased 5% from \$25.1 million in 1995 to \$23.8 million in 1996 due primarily to a 10% decline in the Company's average depletion rate per BOE, offset in part by a 5% increase in production on a BOE basis. Under the successful efforts method of accounting, costs of oil and gas properties are amortized on a unit-of-production method based on estimated proved reserves. The lower depletion rate is attributable to a combination of higher proved reserves resulting from both newly completed wells and higher product prices, and lower depletable costs resulting from the impairment of certain producing properties in October 1995 and June 1996 pursuant to Statement of Financial Accounting Standards No. 121 "Accounting for Impairment of Long-Lived Assets" ("SFAS 121"). As a result, the average depletion rate declined from \$8.16 per BOE in 1995 to \$7.32 per BOE in 1996.

The Company recorded a provision for impairment of property and equipment of \$1.2 million during the second quarter of 1996 in accordance with SFAS 121, as compared to a \$10.3 million provision made during the fourth quarter of 1995 upon the adoption of SFAS 121.

G&A expenses decreased 11% from \$3.7 million in 1995 to \$3.3 million in 1996. Certain cost reduction measures implemented beginning in March 1994 were fully realized during 1995. Accordingly, the Company does not expect G&A expenses to continue to decrease as they have in recent years.

Costs of natural gas services decreased 8% from \$3.7 million in 1995 to \$3.4 million in 1996 due primarily to the sale of the Company's two principal gas gathering and processing systems in August 1995, and offset in part by additional costs incurred in 1996 related to a gas plant and three gathering systems acquired during the first quarter of 1996.

INTEREST EXPENSE AND OTHER

Interest expense decreased 38% from \$5.5 million in 1995 to \$3.4 million in 1996 due primarily to lower average levels of indebtedness on the Credit Facility and, to a lesser extent, lower average interest rates. The average daily principal balance outstanding on such facility in 1996 was \$36.9 million compared to \$52.3 million in 1995. The effective annual interest rate on bank debt in 1996 was 9.4% compared to 10.6% in 1995. Proceeds from the sales of assets in August 1995 and January 1996 and the sale of common stock through a shareholder rights offering in September 1995, which aggregated approximately \$15 million, were used to reduce bank indebtedness and contributed largely to the reduction in interest expense in 1996 as compared to 1995. In addition, the Company used \$17 million of proceeds from the sale of common stock to further reduce bank debt in November 1996. As a result, the Company anticipates interest expense in 1997 to be lower than 1996.

Other income decreased from \$6 million in 1995 to \$335,000 in 1996. In August 1995, XCEL Gas Company, a general partnership in which the Company owned a 77% interest, sold its interest in a gas gathering system, and the Company sold its 43% interest in the El Campo gas processing system, for aggregate net proceeds of \$7.7 million, resulting in a combined gain on sale of property and equipment of \$6 million, net to the Company.

REVENUES

Oil and gas sales increased 1% from \$43.6 million in 1994 to \$43.9 million in 1995 due primarily to higher oil prices, the benefit of which was largely eliminated by the effects of lower gas prices and a 4% decline in oil and gas production. Although production from wells completed after December 31, 1994 accounted for 33% of the Company's 1995 production, these additions were more than offset by characteristically steep production declines from previously existing Trend wells. Average prices received for oil production increased 10% while average gas prices declined 11%.

Revenues from natural gas services decreased 8% from \$5.9 million in 1994 to \$5.4 million in 1995, despite the sale in August 1995 of the Company's two principal gas gathering and processing systems, since one of the systems sold was acquired effective January 1995 and did not contribute to revenues in 1994.

COSTS AND EXPENSES

Lease operations expenses increased 5% from \$12.8 million in 1994 to \$13.5 million in 1995 despite a 4% decline in BOE production. On a BOE basis, lease operations expenses increased from \$4.12 per BOE to \$4.55 per BOE. Operating expenses of Trend wells are generally lower on a BOE basis in the early stages of production since a large portion of the operating expenses are fixed in nature and do not vary with production volume. As production volumes decline, operating expenses per BOE typically increase. In addition, during 1995, the Company conducted most of its drilling activity in the updip area of the Trend where the reservoir pressures are lower. Generally, this requires wells to be converted from flowing wells to electric-powered pumping units at an earlier stage of production, which increases the lifting costs associated with the updip wells.

Effective October 1, 1995, the Company adopted SFAS 121, and recorded a \$10.3 million non-cash provision for impairment of certain producing assets. Substantially all of the impaired assets are located in the Pearsall Field in the Trend.

DD&A expense remained constant from 1994 to 1995, despite a 4% decline in production, due to slightly higher amortization rates per BOE. Under the successful efforts method of accounting, costs of oil and gas properties are amortized on a unit-of-production method based on estimated proved reserves. The effects on amortization rates of a 15% downward revision of estimated proved reserves at December 31, 1994 were substantially offset by the adoption of SFAS 121, which reduced DD&A rates on the impaired properties.

G&A expenses decreased 35% from \$5.7 million in 1994 to \$3.7 million in 1995. Since March 1994, the Company has reduced its overhead by implementing certain cost reduction measures, including the closing of its San Antonio office, the elimination or reduction of certain professional services, and the control of personnel costs through staff and wage reductions and employee benefit cost controls. The benefit of these measures was fully realized in 1995.

Exploration costs decreased 77% from \$7.1 million in 1994 to \$1.6 million in 1995 due primarily to provisions for dry hole costs, impairments of unproved properties and seismic expenses in 1994 related to the Company's acreage in the Sabine Area of the Trend, its Argentina venture and its West and North Central Texas 3-D seismic program which did not recur in 1995.

Costs of natural gas services increased 6% from \$3.5 million in 1994 to \$3.7 million in 1995 despite the sale in August 1995 of the Company's two principal gas gathering and processing systems. The reduction in costs related to the assets sold was more than offset by the fact that one of the systems sold was acquired effective January 1995 and did not contribute to costs in 1994.

INTEREST EXPENSE AND OTHER

Interest expense increased 22% from \$4.5 million in 1994 to \$5.5 million in 1995 due primarily to higher average interest rates on the Credit Facility. The effective annual interest rate on bank debt during 1995 was 10.6% compared to 8.7% in 1994. Proceeds from the sale of certain natural gas gathering and processing systems in August 1995 and the sale of Common Stock pursuant to a rights offering in September 1995 resulted in a slight reduction in average levels of bank debt in 1995. The average daily principal balance outstanding on bank debt during 1995 was \$52.3 million compared to \$52.6 million in 1994.

Other income increased from \$800,000 in 1994 to \$6 million in 1995. In August 1995, the Company sold certain gas gathering assets for aggregate net proceeds of \$7.7 million, resulting in a combined gain on sale of property and equipment of \$6 million, net to the Company.

LIQUIDITY AND CAPITAL RESOURCES

OVERVIEW

The Company's primary financial resource is its oil and gas reserves. In accordance with the terms of the Credit Facility, the banks establish a borrowing base, as derived from the estimated value of the Company's oil and gas properties, against which the Company may borrow funds as needed to supplement its internally generated cash flow as a source of financing for its capital expenditure program. Product prices, over which the Company has very limited control, have a significant impact on such estimated value and thereby on the Company's borrowing availability under the Credit Facility. Within the confines of product pricing, the Company must be able to find and develop or acquire oil and gas reserves in a cost effective manner in order to generate sufficient financial resources through internal means to complete the financing of its capital expenditure program.

The following discussion sets forth the Company's current plans for capital expenditures in 1998, and the expected capital resources needed to finance such plans.

CAPITAL EXPENDITURES

In April 1998, the Company plans to indefinitely suspend its Trend drilling activities pending an improvement in oil prices, which have fallen to their lowest levels in four years. Through the first quarter of 1998, the Company will have spent approximately \$3.5 million on Trend leasing and drilling activities, and, depending on the duration of the suspension, may spend up to \$18 million in the Trend during 1998.

During 1998, the Company plans to spend approximately \$9 million on the Cotton Valley Exploratory Project to complete the interpretation of its 3-D seismic survey, extend and renew existing leases as required, and drill an exploratory well on one of the Cotton Valley Pinnacle Reef prospects generated by such survey. In addition, the Company plans to spend \$9 million in 1998 on other exploration projects in south Texas, Louisiana and Mississippi. The incurrence of such costs may adversely affect the Company's results of operations in 1998 (see "RESULTS OF OPERATIONS - 1997 COMPARED TO 1996 - COSTS AND EXPENSES").

Substantially all of the planned 1998 activity is discretionary. This allows the Company to make adjustments to its level of capital and exploratory expenditures based upon such factors as the availability of capital resources, product prices and drilling results. Thus, if the Company's ability or desire to conduct the planned activities is diminished or enhanced by any of these factors, the Company can modify its expenditures accordingly.

The Company does not have any specified amounts of capital expenditures designated for acquisitions of proven properties in 1998. However, the Company plans to actively seek and evaluate acquisition opportunities and will commit only to those acquisitions which the Company can adequately finance through internal and external sources.

CAPITAL RESOURCES

CREDIT FACILITY

The Credit Facility provides for a revolving loan facility in an amount not to exceed the lesser of the borrowing base, as established by the banks, or that portion of the borrowing base determined by the Company to be the elected borrowing limit. At December 31, 1997, the elected borrowing limit was \$50 million, and the available credit on the revolving facility was \$14.3 million. The borrowing base is scheduled for redetermination in May 1998, at which time the Company may elect a higher borrowing limit, if such an increase in borrowing capacity is both needed and available. The Company intends to use such borrowing capacity, together with internally generated funds, to finance its 1998 planned capital expenditure program.

WORKING CAPITAL AND CASH FLOW

During 1997, the Company generated cash flow from operating activities of \$39.3 million and borrowed \$17.7 million on the Credit Facility. During the same period, the Company spent \$56.2 million on capital expenditures and \$1.5 million to acquire shares of its common stock for treasury.

The Company's working capital deficit increased from \$3.4 million at December 31, 1996 to \$6.4 million at December 31, 1997 due primarily to a net increase in current liabilities attributable to increased levels of drilling, leasing and exploration activities. The Company applies most of its available cash toward the repayment of the Credit Facility. Since all outstanding indebtedness on the Credit Facility is classified as a noncurrent liability, the timing of receipts and disbursements can cause reported working capital to fluctuate as it did from December 31, 1996 to December 31, 1997. However, working capital will increase as funds are advanced on the Credit Facility to finance the Company's capital expenditure program.

The Company believes that the funds available under the Credit Facility and cash provided by operations will be adequate to fund the Company's operations and projected capital and exploratory expenditures during 1998. However, because future cash flows and the availability of borrowings are subject to a number of variables, such as the level of production from existing wells, the Company's success in locating and producing new reserves, prevailing prices of oil and gas, and the uncertainty with respect to the amount of funds which may ultimately be required to finance the Company's exploration program, there can be no assurance that the Company's capital resources will be sufficient to sustain the Company's exploratory and development activities. If such capital resources are insufficient, the Company may be required to cease or delay such activities.

INFLATION AND CHANGES IN PRICES

The Company's revenues and the value of its oil and gas properties have been and will continue to be affected by changes in oil and gas prices. The Company's ability to maintain adequate borrowing capacity and to obtain additional capital on attractive terms is also substantially dependent on oil and gas prices. Oil and gas prices are subject to significant seasonal and other fluctuations that are beyond the Company's ability to control or predict. In an attempt to manage this price risk, the Company from time to time engages in hedging transactions.

Although certain of the Company's costs and expenses are affected by the level of inflation, inflation did not have a significant effect on the Company's results of operations during 1998.

HEDGING TRANSACTIONS

From time to time, the Company has utilized hedging transactions with respect to a portion of its oil and gas production to achieve a more predictable cash flow, as well as to reduce its exposure to price fluctuations. While the use of these hedging arrangements limits the downside risk of price declines, such use may also limit any benefits which may be derived from price increases.

The Company uses various financial instruments, such as swaps and collars, whereby monthly settlements are based on differences between the prices specified in the instruments and the settlement prices of certain futures contracts quoted on the NYMEX or certain other indices. Generally, when the applicable settlement price is less than the price specified in the contract, the Company receives a settlement from the counterparty based on the difference. Similarly, when the applicable settlement price is higher than the specified price, the Company pays the counterparty based on the difference. The instruments utilized by the Company differ from futures contracts in that there is not a contractual obligation which requires or allows for the future physical delivery of the hedged products.

The Company has entered into swap arrangements for 1,780,000 barrels of oil production for the period from January 1998 through December 1998 at an average price of \$19.61. In addition, the Company has hedged 570,000 MMBtu of its gas production from January 1998 through March 1998 under collar arrangements with average floor prices of \$2.92 and average ceiling prices of \$3.26, and has hedged 1,140,000 MMBtu from April 1998 through September 1998 at an average price of \$2.08.

YEAR 2000 COMPLIANCE

The Company has developed a plan to ensure its systems are compliant with the requirements to process transactions in the year 2000 and beyond. The costs associated with final compliance are expected to be minimal.

ITEM 8 - FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

For the financial statements and supplementary data required by this Item 8, see the Index to Consolidated Financial Statements included elsewhere in this Form 10-K.

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

None.

PART III

ITEM 10 - DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

The Information required by this Item is incorporated herein by reference to the Company's definitive proxy statement which will be filed with the Commission within 120 days after December 31, 1997.

ITEM 11 - EXECUTIVE COMPENSATION

The information required by this Item is incorporated herein by reference to the Company's definitive proxy statement which will be filed with the Commission within 120 days after December 31, 1997.

ITEM 12 - SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The information required by this Item is incorporated herein by reference to the Company's definitive proxy statement which will be filed with the Commission within 120 days after December 31, 1997.

ITEM 13 - CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

The information required by this Item is incorporated herein by reference to the Company's definitive proxy statement which will be filed with the Commission within 120 days after December 31, 1997.

PART IV

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

FINANCIAL STATEMENTS AND SCHEDULES

For a list of the consolidated financial statements filed as part of this Form 10-K, see the Index to Consolidated Financial Statements on page F-1.

No financial statement schedules are required to be filed as a part of this Form 10-K.

REPORTS ON FORM 8-K

No reports on Form 8-K were filed during the quarter ended December 31, 1997.

EXHIBITS

EXHIBIT NUMBER	DESCRIPTION OF EXHIBIT
**3.1	Second Restated Certificate of Incorporation of the Company, filed as an exhibit to the Form S-2 Registration Statement, Registration No. 333-13441
**3.2	Bylaws of the Company, filed as an exhibit to the Form S-1 Registration Statement, Registration No. 33-43350
**10.1	Fifth Restated Loan Agreement dated as of July 18, 1996, among Clayton Williams Energy, Inc., Warrior Gas Co., CWEI Acquisitions, Inc., Bank One, Texas, N.A., Banque Paribas and the First National Bank of Chicago, filed as an exhibit to the June 30, 1996 Form 10-Q
**10.2	First Amendment to Fifth Restated Loan Agreement dated December 31, 1996, among Clayton Williams Energy, Inc., Warrior Gas Co., CWEI Acquisitions, Inc., Bank One, Texas, N.A., Banque Paribas and the First National Bank of Chicago, filed as an exhibit to the December 31, 1996 Form 10-K
**10.3	1993 Stock Compensation Plan, filed as an exhibit to the Form S-8 Registration Statement, Registration No. 33-68318
**10.4	First Amendment to 1993 Stock Compensation Plan, filed as an exhibit to the December 31, 1995 Form 10-K
**10.5	Second Amendment to the 1993 Stock Compensation Plan, filed as an exhibit to the Form S-8 Registration Statement, Registration No. 33-68318
**10.6	Outside Directors Stock Option Plan, filed as an exhibit to the Form S-8 Registration Statement, Registration No. 33-68316
**10.7	First Amendment to Outside Directors Stock Option Plan, filed as an exhibit to the December 31, 1995 Form 10-K
**10.8	Bonus Incentive Plan, filed as an exhibit to the Form S-8 Registration Statement, Registration No. 33-68320
*10.9	First Amendment to Bonus Incentive Plan
**10.10	Amended and Restated 401(k) Plan & Trust, filed as an exhibit to the December 31, 1995 Form 10-K

EXHIBIT NUMBER	DESCRIPTION OF EXHIBIT
**10.11	Second Amendment to Amended and Restated 401(k) Plan & Trust, filed as an exhibit to the December 31, 1995 Form 10-K
**10.12	Third Amendment to Amended and Restated 401(k) Plan & Trust, filed as an exhibit to the December 31, 1995 Form 10-K
**10.13	Executive Incentive Stock Compensation Plan, filed as an exhibit to the Form S-8 Registration Statement, Registration No. 33-92834
**10.14	First Amendment to Executive Incentive Stock Compensation Plan, filed as an exhibit to the December 31, 1996 Form 10-K
**10.15	Consolidation Agreement dated May 13, 1993 among Clayton Williams Energy, Inc., Warrior Gas Co. and the Williams Entities, filed as an exhibit to the Form S-1 Registration Statement, Registration No. 33-43350
**10.16	Agreement dated April 23, 1993 between the Company and Robert C. Lyon, filed as an exhibit to the Form S-1 Registration Statement, Registration No. 33-43350
**10.17	Service Agreement effective October 1, 1995 among Clayton Williams Energy, Inc. and certain Williams Entities, filed as an exhibit to the December 31, 1995 Form 10-K
**21	Subsidiaries of the Registrant, filed as an exhibit to the December 31, 1996 Form 10-K
*23.1	Consent of Arthur Andersen LLP
*23.2	Consent of Williamson Petroleum Consultants, Inc.
*24.1	Power of Attorney
*24.2	Certified copy of resolution of Board of Directors of Clayton Williams Energy, Inc. authorizing signature pursuant to Power of Attorney
*27.1	Financial Data Schedules for the year ended December 31, 1997
*27.2	Restated Financial Data Schedules for the years ended December 31, 1995 and 1996, and the quarters ended March 31, 1996, June 30, 1996 and September 30, 1996
*27.3	Restated Financial Data Schedules for the quarters ended March 31, 1996, June 30, 1996 and September 30, 1996

* Filed herewith ** Incorporated by reference to the filing indicated

SIGNATURES

In accordance with 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.

CLAYTON WILLIAMS ENERGY, INC. (Registrant)

By: /s/ CLAYTON W. WILLIAMS, JR. *

Clayton W. Williams, Jr.
Chairman of the Board, President
and Chief Executive Officer

In accordance with the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Signature	Title	Date
----- /s/ CLAYTON W. WILLIAMS, JR. * ----- Clayton W. Williams, Jr.	Chairman of the Board, President and Chief Executive Officer and Director	March 20, 1998
----- /s/ L. PAUL LATHAM ----- L. Paul Latham	Executive Vice President, Chief Operating Officer and Director	March 20, 1998
----- /s/ MEL G. RIGGS * ----- Mel G. Riggs	Senior Vice President - Finance, Secretary, Treasurer, Chief Financial Officer and Director	March 20, 1998
----- /s/ STANLEY S. BEARD * ----- Stanley S. Beard	Director	March 20, 1998
----- /s/ WILLIAM P. CLEMENTS, JR. * ----- William P. Clements, Jr.	Director	March 20, 1998
----- /s/ ROBERT L. PARKER * ----- Robert L. Parker	Director	March 20, 1998
* By: /s/ L. PAUL LATHAM ----- L. Paul Latham ATTORNEY-IN-FACT		

CLAYTON WILLIAMS ENERGY, INC.

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REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To the Board of Directors of
Clayton Williams Energy, Inc.:

We have audited the accompanying consolidated balance sheets of Clayton Williams Energy, Inc. as of December 31, 1997 and 1996, and the related consolidated statements of operations, stockholders' equity and cash flows for each of the three years in the period ended December 31, 1997. 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 in accordance with generally accepted auditing standards. Those standards 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. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Clayton Williams Energy, Inc. as of December 31, 1997 and 1996, and the results of its operations and cash flows for each of the three years in the period ended December 31, 1997, in conformity with generally accepted accounting principles.

As discussed in Note 9, effective October 1, 1995, the Company adopted Statement of Financial Accounting Standards No. 121 "Accounting for Impairment of Long-Lived Assets and Long-Lived Assets to Be Disposed Of."

ARTHUR ANDERSEN LLP

Dallas, Texas
February 27, 1998

CLAYTON WILLIAMS ENERGY, INC.
CONSOLIDATED BALANCE SHEETS
(DOLLARS IN THOUSANDS)

ASSETS

	DECEMBER 31,	
	1997	1996
CURRENT ASSETS		
Cash and cash equivalents.....	\$ 2,150	\$ 2,479
Accounts receivable:		
Trade, net.....	4,197	1,876
Affiliates.....	173	92
Oil and gas sales.....	9,126	10,440
Inventory.....	2,530	518
Other.....	1,243	557
	-----	-----
	19,419	15,962
	-----	-----
PROPERTY AND EQUIPMENT		
Oil and gas properties, successful efforts method....	412,352	354,532
Natural gas gathering and processing systems.....	7,869	7,655
Other	10,411	9,547
	-----	-----
	430,632	371,734
	-----	-----
Less accumulated depreciation, depletion and amortization.....	(315,559)	(284,173)
	-----	-----
Property and equipment, net.....	115,073	87,561
	-----	-----
OTHER ASSETS.....	70	75
	-----	-----
	\$134,562	\$103,598
	-----	-----

LIABILITIES AND STOCKHOLDERS' EQUITY

CURRENT LIABILITIES		
Accounts payable:		
Trade.....	\$ 16,480	\$ 10,233
Affiliates.....	603	615
Oil and gas sales.....	7,679	7,454
Current maturities of long-term debt.....	42	112
Accrued liabilities and other.....	984	970
	-----	-----
	25,788	19,384
	-----	-----
LONG-TERM DEBT.....	35,700	18,000
	-----	-----
COMMITMENTS AND CONTINGENCIES		
STOCKHOLDERS' EQUITY:		
Preferred stock, par value \$.10 per share; authorized - 3,000,000 shares; issued and outstanding - none.....	-	-
Common stock, par value \$.10 per share; authorized - 15,000,000 shares; issued - 8,980,539 shares in 1997 and 8,927,658 shares in 1996.....	898	893
Additional paid-in capital.....	70,856	70,248
Retained earnings (deficit).....	2,840	(4,927)
	-----	-----
	74,594	66,214
Less treasury stock, at cost (95,000 shares in 1997)	(1,520)	-
	-----	-----
	73,074	66,214
	-----	-----
	\$134,562	\$103,598
	-----	-----

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

CLAYTON WILLIAMS ENERGY, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(IN THOUSANDS, EXCEPT PER SHARE)

	YEAR ENDED DECEMBER 31,		
	1997	1996	1995
REVENUES			
Oil and gas sales.....	\$70,929	\$60,610	\$43,883
Natural gas services.....	4,559	4,281	5,388
Total revenues.....	75,488	64,891	49,271
COSTS AND EXPENSES			
Lease operations.....	16,205	14,776	13,533
Exploration:			
Abandonments and impairments.....	2,692	597	1,472
Seismic and other.....	7,629	1,036	83
Natural gas services.....	3,955	3,437	3,714
Depreciation, depletion and amortization...	31,273	23,758	25,110
Impairment of property and equipment.....	236	1,186	10,259
General and administrative.....	4,181	3,266	3,708
Total costs and expenses.....	66,171	48,056	57,879
Operating income (loss).....	9,317	16,835	(8,608)
OTHER INCOME (EXPENSE)			
Interest expense.....	(1,767)	(3,440)	(5,493)
Other.....	217	335	6,022
Total other income (expense).....	(1,550)	(3,105)	529
INCOME (LOSS) BEFORE INCOME TAXES.....	7,767	13,730	(8,079)
INCOME TAX EXPENSE			
Current.....	-	-	-
Deferred.....	-	-	-
Total income tax expense.....	-	-	-
NET INCOME (LOSS).....	\$ 7,767	\$13,730	\$(8,079)
Net income (loss) per common share:			
Basic.....	\$.87	\$ 1.80	\$(1.31)
Diluted.....	\$.85	\$ 1.76	\$(1.31)
Weighted average common shares outstanding:			
Basic.....	8,888	7,624	6,165
Diluted.....	9,094	7,800	6,165

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

CLAYTON WILLIAMS ENERGY, INC.
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(IN THOUSANDS)

	COMMON STOCK		ADDITIONAL PAID-IN CAPITAL	RETAINED EARNINGS (DEFICIT)	TREASURY STOCK	TOTAL
	NO. OF SHARES	PAR VALUE				
BALANCE, December 31, 1994.....	5,700	\$570	\$48,934	\$(10,578)	\$ -	\$38,926
Sale of stock through rights offering, net of offering costs.....	1,599	160	3,648	-	-	3,808
Issuance of stock through compensation plans.....	111	11	330	-	-	341
Net loss.....	-	-	-	(8,079)	-	(8,079)
BALANCE, December 31, 1995.....	7,410	741	52,912	(18,657)	-	34,996
Sale of stock through secondary public offering, net of offering costs.....	1,428	143	16,874	-	-	17,017
Issuance of stock through compensation plans.....	90	9	462	-	-	471
Net income.....	-	-	-	13,730	-	13,730
BALANCE, December 31, 1996.....	8,928	893	70,248	(4,927)	-	66,214
Repurchase of common stock for treasury.....	-	-	-	-	(1,520)	(1,520)
Issuance of stock through compensation plans.....	53	5	608	-	-	613
Net income.....	-	-	-	7,767	-	7,767
BALANCE, December 31, 1997.....	8,981	\$898	\$70,856	\$ 2,840	\$(1,520)	\$73,074

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

CLAYTON WILLIAMS ENERGY, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(IN THOUSANDS)

	YEAR ENDED DECEMBER 31,		
	1997	1996	1995
CASH FLOWS FROM OPERATING ACTIVITIES			
Net income (loss).....	\$7,767	\$ 13,730	\$ (8,079)
Adjustments to reconcile net income (loss) to cash provided by operating activities:			
Depreciation, depletion and amortization.....	31,273	23,758	25,110
Impairment of property and equipment.....	236	1,186	10,259
Exploration costs.....	2,692	597	1,472
Gain on sales of property and equipment.....	(155)	(293)	(5,978)
Other.....	582	445	341
Changes in operating working capital:			
Accounts receivable.....	(1,088)	(3,871)	121
Accounts payable.....	766	4,824	737
Other.....	(2,749)	(70)	220
Net cash provided by operating activities.....	39,324	40,306	24,203
CASH FLOWS FROM INVESTING ACTIVITIES			
Additions to property and equipment.....	(56,167)	(33,100)	(20,433)
Proceeds from sales of property and equipment.....	303	3,862	7,950
Net cash used in investing activities.....	(55,864)	(29,238)	(12,483)
CASH FLOWS FROM FINANCING ACTIVITIES			
Proceeds from long-term debt.....	17,700	-	-
Repayments of long-term debt.....	-	(26,935)	(15,656)
Repurchase of common stock for treasury.....	(1,520)	-	-
Proceeds from sale of common stock.....	31	17,043	3,808
Net cash provided by (used in) financing activities.....	16,211	(9,892)	(11,848)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS.....			
Beginning of period.....	2,479	1,303	1,431
End of period.....	\$ 2,150	\$ 2,479	\$ 1,303
SUPPLEMENTAL DISCLOSURES			
Cash paid for interest, net of amounts capitalized.....	\$ 1,668	\$ 3,434	\$ 5,613

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

CLAYTON WILLIAMS ENERGY, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. ORGANIZATION AND PRESENTATION

Clayton Williams Energy, Inc. (the "Company"), a Delaware corporation, was incorporated in September 1991 for the purpose of consolidating and continuing certain operations previously conducted by affiliates of Clayton W. Williams, Jr. ("Mr. Williams"). Concurrent with the completion of the initial public offering of the Company's common stock on May 26, 1993, these operations were consolidated, and the Company succeeded to most of the oil and gas properties, exploration and development operations and the natural gas gathering and marketing operations of Mr. Williams and his affiliates.

The Company is primarily engaged in the exploration for and development and production of oil and natural gas in South and East Texas, Southeastern New Mexico and the Texas Gulf Coast.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

ESTIMATES AND ASSUMPTIONS

The preparation of financial statements in conformity with generally accepted accounting principles requires management of the Company 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 reporting period. Actual results could differ from those estimates.

PRINCIPLES OF CONSOLIDATION

The consolidated financial statements include the accounts of Clayton Williams Energy, Inc. and its subsidiaries (collectively, the "Company"). The Company accounts for its interests in joint ventures and partnerships (all of which are undivided) using the proportionate consolidation method, whereby its share of assets, liabilities, revenues and expenses are consolidated with other operations. All significant intercompany transactions and balances associated with the consolidated operations have been eliminated.

OIL AND GAS PROPERTIES

The Company follows the successful efforts method of accounting for its oil and gas properties, whereby costs of productive wells, developmental dry holes and productive leases are capitalized and amortized using the unit-of-production method based on estimated proved reserves. Sales proceeds from sales of individual properties are credited to property costs. No gain or loss is recognized until the entire amortization base is sold or abandoned.

Costs of acquisition of leaseholds are capitalized. Unproved oil and gas properties with individually significant acquisition costs are periodically assessed and any impairment in value is charged to exploration costs. The amount of impairment recognized on unproved properties which are not individually significant is determined by amortizing the costs of such properties within appropriate groups based on the Company's historical experience, acquisition dates and average lease terms. The costs of unproved properties which are determined to hold proved reserves are transferred to proved oil and gas properties.

Exploration costs, including geological and geophysical expenses and delay rentals, are charged to expense as incurred. Exploratory drilling costs, including the cost of stratigraphic test wells, are initially capitalized but charged to exploration expense if and when the well is determined to be unsuccessful.

NATURAL GAS AND OTHER PROPERTY AND EQUIPMENT

Natural gas gathering and processing systems consist primarily of gas gathering pipelines, compressors and gas processing plants. Other property and equipment consists primarily of field equipment and facilities, office equipment, leasehold improvements and vehicles. Major renewals and betterments are

CLAYTON WILLIAMS ENERGY, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

capitalized while the costs of repairs and maintenance are charged to expense as incurred. The costs of assets retired or otherwise disposed of and the applicable accumulated depreciation are removed from the accounts, and any gain or loss is included in other income in the accompanying consolidated statements of operations.

Depreciation of natural gas gathering and processing systems and other property and equipment is computed on the straight-line method over the estimated useful lives of the assets, which range from 3 to 32 years.

VALUATION OF PROPERTY AND EQUIPMENT

The Company follows the provisions of Statement of Financial Accounting Standards No. 121 "Accounting for Impairment of Long-Lived Assets" ("SFAS 121"), which requires that the Company's long-lived assets, including its oil and gas properties, be assessed for potential impairment in their carrying values whenever events or changes in circumstances indicate such impairment may have occurred.

INCOME TAXES

The Company follows the asset and liability method prescribed by Statement of Financial Accounting Standards No. 109 "Accounting for Income Taxes" ("SFAS 109"). Under this method of accounting for income taxes, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. Under SFAS 109, the effect on deferred tax assets and liabilities of a change in enacted tax rates is recognized in income in the period that includes the enactment date.

INVENTORY

Inventory consists primarily of tubular goods and other well equipment which the Company plans to utilize in its ongoing exploration and development activities and is carried at the lower of cost or market value.

CAPITALIZATION OF INTEREST

Interest costs associated with maintaining the Company's inventory of unproved oil and gas properties are capitalized. During the years ended December 31, 1997, 1996 and 1995, the Company capitalized interest totaling approximately \$346,000, \$68,000 and \$85,000, respectively.

STATEMENTS OF CASH FLOWS

The Company considers all highly liquid investments with original maturities of three months or less to be cash equivalents.

NET INCOME (LOSS) PER COMMON SHARE

The Company computes net income (loss) per common share in accordance with Statement of Financial Accounting Standards No. 128 "Earnings Per Share" ("SFAS 128"). Basic net income (loss) per common share is based on the weighted average number of common shares outstanding during each period. Diluted net income (loss) per share gives further effect to the additional dilution, if any, related to outstanding employee stock options.

STOCK-BASED COMPENSATION

The Company accounts for stock-based compensation utilizing the intrinsic value method prescribed by Accounting Principles Board Opinion No. 25 "Accounting for Stock Issued to Employees" ("APB 25").

CLAYTON WILLIAMS ENERGY, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

REVENUE RECOGNITION AND GAS BALANCING

The Company utilizes the sales method of accounting for natural gas revenues whereby revenues are recognized based on the amount of gas sold to purchasers. The amount of gas sold may differ from the amount to which the Company is entitled based on its revenue interests in the properties. The Company did not have any significant imbalance positions at December 31, 1997, 1996 or 1995.

3. LONG-TERM DEBT

Long-term debt consists of the following:

	DECEMBER 31,	
	1997	1996
	(IN THOUSANDS)	
Secured Bank Credit Facility (matures July 31, 1999)...	\$35,700	\$18,000
Other.....	42	112
	35,742	18,112
Less current maturities.....	42	112
	\$35,700	\$18,000

Aggregate maturities of long-term debt at December 31, 1997 are as follows: 1998 - \$42,000; and 1999 - \$35,700,000.

SECURED BANK CREDIT FACILITY

The Company's secured bank credit facility provides for a revolving loan facility in an amount not to exceed the lesser of the borrowing base, as established by the banks, or that portion of the borrowing base determined by the Company to be the elected borrowing limit. At December 31, 1997, the elected borrowing limit was \$50 million, and the available credit on the revolving facility was \$14.3 million. The borrowing base is scheduled to be redetermined in May 1998 and at least semi-annually thereafter; however, either the Company or the banks may request a borrowing base redetermination at any other time during the year. Any redetermination will be made at the discretion of the banks. If, at any time, outstanding advances plus letters of credit exceed the borrowing base, the Company will be required to (i) pledge additional collateral, (ii) prepay the excess in not more than five equal monthly installments or (iii) elect to convert the entire amount of the facility to a term obligation based on amortization formulas set forth in the loan agreement. Substantially all of the Company's oil and gas properties are pledged to secure advances under the secured bank credit facility.

All outstanding balances on the secured bank credit facility may be designated, at the Company's option, as either "Base Rate Loans" or "Eurodollar Loans" (as defined in the loan agreement), provided that not more than two Eurodollar tranches may be outstanding at any time. Base Rate Loans will bear interest at the fluctuating Base Rate plus a Base Rate Margin ranging from 0% to 3/8% per annum, depending on levels of outstanding advances and letters of credit. Eurodollar Loans will bear interest at the LIBOR rate for a fixed period of time elected by the Company plus a Eurodollar Margin ranging from 1% to 1.75% per annum. At December 31, 1997, all of the Company's indebtedness under the Credit Facility consisted of \$5.7 million of Base Rate Loans at a rate of 8.8% and \$30 million of Eurodollar Loans at a rate of 7.5%.

In addition, the Company pays the banks a commitment fee equal to 1/4% per annum on the unused portion of the revolving loan commitment. Interest on the revolving loan and commitment fees are payable quarterly, and all outstanding principal and interest will be due July 31, 1999.

The loan agreement requires the Company to maintain financial ratios covering working capital, cash flow and net tangible assets. The Company was in compliance with all covenants at December 31, 1997.

CLAYTON WILLIAMS ENERGY, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

4. STOCKHOLDERS' EQUITY

In September 1995, the Company received \$3,808,000, net of offering costs of \$93,000, from the sale of 1,598,971 shares of common stock at a price of \$2.44 per share pursuant to a registered rights offering made to stockholders of record on August 18, 1995. Proceeds from the offering were used to repay indebtedness on the secured bank credit facility.

In November 1996, the Company received \$17,017,000, net of underwriters discounts and other offering costs totaling \$1,541,000, from the sale of 1,427,500 shares of common stock to the public at a price of \$13.00. Proceeds from the offering were used to repay indebtedness on the secured bank credit facility.

In January 1997, the Company's Board of Directors authorized the Company to spend up to \$2 million in 1997 to repurchase shares of its common stock on the open market. As of December 31, 1997, the Company had purchased 95,000 shares at a cost of \$1,520,000.

5. EARNINGS PER SHARE

In 1997, the Company adopted SFAS 128, which changes the method of computing and disclosing earnings per share for periods ending after December 15, 1997. In accordance with SFAS 128, basic earnings per common share was computed by dividing net income (loss) by the weighted average number of shares of common stock outstanding during the period. Diluted earnings per common share was computed by including the dilutive effect, if any, of outstanding employee stock options utilizing the treasury stock method. All prior periods have been restated to give effect to the adoption of SFAS 128, the impact of which was immaterial. For all periods presented, the differences between basic shares and diluted shares were attributable to the dilutive effect of employee stock options.

6. STOCK COMPENSATION PLANS

1993 PLAN

The Company has reserved 898,200 shares of common stock for issuance under the 1993 Stock Compensation Plan ("1993 Plan"). The 1993 Plan provides for the issuance of nonqualified stock options with an exercise price which is not less than the market value of the Company's common stock on the date of grant. All options granted through December 31, 1997 expire 10 years from the date of grant and become exercisable based on varying vesting schedules.

CLAYTON WILLIAMS ENERGY, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following table reflects activity in the 1993 Plan for 1997, 1996 and 1995.

	1997		1996		1995	
	SHARES	WEIGHTED AVERAGE PRICE	SHARES	WEIGHTED AVERAGE PRICE	SHARES	WEIGHTED AVERAGE PRICE
Beginning of year.....	458,766	\$8.46	151,601	\$2.45	149,101	\$7.25
Granted (a).....	210,700	\$15.36	321,500	\$11.03	149,101	\$2.38
Exercised.....	(12,791)	\$2.53	(10,410)	\$2.38	-	-
Forfeited.....	(24,406)	\$5.53	(3,925)	\$2.82	(18,540)	\$7.25
Cancelled (b).....	-	-	-	-	(128,061)	\$7.25
End of year.....	632,269	\$10.99	458,766	\$8.46	151,601	\$2.45
Exercisable.....	194,357	\$6.00	104,449	\$2.47	75,800	\$2.45
Issuable.....	265,931		439,434		146,599 (c)	

(a) In addition to the reissuances described in note (b), the Company granted new options as follows: 1997 - 48,700 shares at \$14.00 per share, 12,000 shares at \$14.44 per share, and 150,000 shares at \$15.88 per share; 1996 - 121,500 shares at \$3.25 per share and 200,000 shares at \$15.75 per share; and 1995 - 21,040 shares at \$2.38 per share.

(b) In 1995, the Company exchanged options to purchase 128,061 shares granted in 1994 at an option price of \$7.25 per share for an equal number of options at an option price of \$2.38 per share.

(c) At December 31, 1995, the Company had 298,200 shares reserved for issuance under the 1993 Plan.

DIRECTORS PLAN

The Company has reserved 86,300 shares of common stock for issuance under the Outside Directors Stock Option Plan ("Directors Plan"). Since inception of the Directors Plan, the Company has issued options covering 15,000 shares of common stock (3,000 per year from 1993 through 1997) at option prices ranging from \$3.25 to \$18.50 per share. All options expire 10 years from the date of grant and are fully exercisable upon issuance. At December 31, 1997, options to purchase 15,000 shares were outstanding, and 71,300 shares remain available for future grants.

BONUS INCENTIVE PLAN

The Company has reserved 115,500 shares of common stock for issuance under the Bonus Incentive Plan. The plan provides that the Board of Directors each year may award bonuses in cash, common stock of the Company, or a combination thereof. In November 1997, cash awards totaling \$31,500 and stock awards totaling 9,310 shares of common stock at a market price of \$16.00 per share were granted to certain employees and officers. At December 31, 1997, 106,190 shares remain available for issuance under this plan.

STOCK COMPENSATION PLANS

In May 1995, the Company's Board of Directors adopted two stock compensation plans, one for selected officers and one for outside directors of the Company, permitting the Company to pay all or part of selected executives' salaries and all outside director's fees in shares of common stock in lieu of cash. The Company reserved an aggregate of 650,000 shares of common stock for issuance under these plans. During 1997 and 1996, the Company issued Mr. Williams 30,808 and 67,785 shares, respectively, of common stock in lieu of cash compensation aggregating \$421,000 and \$384,000, respectively, and issued 690 and 11,581 shares, respectively, to three outside directors in lieu of cash compensation aggregating \$12,000 and \$61,000, respectively. The amounts of such compensation are included in general and administrative expense in the accompanying consolidated financial statements. The Company terminated the outside directors stock compensation plan in January 1997.

CLAYTON WILLIAMS ENERGY, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

SUPPLEMENTAL DISCLOSURE

In October 1995, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 123 "Accounting for Stock-Based Compensation" ("SFAS 123"). SFAS 123 establishes a fair value method and disclosure standards for stock-based employee compensation arrangements, such as stock option plans. As permitted by SFAS 123, the Company has elected to continue following the provisions of APB 25 for such stock-based compensation, under which no compensation expense has been recognized. Had compensation expense for these plans been determined consistent with SFAS 123, the Company's net income (loss) and net income (loss) per share would have been as follows:

	1997	1996	1995
	(IN THOUSANDS, EXCEPT PER SHARE)		
Net income (loss):			
As reported.....	\$7,767	\$13,730	\$(8,079)
Pro forma.....	\$7,175	\$13,558	\$(8,170)
Net income (loss) per share:			
Basic:			
As reported.....	\$.87	\$1.80	\$(1.31)
Pro forma.....	\$.81	\$1.78	\$(1.33)
Diluted:			
As reported.....	\$.85	\$1.76	\$(1.31)
Pro forma.....	\$.79	\$1.74	\$(1.33)

SFAS 123 requires the use of option valuation models which were generally developed for use in estimating the fair value of traded options which have no vesting restrictions, are fully transferable and generally have shorter life expectancies. These valuation models also require the input of highly subjective assumptions, including the expected stock price volatility. Because the Company's stock option plans have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, in management's opinion, the existing models do not necessarily provide a reliable single measure of the fair value of its employee stock options.

For purposes of the above pro forma disclosures, the fair value of each option grant is estimated as of the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions for grants in 1997, 1996 and 1995, respectively: risk-free interest rates of 6.1%, 5.8% and 5.8%; dividend yields of 0%; volatility factors of the expected market price of the Company's common stock of .575, .561 and .411; and a life expectancy of each option of 7, 5.1 and 4.8 years.

7. TRANSACTIONS WITH AFFILIATES

During the periods presented, the Company and various entities controlled by Mr. Williams provided certain general and administrative services to one another. General and administrative expenses in the accompanying financial statements are net of charges by the Company to affiliates for services aggregating \$684,000, \$615,000 and \$772,000 for the years ended December 31, 1997, 1996 and 1995, respectively, and include charges to the Company by affiliates for rents and services aggregating \$200,000, \$235,000 and \$289,000 for the years ended December 31, 1997, 1996 and 1995, respectively.

Prior to October 1995, the Company owned a 90% interest in the Mentone gas plant constructed in 1993 to process gas from two wells in Loving County, Texas pursuant to a long-term contract. The two wells were substantially owned by entities controlled by Mr. Williams. Because the plant and the wells are

CLAYTON WILLIAMS ENERGY, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

largely dependent upon each other for their economic viability, the Company and the entities controlled by Mr. Williams contributed their respective interests in the plant and wells to a partnership effective October, 1995. After recoupment of certain workover costs borne by the original well owners, the Partnership was dissolved in 1996, and the Company received an undivided 45% interest in the wells, proportionately reduced to the original well owners' interests, and retained a 45% interest in the plant.

Accounts receivable from affiliates and accounts payable to affiliates include, among other things, amounts for charges whereby the Company is the operator of certain wells in which affiliates own an interest. These charges are on terms which are consistent with the terms offered to unaffiliated third parties which own interests in wells operated by the Company.

8. COMMITMENTS AND CONTINGENCIES

LEASES

The Company leases office space from affiliates and nonaffiliates under noncancelable operating leases. Rental expense pursuant to the office leases amounted to \$337,000, \$398,000 and \$453,000 for the years ended December 31, 1997, 1996 and 1995, respectively. Included in property and equipment are assets under capital leases aggregating \$33,000, \$133,000 and \$233,000 net of accumulated depreciation, at December 31, 1997, 1996 and 1995, respectively.

Future minimum payments under noncancelable leases at December 31, 1997, are as follows:

	CAPITAL LEASES	OPERATING LEASES
	(IN THOUSANDS)	
1998.....	\$43	\$ 506
1999.....	-	407
2000.....	-	349
Thereafter.....	-	369
	---	-----
Total minimum lease payments.....	43	\$1,631
	---	-----
Less amount representing interest.....	(1)	

Present value of net minimum lease payments.....	\$42	

CONCENTRATION OF CREDIT RISK

The Company's revenues are derived principally from uncollateralized sales to customers in the oil and gas industry. The concentration of credit risk in a single industry affects the Company's overall exposure to credit risk because customers may be similarly affected by changes in economic and other conditions. The Company has not experienced significant credit losses on such receivables.

HEDGING ACTIVITIES

From time to time, the Company utilizes forward sale and other financial option arrangements, such as swaps and collars, to reduce price risks on the sale of its oil and gas production. The Company accounts for such arrangements as hedging activities and, accordingly, records all realized gains and losses as oil and gas revenues in the period the hedged production is sold. Included in oil and gas revenues are gains totaling \$252,000 in 1997, net losses totaling \$1,156,000 in 1996 (comprised of losses of \$1,299,000 partially offset by gains of \$143,000), and \$342,000 in 1995 (comprised of losses of \$426,000 partially offset by gains of \$84,000). As of December 31, 1997, the Company had entered into swap arrangements for 1,780,000 barrels of oil production for the period from January 1998 through December 1998 at an average price of \$19.61. In addition, the Company has hedged 570,000 MMBtu of its gas production from January 1998 through March 1998 under collar arrangements with average floor prices of \$2.92 and average ceiling prices

CLAYTON WILLIAMS ENERGY, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

of \$3.26, and has hedged 1,140,000 MMBtu from April 1998 through September 1998 at an average price of \$2.08.

LEGAL PROCEEDINGS

The Company is a defendant in a suit styled The State of Texas, et al v. Union Pacific Resources Company et al, presently pending in Lee County, Texas. The suit attempts to establish a class action consisting of unidentified royalty and working interest owners throughout the State of Texas. Among other things, the plaintiffs are seeking actual and exemplary damages for alleged violation of various statutes relating to common carriers and common purchasers of crude oil including discrimination in the purchase of oil by giving preferential treatment to defendants' own oil and conspiring to keep the posted price or sales price of oil below market value. A general denial has been filed. Because the Company is neither a common purchaser nor common carrier of oil, management of the Company believes there is no merit to the allegations as they relate to the Company or its operations.

The Company is involved in various legal proceedings arising in the normal course of its business, including actions for which insurance coverage is available. While the ultimate results of these proceedings cannot be predicted with certainty, the Company does not believe that the outcome of any of these matters will have, individually or in the aggregate, a material adverse effect on its financial condition; however, they could have a material impact on results of operations in an annual or interim period.

9. IMPAIRMENT OF PROPERTY AND EQUIPMENT

Effective October 1, 1995, the Company adopted SFAS 121 and recorded a provision for impairment of property and equipment totaling \$10.3 million, of which \$9.1 million related to proved oil and gas properties and \$1.2 million related to gas gathering and processing systems. Substantially all of the impaired assets are located in the Pearsall Field of South Texas.

During 1996, the Company recorded an additional provision for impairment under SFAS 121 of \$1.2 million resulting from a revision in reserve estimates subsequent to December 31, 1995, attributable to a proved undeveloped location in the Texas Gulf Coast area.

During 1997, the Company recorded an additional provision for impairment under SFAS 121 of \$236,000 attributable to certain minor-value properties.

10. SALES OF ASSETS

In August 1995, XCEL Gas Company, a general partnership in which the Company owned a 77% interest, sold its interest in a gas gathering system, and the Company sold its 43% interest in the El Campo gas processing system, for aggregate net proceeds of \$7.7 million, resulting in a combined gain on sale of property and equipment of \$6.0 million, net to the Company. The Company used the proceeds from these sales to repay indebtedness on the secured bank credit facility.

In January 1996, the Company sold its rights to the Buda and Georgetown formations under approximately 28,000 net acres in Robertson County, Texas for \$3.5 million. The net proceeds were used to repay indebtedness on the secured bank credit facility. No gain or loss was recognized on the sale.

11. INCOME TAXES

Since the Consolidation discussed in Note 1, the Company has incurred net income for financial reporting purposes aggregating \$2.8 million and has recognized cumulative tax losses of approximately \$36 million which can be carried forward and used to offset future taxable income. Tax loss carryforwards

CLAYTON WILLIAMS ENERGY, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

begin to expire in 2008. Due to the uncertainty of realizing the related future benefits from tax loss carryforwards, valuation allowances have been recorded to the extent net deferred tax assets exceed net deferred tax liabilities at December 31, 1997, 1996 and 1995.

The tax effected temporary differences and tax loss carryforwards which comprise net deferred tax assets and liabilities are as follows:

	DECEMBER 31,		
	1997	1996	1995

	(IN THOUSANDS)		
Deferred tax assets (liabilities):			
Depreciable and depletable property....	\$(12,828)	\$(10,216)	\$(4,030)
Tax loss carryforwards.....	12,584	12,737	11,305
Other.....	936	929	912
Valuation allowance.....	(692)	(3,450)	(8,187)

Net deferred tax asset (liability)...	\$ -	\$ -	\$ -

The reductions in the valuation allowances reported above are based on improvements in financial results of the Company since 1995. All of the differences between the statutory income tax rates and the effective income tax rates are attributable to the change in the valuation allowance.

12. COSTS OF OIL AND GAS PROPERTIES

The following table sets forth certain information with respect to costs incurred in connection with the Company's oil and gas producing activities:

	YEAR ENDED DECEMBER 31,		
	1997	1996	1995

	(IN THOUSANDS)		
Property acquisitions:			
Proved.....	\$ -	\$ 1,375	\$ -
Unproved.....	14,042	5,002	2,254
Developmental costs.....	32,656	20,931	16,823
Exploratory costs.....	13,813	6,306	1,407

Total.....	\$60,511	\$33,614	\$20,484

The following table sets forth the capitalized costs for oil and gas properties:

	DECEMBER 31,	
	1997	1996

	(IN THOUSANDS)	
Proved properties.....	\$ 393,672	\$ 349,752
Unproved properties.....	18,680	4,780

Total capitalized costs.....	412,352	354,532
Accumulated depreciation, depletion and amortization.....	(300,569)	(269,961)

Net capitalized costs.....	\$ 111,783	\$ 84,571

CLAYTON WILLIAMS ENERGY, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

13. OIL AND GAS RESERVE INFORMATION (UNAUDITED)

The estimates of proved oil and gas reserves utilized in the preparation of the consolidated financial statements were prepared by independent petroleum engineers. Such estimates are in accordance with guidelines established by the Securities and Exchange Commission and the Financial Accounting Standards Board, which require that reserve reports be prepared under economic and operating conditions existing at the registrant's year end with no provision for price and cost escalations except by contractual arrangements. The Company's reserves are substantially located onshore in the United States.

The Company emphasizes that reserve estimates are inherently imprecise. Accordingly, the estimates are expected to change as more current information becomes available. In addition, a portion of the Company's proved reserves is undeveloped, which increases the imprecision inherent in estimating reserves which may ultimately be produced.

The following table sets forth proved oil and gas reserves together with the changes therein (oil in MBbls, gas in MMcf, gas converted to MBOE at one MBbl per six MMcf):

	YEAR ENDED DECEMBER 31,								
	1997			1996			1995		
	Oil	Gas	MBOE	Oil	Gas	MBOE	Oil	Gas	MBOE
Proved reserves									
Beginning of period	8,507	35,798	14,474	5,963	39,496	12,546	5,304	46,691	13,086
Revisions	(726)	1,020	(556)	457	(2,359)	64	98	(914)	(54)
Extensions and discoveries	3,532	1,134	3,721	4,077	113	4,096	2,392	564	2,486
Purchases of minerals-in-place	-	-	-	213	4,132	902	-	-	-
Production	(2,903)	(5,091)	(3,752)	(2,203)	(5,584)	(3,134)	(1,831)	(6,845)	(2,972)
End of period	8,410	32,861	13,887	8,507	35,798	14,474	5,963	39,496	12,546
Proved developed reserves									
Beginning of period	7,199	30,496	12,282	5,381	31,668	10,659	4,635	38,505	11,052
End of period	7,826	27,392	12,392	7,199	30,496	12,282	5,381	31,668	10,659

The standardized measure of discounted future net cash flows relating to proved reserves was as follows:

	DECEMBER 31,		
	1997	1996	1995
	(IN THOUSANDS)		
Future cash inflows	\$219,528	\$342,576	\$191,191
Future costs:			
Production	(67,207)	(93,359)	(55,626)
Development	(13,445)	(15,543)	(9,295)
Income taxes	(10,445)	(50,508)	(9,875)
Future net cash flows	128,431	183,166	116,395
10% discount factor	(36,028)	(47,453)	(27,565)
Standardized measure of discounted future net cash flows	\$ 92,403	\$135,713	\$ 88,830

CLAYTON WILLIAMS ENERGY, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Changes in the standardized measure of discounted future net cash flows relating to proved reserves were as follows:

	YEAR ENDED DECEMBER 31,		
	1997	1996	1995
	-----	-----	-----
		(IN THOUSANDS)	
Standardized measure, beginning of period	\$135,713	\$ 88,830	\$ 74,210
Net changes in sales prices, net of production costs	(49,024)	56,812	12,515
Revisions of quantity estimates	(4,376)	811	(383)
Accretion of discount	16,067	8,883	7,421
Changes in future development costs, including development costs incurred that reduced future development costs	8,622	5,713	3,777
Changes in timing and other	(874)	(887)	(3,460)
Net change in income taxes	17,442	(24,957)	-
Extensions and discoveries	23,557	38,703	25,100
Sales, net of production costs	(54,724)	(45,834)	(30,350)
Purchases of minerals-in-place	-	7,639	-
	-----	-----	-----
Standardized measure, end of period	\$ 92,403	\$135,713	\$ 88,830
	-----	-----	-----

INDEX TO EXHIBITS

EXHIBIT NUMBER	DESCRIPTION OF EXHIBIT
10.9	First Amendment to Bonus Incentive Plan
23.1	Consent of Arthur Andersen LLP
23.2	Consent of Williamson Petroleum Consultants, Inc.
24.1	Power of Attorney
24.2	Certified copy of resolution of Board of Directors of Clayton Williams Energy, Inc. authorizing signature pursuant to Power of Attorney
27.1	Financial Data Schedules for the year ended December 31, 1997
27.2	Restated Financial Data Schedules for the years ended December 31, 1995 and 1996, and the quarters ended March 31, 1996, June 30, 1996 and September 30, 1996
27.3	Restated Financial Data Schedules for the quarters ended March 31, 1997, June 30, 1997 and September 30, 1997

EXHIBIT 10.9

**FIRST AMENDMENT TO BONUS INCENTIVE PLAN OF
CLAYTON WILLIAMS ENERGY, INC.**

**ADOPTED BY THE BOARD OF DIRECTORS OF
CLAYTON WILLIAMS ENERGY, INC. ON NOVEMBER 12, 1997**

1. Section 6 of the Bonus Incentive Plan of Clayton Williams Energy, Inc. (the "Plan"), is hereby modified by deleting the first sentence of Section 6, and replacing such first sentence with the following:

Between November 1, of each Fiscal Year and February 28 of the following year, the Committee shall submit its recommendations to the Board of Directors with respect to (i) each participant, if any, the Committee has selected as a potential Beneficiary to receive an Award for such Fiscal Year, (ii) the proposed amount to each such Award, and (iii) whether each such Award should be paid in cash, in shares of Common Stock, or a combination thereof.

2. Section 7 of the Plan is hereby modified by deleting the first sentence of Section 7, and replacing such first sentence with the following:

Promptly upon receiving the recommendations of the Committee, but in no event later than February 28 of the year following the Fiscal Year under consideration, the Board of Directors shall determine (i) the Beneficiaries who will be entitled to receive Awards for such Fiscal Year, (ii) the amount of each such Award, and (iii) whether each such Award will be made in cash, shares of Common Stock or a combination thereof.

3. Except as expressly modified above, the Plan shall remain unchanged and in full force and effect.

EXHIBIT 23.1

CONSENT OF INDEPENDENT PUBLIC ACCOUNTANTS

As independent public accountants, we hereby consent to the incorporation of our report included in this Form 10-K into the Company's previously filed Registration Statements on Form S-8 File Numbers 33-68320, 33-68318, 33-68316, 33-69688, and 33-92834.

ARTHUR ANDERSEN LLP

Dallas, Texas
March 20, 1998

EXHIBIT 23.2

CONSENT OF INDEPENDENT ENGINEERS

As independent engineering consultants, we hereby consent to the use of our report entitled "Evaluation of Oil and Gas Reserves 1) to the Interests of Clayton Williams Energy, Inc. in Domestic Oil and Gas Properties and 2) to the Interests of Warrior Gas Company in the Gataga Gas Unit No. 5A, Vermejo (Ellenburger) Field, Loving County, Texas, Effective December 31, 1997, for Disclosure to the Securities and Exchange Commission, Utilizing Aries Software, Williamson Project 7.8548" dated March 6, 1998 and data extracted therefrom (and all references to our Firm) included in or made a part of this Form 10-K Annual Report to be filed on or about March 20, 1998 and to the incorporation by reference of this Form 10-K Annual Report (including the use of our report and references to our Firm herein) into those certain Registration Statements on Form S-8 filed by Clayton Williams Energy, Inc. with the Securities and Exchange Commission, file numbers 33-68320, 33-68318, 33-68316, 33-69688, and 33-92834 covering the Bonus Incentive Plan of Clayton Williams Energy, Inc., 1993 Stock Compensation Plan of Clayton Williams Energy, Inc., Outside Directors Stock Option Plan of Clayton Williams Energy, Inc., Clayton Williams Energy, Inc. 401(k) Plan & Trust, and the Executive Incentive Stock Compensation Plan of Clayton Williams Energy, Inc., respectively.

WILLIAMSON PETROLEUM CONSULTANTS, INC.

Houston, Texas
March 17, 1998

EXHIBIT 24.1

POWER OF ATTORNEY

KNOW ALL MEN BY THESE PRESENTS, the undersigned, being Officers and Directors of Clayton Williams Energy, Inc. (the "Company"), a Delaware corporation, do hereby constitute and appoint Clayton W. Williams, Jr. and L. Paul Latham, or either of them, with full power of substitution, our true and lawful attorneys and agents, to do any and all acts and things in our names in the capacities indicated which Clayton W. Williams, Jr. and L. Paul Latham, or either of them, may deem necessary or advisable to enable the Company to comply with the Securities Exchange Act of 1934, as amended, and any rules, regulations and requirements of the Securities and Exchange Commission in connection with the Company's Annual Report on Form 10-K for the year ended December 31, 1997, including specifically, but not limited to, the power and authority to sign such Form 10-K for us, or any of us, in our names in the capacities indicated, and any and all amendments thereto; and we do hereby ratify and confirm all that Clayton W. Williams, Jr., and L. Paul Latham or either of them, shall do or cause to be done by virtue hereof.

IN WITNESS WHEREOF, I have hereunto set my hand this thirteenth day of March, 1998.

/s/ Clayton W. Williams, Jr.

/s/ L. Paul Latham

CLAYTON W. WILLIAMS, JR.
President, Chairman of the Board,
Chief Executive Officer and a
Director

L. PAUL LATHAM
Executive Vice President, Chief
Operating Officer and a Director

/s/ Mel G. Riggs

/s/ William P. Clements

MEL G. RIGGS
Senior Vice President - Finance and
Secretary (Principal Financial and
Accounting Officer)

WILLIAM P. CLEMENTS
Director

/s/ Stanley S. Beard

/s/ Robert L. Parker

STANLEY S. BEARD
Director

ROBERT L. PARKER
Director

EXHIBIT 24.2

CERTIFICATE OF RESOLUTION

I, Mel G. Riggs, Secretary of Clayton Williams Energy, Inc., a Delaware corporation, do hereby certify that the Board of Directors of Clayton Williams Energy, Inc. acting by unanimous consent duly adopted the following resolutions as of March 13, 1998.

RESOLVED, that the Directors and proper officers of this corporation be and they are hereby authorized and directed to execute and deliver a Power of Attorney to CLAYTON W. WILLIAMS, JR. and L. PAUL LATHAM in the following form:

KNOW ALL MEN BY THESE PRESENTS, the undersigned, being Officers and Directors of Clayton Williams Energy, Inc. (the "Company"), a Delaware corporation, do hereby constitute and appoint Clayton W. Williams, Jr. and L. Paul Latham, or either of them, with full power of substitution, our true and lawful attorneys and agents, to do any and all acts and things in our names in the capacities indicated which Clayton W. Williams, Jr. and L. Paul Latham, or either of them, may deem necessary or advisable to enable the Company to comply with the Securities Exchange Act of 1934, as amended, and any rules, regulations and requirements of the Securities and Exchange Commission in connection with the Company's Annual Report on Form 10-K for the year ended December 31, 1997, including specifically, but not limited to, the power and authority to sign such Form 10-K for us, or any of us, in our names in the capacities indicated, and any and all amendments thereto; and we do hereby ratify and confirm all that Clayton W. Williams, Jr., and L. Paul Latham or either of them, shall do or cause to be done by virtue hereof.

RESOLVED FURTHER, that the proper officers of this corporation be and they are hereby authorized and directed to take all such other action as they may deem advisable in order to carry out the intent and purposes of the foregoing resolution.

IN WITNESS WHEREOF, I have hereunto set my hand on behalf of this corporation on this twentieth day of March, 1998.

/s/ Mel G. Riggs

MEL G. RIGGS, Secretary

ARTICLE 5

MULTIPLIER: 1,000

PERIOD TYPE	YEAR
FISCAL YEAR END	DEC 31 1997
PERIOD START	JAN 01 1997
PERIOD END	DEC 31 1997
CASH	2,150
SECURITIES	0
RECEIVABLES	13,496
ALLOWANCES	0
INVENTORY	2,530
CURRENT ASSETS	19,419
PP&E	430,632
DEPRECIATION	315,559
TOTAL ASSETS	134,562
CURRENT LIABILITIES	25,788
BONDS	35,700
PREFERRED MANDATORY	0
PREFERRED	0
COMMON	898
OTHER SE	72,196
TOTAL LIABILITY AND EQUITY	134,562
SALES	70,929
TOTAL REVENUES	75,488
CGS	16,205
TOTAL COSTS	66,171
OTHER EXPENSES	(217)
LOSS PROVISION	0
INTEREST EXPENSE	1,767
INCOME PRETAX	7,767
INCOME TAX	0
INCOME CONTINUING	7,767
DISCONTINUED	0
EXTRAORDINARY	0
CHANGES	0
NET INCOME	7,767
EPS PRIMARY	.87
EPS DILUTED	.85

ARTICLE 5

RESTATED:

MULTIPLIER: 1,000

PERIOD TYPE	YEAR	YEAR	3 MOS	6 MOS 9-MOS
FISCAL YEAR END	DEC 31 1996	DEC 31 1995	DEC 31 1996	DEC 31 1996 DEC-31-1996
PERIOD START	JAN 01 1996	JAN 01 1995	JAN 01 1996	JAN 01 1996 JAN-01-1996
PERIOD END	DEC 31 1996	DEC 31 1995	MAR 31 1996	JUN 30 1996 SEP-30-1996
CASH	2,479	1,303	1,065	1,210 1,241
SECURITIES	0	0	0	0 0
RECEIVABLES	12,408	8,537	8,664	9,641 8,603
ALLOWANCES	0	0	0	0 0
INVENTORY	518	565	471	445 418
CURRENT ASSETS	15,962	10,910	10,515	11,861 10,897
PP&E	371,734	341,679	346,827	355,251 363,067
DEPRECIATION	284,173	259,533	265,154	272,512 278,377
TOTAL ASSETS	103,598	93,161	92,249	94,672 95,647
CURRENT LIABILITIES	19,384	24,627	25,374	17,057 16,456
BONDS	18,000	33,538	30,358	38,528 36,522
PREFERRED MANDATORY	0	0	0	0 0
PREFERRED	0	0	0	0 0
COMMON	893	741	745	748 749
OTHER SE	65,321	34,255	35,772	38,339 41,920
TOTAL LIABILITY AND EQUITY	103,598	93,161	92,249	94,672 95,647
SALES	60,610	43,883	12,368	27,517 42,136
TOTAL REVENUES	64,891	49,271	13,332	29,466 45,050
CGS	14,776	13,533	3,598	7,161 10,808
TOTAL COSTS	48,056	57,879	10,993	23,720 35,014
OTHER EXPENSES	(335)	(6,022)	(47)	(40) (60)
LOSS PROVISION	0	0	0	0 0
INTEREST EXPENSE	3,440	5,493	982	1,943 2,783
INCOME PRETAX	13,730	(8,079)	1,404	3,843 7,313
INCOME TAX	0	0	0	0 0
INCOME CONTINUING	13,730	(8,079)	1,404	3,843 7,313
DISCONTINUED	0	0	0	0 0
EXTRAORDINARY	0	0	0	0 0
CHANGES	0	0	0	0 0
NET INCOME	13,730	(8,079)	1,404	3,843 7,313
EPS PRIMARY	1.80	(1.31)	.19	.51 .97
EPS DILUTED	1.76	(1.31)	.19	.51 .95

ARTICLE 5

RESTATED:

MULTIPLIER: 1,000

PERIOD TYPE	3 MOS	6 MOS	9 MOS
FISCAL YEAR END	DEC 31 1997	DEC 31 1997	DEC 31 1997
PERIOD START	JAN 01 1997	JAN 01 1997	JAN 01 1997
PERIOD END	MAR 31 1997	JUN 30 1997	SEP 30 1997
CASH	1,176	1,614	1,712
SECURITIES	0	0	0
RECEIVABLES	11,099	10,124	11,542
ALLOWANCES	0	0	0
INVENTORY	502	704	952
CURRENT ASSETS	13,268	12,873	15,107
PP&E	384,379	397,386	411,128
DEPRECIATION	290,485	298,087	306,629
TOTAL ASSETS	107,189	112,201	119,689
CURRENT LIABILITIES	21,722	19,637	21,211
BONDS	17,000	22,800	27,500
PREFERRED MANDATORY	0	0	0
PREFERRED	0	0	0
COMMON	895	895	896
OTHER SE	67,572	68,869	70,082
TOTAL LIABILITY AND EQUITY	107,189	112,201	119,689
SALES	16,564	32,820	51,538
TOTAL REVENUES	17,894	34,987	54,912
CGS	4,141	7,930	11,847
TOTAL COSTS	14,337	29,873	48,225
OTHER EXPENSES	(26)	(95)	(109)
LOSS PROVISION	0	0	0
INTEREST EXPENSE	352	791	1,271
INCOME PRETAX	3,231	4,418	5,525
INCOME TAX	0	0	0
INCOME CONTINUING	3,231	4,418	5,525
DISCONTINUED	0	0	0
EXTRAORDINARY	0	0	0
CHANGES	0	0	0
NET INCOME	3,231	4,418	5,525
EPS PRIMARY	.36	.50	.62
EPS DILUTED	.35	.49	.61

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