ABRAXAS PETROLEUM CORP
Form 10-Q
November 15, 2010

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

FORM 10-Q

(Mark One)
x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2010

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE TRANSITION PERIOD FROM ______ TO ______

COMMISSION FILE NUMBER: 001-16071

ABRAXAS PETROLEUM CORPORATION
(Exact name of registrant as specified in its charter)

Nevada	74-2584033
(State of Incorporation)	(I.R.S. Employer Identification No.)

18803 Meisner Drive, San Antonio, TX 78258
(Address of principal executive offices) (Zip Code)

210-490-4788
(Registrant's telephone number, including area code)

Not Applicable
(Former name, former address and former fiscal year, if changed since last report)

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 the filing requirements for the past 90 days.

Yes x No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ¨ No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definition of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act. (Check One)

Large accelerated filer	o	Accelerated filer	o
Non-accelerated filer (Do not mark if a smaller reporting company)	x	Smaller reporting company	o

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

The number of shares of the issuer’s common stock outstanding as of November 11, 2010 was:

Class	Shares Outstanding
Common Stock, $.01 Par Value	76,394,121

Forward-Looking Information

We make forward-looking statements throughout this document. Whenever you read a statement that is not simply a statement of historical fact (such as statements including words like “believe,” “expect,” “anticipate,” “intend,” “will,” “plan,” “estimate,” “could,” “potentially” or similar expressions), you must remember that these are forward-looking statements, and that our expectations may not be correct, even though we believe they are reasonable. The forward-looking information contained in this document is generally located in the material set forth under the headings “Risk Factors,” and “Management’s Discussion and Analysis of Financial Condition and Results of Operations” but may be found in other locations as well. These forward-looking statements generally relate to our plans and objectives for future operations and are based upon our management’s reasonable estimates of future results or trends. The factors that may affect our expectations regarding our operations include, among others, the following:

- our success in development, exploitation and exploration activities;
- our ability to procure services and equipment for our drilling and completion activities;
- our ability to make planned capital expenditures;
- declines in our production of oil and gas;
- the prices we receive for our oil and gas and the effectiveness of our hedging activities;
- the availability of capital;
- the success of our divestiture program for non-core assets;
- political and economic conditions in oil producing countries, especially those in the Middle East;
- price and availability of alternative fuels;
- our restrictive debt covenants;
- our acquisition and divestiture activities;
- weather conditions and events;
- the proximity, capacity, cost and availability of pipelines and other transportation facilities; and
- other factors discussed elsewhere in this document.

In addition to these factors, important factors that could cause actual results to differ materially from our expectations (“Cautionary Statements”) are disclosed under “Risk Factors” in our Annual Report on Form 10-K for the year ended December 31, 2009. All subsequent written and oral forward-looking statements attributable to us, or persons acting on our behalf, are expressly qualified in their entirety by the Cautionary Statements.

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GLOSSARY OF TERMS

Unless otherwise indicated in this report, gas volumes are stated at the legal pressure base of the State or area in which the reserves are located at 60 degrees Fahrenheit. Oil and gas equivalents are determined using the ratio of six Mcf of gas to one barrel of oil, condensate or NGLs.

The following definitions shall apply to the technical terms used in this report.

Terms used to describe quantities of oil and gas:

"Bbl" – barrel or barrels.

"Bcf" – billion cubic feet of gas.

"Bcfe" – billion cubic feet of gas equivalent.

"Boe" – barrels of oil equivalent.

"Boepd" – barrels of oil equivalent per day.

"Bopd" – barrels of oil per day.

"MBbl" – thousand barrels.

"MBoe" – thousand barrels of oil equivalent.

"Mcf" – thousand cubic feet of gas.

"Mcfe" – thousand cubic feet of gas equivalent.

"MMBbls" – million barrels.

"MMBoe" – million barrels of oil equivalent.

"MMbtu" – million British Thermal Units.

"MMcf" – million cubic feet of gas.

"MMcfe" – million cubic feet of gas equivalent.

"MMcfepd" – million cubic feet of gas equivalent per day.

"MMcfpd" – million cubic feet of gas per day.

Terms used to describe our interests in wells and acreage:

"Developed acreage" means acreage which consists of leased acres spaced or assignable to productive wells.

"Development well" is a well drilled within the proved area of an oil or gas reservoir to the depth of stratigraphic horizon (rock layer or formation) noted to be productive for the purpose of extracting proved oil or gas reserves.

"Dry hole" is an exploratory or development well found to be incapable of producing either oil or gas in sufficient quantities to justify completion as an oil or gas well.

“Exploratory well” is a well drilled to find and produce oil or gas in an unproved area, to find a new reservoir in a field previously found to be producing oil or gas in another reservoir, or to extend a known reservoir.

“Gross acres” refer to the number of acres in which we own a working interest.

“Gross well” is a well in which we own an interest.

“Net acres” are deemed to exist when the sum of fractional ownership working interests in gross acres equals one (e.g., a 50% working interest in a lease covering 320 gross acres is equivalent to 160 net acres).

“Net well” is deemed to exist when the sum of fractional ownership working interests in gross wells equals one.

“Productive well” is an exploratory or a development well that is not a dry hole.

“Undeveloped acreage” means those leased acres on which wells have not been drilled or completed to a point that would permit the production of economic quantities of oil and gas, regardless of whether or not such acreage contains proved reserves.

Terms used to assign a present value to or to classify our reserves:

“Proved reserves” or “reserves” Proved oil and gas reserves are those quantities of oil and gas, which, by analysis of geoscience and engineering data, can be estimated with reasonable certainty to be economically producible—from a given date forward, from known reservoirs, and under existing economic conditions, operating methods, and government regulations—prior to the time at which contracts providing the right to operate expire, unless evidence indicates that renewal is reasonably certain, regardless of whether deterministic or probabilistic methods are used for the estimation.

“Proved developed reserves” Proved oil and gas reserves that can be expected to be recovered through existing wells with existing equipment and operating methods. Additional oil and gas expected to be obtained through the application of fluid injection or other improved recovery techniques for supplementing the natural forces and mechanisms of primary recovery are included in “proved developed reserves” only after testing by a pilot project or after the operation of an installed program has confirmed through production response that increased recovery will be achieved.

“Proved developed non-producing reserves” or “PDNP’s” Proved oil and gas reserves that are developed behind pipe, shut-in or that can be recovered through improved recovery only after the necessary equipment has been installed, or when the costs to do so are relatively minor. Shut-in reserves are expected to be recovered from (1) completion intervals which are open at the time of the estimate but which have not started producing, (2) wells that were shut-in for market conditions or pipeline connections, or (3) wells not capable of production for mechanical reasons. Behind-pipe reserves are expected to be recovered from zones in existing wells that will require additional completion work or future recompletion prior to the start of production.

“Proved undeveloped drilling location” A site on which a development well can be drilled consistent with spacing rules for purposes of recovering proved undeveloped reserves.

“Proved undeveloped reserves” or “PUD’s” Proved oil and gas reserves that are expected to be recovered from new wells on undrilled acreage or from existing wells where a relatively major expenditure is required for development. Reserves on undrilled acreage are limited to those drilling units offsetting productive units that are reasonably certain of production when drilled. Proved reserves for other undrilled units are claimed only where it can be demonstrated with certainty that there is continuity of production from the existing productive formation. Estimates for proved

undeveloped reserves are not attributed to any acreage for which an application of fluid injection or other improved recovery technique is contemplated, unless such techniques have been proven effective by actual tests in the area and in the same reservoir.

“Probable reserves” are those additional reserves which analysis of geoscience and engineering data indicate are less likely to be recovered than proved reserves but more certain to be recovered than possible reserves.

“Possible reserves” are those additional reserves which analysis of geoscience and engineering data suggest are less likely to be recoverable than probable reserves.

“PV-10” means estimated future net revenue, discounted at a rate of 10% per annum, before income taxes and with no price or cost escalation or de-escalation in accordance with guidelines promulgated by the SEC.

“Standardized Measure” means estimated future net revenue, discounted at a rate of 10% per annum, after income taxes and with no price or cost escalation, calculated in accordance with ASC 932, formerly Statement of Financial Accounting Standards No. 69 “Disclosures About Oil and Gas Producing Activities.”

ABRAXAS PETROLEUM CORPORATION
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PART I
FINANCIAL INFORMATION

Item 1. Financial Statements

Abraxas Petroleum Corporation
Condensed Consolidated Balance Sheets
(in thousands)

	September 30, 2010 (Unaudited)	December 31, 2009
Assets		
Current assets:		
Cash and cash equivalents	$ 2,060	$ 1,861
Accounts receivable, net:		
Joint owners	514	865
Oil and gas production	5,922	7,873
Other	349	31
	6,785	8,769
Derivative asset – current	7,676	325
Other current assets	442	514
Total current assets	16,963	11,469
Property and equipment:		
Oil and gas properties, full cost method of accounting:		
Proved	425,204	454,142
Unproved properties excluded from depletion	6,594	—
Other property and equipment	11,390	11,259
Total	443,188	465,401
Less accumulated depreciation, depletion, and amortization	(321,728)	(309,245)
Total property and equipment – net	121,460	156,156
Investment in joint venture	24,263	—
Deferred financing fees, net	4,136	5,804
Derivative asset – long-term	10,486	2,253
Other assets	801	554
Total assets	$ 178,109	$ 176,236

See accompanying notes to condensed consolidated financial statements (unaudited)

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Abraxas Petroleum Corporation
Condensed Consolidated Balance Sheets (continued)
(in thousands, except share data)

	September 30, 2010 (Unaudited)	December 31, 2009
Liabilities and Stockholders' Deficit		
Current liabilities:		
Accounts payable	$ 10,155	$ 8,773
Oil and gas production payable	3,120	3,606
Accrued interest	339	563
Other accrued expenses	1,727	770
Derivative liability – current	6,666	7,047
Current maturities of long-term debt	164	8,141
Total current liabilities	22,171	28,900
Long-term debt, excluding current maturities	139,965	143,592
Derivative liability – long-term	8,810	11,781
Future site restoration	8,836	10,326
Total liabilities	179,782	194,599
Stockholders' Deficit		
Preferred stock, par value $.01 per share, authorized 1,000,000 shares; -0- issued and outstanding	—	—
Common stock, par value $.01 per share-authorized 200,000,000 shares; issued and outstanding 76,378,132 and 76,231,751	764	762
Additional paid-in capital	183,847	182,647
Accumulated deficit	(186,347)	(201,974)
Accumulated other comprehensive income	63	202
Total stockholders' deficit	(1,673)	(18,363)
Total liabilities and stockholders' deficit	$ 178,109	$ 176,236

See accompanying notes to condensed consolidated financial statements (unaudited)

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Abraxas Petroleum Corporation
Condensed Consolidated Statements of Operations
(Unaudited)
(in thousands except per share data)

	Three Months Ended September 30, 2010	Three Months Ended September 30, 2009	Nine Months Ended September 30, 2010	Nine Months Ended September 30, 2009
Revenue:				
Oil and gas production revenues	$13,709	$13,215	$44,218	$35,930
Rig revenues	259	192	779	692
Other	1	2	7	5
	13,969	13,409	45,004	36,627
Operating costs and expenses:				
Lease operating and production taxes	6,558	6,802	19,412	18,656
Depreciation, depletion, and amortization	3,821	4,126	12,495	13,120
Rig operations	223	178	613	577
General and administrative (including stock-based compensation of $358, $264, $1,205 and $860)	2,094	1,746	6,426	5,476
	12,696	12,852	38,946	37,829
Operating income (loss)	1,273	557	6,058	(1,202)
Other (income) expense:				
Interest income	(2)	(2)	(6)	(13)
Interest expense	2,271	3,276	6,857	8,883
Financing fees	—	—	—	362
Amortization of deferred financing fees	515	213	1,837	799
Loss (gain) on derivative contracts (unrealized $(332), $8,217, $(17,968) and $22,676)	(831)	4,527	(18,358)	6,222
Equity in loss of joint venture	237	—	237	—
Other	(61)	13	(136)	2,242
	2,129	8,027	(9,569)	18,495
Consolidated net income (loss)	(856)	(7,470)	15,627	(19,697)
Less: Net loss attributable to non-controlling interest	—	3,100	—	9,745
Net income (loss)	$(856)	$(4,370)	$15,627	$(9,952)
Net income (loss) per common share – basic	$(0.01)	$(0.09)	$0.21	$(0.20)
Net income (loss) per common share – diluted	$(0.01)	$(0.09)	$0.20	$(0.20)

See accompanying notes to condensed consolidated financial statements (unaudited)

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Abraxas Petroleum Corporation
Condensed Consolidated Statements of Cash Flows
(Unaudited)
(in thousands)

	Nine Months Ended September 30,	
	2010	2009
Operating Activities		
Net income (loss)	$15,627	$(19,697)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Change in derivative fair value	(18,936)	20,411
Monetization of derivative contracts	—	26,736
Depreciation, depletion, and amortization	12,495	13,120
Amortization of deferred financing fees	1,837	799
Accretion of future site restoration	399	420
Stock-based compensation	1,205	860
Other non-cash expenses	24	141
Equity in loss of joint venture	237	—
Registration fees previously capitalized	—	2,210
Changes in operating assets and liabilities:		
Accounts receivable	1,984	1,373
Other	(314)	(1,485)
Accounts payable and accrued expenses	(260)	(3,521)
Net cash provided by operating activities	14,298	41,367
Investing Activities		
Capital expenditures, including purchases and development of properties	(20,362)	(12,214)
Proceeds from the sale of oil and gas properties	18,063	—
Net cash used in investing activities	(2,299)	(12,214)
Financing Activities		
Proceeds from long-term borrowings	2,000	6,137
Payments on long-term borrowings	(13,604)	(30,702)
Deferred financing fees	(169)	(3,289)
Proceeds from exercise of stock options	48	77
Partnership distributions to non-controlling interest	—	(2,257)
Other	(75)	(569)
Net cash used in financing activities	(11,800)	(30,603)
Increase (decrease) in cash	199	(1,450)
Cash and equivalents, at beginning of period	1,861	1,924
Cash and equivalents, at end of period	$2,060	$474

See accompanying notes to condensed consolidated financial statements (unaudited)

Abraxas Petroleum Corporation
Condensed Consolidated Statements of Cash Flows (continued)
(Unaudited)
(in thousands)

	Nine Months Ended September 30,	
	2010	2009
Supplemental disclosure of cash flow information:		
Interest paid	$6,683	$8,463
Non-Cash Investing Activities:		
Asset retirement obligation cost and liabilities	$(6)	$9
Asset retirement obligations associated with property acquisitions and dispositions	$(1,728)	$12
Properties contributed to joint venture	$24,500	$—

See accompanying notes to condensed consolidated financial statements (unaudited)

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Abraxas Petroleum Corporation
Notes to Condensed Consolidated Financial Statements
(Unaudited)
(tabular amounts in thousands, except per share data)

Note 1. Basis of Presentation

The accounting policies followed by Abraxas Petroleum Corporation and its subsidiaries (the "Company") are set forth in the notes to the Company's audited consolidated financial statements in the Annual Report on Form 10-K filed for the year ended December 31, 2009. Such policies have been continued without change. Also, refer to the notes to those financial statements for additional details of the Company's financial condition, results of operations, and cash flows. All material items included in those notes have not changed except as a result of normal transactions in the interim, or as disclosed within this report. The accompanying interim consolidated financial statements have not been audited by our independent registered public accountants, but in the opinion of management, reflect all adjustments necessary for a fair presentation of the financial position and results of operations. Any and all adjustments are of a normal and recurring nature. Although management believes the unaudited interim related disclosures in these consolidated financial statements are adequate to make the information presented not misleading, certain information and footnote disclosures normally included in annual audited consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission. The results of operations and the cash flows for the periods ended September 30, 2010 are not necessarily indicative of the results to be expected for the full year. The condensed consolidated financial statements included herein should be read in conjunction with the consolidated audited financial statements and the notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2009.

Consolidation Principles

The terms "Abraxas" or "Abraxas Petroleum" refer to Abraxas Petroleum Corporation and its subsidiaries other than Abraxas Energy Partners, L.P., which we refer to as "Abraxas Energy Partners" or the "Partnership," and its subsidiary, Abraxas Operating, LLC, which we refer to as "Abraxas Operating" and the terms "we," "us," "our" or the "Company" refer Abraxas Petroleum Corporation and all of its consolidated subsidiaries including Abraxas Energy Partners and Abraxas Operating through October 5, 2009. The operations of Abraxas Petroleum and the Partnership were consolidated for financial reporting purposes through October 5, 2009, with the interest of the 51.8% non-controlling owners of the Partnership presented as non-controlling interest. Abraxas owned the remaining 48.2% of the Partnership interests. The Company determined that based on its control of the general partner of the Partnership, this 48.2% owned entity should be consolidated for financial reporting purposes. As discussed below, on October 5, 2009, the Partnership was merged into Abraxas Petroleum Corporation.

On June 30, 2009, Abraxas Petroleum and Abraxas Energy Partners signed an Agreement and Plan of Merger, which we refer to as the Original Merger Agreement, pursuant to which Abraxas Energy Partners agreed to merge with and into Abraxas Petroleum with Abraxas Petroleum surviving and on July 17, 2009, Abraxas Petroleum and Abraxas Energy Partners signed an Amended and Restated Agreement and Plan of Merger, which we refer to as the Merger Agreement, pursuant to which Abraxas Energy Partners agreed to merge with and into Abraxas Merger Sub, LLC, which we refer to as Merger Sub, with Merger Sub surviving the merger as a wholly-owned subsidiary of Abraxas Petroleum. We refer to this merger as the Merger. Under the terms of the Merger Agreement, at the effective time of the Merger on October 5, 2009, each common unit of Abraxas Energy Partners not owned by Abraxas Petroleum and its subsidiaries was converted into the right to receive 4.25 shares of Abraxas Petroleum common stock. We issued a total of 26,174,061 shares of our common stock in the Merger, including 420,552 shares of restricted common stock issued in exchange for restricted units and phantom units of Abraxas Energy Partners under the Abraxas Petroleum

Corporation 2005 Employee Long-Term Equity Incentive Plan, or LTIP.

The Company consolidates its financial statements based on the guidance of Accounting Standards Codification ("ASC") 810. ASC 810 establishes accounting and reporting standards for (1) ownership interests in subsidiaries held by others, (2) the amount of consolidated net income attributable to the controlling and non-controlling interests, (3) changes in the controlling ownership interest, (4) the valuation of retained non-controlling equity investments when a subsidiary is deconsolidated and (5) disclosures that clearly identify and distinguish between the interests of the controlling and non-controlling owners. The adoption of ASC 810 resulted in changes to our presentation for non-controlling interests and did not have a material impact on the Company's results of operations and financial condition.

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In accordance with generally accepted accounting principles in effect prior to the adoption of ASC 810, which codifies SFAS 160, when cumulative losses applicable to the non-controlling interest exceed the non-controlling interest equity capital in the entity, such excess and any further losses applicable to the non-controlling interest were charged to the earnings of the controlling interest. Future earnings were recognized by the non-controlling interest and were credited to the controlling interest (Abraxas) to the extent of such losses previously absorbed.

Use of Estimates

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

Equity-based Compensation

Stock Options

The Company currently utilizes a standard option-pricing model (i.e., Black-Scholes) to measure the fair value of stock options granted to employees. For the three and nine months ended September 30, 2010 and 2009, the Company recognized expense of $260,000, $897,000, $203,000 and $653,000, respectively, related to stock options.

The following table summarizes the stock option activities for the nine months ended September 30, 2010.

	Shares	Weighted Average Option Exercise Price Per Share	Weighted Average Grant Date Fair Value Per Share	Aggregate Intrinsic Value
Outstanding, December 31, 2009	4,090	$ 2.18	$ 1.59	$ 5,480
Granted	965	$ 2.12	$ 1.61	1,553
Exercised	(171)	$ 0.92	$ 0.64	(109)
Expired or canceled	(16)	$ 2.94	$ 1.82	(29)
Outstanding, September 30, 2010	4,868	$ 2.21	$ 1.42	$ 6,895

The following table shows the weighted average assumptions used in the Black-Scholes valuation of the fair value of option grants for the nine months ended September 30, 2010.

Expected dividend yield	0%
Volatility	84.03%
Risk free interest rate	2.87%
Expected life	8.99Years
Fair value of options granted (in thousands)	$ 1,553
Weighted average grant date fair value per share of options granted	$ 1.61

Additional information related to options at September 30, 2010 and December 31, 2009 is as follows:

	September 30, 2010	December 31, 2009

Options exercisable	2,029	1,808

As of September 30, 2010, there was approximately $2.8 million of unamortized compensation expense related to outstanding options that will be recognized in 2010 through 2014.

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Restricted Stock Awards

Restricted stock awards are awards of common stock that are subject to restrictions on transfer and to a risk of forfeiture if the awardee terminates employment with the Company prior to the lapse of the restrictions. The value of such stock was determined using the market price on the grant date. Compensation expense is recorded over the applicable restricted stock vesting periods.

A summary of the Company's restricted stock activity for the nine months ended September 30, 2010 is presented in the following table:

	Number of Shares		Weighted Average Grant Date Fair Value (per share)
Unvested December 31, 2009	549	$	2.05
Granted	20		2.45
Vested/Released	(155)		2.22
Forfeited	(8)		1.20
Unvested September 30, 2010	406	$	2.03

For the three and nine months ended September 30, 2010 and 2009, the Company incurred $98,000, $308,000, $38,000 and $112,000, respectively, in stock-based compensation expense relating to restricted stock. As of September 30, 2010, there was approximately $584,000 of unamortized compensation expense related to outstanding restricted shares that will be recognized in 2010 through 2014.

Restricted Unit Awards

Restricted unit awards were awards of Partnership units that were subject to restrictions on transfer and to a risk of forfeiture if the awardee terminated employment with the Company prior to the lapse of the restrictions. The value of such unit was determined using the implied market price on the grant date. The implied market price was determined by comparing the average trading yields of comparable publicly-traded master limited partnerships to the distribution paid or declared by the Partnership prior to the grant date. Compensation expense was recorded over the applicable restricted unit vesting periods.

For the three and nine months ended September 30, 2009, the Partnership incurred $23,000 and $70,000, respectively, in equity-based compensation expense relating to restricted units. In connection with the closing of the Merger, restricted unit awards were converted into restricted stock awards of the Company.

Phantom Units

On January 31, 2008, in connection with the closing of the St. Mary acquisition, the Partnership awarded phantom units with distribution equivalency rights under its long-term incentive plan to certain key employees of Abraxas Petroleum.

For the three and nine months ended September 30, 2009, the Partnership incurred $0 and $25,000, respectively, in equity based compensation expense relating to phantom units. In connection with the closing of the Merger,

outstanding phantom unit awards were converted into restricted stock awards of the Company.

Oil and Gas Properties

The Company follows the full cost method of accounting for oil and gas properties. Under this method, all direct costs and certain indirect costs associated with acquisition of properties and successful as well as unsuccessful exploration and development activities are capitalized. Depreciation, depletion, and amortization of capitalized oil and gas properties and estimated future development costs, excluding unproved properties, are based on the unit-of-production method based on proved reserves. Net capitalized costs of oil and gas properties, less related deferred taxes, are limited to the lower of unamortized

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cost or the cost ceiling, defined as the sum of the present value of estimated future net revenues from proved reserves based on unescalated prices discounted at 10 percent, plus the cost of properties not being amortized, if any, plus the lower of cost or estimated fair value of unproved properties included in the costs being amortized, if any, less related income taxes. The Company does not have any properties that are being excluded from amortization. Costs in excess of the present value of estimated future net revenues as discussed above are charged to proved property impairment expense. No gain or loss is recognized upon sale or disposition of oil and gas properties, except in unusual circumstances. We apply the full cost ceiling test on a quarterly basis on the date of the latest balance sheet presented.

The estimates of our reserves as of December 31, 2009, are based upon various assumptions about future production levels, prices and costs that may not prove to be correct over time. In particular, estimates of oil and gas reserves, future net revenue from proved reserves and the PV-10 thereof for our oil and gas properties are based on the assumption that future oil and gas prices remain the same as the twelve month un-weighted first-day-of-the-month average oil and gas prices for the one year period ended December 31, 2009. The average realized sales prices as of such date used for purposes of such estimates were $3.42 per Mcf of gas and $55.05 per Bbl of oil. As of December 31, 2009 and September 30, 2010, our net capitalized costs of oil and gas properties did not exceed the present value of our estimated proved reserves.

Restoration, Removal and Environmental Liabilities

The Company is subject to extensive Federal, state and local environmental laws and regulations. These laws regulate the discharge of materials into the environment and may require the Company to remove or mitigate the environmental effects of the disposal or release of petroleum substances at various sites. Environmental expenditures are expensed or capitalized depending on their future economic benefit. Expenditures that relate to an existing condition caused by past operations and that have no future economic benefit are expensed.

Liabilities for expenditures of a non-capital nature are recorded when environmental assessments and/or remediation is probable, and the costs can be reasonably estimated. Such liabilities are generally undiscounted unless the timing of cash payments for the liability or component are fixed or reliably determinable.

The Company accounts for asset retirement obligations based on the guidance of ASC 410 (formerly FASB 143) which addresses accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. ASC 410 requires that the fair value of a liability for an asset's retirement obligation be recorded in the period in which it is incurred and the corresponding cost capitalized by increasing the carrying amount of the related long-lived asset. The liability is accreted to its then present value each period, and the capitalized cost is depreciated over the estimated useful life of the related asset. For all periods presented, we have included estimated future costs of abandonment and dismantlement in our full cost amortization base and amortize these costs as a component of our depletion expense in the accompanying consolidated financial statements.

The following table summarizes the Company’s asset retirement obligation transactions for the nine months ended September 30, 2010 and the year ended December 31, 2009:

	September 30, 2010	December 31, 2009
Beginning asset retirement obligation	$ 10,326	$ 9,959
Settled	(155)	(113)
Revisions	(6)	(80)
New wells placed on production and other	26	91
Deletions related to property divestitures	(1,754)	(89)

Accretion expense		399		558
Ending asset retirement obligation	$	8,836	$	10,326

Working Capital (Deficit)

At September 30, 2010, our current liabilities of approximately $22.2 million exceeded our current assets of $17.0 million resulting in a working capital deficit of $5.2 million. This compares to a working capital deficit of approximately $17.4 million at December 31, 2009. Current liabilities at September 30, 2010 primarily consisted of the current portion of derivative liabilities of $6.7 million, trade payables of $10.2 million,

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revenues due third parties of $3.1 million, and other accrued liabilities of $2.2 million.

Recently Issued Accounting Pronouncements

In January 2010, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update No. 2010-6, "Improving Disclosures about Fair Value Measurements" ("ASU No. 2010-06"). ASU No. 2010-06 amends FASB Accounting Standards Codification ("ASC") Topic 820, "Fair Value Measurements and Disclosures", to require additional information to be disclosed principally regarding Level 3 measurements and transfers to and from Level 1 and 2. In additional, enhanced disclosure is required concerning inputs and valuation techniques used to determine Level 2 and Level 3 measurements. This guidance is generally effective for interim and annual reporting periods beginning after December 15, 2009; however, requirements to disclose separately purchases, sales, issuances, and settlements in the Level 3 reconciliation are effective for fiscal years beginning after December 15, 2010 (and for interim periods within such years). The update will not have a material impact on the Company's consolidated results of operations or financial position.

In February 2010, the FASB issued Accounting Standards Update No. 2010-09, "Amendments to Certain Recognition and Disclosure Requirements" ("ASU No. 2010-09"). ASU No. 2010-09 amends FASB ASC Topic 855-10, "Subsequent Events", to remove the requirement for an SEC filer to disclose the date through which subsequent events have been evaluated in both issued and revised financial statements. This change alleviates potential conflicts between ASC 855-10 and the SEC's requirements. The update did not have a material impact on the Company's consolidated results of operations or financial position.

Note 2. Formation of Joint Venture

On August 18, 2010, Abraxas Petroleum Corporation and its wholly-owned subsidiary, Abraxas Operating, LLC, contributed 8,333 net acres in the Eagle Ford Shale play to Blue Eagle Energy, LLC (the "Blue Eagle JV") and received a $25 million equity interest in the Blue Eagle JV pursuant to the terms of the Subscription and Contribution Agreement among Abraxas Petroleum, Abraxas Operating, Blue Eagle and Blue Stone Oil & Gas, LLC ("Blue Stone"). Simultaneously, Blue Stone contributed $25 million in cash to the Blue Eagle JV for a $25 million equity interest in the Blue Eagle JV.

In addition, under the terms of the Limited Liability Company Agreement of the Blue Eagle JV, Blue Stone committed to contribute an additional $50 million in cash to the Blue Eagle JV, which combined with the initial $25 million, will be used to acquire additional acreage and 3-D seismic data, and to drill and complete wells targeting the Eagle Ford Shale formation. Upon full funding, Abraxas Petroleum will own a 25% equity interest in the Blue Eagle JV and Blue Stone will own a 75% equity interest in the Blue Eagle JV.

The Blue Eagle JV's subject area will encompass 12 counties across the Eagle Ford Shale play for expected future acreage acquisitions. Abraxas Petroleum will operate the wells owned by the Blue Eagle JV and Blue Stone will manage the day-to-day business affairs of the Blue Eagle JV. Robert L. G. Watson, our President and CEO, will serve on the Board of Managers of the Blue Eagle JV.

Blue Stone recently changed its name to Rock Oil Company, LLC.

At formation and as of September 30, 2010, we own a non-controlling 49.9% interest in the joint venture. We account for the joint venture under the equity method of accounting. Under the equity method of accounting, the Company's share of net income (loss) from the joint venture is reflected as an increase (decrease) in its investment account in "Investment in joint venture" and is also recorded as equity investment income (loss) in "Equity in loss of joint venture." For the three and nine months ended September 30, 2010, we incurred a loss of $237,000.

Note 3. Income Taxes

The Company records income taxes using the liability method. Under this method, deferred tax assets and liabilities are determined based on differences between financial reporting and tax basis of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse.

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For the three and nine month periods ended September 30, 2010 and 2009, there is no current or deferred income tax expense or benefit due to losses and/or loss carryforwards and valuation allowances which have been recorded against such benefits.

The Company accounts for uncertain tax positions under provisions ASC 740-10. ASC 740-10 did not have any effect on the Company's financial position or results of operations for the nine months ended September 30, 2010 and 2009. The Company recognizes interest and penalties related to uncertain tax positions in income tax expense. As of September 30, 2010, the Company did not have any accrued interest or penalties related to uncertain tax positions. The tax years from 1999 through 2009 remain open to examination by the tax jurisdictions to which the Company is subject.

Note 4. Long-Term Debt

Long-term debt consisted of the following:

	September 30, 2010	December 31, 2009
Credit facility – Term portion	$ —	$ 8,000
Credit facility – Revolving portion	135,000	138,500
Real estate lien note	5,129	5,233
	140,129	151,733
Less current maturities	(164)	(8,141)
	$ 139,965	$ 143,592

Credit Facility

On October 5, 2009, in connection with the closing of the Merger, we entered into an amended and restated senior secured credit facility with Société Générale, as administrative agent and issuing lender, and certain other lenders, which we refer to as the credit facility, which was amended on August 18, 2010. In connection with the Merger, we borrowed $145.0 million under the credit facility, of which $135.0 million was borrowed under the revolving portion and $10.0 million was borrowed under the term loan portion. As of September 30, 2010, $135.0 million was outstanding under the revolving portion of the credit facility. The term portion of the credit facility was paid in full on March 30, 2010.

The revolving portion of the credit facility has a maximum commitment of $300.0 million and availability is subject to a borrowing base. The borrowing base is currently $145.0 million and is determined semi-annually by the lenders based upon our reserve reports, one of which must be prepared by our independent petroleum engineers and one of which may be prepared internally. The amount of the borrowing base is calculated by the lenders based upon their valuation of our proved reserves utilizing these reserve reports and their own internal decisions. In addition, the lenders, in their sole discretion, are able to make one additional borrowing base redetermination during any six-month period between scheduled redeterminations and we are able to request one redetermination during any six-month period between scheduled redeterminations. The lenders are also able to make a redetermination in connection with any sales of producing properties with a market value of 5% or more of our then-current borrowing base and in connection with any hedge termination which could reduce the collateral value by 5% or more. Our borrowing base of $145.0 million was determined based upon our reserve report dated December 31, 2009. Our borrowing base can never exceed the $300.0 million maximum commitment amount. Outstanding amounts under the revolving portion of the credit facility bear interest at (a) the greater of (1) the reference rate announced from time to time by Société

Générale, (2) the Federal Funds Rate plus 0.5%, and (3) a rate determined by Société Générale as the daily one-month LIBOR plus, in each case, (b) 1.5%—2.75%, depending on the utilization of the borrowing base, or, if we elect, at the greater of (1) 2.0% and (2) LIBOR plus, in each case, 2.5%—3.75%, depending on the utilization of the borrowing base. At September 30, 2010, the interest rate on the revolving portion of the credit facility was 5.75%.

Subject to earlier termination rights and events of default, the stated maturity date of the credit facility is October 5, 2012. Interest is payable quarterly on reference rate advances and not less than quarterly on Eurodollar advances. We are permitted to terminate the credit facility and are able, from time to time, to permanently reduce the lenders' aggregate commitment under the credit facility in compliance with certain notice and dollar increment requirements.

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Each of our subsidiaries has guaranteed our obligations under the credit facility on a senior secured basis. Obligations under the credit facility are secured by a first priority perfected security interest, subject to certain permitted encumbrances, in all of our and our subsidiary guarantors' material property and assets.

Under the credit facility, we are subject to customary covenants, including certain financial covenants and reporting requirements. We are required to maintain a current ratio as of the last day of each quarter of not less than 1.00 to 1.00 and an interest coverage ratio as of the last day of each quarter of not less than 2.50 to 1.00. We are also required to maintain a total debt to EBITDAX ratio as of the last day of each quarter of not more than 4.50 to 1.00 for the quarter ending September 30, 2009 through the quarter ending September 30, 2010, and not more than 4.00 to 1.00 thereafter. The current ratio is defined as the ratio of consolidated current assets to consolidated current liabilities. For the purposes of this calculation, current assets include the portion of the borrowing base which is undrawn but excludes any cash deposited with or at the request of a counter-party to a hedging arrangement and any assets representing a valuation account arising from the application of ASC 815 (which relates to derivative instruments and hedging activities and was previously referred to as SFAS 133) and ASC 410-20 (which relates to asset retirement obligations and was previously referred to as SFAS 143) and current liabilities exclude the current portion of long-term debt and any liabilities representing a valuation account arising from the application of ASC 815 and ASC 410-20. The interest coverage ratio is defined as the ratio of consolidated EBITDAX to consolidated interest expense for the four fiscal quarters ended on the calculation date after giving pro forma effect to the Merger. For the purposes of this calculation, EBITDAX is consolidated net income plus interest expense, oil and gas exploration expenses, taxes, depreciation, amortization, depletion and other non-cash charges including non-cash charges resulting from the application of ASC 718 (which relates to stock-based compensation and was previously referred to as SFAS 123R), ASC 815 and ASC 410-20 plus all realized net cash proceeds arising from the settlement or monetization of any hedge contracts or upon the termination of any hedge contract minus all non-cash items of income which were included in determining consolidated net income, including all non-cash items resulting from the application of ASC 815 and ASC 410-20. Interest expense includes total interest, letter of credit fees and other fees and expenses incurred in connection with any debt. The total debt to EBITDAX ratio is defined as the ratio of total debt to consolidated EBITDAX for the four fiscal quarters ended on the calculation date after giving pro forma effect to the Merger. For the purposes of this calculation, total debt is the outstanding principal amount of debt, excluding debt associated with the office building, and obligations with respect to surety bonds and hedge arrangements. We were in compliance with all covenants as of September 30, 2010.

As of September 30, 2010, the current ratio was 1.26 to 1.00, the interest coverage ratio was 3.10 to 1.00 and the total debt to EBITDAX ratio was 3.93 to 1.00.

The credit facility also required that we enter into hedging arrangements for specified volumes, which equated to approximately 85% of the estimated oil and gas production from our net proved developed producing reserves through December 31, 2012 and 70% for 2013. We satisfied this requirement by assuming all of the Partnership's derivative contracts in connection with the Merger.

In addition to the foregoing and other customary covenants, the credit facility contains a number of covenants that, among other things, restrict our ability to:

- incur or guarantee additional indebtedness;
- transfer or sell assets;
- create liens on assets;

- engage in transactions with affiliates other than on an “arm’s-length” basis;
- make any change in the principal nature of our business; and
- permit a change of control.

The credit facility also contains customary events of default, including nonpayment of principal or interest, violations of covenants, cross default and cross acceleration to certain other indebtedness, bankruptcy and material judgments and liabilities.

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Real Estate Lien Note

On May 9, 2008, the Company entered into an advancing line of credit in the amount of $5.4 million for the purchase and finish out of a building to serve as its corporate headquarters. This note was refinanced in November 2008. The note bears interest at a fixed rate of 6.375%, and is payable in monthly installments of principal and interest of $39,754 based on a twenty year amortization. The note matures in May 2015 at which time the outstanding balance becomes due. The note is secured by a first lien deed of trust on the property and improvements. As of September 30, 2010, $5.1 million was outstanding on the note.

Note 5. Earnings (Loss) Per Share

The following table sets forth the computation of basic and diluted earnings (loss) per share:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Numerator:				
Net income (loss) available to common stockholders	$ (856)	$ (4,370)	$ 15,627	$ (9,952)
Denominator:				
Denominator for basic earnings (loss) per share -				
Weighted-average shares	75,972	49,672	75,893	49,600
Effect of dilutive securities:				
Stock options and warrants	—	—	1,226	—
Dilutive potential common shares				
Denominator for diluted earnings (loss) per share -				
Weighted-average shares and assumed conversions	75,972	49,672	77,119	49,600
Net earnings (loss) per common share – basic	$ (0.01)	$ (0.09)	$ 0.21	$