ABRAXAS PETROLEUM CORP
Form 10-Q
August 10, 2009

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 JUNE 30, 2009

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 (State of Incorporation)	74-2584033 (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 x
Non-accelerated filer o (Do not mark if a smaller reporting company)	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 August 7, 2009 was:

Class	Shares Outstanding
Common Stock, $.01 Par Value	49,834,894

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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”, “plan”, “s “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 “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 high debt level;
- our success in development, exploitation and exploration activities;
- our ability to make planned capital expenditures;
- declines in our production of oil and gas;
- prices for oil and gas;
- our ability to raise equity capital or incur additional indebtedness;
- political and economic conditions in oil producing countries, especially those in the Middle East;
- prices and availability of alternative fuels;
- our restrictive debt covenants;
- our acquisition and divestiture activities;
- results of our hedging activities; and
- other factors discussed elsewhere in this report.

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, 2008. 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.

ABRAXAS PETROLEUM CORPORATION

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PART I
FINANCIAL INFORMATION

Item 1. Financial Statements

Abraxas Petroleum Corporation
Condensed Consolidated Balance Sheets
(in thousands)

	June 30, 2009 (Unaudited)	December 31, 2008 (1)
Assets		
Current assets:		
Cash and cash equivalents	$ 1,790	$ 1,924
Accounts receivable, net:		
Joint owners	845	1,740
Oil and gas production	6,217	6,168
Other	325	58
	7,387	7,966
Derivative asset – current	18,092	22,832
Other current assets	432	572
Total current assets	27,701	33,294
Property and equipment:		
Oil and gas properties, full cost method of accounting:		
Proved	448,093	440,712
Unproved properties excluded from depletion	—	—
Other property and equipment	11,116	10,986
Total	459,209	451,698
Less accumulated depreciation, depletion, and amortization	300,385	291,390
Total property and equipment – net	158,824	160,308
Deferred financing fees, net	4,099	1,443
Derivative asset – long-term	9,456	16,394
Other assets	483	400
Total assets	$ 200,563	$ 211,839

(1) As adjusted for FAS No. 160 "Noncontrolling Interest in Consolidated Financial Statements." (See Note 1)

See accompanying notes to condensed consolidated financial statements (unaudited)

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

	June 30, 2009 (Unaudited)	December 31, 2008 (1)
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	$ 5,240	$ 10,748
Oil and gas production payable	2,750	3,176
Accrued interest	273	350
Other accrued expenses	1,575	1,886
Derivative liability – current	2,697	3,000
Current maturities of long-term debt	46,062	40,134
Other current liabilities	19	—
Total current liabilities	58,616	59,294
Long-term debt, excluding current maturities	128,843	130,835
Derivative liability – long-term	3,202	—
Future site restoration	10,172	9,959
Total liabilities	200,833	200,088
Equity (Deficit)		
Abraxas Petroleum stockholders' equity (deficit):		
Convertible preferred stock, par value $.01, authorized 1,000,000 shares; -0- issued and outstanding	—	—
Common Stock, par value $.01, authorized 200,000,000 shares; issued and outstanding 49,804,894 and 49,622,423	498	496
Additional paid-in capital	187,938	187,243
Accumulated deficit	(188,776)	(183,194)
Accumulated other comprehensive income	192	113
Total Abraxas Petroleum stockholders' equity (deficit)	(148)	4,658
Non-controlling interest equity (deficit)	(122)	7,093
Total stockholders' equity (deficit)	(270)	11,751
Total liabilities and stockholders' equity (deficit)	$ 200,563	$ 211,839

(1) As adjusted for FAS No. 160 "Non-controlling Interest in Consolidated Financial Statements." (See Note 1)

See accompanying notes to condensed consolidated financial statements (unaudited)

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008 (1)	2009	2008 (1)
Revenue:				
Oil and gas production revenues	$12,119	$34,083	$22,715	$55,946
Rig revenues	247	329	500	635
Other	2	11	3	12
	12,368	34,423	23,218	56,593
Operating costs and expenses:				
Lease operating and production taxes	5,985	7,170	11,854	12,372
Depreciation, depletion, and amortization	4,507	6,004	8,994	11,098
Rig operations	211	193	399	403
General and administrative (including stock based compensation of $329, $650, $596, and $896)	1,601	1,873	3,730	3,672
	12,304	15,240	24,977	27,545
Operating income (loss)	64	19,183	(1,759)	29,048
Other (income) expense:				
Interest income	(6)	(31)	(11)	(127)
Interest expense	3,051	2,672	5,607	5,138
Financing fees	—	—	362	—
Amortization of deferred financing fee	374	273	586	467
Loss on derivative contracts (unrealized $20,889, $74,517, $14,459 and $100,592)	14,560	81,135	1,695	108,093
Other	2,208	734	2,229	734
	20,187	84,783	10,468	114,305
Consolidated net loss	(20,123)	(65,600)	(12,227)	(85,257)
Less: Net loss attributable to non-controlling interest	10,091	7,912	6,645	18,578
Net loss attributable to Abraxas Petroleum	$(10,032)	$(57,688)	$(5,582)	$(66,679)
Net loss attributable to Abraxas Petroleum common stockholders -per common share – basic	$(0.20)	$(1.18)	$(0.11)	$(1.36)
Net loss attributable to Abraxas Petroleum common stockholders -per common share – diluted	$(0.20)	$(1.18)	$(0.11)	$(1.36)

(1) As adjusted for FAS No. 160 “Non-controlling Interest in Consolidated Financial Statements.” (See Note 1)

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)

	Six Months Ended June 30, 2009	Six Months Ended June 30, 2008 (1)
Operating Activities		
Net loss	$(12,227)	$(85,257)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Change in derivative fair value	14,577	100,038
Depreciation, depletion, and amortization	8,994	11,098
Amortization of deferred financing fees	586	467
Accretion of future site restoration	281	263
Stock-based compensation	596	896
Other non-cash expenses	123	42
Registration fees previously capitalized	2,207	—
Changes in operating assets and liabilities:		
Accounts receivable	579	(14,068)
Other	135	68
Accounts payable and accrued expenses	(6,395)	16,940
Net cash provided by operating activities	9,456	30,487
Investing Activities		
Capital expenditures, including purchases and development of properties	(7,510)	(155,475)
Net cash used in investing activities	(7,510)	(155,475)
Financing Activities		
Proceeds from long-term borrowings	5,924	124,362
Payments on long-term borrowings	(1,988)	—
Partnership distributions	(2,257)	(4,029)
Deferred financing fees	(3,242)	(1,615)
Exercise of stock options	49	44
Other	(566)	—
Net cash provided by financing activities	(2,080)	118,762
Decrease in cash	(134)	(6,226)
Cash, at beginning of period	1,924	18,936
Cash, at end of period	$1,790	$12,710
Supplemental disclosure of cash flow information:		
Interest paid	$5,402	$3,975

(1) As adjusted for FAS No. 160 “Non-controlling Interest in Consolidated Financial Statements.” (See Note 1)

See accompanying notes to condensed consolidated financial statements (unaudited)

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, 2008. 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 the 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 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. The results of operations for the three and six months ended June 30, 2009 are not necessarily indicative of results to be expected for the full year.

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 effective May 25, 2007. The operations of Abraxas Petroleum and the Partnership are consolidated for financial reporting purposes with the interest of the 51.8% non-controlling owners of the Partnership presented as non-controlling interest. Abraxas owns the remaining 48.2% of the partnership interests. The Company has 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.

In the opinion of management, the unaudited condensed consolidated financial statements include all recurring adjustments necessary for a fair presentation of the financial position as of June 30, 2009, the results of operations and the cash flows for each of the three and six month periods ended June 30, 2009 and 2008. 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 three and six month periods ended June 30, 2009 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, 2008.

On January 1, 2009, the Company adopted Statement of Financial Accounting Standards (“SFAS”) No. 160, “Noncontrolling Interests in Consolidated Financial Statements - An Amendment of ARB No. 51” (“SFAS 160”). SFAS 160 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 noncontrolling interests, (3) changes in the controlling ownership interest, (4) the valuation of retained noncontrolling equity investments when a subsidiary is deconsolidated and (5) disclosures that clearly identify and distinguish between the interests of the controlling and noncontrolling owners. The adoption of SFAS 160 resulted in changes to our presentation for noncontrolling interests and did not have a material impact on the Company’s results of operations and financial condition. Certain prior period balances have been restated to reflect the changes required by SFAS 160.

The following table illustrates the changes in consolidated equity:

	Abraxas Petroleum Corporation Shareholders Equity (deficit)						
	Comprehensive Income	Common Stock	Additional Paid-in Capital	Accumulated Deficit	Accumulated Other Comprehensive Income	Parent Equity (deficit)	Non-Controlling Interest
January 1, 2009	$ —	$496	$187,243	$ (183,194)	$ 113	$4,658	$7,093
Comprehensive income:							
Net loss	(12,227)	—	—	(5,582)	—	(5,582)	(6,645)
Unrealized gain on securities	79	—	—	—	79	79	—
Equity based compensation	—	—	526	—	—	526	46
Partnership distributions	—	—	—	—	—	—	(2,257)
Registration fees	—	—	—	—	—	—	1,385
Shares issued for compensation	—	—	36	—	—	36	—
Options exercised	—	1	48	—	—	49	—
Other	—	1	85	—	—	86	256
June 30, 2009	$ (12,148)	$498	$187,938	$ (188,776)	$ 192	$(148)	$(122)

In accordance with generally accepted accounting principles in effect prior to the adoption of 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 and any excess earnings will increase the recorded value. For the year ended December 31, 2008, primarily as a result of the ceiling test impairment of the Partnerships' oil and gas properties, losses applicable to the non-controlling interest exceeded the non-controlling equity capital by $9.3 million and, as a result, $9.3 million of the non-controlling interest loss in excess of equity was charged to earnings and was reflected as a reduction of the loss applicable to the non-controlling interest.

In June 2008, the FASB ratified EITF Issue No. 07-5, Determining Whether an Instrument (or Embedded Feature) is indexed to an Entity's Own Stock ("EITF 07-5"). EITF 07-5 is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. Early application is not permitted. EITF 07-5 provides a new two-step model to be applied in determining whether a financial instrument or an embedded feature is indexed to an issuer's own stock and thus able to qualify for the SFAS No. 133 paragraph 11(a) scope exception. The Company intends to utilize liability treatment of warrants going forward. The adoption of this standard has not had a significant impact on the Company's consolidated financial position, results of operations or cash flows.

Fair Value of Financial Instruments

The carrying amount of cash and cash equivalents, accounts receivable, accounts payable, accrued liabilities and short-term debt approximate fair value due to the short-term nature of these instruments.

The fair value of the Company's long-term debt is estimated based on the discounted value of the future cash flows expected to be paid on the loans. The discount rate used to estimate the fair value of the loans is the rate currently available to the Company for loans with similar terms and maturities. The fair value at June 30, 2009 approximated the carrying value, however, as of June 30, 2009 the Company does not believe it is practicable to estimate the fair value of its outstanding debt in light of the impending maturity on August 14, 2009 that the Company is currently seeking to address..

Use of Estimates

The preparation of financial statements in conformity with generally accepted 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 six months ended June 30, 2009, the Company recognized $270,000 and $450,000, respectively, related to stock options.

The following table summarizes the stock option activities for the six months ended June 30, 2009. (In thousands, except per share amounts).

	Shares	Weighted Average Option Exercise Price Per Share	Weighted Average Grant Date Fair Value Per Share	Aggregate Intrinsic Value
Outstanding, December 31, 2008	2,390	$ 2.81	$ 1.60	$ 3,830
Granted	965	$ 0.99	$ 0.70	678
Exercised	(50)	$ 0.97	$ 0.87	(44)
Expired or canceled	(73)	$ 4.10	$ 2.48	(181)
Outstanding, June 30, 2009	3,232	$ 2.27	$ 1.33	$ 4,283

The following table shows the weighted average assumptions used in the Black-Scholes valuation of the fair value of option grants during 2009.

Expected dividend yield	0%
Volatility	81.61%
Risk free interest rate	2.35%
Expected life	6.06
Fair value of options granted (in thousands)	$ 678
Weighted average grant date fair value of options granted	$ 0.70

Additional information related to options at June 30, 2009 and December 31, 2008 is as follows:

	June 30, 2009	December 31, 2008
Options exercisable (in thousands)	1,952	1,963

As of June 30, 2009, there was approximately $1.1 million of unamortized compensation expense related to outstanding options that will be recognized in 2009 through 2013.

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 is 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 six months ended June 30, 2009 is presented in the following table:

	Number of Shares	Weighted average grant date fair value (per share)
Unvested December 31, 2008	164,280	$ 3.35
Granted	5,000	0.80
Vested/Released	(4,625)	3.59
Forfeited	(1,712)	4.24
Unvested June 30, 2009	162,943	$ 3.26

For the three and six months ended June 30, 2009, the Company incurred $36,000 and $75,000 in equity based compensation expense relating to restricted stock.

Restricted Unit Awards

Restricted unit awards are awards of partnership units 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 unit is determined using the implied market price on the grant date. The implied market price is determined by comparing the average trading yields of comparable publicly-traded master limited partnerships to the most recent quarterly distribution paid or declared by the Partnership. Compensation expense is recorded over the applicable restricted unit vesting periods.

A summary of the Partnership's restricted unit activity for the six months ended June 30, 2009 is presented in the following table:

	Number of Units	Weighted average grant date fair value (per Unit)
Unvested December 31, 2008	—	$ —
Granted	52,000	7.23
Vested/Released	—	—
Forfeited	(100)	7.23
Unvested June 30, 2009	51,900	$ 7.23

For the three and six months ended June 30, 2009, the Partnership incurred $23,000 and $46,000 in equity based compensation expense relating to restricted units.

Phantom Units

On January 31, 2008, in connection with the closing of an acquisition of properties from St. Mary Land & Exploration Company, the Board of Directors of the general partner of the Partnership awarded phantom units with distribution equivalency rights under its long-term incentive plan to certain key employees of Abraxas Petroleum.

The phantom units and associated distribution equivalency rights will vest over four years and their value is based on the price of common units, as determined by the Board of Directors of the general partner of the Partnership, quarterly cash distributions and the percentage increase in cash distributions over time.

For the three and six months ended June 30, 2009, the Partnership incurred $0 and $25,000 in equity based compensation expense relating to phantom units.

Oil and Gas Properties

The Company follows the full cost method of accounting for oil and gas properties. Under the full cost accounting rules, the net capitalized cost of oil and gas properties less related deferred taxes, are limited by country, to the lower of the unamortized cost or the cost ceiling, defined as the sum of the present value of estimated unescalated future net revenues from proved reserves, discounted at 10%, 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. If the net capitalized cost of oil and gas properties exceeds the ceiling limit, we are subject to a ceiling limitation write-down to the extent of such excess. A ceiling limitation write-down is a charge to earnings which does not impact cash flow from operating activities. However, such write-downs do impact the amount of our stockholders' equity. The cost ceiling represents the present value (discounted at 10%) of net cash flows from sales of future production, using commodity prices on the last day of the quarter, or alternatively, if prices subsequent to that date have increased, a price near the periodic filing date of the our financial statements. As of June 30, 2009, our net capitalized costs of oil and gas properties did not exceed the present value of our estimated proved reserves.

Working Capital (Deficit)

At June 30, 2009 our current liabilities of approximately $58.6 million exceeded our current assets of $27.7 million resulting in a working capital deficit of $30.9 million. This compares to a working capital deficit of approximately $26.0 million at December 31, 2008. Current liabilities at June 30, 2009 primarily consisted of the current portion of long-term debt consisting of $40.0 million outstanding under the Subordinated Credit Agreement and $5.9 million outstanding under the Credit Facility, the current portion of derivative liabilities of $2.7 million, trade payables of $5.2 million, revenues due third parties of $2.8 million, and other accrued liabilities of $1.6 million. The Abraxas Senior Secured Credit Facility which is due on September 30, 2010 is classified as current maturities at June 30, 2009 as a result of continued non-compliance with the current ratio covenant as defined in the facility. The Subordinated Credit Agreement currently matures on August 14, 2009. The Partnership has entered into discussions with the lenders under the Partnership Credit Facility and the Subordinated Credit Agreement to extend the maturity date and certain other items to September 14, 2009. The Partnership had intended to repay the Subordinated Credit Agreement with proceeds from its initial public offering. Under the terms of the Voting Agreement (defined below), the Partnership agreed to not file any further amendments to the registration statement for its initial public offering or take any actions intended to consummate the initial public offering and, as a result of executing the Merger Agreement (defined below), we and the Partnership are no longer pursuing the refinancing of the Partnership's Subordinated Credit Agreement other than in connection with the new credit facility which is subject to the completion of the Merger (defined below). In connection with a Merger, we have received a non-binding term sheet for a new senior secured revolving credit facility of up to $300.0 million, of which $155.0 million is expected to be available to us at closing. If the Merger is not consummated, the Partnership would be in default under its Subordinated Credit Agreement and under the Partnership Credit Facility. We cannot assure you that either the Merger or the new credit facility will be consummated. If an event of default were to occur under the Subordinated Credit Agreement or the Partnership Credit Facility, the lenders could foreclose on the Partnership's assets and exercise other customary remedies, all of which would have a material adverse effect on us.

Recently Issued Accounting Pronouncements

In June 2009, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 168, "The FASB Accounting Standards CodificationTM and the Hierarchy of Generally Accepted Accounting Principles, a replacement of FASB Statement No. 162" ("SFAS 168"), which establishes the FASB Accounting Standards CodificationTM as the source of GAAP to be applied to nongovernmental agencies. SFAS 168 explicitly recognizes rules and interpretive releases of the SEC under authority of federal securities laws as authoritative GAAP for SEC registrants. SFAS 168 will become effective for interim or annual periods ending after September 15, 2009. SFAS 168 will not have a material impact on our financial statements.

In May 2009, the FASB issued SFAS No. 165, "Subsequent Events" ("SFAS 165"), which sets forth general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. SFAS 165 was adopted effective for the second quarter of 2009 and did not have a material impact on our financial statements. The Company has evaluated subsequent events through the time of filing these financial statements with the SEC on August 10, 2009.

In April 2009, the FASB issued FASB Staff Position No. SFAS 107-1 and APB No. 28-1, "Interim Disclosures about Fair Value of Financial Instruments" ("FSP FAS 107-1 and APB 28-1"), which requires quarterly disclosure of information about the fair value of financial instruments within the scope of SFAS No. 107, "Disclosures about Fair Value of Financial Instruments." FSP FAS 107-1 and APB 28-1 was adopted effective for the second quarter of 2009 and did not have an impact on our financial statements.

In April 2009, the FASB issued FASB Staff Position No. FAS 115-2 and 124-2, "Recognition and Presentation of Other-Than-Temporary Impairments" ("FSP FAS 115-2 and 124-2"). FSP FAS 115-2 and 124-2 amends the other-than-temporary impairment guidance for debt securities to make the guidance more operational and to improve the presentation and disclosure of other-than-temporary impairments on debt and equity securities in the financial statements. FSP FAS 115-2 and 124-2 does not amend existing recognition and measurement guidance related to other-than-temporary impairments of equity securities. FSP FAS 115-2 and 124-2 does not require disclosures for earlier periods presented for comparative purposes at initial adoption. In periods after initial adoption, FSP FAS 115-2 and 124-2 requires comparative disclosures only for periods ending after initial adoption. FSP FAS 115-2 and 124-2 was adopted effective for the second quarter of 2009 and did not have an impact on our financial statements.

In December 2008, the SEC issued Release No. 33-8995, "Modernization of Oil and Gas Reporting," amending oil and gas reporting requirements under Rule 4-10 of Regulation S-X and Industry Guide 2 in Regulation S-K. The new requirements provide for consideration of new technologies in evaluating reserves, allow companies to disclose their probable and possible reserves to investors, report oil and gas reserves using an average price based on the prior 12-month period rather than year-end prices, and revise the disclosure requirements for oil and gas operations. The final rules are effective for fiscal years ending on or after December 31, 2009.

Note 2. Recent Events

Merger Agreement

On July 17, 2009, Abraxas Petroleum and Abraxas Energy Partners and, from and after its accession to the agreement, the Delaware limited liability company formed as a wholly-owned subsidiary of Abraxas ("Merger Sub"), entered into an Amended and Restated Agreement and Plan of Merger (the "Merger Agreement"), pursuant to which Abraxas Energy Partners will, subject to the terms and conditions of the Merger Agreement, merge with and into Merger Sub, with Merger Sub surviving and continuing as a wholly-owned subsidiary of Abraxas Petroleum (the "Merger").

As of July 17, 2009, Abraxas Petroleum and its subsidiaries beneficially owned, within the meaning of Rule 13d-3 of the U.S. Securities and Exchange Act of 1934, as amended, 5,350,598 common units of Abraxas Energy Partners, representing approximately 46.7% of the outstanding Abraxas Energy Partners common units (the "Abraxas Energy Partners Common Units").

Subject to the terms and conditions of the Merger Agreement, if and when the Merger is completed, each outstanding Abraxas Energy Partners Common Unit, other than treasury units and Abraxas Energy Partners Common Units owned by Abraxas Petroleum and its subsidiaries, will be canceled and converted into the right to receive the number of shares of Abraxas Petroleum common stock determined by dividing (i) $6.00 by (ii) the average volume weighted average price for the Abraxas Petroleum common stock as reported on NASDAQ for the twenty consecutive trading days ending on the third business day preceding the date of the meeting of the Abraxas Petroleum stockholders held to approve the Merger (the "Exchange Ratio"); provided, however, that in no event shall the Exchange Ratio be less than 4.25 or greater than 6.

In addition, as of the consummation of the Merger, each outstanding restricted unit and phantom unit of Abraxas Energy Partners will be converted into an equivalent number of shares of restricted stock of Abraxas Petroleum and each unit option of Abraxas Energy Partners which was to be issued upon the completion of the initial public offering of Abraxas Energy Partners will become a stock option of Abraxas Petroleum, with adjustments in the number of shares and exercise price to reflect the Exchange Ratio, but otherwise on substantially the same terms and conditions as were applicable prior to the Merger. The exercise price of the Abraxas Petroleum stock options will be the closing price of the Abraxas Petroleum common stock on the date the Merger closes.

The Merger Agreement contains (a) customary representations and warranties of Abraxas Petroleum Abraxas Energy Partners and Merger Sub; (b) covenants of Abraxas Petroleum and Abraxas Energy Partners to conduct their respective businesses in the ordinary course until the Merger is completed; and (c) covenants of Abraxas Petroleum and Abraxas Energy Partners not to take certain actions during such period, including prohibitions on the declaration or payment of dividends and distributions.

Consummation of the Merger is subject to conditions set forth in the Merger Agreement, including, among others, (1) the approval of the issuance of Abraxas Petroleum common stock in the Merger (the "Stock Issuance") by the affirmative vote of the holders of a majority of the Abraxas Petroleum common stock voting at a stockholders' meeting, (2) the approval of an amendment to the Abraxas Petroleum 2005 Long-Term Equity Incentive Plan to increase the number of authorized shares for issuance under the plan (the "LTIP Amendment") by the affirmative vote of the holders of a majority of the outstanding Abraxas Petroleum common stock voting at a stockholders' meeting, (3) the receipt by Abraxas Petroleum of financing that is sufficient to consummate the Merger and repay all indebtedness outstanding under Abraxas Energy Partner's credit agreement and subordinated credit agreement, and, (4) certain other customary closing conditions.

The board of directors of Abraxas Petroleum and a special committee comprised entirely of independent Abraxas Petroleum directors have approved the Merger Agreement. The board of directors adopted a resolution recommending adoption of the LTIP Amendment and approval of the Stock Issuance by the Abraxas Petroleum stockholders.

The foregoing description of the Merger and the Merger Agreement does not purport to be complete and is qualified in its entirety by reference to the Merger Agreement which was filed with the SEC on July 21, 2009.

The above description of the Merger Agreement has been included to provide investors and security holders with information regarding its terms. It is not intended to provide any other factual information about the parties or their respective subsidiaries and affiliates. The Merger Agreement contains representations and warranties made by and to the parties thereto as of specific dates. The statements embodied in those representations and warranties were made for purposes of that contract between the parties and are subject to qualifications and limitations agreed to by the parties in connection with negotiating the terms of that contract. In addition, certain representations and warranties were made as of a specified date, may be subject to a contractual standard of materiality different from those generally applicable to investors, or may have been used for the purpose of allocating risk between the parties rather than establishing matters as facts.

Voting Agreement

In order to induce Abraxas Petroleum and Abraxas Energy Partners to enter into the Merger Agreement, certain limited partners of Abraxas Energy Partners entered into a Voting, Registration Rights and Lock-Up Agreement (the "Voting Agreement") with Abraxas Petroleum and Abraxas Energy Partners.

The Voting Agreement provides, among other things, that all of the limited partners that are party to the Voting Agreement will:

- vote all of their outstanding common units of Abraxas Energy Partners in favor of the Merger;

- vote against any other merger agreement, consolidation, combination, sale of substantial assets or similar transaction;

- grant an irrevocable proxy to Abraxas Petroleum to vote all of their common units of Abraxas Energy Partners in favor of the Merger Agreement and against any other transaction;

- agree to not, directly or indirectly, transfer any of such limited partners common units of Abraxas Energy Partners to any person (other than an affiliate of such limited partner who agrees to be bound by the terms of this agreement) other than pursuant to the Merger;

- not directly, or indirectly permit any person on behalf of such limited partner, to effect any transactions in the securities of Abraxas Petroleum;

- not transfer any of the shares of Abraxas Petroleum common stock received by such limited partner in the Merger (the "Merger Shares") for 90 days after the effective time of the Merger (the "Effective Time") followed by a staggered lock-up period for the shares of Abraxas Petroleum common stock issued in the Merger; and

- not exercise any of its rights or take any action under the Exchange and Registration Rights Agreement, dated as of May 25, 2007, as amended, by and among Abraxas Petroleum, Abraxas Energy Partners and the limited partners signatories thereto.

The Voting Agreement provides, among other things, that Abraxas Petroleum and Abraxas Energy Partners will

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- not file any further amendments to the registration statement on Form S-1 (No. 333-144537) relating to the initial public offering of the common units of Abraxas Energy Partners; and

- at the Effective Time increase the size of the Board of Directors of Abraxas Petroleum by two members and elect Ed Russell and Brian Melton to serve on the Board of Directors.

In addition, under the Voting Agreement, Abraxas Petroleum agreed to file with the SEC a registration statement on Form S-3 or such other successor form, no later than 120 days following the Effective Time to enable the resale of the Merger Shares by the limited partners party to the Voting Agreement and shall use its commercially reasonable efforts to cause the Registration Statement to become effective. Abraxas Petroleum also granted such limited partners the right to demand that Abraxas Petroleum conduct an underwritten offering and to participate in certain Abraxas offerings.

The foregoing description of the Voting Agreement does not purport to be complete and is qualified in its entirety by reference to the Voting Agreement and Amendment No. 1 to the Voting Agreement which were filed with the SEC on July 21, 2009, respectively.

The above description of the Voting Agreement has been included to provide investors and security holders with information regarding its terms. It is not intended to provide any other factual information about the parties or their respective subsidiaries and affiliates. The Voting Agreement contains representations and warranties made by and to the parties thereto as of specific dates. The statements embodied in those representations and warranties were made for purposes of that contract between the parties and are subject to qualifications and limitations agreed to by the parties in connection with negotiating the terms of that contract. In addition, certain representations and warranties were made as of a specified date, may be subject to a contractual standard of materiality different from those generally applicable to investors, or may have been used for the purpose of allocating risk between the parties rather than establishing matters as facts.

Amendments to the Credit Agreements

On June 30, 2009, Abraxas Energy Partners entered into Amendment No. 4 to the Partnership Credit Facility, dated as of January 31, 2008, by and among Abraxas Energy Partners, the lenders party thereto and Société Générale, as Administrative Agent, and Amendment No. 4 to the Subordinated Credit Agreement dated as of January 31, 2008, by and among Abraxas Energy Partners, the lenders party thereto and Société Générale, as Administrative Agent. Pursuant to these amendments, among other things, the maturity date of the Subordinated Credit Agreement was extended to August 14, 2009.

On July 22, 2009, Abraxas Energy Partners entered into Amendment No. 5 to the Partnership Credit Facility, dated as of January 31, 2008, by and among Abraxas Energy Partners, the lenders party thereto and Société Générale, as Administrative Agent, and Amendment No. 5 to the Subordinated Credit Agreement dated as of January 31, 2008, by and among Abraxas Energy Partners, the lenders party thereto and Société Générale, as Administrative Agent. Pursuant to these amendments, among other things, the lenders permitted the monetization of the Partnership's existing commodity swaps. On July 29, 2009, the Partnership monetized all of its "in-the-money" commodity swaps for \$26.7 million and together with the July 2009 settlement of its commodity swaps of \$2.0 million, the Partnership repaid \$28.7 million of indebtedness under the Partnership Credit Facility on July 31, 2009. In connection with the monetization and repayment, the Partnership's borrowing base was reduced to \$95.0 million and the Partnership was required to enter into new commodity swaps. The following table sets forth the consolidated weighted average derivative contract position as of July 29, 2009 for Abraxas Petroleum and the Partnership:

Contract Period	Fixed-Price Swaps: Oil Daily Volume (Bbl)	Oil Swap Price	Gas Daily Volume (Mmbtu)	Gas Swap Price
Q4 2009	1,355	$68.90	13,981	$4.50
2010	1,158	73.28	11,258	5.73
2011	1,035	76.61	9,580	6.52
2012	946	70.89	8,303	6.77
2013	705	80.79	5,962	6.84

Note 3. Acquisition

On January 31, 2008, Abraxas Operating, LLC, a wholly-owned subsidiary of the Partnership, consummated the acquisition of certain oil and gas properties located in various states from St. Mary Land & Exploration Company ("St. Mary") and certain other sellers. The properties are primarily located in the Rockies and Mid-Continent regions of the United States, and include approximately 57.2 Bcfe (9,525 MBOE) of estimated proved reserves for a purchase price of approximately $126.0 million.

The Partnership borrowed approximately $115.6 million under the Partnership Credit Facility and $50 million under its Subordinated Credit Agreement in order to complete this acquisition and repay its previously outstanding indebtedness of $45.9 million. For a complete description of these credit facilities, please see Note 5 "Long-Term Debt".

Simultaneously, Abraxas Petroleum announced that it had completed the acquisition of certain oil and gas properties from St. Mary with estimated proved reserves of approximately 4.3 Bcfe (725 MBOE) for a purchase price of approximately $5.6 million. Abraxas paid the purchase price from its internal funds. The right to purchase these properties had been assigned to Abraxas by the Partnership.

Substantially all amounts paid in the acquisition, including acquisition costs of approximately $1.1 million, were allocated to the oil and gas properties. The following unaudited supplemental information presents pro forma financial results assuming the acquisition had occurred on January 1, 2008. The unaudited pro forma financial results are not necessarily those that would have been attained had the acquisition occurred as of an earlier date, nor are they necessarily representative of the future results that may occur.

Unaudited Pro Forma Financial Information

		Six months ended June 30, 2008	
Revenue	$	59,591	
Net Income	$	(64,557	)
Earnings per share - basic	$	(1.32	)

Note 4. 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.

For the three and six month periods ended June 30, 2009 and 2008, there is no current or deferred income tax expense or benefit due to losses and/or loss carryforwards and valuation allowance which have been recorded against such benefits.

The Company accounts for uncertain tax positions under provisions of FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes" ("FIN 48"). FIN 48 did not have any effect on the Company's financial position or results of operations for the six months ended June 30, 2008 and 2009. The Company recognizes interest and penalties related to uncertain tax positions in income tax expense. As of June 30, 2009, the Company did not have any accrued interest or penalties related to uncertain tax positions. The tax years from 1999 through 2008 remain open to examination by the tax jurisdictions to which the Company is subject.

Note 5. Long-Term Debt

Long-term debt consisted of the following:

	June 30, 2009	December 31, 2008
Partnership credit facility	$ 123,675	$ 125,600
Partnership subordinated credit agreement	40,000	40,000
Senior secured credit facility	5,924	—
Real estate lien note	5,306	5,369
	174,905	170,969
Less current maturities	(46,062)	(40,134)
	$ 128,843	$ 130,835

Abraxas Senior Secured Credit Facility.

On June 27, 2007, Abraxas entered into a new senior secured revolving credit facility, which we refer to as the Credit Facility, which was amended on February 4, 2009 and May 13, 2009. The Credit Facility has a maximum commitment of $50.0 million. Availability under the Credit Facility is subject to a borrowing base. The borrowing base under the Credit Facility 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, may make one additional borrowing base redetermination during any six-month period between scheduled redeterminations and we may also request one redetermination during any six-month period between scheduled redeterminations. The lenders may also make a redetermination in connection with any sales of producing properties with a market value of 5% or more of our current borrowing base. Our borrowing base at June 30, 2009 of $6.5 million was determined based upon our reserves at December 31, 2008. Our borrowing base can never exceed the $50.0 million maximum commitment amount. Outstanding amounts under the Credit Facility bear interest at (a) the greater of the reference rate announced from time to time by Société Générale, and (b) the Federal Funds Rate plus 0.5% of 1%, plus in each case, (c) 0.5% - 1.5% depending on utilization of the borrowing base, or, if Abraxas elects, at the London Interbank Offered Rate plus 1.5% - 2.5%, depending on the utilization of the borrowing base. At August 7, 2009, the interest rate on the Credit Facility was 2.8%. Subject to earlier termination rights and events of default, the Credit Facility's stated maturity date is September 30, 2010. Interest is payable quarterly on reference rate advances and not less than quarterly on Eurodollar advances.

Abraxas is permitted to terminate the Credit Facility, and may, from time to time, permanently reduce the lenders' aggregate commitment under the Credit Facility in compliance with certain notice and dollar increment requirements.

Each of Abraxas' subsidiaries other than the Partnership, Abraxas General Partner, LLC, which we refer to as the GP, and Abraxas Energy Investments, LLC has guaranteed Abraxas' 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 Abraxas' and the subsidiary guarantors' material property and assets.

Under the Credit Facility, Abraxas is subject to customary covenants, including certain financial covenants and reporting requirements. The Credit Facility requires Abraxas to maintain a minimum current ratio as of the last day of each quarter of not less than 1.00 to 1.00 and an interest coverage ratio of not less than 2.50 to 1.00. The current ratio is the ratio of consolidated current assets to consolidated current liabilities. For purposes of this calculation, current assets include, as of the date of the calculation, the portion of the borrowing base which is undrawn but exclude, as of the date of calculation, any cash deposited with or at the request of a counterparty to any derivative contract, any assets representing a valuation account arising from the application of SFAS 133 (which relates to derivative instruments and hedging activities) and SFAS 143 (which relates to asset retirement obligations) and any distributions payable by the Partnership to the GP unless such distributions have been received by the GP in cash, and current liabilities exclude, as of the date of calculation, the current portion of long-term debt, any liabilities representing a valuation account arising from the application of SFAS 133 and SFAS 143 and any liabilities of the GP arising solely in its capacity as a general partner of the Partnership. The interest coverage ratio is the ratio of consolidated EBITDA for the four quarters then ended to consolidated interest for the four quarters then ended. For the purpose of this calculation, EBITDA is consolidated net income plus interest expense, taxes, depreciation, amortization, depletion and other non-cash charges including non-cash charges resulting from the application of SFAS 123R (which relates to stock-based compensation), SFAS 133 and SFAS 143 less all non-cash items of income which were included in determining consolidated net income, including non-cash items resulting from the application of SFAS 133 and SFAS 143. Interest expense includes total interest, letters of credit fees and other fees and expenses incurred in connection with any debt. For purposes of calculating both ratios, any amounts attributable to the Partnership are not included. At June 30, 2009, our current ratio was 0.85 to 1.00 and our interest coverage ratio was 9.64 to 1.00.

In addition to the foregoing and other customary covenants, the Credit Facility contains a number of covenants that, among other things, will restrict Abraxas' ability to:

- incur or guarantee additional indebtedness;
- transfer or sell assets;
- create liens on assets;
- engage in transactions with affiliates other than on an "arms-length" basis;
- make any change in the principal nature of its 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.

The Company was in compliance with all covenants as of June 30, 2009 or has obtained a waiver for noncompliance. As a result of continued non-compliance with the current ratio covenant, the outstanding amount of this facility has been classified as current liability.

Amended and Restated Partnership Credit Facility.

On May 25, 2007, the Partnership entered into a senior secured revolving credit facility which was amended and restated on January 31, 2008 and further amended on January 16, 2009, April 30, 2009, May 7, 2009, June 30, 2009 and July 22, 2009, which we refer to as the Partnership Credit Facility. The Partnership Credit Facility has a maximum commitment of $300.0 million. Availability under the Partnership Credit Facility is subject to a borrowing base. The borrowing base under the Partnership Credit Facility, which at June 30, 2009, was $128.1 million, is determined semi-annually by the lenders based upon the Partnership's reserve reports, one of which must be prepared by the Partnership's 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 the Partnership's proved reserves utilizing these reserve reports and their own internal decisions. In addition, the lenders, in their sole discretion, may make one additional borrowing base redetermination during any six-month period between scheduled redeterminations. The lenders may also make a redetermination in connection with any sales of producing properties with a market value of 5% or more of the Partnership's then current borrowing base.

The Partnership's borrowing base at June 30, 2009 of $128.1 million was determined based upon its reserves at December 31, 2008. The borrowing base can never exceed the $300.0 million maximum commitment amount. At June 30, 2009 the Partnership had a total of $123.7 million outstanding under the Partnership Credit Facility. On July 31, 2009, the Partnership repaid $28.7 million of indebtedness after which, the Partnership had $95.0 million outstanding under the Partnership Credit Facility. Simultaneously, the borrowing base under the Partnership Credit Facility was reduced to $95.0 million.

Outstanding amounts under the Partnership 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 rate plus, in each case, 1.5% - 2.5%, depending on the utilization of the borrowing base, or, if the Partnership elects, at the greater of (a) 2.0% and (b) the London Interbank Offered Rate plus in each case, 2.5% - 3.5% depending on the utilization of the borrowing base. At August 7, 2009 the interest rate on the Partnership Credit Facility was 5.5%. Subject to earlier termination rights and events of default, the Partnership Credit Facility's stated maturity date is January 31, 2012. Interest is payable quarterly on reference rate advances and not less than quarterly on Eurodollar advances. The Partnership is permitted to terminate the Partnership Credit Facility, and under certain circumstances, may be required, from time to time, to permanently reduce the lenders' aggregate commitment under the Partnership Credit Facility.

The Partnership, GP, which is a wholly-owned subsidiary of Abraxas, and Abraxas Operating, LLC, which is a wholly-owned subsidiary of the Partnership and which we refer to as Abraxas Operating, have guaranteed the Partnership's obligations under the

Partnership Credit Facility on a senior secured basis. Obligations under the Partnership Credit Facility are secured by a first priority perfected security interest, subject to certain permitted encumbrances, in all of the property and assets of the GP, the Partnership and Abraxas Operating, other than the GP's general partner units in the Partnership.

Under the Partnership Credit Facility, the Partnership is subject to customary covenants, including certain financial covenants and reporting requirements. The Partnership Credit Facility requires the Partnership to maintain a minimum current ratio as of the last day of each quarter of 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. Current ratio is defined as the ratio of consolidated current assets to consolidated current liabilities. For purposes of this calculation, current assets include, as of the date of the calculation, the portion of the borrowing base which is undrawn but exclude, as of the date of calculation, any cash deposited with or at the request of a counterparty to any derivative contract and any assets representing a valuation account arising from the application of SFAS 133 and SFAS 143 and current liabilities exclude, as of the date of calculation, the current portion of long-term debt and any liabilities representing a valuation account arising from the application of SFAS 133 and SFAS 143. The interest coverage ratio is the ratio of consolidated EBITDA for the four quarters then ended to consolidated interest for the four quarters then ended. For the purpose of this calculation, EBITDA is consolidated net income plus interest expense, taxes, depreciation, amortization, depletion and other non-cash charges including non-cash charges resulting from the application of SFAS 123R, SFAS 133 and SFAS 143 less all non-cash items of income which were included in determining consolidated net income, including non-cash items resulting from the application of SFAS 133 and SFAS 143. Interest expense includes total interest, letters of credit fees and other fees and expenses incurred in connection with any debt. At June 30, 2009, the Partnership's current ratio was 23.74 to 1.00 and its interest coverage ratio was 3.85 to 1.00.

The Partnership Credit Facility required the Partnership to enter into derivative contracts for specific volumes, which equated to approximately 85% of the estimated oil and gas production from its net proved developed producing reserves through December 31, 2011. The Partnership entered into NYMEX-based fixed price commodity swaps on approximately 85% of its estimated oil and gas production from its estimated net proved developed producing reserves through December 31, 2011. The second amendment to the Partnership Credit Facility required additional derivative contracts for volumes equating to approximately 60% of the estimated oil and gas production from net proved developed producing reserves for the year 2012. As a result, the Partnership entered into NYMEX-based fixed price swaps on 670 barrels of oil per day at $67.60 and 3,000 MMBbtu of gas per day at $6.88 for 2012. On July 29, 2009, the Partnership monetized all of its "in-the-money" commodity swaps for $26.7 million and together with the July 2009 settlement of its commodity swaps of $2.0 million, the Partnership repaid $28.7 million of indebtedness under the Partnership Credit Agreement on July 31, 2009. In connection with the monetization and repayment, the Partnership was required to enter into new commodity swaps on approximately 85% of its estimated oil and gas production from its net proved developed producing reserves through December 31, 2012 and on 70% for the calendar year 2013.

Under the terms of the Partnership Credit Facility, the Partnership may make cash distributions if, after giving effect to such distributions, the Partnership is not in default under the Partnership Credit Facility, there is no borrowing base deficiency and provided that (a) no such distribution shall be made using the proceeds of any advance unless the unused portion of the amount then available under the Partnership Credit Facility is greater than or equal to 10% of the lesser of the Partnership's borrowing base (which at July 31, 2009 was $95.0 million) or the total commitment amount of the Partnership Credit Facility (which at July 31, 2009 was $300.0 million) at such time, (b) with respect to the cash distribution scheduled to be made on or about May 15, 2009 attributable to the first quarter of 2009, no such distribution shall be made unless (i) the sum of unrestricted cash and the unused portion of the amount then available under the Partnership Credit Facility after giving effect to such distribution exceeds $20.0 million, or (ii) the Subordinated Credit Agreement shall have terminated and (c) no cash distribution shall exceed $0.44 per unit per quarter while the Subordinated Credit Agreement is outstanding. The declaration of the cash distribution to be made by the Partnership on or about May 15, 2009 attributable to the first quarter of 2009 was deferred. Furthermore, in accordance with the terms of the Merger Agreement, the Partnership is precluded from declaring or paying any future cash distributions. While the Subordinated Credit Agreement is outstanding, the Partnership's capital expenditures are limited to $12.5 million per year.

In addition to the foregoing and other customary covenants, the Partnership Credit Facility contains a number of covenants that, among other things, will restrict the Partnership's ability to:

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

- engage in transactions with affiliates;
- make any change in the principal nature of its business; and
- permit a change of control.

The Partnership 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 including the Subordinated Credit Agreement described below, bankruptcy and material judgments and liabilities. If the indebtedness under the Subordinated Credit Agreement was not repaid on or before July 1, 2009, the Partnership was required to pay the lenders a consent fee of $2.4 million. This fee was paid by the Partnership on June 30, 2009 and capitalized as deferred financing fees.

The Partnership was in compliance with all covenants as of June 30, 2009.

Subordinated Credit Agreement

On January 31, 2008, the Partnership entered into a subordinated credit agreement which was amended on January 16, 2009 and further amended on April 30, 2009, May 7, 2009, June 30, 2009 and July 22, 2009, which we refer to as the Subordinated Credit Agreement. The Subordinated Credit Agreement has a maximum commitment of $40.0 million. Outstanding amounts under the Subordinated Credit Agreement 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 Offered Rate, plus in each case (b) 12.0% or, if the Partnership elects, at the greater of (a) 2.0% and (b) the London Interbank Offered Rate, in each case, plus 13.00%. At August 7, 2009, the interest rate on the Subordinated Credit Agreement was 15.0%. For any interest payment due on or after July 2, 2009, 3% per annum of the accrued interest payable shall be capitalized and added to the principal amount of the loan. Interest is payable quarterly on reference rate advances and not less than quarterly on Eurodollar advances. The Partnership is permitted to terminate the Subordinated Credit Agreement, and under certain circumstances, may be required, from time to time, to make prepayments under the Subordinated Credit Agreement.

Each of the GP and Abraxas Operating has guaranteed the Partnership’s obligations under the Subordinated Credit Agreement on a subordinated secured basis. Obligations under the Subordinated Credit Agreement are secured by subordinated security interests, subject to certain permitted encumbrances, in all of the property and assets of the Partnership, GP, and Abraxas Operating, other than the GP’s general partner units in the Partnership.

Under the Subordinated Credit Agreement, the Partnership is subject to customary covenants, including certain financial covenants and reporting requirements. The Subordinated Credit Agreement requires the Partnership to maintain a minimum current ratio as of the last day of each quarter of 1.00 to 1.00 and an interest coverage ratio (defined as the ratio of consolidated EBITDA to consolidated interest expense) as of the last day of each quarter of not less than 2.50 to 1.00. Current ratio is defined as the ratio of consolidated current assets to consolidated current liabilities. For purposes of this calculation, current assets include, as of the date of the calculation, the portion of the borrowing base which is undrawn but exclude, as of the date of calculation, any cash deposited with or at the request of a counterparty to any derivative contract and any assets representing a valuation account arising from the application of SFAS 133 and 143, and current liabilities exclude, as of the date of calculation, the current portion of long-term debt and any liabilities representing a valuation account arising from the application of SFAS 133 and 143. The interest coverage ratio is the ratio of consolidated EBITDA for the four quarters then ended to consolidated interest for the four quarters then ended. For the purpose of this calculation, EBITDA is consolidated net income plus interest expense, taxes, depreciation, amortization, depletion and other non-cash charges including non-cash charges resulting from the application of SFAS 123R (which relates to stock-based compensation), SFAS 133 and SFAS 143 less all non-cash items of income which were included in determining consolidated net income, including non-cash items resulting from the application of SFAS 133 and SFAS 143. Interest expense includes total interest, letters of credit fees and other fees and expenses incurred in connection with any debt. At June 30, 2009, the Partnerships current ratio was 23.74 to 1.00 and its interest coverage ratio was 3.85 to 1.00.

The Subordinated Credit Agreement required the Partnership to enter into derivative contracts for specific volumes, which equated to approximately 85% of the estimated oil and gas production from its net proved developed producing reserves through December 31, 2011. The Partnership entered into NYMEX-based fixed price commodity swaps on approximately 85% of its estimated oil and gas production from its estimated net proved developed producing reserves through December 31, 2011. The second amendment to the Partnership Credit Facility required additional derivative contracts for volumes equating to approximately 60% of the estimated oil and gas production from net proved developed producing reserves for the year 2012. As a result, the Partnership entered into NYMEX-based fixed price swaps on 670 barrels of oil per day at $67.60 and 3,000 MMBbtu of gas per day at $6.88 for 2012. On July 29, 2009, the Partnership monetized all of its “in-the-money” commodity swaps for $26.7 million and together with the July 2009 settlement of its commodity swaps of $2.0 million, the Partnership repaid $28.7 million of indebtedness under the Partnership Credit Agreement on July 31, 2009. In connection with the monetization and repayment, the Partnership was required to enter into new commodity swaps on approximately 85% of its estimated oil and gas production from its net proved developed producing reserves through December 31, 2012 and on 70% for the calendar year 2013.

In addition to the foregoing and other customary covenants, the Subordinated Credit Agreement contains a number of covenants that, among other things, will restrict the Partnership’s ability to:

- incur or guarantee additional indebtedness;
- transfer or sell assets;
- create liens on assets;
- engage in transactions with affiliates;
- make any change in the principal nature of its business; and
- permit a change of control.

The Subordinated Credit Agreement also contains customary events of default, including nonpayment of principal or interest, violations of covenants, cross default and cross acceleration to certain other indebtedness including the Partnership Credit Facility, bankruptcy and material judgments and liabilities. An event of default would also occur if the Partnership fails to receive $20.0 million of proceeds from an equity issuance on or before August 14, 2009. In addition, if the indebtedness under the Subordinated Credit Agreement has not been repaid on or before August 14, 2009, the Partnership is required to issue warrants to purchase 2.5% of the then outstanding units to the lenders at an exercise price of $0.01 per unit. The Subordinated Credit Agreement currently matures on August 14, 2009. The Partnership has entered into discussions with the lenders under the Partnership Credit Facility and the Subordinated Credit Agreement to extend the maturity date and the requirement for proceeds from an equity issuance and the warrant issuance to September 14, 2009. The Partnership had intended to repay the Subordinated Credit Agreement with proceeds from its initial public offering. Under the terms of the Voting Agreement, the Partnership agreed to not file any further amendments to the registration statement for its initial public offering or take any actions intended to consummate the initial public offering and, as a result of executing the Merger Agreement, we and the Partnership are no longer pursuing the refinancing of the Partnership’s Subordinated Credit Agreement other than in connection with the new credit facility which is subject to the completion of the Merger. In connection with the Merger, we have received a non-binding term sheet for a new senior secured revolving credit facility of up to $300.0 million, of which $155.0 million is expected to be available to us at closing. If the Merger is not consummated, the Partnership would be in default under its Subordinated Credit Agreement and under the Partnership Credit Facility. We cannot assure you that the Merger or the new credit facility will be consummated. If an event of default were to occur under the Subordinated Credit Agreement or the Partnership Credit Facility, the lenders could foreclose on the Partnership’s assets and exercise other customary remedies, all of which would have a material adverse effect on us.

The Partnership was in compliance with all covenants as of June 30, 2009.

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 new building to serve as its corporate headquarters. This note was refinanced in November 2008. The new 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 June 30, 2009, $5.3 million was outstanding on the note.

Note 6. Condensed Consolidating Financial Statements

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries and the operations of the Partnership which was formed on May 25, 2007. The operations of Abraxas

Petroleum and the Partnership are consolidated for financial reporting purposes. The interest of the 51.8% owners of the Partnership are presented as non-controlling interest. Abraxas owns the remaining 48.2% of the partnership interests. The Company has 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. The consolidating financial statements are presented as follows:

Condensed Consolidating Balance Sheet
June 30, 2009
(unaudited)
(In thousands)

	Abraxas Petroleum Corporation	Abraxas Energy Partners, L.P.	Reclassifi-cations and eliminations	Consolidated
Assets:				
Cash	$276	$1,514	$—	$ 1,790
Accounts receivable, less allowance for doubtful accounts	7,427	7,953	(7,993)	7,387
Derivative asset – current	—	18,092	—	18,092
Other current assets	391	41	—	432
Total current assets	8,094	27,600	(7,993)	27,701
Property and equipment – net	43,811	112,312	2,701	158,824
Deferred financing fees, net	53	4,046	—	4,099
Derivative asset – long-term	—	9,456	—	9,456
Investment in partnership	11,890	—	(11,890)	—
Other assets	483	—	—	483
Total assets	$64,331	$153,414	$(17,182)	$ 200,563
Liabilities and Stockholders’ equity (deficit):				
Current liabilities:				
Accounts payable	$4,928	$312	$—	$ 5,240
Oil and gas production payable	10,743	—	(7,993)	2,750
Accrued interest	18	255	—	273
Other accrued expenses	1,575	—	—	1,575
Derivative liability – current	—	2,697	—	2,697
Current maturities of long-term debt	6,062	40,000	—	46,062
Dividend payable	—	19	—	19
Total current liabilities	23,326	43,283	(7,993)	58,616
Long-term debt	5,168	123,675	—	128,843
Future site restoration	929	9,243	—	10,172

Derivative liability – long-term	—	3,202	—	3,202
Total liabilities	29,423	179,403	(7,993)	200,833
Abraxas Petroleum equity (deficit)	34,908	(25,989)	(9,067)	(148)
Non-controlling interest equity (deficit)	—	—	(122)	(122)
Total equity (deficit)	34,908	(25,989)	(9,189)	(270)
Total liabilities and stockholders' equity (deficit)	$64,331	$153,414	$(17,182)	$ 200,563

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Condensed Consolidating Balance Sheet
December 31, 2008 (1)
(unaudited)
(In thousands)

	Abraxas Petroleum Corporation	Abraxas Energy Partners, L.P.	Reclassifications and eliminations	Consolidated
Assets:				
Cash	$—	$1,924	$—	$ 1,924
Accounts receivable, less allowance for doubtful accounts	11,514	7,695	(11,243)	7,966
Derivative asset – current	—	22,832	—	22,832
Other current assets	535	37	—	572
Total current assets	12,049	32,488	(11,243)	33,294
Property and equipment – net	41,291	119,017	—	160,308
Deferred financing fees, net	102	1,341	—	1,443
Derivative asset – long-term	—	16,394	—	16,394
Investment in partnership	11,889	—	(11,889)	—
Other assets	400	—	—	400
Total assets	$65,731	$169,240	$(23,132)	$ 211,839
Liabilities and Stockholders' equity:				
Current liabilities:				
Accounts payable	$9,606	$1,142	$—	$ 10,748
Oil and gas production payable	12,053	8	(8,885)	3,176
Accrued interest	18	332	—	350
Other accrued expenses	1,643	243	—	1,886
Derivative liability – current	—	3,000	—	3,000
Current maturities of long-term debt	134	40,000	—	40,134
Dividend payable	—	2,358	(2,358)	—
Total current liabilities	23,454	47,083	(11,243)	59,294
Long-term debt	5,235	125,600	—	130,835
Future site restoration	910	9,049	—	9,959
Total liabilities	29,599	181,732	(11,243)	200,088
Abraxas Petroleum equity (deficit)	36,132	(12,492)	(18,982)	4,658

Non-controlling interest equity	—	—	7,093	7,093
Total equity (deficit)	36,132	(12,492)	(11,889)	11,751
Total liabilities and stockholders' equity (deficit)	$65,731	$169,240	$(23,132)	$211,839

(1) As adjusted for FAS No. 160 "Non-controlling Interest in Consolidated Financial Statements."

Condensed Consolidating Statement of Operations
For the three months ended June 30, 2009
(unaudited)
(In thousands)

	Abraxas Petroleum Corporation	Abraxas Energy Partners, L.P.	Reclassifi-cations and eliminations	Consolidated
Revenues:				
Oil and gas production revenues	$2,428	$9,691	$ —	$ 12,119
Rig revenues	247	—	—	247
Other	2	—	—	2
	2,677	9,691	—	12,368
Operating costs and expenses:				
Lease operating and production taxes	956	5,029	—	5,985
Depreciation, depletion, and amortization	935	3,502	70	4,507
Rig operations	211	—	—	211
General and administrative	933	668	—	1,601
	3,035	9,199	70	12,304
Operating income (loss)	(358)	492	(70)	64
Other (income) expense:				
Interest income	(2)	(4)	—	(6)
Amortization of deferred financing fees	39	335	—	374
Interest expense	167	2,884	—	3,051
Loss on derivative contracts	—	14,560	—	14,560
Other	—	2,208	—	2,208
	204	19,983	—	20,187
Net loss	(562)	(19,491)	(70)	(20,123)
Less: Net loss attributable to non-controlling interest	—	—	10,091	10,091
Net loss attributable to Abraxas Petroleum	$ (562)	$ (19,491)	$ 10,021	$ (10,032)

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Condensed Consolidating Statement of Operations
For the three months ended June 30, 2008 (1)
(unaudited)
(In thousands)

	Abraxas Petroleum Corporation	Abraxas Energy Partners, L.P.	Reclassifi-cations and eliminations	Consolidated
Revenues:				
Oil and gas production revenues	$ 5,639	$ 28,444	$ —	$ 34,083
Rig revenues	329	—	—	329
Other	11	—	—	11
	5,979	28,444	—	34,423
Operating costs and expenses:				
Lease operating and production taxes	840	6,330	—	7,170
Depreciation, depletion, and amortization	925	5,079	—	6,004
Rig operations	193	—	—	193
General and administrative	1,097	776	—	1,873
	3,055	12,185	—	15,240
Operating income	2,924	16,259	—	19,183
Other (income) expense:				
Interest income	(28)	(3)	—	(31)
Amortization of deferred financing fees	10	263	—	273
Interest expense	48	2,624	—	2,672
Loss on derivative contracts	—	81,135	—	81,135
Other	23	711		734
	53	84,730	—	84,783
Net income (loss)	2,871	(68,471)	—	(65,600)
Less: Net loss attributable to non-controlling interest………………	—	—	7,912	7,912
Net income (loss) attributable to Abraxas Petroleum.	$ 2,871	$(68,471)	$ 7,912	$ (57,688)

(1) As adjusted for FAS No. 160 “Non-controlling Interest in Consolidated Financial Statements.”

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Condensed Consolidating Statement of Operations
For the six months ended June 30, 2009
(unaudited)
(In thousands)

	Abraxas Petroleum Corporation	Abraxas Energy Partners, L.P.	Reclassifi-cations and eliminations	Consolidated
Revenues:				
Oil and gas production revenues	$ 4,394	$ 18,321	$ —	$ 22,715
Rig revenues	500	—	—	500
Other	3	—	—	3
	4,897	18,321	—	23,218
Operating costs and expenses:				
Lease operating and production taxes	2,021	9,833	—	11,854
Depreciation, depletion, and amortization	1,892	7,028	74	8,994
Impairment	—	2,775	(2,775)	—
Rig operations	399	—	—	399
General and administrative	2,255	1,475	—	3,730
	6,567	21,111	(2,701)	24,977
Operating income (loss)	(1,670)	(2,790)	2,701	(1,759)
Other (income) expense:				
Interest income	(5)	(6)	—	(11)
Amortization of deferred financing fees	49	537	—	586
Interest expense	285	5,322	—	5,607
Financing fees	—	362	—	362
Loss on derivative contracts	—	1,695	—	1,695
Other	—	2,229	—	2,229
	329	10,139	—	10,468
Net loss	(1,999)	(12,929)	2,701	(12,227)
Less: Net loss attributable to non-controlling interest	—	—	6,645	6,645
Net loss attributable to Abraxas Petroleum	$ (1,999)	$ (12,929)	$ 9,346	$ (5,582)

Condensed Consolidating Statement of Operations
For the six months ended June 30, 2008 (1)
(unaudited)
(In thousands)

	Abraxas Petroleum Corporation	Abraxas Energy Partners, L.P.	Reclassifi-cations and eliminations	Consolidated
Revenues:				
Oil and gas production revenues	$ 8,686	$ 47,260	$ —	$ 55,946
Rig revenues	635	—	—	635
Other	12	—	—	12
	9,333	47,260	—	56,593
Operating costs and expenses:				
Lease operating and production taxes	1,616	10,756	—	12,372
Depreciation, depletion, and amortization	1,515	9,583	—	11,098
Rig operations	403	—	—	403
General and administrative	2,382	1,290	—	3,672
	5,916	21,629	—	27,545
Operating income	3,417	25,631	—	29,048
Other (income) expense:				
Interest income	(111)	(16)	—	(127)
Amortization of deferred financing fees	20	447	—	467
Interest expense	70	5,068	—	5,138
Loss on derivative contracts	—	108,093	—	108,093
Other	23	711	—	734
	2	114,303	—	114,305
Net income (loss)	3,415	(88,672)	—	(85,257)
Less: Net loss attributable to non-controlling interest	—	—	18,578	18,578
Net income (loss) attributable to Abraxas Petroleum .	$ 3,415	$ (88,672)	$ 18,578	$ (66,679)

(1) As adjusted for FAS No. 160 “Non-controlling Interest in Consolidated Financial Statements.”

Condensed Consolidating Statement of Cash Flows
For the six months ended June 30, 2009
(unaudited)
(In thousands)

	Abraxas Petroleum Corporation	Abraxas Energy Partners, L.P.	Reclassifi-cations and eliminations	Consolidated
Operating Activities				
Net income (loss)	$ (1,999)	$ (12,929)	$ 2,701	$ (12,227)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:				
Change in derivative fair value	—	14,577	—	14,577
Depreciation, depletion, and amortization	1,892	7,028	74	8,994
Proved property impairment	—	2,775	(2,775)	—
Accretion of future site restoration	26	255	—	281
Amortization of deferred financing fees	49	537	—	586
Stock-based compensation	526	70	—	596
Other non-cash transactions	123	—	—	123
Previously capitalized registration fees	—	2,207	—	2,207
Changes in operating assets and liabilities:				
Accounts receivable	4,087	(258)	(3,250)	579
Other assets	139	(4)	—	135
Accounts payable and accrued expenses	(6,063)	(3,582)	3,250	(6,395)
Net cash provided by (used in) operations	(1,220)	10,676	—	9,456
Investing Activities				
Capital expenditures, including purchases and development of properties – net of dispositions	(4,412)	(3,098)	—	(7,510)
Net cash used in investing activities	(4,412)	(3,098)	—	(7,510)
Financing Activities				
Proceeds from issuance of common stock				
Proceeds from long-term borrowings	5,924	—	—	5,924
Payments on long-term borrowings	(63)	(1,925)	—	(1,988)

Partnership distribution	—	(2,257)	—	(2,257)
Deferred financing fees	—	(3,242)	—	(3,242)
Other	47	(564)	—	(517)
Net cash provided by (used in) financing activities	5,908	(7,988)	—	(2,080)
Increase (decrease) in cash	276	(410)	—	(134)
Cash at beginning of period	—	1,924	—	1,924
Cash at end of period	$ 276	$ 1,514	$ —	$ 1,790

Condensed Consolidating Statement of Cash Flows
For the six months ended June 30, 2008 (1)
(unaudited)
(In thousands)

	Abraxas Petroleum Corporation	Abraxas Energy Partners, L.P.	Reclassifications and eliminations	Consolidated
Operating Activities				
Net income (loss)	$ 3,415	$ (88,672)	$ —	$ (85,257)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:				
Change in derivative fair value	—	100,038	—	100,038
Depreciation, depletion, and amortization	1,515	9,583	—	11,098
Distribution from Energy Partners	4,154	—	(4,154)	—
Accretion of future site restoration	39	224	—	263
Amortization of deferred financing fees	20	447	—	467
Stock-based compensation	896	—	—	896
Other non-cash transactions	42	—	—	42
Changes in operating assets and liabilities:				
Accounts receivable	(18,801)	(9,871)	14,604	(14,068)
Other assets	78	(10)	—	68
Accounts payable and accrued expenses	20,601	7,546	(11,207)	16,940
Net cash provided by operations	11,959	19,285	(757)	30,487
Investing Activities				
Capital expenditures, including purchases and development of properties	(21,436)	(134,039)	—	(155,475)
Net cash used in investing activities	(21,436)	(134,039)	—	(155,475)
Financing Activities				
Proceeds from stock options	44	—	—	44
Proceeds from long-term borrowings	4,662	119,700	—	124,362
Partnership distribution	—	(4,786)	757	(4,029)
Deferred financing fees	—	(1,615)	—	(1,615)
Net cash provided by financing activities	4,706	113,299	757	118,762
Decrease in cash	(4,771)	(1,455)	—	(6,226)
Cash at beginning of period	17,177	1,759	—	18,936

Cash at end of year period	$ 12,406	$ 304	$ —	$ 12,710

(1) As adjusted for FAS No. 160 “Non-controlling Interest in Consolidated Financial Statements.”

Note 7. Earnings (Loss) Per Share

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
Numerator:				
Net loss available to common stockholders	$(10,032)	$(57,688)	$(5,582)	$(66,679)
Denominator:				
Denominator for basic earnings (loss) per share -				
Weighted-average shares	49,564	48,911	49,628	48,901
Effect of dilutive securities:				
Stock options and warrants	—	—	—	—
Dilutive potential common shares	—	—	—	—
Denominator for diluted earnings (loss) per share - adjusted weighted-average shares and assumed conversions	49,564	48,911	49,628	48,901
Net loss per common share – basic	$(0.20)	$(1.18)	$(0.11)	$(1.36)
Net loss per common share – diluted	$(0.20)	$(1.18)	$(0.11)	$(1.36)

For the three and six months ended June 30, 2009 and 2008 none of the shares issuable in connection with stock options or warrants are included in diluted shares. Inclusion of these shares would be antidilutive due to losses incurred in the periods. Had there not been losses in the periods, dilutive shares would have been 321,286 and 330,226 shares and 607,610 and 508,958 shares for the three and six months ended June 30, 2009 and 2008, respectively.

Note 8. Hedging Program and Derivatives

The Company does not use hedge accounting rules as prescribed by SFAS 133 Accounting for Derivative Instruments and Hedging Activities, and related interpretations. Accordingly, instruments are recorded on the balance sheet at their fair value with adjustments to the carrying value of the instruments being recognized in gain loss on derivative contracts in the current period.

Under the terms of the Partnership Credit Facility, Abraxas Energy Partners was required to enter into derivative contracts for specified volumes, which equated to approximately 85% of the estimated oil and gas production through December 31, 2011. In connection with the April 30, 2009 amendment to the Partnership Credit Facility, the Partnership was required to enter into additional derivative contracts for volumes equating to approximately 60% of the estimated oil and gas production from net proved developed producing reserves for the year 2012. The Partnership intends to enter into derivative contracts in the future to reduce the impact of price volatility on its cash flow. We have not designated any of these derivative contracts as a hedge as prescribed by applicable accounting rules.

The following table sets forth the Partnership's derivative contract position at June 30, 2009:

Period Covered	Product	Volume (Production per day)	Fixed Price
Year 2009	Gas	10,595 Mmbtu	$8.44
Year 2009	Oil	1,000 Bbl	$83.80
Year 2010	Gas	9,130 Mmbtu	$8.22
Year 2010	Oil	895 Bbl	$83.26
Year 2011	Gas	8,010 Mmbtu	$8.10
Year 2011	Oil	810 Bbl	$86.45
Year 2012	Gas	3,000 Mmbtu	$6.88
Year 2012	Oil	670 Bbl	$67.60

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At June 30, 2009, the aggregate fair market value of our commodity derivative contracts was approximately $24.3 million.

On July 29, 2009, the derivative contracts for the periods 2009 through 2011 were monetized for $26.7 million. These funds, together with the July 2009 settlement of its commodity swaps of $2.0 million, were used by the Partnership to repay outstanding indebtedness under the Partnership Credit Facility. In connection with the monetization and repayment, the Partnership was required to enter into new commodity swaps. The following table sets forth the consolidated weighted average derivative contract position as of July 29, 2009 for Abraxas Petroleum and the Partnership:

	Fixed-Price Swaps			
	Oil		Gas	
Contract Period	Daily Volume (Bbl)	Swap Price	Daily Volume (Mmbtu)	Swap Price
Q4 2009	1,355	$68.90	13,981	$4.50
2010	1,158	73.28	11,258	5.73
2011	1,035	76.61	9,580	6.52
2012	946	70.89	8,303	6.77
2013	705	80.79	5,962	6.84

In order to mitigate its interest rate exposure, the Partnership entered into an interest rate swap, effective August 12, 2008, amended in February 2009, to fix its floating LIBOR based debt. The 2-year interest rate swap arrangement is for $100 million at a fixed rate of 2.95%. The arrangement expires on August 12, 2010. The fair value of this interest rate swap at June 30, 2009 was a liability of $2.7 million.

Note 9. Financial Instruments

SFAS 157—Effective January 1, 2008, the Company adopted Financial Accounting Standards Board (“FASB”) Statement No. 157, Fair Value Measurements (“SFAS 157”), which defines fair value, establishes a framework for measuring fair value, establishes a fair value hierarchy based on the quality of inputs used to measure fair value and enhances disclosure requirements for fair value measurements. The implementation of SFAS 157 did not cause a change in the method of calculating fair value of assets or liabilities, with the exception of incorporating a measure of the Company’s own nonperformance risk or that of its counterparties as appropriate, which was not material. The primary impact from adoption was additional disclosures.

The Company elected to implement SFAS 157 with the one-year deferral permitted by FASB Staff Position No. FAS 157-2, Effective Date of FASB Statement No. 157 (“FSP 157-2”), issued February 2008, which deferred the effective date of SFAS 157 for one year for certain nonfinancial assets and nonfinancial liabilities measured at fair value, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis. As it relates to the Company, the deferral applies to certain nonfinancial assets and liabilities as may be acquired in a business combination and thereby measured at fair value; impaired oil and gas property assessments; and the initial recognition of asset retirement obligations for which fair value is used. The adoption of FAS 157 did not have an impact on the Company.

Fair Value Hierarchy—SFAS 157 establishes a three-level valuation hierarchy for disclosure of fair value measurements. The valuation hierarchy categorizes assets and liabilities measured at fair value into one of three different levels depending on the observability of the inputs employed in the measurement. The three levels are defined as follows:

•

Level 1 – inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets.

- Level 2- inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.

- Level 3 - inputs to the valuation methodology are unobservable and significant to the fair value measurement.

A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement. The Company's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment and considers factors specific to the asset or liability. The following table presents information about the Company's assets and liabilities measured at fair value on a recurring basis as of June 30, 2009, and indicates the fair value hierarchy of the valuation techniques utilized by the Company to determine such fair value (in thousands):

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance as of June 30, 2009
Assets				
Investment in common stock	$192	$ —	$ —	$ 192
NYMEX-based fixed price derivative contracts	—	27,548	—	27,548
Total assets	$192	$ 27,548	$ —	$ 27,740
Liabilities				
NYMEX-based fixed price derivative contracts	$—	$3,202	$ —	$3,202
Interest Rate Swaps	—	—	2,697	2,697
Total Liabilities	$—	$ 3,202	$ 2,697	$ 5,899

The Company has an investment in a former subsidiary consisting of shares of common stock. The stock is actively traded on the Toronto Stock Exchange. This investment is valued at its quoted price as of June 30, 2009 in US dollars. Accordingly this investment is characterized as Level 1.

The Partnership's derivative contracts consist of NYMEX-based fixed price commodity swaps and interest rate swaps, which are not traded on a public exchange. The NYMEX-based fixed price derivative contracts are indexed to NYMEX futures contracts, which are actively traded, for the underlying commodity, and are commonly used in the energy industry. A number of financial institutions and large energy companies act as counter-parties to these type of derivative contracts. As the fair value of these derivative contracts is based on a number of inputs, including contractual volumes and prices stated in each derivative contract, current and future NYMEX commodity prices, and quantitative models that are based upon readily observable market parameters that are actively quoted and can be validated through external sources, we have characterized these derivative contracts as Level 2.

In August 2008, the Partnership entered into a two year interest rate swap. The notional amount is $100.0 million for the first year and $50.0 million for the second year. The Partnership will pay interest at 3.367% and be paid on a floating LIBOR rate. The interest rate swap was amended in February 2009 and increased the notional amount in the second year to $100.0 million and reduced the overall interest rate to 2.95%. As there is no actively traded market for this type of swap and no observable market parameters, these derivative contracts are classified as Level 3.

Additional information for the Partnership's recurring fair value measurements using significant unobservable inputs (Level 3 inputs) for the three and six months ended June 30, 2009 is as follows (in thousands):

	Derivative Assets and (Liabilities) - net	
	Three Months Ended June 30, 2009	Six Months Ended June 30, 2009
Balance Beginning of period	$(2,950)	$(3,000)
Total realized and unrealized losses included in change in net liability	(357)	(869)
Settlements during the period	610	1,172
Ending balance June 30, 2009	$(2,697)	$(2,697)

Note 10. Contingencies - Litigation

From time to time, the Company is involved in litigation relating to claims arising out of its operations in the normal course of business. At June 30, 2009, the Company was not engaged in any legal proceedings that are expected, individually or in the aggregate, to have a material adverse effect on its operations.