

ABRAXAS PETROLEUM CORP
Form 10-K
March 15, 2019

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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

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

For the Fiscal Year Ended December 31, 2018

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

Commission File Number 001-16071

ABRAXAS PETROLEUM CORPORATION

(Exact name of Registrant as specified in its charter)

Nevada **74-2584033**
(State or Other Jurisdiction of (I.R.S. Employer Identification Number)
Incorporation or Organization)

18803 Meisner Drive

San Antonio, TX 78258

(Address of principal executive offices)

(210) 490-4788

Registrant's telephone number, including area code

SECURITIES REGISTERED PURSUANT TO SECTION 12(b) OF THE ACT:

Title of each class:	Name of each exchange on which registered:
Common Stock, par value \$.01 per share	The NASDAQ Stock Market, LLC

SECURITIES REGISTERED PURSUANT TO SECTION 12(g) OF THE ACT:

None

Indicate by check mark if the registrant is a well-known seasoned issuer as defined in Rule 405 of the Securities Act.
Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act.

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark if 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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Yes No

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Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or 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		Accelerated filer
Non-accelerated filer	(Do not check if a smaller reporting company)	Smaller reporting company
		Emerging Growth Company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

As of June 30, 2018, the last day of the registrant’s most recently completed second fiscal quarter, the aggregate market value of the common stock held by non-affiliates of the registrant was \$470,774,656 based on the closing sale price as reported on The NASDAQ Stock Market.

As of March 8, 2019, there were 166,934,860 shares of common stock outstanding.

Documents Incorporated by Reference:

Document	Parts Into Which Incorporated
Portions of the registrant’s Proxy Statement relating to the 2019 Annual Meeting of Stockholders to be held on May 7, 2019.	Part III

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

- the prices we receive for our production and the effectiveness of our hedging activities;
- the availability of capital including under our credit facility;
- our success in development, exploitation and exploration activities;
- declines in our production of oil and gas;
- our indebtedness and the significant amount of cash required to service our indebtedness,
- the proximity, capacity, cost and availability of pipelines and other transportation facilities,
- limits on our growth and our ability to finance our operations, fund our capital needs and respond to changing conditions imposed by our credit facility and restrictive debt covenants;
- our ability to make planned capital expenditures;
- oil price write-downs resulting, and that could result in the future, from lower oil and gas prices;
- political and economic conditions in oil producing countries, especially those in the Middle East;
- price and availability of alternative fuels;
- our ability to procure services and equipment for our drilling and completion activities;

our acquisition and divestiture activities;

weather conditions and events; and

other factors discussed elsewhere in this report.

Initial production, or IP, rates, for both our wells and for those wells that are located near our properties, are limited data points in each well's productive history. These rates are sometimes actual rates and sometimes extrapolated or normalized rates. As such, the rates for a particular well may change as additional data becomes available. Peak production rates are not necessarily indicative or predictive of future production rates, expected ultimate recovery, or EUR, or economic rates of return from such wells and should not be relied upon for such purposes. Equally, the way we calculate and report peak IP rates and the methodologies employed by others may not be consistent, and thus the values reported may not be directly and meaningfully comparable. Lateral lengths described are indicative only. Actual completed lateral lengths depend on various considerations such as lease-line offsets. Abraxas standard length laterals, sometimes referred to as 5,000 foot laterals, are laterals with completed length generally between 4,000 feet and 5,500 feet. Mid-length laterals, sometimes referred to as 7,500 foot laterals, are laterals with completed length generally between 6,500 feet and 8,000 feet. Long laterals, sometimes referred to as 10,000 foot laterals, are laterals with completed length generally longer than 8,000 feet.

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GLOSSARY OF TERMS

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

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

Terms used to describe quantities of oil and gas:

“*Bbl*” – barrel or barrels.

“*Bcf*” – billion cubic feet of gas.

“*Bcfe*” – billion cubic feet of gas equivalent.

“*Boe*” – barrels of oil equivalent.

“*Boepd*” - barrels of oil equivalents per day.

“*MBbl*” – thousand barrels.

“*MBoe*” – thousand barrels of oil equivalent.

“*Mcf*” – thousand cubic feet of gas.

“*Mcfe*” – thousand cubic feet of gas equivalent.

“*MMBbl*” – million barrels.

“*MMBoe*” – million barrels of oil equivalent.

“*MMBtu*” – million British Thermal Units of gas.

“*MMcf*” – million cubic feet of gas.

“*MMcfe*” – million cubic feet of gas equivalent.

“*NGL*” – natural gas liquids measured in barrels.

Terms used to describe our interests in wells and acreage:

“*Developed acreage*” means acreage which consists of leased acres spaced or assignable to productive wells.

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

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

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

“*Gross acres*” are the number of acres in which we own a working interest.

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

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

“*Net well*” is the sum of fractional ownership working interests in gross wells.

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

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

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

“*Developed oil and gas reserves**” Developed oil and gas reserves are reserves of any category that can be expected to be recovered:

(i) Through existing wells with existing equipment and operating methods or in which the cost of the required equipment is relatively minor compared to the cost of a new well; and

(ii) Through installed extraction equipment and infrastructure operational at the time of the reserves estimate if the extraction is by means not involving a well.

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

“Proved developed reserves*” Reserves that can be expected to be recovered through existing wells with existing equipment and operating methods.

“Proved reserves*” Reserves that geological and engineering data demonstrate with reasonable certainty to be recoverable in future years from known reservoirs under existing economic and operating conditions.

“Proved undeveloped reserves” or “PUDs*” Reserves that are expected to be recovered from new wells on undrilled acreage or from existing wells, in each case where a relatively major expenditure is required.

“PV-10” means estimated future net revenue, discounted at a rate of 10% per annum, before income taxes and with no price or cost escalation or de-escalation, calculated in accordance with guidelines promulgated by the Securities and Exchange Commission (“SEC”). PV-10 is considered a non-GAAP financial measure under SEC regulations because it does not include the effects of future income taxes, as is required in computing the standardized measure of discounted future net cash flows. We believe that PV-10 is an important measure that can be used to evaluate the relative significance of our oil and gas properties and that PV-10 is widely used by securities analysts and investors when evaluating oil and gas companies. Because many factors that are unique to each individual company impact the amount of future income taxes to be paid, the use of a pre-tax measure provides greater comparability of assets when evaluating companies. We believe that most other companies in the oil and gas industry calculate PV-10 on the same basis. PV-10 is computed on the same basis as the standardized measure of discounted future net cash flows but without deducting income taxes.

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

“Undeveloped oil and gas reserves*” Undeveloped oil and gas reserves are reserves of any category that are expected to be recovered from new wells on undrilled acreage, or from existing wells where a relatively major expenditure is required for recompletion.

* This definition is an abbreviated version of the complete definition set forth in Rule 4-10(a) of Regulation S-X. For the complete definition, see:

<http://www.ecfr.gov/cgi-bin/retrieveECFR?gp=1&SID=7aa25d3cede06103c0ecec861362497d&ty=HTML&h=L&n=pt17.3.2>

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Information contained in this report represents the consolidated operations of Abraxas Petroleum Corporation. The terms “Abraxas,” “we,” “us,” “our,” or the “Company,” refer to Abraxas Petroleum Corporation, together with its consolidated subsidiaries including Raven Drilling, LLC which is a wholly owned subsidiary that owns a drilling rig. Unless otherwise noted, all disclosures are for Continuing Operations.

Item 1. Business**General**

We are an independent energy company primarily engaged in the acquisition, exploration, development and production of oil and gas. At December 31, 2018, our estimated net proved reserves were 67.2 MMBoe, of which 37% were classified as proved developed, 63% were oil and 96% of which (on a Boe basis) were operated by us. Our daily net production for the year ended December 31, 2018 was 9,809 Boepd, of which 64% was oil. Abraxas Petroleum Corporation was incorporated in Nevada in 1990. Our address is 18803 Meisner Drive, San Antonio, Texas 78258 and our phone number is (210) 490-4788.

Our oil and gas assets are located in three operating regions, the Permian/Delaware Basin, the Rocky Mountain, and South Texas. The following table sets forth certain information related to our properties as of and for the year ended December 31, 2018:

				Estimated Net Proved Reserves		Net Production	
	Gross Producing Wells	Average Working Interest	Total Net Acres	(Mboe)	% Oil	(Mboe)	% Oil
Permian/Delaware Basin	115	74.44	% 23,617	41,058	61 %	1,328	64 %
Rocky Mountain	539	13.80	% 20,616	24,331	68 %	2,040	66 %
South Texas	24	96.88	% 12,959	1,839	27 %	212	57 %
Total United States	678	28.08	% 57,192	67,228	63 %	3,580	58 %

Our properties in the Permian/Delaware Basin region are primarily located in Ward and Winkler Counties, Texas and produce oil and gas primarily from the Bone Spring and Wolfcamp formations.

Our properties in the Rocky Mountain region are primarily located in the Williston Basin of North Dakota and Montana. In this region, our wells produce oil and gas from various reservoirs, primarily the Bakken, Three Forks and Red River formations.

Our properties in the South Texas region are located along the Edwards trend in DeWitt and Lavaca Counties, Texas and the Eagle Ford shale and the Austin Chalk in Atascosa County, Texas. In the Edwards trend, our wells produce gas from the Edwards formation.

Strategy

Our business strategy is to focus our capital and resources on our core operated basins, improve financial flexibility and profitably grow production and reserves. Key elements of our business strategy include:

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Focus our capital and resources on our core operated basins. Our core basins consist of the Permian/Delaware Basin (Bone Spring and Wolfcamp) and Williston Basin (Bakken and Three Forks). Given the disparity which has existed during the past several years and which continues currently between oil and gas prices, the economics of drilling oil wells is far superior to drilling gas wells. We anticipate making capital expenditures in 2019 of approximately \$94.5 million, of which approximately \$46.2 million is allocated to acquiring additional acreage and developing our Bone Spring/Wolfcamp properties in the Permian/Delaware Basin. The 2019 budget also allocates approximately \$38.3 million for developing our Williston Basin/Bakken/Three Forks play in North Dakota, with the remaining amount allocated to acquisitions, facilities and general corporate purposes. As part of our efforts to focus our property portfolio, we also seek to sell assets we have deemed non-core. These include assets with a low working interest that are non-operated and/or that fall outside of our three core basins. Any proceeds from these asset sales have been and will continue to be used to reduce our indebtedness and/or be redeployed into our core operating basins. We are currently actively working to monetize our remaining Eagle Ford assets in South Texas.

Improve financial flexibility. Our primary sources of capital are availability under our credit facility and cash flows from operations. Availability under our credit facility is subject to a borrowing base which is determined semi-annually by our lenders. The next redetermination is scheduled for April 2019. As of December 31, 2018, we had \$180.0 million outstanding on our credit facility and availability of \$20.0 million, and we generated approximately \$80.0 million of cash flows from operations.

We have also sold producing properties from time to time in order to provide us with financial flexibility. In December 2018 and January 2019, we sold various Eagle Ford assets in our South Texas region for approximately \$1.6 million and are currently marketing our remaining Eagle Ford assets. In January 2019, we announced that we had engaged Petrie Partners to assist us in identifying and assessing our options for our Bakken properties. We are still early in this process and do not know the ultimate outcome. In the event that this process were to result in the sale of our Bakken properties, we believe that the proceeds would be used to significantly pay down or fully retire our debt, support our Raven No. 1 rig in the Delaware Basin until it achieves free cash flow and possibly buy back stock.

We seek to reduce the volatility of our cash flows from operations by hedging a portion of our production. As of December 31, 2018, we had NYMEX-based fixed price commodity swap arrangements, on approximately 51% of the oil production from our estimated net proved developed producing reserves (as of December 31, 2018) through December 31, 2019, 62% for 2020 and 66% for 2021. Subsequent to December 31, 2018, in connection with the redetermination of our credit facility, we have entered into additional fixed price commodity swaps. Taking these additional contracts into consideration, we have entered into fixed price commodity swap arrangements on approximately 61% of the oil production of our estimated net proved developed producing reserves (as of December 31, 2018) through December 31, 2019, 80% for 2020 and 75% for 2021.

During 2018, we had originally established a capital budget of \$140.0 million. Capital spending for 2018 was \$174.0 million. We exceeded our 2018 capital budget as a result of successfully acquiring more acreage in the Delaware Basin than we had originally budgeted which resulted in increased spending for acquisitions as well as for drilling and completing wells in this area as a result of our higher ownership interests.

We intend to maintain our liquidity and our balance sheet during 2019 by adjusting our capital budget as necessary, seeking to reduce expenses and by funding our capital budget primarily with cash flow from operations.

Profitably grow production and reserves. We have a substantial low-decline legacy production base as evidenced by our approximate 21-year average reserve life as of year-end 2018. Our capital is currently being deployed largely into unconventional oil assets with relatively predictable production profiles, yet steep initial decline rates. Therefore, the economics of these oil wells are highly dependent on both near term commodity prices and strong operational cost control. Cost savings achieved through efficiencies of using our own rig in the Williston Basin, and heightened focus on cost control in all of our operated positions both contribute to our historical success in adding low cost barrels to our production base.

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2019 Budget and Drilling Activities

Our capital expenditure budget for 2019 is approximately \$94.5 million of which approximately \$46.2 million is allocated to acquiring additional acreage and developing the Company's Bone Spring/Wolfcamp acreage in the Permian/Delaware Basin. The budget also allocates approximately \$38.3 million to developing our Williston Basin Bakken/Three Forks play in North Dakota, with the remaining amount allocated to acquisitions, facilities and general corporate purposes. The 2019 capital expenditure budget is subject to change depending upon a number of factors, including the availability of sufficient capital resources including under our credit facility, the availability and costs of drilling and service equipment and crews, economic and industry conditions at the time of drilling, prevailing and anticipated prices for oil and gas, the results of our exploitation efforts, our financial results and our ability to obtain permits for drilling locations.

Markets and Customers

The revenue generated by our operations is highly dependent upon the prices we receive for our oil and gas. Historically, the markets for oil and gas have been volatile and are likely to continue to be volatile in the future. The prices we receive for our oil and gas production are subject to wide fluctuations and depend on numerous factors beyond our control including seasonality, the condition of the world wide economy (particularly the manufacturing sector), foreign imports, political conditions in other petroleum producing countries, the actions of the Organization of Petroleum Exporting Countries, domestic regulation, legislation and policies. Decreases in the prices we receive for our oil and gas have had, and could have in the future, an adverse effect on the carrying value of our proved reserves, our revenue, profitability and cash flow from operations. Refer to "Risk Factors – Risks Related to Our Industry — Market conditions for oil and gas and particularly volatility of prices for oil and gas, could adversely affect our revenue, cash flows from operations, profitability and growth" and "Management's Discussion and Analysis of Financial Condition and Results of Operations – Critical Accounting Policies" for more information relating to the effects that decreases in oil and gas prices have on us. To help mitigate the impact of commodity price volatility, we hedge a portion of our production through the use of fixed price swaps and basis differential swap contracts. See "Management's Discussion and Analysis of Financial Condition and Results of Operations – General – Commodity Prices and Hedging Arrangements" and Note 11 of the notes to our consolidated financial statements for more information regarding our derivative activities.

Substantially all of our oil and gas is sold at current market prices under short-term arrangements, as is customary in the industry. During the year ended December 31, 2018, two purchasers of production accounted for approximately 57% of our oil and gas sales. During the year ended December 31, 2017, three purchasers of production accounted for approximately 69% of our oil and gas sales and in 2016, two purchasers accounted for approximately 71% of our oil and gas sales. We believe that there are numerous other purchasers available to buy our oil and gas and that the loss of any of these purchasers would not materially affect our ability to sell our oil and gas. Furthermore, the largest purchasers of our oil and gas have changed from year to year from 2016 to 2018.

Regulation of Oil and Gas Activities

The exploration, production and transportation of all types of hydrocarbons are subject to significant governmental regulations. Our properties are affected from time to time in varying degrees by political developments and federal, state and local laws and regulations. In particular, oil and gas production operations and economics are, or in the past have been, affected by industry specific price controls, taxes, conservation, safety, environmental and other laws relating to the petroleum industry, and by changes in such laws and by periodically changing administrative regulations.

Federal, state and local laws and regulations govern oil and gas activities. Operators of oil and gas properties are required to have a number of permits in order to operate such properties, including operator permits and permits to dispose of salt water. In addition, under federal law, operators of oil and gas properties are required to possess certain certificates and permits in order to operate such properties. We possess all material requisite permits required by Federal, state and other local authorities in which we operate properties.

Development and Production

The operations of our properties are subject to various types of regulation at the federal, state and local levels. These types of regulations include requiring the operator of oil and gas properties to possess permits for the drilling and development of wells, post bonds in connection with various types of activities, and file reports concerning operations. Most states, and some counties and municipalities in which we operate, regulate one or more of the following:

- the location of wells;
- the method of drilling and casing wells;
- the flaring of gas;
- the method of completing and fracture stimulating wells;
- the surface use and restoration of properties upon which wells are drilled;
- the plugging and abandoning of wells; and
- the notice to surface owners and other third parties.

Some states regulate the size and shape of development and spacing units or proration units for oil and gas properties. Some states allow forced pooling or unitization of tracts to facilitate exploration while other states rely on voluntary pooling of lands and leases. In some instances, forced pooling or unitization may be implemented by third parties and may reduce our interest in the unitized properties. In addition, state conservation laws establish maximum allowable rates of production from oil and gas wells, generally prohibit the venting or flaring of gas and impose requirements regarding the ratability of production. These laws and regulations may limit the amount of oil and gas we can produce from our wells or limit the number of wells or the locations at which our wells can be drilled. Moreover, each state generally imposes a production or severance tax with respect to the production and sale of oil, gas and NGLs within its jurisdiction.

Operations on Federal or Indian oil and gas leases must comply with numerous regulatory restrictions, including various non-discrimination statutes, and certain of such operations must be conducted pursuant to certain on-site security regulations and other permits issued by various tribal and federal agencies, including the Bureau of Land Management and the Office of Natural Resources Revenue, which we refer to as ONRR, (formerly Minerals Management Service). ONRR establishes the basis for royalty payments due under federal oil and gas leases through regulations issued under applicable statutory authority. State regulatory authorities establish similar standards for royalty payments due under state oil and gas leases. The basis for royalty payments established by ONRR and the state regulatory authorities is generally applicable to all federal and state oil and gas leases. Accordingly, we believe that the impact of royalty regulation on the operations of our properties should generally be the same as the impact on our competitors. We believe that the operations of our properties are in material compliance with all applicable regulations as they pertain to Federal or Indian oil and gas leases.

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The failure to comply with these rules and regulations can result in substantial penalties, including lease suspension or termination in certain cases. The regulatory burden on the oil and gas industry increases our cost of doing business and, consequently, affects our profitability. Our competitors in the oil and gas industry are subject to the same regulatory requirements and restrictions that affect us.

Regulation of Transportation and Sale of Gas in the United States

Historically, the transportation and sale for resale of gas in interstate commerce have been regulated pursuant to the Natural Gas Act of 1938, as amended, which we refer to as NGA, the Natural Gas Policy Act of 1978, as amended, which we refer to as NGPA, and regulations promulgated thereunder by the Federal Energy Regulatory Commission, which we refer to as FERC, and its predecessors. In the past, the federal government has regulated the prices at which gas could be sold. Deregulation of wellhead gas sales began with the enactment of the NGPA. In 1989, Congress enacted the Natural Gas Wellhead Decontrol Act, as amended, which we refer to as the Decontrol Act. The Decontrol Act removed all NGA and NGPA price and non-price controls affecting wellhead sales of gas effective January 1, 1993. While sales by producers of gas can currently be made at unregulated market prices, Congress could reenact price controls in the future.

Since 1985, FERC has endeavored to make gas transportation more accessible to gas buyers and sellers on an open and non-discriminatory basis. FERC has stated that open access policies are necessary to improve the competitive structure of the interstate gas pipeline industry and to create a regulatory framework that will put gas sellers into more direct contractual relations with gas buyers by, among other things, unbundling the sale of gas from the sale of transportation and storage services. Beginning in 1992, FERC issued Order No. 636 and a series of related orders, which we refer to collectively as Order No. 636, to implement its open access policies. As a result of the Order No. 636 program, the marketing and pricing of gas have been significantly altered. The interstate pipelines' traditional role as wholesalers of gas has been eliminated and replaced by a structure under which pipelines provide transportation and storage service on an open access basis to others who buy and sell gas. FERC continues to regulate the rates that interstate pipelines may charge for such transportation and storage services. Although FERC's orders do not directly regulate gas producers, they are intended to foster increased competition within all phases of the gas industry.

In 2000, FERC issued Order No. 637 and subsequent orders, which we refer to, collectively, as Order No. 637, which imposed a number of additional reforms designed to enhance competition in gas markets. Among other things, Order No. 637 effected changes in FERC regulations relating to scheduling procedures, capacity segmentation, penalties, rights of first refusal and information reporting. Most major aspects of Order No. 637 have been upheld on judicial review, and most pipelines' tariff filings to implement the requirements of Order No. 637 have been accepted by the FERC and placed into effect.

The Energy Policy Act of 2005, which we refer to as EP Act 2005, gave FERC increased oversight and penalty authority regarding market manipulation and enforcement. EP Act 2005 amended the NGA to prohibit market manipulation and also amended the NGA and the NGPA to increase civil and criminal penalties for any violations of the NGA, NGPA and any rules, regulations or orders of FERC to up to \$1,000,000 per day, per violation. In addition, FERC issued a final rule effective January 26, 2006, regarding market manipulation, which makes it unlawful for any entity, in connection with the purchase or sale of gas or transportation service subject to FERC jurisdiction, to defraud, make an untrue statement, or omit a material fact or engage in any practice, act, or course of business that operates or would operate as a fraud. This final rule works together with FERC's enhanced penalty authority to provide increased oversight of the gas marketplace.

The gas industry historically has been very heavily regulated; therefore, there is no assurance that the less stringent regulatory approach currently pursued by FERC will continue. However, we do not believe that any action taken will affect us in a way that materially differs from the way it affects other gas producers, gatherers and marketers.

Generally, intrastate gas transportation is subject to regulation by state regulatory agencies, although FERC does regulate the rates, terms, and conditions of service provided by intrastate pipelines that transport gas subject to FERC's NGA jurisdiction pursuant to Section 311 of the NGPA. The basis for state regulation of intrastate gas transportation and the degree of regulatory oversight and scrutiny given to intrastate gas pipeline rates and services varies from state to state. Insofar as such regulation within a particular state will generally affect all intrastate gas shippers within the state on a comparable basis, we believe that the regulation of similarly situated intrastate gas transportation in any states in which we operate and ship gas on an intrastate basis will not affect the operations of our properties in any way that is materially different from the effect of such regulation on our competitors.

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Gas Gathering in the United States

Section 1(b) of the NGA exempts gas gathering facilities from the jurisdiction of the FERC. FERC has developed tests for determining which facilities constitute jurisdictional transportation facilities under the NGA and which facilities constitute gathering facilities exempt from FERC's NGA jurisdiction. From time to time, FERC reconsiders its test for defining non-jurisdictional gathering. FERC has also permitted jurisdictional pipelines to "spin down" exempt gathering facilities into affiliated entities that are not subject to FERC jurisdiction, although FERC continues to examine the circumstances in which such a "spin down" is appropriate and whether it should reassert jurisdiction over certain gathering companies and facilities that previously had been "spun down." We cannot predict the effect that FERC's activities in this regard may have on the operations of our properties, but we do not expect these activities to affect the operations in any way that is materially different from the effect thereof on our competitors.

State regulation of gathering facilities generally includes various safety, environmental, and in some circumstances, non-discriminatory take or service requirements, but does not generally entail rate regulation. In the United States, gas gathering has received greater regulatory scrutiny at both the state and federal levels in the wake of the interstate pipeline restructuring under FERC Order 636. For example, the Texas Railroad Commission enacted a Natural Gas Transportation Standards and Code of Conduct to provide regulatory support for the state's more active review of rates, services and practices associated with the gathering and transportation of gas by an entity that provides such services to others for a fee, in order to prohibit such entities from unduly discriminating in favor of their affiliates.

Regulation of Transportation of Oil in the United States

Sales of oil, condensate and gas liquids are not currently regulated and are made at negotiated prices. The transportation of oil in common carrier pipelines is subject to rate regulation. FERC regulates interstate oil pipeline transportation rates under the Interstate Commerce Act. In general, interstate oil pipeline rates must be cost-based, although settlement rates agreed to by all shippers are permitted and market-based rates may be permitted in certain circumstances. Effective January 1, 1995, FERC implemented regulations establishing an indexing system (based on inflation) for transportation rates for oil that allowed for an increase or decrease in the cost of transporting oil to the purchaser. A review of these regulations by FERC in 2000 was successfully challenged on appeal by an association of oil pipelines. On remand, FERC, in February 2003, increased the index slightly, effective July 2001. Intrastate oil pipeline transportation rates are subject to regulation by state regulatory commissions. The basis for intrastate oil pipeline regulations, and the degree of regulatory oversight and scrutiny given to intrastate oil pipeline rates varies from state to state. Insofar as effective interstate and intrastate rates are equally applicable to all comparable shippers, we believe that the regulation of oil transportation rates will not affect the operations of our properties in any way that is materially different from the effect of such regulation on our competitors.

Further, interstate and intrastate common carrier oil pipelines must provide service on a non-discriminatory basis. Under this open access standard, common carriers must offer service to all shippers requesting service on the same

terms and under the same rates. When oil pipelines operate at full capacity, access is governed by prorationing provisions set forth in the pipelines' published tariffs. Accordingly, we believe that access to oil pipeline transportation services generally will be available to us to the same extent as to our competitors.

All of our oil is sold on lease, at which time custody transfers, either by truck or pipeline. We are not able to determine how much of our sold oil is ultimately shipped to market centers using rail transportation facilities owned and operated by third parties. The U.S. Department of Transportation's ("U.S. DOT") Pipeline and Hazardous Materials Safety Administration ("PHMSA") establishes safety regulations relating to transportation of oil by rail transportation. In addition, third party rail operators are subject to the regulatory jurisdiction of the Surface Transportation Board of the U.S. DOT, the Federal Railroad Administration ("FRA") of the DOT, the U.S. Occupational Safety and Health Administration, as well as other federal regulatory agencies. Additionally, various state and local agencies have jurisdiction over disposal of hazardous waste and seek to regulate movement of hazardous materials in ways not preempted by federal law.

In response to rail accidents occurring between 2002 and 2008, the U.S. Congress passed the Rail Safety and Improvement Act of 2008, which implemented regulations governing different areas related to railroad safety. Recently, in response to train derailments occurring in 2013, U.S. regulators have been implementing or considering new rules to address the safety risks of transporting oil by rail. On January 23, 2014, the National Transportation Safety Board ("NTSB") issued a series of recommendations to the FRA and PHMSA to address safety risks, including (i) requiring expanded hazardous material route planning for railroads to avoid populated and other sensitive areas, (ii) developing an audit program to ensure rail carriers that carry petroleum products have adequate response capabilities to address worst-case discharges of the entire quantity of product carried on a train, and (iii) auditing shippers and rail carriers to ensure they are properly classifying hazardous materials in transportation and that they have adequate safety and security plans in place. Additionally, on February 25, 2014 the DOT issued an emergency order requiring all persons, prior to offering oil into transportation, to ensure such product is properly tested and classed and to assure all shipments by rail of oil be handled as a Packing Group I or II hazardous material.

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We do not currently own or operate rail transportation facilities or rail cars; however, the adoption of any regulations that impact the testing or handling of shipments of oil by rail transportation could increase our costs of doing business and limit our ability to transport and sell our oil at favorable prices at market centers throughout the United States, the consequences of which could have a material adverse effect on our financial condition, results of operations and cash flows from operations. At this time, it is not possible to estimate the potential impact on our business if new federal or state rail transportation regulations are enacted.

Environmental Matters

Oil and gas operations are subject to numerous federal, state and local laws and regulations controlling the generation, use, treatment, storage and disposal of materials and the discharge of materials into the environment or otherwise relating to the protection of the environment. These laws and regulations may:

- require the acquisition of a permit or other authorization before construction or drilling commences;

- impose design, construction and permitting requirements on facilities in conjunction with oil and gas operations, including the construction of pollution control devices;

- require protective measures to prevent certain fluids from coming into contact with ground water;

- restrict the types, quantities and concentrations of various substances that can be released into the environment in connection with drilling, production, and gas processing activities;

- suspend, limit or prohibit construction, drilling and other activities in certain lands lying within wilderness, wetlands, and areas inhabited by threatened or endangered species and other protected areas;

- require remedial measures to mitigate pollution from historical and on-going operations such as the use of pits and plugging of abandoned wells;

- require disclosure of chemicals injected into wells in conjunction with hydraulic fracturing operations;

- restrict injection of liquids into subsurface strata that may contaminate groundwater or increase seismic activity;

- restrict the availability of water necessary for hydraulic fracturing operations;
- impose substantial penalties for violations of environmental rules or pollution resulting from our operations;
- curtail production in association with permit limits; and
- curtail or prohibit production for exceeding gas flaring limits.

Environmental permits that the operators of properties are required to possess may be subject to revocation, modification, and renewal by issuing authorities. Governmental authorities have the power to enforce compliance with their regulations and permits, and violations are subject to injunction, civil fines, and even criminal penalties. Our management believes that we are in substantial compliance with current environmental laws and regulations, and that we will not be required to make material capital expenditures to comply with existing laws. Nevertheless, changes in existing environmental laws and regulations or interpretations thereof could have a significant impact on our operations as well as the oil and gas industry in general, and thus we are unable to predict the ultimate cost and effects of future changes in environmental laws and regulations.

We are not currently involved in any administrative, judicial or legal proceedings arising under federal, state, or local environmental protection laws and regulations, or under federal or state common law, which would have a material adverse effect on our respective financial positions or results of operations. Moreover, we maintain insurance against the costs of clean-up operations, but we are not fully insured against all such risks. A serious incident of pollution may result in the suspension or cessation of operations in the affected area.

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The following is a discussion of the current relevant environmental laws and regulations that relate to our operations.

Comprehensive Environmental Response, Compensation and Liability Act. The Comprehensive Environmental Response, Compensation and Liability Act, also known as Superfund, and which we refer to as CERCLA, and comparable state statutes impose strict joint, and several liability, without regard to fault or legality of conduct, on certain classes of persons who are considered to have contributed to the release of a “hazardous substance” into the environment. These persons include among others, the current and former owners or operators of a disposal site or sites where a release occurred and companies that arranged for the transportation or disposal of the hazardous substances released at the site. Under CERCLA, such persons or companies may be retroactively liable for the costs of cleaning up the hazardous substances that have been released into the environment, for damages to natural resources, and for the costs of certain health studies. CERCLA authorizes the Environmental Protection Agency (“EPA”), and in some cases third parties, to take actions in response to threats to the public health or the environment and to seek to recover from the responsible classes of persons the costs they incur. In addition, it is not uncommon for neighboring land owners and other third parties to file claims for personal injury, property damage, and recovery of response costs allegedly caused by the hazardous substances released into the environment.

In the course of our ordinary operations, certain wastes may be generated that may fall within CERCLA’s definition of a “hazardous substance.” We may be liable under CERCLA or comparable state statutes for all or part of the costs required to clean up sites at which these wastes have been disposed. Although CERCLA contains a “petroleum exclusion” from the definition of “hazardous substance,” state laws affecting our operations impose cleanup liability relating to petroleum and petroleum related products, including oil cleanups.

We currently own or lease, and have in the past owned or leased, numerous properties that for many years have been used for the exploration and production of oil and gas. Although we have utilized standard industry operating and disposal practices at the time, hydrocarbons or other wastes may have been disposed of or released on or under the properties we owned or leased or on or under other locations where such wastes have been taken for disposal. In addition, many of these properties have been operated by third parties whose treatment and disposal or release of hydrocarbons or other wastes was not under our control. These properties and the wastes disposed thereon may be subject to CERCLA, RCRA (as defined below), and analogous state laws. Under these laws, we could be required to remove or remediate previously disposed wastes, including wastes disposed or released by prior owners or operators; to clean up contaminated property, including contaminated groundwater; or to perform remedial operations to prevent future contamination.

Oil Pollution Act of 1990. Federal regulations also require certain owners and operators of facilities that store or otherwise handle oil to prepare and implement spill response plans relating to the potential discharge of oil into surface waters. The Federal Oil Pollution Act, which we refer to as OPA, and analogous state laws, contain numerous requirements relating to prevention of, reporting of, and response to oil spills into waters of the United States. A failure to comply with OPA’s requirements or inadequate cooperation during a spill response action may subject a responsible party to civil or criminal enforcement actions. We are not aware of any action or event that would subject us to liability under OPA, and we believe that compliance with OPA’s financial responsibility and other operating

requirements will not have a material adverse effect on our financial position or results of operations.

Resource Conservation and Recovery Act. The Resource Conservation and Recovery Act, which we refer to as RCRA, is the principal federal statute governing the treatment, storage and disposal of hazardous and non-hazardous solid wastes. RCRA imposes stringent requirements and liability for failure to meet such requirements, on persons who generate or transport regulated waste materials and also on persons who own or operate a waste treatment, storage or disposal facility. Analogous state laws also impose requirements associated with the management such wastes. At present, RCRA includes a statutory exemption that allows most oil and gas exploration and production wastes to be classified and regulated as non-hazardous wastes. A similar exemption is contained in many of the state counterparts to RCRA. At various times in the past, proposals have been made to amend RCRA to rescind the exemption that excludes oil and gas exploration and production wastes from regulation as hazardous wastes. Repeal or modification of the exemption by administrative, legislative or judicial process, or modification of similar exemptions in applicable state statutes, would increase the volume of hazardous waste we are required to manage and dispose and would cause us to incur increased operating expenses. Also, in the ordinary course of our operations, we generate small amounts of ordinary industrial wastes, such as paint wastes, waste solvents and waste oils that may be regulated as hazardous wastes. We believe that our operations comply in all material respects with the requirements of RCRA and its state counterparts.

Naturally Occurring Radioactive Materials, which we refer to as NORM, are materials not covered by the Atomic Energy Act, whose radioactivity is enhanced by technological operations such as mineral extraction or processing through exploration and production conducted by the oil and gas industry. NORM wastes are regulated under the RCRA framework, but primary responsibility for NORM regulation has been a state function. Standards have been developed for worker protection; treatment, storage and disposal of NORM waste; management of waste piles, containers and tanks; and limitations upon the release of NORM contaminated land for unrestricted use. We believe that the operations of our properties are in material compliance with all applicable NORM standards established by the various states in which we operate wells.

Clean Water Act. The Clean Water Act, which we refer to as the CWA, and analogous state laws, impose restrictions and controls on the discharge of pollutants, including spills and leaks of oil and other substances, into waters of the United States. The discharge of pollutants into regulated waters is prohibited, except in accordance with the terms of a permit issued by EPA or an analogous state agency. The CWA regulates storm water run-off from oil and gas facilities and requires a storm water discharge permit for certain activities. Such a permit requires the regulated facility to monitor and sample storm water run-off from its operations. The CWA and regulations implemented thereunder also prohibit discharges of dredged and fill material in wetlands and other waters of the United States unless authorized by an appropriately issued permit. Spill prevention, control and countermeasure requirements of the CWA require appropriate containment berms and similar structures to help prevent the contamination of waters of the United States in the event of a petroleum hydrocarbon tank spill, rupture or leak. The reach and scope of the CWA, and the determination of what water bodies and land areas are regulated as waters of the U.S., is the subject of various rules adopted by EPA and the U.S. Army Corps of Engineers which we refer to as the WOTUS Rules, and on-going federal court litigation arising out of the rules and recent amendments. The WOTUS Rules, litigation over the rules, and the associated regulatory uncertainty, could impact our operations by subjecting new land and waters to regulation, and increase our cost of operations. The CWA and comparable state statutes provide for civil, criminal and administrative penalties for unauthorized discharges of oil and other pollutants and impose liability on parties responsible for those discharges for the costs of cleaning up any environmental damage caused by the release and for resource damages resulting from the release. We believe that the operations of our properties comply in all material respects with the requirements of the CWA and state statutes enacted to control water pollution.

Safe Drinking Water Act. Our operations also produce wastewaters that are disposed via underground injection wells. These activities are regulated by the Safe Drinking Water Act, which we refer to as the SDWA, and analogous state and local laws. Underground injection is the subsurface placement of fluid through a well, such as the reinjection of brine produced and separated from oil and gas production, or the flow-back of hydraulic fracturing fluids. The main goal of the SDWA is the protection of usable aquifers. The primary objective of injection well operating requirements is to ensure the mechanical integrity of the injection apparatus and to prevent migration of fluids from the injection zone into underground sources of drinking water. Injection well operations are strictly controlled, and certain wastes, absent an exemption, cannot be injected into underground injection control wells. In most states, no underground injection may take place except as authorized by permit or rule. In addition, subsurface injection of water or other produced fluids from drilling or hydraulic fracturing processes have come under increased public and governmental scrutiny. Some jurisdictions, Texas for example, have adopted new and more stringent rules for injection wells aimed at reducing the potential for earthquakes associated with injection activities, including new restrictions on siting of such injection wells. We currently own and operate various underground injection wells and rely on third-party owned injection wells. Failure to comply with our permits could subject us to civil and/or criminal enforcement. More stringent regulations of injection wells could additionally increase our cost of operations. We believe that we are in

compliance in all material respects with the requirements of applicable state underground injection control programs and our permits.

Clean Air Act. The Clean Air Act, which we refer to as the CAA, and state air pollution laws and regulations provide a framework for national, state and local efforts to protect air quality. The operation of our properties utilize equipment that emits air pollutants which may be subject to federal and state air pollution control laws. These laws require utilization of air emissions abatement equipment to achieve prescribed emissions limitations and ambient air quality standards, as well as operating permits for existing equipment and construction permits for new and modified equipment. In the past few years, EPA has adopted new more restrictive regulations governing air emissions from oil and gas operations, including regulations which restrict emissions of methane, volatile organic compounds and hazardous air pollutants.

Permits and related compliance obligations under the CAA, as well as changes to state implementation plans for controlling air emissions in regional non-attainment areas may require us to incur future capital expenditures in connection with the addition or modification of existing air emission control equipment and strategies. In addition, some oil and gas facilities may be included within the categories of hazardous air pollutant sources, which are subject to more stringent regulation under the CAA. Failure to comply with these requirements could subject us to monetary penalties, injunctions, conditions or restrictions on operations and enforcement actions. We may be required to incur capital expenditures in the future for air pollution control equipment in connection with obtaining and maintaining operating permits and approvals for air emissions. We believe that we are in compliance in all material respects with the requirements of applicable federal and state air pollution control laws.

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Hydraulic Fracturing. Most of our current operations depend on the use of hydraulic fracturing to enhance production from oil and gas wells. This technology involves the injection of fluids—usually consisting mostly of water but typically including small amounts of chemical additives—as well as sand, or other proppants, into a well under high pressure in order to create fractures in the rock that allow oil or gas to flow more freely to the wellbore. Many of our newer wells would not be economical without the use of hydraulic fracturing to stimulate the formation to enhance production from the well. Hydraulic fracturing operations have historically been overseen by state regulators as part of their oil and gas regulatory programs, but where these operations occur on federal or tribal lands they are subject to regulation by the U.S. Department of the Interior, Bureau of Land Management (“BLM”). In addition to federal legislative and regulatory actions, some states and local governments have considered imposing, or have adopted various conditions and restrictions on hydraulic fracturing operations, including but not limited to requirements regarding chemical disclosure, casing and cementing of wells, withdrawal of water for use in hydraulic fracturing, baseline testing of nearby water wells, and restrictions on the type of additives that may be used in hydraulic fracturing operations. In some states, including Texas, water use may also be regulated and potentially curtailed by local groundwater management districts which could impact the availability of water for hydraulic fracturing. If these types of restrictions are widely adopted, we could be subject to increased costs and possibly limits on the productivity of certain wells, and these laws could make it easier for third parties to initiate litigation against us in the event of perceived problems with water wells in the vicinity of an oil or gas well or other alleged environmental problems. Additional information concerning hydraulic fracturing is included under Item 1A “Risk Factors.”

Climate Change and Greenhouse Gas Regulation. Scientific studies have indicated that emissions of certain gases may be contributing to warming of the Earth’s atmosphere. In response to these studies, many nations have agreed to limit emissions of “greenhouse gases” or “GHGs” pursuant to efforts spearheaded by the United Nations . Domestically, the Fourth National Climate Assessment report, released in November 2018, noted that climate change is mostly driven by GHG emissions and that climate change is accelerating. Methane, a primary component of natural gas, and carbon dioxide, a byproduct of the burning of oil, gas, and refined petroleum products, are considered GHGs. We expect continuing debate, especially in the political arena, over how to address climate change and what policies and regulations are necessary to address the issue. It is possible that domestic and international regulations addressing climate change will have adverse effects on the market for oil, gas and other fossil fuel products as well as adverse effects on the business and operations of companies engaged in the exploration for, and production of, oil, gas and other fossil fuel products. Given widely divergent political views on climate change regulation, we are unable to predict the timing, scope and effect of any proposed or future investigations, laws, regulations or treaties regarding climate change and GHG emissions, but the direct and indirect costs of such investigations, laws, regulations and treaties (if enacted) could materially and adversely affect our operations, financial condition and results of operations. In addition, several states and local governments have adopted, or are considering adopting, regulations or ordinances to reduce emissions of GHGs. Restrictions on emissions of methane or carbon dioxide that may be imposed in various states could adversely affect our operations and demand for our products. The various efforts to regulate the emissions of GHGs (including lawsuits pending in United States federal courts) may affect the cost of our operations, may affect the public’s perception of our industry, and may reduce demand for our products.

An example of the uncertainty in regulations comes from the BLM flaring rule. In November 2016, BLM issued a final rule to further restrict venting and flaring of gas from oil and gas operations on public lands. Then, BLM issued a stay of these requirements in December 2017. In September 2018, BLM published a final rule to modify and rescind substantial portions of the flaring rule. The rescission was challenged by litigation filed in the U.S. District Court for the Northern District of California. If the litigation is successful and the rule restricting flaring of gas were to become

effective, we would have to curtail production from the affected wells and would incur additional costs of compliance as well as increased monitoring and recordkeeping for some of our facilities.

Any of the climate change regulatory and legislative initiatives described above could have a material adverse effect on our business, financial condition, and results of operations. Additional information concerning climate change is included under Item 1A. "Risk Factors."

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National Environmental Policy Act. Oil and gas exploration and production activities on federal lands are subject to the National Environmental Policy Act, which we refer to as NEPA. NEPA requires federal agencies, including the Department of Interior, to evaluate major agency actions having the potential to significantly impact the environment. In the course of such evaluations, an agency will prepare an Environmental Assessment that assesses the potential direct, indirect and cumulative impacts of a proposed project and, if necessary, will prepare a more detailed Environmental Impact Statement that may be made available for public review and comment. If we were to conduct any exploration and production activities on federal lands in the future, those activities may need to obtain governmental permits that are subject to the requirements of NEPA. This process has the potential to delay the development of oil and gas projects and increase the cost of such operations.

Endangered Species Act. The Endangered Species Act, which we refer to as the ESA, restricts activities that may affect endangered or threatened species or their habitats. While some of our properties may be located in areas that may be designated as habitat for endangered or threatened species, we believe that we are in substantial compliance with the ESA. Looking forward, we expect more listings of such species to occur, in light of renewed efforts by certain environmental activists to use the ESA as a mechanism to restrict land development and energy production. Such listings could include habitat in areas where we operate or plan to operate, or which could adversely affect our ability to secure needed sand, water or other materials for our operations or to transport oil or gas via pipeline to our customers. Further, some of the species could become subject to voluntary rangeland conservation plans that could affect our operations of sources of materials. Such listing of additional species, or the discovery of previously unidentified endangered or threatened species, or the adoption of conservation plans, could cause us to incur additional costs or become subject to operating restrictions, construction delays, or bans on operating in the affected areas.

Abandonment Costs. All of our oil and gas wells will require proper plugging and abandonment at some time in the future. We have posted bonds with most regulatory agencies to ensure compliance with our plugging responsibility. Plugging and abandonment operations and associated reclamation of the surface site are important components of our environmental management system. We plan accordingly for the ultimate disposition of properties that are no longer producing.

Title to Properties

As is customary in the oil and gas industry, we make only a cursory review of title to undeveloped oil and gas leases at the time we acquire them. However, before drilling commences, we make a thorough title search, and any material defects in title are remedied prior to the time actual drilling of a well begins. To the extent title opinions or other investigations reflect title defects, we, rather than the seller/lessor of the undeveloped property, are typically obligated to cure any title defect at our expense. If we were unable to remedy or cure any title defect of a nature such that it would not be prudent to commence drilling operations on the property, we could suffer a loss of our entire investment in the property. We believe that we have good title to our properties, some of which are subject to immaterial encumbrances, easements and restrictions. The oil and gas properties we own are also typically subject to royalty and other similar non-cost bearing interests customary in the industry. We do not believe that any of these encumbrances

or burdens will materially affect our ownership or use of our properties.

Competition

We operate in a highly competitive environment. The principal resources necessary for the exploration and production of oil and gas are leasehold prospects under which oil and gas reserves may be discovered, drilling rigs and related equipment and services to explore for such reserves and knowledgeable personnel to conduct all phases of oil and gas operations. We must compete for such resources with both major oil and gas companies and independent operators. Many of these competitors have financial and other resources substantially greater than ours. Although we believe our current operating and financial resources are adequate to preclude any significant disruption of our near term operations, we cannot assure you that such materials and resources will be available to us in the future.

Employees

As of March 8, 2019, we had 100 full-time employees. We retain independent geological, land, marketing, engineering and health and safety consultants from time to time and expect to continue to do so in the future.

Available Information

We file annual, quarterly and current reports, proxy statements and other information with the Securities and Exchange Commission (“SEC”). You may read and copy any document we file with the SEC at the SEC’s public reference room at 100 F Street, NE, Room 1580, Washington, D.C. 20549. Please call the SEC at 1-800-SEC-0330 for information on the public reference room. The SEC maintains an internet web site that contains annual, quarterly and current reports, proxy statements and other information that issuers (including Abraxas) file electronically with the SEC. The SEC’s web site is www.sec.gov.

Our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and other reports and amendments filed with the SEC are available free of charge on our web site at www.abraxaspetroleum.com in the Investor Relations section as soon as practicable after such reports are filed. Information on our web site is not incorporated by reference into this Form 10-K and should not be considered part of this report or any other filing that we make with the SEC.

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Item 1A. Risk Factors

Risks Related to Our Business

We have substantial indebtedness which may adversely affect our cash flow and business operations.

At December 31, 2018, we had a total of \$180.0 million of indebtedness under our credit facility and total indebtedness of \$183.4 million (including the current portion). While the amount borrowed under our credit facility at March 8, 2019 was \$180.0 million (and total indebtedness was \$183.3 million), this amount will likely increase as we pursue drilling and completion of wells. Our indebtedness could have important consequences to us, including:

affecting our ability to obtain additional financing, if necessary, for working capital, capital expenditures, acquisitions or other purposes which may be impaired or not available on favorable terms;

requiring us to meet financial tests contained in our credit facility and future debt arrangements that may affect our flexibility in planning for and reacting to changes in our business, including future business opportunities;

requiring us to use a substantial portion of our cash flow from operations to make principal and interest payments on our indebtedness, reducing the funds that would otherwise be available for operations and future business opportunities; and

making us more vulnerable to competitive pressures if there is a downturn in our business or the economy in general, than our competitors with less debt.

Our ability to service our indebtedness will depend upon, among other things, our future financial and operating performance, which will be affected by prevailing economic conditions and financial, business, regulatory and other factors, some of which are beyond our control. If our operating results are not sufficient to service our current or future indebtedness, we will be forced to take actions such as reducing or delaying capital expenditures, acquisitions and/or selling assets, restructuring or refinancing our indebtedness or seeking additional debt or equity capital or bankruptcy protection. We may not be able to affect any of these remedies on satisfactory terms or at all.

A breach of the terms and conditions of our credit facility, including the inability to comply with the required financial covenants, could result in an event of default. If an event of default occurs (after any applicable notice and cure periods), the lenders would be entitled to terminate any commitment to make further extensions of credit under our

credit facility and to accelerate the repayment of amounts outstanding (including accrued and unpaid interest and fees). Upon a default under our credit facility, the lenders could also foreclose against any collateral securing such obligations, which may be all or substantially all of our assets. If that occurred, we may not be able to continue to operate as a going concern. As of December 31, 2018, the Company was in violation of its current ratio covenant under its credit facility. A waiver of this violation has been obtained. We cannot assure you that we will be able to obtain similar waivers in the future.

Depressed oil and/or gas prices would have a material and adverse effect on us.

Our financial results and the value of our properties are highly dependent on the general supply and demand for oil, gas and NGL, which impact the prices we ultimately realize on our sales of these commodities. Oil, gas and NGL prices have been more volatile since the second half of 2014, when there was a significant decline in oil, gas and NGL prices, which adversely affected our operating results and contributed to a reduction in our anticipated future capital expenditures. Prices improved in 2017 and 2018 before declining in the last quarter of 2018. In addition to the impact on our results of operations, declines in oil and gas prices could cause us to write down the value of our estimated proved reserves. For example, the decline in commodity prices prior to 2017 adversely impacted our estimated proved reserves and resulted in a proved property impairment of \$67.6 million in 2016. We could record impairments in future periods, the amount of which will be dependent upon many factors such as future prices of oil, gas and NGL, increases or decreases in our reserve base, changes in estimated costs and expenses, and oil and gas property acquisitions.

While oil and gas prices began to improve in late 2016 and remained at somewhat improved levels in 2017 and 2018, prices have remained relatively low and price volatility has continued. A sustained weakness or further deterioration in commodity prices could materially and adversely impact our business by resulting in, or exacerbating, the following effects:

• reducing the amount of oil, gas and NGL that we can produce economically;

• reducing the borrowing base of our credit facility;

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- limiting our financial flexibility, liquidity and access to sources of capital, such as equity and debt;
- reducing our revenues, cash flows from operations and profitability;
- causing us to decrease our capital expenditures or maintain reduced capital spending for an extended period, resulting in lower future production of oil, gas and NGL; and
- reducing the carrying value of our properties, resulting in additional noncash write-downs.

Market prices and our realized prices have been volatile and are likely to continue to be volatile in the future due to numerous factors beyond our control. These factors include:

- the level of demand;
- domestic and global supplies of oil, NGL and gas;
- the price and quantity of imported and exported oil, NGL and gas;
- the actions of other oil exporting nations;
- weather conditions and changes in weather patterns;
- the availability, proximity and capacity of appropriate transportation facilities, gathering, processing and compression facilities, storage facilities and refining facilities;
- worldwide economic and political conditions, including political instability or armed conflict in oil and gas producing regions, competition for markets and political initiatives disfavoring fossil fuels;
- the price and availability of, and demand for, competing energy sources, including alternative energy sources;
- the nature and extent of governmental regulation, including environmental regulation, regulation of derivatives transactions and hedging activities, tax laws and regulations and laws and regulations with respect to the import and export of oil, gas and related commodities;

the level and effect of trading in commodity futures markets, including trading by commodity price speculators and others, and;

the effect of worldwide energy conservation measures.

Our cash flows from operations, results of operations and the borrowing base under our credit facility depend to a great extent on the prevailing prices for oil and gas. Prolonged or substantial declines in oil and/or gas prices would materially and adversely affect our liquidity, the amount of cash flows we have available for our capital expenditures and other operating expenses, our ability to access the credit and capital markets and our results of operations.

The marketability of our production depends largely upon the availability, proximity and capacity of oil and gas gathering systems, pipelines, storage and processing facilities.

The marketability of our production depends in part upon processing, storage and transportation facilities, which are also known as midstream facilities, owned and operated by third parties. Transportation space on such gathering systems and pipelines is limited and at times unavailable due to repairs or improvements being made to such facilities or due to such space being utilized by other companies with priority transportation agreements. Our access to transportation options can also be affected by federal and state regulation of oil and gas production and transportation, general economic conditions and changes in supply and demand. These factors and the availability of markets are beyond our control. If adequate transportation and storage options are not available to us, the financial impact on us could be substantial and adversely affect our ability to produce and market our oil and gas. For example, our principal third party provider in the Bakken Field for these services has experienced significantly increased gathering system pressures which have resulted in capacity constraints. These constraints, in turn, have restricted our production and required us to flare gas, decreasing the volumes sold from our wells. Similarly, rapid production growth in the Permian Basin has strained the available midstream infrastructure there with adverse effects on our operations.

In addition to causing production curtailments and reducing the price we receive for the oil, gas and NGL we produce, given environmental impacts, including GHG production, regulatory agencies including the North Dakota Industrial Commission have adopted policies to reduce the volume of flared gas, the number of wells flaring and the duration of flaring. While these regulations have not had a material adverse effect on us to date, these current regulations relating to flaring gas or the adoption of additional regulations could cause us to shut-in production or curtail the drilling of new wells either of which could have a material adverse effect on us.

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We rely on third parties to continue to construct additional midstream facilities and related infrastructure to accommodate our growth, and the ability and willingness of those parties to do so is subject to a variety of risks.

For example:

Decreases in commodity prices in recent years have resulted in reduced investment in midstream facilities by some third parties;

Various interest groups have protested the construction of new pipelines, and particularly pipelines near water bodies, in various places throughout the country, and protests have at times physically interrupted pipeline construction activities;

Some companies in our industry have sought to reject volume commitment agreements with midstream providers in bankruptcy proceedings, and the risk that such efforts will succeed, or that upstream energy company counterparties will otherwise be unable or unwilling to satisfy their volume commitments, may have the effect of reducing investment in midstream infrastructure; and

We have pursued a variety of strategies to alleviate some of the risks associated with the midstream services and facilities upon which we rely, including seeking alternative sources for processing and transporting gas that we produce. There can be no assurance that the strategies we pursue will be successful or adequate to meet our needs.

Any significant reduction in the borrowing base under our credit facility as a result of a periodic borrowing base redetermination or otherwise will negatively impact our liquidity and, consequently, our ability to fund our operations, and we may not have sufficient funds to repay borrowings under our credit facility or any other obligation if required as a result of a borrowing base redetermination

Availability under our credit facility is currently subject to a borrowing base of \$200.0 million. The borrowing base is subject to scheduled semiannual (April 1 and October 1) and other elective borrowing base redeterminations. The amount of the borrowing base is calculated by the lenders based upon their valuation of our proved reserves securing the facility utilizing these reserve reports and their own internal decisions. The lenders under our credit facility can unilaterally adjust the borrowing base and the borrowings permitted to be outstanding under our credit facility. A number of factors could reduce our borrowing base, including:

• lower commodity prices or production;

• a reduction in reserve estimates;

inability to drill or unfavorable drilling results;

increased operating and/or capital costs;

the lenders' inability to agree to an adequate borrowing base; or

adverse changes in the lenders' practices (including required regulatory changes) regarding estimation of reserves.

As of March 8, 2019, we had \$180.0 million of borrowings outstanding and availability of \$20.0 million under our credit facility. Any significant reduction in our borrowing base as a result of borrowing base redeterminations or otherwise will negatively impact our liquidity and our ability to fund our operations and, as a result, would have a material adverse effect on our financial position, results of operations and cash flows from operations. Further, if the outstanding borrowings under our credit facility were to exceed the borrowing base as a result of redetermination, we would be required to repay the excess amount or pledge additional assets. We may not have sufficient funds to make such repayment and we do not have any substantial unpledged assets. If we do not have sufficient funds and we are otherwise unable to negotiate renewals of our borrowings or arrange new financing, we may have to sell significant assets. Any such sale could have a material adverse effect on our business and financial results.

Lower oil and/or gas prices may also reduce the amount of oil and/or gas that we can produce economically.

Sustained substantial declines in oil and/or gas prices may render uneconomic a significant portion of our exploration, development and exploitation projects, which may result in our having to make significant downward adjustments to our estimated proved reserves. As a result, a prolonged or substantial decline in oil and/or gas prices such as we have experienced since mid-2014 has in the past caused, and would likely in the future cause, a material and adverse effect on our future business, financial condition, results of operations, liquidity and ability to finance capital expenditures. Additionally, if we experience significant sustained decreases in oil and gas prices such that the expected future cash flows from our oil and gas properties falls below the net book value of our properties, we may be required to write down the value of our oil and gas properties. Any such asset impairments could materially and adversely affect our results of operations and, in turn, the trading price of our common stock.

We may not be able to fund the capital expenditures that will be required for us to increase reserves and production.

We must make capital expenditures to develop our existing reserves and to discover new reserves. Historically, we have financed our capital expenditures primarily with cash flows from operations, borrowings under credit facilities, sales of properties, monetizing derivative contracts and sales of debt and equity securities and we expect to continue to utilize these sources in the future to the extent available. We cannot assure you that we will have sufficient capital resources in the future to finance all of our planned capital expenditures.

Volatility in oil and gas prices, the timing of our drilling programs and drilling results will affect our cash flows from operations. Lower prices and/or lower production could also decrease revenues and cash flows from operations, thus reducing the amount of financial resources available to meet our capital requirements, including reducing the amount available to pursue our drilling opportunities. If our cash flows from operations does not increase as a result of capital expenditures, a greater percentage of our cash flows from operations will be required for debt service and operating expenses and our capital expenditures would, by necessity, be decreased.

If cash flows from operations or our borrowing base decrease, our ability to undertake exploration and development activities could be adversely affected. As a result, our ability to replace production may be limited. In addition, if the borrowing base under our credit facility is reduced, we would be required to reduce borrowings under our credit facility so that such borrowings do not exceed the borrowing base. This could further reduce the cash available to us for capital spending and, if we did not have sufficient capital to reduce our borrowing level, we may be in default under the credit facility.

We have sold producing properties to provide us with liquidity and capital resources in the past and we may continue to do so in the future. After any such sale, we would expect to utilize the proceeds to reduce our indebtedness and/or to drill new wells on our remaining properties. If we cannot replace the production from the properties sold with production from our remaining properties, our cash flows from operations will likely decrease, which in turn, could decrease the amount of cash available for additional capital spending.

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Restrictive debt covenants could limit our growth and our ability to finance our operations, fund our capital needs, respond to changing conditions and engage in other business activities that may be in our best interests.

Our credit facility contains a number of significant covenants that, among other things, limit our ability to:

• incur or guarantee additional indebtedness and issue certain types of preferred stock or redeemable stock;

• transfer or sell assets;

• create liens on assets;

• pay dividends or make other d