ABRAXAS PETROLEUM CORP
Form S-3
June 14, 2007
As filed with the Securities and Exchange Commission on June 14, 2007.

Registration No. 333-_______

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

**FORM S-3**

**REGISTRATION STATEMENT**

**THE SECURITIES ACT OF 1933**

**ABRAXAS PETROLEUM CORPORATION**

(Exact name of registrant as specified in its charter)

| | |
|---|---|
| **Nevada**<br>(State or other jurisdiction of<br>incorporation or organization) | **74-2584033**<br>(I.R.S. Employer<br>Identification Number) |

| | |
|---|---|
| **500 North Loop 1604 East**<br>**Suite 100**<br>**San Antonio, Texas 78232**<br>**(210) 490-4788**<br>(Address, including zip code, and telephone number, including area code, of registrant s principal executive offices) | **Robert L. G. Watson**<br>**500 North Loop 1604 East**<br>**Suite 100**<br>**San Antonio, Texas 78232**<br>**(210) 490-4788**<br>(Name, Address including zip code, and telephone number, including area code, of agent for service) |

Copies to:

Jackson Walker L.L.P.

112 E. Pecan Street, Suite 2400

San Antonio, Texas 78205

(210) 978-7700

Attention: Steven R. Jacobs

Marcello E. Tamez

Approximate date of commencement of proposed sale to the public: From time to time after this Registration Statement becomes effective.

___________________________

If the only securities being registered on this Form are being offered pursuant to dividend or interest reinvestment plans, please check the following box: [ ]

If any of the securities being registered on this Form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933, other than securities offered only in connection with dividend or interest reinvestment plans, please check the following box: [ X ]

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, please check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering: [ ]

If this Form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering: [ ]

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If this Form is a registration statement pursuant to General Instruction I.D. or a post-effective amendment thereto that shall become effective upon filing with the Commission pursuant to Rule 462(e) under the Securities Act, check the following box: [ ]

If this Form is a post-effective amendment to a registration statement filed pursuant to General Instruction I.D. filed to register additional securities or additional classes of securities pursuant to Rule 413(b) under the Securities Act, check the following box: [ ]

**CALCULATION OF REGISTRATION FEE**

| **Title of Each Class of Securities to be Registered** | **Amount to be Registered** | **Proposed Maximum Offering Price Per Share** | **Proposed Maximum Aggregate Offering Price** | **Amount of Registration Fee** |
|---|---|---|---|---|
| Common Stock, par value $0.01 per share | 7,049,617 | $4.06 (1) | $28,621,445 | $879 |

(1) Estimated in accordance with Rule 457(c) of the Securities Act solely for the purpose of computing the amount of registration fee based on the average of the high and low prices of the registrant s Common Stock as reported on The American Stock Exchange on June 12, 2007.

**THE REGISTRANT HEREBY AMENDS THIS REGISTRATION STATEMENT ON SUCH DATE OR DATES AS MAY BE NECESSARY TO DELAY ITS EFFECTIVE DATE UNTIL THE REGISTRANT SHALL FILE A FURTHER AMENDMENT WHICH SPECIFICALLY STATES THAT THIS REGISTRATION STATEMENT SHALL THEREAFTER BECOME EFFECTIVE IN ACCORDANCE WITH SECTION 8(a) OF THE SECURITIES ACT OF 1933 OR UNTIL THIS REGISTRATION STATEMENT SHALL BECOME EFFECTIVE ON SUCH DATE AS THE COMMISSION, ACTING PURSUANT TO SAID SECTION 8(a), MAY DETERMINE.**

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**THE INFORMATION IN THIS PROSPECTUS IS NOT COMPLETE AND MAY CHANGE. THIS PROSPECTUS IS INCLUDED IN A REGISTRATION STATEMENT THAT WE FILED WITH THE SECURITIES AND EXCHANGE COMMISSION. THE SELLING STOCKHOLDERS CANNOT SELL THESE SECURITIES UNTIL THAT REGISTRATION STATEMENT BECOMES EFFECTIVE. THIS PROSPECTUS IS NOT AN OFFER TO SELL THESE SECURITIES AND IS NOT SOLICITING AN OFFER TO BUY THESE SECURITIES IN ANY STATE WHERE THE OFFER OR SALE IS NOT PERMITTED.**

**SUBJECT TO COMPLETION DATED JUNE 14, 2007**

**ABRAXAS PETROLEUM CORPORATION**

**7,049,617 shares**

**of Common Stock**

This prospectus relates to the offer and sale from time to time of up to an aggregate of 7,049,617 shares of our common stock by the selling stockholders named in this prospectus. The selling stockholders may sell none, some or all of the shares offered by this prospectus. We cannot predict when or in what amounts a selling stockholder may sell any of the shares offered by this prospectus. We will not receive any proceeds from any such sale by any selling stockholder.

**Investing in our common stock involves risks. Please carefully read the information under the headings Forward-Looking Statements on page ii and Risk Factors beginning on page 5 of this prospectus before you invest in our common stock.**

Our common stock trades on The American Stock Exchange under the symbol ABP. On June 12, 2007, the closing price of our common stock on The American Stock Exchange was $4.06.

NEITHER THE SECURITIES AND EXCHANGE COMMISSION NOR ANY STATE SECURITIES COMMISSION HAS APPROVED OR DISAPPROVED OF THESE SECURITIES OR DETERMINED IF THIS PROSPECTUS IS TRUTHFUL OR COMPLETE. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.

**This Prospectus is dated ___________, 2007**

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You should rely only on the information contained or incorporated by reference in this prospectus. We have not authorized anyone to provide you with different information. You should not assume that the information contained in this prospectus is accurate as of any date other than the date on the front of this prospectus.

**ABOUT THIS PROSPECTUS**

This prospectus is part of a registration statement that we filed with the Securities and Exchange Commission utilizing a shelf registration process or continuous offering process. Under this shelf registration process, the selling stockholders may, from time to time, sell the securities described in this prospectus in one or more offerings. This prospectus provides you with a general description of the securities which may be offered by the selling stockholders. Each time a selling stockholder sells securities, the selling stockholder is required to provide you with this prospectus and, in certain cases, a prospectus supplement containing specific information about the selling stockholder and the terms of the securities being offered. That prospectus supplement may include additional risk factors or other special considerations applicable to those securities. Any prospectus supplement may also add, update, or change information in this prospectus. If there is any inconsistency between the information in this prospectus and any prospectus supplement, you should rely on the information in that prospectus supplement. You should read both this prospectus and any prospectus supplement together with additional information described under Where You Can Find More Information.

**FORWARD-LOOKING INFORMATION**

We make forward-looking statements throughout this prospectus and the documents included or incorporated by reference in this prospectus. 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, seek, estimate, could, potentially or similar expressions), you must remember that these are forward-looking st and that our expectations may not be correct, even though we believe they are reasonable. The forward-looking information contained in this prospectus or in the documents included or incorporated by reference in this prospectus is generally located in the material set forth under the headings Summary, Risk Factors, Business, and Management s Discussion and Analysis of Financial Condition and Results of Operations but may be found in other locations as well. These forward-looking statements generally relate to our plans and objectives for future operations and are based upon our management s reasonable estimates of future results or trends. The factors that may affect our expectations regarding our operations include, among others, the following:

- our success in development, exploitation and exploration activities;
- our ability to make planned capital expenditures;
- declines in our production of natural gas and crude oil;
- prices for natural gas and crude oil;
- our ability to raise equity capital or incur additional indebtedness;
- political and economic conditions in oil producing countries, especially those in the Middle East;
- price and availability of alternative fuels;
- our restrictive debt covenants;
- our acquisition and divestiture activities;
- weather conditions and events;
- the proximity, capacity, cost and availability of pipelines and other transportation facilities;
- results of our hedging activities; and
- other factors discussed elsewhere in this prospectus and the documents incorporated by reference in this prospectus.

## SUMMARY

*This summary highlights selected information from this prospectus, but does not contain all information that may be important to you. This prospectus includes specific terms of this offering, information about our business and financial data. To understand all of the terms of this offering and for a more complete understanding of our business, you should carefully read this entire prospectus, particularly the section entitled Risk Factors , our annual report on Form 10-K for the year ended December 31, 2006 and our quarterly report on Form 10-Q for the quarter ended March 31, 2007, including the consolidated financial statements and the notes to those financial statements included in those reports, all of which are incorporated by reference herein. The term Abraxas refers only to Abraxas Petroleum Corporation and the terms we, us, our, or the Company, refer to Abraxas Petroleum Corporation, together with its consolidated subsidiaries including Abraxas Energy Partners, L.P., unless the context otherwise requires. Except as otherwise noted, our consolidated financial, reserve and operating information includes the financial, reserve and operating information of Abraxas Energy Partners, L.P., which is consolidated for financial reporting purposes but is not wholly-owned by us. The terms pro forma or on a pro forma basis refer to what our business might have looked like if the transactions described under Recent Developments had occurred at the times indicated. We have provided definitions for some of the natural gas and crude oil industry terms used in this prospectus in the section entitled Glossary of Terms.*

### Our Business

Abraxas Petroleum Corporation is an independent energy company engaged primarily in the acquisition, development, exploration and production of natural gas and crude oil. Our principal means of growth has been through the acquisition and subsequent development and exploitation of producing properties. As a result of our historical acquisition activities, we have a number of development opportunities on our properties. In addition, Abraxas intends to expand upon its development activities with complementary exploration projects in our core areas of operation. Success in our development and exploration activities is critical to the maintenance and growth of our current production levels and associated reserves.

Our core areas of operation are in South and West Texas and east central Wyoming. As described in more detail below under Recent Developments, in May 2007, Abraxas formed a new limited partnership, Abraxas Energy Partners, L.P., which we refer to as the Partnership, and contributed certain of Abraxas producing properties located in South and West Texas to the Partnership and received a 47.2% interest in the Partnership. As a result, Abraxas now owns a smaller base of producing properties with a large inventory of high impact proved undeveloped and probable locations in Wyoming and in West and South Texas. Abraxas believes that a single successful well could have a significant impact on production and reserves. On June 7, 2007, for example, Abraxas announced the successful completion of a horizontal well drilled in the Oates SW Field area of West Texas. At June 7, 2007, the well was producing an average of 4.5 MMcfepd which represents a production increase of 145% over Abraxas first quarter of 2007 daily production on a pro forma basis. The Partnership owns producing properties which are characterized by long-lived reserves and established production profiles with an emphasis on natural gas.

At December 31, 2006, we owned interests in 101,815 gross acres (87,554 net acres) and operated properties accounting for approximately 95% of our PV-10, affording us substantial control over the timing and incurrence of operating and capital expenditures. On a pro forma basis, at December 31, 2006, Abraxas owned interests in approximately 88,250 gross acres (76,150 net acres), and operated properties accounting for approximately 99% of its PV-10 and the Partnership owned interests in approximately 16,400 gross acres (13,500 net acres), and operated properties accounting for approximately 90% of its PV-10. At December 31, 2006, estimated total proved reserves were 98.8 Bcfe with an aggregate PV-10 of $161 million. On a pro forma basis, at December 31, 2006, Abraxas estimated total proved reserves were 33.4 Bcfe with an aggregate PV-10 of $45 million and the Partnership s estimated total proved reserves were 65.4 Bcfe with an aggregate PV-10 of $116 million.

Abraxas business strategy is to provide long term growth in net asset value per share, through the growth and expansion of its natural gas and crude oil reserves and production. Abraxas focuses on adding reserve value through careful evaluation and aggressive pursuit of natural gas and crude oil drilling and acquisition opportunities. As a result, Abraxas has a substantial inventory of projects, any one of which could provide a basis for significant production and reserve increases.

Several of the key elements of our strategy are the following:

*Exploit and Develop Existing Property Base*. Abraxas seeks to maximize the value of its existing assets by developing and exploiting its properties with the lowest risk and the highest production and reserve growth potential. Abraxas continually performs field studies of its existing properties and re-evaluates exploitation and development opportunities using advanced technologies, such as modern log analysis, reservoir modeling, 3-D seismic and horizontal drilling.

*Pursue Successful Exploration Projects*. Abraxas seeks to complement the development of its existing assets with an active exploration program within its core areas of operation and in other areas with similar characteristics. Abraxas utilizes 3-D seismic data and other technical applications, as appropriate, to manage its exploration risk.

*Pursue Strategic Acquisitions*. Abraxas focuses its acquisition efforts in areas where it can apply its technical expertise. To leverage its regional knowledge base, Abraxas seeks to acquire large acreage positions with significant drilling potential in its core areas and/or areas that exhibit similar characteristics to its existing properties.

*Focus on Operational Control and High Working Interest*. Abraxas endeavors to operate the majority of its properties as this affords Abraxas the ability to control the timing of projects. Similarly, retaining a high working interest further reinforces control, as a minority interest owner cannot force an action that may not be deemed prudent.

*Maintain Natural Gas Focus*. Abraxas portfolio of producing properties is largely concentrated in natural gas.

**Recent Developments**

On May 25, 2007, Abraxas completed a series of transactions which resulted in Abraxas refinancing and repaying all of its outstanding indebtedness. The following is a summary of these transactions.

Abraxas formed a limited partnership, Abraxas Energy Partners, L.P., which we refer to as the Partnership, pursuant to which Abraxas contributed certain assets located in South and West Texas to a wholly-owned subsidiary of the Partnership. The assets contributed had estimated proved reserves of approximately 65 Bcfe as of December 31, 2006 and accounted for approximately 85% of Abraxas daily production as of such date. Abraxas, through certain wholly-owned subsidiaries, owns an approximate 47.2% interest in the Partnership, consisting of 5,131,959 common units and 227,232 general partner units. The general partner of the Partnership, Abraxas General Partner, LLC, is a wholly-owned subsidiary of Abraxas.

The Partnership sold an approximate 52.8% interest, consisting of 6,002,408 common units at a purchase price of $16.66 per unit to various purchasers in a private placement. In connection with the private placement of the Partnership units, the Partnership entered into a registration rights agreement with regard to the limited partner units purchased by the investors. Under the registration rights agreement, as soon as practicable after May 25, 2007, the Partnership agreed (a) to prepare and file with the SEC a registration statement for (i) the initial public offering, or IPO, of the common units and (ii) a shelf registration statement for the resale of the common units by the investors and (b) to use its commercially reasonable efforts to cause the IPO registration statement and the shelf registration statement to be declared effective by February 14, 2008.

The Partnership entered into a $150 million senior secured revolving credit facility, of which $35 million was borrowed at closing, with Société Générale, as administrative agent and issuing lender, and the other lenders signatory thereto. Borrowing availability under the Partnership s credit facility is subject to a borrowing base consistent with customary natural gas and crude oil lending transactions. Outstanding amounts under the Partnership s credit facility bear interest at the reference rate announced from time to time by Société Générale plus 0.25% - 1.25% depending on utilization of the borrowing base or, if the Partnership elects, at the London Interbank Offered Rate plus 1.25% - 2.25%, depending on the utilization of the borrowing base. Subject to earlier termination rights and events of default, the Partnership s credit facility s stated maturity date is May 25, 2011. Interest is payable quarterly on reference rate advances and not less than quarterly on Eurodollar advances. Obligations under the Partnership s credit facility are secured by a first priority perfected security interest, subject to certain permitted encumbrances, in all of the general partner s, the Partnership s and its subsidiary s property and assets, other than the general partner s general partner units.

Abraxas sold approximately $22.5 million of its common stock in a private placement offering to several purchasers of the Partnership units. The private placement consisted of 5,874,678 shares of common stock, at a purchase price of $3.83 per share. The purchase price reflected the 10-day volume weighted average price of Abraxas common stock prior to closing. The purchasers of the common stock were also issued five-year warrants to purchase up to an additional 1,174,939 shares of common stock, at an exercise price of $3.83 per share.

Net proceeds from these transactions of approximately $147.3 million (including $35.0 million borrowed under the Partnership s credit facility ) were used to refinance and repay all of Abraxas and its subsidiaries outstanding indebtedness (including accrued and unpaid interest due June 1, 2007) and pay preformation and transaction expenses with the excess proceeds dedicated by Abraxas to fund future drilling opportunities and for general corporate purposes.

Abraxas, the Partnership and the purchasers of the common units of the Partnership also entered into an Exchange and Registration Rights Agreement dated May 25, 2007. Under the terms of this agreement, in the event that the Partnership has not consummated its initial public offering by November 15, 2008, which we refer to as the Trigger Date, the investors will have the right to convert their common units obtained in the private placement offering into shares of common stock. Each common unit will be convertible into a number of shares of common stock equal to $16.66 divided by the volume weighted average price of the common stock for the ten (10) business day period immediately prior to the first business day following the Trigger Date times 0.9. If stockholder approval is required for such issuance, Abraxas has agreed to call a special meeting of the stockholders within 60 days of November 15, 2008, which we refer to as the Exchange Filing Date, and the executive officers and directors of Abraxas have agreed to vote the shares of common stock then held by them in favor of such issuance. Under this agreement, Abraxas also agreed within 30 days of the Trigger Date, to prepare and file with the Securities and Exchange Commission a registration statement, which we refer to as the Exchange Registration Statement, to enable the resale of the common stock, which we refer to as the Exchange Shares, by the investors or their transferees from time to time over any national stock exchange on which the common stock is then traded, or in privately-negotiated transactions. If the Exchange Registration Statement is not declared effective by the 120th day following the Trigger Date (which period would be extended to the 180th day following the Trigger Date under certain circumstances), then in addition to any other rights the investors may have under the Exchange and Registration Rights Agreement or under applicable law, Abraxas is required to pay an amount in cash as liquidated damages and not as a penalty, equal to 1.0% of the product of $3.83 times the number of Exchange Shares then held by such investor for each 30-day period until the Exchange Registrations Statement is declared effective.

In addition, Abraxas has received a commitment letter for a new $50 million credit facility with Société Générale, which we refer to as the new credit facility. Borrowing availability under the new credit facility will be subject to a borrowing base consistent with customary natural gas and crude oil lending transactions. It is expected that the initial borrowing base will be $6,500,000. Outstanding amounts under the new credit facility will bear interest at the reference rate announced from time to time by Société Générale plus 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. Subject to earlier termination rights and events of default, the new credit facility s stated maturity date will be four years after the date it is consummated. Interest will be payable quarterly on reference rate advances and not less than quarterly on Eurodollar advances. Obligations under the new credit facility will be secured by a first priority perfected security interest, subject to certain permitted encumbrances, in all of Abraxas property and assets.

**The Offering**

In connection with the private placement of Abraxas common stock and warrants, we agreed to prepare and file with the Securities and Exchange Commission, no later than June 25, 2007, a registration statement to enable the resale of the common stock by the selling stockholders or their transferees. Abraxas also agreed to use its commercially reasonable efforts to cause such registration statement to become effective prior to August 24, 2007 (subject to certain conditions) and to remain continuously effective for a period ending on the date that is the earlier of (i) the date on which the selling stockholder may sell all of the shares of common stock purchased pursuant to the private placement and then held by such selling stockholder without restriction under Rule 144(k), or (ii) such time as all of such shares of common stock purchased by such selling stockholder pursuant to the private placement have been sold or otherwise transferred pursuant to a registration statement or otherwise.

As a result of Abraxas obligations in connection with the private placement, Abraxas has filed a registration statement, of which this prospectus is a part, for the resale of a total of 7,049,617 shares of its common stock, consisting of the 5,874,678 shares of its common stock issued in the private placement and the 1,174,939 shares of common stock issuable upon exercise of the warrants issued in the private placement.

**Corporate Information**

Abraxas was originally incorporated in Texas in 1977 and re-incorporated in Nevada in 1990 when it became a public company. Abraxas common stock is listed on The American Stock Exchange under the symbol ABP. Abraxas principal offices are located at 500 North Loop 1604 East, Suite 100, San Antonio, Texas 78232, and its telephone number is (210) 490-4788. Abraxas internet address is www.abraxaspetroleum.com.

**RISK FACTORS**

**Risks Related to Abraxas Business**

***Abraxas may not be able to fund the substantial capital expenditures that will be required for it to increase reserves and production.***

Abraxas must make substantial capital expenditures to develop its existing reserves and to discover new reserves. Historically, Abraxas has financed capital expenditures primarily with cash flow from operations, borrowings under credit facilities and sales of producing properties, and expects to continue to do so in the future. Abraxas also anticipates receiving distributions of available cash from the Partnership. Abraxas cannot assure you that it will have sufficient capital resources in the future to finance its capital expenditures.

Volatility in natural gas and crude oil prices, the timing of both Abraxas and the Partnership s drilling programs and drilling results will affect both Abraxas and the Partnership s cash flow from operations as well as distributions of available cash by the Partnership to Abraxas. Lower prices and/or lower production of natural gas or crude oil will also decrease revenues and cash flow, thus reducing the amount of financial resources available to meet both Abraxas and the Partnership s capital requirements, including reducing the amount available to pursue drilling opportunities. If Abraxas cash flow from operations does not increase as a result of planned capital expenditures, Abraxas cash flow from operations will first be required to satisfy debt service obligations and Abraxas planned capital expenditures would, by necessity, be decreased.

The borrowing base under Abraxas new credit facility and under the Partnership s credit facility will be determined from time to time by the lenders, consistent with their customary natural gas and crude oil lending practices. Reductions in estimates of natural gas and crude oil reserves could result in a reduction in the borrowing bases, which would reduce the amount of financial resources available under both Abraxas new credit facility and the Partnership s credit facility to meet their respective capital requirements. Such a reduction could be the result of lower commodity prices or production, inability to drill or unfavorable drilling results, adverse changes in natural gas and crude oil reserve engineering, the lenders inability to agree to an adequate borrowing base or adverse changes in the lenders practices regarding estimation of reserves.

If cash flow from operations or the borrowing bases decrease for any reason, both Abraxas and the Partnership s ability to undertake exploitation and development activities would be adversely affected. As a result, both Abraxas and the Partnership s ability to replace production may be limited. In addition, if either of the borrowing bases is reduced, Abraxas and/or the Partnership would be required to reduce the level of borrowings so that such borrowings do not exceed the applicable borrowing base. This could further reduce the cash available for capital spending and, if either Abraxas or the Partnership did not have sufficient capital to reduce its borrowing level, Abraxas and/or the Partnership may default under their respective credit facilities.

Abraxas has sold producing properties to provide it with liquidity and capital resources in the past and both Abraxas and the Partnership may do so in the future. After any such sale, we would expect to utilize the proceeds to drill new wells on our remaining properties. If we cannot replace the production lost from properties sold with production from the remaining properties, both Abraxas and the Partnership s cash flow from operations, including distributions of available cash from the Partnership, will likely decrease which, in turn, would decrease the amount of cash available for additional capital spending.

***Abraxas may be unable to acquire or develop additional reserves, in which case its results of operations and financial condition would be adversely affected.***

Abraxas future natural gas and crude oil production, and therefore its success, is highly dependent upon its ability to find, acquire and develop additional natural gas and crude oil reserves that are profitable to produce. The rate of production from Abraxas natural gas and crude oil properties and proved reserves will decline as reserves are produced unless Abraxas acquires additional properties containing proved reserves, conducts successful development and exploitation activities or, through engineering studies, identifies additional behind-pipe zones or secondary recovery reserves. Abraxas cannot assure you that its exploration, exploitation and development activities will result in increases in its proved reserves. While Abraxas has had some success in pursuing these activities, Abraxas has not been able to fully replace the production volumes lost from natural field declines and prior property sales. As its proved reserves, and consequently its production, decline, Abraxas cash flow from operations and the amount that it is able to borrow under its new credit facility will also decline. In addition, approximately 71% of Abraxas and 42% of the Partnership s total estimated proved reserves at December 31, 2006 were undeveloped. By their nature, estimates of undeveloped reserves are less certain. Recovery of such reserves will require significant capital expenditures and successful drilling operations. In addition, even if Abraxas is successful in its development efforts, it could take several years for a significant portion of these undeveloped reserves to generate positive cash flow.

***Abraxas may not find any commercially productive natural gas or crude oil reservoirs.***

We cannot assure you that any new wells Abraxas drills will be productive or that Abraxas will recover all or any portion of its capital investment employed in such drilling activities. Drilling for natural gas and crude oil may be unprofitable. Dry holes and wells that are productive but do not produce sufficient net revenues after drilling, operating and other costs are unprofitable. The inherent risk of not finding commercially productive reservoirs will be compounded by the fact that 71% of Abraxas and 42% of the Partnership s total estimated proved reserves at December 31, 2006 were undeveloped. By their nature, estimates of undeveloped reserves are less certain. Recovery of such reserves will require significant capital expenditures and successful drilling operations. In addition, our properties may be susceptible to drainage from production by other operations on adjacent properties, which could make previously commercially productive reservoirs unprofitable. If the volume of natural gas and crude oil we produce decreases, our cash flow from operations and the amount of any distributions that Abraxas may receive from the Partnership will decrease.

***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.***

Abraxas new credit facility and the Partnership s credit facility contain a number of significant covenants that, among other things, limit both Abraxas and the Partnership s 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 distributions on capital stock or make other restricted payments, including repurchasing, redeeming or retiring capital stock or subordinated debt or making certain investments or acquisitions;
- engage in transactions with affiliates;
- guarantee other indebtedness;
- make any change in the principal nature of our business;
- permit a change of control; or
- consolidate, merge or transfer all or substantially all of the consolidated assets of Abraxas and our restricted subsidiaries.

In addition, both Abraxas new credit facility and the Partnership s credit facility require each of them to maintain compliance with specified financial ratios and satisfy certain financial condition tests. Both Abraxas and the Partnership s ability to comply with these ratios and financial condition tests may be adversely affected by events beyond our control, and we cannot assure you that either Abraxas or the Partnership will meet these ratios and financial condition tests. These financial ratio restrictions and financial condition tests could limit both Abraxas and the Partnership s ability to obtain future financings, make needed capital expenditures, withstand a future downturn in our business or the economy in general or otherwise conduct necessary or desirable corporate activities.

A breach of any of these covenants or either Abraxas or the Partnership s inability to comply with the required financial ratios or financial condition tests could result in a default under Abraxas new credit facility and/or the

Partnership s credit facility. A default, if not cured or waived, could result in all of our indebtedness becoming immediately due and payable. If that should occur, we may not be able to pay all such debt or to borrow sufficient funds to refinance it. Even if new financing were then available, it may not be on terms that are acceptable or favorable to us.

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

The marketability of our production depends in part upon processing and transportation facilities. Transportation space on such gathering systems and pipelines is occasionally limited and at times unavailable due to repairs, maintenance 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 adversely affected by U.S. federal and state regulation of natural gas and crude oil production and transportation, general economic conditions and changes in supply and demand for such products. These factors and the availability of markets for our natural gas and crude oil production are beyond our control. If market factors dramatically change significantly, the financial impact on us could be substantial and may adversely affect our ability to produce and market natural gas and crude oil.

***Hedging transactions have in the past and may in the future impact our cash flow from operations.***

Both Abraxas and the Partnership enter into hedging arrangements from time to time to reduce our exposure to fluctuations in natural gas and crude oil prices and to achieve more predictable cash flow. In 2005, Abraxas incurred a hedging loss of $592,000, resulting from the price floors it established. For the years ended December 31, 2004 and 2006, Abraxas recognized a gain from hedging activities of approximately $118,000 and $646,000, respectively. The Partnership s credit facility requires the Partnership to enter into hedging arrangements for not less than 75% (nor more than 90%) of the Partnership s projected natural gas and crude oil production. The Partnership entered into fixed price commodity swaps at current market prices on May 25, 2007 on approximately 75% of the Partnership s projected proved developed reserves for the period from June 1, 2007 to December 31, 2010. For more information on risks associated with the Partnership s hedging activities, see Risks Related to Abraxas Ownership of General Partner Units and Common Units of the Partnership The Partnership s derivative activities could increase cash flow volatility and adversely affect its ability to pay distributions.

The following table sets forth Abraxas hedge position at June 1, 2007:

| Time Period | Notional Quantities | Price |
|---|---|---|
| July 2007 | 10,000 MMbtu of production per day | Floor of $4.25 |
| August 2007 | 10,000 MMbtu of production per day | Floor of $5.00 |
| September 2007 | 10,000 MMbtu of production per day | Floor of $5.50 |

We cannot assure you that the hedging transactions we have entered into, or will enter into, will adequately protect us from financial loss in the future due to circumstances such as:

- highly volatile natural gas and crude oil prices;
- our natural gas and crude oil price production being less than expected; or
- a counterparty to one of our hedging transactions defaulting on its contractual obligations.

***Lower natural gas and crude oil prices increase the risk of ceiling limitation write-downs.***

We use the full cost method to account for our natural gas and crude oil operations. Accordingly, we capitalize the cost to acquire, explore for and develop natural gas and crude oil properties. Under full cost accounting rules, the net capitalized cost of natural gas and crude oil properties may not exceed a ceiling limit which is based upon the present value of estimated future net cash flows from proved reserves, discounted at 10%. If net capitalized costs of natural gas and crude oil properties exceed the ceiling limit, we must charge the amount of the excess to earnings. This is called a ceiling limitation write-down. This charge does not impact cash flow from operating activities, but does reduce our stockholders equity and earnings. The risk that we will be required to write-down the carrying value of natural gas and crude oil properties increases when natural gas and crude oil prices are low. In addition, write-downs may occur if we experience substantial downward adjustments to our estimated proved reserves. An expense recorded in one period may not be reversed in a subsequent period even though higher natural gas and crude oil prices may have increased the ceiling applicable to the subsequent period.

Abraxas has incurred ceiling limitation write-downs in the past. At June 30, 2002, for example, Abraxas recorded a ceiling limitation write-down of $28.2 million. We cannot assure you that we will not experience additional ceiling limitation write-downs in the future.

***Abraxas depends on its Chairman, President and CEO and the loss of his services could have an adverse effect on its operations.***

Abraxas depends to a large extent on Robert L. G. Watson, its Chairman of the Board, President and Chief Executive Officer, for our management and business and financial contacts. Mr. Watson may terminate his employment agreement with Abraxas at any time on 30 days notice, but, if he terminates without cause, he would not be entitled to the severance benefits provided under the terms of that agreement. Mr. Watson is not precluded from working for, with or on behalf of a competitor upon termination of his employment with Abraxas. If Mr. Watson were no longer able or willing to act as Abraxas Chairman, President and Chief Executive Officer, the loss of his services could have an adverse effect on our operations. In addition, in connection with the initial public offering by Abraxas previously wholly-owned subsidiary, Grey Wolf Exploration Inc., Abraxas, Grey Wolf and Mr. Watson agreed that Mr. Watson would continue to serve as Abraxas Chief Executive Officer and President and as the Chief Executive Officer and President of Grey Wolf, with Mr. Watson devoting two-thirds of his time to his positions and duties with Abraxas and one-third of his time to his position and duties with Grey Wolf. In consideration for receiving Mr. Watson s services, Grey Wolf makes an annual payment to Abraxas of U.S. $100,000 and reimburses Abraxas for Mr. Watson s expenses incurred in connection with providing such services.

**Risks Related to Abraxas Ownership of General Partner Units and Common Units of the Partnership**

***The Partnership may not have sufficient cash flow from operations to pay the quarterly distributions on the general partner units and common units following establishment of cash reserves and payment of fees and expenses.***

Under the terms of the Partnership s partnership agreement, the amount of cash otherwise available for distribution will be reduced by the Partnership s operating expenses and the amount of any cash reserve amounts that its general partner establishes to provide for future operations, future capital expenditures, future debt service requirements and future cash distributions to its unitholders, including Abraxas. The Partnership has informed Abraxas that the Partnership intends to reserve a substantial portion of its cash generated from operations to develop its natural gas and crude oil properties and to acquire additional natural gas and crude oil properties in order to maintain and grow the Partnership s level of natural gas and crude oil reserves.

The amount of cash the Partnership actually generates will depend upon numerous factors related to its business that may be beyond its control, including among other things:

- the amount of natural gas and crude oil it produces;
- demand for and price of natural gas and crude oil;
- continued drilling and development of natural gas and crude oil wells;
- the level of the Partnership s operating costs, including reimbursement of expenses to its general partner;
- prevailing economic conditions; and
- government regulation and taxation.

In addition, the actual amount of cash that the Partnership will have available for distribution will depend on other factors, including:

- the level of its capital expenditures;
- its ability to make borrowings under its credit facility to pay distributions;
- sources of cash used to fund acquisitions;
- debt service requirements and restrictions on distributions contained in its credit facility or future debt agreements;
- fluctuations in its working capital needs;
- general and administrative expenses;
- cash settlement of hedging positions;
- timing and collectibility of receivables; and
- the amount of cash reserves, which the Partnership expects to be substantial, established by its general partner for the proper conduct of its business.

***The Partnership is unlikely to be able to sustain its expected level of distributions without making accretive acquisitions or capital expenditures that maintain or grow its asset base. If the Partnership does not set aside sufficient cash reserves or make sufficient cash expenditures to maintain its asset base, it will be unable to pay distributions at the expected level from cash generated from operations and would likely reduce distributions.***

Producing natural gas and crude oil reservoirs are characterized by declining production rates that vary based on reservoir characteristics and other factors. The rate of decline of the reserves and production from wells owned by the Partnership and included in Abraxas reserve report at December 31, 2006, will change if production from the Partnership s existing wells declines in a different manner than has been estimated in such report and may change when the Partnership drills additional wells, makes acquisitions and under other circumstances. The Partnership s future natural gas and crude oil reserves and production and its resulting cash flow and ability to make distributions depends on its success in developing and exploiting its current reserves efficiently and finding or acquiring additional recoverable reserves economically. The Partnership may not be able to develop, find or acquire additional reserves to replace its current and future production at acceptable costs, which would adversely affect its business, financial condition and results of operations and reduce cash available for distribution.

The Partnership is unlikely to be able to sustain its expected level of distributions without making accretive acquisitions or capital expenditures that maintain or grow its asset base. The Partnership will need to make substantial capital expenditures to maintain and grow its asset base, which will reduce cash available for distributions. Because the timing and amount of these capital expenditures fluctuate each quarter, the Partnership expects to reserve substantial amounts of cash each quarter to finance these expenditures over time. The Partnership may use the reserved cash to reduce indebtedness until it makes the capital expenditures. Over a longer period of time, if the Partnership does not set aside sufficient cash reserves or make sufficient expenditures to maintain its asset base, it will be unable to pay distributions at the expected level from cash generated from operations and would therefore expect to reduce cash distributions. If the Partnership does not make sufficient growth capital expenditures, it will be unable to sustain its business operations and therefore will be unable to maintain its proposed or current level of distributions and its business, financial condition and results of operations would be adversely affected.

***To fund its growth capital expenditures, the Partnership will be required to use cash generated from operations, additional borrowings or the issuance of additional partnership interests, or some combination thereof.***

Use of cash generated from operations by the Partnership will reduce cash available for distribution to Abraxas as a unitholder. The Partnership s ability to borrow from its existing credit facility or to obtain additional bank financing or to access the capital markets for future equity or debt offerings may be limited by its financial condition at the time of any such borrowing, financing or offering and the covenants in its then-existing debt agreements, as well as by adverse market conditions resulting from, among other things, general economic conditions, operations and contingencies and uncertainties that are beyond the Partnership s control. The Partnership s failure to obtain the funds for necessary future capital expenditures could have a material adverse effect on its business, results of operations, financial condition and ability to pay distributions. Even if the Partnership is successful in obtaining the necessary funds, the terms of such financings could limit its ability to pay distributions to unitholders, including Abraxas. In addition, incurring additional debt may significantly increase the Partnership s interest expense and financial leverage, and issuing additional partnership interests may result in significant unitholder dilution thereby increasing the aggregate amount of cash required to maintain the then-current distribution rate, which could have a material adverse effect on the Partnership s ability to pay distributions at the then-current distribution rate.

***The amount of cash the Partnership has available for distribution to unitholders, including Abraxas, depends primarily on the Partnership s cash flow and not solely on profitability.***

The amount of cash the Partnership has available for distribution depends primarily on its cash flow, including cash from financial reserves and working capital or other borrowings, and not solely on profitability, which will be affected by non-cash items. As a result, the Partnership may make cash distributions during periods when it records losses and may not make cash distributions during periods when it records net income.

***If the Partnership does not make acquisitions on economically acceptable terms, its future growth and ability to pay or increase distributions will be limited and acquisitions may decrease available cash.***

The Partnership s ability to grow and to increase distributions to unitholders depends in part on its ability to make acquisitions that result in an increase in pro forma available cash per unit. The Partnership may be unable to make such acquisitions because it is:

- unable to identify attractive acquisition candidates or negotiate acceptable purchase contracts with them;
- unable to obtain financing for these acquisitions on economically acceptable terms; or
- outbid by competitors.

If the Partnership is unable to acquire properties containing proved reserves, its total level of proved reserves will decline as a result of production, and it will be limited in its ability to increase or possibly even to maintain its level of cash distributions.

Any acquisitions the Partnership completes will be subject to substantial risks that could reduce its ability to make distributions to unitholders, including Abraxas.

Even if the Partnership completes acquisitions that it believes will increase pro forma available cash per unit, these acquisitions may nevertheless result in a decrease in pro forma available cash per unit. Any acquisition involves potential risks, including, among other things:

- the validity of the assumptions about reserves, future production, revenues and costs, including synergies;
- an inability to integrate successfully the businesses acquired;