ABRAXAS PETROLEUM CORP
Form 10-Q/A
March 30, 2006

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

FORM 10-Q/A Number 1

(Mark One)

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2005

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

COMMISSION FILE NUMBER: 0-19118

ABRAXAS PETROLEUM CORPORATION

(Exact name of registrant as specified in its charter)

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

500 N. Loop 1604 East, Suite 100, San Antonio, TX 78232

(Address of principal executive offices) (Zip Code)
210-490-4788

(Registrant's telephone number, including area code)

Not Applicable

(Former name, former address and former fiscal year, if changed since last report)

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

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes [ ] No [X]

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

The number of shares outstanding of each of the issuer's classes of common stock, as of November 3, 2005.

Class	Shares Outstanding
Common Stock $.01 Par Value	42,057,667

Explanatory Note

Abraxas Petroleum Corporation is filing this Amendment Number 1 to Quarterly Report on Form 10-Q for the period ended September 30, 2005, initially filed with the SEC on November 7, 2005, in order to correct the accounting for the gain on the sale of Abraxas' Canadian subsidiary in February 2005. Due to an error in the accounting for other comprehensive income related to the sale, the gain on the transaction was understated by $2.2 million and resulted in a restatement of the Condensed Statement of Operations and the Condensed Consolidated Statement of Cash Flow for the nine months ended September 30, 2005. Pursuant to Rule 12b-15 under the Securities Exchange Act of 1934, the complete text of Form 10-Q as revised is included in this filing.

Forward-Looking Information

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

- our high debt level;
- our success in development, exploitation and exploration activities;
- our ability to make planned capital expenditures;
- declines in our production of 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;
- results of our hedging activities; and
- other factors discussed elsewhere in this document.

In addition to these factors, important factors that could cause actual results to differ materially from our expectations ("Cautionary Statements") are disclosed under "Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2004 which are incorporated by reference herein. All subsequent written and oral forward-looking statements attributable to us, or persons acting on our behalf, are expressly qualified in their entirety by the Cautionary Statements.

ABRAXAS PETROLEUM CORPORATION
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PART I
FINANCIAL INFORMATION

Abraxas Petroleum Corporation
Condensed Consolidated Balance Sheets
(in thousands)

September 30,

		2005 (Unaudited)	D
Assets:			
Current assets:			
Cash	$	763	$
Accounts receivable, net			
Joint owners..		441	
Oil and gas production..............................		8,518	
Other..		100	
		9,059	
Equipment inventory...		903	
Other current assets..		1,883	
		12,608	
Assets held for sale..		-	
Total current assets..................................		12,608	
Property and equipment:			
Oil and gas properties, full cost method of accounting:			
Proved...		325,996	
Other property and equipment.............................		3,184	
Total...		329,180	
Less accumulated depreciation, depletion, and amortization..		228,122	
Total property and equipment - net......................		101,058	
Deferred financing fees, net		6,418	
Deferred tax asset...		-	
Other assets		298	
Total assets...	$	120,382	$

See accompanying notes to condensed consolidated financial statements

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Abraxas Petroleum Corporation
Condensed Consolidated Balance Sheets (continued)
(in thousands)

	September 30, 2005 (Unaudited)
Liabilities and Stockholders' Deficit	

Current liabilities:			
Accounts payable...	$	6,808	$
Oil and gas production payable..............................		3,598	
Accrued interest...		4,705	
Other accrued expenses.......................................		1,635	
		16,746	
Liabilities related to assets held for sale.................		-	
Total current liabilities..................................		16,746	
Long-term debt...		129,842	
Future site restoration..		979	
Total liabilities....................................		147,567	
Stockholders' deficit:			
Common Stock, par value $.01 per share- Authorized 200,000,000 shares; issued, 42,047,667 and 36,597,045 at September 30, 2005 and December 31, 2004, respectively..		420	
Additional paid-in capital................................		165,094	
Accumulated deficit..		(194,103)	
Treasury stock, at cost, 56,477 and 105,989 shares at September 30, 2005 and December 31, 2004 respectively........		(408)	
Accumulated other comprehensive loss.........................		1,812	
Total stockholders' deficit.............................		(27,185)	
Total liabilities and stockholders' deficit....................	$	120,382	$

See accompanying notes to condensed consolidated financial statements

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Abraxas Petroleum Corporation
Consolidated Statements of Operations
(Unaudited)

	Three Months Ended September 30,				Nine Se
	2005		2004		2005
	(in thousands, except per sha				
Revenue:					
Oil and gas production revenues.............	$	13,829	$	8,018	$ 30,6
Rig revenues................................		330		214	9

Other......................................	5	5	
	14,164	8,237	31,6
Operating costs and expenses:			
Lease operating and production taxes.........	3,007	2,109	7,8
Depreciation, depletion, and amortization....	2,107	1,744	5,6
Rig operations.............................	176	174	5
General and administrative..................	953	998	2,9
Stock-based compensation....................	7,053	1,375	7,3
	13,296	6,400	24,3
Operating income	868	1,837	7,2
Other (income) expense:			
Interest income.............................	(11)	(2)	(
Interest expense............................	3,700	4,285	10,2
Amortization of deferred financing fees......	403	468	1,2
Financing cost..............................	-	68	
Other expense...............................	30	-	2
	4,122	4,819	11,7
Earnings (loss) from continuing operations	(3,254)	(2,982)	(4,4
Net income from discontinued operations (net of $6,060 income tax expense in 2005)...............	-	1,339	12,8
Net earnings (loss).............................	$ (3,254)	$ (1,643)	$ 8,4
Basic earnings (loss) per common share:			
Net earnings (loss) per common from continuing operations.................................	$ (0.08)	$ (0.08)	(0.
Discontinued operations.......................	-	0.04	0.
Net earnings (loss) per common share - basic......	$ (0.08)	$ (0.04)	$ 0.
Diluted earnings (loss) per common share:			
Net earnings (loss) per common from continuing operations.................................	$ (0.08)	$ (0.08)	$ (0.
Discontinued operations..........................	-	0.04	0.
Net earnings (loss) per common share - diluted....	$ (0.08)	$ (0.04)	$ 0.

See accompanying notes to condensed consolidated financial statements

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

(in thousands)

	Nine Months Ended September 30, 2005	
Operating Activities		
Net earnings (loss)	$ 8,431	$
Income from discontinued operations	(12,894)	
Loss from continuing operations	(4,463)	
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation, depletion, and amortization	5,622	
Amortization of deferred financing fees	1,257	
Accretion of future site restoration	71	
Non-cash interest and financing cost	-	
Stock-based compensation	7,330	
Changes in operating assets and liabilities:		
Accounts receivable	(2,774)	
Equipment inventory	(168)	
Other	3,017	
Accounts payable and accrued expenses	4,877	
Net cash provided by continuing operations	14,769	
Net cash (used in) provided by discontinued operations	(4,132)	
Net cash provided by operations	10,637	
Investing Activities		
Capital expenditures, including purchases and development of properties	(28,604)	
Net cash used in continuing operations	(28,604)	
Net cash provided by (used in) discontinued operations	25,719	
Net cash used in investing activities	(2,885)	
Financing Activities		
Proceeds from long-term borrowings	17,688	
Payments on long-term borrowings	(14,271)	
Proceeds from stock sale receivable	-	
Proceeds from issuance of common stock (net)	11,275	
Issuance of stock for compensation	102	
Deferred financing fees	(57)	
Exercise of stock options	397	
Net cash provided by (used in) continuing operations	15,134	
Net cash used in discontinued operations	(23,407)	
Net cash used in financing activities	(8,273)	
Increase (decrease) increase in cash	(521)	
Cash, at beginning of period	1,284	
Cash, at end of period	$ 763	$
Supplemental disclosure of cash flow information:		
Interest paid	$ 7,635	$

Non-cash items:		
Future site restoration....................................	$ 29	$

See accompanying notes to condensed consolidated financial statements

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

Note 1. Basis of Presentation

The accounting policies followed by Abraxas Petroleum Corporation and its subsidiaries (the "Company" or "Abraxas") are set forth in the notes to the Company's audited financial statements in the Annual Report on Form 10-K filed for the year ended December 31, 2004. Such policies have been continued without change. Also, refer to the notes to those financial statements for additional details of the Company's financial condition, results of operations, and cash flows. All the material items included in those notes have not changed except as a result of normal transactions in the interim, or as disclosed within this report. The accompanying interim consolidated financial statements have not been audited by independent accountants, but in the opinion of management, reflect all adjustments necessary for a fair presentation of the financial position and results of operations. Any and all adjustments are of a normal and recurring nature. The results of operations for the three and nine months ended September 30, 2005 are not necessarily indicative of results to be expected for the full year.

The consolidated financial statements include the accounts of the Company and its wholly-owned foreign subsidiary, Grey Wolf Exploration Inc. ("Grey Wolf"). On February 28, 2005 Grey Wolf closed an initial public offering, resulting in the substantial divestiture of our capital stock and operations in Grey Wolf. As a result of the disposal of Grey Wolf, the results of operations of Grey Wolf through February 28, 2005 are reflected in our Financial Statements as discontinued operations.

Stock-based Compensation.

The Company accounts for stock-based compensation using the intrinsic value method prescribed in Accounting Principles Board Opinion ("APB") No. 25, "Accounting for Stock Issued to Employees," and related interpretations. Accordingly, compensation cost for stock options is measured as the excess, if any, of the quoted market price of the Company's stock at the date of the grant over the amount an employee must pay to acquire the stock.

Effective July 1, 2000, the Financial Accounting Standards Board ("FASB") issued FIN 44, "Accounting for Certain Transactions Involving Stock Compensation", an interpretation of APB No. 25. Under the interpretation, certain modifications to fixed stock option awards which were made subsequent to December 15, 1998, and were not exercised prior to July 1, 2000, require that the awards be accounted for as variable until they are exercised, forfeited, or expired. In January 2003, the Company amended the exercise price to $0.66 on certain options with an existing exercise price greater than $0.66. The Company recognized expense of approximately $7.1 million and $7.3 million during the three and nine months ended September 30, 2005, respectively, as stock-based compensation expense in the accompanying consolidated financial statements. For the three and nine months ended September 30, 2004, the Company recognized an expense of approximately $1.4 million and $1.1 million, respectively.

Pro forma information regarding net income (loss) and earnings (loss) per share is required by SFAS 123, "Accounting for Stock-Based Compensation" (SFAS 123), which also requires that the information be determined as if the Company has accounted for its employee stock options granted subsequent to December 31, 1995 under the fair value method prescribed by SFAS 123. The fair value for these options was estimated at the date of grant using a Black-Scholes option pricing model with the following weighted-average assumptions for the three and nine months ended September 30, 2005 and 2004, risk-free interest rates of 2.9% and 1.5%, respectively; dividend yields of -0-%; volatility factor of the expected market price of the Company's common stock of .185 and .35 respectively; and a weighted-average expected life of the option of eight and ten years, respectively.

The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options which have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions including the expected stock price volatility. Because the Company's employee stock options have characteristics

significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, in management's opinion, the existing models do not necessarily provide a reliable single measure of the fair value of its employee stock options.

In October 2002, the FASB issued Statement No. 148 "Accounting for Stock-Based Compensation-Transition and Disclosure" (SFAS No. 148), providing alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. SFAS No. 148 also amends the disclosure requirement of SFAS 123 to include prominent disclosures in annual and interim financial statements about the method of accounting for stock-based compensation and the effect of the method used on reported results. The Company adopted the disclosure provisions of SFAS No. 148 on December 31, 2002.

Had the Company determined stock-based compensation costs based on the estimated fair value at the grant date for its stock options, the Company's net income (loss) per share for the three and nine months ended September 30, 2005 and September 30, 2004 would have been:

	Three Months Ended September 30, 2005	Three Months Ended September 30, 2004	Nine Months En[ded] September 30 2005	
	(In Thousands, except per share data)			
Net income (loss) as reported	$ (3,254)	$ (1,643)	$ 8,431	$
Add: Stock-based employee compensation expense included in reported net income, net of related tax effects	7,053	1,375	7,330	
Deduct: Total stock-based employee				

compensation expense determined under fair value based method for all awards, net of related tax effects	(16)	(30)	(57)	
Pro forma net income (loss)	$ 3,783	$ (298)	$ 15,704	$
Earnings (loss) per share:				
Basic - as reported	$ (0.08)	$ (0.04)	$ 0.22	
Basic - pro forma	$ 0.09	$ (0.01)	0.41	
Diluted - as reported	$ (0.08)	$ (0.04)	0.22	
Diluted - pro forma	$ 0.08	$ (0.01)	0.39	

Certain prior year balances have been reclassified for comparative purposes.

Note 2. Discontinued operations

On February 28, 2005, Grey Wolf completed an IPO resulting in Abraxas substantially divesting itself of its investment in Grey Wolf. Pursuant to an Underwriting Agreement, the underwriters purchased 17.8 million common shares of Grey Wolf capital stock from Grey Wolf ("Treasury Shares"), and 9.1 million shares of Grey Wolf common stock owned by Abraxas from Abraxas ("Secondary Shares") at a purchase price of CDN $2.80 per share.

Grey Wolf utilized the proceeds from the sale of the Treasury Shares to re-pay and terminate its $35 million term loan and re-pay $1 million in inter-company debt to Abraxas. Abraxas utilized the $1 million received from Grey Wolf and the proceeds received from the sale of the Secondary Shares to re-pay outstanding debt under its $25 million second lien increasing rate bridge loan.

Abraxas also granted an over-allotment option to the underwriters to purchase from Abraxas, at the underwriters' election, up to an additional 3,902,360 shares of Grey Wolf common stock held by Abraxas (the "Option Shares"). On March 24, 2005, Abraxas was advised of the underwriter's intent to exercise 3.5 million of the over-allotment option shares. Closing occurred on March 31, 2005 and provided approximately $7.6 million that Abraxas utilized to

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re-pay the remaining balance of its bridge loan and reduce the outstanding balance under its senior secured revolving credit facility.

The operations of Grey Wolf, previously reported as a business segment, are reported as discontinued operations for all periods presented in the accompanying financial statements and the operating results are reflected separately from the results of continuing operations.

Income from discontinued operations for the nine months ended September 30, 2005 includes a gain on the disposal of Grey Wolf of $21.8 million, less non-cash income tax of $6.1 million, and a loss from operations, including debt retirement costs, of $2.8 million.

Note 3. Income Taxes

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

For the period ended September 30, 2005, there is no current or deferred income tax expense or benefit due to losses and/or loss carryforwards and valuation allowance which has been recorded against such benefits.

Note 4. Long-Term Debt

Long-term debt consisted of the following:

	September 30, 2005	De
Floating rate senior secured notes due 2009	$ 125,000	$
Senior secured revolving credit facility	4,842	
	129,842	
Less current maturities	-	
	$ 129,842	$

Floating Rate Senior Secured Notes due 2009. In connection with its October 2004 financial restructuring, Abraxas issued $125 million in aggregate principal amount of floating rate senior secured notes due 2009. The notes will mature on December 1, 2009 and began accruing interest from the date of issuance, October 28, 2004, at a per annum floating rate of six-month LIBOR plus 7.50%. The initial interest rate on the notes was 9.72% per annum. The interest is reset semi-annually on each June 1 and December 1, commencing on June 1, 2005. The current interest rate, effective June 1, 2005, is 11.03% per annum. Interest is payable semi-annually in arrears on June 1 and December 1 of each year, commencing on June 1, 2005.

Senior Secured Revolving Credit Facility. On October 28, 2004, Abraxas entered into an agreement for a new revolving credit facility having a maximum commitment of $15 million, which includes a $2.5 million subfacility for letters of credit. Availability under the revolving credit facility is subject to a borrowing base consistent with normal and customary natural gas and crude oil lending transactions. Outstanding amounts under the revolving credit facility bear interest at the prime rate announced by Wells Fargo Bank, National Association plus 1.00%. Subject to earlier termination rights and events of default, the stated maturity date under the revolving credit facility is October 28, 2008.

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Note 5. Earnings Per Share

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

		Three Months Ended September 30,			Nin
		2005		2004		2005
Numerator:						
Net income (loss) before effect of discontinued operations...................	$	(3,254)	$	(2,982)	$	(4,4
Discontinued operations.......................		-		1,339		12,8
Net earnings (loss) available to common stockholders..............................		(3,254)		(1,643)		8,4
Denominator:						
Denominator for basic earnings per share - Weighted-average shares.....................		40,962,427		36,251,323		38,478,3
Effect of dilutive securities:						
Stock options and warrants		-		-		
Dilutive potential common shares						
Denominator for diluted earnings per share - adjusted weighted-average shares and assumed Conversions................................		40,962,427		36,251,323		38,478,3
Basic earnings (loss) per share:						
Net income (loss) from continuing operations	$	(0.08)	$	(0.08)	$	(0.
Discontinued operations....................		-		0.04		0.
Net earnings (loss) per common share - basic....	$	(0.08)	$	(0.04)	$	0.
Diluted earnings (loss) per share:						
Net income (loss) from continuing operations	$	(0.08)	$	(0.08)	$	(0.
Discontinued operations....................		-		0.04		0.
Net earnings (loss) per common share - basic....	$	(0.08)	$	(0.04)	$	0.

For the three months ended September 30, 2005 and 2004 and nine months ended September 30, 2005 and 2004, none of the shares issuable in connection with stock options or warrants are included in diluted shares. Inclusion of these shares would be antidilutive due to losses from continuing operations incurred in the periods. Had there not been losses from continuing operations in these periods, dilutive shares would have been 1,420,879 and 1,689,884 for the three and nine months ended September 30, 2004, respectively and 1,870,121 and 1,662,562 for the three months and nine months ended September 30, 2005, respectively.

Note 6. Hedging Program and Derivatives

On January 1, 2001, the Company adopted SFAS 133 "Accounting for Derivative Instruments and Hedging Activities" (SFAS 133) as amended by SFAS 137 "Accounting for Derivative Instruments and Hedging Activities - Deferral of the Effective Date of FASB 133" and SFAS 138 "Accounting for Certain Derivative Instruments and Certain Hedging Activities". Under SFAS 133, all derivative instruments are recorded on the balance sheet at fair value. If the derivative does not qualify as a hedge or is not designated as a hedge, the gain or loss on the derivative is recognized currently in earnings. To qualify for hedge accounting, the derivative must qualify either as a fair value hedge, cash flow hedge or foreign currency hedge. As of September 30, 2005, the derivatives that the Company had in place were not designated as hedges and, accordingly, changes in the fair value of the derivatives are recorded in current period oil and gas revenue.

Under the terms of our revolving credit facility, we are required to maintain hedging positions on not less than 25% nor more than 75% of our projected natural gas and crude oil production for a rolling six month period.

The following table sets forth the Company's current hedge position:

Time Period	Notional Quantities	Price
October - December 2005	9,500 MMbtu of production per day	Floor of $5.00
January 2006	10,000 MMbtu of production per day	Floor of $5.00
February 2006	10,000 MMbtu of production per day	Floor of $5.00
March 2006	10,000 MMbtu of production per day	Floor of $5.00
April 2006	10,000 MMbtu of production per day	Floor of $7.00
May 2006	10,000 MMbtu of production per day	Floor of $8.00

Note 7. Contingencies - Litigation

From time to time, the Company is involved in litigation relating to claims arising out of its operations in the normal course of business. At September 30, 2005, the Company was not engaged in any legal proceedings that are expected, individually or in the aggregate, to have a material adverse effect on its operations.

Note 8. 2005 Non-Employee Directors Long-Term Equity Incentive Plan.

On June 1, 2005, Abraxas Petroleum Corporation held its 2005 Annual Meeting of Stockholders at which the stockholders approved the 2005 Non-Employee Directors Long-Term Equity Incentive Plan (the "2005 Directors Plan"). The following is a summary of the 2005 Directors Plan.

Purpose. The purpose of the 2005 Directors Plan is to attract and retain members of the Board of Directors and to promote the growth and success of Abraxas by aligning the long-term interests of the Board of Directors with those of Abraxas' stockholders by providing an opportunity to acquire an interest in Abraxas and by providing both rewards for exceptional performance and long term incentives for future contributions to the success of Abraxas.

Administration and Eligibility. The 2005 Directors Plan will be administered by the Compensation Committee (the "Committee") of the Board of Directors and authorizes the Board to grant non-qualified stock options or issue restricted stock to those persons who are non-employee directors of Abraxas, including advisory directors of Abraxas, which currently amounts to a total of ten people.

Shares Reserved and Awards. The 2005 Directors Plan reserves 900,000 shares of Abraxas common stock, subject to adjustment following certain events, as discussed below. The 2005 Directors Plan provides that each year, at the first regular meeting of the Board of Directors immediately following Abraxas' annual stockholder's meeting, each non-employee director shall be granted or issued awards of 10,000 shares of Abraxas common stock, for participation in Board and Committee meetings during the previous calendar year. The maximum annual award for any one person is 10,000 shares of Abraxas common stock or options for common stock. If options, as opposed to shares, are awarded, the exercise share price shall be no less than 100% of the fair market value on the date of the award while the option terms and vesting schedules are at the discretion of the Committee.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operation

Prior to February 2005, Grey Wolf Exploration Inc. was a wholly-owned Canadian subsidiary of Abraxas. In February 2005, Grey Wolf, completed an initial public offering resulting in the substantial divestiture of our capital stock in Grey Wolf. As a result of the Grey Wolf IPO and the significant divestiture of our interest in Grey Wolf, the results of operations of Grey Wolf are reflected in our Financial Statements and in this document as "Discontinued Operations" and our remaining operations are referred to in our Financial Statements and in this document as "Continuing Operations" or "Continued Operations". Unless otherwise noted, all disclosures are for continuing operations.

The following is a discussion of our financial condition, results of operations, liquidity and capital resources. This discussion should be read in conjunction with our consolidated financial statements and the notes thereto included in our Annual Report on Form 10-K filed for the year ended December 31, 2004.

Critical Accounting Poli7ies

There have been no changes from the Critical Accounting Policies described in our Annual Report on Form 10-K for the year ended December 31, 2004.

General

We are an independent energy company primarily engaged in the development and production of natural gas and crude oil. Historically, we have grown through the acquisition and subsequent development and exploitation of producing properties, principally through the redevelopment of old fields utilizing new technologies such as modern log analysis and reservoir modeling techniques as well as 3-D seismic surveys and horizontal drilling. As a result of these activities, we believe that we have a substantial inventory of low risk development opportunities, which provide a basis for significant production and reserve increases. In addition, we intend to expand upon our exploitation and development activities with complementary exploration projects in our core areas of operation.

Our financial results depend upon many factors which significantly affect our results of operations including the following:

- the sales prices of natural gas, natural gas liquids and crude oil;

- the level of total sales volumes of natural gas, natural gas liquids and crude oil;

- the availability of, and our ability to raise additional capital resources and provide liquidity to meet cash flow needs;

- our ability to use our cash flow from operations for capital expenditures to increase production and reserves;

- the level of and interest rates on borrowings; and

- the level and success of exploitation, exploration and development activity.

Commodity Prices and Hedging Activities. Our results of operations are significantly affected by fluctuations in commodity prices. Price volatility in the natural gas market has remained prevalent in the last few years with prices generally being strong since the first quarter of 2004. The table below illustrates how natural gas prices have fluctuated over the eight quarters prior to and including the quarter ended September 30, 2005 and contains the last three day average of NYMEX traded contracts price and the prices we realized during each quarter presented, including the impact of our hedging activities.

Natural Gas Prices by Quarter (in $ per Mcf)

	Quarter Ended					
	Dec. 31, 2003	Mar. 31, 2004	June 30, 2004	Sept. 30, 2004	Dec. 31, 2004	Mar. 31, 2005
Index	$4.60	$5.69	$5.97	$5.85	$6.77	$6.30
Realized	$4.29	$4.98	$5.52	$5.24	$6.14	$5.26

The NYMEX natural gas price November 3, 2005 was $11.69 per Mcf.

The table below illustrates how crude oil prices have fluctuated over the eight quarters prior to and including the quarter ended September 30, 2005 and contains the last three day average of NYMEX traded contracts price and the prices we realized during each quarter presented, including the impact of our hedging activities.

Crude Oil Prices by Quarter (in $ per Bbl)

	Quarter Ended					
	Dec. 31, 2003	Mar. 31, 2004	June 30, 2004	Sept. 30, 2004	Dec. 31, 2004	Mar. 31, 2005
Index	$29.64	$34.76	$38.48	$42.32	$49.46	$47.33
Realized	$29.99	$34.18	$37.29	$42.43	$46.81	$47.13

The NYMEX crude oil price on November 3, 2005 was $61.78 per Bbl.

Under the terms of our revolving credit facility, we are required to maintain hedging positions on not less than 25% nor more than 75% of our projected natural gas and crude oil production for a rolling six month period. We currently have the following hedges in place:

Time Period	Notional Quantities	Price
October - December 2005	9,500 MMbtu of production per day	Floor of $5.00
January 2006	10,000 MMbtu of production per day	Floor of $5.00
February 2006	10,000 MMbtu of production per day	Floor of $5.00
March 2006	10,000 MMbtu of production per day	Floor of $5.00
April 2006	10,000 MMbtu of production per day	Floor of $7.00
May 2006	10,000 MMbtu of production per day	Floor of $8.00

Production Volumes. Because our proved reserves will decline as natural gas, natural gas liquids and crude oil are produced, unless we acquire additional properties containing proved reserves or conduct successful exploitation, exploration and development activities, our reserves and production will decrease. Our ability to acquire or find additional reserves in the near future will be dependent, in part, upon the amount of available funds for acquisition, exploitation and development projects.

We had capital expenditures of $4.8 million and $28.6 million during the first nine months of 2004 and 2005, respectively. As a result of the capital spending limitations included in our previous credit agreement (which was terminated in October 2004) and our 11 1/2 % secured notes due 2007 (which were redeemed in October 2004), we were limited for most of 2004 in our ability to replace existing production and, consequently, our production volumes decreased during 2004 and continued to decrease in the first three months of 2005. We experienced an increase in our production volumes during the three months ended September 30, 2005. If natural gas and crude oil prices return to depressed levels or if our production levels decrease, our revenues, cash flow from operations and financial condition will be materially adversely affected.

Availability of Capital. As described more fully under "Liquidity and Capital Resources" below, our sources of capital going forward will primarily be cash from operating activities, funding under our revolving credit facility, cash on hand, and if an appropriate opportunity presents itself, proceeds from the sale of properties. As of September 30, 2005, we had approximately $10.2 million of availability under our revolving credit facility.

Exploitation and Development Activity. We believe that our high quality asset base, high degree of operational control and large inventory of drilling projects position us for future growth. Our properties are concentrated in locations that facilitate substantial economies of scale in drilling and production operations and efficient reservoir management practices. We currently operate 94% of our properties accounting for approximately 90% of our PV-10, giving us substantial control over the timing and incurrence of operating and capital expenditures. In addition, at December 31, 2004 we had 47 proved undeveloped locations and had identified over 100 drilling and recompletion opportunities on our existing U.S. acreage, the successful development of which we believe could significantly increase our daily production and proved reserves. During the three months ended September 30, 2005, we continued exploitation activities on our properties. We invested $28.4 million in capital spending during the nine months ended September 30, 2005 on nine wells in South Texas, West Texas and Wyoming. We are currently completing and/or testing one vertical well in West Texas and re-entering a vertical well in West Texas. Three horizontal wells in South Texas and one horizontal well in West Texas (started in 2004) have been brought on line during the nine-month period. Our drilling activities resulted in increased natural gas production during the three and nine months ended September 30, 2005. In the latter part of the third quarter we drilled and are currently completing four vertical crude oil wells in Wyoming. Our future natural gas and crude oil production, and therefore our success, is highly dependent upon our ability to find, acquire and develop additional reserves that are profitable to produce. The rate of production from our natural gas and crude oil properties and our proved reserves will decline as our reserves are produced unless we acquire additional properties containing proved reserves, conduct successful development and exploitation activities or, through engineering studies, identify additional behind-pipe zones or secondary recovery reserves. We cannot assure you that our exploitation and development activities will result in increases in our proved reserves. In addition, approximately 49% of our total estimated proved reserves at December 31, 2004 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.

Borrowings and Interest. At September 30, 2005, we had indebtedness of approximately $125.0 million under the notes and $4.8 million under the revolving credit facility and availability of $10.2 million. Unlike the 11 1/2% secured notes due 2007 (which were redeemed in October 2004), interest on the notes is payable in cash, which will require us to increase our production and cash flow from operations in order to meet our debt service requirements, as well as to fund the development of our numerous drilling opportunities.

Recent events. In July 2005, we acquired an average 44% of the mineral rights, all executive rights and certain surface rights under approximately 12,000 contiguous acres in the Oates Southwest Field area of West Texas, plus a 3-year lease on a large portion of the remaining mineral interests, for approximately $2.9 million.

On July 20, 2005, we completed a $12.0 million private placement pursuant to which we issued 4.0 million shares of common stock to accredited investors at a price of $3.00 per share. Net proceeds of approximately $11.3 million from the private placement were used to re-pay indebtedness under our revolving credit facility, for development in Texas and Wyoming, and for working capital and general corporate purposes.

Outlook for 2005. The Company has previously provided guidance for the calendar year 2005 which was updated on August 10, 2005. As a result of industry conditions, namely delays in obtaining various stimulation and completion services, several of the Company's newly drilled wells have taken longer to get on production than originally estimated. A general increase in field operating costs experienced by the entire industry has also had an impact on the Company's direct operating costs and will affect our per unit costs for 2005. The Company's G&A costs have been adversely impacted due to Sarbanes-Oxley related costs during the year and will continue to be so impacted for the remainder of 2005. The G&A expense amounts shown below include only regularly occuring G&A expenses and do not take into account any potential bonuses that might be earned for 2005 or non-recurring expenses. In August 2005 we also revised our total capital spending amount for 2005 to $32.0 million as a result of the successful completion of the recent private placement transaction and the Company's improved liquidity position. Our updated guidance for 2005 remains as follows:

Production:	
Bcfe(approximately 80% gas).........	6.5 - 7.5

Exit Rate (Mmcfe/d)....................	19-21
Price Differentials (Pre Hedge):	
$ Per Bbl..........................	0.55
$ Per Mcf..........................	0.75
Direct Lifting Costs, $ Per Mcfe.......	1.10
Production taxes.......................	10% of Revenue
G&A, $ Per Mcfe........................	0.75

Results of Operations

The following table sets forth certain of our operating data for the periods presented.

	Three Months Ended September 30,		Nine Se
	2005	2004	2005
Operating Revenue (in thousands):			
Crude Oil Sales.................................	$ 2,699	$ 2,289	$ 7,54
Natural Gas Sales...............................	11,130	5,670	23,14
Natural Gas Liquids Sales.......................	-	59	
Rig Operations..................................	330	214	90
Other...	5	5	1
	$ 14,164	$ 8,237	$ 31,61
Operating Income (in thousands) (1).............	$ 868	$ 1,837	$ 7,29
Crude Oil Production (MBbls)....................	45	54	14
Natural Gas Production (MMcfs)..................	1,366	1,083	3,42
Natural Gas Liquids Production (MBbls)..........	-	2	
Average Crude Oil Sales Price ($/Bbl)...........	$ 60.24	$ 42.43	$ 51.9
Average Natural Gas Sales Price ($/Mcf).........	$ 8.15	$ 5.24	$ 6.7
Average Liquids Sales Price ($/Bbl).............	$ -	$ 27.55	$

(1) Includes $7.1 million and $7.3 million in non-cash, stock-based compensation expense for the three and nine months ended September 30, 2005, respectively, and $1.4 million and $1.1 million in non-cash stock-based compensation expense for the three and nine months ended September 30, 2004, respectively.

Comparison of Three Months Ended September 30, 2005 to Three Months Ended September 30, 2004

Operating Revenue. During the three months ended September 30, 2005, operating revenue from natural gas, natural gas liquids and crude oil sales increased by $5.8 million to $13.8 million compared to $8.0 million during three months ended September 30, 2004. The increase in revenue was primarily due to increased natural gas production volumes and higher commodity prices during the period. Higher commodity prices contributed $4.1 million to crude oil and natural gas production revenues, while increased production volumes contributed $1.7 million.

Average sales prices net of hedging cost for the quarter ended September 30, 2005 were:

- $60.24 per Bbl of crude oil, and
- $8.15 per Mcf of natural gas

Average sales prices net of hedging cost for the quarter ended September 30, 2004 were:

- $42.43 per Bbl of crude oil,
- $27.55 per Bbl of natural gas liquids, and
- $5.24 per Mcf of natural gas

Crude oil production volumes decreased from 54.0 MBbls during the quarter ended September 30, 2004 to 44.8 MBbls for the same period of 2005. The decrease in crude oil production volumes was primarily due to natural field declines. Natural gas production volumes increased 283 MMcf to 1,366 MMcf for the three months ended September 30, 2005 from 1,083 MMcf for the same period of 2004. The increase in natural gas production volumes was attributable to new production during the quarter ended September 30, 2005 as a result of drilling activities undertaken since the beginning of 2005. New production added 376 MMcf for the quarter ended September 30, 2005, which was partially offset by natural field declines.

Lease Operating Expenses ("LOE"). LOE for the three months ended September 30, 2005 increased to $3.0 million from $2.1 for the same period of 2004. The increase was primarily due to increased production taxes related to higher commodity prices, increased natural gas production and generally increasing industry cost of services. Our LOE on a per Mcfe basis for the three months ended September 30, 2005 increased to $1.84 compared to $1.49 for the same period of 2004. The increase in the per Mcfe rate was primarily due to increased production taxes related to higher commodity prices.

General and Administrative ("G&A") Expenses. G&A expenses decreased slightly to $953,000 for the quarter ended September 30, 2005 from $998,000 for the same period of 2004. The decrease was primarily due to a decrease in professional fees in the third quarter of 2005 as compared to the same period of 2004. G&A expense on a per Mcfe basis was $0.58 for the third quarter of 2005 compared to $0.70 for the same period of 2004 due to higher production volumes in 2005.

Stock-based Compensation. Effective July 1, 2000, the Financial Accounting Standards Board ("FASB") issued FIN 44, "Accounting for Certain Transactions Involving Stock Compensation", an interpretation of Accounting Principles Board Opinion No. ("APB") 25. Under the interpretation, certain modifications to fixed stock option awards which were made subsequent to December 15, 1998, and not exercised prior to July 1, 2000, require that the awards be accounted for as variable expenses until they are exercised, forfeited, or expired. In January 2003, we amended the exercise price to $0.66 per share on certain options with an existing exercise price greater than $0.66 per share which resulted in variable accounting. We recognized an expense of $7.1 million during the quarter ended September 30, 2005 compared to $1.4 million during the same period of 2004 related to these repricings. The increase in stock-based compensation expense was the result of the increase in the price of our common stock during the quarter ended September 30, 2005 compared to the price at June 30, 2005.

Depreciation, Depletion and Amortization("DD&A") Expenses. DD&A expense increased to $2.1 million for the three months ended September 30, 2005 from $1.7 million for the same period of 2004. The increase in DD&A was primarily due to increased production volumes during the quarter ended September 30, 2005 and increased capital expenditures during 2005 as compared to the same period of

2004. Our DD&A on a per Mcfe basis for the quarter ended September 30, 2005 was $1.29 per Mcfe as compared to $1.23 in 2004.

Interest Expense. Interest expense decreased to $3.7 million for the third quarter of 2005 compared to $4.3 million ($1.2 million of which was cash interest expense) for the same period of 2004. The decrease in interest expense (and increase in cash interest expense) was due to the refinancing of our long-term debt in October 2004. Our long-term debt was $190.5 million at September 30, 2004 compared to $129.8 million at September 30, 2005.

Income taxes. There is no current or deferred income tax expense or benefit due to losses or loss carryforwards and valuation allowance which has been recorded against such benefits.

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Comparison of Nine Months Ended September 30, 2005 to Nine Months Ended September 30, 2004

Operating Revenue. During the nine months ended September 30, 2005, operating revenue from natural gas, natural gas liquids and crude oil sales increased to $30.7 million as compared to $24.2 million in the nine months ended September 30, 2004. The increase in revenue was primarily due to higher commodity prices during 2005 as compared to the same period of 2004. Higher commodity prices contributed $7.2 million to crude oil and natural gas revenue during the nine months ended September 30, 2005. The increase in revenue resulting from higher commodity prices was partially offset by a decline in production volumes for the nine months ended September 30, 2005 as compared to the same period of 2004. Decreased production volumes had a negative impact on revenue of approximately $702,000.

Average sales prices net of hedging cost for the nine months ended September 30, 2005 were:

- $51.95 per Bbl of crude oil, and
- $6.75 per Mcf of natural gas

Average sales prices net of hedging cost for the nine months ended September 30, 2004 were:

- $37.91 per Bbl of crude oil,
- $24.71 per Bbl of natural gas liquids, and
- $5.24 per Mcf of natural gas

Crude oil production volumes decreased to 145.2 MBbls during the nine months ended September 30, 2005 from 165.6 MBbls for the same period of 2004. The decrease in crude oil production was primarily due to natural field declines. Natural gas production volumes increased slightly to 3,427 MMcf for the nine months ended September 30, 2005 from 3,382 MMcf for the same period of 2004. New production during the nine months ended September 30, 2005 contributed 485 MMcf which was offset by natural field declines.

Lease Operating Expenses. LOE for the nine months ended September 30, 2005 increased to $7.8 million from $6.7 million for the same period of 2004. The increase was primarily due to increased production taxes related to higher commodity prices, increased natural gas production and generally increasing industry cost of services. Our LOE on a per Mcfe basis for the nine months ended September 30, 2005 increased to $1.82 compared to $1.52 for the same period of 2004. The increase in the per Mcfe rate was primarily due to increased production taxes related to higher commodity prices.

G&A Expenses. G&A expenses decreased to $3.0 million for the first nine months of 2005 from $3.8 million for the first nine months of 2004. The decrease was primarily due to lower performance bonuses paid during the third quarter of 2005 as compared to the same period in 2004. G&A expense on a per Mcfe basis was $0.70 for the first nine months of 2005 compared to $0.85 for the same period of 2004 due to higher production volumes in 2005.

Stock-based Compensation. Effective July 1, 2000, the Financial Accounting Standards Board ("FASB") issued FIN 44, "Accounting for Certain Transactions Involving Stock Compensation", an interpretation of Accounting Principles Board Opinion No. ("APB") 25. Under the interpretation, certain modifications to fixed stock option awards which were made subsequent to December 15, 1998, and not exercised prior to July 1, 2000, require that the awards be accounted for as variable expenses until they are exercised, forfeited, or expired. In January 2003, we amended the exercise price to $0.66 per share on certain options with an existing exercise price greater than $0.66 per share which resulted in variable accounting. We recognized an expense of $7.3 million during the nine months ended September 30, 2005 and $1.1 million during the same period of 2004 related to these repricings. The increase in stock-based compensation expense was the result of the increase in the price of our common stock from December 31, 2004 to September 30, 2005.

DD&A Expenses. DD&A expense increased to $5.6 million for the nine months ended September 30, 2005 from $5.4 million for the same period of 2004. The increase was primarily due to increased capital expenditures during the nine months ended September 30, 2005 as compared to the same period of 2004. Our DD&A on a per Mcfe basis for the nine months ended September 30, 2005 was $1.31 per Mcfe as compared to $1.22 in 2004.

Interest Expense. Interest expense decreased to $10.2 million for the first nine months of 2005 compared to $13.4 million (of which approximately $4.2 million was cash interest expense) for the same periods of 2004. The decrease in interest expense (and increase in cash interest expense) was due to the refinancing of our long-term debt in October 2004. Our long-term debt was $129.8 million at September 30, 2005 compared to $190.5 million at September 30, 2004.

Income taxes. There is no current or deferred income tax expense or benefit due to losses or loss carryforwards and valuation allowance which has been recorded against such benefits.

Liquidity and Capital Resources

General. The natural gas and crude oil industry is a highly capital intensive and cyclical business. Our capital requirements are driven principally by our obligations to service debt and to fund the following costs:

- the development of existing properties, including drilling and completion costs of wells;
- acquisition of interests in natural gas and crude oil properties; and
- production and transportation facilities.

The amount of capital expenditures we are able to make has a direct impact on our ability to increase cash flow from operations, and, thereby, will directly affect our ability to service our debt obligations and to continue to grow the business through the development of existing properties and the acquisition of new properties.

Our sources of capital going forward will primarily be cash from operating activities, funding under our revolving credit facility, cash on hand, and if an appropriate opportunity presents itself, proceeds from the sale of properties. However, under the terms of the notes, proceeds of optional sales of our assets that are not timely reinvested in new natural gas and crude oil assets will be required to be used to reduce indebtedness and proceeds of mandatory sales must be used to repay or redeem indebtedness.

Working Capital (Deficit). At September 30, 2005, we had current assets of $12.6 million and current liabilities of $16.7 million resulting in a working capital deficit of approximately $4.1 million. This compares to a working capital deficit of $3.9 million at December 31, 2004 related to continuing operations. Current liabilities at September 30, 2005 consisted of trade payables of $6.8 million, revenues due third parties of $3.6 million, accrued interest of $4.7 million and other accrued liabilities of $1.6 million.

Capital expenditures. The table below sets forth the components of our capital expenditures on a historical basis for the nine months ended September 30, 2005 and 2004.

	Nine Months Ended September 30,	
	2005	20
Expenditure category (in thousands):		
Development	$ 28,350	$
Facilities and other	254	
Total	$ 28,604	$

During the nine months ended September 30, 2005 and 2004, capital expenditures were primarily for the development of existing properties. During 2004, our capital expenditures were subject to limitations imposed under our previously existing credit facility and 11 1/2% secured notes due 2007. These limitations were removed in connection with the refinancing that was completed in October 2004. We increased our previously stated capital expenditure budget of $22.0 million for 2005, as a result of the increased liquidity provided by our recently completed private placement of common stock, to $32.0 million in early September. During the first nine months of 2005, we undertook nine projects expending approximately $28.4 million. Our capital expenditures could include expenditures for acquisition of producing properties if such opportunities arise, but we currently have no agreements, arrangements or undertakings regarding any material acquisitions. We have no material long-term capital commitments and are consequently able to adjust the level of our

expenditures as circumstances dictate. Additionally, the level of capital expenditures will vary during future periods depending on market conditions and other related economic factors. Should the prices of natural gas and crude oil decline from current levels, our cash flows will decrease which may result in a reduction of the capital expenditures budget. If we decrease our capital expenditures budget, we may not be able to offset natural gas and crude oil production volumes decreases caused by natural field declines and sales of producing properties, if any.

Sources of Capital. The net funds provided by and/or used in each of the operating, investing and financing activities relating to continuing operations are summarized in the following table:

	Nine Months Ended September 30, 2005	Nine Months Ended September 30, 2004
Net cash provided by operating activities	$ 14,769	$ 8,971
Net cash used in investing activities	(28,604)	(4,789)
Net cash provided by financing activities	15,134	(1,288)
Total	$ 1,299	$ 2,894

Operating activities during the nine months ended September 30, 2005 provided $14.8 million in cash compared to providing $9.0 million in the same period in 2004. Net income plus non-cash expense items and net changes in operating assets and liabilities accounted for most of these funds. Financing activities provided approximately $15.1 million for the first nine months of 2005 compared to using $1.3 million for the same period of 2004. Proceeds from long-term borrowings provided $17.7 million in 2005 while payments on long-term borrowings used $14.3 million in 2005. Proceeds from an equity offering in July 2005 provided $11.3 million for the nine months ended September 30, 2005. Investing activities used $28.6 million for the nine months ended September 30, 2005 compared to using $4.8 million for the same period of 2004. Expenditures during the nine months ended September 30, 2005 and 2004 were primarily for the development of existing properties and the acquisition of mineral rights, all executive rights and certain surface rights and a three year lease in the Oates Southwest Field area of West Texas for approximately $2.9 million in July 2005.

Future Capital Resources. We currently have four principal sources of liquidity going forward: (i) cash from operating activities, (ii) funding under our revolving credit facility, (iii) cash on hand, and (iv) if an appropriate opportunity presents itself, the sale of producing properties. While we are no longer subject to limitations on capital expenditures under our 11 1/2% secured notes due 2007, covenants under the indenture for the notes and the revolving credit facility restrict our use of cash from operating activities, cash on hand and any proceeds from asset sales. Under the terms of the notes, proceeds of optional sales of our assets that are not timely reinvested in new natural gas and crude oil assets will be required to be used to reduce indebtedness and proceeds of mandatory sales must be used to redeem indebtedness. The terms of the notes and the revolving credit facility also substantially restrict our ability to:

- incur additional indebtedness;
- grant liens;
- pay dividends or make certain other restricted payments;
- merge or consolidate with any other person; or
- sell, assign, transfer, lease, convey or otherwise dispose of all or substantially all of our assets.

Our cash flow from operations depends heavily on the prevailing prices of natural gas and crude oil and our production volumes of natural gas and crude oil. Although we have hedged a portion of our natural gas and crude oil production and will continue this practice as required pursuant to the revolving credit facility, future natural gas and crude oil price declines would have a material adverse effect on our overall results, and therefore, our liquidity. Low natural gas and crude oil prices could also negatively affect our ability to raise capital on terms favorable to us or at all.

Our cash flow from operations will also depend upon the volume of natural gas and crude oil that we produce. Unless we otherwise expand reserves, our production volumes may decline as reserves are produced. Due to sales of properties in 2002 and 2003 and the divestiture of Grey Wolf during the first quarter of 2005, and restrictions on capital expenditures under the terms of our 11 1/2% secured notes due 2007 (which were refinanced in October 2004), we now have significantly reduced reserves and production as compared with pre-2003 levels. In the future, if an appropriate opportunity presents itself, we may sell additional properties, which could further reduce our production volumes. To offset the loss in production volumes resulting from natural field declines and sales of producing properties, we must conduct successful, exploitation, exploration and development activities, acquire additional producing properties or identify additional behind-pipe zones or secondary recovery reserves. While we have had some success in pursuing these activities since January 1, 2003, we have not been able to fully replace the production volumes lost from natural field declines and property sales. We believe our numerous drilling opportunities will allow us to increase our production volumes; however, our drilling activities are subject to numerous risks, including the risk that no commercially productive natural gas or crude oil reservoirs will be found. The risk of not finding commercially productive reservoirs will be compounded by the fact that 49% of our total estimated proved reserves at December 31, 2004 were undeveloped. During the first nine months of 2005, we expended approximately $28.4 million for nine wells in South Texas, West Texas and Wyoming. We are currently completing and/or testing one vertical wells in West Texas and re-entering a vertical well in West Texas. Three horizontal wells in South Texas and one horizontal well in West Texas (started in 2004) have been brought on line which have thus far resulted in 485 MMcf of new natural gas production for the nine-month period. In the latter part of the third quarter we drilled and are currently completing four vertical wells in Wyoming. If the volume of natural gas and crude oil we produce decreases, our cash flow from operations may decrease.

Our total indebtedness and cash interest expense as a result of issuing the notes and entering into the revolving credit facility require us to increase our production and cash flow from operations in order to meet our debt service requirements, as well as to fund the development of our numerous drilling opportunities. The ability to satisfy these new obligations will depend upon our drilling success as well as prevailing commodity prices.

Contractual Obligations. We are committed to making cash payments in the future on the following types of agreements:

- Long-term debt
- Interest on long-term debt
- Operating leases for office facilities

We have no off-balance sheet debt or unrecorded obligations and we have not guaranteed the debt of any other party. Below is a schedule of the future payments that we are obligated to make based on agreements in place as of September 30, 2005:

Contractual Obligations (dollars in thousands)	Total	Less than one year	1-3 years	3-5 years	Mo[re than] 5 [years]
	Payments due in:				
Long-Term Debt (1)	$ 129,842	$ -	$ -	$ 129,842	$
Interest on long-term debt (2)	58,606	14,163	28,326	16,117	
Operating Leases (3)	823	264	537	22	
Total	$ 189,320	$ 14,414	$ 28,863	$ 146,043	$

(1) These amounts represent the balances outstanding under the revolving credit facility and the new notes. These repayments assume that we will not draw down additional funds.
(2) Interest expense assumes the balances of long-term debt at the end of the period and current effective interest rates.
(3) Office lease obligations. The lease for office space expires in January 2009.

Other obligations. We make and will continue to make substantial capital expenditures for the acquisition, exploitation, development, exploration and production of natural gas and crude oil. In the past, we have funded our

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operations and capital expenditures primarily through cash flow from operations, sales of properties, sales of production payments and borrowings under our bank credit facilities and other sources. Given our high degree of operating control, the timing and incurrence of operating and capital expenditures is largely within our discretion.

Long-Term Indebtedness

	September 30, 2005	December 31, 2004
	(In thousands)	
Floating rate senior secured notes due 2009...........	$ 125,000	$ 125,000
Senior secured revolving credit facility.............	4,842	1,425
	129,842	126,425
Less current maturities	-	-
	$ 129,842	$ 126,425

Floating Rate Senior Secured Notes due 2009. In connection with our October 2004 refinancing, Abraxas issued $125 million in principal aggregate amount of Floating Rate Senior Secured Notes due 2009. The notes will mature on December 1, 2009 and began accruing interest from the date of issuance, October 28, 2004 at a per annum floating rate of six-month LIBOR plus 7.50%. The initial interest rate on the notes was 9.72% per annum. The interest will be reset semi-annually on each June 1 and December 1, commencing on June 1, 2005. The current interest rate, effective June 1, 2005, is 11.03% per annum. Interest is payable semi-annually in arrears on June 1 and December 1 of each year, commencing on June 1, 2005.

The notes rank equally among themselves and with all of our unsubordinated and unsecured indebtedness, including our credit facility and senior in right of payment to our existing and future subordinated indebtedness.

Each of our subsidiaries, Eastside Coal Company, Inc., Sandia Oil & Gas Corporation, Sandia Operating Corp., Wamsutter Holdings, Inc. and Western Associated Energy Corporation (collectively, the "Subsidiary Guarantors"), has unconditionally guaranteed, jointly and severally, the payment of the principal, premium and interest on the notes on a senior secured basis. In addition, any other subsidiary or affiliate of ours, that in the future guarantees any other indebtedness with us, or our restricted subsidiaries, will also be required to guarantee the notes.

The notes and the Subsidiary Guarantors' guarantees thereof, together with our credit facility and the Subsidiary Guarantors' guarantees thereof, are secured by shared first priority perfected security interests, subject to certain permitted encumbrances, in all of our and each of our restricted subsidiaries' material property and assets, including substantially all of our and their natural gas and crude oil properties and all of the capital stock (or in the case of an unrestricted subsidiary that is a controlled foreign corporation, up to 65% of the outstanding capital stock) of any entity, owned by us and our restricted subsidiaries (collectively, the "Collateral").

The Notes may be redeemed, at the election of the Company, as a whole or from time to time in part, at any time after April 28, 2007, upon not less than 30 nor more that 60 days' notice to each holder of notes to be redeemed, subject to the conditions and at the redemption prices (expressed as percentages of principal amount) set forth below, together with accrued and unpaid interest and Liquidating Damages, if any, to the applicable redemption date.

Year	Percentage
From April 29, 2007 to April 28, 2008	104.00%
From April 29, 2008 to April 28, 2009	102.00%
After April 28, 2009	100.00%

Prior to April 28, 2007, we may redeem up to 35% of the aggregate original principal amount of the notes using the net proceeds of one or more equity offerings, in each case at the redemption price equal to the product of (i) the

principal amount of the notes being so redeemed and (ii) a redemption price factor of 1.00 plus the per annum interest rate on the notes (expressed as a decimal) on the applicable redemption date plus accrued and unpaid interest to the applicable redemption date, provided certain conditions are also met.

If we experience specific kinds of change of control events, each holder of notes may require us to repurchase all or any portion of such holder's notes at a purchase price equal to 101% of the principal amount of the notes, plus accrued and unpaid interest to the date of repurchase.

The indenture governing the notes contains 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 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;
- permit restrictions on the ability of our subsidiaries to distribute or lend money to us;
- cause a restricted subsidiary to issue or sell its capital stock; and
- consolidate, merge or transfer all or substantially all of the consolidated assets of our and our restricted subsidiaries.

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

Senior Secured Revolving Credit Facility. On October 28, 2004, we entered into an agreement for a new revolving credit facility having a maximum commitment of $15 million, which includes a $2.5 million subfacility for letters of credit. Availability under the revolving credit facility is subject to a borrowing base consistent with normal and customary natural gas and crude oil lending transactions.

Outstanding amounts under the revolving credit facility bear interest at the prime rate announced by Wells Fargo Bank, National Association plus 1.00%. Subject to earlier termination rights and events of default, the stated maturity date under the revolving credit facility is October 28, 2008.

We are permitted to terminate the revolving credit facility, and under certain circumstances, may be required, from time to time, to permanently reduce the lenders' aggregate commitment under the revolving credit facility. Such termination and each such reduction is subject to a premium equal to the percentage listed below multiplied by the lenders' aggregate commitment under the revolving credit facility, or, in the case of partial reduction, the amount of such reduction.

Year	% Premium
1	1.5
2	1.0
3	0.5
4	0.0

Each of our current subsidiaries has guaranteed, and each of our future restricted subsidiaries will guarantee, our obligations under the revolving credit facility on a senior secured basis. In addition, any other subsidiary or affiliate of ours, that in the future guarantees any of our other indebtedness or of our restricted subsidiaries will be required to guarantee our obligations under the revolving credit facility. Obligations under the revolving credit facility are secured, together with the notes, by a shared first priority perfected security interest, subject to certain permitted encumbrances, in all of our and each of our restricted subsidiaries' material property and assets, including substantially all of our and their natural gas and crude oil properties and all of the capital stock (or in the case of an unrestricted subsidiary that is a controlled foreign corporation, up to 65% of the outstanding capital stock) in any entity, owned by us and our restricted subsidiaries.

Under the revolving credit facility, we are subject to customary covenants, including certain financial covenants and reporting requirements. The revolving credit facility requires us to maintain a minimum net cash interest coverage and also requires us to enter into hedging agreements on not less than 25% or more than 75% of our projected natural gas and crude oil production for a rolling six month period.

In addition to the foregoing and other customary covenants, the revolving credit facility contains a number of covenants that, among other things, restrict Abraxas' 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;
- prepay, redeem, purchase or otherwise acquire any of our or our restricted subsidiaries' indebtedness;
- permit a change of control;
- directly or indirectly make or acquire any investment;
- cause a restricted subsidiary to issue or sell our capital stock; and
- consolidate, merge or transfer all or substantially all of the consolidated assets of Abraxas and our restricted subsidiaries.

The revolving credit facility also contains customary events of default, including nonpayment of principal or interest, violations of covenants, cross default and cross acceleration to certain other indebtedness, bankruptcy and material judgments and liabilities, and is subject to an Intercreditor, Security and Collateral Agency Agreement, which specifies the rights of the parties thereto to the proceeds from the Collateral.

Intercreditor Agreement. The holders of the notes, together with the lenders under our credit facility, are subject to an Intercreditor, Security and Collateral Agency Agreement, which specifies the rights of the parties thereto to the proceeds from the Collateral. The Intercreditor Agreement, among other things, (i) creates security interests in the Collateral in favor of a collateral agent for the benefit of the holders of the notes and the credit facility lenders and (ii) governs the priority of payments among such parties upon notice of an event of default under the Indenture or the credit facility.

So long as no such event of default exists, the collateral agent will not collect payments under the credit facility documents or the indenture governing the notes and other note documents (collectively, the "Secured Documents"), and

all payments will be made directly to the respective creditor under the applicable Secured Document. Upon notice of an event of default and for so long as an event of default exists, payments to each credit facility lender and holder of the notes from us and our current subsidiaries and proceeds from any disposition of any collateral, will, subject to limited exceptions, be collected by the collateral agent for deposit into a collateral account and then distributed as provided in the following paragraph.

Upon notice of any such event of default and so long as an event of default exists, funds in the collateral account will be distributed by the collateral agent generally in the following order of priority:

first, to reimburse the collateral agent for expenses incurred in protecting and realizing upon the value of the Collateral;

second, to reimburse the credit facility administrative agent and the trustee, on a pro rata basis, for expenses incurred in protecting and realizing upon the value of the Collateral while any of these parties was acting on behalf of the Control Party (as defined below);

third, to reimburse the credit facility administrative agent and the trustee, on a pro rata basis, for expenses incurred in protecting and realizing upon the value of the Collateral while any of these parties was not acting on behalf of the Control Party;

fourth, to pay all accrued and unpaid interest (and then any unpaid commitment fees) under the credit facility;

fifth, if, the collateral coverage value of three times the outstanding obligations under the credit facility would be met after giving effect to any payment under this clause "fifth," to pay all accrued and unpaid interest on the notes;

sixth, to pay all outstanding principal of (and then any other unpaid amounts, including, without limitation, any fees, expenses, premiums and reimbursement obligations) the credit facility;

seventh, to pay all accrued and unpaid interest on the notes (if not paid under clause "fifth");

eighth, to pay all outstanding principal of (and then any other unpaid amounts, including, without limitation, any premium with respect to) the notes; and

ninth, to pay each credit facility lender, holder of the notes, and other secured party, on a pro rata basis, all other amounts outstanding under the credit facility and the notes.

To the extent there exists any excess monies or property in the collateral account after all of our and our subsidiaries' obligations under the credit facility, the indenture and the notes are paid in full, the collateral agent will be required to return such excess to us.

The collateral agent will act in accordance with the Intercreditor Agreement and as directed by the "Control Party" which for purposes of the Intercreditor is the holders of the notes and the credit facility lenders, acting as a single class, by vote of the holders of a majority of the aggregate principal amount of outstanding obligations under the notes and the credit facility.

The Intercreditor Agreement provides that the lien on the assets constituting part of the Collateral that is sold or otherwise disposed of in accordance with the terms of each Secured Document may be released if (i) no default or event of default exists under any of the Secured Documents, (ii) we have delivered an officers' certificate to each of the collateral agent, the trustee, the credit facility administrative agent certifying that the proposed sale or other disposition of assets is either permitted or required by, and is in accordance with the provisions of, the applicable Secured Documents and (iii) the collateral agent has acknowledged such certificate.

The Intercreditor Agreement provides for the termination of security interests on the date that all obligations under the Secured Documents are paid in full.

Hedging Activities.

Our results of operations are significantly affected by fluctuations in commodity prices and we seek to reduce our exposure to price volatility by hedging our production through commodity derivative instruments. Under the revolving credit facility, we are required to maintain hedge positions on not less than 25% nor more than 75% of our projected oil and gas production for a rolling six month period.

Net Operating Loss Carryforwards.

At December 31, 2004, we had $184.9 million of net operating loss carryforwards for U.S. tax purposes. These loss carryforwards will expire through 2022 if not utilized.

Uncertainties exist as to the future utilization of the operating loss carryforwards under the criteria set forth under FASB Statement No. 109. Therefore, we have established a valuation allowance of $73.0 million for deferred tax assets at December 31, 2004 and September 30, 2005.

Item 3. Quantitative and Qualitative Disclosures about Market Risk.

Commodity Price Risk

As an independent natural gas and crude oil producer, our revenue, cash flow from operations, other income and profitability, reserve values, access to capital and future rate of growth are substantially dependent upon the prevailing prices of natural gas, natural gas liquids and crude oil. Declines in commodity prices will materially adversely affect our financial condition, liquidity, ability to obtain financing and operating results. Lower commodity prices may reduce the amount of natural gas and crude oil that we can produce economically. Prevailing prices for such commodities are subject to wide fluctuation in response to relatively minor changes in supply and demand and a variety of additional factors beyond our control, such as global political and economic conditions. Historically, prices received for natural gas and crude oil production have been volatile and unpredictable, and such volatility is expected to continue. Most of our production is sold at market prices. Generally, if the commodity indexes fall, the price that we receive for our production will also decline. Therefore, the amount of revenue that we realize is partially determined by factors beyond our control. Assuming the production levels we attained during the nine months ended September 30, 2005, a 10% decline in natural gas, natural gas liquids and crude oil prices would have reduced our operating revenue, cash flow and net income by approximately $3.1 million for the period.

Hedging Sensitivity

On January 1, 2001, we adopted SFAS 133 as amended by SFAS 137 and SFAS 138. Under SFAS 133, all derivative instruments are recorded on the balance sheet at fair value. If the derivative does not qualify as a hedge or is not designated as a hedge, the gain or loss on the derivative is recognized currently in earnings. To qualify for hedge accounting, the derivative must qualify either as a fair value hedge, cash flow hedge or foreign currency hedge. None of the derivatives in place as of September 30, 2005 are designated as hedges. Accordingly, the change in the market value of the instrument is reflected in current oil and gas revenue.

Under the terms of the revolving credit facility, we are required to maintain hedging positions on not less than 25% nor more than 75% of our natural gas and crude oil production for a rolling six month period.

See "General - Commodity Prices and Hedging Activities" for a summary of our current hedge positions.

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Interest Rate Risk

At September 30, 2005, as a result of the refinancing that occurred in October 2004, we had $125.0 million in outstanding indebtedness under the floating rate senior secured notes due 2009. The notes bear interest at a per annum rate of six-month LIBOR plus 7.5%. The rate is redetermined on June 1 and December 1 of each year, beginning June 1, 2005. The current rate on the notes is 11.03%. For every percentage point that the LIBOR rate rises, our interest expense would increase by approximately $1.3 million on an annual basis. At September 30, 2005 we had $4.8 million of outstanding indebtedness under our revolving credit facility. Interest on this facility accrues at the prime rate announced by Wells Fargo Bank plus 1.00%. For every percentage point increase in the announced prime rate, our interest expense would increase by approximately $48,000 on an annual basis.

Item 4. Controls and Procedures.

As of the end of the period covered by this report, our Chief Executive Officer and Chief Financial Officer carried out an evaluation of the effectiveness of Abraxas' "disclosure controls and procedures" (as defined in the Securities Exchange Act of 1934 Rules 13a-15(e)and 15d-15(e)) and concluded that the disclosure controls and procedures were effective and designed to ensure that material information relating to Abraxas and our consolidated subsidiaries which is required to be included in our periodic Securities and Exchange Commission filings would be made known to them by others within those entities. There were no changes in our internal controls that could materially affect, or are reasonably likely to materially affect, our financial reporting during the third quarter of 2005.

ABRAXAS PETROLEUM CORPORATION

PART II
OTHER INFORMATION

Item 1. Legal Proceedings.

There have been no changes in legal proceedings from that described in the Company's Annual Report of Form 10-K for the year ended December 31, 2004, and in Note 7 in the Notes to Condensed Consolidated Financial Statements contained in Part I of this report on Form 10-Q/A Number 1.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

On July 20, 2005, we entered into a Common Stock Purchase Agreement with certain accredited investors, pursuant to which we issued 4.0 million shares of our common stock, par value $.01 per share, to the accredited investors at a price of $3.00 per share, or an aggregate of $12.0 million in cash before transaction expenses. The sale of common stock was not registered under the Securities Act of 1933, as amended, or any applicable state securities laws in reliance on the exemption provided by ss. 4(2) of the Securities Act and Rule 506 of the regulations promulgated thereunder. There was no general solicitation involved in the offer and the common stock was sold exclusively to accredited investors as defined under Regulation D. We paid a 5% cash commission out of such proceeds to Energy Capital Solutions LLC which acted as our financial advisor. Net proceeds of approximately $11.3 million from the private placement were used to re-pay indebtedness under our revolving credit facility, for development in Texas and Wyoming, and for working capital and general corporate purposes. We subsequently filed a registration statement on Form S-3 to enable the investors to resell the common stock which was declared effective on September 29, 2005.

Item 3. Defaults Upon Senior Securities.

None

Item 4. Submission of Matters to a Vote of Security Holders.

None

Item 5. Other Information.

None

Item 6. Exhibits.

(a) Exhibits

Exhibit 31.1 Certification - Robert L.G. Watson, CEO
Exhibit 31.2 Certification - Chris E. Williford, CFO
Exhibit 32.1 Certification pursuant to 18 U.S.C. Section 1350 - Robert L.G. Watson, CEO
Exhibit 32.2 Certification pursuant to 18 U.S.C. Section 1350 - Chris E. Williford, CFO

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ABRAXAS PETROLEUM CORPORATION

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Date: March 30, 2006

By:/s/ Robert L.G. Watson

ROBERT L.G. WATSON,
President and Chief
Executive Officer

Date: March 30, 2006

By:/s/ Chris E. Williford

CHRIS E. WILLIFORD,
Executive Vice President and
Principal Accounting Officer

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