

ABRAXAS PETROLEUM CORP
Form 10-Q
November 15, 2010

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

FORM 10-Q

(Mark One)

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

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

COMMISSION FILE NUMBER: 001-16071

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

Nevada
(State of Incorporation)

74-2584033
(I.R.S. Employer
Identification No.)

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

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

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to the filing requirements for the past 90 days.

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Yes No

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

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

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

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

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

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

Forward-Looking Information

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

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

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

GLOSSARY OF TERMS

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

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

Terms used to describe quantities of oil and gas:

“Bbl” – barrel or barrels.

“Bcf” – billion cubic feet of gas.

“Bcfe” – billion cubic feet of gas equivalent.

“Boe” – barrels of oil equivalent.

“Boepd” – barrels of oil equivalent per day.

“Bopd” – barrels of oil per day.

“MBbl” – thousand barrels.

“MBoe” – thousand barrels of oil equivalent.

“Mcf” – thousand cubic feet of gas.

“Mcfce” – thousand cubic feet of gas equivalent.

“MMBbls” – million barrels.

“MMBoe” – million barrels of oil equivalent.

“MMbtu” – million British Thermal Units.

“MMcf” – million cubic feet of gas.

“MMcfce” – million cubic feet of gas equivalent.

“MMcfepd” – million cubic feet of gas equivalent per day.

“MMcfpd” – million cubic feet of gas per day.

Terms used to describe our interests in wells and acreage:

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

ABRAXAS PETROLEUM CORPORATION
FORM 10 – Q
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PART I
FINANCIAL INFORMATION

Item 1. Financial Statements

Abraxas Petroleum Corporation
Condensed Consolidated Balance Sheets
(in thousands)

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

See accompanying notes to condensed consolidated financial statements (unaudited)

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

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

See accompanying notes to condensed consolidated financial statements (unaudited)

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

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

See accompanying notes to condensed consolidated financial statements (unaudited)

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

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

See accompanying notes to condensed consolidated financial statements (unaudited)

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

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

See accompanying notes to condensed consolidated financial statements (unaudited)

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

Note 1. Basis of Presentation

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

Consolidation Principles

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

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

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

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

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

Use of Estimates

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

Equity-based Compensation

Stock Options

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

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

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

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

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