

HKN, Inc.
Form 10-Q
November 12, 2013

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

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

For the quarterly period ended September 30, 2013

or

**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 1-10262

HKN, INC.

(Exact name of registrant as specified in its charter)

Delaware

95-2841597

(State or other jurisdiction of

(I.R.S. Employer

incorporation or organization)

Identification No.)

180 State Street, Suite 200

76092

Southlake, Texas

(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code **(817) 424-2424**

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

Indicate by check mark 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 the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company) 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 common stock, par value \$0.01 per share, outstanding as of November 5, 2013 was 401,941.

HKN, INC.

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September 30, 2013

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HKN, INC.**CONSOLIDATED CONDENSED BALANCE SHEETS**

(in thousands, except for share and per share amounts)

| | September 30, 2013 (Unaudited) | December 31, 2012 |
|--|---|----------------------------------|
| <u>Assets</u> | | |
| Current Assets: | | |
| Cash and cash equivalents | \$ 15,573 | \$ 19,286 |
| Accounts receivable, net of allowance of \$21 thousand and \$65 thousand at September 30, 2013 and December 31, 2012, respectively | 447 | 203 |
| Assets of discontinued operations | 25 | — |
| Prepaid expenses and other current assets | 352 | 297 |
| Total Current Assets | 16,397 | 19,786 |
| Oil and gas property, using the successful efforts method of accounting | 4,299 | 2,953 |
| Construction in progress - plant | 6,685 | 1,717 |
| Weathered lagoon plant | 6,236 | 6,236 |
| Office equipment and other | 282 | 261 |
| Accumulated depreciation and depletion | (653) | (358) |
| Total Property and Equipment, net | 16,849 | 10,809 |
| Intangible assets, net | 1,719 | 1,872 |
| Long term note receivable - related party, net of deferred transaction fees of \$223 thousand and \$119 thousand at September 30, 2013 and December 31, 2012, respectively | 13,277 | 16,881 |
| Investment in Global | 19,857 | 23,607 |
| Other assets | 215 | 1,022 |
| Total Assets | \$ 68,314 | \$ 73,977 |
| Liabilities and Stockholders' Equity | | |
| Current Liabilities: | | |
| Trade payables | \$ 561 | \$ 244 |
| Liabilities of discontinued operations | 109 | 247 |
| Accrued liabilities and other | 2,083 | 260 |
| Preferred stock dividends | 4 | — |
| Total Current Liabilities | 2,757 | 751 |
| Asset retirement obligation | 2 | 4 |
| BWI contingency | 800 | 800 |
| Total Liabilities | 3,559 | 1,555 |

Contingencies (Note 2 and 13)

Stockholders' Equity:

| | | |
|--|------------|-----------|
| Series G1 preferred stock, \$1.00 par value; \$100,000 liquidation value; 700,000 shares authorized; 1,000 shares outstanding | 1 | 1 |
| Series G2 preferred stock, \$1.00 par value; \$100,000 liquidation value; 100,000 shares authorized; 1,000 shares outstanding | 1 | 1 |
| Common stock, \$0.01 par value; 2,000,000 shares authorized; 401,941 and 435,328 shares issued and outstanding, respectively | 4 | 4 |
| Additional paid-in capital | 450,359 | 453,300 |
| Accumulated deficit | (395,064) | (394,170) |
| Accumulated other comprehensive income | 9,454 | 13,286 |
| Total Stockholders' Equity | 64,755 | 72,422 |
| Total Liabilities and Stockholders' Equity | \$ 68,314 | \$ 73,977 |

The accompanying Notes to the Consolidated Condensed Financial Statements are

an integral part of these Statements.

HKN, INC.**CONSOLIDATED CONDENSED STATEMENTS OF OPERATIONS**

(Unaudited, in thousands, except for share and per share amounts)

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|-------------------------------------|-----------|------------------------------------|------------|
| | 2013 | 2012 | 2013 | 2012 |
| Revenues: | | | | |
| Oil and gas operations | \$309 | \$185 | \$823 | \$185 |
| Total revenues | 309 | 185 | 823 | 185 |
| Operating costs and expenses: | | | | |
| Oil and gas operating | 60 | 21 | 126 | 21 |
| Selling, general and administrative | 827 | 857 | 2,475 | 3,157 |
| Depreciation, depletion and amortization | 211 | 117 | 555 | 244 |
| Total operating costs and expenses | 1,098 | 995 | 3,156 | 3,422 |
| Loss from operations | (789) | (810) | (2,333) | (3,237) |
| Other income and expenses: | | | | |
| Interest and other expenses | (35) | — | (35) | — |
| Interest and other income - related party | 528 | 496 | 1,773 | 1,336 |
| Interest and other income | 4 | 12 | 41 | 33 |
| Total other income | 497 | 508 | 1,779 | 1,369 |
| Loss from continuing operations before income taxes | (292) | (302) | (554) | (1,868) |
| Income tax benefit | — | 2 | — | 80 |
| Loss from continuing operations | (292) | (300) | (554) | (1,788) |
| Loss on disposal of discontinued operations | — | (24) | — | (93) |
| Loss from discontinued operations | (69) | (82) | (340) | (302) |
| Net loss | (361) | (406) | (894) | (2,183) |
| Accrual of dividends related to preferred stock | (4) | (4) | (12) | (12) |
| Gain on payments of dividends of preferred stock | — | — | 8 | 8 |
| Net loss attributed to common stock | \$(365) | \$(410) | \$(898) | \$(2,187) |
| Loss per common share from continuing operations | \$(0.74) | \$(0.70) | \$(1.36) | \$(4.01) |
| Loss per common share from discontinued operations | (0.17) | (0.24) | (0.83) | (0.88) |
| Net loss per common share, basic and diluted | \$(0.91) | \$(0.94) | \$(2.19) | \$(4.89) |
| Weighted average common shares outstanding: | | | | |
| Basic and diluted | 401,941 | 436,896 | 410,266 | 447,411 |

The accompanying Notes to the Consolidated Condensed Financial Statements are

an integral part of these Statements.

HKN, INC.

CONSOLIDATED CONDENSED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(Unaudited, in thousands)

| | Three Months Ended September 30, 2013 | | Nine Months Ended September 30, 2012 | |
|--|--|-----------|---|-----------|
| Net loss | \$(361) | \$(406) | \$(894) | \$(2,183) |
| Foreign currency translation adjustments | 963 | 503 | (331) | 664 |
| Unrealized gain (loss) on investments | 4,903 | (1,940) | (3,501) | (6,352) |
| Other comprehensive income (loss) | 5,866 | (1,437) | (3,832) | (5,688) |
| Comprehensive income (loss) | \$5,505 | \$(1,843) | \$(4,726) | \$(7,871) |

The accompanying Notes to the Consolidated Condensed Financial Statements
are an integral part of these Statements.

HKN, INC.

CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS

(Unaudited, in thousands)

| | Nine Months Ended September 30, | |
|--|------------------------------------|------------|
| | 2013 | 2012 |
| Cash flows from operating activities: | | |
| Net loss | \$(894) | \$(2,183) |
| Adjustments to reconcile net loss to net cash used in operating activities: | | |
| Depreciation, depletion and amortization | 555 | 244 |
| Stock-based compensation expense | 30 | 57 |
| Loss on disposal of discontinued operations | — | 93 |
| Amortization of long term note receivable - related party transaction fee | (236) | (90) |
| Other | (16) | (1) |
| Change in operating assets and liabilities: | | |
| Accounts receivable and accounts receivable - related party | (255) | (128) |
| Prepaid assets and other | (210) | (53) |
| Trade payables and other | 309 | (751) |
| Net cash used in operating activities - continuing operations | (717) | (2,812) |
| Net cash used in operating activities - discontinued operations | (163) | (731) |
| Net cash used in operating activities | (880) | (3,543) |
| Cash flows from investing activities: | | |
| Capital expenditures | (3,730) | (1,109) |
| Purchase of Global shares | (32) | (175) |
| Net proceeds from sales of assets | 55 | 1 |
| Investment in Gerrity Oil joint venture, net of proportionate share of cash acquired of \$2 million | — | (2,000) |
| Origination fee from long term note receivable - related party restructuring | 340 | — |
| Repayment of long term note receivable - related party | 3,500 | — |
| Issuance of notes receivable to Global, net of transaction fees of \$260 thousand | — | (11,740) |
| Net cash provided by (used in) investing activities | 133 | (15,023) |
| Cash flows from financing activities: | | |
| Purchase of treasury stock | (2,966) | (2,901) |
| Net cash used in financing activities | (2,966) | (2,901) |
| Net decrease in cash and cash equivalents | (3,713) | (21,467) |
| Cash and cash equivalents at beginning of period | 19,286 | 43,431 |
| Cash and cash equivalents at end of period | \$15,573 | \$21,964 |

The accompanying Notes to the Consolidated Condensed Financial Statements are an integral part of these Statements.

HKN, INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

September 30, 2013 and 2012

(unaudited)

(1) BASIS OF PRESENTATION

Our accompanying consolidated condensed financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (“SEC”). Certain information and note disclosures normally included in annual financial statements prepared in accordance with generally accepted accounting principles in the United States of America (“U.S. GAAP”) have been condensed or omitted pursuant to these rules and regulations, although we believe that the disclosures made are adequate to prevent the information presented from being misleading. In our opinion, these consolidated condensed financial statements contain all adjustments necessary to present fairly our financial position as of September 30, 2013 and December 31, 2012, the results of our operations for the three and nine months presented as of September 30, 2013 and 2012 and changes in our cash flows for the nine months presented as of September 30, 2013 and 2012. The December 31, 2012 consolidated condensed balance sheet information is derived from audited financial statements. All adjustments represent normal recurring items. These consolidated condensed financial statements should be read in conjunction with the consolidated financial statements and the notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2012. Certain prior year amounts have been reclassified to conform to the 2013 presentation.

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reported period. Actual results could differ from these estimates. The results of operations for the three and nine months ended September 30, 2013 are not necessarily indicative of the results to be expected for the full year.

Principles of Consolidation – The consolidated condensed financial statements include the accounts of all companies that we, through our direct or indirect ownership or shareholding, were provided the ability to control their operating policies and procedures. All significant intercompany balances and transactions have been eliminated.

In July 2012, we obtained a 50% interest in Gerrity Oil, LLC (“Gerrity Oil”), a legal entity which held non-operated working interests in properties strategically located in the Bakken and Niobrara shale oil plays. In January 2013, we made the decision to dissolve the joint venture and obtain a direct ownership interest in our 50% portion of the Gerrity

Oil assets and properties under a newly formed corporation, HKN Bakken, Inc. (“HBI”). Prior to its dissolution, we had accounted for Gerrity Oil under proportionate consolidation rules pursuant to which our 50% portion of the assets, liabilities and results of operations of Gerrity Oil were included in our consolidated condensed financial statements. Effective January 1, 2013, we began consolidating 100% of HBI. Due to the facts that we followed the proportionate consolidation rules for Gerrity Oil and our ownership interests in the underlying assets have not changed, these events did not affect our consolidated condensed balance sheets or consolidated condensed statements of operations (see Note 3 – “HKN Bakken, Inc.”).

As of September 30, 2013, we owned less than a majority of the ordinary shares of Global Energy Development PLC (“Global”) and did not possess the legal power to direct Global’s operating policies and procedures. Accordingly, we have concluded that Global was not a Variable Interest Entity (“VIE”) as defined by the Financial Accounting Standards Board (“FASB”) at September 30, 2013.

As a result of the sales of our Gulf Coast oil and gas properties and the abandonment of our coalbed methane projects during 2011, any remaining Gulf Coast and coalbed methane and oil and gas activities are included as discontinued operations on the consolidated condensed balance sheets, consolidated condensed statements of operations and consolidated condensed statements of cash flows for all periods presented.

Accumulated Other Comprehensive Income – Comprehensive income includes changes in stockholders’ equity during the periods that do not result from transactions with stockholders. Changes in our accumulated other comprehensive income during the period are as follows (in thousands):

| | Foreign Currency Translation Adjustments | Unrealized Gain (Loss) on Investments | Accumulated Other Comprehensive Income |
|---|---|--|---|
| Balance as of December 31, 2012 | \$ 1,055 | \$ 12,231 | \$ 13,286 |
| Current period other comprehensive loss | (331) | (3,501) | (3,832) |
| Balance as of September 30, 2013 | \$ 724 | \$ 8,730 | \$ 9,454 |

Fair Value of Financial Instruments – Financial instruments are stated at fair value as determined in good faith by management. Factors considered in valuing individual investments include, without limitation, available market prices, reported net asset values, marketability, restrictions on disposition, current financial position and operating results, and other pertinent information (see Note 7 – “Fair Value Measurements”).

We carry our financial instruments, which include cash, our common stock investment in Global and our Global note receivable, at their estimated fair values. Our investment in ordinary shares of Global has been designated as available for sale rather than a trading security. The associated unrealized gains and losses on our available for sale investment are recorded to other comprehensive income until realized and reclassified into earnings using specific identification. The fair value of our investment in the ordinary shares of Global is based on prices quoted in an active market. Our investment in Global is classified as a non-current asset in our accompanying consolidated condensed balance sheets.

Translation of Non-U.S. Currency Amounts – Our investment in Global is subject to foreign currency exchange rate risk as Global’s ordinary shares are denominated in British pounds sterling. Translation adjustments are included in other comprehensive income until the investment is sold.

Property and Equipment – We sold certain property during the first nine months of 2013 and recognized a gain of \$28 thousand within the interest and other income line in our consolidated condensed statements of operations. We recorded depreciation expense related to other property and equipment of \$14 thousand and \$13 thousand for the three months and \$43 thousand and \$37 thousand for the nine months ended September 30, 2013 and 2012, respectively. Depreciation, depletion and amortization expense for oil and gas producing properties and related equipment was \$146 thousand and \$53 thousand for the three months and \$358 thousand and \$53 thousand for the nine months ended September 30, 2013 and 2012, respectively.

Intangible Assets – Our intangible assets consist of patents acquired in connection with our investment in BriteWater International, Inc. (“BWI”). Our patents have been valued at \$2.6 million and are amortized on a straight-line basis over a period of 6-21 years, based on their respective contractual lives. Accumulated amortization in the amount of \$873 thousand has been recorded on these patents to date. We have recorded amortization expense related to these patents of \$51 thousand for both the three months and \$154 thousand for both the nine months ended September 30, 2013 and 2012, respectively. Patent annuity fees and legal fees related to the renewal of our existing patents are expensed as incurred and recorded within selling, general and administrative expenses in our consolidated condensed statements of operations.

Other Assets – At September 30, 2013, other assets included \$205 thousand in prepaid drilling costs related to the drilling and completion of wells held by HBI and \$10 thousand in spare parts inventory for the Arctic Star plant.

Recent Accounting Pronouncements – In February 2013, the FASB issued Accounting Standards Update No. 2013-02 on reporting amounts reclassified out of accumulated other comprehensive income. The update to this standard will require us to report the effect of any significant reclassifications out of accumulated other comprehensive income on the respective line items in net income if the amount being reclassified is required to be reclassified to net income. For other amounts that are not required to be reclassified to net income in the same reporting period, it requires a cross-reference to other required disclosures that provide additional detail about those amounts. This standard was effective for us starting with our first quarter interim reporting on Form 10-Q as of March 31, 2013. We currently do not have any reclassifications out of accumulated other comprehensive income into net income.

(2) BRITEWATER INTERNATIONAL, INC.

BWI owns a patented oilfield emulsion breaking technology. This is a continuous process technology that can purify oilfield emulsions by breaking and separating the emulsions into oil, water and solids, thereby reducing the environmental impact and disposal costs of these waste materials while recovering valuable oil. BWI has completed the design of standardized modules which can be used for both upstream and downstream applications in the oil and gas industry, including processing oilfield and refinery emulsions to recover valuable oil and oil spill remediation.

BWI’s wholly-owned subsidiary, Arctic Star Alaska, Inc. (“Arctic Star”) is currently in the process of constructing a mobile waste processing plant which will be located on the North Slope of Alaska. Arctic Star currently holds contracts which grant them the right of first refusal for oilfield waste generated in certain fields on the North Slope.

BWI also has a completed purpose-built plant which was designed to break emulsions found in weathered lagoon pits.

BWI Contingency – BWI has a contingent liability of \$800 thousand which may be payable upon the conclusion of certain performance events related to its weathered lagoon plant. There were no changes to the BWI liability recorded during the nine months ended September 30, 2013.

(3) HKN BAKKEN, INC.

In July 2012, we obtained a 50% interest in Gerrity Oil, a legal entity which held non-operated working interests in properties strategically located in the Bakken and Niobrara shale oil plays. In January 2013, we made the decision to dissolve the joint venture and obtain a direct ownership interest in our 50% portion of the Gerrity Oil assets and properties under the newly formed HBI entity. We invested in these assets because we believe they present significant near-term growth potential and align well with our long term investment goals.

Prior to its dissolution, we accounted for Gerrity Oil under proportionate consolidation rules pursuant to which our 50% portion of the assets, liabilities and results of operations of Gerrity Oil were included in our consolidated condensed financial statements. Effective January 1, 2013, we began consolidating 100% of HBI. Due to the facts that we followed the proportionate consolidation rules for Gerrity Oil and our ownership interests in the underlying assets have not changed, these events did not affect our consolidated condensed balance sheets or consolidated condensed statements of operations.

During the second quarter 2013, we finalized the purchase price allocation of our investment in Gerrity Oil. The following table presents the recognized fair values of identifiable assets acquired and liabilities assumed as of the formation date (in thousands).

| | |
|--------------------------------|---------|
| Cash and cash equivalents | \$2,000 |
| Accounts receivable, net | 65 |
| Oil and gas property- proved | 1,445 |
| Oil and gas property- unproved | 326 |
| Other assets | 335 |
| Trade payables | (31) |
| Accrued liabilities | (137) |
| Asset retirement obligation | (3) |
| Total identifiable net assets | \$4,000 |

The fair value of the oil and gas properties of approximately \$1.8 million was determined based on third party reserve valuations that were completed during the second quarter 2013. These valuations used a discounted forecasted cash flow analysis based on estimated future production to estimate the fair value of the oil and gas properties contributed. We consider this valuation of our oil and gas properties to be a non-recurring, Level 3 classification. See Note 7 - "Fair Value Measurements" for further discussions of Level 3 valuation definitions.

As a result of this valuation, we have finalized our purchase accounting which resulted in immaterial adjustments in the current period to the identifiable assets and liabilities acquired as compared to amounts included in our December 31, 2012 consolidated financial statements. As such, these adjustments were not restated for the prior period presented. Other assets of \$335 thousand consist of prepaid drilling deposits related to the drilling and completion of contributed wells, which were previously recorded at December 31, 2012.

Assuming our 50% portion of Gerrity Oil was acquired on January 1, 2012, proforma revenues and earnings for the nine months ended September 30, 2012 would not be material to our financial statements.

(4) INVESTMENT IN GLOBAL

Our non-current available for sale investment consists of our ownership of approximately 34% of Global's outstanding ordinary shares. At September 30, 2013 and December 31, 2012, our investment in Global was equal to the market value of Global's ordinary shares as follows (in thousands, except for closing price and exchange rate amounts):

| | September 30, 2013 | December 31, 2012 |
|--------------------------------------|-----------------------|----------------------|
| Shares of Global Stock Held by HKN | 12,407 | 12,357 |
| Closing Price of Global Stock | £ 0.99 | £ 1.18 |
| Foreign Currency Exchange Rate | 1.6167 | 1.6259 |
| Market Value of Investment in Global | \$ 19,857 | \$ 23,607 |

The foreign currency translation adjustment of approximately \$331 thousand and the unrealized loss on investment of \$3.5 million for the changes in market value between the two periods were recorded to other comprehensive income in stockholders' equity during the nine months ended September 30, 2013.

During September 2013, we purchased an additional 50 thousand shares of Global for \$82 thousand, increasing our ownership from 34.22% to 34.36%.

Our policy is to review our investment in Global semi-annually or more often if any indicators of impairment become known. We continuously monitor macroeconomic indicators and track Global's stock price volatility for any downward trends in the market. We also review public financial information including Global's issued financial statements, investor presentations, as well as financial analysts' reviews and recommendations for any indicators of an other than temporary impairment in our carrying value. Additionally, we monitor public reports regarding the reserves in Colombia's Middle Magdalena basin in which Global operates. We also assess internally our ability and intent to hold our investment in Global should the fair value drop below our cost. Any resulting other than temporary impairment would be immediately recognized in earnings. We have not recognized any such impairment as of September 30, 2013. We currently have a cumulative unrealized gain position on our investment in Global of \$9.5 million.

(5) NOTES RECEIVABLE – RELATED PARTY

In March 2013, we entered into a new loan agreement (the "Global 2013 Note") with Global to refinance the outstanding \$5 million Global Note Receivable and the \$12 million Global Loan into one \$17 million note. The Global 2013 Note extended the maturity date to June 15, 2015 and increased the interest rate from 12.5% to 12.75%. Principal payments are required quarterly and began on March 31, 2013. During the nine months ended September 30, 2013, we have received \$3.5 million in principal payments from Global. Accrued interest on the outstanding principal balance is due on each quarterly principal payment date. During the three and nine months ended September 30, 2013, we have received \$478 thousand and approximately \$1.5 million, respectively, in interest payments from Global. Payment of the Global 2013 Note is guaranteed by Global's principal operating subsidiary. In connection with the new

loan agreement, Global paid us a transaction fee of \$340 thousand, of which \$223 thousand was deferred and presented net of our long term notes receivable at September 30, 2013. The remaining deferred transaction fee will be recognized over the life of the loan. Additionally, we recognized \$86 thousand of unamortized origination fees related to the old loans upon execution of the new note agreement. The remaining payments due to us under the new Global 2013 Note are as follows: \$1.5 million due quarterly from December 31, 2013 through March 31, 2015 and \$4.5 million due June 15, 2015.

Currently, our related party loans are classified as long-term due to the historic uncertainty around the timing of collection in spite of the stated repayment terms in the agreements. As of September 30, 2013, all required quarterly payments on the Global 2013 Note have been received from Global. As a related party, however, it is in our best interest to work with Global on payment terms to maximize our return on this investment. We assess the collectability of our related party loan with Global on a semi-annual basis based on review of their publicly disclosed financial information. Additionally, we continually monitor all Global disclosures for any events that could adversely affect their liquidity or results of operations. As of the date of this quarterly report on Form 10-Q we do not have any reason to believe that our Global 2013 Note is not collectible or is impaired. Accordingly, we did not record any allowance for doubtful accounts related to our related party notes receivable at September 30, 2013.

(6) ASSET RETIREMENT OBLIGATION

We recognize the present value of asset retirement obligations beginning in the period in which they are incurred if a reasonable estimate of a fair value can be made. The associated asset retirement costs are capitalized as part of the carrying amount of the long-lived asset. A summary of our asset retirement obligations as of September 30, 2013 is as follows (in thousands):

| Asset Category | Asset Retirement Obligation | Estimated Life |
|----------------------------------|--------------------------------|-----------------|
| Oil and gas producing properties | \$ | 2 (1)27.5 years |

(1) This is a Level 3 fair value measurement.

The following table describes all changes to our asset retirement obligation liability during the nine months ended September 30, 2013 (in thousands):

| | 2013 |
|--|------|
| Asset retirement obligation at beginning of period | \$4 |
| Additions during the period | 1 |
| Disposals during the period | — |
| Revisions of estimates | (3) |
| Accretion expense | — |
| Asset retirement obligation at end of period | \$2 |

During the second quarter 2013, we revised our asset retirement obligation to reflect an increase in estimated life of our HBI oil and gas properties from 15 years to 27.5 years based on estimates provided in a third party reserve valuation.

(7) FAIR VALUE MEASUREMENTS

We account for certain assets and liabilities at fair value. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The accounting guidance establishes a framework for measuring fair value and a valuation hierarchy based upon the transparency of inputs used in the valuation of an asset or liability. Classification within the hierarchy is based upon the lowest level of input that is significant to the fair value measurement. The valuation hierarchy contains three levels:

- Level 1 – Valuation inputs are unadjusted quoted market prices for identical assets or liabilities in active markets.

- Level 2 – Valuation inputs are quoted prices for identical assets or liabilities in markets that are not active, quoted market prices for similar assets and liabilities in active markets and other observable inputs directly or indirectly related to the asset or liability being measured.
- Level 3 – Valuation inputs are unobservable and significant to the fair value measurement.

Valuation of Acquired Gerrity Oil Property – The fair value of the acquired oil and gas properties of \$1.8 million is non-recurring and was estimated based on third party valuations using the income approach method, which is based on a discounted forecasted cash flow analysis derived from estimated future production. We consider this valuation to be a Level 3 classification.

The following tables present recurring financial assets which are carried at fair value as of September 30, 2013 and December 31, 2012 (in thousands):

| | September 30, 2013 | | |
|--------------------------|---------------------------|----------------|----------------|
| | Level 1 | Level 2 | Level 3 |
| Investment in Global (1) | \$19,857 | \$— | \$— |

| | December 31, 2012 | | |
|--------------------------|--------------------------|----------------|----------------|
| | Level 1 | Level 2 | Level 3 |
| Investment in Global (1) | \$23,607 | \$— | \$— |

(1) Global’s ordinary shares are publicly traded on the Alternative Investment Market (“AIM”), a market operated by the London Stock Exchange, with quoted prices in active markets. Accordingly, the fair value measurements of these securities have been classified as Level 1.

(8) DISCONTINUED OPERATIONS

As a result of the sales of our Gulf Coast oil and gas properties and the abandonment of our coalbed methane projects during 2011, all related activities are included as discontinued operations on the consolidated condensed balance sheets and consolidated condensed statements of operations for all periods presented.

The carrying amounts of the major classes of assets and liabilities for our discontinued oil and gas operations are summarized below (in thousands):

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| | September 30, 2013 | December 31, 2012 |
|--|--------------------------|-------------------------|
| Current Assets: | | |
| Accounts receivable, net | \$ 25 | \$ — |
| Total Current Assets | 25 | — |
| Total Assets of Discontinued Operations | \$ 25 | \$ — |
| Current Liabilities: | | |
| Trade payables | \$ 42 | \$ 3 |
| Revenues and royalties payable | 17 | 17 |
| Accrued liabilities and other | 50 | 227 |
| Total Current Liabilities | 109 | 247 |
| Total Liabilities of Discontinued Operations | \$ 109 | \$ 247 |

Our Accounts Receivable at September 30, 2013 primarily consists of approved insurance recoveries for legal fees related to the XPLOR Energy litigation (see Note 13 – “Contingencies”). Our Accrued Liabilities and Other at September 30, 2013 include \$50 thousand in legal fees related to this litigation.

Cash used by discontinued operations during the nine months ended September 30, 2013 is mainly related to legal costs resulting from the sale of the oil and gas properties. Upon resolution of the XPLOR Energy litigation and regulatory matters, no significant activities are expected related to these discontinued operations.

The revenues and net income before income tax associated with our discontinued oil and gas operations are as follows (in thousands):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|--|--------|---------------------------------------|---------|
| | 2013 | 2012 | 2013 | 2012 |
| Revenues and other: | | | | |
| Oil and gas operations | \$— | \$— | \$— | \$— |
| Oil and gas processing and handling income | — | — | — | — |
| Total revenues from discontinued operations | \$— | \$— | \$— | \$— |
| Loss from discontinued operations before taxes | \$(69) | \$(82) | \$(340) | \$(302) |

We recognized losses of \$24 thousand and \$93 thousand on the 2011 disposal of our Gulf Coast oil and gas properties during the three months and nine months ended September 30, 2012, respectively, as a result of decreases in actual retained plugging and abandonment costs over estimates at December 31, 2011. No additional losses were recognized on this disposal in the first nine months of 2013.

(9) SEGMENT INFORMATION

Our reportable segments, which consist of BWI and HBI, are aligned around our energy assets which are managed separately. We have included activity of our parent company, HKN, in our disclosure to reconcile to our consolidated operating loss and total assets. HKN, which includes our investment in Global, performs general corporate activities such as corporate reporting and governance, financing, management and growth of current operations and the evaluation of new investment opportunities. Our accounting policies for each of our operating segments are the same as those for our consolidated condensed financial statements. Intersegment interest income and intersegment expenses between our parent company and BWI or HBI have been eliminated in consolidation. There were no material

intersegment sales or transfers for the periods presented.

Our BWI segment owns a patented oilfield emulsion breaking technology. This is a continuous process technology that can purify oilfield emulsions by breaking and separating the emulsions into oil, water and solids, thereby reducing the environmental impact and disposal costs of these waste materials while recovering valuable oil. See Note 2 – “BriteWater International, Inc.” for further discussion.

Our HBI segment holds non-operated working interests in properties strategically located in the Bakken and Niobrara shale oil plays. See Note 3 – “HKN Bakken, Inc.” for further discussion.

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Our financial information, expressed in thousands, for each of our operating segments for the three and nine months ended September 30, 2013 and 2012 is as follows:

For the Three Months Ended September 30, 2013

| | HKN | BWI | HBI | Eliminations | Consolidated |
|--|------------|------------|------------|---------------------|---------------------|
| Oil and gas revenues | \$— | \$— | \$309 | \$— | \$ 309 |
| Oil and gas expenses | — | — | (60) | — | (60) |
| Selling, general and administrative expenses | (576) | (166) | (85) | — | (827) |
| Depreciation, depletion and amortization | (11) | (54) | (146) | — | (211) |
| Interest and other expenses | (27) | (174) | (6) | 172 | (35) |
| Interest and other income - related parties | 700 | — | — | (172) | 528 |
| Interest and other income | 3 | 1 | — | — | 4 |
| Segment income (loss) from continuing operations | \$89 | \$(393) | \$12 | \$— | \$ (292) |
| Capital Expenditures | \$30 | \$1,527 | \$197 | \$— | \$ 1,754 |
| Total Assets | \$58,186 | \$16,273 | \$4,642 | \$(10,787) | \$ 68,314 |

For the Three Months Ended September 30, 2012

| | HKN | BWI | HBI | Eliminations | Consolidated |
|--|------------|------------|------------|---------------------|---------------------|
| Oil and gas revenues | \$— | \$— | \$185 | \$— | \$ 185 |
| Oil and gas expenses | — | — | (21) | — | (21) |
| Selling, general and administrative expenses | (550) | (266) | (41) | — | (857) |
| Depreciation, depletion and amortization | (10) | (54) | (53) | — | (117) |
| Interest and other expenses | — | (83) | — | 83 | — |
| Interest and other income - related parties | 579 | — | — | (83) | 496 |
| Interest and other income | 12 | — | — | — | 12 |
| Income tax benefit | 2 | — | — | — | 2 |
| Segment income (loss) from continuing operations | \$33 | \$(403) | \$70 | \$— | \$ (300) |
| Capital Expenditures | \$10 | \$263 | \$331 | \$— | \$ 604 |
| Total Assets | \$66,215 | \$9,689 | \$4,115 | \$(14,327) | \$ 65,692 |

For the Nine Months Ended September 30, 2013

| | HKN | BWI | HBI | Eliminations | Consolidated |
|--|------------|------------|------------|---------------------|---------------------|
| Oil and gas revenues | \$— | \$— | \$823 | \$— | \$ 823 |
| Oil and gas expenses | — | — | (126) | — | (126) |
| Selling, general and administrative expenses | (1,804) | (490) | (181) | — | (2,475) |
| Depreciation, depletion and amortization | (33) | (164) | (358) | — | (555) |
| Interest and other expenses | (27) | (436) | (8) | 436 | (35) |

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| | | | | | | |
|--|----------|-----------|---------|------------|---|----------|
| Interest and other income - related parties | 2,209 | — | — | (436 |) | 1,773 |
| Interest and other income | 41 | — | — | — | | 41 |
| Segment income (loss) from continuing operations | \$386 | \$(1,090) | \$150 | \$— | | \$(554) |
| Capital Expenditures | \$82 | \$3,177 | \$471 | \$— | | \$3,730 |
| Total Assets | \$58,186 | \$16,273 | \$4,642 | \$(10,787) |) | \$68,314 |

For the Nine Months Ended September 30, 2012

| | HKN | BWI | HBI | Eliminations | Consolidated |
|--|----------|-----------|---------|--------------|--------------|
| Oil and gas revenues | \$— | \$— | \$185 | \$— | \$185 |
| Oil and gas expenses | — | — | (21) | — | (21) |
| Selling, general and administrative expenses | (2,099) | (1,017) | (41) | — | (3,157) |
| Depreciation, depletion and amortization | (29) | (162) | (53) | — | (244) |
| Interest and other expenses | — | (204) | — | 204 | — |
| Interest and other income - related parties | 1,540 | — | — | (204) | 1,336 |
| Interest and other income | 33 | — | — | — | 33 |
| Income tax benefit | 80 | — | — | — | 80 |
| Segment income (loss) from continuing operations | \$(475) | \$(1,383) | \$70 | \$— | \$(1,788) |
| Capital Expenditures | \$16 | \$762 | \$331 | \$— | \$1,109 |
| Total Assets | \$66,215 | \$9,689 | \$4,115 | \$(14,327) | \$65,692 |

(10) STOCKHOLDERS' EQUITY

Effective October 30, 2012, we completed a one-for-forty reverse stock split of our issued and outstanding common stock which was approved by shareholders on October 29, 2012. The reverse stock split was initiated to reduce the amount of small shareholders that typically do not vote their shares. Accordingly, all share and per share amounts have been retroactively restated to reflect the reverse stock split. In conjunction with the reverse stock split, our shareholders also approved a reduction of our common stock shares authorized from 24 million shares to 2 million shares. Our shares authorized have been adjusted to reflect this change.

No changes in the number of preferred shares occurred during the nine months ended September 30, 2013. The changes in the number of common and treasury shares held during the nine months ended September 30, 2013 are as follows:

| Description | Number of Shares | | | |
|---|------------------|--------------|-----------|-----------|
| | Preferred G1 | Preferred G2 | Common | Treasury |
| Balance as of December 31, 2012 | 1,000 | 1,000 | 435,328 | — |
| Shares issued for preferred stock dividends | — | — | 2 | — |
| Treasury stock repurchase | — | — | — | 33,389 |
| Treasury stock retirements | — | — | (33,389) | (33,389) |
| Balance as of September 30, 2013 | 1,000 | 1,000 | 401,941 | — |

Treasury Stock – At September 30, 2013 and December 31, 2012, we held no shares of treasury stock. In January 2013, we announced that our Board of Directors authorized the cancellation of our amended September 2005 stock repurchase plan and authorized a new stock repurchase program which allows us to buy back up to 45 thousand shares of our common stock. During the nine months ended September 30, 2013, we purchased and retired approximately 33 thousand shares of our common stock in privately negotiated transactions for approximately \$3 million. As of September 30, 2013, approximately 12 thousand shares remained available for repurchase under our repurchase program.

Additional Paid in Capital – Additional paid in capital decreased by approximately \$2.9 million during the nine month period ended September 30, 2013 primarily due to the purchase and retirement of our common stock and BWI stock compensation.

(11) BWI STOCK COMPENSATION

In April 2012, our wholly-owned subsidiary, BWI, adopted a 2012 Equity Compensation Plan (the “BWI Plan”), which is administered by the Compensation Committee (the “Committee”) of the HKN Board of Directors. The Committee has complete and absolute authority to make any and all decisions regarding the administration of the BWI Plan, and all employees of BWI, HKN and its subsidiaries are eligible to receive awards under the BWI Plan. An aggregate of 100,000 shares of common stock of BWI (10% of BWI’s currently outstanding shares of common stock) have been reserved for potential award issuance under the BWI Plan.

Awards under the BWI Plan are granted in the form of nonqualified stock options. The Committee also has complete and absolute authority to set the terms, conditions and provisions of each award, including the size of the award, the exercise or base price, the vesting and exercisability schedule (including provisions regarding acceleration of vesting and exercisability) and termination, cancellation and forfeiture provisions, subject to limitations on the exercise price and term under the BWI Plan. In particular, the exercise price for a stock option granted under the BWI Plan may not be less than 100% of the fair market value of the stock on the award date, and no stock option granted under the BWI Plan may expire more than ten years after the award date.

In April 2012, 40 thousand options were granted to BWI officers and directors with an exercise price of \$14.50 per share of BWI common stock and a vesting period of three years, with one third of the options vesting on the first, second and third anniversaries of the grant date. As of September 30, 2013, 14 thousand of these options were forfeited and approximately 9 thousand options were exercisable. The grant date fair value of the stock of \$14.50 per share was based on an independent third-party valuation. This valuation used the income approach method based on a discounted forecasted cash flow analysis.

Stock-based compensation cost is measured at the grant date based on the fair value of the award and is recognized as expense over the requisite service period, which is the vesting period, using the straight-line method. The fair value of each stock option of \$8.56 per share at the grant date was estimated by using the Black-Scholes option-pricing model using the following weighted average assumptions:

| | |
|--------------------------|------------------|
| | April 5, 2012 |
| Expected dividend yield | 0.00% |
| Expected volatility | 65.00% |
| Expected life (in years) | 6.00 |
| Risk free interest rate | 1.29% |

We estimate the expected dividend yield to be zero because we do not anticipate paying dividends out of BWI. Because BWI is not publicly traded, the expected volatility is based on an average historical and implied volatility for comparable public reporting companies over a period similar to the expected life of the options. Expected life is based on the simplified method of computing an average of the vesting periods and the contractual term, and the risk-free interest rate represents the published interest rate for a comparable term US Treasury Bond on the grant date.

We are also required to estimate forfeitures at the time of grant, and to revise those estimates in subsequent periods if actual forfeitures differ from our estimates as a cumulative adjustment in the period of revision. Stock compensation is recorded only for those awards that are expected to vest. In the first quarter of 2013, a total of 12 thousand shares were forfeited and an immaterial amount of stock compensation expense was reversed. No additional forfeiture rate was applied during the nine months ended September 30, 2013, as no further forfeitures were expected.

Total stock-based compensation recognized within selling, general and administrative expenses in our consolidated condensed statements of operations was \$19 thousand and \$29 thousand for the three months and \$30 thousand and \$57 thousand for the nine months ended September 30, 2013 and 2012, respectively.

(12) EARNINGS (LOSS) PER SHARE

The following table sets forth the computation of basic and diluted loss per share for the three and nine months ended September 30, 2013 and 2012 (in thousands, except per share data):

| | Three Months Ended September 30, 2013 | | | Three Months Ended September 30, 2012 | | |
|--------------------------------------|--|----------------------------|----------------------|--|--------------------------------|----------------------|
| | Net Loss Attributed to Common Stock | Weighted-Average Shares | Per Share Loss | Net Loss Attributed to Common Stock | Weighted-Average Shares (3) | Per Share Loss |
| Basic EPS: | | | | | | |
| Loss from continuing operations (1) | \$(296) | | \$(0.74) | \$(304) | | \$(0.70) |
| Loss from discontinued operations | (69) | | (0.17) | (106) | | (0.24) |
| Net loss attributed to common stock | \$(365) | 402 | \$(0.91) | \$(410) | 437 | \$(0.94) |
| <i>Effect of dilutive securities</i> | | | | | | |
| Preferred stock (2) | — | — | — | — | — | — |
| Diluted loss per share | \$(365) | 402 | \$(0.91) | \$(410) | 437 | \$(0.94) |

| | Nine Months Ended September 30, 2013 | | | Nine Months Ended September 30, 2012 | | |
|--------------------------------------|--|----------------------------|----------------------|---|--------------------------------|----------------------|
| | Net Loss Attributed to Common Stock | Weighted-Average Shares | Per Share Loss | Net Loss Attributed to Common Stock | Weighted-Average Shares (3) | Per Share Loss |
| Basic EPS: | | | | | | |
| Loss from continuing operations (4) | \$(558) | | \$(1.36) | \$(1,792) | | \$(4.01) |
| Loss from discontinued operations | (340) | | (0.83) | (395) | | (0.88) |
| Net loss attributed to common stock | \$(898) | 410 | \$(2.19) | \$(2,187) | 447 | \$(4.89) |
| <i>Effect of dilutive securities</i> | | | | | | |
| Preferred stock (5) | — | — | — | — | — | — |
| Diluted loss per share | \$(898) | 410 | \$(2.19) | \$(2,187) | 447 | \$(4.89) |

(1) Includes accrual of dividends, net of the gain on dividends paid with common shares, related to preferred stock for the three months ended September 30, 2013 and 2012 of \$4 thousand.

(2) Includes 11 shares of our common stock related to our Series G1 preferred and Series G2 preferred stock for the three months ended September 30, 2013 and 2012, respectively. These shares were issuable upon their conversion in the period presented and were excluded from the calculation of diluted earnings per share as their effect would have been antidilutive.

(3) Retroactively reflects the effect of a one-for-forty reverse stock split effective October 30, 2012 (see Note 10 – “Stockholders’ Equity”).

(4) Includes accrual of dividends, net of the gain on dividends paid with common shares, related to preferred stock for the nine months ended September 30, 2013 and 2012 of \$4 thousand.

(5) Includes 35 shares of our common stock related to our Series G1 preferred and Series G2 preferred stock for the nine months ended September 30, 2013 and 2012, respectively. These shares were issuable upon their conversion in the period presented and were excluded from the calculation of diluted earnings per share as their effect would have been antidilutive.

(13) CONTINGENCIES

XPLOR Energy Litigation – Pursuant to a Purchase and Sale Agreement (“PSA”) dated as of November 17, 2011 between our subsidiary XPLOR Energy SPV-1, Inc. (“XPLOR”) and Texas Petroleum Investment Company (“TPIC”), XPLOR sold to TPIC its oil and gas production assets and related operations at its Main Pass 35 field. The closing of the

transaction occurred on November 17, 2011 but was effective as of October 1, 2011. On November 21, 2011, TPIC informed XPLOR that they had discovered defects in the salt water disposal system at Main Pass resulting in a salt water spill in the Gulf of Mexico, which had been reported to regulatory authorities.

TPIC has filed a lawsuit against XPLOR in the 236th Judicial District Court, Tarrant County, Texas. The case is styled: *Texas Petroleum Investment Company vs. XPLOR Energy SPV-1, Inc., Richard Cottle, Sarah Gasch, and John Hewitt*. In the lawsuit, TPIC has asserted claims of fraud, fraudulent inducement, negligent misrepresentation, and indemnity related to its purchase of a production platform and associated assets from XPLOR. TPIC's claims focus on alleged salt water system defects, related repairs to the facilities, and purported representations regarding the condition of the platform and associated assets. TPIC is seeking an unstated amount of alleged actual and exemplary damages as well as costs and fees. Although litigation is inherently uncertain, based upon the information known to date, we do not believe TPIC's claims have merit. Accordingly, as of September 30, 2013, we did not record a contingency related to TPIC's allegations as we do not currently believe that it is probable that HKN or XPLOR would be responsible for the costs, fees and damages allegedly incurred by TPIC as a result of its claims, the salt water disposal issues, or third party or governmental claims, if any, resulting therefrom. We intend to vigorously defend any assertions related to the above lawsuit. Based upon information known to date, the range of estimated loss if TPIC were to prevail on its claims is currently estimated not to exceed \$2.5 million in damages, costs, and fees.

BWI Contingencies – See Note 2 – “BriteWater International, Inc.” for further discussion of BWI contingencies.

Main Pass Environmental Investigations – In January 2013, we were notified by the Louisiana Department of Environmental Quality (“LDEQ”) of an investigation and potential penalty related to the TPIC allegations of improper salt water disposal at the Main Pass 35 field previously owned by our subsidiary XPLOR Energy SPV-1, Inc. At the time of filing this report on Form 10-Q, the LDEQ had not completed its investigation. In March 2013, we were advised that the U.S. Environmental Protection Agency was undertaking a criminal investigation of the salt water disposal incident. We are not aware of any damage to or spill from the salt water disposal system prior to TPIC's ownership; accordingly, as of September 30, 2013, we did not record a contingency related to these investigations.

Point Au Fer Lawsuit – During the second quarter 2013, we learned HKN, Inc. was named in a lawsuit filed in the 32nd Judicial District Court for the Parish of Terrebonne, Louisiana by Point Au Fer, L.L.C., and The Roman Catholic Church of the Archdiocese of New Orleans. The case is styled: *Point Au Fer, L.L.C., and The Roman Catholic Church of the Archdiocese of New Orleans v. ExxonMobil Oil Corporation, et al*, No. 169160. In the lawsuit, the plaintiffs have alleged that real property they own in Terrebonne Parish has been environmentally damaged as a result of oil and gas exploration activities of twenty different defendants. The plaintiffs seek damages for testing and remediation of the property, property stigma, loss of use of land and lost profits, civil fruits for defendants trespass, land loss and subsidence, punitive or exemplary damages and attorney’s fees. Per Louisiana law, no actual dollar amount of damages has been alleged in the Petition. With specific regard to HKN, Inc., out of over one hundred wells identified in the Petition, HKN, Inc. only drilled one well, the MA Smythe Nelson #1, which was a dry hole. The MA Smythe Nelson #1 was drilled on June 2, 1980 and plugged and abandoned on July 12, 1980. We have and intend to continue to vigorously defend any assertions related to the above lawsuit. Due to the inherent uncertainties of the lawsuit at this time, we cannot accurately predict the ultimate outcome of the matter. Accordingly, at September 30, 2013, we did not record a contingency related to this matter.

Point a la Hache Lawsuit – During the second quarter 2013, we learned XPLOR Energy Operating Company and XPLOR Energy SPV-1, Inc. were named in a lawsuit filed in the 25th Judicial District Court for the Parish of Plaquemines, Louisiana. The case is styled: *Catherine P. Alford et al. v. BP America Production Company, et al.*, Docket No. 60-479. In the lawsuit, eight plaintiffs have sued 25 defendants, alleging that they own and/or use a certain 4,480 acres located in the Pointe a la Hache oil and gas field. Plaintiffs further allege that the property has been contaminated or otherwise damaged by oil and gas exploration and production activities. Per Louisiana law, no actual dollar amount of damages has been alleged in the Petition. Investigation of the underlying factual background is in the preliminary stages but we intend to vigorously defend any assertions related to the above lawsuit. Due to the inherent uncertainties of the lawsuit at this time, we cannot accurately predict the ultimate outcome of the matter. Accordingly, at September 30, 2013, we did not record a contingency related to this matter.

SLFPA-E Litigation – Plaintiffs South Louisiana Flood Protection Authority—East (“SLFPA-E”) filed this lawsuit in Louisiana state court against over 90 oil and gas and pipeline companies. Generally the lawsuit alleges that activities by defendants—primarily but not exclusively the dredging of canals—have made it more difficult for the SLFPA-E to protect the New Orleans metropolitan area from flooding. Defendants have removed the case to federal court, but the plaintiff seeks to remand the case back to state court. Until that issue is resolved, there is no pending discovery or other activity in the case. The petition alleges that HKN, Inc. is "by virtue of [one or more of] mergers, acquisitions, name changes, etc., responsible for" the actions of Tejas Power Corporation, which is alleged to have obtained in the 1980s certain dredging permits and rights of way. HKN, Inc. disputes that it is responsible for any actions of Tejas Power Corporation. The public record appears to suggest that Tejas Power Corporation may have been a subsidiary of Harken Oil and Gas, Incorporated (a previous name of HKN, Inc.) for a few years in the 1980s and 1990s. However, there appears to be nothing to indicate that HKN, Inc. would have liability for the actions of Tejas Power Corporation, which continued to exist after HKN, Inc. no longer had any interest in Tejas Power Corporation. Due to the inherent uncertainties of the lawsuit at this time, we cannot accurately predict the ultimate outcome of the matter. Accordingly, at September 30, 2013, we did not record a contingency related to this matter.

Louisiana Limited Scope Audit – In April 2012, we received notice from the State of Louisiana’s Department of Revenue that our discontinued oil and gas subsidiary, XPLOR Energy Operating Company, was the subject of a

limited scope sales tax audit focused on the company's on-site use and consumption of lease gas in connection with its lease, gathering and pipeline operations from January 1, 2006 through June 30, 2009. The Louisiana Department of Revenue issued a preliminary assessment, or "Notice of Proposed Tax Due," preliminarily assessing sales tax of \$194 thousand and related penalties and interest of \$142 thousand, resulting in a total assessment of \$336 thousand. In July 2012, we filed an audit protest with the Louisiana Department of Revenue challenging the preliminary assessment, as we do not agree with the legal basis of the assessment or the methodology in which the taxes were calculated and plan to vigorously defend our position. Due to the inherent uncertainties of the audit protest and preliminary assessment, we cannot accurately predict the ultimate outcome of the matter. Accordingly, at September 30, 2013, we did not record a contingency related to this matter. In the event of a negative outcome, the potential loss related to the audit and preliminary assessment is currently estimated not to exceed \$336 thousand.

(14) RELATED PARTY TRANSACTIONS

Our related party transactions at September 30, 2013 include our \$13.5 million note receivable from Global. Our CEO, Mikel Faulkner, serves as Chairman of Global. Please see Note 5 - “Notes Receivable – Related Party” for additional information on our note receivable from Global.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion is intended to assist you in understanding our business and the results of our operations. It should be read in conjunction with the consolidated condensed financial statements and the related notes that appear elsewhere in this report as well as our Annual Report on Form 10-K for the year ended December 31, 2012. Certain statements made in our discussion may be forward-looking. Forward-looking statements involve risks and uncertainties and a number of factors could cause actual results or outcomes to differ materially from our expectations. Unless the context requires otherwise, when we refer to “we,” “us” and “our,” we are describing HKN, Inc. and its consolidated subsidiaries on a consolidated basis.

BUSINESS OVERVIEW

Our business strategy is focused on enhancing value for our shareholders through the development of a well-balanced portfolio of assets in the energy industry. Currently, the majority of the value of our assets is derived from our wholly-owned subsidiaries, BriteWater International, Inc. (“BWI”) and HKN Bakken, Inc. (“HBI”), our investment in publicly-traded ordinary shares of Global Energy Development PLC (“Global”) and our note receivable extended to Global. We consider these assets to be strategic for us, and our objective in 2013 is to build the value of our portfolio of assets through:

- Identifying, developing and marketing applications for the BWI emulsion-breaking technology,
- Pursuing opportunities to invest in or acquire undervalued assets or companies in the energy industry which we believe present significant near-term growth potential,
- Providing management expertise and/or additional capital for our assets to enhance their value and accelerate growth and
- Managing our capital expenditures and selling, general and administrative costs.

Management continues to evaluate additional potential projects and opportunities within the energy and related industries.

BriteWater International, Inc.

BWI owns a patented oilfield emulsion breaking technology. This is a continuous process technology that can purify oilfield emulsions by breaking and separating the emulsions into oil, water and solids, thereby reducing the environmental impact and disposal costs of these waste materials while recovering valuable oil. This technology has been successfully tested in multiple refineries as well as in a demonstration in Prudhoe Bay, Alaska, all of which

confirmed the effectiveness of the emulsion breaking technology to recover valuable hydrocarbons and reduce wastes. BWI has completed the design of standardized modules which can be used for both upstream and downstream applications in the oil and gas industry, including processing oilfield and refinery emulsions to recover valuable oil and oil spill remediation.

BWI's wholly-owned subsidiary, Arctic Star Alaska, Inc. ("Arctic Star"), is currently in the process of constructing a mobile waste processing plant which will be located on the North Slope of Alaska. Arctic Star currently holds contracts which grant Arctic Star the right of first refusal for oilfield waste generated in certain fields on the North Slope and is currently in negotiations to enter into additional feedstock supply agreements and crude sales contracts. All long-lead time equipment for the plant was ordered during the first half of 2013 and construction began during the second quarter of 2013. Construction of the plant is anticipated to be completed during the fourth quarter of 2013. Arctic Star has secured a lease for a location on the Alaska North Slope to locate its plant. Installation and commissioning of the plant is anticipated to be completed during the first half of 2014.

BWI also has an existing purpose-built plant which was designed to break emulsions found in weathered lagoon pits. Although its primary focus in 2013 is to build and launch its Arctic Star plant, BWI hopes to deploy this plant or parts of the plant once the Arctic Star plant is commissioned. Should we determine that this plant is not deployable or that only parts of the plant are deployable however, we could incur a write down of the book value of this asset.

Domestic Energy Investment – HKN Bakken, Inc.

In July 2012, we obtained a 50% interest in Gerrity Oil, LLC (“Gerrity Oil”), a legal entity which currently holds non-operated working interests in properties strategically located in the Bakken and Niobrara shale oil plays. In January 2013, we made the decision to dissolve the joint venture and obtain a direct ownership interest in our 50% portion of the Gerrity Oil assets and properties under the newly formed HBI entity.

We invested in these assets because we believe they represent significant near-term growth potential and align well with our long term investment goals. As HBI, we plan to invest on a non-operated basis in all phases of the oil and gas business including the acquisition of oil and gas leases, fee mineral interests, overriding royalty interests, participating and non-participating royalty interests and production payments, and participating in the drilling, completion, operation and maintenance of oil and gas wells. Prior to its dissolution, we accounted for Gerrity Oil under proportionate consolidation rules pursuant to which our 50% portion of the assets, liabilities and results of operations of Gerrity Oil are included in our consolidated financial statements as of December 31, 2012. Effective January 1, 2013, we began consolidating 100% of HBI. Due to the facts that we followed the proportionate consolidation rules for Gerrity Oil and our ownership interests in the underlying assets have not changed, these events did not affect our consolidated condensed balance sheets or consolidated condensed statements of operations (see Note 3 – “HKN Bakken, Inc.”).

Our domestic reserve estimates at December 31, 2012 consisted of only a portion of our producing properties which represented 81% of all our 2012 production. No nonproducing or undeveloped locations were evaluated or not included in this reserve report. During the second quarter 2013, in connection with the finalization of our purchase price allocation of Gerrity Oil (See Note 3- “HKN Bakken, Inc.”), we obtained a third party reserve valuation for all our proved reserves as of April 1, 2013. This report resulted in an overall increase of proved reserves of approximately 180 thousand bbls and 373 thousand mcfs. This consisted of an increase to our proved developed reserves of approximately 34 thousand bbls and 109 thousand mcfs, and an increase to our proved undeveloped reserves of approximately 146 thousand bbls and 264 thousand mcfs. Of our total proved oil and gas reserves approximately 98% are concentrated in the Bakken formation in North Dakota.

International Energy Investment – Global Energy Development PLC

At September 30, 2013, we held an investment in Global through our ownership of approximately 34% of Global's ordinary shares and a \$13.5 million note receivable. Global is a petroleum exploration and production company focused on Latin America. Global's shares are traded on the Alternative Investment Market ("AIM"), a market operated by the London Stock Exchange. In addition to financing opportunities, we continue to monitor our investment in Global in order to identify opportunities for divesting of shares or making additional investments in the company.

Ordinary Shares - We account for our ownership of Global shares as an available for sale investment. During September 2013, we purchased an additional 50 thousand shares of Global for \$82 thousand, increasing our ownership from 34.22% to 34.36%. At September 30, 2013 and December 31, 2012, our investment in Global was equal to the market value of Global's ordinary shares as follows (in thousands, except for closing price and exchange rate amounts):

| | September 30, 2013 | December 31, 2012 |
|--------------------------------------|-----------------------|----------------------|
| Shares of Global Stock Held by HKN | 12,407 | 12,357 |
| Closing Price of Global Stock | £ 0.99 | £ 1.18 |
| Foreign Currency Exchange Rate | 1.6167 | 1.6259 |
| Market Value of Investment in Global | \$ 19,857 | \$ 23,607 |

The foreign currency translation adjustment of approximately \$331 thousand and the unrealized loss on investment of \$3.5 million for the changes in market value between the two periods were recorded to other comprehensive income in stockholders' equity during the nine months ended September 30, 2013.

Global's asset base and financial information continue to be strong; therefore we intend to hold our shares of Global until we believe the market price more accurately reflects the value of its operations and asset base.

2013 Note Receivable - In March 2013, we entered into a new loan agreement (the "Global 2013 Note") with Global to refinance the outstanding \$5 million Global Note Receivable and the \$12 million Global Loan into one \$17 million note. The Global 2013 Note extended the maturity date to June 15, 2015 and increased the interest rate from 12.5% to 12.75%. Principal payments are required quarterly and began on March 31, 2013. During the nine months ended September 30, 2013, we received \$3.5 million in principal payments from Global. Accrued interest on the outstanding principal balance is due on each quarterly principal payment date. During the three and nine months ended September 30, 2013, we have received \$478 thousand and approximately \$1.5 million, respectively, in interest payments from Global. Payment of the Global 2013 Note is guaranteed by Global's principal operating subsidiary. In connection with the new loan agreement, Global paid us a transaction fee of \$340 thousand, of which \$223 thousand was deferred and presented net of our long term notes receivable at September 30, 2013. The remaining deferred transaction fee will be recognized over the life of the loan.

RECENT DEVELOPMENTS

The divestiture of our Gulf Coast oil and gas properties has given us the opportunity to redeploy capital into other areas of the oil and gas industry which may generate greater value for our shareholders while bearing significantly lower operational and regulatory risks. Throughout the third quarter 2013, we continued to invest in our emulsions-breaking technology through BWI and the construction of the Arctic Star plant, to invest in the Bakken and Niobrara shale plays through HBI, and to support our investments in Global.

Continued Investment in BWI

During the nine months ended September 30, 2013, BWI invested approximately \$5 million in the Arctic Star plant, its initial project to commercialize its emulsions-breaking technology. Arctic Star has completed the detailed engineering and design for this mobile waste processing plant which will be located on the North Slope of Alaska and is currently focused on constructing this plant. Arctic Star currently holds contracts which grant them the right of first refusal for oilfield waste generated in certain fields on the North Slope and is currently in negotiations to enter into additional feedstock supply agreements and a crude sales agreement. All long-lead time equipment for the plant was ordered during the first half of 2013 and construction began during the second quarter of 2013. Construction of the plant is anticipated to be completed during the fourth quarter of 2013. Arctic Star has secured a lease for a location on the Alaska North Slope to locate its plant. Installation and commissioning of the plant is anticipated to be completed during the first half of 2014.

Continued Investment in HBI

We continue to invest in HBI on a non-operated basis, in all phases of the oil and gas business, including the acquisition of oil and gas interests and participation in the drilling, completion, operation and maintenance of oil and gas wells. In the first nine months of 2013, we invested \$471 thousand in drilling and completion costs.

Continued Support of our Investment in Global

In March 2013, we entered into a new loan agreement with Global to refinance the outstanding \$17 million of notes receivable. In connection with the new loan agreement, Global paid us a transaction fee of \$340 thousand, of which \$223 thousand was deferred and presented net of our long term notes receivable at September 30, 2013.

Other Matters

Share Repurchases

During the nine months ended September 30, 2013, we repurchased and retired approximately 33 thousand shares of our common stock for a total of approximately \$3 million.

CRITICAL ACCOUNTING ESTIMATES AND ASSUMPTIONS

Our consolidated condensed financial statements have been prepared in accordance with U.S. GAAP which requires us to use estimates and make assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. Our estimates and assumptions are based on historical experience, industry conditions and various other factors which we believe are appropriate. Actual results could vary significantly from our estimates and assumptions as additional information becomes known. We have identified the following accounting estimates and assumptions critical to our financial statements.

Investment in Global – We do not account for our investment in Global as an equity method investment in spite of our 34% ownership. We are unable to obtain U.S. GAAP financial statements quarterly to perform equity method accounting due to the semi-annual reporting requirements Global follows under the AIM exchange rules. As a result,

we account for Global as an available for sale investment.

We review our investment in Global semi-annually or more often if any indicators of impairment become known. We continuously monitor macroeconomic indicators and track Global's stock price volatility for any downward trends in the market. We also review public financial information including Global's issued financial statements, investor presentations, as well as financial analysts' reviews and recommendations for any indicators of an other than temporary impairment in our carrying value. Additionally, we monitor public reports regarding the reserves in Colombia's Middle Magdalena basin in which Global operates. In addition to these external indicators, we also assess internally our ability and intent to hold our investment in Global should the fair value drop below our cost. Any resulting other than temporary impairment would be immediately recognized in earnings. We have not recognized any impairment losses for the nine months ended September 30, 2013. We currently have a cumulative unrealized gain position on our investment in Global of \$9.5 million.

Oil and Gas Properties – We use the successful efforts method of accounting for our HKN Bakken, Inc. oil and gas activities. The significant principles for this method are:

- Geological and geophysical evaluation costs are expensed as incurred;
- Costs incurred to drill and equip all successful wells are capitalized;
- Dry holes for exploratory wells are expensed;
- Dry holes for development wells are capitalized;
- Capitalized costs related to proved oil and gas property leasehold costs are depleted over total proved oil and gas reserves; and
- Capitalized costs related to wells and related equipment and facilities costs are depreciated over proved developed reserves.

Estimates of proved oil and gas reserves directly impact financial accounting estimates including depreciation, depletion and amortization expense, evaluation of impairment of properties and the calculation of plugging and abandonment liabilities. 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. The process of estimating quantities of proved reserves is very complex, requiring significant subjective decisions in the evaluation of all geological, engineering and economic data for each reservoir. The data for any reservoir may change substantially over time due to results from operational activity.

Capital amounts attributable to proved oil and gas properties are depleted by the unit-of-production method over proved reserves using the unit conversion ratio for gas of six Mcf of gas to one barrel of oil equivalent (“BOE”), and one barrel of NGLs to one BOE for each geological formation (Bakken and Niobrara).

Stock-Based Compensation – We measure all stock-based compensation awards using a fair value method on the date of grant and recognize such expense in our consolidated condensed financial statements over the requisite service period on a straight-line basis. We use the Black-Scholes formula to determine the fair value of stock-based compensation awards on the date of grant. The Black-Scholes formula requires management to make assumptions regarding the option lives, expected volatility, forfeiture rate and risk free interest rates.

RECENT ACCOUNTING PRONOUNCEMENTS

Recently Issued Accounting Pronouncements – In February 2013, the Financial Accounting Standards Board issued Accounting Standards Update No. 2013-02 on reporting amounts reclassified out of accumulated other comprehensive income. The update to this standard will require us to report the effect of any significant reclassifications out of accumulated other comprehensive income on the respective line items in net income if the amount being reclassified is required to be reclassified to net income. For other amounts that are not required to be reclassified to net income in the same reporting period, it requires a cross-reference to other required disclosures that provide additional detail about

those amounts. This standard was effective for us starting with our first quarter interim reporting on Form 10-Q as of March 31, 2013. We currently do not have any reclassifications out of accumulated other comprehensive income into net income.

RESULTS OF OPERATIONS

The following is our discussion and analysis of significant components of our operations which have affected our operating results and balance sheet during the three and nine months ended September 30, 2013 and 2012 included in the accompanying consolidated condensed financial statements.

Results of Operations for the Quarterly Periods Ended September 30, 2013 Compared to September 30, 2012

Our loss from continuing operations decreased slightly from \$300 thousand in the third quarter 2012 to \$292 thousand for the third quarter 2013. The decrease was primarily due to increased oil and gas revenues from our investment in HBI, which were partially offset by higher depletion expenses resulting from increased oil and gas production volumes.

Oil and Gas Revenues and Expenses

Oil and gas revenues increased by \$124 thousand from \$185 thousand for the third quarter 2012 to \$309 thousand for the third quarter 2013. The increase was due to higher oil and gas volumes as well as higher oil and gas prices received during the third quarter 2013.

Oil revenues increased \$104 thousand to \$284 thousand and comprised 92% of our total revenues for the third quarter 2013. We realized a 12% increase in oil prices received, increasing from an average of \$87.45 per barrel in the third quarter 2012 to \$97.53 per barrel in the third quarter 2013. Oil production for the third quarter 2013 was approximately 3 thousand bbls, approximately 90% of which came from our non-operated properties located in the Bakken.

Gas revenues increased \$20 thousand to \$25 thousand and comprised 8% of our total revenues for the third quarter 2013. We realized a 29% increase in gas prices received, increasing from an average of \$4.90 per mcf in the third quarter 2012 to \$6.31 per mcf during in the third quarter 2013. This average price is mainly a result of natural gas produced in the Bakken formation having a higher dollar value than other natural gas production areas due to its higher natural gas liquids content. Gas production for the third quarter 2013 was approximately 4 thousand mcf, approximately 67% of which came from our non-operated properties located in the Bakken.

Assuming stable oil and gas pricing, future revenues from HBI are expected to increase as additional wells are drilled and begin producing.

Oil and gas operating expenses increased \$39 thousand to \$60 thousand for the three months ended September 30, 2013. Oil and gas operating expenses are expected to increase as new wells are drilled in the near term.

Selling, General and Administrative Expenses

Selling, general and administrative expenses decreased approximately 4% from \$857 thousand for the third quarter 2012 to \$827 thousand for the third quarter 2013. We anticipate that our selling, general and administrative expenses may increase in future periods as we dedicate additional resources to the marketing efforts of BWI and new acquisitions. However, we continue to monitor and minimize our controllable costs.

Depreciation, Depletion and Amortization Expense

Depreciation, depletion and amortization expense increased approximately 80% from \$117 thousand for the third quarter 2012 to \$211 thousand for the third quarter 2013, primarily due to depletion of the oil and gas properties of HBI. Depreciation, depletion and amortization expenses are expected to increase in the near term as new wells are drilled and begin producing and the Arctic Star plant is commissioned.

Other Expenses

Other expenses were \$35 thousand in the third quarter 2013, primarily as a result of fees to renew a 20 year easement for lines which were abandoned in place and losses on the sales of assets.

Interest and Other Income

Interest and other income increased approximately 5% from \$508 thousand in the third quarter 2012 to \$532 thousand in the third quarter 2013, primarily as a result of the increased interest rate and the recognition of unamortized origination fees on our new Global 2013 Note, which were partially offset by lower principal balances during the period.

Income Tax Benefit

We did not recognize any income tax expense or benefit in the third quarter 2013. We recognized an income tax benefit of \$2 thousand in the third quarter of 2012 due to an IRS refund being higher than anticipated.

Loss from Discontinued Operations

Our loss from discontinued operations decreased from \$82 thousand in the third quarter 2012 to \$69 thousand in the third quarter 2013. We continued to incur additional legal costs related to the sold oil and gas properties during the third quarter 2013 and the third quarter 2012. During the third quarter 2013, our Directors' and Officers' insurance policy began paying a portion of these legal fees.

Loss on Disposal of Discontinued Operations

We did not recognize any gain or loss on disposal of discontinued operations in the third quarter 2013. We recognized a slight loss of \$24 thousand during the third quarter 2012 on the 2011 disposal of our Gulf Coast oil and gas properties as a result of actual costs being higher than estimated for retained plugging and abandonment costs.

Results of Operations for the Nine Months Ended September 30, 2013 Compared to September 30, 2012

Our loss from continuing operations decreased approximately 69% from \$1.8 million in the first nine months of 2012 to \$554 thousand for the first nine months of 2013. The decrease was due to increased oil and gas revenues from our investment in HBI, increased interest income from our related party notes receivable as a result of note restructurings that occurred during 2012 and 2013, and decreased general and administrative costs.

Oil and Gas Revenues and Expenses

Oil and gas revenues increased by \$638 thousand from \$185 thousand for the first nine months of 2012 to \$823 thousand for the first nine months of 2013. The increase was due to acquiring our interest in the HBI properties in July 2012 as well as higher oil and gas volumes and higher oil and gas prices received during the nine months ended September 30, 2013.

Oil revenues increased \$573 thousand to \$753 thousand and comprised 91% of our total revenues for the nine months ended September 30, 2013. We realized a 7% increase in oil prices received, increasing from an average of \$87.45 per barrel for the 2012 period to \$93.83 per barrel for the 2013 period. Oil production for the nine months ended September 30, 2013 was approximately 8 thousand bbls, approximately 83% of which came from our non-operated properties located in the Bakken.

Gas revenues increased \$65 thousand to \$70 thousand and comprised 9% of our total revenues for the nine months ended September 30, 2013. We realized a 40% increase in gas prices received, increasing from an average of \$4.90 per mcf in the 2012 period to \$6.85 per mcf during in the 2013 period. This average price is mainly a result of natural gas produced in the Bakken formation having a higher dollar value than other natural gas production areas due to its higher natural gas liquids content. Gas production for the nine months ended September 30, 2013 was approximately 10 thousand mcf, approximately 57% of which came from our non-operated properties located in the Bakken.

Assuming stable oil and gas pricing, future revenues from HBI are expected to increase as additional wells are drilled and begin producing.

Oil and gas operating expenses increased \$105 thousand to \$126 thousand for the nine months ended September 30, 2013. Oil and gas operating expenses are expected to increase as new wells are drilled in the near term.

Selling, General and Administrative Expenses

Selling, general and administrative expenses decreased approximately 22% from \$3.2 million for the first nine months of 2012 to \$2.5 million for the first nine months of 2013 primarily due to cost saving measures at our corporate offices and increased capitalization of personnel and other general and administrative costs at BWI as BWI concentrated its efforts on construction of the Arctic Star plant during 2013. We anticipate that our selling, general and administrative expenses may increase in future periods as we dedicate additional resources to the marketing efforts of BWI and new acquisitions. However, we continue to monitor and minimize our controllable costs.

Depreciation, Depletion and Amortization Expense

Depreciation, depletion and amortization expense increased approximately 127% from \$244 thousand for the first nine months of 2012 to \$555 thousand for the first nine months of 2013, primarily due to depletion of the oil and gas properties of HBI. Depreciation, depletion and amortization expenses are expected to increase in the near term as new wells are drilled and begin producing and the Arctic Star plant is commissioned.

Other Expenses

Other expenses were \$35 thousand in the third quarter 2013, primarily as a result of fees to renew a 20 year easement for lines which were abandoned in place and losses on the sales of assets.

Interest and Other Income

Interest and other income increased approximately 29% from \$1.4 million in the first nine months of 2012 to \$1.8 million in the first nine months of 2013, primarily as a result of the increased interest rate and the recognition of unamortized origination fees on our Global notes receivable, which were partially offset by lower principal balances during the period.

Income Tax Benefit

We did not recognize any income tax expense or benefit in the first nine months of 2013. We recognized an income tax benefit of \$80 thousand in the first nine months of 2012 primarily due to a gain realized upon the settlement of the IRS contingency. The estimated contingency recorded of \$225 thousand was settled in April 2012 for \$152 thousand, resulting in an income tax benefit.

Loss from Discontinued Operations

Our loss from discontinued operations increased from \$302 thousand in the first nine months of 2012 to \$340 thousand in the first nine months of 2013. We continued to incur additional legal costs related to the sold oil and gas properties during the nine months ended September 30, 2013 and 2012. During the third quarter 2013, our Directors' and Officers' insurance policy began paying a portion of these legal fees. In addition, we incurred bad debt expense on a potentially uncollectible oil and gas receivable account during the first nine months of 2012.

Loss on Disposal of Discontinued Operations

We did not recognize any gain or loss on disposal of discontinued operations in the first nine months of 2013. We recognized an additional loss on the 2011 disposal of our Gulf Coast oil and gas properties of \$93 thousand in the first nine months of 2012 as a result of additional purchase price adjustments related to capital expenditures which were incurred prior to the effective date of the sales as well as retained plugging and abandonment costs.

LIQUIDITY AND CAPITAL STRUCTURE

Financial Condition

| | September 30, 2013 | December 31, 2012 |
|-----------------------------|--------------------------|-------------------------|
| (Thousands of dollars) | | |
| Current ratio | 5.95 to 1 | 26.35 to 1 |
| Working capital (1) | \$13,640 | \$19,035 |
| Total debt | \$— | \$— |
| Total cash less debt | \$15,573 | \$19,286 |
| Total stockholders' equity | \$64,755 | \$72,422 |
| Total liabilities to equity | 0.05 to 1 | 0.02 to 1 |

(1) Working capital is the difference between current assets and current liabilities.

Cash on hand was primarily generated from proceeds from our oil and gas property divestitures during 2011, along with a rights offering to our stockholders completed in April 2011. The decrease in our working capital as of September 30, 2013 as compared to December 31, 2012 is primarily due to the repurchase of approximately 33 thousand shares of treasury stock for approximately \$3 million, approximately \$3.7 million for capital expenditures and \$1.7 million in accrued liabilities related to the construction of the Arctic Star plant, which were partially offset by principal payments of \$3.5 million received on the Global 2013 Note receivable.

We used approximately \$3.7 million for capital expenditures during the first nine months of 2013, \$3.2 million of which were for Arctic Star plant construction and \$471 thousand for drilling and completion costs for HBI. We anticipate it will cost a total of approximately \$13 million to complete the construction and commissioning of the Arctic Star plant, of which \$5 million has been spent through September 30, 2013.

We anticipate our cash balance on hand will adequately fund our 2013 operating cash flow. We also anticipate that we will have access to other capital resources, if needed, to fund our planned capital expenditures and other investing activities.

We may continue to deploy cash to acquire or invest in other energy-related businesses, to acquire securities, or for discretionary capital expenditures. We may also decide to pay dividends to our common shareholders, subject to our ability to pay dividends and to a determination by management and our Board of Directors that dividends are in our best interests and those of our shareholders.

We may also seek to raise financing through the issuance of equity, debt and convertible debt instruments, if needed, for utilization of acquisition, development or investment opportunities as they arise. Additionally, we may reduce our ownership interests in any of our investments through strategic sales under certain conditions.

Capital Structure

At September 30, 2013, if our remaining convertible preferred stock were converted we would be required to issue the following amounts of our common stock:

| Instrument | Conversion Price (1) | Shares of Common Stock Issuable at September 30, 2013 |
|---------------------|----------------------|---|
| Series G1 Preferred | \$ 11,200 | 8 |

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| | |
|------------------------------|----|
| Series G2 Preferred \$ 2,688 | 37 |
| Common Stock | |
| Potentially Issued | 45 |
| Upon Conversion | |

(1) Certain conversion prices are subject to adjustment under certain circumstances.

Significant Ownership of our Stock

As of September 30, 2013, Brean Murray Carret Group Inc. (“Brean”) beneficially owned approximately 66% of the combined voting power of our outstanding common stock. This entity is beneficially owned by Wayne Quasha through the AQ, JQ and WQ Trusts. Mr. Alan Quasha, Chairman of the Board of Directors of HKN, is the brother of Wayne Quasha, who is deemed the beneficial owner of Brean, but Mr. Alan Quasha disclaims any beneficial ownership of these shares. Brean is in a position to exercise significant influence over the election of our Board of Directors and other matters.

Cash Flows

Net cash used by operating activities during the nine months ended September 30, 2013 was \$880 thousand, as compared to \$3.5 million in the prior year period. Net cash used by continuing operations decreased from \$2.8 million to \$717 thousand. This decrease was primarily as a result of a \$1.3 million decrease in net loss and an approximately \$800 thousand reduction in cash used for operating capital. Cash used by discontinued operations decreased from \$731 thousand in the prior year period to \$163 thousand in the first nine months of 2013.

Net cash provided by investing activities during the nine months ended September 30, 2013 was \$133 thousand, as compared to cash used of \$15 million in the prior year period. Cash provided by investing activities for the nine months ended September 30, 2013 is primarily due to \$3.7 million in capital expenditures, offset by \$3.5 million in repayments and the \$340 thousand origination fee on the Global 2013 Note. Cash used by investing activities during the nine months ended September 30, 2012 was primarily the result of \$11.7 million of net cash used to fund the Global Loan, a net \$2 million used for our investment in the Gerrity Oil joint venture and \$1.1 million used for capital expenditures.

We used cash for financing activities of approximately \$3 million and \$2.9 million during the nine months ended September 30, 2013 and 2012, respectively, for treasury stock repurchases.

Obligations, Contingencies and Commitments

XPLOR Energy Litigation – Pursuant to a PSA dated as of November 17, 2011 between our subsidiary XPLOR and TPIC, XPLOR sold to TPIC its oil and gas production assets and related operations at its Main Pass 35 field. The closing of the transaction occurred on November 17, 2011 but was effective as of October 1, 2011. On November 21, 2011, TPIC informed XPLOR that they had discovered defects in the salt water disposal system at Main Pass resulting in a salt water spill in the Gulf of Mexico, which had been reported to regulatory authorities.

TPIC has filed a lawsuit against XPLOR in the 236th Judicial District Court, Tarrant County, Texas. The case is styled: *Texas Petroleum Investment Company vs. XPLOR Energy SPV-1, Inc., Richard Cottle, Sarah Gasch, and John Hewitt*. In the lawsuit, TPIC has asserted claims of fraud, fraudulent inducement, negligent misrepresentation, and indemnity related to its purchase of a production platform and associated assets from XPLOR. TPIC's claims focus on alleged salt water system defects, related repairs to the facilities, and purported representations regarding the condition of the platform and associated assets. TPIC is seeking an unstated amount of alleged actual and exemplary damages as well as costs and fees. Although litigation is inherently uncertain, based upon the information known to date, we do not believe TPIC's claims have merit. Accordingly, as of September 30, 2013, we did not record a contingency related to TPIC's allegations as we do not currently believe that it is probable that HKN or XPLOR would be responsible for the costs, fees and damages allegedly incurred by TPIC as a result of its claims, the salt water disposal issues, or third

party or governmental claims, if any, resulting therefrom. We intend to vigorously defend any assertions related to the above lawsuit. Based upon information known to date, the range of estimated loss if TPIC were to prevail on its claims is currently estimated not to exceed \$2.5 million in damages, costs, and fees.

Main Pass Environmental Investigations – In January 2013, we were notified by the Louisiana Department of Environmental Quality (“LDEQ”) of an investigation and potential penalty related to the TPIC allegations of improper salt water disposal at the Main Pass 35 field previously owned by our subsidiary XPLOR Energy SPV-1, Inc. At the time of filing this report on Form 10-Q, the LDEQ had not completed its investigation. In March 2013, we were advised that the U.S. Environmental Protection Agency was undertaking a criminal investigation of the salt water disposal incident. We are not aware of any damage to or spill from the salt water disposal system prior to TPIC’s ownership; accordingly, as of September 30, 2013, we did not record a contingency related to these investigations.

Point Au Fer Lawsuit – During the second quarter 2013, we learned HKN, Inc. was named in a lawsuit filed in the 32nd Judicial District Court for the Parish of Terrebonne, Louisiana by Point Au Fer, L.L.C., and The Roman Catholic Church of the Archdiocese of New Orleans. The case is styled: *Point Au Fer, L.L.C., and The Roman Catholic Church of the Archdiocese of New Orleans v. ExxonMobil Oil Corporation, et al*, No. 169160. In the lawsuit, the plaintiffs have alleged that real property they own in Terrebonne Parish has been environmentally damaged as a result of oil and gas exploration activities of twenty different defendants. The plaintiffs seek damages for testing and remediation of the property, property stigma, loss of use of land and lost profits, civil fruits for defendants trespass, land loss and subsidence, punitive or exemplary damages and attorney's fees. Per Louisiana law, no actual dollar amount of damages has been alleged in the Petition. With specific regard to HKN, Inc., out of over one hundred wells identified in the Petition, HKN, Inc. only drilled one well, the MA Smythe Nelson #1, which was a dry hole. The MA Smythe Nelson #1 was drilled on June 2, 1980 and plugged and abandoned on July 12, 1980. We have and intend to continue to vigorously defend any assertions related to the above lawsuit. Due to the inherent uncertainties of the lawsuit at this time, we cannot accurately predict the ultimate outcome of the matter. Accordingly, at September 30, 2013, we did not record a contingency related to this matter.

Point a la Hache Lawsuit – During the second quarter 2013, we learned XPLOR Energy Operating Company and XPLOR Energy SPV-1, Inc. were named in a lawsuit filed in the 25th Judicial District Court for the Parish of Plaquemines, Louisiana. The case is styled: *Catherine P. Alford et al. v. BP America Production Company, et al.*, Docket No. 60-479. In the lawsuit, eight plaintiffs have sued 25 defendants, alleging that they own and/or use a certain 4,480 acres located in the Pointe a la Hache oil and gas field. Plaintiffs further allege that the property has been contaminated or otherwise damaged by oil and gas exploration and production activities. Per Louisiana law, no actual dollar amount of damages has been alleged in the Petition. Investigation of the underlying factual background is in the preliminary stages but we intend to vigorously defend any assertions related to the above lawsuit. Due to the inherent uncertainties of the lawsuit at this time, we cannot accurately predict the ultimate outcome of the matter. Accordingly, at September 30, 2013, we did not record a contingency related to this matter.

SLFPA-E Litigation – Plaintiffs South Louisiana Flood Protection Authority—East (“SLFPA-E”) filed this lawsuit in Louisiana state court against over 90 oil and gas and pipeline companies. Generally the lawsuit alleges that activities by defendants—primarily but not exclusively the dredging of canals—have made it more difficult for the SLFPA-E to protect the New Orleans metropolitan area from flooding. Defendants have removed the case to federal court, but the plaintiff seeks to remand the case back to state court. Until that issue is resolved, there is no pending discovery or other activity in the case. The petition alleges that HKN, Inc. is "by virtue of [one or more of] mergers, acquisitions, name changes, etc., responsible for" the actions of Tejas Power Corporation, which is alleged to have obtained in the 1980s certain dredging permits and rights of way. HKN, Inc. disputes that it is responsible for any actions of Tejas Power Corporation. The public record appears to suggest that Tejas Power Corporation may have been a subsidiary of Harken Oil and Gas, Incorporated (a previous name of HKN, Inc.) for a few years in the 1980s and 1990s. However, there appears to be nothing to indicate that HKN, Inc. would have liability for the actions of Tejas Power Corporation, which continued to exist after HKN, Inc. no longer had any interest in Tejas Power Corporation. Due to the inherent uncertainties of the lawsuit at this time, we cannot accurately predict the ultimate outcome of the matter. Accordingly, at September 30, 2013, we did not record a contingency related to this matter.

Louisiana Limited Scope Audit – In April 2012, we received notice from the State of Louisiana’s Department of Revenue that our discontinued oil and gas subsidiary, XPLOR Energy Operating Company, was the subject of a limited scope sales tax audit focused on the company’s on-site use and consumption of lease gas in connection with its lease, gathering and pipeline operations from January 1, 2006 through June 30, 2009. The Louisiana Department of Revenue issued a preliminary assessment, or “Notice of Proposed Tax Due,” preliminarily assessing sales tax of \$194 thousand and related penalties and interest of \$142 thousand, resulting in a total assessment of \$336 thousand. In July 2012, we filed an audit protest with the Louisiana Department of Revenue challenging the preliminary assessment, as we do not agree with the legal basis of the assessment or the methodology in which the taxes were calculated and plan to vigorously defend our position. Due to the inherent uncertainties of the audit protest and preliminary assessment, we cannot accurately predict the ultimate outcome of the matter. Accordingly, at September 30, 2013, we did not record a contingency related to this matter. In the event of a negative outcome, the potential loss related to the audit and preliminary assessment is currently estimated not to exceed \$336 thousand.

BWI Contingency – BWI has a contingent liability of \$800 thousand related to an obligation which may be payable upon the conclusion of certain performance events related to its weathered lagoon plant. There were no changes to the BWI liability recorded during the nine months ended September 30, 2013.

Off-Balance Sheet Arrangements - As part of our ongoing business, we do not participate in transactions that generate relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities ("SPEs"), which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. As of September 30, 2013, we were not involved in any unconsolidated SPE transactions and we have no off-balance sheet arrangements.

Treasury Stock – At September 30, 2013 and December 31, 2012, we held no shares of treasury stock. In January 2013, we announced that our Board of Directors authorized the cancellation of our September 2005 stock repurchase plan and authorized a new stock repurchase program which allows us to buy back up to 45 thousand shares of our common stock. During the nine months ended September 30, 2013, we purchased and retired approximately 33 thousand shares of our common stock in privately negotiated transactions for approximately \$3 million. As of September 30, 2013, approximately 12 thousand shares remained available for repurchase under our repurchase program.

Adequacy of Capital Sources and Liquidity

We believe that we will have the ability to provide for our operational needs, our planned capital expenditures and possible investments through projected operating cash flow and cash on hand. Our operating cash flow has been adversely affected by the sale of our oil and gas properties and delays in the development of our HBI oil and gas assets, as well as the fact that BWI has not begun generating revenue. To address this challenge, we continue to minimize our controllable costs and generate low-risk interest income until BWI begins revenue generation. We also continue to seek operating assets which will generate cash from operations such as HBI. We expect to generate increased revenues from HBI as the operators further develop the Niobrara and Bakken shale projects, and we

anticipate operating revenues from our BWI segment to begin in the first half of 2014. Should projected operating cash flow not materialize, we may reduce BWI capital expenditures and future investments and/or consider the issuance of debt, equity and convertible debt instruments, if needed, for utilization in planned capital expenditures and new energy-based investment opportunities. All of our HBI and BWI capital expenditures are purely discretionary and may be curtailed or delayed at any time. We may also reduce our ownership interest in our investments through strategic sales.

We had no debt outstanding at September 30, 2013. If we seek to raise other equity or debt financing to fund capital expenditures or other acquisition and development opportunities, those transactions may be affected by the market value of our common stock. If the price of our common stock declines, our ability to utilize our stock either directly or indirectly through convertible instruments for raising capital could be negatively affected. Further, raising additional funds by issuing common stock or other types of equity securities could dilute our existing stockholders, which dilution could be substantial if the price of our common stock decreases. Any securities we issue may have rights, preferences and privileges that are senior to our existing equity securities. Borrowing money may also involve pledging some or all of our assets.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

The Company maintains disclosure controls and procedures that are designed to ensure that information required to be disclosed in its filings with the SEC are recorded, processed, summarized and reported within the time period specified in the SEC's rules and forms, and that such information is accumulated and communicated to management, including its Chief Executive and Chief Financial Officers, as appropriate, to allow timely decisions regarding required disclosure based on the definition of "disclosure controls and procedures" as defined in Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934, as amended (the "Exchange Act"). As of the end of the period covered by this report, and under the supervision and with the participation of management, including the Company's Chief Executive Officer and Chief Financial Officer, the Company evaluated the effectiveness of the design and operation of these disclosure controls and procedures. Based on this evaluation, the Company's Chief Executive Officer and Chief Financial Officer have concluded that the Company's disclosure controls and procedures were effective as of the end of the period covered by this quarterly report.

Changes in Internal Control over Financial Reporting

There have been no significant changes in the Company's internal control over financial reporting that occurred during the period ended September 30, 2013 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II – OTHER INFORMATION**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

(c) The following table provides information about purchases by us during the three months ended September 30, 2013, of our common stock.

| Period | (a) Total Number of Shares Purchased | (b) Average Price Paid per Share | (c) Total Number of Shares Purchased as Part of Publicly Announced Programs | (d) Maximum Number of Shares That May Yet Be Purchased Under the Plans or Programs |
|--|--|--|---|---|
| July 1, 2013 through July 31, 2013 | — | \$ — | — | 11,611 |
| August 1, 2013 through August 31, 2013 | — | \$ — | — | 11,611 |
| September 1, 2013 through September 30, 2013 | — | \$ — | — | 11,611 |
| Total | — | \$ — | — | 11,611 |

Item 6. Exhibits

EXHIBIT INDEX

Exhibit

*31.1 Certificate of the Chief Executive Officer of HKN, Inc. pursuant to section 302 of the Sarbanes-Oxley Act of 2002 (“S.O. Act”)

*31.2 Certificate of the Chief Financial Officer of HKN, Inc. pursuant to section 302 of the S.O. Act

*32.1 Certificate of the Chief Executive Officer of HKN, Inc. pursuant to section 906 of the S.O. Act

*32.2 Certificate of the Chief Financial Officer of HKN, Inc. pursuant to section 906 of the S.O. Act

*101.INS** XBRL Instance

*101.SCH** XBRL Taxonomy Extension Schema

*101.CAL** XBRL Taxonomy Extension Calculation

*101.DEF** XBRL Taxonomy Extension Definition

*101.LAB** XBRL Taxonomy Extension Labels

*101.PRE** XBRL Taxonomy Extension Presentation

* Filed herewith

** XBRL information is furnished and not filed or a part of a registration statement or prospectus for purposes of sections 11 or 12 of the Securities Act of 1933, as amended, is deemed not filed for purposes of section 18 of the Securities Exchange Act of 1934, as amended, and otherwise is not subject to liability under these sections.

HKN, INC.

SIGNATURES

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

HKN, Inc.
(Registrant)

Date: November 12, 2013

By: /s/ Sarah B. Gasch
Sarah B. Gasch
Executive Vice
President and
Chief Financial Officer