

HKN, Inc.
Form 10-K
March 06, 2014

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

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

For the fiscal year ended December 31, 2013

☐ **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

(Zip Code)

(Address of principal executive offices)

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

Securities registered pursuant to Section 12(b) of the Act:

Title of each class:

Name of each exchange on which registered:

Common Stock, Par Value \$0.01 Per Share None

Securities registered pursuant to Section 12(g) of the Act: **None**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes ☐ No ☒

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934. Yes ☐ No ☒

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

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

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

Large accelerated filer ☐ Accelerated filer ☐ Non-accelerated filer ☐ Smaller reporting company ☒

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes ☐ No ☒

The aggregate market value of the voting common stock, par value \$0.01 per share, held by non affiliates of the Registrant as of June 30, 2013 was approximately \$10.7 million. For purposes of the determination of the above stated amount only, all directors, executive officers and 5% or more stockholders of the Registrant are presumed to be affiliates.

The number of shares of common stock, par value \$0.01 per share, outstanding as of February 28, 2014 was 397,954.

TABLE OF CONTENTS

	<u>Page</u>
PART I.	
ITEM 1. Business	4
ITEM 1A. Risk Factors	11
ITEM 1B. Unresolved Staff Comments	12
ITEM 2. Properties	12
ITEM 3. Legal Proceedings	12
ITEM 4. Mine Safety Disclosures	13
PART II.	
ITEM 5. Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities	14
ITEM 6. Selected Financial Data	15
ITEM 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations	15
ITEM 7A. Quantitative and Qualitative Disclosures about Market Risk	25
ITEM 8. Financial Statements and Supplementary Data	26
ITEM 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure	55
ITEM 9A. Controls and Procedures	56
PART III.	
ITEM 10. Directors, Executive Officers and Corporate Governance	57
ITEM 11. Executive Compensation	59
ITEM 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters	62
ITEM 13. Certain Relationships and Related Transactions and Director Independence	63
ITEM 14. Principal Accounting Fees and Services	64

PART
IV.

ITEM 15. Exhibits, Financial Statement Schedules

65

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 Financial Statements and the related notes that appear elsewhere in this report. 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.

PART I

ITEM 1. 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 believe these assets present significant growth potential for us.

We were incorporated in 1973 in the State of California and reincorporated in 1979 in the State of Delaware. Our corporate offices are located at 180 State Street, Suite 200, Southlake, Texas 76092. Our telephone number is (817) 424-2424, and our web site is accessed at www.hkninc.com. We make available, free of charge, on our website, our Code of Business Conduct and Ethics, Code of Ethics for Senior Financial Officers, Audit Committee Charter and Nominating Committee Charter as well as our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and all amendments to those reports as soon as is reasonably practical after such materials are electronically filed with, or furnished to, the Securities and Exchange Commission (“SEC”). You can also access our filings with the SEC at <http://www.sec.gov>.

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 completing the construction of 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. Construction began during the second quarter of 2013 and is anticipated to be completed during the first quarter of 2014, at which time the plant will be shipped to the North Slope. During the first quarter of 2014, Arctic Star executed a lease for a site in Deadhorse, Alaska to install and operate its plant. Installation and commissioning of the plant is anticipated to be completed during the second quarter 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 was to build its Arctic Star plant, BWI hopes to deploy this plant or parts of the plant once the Arctic Star plant is commissioned in 2014. 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 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 represent significant near-term growth potential and align well with our long term investment goals. 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 balance sheets or consolidated statements of operations.

Colombian Energy Investment – Global Energy Development PLC

At December 31, 2013 and 2012, we held an investment in Global through our ownership of approximately 35% and 34%, respectively, of Global’s ordinary shares and notes 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. 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.

Ordinary Shares - We account for our ownership of Global shares as an available for sale investment. During 2013, we purchased an additional 105 thousand shares of Global for \$171 thousand, increasing our ownership from 34.22% to 34.51%. At December 31, 2013 and 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):

	December 31, 2013	December 31, 2012
Shares of Global Stock Held by HKN	12,462	12,357

Closing Price of Global Stock	£ 0.94	£ 1.18
Foreign Currency Exchange Rate	1.6574	1.6259
Market Value of Investment in Global	\$ 19,312	\$ 23,607

The foreign currency translation adjustment of approximately \$160 thousand and the unrealized loss on investment of \$4.6 million for these changes in market value between the two periods were recorded to other comprehensive income in stockholders' equity during the year ended December 31, 2013.

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 year ended December 31, 2013, we received \$5 million in principal payments from Global. Accrued interest on the outstanding principal balance is due on each quarterly principal payment date. During the year ended December 31, 2013, we received approximately \$2 million 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 \$177 thousand was deferred and presented net of our long term notes receivable at December 31, 2013. The remaining deferred transaction fee will be recognized over the life of the loan.

Oil and Gas Operations

As a result of the 2011 sale of our oil and gas properties as discussed in Note 8 - “Discontinued Operations” in the Notes to Consolidated Financial Statements contained in Part II, Item 8 of this Annual Report on Form 10-K, any remaining Gulf Coast oil and gas and coalbed methane activities are included as discontinued operations on the consolidated balance sheets, consolidated statements of operations and consolidated statements of cash flows for all periods presented. As of December 31, 2012, we reflected our 50% share related to our proportionately consolidated Gerrity Oil investment that we acquired in the third quarter of 2012, which is accounted for under the successful efforts method of accounting. Following the dissolution of the Gerrity Oil joint venture, effective January 1, 2013, we began consolidating 100% of the oil and gas operations of HBI.

Oil and Gas Development and Production Operations

As of December 31, 2013 and 2012, all of our non-operated oil and gas development and production operations were located in the United States. Upon our initial investment in Gerrity Oil in July 2012, we acquired working interests and royalty interests of approximately 123 and 32 net acres, respectively, in the Bakken region of North Dakota and 14 and 3 net acres, respectively, in the Niobrara Basin region of Colorado, which was comprised of 18 gross producing working interest wells and 5 gross producing royalty interest wells. During 2012, we acquired additional working interests and royalty interests of approximately 107 and 59 net acres, respectively, at a total average cost of approximately \$5 thousand per net acre.

During 2013, we realized net decreases of approximately 7 net acres for both working interest and royalty interests, comprising of 2 gross producing wells, as a result of title verification and changes in net ownership interest being recognized by the operator’s division orders. We purchased no additional acreage during 2013. As of December 31, 2013, our oil and gas assets are comprised of working interests and royalty interests of 225 and 84 net acres, respectively, in the Bakken region and 12 and 3 net acres, respectively, in the Niobrara region. We also elected to participate in the completion of 23 and 12 producing gross wells during 2013 and 2012, respectively, in which we have a working interest, with a 97% success rate in the Bakken formations since our initial investment. As of

December 31, 2013, we owned working interests in 80 gross oil and gas wells that consisted of 52 that were producing, 8 that were in the process of being drilled and completed and 20 that were permitted. We owned royalty interests in 25 gross oil and gas wells, consisting of 21 that are producing and 4 that were in the process of being drilled and completed, as of December 31, 2013.

We engage in crude oil and natural gas exploration and production by participating on a non-operated, proportionate basis alongside third-party interests in wells drilled and completed in spacing units that include our acreage. We depend on drilling partners to propose, permit and initiate the drilling of wells. Prior to commencing drilling, our partners are required to provide all owners of crude oil, natural gas and mineral interests within the designated spacing unit the opportunity to participate in the drilling costs and revenues of the well to the extent of their pro-rata share of such interest within the spacing unit. We assess each drilling opportunity on a case-by-case basis and participate in wells that we expect to meet our return thresholds based upon our estimates of ultimate recoverable crude oil and natural gas, expertise of the operator and completed well cost from each project, as well as other factors. At the present time, we expect to participate, pursuant to our working interest, in substantially all, if not all, of the wells proposed to us.

Oil and Gas Marketing and Customers

We rely on our operating partners to market and sell our production. We understand that our partners generally sell our production to a variety of purchasers at prevailing market prices under separately negotiated short term contracts. The price at which oil production is sold generally is tied to the spot market for crude oil. Natural gas produced in the Bakken formation has a higher dollar value than other natural gas production areas due to its higher wet gas content. As a result, the average differential based on actual Bakken sales during 2013 was approximately \$3 per mcf above Henry Hub published pricing.

Our operating partners are comprised of 10 different exploration and development companies, which range from large publicly-traded companies to small, privately owned companies. We do not believe that the loss of any single operator would have a material adverse effect on our company as a whole.

Oil and Gas Properties and Locations

Production and Revenues – We use the sales method to recognize our oil and gas revenues. Under this method, revenues are recognized based on our interests of the actual volumes of gas and oil sold to purchasers. The following table shows, for the periods indicated, operating information attributable to our oil and gas interests, all of which are located in the United States:

	2013	2012
Production:		
Natural Gas (Mcf)	14,283	6,069
Oil (Bbls)	11,114	4,308
Barrel of Crude Oil Equivalent (BOE)	13,494	5,319
Revenues:		

Edgar Filing: HKN, Inc. - Form 10-K

Natural Gas	\$96,000	\$35,000
Oil	997,000	359,000
Total	\$1,093,000	\$394,000

Unit Prices:

Natural Gas (per Mcf)	\$6.72	\$5.77
Oil (per Bbl)	\$89.71	\$83.33
Production costs per BOE	\$7.14	\$1.79

Depletion of Oil and Gas Properties – Our depletion expense is driven by many factors including certain exploration costs involved in the development of producing reserves, production levels and estimates of proved reserve quantities and future developmental costs. The following table presents our depletion expenses during 2013 and 2012:

	2013	2012
Depletion of crude oil and natural gas properties	\$479,000	\$212,000
Depletion per BOE	\$35.50	\$39.86

Acreage and Wells – At December 31, 2013, we owned working interests in the following oil and gas wells and acreage.

Country	Gross Wells		Net Wells		Developed Acreage		Undeveloped Acreage	
	Oil	Gas	Oil	Gas	Gross	Net	Gross	Net
United States	79	1	0.45	0.01	5,977	231	360	6
Total	79	1	0.45	0.01	5,977	231	360	6

As a non-operator, we are subject to lease expirations if an operator does not commence the development of operations within the agreed terms of our leases, generally not exceeding five years. In addition, our leases typically provide that the lease does not expire at the end of the primary term if drilling operations have been commenced. While we generally expect to establish production from most of our acreage prior to expiration of the applicable lease terms, there can be no such guarantee we can do so. The approximate expiration of our gross and net acres which are not held by production and thus subject to expire between 2014 and 2018 and thereafter, are set forth below:

Year Ended	Acres Expiring	
	Gross	Net
December 31, 2014	—	—
December 31, 2015	240	3
December 31, 2016	—	—
December 31, 2017	120	3
December 31, 2018 and thereafter	—	—
Total	360	6

We believe that we have satisfactory title to or rights in all of our producing properties. As is customary in the oil and gas industry, minimal investigation of title is made at the time of acquisition of undeveloped properties. We are currently in the process of filing assignments and obtaining division orders for Gerrity Oil and HBI, which could result in changes to our working interests and acreage. We expect that any difference between these division orders

and what was represented at the time of acquisition to be immaterial.

Drilling Activity – The following table sets forth the number of gross and net productive and non-productive wells for our drilling and development activity during 2012 and 2013. The following table does not include the 8 gross wells that were in the process of being drilled, awaiting completion or awaiting flowback subsequent to fracture stimulation at December 31, 2013. Subsequent to December 31, 2013, two of these 8 gross wells have reported production to date and ten additional wells have been spud. We have classified all wells drilled to date targeting the Bakken formation as developmental wells. As of December 31, 2013, we have had a 97% success rate in our Bakken wells.

Number of Gross Wells						
	Exploratory		Developmental		Total	
	Productive	Non-productive	Productive	Non-productive	Productive	Non-productive
2012	—	—	12	—	12	—
2013	—	—	22	1	22	1
Total	—	—	34	1	34	1

Number of Net Wells						
	Exploratory		Developmental		Total	
	Productive	Non-productive	Productive	Non-productive	Productive	Non-productive
2012	—	—	0.02	—	0.02	—
2013	—	—	0.15	0.01	0.15	0.01
Total	—	—	0.17	0.01	0.17	0.01

Reserve Information – The process of estimating oil and gas reserves is complex and requires significant judgment. As a result, our reserve report has been prepared by qualified third-party engineers, as defined by the Society of Petroleum Engineers' standards. We also require that the independent third-party reservoir engineers ensure that the proved reserve estimates are determined in accordance with SEC definitions and guidance. We currently do not have any employees that have professional training or experience in the geological or reserve engineering field. We rely on an independent consultant to provide a final review of our reserve report and the assumptions relied upon in such report. This consultant has a B.S in Geology, 25 years of experience in the oil and gas industry and is a member of the American Society of Petroleum Geologists. He has evaluated and worked on a number of domestic and international unconventional shale oil plays.

Our domestic reserve estimates at December 31, 2013 were prepared by Moyes and Co., which is an independent, registered member of a professional engineering society in the state of Texas. Our domestic reserve estimates at December 31, 2012 were prepared by Gleason Engineering, which is an independent, registered member of a professional engineering society in the state of Texas, for a portion of our producing properties representing 81% of all our 2012 production. No nonproducing or undeveloped locations were evaluated and were not included in the 2012 reserve report. We internally tested these reports to ensure the inputs and assumptions used are reasonable and have reviewed the qualifications of both Moyes and Co. and Gleason Engineering. In addition, the consultant reviewed the published regional geologic studies, wells logs, geological data, well histories, filed rules, oil and gas production data found in the databases of the North Dakota Industrial Commission and Colorado Oil and Gas Conservation Commission and well performance data used by the reserve engineer in order to access the reasonableness of the reserve estimates.

Proved oil and gas reserves are defined as the estimated quantities of crude oil, natural gas, and natural gas liquids which geological and engineering data demonstrate with reasonable certainty to be recoverable in future years from known reservoirs under existing economic and operating conditions. Reservoirs are considered proved if economic productivity is supported by either actual production or conclusive formation tests. The area of a reservoir considered

proved includes that portion delineated by drilling and defined by gas-oil and/or oil-water contacts, if any, and the immediately adjoining portions not yet drilled, but which can be reasonably judged as economically productive on the basis of available geological and engineering data. In the absence of information on fluid contacts, the lowest known structural occurrence of hydrocarbons controls the lower proved limit of the reservoir. Reserves which can be economically produced through application of improved recovery techniques are included in the “proved” classification when either successful testing by a pilot project or the operation of an installed program in the reservoir provides support for the engineering analysis on which the project or program was based.

The reserves set forth in the Moyes and Co. report for the properties were estimated utilizing generally accepted engineering practices. An analysis and interpretation of production history was utilized to make the estimate of recoverable reserves from the captioned leases. In accordance with applicable requirements of the SEC, estimates of our net proved reserves and future net revenues are made using average prices at the beginning of each month in the 12-month period prior to the date of such reserve estimates and are held constant throughout the life of the properties.

The reliability of reserve information is considerably affected by several factors. Reserve information is imprecise due to the inherent uncertainties in, and the limited nature of, the data upon which the estimating of reserve information is predicated. Moreover, the methods and data used in estimating reserve information are often necessarily indirect or analogical in character rather than direct or deductive. Furthermore, estimating reserve information by applying generally accepted petroleum engineering and evaluation principles involves numerous judgments based upon the engineer's educational background, professional training and professional experience. The extent and significance of the judgments to be made are, in themselves, sufficient to render reserve information inherently imprecise.

The following table sets forth our estimated proved reserves based on the SEC rules defined in Rule 4.10(a) of Regulation S-X. Immaterial interests were not included in our reserve estimates.

	(Unaudited)	
	Total (1)	
	Oil	Gas
	(Barrels)	(Mcf)
	(in thousands)	
Proved reserves as of December 31, 2012:		
Proved developed reserves	17	29
Proved undeveloped reserves (2)	—	—
Total Proved Reserves as of December 31, 2012	17	29
Proved reserves as of December 31, 2013:		
Proved developed reserves	52	73
Proved undeveloped reserves	145	187
Total Proved Reserves as of December 31, 2013	197	260

(1) All reserves were held within the United States for the years ended December 31, 2013 and 2012.

(2) We did not obtain an evaluation of proved undeveloped reserves as of December 31, 2012.

During 2012, we incurred approximately \$502 thousand of capital expenditures for drilling activities and approximately \$2.5 million for property acquisitions, all of which directly contributed to the increase in our proved developed reserves during 2012. 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 included in this reserve report. At December 31, 2013, we obtained a third party reserve

valuation for all our proved reserves. This report resulted in an overall increase of proved reserves of approximately 180 thousand bbls and 231 thousand mcfs. This consisted of an increase to our proved developed reserves of approximately 35 thousand bbls and 44 thousand mcfs, and an increase to our proved undeveloped reserves of approximately 145 thousand bbls and 187 thousand mcfs.

During 2013, we incurred approximately \$1.4 million of capital expenditures for drilling activities, which also contributed to a portion of this increase in our proved developed reserves. We recognize proved undeveloped reserves within one offset location from analogous wells with established commercial production. We performed an analysis of producing Bakken wells in the counties we hold ownership interests, and developed a type-curve based on the statistical analysis of the estimated recoveries to determine the estimated reserves for proved undeveloped locations. Of our proved oil and gas reserves 98% are concentrated in the Bakken formation in North Dakota. We expect that any expansion of our proved reserve base will continue to be heavily focused in the Bakken formation.

2014 Outlook

Our objective in 2014 is to continue to build the value of our portfolio of assets through:

- Identifying, developing, operating 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.

Employees

At December 31, 2013, we had 16 employees, 15 of which were full time employees. We have experienced no work stoppages or strikes as a result of labor disputes and consider relations with our employees to be satisfactory. We maintain group medical, dental, vision, life, long-term disability and long-term care insurance plans for our employees.

ITEM 1A. RISK FACTORS

Not applicable.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

Our corporate offices, are located in Southlake, Texas. We have a lease for approximately 5,826 square feet in Southlake, Texas, which runs through August 2017.

In January 2013, our Arctic Star subsidiary, part of our BWI operating segment, entered into a lease of approximately 240 square feet of office space in Anchorage, Alaska, on a month to month basis.

See “Liquidity and Capital Structure – Obligations, Contingencies and Commitments – Consolidated Contractual Obligations” contained in Part II, Item 7, Management’s Discussion and Analysis of Financial Condition and Results of Operations for more information.

See Item 1. “Business” for a discussion of our non-operated interests in oil and gas properties.

ITEM 3. LEGAL PROCEEDINGS

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-I, 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 December 31, 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 XPLO 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.

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 December 31, 2013 we did not record a contingency related to this matter.

Point a la Hache Lawsuit – During the second quarter 2013, we learned XPLORE Energy Operating Company and XPLORE 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 December 31, 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 December 31, 2013, we did not record a contingency related to this matter.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES**Price Range of Common Stock**

Beginning March 1991 until June 2007, our common stock was listed on the American Stock Exchange and traded under the symbol HEC. In June 2007, the trading symbol of our common stock was changed to the symbol HKN. The American Stock Exchange was acquired by NYSE Euronext during 2008 and renamed NYSE Amex. Our common stock was listed on the NYSE Amex until October 26, 2012 when we voluntarily delisted from the exchange. Our common stock is currently traded on the Over the Counter Bulletin Board and quoted on the OTCQB marketplace under the symbol HKNI. At December 31, 2013, there were 64 holders of record of our common stock.

The following table sets forth, for the periods indicated, the reported high and low closing sales prices of our common stock:

		Prices (1)	
		High	Low
2012 --	First Quarter	\$106.80	\$86.00
	Second Quarter	98.00	89.60
	Third Quarter	94.40	75.20
	Fourth Quarter	86.80	54.95
2013 --	First Quarter	\$95.25	\$74.50
	Second Quarter	90.00	78.00
	Third Quarter	79.00	68.00
	Fourth Quarter	80.00	65.00

(1) Prices prior to November 5, 2012 have been restated to reflect our one-for-forty reverse stock split which was effective October 30, 2012.

Dividends

While we have not paid any cash dividends on common stock since our organization, we may decide to pay dividends in the future 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. Dividends may not be paid to holders of common stock prior to all dividend obligations related to our Series G1 preferred stock and Series G2 preferred stock being satisfied.

For discussion of dividends paid to holders of our preferred stock and the terms of our preferred stock outstanding, see “Payments of Preferred Stock Dividends and Preferred Stock Redemptions” contained in Item 7, Management’s Discussion and Analysis of Financial Condition and Results of Operations.

Equity Compensation Plans

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, employees of HKN and its subsidiaries and nonemployee directors of BWI, 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. See Note 11 – “BWI Stock Compensation” in the Notes to Consolidated Financial Statements contained in Part II, Item 8 of this Annual Report on Form 10-K for further information about our equity compensation plan.

Information on Share Repurchases

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 repurchase up to 45 thousand shares of our common stock.

We had no additional purchases of our common stock by us pursuant to our previously announced share repurchase program during the three months ended December 31, 2013. During the year ended December 31, 2013, we purchased and retired approximately 33 thousand shares of our common stock. As of December 31, 2013 we had approximately 12 thousand shares remaining that may be purchased under this program.

ITEM 6. SELECTED FINANCIAL DATA

Not applicable.

ITEM 7. 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 financial statements and the related notes that appear elsewhere in this report. 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.

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

Recent Developments

Additional Investments

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 2013, we continued to invest in our emulsions-breaking technology through BWI and the construction of the Arctic Star plant, to participate in the development of the Bakken and Niobrara shale plays through HBI, and to support our investments in Global.

Continued Investment in BWI

During the year ended December 31, 2013, BWI invested approximately \$7.1 million in the Arctic Star plant, its initial project to commercialize its emulsions-breaking technology. Arctic Star is currently in the process of completing the construction of 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. Construction began during the second quarter of 2013 and is anticipated to be completed during the first quarter of 2014, at which time the plant will be shipped to the North Slope. During the first quarter of 2014, Arctic Star executed a lease for a site in Deadhorse, Alaska to install and operate its plant. Installation and commissioning of the plant is anticipated to be completed during the second quarter 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 participation in the drilling, completion, operation and maintenance of oil and gas wells. During the year ended December 31, 2013, we invested approximately \$1.4 million 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 \$177 thousand was deferred and presented net of our long term notes receivable at December 31, 2013.

During 2013, we purchased an additional 105 thousand shares of Global for \$171 thousand, increasing our ownership from 34.22% to 34.51%.

Other Matters

Share Repurchases

During 2013, we repurchased and retired approximately 33 thousand shares of our common stock for a total of approximately \$3 million.

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 balance sheets and consolidated statements of operations for all periods presented.

CRITICAL ACCOUNTING ESTIMATES AND ASSUMPTIONS

Our consolidated 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 35% 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 at least semi-annually and 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 year ended December 31, 2013. We currently have a cumulative unrealized gain position on our investment in Global of \$8.8 million.

Amortizing Intangible and Long-Lived Asset Impairment Analysis – We review our amortizing intangible assets, currently consisting of patents acquired in connection with our investment in BWI, and our long-lived assets, consisting of BWI's Arctic Star plant under development, the weathered lagoon plant and HBI's producing wells, on an annual basis as well as when events or changes in circumstances indicate the carrying amount of the assets may not be fully recoverable. Recoverability is measured by a comparison of the carrying value of the asset to its undiscounted future cash flows over the life of the related asset. If it is determined that an asset is not recoverable, an estimated fair value of the asset is determined. Any excess of the carrying value of the asset over its fair value is recognized as an impairment loss. Considerable management judgment is necessary to evaluate the impact of operating changes and to estimate asset useful lives and future cash flows. The actual results may vary significantly from these estimates once the BWI assets are placed into service. If actual results are not consistent with our estimates and assumptions used to calculate estimated future cash flows, we may be exposed to impairment losses that could be material. We have not recognized any impairment losses in the years ended December 31, 2012 or 2013.

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 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 years ended December 31, 2013 and 2012 included in the accompanying consolidated financial statements.

Results of Continuing Operations for the Year Ended December 31, 2013 Compared to December 31, 2012

Our loss from continuing operations decreased approximately 61% from \$2.5 million in 2012 to \$1.0 million in 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 \$699 thousand from \$394 thousand for 2012 to \$1.1 million for 2013. The increase was due to acquiring our interest in the HBI properties in July 2012, the drilling of 22 additional wells, and higher oil and gas volumes and higher oil and gas prices received during 2013.

Oil revenues increased \$638 thousand to \$997 thousand and comprised 91% of our total revenues for the year ended December 31, 2013. We realized a 8% increase in oil prices received, increasing from an average of \$83.33 per barrel for 2012 to \$89.71 per barrel for 2013. Oil production for 2013 was approximately 11 thousand bbls, approximately 86% of which came from our non-operated properties located in the Bakken.

Gas revenues increased \$61 thousand to \$96 thousand and comprised 9% of our total revenues for 2013. We realized a 16% increase in gas prices received, increasing from an average of \$5.77 per mcf in 2012 to \$6.72 per mcf in 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 wet gas content. Gas production for 2013 was approximately 14 thousand mcf, approximately 62% 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 \$160 thousand to \$209 thousand for 2013, as a result of a full year of operations during 2013 as well as the drilling of 22 new wells. 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 21% from \$4.4 million for 2012 to \$3.5 million for 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 58% from \$469 thousand for 2012 to \$743 thousand for 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 increased from \$2 thousand in 2012 to \$36 thousand in 2013, primarily as a result of fees paid related to assets which were abandoned in place back in 1999.

Interest and Other Income

Interest and other income increased approximately 23% from \$1.9 million in 2012 to \$2.4 million in 2013, primarily as a result of the increase in the interest rate from 12.5% to 12.75% and the recognition of unamortized origination fees on our restructured Global notes receivable as well as consideration received from the lease of properties, which were partially offset by lower principal balances outstanding on the Global notes during the period.

Income Tax Benefit

We did not recognize any income tax expense or benefit in 2013. We recognized an income tax benefit of \$80 thousand in 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 slightly from \$467 thousand in 2012 to \$471 thousand in 2013. We continue to incur additional legal costs related to litigation and regulatory matters for the sold oil and gas properties during 2013 and 2012, although our insurance policy began paying a portion of these legal fees during the third quarter. In addition to these legal fees, we incurred bad debt expense on a potentially uncollectible oil and gas receivable account during 2012.

Loss on Disposal of Discontinued Operations

We did not recognize any gain or loss on disposal of discontinued operations in 2013. We recognized an additional loss on the 2011 disposal of our Gulf Coast oil and gas properties of \$157 thousand in 2012 as a result of capital expenditures which were incurred prior to the effective date of the sales as well as retained plugging and abandonment costs which were higher than anticipated.

Accrual of Dividends Related to Preferred Stock

All of our preferred stock issues contain dividend provisions. Dividends related to all of our preferred stock are cumulative and may be paid in cash or common stock at our option, depending on the respective preferred agreement. We accrue the dividends at their cash liquidation value and reflect the accrual of dividends as a reduction to net income (loss) to arrive at net income (loss) attributed to common stock. Accrual of dividends related to preferred stock for each of the two years ended December 31, are as follows:

	2013	2012
Series G1	\$8,000	\$8,000
Series G2	8,000	8,000
Total	\$16,000	\$16,000

Payments of Preferred Stock Dividends

At December 31, 2013 and 2012 the following shares of our Preferred Stock issuances were outstanding:

	2013	2012
Series G1	1,000	1,000
Series G2	1,000	1,000
Total	2,000	2,000

Payment of Preferred Stock Dividends -- During both 2013 and 2012, we paid the accrued dividends related to the Series G1 and Series G2 preferred stock with shares of our common stock and issued 4 shares of our common stock as payment for the accrued dividends. The difference between the fair value of the shares of our common stock and the carrying value of the dividend liability, net of withholding taxes paid on behalf of the preferred shareholders, is considered a debt extinguishment gain of \$16 thousand and \$16 thousand in 2013 and 2012, respectively, and is reflected as a gain on payments of dividends of preferred stock as an increase to net income (loss) to arrive at net income (loss) attributed to common stock. The net effect of these payments of preferred stock dividends for the two years ended December 31, is as follows:

	2013	2012
Series G1	\$8,000	\$8,000
Series G2	8,000	8,000
Total	\$16,000	\$16,000

LIQUIDITY AND CAPITAL STRUCTURE

Financial Condition

	December 31, 2013	December 31, 2012
(Thousands of dollars)		
Current ratio	5.76 to 1	26.35 to 1
Working capital (1)	\$12,275	\$19,035
Total debt	\$—	\$—
Total cash less debt	\$14,302	\$19,286
Total stockholders' equity	\$63,577	\$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 and the rights offering to our stockholders, both of which occurred during 2011. These proceeds have been used to develop our BWI and HBI assets as well as to support our Global investment. The decrease in our working capital as of December 31, 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 and approximately \$6.6 million for capital expenditures, which were partially offset by principal payments of \$5 million received on the Global 2013 Note receivable.

We used approximately \$6.6 million for capital expenditures during 2013, \$5.9 million of which were for Arctic Star plant construction and \$598 thousand for drilling and completion costs for HBI. We anticipate it will cost a total of approximately \$13.7 million to complete the construction and commissioning of the Arctic Star plant, of which \$9 million has been spent through December 31, 2013.

We anticipate our cash balance on hand will adequately fund our 2014 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.

At December 31, 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 December 31, 2013
Series G1 Preferred	\$ 11,200	8
Series G2 Preferred	\$ 2,688	37
Common Stock Potentially Issued Upon Conversion		45

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

Significant Ownership of our Stock

As of December 31, 2013, Everest Hill Group, Inc. ("Everest Hill") beneficially owned approximately 66% of the combined voting power of our outstanding common stock. Everest Hill was formerly known as Brean Murray Carret Group, Inc., which changed its name during 2013. 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 Everest Hill, but Mr. Alan Quasha disclaims any beneficial ownership of these shares. Everest Hill 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 year ended December 31, 2013 was \$622 thousand, as compared to \$3.9 million in the prior year period. Net cash used by continuing operations decreased from \$3.2 million to \$529 thousand. This decrease was primarily as a result of a \$1.7 million decrease in net loss and an approximately \$1 million reduction in cash used for operating capital as a result of net revenues from our HBI asset, increased interest income on our Global notes, and decreases in our general and administrative costs. Cash used by discontinued operations decreased from \$706 thousand in the prior year period to \$93 thousand in 2013.

Net cash used by investing activities during the year ended December 31, 2013 was \$1.4 million, as compared to cash used of \$17 million in the prior year period. Cash used by investing activities for 2013 is primarily comprised of \$5.9

million in capital expenditures for BWI and \$598 thousand for HBI, offset by \$5 million in repayments and the \$340 thousand origination fee on the Global 2013 Note. Cash used by investing activities during 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 \$3 million used for capital expenditures.

We used cash for financing activities of approximately \$3 million for both the years ended December 31, 2013 and 2012, primarily to repurchase and retire approximately 33 thousand and 25 thousand, respectively, of our outstanding common shares.

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 XPLO in the 236th Judicial District Court, Tarrant County, Texas. The case is styled: *Texas Petroleum Investment Company vs. XPLO 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 XPLO. 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 December 31, 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 XPLO 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 XPLO Energy SPV-1, Inc. At the time of filing this report on Form 10-K, 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 December 31, 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 December 31, 2013, we did not record a contingency related to this matter.

Point a la Hache Lawsuit – During the second quarter 2013, we learned XPLO Energy Operating Company and XPLO 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 December 31, 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 December 31, 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, XPLORE 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 \$145 thousand, resulting in a total assessment of \$339 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 December 31, 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 \$339 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 year ended December 31, 2013.

Consolidated Contractual Obligations – The following table presents a summary of our consolidated contractual obligations and commercial commitments as of December 31, 2013 (in thousands):

Contractual Obligations (1)	Payments Due by Period					
	2014	2015	2016	2017	Thereafter	Total
Operating Lease Obligations (2)	\$ 189	\$ 192	\$ 194	\$ 131	\$ —	\$ 706
Capital Lease Obligations (3)	246	329	82	—	—	657
Total Contractual Cash Obligations	\$ 435	\$ 521	\$ 276	\$ 131	\$ —	\$ 1,363

-
- (1) As of December 31, 2013, we had no material purchase obligations.
 - (2) Consists of our corporate office lease.
 - (3) Consists of an equipment lease related to the Arctic Star project.

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 December 31, 2013, we were not involved in any unconsolidated SPE transactions and we have no off-balance sheet arrangements.

Treasury Stock – At December 31, 2013 and 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 2013, we purchased and retired approximately 33 thousand shares of our common stock in privately negotiated transactions for approximately \$3 million. As of December 31, 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, delays in the development of our HBI oil and gas assets, and delays in the Arctic Star project for BWI. 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 Bakken and Niobrara shale projects, and we anticipate operating revenues from our BWI segment to begin in the second 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 December 31, 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 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Not applicable.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The following financial statements appear on pages 27 through 55 in this Annual Report.

	<u>Page</u>
Report of Independent Registered Public Accounting Firm	27
Consolidated Balance Sheets -- December 31, 2013 and 2012	28
Consolidated Statements of Operations -- Years ended December 31, 2013 and 2012	29
Consolidated Statements of Comprehensive Income (Loss) -- Years ended December 31, 2013 and 2012	30
Consolidated Statements of Stockholders' Equity -- Years ended December 31, 2013 and 2012	31
Consolidated Statements of Cash Flows -- Years ended December 31, 2013 and 2012	32
Notes to Consolidated Financial Statements	33

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders

HKN, Inc.

We have audited the accompanying consolidated balance sheets of HKN, Inc., and subsidiaries (collectively, the “Company”) as of December 31, 2013 and 2012, and the related consolidated statements of operations, stockholders' equity, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of HKN, Inc. and subsidiaries as of December 31, 2013 and 2012, and the results of their operations and their cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

/s/ Hein & Associates LLP

Dallas, Texas

March 6, 2014

HKN, INC.

CONSOLIDATED BALANCE SHEETS

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

	December 31, 2013	December 31, 2012
<u>Assets</u>		
Current Assets:		
Cash and cash equivalents	\$14,302	\$19,286
Accounts receivable, net of allowance of \$0 and \$65 thousand at December 31, 2013 and 2012, respectively	334	203
Assets of discontinued operations, net of allowance of \$158 thousand and \$156 thousand at December 31, 2013 and 2012, respectively	6	—
Prepaid expenses and other current assets	214	297
Total Current Assets	14,856	19,786
Oil and gas property, using the successful efforts method of accounting	4,450	2,953
Construction in progress - plant	8,833	1,717
Weathered lagoon plant	6,236	6,236
Office equipment and other	305	261
Accumulated depreciation and depletion	(781)	(358)
Total Property and Equipment, net	19,043	10,809
Intangible assets, net	1,667	1,872
Long term note receivable - related party, net of deferred transaction fees of \$177 thousand and \$119 thousand at December 31, 2013 and 2012, respectively	11,823	16,881
Investment in Global	19,312	23,607
Other assets	259	1,022
Total Assets	\$66,960	\$73,977
Liabilities and Stockholders' Equity		
Current Liabilities:		
Trade payables	\$838	\$244
Liabilities of discontinued operations	160	247
Accrued liabilities and other	1,583	260
Total Current Liabilities	2,581	751
Asset retirement obligation	2	4
BWI contingency	800	800
Total Liabilities	3,383	1,555

Commitments and Contingencies (Note 2 and 15)

Stockholders' Equity:

Series G1 convertible preferred stock, \$1.00 par value; \$100,000 liquidation value;

Edgar Filing: HKN, Inc. - Form 10-K

700,000 shares authorized; 1,000 shares outstanding	1	1
Series G2 convertible 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; 401,943 and 435,328 shares issued and outstanding, respectively	4	4
Additional paid-in capital	450,394	453,300
Accumulated deficit	(395,643)	(394,170)
Accumulated other comprehensive income	8,820	13,286
Total Stockholders' Equity	63,577	72,422
Total Liabilities and Stockholders' Equity	\$66,960	\$73,977

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

HKN, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

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

	Year Ended December 31,	
	2013	2012
Revenues:		
Oil and gas operations	\$ 1,093	\$ 394
Total revenues	1,093	394
Operating costs and expenses:		
Oil and gas operating	209	49
Selling, general and administrative	3,520	4,453
Depreciation, depletion and amortization	743	469
Total operating costs and expenses	4,472	4,971
Loss from operations	(3,379)	(4,577)
Other income and expenses:		
Interest and other expenses	(36)	(2)
Interest and other income - related party	2,250	1,917
Interest and other income	163	39
Total other income	2,377	1,954
Loss from continuing operations before income taxes	(1,002)	(2,623)
Income tax benefit	—	80
Loss from continuing operations	(1,002)	(2,543)
Loss on disposal of discontinued operations	—	(157)
Loss from discontinued operations	(471)	(467)
Net loss	(1,473)	(3,167)
Accrual of dividends related to preferred stock	(16)	(16)
Gain on payments of dividends of preferred stock	16	16
Net loss attributed to common stock	\$(1,473)	\$(3,167)
Loss per common share from continuing operations	\$(2.46)	\$(5.72)
Loss per common share from discontinued operations	(1.15)	(1.40)
Net loss per common share, basic and diluted	\$(3.61)	\$(7.12)
Weighted average common shares outstanding:		
Basic and diluted	408,166	444,502

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

HKN, INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE
INCOME (LOSS)

(in thousands)

	Year Ended December 31,	
	2013	2012
Net loss	\$(1,473)	\$(3,167)
Foreign currency translation adjustments	160	857
Unrealized gain (loss) on investments	(4,626)	2,426
Other comprehensive income (loss)	(4,466)	3,283
Comprehensive income (loss)	\$(5,939)	\$116

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

HKN, INC.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

(in thousands)

	Preferred Stock		Common Stock		Additional Paid-In Capital	Treasury Stock	Accumulated Deficit	Accumulated Other Comprehensive Income	Total
	G1	G2	Stock		Capital	Stock	Deficit	Income	
Balance, January 1, 2012	\$1	\$1	\$5		\$456,235	\$—	\$(391,003)	) \$10,003	\$75,242
Reverse stock split - buy back of partial shares	—	—	(1	)	(115	)	—	—	(116)
Stock-based compensation expense	—	—	—		81	—	—	—	81
Accrual of preferred stock dividends	—	—	—		—	—	(16	)	(16)
Issuance of preferred stock dividends	—	—	—		—	—	16	—	16
Treasury stock repurchase	—	—	—		—	(2,901	)	—	(2,901)
Treasury stock retirements	—	—	—		(2,901	)	2,901	—	—
Comprehensive income:									
Net loss							(3,167)	
Unrealized holding gain on available for sale investments								2,426	
Unrealized foreign currency gain								857	
Total comprehensive income									116
Balance, December 31, 2012	1	1	4		453,300	—	(394,170	)	13,286
Stock-based compensation expense	—	—	—		60	—	—	—	60
Accrual of preferred stock dividends	—	—	—		—	—	(16	)	(16)
Issuance of preferred stock dividends	—	—	—		—	—	16	—	16
Treasury stock repurchase	—	—	—		—	(2,966	)	—	(2,966)
Treasury stock retirements	—	—	—		(2,966	)	2,966	—	—
Comprehensive loss:									
Net loss							(1,473)	

Unrealized holding loss on available for sale investments							(4,626)	
Unrealized foreign currency gain							160		
Total comprehensive loss									(5,939)
Balance, December 31, 2013	\$ 1	\$ 1	\$ 4	\$450,394	\$—	\$(395,643	)	\$8,820	\$63,577

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

HKN, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

	Year Ended December 31,	
	2013	2012
Cash flows from operating activities:		
Net loss	\$(1,473)	\$(3,167)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation, depletion and amortization	743	469
Stock-based compensation expense	60	81
Income tax benefit	—	(80)
Loss on disposal of discontinued operations	—	157
Amortization of long term note receivable - related party transaction fee	(282)	(141)
Other	(30)	2
Change in operating assets and liabilities:		
Accounts receivable and accounts receivable - related party	(141)	(108)
Prepaid assets and other	(97)	(86)
Trade payables and other	691	(353)
Net cash used in operating activities - continuing operations	(529)	(3,226)
Net cash used in operating activities - discontinued operations	(93)	(706)
Net cash used in operating activities	(622)	(3,932)
Cash flows from investing activities:		
Capital expenditures	(6,618)	(3,047)
Purchase of Global shares	(171)	(411)
Net proceeds from sales of assets	53	3
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	5,000	—
Issuance of notes receivable to Global, net of transaction fees of \$260 thousand	—	(11,740)
Net cash used in investing activities	(1,396)	(17,195)
Cash flows from financing activities:		
Reverse split - buy back of partial shares	—	(117)
Purchase of treasury stock	(2,966)	(2,901)
Net cash used in financing activities	(2,966)	(3,018)
Net decrease in cash and cash equivalents	(4,984)	(24,145)
Cash and cash equivalents at beginning of period	19,286	43,431
Cash and cash equivalents at end of period	\$14,302	\$19,286

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

HKN, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America (“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 those estimates and such differences could be material. Certain prior year amounts have been reclassified to conform with the 2013 presentation.

The consolidated financial statements retroactively reflect the effect of a one-for-forty reverse stock split which was approved by shareholders on October 29, 2012 and effective October 30, 2012. Accordingly, all disclosures involving the number of shares of our common stock outstanding, issued, or to be issued, such as with a transaction involving our common stock, and all per share amounts, retroactively reflect the impact of 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.

Principles of Consolidation – The consolidated financial statements include the accounts of all companies that we, through our direct or indirect ownership or share-holding, 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 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 balance sheets or consolidated statements of operations (see Note 3 – “HKN Bakken, Inc.”).

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 oil and gas and coalbed methane activities are included as discontinued operations on the consolidated balance sheets, consolidated statements of operations and consolidated statements of cash flows for all periods presented.

Statement of Cash Flows - For purposes of the consolidated statements of cash flows, we consider all highly liquid investments and treasury bills purchased with an original maturity of three months or less to be cash equivalents. No interest or income taxes were paid for the years ended December 31, 2013 and 2012.

Concentrations of Credit Risk - Although our cash and cash equivalents and accounts receivable are exposed to potential credit loss, we do not believe such risk to be significant. Cash and cash equivalents include investments in money markets placed with highly rated financial institutions.

Accounts Receivable and Allowance for Doubtful Accounts – Trade accounts receivable are customer obligations due under normal trade terms. We had \$285 thousand and \$195 thousand in trade receivables related to oil and gas production at December 31, 2013 and 2012, respectively. We had other accounts receivable of \$49 thousand and \$8 thousand at December 31, 2013 and 2012, respectively.

Senior management reviews accounts receivable to determine if any receivables will potentially be uncollectible. We include provisions for any accounts receivable balances that are determined to be uncollectible in the allowance for doubtful accounts. After all attempts to collect a receivable have failed, the receivable is written off against the allowance. However, actual write-offs could exceed the recorded allowance. We recorded an allowance within our Assets of Discontinued Operations of \$2 thousand and \$156 thousand for a potentially uncollectible account related to our discontinued operations during the years ended December 31, 2013 and 2012, respectively. We also recorded \$65 thousand for our portion of a potentially uncollectible account related to our Gerrity Oil joint venture during the year ended December 31, 2012. No allowance has been recognized on our accounts receivable as of December 31, 2013.

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 is 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 income (loss)	160	(4,626)	(4,466)
Balance as of December 31, 2013	\$ 1,215	\$ 7,605	\$ 8,820

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, including cash, our common stock investment in Global and our Global notes 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 are 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 balance sheets.

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

BWI Property and Equipment – Project costs that are clearly associated with the acquisition, development and construction of a plant are capitalized as costs of that project. In addition, indirect project costs that are identified with a specific project, including selling, general and administrative expenses, are capitalized and allocated to the project to which the costs relate. Overhead costs and costs incurred after the project is placed into service are charged to expense as incurred.

The BWI weathered lagoon plant with costs of \$6.2 million within property and equipment on our consolidated balance sheets has not been depreciated at December 31, 2013, as it has not been placed in service as of the date of these financial statements. In addition, Construction in Progress of \$8.8 million related to the BWI Arctic Star plant under development within property and equipment on our consolidated balance sheets is not subject to depreciation while it is under construction. Once construction and commissioning is completed, the Arctic Star plant will be placed in use and subject to depreciation.

Other property and equipment, which includes computer equipment, computer hardware and software, furniture and fixtures, leasehold improvements and automobiles, is recorded at cost and is depreciated on a straight-line basis over the estimated useful lives of the assets, ranging from 3 to 5 years. We recorded depreciation expense related to other property and equipment of \$59 thousand and \$52 thousand for the years ended December 31, 2013 and 2012, respectively.

Oil and Gas Properties – We use the successful efforts method of accounting for our HBI 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.

Our liability for asset retirement obligations is determined using significant assumptions, including current estimates of plugging and abandonment costs, annual inflation of these costs, the productive lives of wells and our risk-adjusted interest rate. Changes in any of these assumptions can result in significant revisions to the estimated asset retirement obligation.

Capital amounts attributable to developed oil and gas properties of \$4.1 million 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. Undeveloped properties of \$354 thousand are excluded from this calculation. Depreciation, depletion and amortization expense for oil and gas producing properties and related equipment was \$479 thousand and \$212 thousand for the years ended December 31, 2013 and 2012, respectively.

We use the sales method to recognize our oil and gas revenues. Under this method, revenues are recognized based on our interests of the actual volumes of gas and oil sold to purchasers.

Intangible Assets – Our intangible assets consist of patents acquired in connection with our investment in 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. The expiration of patents during the next five years is not expected to have a material effect on our expected future cash flows of our BWI investment. Accumulated amortization in the amount of \$924 thousand has been recorded on these patents to date. We have recorded amortization expense related to these patents of \$205 thousand for both the years ended December 31, 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 statements of operations. The estimated future annual amortization of our patents over the next five years is as follows (in thousands):

Year	Amount
2014	\$ 205
2015	191
2016	183
2017	170
2018	75
Thereafter	843
Total	\$ 1,667

Investment in Global – We do not account for our investment in Global as an equity method investment in spite of our 35% 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.

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 published financial statements and 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.

Other Assets – At December 31, 2013, other assets included \$239 thousand in prepaid drilling costs related to the drilling and completion of wells held by HBI, \$10 thousand in spare parts inventory and a \$10 thousand deposit for the Arctic Star plant site lease.

Notes Receivable – Our notes receivable are stated at their outstanding principal balance, less any allowance for doubtful accounts and deferred transaction fees. Transaction fees related to the notes are deferred and amortized using the effective interest method over the life of the loan and are recognized in interest income from related parties within

our consolidated statements of operations.

We evaluate our notes receivable to determine if any receivable will potentially be uncollectible and include provisions for any notes receivable balances that are determined to be uncollectible in the allowance for doubtful accounts.

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 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, and risk free interest rates. Please see Note 11 – “BWI Stock Compensation” for additional information on our stock-based compensation plan.

Provision for Asset Impairments - Assets that are used in our operations and not held for sale, are carried at cost, less accumulated depreciation and amortization. We review our long-lived assets whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. When evidence indicates that operations will not produce sufficient cash flows to cover the carrying amount of the related asset, and when the carrying amount of the related asset cannot be realized through sale, a permanent impairment is recorded and the asset value is written down to fair value. No impairment has been recognized as of December 31, 2013.

Accrued Liabilities and Other – At December 31, 2013, accrued liabilities and other included approximately \$1.1 million in accrued capital costs related to the construction of the Arctic Star plant and approximately \$209 thousand in accrued capital costs related to the drilling and completion of HBI wells under development.

Income Taxes – We account for income taxes under the liability method. Deferred tax assets and liabilities are determined based on differences between financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse. Deferred tax assets and liabilities represent the future tax return consequences of those differences, which will either be taxable or deductible when the assets and liabilities are recovered or settled. We measure and record income tax contingency accruals in accordance with guidance related to uncertain tax positions.

We recognize liabilities for uncertain income tax positions based on a two-step process. The first step is to evaluate the tax position for recognition by determining if the weight of available evidence indicates that it is more likely than not that the position will be sustained on audit, including resolution of related appeals or litigation processes, if any. The second step requires us to estimate and measure the tax benefit as the largest amount that is more than 50% likely to be realized upon ultimate settlement. It is inherently difficult and subjective to estimate such amounts, as we must determine the probability of various possible outcomes. We reevaluate these uncertain tax positions on a quarterly basis or when new information becomes available to management. These reevaluations are based on factors including, but not limited to, changes in facts or circumstances, changes in tax law, successfully settled issues under audit, expirations due to statutes, and new audit activity. Such a change in recognition or measurement could result in the recognition of a tax benefit or an increase to the tax accrual.

We classify interest related to income tax liabilities as income tax expense, and if applicable, penalties are recognized as a component of income tax expense. The income tax liabilities and accrued interest and penalties that are anticipated to be due within one year of the balance sheet date are presented as current liabilities in our consolidated balance sheets.

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, a wholly-owned subsidiary, 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 completing 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 Results of Operations - We recognized losses of \$1.6 million and \$1.9 million for the years ended December 31, 2013 and 2012, respectively, related to BWI in our consolidated statements of operations.

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 year ended December 31, 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

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 balance sheets or consolidated 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 year ended December 31, 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 35% of Global's outstanding ordinary shares at December 31, 2013.

During 2013, we purchased an additional 105 thousand shares of Global for \$171 thousand, increasing our ownership from 34.22% to 34.51%. During 2012, we purchased 230 thousand shares of Global for \$411 thousand. At December 31, 2013 and 2012, our investment in Global was equal to the market value of Global's ordinary shares as follows (in thousands, except share amounts):

	December 31, 2013	December 31, 2012
Shares of Global Stock Held by HKN	12,462	12,357
Closing Price of Global Stock	£ 0.94	£ 1.18
Foreign Currency Exchange Rate	1.6574	1.6259
Market Value of Investment in Global	\$ 19,312	\$ 23,607

The foreign currency translation adjustment of approximately \$160 thousand and the unrealized loss on investment of \$4.6 million for these changes in market value between the two periods were recorded to other comprehensive income in stockholders' equity during the year ended December 31, 2013.

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 published financial statements and 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 December 31, 2013. We currently have a cumulative unrealized gain position on our investment in Global of \$8.8 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 year ended December 31, 2013, we have received \$5 million in principal payments from Global. Accrued interest on the outstanding principal balance is due on each quarterly principal payment date. During the years ended December 31, 2013 and 2012, we have received approximately \$2 million and \$1.8 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 \$177 thousand was deferred and presented net of our long term notes receivable at December 31, 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 March 31, 2014 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 December 31, 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 annual report on Form 10-K 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 December 31, 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 December 31, 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 recurring Level 3 fair value measurement.

The following table describes all changes to our asset retirement obligation liability during the years ended December 31, 2013 and 2012 (in thousands):

	2013	2012
Asset retirement obligation at beginning of period	\$4	\$ —
Additions during the period	1	4
Revisions of estimates	(3)	—
Accretion expense	—	—
Asset retirement obligation at end of period	\$2	\$ 4

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.

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

	December 31, 2013		
	Level 1	Level 2	Level 3
Investment in Global (1)	\$19,312	\$—	\$—

	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 balance sheets and consolidated 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):

	December 31, 2013	December 31, 2012
Current Assets:		
Accounts receivable, net	\$ 6	\$ —
Total Current Assets	6	—
Total Assets of Discontinued Operations	\$ 6	\$ —
Current Liabilities:		
Trade payables	\$ 29	\$ 3
Revenues and royalties payable	18	17
Accrued liabilities and other	113	227
Total Current Liabilities	160	247
Total Liabilities of Discontinued Operations	\$ 160	\$ 247

Our Accrued Liabilities and Other at December 31, 2013 consists of legal fees related to the XPLORE Energy Litigation (see Note 15 – “Commitments and Contingencies”).

Cash used by discontinued operations during the year ended December 31, 2013 is mainly related to legal costs resulting from the sale of the oil and gas properties. Upon resolution of the XPLORE Energy litigation and regulatory matters, no significant activities are expected related to these discontinued operations.

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

	Years Ended December 31, 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	\$(471)	\$(467)

We recognized a loss of \$157 thousand on the 2011 disposal of our Gulf Coast oil and gas properties during the year ended December 31, 2012, 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 during the year ended December 31, 2013.

(9) INCOME TAXES

The total provision for income taxes consists of the following:

	Years Ended December 31, 20132012 (in thousands)	
Current Taxes:		
Federal	\$ —	\$ —
State	—	—
Deferred Taxes:		
Federal	—	(80)
State	—	—
Total tax benefit	\$ —	\$ (80)

The following is a reconciliation of the reported amount of income tax benefit for the years ended December 31, 2013 and 2012 to the amount of income tax expense that would result from applying domestic federal statutory tax rates to pretax income:

	Years Ended December 31, 2013 2012 (in thousands)	
Statutory tax benefit	\$(340)	\$(892)
Increase (decrease) in valuation allowance		
Change in valuation allowance	337	(3,137)
Effect of subsidiary tax consolidation	—	—
Expiration of capital loss carryforwards	—	9
Expiration of NOL carryforwards	—	4,007
Benefit realized on settlement of unrecognized tax benefit	—	(80)
Effect of permanent differences and other	3	13
Total tax benefit	\$ —	\$(80)

At December 31, 2013, we had available for U.S. federal income tax reporting purposes, a net operating loss (NOL) carryforward for regular tax purposes of approximately \$99 million which expires in varying amounts during the tax years 2018 through 2033, an alternative minimum tax NOL carryforward of approximately \$85 million which expires in varying amounts during the tax years 2018 through 2033, and a statutory depletion carryforward of approximately \$8 million which can be carried forward indefinitely to offset our future taxable income, subject to certain limitations imposed by the Internal Revenue Code. Additionally, at December 31, 2013, we have a capital loss carryforward of approximately \$8 million which will expire during the years 2014 through 2015. Current federal income tax law allows corporations to deduct capital losses only if they offset capital gains. In 2003, we underwent a change in ownership, within the meaning of Internal Revenue Code Section 382, which significantly restricts our ability to utilize our domestic NOLs and capital losses.

The components of our federal deferred income taxes were as follows for the years ended December 31, 2013 and 2012:

	2013	2012
	(in thousands)	
Deferred tax assets:		
Net operating losses (NOL) carryover	\$33,973	\$33,444
Depletion carryover	3,020	3,020
Share based compensation	48	28
Deferred book liabilities	1	1
Loan origination fees	60	41
Book vs. tax basis in investments	20,683	19,165
Capital loss carryover	2,688	2,688
Total gross deferred tax assets	60,473	58,387
Deferred tax liabilities:		
Property and equipment	(824)	(753)
Net deferred tax assets	59,649	57,634
Less valuation allowances	(59,649)	(57,634)
Deferred tax liabilities, net of valuation allowance	\$—	\$—

Our policy is to recognize potential interest and penalties accrued related to unrecognized tax benefits within income tax expense. The tax years 2010-2013 remain open to examination for federal income tax purposes and by the other major taxing jurisdictions to which we are subject. The tax years 2009-2013 also remain open for examination purposes for the Texas Franchise tax.

In May 2006, the Governor of Texas signed into law a Texas margin tax (H.B. No. 3) which restructured the state business tax by replacing the taxable capital and earned surplus components of the current franchise tax with a new “taxable margin” component. Specifically, we became subject to an entity level tax on the portion of our total revenue (as that term is defined in the legislation) that is generated in Texas beginning in our tax year ending December 31, 2007. The Texas margin tax is imposed at a maximum effective rate of 0.7% of our total revenue that is apportioned to Texas.

In 2009, we recorded an income tax contingency related to an IRS tax examination of \$225 thousand, including interest and penalties, in our consolidated financial statements. We settled this contingency during 2012, resulting in a gain realized as an income tax benefit of \$73 thousand within our consolidated financial statements during the second quarter 2012. For a complete discussion of the IRS tax contingency, see Note 15 - “Commitments and Contingencies.”

The following table illustrates changes in our gross unrecognized tax benefits (in thousands) for the years ending December 31, 2013 and 2012.

2013 2012

Edgar Filing: HKN, Inc. - Form 10-K

Unrecognized tax benefits at January 1,	\$ —	\$225
Increases for positions taken in current year	—	—
Decreases for positions taken in current year	—	—
Decreases for settlements with taxing authorities	—	(225)
Decreases for lapses in the applicable statute of limitations	—	—
Unrecognized tax benefits at December 31,	\$ —	\$—

(10) STOCKHOLDERS' EQUITY

Common Stock - We have authorized 2 million shares of \$.01 par value common stock. At December 31, 2013 and 2012, we had 401,943 and 435,328 shares, respectively, issued and outstanding. Dividends may not be paid to holders of our common stock prior to the satisfaction of all dividend obligations related to our Series G1 and Series G2 preferred stock.

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.

Treasury Stock - At December 31, 2013 and 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 year ended December 31, 2013, we purchased and retired approximately 33 thousand shares of our common stock in privately negotiated transactions for approximately \$3 million. As of December 31, 2013, approximately 12 thousand shares remained available for repurchase under our repurchase program.

Series G1 Convertible Preferred Stock - Our Series G1 convertible preferred stock ("Series G1 preferred"), which was issued in 2000, has a liquidation value of \$100 per share, is non-voting, and is convertible at the holder's option into our common stock at a conversion price of \$11,200 per share. At December 31, 2013 and 2012, there were 1,000 shares of Series G1 preferred issued and outstanding.

The Series G1 preferred holders shall be entitled to receive dividends at an annual rate equal to \$8 per share when, as and if declared by our Board of Directors. All dividends on the Series G1 preferred are cumulative and payable semi-annually in arrears on June 30 and December 30. At our option, dividends may also be payable in our common stock valued at \$11,200 per share. The Series G1 preferred dividend and liquidation rights shall rank junior to all claims of creditors, but senior to our common stockholders and to any subsequent series of our preferred stock, unless otherwise provided, except for the Series G2 preferred, which shall rank equal to the Series G1 preferred.

Series G2 Convertible Preferred Stock - Our Series G2 convertible preferred stock ("Series G2 preferred"), which was issued in 2000, has a liquidation value of \$100 per share, is non-voting, and is convertible at the holder's option into our common stock at a conversion price of \$2,688 per share. The Series G2 preferred is also convertible by us into

shares of our common stock if for any period of twenty consecutive calendar days the average of the closing prices of our common stock during such period shall have equaled or exceeded \$3,360 per share. At December 31, 2013 and 2012, there were 1,000 shares of Series G2 preferred issued and outstanding.

The Series G2 preferred holders shall be entitled to receive dividends at an annual rate equal to \$8 per share when, as and if declared by our Board of Directors. All dividends on the Series G2 preferred are cumulative and payable semi-annually in arrears on June 30 and December 30. At our option, dividends may also be payable in our common stock valued at \$2,688 per share. The Series G2 preferred dividend and liquidation rights shall rank junior to all claims of creditors but senior to our common stockholders and to any subsequent series of our preferred stock, unless otherwise provided. The Series G2 preferred shall rank equal to the Series G1 preferred.

Changes in our common, preferred and treasury shares during 2013 and 2012 are as follows:

Description	Number of Shares		Common	Treasury
	Preferred G1	Preferred G2		
Balance as of December 31, 2011	1,000	1,000	462,015	—
Shares issued for preferred stock dividends	—	—	4	—
Reverse stock split - buy back of partial shares	—	—	(1,485)	—
Treasury stock repurchase	—	—	—	25,206
Treasury stock retirements	—	—	(25,206)	(25,206)
Balance as of December 31, 2012	1,000	1,000	435,328	—
Shares issued for preferred stock dividends	—	—	4	—
Treasury stock repurchase	—	—	—	33,389
Treasury stock retirements	—	—	(33,389)	(33,389)
Balance as of December 31, 2013	1,000	1,000	401,943	—

Convertible Preferred Stock - At December 31, 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 December 31, 2013
Series G1 Preferred	\$ 11,200	8
Series G2 Preferred	\$ 2,688	37
Common Stock Potentially Issued Upon Conversion		45

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

Stockholder Rights Plan – We had previously adopted a Rights Agreement whereby a dividend of one preferred share purchase right (“Right”) was paid for each outstanding share of our common stock. During April 2012, we amended the existing Rights Agreement to accelerate the final expiration date of the Rights issued thereunder. The effect of this amendment is that our outstanding Rights expired on May 30, 2012 and the shareholder’s rights plan pursuant to which Rights had been issued is of no further force or effect.

(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 December 31, 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.

In December 2013, 24.5 thousand options were granted to BWI directors, officers and employees with an exercise price of \$31.60 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 December 31, 2013, none of these options were exercisable. The grant date fair value of the stock of \$31.60 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 weighted average grant date fair value of each stock option granted during the years ended December 31, 2013 and 2012 was \$16.89 and \$8.56, respectively. The fair value of each option at the grant date was estimated by using the Black-Scholes option-pricing model using the following weighted average assumptions:

	Grant Date	
	December	April
	2013	2012
Expected dividend yield	0.00%	0.00%
Expected volatility	56.00%	65.00%
Expected life (in years)	6.00	6.00
Risk free interest rate	1.86%	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. No forfeiture rate was applied during the years ended December 31, 2013 or 2012, as no forfeitures were expected. However, in the fourth quarter of 2012 and the first quarter of 2013, a total of 14 thousand shares were forfeited and an immaterial amount of stock compensation expense was reversed. No additional forfeiture rate was applied during the year ended December 31, 2013, as no further forfeitures were expected.

The following table summarizes stock option activity during the year ended December 31, 2013:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value (in thousands)
Outstanding at January 1, 2013	38,000	\$ 14.50		
Granted	24,500	31.60		
Exercised	—	—		
Forfeited or Expired	(12,000)	14.50		
Outstanding at December 31, 2013	50,500	\$ 22.80	9.08	\$ 445
Exercisable at December 31, 2013	8,667	\$ 14.50	8.27	\$ 148

The following table summarizes nonvested option activity during the year ended December 31, 2013:

	Shares	Weighted Average Grant Date Fair Value
Nonvested at January 1, 2013	38,000	\$ 8.56
Granted	24,500	16.89
Vested	(8,667)	8.56
Forfeited	(12,000)	8.56
Nonvested at December 31, 2013	41,833	\$ 13.44

At December 31, 2013, there was approximately \$495 thousand of total unrecognized stock compensation expense. This compensation expense is expected to be recognized over the weighted-average vesting term remaining of 2.62 years.

Total stock-based compensation recognized within selling, general and administrative expenses in the Company's consolidated statements of operations for the years ended December 31, 2013 and 2012 was \$60 thousand and \$81 thousand, respectively.

(12) RELATED PARTY TRANSACTIONS

Our related party transactions at December 31, 2013 include our \$12 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.

Our related party transactions also include purchases of shares of Global. See Note 4 – "Investment in Global" for additional information on our purchases of Global stock.

(13) SEGMENT INFORMATION

We currently have one reportable segment consisting of our investment in BWI which is managed separately. Our BWI operating 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.

We have included activity of our parent company, HKN, in our disclosure to reconcile to our consolidated operating loss and total assets. HKN includes our investment in Global, our non-operated working interests in properties held by HBI, performance of 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 financial statements. Intersegment interest income and intersegment expenses between our parent company and BWI have been eliminated in consolidation. There were no material intersegment sales or transfers for the periods presented.

At December 31, 2012 we reported our investment in Gerrity Oil as a reportable segment. 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, HBI. The oil and gas operations of the newly formed HBI entity were absorbed by HKN personnel and no additional resources were allocated to the management of those operations. Therefore, we do not consider our investment in HBI to be a separate operating segment as of December 31, 2013. Since Gerrity Oil was previously reported as a separate reportable segment at December 31, 2012, that period has been restated to be included with the HKN parent company activity consistent with the year ended December 31, 2013.

Our financial information, expressed in thousands, for each of our operating segments for the years ended December 31, 2013 and 2012 is as follows:

For the Year Ended December 31, 2013

	HKN	BWI	Eliminations	Consolidated
Oil and gas revenues	\$1,093	\$—	\$—	\$1,093
Oil and gas expenses	(209)	—	—	(209)
Selling, general and administrative expenses	(2,767)	(753)	—	(3,520)
Depreciation, depletion and amortization	(523)	(220)	—	(743)
Interest and other expenses	(36)	(651)	651	(36)
Interest and other income - related parties	2,901	—	(651)	2,250
Interest and other income	163	—	—	163
Segment income (loss) from continuing operations	\$622	\$(1,624)	\$—	\$(1,002)
Capital Expenditures	\$694	\$5,924	\$—	\$6,618
Total Assets	\$62,149	\$17,014	\$(12,203)	\$66,960

For the Year Ended December 31, 2012

	HKN	BWI	Eliminations	Consolidated
Oil and gas revenues	\$394	\$—	\$—	\$394
Oil and gas expenses	(49)	—	—	(49)

Edgar Filing: HKN, Inc. - Form 10-K

Selling, general and administrative expenses	(3,081)	(1,372)	—	(4,453)
Depreciation, depletion and amortization	(254)	(215)	—	(469)
Interest and other expenses	—	(305)	303	(2)
Interest and other income - related parties	2,220	—	(303)	1,917
Interest and other income	39	—	—	39
Income tax benefit	80	—	—	80
Segment income (loss) from continuing operations	\$(651)	\$(1,892)	\$—	\$(2,543)
Capital Expenditures	\$1,949	\$1,098	\$—	\$3,047
Total Assets	\$78,911	\$4,670	\$(9,604)	\$73,977

(14) EARNINGS (LOSS) PER SHARE

Basic earnings (loss) per share includes no dilution and is computed by dividing income or loss attributed to common stockholders by the weighted-average number of common shares outstanding for the period. Diluted earnings (loss) per share reflects the potential dilution that could occur if security interests were exercised or converted into common stock.

The following table sets forth the computation of basic and diluted income (loss) per share for the years ended December 31, 2013 and 2012 (in thousands, except per share data):

	Year Ended December 31, 2013			Year Ended December 31, 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)	\$(1,002)		\$(2.46)	\$(2,543)		\$(5.72)
Loss from discontinued operations	(471)		(1.15)	(624)		(1.40)
Net loss attributed to common stock	\$(1,473)	408	\$(3.61)	\$(3,167)	445	\$(7.12)
Effect of dilutive securities						
Preferred stock (2)	—	—	—	—	—	—
Diluted loss per share	\$(1,473)	408	\$(3.61)	\$(3,167)	445	\$(7.12)

(1) Includes accrual of dividends, net of the gain on dividends paid with common shares, related to preferred stock for the years ended December 31, 2013 and 2012.

(2) Includes 46 shares of our common stock related to our Series G1 preferred and Series G2 preferred stock for the years ended December 31, 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”).

(15) COMMITMENTS AND CONTINGENCIES

Leases - We lease our corporate and other office space. Total office operating lease payments during 2013 and 2012 totaled \$209 thousand and \$189 thousand, respectively. In addition, we have capital equipment leases related to our Arctic Star project which begin in 2014. Future minimum rental payments required under all leases that have initial or remaining non-cancellable lease terms in excess of one year as of December 31, 2013 are as follows (in thousands):

Year	Operating Capital	
	Leases	Leases
2014	\$ 189	\$ 246
2015	192	329
2016	194	82
2017	131	—
Thereafter	—	—
Total	\$ 706	\$ 657

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

IRS Examination - During 2008, we received a proposed adjustment to our federal tax liability for the calendar year 2005. The proposed adjustment related to the calculation of the adjusted current earnings (“ACE”) component of the alternative minimum tax and asserted that the Company recognized a gain for ACE purposes on the sale of the Global stock in 2005. As a result, we recorded an income tax contingency for this item, including interest and penalties, of \$225 thousand in our consolidated financial statements based, in part, on a preliminary indication of a fair value assessment of the Global stock. During April 2012, we agreed to and paid a tax settlement of \$152 thousand with the IRS, including approximately \$49 thousand in interest. This settlement resulted in a gain realized as an income tax benefit of \$73 thousand within our consolidated financial statements during the second quarter 2012.

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-K, 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 December 31, 2013, we did not record a contingency related to these investigations.

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 December 31, 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.

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 December 31, 2013, we did not record a contingency related to this matter.

Point a la Hache Lawsuit – During the second quarter 2013, we learned XPLORE Energy Operating Company and XPLORE 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 December 31, 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 December 31, 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, XPLORE 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 \$145 thousand, resulting in a total assessment of \$339 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 December 31, 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 \$339 thousand.

(16) OIL AND GAS DISCLOSURES (unaudited)

The following information is presented with regard to our proved oil and gas reserves acquired during the year ended December 31, 2012 (in thousands):

Costs incurred in property acquisition, exploration and development activities (in thousands):

	Years Ended December 31,	
	2013	2012
Domestic costs incurred:		
Acquisition of properties		
Proved	\$4	\$2,451
Unproved	—	—
Exploration	—	—
Development	1,359	502
Total domestic costs incurred	\$1,363	\$2,953

Capitalized Costs Relating to Oil and Gas Producing Activities (in thousands):

	Years Ended December 31,	
	2013	2012
Capitalized costs:		
Proved properties	\$4,124	\$2,953
Unproved properties	326	—
Total capitalized costs	4,450	2,953
Less accumulated depreciation and amortization	(691)	(212)
Net capitalized costs	\$3,759	\$2,741

Included in the capitalized costs of proved properties of \$4.1 million are approximately \$3.2 million in costs related to producing wells and related equipment and approximately \$674 thousand in costs related to mineral interests in properties.

Results of Operations from Oil and Natural Gas Producing Activities

	Years Ended December 31,	
	2013	2012
	(in thousands)	
Oil and gas revenues	\$1,093	\$394

Less:

Oil and gas operating costs	209	49
Depreciation and amortization	479	212
Accretion expense	—	—
Total oil and gas expenses	688	261
Results of operations from oil and gas producing activities	\$405	\$133

Oil and Gas Reserve Data - (Unaudited) - The following information is presented with regard to our proved oil and gas reserves. The reserve values and cash flow amounts reflected in the following reserve disclosures are based on a simple average of the first day of the month price for the period of January 1, 2013 to December 1, 2013, in accordance with ASC 932, *Oil and Gas Reserve Estimation and Disclosure* and the Securities and Exchange Commission's Final Rule, *Modernization of the Oil and Gas Reporting Requirements*.

The following table presents our independent petroleum consultants' estimates of our proved crude oil and natural gas reserves. As of December 31, 2012, we did not include immaterial interests in our reserve estimates, and as a result no nonproducing or undeveloped locations were evaluated or included in this reserve report. At December 31, 2013, we obtained a third party reserve valuation for all our proved reserves. This report resulted in an overall increase of proved reserves of approximately 180 thousand bbls and 231 thousand mcfs. This consisted of an increase to our proved developed reserves of approximately 35 thousand bbls and 44 thousand mcfs, and an increase to our proved undeveloped reserves of approximately 145 thousand bbls and 187 thousand mcfs.

	(Unaudited)	
	Total (1)	
	Oil	Gas
	(Mbbbls)	(Mmcf)
Proved reserves:		
As of December 31, 2011	—	—
Production	(4)	(6)
Purchases of reserves in place	21	35
As of December 31, 2012	17	29
Extensions and discoveries	187	247
Revisions	4	(2)
Production	(11)	(14)
As of December 31, 2013	197	260
Proved developed reserves at:		
December 31, 2013	52	73
Proved undeveloped reserves at:		
December 31, 2013	145	187

(1) All reserves were held within the United States for the years ended December 31, 2013 and 2012.

“Standardized measure” relates to the estimated discounted future net cash flows, as adjusted for our asset retirement obligations, and major components of that calculation relating to proved reserves at the end of the year in the aggregate and by geographic area, based on average prices, costs, and statutory tax rates and using a 10% annual discount rate. Prices at December 31, 2013 were based on a simple average of the first day of the month price for the period of January 1, 2013 to December 1, 2013 of \$93.42 per barrel and \$3.67 per mmbtu, as adjusted by basin for quality, transportation and regional price differentials.

Standardized Measure of Discounted Future Net Cash Flows Relating to Proved Oil and Gas Reserves:

(Unaudited, in thousands)

December 31, 2012:

Future cash inflows	\$1,694	
Production costs	(422)
Development costs	—	
Future income taxes	—	
Future net cash flows	1,272	
10% discount factor	(437)
Standardized measure of discounted future net cash flows (1)	\$835	

December 31, 2013:

Future cash inflows	\$19,778	
Production costs	(5,181)
Development costs	(5,205)
Future income taxes	—	
Future net cash flows	9,392	
10% discount factor	(5,142)
Standardized measure of discounted future net cash flows (1)	\$4,250	

(1) Cash flows associated with asset retirement obligations are included in the Standardized Measure of Discounted Future Net Cash Flows.

	Years Ended December 31, 2013 2012 (Unaudited, in thousands)	
Total		
Standardized measure -- beginning of year	\$835	\$—
Increase (decrease)		
Sales, net of production costs	(884)	(345)
Net change in prices, net of production costs	(64)	37
Revisions of quantity estimates	93	—
Accretion of discount	83	106
Extensions and discoveries, net of future costs	3,925	—
Purchases of reserves-in-place	—	1,037
Other	262	—
Standardized measure -- end of year	\$4,250	\$835

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

55

ITEM 9A. 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 annual report.

Changes in Internal Control over Financial Reporting

There have been no changes in the Company's internal control over financial reporting that occurred during the period ended December 31, 2013 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Management's Report on Internal Control Over Financial Reporting

Management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act. The Company's internal control over financial reporting is designed, under the supervision of the Company's Chief Executive and Chief Financial Officers, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with U.S. GAAP. The Company's internal control over financial reporting includes those policies and procedures that: (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with U.S. GAAP, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company's assets that could have a material effect on the financial statements.

The Company conducted an evaluation of the effectiveness of its internal control over financial reporting as of December 31, 2013. This evaluation was based on the framework in “Internal Control – Integrated Framework” issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in 1992. All internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective can provide only reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with U.S. GAAP.

Based on the Company’s evaluation under the framework in *Internal Control – Integrated Framework*, our Chief Executive Officer and Chief Financial Officer concluded that internal control over financial reporting was effective as of December 31, 2013.

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

Set forth below is information concerning our directors and executive officers:

<u>Name</u>	<u>Age</u>	<u>Position Held with HKN</u>
Michael M. Ameen, Jr.	89	Director (1)
Dr. J. William Petty	71	Director (1)
Alan G. Quasha	64	Chairman of the Board (1)
H.A. Smith	76	Director (1)
Mikel D. Faulkner	64	Director (1), Chief Executive Officer and President
Sarah B. Gasch	38	Executive Vice President and Chief Financial Officer
Kristina M. Humphries	31	Vice President, Chief Accounting Officer and Secretary

(1) Each Director serves a term of one year and until his successor is duly elected and qualified.

Michael M. Ameen, Jr., Director since 1994 and Independent Consultant on Middle East Affairs since 1991. From 1989 to 1999, Mr. Ameen served as a part time consultant to HKN with regard to Middle Eastern exploration projects. Mr. Ameen has previously served as director of American Near East Refugee Aid; past director of Amideast; past director of Middle East Institute; past director of International College in Beirut, Lebanon; past vice president of government relations and director of Washington office of Aramco; past president of Mobil Middle East Development Corporation; and Member, Energy Intelligence Group International Advisory Board.

Dr. J. William Petty, Director since 2000 and Professor of Finance and the W.W. Caruth Chairholder of Entrepreneurship at Baylor University since 1990. From December 1979 to 1990, Dr. Petty served as dean of the Business School at Abilene Christian University. Dr. Petty has also served as the Executive Director of the Baylor Angel Network. The Angel Network consists of high net worth alumni and friends of Baylor University who actively invest in early-stage high potential companies.

Alan G. Quasha, Director since 2003 and President of Quadrant Management, Inc. ("Quadrant"), an investment management company, since 1988. Mr. Quasha has served as Chairman of the Board of HKN since March 2003 and previously served as Chairman of the Board of HKN from June 1983 to February 1991. Mr. Quasha has served as a director of Compagnie Financière Richemont SA, a Swiss luxury goods company, since its formation in 1988, and American Express Funds, the mutual fund arm of American Express Company, from May 2002 to April 2004. From April 1994 to April 1997 Mr. Quasha served as a governor of the American Stock Exchange.

H.A. Smith, Director since 1997 and Consultant to Schlumberger Inc., an oil field service company, since June 1991. Previously, Mr. Smith served as Vice President-Customer Relations for Smith International, Inc. Mr. Smith served as a director of Brigham Exploration Company, an independent oil and gas exploration and production company from

2002 to 2011, where he also served as a member of their Compensation Committee. Mr. Smith also serves as a director of Stallion Oilfield Services Ltd. and is currently a member of their Compensation Committee.

Mikel D. Faulkner, Chief Executive Officer of HKN since 1982 and President of HKN since March 2003. From 1991 to March 2003, Mr. Faulkner served as Chairman of the Board of HKN and, from 1982 to February 1993, Mr. Faulkner served as President of HKN. Mr. Faulkner currently serves as Chairman of the Board of Directors of Global Energy Development PLC (“Global”), a position he has held since April 2002; HKN holds an approximate 35% interest in Global. From August 2007 to July 2008, Mr. Faulkner served on the board of directors and as a member of the compensation committee of Spitfire Energy, Ltd., a Canadian public company. Since October 2009, Mr. Faulkner has served as a director of First Cash Financial Services and is currently a member of their Compensation and Audit Committees.

Sarah B. Gasch has served as Executive Vice President and Chief Financial Officer of HKN since February 2011. Prior to that, Ms. Gasch served as Controller and Corporate Secretary of HKN since 2009 and also served as HKN’s Chief Accounting Officer upon joining HKN in 2006. Prior to joining HKN, Ms. Gasch served as Vice President and Chief Accounting Officer of GreenHunter Energy, Inc.

Kristina M. Humphries is a Certified Public Accountant and has served as Vice President and Chief Accounting Officer of HKN since June 2013 and as Corporate Secretary beginning in May 2013. Prior to that, Ms. Humphries served as the Treasurer and Assistant Secretary, beginning in 2012, as Controller and Technical Accounting Manager beginning in 2010 and Financial Reporting Analyst upon joining HKN in 2008. Prior to joining HKN, Ms. Humphries served as Senior Financial Accounting Analyst at Sabre Holdings, Inc.

Audit Committee Financial Expert

The Audit Committee of our Board (the “Audit Committee”) is composed entirely of independent directors. Although our securities are no longer listed on the NYSE-MKT, we continue to determine the independence of directors under the NYSE-MKT listing standards. Our directors meet the independence, experience and other qualification requirements of the NYSE-MKT, the Securities and Exchange Act of 1934 and the rules and regulations of the SEC. The Chairman of the Audit Committee, Dr. J. William Petty, has been determined by our Board of Directors to be an “audit committee financial expert” as defined by the NYSE MKT rules and the SEC rules and regulations and “financially sophisticated” as required by the NYSE MKT listing standards.

Our Audit Committee’s responsibilities are specified in the Audit Committee Charter (the “Charter”) which is available on our website at www.hkninc.com. As set forth in the Charter, the Audit Committee’s responsibilities include appointing, compensating, retaining and overseeing the work of the independent auditors for the Company (the “Auditors”), for the purpose of preparing or issuing an audit report or related work or performing other audit, review or attestation services for the Company. Our management retains the primary responsibility for the Company’s financial reporting process, principles and internal controls as well as preparation of its financial statements. Our Audit Committee has implemented procedures to ensure that during the course of each fiscal year they devote the attention that they deem necessary or appropriate to each of the matters assigned to the Audit Committee under its Charter.

The Audit Committee is responsible for oversight of the Company’s risks related to accounting matters, financial reporting, and legal and regulatory compliance. To satisfy these overall responsibilities, the Committee separately

meets regularly with the Company's management and our independent auditors. The Audit Committee also reviews the Company's financial statements and proposed audit adjustments.

Code of Ethics

HKN has adopted a code of ethics that applies to all members of the Board of Directors and employees of HKN, including the principal executive officer, principal financial officer, principal accounting officer, controller, or persons performing similar functions. HKN has posted a copy of the code on HKN's website at the internet address: <http://www.hkninc.com/corpgov.html>. Copies of the code of ethics may be obtained free of charge from HKN's website at the above internet address.

Section 16(a) Beneficial Ownership Reporting Compliance

Section 16(a) of the Securities Exchange Act of 1934, as amended (the “Exchange Act”), requires HKN’s directors and executive officers, and any persons who own more than ten percent of a registered class of HKN’s equity securities, to file with the SEC initial reports of ownership and reports of changes in ownership of Common Stock and other equity securities of HKN. Directors, executive officers and greater than ten percent stockholders are required by SEC regulations to furnish HKN with copies of all Section 16(a) forms they file. Based solely on its review of the copies of such forms and written representations from certain reporting persons, HKN believes that all filing requirements applicable to its directors and executive officers have been complied with during 2013.

ITEM 11. EXECUTIVE COMPENSATION**EXECUTIVE COMPENSATION**

The 2013 Summary Compensation Table below sets forth certain information regarding NEO compensation during fiscal years 2013 and 2012. Tables for deferred compensation payments are not presented because HKN does not provide for such forms of compensation.

2013 Summary Compensation Table

Name and Principal Position	Year	Salary	Bonus (1)	Option Awards (2)	All Other Compensation	Total
Mikel D. Faulkner President & CEO	2013	\$325,000	\$16,000	\$36,117	\$35,859 (3)	\$412,976
	2012	\$275,000	\$255,000	\$25,680	\$52,284 (3)	\$607,964
Sarah B. Gasch Executive Vice President and Chief Financial Officer	2013	\$270,000	\$13,000	\$18,058	\$29,821 (4)	\$330,879
	2012	\$238,700	\$40,250	\$12,840	\$17,459 (4)	\$309,249
Kristina M. Humphries Vice President, Chief Accounting Officer and Secretary	2013	\$153,750	\$9,000	\$—	\$17,571 (5)	\$180,321

The bonus amounts for 2013 include additional bonus awards for fiscal year 2012 (which were paid in 2013) as (1) well as bonus awards of \$1,000 paid to each officer. In addition to his 2012 bonus, Mikel D. Faulkner had a \$175,000 bonus award for fiscal year 2011 (which was paid in 2012).

Represents the aggregate grant date fair value in accordance with Accounting Standards Codification 718, “Stock (2) Compensation”. For a discussion of the assumptions made in the valuation of option awards, please refer to Note 11 – “BWI Stock Compensation” to our Consolidated Financial Statements for the fiscal year ended December 31, 2013.

All other compensation for 2013 for Mikel D. Faulkner includes the values of personal use of a company car, club (3) dues, life insurance premiums paid by HKN, HKN’s employer contributions for employee’s 401(k) and a Health Savings Account contribution.

All other compensation for 2012 for Mikel D. Faulkner includes the values of personal use of a company car, life insurance premiums paid by HKN, HKN’s employer contributions for employee’s 401(k), a payment for unused Personal Time Off earned in 2012, a fee allowance and a Health Savings Account contribution.

All other compensation for 2013 for Sarah B. Gasch includes the values of a car allowance, life insurance (4) premiums paid by HKN, HKN’s employer contributions to employee’s 401(k), and a Health Savings Account contribution.

All other compensation for 2012 for Sarah B. Gasch includes the values of HKN’s employer contributions to employee’s 401(k), life insurance premiums paid by HKN and a Health Savings Account contribution.

(5) All other compensation for 2013 for Kristina M. Humphries includes the values of life insurance premiums paid by HKN and HKN’s employer contributions to employee’s 401(k).

The following table sets forth the detail of all outstanding equity awards under the BWI Stock Option Plan by named executive officer.

Outstanding Equity Awards at Fiscal Year-End			
Named Executive Officer	Equity Incentive Plan Awards: Number of Securities Underlying Unexercised Unearned Options (#)	Option Exercise Price (\$)	Option Expiration Date
Mikel D. Faulkner	12,000	\$14.50	2022
	4,000	\$31.60	2023
Sarah B. Gasch	6,000	\$14.50	2022
	2,000	\$31.60	2023
Kristina M. Humphries	0	N/A	N/A

COMPENSATION COMMITTEE INTERLOCKS AND INSIDER PARTICIPATION

During 2013, Dr. J. William Petty and Messrs. Ameen and Smith were members of HKN's Compensation Committee and participated in all deliberations concerning executive compensation. No executive officer of HKN served as a member of the Compensation Committee during 2013. None of the named Executive Officers serves or has served as a member of the board of directors or compensation committee of any other entity which has one or more executive officers serving on HKN's Board of Directors or Compensation Committee.

DIRECTOR COMPENSATION

Name	Fees Earned or Paid in Cash (\$)	Stock Awards (\$)	Option Awards (\$)	Non-Equity Incentive Plan Compensation (\$)	Nonqualified Deferred Compensation Earnings (\$)	All Other Compensation (\$)	Total (\$)
Dr. J. William Petty	\$ 75,000	—	—	—	—	—	\$ 75,000
Michael M. Ameen, Jr.	\$ 75,000	—	—	—	—	—	\$ 75,000
H. A. Smith	\$ 75,000	—	—	—	—	—	\$ 75,000
Alan G. Quasha	—	—	—	—	—	—	—
Mikel D. Faulkner (See 2013 Summary Compensation Table)	—	—	—	—	—	—	—

Board members are paid an annual fixed per director fee of \$75 thousand, with no per meeting fee and no additional fee for a committee chairman.

Director performance is a key influence factor in organizational performance. Just as alignment of HKN's strategic objectives for management compensation are critical, so too is directors' compensation. To this end, directors' compensation is assessed annually to monitor and adjust it, as appropriate, in order to ensure alignment with HKN's strategic objectives.

The analysis and review of directors' compensation is the responsibility of our Compensation Committee and our Board of Directors. In undertaking this responsibility, our Compensation Committee may review compensation surveys of our industry, and may also engage consultants who provide supplemental data considered in establishing the directors' compensation. No third party compensation consultants were used during the fiscal year 2013. The Compensation Committee also takes into consideration HKN's financial results for the previous fiscal year, as compared with internal objectives and targets, the business climate during the year and our industry in general. After our Compensation Committee has reviewed the data, it formulates a recommendation for review by our Board of

Directors.

61

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

OWNERSHIP OF COMMON STOCK

Security Ownership of Certain Beneficial Owners

As of February 28, 2014, HKN had 397,954 shares of common stock outstanding. As of that date, the only persons known by HKN to beneficially own five percent (5%) or more of the outstanding shares of common stock were:

Title of class	Name and address of beneficial owner	Amount and nature of beneficial ownership	Percent of class
Common Stock	Everest Hill Group, Inc. fka Brean Murray Carret Group, Inc. Tropic Isle Building P.O. Box 3331 Road Town, Tortola British Virgin Islands, VG 1110	264,325	66.42 %
Common Stock	First Eagle Investment Management, LLC 1345 Avenue of the Americas New York, NY 10105	22,306	5.6 %

Security Ownership of Directors and Management

The following table sets forth information, as of February 28, 2014, regarding the number of shares of Common Stock beneficially owned by directors and executive officers that are named in the 2013 Summary Compensation Table, and all of HKN's directors and named executive officers as a group. Each director and executive officer has sole voting and investment power with respect to the shares beneficially owned by him/her.

Name	Number of Shares Beneficially Owned	Percent of Class
Michael M. Ameen, Jr.	65	*
Mikel D. Faulkner	75	*
Dr. J. William Petty	81	*
Alan G. Quasha	0 (1)	*
H.A. Smith	33	*
Sarah B. Gasch	0	*
Kristina M. Humphries	0	*
All directors and named executive officers as a group (7 persons)	254	*

* Less than 1%

(1) Does not include 264,325 shares beneficially owned by Everest Hill Group, Inc. (“Everest Hill”). Mr. Alan Quasha is the brother of Wayne Quasha, who is deemed to be the beneficial owner of Everest Hill through the AQ, JQ and WQ Trusts but Mr. Alan Quasha disclaims any beneficial ownership of these shares.

The following table sets forth the securities authorized for issuance under the BWI Stock Option Plan.

Equity Compensation Plan Information

Named Executive Officer	Number of Securities to be Issued Upon Exercise of Outstanding Options (#)	Weighted-Average Exercise Price of Outstanding Options (\$)	Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (#)
Equity compensation plans approved by security holders	50,500	\$22.80	49,500
Equity compensation plans not approved by security holders	0	N/A	0
Total	50,500	\$22.80	49,500

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS AND DIRECTOR INDEPENDENCE

DIRECTOR INDEPENDENCE

Our common stock is currently traded on the Over the Counter Bulletin Board and quoted on the OTCQB marketplace, which does not have director independence requirements. Although our securities are no longer listed on the NYSE- MKT, we continue to determine the independence of directors under the NYSE - MKT listing standards. As such, Dr. J. William Petty, Michael M. Ameen, Jr. and H. A. Smith have been determined by our Board of Directors to meet the requirements for independence under the listing standards of the NYSE-MKT and SEC Rules, and “financially literate or sophisticated” as required by and in compliance with the listing standards of the NYSE-MKT and the regulations of the SEC. Our Board of Directors based its conclusions regarding the independence of these directors on (i) the fact that none of such persons is an executive officer or employee of the Company; and (ii) its opinion that none of such persons has a relationship which will interfere with the exercise of independent judgment in carrying out the responsibilities of such director. Our Board of Directors intends to analyze the independence issue annually to promote arms-length oversight.

As of February 28, 2014, our largest shareholder, Everest Hill, beneficially owned 66.42% of the combined voting power of our Common Stock. Everest Hill is in a position to exercise significant influence over the election of our Board of Directors and other matters.

RELATED PARTY TRANSACTIONS

There are currently no proposed transactions with related parties.

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 year ended December 31, 2013, we have received \$5 million in principal payments from Global. Accrued interest on the outstanding principal balance is due on each quarterly principal payment date. During the year ended December 31, 2013, we have received approximately \$2 million 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 \$177 thousand was deferred and presented net of our long term notes receivable at December 31, 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 March 31, 2014 through March 31, 2015 and \$4.5 million due June 15, 2015.

The Audit Committee Charter authorizes our Audit Committee to review and approve all related party transactions in the absence of a separate committee being established by our Board for that purpose. The Audit Committee and a Special Committee composed of Messrs. Ameen, Smith and Petty both reviewed and approved the Global loans and related amendment. Other than as addressed in the Audit Committee Charter, we do not employ specific written procedures for the review, approval or ratification of related party transactions involving our directors, officers and employees or their family members, but we consider such transactions on a case-by-case basis.

ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES

INDEPENDENT REGISTERED PUBLIC ACCOUNTANTS

Hein & Associates LLP (“Hein”) served as HKN’s independent registered public accounting firm for the years ended December 31, 2013 and 2012.

The following table sets forth information concerning the fees billed by HKN’s independent registered public accountants during the last two fiscal years.

	2013	2012
Audit Fees	\$ 126,629	\$ 116,063
Audit Related Fees	0	0
Tax Fees	0	0
All Other Fees	0	0

Audit Fees include fees billed for the audit of the consolidated financial statements and quarterly reviews of unaudited financial statements.

The Audit Committee, or a designated member thereof, pre-approves audit and non-audit services rendered by its independent registered public accounting firm to HKN and its subsidiaries. If pre-approval authority is delegated, the delegate must report back to the Audit Committee at the first Audit Committee meeting following any approval. For the fiscal year 2013, 100% of all audit and non-audit services were pre-approved by the Audit Committee, which concluded that the provision of such services by HKN's independent registered public accounting firm was compatible with the maintenance of that firm's independence in the conduct of its auditing functions. All persons involved in the services performed by Hein during 2013 were permanent, full-time employees of Hein.

PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES

(a) The following documents are filed as a part of this Annual Report:

(1) Financial Statements included in Part II of this Annual Report:

	<u>Page</u>
HKN, Inc. and Subsidiaries	
-- Report of Independent Registered Public Accounting Firm	27
-- Consolidated Balance Sheets -- December 31, 2013 and 2012	28
-- Consolidated Statements of Operations for the two years ended December 31, 2013	29
-- Consolidated Statements of Comprehensive Income (Loss) for the two years ended December 31, 2013	30
-- Consolidated Statements of Stockholders' Equity for the two years ended December 31, 2013	31
-- Consolidated Statements of Cash Flows for the two years ended December 31, 2013	32
-- Notes to Consolidated Financial Statements	33

The information required by Schedule I is either provided in the related financial statements or in a note thereto, or is not applicable to HKN, Inc. The information required by all other Schedules is not applicable to HKN, Inc.

(3) Exhibits

3.1 Restated Certificate of Incorporation of Harken Energy Corporation (filed as Exhibit 3.1 to HKN's Form 10-K dated February 28, 2006, File No. 1-10262, and incorporated herein by reference).

3.2 Certificate of Amendment of Restated Certificate of Incorporation of Harken Energy Corporation dated June 4, 2007 (filed as Exhibit 3.2 to HKN's Form 10-Q dated August 7, 2007, File No. 1-10262, and incorporated by reference herein).

3.3 Certificate of Amendment to Restated Certificate of Incorporation of HKN, Inc. dated October 29, 2012 and effective October 30, 2012 (filed as Exhibit 99.2 to HKN's current report on Form 8-K, dated October 31, 2012, File No. 1-10262, and incorporated by reference herein).

3.4 Amended and Restated Bylaws of HKN, Inc. (filed as Exhibit 3.1 to HKN's current report on Form 8-K, dated May 1, 2013, File No. 1-10262, and incorporated by reference herein).

4.1 Form of certificate representing shares of HKN, Inc. common stock, par value \$.01 per share (filed as Exhibit 4.1 to HKN's Form 10-Q dated August 7, 2007, File No. 1-10262, and incorporated by reference herein).

4.4

Edgar Filing: HKN, Inc. - Form 10-K

Certificate of Designations of Series G1 Convertible Preferred Stock (filed as Exhibit 3.7 to Harken's Current Report on Form 8-K dated February 13, 2003, File No. 1-10262, and incorporated by reference herein).

Certificate of Increase of Series G1 Convertible Preferred Stock of Harken Energy Corporation (filed as Exhibit 3.8 to Harken's Current Report on Form 8-K dated February 13, 2003, File No. 1-10262, and incorporated by reference herein).

- 4.6 Certificate of Designations of Series G2 Convertible Preferred Stock (filed as Exhibit 4.10 to Harken's Annual Report on Form 10-K, as amended, for the fiscal year ended December 31, 2001, File No. 1-10262, and incorporated by reference herein).
- 10.1 Loan Agreement with Global Energy PLC, principal amount of \$17 million (filed as Exhibit 10.1 to HKN's Current Report on Form 8-K dated March 12, 2013, File No. 1-10262, and incorporated by reference herein).
- *21 Subsidiaries of HKN, Inc.
- *23.1 Consent of Independent Registered Public Accounting Firm – Hein & Associates, LLP
- *23.2 Consent of Moyes and Co. (Independent Reserve Engineers)
- *24 Power of Attorney
- *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
- *99.1 Moyes & Co. Reserve report summary
- *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.

SIGNATURES

Pursuant to the requirements of the Section 13 or 15(d) 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, on March 6, 2014.

HKN, INC.

/s/ Sarah B. Gasch

By: Sarah B. Gasch, Executive Vice President and Chief Financial Officer (Principal Financial Officer and Principal Accounting Officer)

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, this report has been signed below by the following persons on behalf of the registrant and in the capacities on March 6, 2014.

Signature	Title
/s/ Sarah B. Gasch Sarah B. Gasch	Executive Vice President and Chief Financial Officer (Principal Financial Officer and Principal Accounting Officer)
/s/ Mikel D. Faulkner Mikel D. Faulkner	Director, Chief Executive Officer and President (Principal Executive Officer)
/s/ Michael M. Ameen, Jr. * Michael M. Ameen, Jr.	Director
Alan G. Quasha	Director
/s/ Dr. J. William Petty * Dr. J. William Petty	Director
/s/ H. A. Smith * H. A. Smith	Director

/s/ Sarah B. Gasch

* By: Sarah B. Gasch, Attorney in-fact

