GASTAR EXPLORATION LTD
Form 10-K
March 11, 2013
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-K

x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934
For the Fiscal Year Ended December 31, 2012

or

o TRANSITION REPORT PURSUANT TO SECTION 13 or 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to .

Commission file number: 001-32714
Commission file number: 001-35211

GASTAR EXPLORATION LTD.
GASTAR EXPLORATION USA, INC.
(Exact name of registrant as specified in its charter)

Alberta, Canada	98-0570897
Delaware	38-3531640
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

1331 Lamar Street, Suite 650	
Houston, Texas	77010
(Address of principal executive offices)	(Zip Code)

(713) 739-1800
(Registrant’s telephone number, including area code)

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

Gastar Exploration Ltd. Common Stock, No Par Value	NYSE MKT LLC
Gastar Exploration USA, Inc. 8.625% Series A Cumulative Preferred Stock	NYSE MKT LLC
(Title of each class)	(Name of Exchange on which registered)

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 by Rule 405 of the Securities Act.

Gastar Exploration Ltd.	Yes	¨	No	ý

Gastar Exploration USA, Inc.	Yes	¨	No	ý

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

Gastar Exploration Ltd.	Yes	¨	No	ý
Gastar Exploration USA, Inc.	Yes	¨	No	ý

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.

Gastar Exploration Ltd.	Yes	ý	No	¨
Gastar Exploration USA, Inc.	Yes	ý	No	¨

Indicate by check mark 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).

Gastar Exploration Ltd.	Yes	ý	No	¨
Gastar Exploration USA, Inc.	Yes	ý	No	¨

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter)
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.

Gastar Exploration Ltd.	¨
Gastar Exploration USA, Inc.	ý

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

Gastar Exploration Ltd.	Large accelerated filer	¨	Accelerated filer	ý
	Non-accelerated filer	¨	Smaller reporting company	¨
Gastar Exploration USA, Inc.	Large accelerated filer	¨	Accelerated filer	¨
	Non-accelerated filer	ý	Smaller reporting company	¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Securities Exchange Act of 1934).

Gastar Exploration Ltd.	Yes	¨	No	ý
Gastar Exploration USA, Inc.	Yes	¨	No	ý

The aggregate market value of the voting and non-voting common equity of Gastar Exploration Ltd. held by non-affiliates of Gastar Exploration Ltd. as of June 29, 2012 (the last business day of Gastar Exploration Ltd.'s most recently completed second fiscal quarter) was approximately $110.0 million based on the closing price of $1.93 per share on the NYSE MKT LLC.

All common equity in Gastar Exploration USA, Inc. is held by Gastar Exploration Ltd., an affiliate of Gastar Exploration USA, Inc. Gastar Exploration USA, Inc. meets the conditions set forth in General Instruction (I)(1)(a) and (b) and is filing this Form with the reduced disclosure format.

The total number of outstanding common shares, no par value per share, as of March 7, 2013 was:

Gastar Exploration Ltd.	68,450,241	shares of common stock

Gastar Exploration USA, Inc.	750	shares of common stock

DOCUMENTS INCORPORATED BY REFERENCE:

The information required by Part III of Form 10-K (Items 10, 11, 12, 13 and 14) is incorporated by reference from portions of Gastar Exploration Ltd.'s definitive proxy statement relating to its 2013 annual meeting of shareholders to be filed with the U.S. Securities and Exchange Commission (“SEC”) within 120 days of December 31, 2012.

Table of Contents

GASTAR EXPLORATION LTD. AND SUBSIDIARIES
ANNUAL REPORT ON FORM 10-K FOR THE YEAR ENDED DECEMBER 31, 2012
TABLE OF CONTENTS

2

Table of Contents

Table of Contents

CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

This Annual Report on Form 10-K (this “Form 10-K”) includes forward-looking information that is intended to be covered by the “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933, as amended (the "Securities Act"), and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). All statements other than statements of historical fact included or incorporated by reference in this Form 10-K are forward-looking statements, including without limitation all statements regarding future plans, business objectives, strategies, expected future financial position or performance, expected future operational position or performance, budgets and projected costs, future competitive position or goals and/or projections of management for future operations. In some cases, you can identify a forward-looking statement by terminology such as “may,” “will,” “could,” “should,” “expect,” “plan,” “project,” “intend,” “ant “believe,” “estimate,” “predict,” “potential,” “pursue,” “target” or “continue,” the negative of such terms or variations thereon, other comparable terminology.

The forward-looking statements contained in this Form 10-K are largely based on our expectations and beliefs concerning future developments and their potential effect on us, which reflect certain estimates and assumptions made by our management. These estimates and assumptions reflect our best judgment based on currently known market conditions, operating trends and other factors. Forward-looking statements may include statements that relate to, among other things, our:

- financial position;
- business strategy and budgets;
- anticipated capital expenditures;
- drilling of wells, including the anticipated scheduling and results of such operations;
- natural gas, oil and NGLs reserves;
- timing and amount of future production of natural gas, condensate, oil and NGLs;
- operating costs and other expenses;
- cash flow and anticipated liquidity;
- prospect development; and
- property acquisitions and sales.

Although we believe such estimates and assumptions to be reasonable, they are inherently uncertain and involve a number of risks and uncertainties that are beyond our control. As such, management’s assumptions about future events may prove to be inaccurate. For a more detailed description of the known material factors that could cause actual results to differ from those in the forward-looking statements, see “Item 1A. Risk Factors” in Part I of this Form 10-K. We do not intend to publicly update or revise any forward-looking statements as a result of new information, future events, changes in circumstances or otherwise. These cautionary statements qualify all forward-looking statements attributable to us, or persons acting on our behalf. Management cautions all readers that the forward-looking statements contained in this Form 10-K are not guarantees of future performance, and we cannot assure any reader that such statements will be realized or that the events and circumstances they describe will occur.

Factors that could cause actual results to differ materially from those anticipated or implied in the forward-looking statements herein include, but are not limited to:

- the supply and demand for natural gas, condensate, oil and NGLs;
- low and/or declining prices for natural gas, condensate, oil and NGLs;
- natural gas, condensate, oil and NGLs price volatility;
- worldwide political and economic conditions and conditions in the energy market;
- our ability to raise capital to fund planned capital expenditures or repay or refinance debt upon maturity;
- the ability and willingness of our current or potential counterparties, third-party operators or vendors to enter into transactions with us and/or to fulfill their obligations to us;
- failure of our joint interest partners to fund any or all of their portion of any capital program;
- the ability to find, acquire, market, develop and produce new natural gas and oil properties;
- uncertainties about the estimated quantities of natural gas and oil reserves and in the projection of future rates of production and timing of development expenditures of proved reserves;

- strength and financial resources of competitors;
- availability and cost of material and equipment, such as drilling rigs and transportation pipelines;

4

Table of Contents

- availability and cost of processing and transportation;
- changes or advances in technology;
- the risks associated with exploration, including cost overruns and the drilling of non-economic wells or dry wells,
- operating hazards inherent to the natural gas and oil business and down hole drilling and completion risks that are generally not recoverable from third parties or insurance;
- potential mechanical failure or under-performance of significant wells or pipeline mishaps;
- environmental risks;
- possible new legislative initiatives and regulatory changes potentially adversely impacting our business and industry, including, but not limited to, national healthcare, hydraulic fracturing, state and federal corporate income taxes, retroactive royalty or production tax regimes, changes in environmental regulations, environmental risks and liability under federal, state and local environmental laws and regulations;
- effects of the application of applicable laws and regulations, including changes in such regulations or the interpretation thereof;
- potential losses from pending or possible future claims, litigation or enforcement actions;
- potential defects in title to our properties or lease termination due to lack of activity or other disputes with mineral lease and royalty owners, whether regarding calculation and payment of royalties or otherwise;
- the weather, including the occurrence of any adverse weather conditions and/or natural disasters affecting our business;
- ability to find and retain skilled personnel; and
- any other factors that impact or could impact the exploration of natural gas or oil resources, including, but not limited to, the geology of a resource, the total amount and costs to develop recoverable reserves, legal title, regulatory, natural gas administration, marketing and operational factors relating to the extraction of natural gas and oil.

You should not unduly rely on these forward-looking statements in this Form 10-K, as they speak only as of the date of this Form 10-K. Except as required by law, we undertake no obligation to publicly update, revise or release any revisions to these forward-looking statements after the date on which they are made to reflect new information, events or circumstances occurring after the date of this Form 10-K or to reflect the occurrence of unanticipated events.

Unless otherwise indicated or required by the context, (i) “Gastar,” the “Company,” “we,” “us,” “our” and similar terms refer collectively to Gastar Exploration Ltd. and its subsidiaries, including Gastar Exploration USA, Inc., and predecessors, (ii) “Gastar USA” refers to Gastar Exploration USA, Inc., our first-tier subsidiary and primary operating company, (iii) “Parent” refers solely to Gastar Exploration Ltd., (iv) all dollar amounts appearing in this Form 10-K are stated in United States dollars (“U.S. dollars”) unless otherwise noted and (v) all financial data included in this Form 10-K have been prepared in accordance with generally accepted accounting principles in the United States of America (“U.S. GAAP”).

Table of Contents

Glossary of Terms

AMI	Area of Mutual Interest, an agreed designated geographic area where joint venturers or other industry partners have a right of participation in acquisitions and operations
Bbl	Barrel of oil, condensate or NGLs
Bbl/d	Barrels of oil, condensate or NGLs per day
Bcf	One billion cubic feet of natural gas
Bcfe	One billion cubic feet of natural gas equivalent, determined using the ratio of six cubic feet of natural gas to one barrel of oil, condensate or NGLs
Btu	British thermal unit, typically used in measuring natural gas energy content
CBM	Coal bed methane
CRP	Central receipt point
FASB	Financial Accounting Standards Board
GAAP	Accounting principles generally accepted in the United States of America
MBbl	One thousand barrels of oil, condensate or NGLs
MBbl/d	One thousand barrels of oil, condensate or NGLs per day
Mcf	One thousand cubic feet of natural gas
Mcf/d	One thousand cubic feet of natural gas per day
Mcfe	One thousand cubic feet of natural gas equivalent, determined using the ratio of six cubic feet of natural gas to one barrel of oil, condensate or NGLs
MMBtu/d	One million British thermal units per day
MMcf	One million cubic feet of natural gas
MMcf/d	One million cubic feet of natural gas per day
MMcfe	One million cubic feet of natural gas equivalent, determined using the ratio of six cubic feet of natural gas to one barrel of oil, condensate or NGLs
MMcfe/d	One million cubic feet of natural gas equivalent per day, determined using the ratio of six cubic feet of natural gas to one barrel of oil, condensate or NGLs
NGLs	Natural gas liquids
NYMEX	New York Mercantile Exchange

psi	Pounds per square inch
U.S.	United States

6

Table of Contents

PART I

Item 1. Business

Overview

We are an independent energy company engaged in the exploration, development and production of natural gas, condensate, oil and NGLs in the U.S. Our principal business activities include the identification, acquisition, and subsequent exploration and development of natural gas and oil properties with an emphasis on unconventional reserves, such as shale resource plays. We are currently pursuing the development of liquids-rich natural gas in the Marcellus Shale play in West Virginia and, to a lesser extent, central and southwestern Pennsylvania and oil in the Mid-Continent area of the U.S. We also hold prospective acreage in the deep Bossier play in the Hilltop area of East Texas.

Gastar Exploration Ltd. is a Canadian corporation, incorporated in Alberta in 1987 and subsisting under the Business Corporations Act (Alberta), with its common shares listed on the NYSE MKT LLC under the symbol “GST.” Gastar Exploration Ltd. is a holding company and substantially all of its operations are conducted through, and substantially all of its assets are held by, its primary operating subsidiary, Gastar USA and its wholly-owned subsidiaries. Gastar USA is a Delaware corporation with its 8.625% Series A Cumulative Preferred Stock listed on the NYSE MKT LLC under the symbol “GST.PRA.” Our principal office is located at 1331 Lamar Street, Suite 650, Houston, Texas 77010, and our telephone number is (713) 739-1800. Our website address is http://www.gastar.com. Information on our website or about us on any other website is not incorporated by reference into and does not constitute part of this Form 10-K.

Our Strategy

Our strategy is to increase stockholder value by delivering sustainable reserves growth and improved operating results from our existing assets. We recognize that there may be periods, such as the recent declines in natural gas prices, which make it difficult to fully execute this strategy on a short-term basis. We intend to implement our strategy by focusing on:

- continued exploitation of existing Marcellus Shale assets with a focus on areas that we believe are prospective for natural gas with relatively high condensate and NGLs content;
- exploitation and development of our assets in the Mid-Continent horizontal oil play;
- active management of our domestic drilling programs; and
- effective management and utilization of technological expertise.

Continue Exploitation of Existing Marcellus Shale Assets and Focus on Areas with Relatively High NGLs and Condensate Content

We are continuing to focus the majority of our drilling activity in the liquids-rich area of the Marcellus Shale, with approximately 64% of our 2013 capital budget allocated to the Marcellus Shale. Our 2013 capital budget includes plans to place on production an additional 19 gross (9.5 net) operated Marcellus horizontal wells in Marshall County, West Virginia, if we successfully implement our planned drilling program. We believe that the expansion of our acreage position and our drilling activity in the Marcellus Shale during 2012 has provided us with a multi-year inventory of drilling opportunities. Our focus continues to be in a prospectively liquids-rich area with subsequent focus on drilling acreage in order to hold the acreage "by production" prior to lease term expirations.

Exploitation and Development within a Mid-Continent Horizontal Oil Play

During 2012, we acquired approximately 41,900 gross (17,300 net) acres of leasehold in an emerging oil play located in the Mid-Continent region of the U.S. We expect to continue to build our acreage position in this region in partnership with our operating partner during 2013. This program is focused on using modern horizontal drilling and multi-stage fracture stimulation technologies to exploit a predominantly crude oil-bearing reservoir, which has been produced historically using vertical wells conventional with completion techniques. During 2012, we, along with our operating partner, drilled and completed one horizontal well and spud two additional horizontal wells. Based on the 30 days ended February 20, 2013, the initial well produced at an after-processing average gross rate of 105 barrels of oil equivalent per day, comprised of 69 barrels of oil per day, 20 barrels of NGLs per day, 94 Mcf of natural gas per day and 247 barrels of completion fluids per day. Flow back operations on the second well commenced on February 15, 2013, with encouraging preliminary results. Drilling operations on the third well were completed during February 2013 and completion operations are scheduled to commence in mid-March 2013. A fourth horizontal well was spud on February 16, 2013. For the first 12,500 gross acres acquired in the initial AMI prospect, we paid 62.5% of lease acquisition costs for a 50% leasehold interest and 50% of lease acquisition costs on additional acres in excess of 12,500 gross acres acquired for a 50% working interest. We will pay 54.25% of the lease acquisition costs in the two new prospect areas for a 50% working interest. In each prospect area, we pay 62.5% of the gross drilling and completion costs of the first four wells and 56.25 % of the gross drilling and completion costs of the next four

Table of Contents

wells, in each case to earn a 50% working interest. For all additional wells beyond the first eight in a prospect area, we are responsible for paying only the drilling and completion costs associated with our 50% working interest (our approximate net revenue interest is 39.0%). A third-party operator handles all drilling, completion and production activities, and we handle all leasing and permitting activities in this oil play.

Actively Manage Our Domestic Drilling Program

We believe that operating approximately 70% of our drilling projects for 2013 enables us to control the timing and cost of our drilling budget as well as control operating costs and the marketing of our production. We believe that we have assembled an experienced team of operating professionals with the specialized skills needed to plan and execute the drilling and completion of horizontal Marcellus Shale wells.

Manage and Utilize Technological Expertise

We believe that 3-D seismic analysis, micro-seismic data acquisition and interpretation, enhanced natural gas recovery processes, horizontal drilling and other advanced drilling, formation evaluation and production techniques are valuable tools that improve drilling results and ultimately enhance production and returns. We believe that utilizing these technologies and production techniques in exploring for, developing and exploiting natural gas and oil properties has helped us reduce drilling risks, lower finding costs and provide for more efficient production of natural gas and oil from our properties.

Natural Gas and Oil Activities

The following provides an overview of our major natural gas and oil projects during 2012. While actively pursuing specific exploration and development activities in each of the following areas, we continue to review other opportunities. There is no assurance that new drilling opportunities will be identified or that any new drilling opportunities will be successful if drilled.

Marcellus Shale and Other Appalachia

The Marcellus Shale is Devonian aged shale that underlies much of the Appalachian region of Pennsylvania, New York, Ohio, West Virginia and adjacent states. The depth of the Marcellus Shale and its low permeability make the Marcellus Shale an unconventional exploration target in the Appalachian Basin. Advancements in horizontal drilling and stimulation have produced excellent results in the Marcellus Shale. These developments have resulted in increased leasing and drilling activity in the area. As of December 31, 2012, our acreage position in the play was approximately 107,600 gross (75,200 net) acres. We refer to the approximately 46,900 gross (20,900 net) acres reflecting our interest in our Marcellus Shale assets in West Virginia and Pennsylvania subject to the Atinum Joint Venture described below as our “Marcellus West acreage.” We refer to the approximately 60,700 gross (54,200 net) acres in Preston, Tucker, Pocahontas, Randolph and Pendleton Counties, West Virginia as our “Marcellus East acreage.” The entirety of our acreage is believed to be in the core, over-pressured area of the Marcellus Shale play.

On September 21, 2010, we entered into the “Atinum Joint Venture” pursuant to a purchase and sale agreement with an affiliate of Atinum Partners Co. Ltd. (“Atinum”). Pursuant to the agreement, at the closing of the transaction on November 1, 2010, we assigned to Atinum, for $70.0 million in total consideration, an initial 21.43% interest in all of our existing Marcellus Shale assets in West Virginia and Pennsylvania, consisting of certain undeveloped acreage and a 50% working interest in 16 producing shallow conventional wells and one non-producing vertical Marcellus Shale well (the “Atinum Joint Venture Assets”). Atinum paid us approximately $30.0 million in cash upon closing. Additionally, Atinum was obligated to fund its 50% share of drilling, completion and infrastructure costs, and paid an additional $40.0 million of drilling costs in the form of a drilling carry obligation by funding 75% of our 50% share of those same costs. Upon completion of the funding of the drilling carry at December 31, 2011, we made additional assignments in early 2012, as necessary, to Atinum as a result of which Atinum now owns a 50% interest in the Atinum Joint Venture Assets.

The Atinum Joint Venture's initial three-year development program called for the partners to drill a minimum of 12 horizontal wells in 2011 and 24 horizontal wells in each of 2012 and 2013 for a total of 60 wells to be drilled. Due to natural gas price declines, Atinum and Gastar USA agreed during the first quarter 2012 to reduce the 2012 minimum wells to be drilled requirement from 24 wells to 20 wells. Atinum and Gastar USA subsequently agreed to extend the rig contract in the Marcellus Shale to May 2013, resulting in 29 gross operated wells drilled and completed during 2012 and 38 gross wells on production at December 31, 2012. All of our 2012 Marcellus Shale well operations were under the Atinum Joint Venture. Additionally, Atinum and Gastar USA agreed to reduce the 2013 minimum wells to 19 gross wells which will result in 57 gross wells on production at December 31, 2013, compared to the 60 gross wells originally agreed upon. Effective June 30, 2011, Atinum has the right to participate in any future leasehold acquisitions made by us within Ohio, New York, Pennsylvania and West Virginia, excluding the counties of Pendleton, Pocahontas, Preston, Randolph and Tucker, West Virginia, on terms identical to those governing the existing Atinum Joint Venture. We will act as operator and are obligated to offer any future lease acquisitions to

Table of Contents

Atinum on a 50/50 basis. Atinum will pay us on an annual basis an amount equal to 10% of lease bonuses and third party leasing costs up to $20.0 million and 5% of such costs on activities above $20.0 million.

As of December 31, 2012, our operated wells capable of production in Marshall County, West Virginia were comprised of the following:

Pad	Gross Well Count	Net Well Count	Working Interest	Net Revenue Interest	Average Lateral Length (in feet) (1)	Date on Production
Corley	4.0	1.6	40.8%	35.4%	4,900	December 2011
Simms	3.0	1.5	50.0%	43.2%	5,000	December 2011
Hall	3.0	1.2	40.0%	34.7%	4,400	January 2012
Hendrickson	5.0	2.0	40.0%	34.7%	4,700	April 2012
Accettolo	3.0	1.5	50.0%	40.2%	4,600	June 2012
Burch Ridge	5.0	2.5	50.0%	41.5%	5,800	August 2012
Wayne	4.0	2.0	50.0%	40.6%	5,700	September 2012
Wengerd	7.0	3.1	44.5%	37.7%	5,000	November 2012
Lily	4.0	2.0	50.0%	40.6%	5,200	December 2012
	38.0	17.4				

(1) Average well lateral length approximates the actual average well lateral length for the pad wells.

As of December 31, 2012, we had drilling operations at various stages on the following wells in Marshall County, West Virginia:

Pad	Gross Well Count	Net Well Count	Working Interest	Estimated Net Revenue Interest	Average Lateral Length (in feet) (1)	Status	Estimated Production Date
Addison	5.0	2.5	50.0%	41.7%	4,900	Drilling operations in progress	Late First Quarter 2013
Shields	10.0	5.0	50.0%	42.0%	3,400	Drilling and fracture stimulation operations in progress	Mid-First and Third Quarters 2013
	15.0	7.5					