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**UNITED STATES 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, 2012**

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

Commission file number **001-35432**

**ZAZA ENERGY CORPORATION**

(Exact name of registrant as specified in its charter)

**Delaware**

(State or other jurisdiction of incorporation)

**45-2986089**

(I.R.S. Employer Identification Number)

**ZaZa Energy Corporation  
1301 McKinney St Suite 2850  
Houston, Texas 77010**

(Address of principal executive office)

Registrant's telephone number, including area code: **713-595-1900**

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 Section 15(d) of the Act. Yes ☐ No ☒

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

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

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

Large accelerated filer ☐ Accelerated filer ☐ Non-accelerated filer ☒ Smaller Reporting company ☐  
(Do not check if a smaller reporting company)

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

As of February 28, 2013, there were 102,519,001 shares of common stock, par value \$0.01 per share, outstanding.

The aggregate market value of the voting and non-voting common equity of the registrant held by non-affiliates, computed by reference to the closing sales price of such stock, as of February 28, 2013 was \$62,813,483. (For purposes of determination of the aggregate market value, only directors, executive officers and 10% or greater stockholders have been deemed affiliates.)

The information required in Part III of the Annual Report on Form 10-K is incorporated by reference to the registrant's definitive proxy statement to be filed pursuant to Regulation 14A for the registrant's 2013 Annual Meeting of Stockholders.

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## PART I

### ITEM 1 AND 2. BUSINESS AND PROPERTIES

See the "Glossary of Selected Oil and Natural Gas Terms" at the end of Item 1 for the definition of certain terms in this annual report.

ZaZa Energy Corporation ("ZaZa") is an independent exploration and production company focused on unconventional oil and gas resources, particularly tight oil plays. ZaZa has grown its existing property base by developing and exploring its acreage, purchasing new undeveloped leases, and acquiring oil and gas producing properties and drilling prospects. According to our external engineering firm, Ryder Scott, as of December 31, 2012, ZaZa LLC's proved reserves were 3,348 MBOE.

ZaZa is a Delaware corporation formed for the purpose of being a holding company of both Toreador Resources Corporation, a Delaware corporation ("Toreador"), and ZaZa Energy, LLC, a Texas limited liability company ("ZaZa LLC"), from and after completion of the Combination, as described below. Prior to the Combination on February 21, 2012, ZaZa had no assets and had not conducted any material activities other than those incident to its formation. However, upon the consummation of the Combination, ZaZa became the parent company of ZaZa LLC and Toreador. In this Annual Report on Form 10-K, unless the context provides otherwise, "we", "our", "us" and like references refer to ZaZa and its subsidiaries.

ZaZa's principal executive office is located at, 1301 McKinney Street, Suite 2850, Houston, Texas 77010 (telephone number: (713) 595-1900).

On February 22, 2012 our common stock began trading on the NASDAQ Capital Market under the trading symbol "ZAZA".

#### Creation of ZaZa Energy Corporation

On February 21, 2012, we consummated the combination (the "Combination") of ZaZa LLC and Toreador, on the terms set forth in the Agreement and Plan of Merger and Contribution, dated August 9, 2011, and as subsequently amended (as amended, the "Merger Agreement").

Pursuant to the Merger Agreement, (i) a wholly-owned subsidiary of ZaZa merged with and into Toreador (the "Merger"), with Toreador continuing as a surviving entity, (ii) the three former members of ZaZa LLC (the "ZaZa LLC Members"), holding 100% of the limited liability company interests in ZaZa LLC, directly and indirectly contributed all of such interests to ZaZa (the "Contribution"), and (iii) the holders of certain profits interests in ZaZa LLC contributed 100% of such interests to ZaZa (the "Profits Interests Contribution"). Upon the consummation of the Combination, Toreador and ZaZa LLC became our wholly-owned subsidiaries.

The Combination was treated as a reverse merger under the purchase method of accounting in accordance with GAAP. For accounting purposes, ZaZa LLC is considered to have acquired Toreador in the Combination. Under the purchase method of accounting, the assets and liabilities of Toreador were recorded at their respective fair values and added to those of ZaZa LLC in our financial statements.

At the effective time of the Merger, each share of common stock of Toreador issued and outstanding immediately prior to the effective time of the Merger was converted into the right to receive one share of ZaZa common stock, par value \$0.01 per share (the "Common Stock"), which in the aggregate represented 25% of the issued and outstanding shares of Common Stock immediately after the consummation of the Combination (but without giving effect to the shares of Common Stock issuable upon exercise of the Warrants as discussed below).

Simultaneously with the consummation of the Merger, and pursuant to the Contribution Agreement dated August 9, 2011, among the ZaZa LLC Members and ZaZa (the "Contribution Agreement"), the ZaZa LLC Members contributed all of the direct or indirect limited liability company interests in ZaZa LLC to ZaZa in exchange for (i) a number of shares of Common Stock that, in the aggregate, represented 75% of the issued and outstanding shares of Common Stock immediately after the consummation of the Combination (but without giving effect to the shares of Common Stock issuable upon exercise of the Warrants as discussed below), and (ii) subordinated notes in an aggregate amount of \$38.25 million issued to the ZaZa LLC Members as partial consideration for the Combination

(the “Seller Notes”). In addition, as required under the terms of the Merger Agreement and the Contribution Agreement, we issued subordinated notes in an aggregate amount of \$9.08 million to the individuals that own and control the ZaZa LLC Members, Todd Alan Brooks, Gaston L. Kearby and John E. Hearn Jr. (together, the “ZaZa Founders”), in respect of certain unpaid compensation amounts owing to the ZaZa Founders by ZaZa LLC (the “Compensation Notes”).

Immediately after the consummation of the Merger and Contribution, and pursuant to the Net Profits Interest Contribution Agreement, dated August 9, 2011, among ZaZa, ZaZa LLC and the holders of net profits interests in ZaZa LLC, the parties completed the Profits Interests Contribution pursuant to which ZaZa acquired their net profits interests from such holders in exchange for \$4.8 million in cash.

Additionally, in connection with the Combination, we issued senior secured notes with a principal amount of \$100 million maturing in 2017 (the “Senior Secured Notes”) in a private placement to a group of investors led by MSD Energy Partners, L.P. and Senator Investment Group LP. As a result of prepayments in connection with the dissolution of our Hess joint venture and certain asset sales, discussed in more detail elsewhere, we had reduced the outstanding principal amount of the Senior Secured Notes to \$33.2 million as of December 31, 2012. In connection with the issuance of the Senior Secured Notes, ZaZa also issued to the investors warrants to purchase an aggregate of approximately 26.3 million shares of our common stock at \$3.15 per share (the “Warrants”) representing 20.6% of the outstanding shares of our common stock at the closing of the Combination, on a fully diluted and on an as-converted basis. The Warrants expire in five years and are exercisable at any time after August 21, 2012. As a result of anti-dilution adjustments in connection with our issuance of \$40 million of Convertible Senior Notes due 2017 in October 2012, the number of outstanding shares of our common stock represented by the Warrants was increased from 26,315,789 to 27,226,223 and the exercise price per share was reduced to \$3.04 per share. In connection with our recent amendment to the terms of the Senior Secured Notes discussed elsewhere, we agreed to reduce the exercise price of the Warrants to \$2.00 per share.

#### *ZaZa Energy, LLC*

ZaZa LLC was formed in March 2009 primarily to acquire and develop unconventional oil and gas resources and was a privately-held company until February 21, 2012 when it was contributed to ZaZa as part of the Combination. ZaZa LLC was previously controlled by the ZaZa Founders who each beneficially owned one-third of the outstanding limited liability company interests of ZaZa LLC. ZaZa LLC's operations have been concentrated in south Texas, including its exploration area in the core area of the Eagle Ford shale formation and in the eastern extension of the Eagle Ford/Woodbine formation, which we refer to as the "Eaglebine."

ZaZa LLC's initial exploration and production activities were undertaken primarily through a joint venture with Hess Corporation, which accumulated approximately 121,000 gross acres (approximately 11,500 net acres to ZaZa LLC). ZaZa LLC operated the Hess joint venture properties during the first year of drilling, after which Hess had an election to take over operatorship. This provision enabled ZaZa LLC to build an operating track record during this first year of drilling. As operator of the Hess joint venture, ZaZa LLC successfully drilled and completed 18 Eagle Ford wells. Hess then elected to take over operatorship, and the transition from ZaZa LLC to Hess commenced in November 2011 and was expected to be completed in July 2012. In conjunction with the operatorship transition, Hess also made public announcements in the first quarter of 2012 indicating that Hess intended to pursue a drilling program in 2012-2013 that was slower than ZaZa LLC had anticipated. The combination of Hess taking over operatorship and the expectation that Hess would slow the drilling program led ZaZa LLC to negotiate an exit from the Hess joint venture in July 2012. As a result of this exit, ZaZa LLC relinquished the Cotulla Area and regained operational control of approximately 60% of the venture's former acreage (totaling 72,000 net acres). As described below, Tereador also exited its joint venture with Hess in France, which had stalled due to French governmental regulations on the development of unconventional resources. This resulted in ZaZa converting its 50% working interest in the French exploration licenses to a 5% non-cost bearing revenue interest for up to \$130 million in cash receipts. In addition to the aforementioned land transitions in connection with the dissolution of the joint venture, ZaZa also received an aggregate of \$84 million in cash from Hess. For a complete description of the transactions in connection with the dissolution of the Hess Joint Venture, see Item 7, “Management’s Discussion and Analysis of Financial Condition and Results of Operations - 2012 Developments - Hess Joint Venture Dissolution Agreement.”

ZaZa LLC also had accumulated approximately 82,000 gross acres (approximately 60,000 net acres) in the Eaglebine formation, which acreage was not part of its joint venture with Hess. On March 29, 2012, ZaZa LLC entered into a transaction with Range Texas Production, LLC (“Range”), a subsidiary of Range Resources

Corporation, to expand ZaZa's position in the Eaglebine to a total holding of approximately 143,400 gross acres (98,520 net acres). Under the terms of the transaction, ZaZa LLC: obtained a 75% working interest in the acquired acreage; was designated as operator; committed to drill one well; was obligated and satisfied its obligation to commence operations on the commitment well on or before August 1, 2012; and committed to and made two cash payments to Range. After a casing collar failure on the commitment well, Range granted ZaZa LLC an extension to drill a substitute well, which is scheduled for the third quarter of 2013. For a complete description of the transactions in connection with the Range joint venture, see Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations -- 2012 Developments -- Range Transaction."

#### *Toreador Resources Corporation*

Prior to the Combination, Toreador was a publicly held independent energy company engaged in the exploration and production of crude oil with interests in developed and undeveloped oil properties in the Paris Basin, France. At the time of the Combination, Toreador operated solely in the Paris Basin and its operations consisted of (i) a joint venture with Hess Corporation in the Paris Basin focused on unconventional resources and (ii) conventional Paris Basin assets held by ZaZa Energy France SAS.

The unconventional resource joint venture with Hess stalled due to French governmental regulations. ZaZa ended the Hess Paris venture in July 2012 by exchanging its 50% working interest in the Paris Basin exploration licenses it held together with Hess for a 5% cost-free revenue interest in such licenses, in which the total proceeds relating thereto to ZaZa are capped at \$130 million. Following ZaZa's exit from the unconventional resource play in France, ZaZa divested its Paris Basin conventional assets in December 2012 through the sale of 100% of the shares in ZaZa Energy France SAS to Vermillion REP SAS, a wholly-owned subsidiary of Vermillion Energy Inc., for a net sales price of approximately \$76 million. At the end of 2012, ZaZa's only exploration and production asset in France was the Hess royalty interest, which is held by ZaZa.

#### **Recent Development in Business Relationships**

After the termination of the Hess joint venture and the disposition of its French oil and gas properties, ZaZa's principal assets were approximately 66,000 net acres in the Eagle Ford core and approximately 89,000 net acres in the Eaglebine. The Company's strategic objectives since then have focused on executing drilling operations to further appraise its acreage and evaluating joint venture opportunities to realize its development. Since the dissolution of the Hess joint ventures, ZaZa has drilled two wells in the Eaglebine and one well in the Eagle Ford and has entered into the joint venture with EOG Resources, Inc. described below.

#### *Eaglebine Joint Venture with EOG*

On March 21, 2013, we entered into a Joint Exploration and Development Agreement with EOG Resources, Inc., ("our counterparty"), for the joint development of certain of our Eaglebine properties located in Walker, Grimes, Madison, Trinity, and Montgomery Counties, Texas. Under this agreement, we and our counterparty will jointly develop up to approximately 100,000 gross acres (approximately 73,000 net acres) that ZaZa currently owns in the Eaglebine trend in these counties. Our counterparty will act as the operator and will pay us certain cash amounts, the drilling and completion costs of certain specified wells, and a portion of our share of any additional seismic or well costs in order to earn their interest in these properties. Generally, ZaZa will retain a 25% working interest, our counterparty will earn a 75% working interest in the acreage, subject to the agreement, that is currently 100% owned by ZaZa. ZaZa will retain a 25% working interest, our counterparty will earn a 50% working interest, and Range will retain a 25% working interest in the acreage that is currently owned 75% by ZaZa and 25% by Range, subject to the terms of our agreement with Range. This joint development will be divided into three phases.

In the first phase, we will transfer 20,000 net acres, approximately 15,000 of which will come from our joint venture with Range, to our counterparty in exchange for a cash payment by our counterparty to us of \$10 million and an obligation of our counterparty to drill and pay 100% of the drilling and completion costs of three wells. The second of these three wells to be drilled will be the substitute well that we are required to drill pursuant to our agreement with Range described above. Drilling operations on the third well in the first phase of joint development with our counterparty must be commenced by our counterparty before December 31, 2013.

Within 60 days of completion of the third well under the first phase, our counterparty will have the option to elect to go forward with the second phase of the joint development. If they so elect, we will transfer an additional

20,000 net acres to our counterparty in exchange for a cash payment of \$20 million, an obligation of our counterparty to drill and pay 100% of the drilling and completions costs of an additional three wells, and an obligation of our counterparty to pay for up to \$1.25 million of ZaZa's share of additional costs for seismic or well costs.

Within 60 days of completion of the second phase, our counterparty will have the option to elect to go forward with the third phase of the joint development. If they so elect, we will transfer an additional 15,000 net acres to our counterparty in exchange for a cash payment of \$20 million, an obligation of our counterparty to drill and pay 100% of the drilling and completion costs of an additional three wells, and an obligation of our counterparty to pay for up to \$1.25 million of ZaZa's share of additional costs for seismic or well costs.

#### *Sale of Moulton acreage*

On March 5, 2013 the Company entered into a purchase and sale agreement to sell its remaining Moulton prospect for approximately \$9.2 million. This transaction is expected to close on or before April 5, 2013 and is subject to normal closing conditions .

On March 22, 2013, we entered into an agreement to sell approximately 10,000 net acres of our properties in the Eagle Ford trend located in Fayette, Gonzalez and Lavaca Counties, Texas, which we refer to as our Moulton properties, including seven producing wells located on the Moulton properties, for approximately \$43.3 million in cash. The closing of the sale of the Moulton properties is expected to occur during the second quarter of 2013, and net proceeds from the sale, after closing purchase price adjustments and expenses, are expected to be approximately \$42 million. The closing is subject to normal closing conditions, and the amendment of ZaZa's securities purchase agreement for its senior secured notes, and there can be no assurance that this transaction will be consummated. We intend to use these net proceeds to fund a portion of capital expenditures for exploration on our other properties and/or to repay indebtedness.

#### **Strategy**

ZaZa's strategy is to identify prospective unconventional acreage, appraise such acreage and then realize the development of high-graded units through a combination of self-funded development and joint ventures. To this end, ZaZa maintains a team of technical and commercial personnel with experience in unconventional resources. ZaZa's operations in the Hess venture demonstrated a track record of identifying prospective unconventional acreage, acquiring material land positions, and appraising and developing such acreage as its operator. As ZaZa evaluates additional joint venture opportunities with other companies, ZaZa will evaluate whether a transition of operatorship to the joint venture partner is appropriate. When transition occurs, ZaZa can then redeploy its personnel to the evaluation and acquisition of new acreage, the development of its self-funded acreage and/or the delineation of other areas that it is considering for joint ventures.

#### *Areas of Operations*

ZaZa owns producing and non-producing oil and gas properties in proven or prospective basins that are primarily located in South Texas. ZaZa's producing areas are in the Eagle Ford shale located in Gonzales, Fayette, Dewitt, and Lavaca counties. ZaZa also owns prospective acreage in the Eaglebine formation located in Madison, Grimes, and Walker counties. All of ZaZa's assets (other than the overriding royalty interest in certain French production licenses obtained in connection with the dissolution of the Hess joint venture), including long-lived assets, are located within the United States. The following is a summary of its major operating areas.

#### *Eagle Ford Shale*

For the year ending December 31, 2012, ZaZa drilled or participated in 13 gross wells and 1.23 net wells all successful in the Eagle Ford shale. ZaZa also operated 100% of the Boening A-1H well, which began initial flow back in February 2013. ZaZa also installed a pumping unit on its Crabb Ranch well in Gonzales county sustaining production rates over 200 Bbbls per day. In 2012, ZaZa's Eagle Ford operations were conducted as 100% ZaZa operations on the Boening A-1H and non-operated participation with GeoResources (Halcon) on the Ring Unit 1 through 5 wells.

As of December 31, 2012, ZaZa owns operating interest in four Eagle Ford producing wells and non-

operating working interests in ten Eagle Ford producing wells located in South Texas. Our management intends to continue to acquire non-operating working interests in both prospective and producing wells when the opportunity arises and to acquire such properties at attractive valuations. Such interests may be in wells that are considered either conventional or unconventional.

### *Eaglebine Shale*

The Eaglebine is an expansion area of the Eagle Ford shale, but is also prospective for the Woodbine shale as well as the Lower Cretaceous comingled conventional section, hence the industry term "Eaglebine." ZaZa was in the process of drilling 2 gross, 1.75 net wells in the Eaglebine Shale area across the December 31, 2012 timeline one horizontal well targeting the Lower Eaglebine Shale (Stingray A-1H) and one vertical well targeting the Lower Cretaceous (Commodore A1-V). ZaZa's operations on the Stingray A-1H successfully drilled a vertical pilot hole through the Lower Eaglebine section obtaining critical open hole logs and core data. ZaZa then plugged back and successfully drilled a +4000' lateral targeting the Lower Eaglebine section, ran production casing and fracked 15 of 16 stages. At that point the wellbore suffered a casing collar failure in the 5½' casing. ZaZa has re-entered the wellbore to drill vertically to the Lower Cretaceous. ZaZa also commenced drilling the Commodore A-1 V, a vertical well designed to test the Lower Cretaceous section. This well reached total depth and production casing was run on February 10, 2013. ZaZa plans to continue drilling vertical and horizontal wells to demonstrate the commercial viability of the play. Once demonstrated, ZaZa plans to move into the development phase, where it may drill up to one well per month, subject to availability of capital resources to do so. The Company continues to exercise options and extensions maintaining the Eaglebine leases.

On March 29, 2012, ZaZa LLC announced that it had entered into a farm-in transaction with Range to increase its position in the Eaglebine. Currently, ZaZa holds approximately 135,000 gross acres (89,000 net acres) in the Eaglebine. ZaZa's Eaglebine operations are wholly-owned, but ZaZa intends to explore ways to accelerate the drilling program on its Eaglebine acreage by selectively partnering with others. The first such joint venture is the EOG JV. ZaZa also expects to finance a portion of its Eaglebine program with cash flow from operations. If cash flow from operations is not sufficient to fund this program, ZaZa would be required to seek additional financing to maintain and expand this program.

### **Title to Properties**

ZaZa believes it has satisfactory title to all of its producing properties in accordance with standards generally accepted in the oil and gas industry. As is customary in the oil and gas industry, ZaZa makes title investigations and receives title opinions of local counsel not on acquisition but only before it commences drilling operations. ZaZa believes that it has satisfactory title to all of its other assets. ZaZa's properties are subject to customary royalty interests, liens incident to operating agreements, liens for current taxes and other burdens, including other mineral encumbrances and restrictions. Although title to its properties is subject to encumbrances in certain cases, ZaZa believes that none of these burdens will materially detract from the value of ZaZa's properties or from its interest therein or will materially interfere with its use of the properties in the operation of its business.

### **Oil and Gas Continuing Operations**

The following tables present our production data for the referenced geographic areas for the periods indicated :

	For the Year Ended December 31, 2012		
	Gas (Mcf)	Oil (Bbls)	Equivalent (BOE)
Eagle Ford:			
Cotulla	48,492	50,780	58,862
Moulton	10,268	34,106	35,817
Sweet Home	-	-	-
Hackberry	101,335	8,189	25,078
Eaglebine	-	-	-
Other Onshore	2,118	4,523	4,876
Total	162,213	97,598	124,634

For the Year Ended December 31, 2011			
	Gas (Mcf)	Oil (Bbls)	Equivalent (BOE)
Eagle Ford:			
Cotulla	9,551	24,829	26,421
Moulton	-	-	-
Sweet Home	-	-	-
Hackberry	-	-	-
Eaglebine	-	-	-
Other Onshore	2,095	2,955	3,304
Total	11,646	27,784	29,725

For the Year Ended December 31, 2010			
	Gas (Mcf)	Oil (Bbls)	Equivalent (BOE)
Eagle Ford:			
Cotulla	-	-	-
Moulton	-	-	-
Sweet Home	-	-	-
Hackberry	-	-	-
Eaglebine	-	-	-
Other Onshore	4,247	4,331	5,038
Total	4,247	4,331	5,038

## Capital Expenditures

The following table summarizes information regarding ZaZa's development and exploration capital expenditures for the periods indicated:

For the Year Ended December 31,			
	2012	2011	2010
	(In thousands)		
Additions to oil and gas properties	\$ 53,789	\$ 10,667	\$ 6,436
Additions to furniture and fixtures	291	1,975	831
Total capital expenditures	\$ 54,080	\$ 12,642	\$ 7,267



## Productive Wells and Acreage

The following table sets forth our interest in undeveloped acreage, developed acreage and productive wells in which we own a working interest as of December 31, 2012. "Gross" represents the total number of acres or wells in which we own a working interest. "Net" represents our proportionate working interest resulting from our ownership in the gross acres or wells. Productive wells are wells in which we have a working interest and that are capable of producing oil or gas.

	Acres				Productive Wells			
	Undeveloped		Developed		Gross		Net	
	Gross	Net	Gross	Net	Gas	Oil	Gas	Oil
Eagle Ford								
Cotulla	2,270	1,973	-	-	-	-	-	-
Moulton	10,989	10,543	824	824	-	7	-	1.6
Sweet Home	35,405	34,076	-	-	-	-	-	-
Hackberry	22,086	19,537	1,325	1,325	2	-	2	-
Eaglebine	134,711	89,034	-	-	-	-	-	-
Other Onshore U.S.	640	426	2,424	59	-	4	-	0.1

The following table sets forth our interest in undeveloped acreage as of December 31, 2012 that is subject to expiration in 2013, 2014, 2015 and thereafter:

2013		2014		2015		Thereafter	
Gross	Net	Gross	Net	Gross	Net	Gross	Net
104,875	77,937	67,309	51,108	31,884	25,025	2,033	1,519

## Drilling Activity

The following table sets forth the number of gross exploratory and development wells ZaZa drilled or in which it participated during 2012, 2011 and 2010. Productive wells are either producing wells or wells capable of production.

	Gross Wells					
	Exploratory			Development		
	Productive	Dry	Total	Productive	Dry	Total
Year ended December 31, 2012	-	-	-	13	-	13
Year ended December 31, 2011	-	-	-	20	-	20
Year ended December 31, 2010	-	-	-	5	-	5

The following table sets forth the number of net exploratory and net development wells drilled by ZaZa during 2012, 2011 and 2010 based on its proportionate working interest in such wells.

	Net Wells					
	Exploratory			Development		
	Productive	Dry	Total	Productive	Dry	Total
Year ended December 31, 2012	-	-	-	1.23	-	1.23
Year ended December 31, 2011	-	-	-	2.00	-	2.00
Year ended December 31, 2010	-	-	-	0.20	-	0.20

As of December 31, 2012, ZaZa had an additional two exploratory wells being drilled, the Stingray and Boening, that are currently being completed and are pending final results. We have determined the horizontal portion of the Stingray to be dry due to the casing restriction and have recorded \$12.9 million in exploration

expense. These wells are located in our Eaglebine area. Additionally, 8 of the gross wells, (0.8 net), drilled in 2012, were in the Cotulla area which was divested in the Hess joint venture dissolution.

## **Marketing and Customers**

Prior to the dissolution of the Hess joint venture, ZaZa Energy, LLC was dependent upon Hess for all of its oil sales revenue, which had been primarily delivered from two purchasers, Shell Oil and Superior Oil Company. With the dissolution of the joint venture, ZaZa retained production from three operated producing Eagle Ford Shale wells. Sales revenue from these wells is delivered from GulfMark Energy (“GulfMark”); however, multiple purchaser options exist for this production. All existing purchaser contracts are on monthly or “evergreen” terms. Our financial condition and results of operations could be materially adversely affected if this purchaser fails to pay or ceases to acquire its production on terms that are favorable to us, or if the purchaser decreases demand. Should this occur, we are confident we can obtain new contracts that are similar in terms and conditions, and we do not anticipate a significant fluctuation in operations or sales.

We currently receive favorable pricing for crude oil produced from our operated Eagle Ford Shale properties due to the high quality content of the crude and the geographic location of the production. The crude is considered “sweet” because of its low sulfur content and light because it has API gravity between 40 to 45 degrees. Since the production exists in relatively close proximity to refineries in Corpus Christi and Houston, we are able to acquire favorable end-market optionality. Crude oil can be transported via truck or pipeline to these markets, or to barge terminals which give us access to several refineries along the Texas and Louisiana Gulf Coast. These options allow us to take advantage of favorable price differentials between West Texas Intermediate (WTI) and Louisiana Light Sweet (LLS) markets. We currently receive an average net price in excess of \$8.00 per barrel above WTI.

Since the third quarter of 2011, ZaZa has contracted Texla Energy Management, Inc. (“Texla”) to serve as its agent for the marketing and sale of natural gas production. We receive revenue from natural gas sales and natural gas liquid sales from our three producing Eagle Ford Shale wells. With current market conditions, we do not receive significant revenue from these sales; however, the high natural gas liquid content of the gas stream and high recovery percentage of these liquids translates into a net price that is well above the NYMEX settlement price. One hundred percent (100%) of revenue derived from gas sales is attributable to domestic customers and not foreign customers. Limited gas production that is not sold to Texla is flared.

In addition to our Eagle Ford Shale contracts, ZaZa Energy, LLC has also received bids from multiple buyers for both crude oil and natural gas production from its Eaglebine properties. With multiple buyer options, we believe we can assure competitive pricing, reduce buyer credit exposure and market production quickly if needed. Given the similar quality content of the crude oil and the same geographic location advantage as our existing production, we expect to receive a premium price for our crude oil that is as favorable as our Eagle Ford Shale production. Gas gathering and processing options are limited for our Eaglebine properties and will be addressed on a well-by-well basis. We are in the process of negotiating central gas gathering and processing options for all future Eaglebine production.

## **Competition**

The oil and gas industry is highly competitive, and we compete with a substantial number of other companies that have greater resources than us. Many of these companies explore for, produce and market oil and gas, carry on refining operations and market the resulting products on a worldwide basis. The primary areas in which we encounter substantial competition are in locating and acquiring desirable leasehold acreage for development operations, locating and acquiring attractive producing oil and gas properties, and obtaining purchasers and transporters of the oil and gas it produces. There is also competition between producers of oil and gas and other industries producing alternative energy and fuel.

Furthermore, competitive conditions may be substantially affected by various forms of energy legislation and/or regulation considered from time to time by the federal, state and local government. It is not possible to predict the nature of any such legislation or regulation that may ultimately be adopted or its effects upon its future operations. Such legislation and regulations may, however, substantially increase the costs of exploring for, or the development, production or marketing of oil and gas and may prevent or delay the commencement or continuation of a given operation. The effect of these risks cannot be accurately predicted.

## Summary of Oil and Natural Gas Reserves as of December 31, 2012 and 2011

The following table sets forth information about ZaZa's estimated net proved reserves at December 31, 2012 and 2011 for our properties in the Eagle Ford. Ryder Scott Company, L.P. ("Ryder Scott"), independent petroleum consultants, prepared our proved reserves as of December 31, 2012. Rex Morris, an independent petroleum reservoir engineer, audited our proved reserves as of December 31, 2011. We prepared the estimate of standardized measure of proved reserves in accordance with FASB ASC 932, "Extractive Activities-Oil and Gas." No reserve reports have been provided to any governmental agencies.

	At December 31, 2012			At December 31, 2011		
	Gas (MMcf)	Oil (MBbls)	Equivalent (MBOE)	Gas (MMcf)	Oil (MBbls)	Equivalent (MBOE)
Proved developed	303	248	299	1,433	443	682
Proved undeveloped	1,410	2,815	3,049	2,696	502	951
Total proved	1,713	3,063	3,348	4,129	945	1,633

Our proved reserves at December 31, 2012 and 2011 were located in the Eagle Ford Shale in South Texas.

### Internal Controls Over Reserves Estimates

Our policies regarding internal controls over the recording of reserves estimates require reserves to be in compliance with the SEC definitions and guidance and prepared in accordance with generally accepted petroleum engineering principles. Responsibility for compliance in reserves bookings is delegated to a qualified petroleum engineer in our Houston office. The petroleum engineer prepares all reserves estimates for our producing assets. Data used in these integrated assessments include information obtained directly from the subsurface via wellbores such as well logs, reservoir cores, fluid samples, static and dynamic information, production test data and production history. Other types of data used include 2D seismic recently reprocessed and calibrated to available well control. The tools used to interpret the data included reservoir modeling and simulation, Decline Curve Analyses and data analysis packages. We engage a third-party petroleum consulting firm to prepare all of our proved reserves. See "Third-Party Reserves Preparation" below.

### Third-Party Reserves Preparation

The reserves preparation of ZaZa LLC as of December 31, 2012 was performed by Ryder Scott Company, L.P. (Ryder Scott). Ryder Scott evaluate oil and gas properties and independently certify petroleum reserve quantities in the U.S. and internationally. Founded in 1937, Ryder Scott is one of the largest, oldest and most respected reservoir-evaluation consulting firms in the industry. For the last 10 years, Ryder Scott has been the most widely used consulting firm for preparing annual petroleum reserves certifications for filers with the SEC, according to research firm John S. Herold, Ryder Scott also serves clients listed on the London, Ontario, Toronto, Hong Kong, Australian and other stock exchanges.

Ryder Scott determined that the estimates of reserves for ZaZa LLC conform to the guidelines of the SEC, including the criteria of "reasonable certainty," as it pertains to expectations about the recoverability of reserves in future years, under existing economic and operating conditions, consistent with the definition in the recently amended Rule 4-10(a) of Regulation S-X. Ryder Scott prepared our proved reserves as at December 31, 2012, based upon their evaluation. The report is attached to this Annual Report on Form 10-K as Exhibit 99.1.

The reserves audit of ZaZa LLC as of December 31, 2011 was performed by Rex Morris a Consulting Reservoir Engineer. Mr. Morris has over 30 years' experience as a practicing petroleum engineer specializing in reservoir modeling and economics. He earned a Bachelor's of Science in Natural Gas Engineering from Texas A&I University and is a member in good standing in the Society of Petroleum Engineers.

Rex Morris determined that our estimates of reserves for ZaZa LLC conform to the guidelines of the SEC, including the criteria of "reasonable certainty," as it pertains to expectations about the recoverability of reserves in future years, under existing economic and operating conditions, consistent with the definition in the recently amended Rule 4-10(a) of Regulation S-X. Rex Morris issued an unqualified audit opinion on our proved reserves at December 31, 2011, based upon his evaluation. The opinion concluded that our estimates of proved reserves were, in aggregate, reasonable and have been prepared in accordance with generally accepted petroleum engineering and

evaluation principles.

#### *Proved Undeveloped Reserves*

As of December 31, 2012, our proved undeveloped reserves ("PUDs") totaled 2,815 Mbbbl of crude oil and 1,410 Mmcf of natural gas, all of which were associated with the Eagle Ford field. As of December 31, 2012, PUDs represented approximately 91% of our total proved reserves. We currently estimate that future development costs relating to the development of these PUDs are projected to be approximately \$21.0 million in 2013, \$37.6 million in 2014, \$41.0 million in 2015 and \$11.6 million in 2016.

As of December 31, 2011, our proved undeveloped reserves ("PUDs") totaled 502 Mbbbl of crude oil and 2,696 Mmcf of natural gas, all of which were associated with the Eagle Ford field. As of December 31, 2011, PUDs represented approximately 58% of our total proved reserves. We currently estimate that future development costs relating to the development of these PUDs are projected to be approximately \$2.3 million, \$1.8 million and \$3.3 million in 2012, 2013 and 2014, respectively.

#### **Insurance Matters**

As is common in the oil and gas industry, we do not insure fully against all risks associated with our business either because such insurance is unavailable or because premium costs are considered prohibitive. A material loss not fully covered by insurance could have material adverse effect on our financial position, results of operations or cash flows. We maintain insurance at levels we believe to be customary in the industry to limit our financial exposure in the event of a substantial environmental claim resulting from sudden, unanticipated and accidental discharges of certain prohibited substances into the environment. Such insurance might not cover the complete amount of such a claim and would not cover fines or penalties for a violation of an environmental law.

#### **Office Leases**

We occupy 46,121 square feet of office space at 1301 McKinney St, Houston, Texas 77010; 6,376 square feet of office space at 600 Leopard St., Corpus Christi, Texas 78401; 374 square feet of office space at 13760 Noel Rd., Dallas, Texas 75240; and 2,000 square feet of office at 176 Hwy 19, Huntsville, Texas 77340. The total rental expense for 2012 was approximately \$1.2 million.

#### **Employees**

ZaZa had 39 full-time employees, none of whom are represented by unions or are covered by collective bargaining agreements. To date, ZaZa has not experienced any strikes or work stoppages due to labor problems, and believes that it has good relations with its employees. In addition, ZaZa directly engages approximately 31 independent contractors.

#### **Seasonal Nature of Business**

Generally, but not always, the demand for gas decreases during the summer months and increases during the winter months. Seasonal anomalies such as mild winters or abnormally hot summers sometimes lessen this fluctuation. In addition, certain gas users utilize natural gas storage facilities and purchase some of their anticipated winter requirements during the summer. This can also lessen seasonal demand fluctuations. Seasonal weather conditions and lease stipulations can limit drilling and production activities and other oil and gas operations in certain areas. These seasonal anomalies can increase competition for equipment, supplies and personnel.

#### **Internet Address/Availability of Reports**

Our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), are made available free of charge on our website at <http://www.zazaenergy.com> as soon as reasonably practicable after we electronically file such material with, or otherwise furnish it to, the SEC. Corporate governance materials, guidelines, charter and code of conduct are also available on the website. A copy of corporate governance materials is available upon written request to the

Company. The Company will disclose any changes or amendments to the Company's code of ethics as well as waivers to the code of ethics by posting such changes or waivers on the Company's website.

## **GLOSSARY OF OIL AND GAS TERMS**

The terms defined in this section are used throughout this annual report on Form 10-K:

*"3D" or "3D SEISMIC"*—An exploration method of sending energy waves or sound waves into the earth and recording the wave reflections to indicate the type, size, shape, and depth of subsurface rock formations. 3D seismic lines are shot very close together. This allows for the ability for computers to generate seismic profiles in any direction and form 3D surfaces. 3D surveys are measured in square kilometers or square miles.

*"Basin"*—A large natural depression on the earth's surface in which sediments generally brought by water accumulate.

*"Bbl"*—One stock tank barrel, of 42 U.S. gallons liquid volume, used herein in reference to crude oil, condensate or natural gas liquids.

*"Bcf"*—One billion cubic feet of natural gas.

*"BOE"*—Barrel of oil equivalent. Oil equivalents are determined herein using the relative energy content method, with a ratio of 1.0 Bbl of oil or natural gas liquid to 6.0 Mcf of gas.

*"Btu"*—British thermal unit.

*"Completion"*—The process of treating a drilled well followed by the installation of permanent equipment for the production of oil or natural gas, or in the case of a dry hole, the reporting of abandonment to the appropriate agency.

*"DD&A"*—Depreciation, depletion, amortization and accretion.

*"Developed acreage"*—The number of acres that are allocated or assignable to productive wells or wells capable of production.

*"Development well"*—A well drilled within the proved area of an oil or natural gas reservoir to the depth of a stratigraphic horizon known to be productive.

*"Exploratory well"*—A well drilled to find and produce oil or natural gas reserves not classified as proved, to find a new reservoir in a field previously found to be productive of oil or natural gas in another reservoir or to extend a known reservoir.

*"Field"*—An area consisting of a single reservoir or multiple reservoirs all grouped on, or related to, the same individual geological structural feature or stratigraphic condition. The field name refers to the surface area, although it may refer to both the surface and the underground productive formations.

*"Formation"*—A layer of rock which has distinct characteristics that differs from nearby rock.

*"Gross acres" or "gross wells"*—The total acres or wells, as the case may be, in which a working interest is owned.

*"Horizontal drilling"*—A drilling technique used in certain formations where a well is drilled vertically to a certain depth and then drilled at a right angle within a specified interval.

*"Horizontal well"*—A well drilled using horizontal drilling techniques.

*"Hydraulic fracturing"*—A stimulation treatment routinely performed on oil and gas wells in low-permeability reservoirs. Specially engineered fluids are pumped at high pressure and rate into the reservoir interval to be treated, causing a vertical fracture to open. Commonly referred to as "fracking."

*"Identified drilling locations"*—Locations specifically identified by management as an estimation of our multi-year

drilling activities based on evaluation of applicable geologic, seismic, engineering, production and reserves data on contiguous acreage and geologic formations. The availability of local infrastructure, drilling support assets and other factors as management may deem relevant, such as spacing requirements, easement restrictions and state and local regulations, are considered in determining such locations. The drilling locations on which we actually drill wells will ultimately depend upon the availability of capital, regulatory approvals, seasonal restrictions, oil and natural gas prices, costs, actual drilling results and other factors.

*"Liquids"*—Describes oil, condensate and natural gas liquids.

*"KM"*—One kilometer.

*"MBbls"*—One thousand barrels of crude oil, condensate or natural gas liquids.

*"MBOE"*—One thousand barrels of oil equivalent.

*"Mcf"*—One thousand cubic feet of natural gas.

*"MMBbl"*—One million barrels of crude oil, condensate or natural gas liquids.

*"MMBOE"*—One million barrels of oil equivalent.

*"MMBtu"*—One million British thermal units.

*"MMcf"*—One million cubic feet of natural gas.

*"Natural gas liquid"*—Components of natural gas that are separated from the gas state in the form of liquids, which include propane, butanes and ethane, among others.

*"Net acres"*—The percentage of total acres an owner has out of a particular number of acres, or a specified tract. An owner who has 50% interest in 100 acres owns 50 net acres.

*"NYMEX"*—The New York Mercantile Exchange.

*"Productive well"*—A well that is found to be capable of producing hydrocarbons in sufficient quantities such that proceeds from the sale of the production exceed production expenses and taxes.

*"Proved developed reserves ("PDP")* —Reserves that can be expected to be recovered through existing wells with existing equipment and operating methods.

*"Proved reserves"*—The estimated quantities of oil, gas and natural gas liquids which geological and engineering data demonstrate with reasonable certainty to be commercially recoverable in future years from known reservoirs under existing economic and operating conditions.

*"Proved undeveloped reserves ("PUD")* —Proved reserves that are expected to be recovered from new wells on undrilled acreage or from existing wells where a relatively major expenditure is required for recompletion.

*"Reservoir"*—A porous and permeable underground formation containing a natural accumulation of producible oil and/or natural gas that is confined by impermeable rock or water barriers and is separate from other reservoirs.

*"Spacing"*—The distance between wells producing from the same reservoir. Spacing is often expressed in terms of acres, e.g., 40-acre spacing, and is often established by regulatory agencies.

*"Standardized measure"*—Discounted future net cash flows estimated by applying year-end prices to the estimated future production of year-end proved reserves. Future cash inflows are reduced by estimated future production and development costs based on period end costs to determine pre-tax cash inflows. Future income taxes, if applicable, are computed by applying the statutory tax rate to the excess of pre-tax cash inflows over our tax basis in the oil and gas properties. Future net cash inflows after income taxes are discounted using a 10% annual discount rate.

*"Undeveloped acreage"*—Lease acreage on which wells have not been drilled or completed to a point that would

permit the production of commercial quantities of oil and gas regardless of whether such acreage contains proved reserves.

*"Unit"*—The joining of all or substantially all interests in a reservoir or field, rather than a single tract, to provide for development and operation without regard to separate property interests. Also, the area covered by a unitization agreement.

*"Working interest"*—The right granted to the lessee of a property to explore for and to produce and own natural gas or other minerals. The working interest owners bear the exploration, development, and operating costs on either a cash, penalty, or carried basis.

## ITEM 1A. *RISK FACTORS*

### **Risks Related to Our Company**

**Our independent registered public accounting firm expressed substantial doubt regarding our ability to continue as a going concern in their audit opinion for our December 31, 2012 financial statements.**

Our audited financial statements for the year ended December 31, 2012 have been prepared under the assumption that we will continue as a going concern. Our independent registered public accounting firm has issued their report dated April 1, 2013, in connection with the audit of our financial statements for the year ended December 31, 2012 that included an explanatory paragraph describing the existence of conditions that raise substantial doubt about our ability to continue as a going concern due to our liquidity. The fact that we have received this “going concern qualification” from our independent registered public accounting firm will likely make it more difficult for us to raise capital on favorable terms and could hinder, to some extent, our operations. Additionally, if we are not able to continue as a going concern, it is possible stockholders may lose part or all of their investment. Our financial statements do not include any adjustments that might result from the outcome of this uncertainty.

**Our development and exploration operations require substantial capital and we may be unable to obtain needed capital or financing on satisfactory terms or at all, which could lead to a loss of properties and a decline in our oil and gas reserves.**

The oil and gas exploration and development industry is capital intensive. We expect to continue making substantial capital expenditures in our business and operations for the purpose of exploration, development, production and acquisition of, oil and gas reserves. Historically, we financed capital expenditures in part from contributions, bonus payments and cost reimbursements by Hess under our joint venture with them. As a result of the termination of our joint venture with Hess in 2012, we have sold assets and incurred indebtedness in order to provide capital to carry out our activities. To maintain our oil and gas leases and pursue our planned drilling program, we will need to raise additional capital. Our cash flow from operations and access to capital are subject to a number of variables that may or may not be within our control, including:

- the level of oil and gas we are able to produce from existing wells;
- the prices at which our oil and gas production is sold;
- the results of our development programs associated with proved and unproved reserves;
- our ability to acquire, locate and produce new economically recoverable reserves;
- global credit and securities markets; and
- the ability and willingness of lenders and investors to provide capital and the cost of that capital.

We will need to raise capital to maintain our oil and gas leases and finance our drilling operations. We intend to pursue various strategies to raise capital, including asset sales, debt or equity financing, and joint ventures. However, our existing indebtedness contains covenants that restrict our ability to pursue these strategies. If we are unable to sell assets or if financing and joint venture partnerships are not available on acceptable terms or at all, we may have limited ability to obtain the capital necessary to sustain our operations at current levels or to implement our strategy, including executing on our portfolio of drilling opportunities or expanding our existing portfolio. There can be no assurance as to our ability to sell assets or as to the availability or terms of any joint ventures or other financing.

The failure to obtain additional capital could result in an inability to implement our strategy to pursue our drilling program and a curtailment of our operations relating to exploration and development of our prospects, which in turn could lead to possible write-downs in the carrying value of our properties, a material decline in our oil and gas reserves as well as our revenues and results of operations. The failure to obtain additional capital could also materially adversely affect our operations and prospects, including potentially resulting in the reversion of certain portions of our acreage to the lessors.

**If we are unable to find a joint venture partner or partners in the Eagle Ford to finance development costs or to complete the joint development of our Eaglebine acreage with EOG Resources, we may need to find alternative sources of capital, which may not be available on favorable terms, or at all.**



We are currently planning to have discussions with potential joint venture partners to develop our properties in the Eagle Ford trend, evaluating asset sale options for our properties in the Eagle Ford trend, and have recently entered into a joint development arrangement with EOG Resources for certain of our Eaglebine acreage. ZaZa holds approximately 89,000 net acres in the Eaglebine (before giving effect to any transfers of interests therein to EOG Resources), and approximately 66,000 net acres in the Eagle Ford (before giving effect to our sale of our Moulton properties). There can be no assurances that we will identify a joint venture partner or partners for our Eagle Ford acreage or that such partner(s) will provide funding on acceptable terms to develop the existing properties or acquire new properties. There can be no assurances that we will be able to sell assets in the Eagle Ford trend at valuations we deem acceptable. There can also be no assurances that EOG Resources will elect to proceed with subsequent phases of the joint development of our Eaglebine acreage. If we cannot identify a joint venture partner or partners for our Eagle Ford acreage, sell assets at acceptable valuations or are unable to complete the joint development of our Eaglebine acreage, we will need to utilize cash flow from other operations or will need to find alternative sources of capital to finance operations, which may slow the development of our properties and have a material adverse effect on our operations and prospects.

**Joint venture agreements that we may enter into could present a number of challenges that could have a material adverse effect on our business, financial condition and results of operations.**

We are seeking joint venture partners to develop our properties in the Eagle Ford trend and have recently entered into a joint development arrangement with EOG Resources for certain of our Eaglebine acreage. Joint venture and joint development arrangements typically present financial, managerial and operational challenges, including potential disputes, liabilities or contingencies and may involve risks not otherwise present when exploring and developing properties directly, including, for example:

- the joint venture partners may share certain approval rights over major decisions, including the acquisition of oil and gas properties;
- the joint venture partners may not pay their share of the joint venture's obligations, potentially leaving us liable for their share of such obligations;
- the joint venture partners may have options to assume the operation of the properties acquired by the joint venture;
- the joint venture partners may terminate the agreements under certain circumstances;
- we may incur liabilities or losses as a result of an action taken by the joint venture partners; and
- disputes between us and the joint venture partners may result in delays, litigation or operational impasses.

The risks described above or the failure to continue any joint venture or joint development arrangement or to resolve disagreements with the joint venture partners could materially adversely affect our ability to transact the business that is the subject of such joint venture, which would in turn negatively affect our financial condition and results of operations.

**Our indebtedness and near term obligations could materially adversely affect our financial health, limit our ability to finance capital expenditures and future acquisitions and prevent us from executing our business strategy.**

We have approximately \$33 million outstanding in aggregate principal under our Senior Secured Notes due 2017 (the "Senior Secured Notes") and \$40 million outstanding in aggregate principal under our 9% Convertible Senior Notes due 2017 (the "Convertible Notes") and we may incur additional indebtedness in the future. In addition, we have approximately \$47 million outstanding in aggregate principal amount under our Subordinated Notes. Our level of indebtedness has, or could have, important consequences to our business, because:

- a substantial portion of our cash flows from operations will have to be dedicated to interest and principal payments and may not be available for operations, working capital, capital expenditures, expansion, acquisitions or general corporate or other purposes;
- it may impair our ability to obtain additional financing in the future for acquisitions, capital expenditures or general corporate purposes;
- it may limit our flexibility in planning for, or reacting to, changes in our business and industry; and

- we may be substantially more leveraged than some of our competitors, which may place us at a relative competitive disadvantage and make us more vulnerable to downturns in our business, our industry or the economy in general.

In addition, the terms of our Senior Secured Notes and our Convertible Notes restrict, and the terms of any future indebtedness, including any future credit facility, may restrict our ability to incur additional indebtedness and grant liens because of debt or financial covenants we are, or may be, required to meet. Thus, we may not be able to obtain sufficient capital to grow our business or implement our business strategy and may lose opportunities to acquire interests in oil properties or related businesses because of our inability to fund such growth.

Our ability to comply with restrictions and covenants, including those in our Senior Secured Notes, Convertible Notes or in any future debt agreement, is uncertain and will be affected by the levels of cash flow from our operations and events or circumstances beyond our control. Our Senior Secured Notes also contain restrictions on the operation of our business, such as limitations on the sale and acquisition of assets, limitations on entering into joint ventures, limitations on restricted payments, limitations on mergers and consolidations, limitations on loans and investments, and limitations on the lines of business in which we may engage, which may limit our activities. Our Convertible Notes contain certain of the foregoing restrictions as well. We must obtain consent from the holders of a majority of the Senior Secured Notes for all transactions involving oil and gas properties, with certain carveouts and requirements to apply a portion of net sales proceeds to pay down the Senior Secured Notes and with certain carveouts to enter into our joint venture with EOG and to sell our Moulton acreage. Thus, we may not be able to manage our cash flow in a manner that maximizes our business opportunities. Our failure to comply with any of the restrictions and covenants could result in a default, which could permit the holders of our Senior Secured Notes and our Convertible Notes to accelerate repayments and foreclose on the collateral securing the indebtedness.

**We may not have the ability to raise the funds necessary to purchase the Senior Secured Notes and the Convertible Notes upon a fundamental change, and our future debt may contain limitations on our ability to purchase the Senior Secured Notes and the Convertible Notes.**

Holders of the Senior Secured Notes and the Convertible Notes will have the right to require us to purchase the notes upon the occurrence of a fundamental change at 101% and 100%, respectively, of their principal amount plus accrued and unpaid interest. However, we may not have enough available cash or be able to obtain financing at the time we are required to make purchases of tendered Senior Secured Notes and Convertible Notes. In addition, our ability to purchase the Senior Secured Notes and Convertible Notes may be limited by law, by regulatory authority or by the agreements governing our then current and future indebtedness. Our failure to purchase tendered Senior Secured Notes and Convertible Notes at a time when the purchase is required by the terms of the Senior Secured Notes or Convertible Notes would constitute a default under those notes. A default under those notes or the fundamental change itself could also lead to a default or require a prepayment under, or result in the acceleration of the maturity or purchase of, our existing or future other indebtedness. The requirement that we offer to purchase the Senior Secured Notes and Convertible Notes upon a fundamental change is limited to the transactions specified in the definition of a “fundamental change,” which definition may differ from the definition of a “fundamental change” or “change of control” in the agreements governing our existing or future other indebtedness. If the repayment of the related indebtedness were to be accelerated after any applicable notice or grace periods, we may not have sufficient funds to repay the indebtedness and purchase the Senior Secured Notes and the Convertible Notes.

**If we do not satisfy our drilling obligations under our agreement with Range, we could lose a portion of our acreage and revenue stream in the Eaglebine, which could adversely affect our expected revenues.**

On March 28, 2012, the Company entered into a Participation Agreement (the “Range Agreement”), and associated Joint Operating Agreement, with Range Texas Production, LLC (“Range”), a subsidiary of Range Resources Corporation, under which the Company agreed to acquire a 75% working interest from Range in certain leases located in Grimes County, Texas (the “Leases”). Pursuant to the terms of the Range Agreement, Range retained a 25% working interest in the Leases and the Company committed to drill a well (the “Commitment Well”). The Company recently ceased completion operations at the Commitment Well, and effective January 16, 2013, the Company and Range entered into an Amendment No. 5 to the Range Agreement (the “Amendment”). Under the terms of the Amendment, if the Company fails to commence re-completion operations at the Commitment Well (the “Re-entry Well”) in a bona fide attempt to complete the Re-entry Well as a vertical well within 60 days of January 16, 2013 (the Company has timely commenced such operations) or fails to commence drilling of a substitute well for the Commitment Well within 180 days of January 16, 2013, the Company will be required to assign a 25% working interest in the Leases to Range, resulting in the Company retaining a 50% working interest in the Leases,

and transfer operatorship in the Leases to Range. If the Company fails to meet either of these deadlines, the foregoing remedies will have an impact on our expected revenues in the Eaglebine.

**Our ability to use net operating loss carryforwards to offset future taxable income may be limited or such net operating loss carryforwards may expire before utilization.**

As of December 31, 2012, we had U.S. federal tax net operating loss carryforwards (“NOLs”) of approximately \$45.2 million, which expire at various dates from fiscal year 2026 through fiscal year 2032. These net operating loss carryforwards, subject to certain requirements and restrictions, including limitations on their use as a result of an “ownership change”, may be used to offset future taxable income and thereby reduce our U.S. federal income taxes otherwise payable. We are required to evaluate the likelihood of utilizing the NOLs according to a “more likely than not” standard in accordance with GAAP and, if as a result of such evaluation we determine we may not be able to meet such standard, we may be required to recognize a valuation allowance for this deferred tax asset. The recognition of a valuation allowance would reduce earnings and would also result in a corresponding reduction of stockholders’ equity. Recognition of a valuation allowance is a non-cash charge to earnings and it does not preclude us from using the NOLs to reduce future taxable income otherwise payable. Section 382 of the Internal Revenue Code of 1986, as amended (the “Code”), imposes an annual limit on the ability of a corporation that undergoes an “ownership change” to use its net operating loss carry forwards to reduce its tax liability. The amount of taxable income in each tax year after the ownership change that may be offset by pre-change NOLs and certain other pre-change tax attributes is generally equal to the product of (a) the fair market value of the corporation’s outstanding stock immediately prior to the ownership change and (b) the long-term tax exempt rate (i.e., a rate of interest established by the Internal Revenue Service that fluctuates from month to month). An “ownership change” would occur if stockholders, deemed under Section 382 to own 5% or more of our capital stock by value, increase their collective ownership of the aggregate amount of our capital stock to more than 50 percentage points over a defined period of time. In the event of certain changes in our stockholder base, we may at some point in the future experience an “ownership change” as defined in Section 382 of the Code. Accordingly, our use of the net operating loss carryforwards and credit carryforwards may be limited at some point in the future by the annual limitations described in Sections 382 and 383 of the Code.

***We have disclosed a material weakness in our internal disclosure controls and procedures which could erode investor confidence, jeopardize our ability to obtain insurance, and limit our ability to attract qualified persons to serve at ZaZa.***

As of December 31, 2012, an evaluation was conducted by ZaZa management, including our Chief Executive Officer and Chief Financial Officer, as to the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Rules 13a-15(e) and 15d-15(e) of the Exchange Act. Based on that evaluation, our management concluded that our disclosure controls and procedures were not effective as of December 31, 2012 because of material weaknesses in our internal controls over financial reporting resulting from the write off of exploration costs associated with a failed lateral portion of an exploratory well, and an error in the calculation of certain deferred income tax losses.

Our management believes that this error was a result of the failure of coordination between our personnel that make our determinations of well outcomes and our personnel that prepare our financial statements. This evaluation is more fully described elsewhere in this Annual Report on form 10-K for the fiscal year ended December 31, 2012. Failure to comply with rules regarding internal controls and procedures may make it more difficult for us to obtain certain types of insurance, including director and officer liability insurance. We may be forced to accept reduced policy limits and coverage and/or incur substantially higher costs to obtain the same or similar coverage. The impact of these events could also make it more difficult for us to attract and retain qualified persons to serve on our Board of Directors, on committees of our Board of Directors, or as executive officers.

Our management identified an error in the calculation of certain deferred tax liabilities for the period ended March 31, 2012. This error was corrected prior to our filing of the financial statements for such period with the SEC. Accordingly, management believes that the financial statements included in this report fairly present in all material respects our financial condition, results of operations and cash flows for the periods presented. Notwithstanding the correct presentation in our financial statements, our management believes that this error was a result of the failure of coordination between our personnel that calculate our tax liabilities and our personnel that prepare the financial statements.

Management is reviewing remediation steps necessary to address the material weaknesses and to improve our internal control over financial reporting. We intend to correct the material weaknesses promptly.

**Title to the properties in which ZaZa has an interest may be impaired by title defects.**

ZaZa generally obtains title opinions on significant properties that it drills or acquires. Additionally, undeveloped acreage has greater risk of title defects than developed acreage. Generally, under the terms of the operating agreements affecting its properties, any monetary loss is to be borne by all parties to any such agreement in proportion to their interests in such property. If there are any title defects or defects in assignment of leasehold rights in properties in which ZaZa holds an interest, we could suffer a material financial loss.

**The unavailability or high cost of drilling rigs, equipment, raw materials, supplies, personnel and oil field services could materially adversely affect our ability to execute our exploration and development plans on a timely basis and within its budget.**

Our industry is cyclical and, from time to time, there is a shortage of drilling rigs, equipment, raw materials (particularly sand, cement and other proppants), supplies or qualified personnel. During these periods, the costs and delivery times of rigs, equipment, raw materials and supplies are substantially greater. In addition, the demand for, and wage rates of, qualified drilling rig crews rise as the number of active rigs in service increases. If oil and gas prices increase in the future, increasing levels of exploration, development and production could result in response to these stronger prices, and as a result, the demand and the costs of oilfield services, drilling rigs, raw materials, supplies and equipment could increase, while the quality of these services and supplies may suffer. In addition, our exploration, development and production operations also require local access to large quantities of water supplies and disposal services for produced water in connection with our hydraulic fracture stimulations due to prohibitive transportation costs. Existing shortages of drilling rig service providers for pressure pumping and other services required for well completion in the Eagle Ford shale have delayed our development and production operations and caused us to incur additional expenditures that were in excess of those provided for in its capital budget. We cannot determine the magnitude or length of these shortages or future shortages or price increases, which could have a material adverse effect on its business, cash flows, financial condition or results of operations. In addition, shortages and price increases could restrict our ability to drill wells and conduct ordinary operations.

**Drilling for and producing oil and gas are high-risk activities with many uncertainties that could materially adversely affect our financial condition and results of operations.**

Our success will depend on the results of our exploration, development and production activities. Oil and gas exploration, development and production activities are subject to numerous risks beyond our control, including the risk that drilling will not result in commercially viable oil or gas production. Decisions to purchase, explore, develop or otherwise exploit prospects or properties will depend in part on the evaluation of data obtained through geophysical and geological analyses, production data, and engineering studies, the results of which are often inconclusive or inaccurate or subject to varying interpretations or uncertainty. Costs of drilling, completing and operating wells are often uncertain before drilling commences. Overruns in budgeted expenditures are common risks that can make a particular project uneconomical. Furthermore, many factors may curtail, delay or cancel drilling, and such work stoppage may not be covered by our insurance, including:

- shortages of or delays in obtaining equipment and qualified personnel;
- pressure or irregularities in geological formations;
- equipment failures or accidents;
- the joint venture partners may not pay their share of the joint venture's obligations, potentially leaving us liable for their share of such obligations;
- the joint venture partners may have options to assume the operation of the properties acquired by the joint venture;
- the joint venture partners may terminate the agreements under certain circumstances;
- we may incur liabilities or losses as a result of an action taken by the joint venture partners; and
- disputes between us and the joint venture partners may result in delays, litigation or operational impasses.

The risks described above or the failure to continue any joint venture or to resolve disagreements with the joint venture partners could materially adversely affect our ability to transact the business that is the subject of such joint venture, which would in turn negatively affect our financial condition and results of operations.

**Numerous uncertainties will be inherent in our estimates of oil and gas reserves and estimated reserve quantities, and the present value calculations presented in the future relating to such reserves may not be accurate. Any material inaccuracies in reserve estimates or underlying assumptions will affect materially the estimated quantities and present value of our reserves.**

There are numerous uncertainties inherent in estimating quantities of proved oil and gas reserves and cash flows attributable to such reserves, including factors beyond our engineers' control (or the third party preparing the reserve report). Reserve engineering is a subjective process of estimating underground accumulations of oil and gas that cannot be measured in an exact manner. The accuracy of an estimate of quantities of reserves, or of cash flows attributable to such reserves, is a function of the available data, assumptions regarding future oil and gas prices, expenditures for future development and exploration activities, engineering and geological interpretation and judgment. In addition, accurately estimating reserves in shale formations such as ours can be even more difficult than estimating reserves in more traditional hydrocarbon bearing formations given the complexities of the projected decline curves and economics of shale gas wells. Additionally, "probable" and "possible" reserve estimates are estimates of unproved reserves and may be misunderstood or seen as misleading to investors that are not experts in the oil or natural gas industry. As such, investors should not place undue reliance on these estimates. Reserves and future cash flows may be subject to material downward or upward revisions, based upon production history, development and exploration activities and prices of oil and gas. In addition, different reserve engineers may make different estimates of reserves and cash flows based on the same available data.

The present value of future net revenues from our proved reserves referred to in any reserve report will not necessarily be the actual current market value of our estimated oil and gas reserves at such time. In accordance with SEC requirements, we base the estimated discounted future net cash flows from its proved reserves using the un-weighted arithmetic average of the first day of the month for each month within a twelve month period.

**Unless we replace our reserves, our reserves and production will decline, which would adversely affect our financial condition, results of operations and cash flows.**

Producing oil and gas reservoirs generally are characterized by declining production rates that vary depending upon reservoir characteristics and other factors. Decline rates are typically greatest early in the productive life of a well. Estimates of the decline rate of an oil or gas wells, and those in shale formations, in particular are inherently imprecise, and are less precise with respect to new or emerging oil and gas formations with limited production histories than for more developed formations with established production histories. Our production levels and the reserves that we may recover from our wells will change if production from our existing wells declines in a different manner than we have estimated. Thus, our future oil and gas reserves and production and, therefore, our future cash flow and results of operations, are highly dependent upon our success in efficiently developing and exploiting our current properties and economically finding or acquiring additional recoverable reserves. We may not be able to develop, find or acquire additional reserves or future production at acceptable costs. If we are unable to replace our current or future production, our cash flows and the value of our reserves may decrease, and have a material adverse effect on our business, financial condition and results of operations.

**We are concentrated in one geographic area, which increases our exposure to many of the risks enumerated herein.**

Currently, ZaZa's operations are highly concentrated in the Eagle Ford shale and the Eaglebine. This concentration increases the potential impact that many of the risks stated herein may have upon our ability to perform. For example, we have greater exposure to regulatory actions impacting Texas, natural disasters in the geographic area, competition for equipment, services and materials available in the area and access to infrastructure and markets.

**We have historically depended on a few customers and a loss of any customer or a decrease in demand would adversely affect our business and operating results.**

Our customer base has been highly concentrated. GulfMark is the primary purchaser of the Company's crude oil, and Texla is our primary purchaser of natural gas. We expect that revenue from a small number of customers will continue to account for a high percentage of our revenue for the foreseeable future.

**Hedging activities may require us to make significant payments that are not offset by sales of production and may prevent us from benefiting from increases in oil prices.**

ZaZa has not historically entered into hedging transactions. However, we may in the future enter into various hedging transactions for a portion of our production in an attempt to reduce our exposure to the volatility of oil prices. In a typical hedge transaction, we will have the right to receive from the counterparty to the hedge the excess of the fixed price specified in the hedge over a floating price based on a market index, multiplied by the quantity hedged. If the floating price exceeds the fixed price, we will be required to pay the counterparty this difference multiplied by the quantity hedged. In such case, we will be required to pay the difference regardless of whether we have sufficient production to cover the quantities specified in the hedge. Significant reductions in production at times when the floating price exceeds the fixed price could require us to make payments under the hedge agreements even though such payments are not offset by sales of production. Hedging also could prevent us from receiving the full advantage of increases in oil prices above the fixed amount specified in the hedge.

**We may not be able to obtain access to pipelines, gas gathering, transmission, storage and processing facilities to market our oil and gas production and our ability to sell our production and/or receive market prices for our production may be materially adversely affected by transportation capacity constraints and interruptions.**

The marketing of oil and gas production depends in large part on the availability, proximity and capacity of pipelines and storage facilities, gas gathering systems and other transportation, processing and refining facilities, as well as the existence of adequate markets. If there were insufficient capacity available on these systems, or if these systems were unavailable to us, the price offered for our production could be significantly depressed, or we could be forced to shut-in some production or delay or discontinue drilling plans and commercial production following a discovery of hydrocarbons while it constructs its own facility. We also rely (and expect to rely in the future) on facilities developed and owned by third parties in order to store, process, transmit and sell our oil and gas production. Our plans to develop our oil and gas reserves could be materially and adversely affected by the inability or unwillingness of third parties to provide sufficient transmission, storage or processing facilities to us, especially in areas of planned expansion where such facilities do not currently exist.

If the amount of oil, gas or condensate being produced by us and others exceeds the capacity of the various transportation pipelines and gathering systems currently available in our operating areas, it will be necessary for new transportation pipelines and gathering systems to be built. Or, in the case of oil and condensate, it will be necessary for us to rely more heavily on trucks to transport our production, which is more expensive and less efficient than transportation by pipeline. The construction of new pipelines and gathering systems is capital intensive and construction may be postponed, interrupted or cancelled in response to changing economic conditions and the availability and cost of capital. In addition, capital constraints could limit our ability to build gathering systems to transport our production to transportation pipelines. In such event, costs to transport our production may increase materially or we might have to shut-in its wells awaiting a pipeline connection or capacity and/or sell its production at much lower prices than market or than we currently project, which would materially adversely affect our results of operation.

A portion of our production may also be interrupted, or shut-in, from time to time for numerous other reasons, including as a result of weather conditions, loss of pipeline or gathering system access, field labor issues or strikes, or we might voluntarily curtail production in response to market conditions. If a substantial amount of our production is interrupted at the same time, it could materially adversely affect our cash flow.

**Our identified drilling location inventories are scheduled out over several years, making them susceptible to uncertainties that could materially alter the occurrence or timing of their drilling.**

Our management has specifically identified and scheduled drilling locations as an estimation of its future multi-year drilling activities on its existing acreage. These identified drilling locations represent a significant part of our growth strategy. Our ability to drill and develop these locations depends on a number of factors, including the

availability of capital, seasonal conditions, regulatory approvals, oil and gas prices, negotiation of agreements with third parties, costs, access to and availability of equipment, services and personnel and drilling results. Because of these uncertainties, we cannot give any assurance as to the timing of these activities, if the potential drilling locations we have identified will ever be drilled or if it will be able to economically produce oil or gas from these or any other potential drilling locations. As such, our actual drilling activities may materially differ from our current expectations, which could materially adversely affect our business, results of operations and financial condition.

**Competition in the oil and gas industry is intense, and many of our competitors have resources that are greater than ours.**

We operate in a highly competitive environment for acquiring prospects and productive properties, marketing oil and gas and securing equipment and trained personnel. Our competitors include major and large independent oil and gas companies that possess financial, technical and personnel resources substantially greater than our resources. Those companies may be able to develop and acquire more prospects and productive properties at a lower cost and more quickly than our financial or personnel resources permit. Our ability to acquire additional prospects and discover reserves in the future will depend on our ability to evaluate and select suitable properties and consummate transactions in a highly competitive environment. Larger competitors may be better able to withstand sustained periods of unsuccessful drilling and absorb the burden of changes in laws and regulations more easily than we can, which could materially adversely affect our competitive position. We may not be able to compete successfully in the future in acquiring prospective reserves, developing reserves, marketing hydrocarbons, attracting and retaining quality personnel and raising additional capital.

**A failure to attract and retain qualified personnel could have a material adverse effect on our business, financial position, results of operations, cash flows and future growth.**

Our success is largely dependent upon our ability to attract and retain personnel with the technical expertise, specialized knowledge and training, skills and experience required for our business. An inability to sufficiently staff our operations or the loss of the services of one or more members of our senior management or of numerous employees with technical skills could have a material adverse effect on our business, financial position, results of operations, cash flows and future growth. While we have entered into employment arrangements with certain of our senior executives, and while a number of consultants have consulting agreements with us, there can be no assurances that any of them will remain with us.

**Shortage and competition in hydraulic fracturing services could impede our ability to develop our shale plays.**

The unavailability or high cost of high pressure pumping services (or hydraulic fracturing services), chemicals, proppant, water, and related services and equipment could limit our ability to execute our exploration and development plans on a timely basis and within its budget. Our industry is experiencing a growing emphasis on the exploitation and development of shale gas and shale oil resource plays, which are dependent on hydraulic fracturing for economically successful development. Hydraulic fracturing in shale plays requires high pressure pumping service crews. A shortage of service crews or proppant, chemical, or water, especially if this shortage occurred in South Texas, could materially and adversely affect our operations and the timeliness of executing our development plans within our budget.

**ZaZa does not own all of the land on which its transportation pipelines and gathering and treating systems are located, which could materially disrupt its operations.**

ZaZa does not own all of the land on which its gathering and treating systems have been constructed, and we are therefore subject to the possibility of increased costs to retain necessary land use. ZaZa obtains the rights to construct and operate our gathering and treating systems on land owned by third parties and governmental agencies for a specific period of time. Our loss of these rights, through our inability to renew right-of-way contracts or otherwise, could have a material adverse effect on our business, results of operations and financial condition.

**Our property acquisition strategy could fail or present unanticipated problems for our business in the future, which could materially adversely affect our ability to make property acquisitions or realize anticipated benefits of those acquisitions.**

Our growth strategy includes acquiring oil and gas properties depending on the availability of capital. We may not be able to identify suitable acquisition opportunities or finance and complete any particular acquisition successfully. Furthermore, acquisitions involve a number of risks and challenges, including:

- diversion of management's attention;
- ability or impediments to conducting thorough due diligence activities;
- an increase in our expenses and working capital requirements;
- the validity of our assumptions about reserves, future production, revenues, capital expenditures, and operating costs, including synergies;
- a decrease in our liquidity by using a significant portion of our available cash or borrowing capacity, if any, to finance acquisitions;
- a significant increase in interest expense or financial leverage if we incur additional debt to finance acquisitions;
- the assumption of unknown liabilities, losses, or costs for which we are not indemnified or for which indemnity is inadequate; and
- the incurrence of other significant charges, such as impairment of oil and gas properties, asset devaluation, or restructuring charges.

Our decision to acquire a property will depend in part on the evaluation of data obtained from production reports and engineering studies, geophysical and geological analyses, and seismic and other information, the results of which are often inconclusive and subject to various interpretations.

Also, our reviews of acquired properties are inherently incomplete because it generally is not feasible to perform an in-depth review of the individual properties involved in each acquisition given time constraints imposed by sellers. Even a detailed review of records and properties may not necessarily reveal existing or potential problems, nor will it permit a buyer to become sufficiently familiar with the properties to fully access their deficiencies and potential. Inspections may not always be performed on every well, and environmental problems, such as groundwater contamination, are not necessarily observable even when an inspection is undertaken.

**We face risks associated with hurricanes and other natural disasters in connection with our operations near coastal areas in Texas.**

A portion of our oil and gas properties are located near coastal areas of the Texas Gulf Coast. As a result, in the event of damage due to hurricanes, tropical storms, flooding or similar natural disasters, we could be subject to production curtailments in the future resulting from hurricane damage to certain fields or, even in the event that producing fields are not damaged, production could be curtailed due to damage to facilities and equipment owned by oil and gas purchasers, or vendors and suppliers.

**Access to water to conduct hydraulic fracturing may not be available if water sources become scarce.**

The availability of sources of water is crucial to conduct hydraulic fracturing. Approximately 80,000-100,000 gallons of water are necessary for drilling and completing one well in the Eagle Ford shale and in the Eaglebine. Texas is currently experiencing a severe drought that has limited the water supplies that are necessary to conduct hydraulic fracturing. We have been sourcing our water from deeper aquifers that have not yet been impacted by the drought. We can make no assurances that sufficient water resources will be available in the short or long term to carry out our current activities.

#### **Risks Related to Our Industry**

**Volatile oil and gas prices could materially adversely affect our financial condition and results of operations.**

Our most significant market risk is the pricing of oil and gas. Management expects energy prices to remain volatile and unpredictable. Moreover, oil and gas prices depend on factors that are outside of our control, including:



- actions of the Organization of Petroleum Exporting Countries and state controlled oil companies relating to oil prices and production controls;
- impact of energy conservation efforts;
- consumer demand;
- domestic and foreign governmental regulations, actions and taxes;
- refining capacity;
- seasonal variations in oil and gas prices;
- economic and energy infrastructure disruptions caused by actual or threatened acts of war, or terrorist activities;
- weather conditions, such as hurricanes, including energy infrastructure disruptions resulting from those conditions and natural disasters;
- changes in the global oil and gas supply, demand and inventories;
- changes in domestic gas supply, demand and inventories;
- the price and quantity of foreign imports of oil and gas;
- the price and availability of liquefied gas imports;
- political conditions in or affecting other oil-producing and gas producing countries, including the current conflicts in the Middle East and North Africa;
- general economic conditions in the United States and worldwide;
- the level of worldwide oil and gas exploration and production activity;
- technological advances affecting energy production and consumption; and
- the price and availability of alternative fuels.

Further, oil and gas prices do not necessarily fluctuate in direct relation to each other. Lower oil and gas prices not only decrease revenues on a per unit basis, but also may reduce the amount of oil and gas that we can economically produce. Lower prices could also negatively impact estimates of our proved reserves. Our revenues, profitability and cash flow depend upon the price of and demand for oil and gas, and a drop in prices can significantly affect our financial results and impede our growth.

**If oil and gas prices decrease or exploration efforts are unsuccessful, we may be required to write-down the capitalized cost of individual oil and gas properties.**

A write-down of the capitalized cost of individual oil and gas properties could occur when oil and gas prices are low or if we have substantial downward adjustments to our estimated proved oil and gas reserves, if operating costs or development costs increase over prior estimates, or if exploratory drilling is unsuccessful.

We use the successful efforts accounting method. All property acquisition costs and costs of exploratory and development wells are capitalized when incurred, pending the determination of whether proved reserves are discovered. If proved reserves are not discovered with an exploratory well, the costs of drilling the well are expensed. All geological and geophysical costs on exploratory prospects are expensed as incurred.

The capitalized costs of our proved oil and gas properties, on a field-by-field basis, may exceed the estimated undiscounted future cash flows of that field. If so, we will adjust the carrying value of the field to its fair value in the current period. The factors used to determine fair value include, but are not limited to, estimates of reserves, future commodity prices, future production estimates, anticipated capital expenditures, and a discount rate commensurate with the risk associated with realizing the expected cash flows projected. Unproved properties are reviewed to determine if there has been an impairment of the carrying value, with any such impairment charged to expense. Given the complexities associated with oil and gas reserves estimates and the history of price volatility in the oil and gas market, events may arise that will require us to record an impairment of our oil and gas properties and there can be no assurance that such impairments will not be required in the future nor that they will not be material.

**We may incur substantial losses and be subject to substantial liability claims as a result of our oil and gas operations.**

Oil and gas exploration, drilling and production activities are subject to numerous operating risks, including the possibility of:

- blowouts, fires and explosions;

- personal injuries and death;
- uninsured or underinsured losses;
- unanticipated, abnormally pressured formations;
- uncontrollable flows of oil, gas or well fluids;
- mechanical difficulties, such as stuck oil field drilling and service tools and casing collapses; and
- environmental hazards, such as uncontrollable flows of oil, gas, brine, well fluids, toxic gas or other pollution into the environment, including groundwater contamination.

Any of these operating hazards could cause damage to properties, serious injuries, fatalities, oil spills, discharge of hazardous materials, remediation and clean-up costs, and other environmental damages, which could expose us to liabilities. The payment of any of these liabilities could reduce, or even eliminate, the funds available for exploration, development, and acquisition or could result in a loss of our properties. We are not fully insured against all risks, including development and completion risks that are generally not recoverable from third parties or insurance. In addition, our insurance policies provide limited coverage for losses or liabilities relating to sudden and accidental pollution, but not for other types of pollution. Our insurance might be inadequate to cover our liabilities. Our energy package is written on reasonably standard terms and conditions that are generally available to the exploration and production industry. The insurance market in general and the energy insurance market in particular have been difficult markets over the past several years. Insurance costs could increase in the future as the insurance industry adjusts to difficult exposures and we may decrease coverage and retain more risk to mitigate future cost increases. If we incur substantial liability and the damages are not covered by insurance or are in excess of policy limits, or if we incur a liability for a risk at a time when we do not have liability insurance, then our business, financial position, results of operations and cash flows could be materially adversely affected.

**We are subject to regulations that are evolving and may cause us to incur substantial costs.**

Our activities are subject to federal, state, regional and local laws and regulations. Extensive laws, regulations and rules regulate activities and operations in the oil and gas industry. For example, matters subject to regulation and the types of permits required include:

- drilling permits;
- water discharge and disposal permits for drilling operations;
- the amounts and types of substances and materials that may be released into the environment;
- drilling and operating bonds;
- environmental matters and reclamation;
- spacing of wells;
- the use of underground injection wells, which affects the disposal of water from its wells;
- occupational safety and health;
- unitization and pooling of properties;
- air quality, noise levels and related permits;
- rights-of-way and easements;
- reports concerning operations to regulatory authorities;
- calculation and payment of royalties;
- gathering, transportation and marketing of oil and gas;
- taxation; and
- waste disposal.

Under these laws and regulations, we could be liable for:

- personal injuries;
- property damage;
- oil spills;
- discharge or disposal of hazardous materials;
- well reclamation costs;
- surface remediation and clean-up costs;
- fines and penalties;
- natural resource damages; and
- other environmental protection and damages issues.

Environmental and other governmental laws and regulations also increase the costs to plan, permit, design, drill, install, operate and abandon oil and gas wells. A major risk inherent in our drilling plans is the need to obtain drilling permits from applicable federal, state and local authorities. Delays in obtaining regulatory approvals or drilling permits for producing and water injection wells, the failure to obtain a drilling permit for a well, or the receipt of a permit with excessive conditions or costs could have a material adverse effect on our ability to explore or develop its properties. Additionally, the oil and gas regulatory environment could change in ways that might substantially increase the financial and managerial costs to comply with the requirements of these laws and regulations and, consequently, adversely affect our profitability. Furthermore, we may be put at a competitive disadvantage to larger companies in our industry that can spread these additional costs over a greater number of wells and larger operating area. Any or all of these contingencies could delay or halt our drilling activities or the construction of ancillary facilities necessary for production, which would prevent us from developing its property interests as planned. Conditions, delays or restrictions imposed on the management of groundwater produced during drilling could severely limit our operations or make them uneconomic.

Changes in laws and regulations could affect our costs of operations, production levels, royalty obligations, price levels, environmental requirements, and other aspects of our business, including our general profitability. We are unable to predict changes to existing laws and regulations. For example, the U.S. Environmental Protection Agency, or the “EPA,” has recently focused on public concerns about the risk of water contamination and public health problems from drilling and hydraulic fracturing activities. This renewed focus could lead to additional federal and state regulations affecting the oil and gas industry. There can be no assurance that present or future regulations will not materially adversely affect our business and operations, including that we may be required to suspend drilling operations or shut-in production pending compliance. Additional regulations or other changes to or reinterpretations of existing laws and regulations could significantly impact our business, results of operations, cash flows, financial position and future growth.

**Environmental matters and costs can be significant.**

Our oil and gas exploration and production operations are subject to stringent and complex federal, state and local laws and regulations governing health and safety aspects of our operations, the discharge of materials into the environment, the generation, storage, transportation and handling of hazardous materials or otherwise relating to environmental protection. These laws and regulations may impose numerous obligations that are applicable to our operations including the acquisition of a permit before conducting drilling or underground injection activities; the restriction of types, quantities and concentration of materials that can be released into the environment; the limitation or prohibition of drilling activities on certain lands lying within wilderness, wetlands and other protected areas; the application of specific health and safety criteria addressing worker protection; and the imposition of substantial liabilities for pollution resulting from operations. Numerous governmental authorities, such as the EPA and analogous state agencies, have the power to enforce compliance with these laws and regulations and the permits issued under them, oftentimes requiring difficult and costly actions. Failure to comply with these laws and regulations may result in the assessment of sanctions, including administrative, civil or criminal penalties, the imposition of investigatory or remedial obligations, and the issuance of orders limiting or prohibiting some or all of our operations.

There is inherent risk of incurring significant environmental costs and liabilities in the performance of our operations due to our handling of petroleum hydrocarbons and wastes, because of air emissions and wastewater discharges related to its operations, and as a result of historical industry operations and waste disposal practices. The exploration and production of oil and gas involves many risks concerning equipment and human operational problems that could lead to leaks or spills of petroleum products. Under certain environmental laws and regulations, we could be subject to strict, joint and several liability for the removal or remediation of previously released materials or property contamination regardless of whether we were responsible for the release or contamination or whether the operations were in compliance with all applicable laws at the time those actions were taken. Private parties, including the owners of properties upon which our wells are drilled and facilities where ZaZa’s petroleum hydrocarbons or wastes are taken for reclamation or disposal, also may have the right to pursue legal actions to enforce compliance as well as to seek damages for non-compliance with environmental laws and regulations or for personal injury or property or natural resource damages. Contamination of groundwater by oil and gas drilling, production and related operations may result in fines, penalties, and remediation costs. In addition, the risk of accidental spills or releases could expose us to significant liabilities that could have a material adverse effect on our business, financial condition or results of operations. Changes in environmental laws and regulations occur frequently, and any changes that result in more stringent or costly waste control, handling, storage, transport,

disposal or cleanup requirements could require us to make significant expenditures to attain and maintain compliance and may otherwise have a material adverse effect on its own results of operations, competitive position or financial condition.

**Possible legislation and regulations related to global warming and climate change could have a material adverse effect on our operations and the demand for oil and gas.**

In December 2009, the EPA determined that emissions of carbon dioxide, methane, and other greenhouse gases, or “GHGs,” present an endangerment to public health and the environment because emissions of such gasses are contributing to the warming of the earth’s atmosphere and other climatic changes. Based on these findings, the EPA recently adopted regulations under existing provisions of the Clean Air Act that require a reduction in emissions of GHGs from motor vehicles and that regulate emissions of GHGs from certain large stationary sources, effective January 2, 2011. The EPA has published its final rule to address the permitting of GHG emissions from stationary sources under the Prevention of Significant Deterioration, or “PSD,” and Title V permitting programs, pursuant to which these permitting programs have been “tailored” to apply to certain stationary sources of GHG emissions in a multi-step process, with the largest sources subject to permitting first. Facilities required to obtain PSD permits for their GHG emissions also will be required to meet “best available control technology” standards, which will be established by the states or, in some instances, by the EPA on a case-by-case basis. Although our current operations do not require PSD or Title V air permits and are not affected by the tailoring rule, the rule may affect us in the future as its operations grow. Such EPA rulemakings could materially adversely affect our operations and restrict or delay our ability to obtain air permits for new or modified facilities. As a result of these regulatory initiatives, our operating costs may increase in compliance with these programs. The EPA has also adopted regulations requiring the reporting of GHG emissions from specified large GHG emission sources in the United States including certain onshore and offshore oil and gas production facilities, which may include certain of our operations, beginning in 2012 for emissions occurring in 2011.

In addition, Congress has from time to time considered adopting legislation to reduce emissions of GHGs and almost one-half of the states have already taken legal measures to reduce emissions of GHGs primarily through the planned development of GHG emission inventories and/or regional GHG cap and trade programs. Most of these cap and trade programs work by requiring either major sources of emissions or major producers of fuels to acquire and surrender emission allowances, with the number of allowances available for purchase reduced each year until the overall GHG emission reduction goal is achieved. These allowances would be expected to escalate significantly in cost over time. The adoption of legislation or regulatory programs to reduce emissions of GHGs could require us to incur increased operating costs, such as costs to purchase and operate emissions control systems, to acquire emissions allowances or to comply with new regulatory or reporting requirements. Any such legislation or regulatory programs could also increase the cost of consuming, and thereby reduce demand for, the oil and gas we produce. Consequently, legislation and regulatory programs to reduce emissions of GHGs could have a material adverse effect on our business, financial condition and results of operations. Finally, some scientists have concluded that increasing concentrations of GHGs in the Earth’s atmosphere may produce climate changes that have significant physical effects, such as increased frequency and severity of storms, floods and other climatic events. If any such effects were to occur, they could have a material adverse effect on our financial condition and results of operations.

**Federal and state legislation and regulatory initiatives relating to hydraulic fracturing could result in increased costs and additional operating restrictions or delays and inability to book future reserves.**

Hydraulic fracturing involves the injection of water, sand and additives under pressure into rock formations to stimulate hydrocarbon (oil and gas) production. We engage third parties to provide hydraulic fracturing or other well stimulation services to us in connection with several wells or proposed wells for which we are the operator. We find that the use of hydraulic fracturing is necessary to produce commercial quantities of oil and gas from many reservoirs where we have significant acreage. The process is typically regulated by state oil and gas commissions. However, Congress has considered bills which, if enacted, would repeal an exemption in the federal SDWA for the underground injection of hydraulic fracturing fluids near drinking water sources and could result in additional regulatory burdens, such as permitting, construction, financial assurance, monitoring, recordkeeping and plugging and abandonment requirements. In addition, several states, including Texas, have adopted rules requiring the reporting and public disclosure of chemicals used in the fracturing process. The availability of this information could make it easier for third parties opposing the hydraulic fracturing process to initiate legal proceedings based on allegations that specific chemicals used in the fracturing process could adversely affect groundwater.

Hydraulic fracturing impacts and practices have also been the subject of a number of governmental and private studies. The EPA is conducting an investigation of hydraulic fracturing practices. On November 3, 2011, the EPA released its study plan on the effects of hydraulic fracturing on human health and the environment to the EPA's Science Advisory Board for comment. The EPA issued an update on the study on December 21, 2012 and expects to issue the final report in 2014. On April 13, 2012, the Department of Interior, the Department of Energy and the Environmental Protection Agency issued a memorandum outlining the multi-agency collaboration on unconventional oil and gas research in response to the White House "Blueprint for a Secure Energy Future" and the recommendation of the Secretary of Energy Advisory Board Subcommittee on Natural Gas. These ongoing and proposed studies could lead to initiatives to further regulate hydraulic fracturing. Additional requirements could be imposed, including permitting requirements, financial assurances, public disclosure obligations, monitoring and reporting requirements. New requirements could increase operating costs and any disclosure requirements could increase the possibility of third-party or governmental legal challenges to hydraulic fracturing.

The EPA has also begun to assert regulatory authority over certain aspects of hydraulic fracturing. Recently, the EPA asserted federal regulatory authority over hydraulic fracturing involving diesel additives under the SDWA's Underground Injection Control Program, or the "UIC," and is currently developing UIC permitting guidance for hydraulic fracturing activities that use diesel fuel in fracturing fluids. In addition, the EPA has issued new emission standards to reduce VOC emissions from oil and gas exploration and production operations including specific limitations for emissions associated with hydraulic fracturing. In particular, hydraulically fractured gas wells must comply with reduced emission (REC) techniques by January 1, 2015. Further, the agency has announced that one of its enforcement initiatives for its 2011 to 2013 fiscal years would be to focus on environmental compliance by the energy extraction sector. Finally, on October 20, 2011, the EPA announced its plan to propose pretreatment standards for wastewater generated during the hydraulic fracturing process. These governmental studies of hydraulic fracturing impacts and practices and the EPA's regulatory and enforcement initiatives could make it more difficult to perform hydraulic fracturing and increase our costs of compliance and doing business. If hydraulic fracturing becomes regulated at the federal level as a result of federal legislation or regulatory initiatives by the EPA, our fracturing activities could become subject to additional permitting requirements and also to attendant permitting delays and potential increases in costs. If such permitting requirements delay our drilling activity, our ability to present reserves, and once presented, book reserves, will be delayed as well.

In addition, some states have adopted, and other states are considering adopting, regulations that could impose more stringent permitting, disclosure and well construction requirements on hydraulic fracturing operations. For example, Pennsylvania, Colorado, and Wyoming have each adopted a variety of well construction, set back, and disclosure regulations limiting how fracturing can be performed and requiring various degrees of chemical disclosure. Texas recently passed a law requiring public disclosure of certain information about chemicals used in the hydraulic fracturing process, and the Texas Railroad Commission has adopted rules setting forth requirements for such public disclosure. In addition, the Texas Commission on Environmental Quality recently adopted more stringent air emission and permitting requirements for oil and gas exploration operations in the Barnett Shale. More stringent air emissions and permitting requirements may be imposed on the areas in which we operate sometime in the future. These regulations, if adopted, would affect our operations, increase our costs of exploration and production and limit the quantity of oil and gas that we can economically produce. A major risk inherent in our drilling plans is the need to obtain drilling permits from state and local authorities on a timely basis following leasing. In addition to the imposition of more stringent regulations at the state and federal level, certain local authorities have passed or are considering moratoria on oil and gas drilling and restrictions on hydraulic fracturing. Delays in obtaining regulatory approvals, drilling permits, the failure to obtain a drilling permit for a well or the receipt of a permit with unreasonable conditions or costs could have a material adverse effect on our ability to explore or develop its properties. Additionally, the oil and gas regulatory environment could change in ways that might substantially increase our financial and managerial costs to comply with the requirements of these laws and regulations and, consequently, materially adversely affect our profitability. Furthermore, these additional costs may put us at a competitive disadvantage compared to larger companies in the industry which can spread such additional costs over a greater number of wells and larger operating staff.

Any increased costs for fracturing or restrictions on the use of fracturing could result in we being unable to economically produce hydrocarbons that we discover, resulting in our inability to book reserves, and materially adversely affecting its future results of operations.

**Global financial and economic circumstances may have impacts on our business and financial condition that we currently cannot predict.**

Global financial markets may have a material adverse impact on our business and its financial condition, and it may face challenges if conditions in the financial markets are inadequate to finance our activities at a reasonable cost of capital. While the current economic situation has improved since 2008, continuing concerns over the worldwide economic outlook, geopolitical issues, the availability and costs of credit, and the sovereign debt crisis have contributed to increased volatility in the global financial markets and commodity prices and diminished expectations for the global economy and these conditions could make it more difficult for us to access capital. In addition, adverse economic circumstances could cause customers, joint owners or other parties with whom we transact business to fail to meet their obligations to us. Also, worldwide economic conditions could lead to reduced demand for oil and gas, or lower prices for oil and gas, or both, which could have a material negative impact on our revenues, results of operations and financial conditions.

***Certain federal income tax deductions currently available with respect to oil and gas exploration and development may be eliminated as a result of future legislation.***

Recently the President and certain members of Congress have proposed changes in the tax code to eliminate certain U.S. federal income tax deductions and credits currently available to oil and gas exploration and production companies. Such proposed changes include, but are not limited to, (i) the repeal of the percentage depletion allowance for oil and gas properties; (ii) the elimination of current deductions for intangible drilling and development costs; (iii) the elimination of the deduction for certain U.S. production activities; and (iv) an extension of the amortization period for certain geological and geophysical expenditures. It is unclear, however, whether any such changes will be enacted or, if enacted, how soon such changes would be effective. The passage of any legislation as a result of the budget proposal or any other similar change in U.S. federal income tax law could eliminate or defer certain tax deductions that are currently available with respect to oil and gas exploration and development, and any such change could negatively affect our financial condition, results of operations and cash flows.

**Laws regulating derivatives established under the Dodd-Frank Act and the regulations being promulgated thereunder could adversely affect our ability to manage business and financial risks by reducing the availability of, and increasing our cost of using, derivative instruments as hedges against fluctuating commodity prices and interest rates.**

On July 21, 2010 new comprehensive financial reform legislation, known as the Dodd-Frank Wall Street Reform and Consumer Protection Act, or the Dodd-Frank Act, was enacted that establishes federal oversight and regulation of the over-the-counter derivatives market and entities that participate in that market. The Dodd-Frank Act requires the Commodities Futures Trading Commission, or CFTC, federal regulators of banks and other financial institutions, or the prudential regulators, and the SEC to promulgate rules and regulations implementing the new legislation.

We have not historically entered into hedging transactions. If we choose to do so, we will be required to comply with certain clearing and trade execution requirements (or to take steps to qualify for an exemption to such requirements) that are set forth in the new legislation. In addition, new regulations may require us to comply with margin requirements in connection with our entry into certain derivatives activities, although these regulations are not finalized and their application to us is uncertain at this time. Such a requirement may increase our costs and decrease our profitability. Moreover, our counterparties may also be required to post margin on our transactions and comply with minimum capital requirements, which could result in additional costs being passed on to us, thereby negatively affecting our business, results of operations and financial condition. Other regulations also remain to be finalized, and the CFTC recently has delayed the compliance dates for various regulations already finalized. As a result, it is not possible at this time to predict with certainty the full effects of the Dodd-Frank Act and CFTC rules on us and the timing of such effects.

To the extent we do enter into derivatives transactions, the Dodd-Frank Act may also require the counterparties to our derivative instruments to spin off some of their derivatives activities to separate entities, which may not be as creditworthy as the current counterparties. The Dodd-Frank Act and regulations could significantly increase the cost of derivative contracts (including from swap recordkeeping and reporting requirements and through requirements to post collateral which could adversely affect our available liquidity), materially alter the terms of derivative contracts, reduce the availability of derivatives to protect against risks we encounter, reduce our ability to

monetize or restructure our existing derivative contracts, and increase our exposure to less creditworthy counterparties. If we reduce our use of derivatives as a result of the Dodd-Frank Act and regulations, our results of operations may become more volatile and our cash flows may be less predictable, which could adversely affect our ability to plan for and fund capital expenditures.

#### **Risks Related to the Ownership of Our Common Stock**

##### **We do not intend to pay cash dividends on its common stock in the foreseeable future.**

We do not anticipate paying dividends in the foreseeable future, but expect to retain earnings to finance the growth of our business. Therefore, any return on investments will only occur if the market price of our common stock appreciates. In addition, the terms of our Senior Secured Notes and Warrants prohibit the payment of dividends.

##### **An active public market for our common stock may not be sustained.**

Prior to the completion of the Combination, no public market existed for the shares of ZaZa Energy Corporation common stock. Although our shares of common stock are listed on the Nasdaq Capital Market, an active public market for our common stock may not be sustained, which could affect the ability to sell, or depress the market price of, our common stock. We are unable to predict whether an active trading market for our common stock will be sustained.

##### **The public price and trading volume of our common stock may be volatile.**

The price and volume of our common stock may be volatile and subject to fluctuations. Some of the factors that could cause fluctuations in the stock price or trading volume of our common stock include:

- general market and economic conditions and market trends, including in the energy and oil industries and the financial markets generally;
- the political, economic and social situation in the United States;
- actual or expected variations in operating results;
- variations in quarterly operating results;
- inability to meet projections in production and revenue;
- announcements by us or our competitors of significant acquisitions, strategic partnerships, joint ventures, capital commitments, or other business developments, such as oil or gas discoveries;
- adoption of new accounting standards affecting the industry in which we operate;
- operations and stock performance of competitors;
- litigation or governmental action involving or affecting us or our subsidiaries;
- changes in financial estimates and recommendations by securities analysts;
- recruitment or departure of key personnel;
- purchase or sales of blocks of our common stock; and
- operating and stock performance of the companies that investors may consider to be comparable.

There can be no assurance that the price of our common stock will not fluctuate or decline significantly. The stock market in recent years has experienced considerable price and volume fluctuations that has often been unrelated or disproportionate to the operating performance of individual companies and that could materially adversely affect the price of our common stock, regardless of our operating performance. The market prices of stock in exploration stage companies have been especially volatile. In addition, price volatility might be worse if the trading volume of shares of the common stock is low. Furthermore, stockholders may initiate securities class action lawsuits if the market price of ZaZa Energy Corporation's stock declines significantly, which may cause us to incur substantial costs and could divert the time and attention of our management.

##### **We have the ability to issue "blank check" preferred stock, which could affect the rights of holders of our common stock.**

Our certificate of incorporation allows the Board of Directors to issue up to 25 million shares of preferred stock and to set the terms of such preferred stock. The terms of such preferred stock may materially adversely impact the dividend and liquidation rights of holders of our common stock.

**The requirements of being a public company, including the requirements of the Sarbanes-Oxley Act of 2002, may strain our resources, increase our costs and distract management; and we may be unable to comply with these requirements in a timely or cost-effective manner.**

We have limited history operating as a publicly-traded company. We need to comply with certain laws and regulations and public reporting requirements, including the reporting obligations of the Securities Exchange Act of 1934, as amended, or the Exchange Act, certain corporate governance provisions of the Sarbanes-Oxley Act of 2002, laws, and regulations and rules of the SEC and the Nasdaq. Complying with these statutes, regulations and requirements will increase our general and administrative costs as a result of higher expenses associated with director and officer liability insurance, audit work, regulatory requirements and the establishment and maintenance of heightened corporate governance measures and management oversight. Compliance will occupy a significant portion of our board of directors' and management's time.

We are currently:

- instituting a more comprehensive compliance function;
- designing, establishing, and evaluating a system of internal controls over financial reporting in compliance with the requirements of Section 404 of the Sarbanes-Oxley Act of 2002 and the related rules and regulations of the SEC and the Public Company Accounting Oversight Board;
- establishing internal policies, such as those relating to disclosure controls and procedures and insider trading;
- preparing and filing periodic and annual reports; and
- establishing an investor relations function.

If we are unable to accomplish these objectives in a timely and effective fashion, our ability to comply with our public reporting requirements and other rules that apply to public companies could be impaired, and we may be subject to sanction or investigation by the SEC or the Nasdaq.

**We are an emerging growth company, and we cannot be certain if the reduced disclosure requirements applicable to emerging growth companies will make our common stock less attractive to investors.**

We are an "emerging growth company," as defined in the JOBS Act, and we intend to take advantage of certain exemptions from various reporting requirements that are applicable to other public companies that are not emerging growth companies, including, but not limited to reduced disclosure obligations regarding executive compensation in our periodic reports and proxy statements, and exemptions from the requirements of holding a nonbinding advisory vote on executive compensation and shareholder approval of any golden parachute payments not previously approved. In addition, even if we comply with the greater obligations of public companies that are not emerging growth companies immediately after this offering, we may avail ourselves of the reduced requirements applicable to emerging growth companies from time to time in the future, so long as we are an emerging growth company. We will remain an emerging growth company for up to five years, though we may cease to be an emerging growth company earlier under certain circumstances, including if, before the end of such five years, we are deemed to be a large accelerated filer under the rules of the SEC (which depends on, among other things, having a market value of common stock held by nonaffiliates in excess of \$700 million). Investors and securities analysts may find it more difficult to evaluate our common stock because we will rely on one or more of these exemptions, and, as a result, investor confidence and the market price of our common stock may be materially and adversely affected.

Further, Section 102(b)(1) of the JOBS Act exempts emerging growth companies from being required to comply with new or revised financial accounting standards until private companies (that is, those that have not had a Securities Act registration statement declared effective or do not have a class of securities registered under the Exchange Act) are required to comply with the new or revised financial accounting standards. The JOBS Act provides that a company can elect to opt out of the extended transition period and comply with the requirements that apply to nonemerging growth companies but any such election to opt out is irrevocable. We have elected not to opt out of such extended transition period which means that when a standard is issued or revised and it has different application dates for public or private companies, we, as an emerging growth company, can adopt the new or revised standard at the time private companies adopt the new or revised standard. This may make our financial statements not comparable with those of another public company which is neither an emerging growth company nor an



emerging growth company which has opted out of using the extended transition period because of the potential differences in accounting standards used.

**Our failure to achieve and maintain effective internal control in accordance with Section 404 of the Sarbanes-Oxley Act could result in a restatement of our financial statements, cause investors to lose confidence in our financial statements and us and have a material adverse effect on our business and stock price.**

Prior to the Combination, neither ZaZa nor ZaZa LLC was required to evaluate its internal control over financial reporting in the manner that is currently required of certain public companies in the United States. As a public company, we are required to document and test our internal control procedures in order to satisfy the requirements of Section 404 of the Sarbanes-Oxley Act and the related rules and regulations of the SEC, the Public Company Accounting Oversight Board, including annual management assessments of the effectiveness of our internal control over financial reporting and a report by our independent registered public accounting firm that addresses our internal control over financial reporting. The requirement for such auditor report however, will likely not apply for four years (assuming we remain an emerging growth company during such period).

If, as a result of deficiencies in our financial or other internal controls, including material weaknesses, we have not or cannot provide reliable financial reports or internal recordkeeping or compliance procedures, our business decisions or compliance processes may be adversely affected, our business and operating results could be harmed, we may be subject to legal penalties or other claims, investors could lose confidence in our reported financial information and the price of our stock could decrease.

**The majority of our common stock is owned by the founders, whose interests may not be aligned with the interests of other stockholders.**

Under our stockholders' agreement with the entities controlled by the ZaZa founders, the significant ZaZa owners, during the three years following the closing of the Combination will be entitled to designate a proportional number of directors to the Board (but not more than seven) based upon the significant ZaZa owners' (and their permitted transferees') percentage ownership of ZaZa. The remaining directors of ZaZa will be nominated by a nominating committee consisting of two directors selected by the designees on the Board that were selected by Toreador prior to the closing of the combination (and their successors) and one independent director selected by the significant ZaZa owners. The three individuals that founded ZaZa LLC, the ZaZa founders collectively own approximately 60% of the common stock as of December 31, 2012. During the three years after closing, the ZaZa founders will be required to vote their shares in favor of the nominees of the nominating committee. However, after the third anniversary of the closing, there will be no limitation on the number of directors of ZaZa that the significant ZaZa owners may nominate and elect and, as such, they may be able to nominate and elect the entire Board and remove any directors, including directors who were Toreador designees or nominated by the Board's nominating committee. In addition, as a result of their share ownership in ZaZa, the significant ZaZa owners will be able to control all matters requiring approval by ZaZa stockholders, including, but not limited to: mergers, consolidations or acquisitions; the sale of all or substantially all of ZaZa's assets and other decisions affecting ZaZa's capital structure; the amendment of ZaZa's certificate of incorporation and bylaws, and ZaZa's liquidation, winding up and dissolution. Finally, under the stockholders' agreement, the significant ZaZa owners are subject to a three-year standstill period starting on the date of the consummation of the transactions. However, once the stand-still period ends, there will be no contractual restriction on the significant ZaZa owners' ability to purchase additional shares of our common stock or take us private on terms that may not be favorable to the other stockholders of ZaZa. The interests of the significant ZaZa owners may not be aligned with the interests of the other stockholders. This concentration of share ownership may have a material adverse effect on the trading price of our common stock because investors may perceive disadvantages in owning shares in a company with significant stockholders.

**The ZaZa founders have economic interests in our properties and their interests may not be aligned with the interests of us.**

The ZaZa founders are board members and collectively, beneficially own approximately 60% of our common stock as of December 31, 2012. In addition to their interests as equity owners, each of these individuals also has a direct or indirect overriding royalty interest relating to certain of our properties. These overriding royalty interests generally entitle them to three percent of the net revenue interest associated with sales of oil and gas produced from these properties, without any corresponding responsibility for payment of any expenses.

**There is a potential market overhang that could depress the value of our common stock, and future sales of our common stock could put a downward pressure on the price of our shares and could have a material adverse effect on the price of our shares.**

In December 2012, we filed a resale registration statement on Form S-1 for the sale of approximately 32 million shares of our common stock, including approximately 27 million shares of common stock issuable upon exercise of our Warrants. A substantial majority of those shares remain unsold. In addition, we also filed a resale registration statement on Form S-8 in December 2012 for the sale of approximately 6 million shares of our common stock by certain current and former consultants and employees of the Company. A substantial majority of those shares remain unsold. In October 2012, we issued \$40 million in aggregate principal amount of our Convertible Notes, which are convertible into 16 million shares of our common stock. Shares of our common stock issued upon conversion of the Convertible Notes may generally be sold by non-affiliates without restriction after October 2013 pursuant to Rule 144 under the Securities Act. The possibility that substantial amounts of our outstanding common stock may be sold by such holders, or the perception that such sales could occur, could materially adversely affect the market price of our common stock and impair our ability to raise additional capital through the sale of equity securities in the future. In addition, this selling activity could decrease the level of public interest in our common stock, inhibit buying activity that might otherwise help support the market price of our common stock, and prevent possible upward price movements in our common stock.

In addition, the significant ZaZa owners have demand and piggyback registration rights pursuant to our stockholders' agreement commencing on the six month anniversary of the closing of the Combination. Pursuant to the Lock-Up agreement entered into with the holders of our Warrants, the significant ZaZa owners have significant limitations on their ability to sell any shares for five years, subject to certain exceptions. The possibility that the significant ZaZa owners could sell under those exceptions could add to the effect of such overhang.

**Upon the expiration of the non-competition agreements and under certain other circumstances, the three ZaZa founders will be able to directly compete with New ZaZa.**

On August 9, 2011, each of the three ZaZa founders (referred to as a "restricted person") entered into a separate non-competition agreement with ZaZa. The non-competition agreements provide that each of the restricted persons and his controlled affiliates may not engage in, carry on or assist any oil or gas business in specified areas in the Eagle Ford and Eagle Ford/Woodbine resource plays in Texas and the Paris Basin in France or acquire oil and gas interests in, or acquire interests in any businesses with oil and gas interests in, those specified areas, subject to certain exceptions. The restricted persons also agreed not to advise, request, induce, attempt to induce or otherwise divert any customer, supplier, licensee or other business relation of ZaZa, ZaZa LLC and Toreador and their present and future subsidiaries, and further agreed not to materially curtail, limit or cease doing business with any such entities or materially interfere with the customer, supplier and other business relationships of, or oil and gas interests or the businesses of, ZaZa, and its present and future subsidiaries. The non-competition agreement with each restricted person lasts only until the later of the termination of the restricted person's employment with ZaZa or three years after the consummation of the transaction.

In addition, the non-competition agreements do not apply to any opportunity in which the restricted persons would be prohibited from participating, if such opportunity is first offered to ZaZa and a majority of the full board of directors of ZaZa, including a majority of the disinterested directors, declines to pursue such opportunity, or a majority of the disinterested directors fails to make a determination as to whether ZaZa will pursue such opportunity within ten business days following such offer. Upon the expiration of the non-competition agreements, or during the term of the non-competition agreements if the ZaZa board of directors declines or fails to determine whether to pursue a corporate opportunity within ten business days, the ZaZa founders will be free to pursue competitive activities or such corporate opportunities, which could create conflicts of interest and limit ZaZa's ability to acquire additional assets or pursue its businesses and could have a material adverse effect on us.

**We are a "controlled company" within the meaning of the Nasdaq rules and qualify for, and rely on, exemptions from certain corporate governance standards, which may limit the presence of independent directors on the board of directors or board committees of ZaZa.**

The ZaZa founders beneficially own shares of our stock which represents approximately 6.0% of the outstanding voting power of our capital stock as of December 31, 2012. Accordingly, the ZaZa founders will have the ability to elect our Board of Directors and thereby control the management and affairs of ZaZa. Therefore, we are deemed to be a "controlled company" for purposes of Nasdaq Rule 5615(c)(2). Under this rule, a company of

which more than 50% of the voting power for the election of directors is held by an individual, a group or another company is a “controlled company” and may elect to be exempt from certain corporate governance requirements, including requirements that (1) a majority of the board of directors consist of independent directors, (2) compensation of officers be determined or recommended to the board of directors by a majority of its independent directors or by a compensation committee comprised of independent directors.

**Conversion of the Convertible Notes and exercise of the Warrants may dilute the ownership interest of existing shareholders, or may otherwise depress the market price of our common stock.**

The conversion of some or all of the Convertible Notes and the exercise of some or all of the Warrants may dilute the ownership interests of existing shareholders of our common stock. Any sales in the public market of the shares of our common stock issuable upon such conversion or exercise could adversely affect prevailing market prices of our common stock. In addition, the existence of the Convertible Notes and the Warrants may encourage short selling by market participants because the conversion of the Convertible Notes or exercise of the Warrants could be used to satisfy short positions, or anticipated conversion of the Convertible Notes into shares of our common stock or exercise of the Warrants could depress the market price of our common stock.

**Provisions of Delaware law, our charter documents and the agreements governing the Convertible Notes and the Senior Secured Notes may impede or discourage a takeover, which could cause the market price of our common stock to decline.**

We are a Delaware corporation, and the anti-takeover provisions of Delaware law impose various impediments to the ability of a third party to acquire control of us, even if a fundamental change or a change in control would be beneficial to our existing stockholders. In addition, our board of directors has the power, without stockholder approval, to designate the terms of one or more series of preferred stock and issue shares of preferred stock. The ability of our board of directors to create and issue a new series of preferred stock and certain provisions of Delaware law and our certificate of incorporation and bylaws could impede a merger, takeover or other business combination involving us or discourage a potential acquirer from making a tender offer for our common stock, which, under certain circumstances, could reduce the market price of our common stock.

In addition, certain provisions of the Convertible Notes and the Senior Secured Notes could make it more difficult or more expensive for a third party to acquire us. Upon the occurrence of a fundamental change, subject to certain conditions, holders of Senior Secured Notes and Convertible Notes will have the right, at their option, to require us to purchase for cash all or any portion of their notes. We may also be required, under certain circumstances, to increase the conversion rate for the Convertible Notes if a holder elects to convert its Convertible Notes in connection with a make-whole fundamental change.

**ITEM 1B. UNRESOLVED STAFF COMMENTS**

None.

**ITEM 2. PROPERTIES**

See Items 1 and 2 Business and Properties.

**ITEM 3. LEGAL PROCEEDINGS**

**Tiway Arbitration**

Toreador entered into a Share Purchase Agreement (“SPA”) between Tiway Oil BC (“Tiway”), Tiway Oil AS and Toreador on September 30, 2009 for the purchase by Tiway of the entire issued share capital of Tiway Turkey Limited, f/k/a Toreador Turkey Limited (“TTL”). Tiway alleges in its request for arbitration that Toreador breached representations and warranties in the SPA as to five matters:

1. **Petrol Ofisi.** Tiway alleges that Toreador breached its representations and warranties under the SPA in respect of a third-party claim asserted by Petrol Ofisi against Toreador Turkey Ltd. in the amount of TRY

7.6 million (\$5.1 million), for which Tiway alleges Toreador is liable for an estimated TRY 2.07 million (approximately \$1.38 million), plus estimated interest of TRY 390 thousand (\$260 thousand), together with a fine of 40% of the amount claimed (i.e. an estimated further \$0.5 million). At the September 13, 2012 hearing, the Tribunal decided to complete its examination of two separate expert reports and then decide if it's necessary to send the case-file to a third expert for the elimination of any conflicts between the first two expert reports. The hearing scheduled for November 15, 2012 was postponed until December 25, 2012. At the December 25, 2012 hearing, the court decided that Petrol Ofisi was not entitled to claim TRY 2.07 million from Tiway. Petrol Ofisi may appeal the decision.

2. **TPAO.** Tiway alleges that Toreador breached its representations and warranties under the SPA in respect of arbitration proceedings commenced by Türkiye Petrolleri Anonim Ortaklığı ("TPAO") against TTL before the International Court of Arbitration. Two claims were heard within the same arbitration in late 2011 relating to alleged damages and losses suffered by TPAO of approximately \$3.7 million plus TRY 1,167,246 (approximately \$780 thousand), plus interest (currently unquantified) in connection with certain construction efforts in the South Akcakoca Sub-Basin ("SASB") gas project that were undertaken while TTL was the official operator of the SASB project. The SASB project was governed by a joint operating agreement (the "JOA") between TPAO and TTL. In both the first and the second claims, TPAO alleges that TTL breached its obligations under the JOA. Tiway is asserting its right to indemnification as to any amounts awarded to TPAO with respect to the arbitration. Tiway assumed the defense of this matter and its legal representatives in Turkey provided a detailed defense in which Tiway rejected each of the damages and losses alleged by the TPAO. The Tribunal issued its award in favor of Tiway and dismissed TPAO's claims in their entirety.
3. **Momentum.** In 2006, TTL entered into an agreement with Momentum Engineering LLC ("Momentum"). The agreement was an EPIC contract relating to the SASB project. Momentum completed and delivered major installation works, leaving some work outstanding, namely the removal of several flotation tanks from the Ayazli tripod. The Settlement and Release Agreement for the works, signed by Momentum, TTL and the Company on August 13, 2008 specifically included a statement that Momentum would undertake to remove the fallen tanks by September 30, 2008; however it did not do so. In September 2009, TPAO, the current operator for the SASB project, sought the removal of the flotation tanks. Tiway contends that since TTL had been the operator in 2006, TTL was responsible for asking Momentum to remove the tanks, failing which TPAO would arrange for an independent contractor to do so, whereupon TTL would be responsible for claiming the cost from Momentum. In Momentum's operation to remove the tanks in October 2009, one of the tanks fell to the seabed. Momentum stated it had no intention of removing the fallen tank and TPAO thus arranged for a third party contractor to remove the tank and invoiced \$118 thousand plus VAT (estimated total amount of cost is \$250 thousand) to TTL for its share of the costs in removing the tank. Tiway alleges that Toreador breached its representations and warranties under the SPA with respect to the Momentum matter and has demanded indemnification for any losses or costs suffered by it in connection with such matter.
4. **GDPA Training Obligations.** Tiway alleges that Toreador breached its representations and warranties under the SPA in respect of an alleged liability to the General Directorate of Petroleum Affairs and the Ministry of Energy of Republic of Turkey relating to the payment of training costs pursuant to the petroleum laws of Turkey. Tiway alleges that these training costs were incurred prior to the sale of TTL to Tiway. TTL has made an estimate of its potential liability if required to meet these training obligations of approximately \$0.5 million.
5. **Insurance Premiums.** Tiway alleges that Toreador breached its representations and warranties under the SPA in connection with the partial rebates of two insurance premiums. Two policies were issued in the name of TTL, but when the policies were cancelled (as agreed upon the conclusion of the SPA), the rebates were paid to Toreador. While Tiway claims estimated damages of approximately \$300 thousand, Toreador only received credits and rebates for approximately \$108 thousand. In addition, the credits and rebates may at least in part have related to policies that were not included in the scheduled policies of the SPA.

In addition, Tiway seeks to recover the "significant" costs it has incurred in defending the above claims as damages under the SPA. ZaZa views any liability at the levels stated in claims 1.- 4. above to be remote because such claims may be deemed withdrawn or are, in management's opinion, otherwise unsupported by the provisions in the SPA.

On December 12, 2011, Tiway Oil BV (“Tiway”) commenced arbitration against Toreador by submitting a formal Request for Arbitration to the London Court of International Arbitration (“the LCIA”) pursuant to the SPA. An arbitrator was selected in the first quarter of 2012, but no further actions have been made. On August 9, 2012, Tiway agreed a stay of the arbitration against Toreador pending the arbitrators’ award in the International Chamber of Commerce arbitration between TPAO and Tiway. Tiway and Toreador have negotiated a settlement of all claims, including the insurance premium claim discussed above, for an immaterial amount of cash consideration, waiver of certain rights under the SPA, and contingent liability for the GDPA training obligations not to exceed \$200,000.

### **Fallen Structures**

In 2005, two separate incidents occurred offshore Turkey in the Black Sea, which resulted in the sinking of two caissons (the “Fallen Structures”) and the loss of three natural gas wells. Toreador has not been requested to or ordered by any governmental or regulatory body to remove the caissons. Therefore, ZaZa believes that the likelihood of receiving such a request or order is remote and no liability has been recorded. In connection with Toreador’s sale of its 26.75% interest in the SASB project to Petrol Ofisi in March 2009 and its sale of TTL to Tiway in October 2009, Toreador agreed to indemnify Petrol Ofisi and Tiway, respectively, against and in respect of any claims, liabilities and losses arising from the Fallen Structures. Toreador also agreed to indemnify a third-party vendor for any claims made related to these incidents. To date, no claims have been made or are currently anticipated.

### **Lundin Indemnification**

Toreador Energy France (TEF) executed on August 6, 2010, an indemnification and guarantee agreement (“IGA”) for a maximum aggregate amount of €50 million to cover Lundin International (“Lundin”) against any claim by a third party arising from drilling works executed by TEF as operator on the Mairy permit in France. The title to the Mairy permit was awarded to Lundin, TEF and EnCore (E&P) Ltd jointly in August 2007. In March 2010, Lundin communicated its desire to withdraw from the permit on which no drilling works had been performed and consequently assigned its working interest of 40% in equal parts to TEF and EnCore (E&P) Ltd. TEF subsequently assigned half of its now 50% working interest to Hess. Under French mining law, all titleholders are held jointly and severally responsible for all damages and claims relating to works on a permit. Therefore, under the IGA, TEF agreed to indemnify Lundin upon notice of any liability or claim for damages by a third party against Lundin in connection with works performed by TEF on the Mairy permit from February 15, 2010 until the transfer of title of such permit is formally accepted by the French government, which is expected to occur over the next nine months. To date, no claims have been made or are currently anticipated under the IGA.

### **FLMK/Emerald Leasing Claims**

ZaZa LLC filed a lawsuit against certain lease brokers, consultants and law firms who were involved in the leasing of acreage for the company in DeWitt and Lavaca Counties, including Emerald Leasing LLC, FLMK Acquisition, LLC, John T. Lewis, Billy Marcum, Brad Massey, Max Smith, Randy Parsley, Timothy E. Malone, Heroux & Helton PLLC, and Whitaker Chalk Swindle & Schwartz PLLC. ZaZa paid certain of these brokers for approximately 3,924 acres of leases for which the brokers have not delivered to the company. Additionally, there are net lease acreage shortages for which ZaZa has made a claim. To the extent that the Company receives any cash settlement from these persons, it is required to share one-half of the cash settlement with Hess pursuant to the terms of the agreement dissolving the Hess joint venture.

### **Sankalp Amercias, Inc. Casing Collar Failure**

ZaZa LLC has filed a lawsuit against Sankalp Americas, Inc. (“Sankalp”). The dispute has arisen due to the catastrophic loss of a 17,000+ foot horizontal well, the Stingray A-1H, drilled by ZaZa LLC in Walker County, Texas. While ZaZa LLC worked to complete the sixteenth stage of its hydraulic fracturing operations, a casing collar manufactured by Sankalp failed, separating completely, and causing a downhole restriction. This restriction, which could not be remediated, ultimately resulted in the loss of the entire horizontal portion of the well. ZaZa LLC seeks to recover from Sankalp for its substantial losses caused by such failure.

**Other**

From time to time, we are named as a defendant in other legal proceedings arising in the normal course of business. In our opinion, the final judgment or settlement, if any, which may be awarded with any suit or claim would not have a material adverse effect on our financial position, results of operations or cash flows.

**ITEM 4. *MINE SAFETY DISCLOSURE***

None

## PART II

### **ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SHARES**

Our common stock is listed on the NASDAQ Capital Market and commenced trading on February 22, 2012 under the ticker symbol "ZAZA." Prior to that date, there was no public market for our common stock.

As of February 28, 2013, there were approximately 122 holders of record of our common stock and approximately 8,000 beneficial holders of our common stock.

The following table sets forth the high and low sale prices per share of our common stock as reported by the NASDAQ Capital Market based upon quotations that reflect inter-dealer prices, without retail mark-up, mark-down or commission and may not necessarily represent actual transactions:

	High	Low
<b>2012</b>		
First Quarter (a)	\$ 5.07	\$ 3.44
Second Quarter	\$ 5.18	\$ 2.77
Third Quarter	\$ 4.93	\$ 2.81
Fourth Quarter	\$ 3.11	\$ 1.20

(a) First quarter figures for 2012 are given for the period from February 22, 2012 (the date our common stock commenced trading on NASDAQ) to March 31, 2012.

No dividends have ever been paid on our common stock. Our dividend policy is to retain earnings to finance the operations and expansion of our businesses. We do not anticipate paying any cash dividends on our common stock at this time.

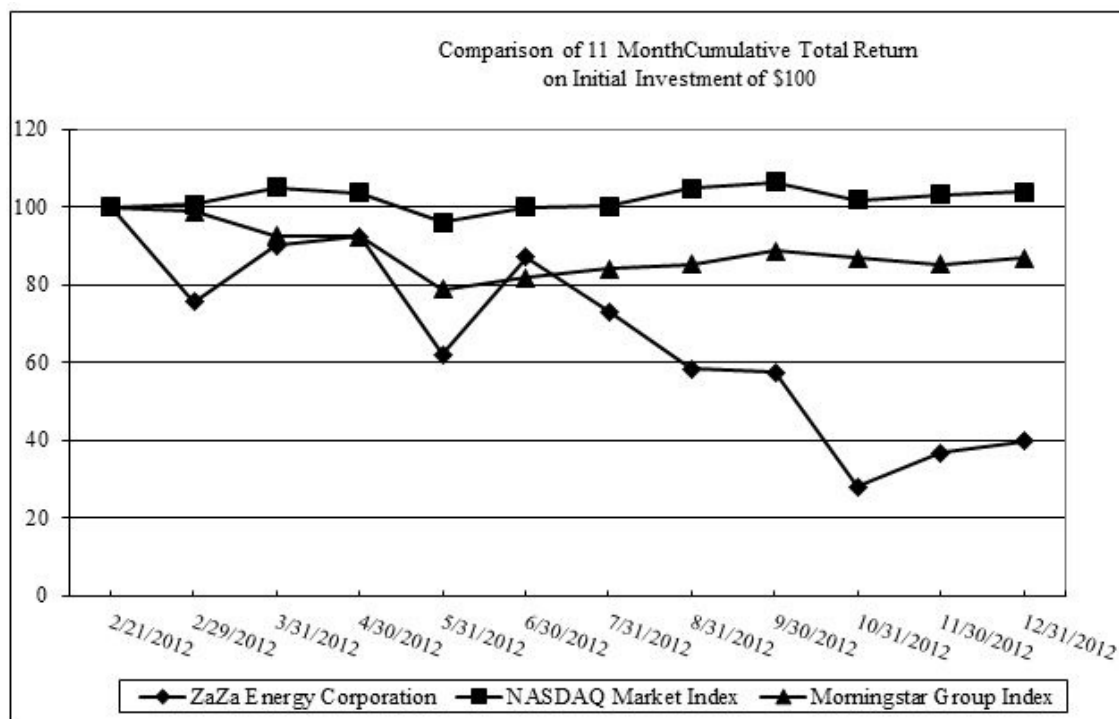
#### **Securities Authorized for Issuance Under Equity Compensation Plans**

The following table summarizes equity compensation plan information regarding equity securities authorized for issuance under individual stock option compensation agreements:

Plan category	Number of Securities to be Issued Upon Exercise of Outstanding Options, Warrants and Rights	Weighted Average Exercise Price of Outstanding Options, Warrants and Rights	Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected in Column (a))
	(a)	(b)	(c)
Equity compensation plans approved by shareholders	-	\$ -	5,783,467
Equity compensation plans not approved by shareholders	-	-	-
Total	-	\$ -	5,783,467

## Comparative Stock Performance

The performance graph shown below compares the cumulative eleven months since commencement of trading total return to stockholders of ZaZa common stock compared to same period total return on NASDAQ Market Index and Morningstar Group Index. The comparison assumes an initial investment of \$100 and reinvestment of dividends.



	2/21/2012	2/29/2012	3/31/2012	4/30/2012	5/31/2012	6/30/2012	7/31/2012	8/31/2012	9/30/2012	10/31/2012	11/30/2012	12/31/2012
ZaZa Energy Corporation	\$100.00	\$75.68	\$90.15	\$92.28	\$61.97	\$86.87	\$72.97	\$58.30	\$57.34	\$27.99	\$36.87	\$39.58
NASDAQ Market Index	\$100.00	\$100.64	\$104.95	\$103.48	\$96.20	\$99.96	\$100.16	\$104.72	\$106.50	\$101.81	\$103.22	\$103.87
Morningstar Group Index	\$100.00	\$98.77	\$92.52	\$92.27	\$78.75	\$81.70	\$84.03	\$85.13	\$88.63	\$86.81	\$85.26	\$86.77



## ITEM 6. SELECTED FINANCIAL DATA

The following selected financial information is summarized from ZaZa's results of operations for the period from March 4, 2009 (inception) to December 31, 2009 and for the years ended December 31, 2012, 2011 and 2010, as well as selected balance sheet data of ZaZa as of December 31, 2012, 2011, 2010 and 2009 and should be read in conjunction with the related financial statements and the notes thereto.

	Year Ended December 31,			
	2012	2011	2010	2009
	(In thousands)			
<b>Operating results:</b>				
Revenues and other income	\$ 205,152 *	\$ 17,574	\$ 10,495	\$ 100
Operating costs and expenses	130,882	20,042	3,977	-
Operating income (loss)	74,270	(2,468)	6,518	100
Other income (expense)	(45,406)	(264)	(2)	-
Income (loss) from continuing operations before income taxes	28,864	(2,732)	6,516	100
Income tax expense (benefit)	82,920	123	74	-
Income (loss) from continuing operations	(54,056)	(2,855)	6,442	100
Income (loss) from discontinued operations, net of tax	(52,171)	-	-	-
<b>Net income (loss)</b>	<b>\$ (106,227)</b>	<b>\$ (2,855)</b>	<b>\$ 6,442</b>	<b>\$ 100</b>
<b>Balance Sheet data:</b>				
Working capital (deficit) **	\$ (26,525)	\$ (15,878)	\$ 368	\$ 103
Oil and gas properties, net	148,776	16,856	6,200	-
Total assets	223,113	70,006	31,727	118
Total debt	70,977	8,000	3,000	15
Stockholders' or Members' equity	1,648	2,939	7,295	103
<b>Cash Flow data:</b>				
Net cash provided by (used in) operating activities	\$ (123,815)	\$ 2,975	\$ 20,316	\$ (15)
Capital expenditures on oil and gas properties	53,789	10,667	6,436	-

\* Includes \$195.6 million related to the gain on termination of Hess agreements, see "Results of operations".

\*\* Defined as current assets less current liabilities.

## **ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

### **DISCLOSURES REGARDING FORWARD-LOOKING STATEMENTS**

Certain matters discussed under "Management's Discussion and Analysis of Financial Condition and Results of Operations" and elsewhere in this report may constitute "forward-looking" statements within the meaning of the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act") and, as such, may involve known and unknown risks, uncertainties and other factors that may cause the actual results, performance or achievements to be materially different from future results, performance or achievements expressed or implied by such forward-looking statements. When used in this report, the words "anticipates," "estimates," "plans," "believes," "continues," "expects," "projections," "forecasts," "intends," "may," "might," "will," "would," "could," "should," and similar expressions are intended to be among the statements that identify forward-looking statements. The factors that may affect our expectations regarding our operations include, among others, the following:

- our registered public accounting firm has expressed doubt about our ability to continue as a going concern;
- our ability to raise necessary capital in the future;
- the effect of our indebtedness on our financial health and business strategy;
- our ability to maintain or renew our existing oil and gas leases or obtain new ones;
- possible title impairments to our properties;
- our ability to obtain equipment and personnel;
- reserves estimates turning out to be inaccurate;
- our ability to replace oil reserves;
- the loss of the current purchaser of our oil production;
- our ability to market and transport our production;
- our ability to compete in a highly competitive oil industry;
- the loss of senior management or key employees;
- assessing and integrating acquisitions;
- hurricanes, natural disasters or terrorist activities;
- change in legal rules applicable to our activities;
- extensive regulation, including environmental regulation, to which we are subject;
- declines in prices for crude oil; and
- our ability to execute our business strategy and be profitable.

In addition to these factors, important factors that could cause actual results to differ materially from our expectations ("Cautionary Statements") are disclosed under "Risk Factors" included under Item 1A of this annual report, which are incorporated by reference herein.

All written and oral forward-looking statements attributable to us are expressly qualified in their entirety by the Cautionary Statements. We undertake no obligation to update or revise publicly any forward-looking statements, whether as a result of new information, future events, or otherwise unless required by law.

### **EXECUTIVE OVERVIEW**

ZaZa is a Delaware corporation formed for the purpose of being a holding company of both Toreador Resources Corporation, a Delaware corporation ("Toreador"), and ZaZa Energy LLC, a Texas limited liability company ("ZaZa LLC"), from and after completion of the Combination, as described below. Prior to the Combination on February 21, 2012, ZaZa had no assets and had not conducted any material activities other than those incident to its formation. However, upon the consummation of the Combination, ZaZa became the parent company of ZaZa LLC and Toreador. In this Annual Report on Form 10-K, unless the context provides otherwise, "we", "our", "us" and like references refer to ZaZa, and its subsidiaries.

## Creation of ZaZa Energy Corporation

On February 21, 2012, we consummated the combination (the “Combination”) of ZaZa LLC and Toreador, on the terms set forth in the Agreement and Plan of Merger and Contribution, dated August 9, 2011, and as subsequently amended (as amended, the “Merger Agreement”).

Pursuant to the Merger Agreement, (i) a wholly -owned subsidiary of ZaZa merged with and into Toreador (the “Merger”), with Toreador continuing as a surviving entity, (ii) the three former members of ZaZa LLC (the “ZaZa LLC Members”), holding 100% of the limited liability company interests in ZaZa LLC, directly and indirectly contributed all of such interests to ZaZa (the “Contribution”), and (iii) the holders of certain profits interests in ZaZa LLC contributed 100% of such interests to ZaZa (the “Profits Interests Contribution”). Upon the consummation of the Combination, Toreador and ZaZa LLC became our wholly -owned subsidiaries.

The Combination was treated as a reverse merger under the purchase method of accounting in accordance with GAAP. For accounting purposes, ZaZa LLC is considered to have acquired Toreador in the Combination. Under the purchase method of accounting, the assets and liabilities of Toreador were recorded at their respective fair values and added to those of ZaZa LLC in our financial statements.

At the effective time of the Merger, each share of common stock of Toreador issued and outstanding immediately prior to the effective time of the Merger was converted into the right to receive one share of ZaZa common stock, par value \$0.01 per share (the “Common Stock”), which in the aggregate represented 25% of the issued and outstanding shares of Common Stock immediately after the consummation of the Combination (but without giving effect to the shares of Common Stock issuable upon exercise of the Warrants as discussed below).

Simultaneously with the consummation of the Merger, and pursuant to the Contribution Agreement dated August 9, 2011, among the ZaZa LLC Members and ZaZa (the “Contribution Agreement”), the ZaZa LLC Members contributed all of the direct or indirect limited liability company interests in ZaZa LLC to ZaZa in exchange for (i) a number of shares of Common Stock that, in the aggregate, represented 75% of the issued and outstanding shares of Common Stock immediately after the consummation of the Combination (but without giving effect to the shares of Common Stock issuable upon exercise of the Warrants as discussed below), and (ii) subordinated notes in an aggregate amount of \$38.25 million issued to the ZaZa LLC Members as partial consideration for the Combination (the “Seller Notes”). In addition, as required under the terms of the Merger Agreement and the Contribution Agreement, we issued subordinated notes in an aggregate amount of \$9.08 million to the individuals that own and control the ZaZa LLC Members, Todd Alan Brooks, Gaston L. Kearby and John E. Hearn Jr. (together, the “ZaZa Founders”), in respect of certain unpaid compensation amounts owing to the ZaZa Founders by ZaZa LLC (the “Compensation Notes”).

Immediately after the consummation of the Merger and Contribution, and pursuant to the Net Profits Interest Contribution Agreement, dated August 9, 2011, among ZaZa, ZaZa LLC and the holders of net profits interests in ZaZa LLC, the parties completed the Profits Interests Contribution pursuant to which ZaZa acquired their net profits interests from such holders in exchange for \$4.8 million in cash.

Additionally, in connection with the Combination, we issued senior secured notes with a principal amount of \$100 million maturing in 2017 (the “Senior Secured Notes”) in a private placement to a group of investors led by MSD Energy Partners, L.P. and Senator Investment Group LP. As a result of prepayments in connection with the dissolution of our Hess joint venture and certain asset sales, discussed in more detail elsewhere, we had reduced the outstanding principal amount of the Senior Secured Notes to \$33.2 million as of December 31, 2012. In connection with the issuance of the Senior Secured Notes, ZaZa also issued to the investors warrants to purchase an aggregate of approximately 26.3 million shares of our common stock at \$3.15 per share (the “Warrants”) representing 20.6% of the outstanding shares of our common stock at the closing of the Combination, on a fully diluted and on an as-converted basis. The Warrants expire in five years and are exercisable at any time after August 21, 2012. As a result of anti-dilution adjustments in connection with our issuance of \$40 million of Convertible Senior Notes due 2017 in October 2012, the number of outstanding shares of our common stock represented by the Warrants was increased from 26,315,789 to 27,226,223 and the exercise price per share was reduced to \$3.04 per share. In connection with our recent amendment to the terms of the Senior Secured Notes discussed elsewhere, we agreed to reduce the exercise price of the Warrants to \$2.00 per share.

### *ZaZa Energy, LLC*

ZaZa LLC was formed in March 2009 primarily to acquire and develop unconventional oil and gas resources and was a privately-held company until February 21, 2012 when it was contributed to ZaZa as part of the Combination. ZaZa LLC was previously controlled by the ZaZa Founders who each beneficially owned one-third of the outstanding limited liability company interests of ZaZa LLC. ZaZa LLC's operations have been concentrated in south Texas, including its exploration area in the core area of the Eagle Ford shale formation and in the eastern extension of the Eagle Ford/Woodbine formation, which we refer to as the "Eaglebine."

ZaZa LLC's initial exploration and production activities were undertaken primarily through a joint venture with Hess Corporation, which accumulated approximately 121,000 gross acres (approximately 11,500 net acres to ZaZa LLC). ZaZa LLC operated the Hess joint venture properties during the first year of drilling, after which Hess had an election to take over operatorship. This provision enabled ZaZa LLC to build an operating track record during this first year of drilling. As operator of the Hess joint venture, ZaZa LLC successfully drilled and completed 18 Eagle Ford wells. Hess then elected to take over operatorship, and the transition from ZaZa LLC to Hess commenced in November 2011 and was expected to be completed in July 2012. In conjunction with the operatorship transition, Hess also made public announcements in the first quarter of 2012 that indicated that they intended to pursue a drilling program in 2012-2013 that was slower than ZaZa LLC had anticipated. The combination of Hess taking over operatorship and the expectation that Hess would slow the drilling program led ZaZa LLC to negotiate an exit from the Hess joint venture in July 2012. As a result of this exit, ZaZa LLC relinquished the Cotulla Area and regained operational control of approximately 60% of the venture's former acreage (totaling 72,000 net acres). As described below, Toreador also exited its joint venture with Hess in France, which had stalled due to French governmental regulations on the development of unconventional resources. This resulted in ZaZa converting its 50% working interest in the French exploration licenses to a 5% non-cost bearing revenue interest for up to \$130 million in cash receipts. In addition to the aforementioned land transitions, ZaZa also received an aggregate of \$84 million in cash in connection with the dissolution of the joint ventures. For a complete description of the transactions in connection with the dissolution of the Hess Joint Venture, see "2012 Developments".

ZaZa LLC also had accumulated approximately 82,000 gross acres (approximately 60,000 net acres) in the Eaglebine formation, which acreage was not part of its joint venture with Hess. On March 29, 2012, ZaZa LLC entered into a transaction with Range Texas Production, LLC ("Range"), a subsidiary of Range Resources Corporation, to expand ZaZa's position in the Eaglebine to a total holding of approximately 143,400 gross acres (98,520 net acres). Under the terms of the transaction, ZaZa LLC obtained a 75% working interest in the acquired acreage; was designated as operator; committed to drill one well; was obligated and satisfied its obligation to commence operations on the commitment well on or before August 1, 2012; and committed to and made two cash payments to Range. After a casing collar failure on the commitment well, Range granted ZaZa LLC an extension to drill a substitute well, which is scheduled for the third quarter of 2013. For a complete description of the transactions in connection with the Range joint venture, see "2012 Developments".

### *Toreador Resources Corporation*

Prior to the Combination, Toreador was a publicly held independent energy company engaged in the exploration and production of crude oil with interests in developed and undeveloped oil properties in the Paris Basin, France. At the time of the Combination, Toreador operated solely in the Paris Basin and its operations consisted of (i) a joint venture with Hess Corporation in the Paris Basin focused on unconventional resources and (ii) conventional Paris Basin assets held by ZaZa Energy France SAS.

The unconventional resource joint venture with Hess stalled due to French governmental regulations. ZaZa ended the Hess Paris venture in July 2012 by exchanging its 50% working interest in the Paris Basin exploration licenses it held together with Hess for a 5% cost-free revenue interest in such licenses, in which the total proceeds relating thereto to ZaZa are capped at \$130 million. Following ZaZa's exit from the unconventional resource play in France, ZaZa divested its Paris Basin conventional assets in December 2012 through the sale of 100% of the shares in ZaZa Energy France SAS to Vermillion REP SAS, a wholly-owned subsidiary of Vermillion Energy Inc., for a net sales price of approximately \$76 million. At the end of 2012, ZaZa's only exploration and production asset in France was the Hess royalty interest, which is held by ZaZa.

## **Recent Developments**

### Range Transaction

On March 28, 2012, ZaZa LLC entered into a Participation Agreement (the “Range Agreement”) with Range Texas Production, LLC (“Range”), a subsidiary of Range Resources Corporation, under which ZaZa LLC agreed to acquire a 75% working interest from Range in certain leases located in Walker and Grimes Counties, Texas (the “Leases”). Pursuant to the terms of the Range Agreement, Range retained a 25% working interest in the Leases and ZaZa LLC committed to drill a well (the “Commitment Well”). ZaZa LLC drilled the Commitment Well but ceased completion operations due to a restriction. As a result of the restriction, the lateral section of the well was lost and, because of the resulting operational delay, effective January 16, 2013, ZaZa LLC and Range entered into an Amendment No. 5 to the Range Agreement (the “Amendment”). The Amendment requires ZaZa LLC to (i) commence re-completion operations on the Commitment Well by March 16, 2013 (ZaZa has timely commenced such operations), (ii) commence drilling operations of a substitute Commitment Well (the “Substitute Well”) by July 17, 2013, and (iii) initiate sales of oil and/or gas from the Substitute Well by September 1, 2013. Failure to do so will require ZaZa to assign a 25% working interest in the Leases to Range and relinquish operatorship.

### Hess Joint Venture Dissolution

Based on public communications from Hess, it became clear that Hess and ZaZa had different understandings about Hess’s obligations under the agreement relating to our joint venture. Correspondence and communications between the parties relating to the disagreements between the parties led to the conclusion that it would be in the best interest of both parties to dissolve the joint venture and divide the combined assets. These disagreements included overhead allocations and reimbursements, timing of the delivery of lease assignments and net acreage shortfalls (some of which disagreements are the subject of our claim against FLMK/Emerald Leasing discussed in “Note 11 - Commitments and Contingencies”), timing and amounts of payments, drilling obligations and drilling schedules, obligations to transfer undrilled acreage to ZaZa prior to lease expiration, and the interpretation of the other rights and obligations of the parties. Accordingly, the parties entered into a Heads of Agreement on June 8, 2012 outlining the terms of a division of assets to dissolve the joint venture, and the parties entered into definitive agreements regarding such division of assets and dissolution of the joint venture on July 25, 2012.

The Exploration and Development Agreement (EDA) for the Hess joint venture required ZaZa LLC to operate the Hess joint venture properties during the first year of drilling, after which Hess had an election to take over operatorship. This provision enabled ZaZa LLC to build an operating track record during this first year of drilling. As operator of the Hess joint venture, ZaZa LLC successfully drilled and completed 18 Eagle Ford wells. Hess elected to take over operatorship, and the transition from ZaZa LLC to Hess commenced in November 2011 and was expected to be completed in July 2012. In conjunction with the operatorship transition, Hess also made public announcements in the first quarter of 2012 that indicated that they intended to pursue a drilling program in 2012-2013 that was slower than ZaZa LLC had anticipated. The combination of Hess taking over operatorship and the expectation that Hess would slow the drilling program led ZaZa LLC to negotiate an exit from the EDA in July 2012. As a result of this exit, ZaZa LLC relinquished the Cotulla Area and regained operational control of approximately 60% of the venture’s former acreage (totaling 72,000 net acres). TEF also exited its joint venture agreement with Hess in France (subject to French regulatory approval), which had stalled due to French governmental regulations. This resulted in the Company converting its 50% working interest to a 5% non-cost bearing revenue interest for up to \$130 million in cash receipts. In addition to the aforementioned land transitions, the Company also received an aggregate of \$84 million in cash from Hess.

### Hess Joint Venture Dissolution Agreement

In order to resolve our disagreements with Hess relating to our joint venture, on June 8, 2012, ZaZa, ZaZa LLC, ZaZa Energy France SAS. (formerly known as Toreador Energy France SAS.)(“ZEF”), Hess and Hess Oil France SAS. (“Hess France”) entered into a Heads of Agreement (“HoA”), that provided for the termination of the ongoing obligations of the parties under the EDA and the agreements between ZEF and Hess France, including that certain Investment Agreement dated May 10, 2010, as amended, and that certain agreement dated July 21, 2011 with Vermillion REP, SAS., (the “French Agreements”), and the division of the assets covered by the EDA and the French Agreements.

In connection with the execution of the HoA, ZaZa LLC and Hess entered into an amendment to the Exploration and Development Agreement Eagleford Shale Area dated April 28, 2010, as amended, and the applicable joint operating agreements, to eliminate Hess's obligation to carry the cost of the wells under those agreements in the Cotulla Prospect Area, in exchange for a cash payment by Hess to ZaZa LLC of \$15 million. This \$15 million was paid to ZaZa on June 8, 2012. ZaZa LLC had the right under the amendment to reinstate Hess's well-carry obligations at any time prior to September 28, 2012, if the Exploration and Development Agreement was still in effect, by paying Hess \$15 million. Given the uncertainty surrounding the EDA, the proceeds received were recognized as a deferred gain in the second quarter financial statements, contingent on the signing of definitive documentation. The gain was recognized in the third quarter in connection with the termination of the EDA.

On July 25, 2012, the Company and its subsidiaries entered into the definitive documentation to carry out the transactions contemplated by the HoA and consummated the transactions contemplated by the HoA (and such definitive documentation). The definitive documentation included the following:

- A Texas Division of Assets Agreement, by and among the Company, ZaZa LLC and Hess, pursuant to which the ongoing obligations of ZaZa LLC and Hess under the "Eagle Ford Agreements" between Hess and ZaZa LLC (which included that certain Funding Agreement dated April 28, 2010, that certain Exploration and Development Agreement Hackberry Creek Project Area dated March 26, 2010, that certain Exploration and Development Agreement Eagleford Shale Area dated April 28, 2010, as amended, and the applicable joint operating agreements), including funding for additional leases, well carry or carry for expenses, were terminated and the assets covered by the Eagle Ford Agreements were divided; and
- A Paris Basin Purchase and Sale Agreement, by and among Hess France and ZEF, pursuant to which, following governmental approval, the ongoing obligations of the parties thereto under the "French Agreements" between ZEF and Hess France (which included that certain Investment Agreement dated May 10, 2010, as amended, and that certain Agreement dated July 21, 2011 with Vermilion REP, SAS.), including funding for additional leases, well carry or carry for expenses, were terminated and the assets covered by the French Agreements were divided, in each case following regulatory approval which was obtained on September 19, 2012.

Pursuant to the Texas Division of Assets Agreement and the Paris Basin Purchase and Sale Agreement (collectively, the "Hess Agreements"), ZaZa received the following:

- Approximately \$69 million in cash, in addition to the \$15 million in the second quarter of 2012;
- Approximately 60,500 additional net acres in the Eagle Ford core area;
- The right to receive five percent of any net sales proceeds in excess of \$1 billion and ten percent of any net sales proceeds in excess of \$1.2 billion if Hess sells any of its retained working interest in the Cotulla Prospect Area by May 1, 2013; and
- A five percent overriding royalty interest ("ORRI") in certain of Hess's exploration licenses in the Paris Basin capped at \$130 million.

As a result of consummation of the transactions set forth in the Hess Settlement Agreements, ZaZa's net acreage holdings in the Eagle Ford core increased from a total of 11,500 acres to approximately 72,000 acres. The acreage by area comprises approximately 1,970 acres in the Cotulla Prospect Area in the proved, productive region of southern Frio County, 23,120 acres in the Hackberry Prospect Area (Lavaca and Colorado Counties), 10,810 acres in the Moulton Prospect Area (Fayette, Gonzalez and Lavaca Counties) and 35,650 acres in the Sweet Home Prospect Area (DeWitt and Lavaca Counties). Following the receipt of the necessary governmental approvals, ZaZa transferred its 50% working interest in the Paris Basin exploration licenses as provided for in the Investment Agreement between Hess France and ZEF retained a 5% ORRI in such licenses, in which the total proceeds relating thereto to ZaZa are capped at \$130 million.

Pursuant to the Hess Agreements, Hess received the following:

- Approximately 4,490 net acres in LaSalle, Frio, Zavala, and Dimmit Counties (the "Cotulla Prospect Area");
- A two percent ORRI on the Moulton Prospect Area and a one percent ORRI in the Hackberry and Sweet Home Prospect Areas; and

- All rights and title to the exploration permits and pending permits in France (ZaZa retains all current production in France from its operating concessions).

As described above, in connection with the entry into the Hess Agreements, ZaZa LLC and Hess terminated the Eagle Ford Agreements. Pursuant to the Eagle Ford Agreements, ZaZa LLC retained a 10% working interest in all acreage acquired on behalf of the joint venture in the Eagle Ford shale and also earned a cash bonus of 10% on all acreage acquired on behalf of the joint venture. Under the terms of the joint venture, Hess had a right to participate in all leases acquired by ZaZa LLC in the Eagle Ford shale. If Hess elected to participate in a lease, the lease became part of the joint venture and Hess paid all of the acquisition costs up to a cap, and paid all of the exploration and development costs for a specified number of approved wells on the leased acreage until production. ZaZa LLC also received a partial reimbursement of general and administrative expenses while it was the operator of wells under the joint venture. ZaZa LLC's 10% working interest in each well (subject to a cap) in the joint venture was "carried" by Hess pursuant to the Eagle Ford Agreements.

Pursuant to the Hess Agreements, Hess has assigned to ZaZa certain claims that the joint venture had against various leasing contractors and brokers who had been paid for acreage but had neither delivered the acreage nor refunded the payments. Hess is entitled to 50% of any cash proceeds received by ZaZa in its prosecution of these claims, however, ZaZa is entitled to all of the acreage delivered in kind by the leasing contractors/brokers. ZaZa LLC filed a lawsuit against certain lease brokers, consultants and law firms who were involved in the leasing of acreage for the company in DeWitt and Lavaca Counties, including Emerald Leasing LLC, FLMK Acquisition, LLC, John T. Lewis, Billy Marcum, Brad Massey, Max Smith, Randy Parsley, Timothy E. Malone, Heroux & Helton PLLC, and Whitaker Chalk Swindle & Schwartz PLLC.

In connection with the division of assets, Hess France and ZEF also agreed to terminate the French Agreements. The French Agreements provided the framework for a proof of concept program in the Paris Basin and the sharing on a 50-50 basis of the permits in certain areas in the Paris Basin. As a result of recent legislation in France banning hydraulic fracturing, ZaZa's plan to drill on the land had been adversely affected and the value of the French Agreements had declined. The French Agreements were terminated as of October 1, 2012, following the receipt of the necessary governmental approvals to the transfer and division of the French assets contemplated by the Hess Agreement.

The termination of agreements with Hess and the division of assets resulted in a gain of \$ 195.6 million consisting of oil and gas property fair valued at \$117 million, a write off of \$5.4 million in working capital and cash proceeds of \$84 million. Property received consisted of producing wells and unproved acreage. All receivables and payables related to Hess were written off.

#### Note Amendments

On June 8, 2012, ZaZa entered into an amendment and waiver ("Amendment") to the Securities Purchase Agreement dated February 21, 2012 (the "SPA"), relating to our 8% senior secured notes due 2017 (the "Senior Secured Notes"). The Amendment No. 1:

- permitted certain intercompany loans;
- required the consent of the holders of a majority of the Senior Secured Notes to any amendment or termination of the Eagle Ford Agreements or the French Agreements and to dispositions of oil and gas properties (which consent was obtained in connection with the entry into the waiver and Amendment No. 2 to the SPA described below);
- required certain further amendments to the SPA, which were provided for in the Waiver and Amendment No. 2 to the SPA described below; and
- waived all existing defaults arising under the SPA, including the Company's failure to timely provide financial statements with an unqualified opinion to the holders of the Senior Secured Notes.

The parties also entered into an Amended and Restated Subordination Agreement with Todd A. Brooks, a director and President and Chief Executive Officer of the Company, John Hearn, a director and Chief Operating Officer of the Company, Gaston Kearby, a director of the Company, Omega Energy, LLC, Blackstone Oil & Gas, LLC, and Lara Energy, Inc., entities controlled by Messrs. Brooks, Hearn and Kearby, specifying that payments may not be made by the Company under the relevant subordinated promissory notes until after the consummation of the

transactions outlined in the HoA and the related \$33.0 million pay down of the principal amount of the Senior Secured Notes, which conditions have now been satisfied.

On July 25, 2012, in connection with entry into the definitive documents with Hess contemplated under the HoA, we entered into a Waiver and Amendment No. 2 to the SPA ("Amendment No. 2). Under Amendment No. 2, we paid down the outstanding principal amount of the Senior Secured Notes by \$33.0 million and paid a \$3.5 million associated fee. We also recorded a charge of \$11.7 million due to the write off of issuance costs and discount amount.

Amendment No. 2 provided waivers of certain technical defaults under the SPA. Amendment No. 2 also provides for:

- (a) consent rights for the holders of a majority of the Senior Secured Notes on all sale or joint venture transactions involving oil and gas properties, with certain carveouts and requirements to apply a portion of net sales proceeds to pay down the Senior Secured Notes, until such time as the Senior Secured Notes have an outstanding principal amount of \$25 million or less;
- (b) a provision that if the Senior Secured Notes have not been paid down to \$35 million by February 21, 2013, the interest rate would increase from 8% to 10% per annum;
- (c) a limit on additional debt incurrence of ZaZa to \$50 million in reserve-based lending; and
- (d) a requirement that the Company engage an investment banker to assist the Company in securing a joint venture partner or partners for its Eagle Ford and Woodbine/Eaglebine assets, as well as to evaluate other strategic opportunities available to the Company, which has been satisfied by our engaging Jefferies & Company, Inc. as our financial advisors.

Effective October 16, 2012, the Company and the Senior Secured Notes holders entered into a third amendment to the Securities Purchase Agreement (the "Third Amendment"), pursuant to which the Securities Purchase Agreement was amended to permit the incurrence of the debt arising under the Convertible Senior Notes described below, revise certain defined terms in the Securities Purchase Agreement and in the warrants issued in connection therewith (the "Amended Warrants"), and make certain other changes.

Effective December 17, 2012, we entered into an Amendment No. 4 to the SPA ("Amendment No. 4"), pursuant to which the SPA was amended to permit the intercompany transfer of certain intercompany loans in connection with the closing of the sale of the Company's French subsidiary ZaZa Energy France SAS, revise certain defined terms in the SPA and in the warrants issued in connection therewith, and make certain other changes. We paid down the outstanding principal amount of the Senior Secured Notes by \$33.8 million and paid a \$1.7 million associated fee in connection with the sale of such subsidiary. We also recorded a loss of \$11.1 million on the extinguishment of debt due to the write off of issuance costs and discount amount.

On March 28, 2013, we entered into Amendment No. 5 to the SPA ("Amendment No. 5"). Under Amendment No. 5, we agreed to make a prepayment on the Senior Secured Notes with the proceeds of an asset sale, which prepayment had previously been deferred, of approximately \$4.6 million.

Amendment No. 5 amended certain requirements with respect to our 2012 financials. Amendment No. 5 also provides for:

- (a) revisions to the prepayment provisions to permit the Company to voluntarily prepay the Senior Secured Notes at 105% of their principal amount plus accrued and unpaid interest, if the aggregate principal amount of the Senior Secured Notes exceeds \$25 million, at 103% if the aggregate principal amount of the Senior Secured Notes exceeds \$15 million, and at 100% if the aggregate principal amount of the Senior Secured Notes are \$15 million or less;
- (b) the Company to make a prepayment to pay down the Senior Secured Notes to \$15 million by February 28, 2014, and a provision that if the Senior Secured Notes have not been repaid in full by February 28, 2014, the interest rate will increase from 8% to 10% per annum;
- (c) the Company to make a prepayment on the Senior Secured Notes if the Company sells some of its acreage in Sweet Home or the Company receives the release of certain escrow funds, which funds were placed in escrow for the benefit of Hess in connection with the Company's sale of its French subsidiary, in each case prior to February 28, 2014, but solely to the extent to reduce the principal outstanding balance of the Senior Secured Notes to \$15 million;



- (d) consent to our new joint venture in the Eaglebine with EOG without any requirement to use the proceeds of our joint venture to pay down the Senior Secured Notes;
- (e) reversion of consent rights on all joint ventures involving oil and gas properties to permit our recently announced joint venture in the Eaglebine without any requirement to use the proceeds thereof to pay down the Senior Secured Notes and to permit joint ventures in Hackberry or Sweet Home as long as 10% of the gross proceeds in excess of \$10 million are used to pay down the Senior Secured Notes;
- (f) the modification of the asset sale covenant in Amendment No. 2 to require (i) only 10% of the gross proceeds from asset sales in the Eaglebine to be used to pay down the Senior Secured Notes, (ii) only 10% of the net proceeds from the sale of the Moulton Properties to be used to pay down the Senior Secured Notes, and (iii) only 10% of the gross proceeds from asset sales in the Eagle Ford to be used to pay down the Senior Secured Notes until such time as the Notes have been paid down to \$15 million, whereupon no such paydown shall be required subject to certain requirements regarding reinvestment of funds;
- (g) the exercise price of the warrants issued in connection with the Senior Secured Notes to be reduced to \$2.00 per share; and
- (h) the amendment of certain provisions of the lockup agreement entered into in connection with the SPA to permit certain additional categories of transfers.

#### Sale of Convertible Senior Notes due 2017

On October 22, 2012, the Company successfully completed the issuance and sale of \$40,000,000 aggregate principal amount of 9% Convertible Senior Notes due 2017 (the “Convertible Notes”). The Convertible Notes were sold in a private placement to investors that are qualified institutional buyers and accredited investors (as such terms are defined under the Securities Act), in reliance upon applicable exemptions from registration under Section 4(a)(2) of and Regulation D under the Securities Act of 1933, as amended, pursuant to Note Purchase Agreements, dated October 16, 2012 (collectively, the “Note Purchase Agreement”) among the Company and the several purchasers that are signatories thereto (collectively, the “Purchasers”). The Notes were issued to the Purchasers pursuant to an Indenture, dated October 22, 2012 (the “Indenture”), among the Company, certain subsidiary guarantors party thereto (the “Guarantors”), and Wilmington Trust, National Association, as trustee thereunder. The Convertible Notes were sold to the Purchasers at a price of \$950 for each \$1,000 original principal amount thereof, for aggregate gross proceeds of \$38.0 million. The Company intends to use the net proceeds from the offering of the Convertible Notes, after discounts and offering expenses, of approximately \$35.2 million to fund drilling capital expenditures and leasehold transactions and for general corporate purposes.

The Convertible Notes accrue interest from October 22, 2012 and mature August 1, 2017. The Convertible Notes are the senior, unsecured obligations of the Company, bear interest at a fixed rate of 9.0% per year, payable semiannually in arrears on February 1 and August 1 of each year beginning February 1, 2013, and mature on August 1, 2017 unless earlier converted, redeemed or repurchased.

The Convertible Notes are convertible, at the option of the holder, at any time prior to the third trading day immediately preceding the maturity date, into shares of the Company's common stock, par value \$0.01 per share (the “Conversion Shares”), and cash in lieu of fractional shares of common stock. The initial conversion rate will be 400 shares per \$1,000 Convertible Note, reflecting a conversion premium of approximately 32.28% of the closing price of the Company's common stock on the pricing date of the offering, which equates to an initial conversion price of \$2.50 per share. In certain circumstances, after the occurrence of a fundamental change (as defined in the Indenture), the conversion rate shall be increased (according to the date of such fundamental change) for holders who convert their Convertible Notes on or after the effective date of such fundamental change. In addition, upon the occurrence of a fundamental change, holders may require the Company to repurchase for cash all or a portion of such holder's Convertible Notes at a purchase price equal to 100% of the principal amount of the Convertible Notes to be purchased, plus any accrued and unpaid interest to, but excluding, the fundamental change repurchase date.

If a holder converts some or all of its Convertible Notes on or after May 1, 2013 but prior to August 1, 2017, in addition to the Conversion Shares, such holder will receive a coupon make-whole payment for the Convertible Notes being converted. The coupon make-whole payment will be equal to the sum of the present values of the lesser of five semi-annual interest payments or the number of semi-annual interest payments that would have been payable on such converted Convertible Notes from the last day through which interest was paid on the Convertible Notes through July 31, 2017. The Company may elect to pay such make-whole payment in either cash or, subject to shareholder approval if required under applicable stock exchange rules, shares of common stock, and if paid in shares of common stock, then the stock will be valued at 95% of the simple average of the daily volume

weighted average prices for the common stock for the 10 trading days ending on and including the trading day immediately preceding the conversion date.

The Company may not redeem the Convertible Notes prior to August 1, 2015. Beginning August 1, 2015, the Company may redeem for cash all or part of the Convertible Notes if the last reported sale price of its common stock equals or exceeds 150% of the applicable conversion price for at least 20 trading days during the 30 consecutive trading day period ending on the trading day immediately prior to the date on which the Company delivers the notice of the redemption. The redemption price will equal 100% of the principal amount of the Convertible Notes to be redeemed, plus any accrued and unpaid interest to, but excluding, the redemption date.

The Convertible Notes and Conversion Shares have not been registered, nor are required to be registered, under the Securities Act or applicable state securities laws and may not be offered or sold in the United States absent registration or an applicable exemption from the registration requirements of the Securities Act and applicable state laws.

#### Sale of ZaZa Energy France SAS

On November 13, 2012, the Company, through its wholly-owned subsidiary ZaZa France SAS (“Seller”), and Vermillion REP SAS (“Buyer”), a wholly-owned subsidiary of Vermillion Energy Inc., entered into a Share Purchase Agreement (the “Purchase Agreement”) pursuant to which Seller sold to Buyer all of its shares in Seller’s wholly-owned subsidiary, ZaZa Energy France SAS (“ZEF”), formerly Toreador Energy France SAS. On December 21, 2012, the Company completed the sale of 100% of the shares in ZaZa Energy France SAS to Vermillion REP SAS.

Upon the closing, the net purchase price paid to Seller was approximately \$76.0 million in cash following the application of certain closing adjustments required by the Purchase Agreement. Following reductions for advisor fees, estimated liquidation costs and taxes, the net proceeds to Company were approximately \$68.0 million. The Company used approximately half of the net proceeds to pay down a portion of its remaining senior secured notes. Additionally, as part of the Paris Basin Agreement signed with Hess Corporation (“Hess”) in July 2012, \$15.0 million of the sales proceeds will be held in escrow until all exploration permits for the Paris Basin are successfully transferred to Hess. Additionally, \$6.2 million has been earmarked and included in restricted cash for wind up activities of ZEC, including French capital gains tax and severance. The remaining net proceeds will be used by the Company to fund its development program.

As a result of the consummation of the Purchase Agreement and with the exception of an 5% overriding royalty interest retained under the Paris Basin Agreement with Hess, the Company no longer has any meaningful operations or assets in connection with oil and gas operations in France which were acquired in the February 2012 Combination of ZaZa LLC and Toreador. The Company anticipates solely focusing its efforts and resources on its oil and gas operations based in the United States.

#### Business Relationships

After the termination of the Hess joint venture and the disposition of its French oil and gas properties, ZaZa’s principal assets were approximately 66,000 net acres in the Eagle Ford core and approximately 89,000 net acres in the Eaglebine. The Company’s strategic objectives since then have focused on executing drilling operations to further appraise its acreage and in evaluating joint venture opportunities to realize its development plans. Since the dissolution of the Hess joint ventures, ZaZa has drilled two wells in the Eaglebine and one well in the Eagle Ford, sold its Moulton acreage (described below) and has entered into the joint venture with EOG Resources, Inc. (described below).

#### *Eaglebine Joint Venture with EOG*

On March 21, 2013, ZaZa entered into a Joint Exploration and Development Agreement with EOG Resources, Inc., (“our counterparty”), for the joint development of certain of our Eaglebine properties located in Walker, Grimes, Madison, Trinity, and Montgomery Counties, Texas. Under this agreement, we and our counterparty will jointly develop up to approximately 100,000 gross acres (approximately 73,000 net acres) that ZaZa currently owns in the Eaglebine trend in these counties. Our counterparty will act as the operator and will pay us certain cash amounts, the drilling and completion costs of certain specified wells, and a portion of our share of any additional seismic or well costs in order to earn their interest in these properties. Generally, ZaZa will retain a

25% working interest, our counterparty will earn a 75% working interest in the acreage, subject to the agreement, that is currently 100% owned by ZaZa. ZaZa will retain a 25% working interest, our counterparty will earn a 50% working interest, and Range will retain a 25% working interest in the acreage that is currently owned 75% by ZaZa and 25% by Range, subject to the terms of our agreement with Range. This joint development will be divided into three phases.

In the first phase, we will transfer 20,000 net acres, approximately 15,000 of which will come from our joint venture with Range, to our counterparty in exchange for a cash payment by our counterparty to us of \$10 million and an obligation of our counterparty to drill and pay 100% of the drilling and completion costs of three wells. The second of these three wells to be drilled will be the substitute well that we are required to drill pursuant to our agreement with Range described above. Drilling operations on the third well in the first phase of joint development with our counterparty must be commenced by our counterparty before December 31, 2013.

Within 60 days of completion of the third well under the first phase, our counterparty will have the option to elect to go forward with the second phase of the joint development. If they so elect, we will transfer an additional 20,000 net acres to our counterparty in exchange for a cash payment of \$20 million, an obligation of our counterparty to drill and pay 100% of the drilling and completions costs of an additional three wells, and an obligation of our counterparty to pay for up to \$1.25 million of ZaZa's share of additional costs for seismic or well costs.

Within 60 days of completion of the second phase, our counterparty will have the option to elect to go forward with the third phase of the joint development. If they so elect, we will transfer an additional 15,000 net acres to our counterparty in exchange for a cash payment of \$20 million, an obligation of our counterparty to drill and pay 100% of the drilling and completion costs of an additional three wells, and an obligation of our counterparty to pay for up to \$1.25 million of ZaZa's share of additional costs for seismic or well costs.

*Sale of Moulton acreage (collectively "Moulton Transactions")*

On March 5, 2013 the Company entered into a purchase and sale agreement to sell its remaining Moulton prospect for approximately \$9.2 million. This transaction is expected to close on or before April 5, 2013 and is subject to normal closing conditions.

On March 22, 2013, we entered into an agreement to sell approximately 10,000 net acres of our properties in the Eagle Ford trend located in Fayette, Gonzalez and Lavaca Counties, Texas, which we refer to as our Moulton properties, including [seven] producing wells located on the Moulton properties, for approximately \$43.25 million in cash. The closing of the sale of the Moulton properties is expected to occur during the second quarter of 2013, and net proceeds from the sale, after closing purchase price adjustments and expenses, are expected to be approximately \$42 million. The closing is subject to normal closing conditions, and the amendment of ZaZa's securities purchase agreement for its senior secured notes, and there can be no assurance that this transaction will be consummated. We intend to use these net proceeds to fund a portion of capital expenditures for exploration on our other properties and/or to repay indebtedness.

## Financial Summary

For the year ended December 31, 2012:

- Revenues and other income from continuing operations were \$ 205.2 million.
- Operating costs of continuing operations were \$ 130.9 million.
- Net loss from continuing operations was \$54.1 million.
- Production was 125 MBOE.

At December 31, 2012, we had:

- Cash and cash equivalents of \$34.6 million.
- Current ratio (current assets/current liabilities) of 0.69 to 1.
- Proved reserves of 3,348 MBOE.

## RESULTS OF OPERATIONS

The results of operations include the results of our accounting predecessor, ZaZa LLC, from January 1, 2012 through February 20, 2012 and all of our subsidiaries, since February 21, 2012 excluding ZEF which was sold on December 21, 2012 and is presented as discontinued operations. The discussion below relates to our continuing corporate activities and oil and gas exploration and production operations, and excludes discontinued operations.

The following table presents our production and average prices obtained for our production for the years ended December 31, 2012, 2011 and 2010:

	For the Year Ended December 31,		
	2012	2011	2010
<b><u>Production:</u></b>			
Oil (Bbls):	97,598	27,784	4,331
Gas (Mcf):	162,213	11,646	4,247
Equivalents (BOE):	124,634	29,725	5,039
<b><u>Average Price:</u></b>			
Oil (\$/Bbl):	\$ 93.73	\$ 93.94	\$ 77.80
Gas(\$/Mcf):	\$ 2.68	\$ 3.08	\$ 4.88

The following tables present our production data for the referenced geographic areas for the periods indicated :

	For the Year Ended December 31, 2012		
	Gas (Mcf)	Oil (Bbls)	Equivalent (BOE)
Eagle Ford:			
Cotulla	48,492	50,780	58,862
Moulton	10,268	34,106	35,817
Sweet Home	-	-	-
Hackberry	101,335	8,189	25,078
Eaglebine	-	-	-
Other Onshore	2,118	4,523	4,876
Total	162,213	97,598	124,634

For the Year Ended December 31, 2011			
	Gas (Mcf)	Oil (Bbls)	Equivalent (BOE)
Eagle Ford:			
Cotulla	9,551	24,829	26,421
Moulton	-	-	-
Sweet Home	-	-	-
Hackberry	-	-	-
Eaglebine	-	-	-
Other Onshore	2,095	2,955	3,304
Total	11,646	27,784	29,725

For the Year Ended December 31, 2010			
	Gas (Mcf)	Oil (Bbls)	Equivalent (BOE)
Eagle Ford:			
Cotulla	-	-	-
Moulton	-	-	-
Sweet Home	-	-	-
Hackberry	-	-	-
Eaglebine	-	-	-
Other Onshore	4,247	4,331	5,038
Total	4,247	4,331	5,038

## Revenue and other income

### *Oil and gas revenue*

Oil and gas revenue for the year ended December 31, 2012 was \$9.6 million, compared to \$2.5 million for the year ended December 31, 2011. This increase is primarily due to increased production in the United States due to additional wells coming online along with the increased net revenue interests received in the termination agreements with Hess, coupled with an overall increase in oil prices period over period.

Oil and gas revenue for the year ended December 31, 2011 was \$2.5 million, an increase of \$2.2 million over the comparable period in 2010. This increase is primarily due to increased production as productive well count increased in the Hess joint venture.

The table of production and average prices compares both volumes and prices received for oil for the years ended December 31, 2012, 2011 and 2010. The results of our operations are highly dependent upon the prices received from our oil production, which are dependent on numerous factors beyond our control. Accordingly, significant changes to oil prices are likely to have a material impact on our financial condition, results of operation, cash flows and revenue.

### *Bonus income*

Revenue generated from the bonus paid to ZaZa under the Hess joint venture was \$ 15.0 million for the year ended December 31, 2011. We did not generate any such bonus income in 2012. The bonus is based on completed lease acquisitions during the period, represents 10% of the total lease acquisition cost and is recognized as revenue after all leases are obtained, title is cured and transferred to Hess, and recorded with the appropriate county. We do not expect to generate any further bonus income as described in "Note 2 - Agreements with Hess Corporation" to the consolidated financial statements.

Revenue generated from the bonus paid to ZaZa under the Hess joint venture was \$15 million for the year ended December 31, 2011 versus \$9.8 million for the comparable period in 2010.

### *Other income*

Other income for the year ended December 31, 2012 relates to the gain on the termination of the agreements with Hess and the division of assets. The gain of \$195.6 million consisted of a step up to oil and gas property to fair value of \$117 million, a write off of \$ 5.4 million in working capital and cash of \$84 million.

We did not have any other income for the year ended December 31, 2011 and had \$360 thousand in other income for the same period in 2010 which was generated from the forfeiture by counterparties of earnest money paid to ZaZa in connection with ZaZa arranging leases for such counterparties.

### **Operating costs and expenses**

The following table presents our lease operating expense for the referenced geographical areas for the periods indicated:

	For the Year Ended December 31,		
	2012	2011	2010
Eagle Ford:			
Cotulla	\$ 1,540	\$ 1,038	\$ 22
Moulton	736	-	-
Sweet Home	-	-	-
Hackberry	1,305	-	-
Eaglebine	20	-	-
Other Onshore U.S.	1	-	-
Total	\$ 3,602	\$ 1,038	\$ 22

### *Lease operating expense*

Lease operating expense was \$3.6 million, or \$28.90 per BOE produced, for the year ended December 31, 2012, compared to \$1.0 million, or \$34.91 per BOE produced, for the year ended December 31, 2011. This decrease is due to the revised working interests received in the termination of agreements with Hess and the associated production taxes and ad valorem (\$ 0.7 million and \$0.1 million for the years ended December 31, 2012 and 2011, respectively).

Lease operating expense for the year ended December 31, 2011 was \$1.0 million, of which approximately \$0.1 million was attributable to production taxes, and increased from the year ended December 31, 2010 from approximately \$22 thousand, of which approximately \$18 thousand was attributable to production taxes. The increase in production taxes is directly attributable to an increase in production due to the drilling of new wells. Lease operating expense on a per BOE basis for the year ended December 31, 2011 and 2010 was \$34.91 and \$4.48, respectively.

### *Exploration expense*

Exploration expense for the year ended December 31, 2012, was \$12.9 million. The increase was due to the unsuccessful horizontal portion of the Stingray well. We did not have any exploration expense in the years ended December 31, 2011 and 2010.

### *Depreciation, depletion and amortization*

Depreciation, depletion and amortization for the year ended December 31, 2012 was \$6.6 million (\$1.0 million related to furniture and fixtures) or \$45.20 per BOE produced, compared to \$0.9 million (\$0.6 million related to furniture and fixtures) or \$10.71 per BOE produced for the year ended December 31, 2011. These increases are primarily due to the step up of oil properties associated with the termination of agreements with Hess.

Depreciation, depletion and amortization expense was \$0.9 million (\$0.6 million related to furniture and fixtures) for the year ended December 31, 2011 compared to \$0.3 million (\$0.1 million related to furniture and fixtures) for the year ended December 31, 2010. Depreciation, depletion and amortization expense per BOE for the year ended December 31, 2011 was \$10.71, compared to a \$46.77 in the year ended December 31, 2010, as production leveled off and no further development costs have been incurred.

### *Accretion Expense*

The accretion expense is composed of our asset retirement obligation expense. Accretion expense was \$21 thousand for the year ended December 31, 2012, compared to \$2 thousand for the same periods in 2011. This increase in expense is due to Texas wells coming online in late 2011 and 2012 which resulted in increased asset retirement obligation, thus higher accretion. We did not have any accretion expense in the year ended December 31, 2010.

### *Impairment of oil and gas properties*

Oil and gas properties with a carrying value of \$59.2 million were written down to their fair value of \$51.7 million, resulting in a pretax impairment charge of \$7.5 million for the year ended December 31, 2012. Additionally expiring leases with book value of \$2.3 million were written off.

### *General and administrative*

General and administrative expense for the year ended December 31, 2012 totaled \$97.9 million, compared to \$18.1 million for the same period in 2011. This increase is due to legal and advisory fees incurred in connection with the Combination of \$9.7 million, payment of \$4.8 million to four executives of ZaZa LLC pursuant to net profit agreements between ZaZa LLC and each such executive and bonuses to ZaZa LLC Members of \$17.5 million triggered by the Combination. Also included is stock compensation expense of \$16.5 million due to stock granted during 2012, the tax reimbursement to founders of \$4.1 million, increased employee benefits and severance of \$1.4 million, and rent by \$1.1 million. Costs of being a public company increased attorney fees by \$4.9 million and director fees of \$1.1 million. Toreador contributed \$14.4 million to G&A expense. These increases were offset by a reduction in marketing expense of \$1.3 million. Additionally, during the years ended December 31, 2012 and 2011, G&A expense was offset by \$3.2 million and \$8.7 million, respectively, for reimbursements made under the terms of the Hess joint venture for expenses related to lease acquisition costs.

G&A expenses increased from \$3.6 million for the year ended December 31, 2010 to \$18.1 million for the year ended December 31, 2011. G&A expense for the year ended December 31, 2011 included approximately \$1.1 million paid to four executives of ZaZa pursuant to net profit agreements between ZaZa LLC and each such executive. The increase in G&A expense was primarily due to increased operating activity and start-up costs associated with initial development activities in connection with the commencement of operations, and the increase in senior management in preparation for the Combination. ZaZa LLC has also incurred expenses of approximately \$2.4 million related to Combination costs. In addition, in the year ended December 31, 2011 and 2010, G&A expense was offset by \$8.7 million and \$2.9 million, respectively, for reimbursements made under the terms of the Hess joint venture for expenses related to acquisition costs.

## Other expenses

### *Loss on extinguishment of debt*

We recorded a loss on the extinguishment of debt associated with our aggregate principal payments of \$66.8 million on Senior Secured Notes. The loss consisted of \$5.2 million of fees paid in connection with the prepayments, and \$22.8 million due to the write off of issuance costs and original issuance discount.

### *Interest expense, net*

The following table presents details of net interest expense for the periods indicated:

	Year Ended December 31,		
	2012	2011	2010
Amortization of issuance costs on Senior Secured Notes	\$ 454	\$ -	\$ -
Amortization original issuance discount on Senior Secured Notes	3,986	-	-
Interest expense on Senior Secured Notes	5,838	-	-
Amortization of issuance costs on Convertible Senior Notes	82	-	-
Amortization original issuance discount on Convertible Senior Notes	480	-	-
Interest expense on Convertible Senior Notes	690	-	-
Interest expense on Subordinated Notes	3,308	-	-
Interest expense on revolving credit line	45	-	-
Interest expense on Members' Notes	50	313	2
Other interest (income) expense	335	(49)	-
Capitalized interest	(563)	-	-
Total interest expense, net	<u>\$ 14,705</u>	<u>\$ 264</u>	<u>\$ 2</u>

### *Gain (loss) on valuation of warrants and embedded derivatives*

For the year ended December 31, 2012, we recorded a gain in fair value of warrants associated with our Senior Secured Notes issued in February 2012, of \$5.6 million and a loss in fair value of embedded derivatives associated with our Convertible Senior Notes issued in October 2012, of \$8.2 million. The variances are mainly a result of fluctuations in our stock price since the initial valuation at issuance.

### *Income tax expense*

Income tax expense related to continuing operations for the year ended December 31, 2012 was \$82.9 million. At the time of the Combination we assumed a net deferred tax liability of \$9.2 million which primarily consisted of deferred tax assets of \$35 million due to Toreador NOLs offset by deferred tax liabilities of \$27 million due to the step up of property and \$17 million of deferred taxes on historical property. On December 21, 2012 we divested ZEF which held Toreador's deferred tax liabilities. We retained the NOLs. Based on the lack of positive evidence at the consolidated level, we recorded a valuation allowance of \$37.0 million. In addition as a result of the divestiture, the Company provided for the related tax liability of approximately \$31.5 million on the amounts that will be repatriated, which will be primarily offset by net operating losses and is not expected to result in significant amount of cash tax payments.

We recorded an income tax expense of \$123 thousand and \$74 thousand for the years ended December 31, 2011 and 2010, respectively, which primarily related to Texas Margin Tax and related adjustments.

## LIQUIDITY AND CAPITAL RESOURCES

This section should be read in conjunction with "Note 1 - Basis of Presentation", "Note 2 - Agreement with Hess Corporation", "Note 3 - Going Concern" and "Note 8 - Long Term Debt" in the Notes to the consolidated financial statements included in this filing.



## Liquidity

For 2013, we are dependent on the sale of non-core assets and the proceeds from the creation of a joint venture (see below) in order to maintain a positive liquidity position and to fund our debt service requirements. Our lack of sufficient current operating cash flow, the exploratory uncertainties surrounding the development plan of our recently announced joint venture, and the amount of our current indebtedness, when considered in the aggregate, raise substantial doubt about our ability to continue as a going concern. We currently expect that the proceeds from the sale of our Moulton prospect and the recently announced joint venture will continue to improve our overall liquidity position. Our 2013 plan assumes the above transactions are consummated in the second quarter of 2013. The first phase of the joint venture will result in ZaZa receiving \$10 million being 100% carried on the drilling and completion costs of three (3) exploratory wells. The Moulton sale will provide approximately \$52.5 million of cash but will also decrease our proved reserves and related operating income significantly. We estimate that we will use a portion of the proceeds from these transactions to reduce the outstanding principal amount of our Senior Secured Notes to approximately \$25.6 million by the end of 2013. In addition to the transactions, we are currently in the process of drilling and completing three (3) stand-alone exploratory wells. These wells are estimated to cost approximately \$30.9 million in the aggregate and will be funded with readily available liquidity and cash flows from operations. Also included in the 2013 business plan is approximately \$15.1 million in leasehold costs to hold our leases that are not held by production. To offset a portion of these costs, our 2013 business plan also includes a 35% reduction in our general and administrative costs beginning in the second quarter of 2013.

Going forward, we will utilize cash flow from operations, alternative sources of equity or debt capital and possible asset divestitures to finance additional drilling operations in the Eaglebine. However, there is no assurance that asset divestitures will be available to the Company at appropriate valuations. Absent additional sources of financing, or the sale of additional assets, the Company will have to further reduce our expenditures in 2013 and beyond.

The following table summarizes information regarding ZaZa's development and exploration capital expenditures for the periods indicated:

	For the Year Ended December 31,		
	2012	2011	2010
	(In thousands)		
Additions to oil and gas properties	\$ 53,789	\$ 10,667	\$ 6,436
Additions to furniture and fixtures	291	1,975	831
Total capital expenditures	<u>\$ 54,080</u>	<u>\$ 12,642</u>	<u>\$ 7,267</u>

During the year ended December 31, 2012 capital expenditures of \$ 27.8 million related to drilling of two exploration wells in the Eaglebine and \$20.0 million related to lease extensions and options in the Eaglebine and Eagle Ford.

During the years ended December 31, 2011 and 2010, capital expenditures were primarily related to the acquisition of acreage in the Eaglebine.

### Sale of 8.00% Senior Secured Notes due 2017 and Warrants

On February 21, 2012, we entered into the SPA with the purchasers thereunder, including MSDC ZEC Investments, LLC and Senator Sidecar Master Fund LP (collectively, the "Purchasers"), pursuant to which we issued senior secured notes in the aggregate principal amount of \$100,000,000 and warrants (the "Warrants") to purchase 26,315,789 shares of our Common Stock. The proceeds of the sale of the Senior Secured Notes and the Warrants were used for the (i) repayment of the outstanding convertible notes of Toreador, and (ii) payment of fees and expenses incurred in connection with the Combination, with the balance to be used for general working capital purposes.

The Senior Secured Notes will mature on February 21, 2017. Subject to certain adjustments set forth in the SPA, interest on the Senior Secured Notes accrues at 8% per annum, payable quarterly in cash. With respect to overdue interest payments or during periods in which an event of default under the SPA has occurred and is

continuing, the annual rate of interest will increase to the greater of 3% per annum in excess of the non-default interest rate and 8% over the yield to maturity for 10-Year United States treasury securities. In addition, the annual interest rate payable on the Senior Secured Notes will increase by 0.5% per annum, beginning 181 days after the date of the SPA, if a shelf registration statement with respect to the shares of Common Stock that are issuable upon exercise of the Warrants has not been filed and declared effective by the SEC, and ending on the date such shelf registration statement is declared effective by the SEC, as well as for certain periods thereafter if the shelf registration statement is no longer effective or otherwise becomes unavailable to holders of the Warrants. In addition, if, prior to the third anniversary of the date of the SPA, we authorize the issuance and sale of any equity interests in the Company, we will use our commercially reasonable efforts to offer each Purchaser an opportunity to purchase up to such Purchaser's pro rata portion of the offered securities on the terms set forth in the SPA.

The Senior Secured Notes are guaranteed by all of our subsidiaries and secured by a first-priority lien on substantially all of our assets and of our domestic subsidiaries. To the extent such assets include stock of our foreign subsidiaries, only 65% of such foreign subsidiary stock is to be pledged as security for the Senior Secured Notes. The Senior Secured Notes will rank senior to all of our other debt and obligations. We are permitted to have up to \$50 million in additional reserves-based secured lending (including, but not limited to, pre-paid swaps); such borrowings may be secured by liens that come ahead of the liens securing the Senior Secured Notes.

Beginning on February 21, 2015, the Purchasers may require us to purchase all or a portion of the Senior Secured Notes at a price equal to the principal amount of the Senior Secured Notes to be purchased, plus any accrued and unpaid interest on such notes. In addition, if a fundamental change (as defined in the SPA) occurs at any time prior to maturity of the Senior Secured Notes, noteholders may require us to purchase all or a portion of the Senior Secured Notes at a price equal to 101% of the principal amount of the Senior Secured Notes to be purchased, plus any accrued and unpaid interest on such notes.

On or prior to February 21, 2015, we may purchase at any time or from time to time any or all of the Senior Secured Notes at 100% of the principal amount of the Senior Secured Notes to be purchased, plus accrued and unpaid interest on such notes, plus a make-whole premium on the principal amount of such notes. After February 21, 2015 and ending on February 21, 2016, we may purchase at any time or from time to time any or all of the Senior Secured Notes at a price equal to 105% of the principal amount of the Senior Secured Notes to be purchased, plus accrued and unpaid interest on such notes. After February 21, 2016, we may purchase at any time or from time to time any or all of the Senior Secured Notes at 100% of the principal amount of the Senior Secured Notes to be purchased, plus accrued and unpaid interest on such notes.

We are subject to certain affirmative and negative covenants pursuant to the Senior Secured Notes, including, without limitation, restrictions on our and our subsidiaries' abilities to incur additional debt, pay dividends or make other distributions, redeem stock, make investments, incur liens, enter into transactions with affiliates, merge or consolidate and transfer or sell assets, in each case subject to certain baskets and carve-outs.

After giving effect to the shares issued to the ZaZa LLC Members and the former stockholders of Toreador in the Combination, the Warrants represented approximately 20.6% of the outstanding shares of Common Stock on an as-converted and fully-diluted basis. The Warrants contain a cashless exercise provision and became exercisable at the option of the holder at any time beginning August 17, 2012. We can force exercise of the Warrants at any time beginning February 21, 2015 if the daily volume weighted average price (the "VWAP") of Common Stock is, at the time of such conversion, greater than or equal to \$10.00 per share for the prior 45 consecutive trading day period. The Warrants expire on February 21, 2017. The exercise price of the Warrants is \$3.15 per share, subject to certain anti-dilution protections, including, but not limited to, stock splits and stock dividends, and issuances below the strike price or below 90% of the market price of our Common Stock. The Warrants also prohibit the payment of cash dividends for as long as the Warrants remain outstanding. As a result of the anti-dilution adjustments in the Warrants, the number of outstanding shares of our common stock represented by the Warrants was increased from 26,315,789 to 27,226,223 and the exercise price per share was reduced to \$3.04 per share on October 22, 2012 following the issuance of our convertible notes.

Until January 21, 2017, a holder of Warrants will not be entitled to receive shares of Common Stock upon exercise of such warrants to the extent that such receipt would result in the holder becoming a "beneficial owner" (as defined in Section 13(d) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and the rules and regulations thereunder) of a number of shares of Common Stock exceeding a maximum percentage of the total number of shares of Common Stock then outstanding, unless such limitation has been terminated with 61 days' notice from the holder. The maximum percentage of Common Stock that a holder of a Warrant may beneficially

own is initially 5% but may be increased to 10% under certain circumstances. Upon the occurrence of a fundamental change as set forth in the Warrants, we must make an offer to repurchase all Warrants at the option value of the Warrant using Black-Scholes calculation methods and making certain assumptions described in the Black-Scholes methodology as set forth in the Warrants.

The Purchasers entered into lock-up agreements with respect to sales (including hedging) of the Warrants for a period of 180 days from the date of the Purchase Agreement. The ZaZa LLC Members and the ZaZa Principals similarly entered into a lock-up agreement with us, dated February 21, 2012 (the "Lock-Up Agreement"), pursuant to which the ZaZa LLC Members and the ZaZa Principals have agreed not to sell shares of Common Stock for a period of 180 days from the date of the Purchase Agreement. The ZaZa LLC Members and the ZaZa Principals have also agreed, pursuant to the Lock-Up Agreement, to limit their aggregate sales of shares of Common Stock (including hedging) until February 21, 2017 to an amount not to exceed annually a maximum percentage of the aggregate amount of Common Stock then outstanding. The maximum percentage will be determined based on the VWAP of Common Stock for the 10 trading days prior to such determination. In connection with entering into Amendment No. 5, the holders of our Senior Secured Notes agreed to increase the maximum percentage contained in the Lock-up Agreement.

#### Note Amendments

On June 8, 2012, ZaZa entered into an amendment and waiver ("Amendment") to the Securities Purchase Agreement dated February 21, 2012 (the "SPA"), relating to our 8% senior secured notes due 2017 (the "Senior Secured Notes"). The Amendment No. 1:

- permitted certain intercompany loans;
- required the consent of the holders of a majority of the Senior Secured Notes to any amendment or termination of the Eagle Ford Agreements or the French Agreements and to dispositions of oil and gas properties (which consent was obtained in connection with the entry into the waiver and Amendment No. 2 to the SPA described below); and
- required certain further amendments to the SPA, which were provided for in the Waiver and Amendment No. 2 to the SPA described below; and
- waived all existing defaults arising under the SPA, including the Company's failure to timely provide financial statements with an unqualified opinion to the holders of the Senior Secured Notes.

The parties also entered into an Amended and Restated Subordination Agreement with Todd A. Brooks, a director, President and Chief Executive Officer of the Company, John Hearn, a director and Chief Operating Officer of the Company, Gaston Kearby, a director of the Company, Omega Energy, LLC, Blackstone Oil & Gas, LLC, and Lara Energy, Inc., entities controlled by Messrs. Brooks, Hearn and Kearby, specifying that payments may not be made by the Company under the relevant subordinated promissory notes described below until after the consummation of the transactions outlined in the HoA and the related \$33.0 million pay down of the principal amount of the Senior Secured Notes, which conditions have now been satisfied.

On July 25, 2012, in connection with entry into the definitive documents with Hess contemplated under the HoA, we entered into a Waiver and Amendment No. 2 to the SPA ("Amendment No. 2). Under Amendment No. 2, we paid down the outstanding principal amount of the Senior Secured Notes by \$33.0 million and paid a \$3.5 million associated fee. We also recorded a loss of \$11.7 million on the extinguishment of debt due to the write off of issuance costs and discount amount.

Amendment No. 2 provided waivers of certain technical defaults under the SPA. Amendment No. 2 also provides for:

- (a) consent rights for the holders of a majority of the Senior Secured Notes on all sale or joint venture transactions involving oil and gas properties, with certain carveouts and requirements to apply a portion of net sales proceeds to pay down the Senior Secured Notes, until such time as the Senior Secured Notes have an outstanding principal amount of \$25 million or less;
- (b) a provision that if the Senior Secured Notes have not been paid down to \$35 million by February 21, 2013, the interest rate will increase from 8% to 10% per annum;
- (c) a limit on additional debt incurrence of ZaZa to \$50 million in reserve-based lending; and

- (d) a requirement that the Company engage an investment banker to assist the Company in securing a joint venture partner or partners for its Eagle Ford and Woodbine/Eaglebine assets, as well as to evaluate other strategic opportunities available to the Company, which has been satisfied by our engaging Jefferies & Company, Inc. as our financial advisors, as described above.

Effective October 16, 2012, the Company and the Senior Secured Notes holders entered into a third amendment to the Securities Purchase Agreement (the "Third Amendment"), pursuant to which the Securities Purchase Agreement was amended to permit the incurrence of the debt arising under the Convertible Senior Notes, revise certain defined terms in the Securities Purchase Agreement and in the warrants issued in connection therewith (the "Amended Warrants"), and make certain other changes.

Effective December 17, 2012, we entered into an Amendment No. 4 to the SPA ("Amendment No. 4"), pursuant to which the SPA was amended to permit the intercompany transfer of certain intercompany loans in connection with the closing of the sale of the Company's French subsidiary ZaZa Energy France SAS, revise certain defined terms in the SPA and in the warrants issued in connection therewith, and make certain other changes. We paid down the outstanding principal amount of the Senior Secured Notes by \$33.8 million and paid a \$1.7 million associated fee in connection with the sale of such subsidiary. We also recorded a loss of \$11.1 million on the extinguishment of debt due to the write off of issuance costs and discount amount.

On March 28, 2013, we entered into Amendment No. 5 to the SPA ("Amendment No. 5"). Under Amendment No. 5, we agreed to make a prepayment on the Senior Secured Notes with the proceeds of an asset sale, which prepayment had previously been deferred, of approximately \$4.6 million.

Amendment No. 5 amended certain requirements with respect to our 2012 financials. Amendment No. 5 also provides for:

- (a) revisions to the prepayment provisions to permit the Company to voluntarily prepay the Senior Secured Notes at 105% of their principal amount plus accrued and unpaid interest, if the aggregate principal amount of the Senior Secured Notes exceeds \$25 million, at 103% if the aggregate principal amount of the Senior Secured Notes exceeds \$15 million, and at 100% if the aggregate principal amount of the Senior Secured Notes are \$15 million or less;
- (b) the Company to make a prepayment to pay down the Senior Secured Notes to \$15 million by February 28, 2014, and a provision that if the Senior Secured Notes have not been repaid in full by February 28, 2014, the interest rate will increase from 8% to 10% per annum;
- (c) the Company to make a prepayment on the Senior Secured Notes if the Company sells some of its acreage in Sweet Home or the Company receives the release of certain escrow funds, which funds were placed in escrow for the benefit of Hess in connection with the Company's sale of its French subsidiary, in each case prior to February 28, 2014, but solely to the extent to reduce the principal outstanding balance of the Senior Secured Notes to \$15 million;
- (d) consent to our new joint venture in the Eaglebine with EOG without any requirement to use the proceeds of our joint venture to pay down the Senior Secured Notes;
- (e) reversion of consent rights on all joint ventures involving oil and gas properties to permit our recently announced joint venture in the Eaglebine without any requirement to use the proceeds thereof to pay down the Senior Secured Notes and to permit joint ventures in Hackberry or Sweet Home as long as 10% of the gross proceeds in excess of \$10 million are used to pay down the Senior Secured Notes;
- (f) the modification of the asset sale covenant in Amendment No. 2 to require (i) only 10% of the gross proceeds from asset sales in the Eaglebine to be used to pay down the Senior Secured Notes, (ii) only 10% of the net proceeds from the sale of the Moulton Properties to be used to pay down the Senior Secured Notes, and (iii) only 10% of the gross proceeds from asset sales in the Eagle Ford to be used to pay down the Senior Secured Notes until such time as the Notes have been paid down to \$15 million, whereupon no such paydown shall be required subject to certain requirements regarding reinvestment of funds;
- (g) the exercise price of the warrants issued in connection with the Senior Secured Notes to be reduced to \$2.00 per share; and
- (h) the amendment of certain provisions of the lockup agreement entered into in connection with the SPA to permit certain additional categories of transfers.

## Convertible Senior Notes due 2017

On October 22, 2012, the Company successfully completed the issuance and sale of \$ 40,000,000 aggregate principal amount of 9% Convertible Senior Notes due 2017 (the “Convertible Notes”). The Convertible Notes were sold in a private placement to investors that are qualified institutional buyers and accredited investors (as such terms are defined under the Securities Act), in reliance upon applicable exemptions from registration under Section 4(a)(2) of and Regulation D under the Securities Act of 1933, as amended, pursuant to Note Purchase Agreements, dated October 16, 2012 (collectively, the “Note Purchase Agreement”) among the Company and the several purchasers that are signatories thereto (collectively, the “Purchasers”). The Notes were issued to the Purchasers pursuant to an Indenture, dated October 22, 2012 (the “Indenture”), among the Company, certain subsidiary guarantors party thereto (the “Guarantors”), and Wilmington Trust, National Association, as trustee thereunder. The Convertible Notes were sold to the Purchasers at a price of \$ 950 for each \$1,000 original principal amount thereof, for aggregate gross proceeds of \$ 38.0 million. The Company intends to use the net proceeds from the offering of the Convertible Notes, after discounts and offering expenses, of approximately \$ 35.2 million to fund drilling capital expenditures and leasehold transactions and for general corporate purposes.

The Convertible Notes accrue interest from October 22, 2012 and mature August 1, 2017. The Convertible Notes are the senior, unsecured obligations of the Company, bear interest at a fixed rate of 9.0% per year, payable semiannually in arrears on February 1 and August 1 of each year beginning February 1, 2013, and mature on August 1, 2017 unless earlier converted, redeemed or repurchased.

The Convertible Notes are convertible, at the option of the holder, at any time prior to the third trading day immediately preceding the maturity date, into shares of the Company's common stock, par value \$ 0.01 per share (the “Conversion Shares”), and cash in lieu of fractional shares of common stock. The initial conversion rate will be 400 shares per \$1,000 Convertible Note, reflecting a conversion premium of approximately 32.28% of the closing price of the Company's common stock on the pricing date of the offering, which equates to an initial conversion price of \$2.50 per share. In certain circumstances, after the occurrence of a fundamental change (as defined in the Indenture), the conversion rate shall be increased (according to the date of such fundamental change) for holders who convert their Convertible Notes on or after the effective date of such fundamental change. In addition, upon the occurrence of a fundamental change, holders may require the Company to repurchase for cash of all or a portion of such holder's Convertible Notes at a purchase price equal to 100% of the principal amount of the Convertible Notes to be purchased, plus any accrued and unpaid interest to, but excluding, the fundamental change repurchase date.

If a holder converts some or all of its Convertible Notes on or after May 1, 2013 but prior to August 1, 2017, in addition to the Conversion Shares, such holder will receive a coupon make-whole payment for the Convertible Notes being converted. The coupon make-whole payment will be equal to the sum of the present values of the lesser of five semi-annual interest payments or the number of semi-annual interest payments that would have been payable on such converted Convertible Notes from the last day through which interest was paid on the Convertible Notes through July 31, 2017. The Company may elect to pay such make-whole payment in either cash or, subject to shareholder approval if required under applicable stock exchange rules, shares of common stock, and if paid in shares of common stock, then the stock will be valued at 95% of the simple average of the daily volume weighted average prices for the common stock for the 10 trading days ending on and including the trading day immediately preceding the conversion date.

The Company may not redeem the Convertible Notes prior to August 1, 2015. Beginning August 1, 2015, the Company may redeem for cash all or part of the Convertible Notes if the last reported sale price of its common stock equals or exceeds 150% of the applicable conversion price for at least 20 trading days during the 30 consecutive trading day period ending on the trading day immediately prior to the date on which the Company delivers the notice of the redemption. The redemption price will equal 100% of the principal amount of the Convertible Notes to be redeemed, plus any accrued and unpaid interest to, but excluding, the redemption date.

The Indenture contains covenants that, among other things, limit the Company's ability and the ability of certain of its subsidiaries to, with certain exceptions, incur additional indebtedness or guarantees of indebtedness, and to dispose of assets, except under certain conditions and with certain exceptions, including contributions of assets to specified joint venture transactions. In addition, the terms of the Indenture require that the Company file all reports customarily filed with the SEC within the time frames required by SEC rules and provide information to permit the trading of the Convertible Notes pursuant to SEC Rule 144A, and that all current and future domestic restricted subsidiaries (as defined in the Indenture) of the Company, except for immaterial subsidiaries, jointly and severally guarantee the Convertible Notes on a senior unsecured basis. The Company will be able to designate a

restricted subsidiary as an unrestricted subsidiary under specified conditions.

The Company designated its foreign subsidiaries as unrestricted. These subsidiaries had no business operations as of December 31, 2012 and had assets consisting of \$21.9 million of restricted cash and \$17.3 million of intercompany receivables. These intercompany receivables are planned to be dividended up and forgiven in accordance with lender approval, during 2013 or as soon as commercially possible.

The Indenture contains customary events of default, including failure to pay interest after a 30 day grace period, failure to pay principal when due, failure to comply with certain covenants, such as the offer to repurchase upon a fundamental change, failure to comply with other covenants after a customary grace period, cross-defaults, judgment defaults and certain bankruptcy events. If an event of default on the Convertible Notes has occurred and is continuing, the principal amount of the Convertible Notes, plus any accrued and unpaid interest, may become immediately due and payable. Upon the occurrence of certain events of default, these amounts automatically become due and payable.

In addition, if the Company elects, the sole remedy for an event of default relating to the Company's failure to comply with the SEC reporting requirements under the Indenture will, for the first 90 days after the occurrence of such an event of default, consist exclusively of the right to receive special interest on the Convertible Notes at a rate equal to 0.50% per annum of the principal amount of the Convertible Notes. If the Company elects, such special interest will be payable in the same manner and on the same dates as the stated interest payable on the Convertible Notes.

The Convertible Notes and Conversion Shares have not been registered, nor are required to be registered, under the Securities Act or applicable state securities laws and may not be offered or sold in the United States absent registration or an applicable exemption from the registration requirements of the Securities Act and applicable state laws.

### **Subordinated Notes**

Simultaneously with the consummation of the Merger, and pursuant to the Contribution Agreement dated August 9, 2011 among the ZaZa LLC Members and ZaZa (the "Contribution Agreement"), the ZaZa LLC Members contributed all of the direct or indirect limited liability company interests in ZaZa LLC to us in exchange for (i) a number of shares of Common Stock that, in the aggregate, represented 75% of the issued and outstanding shares of Common Stock immediately after the consummation of the Combination (but without giving effect to the shares of Common Stock issuable upon exercise of the Warrants as discussed above), and (ii) subordinated notes in an aggregate amount of \$38.25 million issued to the ZaZa LLC Members as partial consideration for the Combination (the "Seller Notes"). In addition, as required under the terms of the Merger Agreement and the Contribution Agreement, we issued subordinated notes in an aggregate amount of \$9.08 million to the individuals that own and control the ZaZa LLC Members, Todd Alan Brooks, Gaston L. Kearby and John E. Hearn Jr., in respect of certain unpaid compensation amounts owing to the ZaZa Founders by ZaZa LLC (the "Compensation Notes") for back salary, bonuses, incentive compensation or other compensation payable to them by ZaZa LLC in connection with or in respect of periods prior to the consummation of the Combination. The Seller Notes and Compensation Notes accrue interest at a rate of 8% per annum, are payable monthly in cash, and mature on August 17, 2017. Subject to certain conditions, we may make regularly scheduled interest payments to the ZaZa LLC Members and the ZaZa Founders on these notes and may prepay these notes at any time. We are required to repay these notes, pro rata, with 20% of the proceeds of any subordinated debt financing and 20% of the proceeds of any equity financing completed on or after the third anniversary of the issuance of the Senior Secured Notes, which are described above. We have not been making regular interest payments on these notes. On September 11, 2012, we made a partial interest payment on the notes and the holders of the notes agreed, subject to board approval, to defer the payment of any further accrued interest, as well as the payment of any interest that accrues after such date, until the earlier of (i) the occurrence of an event providing us with liquidity sufficient to make such payments and (ii) February 21, 2013. On October 22, 2012, we completed the issuance of \$40 million 9% Convertible Senior Notes due 2017 which allowed us to pay \$1.6 million in back interest on the Subordinated Notes. Interest is due and paid on the last day of each month.

## Contractual Obligations

ZaZa is committed to making cash payments in the future on the following types of agreements:

- Operating leases;
- Long-term debt (to the extent such long term debt is incurred); and
- Interest on long-term debt (to the extent such long term debt is incurred).

ZaZa has no unrecorded obligations and has not guaranteed the debt of any other party. Below is a schedule of the future payments that ZaZa is obligated to make based on agreements in place as of December 31, 2012:

	Payments due in twelve month periods ending December 31,							
	Total	2013	2014	2015	2016	2017	Thereafter	
	(In thousands)							
Interest payable on Senior Secured Notes	\$ 11,237	\$ 2,472	\$ 2,693	\$ 2,693	\$ 2,700	\$ 679	\$	-
Senior Secured Notes principal	33,200	-	-	-	-	33,200		-
Interest payable on Convertible Senior Notes	17,190	2,790	3,600	3,600	3,600	3,600		-
Convertible Senior Notes principal	40,000	-	-	-	-	40,000		-
Interest payable on Subordinated Notes	17,563	3,786	3,786	3,786	3,786	2,419		-
Subordinated Notes principal	47,330	-	-	-	-	47,330		-
Operating leases	2,881	1,190	1,180	190	190	73		58
Total	\$ 169,401	\$ 10,238	\$ 11,259	\$ 10,269	\$ 10,276	\$ 127,301	\$	58

ZaZa maintains a reserve for costs associated with the retirement of tangible long-lived assets. At December 31, 2012 and 2011, reserve for these obligations totaled \$130 thousand and \$309 thousand, respectively, but was not subject to contractual commitments.

## Off-balance Sheet Arrangements

We have no off-balance sheet arrangements that have or are reasonably likely to have a current or future material effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources.

## Dividends

Dividends on our common stock may be declared and paid out of funds legally available when and as determined by our Board of Directors, subject to certain loan covenants. Our policy is to hold and invest corporate funds on a conservative basis, and, thus, we do not anticipate paying cash dividends on our common stock in the foreseeable future.

## RELATED PARTY TRANSACTIONS

Each of the three original managing partners of ZaZa LLC has a direct or indirect interest in an overriding royalty interest generally equal to one percent (1%) (for a total of three percent (3%)) in:

- Each leasehold estate located within the boundaries of the “area of mutual interest” map that was attached to the Exploration and Development Agreement between ZaZa and Hess (the “EDA”) that has been or may be acquired by ZaZa prior to April 2016 including the Eagle Ford shale trend and the Eaglebine trend; and

- Each leasehold estate located within the boundaries of an “expansion area” covering certain counties in Alabama, Florida, Louisiana and Mississippi that may be acquired by ZaZa prior to April 2016, unless a longer period of time is stated in any area of mutual interest agreement that may be entered into between ZaZa and a third party.

In March 2010, ZaZa LLC entered into an agreement with the ZaZa LLC Members and Eli Smith & Associates, which we refer to as Smith, to acquire 100% working interests in any unproved acreage identified in a defined area of mutual interest located in the Colorado and Lavaca counties of Texas. During the year ended December 31, 2011, ZaZa acquired acreage for a total of approximately \$ 6.1 million pursuant to this agreement. During the year ended December 31, 2010, ZaZa acquired acreage totaling approximately \$ 28.9 million pursuant to this agreement; \$6.2 million of the purchase price was in the form of \$ 3 million notes payable due to the ZaZa LLC Members and \$3.2 million in accounts payable due to ZaZa LLC Members, which was paid in January 2011. The ZaZa LLC managing partners and Smith retain a direct or indirect reserved overriding royalty interest generally equal to three percent (3%) in each property sold to ZaZa, which is divided pro-rata among the four sellers in the transactions. Simultaneously with each purchase, ZaZa pursuant to a separate agreement sold 90% of the acquired working interests to Hess, and retained a 10% working interest in each property. No gain or loss was recognized on the sales to Hess.

Effective May 1, 2010, ZaZa and its members entered into a compensation agreement in which base salary, discretionary bonus and incentive compensation were defined. Incentive compensation was based on the fulfillment of certain performance metrics and the occurrence of a “Company liquidity event,” defined therein as an initial public offering, merger, reverse merger, financing or other availability of capital deemed financially beneficial to ZaZa. During the year ended December 31, 2011, no discretionary bonuses were approved by ZaZa. For the year ended December 31, 2012, ZaZa paid \$17.5 million in discretionary bonuses and incentive compensation under these agreements. These compensation agreements were terminated in connection with the Combination.

In March 2011 ZaZa entered into a management agreement (the “Management Agreement”) with Sequent Petroleum Management, LLC (“SPM”) pursuant to which SPM provided ZaZa with contractors and consultants and their related benefits programs in exchange for a monthly fee for managing such personnel. Scott Gaille, who was appointed ZaZa Energy Corporation’s Chief Compliance Officer as of March 2012 was a principal of SPM until September 6, 2012, when he disposed of all of his interests in SPM. ZaZa reimbursed SPM for the costs of the personnel under the Management Agreement, including for the costs of their insurance and other benefits. SPM handled all payroll, tax, accounting and benefit services for the contractors and consultants provided under the Management Agreement. For the years ended December 31, 2012 and 2011, ZaZa paid SPM \$18.3 million (including \$52 thousand in management fees) and \$6.3 million (including \$50 thousand in management fees), respectively, under this agreement. At December 31, 2011, ZaZa had a receivable from SPM of \$84 thousand related to the estimated period end payroll. Effective November 1, 2012, 100% of the units and ownership in SPM was assigned to ZaZa LLC.

Lot-A-Go 5 (“LG5”) is an airplane rental company in which Todd A. Brooks and Gaston Kearby hold partnership interest. From time to time, ZaZa will rent the plane for business travel reasons. ZaZa was charged for the pilots’ time, hanger fees and fuel. During the year ended December 31, 2012 ZaZa was charged and paid \$115 thousand for such services. In addition, at December 31, 2011, ZaZa had a payable to LG5 for \$80 thousand related to the remainder of a short-term working capital loan that bears no interest, which was repaid in September 2012.

### ***Entry into Reimbursement Agreements***

In connection with but following consummation of the combination of Toreador Resources Corporation and ZaZa LLC, the three former members of ZaZa LLC, Todd A. Brooks, Gaston L. Kearby, and John E. Hearn Jr. (together, the “ZaZa Founders”), each determined to transfer to certain service providers approximately 1.7 million shares of restricted common stock of the Company, par value \$0.01 per share (the “Restricted Stock”), held by entities controlled by the ZaZa Founders. Because such transfers were expected to give rise to a compensation expense deduction to the Company upon vesting of the grants, as opposed to giving rise to a deduction to the ZaZa Founders, the Company agreed to pay in cash to the ZaZa Founders the economic value of any tax deduction the Company receives as a result of these grants by the ZaZa Founders.

On September 11, 2012, the Company entered into separate Reimbursement Agreements with each of Blackstone Oil & Gas, LLC (“Blackstone”), Omega Energy Corp. (“Omega”), and Lara Energy, Inc. (“Lara”)



(together, the “Reimbursement Agreements”). Blackstone, Omega, and Lara are respectively controlled by Todd A. Brooks, who serves as the Company’s President and Chief Executive Officer and also as a Director, Gaston L. Kearby, who is the former Executive Director-Operations and currently serves as a Director of the Company, and John E. Hearn Jr., who serves as the Chief Operating Officer and a Director of the Company. Pursuant to the Reimbursement Agreements, the Company will reimburse each of Blackstone, Lara, and Omega for the value of the tax benefit(s) received by the Company due to the transfers of Restricted Stock within thirty (30) days of such time(s) when the Company is able to make use of the expense(s) relating thereto to reduce its federal income tax withholding or payments (the “Reimbursements”). If Blackstone, Lara, and Omega together cease to control a majority of the common stock of the Company prior to the time that the Company is able to make use of any or all of such expenses to reduce its federal income tax withholding or payments, then the Company will pay to each of Blackstone, Lara, and Omega an amount equal to thirty-five percent (35%) of the value of the shares of the Restricted Stock (determined at the time of vesting) transferred by each such grantor.

The Company estimates that the Reimbursements could be as much as \$ 1.4 million for each of Blackstone, Lara, and Omega , no payments have been made during the year ended December 31, 2012 . The tax characterization of the Reimbursements and their reporting shall be determined by a third party tax advisor to the founders. Each of Blackstone, Lara, and Omega will be responsible and liable for any tax consequences (including, but not limited to, any interest or penalties) as a result of the Reimbursements.

### ***Assignment of Stadium Suite Lease***

On September 28, 2011, ZaZa LLC entered into that certain Reliant Stadium Suite Lease Agreement (the “Original Suite Lease”) with Houston NFL Holdings, L.P. (the “Landlord”), whereby ZaZa LLC leased a luxury suite at Reliant Stadium for Houston Texans professional football games and certain other events. On February 23, 2012, ZaZa LLC entered into that certain Houston Texans Reliant Stadium Suite Lease Agreement (the “Amended Suite Lease”) with Landlord, which amended and restated the Original Suite Lease. In order to reduce overhead costs, the Company’s Board of Directors has approved the assignment and assumption of the Amended Suite Lease, and, subject to Landlord approval, ZaZa LLC will assign the Amended Suite Lease to Blackstone Oil & Gas, LLC (“Blackstone”), and Blackstone will agree to assume from ZaZa LLC, ZaZa LLC’s obligations under the Amended Suite Lease. Todd A. Brooks, President and Chief Executive Officer of the Company, holds all outstanding equity interests in Blackstone and is its President. The Landlord has not yet consented to such assignment and assumption, but is expected to do so. To the extent the assignment and assumption are approved by the Landlord, and the Amended Suite Lease is assigned to Blackstone and then subsequently assigned by Blackstone to a third party for a profit, Blackstone will reimburse the Company for the value of the benefit, if any, which it receives. The term of the Amended Suite Lease commenced at the start of the 2012 National Football League (“NFL”) season and will terminate at the conclusion of the 2018 NFL season. The base rate (including additional rent) of rent for the Amended Suite Lease is \$ 248,000 for the first year of the term, and thereafter is subject to increases of up to five percent ( 5%) per year in each subsequent year. Blackstone previously paid for the first year’s rent for and on behalf of ZaZa LLC, for which Blackstone will not be reimbursed. The additional rent payments for the remaining six years of the Amended Suite Lease will total no less than \$ 1,488,000.

## **CRITICAL ACCOUNTING POLICIES**

The preparation of financial statements in conformity with GAAP requires that management apply accounting policies and make estimates and assumptions that affect results of operations and the reported amounts of assets and liabilities in the financial statements. The following represents those policies that management believes are particularly important to the financial statements and that require the use of estimates and assumptions to describe matters that are inherently uncertain.

### **Revenue Recognition and Imbalances**

The Company derives its oil and gas revenue primarily from the sale of produced oil and gas. The Company uses the sales method of accounting for the recognition of gas revenue whereby revenues, net of royalties are recognized as the production is sold to the purchaser. The amount of gas sold may differ from the amount to which the Company is entitled based on its working interest or net revenue interest in the properties. Revenue is recorded when title is transferred based on our nominations and net revenue interests. Pipeline imbalances occur when production delivered into the pipeline varies from the gas we nominated for sale. Pipeline imbalances are settled with cash approximately 30 days from date of production and are recorded as a reduction of revenue or

increase of revenue depending upon whether we are over-delivered or under-delivered. Settlements of oil and gas sales occur after the month in which the product was produced. We estimate and accrue for the value of these sales using information available at the time financial statements are generated. Differences are reflected in the accounting period during which payments are received from the purchaser.

Until the dissolution of the Hess joint venture agreements, the Company also derived its bonus income revenue from a bonus on leasehold amounts that Hess agreed to participate in. The bonus amount was equal to 10% of the sum of all direct costs associated with acquiring the net mineral acres as defined in the EDA and was recognized after the leases were obtained, title was cured and transferred to Hess, and recorded with the appropriate county.

### **Successful Efforts Method of Accounting for Oil and Gas Activities**

The Company accounts for its natural gas and crude oil exploration and production activities under the successful efforts method of accounting. Oil and gas lease acquisition costs are capitalized when incurred. Lease rentals are expensed as incurred. Oil and gas exploration costs, other than the costs of drilling exploratory wells, are charged to expense as incurred. The costs of drilling exploratory wells are capitalized pending determination of whether they have discovered proved commercial reserves. Exploratory drilling costs are capitalized when drilling is complete if it is determined that there is economic producibility supported by either actual production or a conclusive formation test. If proved commercial reserves are not discovered, such drilling costs are expensed. In some circumstances, it may be uncertain whether proved commercial reserves have been found when drilling has been completed. Such exploratory well drilling costs may continue to be capitalized if the reserve quantity is sufficient to justify its completion as a producing well and sufficient progress in assessing the reserves and the economic and operating viability of the project is being made. Costs to develop proved reserves, including the costs of all development wells and related equipment used in the production of natural gas and crude oil, are capitalized. Unproved properties with individually significant acquisition costs are analyzed on a property-by-property basis for any impairment in value. If the unproved properties are determined to be productive, the appropriate related costs are transferred to proved oil and gas properties.

ZaZa's third party engineers estimate proved oil and gas reserves, which directly impact financial accounting estimates, including depreciation, depletion, and amortization. Our proved reserves represent estimated quantities of oil and condensate, natural gas liquids and gas that geological and engineering data demonstrate, with reasonable certainty, to be recovered in future years from known reservoirs under economic and operating conditions existing at the time the estimates were made. The process of estimating quantities of proved oil and gas reserves is very complex requiring significant subjective decisions in the evaluation of all available geological, engineering, and economic data for each reservoir. The data for a given reservoir may also change substantially over time as a result of numerous factors including, but not limited to, additional development activity, evolving producing history, and continual reassessment of the viability of production under varying economic conditions. Consequently, material revisions (upward or downward) to existing reserve estimates may occur from time to time.

Depreciation, depletion, and amortization of the cost of proved oil and gas properties are calculated using the unit-of-production method. The reserve base used to calculate depreciation, depletion, and amortization for leasehold acquisition costs is the sum of proved developed reserves and proved undeveloped reserves. With respect to lease and well equipment costs, which include development costs and successful exploration drilling costs, the reserve base includes only proved developed reserves. Estimated future dismantlement, restoration, and abandonment costs, net of salvage values are taken into account.

Amortization rates are updated quarterly to reflect: (1) the addition of capital costs, (2) reserve revisions (upwards or downwards) and additions, (3) property acquisitions and/or property dispositions, and (4) impairments. When circumstances indicate that an asset may be impaired, the Company compares expected undiscounted future cash flows at a producing field level to the unamortized capitalized cost of the asset. If the future undiscounted cash flows, based on the Company's estimate of future natural gas and crude oil prices, operating costs, anticipated production from proved reserves, and other relevant data, are lower than the unamortized capitalized cost, the capitalized cost is reduced to fair value. Fair value is calculated by discounting the future cash flows at an appropriate risk-adjusted discount rate.

## **Reserves Estimate**

Proved reserves are estimated 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 recoverable in future years from known reservoirs, and under existing economic conditions, operating methods, and government regulations—prior to the time at which contracts providing the right to operate expire, unless evidence indicates that renewal is reasonably certain. Proved developed reserves are reserves that can be expected to be recovered through existing wells with existing equipment and operating methods or in which the cost of the required equipment is relatively minor compared to the cost of a new well and through installed extraction equipment and infrastructure operational at the time of the reserves estimate if the extraction is by means not involving a well. Proved undeveloped reserves are reserves that are expected to be recovered from new wells on undrilled acreage or from existing wells where a relatively major expenditure is required for recompletion. Proved undeveloped reserves on undrilled acreage are limited (i) to those directly offsetting development spacing areas that are reasonably certain of production when drilled, unless evidence using reliable technology exists that establishes reasonable certainty of economic producibility at greater distances and (ii) to other undrilled locations if a development plan has been adopted indicating that they are scheduled to be drilled within five years, unless the specific circumstances justify a longer time.

## **Income Taxes**

For financial reporting purposes, we generally provide taxes at the rate applicable for the appropriate tax jurisdiction. Management periodically assesses the need to utilize these unremitted earnings to finance our foreign operations. This assessment is based on cash flow projections that are the result of estimates of future production, commodity prices and expenditures by tax jurisdiction for our operations. Such estimates are inherently imprecise since many assumptions utilized in the cash flow projections are subject to revision in the future.

Management also periodically assesses, by tax jurisdiction, the probability of recovery of recorded deferred tax assets based on its assessment of future earnings estimates. Such estimates are inherently imprecise since many assumptions utilized in the assessments are subject to revision in the future.

## **Earnings (loss) Per Common Share**

Basic earnings (loss) per share was calculated by dividing net income or loss applicable to common shares by the weighted average number of common shares outstanding during the periods presented. Diluted earnings (loss) per share incorporate the potential dilutive impact of options and unvested stock outstanding during the periods presented, unless their effect is anti-dilutive. In addition, the Company applies the if-converted method to our convertible debt instruments, the effect of which is that conversion will not be assumed for purposes of computing diluted earnings (loss) per share if the effect would be anti-dilutive.

The equity structure of the legal subsidiary (the accounting acquirer) has been retroactively adjusted using the exchange ratio established in the Agreement and Plan of Merger and Contribution, dated August 9, 2011, as amended, to reflect the number of shares of the legal parent (the accounting acquiree) issued in the reverse merger. For the purpose of 2011 and 2010 earnings per share calculation (“EPS”) the number of weighted average shares outstanding represents assumed shares outstanding as of December 31, 2011 and 2010, as there were no changes in the capital structure of ZaZa LLC during the years ended then. The shares outstanding were calculated based on the Toreador shares outstanding and the exchange ratio.

## **Foreign Currency Translation**

The United States dollar is the functional currency for all of ZaZa’s consolidated subsidiaries except for certain of its French subsidiaries, for which the functional currency is the Euro. For subsidiaries whose functional currency is deemed to be other than the United States dollar, asset and liability accounts are translated using the period-end exchange rates and revenues and expenses are translated at average exchange rates prevailing during the period. Translation adjustments are included in Accumulated Other Comprehensive Income (“AOCI”) on the Consolidated Balance Sheets. Any gains or losses on transactions or monetary assets or liabilities in currencies other than the functional currency are included in net income (loss) in the current period.

## Stock-based Compensation

Stock-based compensation cost is measured at the date of grant, based on the fair value of the award, and is recognized as expense over the vesting period of the award. Forfeitures are estimated at the time of grant and revised, if necessary, in subsequent periods to reflect actual forfeitures. Awards subject to vesting requirements for non-employees will be fair valued each reporting period, final fair value being determined at the vesting date.

## ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are exposed to market risk, including the effects of adverse changes in commodity prices and, potentially, interest rates as described below.

The primary objective of the following information is to provide quantitative and qualitative information about our potential exposure to market risks. The term "market risk" refers to the risk of loss arising from adverse changes in oil and gas prices and interest rates. The disclosures are not meant to be precise indicators of expected future losses, but rather indicators of reasonably possible losses. All of our market risk sensitive agreements were entered into for purposes other than speculative trading.

**Commodity Price Risk** - Our major market risk exposure is in the pricing it receives for its oil and gas production. Realized pricing is primarily driven by the prevailing price for oil and the spot market prices applicable to natural gas production. Pricing for oil and gas has been volatile and unpredictable for several years, and this volatility is expected to continue in the future. The prices we receive for its oil and gas production depend on many factors outside of its control, such as the strength of the global economy.

To reduce the impact of fluctuations in oil and gas prices on its revenues, or to protect the economics of property acquisitions, we in the future may periodically enter into derivative contracts with respect to a portion of its projected oil and gas production through various transactions that fix or, through options, modify the future prices realized. These transactions may include price swaps whereby we would receive a fixed price for its production and pay a variable market price to the contract counterparty. Additionally, we may enter into collars, whereby it would receive the excess, if any, of the fixed floor over the floating rate or pay the excess, if any, of the floating rate over the fixed ceiling price. In addition, we may in the future enter into option transactions, such as puts or put spreads, as a way to manage its exposure to fluctuating prices. Such hedging activities are intended to manage exposure to oil and gas price fluctuations.

**Interest Rate Risk** - ZaZa historically have not had any long term debt, but we have now incurred long term debt under our Senior Secured Notes, Convertible Senior Notes and Subordinated notes. We may enter into interest rate derivative contracts on a portion of its then outstanding debt to mitigate the risk of fluctuating interest rates .

**Fair Value Measurement Risk** - The warrants associated with our Senior Secured Notes and embedded conversion option and fundamental change provisions associated with our Convertible Secured Notes are subject to fair value measurement risk.

The warrants were valued as written call options using a Monte Carlo stock option pricing simulation. Exercise behavior prior to maturity was simulated using a Least-Squares approach based on the Longstaff-Schwartz Least Squares Monte Carlo (LSM) option pricing model. Key inputs into this valuation model are our current stock price, LIBOR zero coupon yield curve, and the underlying stock price volatility. The debt was valued under the income approach using discounted cash flows. The discounting utilized the LIBOR zero coupon yield curve and our implied credit spread. The current stock price and LIBOR yield curve are based on observable market data and are considered Level 2 inputs while the stock price volatility and implied credit spread are unobservable and thus require management's judgment and are considered Level 3 inputs. We used average daily stock price volatility of 5% and credit spread of S&P CCC+ rated companies. The fair value measurements are considered a Level 3 measurement within the fair value hierarchy. An increase in the volatility by 5% results in a \$0.3 million increase in the fair value of the warrants. A decrease in the volatility by 5% results in a \$1.9 million decrease in the fair value of the warrants. An increase the credit spread by 500 basis points results in a \$4.6 million decrease in fair value on the notes. A decrease in the credit spread by 500 basis points results in a \$5.6 million increase in fair value of the notes. On December 31, 2012, the Senior Secured Notes, which had a book value of \$ 23.6 million, had a fair market value of approximately \$ 28.4 million.

The embedded conversion options were valued as written call options using a Monte Carlo stock option pricing simulation where exercise was based on periods where the stock price multiplied by shares plus the outstanding interest were greater than the value of the notes. Exercise behavior prior to maturity was simulated using a Least-Squares approach based on the Longstaff-Schwartz Least Squares Monte Carlo (LSM) option pricing model. Key inputs into this valuation model are our current stock price, LIBOR zero coupon yield curve, credit spread curve, and the underlying stock price volatility. The debt was valued under the income approach using discounted cash flows. The discounting utilized the LIBOR zero coupon yield curve and our implied credit spread. The current stock price and LIBOR yield curve are based on observable market data and are considered Level 2 inputs while the stock price volatility and implied credit spread are unobservable and thus require management's judgment and are considered Level 3 inputs. We used average daily stock price volatility of 5% and credit spread of S&P CCC+ rated companies. The fair value measurements are considered a Level 3 measurement within the fair value hierarchy. An increase the volatility by 5% results in a \$1.0 million increase in the fair value of the conversion options. A decrease in the volatility by 5% results in a \$0.8 million dollar decrease in the fair value of the conversion options. An increase in the credit spread by 500 basis points results in \$6.1 million decrease in fair value of the convertible notes and a \$0.7 million increase in the fair value of the conversion options. A decrease in the credit spread by 500 basis points results in \$7.6 million increase in fair value of the convertible notes and a \$0.4 million increase in the fair value of the conversion options. On December 31, 2012, the Convertible Notes, which had a book value of \$27.0 million, had a fair market value of approximately \$34.6 million.

**Counterparty and Customer Credit Risk** - We are subject to credit risk due to the concentration of its oil and gas receivables with only a few significant customers. Please read "Business, Industry & Properties—Marketing and Customers" for further detail about our significant customers. Our inability, or the failure of its significant customers to meet their obligations to us or their insolvency or liquidation, may materially adversely affect our financial results. In addition, any oil and gas derivative contracts that we may enter into in the future may expose us to credit risk in the event of nonperformance by counterparties.

The risks inherent in our market-sensitive instruments are the potential loss arising from adverse changes in oil prices and foreign currency exchange rates as discussed below. The sensitivity analysis however, neither considers the effects that such adverse changes may have on overall economic activity nor does it consider additional actions we may take to mitigate our exposure to such changes. Actual results may differ.

The following quantitative and qualitative information is provided about financial instruments from which we may incur future earnings gains or losses from changes in commodity prices. We do not designate our derivatives as hedges; however, we do not enter into derivative or other financial instruments for trading purposes.

## **ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA**

The Reports of Independent Registered Public Accounting Firms and Consolidated Financial Statements are set forth beginning on page F-1 of this Annual Report on Form 10-K and are included herein.

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

None.

## **ITEM 9A. CONTROLS AND PROCEDURES**

### **Evaluation of Disclosure Controls and Procedures**

We maintain disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) that are designed to provide reasonable assurance that the information required to be disclosed by us in reports filed under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the SEC.

As of December 31, 2012, an evaluation was conducted by ZaZa management, including our Chief Executive Officer and Chief Financial Officer, as to the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Rules 13a-15(e) and 15d-15(e) of the Exchange Act. Based on that evaluation, our management concluded that our disclosure controls and procedures were not effective as of December 31, 2012 because of material weaknesses in our internal controls over financial reporting resulting from our auditors identifying an adjustment related to the write-off of exploration costs associated with a failed lateral portion of an exploratory well in the fourth quarter 2012 and errors in the calculation of certain income taxes attributable to our merger with Toreador in the first quarter 2012 and subsequent disposition of our foreign assets in the fourth quarter of 2012. Each of these errors were corrected prior to our filing the financial statements for such period with the SEC. Accordingly, management believes that the financial statements included in this report fairly present in all material respects our financial condition, results of operations and cash flows for the periods presented.

Our management believes that the error related to our exploratory well was a result of the failure of coordination between our personnel that make our determinations of well outcomes and our personnel that prepare our financial statements. Furthermore, our management believes that the errors related to our income taxes relate to (1) the tax complexities of our merger, (2) the tax implications of our disposition of our foreign operations and (3) the communication amongst those internal and external individuals preparing such provisions and financial statements.

Failure to comply with rules regarding internal controls and procedures may make it more difficult for us to obtain certain types of insurance, including director and officer liability insurance. We may be forced to accept reduced policy limits and coverage and/or incur substantially higher costs to obtain the same or similar coverage. The impact of these events could also make it more difficult for us to attract and retain qualified persons to serve on our Board of Directors, on committees of our Board of Directors, or as executive officers.

Management is reviewing remediation steps necessary to address the material weaknesses and to improve our internal control over financial reporting. We intend to correct the material weaknesses promptly.

### **Management's Annual Report on Internal Control over Financial Reporting**

This annual report does not include a report of management's assessment regarding internal control over financial reporting or an attestation report of the company's registered public accounting firm due to a transition period established by rules of the Securities and Exchange Commission for emerging growth companies.

There have been no changes in our internal control over financial reporting during the quarter ended December 31, 2012 that have materially affected or are reasonably likely to materially affect our internal control over financial reporting.

### **ITEM 9B. OTHER INFORMATION**

On March 28, 2013, we entered into Amendment No. 5 to the SPA ("Amendment No. 5"). Under Amendment No. 5, we agreed to make a prepayment on the Senior Secured Notes with the proceeds of an asset sale, which prepayment had previously been deferred, of approximately \$4.6 million.

Amendment No. 5 amended certain requirements with respect to our 2012 financials. Amendment No. 5 also provides for:

- (a) revisions to the prepayment provisions to permit the Company to voluntarily prepay the Senior Secured Notes at 105% of their principal amount plus accrued and unpaid interest, if the aggregate principal amount of the Senior Secured Notes exceeds \$25 million, at 103% if the aggregate principal amount of the Senior Secured Notes exceeds \$15 million, and at 100% if the aggregate principal amount of the Senior Secured Notes are \$15 million or less;
- (b) the Company to make a prepayment to pay down the Senior Secured Notes to \$15 million by February 28, 2014, and a provision that if the Senior Secured Notes have not been repaid in full by February 28, 2014, the interest rate will increase from 8% to 10% per annum;
- (c) the Company to make a prepayment on the Senior Secured Notes if the Company sells some of its acreage in Sweet Home or the Company receives the release of certain escrow funds, which funds were placed in escrow for the benefit of Hess in connection with the Company's sale of its French subsidiary,

in each case prior to February 28, 2014, but solely to the extent to reduce the principal outstanding balance of the Senior Secured Notes to \$15 million;

- (d) consent to our new joint venture in the Eaglebine with EOG without any requirement to use the proceeds of our joint venture to pay down the Senior Secured Notes;
- (e) reversion of consent rights on all joint ventures involving oil and gas properties to permit our recently announced joint venture in the Eaglebine without any requirement to use the proceeds thereof to pay down the Senior Secured Notes and to permit joint ventures in Hackberry or Sweet Home as long as 10% of the gross proceeds in excess of \$10 million are used to pay down the Senior Secured Notes;
- (f) the modification of the asset sale covenant in Amendment No. 2 to require (i) only 10% of the gross proceeds from asset sales in the Eaglebine to be used to pay down the Senior Secured Notes, (ii) only 10% of the net proceeds from the sale of the Moulton Properties to be used to pay down the Senior Secured Notes, and (iii) only 10% of the gross proceeds from asset sales in the Eagle Ford to be used to pay down the Senior Secured Notes until such time as the Notes have been paid down to \$15 million, whereupon no such paydown shall be required subject to certain requirements regarding reinvestment of funds;
- (g) the exercise price of the warrants issued in connection with the Senior Secured Notes to be reduced to \$2.00 per share; and
- (h) the amendment of certain provisions of the lockup agreement entered into in connection with the SPA to permit certain additional categories of transfers.

## **PART III**

### **ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE**

Information under the caption “Directors, Executive Officers and Corporate Governance,” which will be contained in the Company’s Definitive Proxy Statement for the 2013 Annual Meeting of Stockholders to be filed within 120 days of year end, is incorporated herein by reference.

### **ITEM 11. EXECUTIVE COMPENSATION**

Information under the caption “Executive Compensation,” which will be contained in the Company’s Definitive Proxy Statement for the 2013 Annual Meeting of Stockholders to be filed within 120 days of year end, is incorporated herein by reference.

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

Information under the caption “Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters,” which will be contained in the Company’s Definitive Proxy Statement for the 2013 Annual Meeting of Stockholders to be filed within 120 days of year end, is incorporated herein by reference.

### **ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE**

Information under the caption “Certain Relationships and Related Transactions, and Director Independence,” which will be contained in the Company’s Definitive Proxy Statement for the 2013 Annual Meeting of Stockholders to be filed within 120 days of year end, is incorporated herein by reference.

### **ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES**

Information under the caption “Principal Accounting Fees and Services,” which will be contained in the Company’s Definitive Proxy Statement for the 2013 Annual Meeting of Stockholders to be filed within 120 days of year end, is incorporated herein by reference.



## PART IV

### ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

The following documents are filed as part of this report:

**1. Index to Consolidated Financial Statements**

Index to Financial Statements, Report of Independent Registered Public Accounting Firm, Balance Sheets as of December 31, 2012 and 2011, Statements of Operation and Stockholders' and Members' Equity and Cash Flows for each of the three years in the period ended December 31, 2012 and Notes to the Financial Statements for ZaZa Energy Corporation.

**2.** The financial statement schedules have been omitted because they are not applicable or the required information is shown in the Consolidated Financial Statements or the Notes to Consolidated Financial Statements.

**3.** Exhibits: The exhibits required to be filed by this Item 15 are set forth in the Index to Exhibits accompanying this report.

#### ZaZa Energy Corporation 2012 10-K Exhibit List

Exhibit Number	Description
2.1	Agreement and Plan of Merger and Contribution, dated August 9, 2011, by and among Toreador Resources Corporation, ZaZa Energy, LLC, ZaZa Energy Corporation and Thor Merger Sub Corporation (incorporated by reference to Exhibit 2.1 to Toreador Resources Corporation's Current Report on Form 8-K filed August 10, 2011).
2.2	Amendment No. 1 to the Agreement and Plan of Merger and Contribution, dated November 10, 2011, by and among Toreador Resources Corporation, ZaZa Energy, LLC, ZaZa Energy Corporation and Thor Merger Sub Corporation (incorporated by reference to Exhibit 2.4 to ZaZa Energy Corporation's Form S-4/A (333-177264) filed November 21, 2011).
2.3	Amendment No. 2 to the Agreement and Plan of Merger and Contribution, dated February 21, 2012, by and among Toreador Resources Corporation, ZaZa Energy, LLC, ZaZa Energy Corporation and Thor Merger Sub Corporation (incorporated by reference to Exhibit 2.3 of ZaZa Energy Corporation's Current Report on Form 8-K filed February 22, 2012).
2.4	Contribution Agreement, dated August 9, 2011, by and among Blackstone Oil & Gas, LLC, Omega Energy Corp., Lara Energy, Inc. and ZaZa Energy Corporation (incorporated by reference to Exhibit 2.2 to Toreador Resources Corporation's Current Report on Form 8-K filed August 10, 2011).
2.5	Amendment No. 1 to the Contribution Agreement, dated November 10, 2011, by and among Blackstone Oil & Gas, LLC, Omega Energy Corp., Lara Energy, Inc. and ZaZa Energy Corporation, and consented to and agreed to by Toreador Resources Corporation (incorporated by reference to Exhibit 2.4 to ZaZa Energy Corporation's Form S-4/A (333-177264) filed November 21, 2011).
2.6	Net Profits Interests Contribution Agreement, dated August 9, 2011, by and among the holders of net profits interests of ZaZa Energy, LLC and ZaZa Energy Corporation (incorporated by reference to Exhibit 2.3 to Toreador Resources Corporation's Current Report on Form 8-K filed August 10, 2011).
3.1	Restated Certificate of Incorporation of ZaZa Energy Corporation (incorporated by reference to Exhibit 3.1 of ZaZa Energy Corporation's Current Report on Form 8-K filed February 22, 2012).
3.2	Amended and Restated Bylaws of ZaZa Energy Corporation (incorporated by reference to Exhibit 3.2 of ZaZa Energy Corporation's Current Report on Form 8-K filed February 22, 2012).
4.1	Securities Purchase Agreement, dated as of February 21, 2012, by and among ZaZa Energy Corporation and purchasers thereunder, including MSDC ZEC Investments, LLC and Senator Sidecar Master Fund LP (incorporated by reference to Exhibit 4.1 of ZaZa Energy Corporation's

Current Report on Form 8-K filed February 22, 2012).

- 4.2 Amendment and Waiver, dated June 8, 2012, to the Securities Purchase Agreement, dated February 21, 2012, among ZaZa Energy Corporation and the purchasers party thereto (incorporated by reference to Exhibit 10.3 of ZaZa Energy Corporation's Quarterly Report on Form 10-Q for the quarter ended June 30, 2012).
- 4.3 Waiver and Amendment No. 2, dated July 25, 2012, to the Securities Purchase Agreement, dated February 21, 2012, among ZaZa Energy Corporation and the purchasers party thereto (incorporated by reference to Exhibit 10.7 of ZaZa Energy Corporation's Quarterly Report on Form 10-Q for the quarter ended June 30, 2012).
- 4.4 Waiver and Amendment No. 3, dated October 16, 2012, to the Securities Purchase Agreement, dated February 21, 2012, among ZaZa Energy Corporation and the purchasers party thereto (incorporated by reference to Exhibit 4.4 of ZaZa Energy Corporation's Current Report on Form 8-K filed October 22, 2012).
- 4.5 Amendment No. 4, dated December 17, 2012, to the Securities Purchase Agreement, dated February 21, 2012, among ZaZa Energy Corporation and the purchasers party thereto (incorporated by reference to Exhibit 4.1 of ZaZa Energy Corporation's Current Report on Form 8-K filed December 21, 2012).
- 4.6 Form of Secured Notes issued pursuant to the Securities Purchase Agreement, dated as of February 21, 2012, by and among ZaZa Energy Corporation and purchasers thereunder, including MSDC ZEC Investments, LLC and Senator Sidecar Master Fund LP (incorporated by reference to Exhibit 4.2 of ZaZa Energy Corporation's Current Report on Form 8-K filed February 22, 2012).
- 4.7 Form of Warrant to Purchase Shares of Common Stock of ZaZa Energy Corporation, dated February 21, 2012 (incorporated by reference to Exhibit 4.3 of ZaZa Energy Corporation's Current Report on Form 8-K filed February 22, 2012).
- 4.8 Form of Amended Warrant issued in replacement of warrants originally issued February 21, 2012 to the purchasers under the Secured Purchase Agreement, dated February 21, 2012, as amended (incorporated by reference to Exhibit 4.5 of ZaZa Energy Corporation's Current Report on Form 8-K filed October 22, 2012).
- 4.9 Form of Registration Rights Letter, dated February 22, 2012, by and among ZaZa Energy Corporation and certain purchasers (incorporated by reference to Exhibit 4.5 of ZaZa Energy Corporation's Current Report on Form 8-K filed February 22, 2012).
- 4.10 Restricted Stock Agreement, dated September 17, 2012, between ZaZa Energy Corporation and Ian H. Fay (incorporated by reference to Exhibit 10.1 of ZaZa Energy Corporation Current Report on Form 8-K filed on September 21, 2012).
- 4.11 Form of Note Purchase Agreement, dated as of October 16, 2012, by and among ZaZa Energy Corporation and purchasers thereunder (incorporated by reference to Exhibit 4.1 of ZaZa Energy Corporation's Current Report on Form 8-K filed October 22, 2012).
- 4.12 Indenture, dated as of October 22, 2012, by and among ZaZa Energy Corporation, the Guarantors named therein, and Wilmington Trust, National Association, as trustee thereunder (incorporated by reference to Exhibit 4.2 of ZaZa Energy Corporation's Current Report on Form 8-K filed October 22, 2012).
- 4.13 Form of 9% Convertible Senior Notes due 2017 of ZaZa Energy Corporation (incorporated by reference to Exhibit 4.3 of ZaZa Energy Corporation's Current Report on Form 8-K filed October 22, 2012).
- 4.14 Form of Restricted Stock Award Agreement, by and between Blackstone Oil and Gas, LLC, Omega Energy, LLC, Lara Energy Inc., and certain employees of ZaZa Energy Corporation (incorporated by reference to Exhibit 4.1 of ZaZa Energy Corporation's Form S-8 (333-185586) filed December 20, 2012).
- 4.15 Form of Restricted Stock Award Agreement, by and between Blackstone Oil and Gas, LLC, Omega Energy, LLC, Lara Energy Inc., and certain consultants of ZaZa Energy Corporation (incorporated by reference to Exhibit 4.2 of ZaZa Energy Corporation's Form S-8 (333-185586) filed December 20, 2012).
- 4.16 Form of Stock Award Agreement, by and between Blackstone Oil and Gas, LLC, Omega Energy, LLC, Lara Energy Inc., and certain employees of ZaZa Energy Corporation (incorporated by reference to Exhibit 4.3 of ZaZa Energy Corporation's Form S-8 (333-185586) filed December 20, 2012).
- 4.17 Form of Amendment to Stock Award Agreement, by and between Blackstone Oil and Gas, LLC, Omega Energy, LLC, Lara Energy Inc., and certain employees of ZaZa Energy Corporation (incorporated by reference to Exhibit 4.4 of ZaZa Energy Corporation's Form S-8 (333-185586) filed December 20, 2012).

- 4.18 Restricted Stock Award, dated July 30, 2012, by and among Blackstone Oil & Gas, LLC, Omega Energy LLC, Lara Energy, Inc., and Craig McKenzie (incorporated by reference to Exhibit 4.5 of ZaZa Energy Corporation's Form S-8 (333-185586) filed December 20, 2012).
- 4.19 Form of Director Restricted Stock Award Agreement, by and between ZaZa Energy Corporation and certain directors of ZaZa Energy Corporation (incorporated by reference to Exhibit 4.6 of ZaZa Energy Corporation's Form S-8 (333-185586) filed December 20, 2012).
- 4.20 Form of Stock Award Agreement, by and between ZaZa Energy Corporation and certain consultants that are former directors of ZaZa Energy Corporation (incorporated by reference to Exhibit 4.7 of ZaZa Energy Corporation's Form S-8 (333-185586) filed December 20, 2012).
- 4.21 Form of Stock Award Agreement, by and between ZaZa Energy Corporation and certain employees of ZaZa Energy Corporation (incorporated by reference to Exhibit 4.9 of ZaZa Energy Corporation's Form S-8 (333-185586) filed December 20, 2012).
- 4.22 Form of Stock Award Agreement, by and between ZaZa Energy Corporation and certain consultants of ZaZa Energy Corporation (incorporated by reference to Exhibit 4.10 of ZaZa Energy Corporation's Form S-8 (333-185586) filed December 20, 2012).
- 10.1 Exploration and Development Agreement, Hackberry Creek Project Area, dated March 26, 2010, by and between Hess Corporation and ZaZa Energy, LLC (incorporated by reference to Exhibit 10.15 of ZaZa Energy Corporation's Form S-4 (333-177264) filed on October 12, 2011).
- 10.2 Exploration and Development Agreement, Eagle Ford Shale Area, dated April 28, 2010, by and between Hess Corporation and ZaZa Energy, LLC (incorporated by reference to Exhibit 10.14 of ZaZa Energy Corporation's Form S-4 (333-177264) filed on October 12, 2011).
- 10.3 Amendment, dated June 8, 2012, to Exploration and Development Agreement, Eagleford Shale Area dated April 28, 2010, as amended, between ZaZa Energy Corporation and Hess Corporation (incorporated by reference to Exhibit 10.2 of ZaZa Energy Corporation's Quarterly Report on Form 10-Q for the quarter ended June 30, 2012).
- 10.4 Investment Agreement, dated May 20, 2010, between Toreador Energy France S.C.S. and Hess Oil France S.A.S. (incorporated by reference to Exhibit 10.1 to Toreador Resources Corporation's Current Report on Form 8-K filed on May 10, 2010).
- 10.5 Amendment to the Investment Agreement, dated May 18, 2011, between Toreador Energy France S.C.S. and Hess Oil France S.A.S. (incorporated by reference to Exhibit 10.1 to Toreador Resources Corporation's Current Report on Form 8-K filed on May 23, 2011).
- 10.6 Letter Agreement, dated August 9, 2011, by and among Todd Alan Brooks, ZaZa Energy, LLC and ZaZa Energy Corporation (incorporated by reference to Exhibit 10.7 of ZaZa Energy Corporation's Form S-4 (333-177264) filed October 12, 2011).
- 10.7 Amendment No. 1 to Letter Agreement, dated November 10, 2011, by and among Todd Alan Brooks, ZaZa Energy, LLC and ZaZa Energy Corporation (incorporated by reference to Exhibit 10.17 of ZaZa Energy Corporation's Form S-4 (333-177264) filed on October 12, 2011).
- 10.8 Letter Agreement, dated August 9, 2011, by and among John E. Hearn, Jr., ZaZa Energy, LLC and ZaZa Energy Corporation (incorporated by reference to Exhibit 10.8 of ZaZa Energy Corporation's Form S-4 (333-177264) filed October 12, 2011).
- 10.9 Amendment No. 1 to Letter Agreement, dated November 10, 2011, by and among John E. Hearn, Jr., ZaZa Energy, LLC and ZaZa Energy Corporation (incorporated by reference to Exhibit 10.18 of ZaZa Energy Corporation's Form S-4 (333-177264) filed on October 12, 2011).
- 10.10 Letter Agreement, dated August 9, 2011, by and among Gaston L. Kearby, ZaZa Energy, LLC and ZaZa Energy Corporation (incorporated by reference to Exhibit 10.9 of ZaZa Energy Corporation's Form S-4 (333-177264) filed October 12, 2011).
- 10.11 Amendment No. 1 to Letter Agreement, dated November 10, 2011, by and among Gaston L. Kearby, ZaZa Energy, LLC and ZaZa Energy Corporation (incorporated by reference to Exhibit 10.19 of ZaZa Energy Corporation's Form S-4 (333-177264) filed on October 12, 2011).
- 10.12 Stockholders' Agreement, dated August 9, 2011, by and among ZaZa Energy Corporation, Blackstone Oil & Gas, LLC, Omega Energy Corp. and Lara Energy, Inc. (incorporated by reference to Exhibit 2.4 to Toreador Resources Corporation's Current Report on Form 8-K filed

August 10, 2011).

- 10.13 Non-Competition Agreement, dated August 9, 2011, between ZaZa Energy Corporation and Todd Alan Brooks (incorporated by reference to Exhibit 10.2 of ZaZa Energy Corporation's Form S-4 (333-177264) filed October 12, 2011).
- 10.14 Non-Competition Agreement, dated August 9, 2011, between ZaZa Energy Corporation and John E. Hearn, Jr. (incorporated by reference to Exhibit 10.3 of ZaZa Energy Corporation's Form S-4 (333-177264) filed October 12, 2011).
- 10.15 Non-Competition Agreement, dated August 9, 2011, between ZaZa Energy Corporation and Gaston L. Kearby (incorporated by reference to Exhibit 10.4 of ZaZa Energy Corporation's Form S-4 (333-177264) filed October 12, 2011).
- 10.16 Revolving Credit Agreement and Revolving Credit Promissory Note, dated September 23, 2011 by and between Texas Champion Bank and ZaZa Energy, LLC (incorporated by reference to Exhibit 10.16 of ZaZa Energy Corporation's Form S-4 (333-177264) filed October 12, 2011).
- 10.17 Amended and Restated Management Agreement, dated November 18, 2011, by and between Sequent Petroleum Management, LLC and ZaZa Energy, LLC (incorporated by reference to Exhibit 10.20 of ZaZa Energy Corporation's Form S-4 (333-177264) filed on October 12, 2011).
- 10.18 Form of Indemnity Agreement between ZaZa Energy Corporation and each executive officer and director (incorporated by reference to Exhibit 10.22 of ZaZa Energy Corporation's Annual Report on Form 10-K for the year ended December 31, 2011).
- 10.19 Form of Subordinated Promissory Note, dated February 21, 2012, issued to Blackstone Oil & Gas, LLC, Omega Energy Corp., Lara Energy, Inc., Todd Alan Brooks, John E. Hearn, Jr., and Gaston L. Kearby (incorporated by reference to Exhibit 4.4 of ZaZa Energy Corporation's Current Report on Form 8-K filed February 22, 2012).
- 10.20 Guaranty Agreement, dated as of February 21, 2012, among ZaZa Holdings Inc., ZaZa Energy, LLC and Toreador Resources Corporation in favor of MSDC ZEC Investments, LLC, Senator Sidecar Master Fund LP, the other purchasers of the secured notes and U.S. Bank National Association, as collateral agent (incorporated by reference to Exhibit 10.1 of ZaZa Energy Corporation's Current Report on Form 8-K filed on February 22, 2012).
- 10.21 Lock-Up Agreement, dated as of February 21, 2012, by and between the Restricted Stockholders (as defined therein) and ZaZa Energy Corporation (incorporated by reference to Exhibit 10.4 of ZaZa Energy Corporation's Current Report on Form 8-K filed on February 22, 2012).
- 10.22 Collateral Agency Agreement, dated as of February 21, 2012, among U.S. Bank National Association, as collateral agent, and MSDC ZEC Investments, LLC, Senator Sidecar Master Fund LP and the other purchasers of secured notes (incorporated by reference to Exhibit 10.19 of ZaZa Energy Corporation's Annual Report on Form 10-K for the year ended December 31, 2011).
- 10.23 Subordination Agreement, dated as of February 21, 2012, by and among Blackstone Oil & Gas, LLC, Omega Energy Corp., Lara Energy, Inc., Todd Alan Brooks, John E. Hearn, Jr., and Gaston L. Kearby, U.S. Bank National Association, as collateral agent, the Purchasers of the Notes and ZaZa Energy Corporation (incorporated by reference to Exhibit 10.3 of ZaZa Energy Corporation's Current Report on Form 8-K filed on February 22, 2012).
- 10.24 Amended and Restated Subordination Agreement, dated June 8, 2012, among ZaZa Energy Corporation, the purchasers party to the Securities Purchase Agreement dated February 21, 2012, Todd A. Brooks, John E. Hearn, Jr., Gaston L. Kearby, Omega Energy, LLC, Blackstone Oil & Gas, LLC, and Lara Energy, Inc. (incorporated by reference to Exhibit 10.4 of ZaZa Energy Corporation's Quarterly Report on Form 10-Q for the quarter ended June 30, 2012).
- 10.25 Security Agreement, dated as of March 22, 2012, by and among ZaZa Energy Corporation, ZaZa Energy, LLC, ZaZa Holdings, Inc., Toreador Resources Corporation and U.S. Bank National Association (incorporated by reference to Exhibit 10.2 of ZaZa Energy Corporation's Quarterly Report on Form 10-Q for the quarter ended March 31, 2012).
- 10.26 Pledge Agreement, dated as of March 22, 2012, by and among ZaZa Energy Corporation, ZaZa Holdings, Inc. and U.S. Bank National Association (incorporated by reference to Exhibit 10.3 of ZaZa Energy Corporation's Quarterly Report on Form 10-Q for the quarter ended March 31, 2012).
- 10.27 Participation Agreement, dated March 28, 2012, by and between ZaZa Energy Corporation and Range Texas

Production, LLC, a subsidiary of Range Resources Corporation (incorporated by reference to Exhibit 10.1 of ZaZa Energy Corporation's Quarterly Report on Form 10-Q for the quarter ended March 31, 2012)

- 10.28 Form of Deed of Trust, dated April 10, 2012, between ZaZa Energy, LLC and U.S. Bank National Association (incorporated by reference to Exhibit 10.1 of ZaZa Energy Corporation's Quarterly Report on Form 10-Q for the quarter ended June 30, 2012).
- 10.29 Texas Division of Assets Agreement, dated July 25, 2012, among ZaZa Energy Corporation, ZaZa Energy, LLC, and Hess Corporation (incorporated by reference to Exhibit 10.5 of ZaZa Energy Corporation's Quarterly Report on Form 10-Q for the quarter ended June 30, 2012).
- 10.30 Paris Basin Purchase and Sale Agreement, dated July 25, 2012, among ZaZa Energy France S.A.S. (f/k/a Toreador Energy France S.A.S.) and Hess Oil France S.A.S. (incorporated by reference to Exhibit 10.6 of ZaZa Energy Corporation's Quarterly Report on Form 10-Q for the quarter ended June 30, 2012).
- 10.31 Separation Agreement and General Release, dated July 30, 2012, between ZaZa Energy Corporation and Craig M. McKenzie (incorporated by reference to Exhibit 10.8 of ZaZa Energy Corporation's Quarterly Report on Form 10-Q for the quarter ended June 30, 2012).
- 10.32 Form of Reimbursement Agreement, dated September 11, 2012, between ZaZa Energy Corporation and each of Blackstone Oil & Gas, LLC, Omega Energy Corp., and Lara Energy, Inc (incorporated by reference to Exhibit 10.9 of ZaZa Energy Corporation's Quarterly Report on Form 10-Q for the quarter ended June 30, 2012).
- 10.33 Side Letter dated September 11, 2012 regarding the Subordinated Notes with holders thereof (incorporated by reference to Exhibit 10.10 of ZaZa Energy Corporation's Quarterly Report on Form 10-Q for the quarter ended June 30, 2012).
- 10.34 Form of Employment Agreement dated September 11, 2012 between ZaZa Energy Corporation and Todd A. Brooks (incorporated by reference to Exhibit 10.12 of ZaZa Energy Corporation's Quarterly Report on Form 10-Q for the quarter ended June 30, 2012).
- 10.35 Form of Employment Agreement dated September 11, 2012 between ZaZa Energy Corporation and Ian H. Fay (incorporated by reference to Exhibit 10.13 of ZaZa Energy Corporation's Quarterly Report on Form 10-Q for the quarter ended June 30, 2012).
- 10.36 Form of Employment Agreement dated September 11, 2012 between ZaZa Energy Corporation and John E. Hearn, Jr. (incorporated by reference to Exhibit 10.14 of ZaZa Energy Corporation's Quarterly Report on Form 10-Q for the quarter ended June 30, 2012).
- 10.37 Form of Employment Agreement dated October 3, 2012 between ZaZa Energy Corporation and S. Scott Gaille (incorporated by reference to Exhibit 10.1 of ZaZa Energy Corporation Current Report on Form 8-K filed on October 5, 2012).
- 10.38 Share Purchase Agreement, dated November 13, 2012, by and between ZaZa France SAS and Vermillion REP SAS (incorporated by reference to Exhibit 10.1 of ZaZa Energy Corporation Current Report on Form 8-K filed on November 19, 2012).
- 10.39 Consulting Agreement between ZaZa Energy Corporation and Adam Kroloff, dated December 7, 2012 (incorporated by reference to Exhibit 10.1 of ZaZa Energy Corporation Current Report on Form 8-K filed on December 7, 2012).
- 10.40 Consulting Agreement between ZaZa Energy Corporation and Bernard de Combret, dated December 7, 2012 (incorporated by reference to Exhibit 10.2 of ZaZa Energy Corporation Current Report on Form 8-K filed on December 7, 2012).
- 10.41 ZaZa Energy Corporation Long-Term Incentive Plan (incorporated by reference to Exhibit 99.1 of ZaZa Energy Corporation's Form S-8 (333-185586) filed December 20, 2012).
- 16.1 Letter from KPMG LLP, to the Securities and Exchange Commission, dated October 12, 2011 (incorporated by reference to Exhibit 16.1 of ZaZa Energy Corporation's registration statement on Form S-4 (Registration No. 333-177264) filed October 12, 2011).
- 21.1 \*Subsidiaries of ZaZa Energy Corporation.
- 23.1 \*Consent of Ernst & Young, LLP.
- 23.2 \*Consent of Ryder Scott.

23.3 \*Consent of Rex Morris.

24.1 Power of Attorney (included as part of the signature page).

31.1 \*Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

31.2 \*Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

32.1 +Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

99.1 \*Report of Ryder Scott, dated March 1, 2013.

101.INS\*XBRL Instance Document

101.SCH\*XBRL Schema Document

101.CAL\*XBRL Calculation Linkbase Document

101.LAB\*XBRL Label Linkbase Document

101.PRE\*XBRL Presentation Linkbase Document

101.DEF\*XBRL Definition Linkbase Document













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*	Filed herewith
+	Furnished herewith

## SIGNATURES

Pursuant to the requirements of 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.

### ZAZA ENERGY CORPORATION

April 1, 2013

By: /s/ Todd A. Brooks  
**Todd A. Brooks**  
**President and Chief Executive Officer**

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on April 1, 2013.

<u>Signature</u>	<u>Title</u>
<u>/s/ Todd A. Brooks</u> <b>Todd A. Brooks</b>	Director, President and Chief Executive (principal executive officer)
<u>/s/ Travis H. Burris</u> <b>Travis H. Burris</b>	Director
<u>/s/ A. Haag Sherman</u> <b>A. Haag Sherman</b>	Director
<u>/s/ Gaston L. Kearby</u> <b>Gaston L. Kearby</b>	Director
<u>/s/ John E. Hearn, Jr.</u> <b>John E. Hearn, Jr.</b>	Director
<u>/s/ Herbert C. Williamson III</u> <b>Herbert C. Williamson III</b>	Director
<u>/s/ Ian H. Fay</u> <b>Ian H. Fay</b>	Chief Financial Officer (principal financial officer)
<u>/s/ Jennifer A. Frisch</u> <b>Jennifer A. Frisch</b>	Chief Accounting Officer (principal accounting officer)

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Financial Statements**

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## Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders of

ZaZa Energy Corporation

We have audited the accompanying consolidated balance sheets of ZaZa Energy Corporation (the Company) as of December 31, 2012 and 2011, and the related consolidated statements of operations and comprehensive income, changes in stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2012. 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. We were not engaged to perform an audit of the Company's 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, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of ZaZa Energy Corporation at December 31, 2012 and 2011, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2012, in conformity with U.S. generally accepted accounting principles.

The accompanying consolidated financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 3 to the financial statements, the Company has not achieved sustainable operating cash flows and the current business activities are focused primarily on the exploration of oil and gas resources. The Company is dependent on the sale of non-core assets and the proceeds and future results of a joint venture arrangement entered into subsequent to December 31, 2012, to maintain a positive liquidity position. The uncertainties surrounding the amount of proceeds and future operating cash flows that can be generated from these transactions and the current lack of readily available liquidity sufficient to meet the continuing operations, capital commitments and debt service obligations raise substantial doubt about the Company's ability to continue as a going concern. Management's plans in regard to these matters are also described in Note 3. The consolidated financial statements do not include any adjustments that might result from the outcome of these uncertainties.

/s/ Ernst & Young LLP

Houston, Texas  
April 1, 2013

**ZAZA ENERGY CORPORATION**  
**CONSOLIDATED BALANCE SHEETS**

	December 31, 2012	December 31, 2011
	(In thousands, except share and per share data)	
<b>ASSETS</b>		
Current assets		
Cash and cash equivalents	\$ 34,649	\$ 10,619
Restricted cash	21,875	111
Accounts receivable - joint interest	51	37,303
Accounts receivable - revenue receivable	1,303	533
Accounts receivable - related party	-	164
Prepayments and other current assets	1,134	2,150
Total current assets	<u>59,012</u>	<u>50,880</u>
Property and equipment		
Oil and gas properties, successful efforts method	151,828	17,410
Furniture and fixtures	2,947	2,806
Total property and equipment	<u>154,775</u>	<u>20,216</u>
Accumulated depletion, depreciation and amortization	<u>(4,705)</u>	<u>(1,260)</u>
Property and equipment, net	<u>150,070</u>	<u>18,956</u>
Assets held for sale	9,965	-
Other assets	4,066	170
<b>Total assets</b>	<b>\$ 223,113</b>	<b>\$ 70,006</b>

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**ZAZA ENERGY CORPORATION**  
**CONSOLIDATED BALANCE SHEETS**

	December 31, 2012	December 31, 2011
	(In thousands, except share and per share data)	
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable - trade	\$ 8,431	\$ 38,209
Accounts payable - related parties	-	419
Advances from joint interest owner	-	112
Deferred income taxes	14,568	-
Accrued liabilities	12,200	19,895
Revolving line of credit	-	5,000
Notes payable to members	-	3,000
Convertible Senior Notes, net of discount	25,298	-
Embedded conversion options associated with Convertible Senior Notes	21,382	-
Income taxes payable	3,658	123
Total current liabilities	85,537	66,758
Long-term accrued liabilities	53	-
Asset retirement obligations	130	309
Deferred income taxes	32,597	-
Long-term payable - related parties	4,128	-
Subordinated notes	47,330	-
Senior Secured Notes, net of discount	23,647	-
Warrants associated with Senior Secured Notes	28,043	-
Total liabilities	221,465	67,067
Stockholders' equity (deficit):		
Preferred stock, \$0.01 par value, 25,000,000 shares authorized; zero issued or outstanding	-	-
Common stock, \$0.01 par value, 250,000,000 shares authorized; 102,519,001 and 75,976,500 shares issued and outstanding at December 31, 2012 and 2011, respectively	1,025	760
Additional paid-in capital	104,639	-
Accumulated retained earnings (deficit)	(104,048)	2,179
Accumulated other comprehensive income	32	-
Total stockholders' equity (deficit)	1,648	2,939
<b>Total liabilities and stockholders' equity (deficit)</b>	<b>\$ 223,113</b>	<b>\$ 70,006</b>

The accompanying notes are an integral part of these financial statements.

**ZAZA ENERGY CORPORATION**

**CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME**

	Year Ended December 31,		
	2012	2011	2010
	(In thousands, except per share data)		
Revenues and other income:			
Oil and gas revenues	\$ 9,583	\$ 2,547	\$ 358
Bonus income	-	15,027	9,777
Other income	195,569	-	360
<b>Total revenues and other income</b>	<u>205,152</u>	<u>17,574</u>	<u>10,495</u>
Operating costs and expenses:			
Lease operating expense	3,602	1,038	22
Exploration expense	12,913	-	-
Depreciation, depletion and amortization	6,641	919	341
Accretion expense	21	2	-
Impairment of oil and gas properties	9,764	-	-
General and administrative	97,941	18,083	3,614
Total operating costs and expenses	<u>130,882</u>	<u>20,042</u>	<u>3,977</u>
<b>Operating income (loss)</b>	74,270	(2,468)	6,518
Other expense			
Foreign currency exchange (gain) loss	65	-	-
Loss on extinguishment of debt	28,026	-	-
Interest expense, net	14,705	264	2
(Gain) loss on fair value of warrants	(5,589)	-	-
(Gain) loss on fair value of embedded conversion options	8,199	-	-
Total other expense	<u>45,406</u>	<u>264</u>	<u>2</u>
Income (loss) from continuing operations before income taxes	28,864	(2,732)	6,516
Income tax expense (benefit)	82,920	123	74
Income (loss) from continuing operations	(54,056)	(2,855)	6,442
(Loss) from discontinued operations, net of income taxes	(52,171)	-	-
<b>Net income (loss)</b>	<u>\$ (106,227)</u>	<u>\$ (2,855)</u>	<u>\$ 6,442</u>

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# ZAZA ENERGY CORPORATION

## CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME

	Year Ended December 31,		
	2012	2011	2010
	(In thousands, except per share data)		
Basic income (loss) per share:			
Continuing operations	\$ (0.55)	\$ (0.04)	\$ 0.08
Discontinued operations	(0.53)	-	-
	<u>\$ (1.08)</u>	<u>\$ (0.04)</u>	<u>\$ 0.08</u>
Diluted income (loss) per share:			
Continuing operations	\$ (0.58)	\$ (0.04)	\$ 0.08
Discontinued operations	(0.53)	-	-
	<u>\$ (1.11)</u>	<u>\$ (0.04)</u>	<u>\$ 0.08</u>
Weighted average shares outstanding:			
Basic	98,029	75,977 (a)	75,977 (a)
Diluted	99,684	75,977 (a)	75,977 (a)
Consolidated Statement of Comprehensive Income			
Net income (loss)	\$ (106,227)	\$ (2,855)	\$ 6,442
Foreign currency translation adjustments, net of taxes	32	-	-
Comprehensive income (loss)	<u>\$ (106,195)</u>	<u>\$ (2,855)</u>	<u>\$ 6,442</u>

(a) Adjusted to reflect the February 21, 2012 Merger with Toreador Resources Corporation, giving retroactive effect for the issuance of shares to former ZaZa LLC members. See Note 1 to the consolidated financial statements.

The accompanying notes are an integral part of these financial statements.

**ZAZA ENERGY CORPORATION**

**CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY**

	Members'	Common	Common	Additional	Accumulated	Accumulated	Total
	Equity	Stock	Stock (\$)	Paid-in	Retained	Other	Stockholders'
		(Shares)		Capital	Earnings	Comprehensive	Equity
					(Deficit)	Income (Loss)	
	(In thousands)						
<b>Balance at December 31, 2009</b>	\$ 102	-	\$ -	\$ -	\$ -	\$ -	102
Member contributions	750	-	-	-	-	-	750
Net income (loss)	6,442	-	-	-	-	-	6,442
<b>Balance at December 31, 2010</b>	7,294	-	-	-	-	-	7,294
Member distributions	(1,500)	-	-	-	-	-	(1,500)
Net income (loss)	(2,855)	-	-	-	-	-	(2,855)
<b>Balance at December 31, 2011</b>	2,939	-	-	-	-	-	2,939
Exchange of ZaZa membership interests	(2,939)	75,977	760	-	2,179	-	-
Issuance of ZaZa Energy Corp shares		26,541	265	88,109	-	-	88,374
Net income (loss)	-	-	-	-	(106,227)	-	(106,227)
Stock-based compensation cost	-	-	-	16,530	-	-	16,530
Foreign currency translation adjustment	-	-	-	-	-	32	32
<b>Balance at December 31, 2012</b>	<b>\$ -</b>	<b>102,518</b>	<b>\$ 1,025</b>	<b>\$ 104,639</b>	<b>\$ (104,048)</b>	<b>\$ 32</b>	<b>\$ 1,648</b>

The accompanying notes are an integral part of these financial statements.

**ZAZA ENERGY CORPORATION**

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

	Year Ended December 31,		
	2012	2011	2010
	(In thousands)		
<b>Cash flows from operating activities:</b>			
Net income (loss)	\$ (106,227)	\$ (2,855)	\$ 6,442
<b>Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:</b>			
Depreciation, depletion and amortization	6,641	919	341
Loss on French divestiture	787	-	-
Loss on disposal of furniture and fixtures	27	-	-
Loss on impairment of oil and gas properties	9,764	-	-
Exploration expense	12,913	-	-
Accretion expense	21	2	-
Deferred income taxes	47,165	-	-
Amortization of deferred debt issuance costs and discount	5,003	-	-
Loss on extinguishment of debt	22,836	-	-
Unrealized loss (gain) on value of warrants	(5,589)	-	-
Unrealized loss (gain) on value of embedded conversion options	8,199	-	-
Stock-based compensation expense	16,530	-	-
(Gain) on the Hess transaction	(195,527)	-	-
<b>Changes in operating assets and liabilities:</b>			
Restricted cash	111	4,876	(4,987)
Accounts receivable - joint interest	17,540	(34,606)	(2,697)
Accounts receivable - related party	164	(126)	77
Accounts receivable - revenue receivable	(1,250)	(430)	(104)
Prepayments and other current assets	1,281	(1,960)	(189)
Other assets	(90)	(170)	-
Accounts payable - trade	(31,406)	35,760	2,449
Accounts payable - related parties	(419)	(2,795)	3,214
Advances from joint interest owner	20,060	(14,760)	14,872
Income taxes payable	3,534	50	74
Accrued liabilities	(13,647)	19,070	824
Long-term payable - related parties	4,128	-	-
Cash provided by (used in) operating activities - continuing operations	(177,451)	2,975	20,316
Cash provided by operating activities - discontinued operations	53,636	-	-
Net cash provided by (used in) operating activities	(123,815)	2,975	20,316

Continued on next page

**ZAZA ENERGY CORPORATION**

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

	Year Ended December 31,		
	2012	2011	2010
	(In thousands)		
<b>Cash flows from investing activities:</b>			
Cash acquired in connection with the merger	4,118	-	-
Proceeds from the Hess transaction	83,892	-	-
Proceeds from French divestiture, net of cash transferred	64,745	-	-
Funds held for restricted use	(21,875)	-	-
Additions to oil and gas properties	(53,789)	(10,667)	(6,436)
Additions to furniture and fixtures	(291)	(1,975)	(831)
Cash provided by (used in) investing activities - continuing operations	76,800	(12,642)	(7,267)
Cash provided by investing activities - discontinued operations	45,792	-	-
Net cash provided by (used in) investing activities	122,592	(12,642)	(7,267)
<b>Cash flows from financing activities:</b>			
Issuance of convertible senior notes, net of cash discount	38,000	-	-
Issuance of senior secured notes	100,000	-	-
Payment of senior secured notes	(66,800)	-	-
Payment of debt issuance costs	(7,030)	-	-
Payment of notes payable - members	(3,000)	-	-
Member contributions	-	-	750
Member withdrawals	-	(1,500)	-
Proceeds from revolving line of credit	-	5,000	2,985
Payment of revolving line of credit	(5,000)	-	-
Payment of Toreador notes	(31,754)	-	-
Cash provided by financing activities - continuing operations	24,416	3,500	3,735
Effects of foreign currency translation on cash and cash equivalents	837	-	-
Net increase (decrease) in cash and cash equivalents	24,030	(6,167)	16,784
Cash and cash equivalents, beginning of period	10,619	16,786	2
<b>Cash and cash equivalents, end of period</b>	<b>\$ 34,649</b>	<b>\$ 10,619</b>	<b>\$ 16,786</b>
<b>Supplemental disclosures:</b>			
Cash paid during the period for interest	\$ 9,118	\$ 45	\$ -
Cash paid during the period for income taxes	\$ 112	\$ 74	\$ -

The accompanying notes are an integral part of these financial statements

## ZAZA ENERGY CORPORATION

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

#### NOTE 1 - BASIS OF PRESENTATION

ZaZa Energy Corporation (“ZEC”, or “ZaZa” or the “Company”) was formed on August 4, 2011 for the purpose of being a holding company of both ZaZa Energy, LLC (“ZaZa LLC”) and Toreador Resources Corporation (“Toreador”) upon completion of an Agreement and Plan of Merger and Contribution, dated August 9, 2011, as amended (the “Combination”). On February 21, 2012, upon the consummation of the transaction under the Agreement and Plan of Merger and Contribution, ZaZa became the parent company of ZaZa LLC and Toreador. In this annual report on Form 10-K, unless the context provides otherwise, “we”, “our”, “us” and like references refer to ZaZa, its two subsidiaries (ZaZa LLC and Toreador) and each of their respective subsidiaries.

The Combination has been treated as a reverse merger under the purchase method of accounting in accordance with accounting principles generally accepted in the United States (“GAAP”). For accounting purposes, ZaZa LLC is considered to have acquired Toreador in the Combination. Under the purchase method of accounting, the assets and liabilities of Toreador have been recorded at their respective fair values and added to those of ZaZa LLC in our financial statements.

The accompanying consolidated Balance Sheets as of December 31, 2012 and 2011 include the accounts of ZaZa Energy Corporation and all subsidiaries, including ZaZa LLC and Toreador. The Statements of Operations and Comprehensive Income and Stockholders’ and Members’ Equity and Cash Flows for each of the three years in the period ended December 31, 2012 and Notes to the Financial Statements include the results of our accounting predecessor, ZaZa LLC, through February 20, 2012 and all of our subsidiaries, including ZaZa LLC and Toreador, since February 21, 2012. All figures presented are in thousands except per share data unless otherwise indicated.

The accompanying consolidated financial statements were prepared following a reverse merger and are issued under the name of the legal parent (ZaZa Energy Corporation) (the accounting acquiree) but are a continuation of the financial statements of the legal subsidiary (ZaZa Energy LLC) (accounting acquirer), with one adjustment, which is to retroactively adjust the accounting acquirer’s legal capital to reflect the legal capital of the legal parent (the accounting acquiree). Comparative information presented in those consolidated financial statements also is retroactively adjusted to reflect the legal capital of the legal parent (accounting acquiree). Accordingly, the equity structure of the legal subsidiary (the accounting acquirer) is retroactively adjusted using the exchange ratio established in the Agreement and Plan of Merger and Contribution, dated August 9, 2011, as amended, to reflect the number of shares of the legal parent (the accounting acquiree) issued in the reverse merger.

The accompanying consolidated financial statements are prepared in accordance with GAAP and reflect all adjustments, consisting of only normal recurring adjustments, that are, in the opinion of management, necessary for a fair statement of the results for the period. All material intercompany accounts and transactions have been eliminated in consolidation.

The preparation of these consolidated financial statements, in conformity with accounting principles generally accepted in the United States, requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the financial statements and the reported amounts of revenues and expenses during the reported period. Actual results could be materially different from these estimates.

#### **Combination of ZaZa LLC and Toreador Resources Corporation**

On February 21, 2012, we consummated the combination of ZaZa LLC and Toreador Resources Corporation, on the terms set forth in the Agreement and Plan of Merger and Contribution, dated August 9, 2011, and as subsequently amended by Amendment No. 1 thereto on November 10, 2011 and Amendment No. 2 thereto on February 21, 2012 (as amended, the “Merger Agreement”), by and among us, ZaZa LLC, Toreador, and Thor Merger Sub Corporation, our wholly-owned subsidiary (“Merger Sub”).

Pursuant to the Merger Agreement, (i) Merger Sub merged with and into Toreador (the “Merger”), with Toreador continuing as a surviving entity, (ii) the 3 former members of ZaZa LLC (the “ZaZa LLC Members”), holding 100% of the limited liability company interests in ZaZa LLC, directly and indirectly contributed all of such interests to us (the “Contribution”), and (iii) the holders of certain profits interests in ZaZa LLC contributed 100% of

such interests to us (the “Profits Interests Contribution”). Upon the consummation of the Combination, Toreador and ZaZa LLC became our wholly-owned subsidiaries.

At the effective time of the Merger, each share of common stock, par value \$ 0.15625 per share, of Toreador issued and outstanding immediately prior to the effective time of the Merger was converted into the right to receive one share of ZaZa common stock, par value \$0.01 per share (the “Common Stock”), which in the aggregate represented 25% of the issued and outstanding shares of Common Stock immediately after the consummation of the Combination (but without giving effect to the shares of Common Stock issuable upon exercise of the Warrants as discussed below).

Immediately after the consummation of the Merger and Contribution, and pursuant to the Net Profits Interest Contribution Agreement, dated August 9, 2011, among ZaZa, ZaZa LLC and the holders of net profits interests in ZaZa LLC, the holders of certain profits interests in ZaZa LLC completed the Profits Interests Contribution in exchange for \$ 4.8 million in cash.

The fair value of the merger consideration was determined as follows (in thousands, except per share amounts):

Shares of Toreador outstanding as of February 21, 2012	26,047
Toreador share price as of February 21, 2012	\$ 5.18
Total estimated purchase price	<u>\$ 134,922</u>

The fair value of the merger consideration received by the Toreador stockholders was approximately \$134.9 million in the aggregate. This amount has been allocated to Toreador’s tangible and intangible assets and liabilities based on an estimate of the fair value of Toreador’s assets and liabilities. The following is a summary of the value of the merger consideration and the fair value of the underlying assets and liabilities of Toreador (in thousands):

Consideration exchanged (value of stock)	\$ 134,922
Assets acquired:	
Cash	4,118
Accounts receivable	3,000
Other current assets	3,380
Oil and gas properties	139,350
Furniture and fixtures	950
Other assets	<u>533</u>
Total assets acquired:	151,331
Liabilities assumed:	
Accounts payable	10,206
Deferred lease payable	267
Income taxes payable	925
Long term liabilities	241
Asset retirement obligations	4,513
Long-term debt	31,754
Deferred tax liability	<u>9,168</u>
Total liabilities assumed:	57,074
Net assets acquired	<u>\$ 94,257</u>
Excess purchase price (i.e. goodwill)	<u>\$ 40,665</u>



### *Pro Forma Results*

The following table provides pro forma results of operations as if the merger between ZaZa and Toreador had been completed at the beginning of each period presented (in thousands, except per share data):

	Year Ended December 31,	
	2012	2011
Total revenues	\$ 236,375	\$ 50,530
Net income (loss)	\$ (107,074)	\$ (16,428)
Basic earnings (loss) per share	\$ (1.09)	\$ (0.16)
Diluted earnings (loss) per share	\$ (1.11)	\$ (0.16)

The equity structure of the legal subsidiary (the accounting acquirer) has been retroactively adjusted using the exchange ratio established in the Agreement and Plan of Merger and Contribution, dated August 9, 2011, as amended, to reflect the number of shares of the legal parent (the accounting acquiree) issued in the reverse merger. For the purpose of 2011 and 2010 earnings per share calculation ("EPS"), the number of weighted average shares outstanding represents assumed shares outstanding as of December 31, 2011 and 2010, as there were no changes in the capital structure of ZaZa LLC during the years ended December 31, 2011 and 2010. The shares outstanding were calculated based on the Toreador shares outstanding and the exchange ratio.

### **Sale of ZaZa Energy France SAS**

On November 13, 2012, the Company, through its wholly-owned subsidiary ZaZa France SAS ("Seller"), and Vermillion REP SAS ("Buyer"), a wholly owned subsidiary of Vermillion Energy Inc., entered into a Share Purchase Agreement (the "Purchase Agreement") pursuant to which Seller sold to Buyer all of its shares in Seller's wholly-owned subsidiary, ZaZa Energy France SAS ("ZEF"), formerly Toreador Energy France SAS. On December 21, 2012, the Company completed the sale of 100% of the shares in ZaZa Energy France SAS to Vermillion REP SAS.

Upon the closing, the net purchase price paid to Seller was approximately \$ 76.0 million in cash following the application of certain closing adjustments required by the Purchase Agreement. Following reductions for advisor fees, estimated liquidation costs and taxes, the net proceeds to Company were approximately \$ 68.0 million. The Company used approximately half of the net proceeds to pay down part of its remaining Senior Secured Notes. Additionally, as part of the Paris Basin Agreement signed with Hess Corporation ("Hess") in July 2012, \$ 15.0 million of the sales proceeds will be held in escrow until all exploration permits for the Paris Basin are successfully transferred to Hess. Additionally, \$6.2 million has been earmarked and included in restricted cash for wind up activities of ZEC, including French capital gains tax and severance. The remaining net proceeds will be used by the Company to fund its development program.

As a result of the consummation of the Purchase Agreement and with the exception of an 5% overriding royalty interest retained under the Paris Basin Agreement with Hess, the Company no longer has any meaningful operations or assets in connection with oil and gas operations in France which were acquired in the February 2012 Combination of ZaZa LLC and Toreador. The Company anticipates solely focusing its efforts and resources on its oil and gas operations based in the United States. In our quarterly reports, we have previously classified the French operations as a segment based on the geographic regions. After the sale of ZEF, we operate under one segment.

The results of operations of entities in France have been presented as discontinued operations in the accompanying consolidated statement of operations. Results for these entities reported as discontinued operations from February 21, 2012 to December 21, 2012 were as shown in the table following. Since the divested assets were acquired in 2012, comparative results are unavailable for prior years.

		Period from February 21, 2012 to December 31, 2012
		(In thousands)
Oil revenues	\$	27,861
Operating loss		53,655
Other expenses		(719)
Loss on disposal of assets		787
Income tax benefit		1,552
Loss from discontinued operations	\$	52,171

## NOTE 2 — AGREEMENTS WITH HESS CORPORATION

### ZaZa LLC

In April 2010, ZaZa LLC entered into an agreement with Hess Corporation (“Hess”) in which ZaZa LLC was to identify certain geographical areas in the Eagle Ford Shale trend that were available for leasing and subsequently conduct exploration and production activities thereon. Hess was to pay all acquisition costs including ZaZa LLC’s interest until production up to \$ 500 million. As of September 30, 2012, approximately \$366 million in leases had been acquired pursuant to this agreement. After production, Hess was to retain a 90% working interest and ZaZa LLC, the operator, a 10% working interest. Hess also was to pay ZaZa LLC a 10% cash bonus per net acre for each lease purchased. The 10% cash bonus was recognized as revenue after the leases were obtained, title was cured and transferred to Hess, and recorded with the appropriate county.

In connection with the Exploration and Development Agreement (“EDA”), Hess periodically advanced non-interest bearing funds to ZaZa LLC to fund lease acquisitions, exploration and development activities, and reimbursed ZaZa LLC for certain general and administrative expenses incurred in performing these activities. The funds received related to lease acquisitions were deemed restricted as to use pursuant to the EDA until the lease was acquired. Hess also approved all exploration and development activities based on the underlying approved authorization for expenditures (“AFE”) and advanced funds to ZaZa LLC for such activities, usually 30 days in advance of actual expenditures being incurred. The funds, once received, were commingled with ZaZa LLC’s own cash and were not restricted as to use. The amounts received by ZaZa LLC for lease acquisitions and exploration and development activities in excess of the amounts incurred to date were recorded as advances from joint interest owner in the accompanying consolidated balance sheets. Given the nature of the EDA arrangement to ZaZa LLC’s overall business activities, the cash flows from each of the above activities have been presented as operating cash flows in the accompanying statements of cash flows.

### Toreador

On May 10, 2010, ZEF, a company organized under the laws of France and an indirect subsidiary of the Company, entered into the Hess Investment Agreement (“the Investment Agreement”) with Hess Oil France SAS., a company organized under the laws of France and a wholly-owned subsidiary of Hess Corporation, a Delaware corporation, pursuant to which (x) Hess became a 50% holder of Toreador Energy France’s (“TEF”) working interests in its awarded and pending exploration permits in the Paris Basin, France (the “Permits”) subject to fulfillment of Work Program (as described in (y) (2) hereafter) and (y) (1) Hess was required to make a \$ 15 million upfront payment to TEF, (2) Hess had the right to invest up to \$ 120 million in fulfillment of a two-phase work program (the “Work Program”) and (3) TEF would be entitled to receive up to a maximum of \$ 130 million of success fees based on reserves and upon the achievement of an oil production threshold, each as described more fully below.

The Ministère de l'Écologie, de l'Énergie, du Développement Durable et de la Mer (Ministry of Ecology, Energy, Sustainable Development and the Sea) in France granted first-stage approval on June 25, 2010. An application for the grant to Hess of title (together with TEF) on each of the pending exploration permits in the Paris Basin was also filed with the French Government.

Under the terms of the Investment Agreement, Phase 1 of the Work Program was expected to consist of an evaluation of the acreage underlying the Permits and the drilling of six wells ("Phase 1"). If Hess did not spend \$ 50 million in fulfillment of the Work Program within 30 months of receipt of government approval, Hess was required to promptly transfer back to TEF the transfer working interests. In light of the political situation in France and our voluntary agreement with the French government to delay drilling in our permits, TEF entered into an Amendment Agreement to the Investment Agreement that extended the deadline to complete Phase 1 by 18 months for a total of 48 months after receipt of government approval.

Under the terms of the Investment Agreement, if Hess spent \$50 million in Phase 1, Hess would have had the option to proceed to Phase 2 of the Work Program. If Hess elected not to proceed to Phase 2 of the Work Program, Hess was required to promptly transfer back to TEF a percentage of the transfer working interests determined with reference to the amount of money spent by Hess in fulfillment of the Work Program during Phase 1.

Under the terms of the Investment Agreement, if Hess elected to proceed, Phase 2 of the Work Program was expected to consist of appraisal and development activities, depending on the results of the work in Phase 1. If Hess did not spend \$ 70 million (less money spent by Hess in fulfillment of the Work Program in excess of \$50 million in Phase 1) in fulfillment of the Work Program within 36 months ("Phase 2"), Hess was required to promptly transfer back to TEF a percentage of the transfer working interests determined with reference to the amount of money spent by Hess in fulfillment of the Work Program during Phase 1. Following Phase 2, TEF and Hess were to bear the costs of subsequent exploration, appraisal and development activities in accordance with individual participation agreements governing the joint operations on each Permit.

Under the terms of the Investment Agreement, Hess agreed to pay TEF: (x) a success fee based on proved developed oil reserves (as defined by Rule 4-10(a) of Regulation S-X), up to a maximum of \$ 80 million and (y) a success fee if oil production exceeded an agreed threshold, up to a maximum of \$50 million, each of which was subject to reduction under certain circumstances.

Under the terms of the Investment Agreement, TEF and Hess designated an area of mutual interest within the Paris Basin (the "AMI"). If either party acquired or applied for a working interest in an exploration permit or exploitation concession within the AMI, such party would be required to offer to the other party 50% of such interest on the same terms and conditions.

Under the terms of the Investment Agreement, TEF was entitled to invoice Hess for all exploration, salary and general and administrative expenses that are associated with its activities as operator of the Permits. There was no activity under this agreement in the year ended December 31, 2012.

#### **Termination of the Agreements with Hess**

##### **Hess Joint Venture Dissolution**

Based on public communications from Hess, it became clear that Hess and ZaZa had different understandings about Hess's obligations under the Exploration and Development Agreement (EDA) relating to our joint venture. Correspondence and communications between the parties relating to the disagreements between the parties led to the conclusion that it would be in the best interest of both parties to dissolve the joint venture and divide the combined assets. These disagreements included overhead allocations and reimbursements, timing of the delivery of lease assignments and net acreage shortfalls (some of which disagreements are the subject of our claim against FLMK/Emerald Leasing discussed in "Note 11 - Commitments and Contingencies"), timing and amounts of payments, drilling obligations and drilling schedules, obligations to transfer undrilled acreage to ZaZa prior to lease expiration, and the interpretation of the other rights and obligations of the parties. Accordingly, the parties entered into a Heads of Agreement on June 8, 2012 outlining the terms of a division of assets to dissolve the joint venture, and the parties entered into definitive agreements regarding such division of assets and dissolution of the joint venture on July 25, 2012.

The EDA for the Hess joint venture required ZaZa LLC to operate the Hess joint venture properties during the first year of drilling, after which Hess had an election to take over operatorship. This provision enabled ZaZa LLC to build an operating track record during this first year of drilling. As operator of the Hess joint venture, ZaZa LLC successfully drilled and completed 18 Eagle Ford wells. Hess elected to take over operatorship, and the transition from ZaZa LLC to Hess commenced in November 2011 and was expected to be completed in July 2012. In conjunction with the operatorship transition, Hess also made public announcements in the first quarter of 2012 that indicated that they intended to pursue a drilling program in 2012-2013 that was slower than ZaZa LLC had anticipated. The combination of Hess taking over operatorship and the expectation that Hess would slow the drilling program led ZaZa LLC to negotiate an exit from the EDA in July 2012. As a result of this exit, ZaZa LLC relinquished the Cotulla Area and regained operational control of approximately 60% of the venture's former acreage (totaling 72,000 net acres). TEF also exited the Investment Agreement (subject to French regulatory approval), which had stalled due to French governmental regulations. This resulted in the Company converting its 50% working interest to a 5% non-cost bearing revenue interest for up to \$130 million in cash receipts. In addition to the aforementioned land transitions, the Company also received an aggregate of \$84 million in cash from Hess.

#### Hess Joint Venture Dissolution Agreement

In order to resolve our disagreements with Hess relating to our joint venture, on June 8, 2012, ZaZa, ZaZa LLC, ZaZa Energy France SAS. (formerly known as Toreador Energy France SAS.) ("ZEF"), Hess and Hess Oil France SAS. ("Hess France") entered into a Heads of Agreement ("HoA"), that provided for the termination of the ongoing obligations of the parties under the EDA and the agreements between ZEF and Hess France, including that certain Investment Agreement dated May 10, 2010, as amended, and that certain agreement dated July 21, 2011 with Vermillion REP, SAS., (the "French Agreements"), and the division of the assets covered by the EDAs and the French Agreements.

In connection with the execution of the HoA, ZaZa LLC and Hess entered into an amendment to the Exploration and Development Agreement Eagleford Shale Area dated April 28, 2010, as amended, and the applicable joint operating agreements, to eliminate Hess's obligation to carry the cost of the wells under those agreements in the Cotulla Prospect Area, in exchange for a cash payment by Hess to ZaZa LLC of \$15 million. This \$15 million was paid to ZaZa on June 8, 2012. ZaZa LLC had the right under the amendment to reinstate Hess's well-carry obligations at any time prior to September 28, 2012, if the Exploration and Development Agreement was still in effect, by paying Hess \$15 million. Given the uncertainty surrounding the EDA, the proceeds received were recognized as a deferred gain in the second quarter financial statements, contingent on the signing of definitive documentation. The gain was recognized in the third quarter in connection with the termination of the EDA.

On July 25, 2012, the Company and its subsidiaries entered into the definitive documentation to carry out the transactions contemplated by the HoA and consummated the transactions contemplated by the HoA (and such definitive documentation). The definitive documentation included the following:

- A Texas Division of Assets Agreement, by and among the Company, ZaZa LLC and Hess, pursuant to which the ongoing obligations of ZaZa LLC and Hess under the Eagle Ford Agreements, including funding for additional leases, well carry or carry for expenses, were terminated and the assets covered by the Eagle Ford Agreements were divided; and
- A Paris Basin Purchase and Sale Agreement, by and among Hess France and ZEF, pursuant to which, following governmental approval, the ongoing obligations of the parties thereto under the French Agreements, including funding for additional leases, well carry or carry for expenses, were terminated and the assets covered by the French Agreements were divided, in each case following regulatory approval which was obtained on September 19, 2012.

Pursuant to the Texas Division of Assets Agreement and the Paris Basin Purchase and Sale Agreement (collectively, the "Hess Agreements"), ZaZa received the following:

- Approximately \$69 million in cash, in addition to the \$15 million in the second quarter of 2012;
- Approximately 60,500 additional net acres in the Eagle Ford core area;
- The right to receive five percent of any net sales proceeds in excess of \$1 billion and ten percent of any net sales proceeds in excess of \$1.2 billion if Hess sells any of its retained working interest in the Cotulla Prospect Area by May 1, 2013; and
- A five percent overriding royalty interest ("ORRI") in certain of Hess's exploration licenses in the Paris Basin capped at \$130 million.

As a result of consummation of the transactions set forth in the Hess Settlement Agreements, ZaZa's net acreage holdings in the Eagle Ford core increased from a total of 11,500 acres to approximately 72,000 acres. The acreage by area comprises approximately 1,970 acres in the Cotulla Prospect Area in the proved, productive region of southern Frio County, 23,120 acres in the Hackberry Prospect Area (Lavaca and Colorado Counties), 10,810 acres in the Moulton Prospect Area (Fayette, Gonzalez and Lavaca Counties) and 35,650 acres in the Sweet Home Prospect Area (DeWitt and Lavaca Counties). Following the receipt of the necessary governmental approvals, ZaZa transferred its 50% working interest in the Paris Basin exploration licenses as provided for in the Investment Agreement between Hess France and ZEF retained a 5% ORRI in such licenses, in which the total proceeds relating thereto to ZaZa are capped at \$ 130 million.

Pursuant to the Hess Agreements, Hess received the following:

- Approximately 4,490 net acres in LaSalle, Frio, Zavala, and Dimmit Counties (the "Cotulla Prospect Area");
- A two percent ORRI on the Moulton Prospect Area and a one percent ORRI in the Hackberry and Sweet Home Prospect Areas; and
- All rights and title to the exploration permits and pending permits in France (ZaZa retains all current production in France from its operating concessions).

As described above, in connection with the entry into the Hess Agreements, ZaZa LLC and Hess terminated the Eagle Ford Agreements. Pursuant to the Eagle Ford Agreements, ZaZa LLC retained a 10% working interest in all acreage acquired on behalf of the joint venture in the Eagle Ford shale and also earned a cash bonus of 10% on all acreage acquired on behalf of the joint venture. Under the terms of the joint venture, Hess had a right to participate in all leases acquired by ZaZa LLC in the Eagle Ford shale. If Hess elected to participate in a lease, the lease became part of the joint venture and Hess paid all of the acquisition costs up to a cap, and paid all of the exploration and development costs for a specified number of approved wells on the leased acreage until production. ZaZa LLC also received a partial reimbursement of general and administrative expenses while it was the operator of wells under the joint venture. ZaZa LLC's 10% working interest in each well (subject to a cap) in the joint venture was "carried" by Hess pursuant to the Eagle Ford Agreements.

Pursuant to the Hess Agreements, Hess has assigned to ZaZa certain claims that the joint venture had against various leasing contractors and brokers who had been paid for acreage but had neither delivered the acreage nor refunded the payments. Hess is entitled to 50% of any cash proceeds received by ZaZa in its prosecution of these claims, however, ZaZa is entitled to all of the acreage delivered in kind by the leasing contractors/brokers. ZaZa LLC filed a lawsuit against certain lease brokers, consultants and law firms who were involved in the leasing of acreage for the company in DeWitt and Lavaca Counties, including Emerald Leasing LLC, FLMK Acquisition, LLC, John T. Lewis, Billy Marcum, Brad Massey, Max Smith, Randy Parsley, Timothy E. Malone, Heroux & Helton PLLC, and Whitaker Chalk Swindle & Schwartz PLLC.

In connection with the division of assets, Hess France and ZEF also agreed to terminate the French Agreements. The French Agreements provided the framework for a proof of concept program in the Paris Basin and the sharing on a 50-50 basis of the permits in certain areas in the Paris Basin. As a result of recent legislation in France banning hydraulic fracturing, ZaZa's plan to drill on the land had been adversely affected and the value of the French Agreements had declined. The French Agreements were terminated as of October 1, 2012, following the receipt of the necessary governmental approvals to the transfer and division of the French assets contemplated by the Hess Agreement.

The termination of agreements with Hess and the division of assets resulted in a gain of \$ 195.6 million consisting of oil and gas property fair valued at \$ 117 million, a write off of \$5.4 million in working capital and cash proceeds of \$84 million. Property received consisted of producing wells and unproved acreage. All receivables and payables related to Hess were written off.

In addition, on July 25, 2012, ZaZa entered into a Waiver and Amendment No. 2 ("Amendment No. 2") to the Securities Purchase Agreement dated February 21, 2012 (the "SPA"), relating to our 8% senior secured notes due 2017 (the "Senior Secured Notes"). Amendment No. 2 was a condition to obtaining the requisite consent of the holders of our Senior Secured Notes to the transactions contemplated by the Hess Agreements, and provided the following:

- Consent rights for the holders of a majority of the Senior Secured Notes on all sales or joint venture transactions involving oil and gas properties, with certain carveouts and requirements to apply a portion of net sales proceeds to pay down the Senior Secured Notes, until such time as the Senior Secured Notes have an outstanding principal amount of \$25 million or less;
- A provision that if the Senior Secured Notes have not been paid down to \$ 35 million by February 21, 2013, the interest rate will increase from 8% to 10% per annum;
- A limit on additional debt incurrence of ZaZa to \$ 50 million in reserve-based lending; and
- A requirement that the Company engage an investment banker to assist the Company in securing a joint venture partner or partners for its Eagle Ford and Woodbine/Eaglebine assets, as well as to evaluate other strategic opportunities available to the Company which has been satisfied by our engaging Jefferies & Company, Inc. as our financial advisor.

In addition, immediately following the closing of the transactions contemplated by the Hess Agreement, and as contemplated by Amendment No. 2, the Company paid down the outstanding principal amount of the Senior Secured Notes by \$ 33.0 million and paid a \$3.5 million associated fee. We also recorded a charge of \$11.7 million due to the write off of issuance costs and discount amount.

### **NOTE 3 — GOING CONCERN**

For 2013, we are dependent on the sale of non-core assets and the proceeds from the creation of a joint venture (see below) in order to maintain a positive liquidity position and to fund our debt service requirements. Our lack of sufficient current operating cash flow, the exploratory uncertainties surrounding the development plan of our recently announced joint venture, and the amount of our current indebtedness, when considered in the aggregate, raise substantial doubt about our ability to continue as a going concern. We currently expect that the proceeds from the sale of our Moulton prospect and the recently announced joint venture will continue to improve our overall liquidity position. Our 2013 plan assumes the above transactions are consummated in the second quarter of 2013. The first phase of the joint venture will result in ZaZa receiving \$10 million being 100% carried on the drilling and completion costs of three (3) exploratory wells. The Moulton sale will provide approximately \$52.5 million of cash but will also decrease our proved reserves and related operating income significantly. We estimate that we will use a portion of the proceeds from these transactions to reduce the outstanding principal amount of our Senior Secured Notes to approximately \$ 25.6 million by the end of 2013. In addition to the transactions, we are currently in the process of drilling and completing three (3) stand-alone exploratory wells. These wells are estimated to cost approximately \$30.9 million in the aggregate and will be funded with readily available liquidity and cash flows from operations. Also included in the 2013 business plan is approximately \$ 15.1 million in leasehold costs to hold our leases that are not held by production. To offset a portion of these costs, our 2013 business plan also includes a 35% reduction in our general and administrative costs beginning in the second quarter of 2013.

Going forward, we will utilize cash flow from operations, alternative sources of equity or debt capital and possible asset divestitures to finance additional drilling operations in the Eaglebine. However, there is no assurance that asset divestitures will be available to the Company at appropriate valuations. Absent additional sources of financing, or the sale of additional assets, the Company will have to further reduce our expenditures in 2013 and beyond.

### **NOTE 4 — SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

#### **Use of Estimates**

The preparation of financial statements in conformity with United States generally accepted accounting principles requires us to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

#### **Cash and Cash Equivalents**

The Company considers investments in all highly liquid instruments with original maturities of three months or less at date of purchase to be cash equivalents.

## **Revenue Recognition**

The Company derives its oil and gas revenue primarily from the sale of produced oil and gas. The Company uses the sales method of accounting for the recognition of gas revenue whereby revenues, net of royalties are recognized as the production is sold to the purchaser. The amount of gas sold may differ from the amount to which the Company is entitled based on its working interest or net revenue interest in the properties. Revenue is recorded when title is transferred based on our nominations and net revenue interests. Pipeline imbalances occur when production delivered into the pipeline varies from the gas we nominated for sale. Pipeline imbalances are settled with cash approximately 30 days from date of production and are recorded as a reduction of revenue or increase of revenue depending upon whether we are over-delivered or under-delivered. Settlements of oil and gas sales occur after the month in which the product was produced. We estimate and accrue for the value of these sales using information available at the time financial statements are generated. Differences are reflected in the accounting period during which payments are received from the purchaser.

Until the dissolution of the Hess joint venture agreements, the Company also derived its bonus income revenue from a bonus on leasehold amounts that Hess agreed to participate in. The bonus amount was equal to 10% of the sum of all direct costs associated with acquiring the net mineral acres as defined in the EDA and was recognized after the leases were obtained, title was cured and transferred to Hess, and recorded with the appropriate county.

## **Accounts Receivable**

Accounts receivable include oil and gas revenues, joint interest billing, and related parties receivables. Management periodically assesses the Company's accounts receivable and establishes an allowance for estimated uncollectible amounts. Accounts determined to be uncollectible are charged to operations when that determination is made. The Company usually does not require collateral.

## **Concentration of Credit Risk**

The Company maintains its cash balances at several financial institutions, which are insured by the Federal Deposit Insurance Corporation. The Company's cash balances typically are in excess of the insured limit. This concentration may impact the Company's overall credit risk, either positively or negatively, in that this entity may be similarly affected by changes in economic or other conditions. The Company has incurred no losses related to these accounts.

## **Successful Efforts Method of Accounting for Oil and Gas Activities**

The Company accounts for its natural gas and crude oil exploration and production activities under the successful efforts method of accounting. Oil and gas lease acquisition costs are capitalized when incurred. Lease rentals are expensed as incurred. Oil and gas exploration costs, other than the costs of drilling exploratory wells, are charged to expense as incurred. The costs of drilling exploratory wells are capitalized pending determination of whether they have discovered proved commercial reserves. Exploratory drilling costs are capitalized when drilling is complete if it is determined that there is economic producibility supported by either actual production or a conclusive formation test. If proved commercial reserves are not discovered, such drilling costs are expensed. In some circumstances, it may be uncertain whether proved commercial reserves have been found when drilling has been completed. Such exploratory well drilling costs may continue to be capitalized if the reserve quantity is sufficient to justify its completion as a producing well and sufficient progress in assessing the reserves and the economic and operating viability of the project is being made. Costs to develop proved reserves, including the costs of all development wells and related equipment used in the production of natural gas and crude oil, are capitalized. Unproved properties with individually significant acquisition costs are analyzed on a property-by-property basis for any impairment in value. If the unproved properties are determined to be productive, the appropriate related costs are transferred to proved oil and gas properties.

ZaZa's third party engineers estimate proved oil and gas reserves, which directly impact financial accounting estimates, including depreciation, depletion, and amortization. Our proved reserves represent estimated quantities of oil and condensate, natural gas liquids and gas that geological and engineering data demonstrate, with reasonable certainty, to be recovered in future years from known reservoirs under economic and operating conditions existing at the time the estimates were made. The process of estimating quantities of proved oil and gas reserves is very complex requiring significant subjective decisions in the evaluation of all available geological,

engineering, and economic data for each reservoir. The data for a given reservoir may also change substantially over time as a result of numerous factors including, but not limited to, additional development activity, evolving producing history, and continual reassessment of the viability of production under varying economic conditions. Consequently, material revisions (upward or downward) to existing reserve estimates may occur from time to time.

Depreciation, depletion, and amortization of the cost of proved oil and gas properties are calculated using the unit-of-production method. The reserve base used to calculate depreciation, depletion, and amortization for leasehold acquisition costs is the sum of proved developed reserves and proved undeveloped reserves. With respect to lease and well equipment costs, which include development costs and successful exploration drilling costs, the reserve base includes only proved developed reserves. Estimated future dismantlement, restoration, and abandonment costs, net of salvage values are taken into account.

Amortization rates are updated quarterly to reflect: (1) the addition of capital costs, (2) reserve revisions (upwards or downwards) and additions, (3) property acquisitions and/or property dispositions, and (4) impairments. When circumstances indicate that an asset may be impaired, the Company compares expected undiscounted future cash flows at a producing field level to the unamortized capitalized cost of the asset. If the future undiscounted cash flows, based on the Company's estimate of future natural gas and crude oil prices, operating costs, anticipated production from proved reserves, and other relevant data, are lower than the unamortized capitalized cost, the capitalized cost is reduced to fair value. Fair value is calculated by discounting the future cash flows at an appropriate risk-adjusted discount rate.

### Asset Retirement Obligations

We follow ASC 410-20 which applies to obligations associated with the retirement of tangible long-lived assets that result from the acquisition, construction and development of the assets. ASC 410-20 requires that we record the fair value of a liability for an asset retirement obligation in the period in which it is incurred and a corresponding increase in the carrying amount of the related long-lived asset.

The following table summarizes the changes in our asset retirement liability during the years ended December 31, 2012 and 2011.

	Year Ended December 31,	
	2012	2011
Asset retirement obligations at January 1	\$ 309	\$ -
Obligations assumed in the Combination	4,513	-
Obligations incurred	313	307
Revisions	26	-
Obligations extinguished	(356)	-
Obligations divested	(4,912)	-
Obligations reclassified as held for sale	(183)	-
Accretion expense	420	2
Asset retirement obligations at the end of the period	<u>\$ 130</u>	<u>\$ 309</u>

### Furniture and Fixtures

Furniture and fixtures are stated at cost. Depreciation is calculated using the straight-line method over the assets' estimated useful lives as follows:

Office furniture and fixtures	2 - 5
Computing equipment	2 - 5
Vehicles	5 - 7

### Other Assets

Other assets consist of long term restricted deposits related to letters of credit with the Railroad Commission and other vendors as well as debt issuance costs. At December 31, 2012 debt issuance costs were \$ 7.0 million and accumulated amortization was \$ 3.3 million, which includes \$2.7 million in debt issuance costs expensed



as part of debt extinguishment loss during the year ended December 31, 2012. The costs are being amortized over the life of associated debt.

### **Income Taxes**

For financial reporting purposes, we generally provide taxes at the rate applicable for the appropriate tax jurisdiction. Management periodically assesses the need to utilize any unremitted earnings to finance our operations. This assessment is based on cash flow projections that are the result of estimates of future production, commodity prices and expenditures by tax jurisdiction for our operations. Such estimates are inherently imprecise since many assumptions utilized in the cash flow projections are subject to revision in the future.

Management also periodically assesses, by tax jurisdiction, the probability of recovery of recorded deferred tax assets based on its assessment of future earnings estimates. Such estimates are inherently imprecise since many assumptions utilized in the assessments are subject to revision in the future.

### **Earnings (loss) Per Common Share**

Basic earnings (loss) per share was calculated by dividing net income or loss applicable to common shares by the weighted average number of common shares outstanding during the periods presented. Diluted earnings (loss) per share incorporate the potential dilutive impact of options and unvested stock outstanding during the periods presented, unless their effect is anti-dilutive. In addition, the Company applies the if-converted method to our convertible debt instruments, the effect of which is that conversion will not be assumed for purposes of computing diluted earnings (loss) per share if the effect would be anti-dilutive.

The equity structure of the legal subsidiary (the accounting acquirer) has been retroactively adjusted using the exchange ratio established in the Agreement and Plan of Merger and Contribution, dated August 9, 2011, as amended, to reflect the number of shares of the legal parent (the accounting acquiree) issued in the reverse merger. For the purpose of 2011 and 2010 earnings per share calculation ("EPS") the number of weighted average shares outstanding represents assumed shares outstanding as of December 31, 2011 and 2010, as there were no changes in the capital structure of ZaZa LLC during the years ended then. The shares outstanding were calculated based on the Toreador shares outstanding and the exchange ratio.

### **Foreign Currency Translation**

The United States dollar is the functional currency for all of ZaZa's consolidated subsidiaries except for certain of its French subsidiaries, for which the functional currency is the Euro. For subsidiaries whose functional currency is deemed to be other than the United States dollar, asset and liability accounts are translated using the period-end exchange rates and revenues and expenses are translated at average exchange rates prevailing during the period. Translation adjustments are included in Accumulated Other Comprehensive Income ("AOCI") on the Consolidated Balance Sheets. Any gains or losses on transactions or monetary assets or liabilities in currencies other than the functional currency are included in net income (loss) in the current period.

### **Stock-based Compensation**

Stock-based compensation cost is measured at the date of grant, based on the fair value of the award, and is recognized as expense, generally on a straight line basis over the vesting period of the award. Forfeitures are estimated at the time of grant and revised, if necessary, in subsequent periods to reflect actual forfeitures. Awards subject to vesting requirements for non-employees are fair valued each reporting period, final fair value being determined at the vesting date.

### **Recent Accounting Standards**

In May 2011, the Financial Accounting Standards Board ("FASB") issued guidance that further addresses fair value measurement accounting and related disclosure requirements. The guidance clarifies the FASB's intent regarding the application of existing fair value measurement and disclosure requirements, changes the fair value measurement requirements for certain financial instruments, and sets forth additional disclosure requirements for other fair value measurements. The guidance is to be applied prospectively and is effective for periods beginning after December 15, 2011. We adopted this guidance effective January 1, 2012. The adoption of this guidance did

not have an impact on our consolidated financial position, results of operations or cash flows, as it only expanded disclosures.

In June 2011, the FASB amended current comprehensive income guidance. The amended guidance eliminates the option to present the components of other comprehensive income as part of the statement of shareholders' equity. Instead, we must report comprehensive income in either a single continuous statement of comprehensive income which contains two sections, net income and other comprehensive income, or in two separate but consecutive statements. This guidance will be effective for public companies during the interim and annual periods beginning after December 15, 2011 with early adoption permitted. Also, in December 2011, FASB issued an accounting standard update to abrogate the requirement for presentation in the income statement of the effect on net income of reclassification adjustments out of Accumulated Other Comprehensive Income as required in FASB's June 2011 amendment. We adopted this guidance effective January 1, 2012. The adoption of this guidance did not have an impact on our consolidated financial position, results of operations or cash flows as it only required a change in the format of the current presentation.

## **NOTE 5 — RELATED PARTY TRANSACTIONS**

Each of the three original managing partners of ZaZa LLC has a direct or indirect interest in an overriding royalty interest generally equal to one percent (1%) (for a total of three percent (3%)) in:

- Each leasehold estate located within the boundaries of the "area of mutual interest" map that was attached to the Exploration and Development Agreement between ZaZa and Hess (the "EDA") that has been or may be acquired by ZaZa prior to April 2016 including the Eagle Ford shale trend and the Eaglebine trend; and
- Each leasehold estate located within the boundaries of an "expansion area" covering certain counties in Alabama, Florida, Louisiana and Mississippi that may be acquired by ZaZa prior to April 2016, unless a longer period of time is stated in any area of mutual interest agreement that may be entered into between ZaZa and a third party.

In March 2010, ZaZa LLC entered into an agreement with the ZaZa LLC Members and Eli Smith & Associates, which we refer to as Smith, to acquire 100% working interests in any unproved acreage identified in a defined area of mutual interest located in the Colorado and Lavaca counties of Texas. During the year ended December 31, 2011, ZaZa acquired acreage for a total of approximately \$ 6.1 million pursuant to this agreement. During the year ended December 31, 2010, ZaZa acquired acreage totaling approximately \$ 28.9 million pursuant to this agreement; \$6.2 million of the purchase price was in the form of \$ 3 million notes payable due to the ZaZa LLC Members and \$3.2 million in accounts payable due to ZaZa LLC Members, which was paid in January 2011. The ZaZa LLC managing partners and Smith retain a direct or indirect reserved overriding royalty interest generally equal to three percent (3%) in each property sold to ZaZa, which is divided pro-rata among the four sellers in the transactions. Simultaneously with each purchase, ZaZa pursuant to a separate agreement sold 90% of the acquired working interests to Hess, and retained a 10% working interest in each property. No gain or loss was recognized on the sales to Hess.

Effective May 1, 2010, ZaZa and its members entered into a compensation agreement in which base salary, discretionary bonus and incentive compensation were defined. Incentive compensation was based on the fulfillment of certain performance metrics and the occurrence of a "Company liquidity event," defined therein as an initial public offering, merger, reverse merger, financing or other availability of capital deemed financially beneficial to ZaZa. During the year ended December 31, 2011, no discretionary bonuses were approved by ZaZa. For the year ended December 31, 2012, ZaZa paid \$ 17.5 million in discretionary bonuses and incentive compensation under these agreements. These compensation agreements were terminated in connection with the Combination.

In March 2011 ZaZa entered into a management agreement (the "Management Agreement") with Sequent Petroleum Management, LLC ("SPM") pursuant to which SPM provided ZaZa with contractors and consultants and their related benefits programs in exchange for a monthly fee for managing such personnel. Scott Gaille, who was appointed ZaZa Energy Corporation's Chief Compliance Officer as of March 2012 was a principal of SPM until September 6, 2012, when he disposed of all of his interests in SPM. ZaZa reimbursed SPM for the costs of the personnel under the Management Agreement, including for the costs of their insurance and other benefits. SPM handled all payroll, tax, accounting and benefit services for the contractors and consultants provided under the Management Agreement. For the years ended December 31, 2012 and 2011, ZaZa paid SPM \$ 18.3 million

(including \$52 thousand in management fees) and \$6.3 million (including \$50 thousand in management fees), respectively, under this agreement. At December 31, 2011, ZaZa had a receivable from SPM of \$84 thousand related to the estimated period end payroll. Effective November 1, 2012, 100% of the units and ownership in SPM was assigned to ZaZa LLC.

Lot-A-Go 5 ("LG5") is an airplane rental company in which Todd A. Brooks and Gaston Kearby hold partnership interest. From time to time, ZaZa will rent the plane for business travel reasons. ZaZa was charged for the pilots' time, hanger fees and fuel. During the year ended December 31, 2012 ZaZa was charged and paid \$115 thousand for such services. In addition, at December 31, 2011, ZaZa had a payable to LG5 for \$80 thousand related to the remainder of a short term working capital loan that bears no interest, which was repaid in September 2012.

### ***Entry into Reimbursement Agreements***

In connection with but following consummation of the combination of Toreador Resources Corporation and ZaZa LLC, the three former members of ZaZa LLC, Todd A. Brooks, Gaston L. Kearby, and John E. Hearn Jr. (together, the "ZaZa Founders"), each determined to transfer to certain service providers approximately 1.7 million shares of restricted common stock of the Company, par value \$0.01 per share (the "Restricted Stock"), held by entities controlled by the ZaZa Founders. Because such transfers were expected to give rise to a compensation expense deduction to the Company upon vesting of the grants, as opposed to giving rise to a deduction to the ZaZa Founders, the Company agreed to pay in cash to the ZaZa Founders the economic value of any tax deduction the Company receives as a result of these grants by the ZaZa Founders.

On September 11, 2012, the Company entered into separate Reimbursement Agreements with each of Blackstone Oil & Gas, LLC ("Blackstone"), Omega Energy Corp. ("Omega"), and Lara Energy, Inc. ("Lara") (together, the "Reimbursement Agreements"). Blackstone, Omega, and Lara are respectively controlled by Todd A. Brooks, who serves as the Company's President and Chief Executive Officer and also as a Director, Gaston L. Kearby, who is the former Executive Director-Operations and currently serves as a Director of the Company, and John E. Hearn Jr., who serves as the Chief Operating Officer and a Director of the Company. Pursuant to the Reimbursement Agreements, the Company will reimburse each of Blackstone, Lara, and Omega for the value of the tax benefit(s) received by the Company due to the transfers of Restricted Stock within thirty (30) days of such time(s) when the Company is able to make use of the expense(s) relating thereto to reduce its federal income tax withholding or payments (the "Reimbursements"). If Blackstone, Lara, and Omega together cease to control a majority of the common stock of the Company prior to the time that the Company is able to make use of any or all of such expenses to reduce its federal income tax withholding or payments, then the Company will pay to each of Blackstone, Lara, and Omega an amount equal to thirty-five percent (35%) of the value of the shares of the Restricted Stock (determined at the time of vesting) transferred by each such grantor.

The Company estimates that the Reimbursements could be as much as \$1.4 million for each of Blackstone, Lara, and Omega, no payments have been made during the year ended December 31, 2012. The tax characterization of the Reimbursements and their reporting shall be determined by a third party tax advisor to the founders. Each of Blackstone, Lara, and Omega will be responsible and liable for any tax consequences (including, but not limited to, any interest or penalties) as a result of the Reimbursements.

### ***Assignment of Stadium Suite Lease***

On September 28, 2011, ZaZa LLC entered into that certain Reliant Stadium Suite Lease Agreement (the "Original Suite Lease") with Houston NFL Holdings, L.P. (the "Landlord"), whereby ZaZa LLC leased a luxury suite at Reliant Stadium for Houston Texans professional football games and certain other events. On February 23, 2012, ZaZa LLC entered into that certain Houston Texans Reliant Stadium Suite Lease Agreement (the "Amended Suite Lease") with Landlord, which amended and restated the Original Suite Lease. In order to reduce overhead costs, the Company's Board of Directors has approved the assignment and assumption of the Amended Suite Lease, and, subject to Landlord approval, ZaZa LLC will assign the Amended Suite Lease to Blackstone Oil & Gas, LLC ("Blackstone"), and Blackstone will agree to assume from ZaZa LLC, ZaZa LLC's obligations under the Amended Suite Lease. Todd A. Brooks, President and Chief Executive Officer of the Company, holds all outstanding equity interests in Blackstone and is its President. The Landlord has not yet consented to such assignment and assumption, but is expected to do so. To the extent the assignment and assumption are approved by the Landlord, and the Amended Suite Lease is assigned to Blackstone and then subsequently assigned by Blackstone to a third party for a profit, Blackstone will reimburse the Company for the value of the benefit, if any, which it receives. The term of the

Amended Suite Lease commenced at the start of the 2012 National Football League (“NFL”) season and will terminate at the conclusion of the 2018 NFL season. The base rate (including additional rent) of rent for the Amended Suite Lease is \$ 248,000 for the first year of the term, and thereafter is subject to increases of up to five percent ( 5%) per year in each subsequent year. Blackstone previously paid for the first year’s rent for and on behalf of ZaZa LLC, for which Blackstone will not be reimbursed. The additional rent payments for the remaining six years of the Amended Suite Lease will total no less than \$ 1,488,000.

## NOTE 6 — STOCK-BASED COMPENSATION

### Long Term Incentive Plan (the “Plan”)

We currently have 7.0 million shares authorized for issuance under the Plan adopted in March 2012. At December 31, 2012, approximately 5.8 million shares were available for future grants under the Plan. Our policy is to issue new shares for exercises of stock options, when restricted stock awards are granted, and at vesting of restricted stock units. To date only restricted stock awards have been granted under the Plan.

Stock-based compensation cost is measured at the date of grant, based on the fair value of the award, and is recognized as expense, generally on a straight-line basis over the vesting period as defined in the individual grant agreement. Compensation cost is recognized based on awards ultimately expected to vest. Forfeitures are estimated at the time of grant and revised, if necessary, in subsequent periods to reflect actual forfeitures. Awards subject to vesting requirements for non-employees are fair valued each reporting period, final fair value being determined at the vesting date.

Officers, directors and key employees may be granted restricted stock awards (“RSA”) under the Plan, which is an award of common stock with no exercise price. RSAs are subject to cliff or graded vesting, generally ranging over a three to five year period. We determine the fair value of restricted stock awards based on the market price of our common stock on the date of grant. Compensation cost for RSAs is primarily recognized on a straight-line basis over the vesting period and is net of forfeitures.

### Founders’ Shares

Our financing agreements and stockholders’ agreement permitted the significant ZaZa owners to make grants of up to 6.0 million of their shares of restricted stock to current and former employees, contractors and service providers of the Company. For accounting purposes, these grants are treated as a capital contribution by the significant ZaZa owners of the shares of restricted stock to ZaZa and a subsequent grant of such shares by ZaZa to the recipients, outside of the Plan. The restricted stock subject to vesting requirements for contractors and service providers will be treated as equity awards with variable accounting. The final fair value will be determined at the vesting date.

Stock-based compensation cost for the year ended December 31, 2012 was \$ 16.5 million. We did not have stock-based compensation cost prior to the second quarter of 2012.

The following table presents the changes in restricted stock awards pursuant to the Plan and the owner grants, and related information:

	RSA Number of Shares (in thousand)	Weighted Average Grant Date Fair Value per Share
Unvested balance at December 31, 2011	-	\$ -
Granted	6,492	\$ 4.01
Vested	(6,336)	\$ 4.00
Unvested balance at December 31, 2012	<u>156</u>	<u>\$ 4.32</u>

The total vest date fair value of awards vested in 2012 was \$ 15.0 million. At December 31, 2012, we had \$0.5 million of total unrecognized compensation cost related to unvested awards which is expected to be recognized over a weighted average period of 1.37 years.

## NOTE 7 — EARNINGS (LOSS) PER COMMON SHARE

The following table reconciles the numerators and denominators of the basic and diluted income (loss) per common share computation:

	Year Ended December 31,		
	2012	2011	2010
	(In thousands, except per share data)		
Basic income (loss) per share:			
Numerator:			
Income (loss) from continuing operations	\$ (54,056)	\$ (2,855)	\$ 6,442
Income (loss) from discontinued operations, net	(52,171)	-	-
Net income (loss)	<u>\$ (106,227)</u>	<u>\$ (2,855)</u>	<u>\$ 6,442</u>
Denominator:			
Weighted average common shares outstanding	<u>98,029</u>	<u>75,977</u>	<u>75,977</u>
Basic income (loss) per share:			
Continuing operations	\$ (0.55)	\$ (0.04)	\$ 0.08
Discontinued operations	(0.53)	-	-
	<u>\$ (1.08)</u>	<u>\$ (0.04)</u>	<u>\$ 0.08</u>
Diluted income (loss) per share:			
Numerator:			
Income (loss) from continuing operations	\$ (54,056)	\$ (2,855)	\$ 6,442
Impact of assumed conversions on interest expense, net of income taxes	-	-	-
Less: gain on fair value of warrants, net of tax	(3,633)	-	-
	<u>(57,689)</u>	<u>(2,855)</u>	<u>6,442</u>
Income (loss) from discontinued operations, net	<u>(52,171)</u>	<u>-</u>	<u>-</u>
	<u>\$ (109,860)</u>	<u>\$ (2,855)</u>	<u>\$ 6,442</u>
Denominator:			
Weighted average common shares outstanding	98,029	75,977	75,977
Net warrants issued for secured debt under the treasury stock method	1,655	-	-
Weighted average shares associated with convertible debt	- (a)	-	-
Weighted average diluted shares outstanding	<u>99,684</u>	<u>75,977</u>	<u>75,977</u>
Diluted income (loss) per share:			
Continuing operations	\$ (0.58)	\$ (0.04)	\$ 0.08
Discontinued operations	(0.53)	-	-
	<u>\$ (1.11)</u>	<u>\$ (0.04)</u>	<u>\$ 0.08</u>

- (a) For the year ended December 31, 2012, the number of shares used in the calculation of diluted income per share did not include 12.3 million common equivalent shares from the embedded convertible options associated with the Convertible Senior Notes due to their anti-dilutive effect.

The equity structure of the legal subsidiary (the accounting acquirer) has been retroactively adjusted using the exchange ratio established in the Agreement and Plan of Merger and Contribution, dated August 9, 2011, as amended, to reflect the number of shares of the legal parent (the accounting acquiree) issued in the reverse merger. For the purpose of 2011 and 2010 earnings per share calculation ("EPS") the number of weighted average shares outstanding represents assumed shares outstanding as of December 31, 2011 and 2010, as there were no changes in

the capital structure of ZaZa LLC during the years ended then. The shares outstanding were calculated based on the Toreador shares outstanding and the exchange ratio.

## **NOTE 8 — LONG-TERM DEBT**

### **Sale of 8.00% Senior Secured Notes due 2017 and Warrants**

On February 21, 2012, we entered into the Securities Purchase Agreement (SPA) with the purchasers thereunder, including MSDC ZEC Investments, LLC and Senator Sidecar Master Fund LP (collectively, the “Purchasers”), pursuant to which we issued senior secured notes in the aggregate principal amount of \$ 100,000,000 and warrants (the “Warrants”) to purchase 26,315,789 shares of our Common Stock. The proceeds of the sale of the Senior Secured Notes and the Warrants were used for the (i) repayment of the outstanding convertible notes of Toreador, and (ii) payment of fees and expenses incurred in connection with the Combination, with the balance to be used for general working capital purposes.

The Senior Secured Notes will mature on February 21, 2017. Subject to certain adjustments set forth in the SPA, interest on the Senior Secured Notes accrues at 8% per annum, payable quarterly in cash. With respect to overdue interest payments or during periods in which an event of default under the SPA has occurred and is continuing, the annual rate of interest will increase to the greater of 3% per annum in excess of the non-default interest rate and 8% over the yield to maturity for 10-Year United States treasury securities. In addition, the annual interest rate payable on the Senior Secured Notes will increase by 0.5% per annum, beginning 181 days after the date of the SPA, if a shelf registration statement with respect to the shares of Common Stock that are issuable upon exercise of the Warrants has not been filed and declared effective by the SEC, and ending on the date such shelf registration statement is declared effective by the SEC, as well as for certain periods thereafter if the shelf registration statement is no longer effective or otherwise becomes unavailable to holders of the Warrants. In addition, if, prior to the third anniversary of the date of the SPA, we authorize the issuance and sale of any equity interests in the Company, we will use our commercially reasonable efforts to offer each Purchaser an opportunity to purchase up to such Purchaser’s pro rata portion of the offered securities on the terms set forth in the SPA.

The Senior Secured Notes are guaranteed by all of our subsidiaries and secured by a first-priority lien on substantially all of our assets and of our domestic subsidiaries. To the extent such assets include stock of our foreign subsidiaries, only 65% of such foreign subsidiary stock is to be pledged as security for the Senior Secured Notes. The Senior Secured Notes will rank senior to all of our other debt and obligations. We are permitted to have up to \$50 million in additional reserves-based secured lending (including, but not limited to, pre-paid swaps); such borrowings may be secured by liens that come ahead of the liens securing the Senior Secured Notes.

Beginning on February 21, 2015, the Purchasers may require us to purchase all or a portion of the Senior Secured Notes at a price equal to the principal amount of the Senior Secured Notes to be purchased, plus any accrued and unpaid interest on such notes. In addition, if a fundamental change (as defined in the SPA) occurs at any time prior to maturity of the Senior Secured Notes, noteholders may require us to purchase all or a portion of the Senior Secured Notes at a price equal to 101% of the principal amount of the Senior Secured Notes to be purchased, plus any accrued and unpaid interest on such notes.

On or prior to February 21, 2015, we may purchase at any time or from time to time any or all of the Senior Secured Notes at 100% of the principal amount of the Senior Secured Notes to be purchased, plus accrued and unpaid interest on such notes, plus a make-whole premium on the principal amount of such notes. After February 21, 2015 and ending on February 21, 2016, we may purchase at any time or from time to time any or all of the Senior Secured Notes at a price equal to 105% of the principal amount of the Senior Secured Notes to be purchased, plus accrued and unpaid interest on such notes. After February 21, 2016, we may purchase at any time or from time to time any or all of the Senior Secured Notes at 100% of the principal amount of the Senior Secured Notes to be purchased, plus accrued and unpaid interest on such notes.

We are subject to certain affirmative and negative covenants pursuant to the Senior Secured Notes, including, without limitation, restrictions on our and our subsidiaries’ abilities to incur additional debt, pay dividends or make other distributions, redeem stock, make investments, incur liens, enter into transactions with affiliates, merge or consolidate and transfer or sell assets, in each case subject to certain baskets and carve-outs.

After giving effect to the shares issued to the ZaZa LLC Members and the former stockholders of Toreador in the Combination, the Warrants represent approximately 20.6% of the outstanding shares of Common Stock on an as-converted and fully-diluted basis. The Warrants contain a cashless exercise provision and became exercisable at the option of the holder at any time beginning August 17, 2012. We can force exercise of the Warrants at any time beginning February 21, 2015 if the daily volume weighted average price (the “VWAP”) of Common Stock is, at the time of such conversion, greater than or equal to \$ 10.00 per share for the prior 45 consecutive trading day period. The Warrants expire on February 21, 2017. The exercise price of the Warrants was initially \$3.15 per share, subject to certain anti-dilution protections, including, but not limited to, stock splits and stock dividends, and issuances below the strike price or below 90% of the market price of our Common Stock. The Warrants also prohibit the payment of cash dividends for as long as the Warrants remain outstanding. As a result of the anti-dilution adjustments in the Warrants, the number of outstanding shares of our common stock represented by the Warrants was increased from 26,315,789 to 27,226,223 and the exercise price per share was reduced to \$ 3.04 per share on October 22, 2012 following the issuance of our convertible notes.

Until January 21, 2017, a holder of Warrants will not be entitled to receive shares of Common Stock upon exercise of such warrants to the extent that such receipt would result in the holder becoming a “beneficial owner” (as defined in Section 13(d) of the Securities Exchange Act of 1934, as amended (the “Exchange Act”), and the rules and regulations thereunder) of a number of shares of Common Stock exceeding a maximum percentage of the total number of shares of Common Stock then outstanding, unless such limitation has been terminated with 61 days’ notice from the holder. The maximum percentage of Common Stock that a holder of a Warrant may beneficially own is initially 5% but may be increased to 10% under certain circumstances. Upon the occurrence of a fundamental change as set forth in the Warrants, we must make an offer to repurchase all Warrants at the option value of the Warrant using Black-Scholes calculation methods and making certain assumptions described in the Black-Scholes methodology as set forth in the Warrants.

The Purchasers have entered into lock-up agreements with respect to sales (including hedging) of the Warrants for a period of 180 days from the date of the Purchase Agreement. The ZaZa LLC Members and the ZaZa Principals have similarly entered into a lock-up agreement with us, dated February 21, 2012 (the “Lock-Up Agreement”), pursuant to which the ZaZa LLC Members and the ZaZa Principals have agreed not to sell shares of Common Stock for a period of 180 days from the date of the Purchase Agreement. The ZaZa LLC Members and the ZaZa Principals have also agreed, pursuant to the Lock-Up Agreement, to limit their aggregate sales of shares of Common Stock (including hedging) until February 21, 2017 to an amount not to exceed annually a maximum percentage of the aggregate amount of Common Stock then outstanding. The maximum percentage will be determined based on the VWAP of Common Stock for the 10 trading days prior to such determination.

#### Note Amendments

On June 8, 2012, ZaZa entered into an amendment and waiver (“Amendment”) to the Securities Purchase Agreement dated February 21, 2012 (the “SPA”), relating to our 8% senior secured notes due 2017 (the “Senior Secured Notes”). The Amendment No. 1:

- permitted certain intercompany loans;
- required the consent of the holders of a majority of the Senior Secured Notes to any amendment or termination of the Eagle Ford Agreements or the French Agreements and to dispositions of oil and gas properties (which consent was obtained in connection with the entry into the waiver and Amendment No. 2 to the SPA described below); and
- required certain further amendments to the SPA, which were provided for in the Waiver and Amendment No. 2 to the SPA described below; and
- waived all existing defaults arising under the SPA, including the Company’s failure to timely provide financial statements with an unqualified opinion to the holders of the Senior Secured Notes.

In addition, immediately following the closing of the transactions contemplated by the Hess Agreement, and as contemplated by Amendment No. 2, the Company

The parties also entered into an Amended and Restated Subordination Agreement with Todd A. Brooks, a director, President and Chief Executive Officer of the Company, John Hearn, a director and Chief Operating Officer of the Company, Gaston Kearby, a director of the Company, Omega Energy, LLC, Blackstone Oil & Gas, LLC, and Lara Energy, Inc., entities controlled by Messrs. Brooks, Hearn and Kearby, specifying that payments may not be

made by the Company under the relevant subordinated promissory notes described below until after the consummation of the transactions outlined in the HoA and the related \$33.0 million pay down of the principal amount of the Senior Secured Notes, which conditions have now been satisfied.

On July 25, 2012, in connection with entry into the definitive documents with Hess contemplated under the HoA, we entered into a Waiver and Amendment No. 2 to the SPA ("Amendment No. 2). Under Amendment No. 2, we paid down the outstanding principal amount of the Senior Secured Notes by \$ 33.0 million and paid a \$3.5 million associated fee. We also recorded a charge of \$11.7 million due to the write off of issuance costs and discount amount.

Amendment No. 2 provided waivers of certain technical defaults under the SPA. Amendment No. 2 also provides for:

(a) consent rights for the holders of a majority of the Senior Secured Notes on all sale or joint venture transactions involving oil and gas properties, with certain carveouts and requirements to apply a portion of net sales proceeds to pay down the Senior Secured Notes, until such time as the Senior Secured Notes have an outstanding principal amount of \$ 25 million or less;

(b) a provision that if the Senior Secured Notes have not been paid down to \$ 35 million by February 21, 2013, the interest rate will increase from 8% to 10% per annum;

(c) a limit on additional debt incurrence of ZaZa to \$ 50 million in reserve-based lending; and

(d) a requirement that the Company engage an investment banker to assist the Company in securing a joint venture partner or partners for its Eagle Ford and Woodbine/Eaglebine assets, as well as to evaluate other strategic opportunities available to the Company, which has been satisfied by our engaging Jefferies & Company, Inc. as our financial advisors, as described above.

Effective October 16, 2012, the Company and the Senior Secured Notes holders entered into a third amendment to the Securities Purchase Agreement (the "Third Amendment"), pursuant to which the Securities Purchase Agreement was amended to permit the incurrence of the debt arising under the Convertible Senior Notes, revise certain defined terms in the Securities Purchase Agreement and in the warrants issued in connection therewith (the "Amended Warrants"), and make certain other changes.

Effective December 17, 2012, we entered into an Amendment No. 4 to the SPA ("Amendment No. 4"), pursuant to which the SPA was amended to permit the intercompany transfer of certain intercompany loans in connection with the closing of the sale of the Company's French subsidiary ZaZa Energy France SAS, revise certain defined terms in the SPA and in the warrants issued in connection therewith, and make certain other changes. We paid down the outstanding principal amount of the Senior Secured Notes by \$ 33.8 million and paid a \$ 1.7 million associated fee. We also recorded a loss of \$11.1 million on the extinguishment of debt due to the write off of issuance costs and discount amount.

#### **Convertible Senior Notes due 2017**

On October 22, 2012, the Company successfully completed the issuance and sale of \$ 40,000,000 aggregate principal amount of 9% Convertible Senior Notes due 2017 (the "Convertible Notes"). The Convertible Notes were sold in a private placement to investors that are qualified institutional buyers and accredited investors (as such terms are defined under the Securities Act), in reliance upon applicable exemptions from registration under Section 4(a)(2) of and Regulation D under the Securities Act of 1933, as amended, pursuant to Note Purchase Agreements, dated October 16, 2012 (collectively, the "Note Purchase Agreement") among the Company and the several purchasers that are signatories thereto (collectively, the "Purchasers"). The Notes were issued to the Purchasers pursuant to an Indenture, dated October 22, 2012 (the "Indenture"), among the Company, certain subsidiary guarantors party thereto (the "Guarantors"), and Wilmington Trust, National Association, as trustee thereunder. The Convertible Notes were sold to the Purchasers at a price of \$ 950 for each \$1,000 original principal amount thereof, for aggregate gross proceeds of \$ 38.0 million. The Company intends to use the net proceeds from the offering of the Convertible Notes, after discounts and offering expenses, of approximately \$ 35.2 million to fund drilling capital expenditures and leasehold transactions and for general corporate purposes.

The Convertible Notes accrue interest from October 22, 2012 and mature August 1, 2017. The Convertible Notes are the senior, unsecured obligations of the Company, bear interest at a fixed rate of 9.0% per year, payable semiannually in arrears on February 1 and August 1 of each year beginning February 1, 2013, and mature on August 1, 2017 unless earlier converted, redeemed or repurchased.



The Convertible Notes are convertible, at the option of the holder, at any time prior to the third trading day immediately preceding the maturity date, into shares of the Company's common stock, par value \$ 0.01 per share (the "Conversion Shares"), and cash in lieu of fractional shares of common stock. The initial conversion rate will be 400 shares per \$1,000 Convertible Note, reflecting a conversion premium of approximately 32.28% of the closing price of the Company's common stock on the pricing date of the offering, which equates to an initial conversion price of \$2.50 per share. In certain circumstances, after the occurrence of a fundamental change (as defined in the Indenture), the conversion rate shall be increased (according to the date of such fundamental change) for holders who convert their Convertible Notes on or after the effective date of such fundamental change. In addition, upon the occurrence of a fundamental change, holders may require the Company to repurchase for cash of all or a portion of such holder's Convertible Notes at a purchase price equal to 100% of the principal amount of the Convertible Notes to be purchased, plus any accrued and unpaid interest to, but excluding, the fundamental change repurchase date.

If a holder converts some or all of its Convertible Notes on or after May 1, 2013 but prior to August 1, 2017, in addition to the Conversion Shares, such holder will receive a coupon make-whole payment for the Convertible Notes being converted. The coupon make-whole payment will be equal to the sum of the present values of the lesser of five semi-annual interest payments or the number of semi-annual interest payments that would have been payable on such converted Convertible Notes from the last day through which interest was paid on the Convertible Notes through July 31, 2017. The Company may elect to pay such make-whole payment in either cash or, subject to shareholder approval if required under applicable stock exchange rules, shares of common stock, and if paid in shares of common stock, then the stock will be valued at 95% of the simple average of the daily volume weighted average prices for the common stock for the 10 trading days ending on and including the trading day immediately preceding the conversion date.

The Company may not redeem the Convertible Notes prior to August 1, 2015. Beginning August 1, 2015, the Company may redeem for cash all or part of the Convertible Notes if the last reported sale price of its common stock equals or exceeds 150% of the applicable conversion price for at least 20 trading days during the 30 consecutive trading day period ending on the trading day immediately prior to the date on which the Company delivers the notice of the redemption. The redemption price will equal 100% of the principal amount of the Convertible Notes to be redeemed, plus any accrued and unpaid interest to, but excluding, the redemption date.

The Indenture contains covenants that, among other things, limit the Company's ability and the ability of certain of its subsidiaries to, with certain exceptions, incur additional indebtedness or guarantees of indebtedness, and to dispose of assets, except under certain conditions and with certain exceptions, including contributions of assets to specified joint venture transactions. In addition, the terms of the Indenture require that the Company file all reports customarily filed with the SEC within the time frames required by SEC rules and provide information to permit the trading of the Convertible Notes pursuant to SEC Rule 144A, and that all current and future domestic restricted subsidiaries (as defined in the Indenture) of the Company, except for immaterial subsidiaries, jointly and severally guarantee the Convertible Notes on a senior unsecured basis. The Company will be able to designate a restricted subsidiary as an unrestricted subsidiary under specified conditions.

The Company designated its foreign subsidiaries as unrestricted. These subsidiaries had no business operations as of December 31, 2012 and had assets consisting of \$21.9 million of restricted cash and \$17.3 million of intercompany receivables. These intercompany receivables are planned to be dividended up and forgiven in accordance with lender approval, during 2013 or as soon as commercially possible.

The Indenture contains customary events of default, including failure to pay interest after a 30 day grace period, failure to pay principal when due, failure to comply with certain covenants, such as the offer to repurchase upon a fundamental change, failure to comply with other covenants after a customary grace period, cross-defaults, judgment defaults and certain bankruptcy events. If an event of default on the Convertible Notes has occurred and is continuing, the principal amount of the Convertible Notes, plus any accrued and unpaid interest, may become immediately due and payable. Upon the occurrence of certain events of default, these amounts automatically become due and payable.

In addition, if the Company elects, the sole remedy for an event of default relating to the Company's failure to comply with the SEC reporting requirements under the Indenture will, for the first 90 days after the occurrence of such an event of default, consist exclusively of the right to receive special interest on the Convertible Notes at a rate equal to 0.50% per annum of the principal amount of the Convertible Notes. If the Company elects, such special interest will be payable in the same manner and on the same dates as the stated interest payable on the Convertible

Notes.

The Convertible Notes and Conversion Shares have not been registered, nor are required to be registered, under the Securities Act or applicable state securities laws and may not be offered or sold in the United States absent registration or an applicable exemption from the registration requirements of the Securities Act and applicable state laws.

### **Subordinated Notes**

Simultaneously with the consummation of the Merger, and pursuant to the Contribution Agreement dated August 9, 2011 among the ZaZa LLC Members and ZaZa (the “Contribution Agreement”), the ZaZa LLC Members contributed all of the direct or indirect limited liability company interests in ZaZa LLC to us in exchange for (i) a number of shares of Common Stock that, in the aggregate, represented 75% of the issued and outstanding shares of Common Stock immediately after the consummation of the Combination (but without giving effect to the shares of Common Stock issuable upon exercise of the Warrants as discussed above), and (ii) subordinated notes in an aggregate amount of \$38.25 million issued to the ZaZa LLC Members as partial consideration for the Combination (the “Seller Notes”). In addition, as required under the terms of the Merger Agreement and the Contribution Agreement, we issued subordinated notes in an aggregate amount of \$9.08 million to the individuals that own and control the ZaZa LLC Members, Todd Alan Brooks, Gaston L. Kearby and John E. Hearn Jr., in respect of certain unpaid compensation amounts owing to the ZaZa Founders by ZaZa LLC (the “Compensation Notes”) for back salary, bonuses, incentive compensation or other compensation payable to them by ZaZa LLC in connection with or in respect of periods prior to the consummation of the Combination. The Seller Notes and Compensation Notes accrue interest at a rate of 8% per annum, are payable monthly in cash, and mature on August 17, 2017. Subject to certain conditions, we may make regularly scheduled interest payments to the ZaZa LLC Members and the ZaZa Founders on these notes and may prepay these notes at any time. We are required to repay these notes, pro rata, with 20% of the proceeds of any subordinated debt financing and 20% of the proceeds of any equity financing completed on or after the third anniversary of the issuance of the Senior Secured Notes, which are described above. We have not been making regular interest payments on these notes. On September 11, 2012, we made a partial interest payment on the notes and the holders of the notes agreed, subject to board approval, to defer the payment of any further accrued interest, as well as the payment of any interest that accrues after such date, until the earlier of (i) the occurrence of an event providing us with liquidity sufficient to make such payments and (ii) February 21, 2013. On October 22, 2012, we completed the issuance of \$ 40 million 9% Convertible Senior Notes due 2017 which allowed us to pay \$ 1.6 million in back interest on the Subordinated Notes. Interest is due and paid on the last day of each month.

Our Long-term debt consisted of the following:

	December 31,	
	2012	2011
Revolving line of credit	\$ -	\$ 5,000
Notes payable to members	-	3,000
Subordinated notes	47,330	-
Senior Secured Notes, net of discount (1)	23,647	-
Convertible Senior Notes, net of discount (2)	25,298	-
Subtotal	96,275	8,000
Less: current portion	(25,298)	(8,000)
Total long-term debt	\$ 70,977	\$ -

- (1) The Senior Secured Notes original issuance discount is amortized to the principal amount through the date of the first put right on February 21, 2017 using the effective interest rate method and rate of 14.94%. Additionally \$20.1 million of the original issuance discount was expensed as part of debt extinguishment loss in the year ended December 31, 2012.
- (2) The Convertible Senior Notes original issuance discount is amortized to the principal amount through maturity on August 21, 2017 using the effective interest rate method and rate of 19.04%.

A December 31, 2012, the unamortized original issuance discount related to Senior Secured Notes was \$ 9.6 million and the unamortized original issuance discount related to Convertible Senior Notes was \$ 14.7 million.

For the years ended December 31, 2012, 2011 and 2010, interest expense consisted of the following:

	Year Ended December 31,		
	2012	2011	2010
Amortization of issuance costs on Senior Secured Notes	\$ 454	\$ -	\$ -
Amortization original issuance discount on Senior Secured Notes	3,986	-	-
Interest expense on Senior Secured Notes	5,838	-	-
Amortization of issuance costs on Convertible Senior Notes	82	-	-
Amortization original issuance discount on Convertible Senior Notes	480	-	-
Interest expense on Convertible Senior Notes	690	-	-
Interest expense on Subordinated Notes	3,308	-	-
Interest expense on revolving credit line	45	-	-
Interest expense on Members' Notes	50	313	2
Other interest (income) expense	335	(49)	-
Capitalized interest	(563)	-	-
Total interest expense, net	\$ 14,705	\$ 264	\$ 2

## NOTE 9 — ASSETS HELD FOR SALE

ZaZa's Board of Directors met on November 2, 2012 and authorized management to negotiate the sale of the Hackberry prospect area including both the Conniff and Grahmann wells and unproved acreage. We have created a data room and have engaged a third party to assist in the divestiture. Currently, no market price has been set. Pursuant to ASC 360, we assessed the carrying value of the proved oil and gas properties in the Hackberry prospect area and compared to its fair value of \$0.4 million resulting in an impairment. These net assets have been classified as "Assets Held for Sale" on the consolidated balance sheet.

The following table summarizes the assets and liabilities associated with the Hackberry prospect area.

	<b>December 31, 2012</b>
Accounts receivable - revenue receivable	\$ 113
Oil and gas properties	13,095
Accumulated depletion	(3,060)
Asset retirement obligations	(183)
Total assets held for sale	<u>\$ 9,965</u>

#### **NOTE 10 —INCOME TAXES**

We are subject to income taxes in the United States and France. The current provision for taxes on income consists primarily of income taxes based on the tax laws and rates of the countries in which operations were conducted during the periods presented. All interest and penalties related to income tax is charged to general and administrative expense. We compute our provision for deferred income taxes using the liability method. Under the liability method, deferred income tax assets and liabilities are determined based on differences between financial reporting and income tax basis of assets and liabilities and are measured using the enacted tax rates and laws. The measurement of deferred tax assets is adjusted by a valuation allowance, if necessary, to reduce the future tax benefits to the amount, based on available evidence it is more likely than not deferred tax assets will be realized.

We assumed a net deferred tax liability of \$9.2 million which consisted of deferred tax assets of \$35 million due to Toreador NOLs offset by deferred tax liabilities of \$44 million due to historical deferred tax liability of \$17 million and \$27 million due to the step up of property, at the time of the Combination. As a result of events subsequent to the merger and based on the lack of positive evidence at the consolidated level, we recorded a valuation allowance to offset a portion of the deferred tax assets.

Prior to the merger, ZaZa LLC, a limited liability Company, was only subject to Texas Margin Tax, which has been determined to be an income tax, as income of the Company for federal tax purposes was reported on the tax returns of the individual partners.

As a result of the Company's divestiture of ZEF in December, 2012, the Company provided for the related tax liability of approximately \$20.7 million on the amounts that will be repatriated, which will be primarily offset by net operating losses and not expected to result in significant amount of cash tax payments.

The Company's controlled foreign corporations had significant intercompany payable and receivable balances with various U.S. legal entities that were unsettled as of the end of fiscal 2012. Under U.S. tax rules, the payable balance of a U.S. legal entity owed to a foreign CFC is considered as Section 956 property, and treated as a deemed dividend to the U.S. The Company, however, has substantial net operating losses that were in excess of the required income inclusion under Section 956. Accordingly, the recognition of Section 956 income resulted in a reduction of \$10.8 million of net operating loss deferred tax assets and an increase of \$10.8 million of our provision for income tax expense in the year ended December 31, 2012.

The Company's provision for income taxes consists of the following for the years ended December 31, 2012, 2011 and 2010.

	<b>2012</b>	<b>Year Ended December 31, 2011</b>	<b>2010</b>
Current:			
U.S. Federal	\$ -	\$ -	\$ -
U.S. State	642	123	74
Foreign	572	-	-
Deferred:			
U.S. Federal	82,162	-	-
Foreign	(456)	-	-
	<u>\$ 82,920</u>	<u>\$ 123</u>	<u>\$ 74</u>

The primary reasons for the difference between tax expense at the statutory federal income tax rate and our provision for income taxes for the years ended December 31, 2012, 2011 and 2010 were:

	2012	Year Ended December 31, 2011	2010
Statutory tax at 35%	\$ 10,102	\$ -	\$ -
(Gain) Loss on Warrants	(1,956)	-	-
Unremitted earnings of foreign subsidiary	20,674	-	-
Deemed dividend	10,795	-	-
Adjustments to valuation allowance	37,048	-	-
Foreign rate differential and other	6,257	123	74
	<u>\$ 82,920</u>	<u>\$ 123</u>	<u>\$ 74</u>

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities as of December 31, 2012 and 2011 is as follows:

	December 31, 2012	2011
Net operating loss carryforward - United States	\$ 45,180	\$ -
Net operating loss carryforward - Foreign	1,864	-
Merger costs	3,210	-
Embedded conversion options associated with Convertible Senior Notes	2,870	-
Other	161	-
Deferred tax assets	<u>53,285</u>	<u>-</u>
Valuation allowance	<u>(37,048)</u>	<u>-</u>
Net deferred tax assets	<u>\$ 16,237</u>	<u>\$ -</u>
Oil and gas properties	42,429	-
Unremitted earnings of foreign subsidiary	20,674	-
Other	299	-
Deferred tax liabilities	<u>63,402</u>	<u>-</u>
Net deferred tax liabilities	<u>\$ 47,165</u>	<u>\$ -</u>

At December 31, 2012, the Company had the following carryforwards available to reduce future taxable income:

Jurisdiction	Expiration	Amount
United States	2026 — 2032	\$ 129,086
Foreign	unlimited	\$ 5,693

Realization of our deferred tax assets, specifically our net operating loss carryforwards depends on our ability to generate taxable income within the carryforward period. Due to uncertainty related to the Company's ability to generate taxable income in the respective countries sufficient to realize all of our deferred tax assets we have recorded the following valuation allowances on our loss carryforwards and various deferred tax assets for the years ended December 31, 2012, 2011 and 2010:

	2012	Year Ended December 31, 2011	2010
United States	\$ 35,184	\$ -	\$ -
France	1,864	-	-
	<u>\$ 37,048</u>	<u>\$ -</u>	<u>\$ -</u>

ZaZa Energy Corporation and its subsidiaries file income tax returns in the United States and various local and foreign jurisdictions. We are subject to income tax examinations in the United States for taxable years 2008 - 2012. We have no uncertain tax positions at December 31, 2012.

## NOTE 11 — COMMITMENTS AND CONTINGENCIES

### Tiway Arbitration

Toreador entered into a Share Purchase Agreement (“SPA”) between Tiway Oil BC (“Tiway”), Tiway Oil AS and Toreador on September 30, 2009 for the purchase by Tiway of the entire issued share capital of Tiway Turkey Limited, f/k/a Toreador Turkey Limited (“TTL”). Tiway alleges in its request for arbitration that Toreador breached representations and warranties in the SPA as to five matters:

1. **Petrol Ofisi.** Tiway alleges that Toreador breached its representations and warranties under the SPA in respect of a third-party claim asserted by Petrol Ofisi against Toreador Turkey Ltd. in the amount of TRY 7.6 million (\$5.1 million), for which Tiway alleges Toreador is liable for an estimated TRY 2.07 million (approximately \$1.38 million), plus estimated interest of TRY 390 thousand (\$260 thousand), together with a fine of 40% of the amount claimed (i.e. an estimated further \$0.5 million). At the September 13, 2012 hearing, the Tribunal decided to complete its examination of two separate expert reports and then decide if it’s necessary to send the case-file to a third expert for the elimination of any conflicts between the first two expert reports. The hearing scheduled for November 15, 2012 was postponed until December 25, 2012. At the December 25, 2012 hearing, the court decided that Petrol Ofisi was not entitled to claim TRY 2.07 million from Tiway. Petrol Ofisi may appeal the decision.
2. **TPAO.** Tiway alleges that Toreador breached its representations and warranties under the SPA in respect of arbitration proceedings commenced by Türkiye Petrolleri Anonim Ortaklığı (“TPAO”) against TTL before the International Court of Arbitration. Two claims were heard within the same arbitration in late 2011 relating to alleged damages and losses suffered by TPAO of approximately \$3.7 million plus TRY 1,167,246 (approximately \$780 thousand), plus interest (currently unquantified) in connection with certain construction efforts in the South Akcakoca Sub-Basin (“SASB”) gas project that were undertaken while TTL was the official operator of the SASB project. The SASB project was governed by a joint operating agreement (the “JOA”) between TPAO and TTL. In both the first and the second claims, TPAO alleges that TTL breached its obligations under the JOA. Tiway is asserting its right to indemnification as to any amounts awarded to TPAO with respect to the arbitration. Tiway assumed the defense of this matter and its legal representatives in Turkey provided a detailed defense in which Tiway rejected each of the damages and losses alleged by the TPAO. The Tribunal issued its award in favor of Tiway and dismissed TPAO’s claims in their entirety.
3. **Momentum.** In 2006, TTL entered into an agreement with Momentum Engineering LLC (“Momentum”). The agreement was an EPIC contract relating to the SASB project. Momentum completed and delivered major installation works, leaving some work outstanding, namely the removal of several flotation tanks from the Ayazli tripod. The Settlement and Release Agreement for the works, signed by Momentum, TTL and the Company on August 13, 2008 specifically included a statement that Momentum would undertake to remove the fallen tanks by September 30, 2008; however it did not do so. In September 2009, TPAO, the current operator for the SASB project, sought the removal of the flotation tanks. Tiway contends that since TTL had been the operator in 2006, TTL was responsible for asking Momentum to remove the tanks, failing which TPAO would arrange for an independent contractor to do so, whereupon TTL would be responsible for claiming the cost from Momentum. In Momentum’s operation to remove the tanks in October 2009, one of the tanks fell to the seabed. Momentum stated it had no intention of removing the fallen tank and TPAO thus arranged for a third party contractor to remove the tank and invoiced \$ 118 thousand plus VAT (estimated total amount of cost is \$250 thousand) to TTL for its share of the costs in removing the tank. Tiway alleges that Toreador breached its representations and warranties under the SPA with respect to the Momentum matter and has demanded indemnification for any losses or costs suffered by it in connection with such matter.
4. **GDPA Training Obligations.** Tiway alleges that Toreador breached its representations and warranties under the SPA in respect of an alleged liability to the General Directorate of Petroleum Affairs and the

Ministry of Energy of Republic of Turkey relating to the payment of training costs pursuant to the petroleum laws of Turkey. Tiway alleges that these training costs were incurred prior to the sale of TTL to Tiway. TTL has made an estimate of its potential liability if required to meet these training obligations of approximately \$ 0.5 million.

5. **Insurance Premiums.** Tiway alleges that Toreador breached its representations and warranties under the SPA in connection with the partial rebates of two insurance premiums. Two policies were issued in the name of TTL, but when the policies were cancelled (as agreed upon the conclusion of the SPA), the rebates were paid to Toreador. While Tiway claims estimated damages of approximately \$300 thousand, Toreador only received credits and rebates for approximately \$ 108 thousand. In addition, the credits and rebates may at least in part have related to policies that were not included in the scheduled policies of the SPA.

In addition, Tiway seeks to recover the “significant” costs it has incurred in defending the above claims as damages under the SPA. ZaZa views any liability at the levels stated in claims 1.- 4. above to be remote because such claims may be deemed withdrawn or are, in management’s opinion, otherwise unsupported by the provisions in the SPA.

On December 12, 2011, Tiway Oil BV (“Tiway”) commenced arbitration against Toreador by submitting a formal Request for Arbitration to the London Court of International Arbitration (“the LCIA”) pursuant to the SPA. An arbitrator was selected in the first quarter of 2012, but no further actions have been made. On August 9, 2012, Tiway agreed a stay of the arbitration against Toreador pending the arbitrators’ award in the International Chamber of Commerce arbitration between TPAO and Tiway. Tiway and Toreador negotiated a settlement of all claims, including the insurance premium claim discussed above, for an immaterial amount of cash consideration, waiver of certain rights under the SPA, and contingent liability for the GDPA training obligations not to exceed \$ 200,000.

### **Fallen Structures**

In 2005, two separate incidents occurred offshore Turkey in the Black Sea, which resulted in the sinking of two caissons (the “Fallen Structures”) and the loss of three natural gas wells. Toreador has not been requested to or ordered by any governmental or regulatory body to remove the caissons. Therefore, ZaZa believes that the likelihood of receiving such a request or order is remote and no liability has been recorded. In connection with Toreador’s sale of its 26.75% interest in the SASB project to Petrol Ofisi in March 2009 and its sale of TTL to Tiway in October 2009, Toreador agreed to indemnify Petrol Ofisi and Tiway, respectively, against and in respect of any claims, liabilities and losses arising from the Fallen Structures. Toreador also agreed to indemnify a third-party vendor for any claims made related to these incidents. To date, no claims have been made or are currently anticipated.

### **Lundin Indemnification**

Toreador Energy France (TEF) executed on August 6, 2010, an indemnification and guarantee agreement (“IGA”) for a maximum aggregate amount of €50 million to cover Lundin International (“Lundin”) against any claim by a third party arising from drilling works executed by TEF as operator on the Mairy permit in France. The title to the Mairy permit was awarded to Lundin, TEF and EnCore (E&P) Ltd jointly in August 2007. In March 2010, Lundin communicated its desire to withdraw from the permit on which no drilling works had been performed and consequently assigned its working interest of 40% in equal parts to TEF and EnCore (E&P) Ltd. TEF subsequently assigned half of its now 50% working interest to Hess. Under French mining law, all titleholders are held jointly and severally responsible for all damages and claims relating to works on a permit. Therefore, under the IGA, TEF agreed to indemnify Lundin upon notice of any liability or claim for damages by a third party against Lundin in connection with works performed by TEF on the Mairy permit from February 15, 2010 until the transfer of title of such permit is formally accepted by the French government, which is expected to occur over the next nine months. To date, no claims have been made or are currently anticipated under the IGA.

### **FLMK/Emerald Leasing Claims**

ZaZa LLC filed a lawsuit against certain lease brokers, consultants and law firms who were involved in the leasing of acreage for the company in DeWitt and Lavaca Counties, including Emerald Leasing LLC, FLMK Acquisition, LLC, John T. Lewis, Billy Marcum, Brad Massey, Max Smith, Randy Parsley, Timothy E. Malone, Heroux & Helton PLLC, and Whitaker Chalk Swindle & Schwartz PLLC. ZaZa paid certain of these brokers for approximately 3,924 acres of leases for which the brokers have not delivered to the company. Additionally, there are

net lease acreage shortages for which ZaZa has made a claim. To the extent that the Company receives any cash settlement from these persons, it is required to share one-half of the cash settlement with Hess pursuant to the terms of the agreement dissolving the Hess joint venture.

#### **Sankalp Amercias, Inc. Casing Collar Failure**

ZaZa LLC has filed a lawsuit against Sankalp Americas, Inc. (“Sankalp”). The dispute has arisen due to the catastrophic loss of a 17,000+ foot horizontal well, the Stingray A-1H, drilled by ZaZa LLC in Walker County, Texas. While ZaZa LLC worked to complete the sixteenth stage of its hydraulic fracturing operations, a casing collar manufactured by Sankalp failed, separating completely, and causing a downhole restriction. This restriction, which could not be remediated, ultimately resulted in the loss of the entire horizontal portion of the well. ZaZa LLC seeks to recover from Sankalp for its substantial losses caused by such failure.

#### **Other**

From time to time, we are named as a defendant in other legal proceedings arising in the normal course of business. In our opinion, the final judgment or settlement, if any, which may be awarded with any suit or claim would not have a material adverse effect on our financial position, results of operations or cash flows.

#### **Range Transaction**

On March 28, 2012, ZaZa LLC entered into a Participation Agreement (the “Range Agreement”) with Range Texas Production, LLC (“Range”), a subsidiary of Range Resources Corporation, under which ZaZa LLC agreed to acquire a 75% working interest from Range in certain leases located in Walker and Grimes Counties, Texas (the “Leases”). Pursuant to the terms of the Range Agreement, Range retained a 25% working interest in the Leases and ZaZa LLC committed to drill a well (the “Commitment Well”). ZaZa LLC drilled the Commitment Well but ceased completion operations due to a restriction. As a result of the restriction, the lateral section of the well was lost and, because of the resulting operational delay, effective January 16, 2013, ZaZa LLC and Range entered into an Amendment No. 5 to the Range Agreement (the “Amendment”). The Amendment requires ZaZa LLC to (i) commence re-completion operations on the Commitment Well by March 16, 2013 (the Company has timely commenced such operations), (ii) commence drilling operations of a substitute Commitment Well (the “Substitute Well”) by July 17, 2013, and (iii) initiate sales of oil and/or gas from the Substitute Well by September 1, 2013. Failure to do so will require ZaZa to assign a 25% working interest in the Leases to Range and relinquish operatorship.

#### **NOTE 12 — FAIR VALUE MEASUREMENTS**

The carrying amounts of financial instruments including cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities approximate fair value at December 31, 2012 and 2011, due to the short-term nature or maturity of the instruments.

The warrants were valued as written call options using a Monte Carlo stock option pricing simulation. Exercise behavior prior to maturity was simulated using a Least-Squares approach based on the Longstaff-Schwartz Least Squares Monte Carlo (LSM) option pricing model. Key inputs into this valuation model are our current stock price, LIBOR zero coupon yield curve, and the underlying stock price volatility. The debt was valued under the income approach using discounted cash flows. The discounting utilized the LIBOR zero coupon yield curve and our implied credit spread. The current stock price and LIBOR yield curve are based on observable market data and are considered Level 2 inputs while the stock price volatility and implied credit spread are unobservable and thus require management’s judgment and are considered Level 3 inputs. We used average daily stock price volatility of 5% and credit spread of S&P CCC+ rated companies. The fair value measurements are considered a Level 3 measurement within the fair value hierarchy. An increase in the volatility by 5% results in a \$1.1 million increase in the fair value of the warrants. On December 31, 2012, the Senior Secured Notes, which had a book value of \$23.6 million, had a fair market value of approximately \$ 28.4 million.

The embedded conversion options were valued as written call options using a Monte Carlo stock option pricing simulation where exercise was based on periods where the stock price multiplied by shares plus the outstanding interest were greater than the value of the notes. Exercise behavior prior to maturity was simulated using a Least-Squares approach based on the Longstaff-Schwartz Least Squares Monte Carlo (LSM) option pricing model.



Key inputs into this valuation model are our current stock price, LIBOR zero coupon yield curve, credit spread curve, and the underlying stock price volatility. The debt was valued under the income approach using discounted cash flows. The discounting utilized the LIBOR zero coupon yield curve and our implied credit spread. The current stock price and LIBOR yield curve are based on observable market data and are considered Level 2 inputs while the stock price volatility and implied credit spread are unobservable and thus require management's judgment and are considered Level 3 inputs. We used average daily stock price volatility of 5% and credit spread of S&P CCC+ rated companies. The fair value measurements are considered a Level 3 measurement within the fair value hierarchy. An increase the volatility by 5% results in a \$1.5 million increase in the fair value of the conversion options. An increase in the credit spread by 500 basis points results in a \$2.4 million decrease in the fair value of the conversion options. On December 31, 2012, the Convertible Senior Notes, which had a book value of \$25.3 million, had a fair market value of approximately \$ 28.5 million.

*"ASC 820 - Fair value measurements and disclosures"*, establishes a fair value hierarchy which prioritizes the inputs to valuation techniques used to measure fair value into three levels. The fair value hierarchy gives the highest priority to quoted market prices (unadjusted) in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). Level 2 inputs are inputs, other than quoted prices included within Level 1, which are observable for the asset or liability, either directly or indirectly.

Effective January 1, 2012, we adopted the authoritative guidance that applies to all financial assets and liabilities required to be measured and reported on a fair value basis. Fair value is 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 (exit price). The guidance requires disclosure that establishes a framework for measuring fair value expands disclosure about fair value measurements and requires that fair value measurements be classified and disclosed in one of the following categories:

- Level 1: Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities. We consider active markets as those in which transactions for the assets or liabilities occur with sufficient frequency and volume to provide pricing information on an ongoing basis.
- Level 2: Quoted prices in markets that are not active, or inputs that are observable, either directly or indirectly, for substantially the full term of the asset or liability. This category includes those derivative instruments that we value using observable market data. Substantially all of these inputs are observable in the marketplace throughout the full term of the derivative instrument, can be derived from observable data or supported by observable levels at which transactions are executed in the market place. Instruments in this category include non-exchange traded derivatives such as over-the-counter commodity price swaps, certain investments and interest rate swaps.
- Level 3: Measured based on prices or valuation models that require inputs that are both significant to the fair value measurement and less observable from objective sources (i.e., supported by little or no market activity). Our valuation models for derivative contracts are primarily industry-standard models (i.e., Black-Scholes) that consider various inputs including: (a) quoted forward prices for commodities, (b) time value, (c) volatility factors, (d) counterparty credit risk and (e) current market and contractual prices for the underlying instruments, as well as other relevant economic measures. Level 3 instruments primarily include derivative instruments, such as basis swaps, commodity price collars and floors and accrued liabilities. Although we utilize third -party broker quotes to assess the reasonableness of our prices and valuation techniques, we do not have sufficient corroborating market evidence to support classifying these assets and liabilities as Level 2.

Certain assets and liabilities are reported at fair value on a nonrecurring basis in our consolidated balance sheets. The following methods and assumptions were used to estimate the fair values:

**Asset Impairments** - The Company reviews a proved oil property for impairment when events and circumstances indicate a possible decline in the recoverability of the carrying value of such property as well as an annual assessment. We estimate the undiscounted future cash flows expected in connection with the property at a field level and compare such undiscounted future cash flows to the carrying amount of the property to determine if the carrying amount is recoverable. If the carrying amount of the property exceeds its estimated undiscounted future cash flows, the carrying amount of the property is reduced to its estimated fair value. Fair value may be estimated using comparable market data, a discounted cash flow method, or a combination of the two. In the discounted cash flow method, estimated future cash flows are based on management's expectations for the future and include

estimates of future oil production, commodity prices based on commodity futures price strips as of the date of the estimate, operating and development costs, and a credit risk-adjusted discount rate.

**Goodwill** - We account for goodwill in accordance with “ASC 350 - Intangibles-Goodwill and Other” Under ASC 350, goodwill and indefinite-lived intangible assets are not amortized but are reviewed annually (or more frequently if impairment indicators arise) for impairment. Goodwill fair value is estimated using a discounted cash flow method. We perform our annual impairment test during the month of December. Because of the decline in oil forward pricing at June 30, 2012, goodwill was tested at June 30, 2012 and an impairment loss of \$39.7 million was recorded. After the recognition of the loss, no value in goodwill remained.

The following table summarizes the valuation of our liabilities measured on a recurring basis at levels of fair value. We did not have any liabilities subject to fair value measurement prior to 2012.

	Fair Value Measurement using			Total
	(Level 1)	(Level 2)	(Level 3)	
<u>At December 31, 2012:</u>				
Warrants	-	-	28,043	28,043
Embedded conversion options	-	-	21,382	21,382
Total	\$ -	\$ -	\$ 49,425	\$ 49,425

The following is a reconciliation of changes in fair value of our liabilities classified as Level 3:

	December 31, 2012
Balance at beginning of period	\$ -
Issuance of warrants at February 21, 2012	33,632
Issuance of embedded conversion options on October 22, 2012	13,183
Unrealized (gain) loss on warrants included in earnings	(5,589)
Unrealized (gain) loss on embedded conversion options included in earnings	8,199
Balance at end of period	\$ 49,425

#### NOTE 13 — IMPAIRMENT OF ASSETS

We evaluate producing property costs for impairment and reduce such costs to fair value if the sum of expected undiscounted future cash flows is less than net book value pursuant to FASB ASC 360 “Property, Plant and Equipment”, formerly Statement of Financial Accounting Standard No. 144, “Accounting for the Impairment or Disposal of Long-Lived Assets” (“ASC 360”). We assess impairment of non-producing leasehold costs and undeveloped mineral and royalty interests periodically on a field-by-field basis. We charge any impairment in value to expense in the period incurred. Oil and gas properties with a carrying value of \$59.2 million were written down to their fair value of \$51.7 million, resulting in a pretax impairment charge of \$7.5 million for the year ended December 31, 2012. Significant Level 3 assumptions associated with the calculation of discounted cash flows used in the impairment analysis include management's estimate of future natural gas and crude oil prices, production costs, development expenditures, anticipated production of proved reserves, appropriate risk-adjusted discount rates and other relevant data. We used discounted cash flows based on the December 31, 2012 NYMEX future strip pricing. Additionally capitalized lease costs totaling \$2.3 million related to expired leases were written off in the year ended December 31, 2012.

#### NOTE 14 — OPERATING LEASES

ZaZa has noncancelable office leases in Houston, Corpus Christi, Dallas and Huntsville, Texas, with lease terms until April 2019. Rent expense for the years ended December 31, 2012, 2011 and 2010 totaled \$1.2 million, \$0.7 million and \$0.2 million, respectively, before reimbursements.

Future minimum rental payments under all noncancelable operating leases as of December 31, 2012 were as follows (in thousands):

2013	\$	1,190
2014		1,180
2015		190
2016		190
2017		73
Thereafter		58
	\$	<u>2,881</u>

#### NOTE 15 — SUBSEQUENT EVENTS

The Company evaluated its December 31, 2012 financial statements for subsequent events. Other than as noted herein, the Company is not aware of any subsequent events which would require recognition or disclosure in the consolidated financial statements.

##### *Eaglebine Joint Venture with EOG*

On March 21, 2013, we entered into a Joint Exploration and Development Agreement with EOG Resources, Inc., (“our counterparty”), for the joint development of certain of our Eaglebine properties located in Walker, Grimes, Madison, Trinity, and Montgomery Counties, Texas. Under this agreement, we and our counterparty will jointly develop up to approximately 100,000 gross acres (approximately 73,000 net acres) that ZaZa currently owns in the Eaglebine trend in these counties. Our counterparty will act as the operator and will pay us certain cash amounts, the drilling and completion costs of certain specified wells, and a portion of our share of any additional seismic or well costs in order to earn their interest in these properties. Generally, ZaZa will retain a 25% working interest, our counterparty will earn a 75% working interest in the acreage, subject to the agreement, that is currently 100% owned by ZaZa. ZaZa will retain a 25% working interest, our counterparty will earn a 50% working interest, and Range will retain a 25% working interest in the acreage that is currently owned 75% by ZaZa and 25% by Range, subject to the terms of our agreement with Range. This joint development will be divided into three phases.

In the first phase, we will transfer 20,000 net acres, approximately 15,000 of which will come from our joint venture with Range, to our counterparty in exchange for a cash payment by our counterparty to us of \$10 million and an obligation of our counterparty to drill and pay 100% of the drilling and completion costs of three wells. The second of these three wells to be drilled will be the substitute well that we are required to drill pursuant to our agreement with Range described above. Drilling operations on the third well in the first phase of joint development with our counterparty must be commenced by our counterparty before December 31, 2013.

Within 60 days of completion of the third well under the first phase, our counterparty will have the option to elect to go forward with the second phase of the joint development. If they so elect, we will transfer an additional 20,000 net acres to our counterparty in exchange for a cash payment of \$20 million, an obligation of our counterparty to drill and pay 100% of the drilling and completions costs of an additional three wells, and an obligation of our counterparty to pay for up to \$1.25 million of ZaZa’s share of additional costs for seismic or well costs.

Within 60 days of completion of the second phase, our counterparty will have the option to elect to go forward with the third phase of the joint development. If they so elect, we will transfer an additional 15,000 net acres to our counterparty in exchange for a cash payment of \$20 million, an obligation of our counterparty to drill and pay 100% of the drilling and completion costs of an additional three wells, and an obligation of our counterparty to pay for up to \$1.25 million of ZaZa’s share of additional costs for seismic or well costs.

##### *Sale of Moulton acreage*

On March 5, 2013 the Company entered into a purchase and sale agreement to sell its remaining Moulton prospect for approximately \$9.2 million. This transaction is expected to close on or before April 5, 2013 and is

subject to normal closing conditions.

On March 22, 2013, we entered into an agreement to sell approximately 10,000 net acres of our properties in the Eagle Ford trend located in Fayette, Gonzalez and Lavaca Counties, Texas, which we refer to as our Moulton properties, including seven producing wells located on the Moulton properties, for approximately \$43.3 million in cash. The closing of the sale of the Moulton properties is expected to occur during the second quarter of 2013, and net proceeds from the sale, after closing purchase price adjustments and expenses, are expected to be approximately \$42 million. The closing is subject to normal closing conditions, and the amendment of ZaZa's securities purchase agreement for its senior secured notes, and there can be no assurance that this transaction will be consummated. We intend to use these net proceeds to fund a portion of capital expenditures for exploration on our other properties and/or to repay indebtedness.

*Note Amendments to 8.00% Senior Secured Notes due 2017*

On March 28, 2013, we entered into Amendment No. 5 to the SPA ("Amendment No. 5"). Under Amendment No. 5, we agreed to make a prepayment on the Senior Secured Notes with the proceeds of an asset sale, which prepayment had previously been deferred, of approximately \$4.6 million.

Amendment No. 5 amended certain requirements with respect to our 2012 financials. Amendment No. 5 also provides for:

- (a) revisions to the prepayment provisions to permit the Company to voluntarily prepay the Senior Secured Notes at 105% of their principal amount plus accrued and unpaid interest, if the aggregate principal amount of the Senior Secured Notes exceeds \$ 25 million, at 103% if the aggregate principal amount of the Senior Secured Notes exceeds \$ 15 million, and at 100% if the aggregate principal amount of the Senior Secured Notes are \$ 15 million or less;
- (b) the Company to make a prepayment to pay down the Senior Secured Notes to \$ 15 million by February 28, 2014, and a provision that if the Senior Secured Notes have not been repaid in full by February 28, 2014, the interest rate will increase from 8% to 10% per annum;
- (c) the Company to make a prepayment on the Senior Secured Notes if the Company sells some of its acreage in Sweet Home or the Company receives the release of certain escrow funds, which funds were placed in escrow for the benefit of Hess in connection with the Company's sale of its French subsidiary, in each case prior to February 28, 2014, but solely to the extent to reduce the principal outstanding balance of the Senior Secured Notes to \$ 15 million;
- (d) consent to our new joint venture in the Eaglebine with EOG without any requirement to use the proceeds of our joint venture to pay down the Senior Secured Notes;
- (e) reversion of consent rights on all joint ventures involving oil and gas properties to permit our recently announced joint venture in the Eaglebine without any requirement to use the proceeds thereof to pay down the Senior Secured Notes and to permit joint ventures in Hackberry or Sweet Home as long as 10% of the gross proceeds in excess of \$10 million are used to pay down the Senior Secured Notes;
- (f) the modification of the asset sale covenant in Amendment No. 2 to require (i) only 10% of the gross proceeds from asset sales in the Eaglebine to be used to pay down the Senior Secured Notes, (ii) only 10% of the net proceeds from the sale of the Moulton Properties to be used to pay down the Senior Secured Notes, and (iii) only 10% of the gross proceeds from asset sales in the Eagle Ford to be used to pay down the Senior Secured Notes until such time as the Notes have been paid down to \$15 million, whereupon no such paydown shall be required subject to certain requirements regarding reinvestment of funds;
- (g) the exercise price of the warrants issued in connection with the Senior Secured Notes to be reduced to \$ 2.00 per share; and the amendment of certain provisions of the lockup agreement entered into in connection with the SPA to permit certain additional categories of transfers.

**ZAZA ENERGY CORPORATION**

**SUPPLEMENTAL INFORMATION TO CONSOLIDATED FINANCIAL STATEMENTS**  
(Unaudited)

**QUARTERLY FINANCIAL INFORMATION**

	Three Months Ended			
	March 31	June 30	September 30	December 31
(In thousands, except per share data)				
<b>For the year ended December 31, 2012</b>				
Revenues	\$ 2,081	\$ 3,116	\$ 199,183	\$ 772
Operating income (loss)	(41,631)	(12,312)	176,879	(48,666)
Income (loss) from continuing operations, net of tax	(115,113)	(13,632)	163,066	(88,377)
Income (loss) from discontinued operations, net of tax	(2,710)	(35,831)	(29,234)	15,604
Net income (loss)	(117,823)	(49,463)	133,832	(72,773)
Basic income (loss) per share	(1.35)	(0.49)	1.32	(0.71)
Diluted income (loss) per share	(1.35)	(0.49)	1.02	(0.71)
<b>For the year ended December 31, 2011</b>				
Revenues	\$ 2,243	\$ 9,722	\$ 4,361	\$ 1,248
Operating income (loss)	1,237	6,462	(2,540)	(7,627)
Income (loss) from continuing operations, net of tax	1,169	6,343	(2,562)	(7,805)
Income (loss) from discontinued operations, net of tax	-	-	-	-
Net income (loss)	1,169	6,343	(2,562)	(7,805)
Basic income (loss) per share	0.02	0.08	(0.03)	(0.10)
Diluted income (loss) per share	0.02	0.08	(0.03)	(0.10)

The following amounts formerly included in revenue and operating income (loss) in our quarterly results have been reclassified as discontinued operations for the year ended December 31, 2012.

	Three Months Ended			
	March 31	June 30	September 30	December 31
(In thousands)				
Revenues of discontinued operations	3,775	7,850	8,013	8,223
Operating income (loss) of discontinued operations	(2,004)	(37,044)	(21,406)	6,799

# ZAZA ENERGY CORPORATION

## SUPPLEMENTAL INFORMATION TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

### OIL AND GAS PRODUCING ACTIVITIES

Users of this information should be aware that the process of estimating quantities of proved and proved developed oil and gas reserves is very complex, requiring significant subjective decisions in the evaluation of all available geological, engineering and economic data for each reservoir. The data for a given reservoir also may change substantially over time as a result of numerous factors, including additional development activity, evolving production history and continual reassessment of the viability of production under varying economic conditions. Consequently, material revisions to existing reserve estimates may occur from time to time.

*Reserves Estimates.* All reserve information in this report is based on estimates prepared by our independent engineering firm and is the responsibility of management. The preparation of our oil reserves estimates is completed in accordance with our prescribed internal control procedures, which include verification of data input into reserves forecasting and economics evaluation software, as well as multi-discipline management reviews.

We retain an independent engineering firm to provide annual year-end estimates of our future net recoverable oil and natural gas reserves. Estimated proved net recoverable reserves we have shown below include only those quantities that we can expect to be commercially recoverable at prices and costs in effect at the balance sheet dates under existing regulatory practices and with conventional equipment and operating methods. Proved developed reserves represent only those reserves that we may recover through existing wells. Proved undeveloped reserves include those reserves that we may recover from new wells on undrilled acreage or from existing wells on which we must make a relatively major expenditure for recompletion or secondary recovery operations.

Discounted future cash flow estimates like those shown below are not intended to represent estimates of the fair value of oil and natural gas properties. Estimates of fair value should also consider probable reserves, anticipated future oil and natural gas prices, interest rates, changes in development and production costs and risks associated with future production. Because of these and other considerations, any estimate of fair value is necessarily subjective and imprecise.

*Capitalized Costs Related to Oil and Gas Producing Activities.* The following table presents the capitalized costs relating to ZaZa's oil and gas producing activities at December 31, 2012 and 2011. Capitalized costs of \$10.0 million related to assets held for sale are excluded.

	December 31,	
	2012	2011
	(In thousands)	
Proved properties	\$ 38,788	\$ 3,610
Unproved properties	113,040	13,800
	151,828	17,410
Accumulated depreciation, depletion and amortization	(3,052)	(554)
Net oil and gas properties	\$ 148,776	\$ 16,856

*Costs Incurred.* The following table presents the costs incurred in oil and gas property acquisition, exploration, and development activities, whether capitalized or expensed for the years ended December 31, 2012, 2011 and 2010:

	Year ended December 31,		
	2012	2011	2010
	(In thousands)		
Property acquisition costs:			
Proved	\$ 540	\$ 2,797	\$ 813
Unproved	19,988	8,177	5,623
Exploration	28,366	-	-
Development	8,973	-	-
Total	<u>\$ 57,867</u>	<u>\$ 10,974</u>	<u>\$ 6,436</u>

Total costs incurred during the year ended December 31, 2012, include capitalized interest of \$0.6 million.

*Proved Reserves.* The following table presents ZaZa's proved reserves at December 2012, 2011 and 2010, along with changes in proved reserves for years ended December 31, 2012 and 2011. At December 31, 2010, ZaZa's only proved reserves related to nonoperated property interests which were deemed immaterial for disclosure purposes. ZaZa did not have proved reserves at December 31, 2009.

United States	Gas (MMcf)	Oil (MBbls)	Equivalent (MBOE)
<b>Proved reserves - December 31, 2010</b>	-	-	-
Revisions of prior estimates	-	-	-
Extensions and discoveries (1)	4,141	972	1,662
Improved recovery	-	-	-
Production	(12)	(27)	(29)
Acquisitions of reserves in-place	-	-	-
Divestitures of reserves in-place	-	-	-
<b>Proved reserves - December 31, 2011 (2)</b>	<u>4,129</u>	<u>945</u>	<u>1,633</u>
Revisions of prior estimates	(1,511)	435	183
Extensions and discoveries	1,348	2,639	2,864
Improved recovery	-	-	-
Production	(162)	(98)	(125)
Acquisitions of reserves in-place	-	-	-
Divestitures of reserves in-place	(2,091)	(858)	(1,207)
<b>Proved reserves - December 31, 2012</b>	<u>1,713</u>	<u>3,063</u>	<u>3,348</u>

(1) Consists solely of reserves in the Eagle Ford earned pursuant to the EDA with Hess.

(2) Does not include any pro forma adjustments for the HOA with Hess.

France	Gas (MMcf)	Oil (MBbls)	Equivalent (MBOE)
<b>Proved reserves - December 31, 2011</b>	-	-	-
Revisions of prior estimates	-	-	-
Extensions and discoveries	-	-	-
Improved recovery	-	-	-
Production	-	(252)	(252)
Acquisitions of reserves in-place	-	5,728	5,728
Divestitures of reserves in-place	-	(5,476)	(5,476)
<b>Proved reserves - December 31, 2012</b>	-	-	-

*Standardized Measure of Discounted Future Net Cash Flows Relating to Proved Oil and Gas Reserves.* The following information was developed utilizing procedures prescribed by FASB Accounting Standards Codification Topic 932, *Extractive Industries—Oil and Gas* (Topic 932). The information is based on estimates prepared by our independent engineering firm. The "standardized measure of discounted future net cash flows" should not be viewed as representative of the current value of our proved oil reserves. It and the other information contained in the following tables may be useful for certain comparative purposes, but should not be solely relied upon in evaluating us or our performance.

In reviewing the information that follows, we believe that the following factors should be taken into account:

- future costs and sales prices will probably differ from those required to be used in these calculations;
- actual production rates for future periods may vary significantly from the rates assumed in the calculations; and
- a 10% discount rate may not be reasonable relative to risk inherent in realizing future net oil revenues.

Under the standardized measure, future cash inflows were estimated by applying the prices used in estimating our proved oil and gas reserves to the year-end quantities of those reserves. Future cash inflows were reduced by estimated future development, abandonment and production costs based on year-end costs in order to arrive at net cash flows before tax. The standardized measure is derived from using a discount rate of 10% a year to reflect the timing of future net cash flows relating to proved oil and gas reserves.

In general, management does not rely on the following information in making investment and operating decisions. Such decisions are based upon a wide range of factors, including estimates of probable as well as proved reserves and varying price and cost assumptions considered more representative of a range of possible outcomes.



The following table presents the standardized measure of discounted future net cash flows from production of ZaZa's oil and gas reserves for the years ended December 31, 2012 and 2011:

	(In thousands)
<b>For the year ended December 31, 2012</b>	
Future cash inflows	\$ 306,203
Future production costs	(93,364)
Future development costs	(114,517)
Future income tax expense	(2,143)
Future net cash flows	96,179
10% annual discount for estimated timing of cash flows	(59,032)
Standardized measure of discounted future net cash flows related to proved reserves	<u>\$ 37,147</u>
<b>For the year ended December 31, 2011</b>	
Future cash inflows	\$ 116,837
Future production costs	(25,038)
Future development costs	(7,936)
Future income tax expense (1)	-
Future net cash flows	83,863
10% annual discount for estimated timing of cash flows	(33,520)
Standardized measure of discounted future net cash flows related to proved reserves	<u>\$ 50,343</u>

- (1) Prior to February 21, 2012, ZaZa LLC, a limited liability Company, was only subject to Texas Margin Tax, which has been determined to be an income tax, as income of the Company for federal tax purposes was reported on the tax returns of the individual partners.

The prices of oil and natural gas at December 31, 2012 and 2011, used to estimate reserves in the table shown above, were \$94.67 per Bbl and \$96.83 per Bbl, of oil, respectively, and \$2.76 per MMBtu and \$4.014 per MMBtu of natural gas, respectively. The price utilized was the proceeding twelve month average price based on closing prices on the first day of each month for the year.

*Changes in Standardized Measure of Discounted Future Net Cash Flows.* The following table presents the changes in the standardized measure of discounted future net cash flows for the year ended December 31, 2012.

	United States	France
	(In thousands)	
<b>at December 31, 2011</b>	\$ 50,343	\$ -
Net changes in prices and production costs	(203)	-
Net changes in future development costs	3,050	-
Oil and gas net revenue	(6,009)	(17,210)
Extensions and discoveries	1,347,000 27,905	1,347,000 -
Acquisition of reserves	8,741	139,581
Divestiture of reserves	(45,474)	(125,120)
Revisions of previous quantity estimates	(2,831)	-
Previously estimated development costs incurred	-	-
Net changes in taxes	(1,207)	-
Accretion of discount	3,121	-
Changes in timing and other	(289)	2,749
<b>at December 31, 2012</b>	<u>\$ 37,147</u>	<u>\$ -</u>



**ZAZA ENERGY CORPORATION**  
**SUBSIDIARIES AS OF MARCH 15, 2013**

<b><u>Company</u></b>	<b><u>Jurisdiction</u></b>
Toreador Resources Corporation	Delaware
ZaZa Energy Development, LLC	Texas
ZaZa Energy, LLC	Texas
ZaZa France SAS (f/k/a Toreador France SAS)	France
ZaZa Holdings, Inc.	Delaware
ZaZa Holding SAS (f/k/a Toreador Holding SAS)	France
ZaZa International Holding Limited Liability Company (f/k/a Toreador International Holding LLC)	Hungary
ZaZa Petroleum Management, LLC	Texas

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**CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

We consent to the incorporation by reference in the Registration Statement (Form S-8 No. 333-185586) of ZaZa Energy Corporation and in the related Prospectus of our report dated April 1, 2013, with respect to the consolidated financial statements of ZaZa Energy Corporation included in this Annual Report (Form 10-K) for the year ended December 31, 2012.

/s/ Ernst & Young LLP

Houston, Texas  
April 1, 2013

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TBPE REGISTERED ENGINEERING FIRM F-1580      FAX (713) 651-0849  
1100 LOUISIANA SUITE 4600 HOUSTON, TEXAS 77002-5294 TELEPHONE (713) 651-9191

### CONSENT OF INDEPENDENT PETROLEUM ENGINEER

We hereby consent to the use and reference of our report, delivered to ZaZa Energy Corporation (the “Company”) on March 1, 2013, relating to estimates of proved and probable reserves attributable to certain assets owned by ZaZa Energy, LLC, a subsidiary of the Company, as of December 31, 2012 (the “Reserves Report”), in the Company’s Annual Report on Form 10-K for the year ended December 31, 2012, to be filed with the U.S. Securities and Exchange Commission.

/s/ RYDER SCOTT COMPANY, L.P.

**RYDER SCOTT COMPANY, L.P.**  
TBPE Firm Registration No. F-1580

Houston, Texas  
April 1, 2013

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Rex D. Morris  
Consultant Reservoir Engineer  
600 Leopard, Suite 1314  
Corpus Christi, Texas 78401-0439  
Office: (361) 232-4323  
Fax: (888) 675--1695

**CONSENT OF INDEPENDENT PETROLEUM ENGINEER**

I hereby consent to the reference to myself as petroleum engineer and to the use and reference of my report, delivered to ZaZa Energy Corporation (the "Company") on March 14, 2012 and containing my opinion as to the proved, probable and possible reserves attributable to certain assets owned by ZaZa Energy, LLC, a subsidiary of the Company, as of January 1, 2012 (the "Reserves Report"), in the Company's Annual Report on Form 10-K for the year ended December 31, 2012, to be filed with the U.S. Securities and Exchange Commission .

Your sincerely,

/s/ Rex. D. Morris  
Rex D. Morris  
Consultant Reservoir Engineer

Corpus Christi, Texas  
April 1, 2013

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**CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350, AS ADOPTED PURSUANT TO SECTION 302 OF THE  
SARBANES-OXLEY ACT OF 2002**

I, Todd Brooks, certify that:

(1) I have reviewed this annual report on Form 10-K of ZaZa Energy Corporation;

(2) Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

(3) Based on my knowledge, the financial statements and other financial information included in this report fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

(4) The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) [reserved];

(c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

(5) The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: April 1, 2013

/s/ Todd Brooks

Todd Brooks

*Chief Executive Officer*

*(Principal Executive Officer)*

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**CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350 AS ADOPTED PURSUANT TO SECTION 302 OF THE  
SARBANES-OXLEY ACT OF 2002**

I, Ian H. Fay, certify that:

(1) I have reviewed this annual report on Form 10-K of ZaZa Energy Corporation;

(2) Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

(3) Based on my knowledge, the financial statements and other financial information included in this report fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

(4) The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) [reserved];

(c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

(5) The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: April 1, 2013

/s/ Ian H. Fay

Ian H. Fay

Chief Financial Officer

(Principal Financial Officer)

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**CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350, AS ADOPTED PURSUANT TO SECTION 906 OF THE  
SARBANES-OXLEY ACT OF 2002**

Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (subsections (a) and (b) of Section 1350, Chapter 63 of Title 18, United States Code), each of the undersigned officers of ZaZa Energy Corporation (the "Company") does hereby certify, to such officer's knowledge, that the Annual Report on Form 10-K for the period ended December 31, 2012 (the "Form 10-K") of the Company fully complies with the requirements of Section 13(a) or 15(d), as applicable, of the Securities Exchange Act of 1934, as amended, and the information contained in the Form 10-K fairly presents, in all material respects, the financial condition and results of operations of the Company as of, and for, the periods presented in the Form 10-K.

Dated: April 1, 2013

/s/ Todd Brooks  
Todd Brooks  
*Chief Executive Officer*  
(Principal Executive Officer)

Dated: April 1, 2013

/s/ Ian H. Fay  
Ian H. Fay  
*Chief Financial Officer*  
(Principal Financial Officer)

The foregoing certification is being furnished as an exhibit to the Form 10-K pursuant to Item 601(b)(32) of Regulation S-K and Section 906 of the Sarbanes-Oxley Act of 2002 (subsections (a) and (b) of Section 1350, Chapter 63 of Title 18, United States Code) and accordingly is not being filed as part of the Form 10-K for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and is not incorporated by reference into any filing of the Company, whether made before or after the date hereof, regardless of any general incorporation language in such filing.

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**ZAZA ENERGY CORPORATION**

**Estimated  
Future Reserves  
Attributable to Certain  
Leasehold Interests**

**SEC Parameters**

**As of  
December 31, 2012**

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/s/ Michael F. Stell  
Michael F. Stell, P.E.  
TBPE License No. 56416  
Advising Senior Vice President

**RYDER SCOTT COMPANY, L.P.**  
TBPE Firm Registration No. F-1580

**[SEAL]**

TBPE REGISTERED ENGINEERING FIRM F-1580      FAX (713) 651-0849  
1100 LOUISIANA    SUITE 4600HOUSTON, TEXAS 77002-5294TELEPHONE (713) 651-9191

March 1, 2013

ZaZa Energy Corporation  
1301 McKinney Street, Suite 2850  
Houston, Texas 77010

Gentlemen:

At your request, Ryder Scott Company, L.P. (Ryder Scott) has prepared an estimate of the proved and probable reserves, future production, and income attributable to certain leasehold interests of ZaZa Energy Corporation (ZaZa) as of December 31, 2012. The subject properties are located in the state of Texas. The reserves and income data were estimated based on the definitions and disclosure guidelines of the United States Securities and Exchange Commission (SEC) contained in Title 17, Code of Federal Regulations, Modernization of Oil and Gas Reporting, Final Rule released January 14, 2009 in the Federal Register (SEC regulations). Our third party study, completed on February 20, 2013 and presented herein, was prepared for public disclosure by ZaZa in filings made with the SEC in accordance with the disclosure requirements set forth in the SEC regulations.

-  
The properties evaluated by Ryder Scott represent 100 percent of the total net proved and probable liquid hydrocarbon reserves and 100 percent of the total net proved and probable gas reserves of ZaZa as of December 31, 2012.

The estimated reserves and future net income amounts presented in this report, as of December 31, 2012 are related to hydrocarbon prices. The hydrocarbon prices used in the preparation of this report are based on the average prices during the 12-month period prior to the ending date of the period covered in this report, determined as the unweighted arithmetic averages of the prices in effect on the first-day-of-the-month for each month within such period, unless prices were defined by contractual arrangements, as required by the SEC regulations. Actual future prices may vary significantly from the prices required by SEC regulations; therefore, volumes of reserves actually recovered and the amounts of income actually received may differ significantly from the estimated quantities presented in this report. The results of this study are summarized below.

SUITE 600, 1015 4TH STREET, S.W.CALGARY, ALBERTA T2R 1J4	TEL (403) 262-2799	FAX (403) 262-2790
621 17TH STREET, SUITE 1550DENVER, COLORADO 80293-1501	TEL (303) 623-9147	FAX (303) 623-4258

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**SEC PARAMETERS**  
Estimated Net Reserves and Income Data  
Certain Leasehold Interests of  
**ZaZa Energy Corporation**  
As of December 31, 2012

	Proved		
	Developed Producing	Undeveloped	Total Proved
<b><u>Net Remaining Reserves</u></b>			
Oil/Condensate – Barrels	215,580	2,556,000	2,771,580
Plant Products – Barrels	31,925	259,200	291,125
Gas – MMCF	303	1,410	1,713
<b><u>Income Data</u></b>			
Future Gross Revenue	\$ 23,271,364	\$ 268,374,454	\$ 291,645,818
Deductions	9,252,528	184,071,106	193,323,634
Future Net Income (FNI)	\$ 14,018,836	\$ 84,303,348	\$ 98,322,184
Discounted FNI @ 10%	\$ 9,781,113	\$ 28,572,723	\$ 38,353,836

	Total Probable Undeveloped
<b><u>Net Remaining Reserves</u></b>	
Oil/Condensate – Barrels	8,991,360
Plant Products – Barrels	1,078,963
Gas – MMCF	3,399
<b><u>Income Data</u></b>	
Future Gross Revenue	\$ 945,019,041
Deductions	595,690,257
Future Net Income (FNI)	\$ 349,328,784
Discounted FNI @ 10%	\$ 99,500,100

Liquid hydrocarbons are expressed in standard 42 gallon barrels. All gas volumes are reported on an “as sold basis” expressed in millions of cubic feet (MMCF) at the official temperature and pressure bases of 60 degrees Fahrenheit and 14.65 psia respectively.

The estimates of the reserves, future production, and income attributable to properties in this report were prepared using the economic software package PHDWin Petroleum Economic Evaluation Software, a copyrighted program of TRC Consultants L.C. The program was used at the request of ZaZa. Ryder Scott has found this program to be generally acceptable, but notes that certain summaries and calculations may vary due to rounding and may not exactly match the sum of the properties being summarized. Furthermore, one line economic summaries may vary slightly from the more detailed cash flow projections of the same properties, also due to rounding. The rounding differences are not material.

The future gross revenue is after the deduction of production taxes. The deductions incorporate the normal direct costs of operating the wells, product gathering and processing fees, ad valorem taxes, recompletion costs, development costs, and certain abandonment costs net of salvage. The future net income is before the deduction of state and federal income taxes and general administrative overhead, and has not been adjusted for outstanding loans that may exist nor does it include any adjustment for cash on hand or undistributed income.

Liquid hydrocarbon reserves account for approximately 98 percent and gas reserves account for the remaining 2 percent of total future gross revenue from proved reserves. Liquid hydrocarbon reserves account for approximately 99 percent and gas reserves account for the remaining 1 percent of total future gross revenue from probable reserves.

The discounted future net income shown above was calculated using a discount rate of 10 percent per annum compounded monthly. Future net income was discounted at four other discount rates which were also compounded monthly. These results are shown in summary form as follows.

Discount Rate Percent	Discounted Future Net Income As of December 31, 2012	
	Total Proved	Total Probable
5	\$49,775,909	\$184,236,977
15	\$15,024,612	\$ 53,551,966
20	\$ 6,073,667	\$ 27,510,828
25	\$ 13,246	\$ 12,262,933

The results shown above are presented for your information and should not be construed as our estimate of fair market value.

### ***Reserves Included in This Report***

The proved and probable reserves included herein conform to the definitions as set forth in the Securities and Exchange Commission's Regulations Part 210.4-10(a). An abridged version of the SEC reserves definitions from 210.4-10(a) entitled "Petroleum Reserves Definitions" is included as an attachment to this report.

The various reserve status categories are defined under the attachment entitled "Petroleum Reserves Status Definitions and Guidelines" in this report.

No attempt was made to quantify or otherwise account for any accumulated gas production imbalances that may exist. The proved and probable gas volumes included herein do not attribute gas consumed in operations as reserves.

Reserves are "estimated remaining quantities of oil and gas and related substances anticipated to be economically producible, as of a given date, by application of development projects to known accumulations." All reserve estimates involve an assessment of the uncertainty relating the likelihood that the actual remaining quantities recovered will be greater or less than the estimated quantities determined as of the date the estimate is made. The uncertainty depends chiefly on the amount of reliable geologic and engineering data available at the time of the estimate and the interpretation of these data. The relative degree of uncertainty may be conveyed by placing reserves into one of two

principal classifications, either proved or unproved. Unproved reserves are less certain to be recovered than proved reserves and may be further sub-classified as probable and possible reserves to denote progressively increasing uncertainty in their recoverability. At ZaZa's request, this report addresses the proved and probable reserves attributable to the properties evaluated herein.

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." The SEC has defined reasonable certainty for proved reserves, when based on deterministic methods, as a "high degree of confidence that the quantities will be recovered." Probable reserves are "those additional reserves that are less certain to be recovered than proved reserves but which, together with proved reserves, are as likely as not to be recovered." Possible reserves are "those additional reserves which are less certain to be recovered than probable reserves" and thus the probability of achieving or exceeding the proved plus probable plus possible reserves is low.

The reserves included herein were estimated using deterministic methods and presented as incremental quantities. Under the deterministic incremental approach, discrete quantities of reserves are estimated and assigned separately as proved, probable or possible based on their individual level of uncertainty. Because of the differences in uncertainty, caution should be exercised when aggregating quantities of oil and gas from different reserves categories. Furthermore, the reserves and income quantities attributable to the different reserve categories that are included herein have not been adjusted to reflect these varying degrees of risk associated with them and thus are not comparable.

Reserve estimates will generally be revised only as additional geologic or engineering data become available or as economic conditions change. For proved reserves, the SEC states that "as changes due to increased availability of geoscience (geological, geophysical, and geochemical), engineering, and economic data are made to the estimated ultimate recovery (EUR) with time, reasonably certain EUR is much more likely to increase or remain constant than to decrease." Moreover, estimates of proved and probable reserves may be revised as a result of future operations, effects of regulation by governmental agencies or geopolitical or economic risks. Therefore, the proved and probable reserves included in this report are estimates only and should not be construed as being exact quantities, and if recovered, the revenues therefrom, and the actual costs related thereto, could be more or less than the estimated amounts.

ZaZa's operations may be subject to various levels of governmental controls and regulations. These controls and regulations may include, but may not be limited to, matters relating to land tenure and leasing, the legal rights to produce hydrocarbons, drilling and production practices, environmental protection, marketing and pricing policies, royalties, various taxes and levies including income tax and are subject to change from time to time. Such changes in governmental regulations and policies may cause volumes of proved and probable reserves actually recovered and amounts of proved and probable income actually received to differ significantly from the estimated quantities.

The estimates of proved and probable reserves presented herein were based upon a detailed study of the properties in which ZaZa owns an interest; however, we have not made any field examination of the properties. No consideration was given in this report to potential environmental liabilities that may exist nor were any costs included by ZaZa for potential liabilities to restore and clean up damages, if any, caused by past operating practices.

### ***Estimates of Reserves***

The estimation of reserves involves two distinct determinations. The first determination results in the estimation of the quantities of recoverable oil and gas and the second determination results in the estimation of the uncertainty associated with those estimated quantities in accordance with the definitions set forth by the Securities and Exchange Commission's Regulations Part 210.4-10(a). The process of estimating the quantities of recoverable oil and gas reserves relies on the use of certain generally accepted analytical procedures. These analytical procedures fall into three broad categories or methods: (1) performance-based methods, (2) volumetric-based methods and (3) analogy. These methods may be used singularly or in combination by the reserve evaluator in the process of estimating the quantities of reserves. Reserve evaluators must select the method or combination of methods which in their professional judgment is most appropriate given the nature and amount of reliable geoscience and engineering data available at the time of the estimate, the established or anticipated performance characteristics of the reservoir being evaluated, and the stage of development or producing maturity of the property.

In many cases, the analysis of the available geoscience and engineering data and the subsequent interpretation of this data may indicate a range of possible outcomes in an estimate, irrespective of the method selected by the evaluator. When a range in the quantity of reserves is identified, the evaluator must determine the uncertainty associated with the incremental quantities of the reserves. If the reserve quantities are estimated using the deterministic incremental approach, the uncertainty for each discrete incremental quantity of the reserves is addressed by the reserve category assigned by the evaluator. Therefore, it is the categorization of reserve quantities as proved, probable and/or possible that addresses the inherent uncertainty in the estimated quantities reported. For proved reserves, uncertainty is defined by the SEC as reasonable certainty wherein the "quantities actually recovered are much more likely than not to be achieved." The SEC states that "probable reserves are those additional reserves that are less certain to be recovered than proved reserves but which, together with proved reserves, are as likely as not to be recovered." The SEC states that "possible reserves are those additional reserves that are less certain to be recovered than probable reserves and the total quantities ultimately recovered from a project have a low probability of exceeding proved plus probable plus possible reserves." All quantities of reserves within the same reserve category must meet the SEC definitions as noted above.

Estimates of reserves quantities and their associated reserve categories may be revised in the future as additional geoscience or engineering data become available. Furthermore, estimates of reserves quantities and their associated reserve categories may also be revised due to other factors such as changes in economic conditions, results of future operations, effects of regulation by governmental agencies or geopolitical or economic risks as previously noted herein.

The proved and probable reserves for the properties that we evaluated were estimated by performance methods or the analogy method. All of the proved producing reserves attributable to producing wells and/or reservoirs that we evaluated were estimated by decline curve analysis which utilized extrapolations of historical production data available through December 2012, in those cases where such data were considered to be definitive. The data utilized in this analysis were furnished to Ryder Scott by ZaZa or obtained from public data sources and were considered sufficient for the purpose thereof. All of the proved and probable undeveloped reserves that we evaluated were estimated by the analogy method. The data utilized from the analogues incorporated into our analysis were considered sufficient for the purpose thereof.

To estimate economically recoverable proved and probable oil and gas reserves and related future net cash flows, we consider many factors and assumptions including, but not limited to, the use

of reservoir parameters derived from geological, geophysical and engineering data which cannot be measured directly, economic criteria based on current costs and SEC pricing requirements, and forecasts of future production rates. Under the SEC regulations 210.4-10(a)(22)(v) and (26), proved and probable reserves must be anticipated to be economically producible from a given date forward based on existing economic conditions including the prices and costs at which economic producibility from a reservoir is to be determined. While it may reasonably be anticipated that the future prices received for the sale of production and the operating costs and other costs relating to such production may increase or decrease from those under existing economic conditions, such changes were, in accordance with rules adopted by the SEC, omitted from consideration in making this evaluation.

ZaZa has informed us that they have furnished us all of the material accounts, records, geological and engineering data, and reports and other data required for this investigation. In preparing our forecast of future proved and probable production and income, we have relied upon data furnished by ZaZa with respect to property interests owned, production and well tests from examined wells, normal direct costs of operating the wells or leases, other costs such as transportation and/or processing fees, ad valorem and production taxes, recompletion and development costs, abandonment costs after salvage, product prices based on the SEC regulations, adjustments or differentials to product prices, geological structural and isochore maps, well logs, core analyses, and pressure measurements. Ryder Scott reviewed such factual data for its reasonableness; however, we have not conducted an independent verification of the data furnished by ZaZa. We consider the factual data used in this report appropriate and sufficient for the purpose of preparing the estimates of reserves and future net revenues herein.

In summary, we consider the assumptions, data, methods and analytical procedures used in this report appropriate for the purpose hereof, and we have used all such methods and procedures that we consider necessary and appropriate to prepare the estimates of reserves herein. The proved and probable reserves included herein were determined in conformance with the United States Securities and Exchange Commission (SEC) Modernization of Oil and Gas Reporting; Final Rule, including all references to Regulation S-X and Regulation S-K, referred to herein collectively as the "SEC Regulations." In our opinion, the proved and probable reserves presented in this report comply with the definitions, guidelines and disclosure requirements as required by the SEC regulations.

#### ***Future Production Rates***

For wells currently on production, our forecasts of future production rates are based on historical performance data. If no production decline trend has been established, future production rates were held constant, or adjusted for the effects of curtailment where appropriate, until a decline in ability to produce was anticipated. An estimated rate of decline was then applied to depletion of the reserves. If a decline trend has been established, this trend was used as the basis for estimating future production rates.

Test data and other related information were used to estimate the anticipated initial production rates for those wells or locations that are not currently producing. For reserves not yet on production, sales were estimated to commence at an anticipated date furnished by ZaZa. Wells or locations that are not currently producing may start producing earlier or later than anticipated in our estimates due to unforeseen factors causing a change in the timing to initiate production. Such factors may include delays due to weather, the availability of rigs, the sequence of drilling, completing and/or recompleting wells and/or constraints set by regulatory bodies.

The future production rates from wells currently on production or wells or locations that are not currently producing may be more or less than estimated because of changes including, but not limited



to, reservoir performance, operating conditions related to surface facilities, compression and artificial lift, pipeline capacity and/or operating conditions, producing market demand and/or allowables or other constraints set by regulatory bodies.

### ***Hydrocarbon Prices***

The hydrocarbon prices used herein are based on SEC price parameters using the average prices during the 12-month period prior to the ending date of the period covered in this report, determined as the unweighted arithmetic averages of the prices in effect on the first-day-of-the-month for each month within such period, unless prices were defined by contractual arrangements. For hydrocarbon products sold under contract, the contract prices, including fixed and determinable escalations, exclusive of inflation adjustments, were used until expiration of the contract. Upon contract expiration, the prices were adjusted to the 12-month unweighted arithmetic average as previously described.

ZaZa furnished us with the above mentioned average prices in effect on December 31, 2012. These initial SEC hydrocarbon prices were determined using the 12-month average first-day-of-the-month benchmark prices appropriate to the geographic area where the hydrocarbons are sold. These benchmark prices are prior to the adjustments for differentials as described herein. The table below summarizes the “benchmark prices” and “price reference” used for the geographic area included in the report. In certain geographic areas, the price reference and benchmark prices may be defined by contractual arrangements.

The product prices which were actually used to determine the future gross revenue for each property reflect adjustments to the benchmark prices for gravity, quality, local conditions, transportation fees and/or distance from market, referred to herein as “differentials.” The differentials used in the preparation of this report were furnished to us by ZaZa. The differentials furnished to us were accepted as factual data and reviewed by us for their reasonableness; however, we have not conducted an independent verification of the data used by ZaZa to determine these differentials.

In addition, the table below summarizes the net volume weighted benchmark prices adjusted for differentials and referred to herein as the “average realized prices.” The average realized prices shown in the table below were determined from the total future gross revenue before production taxes and the total net reserves by reserve category for the geographic area and presented in accordance with SEC disclosure requirements for each of the geographic areas included in the report.

Geographic Area	Product	Price Reference	Avg Benchmark Prices	Avg Proved Realized Prices	Avg Probable Realized Prices
North America					
United States	Oil/Condensate	WTI Cushing	\$94.67/Bbl	\$104.61/Bbl	\$104.71/Bbl
	NGLs	Mont Belvieu	\$43.24/Bbl	\$38.49/Bbl	\$38.24/Bbl
	Gas	Henry Hub	\$2.76/MMBTU	\$2.95/MCF	\$2.76/MCF

The effects of derivative instruments designated as price hedges of oil and gas quantities are not reflected in our individual property evaluations.

### ***Costs***

Operating costs utilized herein are based on the operating expense reports of ZaZa and include only those costs directly applicable to the leases or wells for the properties reviewed by us. The operating costs include a portion of general and administrative costs allocated directly to the leases and wells. The operating costs for non-operated properties include the COPAS overhead costs that are allocated directly to the leases and wells under terms of operating agreements. Other costs include product gathering and processing fees. The operating costs furnished by ZaZa were accepted as factual data and reviewed by us for their reasonableness; however, we have not conducted an independent verification of the data used by ZaZa. No deduction was made for loan repayments, interest expenses, or exploration and development prepayments that were not charged directly to the leases or wells.

Development costs furnished by ZaZa are based on authorizations for expenditure for the proposed work or actual costs for similar projects. The development costs furnished by ZaZa were accepted as factual data and reviewed by us for their reasonableness; however, we have not conducted an independent verification of the data used by ZaZa. The estimated net cost of abandonment after salvage was included by ZaZa for properties where abandonment costs net of salvage were significant. ZaZa's estimates of the net abandonment costs were accepted without independent verification.

The proved and probable undeveloped reserves in this report have been incorporated herein in accordance with ZaZa's plans to develop these reserves as of December 31, 2012. The implementation of ZaZa's development plans as presented to us and incorporated herein is subject to the approval process adopted by ZaZa's management. As the result of our inquiries during the course of preparing this report, ZaZa has informed us that the development activities included herein have been subjected to and received the internal approvals required by ZaZa's management at the appropriate local, regional and/or corporate level. In addition to the internal approvals as noted, certain development activities may still be subject to specific partner AFE processes, Joint Operating Agreement (JOA) requirements or other administrative approvals external to ZaZa. Additionally, ZaZa has informed us that they are not aware of any legal, regulatory, political or economic obstacles that would significantly alter their plans.

Current costs used by ZaZa were held constant throughout the life of the properties.

### ***Standards of Independence and Professional Qualification***

Ryder Scott is an independent petroleum engineering consulting firm that has been providing petroleum consulting services throughout the world for over seventy-five years. Ryder Scott is employee-owned and maintains offices in Houston, Texas; Denver, Colorado; and Calgary, Alberta, Canada. We have over eighty engineers and geoscientists on our permanent staff. By virtue of the size of our firm and the large number of clients for which we provide services, no single client or job represents a material portion of our annual revenue. We do not serve as officers or directors of any privately-owned or publicly-traded oil and gas company and are separate and independent from the operating and investment decision-making process of our clients. This allows us to bring the highest level of independence and objectivity to each engagement for our services.

Ryder Scott actively participates in industry-related professional societies and organizes an annual public forum focused on the subject of reserves evaluations and SEC regulations. Many of our staff have authored or co-authored technical papers on the subject of reserves related topics. We

encourage our staff to maintain and enhance their professional skills by actively participating in ongoing continuing education.

Prior to becoming an officer of the Company, Ryder Scott requires that staff engineers and geoscientists have received professional accreditation in the form of a registered or certified professional engineer's license or a registered or certified professional geoscientist's license, or the equivalent thereof, from an appropriate governmental authority or a recognized self-regulating professional organization.

We are independent petroleum engineers with respect to ZaZa. Neither we nor any of our employees have any interest in the subject properties and neither the employment to do this work nor the compensation is contingent on our estimates of reserves for the properties which were reviewed.

The results of this study, presented herein, are based on technical analysis conducted by teams of geoscientists and engineers from Ryder Scott. The professional qualifications of the undersigned, the technical person primarily responsible for overseeing, reviewing and approving, the evaluation of the reserves information discussed in this report, are included as an attachment to this letter.

### ***Terms of Usage***

The results of our third party study, presented in report form herein, were prepared in accordance with the disclosure requirements set forth in the SEC regulations and intended for public disclosure as an exhibit in filings made with the SEC by ZaZa.

ZaZa makes periodic filings on Form 10-K with the SEC under the 1934 Exchange Act. Furthermore, ZaZa has certain registration statements filed with the SEC under the 1933 Securities Act into which any subsequently filed Form 10-K is incorporated by reference. We have consented to the incorporation by reference in the registration statements on Form S-3 and Form S-8 of ZaZa of the references to our name as well as to the references to our third party report for ZaZa, which appears in the December 31, 2012 annual report on Form 10-K of ZaZa. Our written consent for such use is included as a separate exhibit to the filings made with the SEC by ZaZa.

We have provided ZaZa with a digital version of the original signed copy of this report letter. In the event there are any differences between the digital version included in filings made by ZaZa and the original signed report letter, the original signed report letter shall control and supersede the digital version.

The data and work papers used in the preparation of this report are available for examination by authorized parties in our offices. Please contact us if we can be of further service.

Very truly yours,

**RYDER SCOTT COMPANY, L.P.**

TBPE Firm Registration No. F-1580

/s/ Michael F. Stell

Michael F. Stell, P.E.

TBPE License No. 56416

Advising Senior Vice President

[SEAL]

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RYDER SCOTT COMPANY PETROLEUM CONSULTANTS

### **Professional Qualifications of Primary Technical Person**

The conclusions presented in this report are the result of technical analysis conducted by teams of geoscientists and engineers from Ryder Scott Company, L.P. Mr. Michael F. Stell was the primary technical person responsible for overseeing the estimate of the reserves, future production and income.

Mr. Stell, an employee of Ryder Scott Company, L.P. (Ryder Scott) since 1992, is an Advising Senior Vice President and is responsible for coordinating and supervising staff and consulting engineers of the company in ongoing reservoir evaluation studies worldwide. Before joining Ryder Scott, Mr. Stell served in a number of engineering positions with Shell Oil Company and Landmark Concurrent Solutions. For more information regarding Mr. Stell's geographic and job specific experience, please refer to the Ryder Scott Company website at [www.ryderscott.com/Experience/Employees](http://www.ryderscott.com/Experience/Employees).

Mr. Stell earned a Bachelor of Science degree in Chemical Engineering from Purdue University in 1979 and a Master of Science Degree in Chemical Engineering from the University of California, Berkeley, in 1981. He is a licensed Professional Engineer in the State of Texas. He is also a member of the Society of Petroleum Engineers and the Society of Petroleum Evaluation Engineers.

In addition to gaining experience and competency through prior work experience, the Texas Board of Professional Engineers requires a minimum of fifteen hours of continuing education annually, including at least one hour in the area of professional ethics, which Mr. Stell fulfills. As part of his 2009 continuing education hours, Mr. Stell attended an internally presented 13 hours of formalized training as well as a day-long public forum relating to the definitions and disclosure guidelines contained in the United States Securities and Exchange Commission Title 17, Code of Federal Regulations, Modernization of Oil and Gas Reporting, Final Rule released January 14, 2009 in the Federal Register. Mr. Stell attended an additional 15 hours of formalized in-house training as well as an additional five hours of formalized external training during 2009 covering such topics as the SPE/WPC/AAPG/SPEE Petroleum Resources Management System, reservoir engineering, geoscience and petroleum economics evaluation methods, procedures and software and ethics for consultants. As part of his 2010 continuing education hours, Mr. Stell attended an internally presented six hours of formalized training and ten hours of formalized external training covering such topics as updates concerning the implementation of the latest SEC oil and gas reporting requirements, reserve reconciliation processes, overviews of the various productive basins of North America, evaluations of resource play reserves, evaluation of enhanced oil recovery reserves, and ethics training. For 2011 and 2012, as of the date of this report, Mr. Stell has 20 hours of continuing education hours relating to reserves, reserve evaluations, and ethics.

Based on his educational background, professional training and over 30 years of practical experience in the estimation and evaluation of petroleum reserves, Mr. Stell has attained the professional qualifications for a Reserves Estimator and Reserves Auditor set forth in Article III of the "Standards Pertaining to the Estimating and Auditing of Oil and Gas Reserves Information" promulgated by the Society of Petroleum Engineers as of February 19, 2007.

## PETROLEUM RESERVES DEFINITIONS

As Adapted From:

**RULE 4-10(a) of REGULATION S-X PART 210  
UNITED STATES SECURITIES AND EXCHANGE COMMISSION (SEC)**

### ***PREAMBLE***

On January 14, 2009, the United States Securities and Exchange Commission (SEC) published the “Modernization of Oil and Gas Reporting; Final Rule” in the Federal Register of National Archives and Records Administration (NARA). The “Modernization of Oil and Gas Reporting; Final Rule” includes revisions and additions to the definition section in Rule 4-10 of Regulation S-X, revisions and additions to the oil and gas reporting requirements in Regulation S-K, and amends and codifies Industry Guide 2 in Regulation S-K. The “Modernization of Oil and Gas Reporting; Final Rule”, including all references to Regulation S-X and Regulation S-K, shall be referred to herein collectively as the “SEC regulations”. The SEC regulations take effect for all filings made with the United States Securities and Exchange Commission as of December 31, 2009, or after January 1, 2010. Reference should be made to the full text under Title 17, Code of Federal Regulations, Regulation S-X Part 210, Rule 4-10(a) for the complete definitions (direct passages excerpted in part or wholly from the aforementioned SEC document are denoted in italics herein).

*Reserves are estimated remaining quantities of oil and gas and related substances anticipated to be economically producible, as of a given date, by application of development projects to known accumulations.* All reserve estimates involve an assessment of the uncertainty relating the likelihood that the actual remaining quantities recovered will be greater or less than the estimated quantities determined as of the date the estimate is made. The uncertainty depends chiefly on the amount of reliable geologic and engineering data available at the time of the estimate and the interpretation of these data. The relative degree of uncertainty may be conveyed by placing reserves into one of two principal classifications, either proved or unproved. Unproved reserves are less certain to be recovered than proved reserves and may be further sub-classified as probable and possible reserves to denote progressively increasing uncertainty in their recoverability. Under the SEC regulations as of December 31, 2009, or after January 1, 2010, a company may optionally disclose estimated quantities of probable or possible oil and gas reserves in documents publicly filed with the SEC. The SEC regulations continue to prohibit disclosure of estimates of oil and gas resources other than reserves and any estimated values of such resources in any document publicly filed with the SEC unless such information is required to be disclosed in the document by foreign or state law as noted in §229.1202 Instruction to Item 1202.

Reserves estimates will generally be revised only as additional geologic or engineering data become available or as economic conditions change.

Reserves may be attributed to either natural energy or improved recovery methods. Improved recovery methods include all methods for supplementing natural energy or altering natural forces in the reservoir to increase ultimate recovery. Examples of such methods are pressure maintenance, natural gas cycling, waterflooding, thermal methods, chemical flooding, and the use of miscible and immiscible displacement fluids. Other improved recovery methods may be developed in the future as petroleum technology continues to evolve.

Reserves may be attributed to either conventional or unconventional petroleum accumulations. Petroleum accumulations are considered as either conventional or unconventional based on the nature of their in-place characteristics, extraction method applied, or degree of processing prior to sale. Examples of unconventional petroleum accumulations include coalbed or coalseam methane

(CBM/CSM), basin-centered gas, shale gas, gas hydrates, natural bitumen and oil shale deposits. These unconventional accumulations may require specialized extraction technology and/or significant processing prior to sale.

Reserves do not include quantities of petroleum being held in inventory.

Because of the differences in uncertainty, caution should be exercised when aggregating quantities of petroleum from different reserves categories.

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#### **RESERVES (SEC DEFINITIONS)**

Securities and Exchange Commission Regulation S-X §210.4-10(a)(26) defines reserves as follows:

***Reserves.*** *Reserves are estimated remaining quantities of oil and gas and related substances anticipated to be economically producible, as of a given date, by application of development projects to known accumulations. In addition, there must exist, or there must be a reasonable expectation that there will exist, the legal right to produce or a revenue interest in the production, installed means of delivering oil and gas or related substances to market, and all permits and financing required to implement the project.*

***Note to paragraph (a)(26):*** *Reserves should not be assigned to adjacent reservoirs isolated by major, potentially sealing, faults until those reservoirs are penetrated and evaluated as economically producible. Reserves should not be assigned to areas that are clearly separated from a known accumulation by a non-productive reservoir (i.e., absence of reservoir, structurally low reservoir, or negative test results). Such areas may contain prospective resources (i.e., potentially recoverable resources from undiscovered accumulations).*

#### **PROVED RESERVES (SEC DEFINITIONS)**

Securities and Exchange Commission Regulation S-X §210.4-10(a)(22) defines proved oil and gas reserves as follows:

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

*(i) The area of the reservoir considered as proved includes:*

*(A) The area identified by drilling and limited by fluid contacts, if any, and*

*(B) Adjacent undrilled portions of the reservoir that can, with reasonable certainty, be judged to be continuous with it and to contain economically producible oil or gas on the basis of available geoscience and engineering data.*

**PROVED RESERVES (SEC DEFINITIONS) CONTINUED**

*(ii) In the absence of data on fluid contacts, proved quantities in a reservoir are limited by the lowest known hydrocarbons (LKH) as seen in a well penetration unless geoscience, engineering, or performance data and reliable technology establishes a lower contact with reasonable certainty.*

*(iii) Where direct observation from well penetrations has defined a highest known oil (HKO) elevation and the potential exists for an associated gas cap, proved oil reserves may be assigned in the structurally higher portions of the reservoir only if geoscience, engineering, or performance data and reliable technology establish the higher contact with reasonable certainty.*

*(iv) Reserves which can be produced economically through application of improved recovery techniques (including, but not limited to, fluid injection) are included in the proved classification when:*

*(A) Successful testing by a pilot project in an area of the reservoir with properties no more favorable than in the reservoir as a whole, the operation of an installed program in the reservoir or an analogous reservoir, or other evidence using reliable technology establishes the reasonable certainty of the engineering analysis on which the project or program was based; and*

*(B) The project has been approved for development by all necessary parties and entities, including governmental entities.*

*(v) Existing economic conditions include prices and costs at which economic producibility from a reservoir is to be determined. The price shall be the average price during the 12-month period prior to the ending date of the period covered by the report, determined as an unweighted arithmetic average of the first-day-of-the-month price for each month within such period, unless prices are defined by contractual arrangements, excluding escalations based upon future conditions.*

**PROBABLE RESERVES (SEC DEFINITIONS)**

Securities and Exchange Commission Regulation S-X §210.4-10(a)(18) defines probable oil and gas reserves as follows:

***Probable reserves.*** *Probable reserves are those additional reserves that are less certain to be recovered than proved reserves but which, together with proved reserves, are as likely as not to be recovered.*

*(i) When deterministic methods are used, it is as likely as not that actual remaining quantities recovered will exceed the sum of estimated proved plus probable reserves. When probabilistic methods are used, there should be at least a 50% probability that the actual quantities recovered will equal or exceed the proved plus probable reserves estimates.*

*(ii) Probable reserves may be assigned to areas of a reservoir adjacent to proved reserves where data control or interpretations of available data are less certain, even if the interpreted reservoir continuity of structure or productivity does not meet the reasonable certainty criterion.*

*Probable reserves may be assigned to areas that are structurally higher than the proved area if these areas are in communication with the proved reservoir.*

**PROBABLE RESERVES (SEC DEFINITIONS) CONTINUED**

*(iii) Probable reserves estimates also include potential incremental quantities associated with a greater percentage recovery of the hydrocarbons in place than assumed for proved reserves.*

*(iv) See also guidelines in paragraphs (a)(17)(iv) and (a)(17)(vi) of this section.*

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## PETROLEUM RESERVES STATUS DEFINITIONS AND GUIDELINES

As Adapted From:  
RULE 4-10(a) of REGULATION S-X PART 210  
UNITED STATES SECURITIES AND EXCHANGE COMMISSION (SEC)

and

### PETROLEUM RESOURCES MANAGEMENT SYSTEM (SPE-PRMS)

Sponsored and Approved by:  
SOCIETY OF PETROLEUM ENGINEERS (SPE)  
WORLD PETROLEUM COUNCIL (WPC)  
AMERICAN ASSOCIATION OF PETROLEUM GEOLOGISTS (AAPG)  
SOCIETY OF PETROLEUM EVALUATION ENGINEERS (SPEE)

Reserves status categories define the development and producing status of wells and reservoirs. Reference should be made to Title 17, Code of Federal Regulations, Regulation S-X Part 210, Rule 4-10(a) and the SPE-PRMS as the following reserves status definitions are based on excerpts from the original documents (direct passages excerpted from the aforementioned SEC and SPE-PRMS documents are denoted in italics herein).

### **DEVELOPED RESERVES (SEC DEFINITIONS)**

Securities and Exchange Commission Regulation S-X §210.4-10(a)(6) defines developed oil and gas reserves as follows:

- *Developed oil and gas reserves are reserves of any category that can be expected to be recovered:*
  - (i) *Through existing wells with existing equipment and operating methods or in which the cost of the required equipment is relatively minor compared to the cost of a new well; and*
  - (ii) *Through installed extraction equipment and infrastructure operational at the time of the reserves estimate if the extraction is by means not involving a well.*

### **Developed Producing (SPE-PRMS Definitions)**

While not a requirement for disclosure under the SEC regulations, developed oil and gas reserves may be further sub-classified according to the guidance contained in the SPE-PRMS as Producing or Non-Producing.

- **Developed Producing Reserves**  
*Developed Producing Reserves are expected to be recovered from completion intervals that are open and producing at the time of the estimate.*  
  
*Improved recovery reserves are considered producing only after the improved recovery project is in operation.*

**Developed Non-Producing**

*Developed Non-Producing Reserves include shut-in and behind-pipe reserves.*

**Shut-In**

*Shut-in Reserves are expected to be recovered from:*

- (1) *completion intervals which are open at the time of the estimate, but which have not started producing;*
- (2) *wells which were shut-in for market conditions or pipeline connections; or*
- (3) *wells not capable of production for mechanical reasons.*

**Behind-Pipe**

*Behind-pipe Reserves are expected to be recovered from zones in existing wells, which will require additional completion work or future re-completion prior to start of production.*

*In all cases, production can be initiated or restored with relatively low expenditure compared to the cost of drilling a new well.*

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**UNDEVELOPED RESERVES (SEC DEFINITIONS)**

Securities and Exchange Commission Regulation S-X §210.4-10(a)(31) defines undeveloped oil and gas reserves as follows:

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*Undeveloped oil and gas reserves are reserves of any category that are expected to be recovered from new wells on undrilled acreage, or from existing wells where a relatively major expenditure is required for recompletion.*

*(i) Reserves on undrilled acreage shall be limited to those directly offsetting development spacing areas that are reasonably certain of production when drilled, unless evidence using reliable technology exists that establishes reasonable certainty of economic producibility at greater distances.*

*(ii) Undrilled locations can be classified as having undeveloped reserves only if a development plan has been adopted indicating that they are scheduled to be drilled within five years, unless the specific circumstances, justify a longer time.*

*(iii) Under no circumstances shall estimates for undeveloped reserves be attributable to any acreage for which an application of fluid injection or other improved recovery technique is contemplated, unless such techniques have been proved effective by actual projects in the same reservoir or an analogous reservoir, as defined in paragraph (a)(2) of this section, or by other evidence using reliable technology establishing reasonable certainty.*