CONTANGO OIL & GAS CO
Form 10-K
March 09, 2018
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

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

For the fiscal year ended December 31, 2017

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

For the transition period from to

Commission file number 001-16317

CONTANGO OIL & GAS COMPANY

(Exact name of registrant as specified in its charter)

Delaware	95-4079863
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

717 Texas Avenue, Suite 2900

Houston, Texas 77002

(Address of principal executive offices)

(713) 236-7400

(Registrant's telephone number, including area code)

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

Title of each class	Name of exchange on which registered
Common Stock, Par Value $0.04 per share	NYSE American

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

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

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

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

Indicate by 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, smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	Accelerated filer	Non-accelerated filer (Do not check if smaller reporting company)	Smaller reporting company Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

At June 30, 2017, the aggregate market value of the registrant's common stock held by non-affiliates (based upon the closing sale price of shares of such common stock as reported on the NYSE American, was $129.5 million. As of March 5, 2018, there were 25,479,438 shares of the registrant's common stock outstanding.

Documents Incorporated by Reference

Items 10, 11, 12, 13 and 14 of Part III have been omitted from this report since the registrant will file with the Securities and Exchange Commission, not later than 120 days after the close of its fiscal year, a definitive proxy statement, pursuant to Regulation 14A. The information required by Items 10, 11, 12, 13 and 14 of this report, which will appear in the definitive proxy statement, is incorporated by reference into this Form 10-K.

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CONTANGO OIL & GAS COMPANY AND SUBSIDIARIES

ANNUAL REPORT ON FORM 10-K FOR THE FISCAL YEAR ENDED DECEMBER 31, 2017

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CAUTIONARY STATEMENT ABOUT FORWARD-LOOKING STATEMENTS

Certain statements contained in this report may contain “forward-looking statements” within the meaning of Section 27A of the Securities Act of 1933, and Section 21E of the Securities Exchange Act of 1934, as amended. The words and phrases “should be”, “will be”, “believe”, “expect”, “anticipate”, “estimate”, “forecast”, “goal” and similar expressions ide forward-looking statements and express our expectations about future events. Although we believe the expectations reflected in such forward-looking statements are reasonable, such expectations may not occur. These forward-looking statements are made subject to certain risks and uncertainties that could cause actual results to differ materially from those stated. Risks and uncertainties that could cause or contribute to such differences include, without limitation, those discussed in the section entitled “Risk Factors” included in this report and those factors summarized below:

- our ability to successfully develop our undeveloped acreage in the Southern Delaware Basin, integrate the operations relating thereto with our existing operations and realize the benefits associated therewith;
- our financial position;
- our business strategy, including outsourcing;
- meeting our forecasts and budgets;
- expectations regarding natural gas and oil markets in the United States;
- volatility in natural gas, natural gas liquids and oil prices;
- operational constraints, start-up delays and production shut-ins at both operated and non-operated production platforms, pipelines and natural gas processing facilities;
- the risks associated with acting as operator of deep high pressure and high temperature wells, including well blowouts and explosions;
- the risks associated with exploration, including cost overruns and the drilling of non-economic wells or dry holes, especially in prospects in which we have made a large capital commitment relative to the size of our capitalization structure;
- the timing and successful drilling and completion of natural gas and oil wells;
- our ability to generate sufficient cash flow from operations, borrowings or other sources to enable us to fund our operations, satisfy our obligations, and fund our drilling program;
- the cost and availability of rigs and other materials, services, and operating equipment;
- timely and full receipt of sale proceeds from the sale of our production;
- the ability to find, acquire, market, develop and produce new natural gas and oil properties;
- interest rate volatility;
- uncertainties in the estimation of proved reserves and in the projection of future rates of production and timing of development expenditures;
- the need to take impairments on our properties due to lower commodity prices;
- the ability to post additional collateral for current bonds or comply with new supplemental bonding requirements imposed by the Bureau of Ocean Energy Management;
- operating hazards attendant to the natural gas and oil business including weather, environmental risks, accidental spills, blowouts and pipeline ruptures, and other risks;

- downhole drilling and completion risks that are generally not recoverable from third parties or insurance;
- potential mechanical failure or under-performance of significant wells, production facilities, processing plants or pipeline mishaps;
- actions or inactions of third-party operators of our properties;
- actions or inactions of third-party operators of pipelines or processing facilities;
- the ability to retain key members of senior management and key technical employees and to find and retain skilled personnel;
- strength and financial resources of competitors;
- federal and state legislative and regulatory developments and approvals (including additional taxes and changes in environmental regulations);
- worldwide economic conditions;
- the ability to construct and operate infrastructure, including pipeline and production facilities;
- the continued compliance by us with various pipeline and gas processing plant specifications for the gas and condensate produced by us;
- operating costs, production rates and ultimate reserve recoveries of our natural gas and oil discoveries;
- expanded rigorous monitoring and testing requirements; and
- ability to obtain adequate insurance coverage on commercially reasonable terms.

Any of these factors and other factors contained in this report could cause our actual results to differ materially from the results implied by these or any other forward-looking statements made by us or on our behalf. Although we believe our estimates and assumptions to be reasonable, they are inherently uncertain and involve a number of risks and uncertainties that are beyond our control. Our assumptions about future events may prove to be inaccurate. We caution you that the forward-looking statements contained in this report are not guarantees of future performance, and we cannot assure you that those statements will be realized or the forward-looking events and circumstances will occur. All forward-looking statements speak only as of the date of this report.

Reserve engineering is a process of estimating underground accumulations of oil, natural gas and natural gas liquids that cannot be measured in an exact way. The accuracy of any reserve estimate depends on the quality of available data, the interpretation of such data and price and cost assumptions made by reserve engineers. In addition, the results of drilling, testing and production activities may justify revisions of estimates that were made previously. If significant, such revisions would change the schedule of any further production and development drilling. Accordingly, reserve estimates may differ significantly from the quantities of oil, natural gas and natural gas liquids that are ultimately recovered.

All forward-looking statements, expressed or implied, in this report are expressly qualified in their entirety by this cautionary statement. This cautionary statement should also be considered in connection with any subsequent written or oral forward-looking statements that we or any person acting on our behalf may issue.

We do not intend to publicly update or revise any forward-looking statements as a result of new information, future events or otherwise, except as required by law. These cautionary statements qualify all forward-looking statements attributable to us or persons acting on our behalf.

All references in this Form 10-K to the “Company”, “Contango”, “we”, “us” or “our” are to Contango Oil & Gas Company and wholly-owned subsidiaries. Unless otherwise noted, all information in this Form 10-K relating to natural gas and oil reserves and the estimated future net cash flows attributable to those reserves is based on estimates prepared by independent engineers, and is net to our interest.

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PART I

Item 1. Business

Overview

We are a Houston, Texas based independent oil and natural gas company. Our business is to maximize production and cash flow from our offshore properties in the shallow waters of the Gulf of Mexico ("GOM") and onshore properties in Texas and Wyoming and to use that cash flow to explore, develop, exploit, increase production from and acquire crude oil and natural gas properties in onshore West Texas, the Texas Gulf Coast and the Rocky Mountain regions of the United States.

The following table lists our primary producing areas as of December 31, 2017:

Location	Formation
Gulf of Mexico	Offshore Louisiana - water depths less than 300 feet
Madison and Grimes counties, Texas	Woodbine (Upper Lewisville)
Pecos County, Texas	Southern Delaware Basin (Wolfcamp)
Other Texas Gulf Coast	Conventional and smaller unconventional formations
Zavala and Dimmit counties, Texas	Buda / Austin Chalk
Weston County, Wyoming	Muddy Sandstone
Sublette County, Wyoming	Jonah Field (1)

(1) Through a 37% equity investment in Exaro Energy III LLC ("Exaro"). Production from this investment is not included in our reported production results or in our reported reserves for any periods reported herein.

Since October 2013, upon the merger with Crimson Exploration Inc. ("Crimson") (the "Merger"), and prior to the decline in crude oil and natural gas prices in 2015, we focused our drilling efforts on liquids-rich horizontal resource plays. Beginning in the second half of 2015, we reduced our drilling program in response to the challenging commodity price environment, and instead focused on: (i) the preservation of our strong and flexible financial position, including limiting our overall capital expenditure budget; (ii) the identification of opportunities for cost and production efficiencies in all areas of our operations; and (iii) the maintenance of core leases and the continued identification of new resource potential opportunities. As a result, until the latter half of 2016, our only drilling activity was in Weston County, Wyoming, where we completed our third well targeting the Muddy Sandstone formation. During the third quarter of 2016, we acquired a 12,100 gross acre position (5,000 net) in the Southern Delaware Basin in Pecos County, Texas (the "Acquisition"), and as of December 31, 2017, had increased our acreage in the Southern Delaware Basin to 16,500 gross acres (6,800 net). Since the Acquisition, we have begun production from seven wells in the Southern Delaware Basin and are waiting on completion of an eighth well. We currently expect that the Southern Delaware Basin position will continue to be the primary focus of our drilling program for 2018.

In addition to our above producing properties, we also have (i) operated producing properties in the Haynesville Shale, Mid Bossier Shale and the James Lime formations in East Texas and (ii) operated conventional producing properties in the south and southeast areas of Texas. In December 2016, we sold our operated producing properties in the Denver Julesburg Basin (“DJ Basin”) in Weld and Adams counties in Colorado.

During the quarter ended September 30, 2016, in conjunction with the Acquisition, we completed an underwritten public offering of 5,360,000 shares of our common stock for net proceeds of approximately $50.5 million, which were used to fund the initial purchase of this acreage and provide funding for the costs associated with drilling our initial wells in the Southern Delaware Basin.

Our production for the year ended December 31, 2017 was approximately 20.1 Bcfe (or 55.1 Mmcfe/d), was 68% from our offshore properties and was 69% natural gas. Our production for the three months ended December 31, 2017 was approximately 4.8 Bcfe (or 51.8 Mmcfe/d), was 66% from our offshore properties and was 68% natural gas. As of December 31, 2017, our proved reserves were approximately 65% proved developed, were 40% offshore, were 48% natural gas and were 98% attributed to wells and properties operated by us.

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As of December 31, 2017, our proved reserves, as estimated by Netherland, Sewell & Associates, Inc. (“NSAI”) and William M. Cobb and Associates (“Cobb”), our independent petroleum engineering firms, in accordance with reserve reporting guidelines required by the Securities and Exchange Commission (“SEC”), were approximately 189.3 Bcfe, consisting of 91.7 Bcf of natural gas, 10.6 MMBbl of crude oil and condensate and 5.6 MMBbl of natural gas liquids (“NGLs”), with a present value, discounted at a 10% rate (PV 10), of $257.3 million, and a Standardized Measure of Discounted Future Net Cash Flows (“Standardized Measure”) of $255.9 million. PV-10 as of December 31, 2017 was based on adjusted prices of $2.92 per MMbtu of natural gas, $47.41 per barrel of oil, and $18.59 per barrel of NGLs. PV-10 is not an accounting principle generally accepted in the United States of America (“GAAP”) and is therefore classified as a non-GAAP financial measure. A reconciliation of our Standardized Measure to PV 10 is provided under “Item 2. Properties PV-10”.

The following summary table sets forth certain information with respect to our proved reserves as of December 31, 2017 (excluding reserves attributable to our investment in Exaro), as estimated by NSAI and Cobb, and our net average daily production for the year ended December 31, 2017:

Region	Estimated Proved Reserves (Bcfe)	% Crude Oil / Condensate	Natural % Gas	% Natural Gas Liquids	% Proved Developed	Average Daily Production (Mmcfe/d)
Offshore GOM	75.4	3 %	82 %	15 %	100 %	37.7
Southeast Texas	30.9	41 %	37 %	22 %	63 %	8.0
South Texas	25.7	46 %	40 %	14 %	64 %	5.6
West Texas	55.5	64 %	15 %	21 %	19 %	2.6
Other (1)	1.8	65 %	32 %	3 %	100 %	1.2
Total	189.3					55.1

(1) Includes East Texas, Mississippi, Louisiana and Wyoming.

The following summary table sets forth certain information with respect to the proved reserves attributable to our investment in Exaro, as of December 31, 2017, as estimated by W.D. Von Gonten and Associates (“Von Gonten”), and our net share of Exaro’s average daily production for the year ended December 31, 2017:

Region	Estimated Proved Reserves (Bcfe)	% Crude Oil / Condensate	% Natural Gas	% Natural Gas Liquids	% Proved Developed	Average Daily Production (Mmcfe/d)
Investment in Exaro	30.7	6 %	94 %	— %	99 %	26.4

Our Strategy

Our long-term business strategy is:

- Enhancing our portfolio by dedicating the majority of our drilling capital to our oil and liquids-rich opportunities. A key element of our long term strategy is to continue to develop the oil and natural gas liquids resource potential that we believe exists in numerous formations within our various oil/liquids weighted resource plays, and where possible, to expand our presence in those plays. Due to the current superior economics of oil production, as compared to natural gas, we expect to focus on oil and liquids-weighted opportunities as we strive to transition from a heavily weighted natural gas production profile to a more balanced reserve and production profile between oil/liquids and natural gas.

For the foreseeable future, we will focus our drilling capital on the Southern Delaware Basin position, as we believe it provides excellent returns in the current oil price environment. We believe we possess the flexibility to focus on the development of our Southern Delaware Basin potential without jeopardizing our acreage position in other areas, as the vast majority of our acreage in those other areas is held by production or has longer term lease terms.

- Pursuing accretive, opportunistic acquisitions that meet our strategic and financial objectives. We intend to evaluate opportunistic acquisitions of crude oil and natural gas properties, both undeveloped and developed, in areas where we currently have a presence and/or specific operating expertise, and to pursue undeveloped acreage positions, at reasonable cost, in new areas that we believe to be complementary to our existing plays and feel have significant exploration, exploitation or operational upside. We believe that the ongoing low commodity price environment might provide growth opportunities for us through potential corporate combinations.

- Selectively exploiting, in a higher commodity price environment, our existing onshore producing conventional natural gas property portfolio to generate additional cash flows. We believe our multi-year drilling inventory of

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exploitation opportunities on our existing onshore conventional natural gas oriented producing properties provides us with a solid, dependable platform for future reserve and production growth. We will continuously monitor the commodity price environment and technical advancements, and if warranted, make adjustments to our investment strategy.

We currently expect to focus our 2018 capital program on our Southern Delaware Basin acreage, which is expected to continue to generate positive returns on our drilling investment in the current price environment. Assuming results are as expected, and market conditions remain favorable, we will proceed to drill throughout the year. Until a sustained improvement in commodity prices occurs, we do not currently expect to devote meaningful capital to our other areas, but will devote capital to those areas to fulfill leasehold commitments, preserve core acreage and, where determined appropriate to do so, expand our presence in those existing areas. We will continue to make balance sheet strength a priority in 2018 by limiting capital expenditures to a level that can be funded through internally generated cash flow and non-core asset sales. We will continue to evaluate new organic opportunities for growth and will continue to evaluate pursuing stressed or distressed acquisition opportunities that may arise in this low price environment. We retain the flexibility to be more aggressive in our drilling plans should planned results exceed expectations, should commodity prices continue to improve, and/or we continue to show progress in reducing our drilling and completion costs, thereby making an expansion of our drilling program an appropriate business decision. Our 2018 capital expenditure budget is initially expected to include the following:

- Pecos County, Texas – We forecast capital expenditures of approximately $52 million for drilling in this area.
- Other – We forecast capital expenditures of approximately $2 million for unproved leasehold acquisition costs.

Properties

Offshore Gulf of Mexico

As of December 31, 2017, our offshore assets consisted of six federal and five state of Louisiana company-operated wells in the shallow waters of the GOM. These 11 wells are located in two fields. The following summary table sets forth certain information with respect to our offshore reserves as of December 31, 2017 and average daily offshore production for the year ended December 31, 2017:

Field	Estimated Proved Reserves (Bcfe)	% Crude Oil / Condensate	% Natural Gas	% Natural Gas Liquids	% Proved Developed	Average Daily Production (Mmcfe/d)
Dutch and Mary Rose	72.0	3%	81%	16%	100%	33.7
Vermilion 170	3.4	4%	84%	12%	100%	3.8
South Timbalier 17	—	—%	—%	—%	—%	0.2
Total	75.4					37.7

Dutch and Mary Rose Field

We operate five wells located in federal waters at Eugene Island 10 (“Dutch”), and five wells located in adjacent Louisiana state waters (“Mary Rose”). All Dutch and Mary Rose wells flow to a Company-owned and operated production platform at Eugene Island 11. While we do not own the lease for the Eugene Island 11 block, this does not impact our ability to operate our facilities located on that block. Operators in the GOM may place platforms and

facilities on any location without having to own the lease, provided that permission and proper permits from the Bureau of Safety and Environmental Enforcement (“BSEE”) have been obtained. We have obtained such permission and permits. We installed our facilities at Eugene Island 11 because that was the optimal gathering location in proximity to our wells and marketing pipelines.

From our production platform we are able to access two separate gas markets thereby minimizing downtime risk and providing the ability to select the best sales price for our natural gas production. Oil and natural gas production can flow through our 20” gas pipeline to third-party owned and operated onshore processing facilities near Patterson, Louisiana. Alternatively, natural gas can flow via our 8” pipeline to a third-party owned and operated onshore processing facility at Burns Point, Louisiana. We have recently completed a 6” oil pipeline to third-party owned and operated onshore processing facilities in St. Mary Parish, Louisiana, providing us with two separate oil markets. Production facilities include a turbine type compressor capable of servicing all ten Dutch and Mary Rose wells at the Eugene Island 11 platform. Condensate can also flow to onshore markets and multiple refineries.

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Vermilion 170 Field

We own and operate one well located in federal waters with a dedicated production facility at Vermilion 170. Production from this platform, which includes compression equipment, flows via the Sea Robin Pipeline to a third-party owned and operated onshore processing plant.

Other Offshore

Our Ship Shoal 263 field, located in federal waters, and South Timbalier 17 field, located in Louisiana state waters, were historically included in “Other Offshore”. During 2017, the Ship Shoal field was permanently plugged and abandoned, and the production facilities were removed and sold. In late 2017, the South Timbalier well was permanently plugged and abandoned, and the production facilities were removed.

Onshore Properties

Southern Delaware Basin

Since the closing of the Acquisition in late July 2016, we and our partner have increased our leasehold footprint to approximately 6,800 acres, net to Contango. As of December 31, 2017, we currently estimate that we have proven reserves of 55.5 Bcfe and close to 400 gross drilling locations, initially targeting the Wolfcamp A, Wolfcamp B and Second Bone Spring formations. Substantially all of the locations can accommodate 10,000 foot laterals. As previously disclosed, during 2017 we brought our first four Southern Delaware Basin wells on production (two in the Upper Wolfcamp A, one in the Middle Wolfcamp A, and one in the Lower Wolfcamp A), with an average maximum 30 day initial production rate (“IP”) of 968 Boed (72% oil).

In mid-December 2017, we brought our fifth horizontal well on production, the Crusader #1H, targeting the Lower Wolfcamp A. This well was drilled to a total measured depth (“TMD”) of 20,275 feet, including a 10,184 foot lateral, and was completed with 50 stages of fracture stimulation, reaching a 30-day average IP of 389 Boed (67% oil). Our sixth well, the Ragin Bull #3H, targeting the Lower Wolfcamp A, was spud in November 2017. This well was drilled to a TMD of 20,570 feet, including a 10,325 foot lateral, and was completed with 50 stages of fracture stimulation. Production began in January 2018, and the well reached a 30-day average IP of 716 Boed (67% oil).

Our seventh well, the River Rattler #1H, our first Wolfcamp B test, was spud in December 2017. This well was drilled to a TMD of 20,710 feet, including a 10,275 foot lateral, and was completed with 50 stages of fracture stimulation. Production is expected to begin in mid-March 2018. We continue to identify cost efficiencies in our drilling efforts, as evidenced by the fact that the Ragin Bull #3H and River Rattler #1H have been our most efficient wells to date, taking only 27 days from spud to TMD.

Our eighth well, the Ragin Bull #2H, our second Wolfcamp B test, was spud in January 2018. This well was drilled to a TMD of 20,624 feet, including a 10,344 foot lateral, and is currently waiting on completion with 50 stages of fracture stimulation. There have been multiple Wolfcamp B wells adjacent to our leasehold that have been put on production recently by our offset operators, thereby derisking the Wolfcamp B in the area and providing encouragement for the development of that formation on our acreage.

Southeast Texas (Woodbine)

As of December 31, 2017, our Southeast Texas region included approximately 29,300 gross (17,100 net) acres, proven reserves of 30.9 Bcfe, and 81 gross (45 net) producing wells. No drilling capital was allocated to this area in 2016 or 2017 due to the low commodity price environment. For 2018, our current budget does not anticipate further drilling in this area, but should we experience sustained improvement in commodity prices, we could increase our activity. We currently have approximately 12,100 net acres in Madison and Grimes counties, with a multi-year inventory of potential drilling locations encompassing the Woodbine, Eagle Ford Shale and/or Georgetown/Buda formations.

South Texas (Buda/Eagle Ford)

As of December 31, 2017, our South Texas region included approximately 89,600 gross (40,800 net) acres, proven reserves of 25.7 Bcfe, and 217 gross (96.5 net) producing wells. We believe approximately 16,700 gross (7,800 net) acres to be prospective for the Buda and Eagle Ford Shale plays. No drilling activity has been conducted in

this area since 2014 due to the reduction in our capital expenditure programs in response to the commodity price environment. We do not anticipate devoting any drilling capital to this area in 2018.

Our estimated net proven Buda/Eagle Ford reserves in this area were 12.2 Bcfe, comprised of 94% liquids, with 41 gross (17.6 net) producing wells, as of December 31, 2017.

South Texas (Elm Hill Project)

As of December 31, 2017, we held approximately 4,900 gross acres (2,700 net) in Fayette, Gonzales, Caldwell and Bastrop counties, Texas. There was no drilling activity in 2016 or 2017, and we recognized an impairment expense of $6.8 million for the year ended December 31, 2016. The Company and its partner have no plans to further test this area.

The remaining 68,000 gross (30,300 net) acres in our South Texas region are located in our conventional fields that produce primarily from the Wilcox, Frio, and Vicksburg sands. Our estimated net proved conventional reserves in this region were 12.1 Bcfe, comprised of 71% gas, with 176 gross (78.9 net) producing wells, as of December 31, 2017.

Weston County, Wyoming (N. Cheyenne Project)

In 2015, we began drilling the first of three successful wells in this area targeting the Muddy Sandstone formation. Based on current results, a sustained improvement in oil prices will be needed to justify allocation of drilling capital to this area compared to our Southern Delaware Basin position. As a result of drilling these wells, we have satisfied the right to earn 35,000 net acres (approximately 4% of which is held by production).

Natrona County, Wyoming (FRAMS Project)

We spud our first well targeting the Mowry Shale in 2015, which proved to be unsuccessful. As a result, we recognized $6.7 million in exploration expenses for the cost of drilling the well for the year ended December 31, 2016 and $2.9 million in impairment expense in 2016 related to our unproved acreage in Natrona County, Wyoming. No drilling activity was conducted in this area in 2017.

Other (East Texas)

As of December 31, 2017, our East Texas region included approximately 6,000 gross (3,600 net) acres primarily in San Augustine County, with proven reserves of 0.5 Bcfe comprised of 90% gas, and 10 gross (5.1 net) producing wells. We believe that the further exploitation of our acreage in the Haynesville, Mid-Bossier and James Lime formations may provide long-term natural gas reserve and production growth potential in the future. There has been renewed interest in this area by offset operators as they experiment with new frac techniques and refracing of previously drilled wells. We will continue to monitor that activity and results; however, we do not anticipate devoting any capital to this area during 2018. As of December 31, 2017, substantially all of our acreage in our East Texas region was held by production.

Other (Colorado)

On December 30, 2016, we completed the sale of all of our Colorado assets to an independent oil and gas company for an aggregate purchase price of $5.0 million, subject to normal post-closing adjustments. The properties sold consisted of approximately 16,000 gross (11,200 net) acres and associated producing vertical wells primarily in Adams and Weld counties. At the time of sale, the sold properties had proved reserves of 4.2 Bcfe and during 2016 average net daily production was 0.4 Mmcfe/d.

Other

As of December 31, 2017, we held approximately 8,300 gross (6,000 net) mostly undeveloped acres in Louisiana, Mississippi, and North Texas.

Impairment of Long-Lived Assets

We recognized approximately $1.8 million in non-cash impairment charges in 2017. Under US GAAP, an impairment charge is required when the unamortized capital cost of any individual property within the Company's

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proved property base exceeds the risked estimated future net cash flows from the proved, probable and possible reserves for that property. Included in the impairment charge for the year is approximately $0.3 million related to proved property impairment for our Tuscaloosa Marine Shale (“TMS”) properties, a shale play in central Louisiana and Mississippi, due to revised estimated reserves. The 2017 impairment charges also consist of $1.5 million related to the partial impairment of two unused offshore platforms in onshore storage.

If oil and/or natural gas prices decline from prices at December 31, 2017, we may be required to record additional non-cash impairment in the future, thereby impacting our financial results for that period.

Onshore Investments

Jonah Field – Sublette County, Wyoming

Our wholly-owned subsidiary, Contaro Company (“Contaro”), owns a 37% ownership interest in Exaro. As of December 31, 2017, we had invested approximately $46.9 million in Exaro, with no anticipation of making any additional equity contributions, as our commitment to invest in Exaro expired on March 31, 2017. We account for Contaro’s ownership in Exaro using the equity method of accounting, and therefore, do not include its share of individual operating results, reserves or production in those reported for our consolidated results.

As of December 31, 2017, Exaro had 645 wells on production over its 5,760 gross acres (1,040 net acres), with a working interest between 2.4% and 32.5%. These wells were producing at a rate of approximately 26 Mmcfe/d, net to Exaro. The operator of these interests has applied for multiple drilling permits for horizontal wells that will be located on parts of our acreage. Exaro’s working interest in the drilling spacing units for the applied for horizontal wells ranges from 1% to 6%. As of December 31, 2017, the operator has been approved to drill two horizontal wells, in which Exaro has a net working interest of 2.4%. For the year ended December 31, 2017, the Company recognized a net investment gain of approximately $2.7 million, net of no tax expense, as a result of its investment in Exaro. As of December 31, 2017, reserves attributable to our investment in Exaro were 30.7 Bcfe. See Note 10 to our Financial Statements - “Investment in Exaro Energy III LLC” for additional details related to this investment.

Title to Properties

From time to time, we are involved in legal proceedings relating to claims associated with ownership interests in our properties. We believe we have satisfactory title to all of our producing properties in accordance with standards generally accepted in the oil and gas industry. Our properties are subject to customary royalty interests, liens incident to operating agreements, and liens for current taxes and other burdens, which we believe do not materially interfere with the use of or affect the value of such properties. As is customary in the industry in the case of undeveloped properties, little investigation of record title is made at the time of acquisition (other than a preliminary review of local records). Detailed investigations, including a title opinion rendered by a licensed independent third party attorney, are typically made before commencement of drilling operations.

We have granted mortgage liens on substantially all of our natural gas and crude oil properties to secure our senior secured revolving credit facility. These mortgages and the related credit agreement contain substantial restrictions and operating covenants that are customarily found in credit agreements of this type. See Note 12 to our Financial Statements “Long-Term Debt” for further information.

Marketing and Pricing

We derive our revenue principally from the sale of natural gas and oil. As a result, our revenues are determined, to a large degree, by prevailing natural gas and oil prices. We sell a portion of our natural gas production to purchasers

pursuant to sales agreements which contain a primary term of up to three years and crude oil and condensate production to purchasers under sales agreements with primary terms of up to one year. The sales prices for natural gas are tied to industry standard published index prices, subject to negotiated price adjustments, while the sale prices for crude oil are tied to industry standard posted prices subject to negotiated price adjustments.

We typically utilize commodity price hedge instruments to minimize exposure to declining prices on our crude oil, natural gas and natural gas liquids production, by using a series of swaps and/or costless collars. Unrealized gains or losses associated with hedges vary period to period, and will be a function of hedges in place, the strike prices of those hedges and the forward curve pricing for the commodities being hedged.

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As of December 31, 2017, we had the following derivative contracts in place with members of our bank group:

Commodity	Period	Derivative	Volume/Month	Price/Unit
Natural Gas	Jan 2018 - July 2018	Swap	370,000 MMBtus	$ 3.07 (1)
Natural Gas	Aug 2018 - Oct 2018	Swap	70,000 MMBtus	$ 3.07 (1)
Natural Gas	Nov 2018 - Dec 2018	Swap	320,000 MMBtus	$ 3.07 (1)
Oil	Jan 2018 - June 2018	Swap	20,000 Bbls	$ 56.40 (2)
Oil	July 2018 - Oct 2018	Collar	20,000 Bbls	$ 52.00 - 56.85 (2)
Oil	Nov 2018 - Dec 2018	Collar	15,000 Bbls	$ 52.00 - 56.85 (2)
Oil	Jan 2018 - Dec 2018	Collar	2,000 Bbls	$ 52.00 - 58.76 (3)
Oil	Jan 2019 - Dec 2019	Collar	7,000 Bbls	$ 50.00 - 58.00 (2)

In January 2018, we entered into the following additional derivative contracts with members of our bank group:

Commodity	Period	Derivative	Volume/Month	Price/Unit
Oil	Jan 2018 - July 2018	Collar	6,000 Bbls	$ 58.00 - 68.00 (2)
Oil	Nov 2018 - Dec 2018	Collar	5,000 Bbls	$ 58.00 - 68.00 (2)
Oil	Jan 2019 - Dec 2019	Collar	4,000 Bbls	$ 52.00 - 59.45 (3)

(1) Based on Henry Hub NYMEX natural gas prices.
(2) Based on Argus Louisiana Light Sweet crude oil prices.
(3) Based on West Texas Intermediate crude oil prices.

Decreases in commodity prices would adversely affect our revenues, profits and the value of our proved reserves. Historically, the prices received for natural gas and oil have fluctuated widely. Among the factors that can cause these fluctuations are:

- The domestic and foreign supply of natural gas and oil.
- Overall economic conditions.
- The level of consumer product demand.
- Adverse weather conditions and natural disasters.
- The price and availability of competitive fuels such as heating oil and coal.
- Political conditions in the Middle East and other natural gas and oil producing regions.
- The level of LNG imports/exports.
- Domestic and foreign governmental regulations.
- Special taxes on production.
- The loss of tax credits and deductions.

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Historically, we have been dependent upon a few purchasers for a significant portion of our revenue. The largest purchaser of our production for the year ended December 31, 2017, calculated on an equivalent basis, was ConocoPhillips Company (51.2%). This concentration may increase our overall exposure to credit risk, and our purchasers will likely be similarly affected by changes in economic and industry conditions. Our financial condition and results of operations could be materially adversely affected if one or more of our significant purchasers fails to pay us or ceases to acquire our production on terms that are favorable to us. However, we believe our current purchasers could be replaced by other purchasers under contracts with similar terms and conditions.

Competition

The oil and gas industry is highly competitive, and we compete with numerous other companies. Our competitors in the exploration, development, acquisition and production business include major integrated oil and gas companies as well as numerous independent companies, including many that have significantly greater financial resources.

The primary areas in which we encounter substantial competition are in locating and acquiring desirable leasehold acreage for our drilling and development operations, locating and acquiring attractive producing oil and gas properties and obtaining purchasers and transporters for the natural gas and crude oil we produce. There is also competition between producers of natural gas and crude oil 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 federal, state and local governments; however, it is not possible to predict the nature of any such legislation or regulation that may ultimately be adopted or its effects upon our future operations. Such laws and regulations may, however, substantially increase the costs of exploring for, developing or producing natural gas and crude oil and may prevent or delay the commencement or continuation of a given operation. The effect of these risks cannot be accurately predicted.

Governmental Regulations and Industry Matters

Industry Regulations

The availability of a ready market for crude oil, natural gas and natural gas liquids production depends upon numerous factors beyond our control. These factors include regulation of crude oil, natural gas and natural gas liquids production, federal, state and local regulations governing environmental quality and pollution control, state limits on allowable rates of production by well or proration unit, the amount of crude oil, natural gas and natural gas liquids available for sale, the availability of adequate pipeline and other transportation and processing facilities, and the marketing of competitive fuels. For example, a productive natural gas well may be "shut-in" because of an oversupply of natural gas or lack of an available natural gas pipeline in the area in which the well is located. State and federal regulations generally are intended to prevent waste of crude oil, natural gas and natural gas liquids, protect rights to produce crude oil, natural gas and natural gas liquids between owners in a common reservoir, control the amount of crude oil, natural gas and natural gas liquids produced by assigning allowable rates of production, and protect the environment. Pipelines are subject to the jurisdiction of various federal, state and local agencies. We are also subject to changing and extensive tax laws, the effects of which cannot be predicted.

The following discussion summarizes the regulation of the U.S. oil and gas industry. Such statutes, rules, regulations and government orders may be changed or reinterpreted from time to time in response to economic or political conditions, and there can be no assurance that such changes or reinterpretations will not materially adversely affect our results of operations and financial condition. The following discussion is not intended to constitute a complete discussion of the various statutes, rules, regulations and governmental orders to which our operations may be subject.

Regulation of Crude Oil, Natural Gas and Natural Gas Liquids Exploration and Production

Our operations are subject to various types of regulation at the federal, state and local levels. Such regulation includes requiring permits for the drilling of wells, maintaining bonding requirements in order to drill or operate wells and regulating the location of wells, the method of drilling and casing wells, the surface use and restoration of properties upon which wells are drilled, the plugging and abandoning of wells and the disposal of fluids used in connection with operations. Our operations are also subject to various conservation laws and regulations. These include the regulation of the size of drilling and spacing units or proration units and the density of wells that may be drilled in and the unitization or pooling of crude oil and natural gas properties. In this regard, some states allow the forced pooling or integration of tracts to facilitate exploration while other states rely primarily or exclusively on voluntary pooling of lands and leases. In

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areas where pooling is voluntary, it may be more difficult to form units, and therefore more difficult to develop a project, if the operator owns less than 100% of the leasehold. In addition, state conservation laws, which establish maximum rates of production from crude oil and natural gas wells, generally prohibit the venting or flaring of natural gas and impose certain requirements regarding the ratability of production. The effect of these regulations may limit the amount of crude oil, natural gas and natural gas liquids we can produce from our wells and may limit the number of wells or the locations at which we can drill. The regulatory burden on the oil and gas industry increases our costs of doing business and, consequently, affects our profitability. Inasmuch as such laws and regulations are frequently expanded, amended and interpreted, we are unable to predict the future cost or impact of complying with such regulations.

Regulation of Sales and Transportation of Natural Gas

Federal legislation and regulatory controls have historically affected the price of natural gas produced by us, and the manner in which such production is transported and marketed. Under the Natural Gas Act of 1938 (the “NGA”), the Federal Energy Regulatory Commission (the “FERC”) regulates the interstate transportation and the sale in interstate commerce for resale of natural gas. Effective January 1, 1993, the Natural Gas Wellhead Decontrol Act (the “Decontrol Act”) deregulated natural gas prices for all “first sales” of natural gas, including all sales by us of our own production. As a result, all of our domestically produced natural gas may now be sold at market prices, subject to the terms of any private contracts that may be in effect. However, the Decontrol Act did not affect the FERC’s jurisdiction over natural gas transportation.

Section 1(b) of the NGA exempts gas gathering facilities from the FERC's jurisdiction. We believe that the gas gathering facilities we own meet the traditional tests the FERC has used to establish a pipeline system's status as a non-jurisdictional gatherer. There is, however, no bright-line test for determining the jurisdictional status of pipeline facilities. Moreover, the distinction between FERC-regulated transmission services and federally unregulated gathering services is the subject of litigation from time to time, so the classification and regulation of some of our gathering facilities may be subject to change based on future determinations by the FERC and the courts. While we own some gas gathering facilities, we also depend on gathering facilities owned and operated by third parties to gather production from our properties, and therefore, we are affected by the rates charged by these third parties for gathering services. To the extent that changes in federal or state regulation affect the rates charged for gathering services, we also may be affected by these changes. Accordingly, we do not anticipate that we would be affected any differently than similarly situated gas producers.

Under the provisions of the Energy Policy Act of 2005 (the “2005 Act”), the NGA has been amended to prohibit market manipulation by any person, including marketers, in connection with the purchase or sale of natural gas, and the FERC has issued regulations to implement this prohibition. The Commodity Futures Trading Commission (the “CFTC”) also holds authority to monitor certain segments of the physical and futures energy commodities market including oil and natural gas. With regard to physical purchases and sales of natural gas and other energy commodities, and any related hedging activities that we undertake, we are thus required to observe anti-market manipulation laws and related regulations enforced by FERC and/or the CFTC. FERC holds substantial enforcement authority, including the ability to potentially assess maximum civil penalties of approximately $1.24 million per day per violation, subject to annual adjustment for inflation. CFTC also holds substantial enforcement authority, including the ability to potentially assess maximum civil penalties of up to approximately $1.12 million per day per violation or triple the monetary gain.

Under the 2005 Act, the FERC has also established regulations that are intended to increase natural gas pricing transparency through, among other things, new reporting requirements and expanded dissemination of information about the availability and prices of gas sold. For example, on December 26, 2007, FERC issued a final rule on the annual natural gas transaction reporting requirements, as amended by subsequent orders on rehearing, or Order No. 704. Order No. 704 requires buyers and sellers of natural gas above a de minimis level, including entities not

otherwise subject to FERC jurisdiction, to submit on May 1 of each year an annual report to FERC describing their aggregate volumes of natural gas purchased or sold at wholesale in the prior calendar year to the extent such transactions utilize, contribute to or may contribute to the formation of price indices. Order No. 704 also requires market participants to indicate whether they report prices to any index publishers and, if so, whether their reporting complies with FERC's policy statement on price reporting. It is the responsibility of the reporting entity to determine which individual transactions should be reported based on the guidance of Order No. 704 as clarified in orders on clarification and rehearing. In addition, to the extent that we enter into transportation contracts with interstate pipelines that are subject to FERC regulation, we are subject to FERC requirements related to use of such interstate capacity. Any failure on our part to comply with the FERC's regulations could result in the imposition of civil and criminal penalties.

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Our natural gas sales are affected by intrastate and interstate gas transportation regulation. Following the Congressional passage of the Natural Gas Policy Act of 1978 (the “NGPA”), the FERC adopted a series of regulatory changes that have significantly altered the transportation and marketing of natural gas. Beginning with the adoption of Order No. 436, issued in October 1985, the FERC has implemented a series of major restructuring orders that have required interstate pipelines, among other things, to perform “open access” transportation of gas for others, “unbundle” their sales and transportation functions, and allow shippers to release their unneeded capacity temporarily and permanently to other shippers. As a result of these changes, sellers and buyers of gas have gained direct access to the particular interstate pipeline services they need and are better able to conduct business with a larger number of counterparties. We believe these changes generally have improved our access to markets while, at the same time, substantially increasing competition in the natural gas marketplace. It remains to be seen, however, what effect the FERC’s other activities will have on access to markets, the fostering of competition and the cost of doing business. We cannot predict what new or different regulations the FERC and other regulatory agencies may adopt, or what effect subsequent regulations may have on our activities. We do not believe that we will be affected by any such new or different regulations materially differently than any other seller of natural gas with which we compete.

In the past, Congress has been very active in the area of gas regulation. However, as discussed above, the more recent trend has been in favor of deregulation, or “lighter handed” regulation, and the promotion of competition in the gas industry. There regularly are other legislative proposals pending in the federal and state legislatures that, if enacted, would significantly affect the natural gas industry. At the present time, it is impossible to predict what proposals, if any, might actually be enacted by Congress or the various state legislatures and what effect, if any, such proposals might have on us. We do not believe that we will be affected by any such new legislative proposals materially differently than any other seller of natural gas with which we compete.

Oil Price Controls and Transportation Rates

Sales prices of crude oil, condensate and gas liquids by us are not currently regulated and are made at market prices. Our sales of these commodities are, however, subject to laws and to regulations issued by the Federal Trade Commission (the “FTC”) prohibiting manipulative or fraudulent conduct in the wholesale petroleum market. The FTC holds substantial enforcement authority under these regulations, including the ability to potentially assess maximum civil penalties of approximately $1.18 million per day per violation, subject to annual adjustment for inflation. Our sales of these commodities, and any related hedging activities, are also subject to CFTC oversight as discussed above.

The price we receive from the sale of these products may be affected by the cost of transporting the products to market. Much of the transportation is through interstate common carrier pipelines. Effective as of January 1, 1995, the FERC implemented regulations generally grandfathering all previously approved interstate transportation rates and establishing an indexing system for those rates by which adjustments are made annually based on the rate of inflation, subject to certain conditions and limitations. The FERC’s regulation of crude oil and natural gas liquids transportation rates may tend to increase the cost of transporting crude oil and natural gas liquids by interstate pipelines, although the annual adjustments may result in decreased rates in a given year. Every five years, the FERC must examine the relationship between the annual change in the applicable index and the actual cost changes experienced in the oil pipeline industry. We are not able at this time to predict the effects of these regulations or FERC proceedings, if any, on the transportation costs associated with crude oil production from our crude oil producing operations.

There regularly are other legislative proposals pending in the federal and state legislatures that, if enacted, would significantly affect the petroleum industry. At the present time, it is impossible to predict what proposals, if any, might actually be enacted by Congress or the various state legislatures and what effect, if any, such proposals might have on us. We do not believe that we will be affected by any such new legislative proposals materially differently than any other seller of petroleum with which we compete.

Environmental and Occupational Health and Safety Matters

Our crude oil and natural gas exploration, development and production operations are subject to stringent federal, regional, state and local laws and regulations governing occupational health and safety aspects of our operations, the discharge of materials into the environment, or otherwise relating to environmental protection. Numerous governmental authorities, including the U.S. Environmental Protection Agency (the “EPA”) and analogous state agencies, have the power to enforce compliance with these laws and regulations and the permits issued under them, which may cause us to incur significant capital expenditures or costly actions to achieve and maintain compliance. Failure to comply with these laws and regulations may result in the assessment of sanctions, including administrative,

civil and criminal penalties, the imposition of investigatory, remedial and corrective action obligations, the occurrence of delays or restrictions in permitting or performance of projects and the issuance of orders enjoining some or all of our operations in affected areas. Public interest in the protection of the environment has increased dramatically in recent years. The trend in environmental legislation and regulations in recent years has been to place more restrictions and limitations on activities that may affect the environment, which is expected to result in increased costs of doing business and consequently affect profitability.

The Comprehensive Environmental Response, Compensation and Liability Act, as amended, ("CERCLA"), also known as the "Superfund Law", and similar state laws, impose strict joint and several liability, without regard to fault or the legality of the original conduct, on certain classes of potentially responsible persons that are considered to have contributed to the release of a "hazardous substance" into the environment. These potentially responsible persons include the current or past owner or operator of the disposal site or sites where the release occurred and companies that disposed or arranged for the disposal of the hazardous substances released at the site. Persons who are or were responsible for releases of hazardous substances under CERCLA may be subject to liability for the costs of cleaning up the hazardous substances that have been released into the environment, for damages to natural resources and for the costs of certain health studies, and it is not uncommon for neighboring landowners and other third parties to file claims for personal injury and property damage allegedly caused by the hazardous substances released into the environment. We generate materials in the course of our operations that may be regulated as hazardous substances.

We also generate wastes that are subject to the federal Resource Conservation and Recovery Act, as amended (the "RCRA"), and comparable state statutes. The RCRA imposes strict requirements on the generation, storage, treatment, transportation and disposal of nonhazardous and hazardous wastes, and the EPA and analogous state agencies stringently enforce the approved methods of management and disposal of these wastes. While the RCRA currently exempts certain drilling fluids, produced waters, and other wastes associated with exploration, development and production of crude oil and natural gas from regulation as hazardous wastes, allowing us to manage these wastes under RCRA's less stringent non-hazardous waste requirements, we can provide no assurance that this exemption will be preserved in the future. For example, following in response to the filing of a lawsuit by several non-governmental environmental groups against the EPA for the agency's failure to timely assess its RCRA Subtitle D criteria regulations for oil and gas wastes, EPA and the environmental groups entered into an agreement that was finalized in a consent decree issued by the U.S. District Court for the District of Columbia in December 2016. Under the decree, the EPA is required to propose no later than March 15, 2019, a rulemaking for revision of certain Subtitle D criteria regulations pertaining to oil and gas wastes or sign a determination that revision of the regulations is not necessary. If EPA proposes a rulemaking for revised oil and gas waste regulations, the Consent Decree requires that the EPA take final action following notice and comment rulemaking no later than July 15, 2021. Any removal of this exclusion could increase the amount of waste we are required to manage and dispose of as hazardous waste rather than non-hazardous waste, and could cause us to incur increased operating costs, which could have a significant impact on us as well as the natural gas and oil industry in general.

The Clean Air Act, as amended (the "CAA"), and comparable state laws restrict the emission of air pollutants from many sources and also impose various monitoring and reporting requirements. These laws and regulations may require us to obtain pre-approval for the construction or modification of certain projects or facilities expected to produce or significantly increase air emissions, obtain and strictly comply with stringent air permit requirements or utilize specific equipment or technologies to control emissions. Obtaining permits has the potential to delay the development of crude oil and natural gas projects. Over the next several years, we may be required to incur certain capital expenditures for air pollution control equipment or other air emissions-related issues.

Based on findings made by the EPA that emissions of carbon dioxide, methane and other greenhouse gases ("GHGs") present an endangerment to public health and the environment, the EPA adopted regulations under existing provisions of the CAA that, among other things, impose permit reviews and restrict emissions of GHGs from certain large

stationary sources. These EPA regulations could adversely affect our operations and restrict or delay our ability to obtain air permits for new or modified sources. In addition, the EPA has adopted rules requiring the monitoring and reporting of GHG emissions from specified sources in the United States on an annual basis, including certain onshore and offshore production facilities, which include the majority of our operations. We are monitoring and reporting on GHG emissions from certain of our operations.

While Congress has, from time to time considered legislation to reduce emissions of GHGs, there has not been significant activity in the form of adopted legislation to reduce GHG emissions at the federal level in recent years. In the absence of such federal climate legislation, a number of state and regional efforts have emerged that are aimed at

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tracking and/or reducing GHG emissions by means of cap and trade programs that typically require major sources of GHG emissions to acquire and surrender emission allowances in return for emitting those GHGs. Moreover, in December 2015, the United States joined other countries of the United Nations in preparing an agreement requiring member countries to review and establish goals for limiting GHG emissions. This "Paris Agreement" was signed by the United States in April 2016 and entered into force in November 2016; however, this agreement does not create any binding obligations for nations to limit their GHG emissions but, rather, includes pledges to voluntarily limit or reduce future emissions. However, in August 2017, the U.S. State Department informed the United Nations of the intent of the United States to withdraw from the Paris Agreement. The Paris Agreement provides for a four-year exit process beginning when it took effect in November 2016, which would result in an effective exit date of November 2020. The United States' adherence to the exit process and/or the terms on which the United States may re-enter the Paris Agreement or a separately negotiated agreement are unclear at this time.

Although it is not possible at this time to predict how legislation or new regulations that may be adopted to address GHG emissions would impact our business, any such future international, federal or state laws or regulations that impose reporting obligations on us with respect to, or require the elimination of GHG emissions from, our equipment or operations could require us to incur increased operating costs and could adversely affect demand for the oil and natural gas we produce.

The Federal Water Pollution Control Act, as amended (the "Clean Water Act") and analogous state laws impose restrictions and strict controls regarding the discharge of pollutants into state waters and waters of the United States. Any such discharge of pollutants into regulated waters is prohibited except in accordance with the terms of an issued permit. Spill prevention, control and countermeasure plan requirements under federal law require appropriate containment berms and similar structures to help prevent the contamination of navigable waters in the event of a petroleum hydrocarbon tank spill, rupture or leak. In addition, the Clean Water Act and analogous state laws require individual permits or coverage under general permits for discharges of storm water runoff from certain types of facilities. The Clean Water Act also prohibits the discharge of dredge and fill material in regulated waters, including wetlands, unless authorized by permit. Federal and state regulatory agencies can impose administrative, civil and criminal penalties for noncompliance with discharge permits or other requirements of the Clean Water Act and analogous state laws and regulations.

Our oil and natural gas exploration and production operations generate produced water, drilling muds and other waste streams, some of which may be disposed via injection in underground wells situated in non-producing subsurface formations. The disposal of oil and natural gas wastes into underground injection wells are subject to the Safe Drinking Water Act, as amended (the "SDWA"), and analogous state laws. The Underground Injection Well Program under the SDWA requires that we obtain permits from the EPA or analogous state agencies for our disposal wells, establishes minimum standards for injection well operations, restricts the types and quantities that may be injected, and prohibits the migration of fluid containing any contaminants into underground sources of drinking water. Any leakage from the subsurface portions of the injection wells may cause degradation of freshwater, potentially resulting in cancellation of operations of a well, issuance of fines and penalties from governmental agencies, incurrence of expenditures for remediation of the affected resource, and imposition of liability by third parties for alternative water supplies, property damages and personal injuries. Furthermore, in response to a growing concern that the injection of produced water and other fluids into belowground disposal wells triggers seismic activity in certain areas, some states, including Texas, where we operate, have imposed, and other states are considering imposing, additional requirements in the permitting or operation of produced water injection wells. In Texas, the Texas Railroad Commission ("TRC") has adopted a final rule governing the permitting or re-permitting of disposal wells that requires, among other things, the submission of information on seismic events occurring within a specified radius of the disposal well location, as well as logs, geologic cross sections and structure maps relating to the disposal area in question. If the permittee or an applicant of a disposal well fails to demonstrate that the injected fluids are confined to the disposal zone or if scientific data indicates such a disposal well is likely to be or determined to be contributing to

seismic activity, then the TRC may deny, modify, suspend or terminate the permit application or existing operating permit for that well. Increased regulation and attention given to induced seismicity could lead to greater opposition, including litigation, to oil and natural gas activities utilizing injection wells for produced water disposal. These existing and any new seismic requirements applicable to disposal wells that impose more stringent permitting or operational requirements could result in added costs to comply or, perhaps, may require alternative methods of disposing of produced water and other fluids, which could delay production schedules and also result in increased costs.

The Oil Pollution Act of 1990 (the “OPA”) and regulations thereunder impose a variety of regulations on “responsible parties” related to the prevention of oil spills and liability for damages resulting from such spills in U.S. waters. The OPA applies to vessels, onshore facilities and offshore facilities, including exploration and production

facilities that may affect waters of the United States. Under OPA, responsible parties including owners and operators of onshore facilities and lessees and permittees of offshore leases may be held strictly liable for oil cleanup costs and natural resource damages as well as a variety of public and private damages that may result from oil spills. While liability limits apply in some circumstances, a party cannot take advantage of liability limits if the spill was caused by gross negligence or willful misconduct or resulted from violation of federal safety, construction or operating regulations. Few defenses exist to the liability imposed by the OPA. In addition, in January 2018, the federal Bureau of Ocean Energy Management ("BOEM") has raised OPA's damages liability cap to $137.7 million. OPA requires owners and operators of offshore oil production facilities to establish and maintain evidence of financial responsibility to cover costs that could be incurred in responding to an oil spill, and to prepare and submit for approval oil spill response plans. These oil spill response plans must detail the action to be taken in the event of a spill; identify contracted spill response equipment, materials, and trained personnel; and identify the time necessary to deploy these resources in the event of a spill. In addition, OPA currently requires a minimum financial responsibility demonstration of between $35 million and $150 million for companies operating on the federal Outer Continental Shelf ("OCS") waters, including the Gulf of Mexico. We are currently required to demonstrate, on an annual basis, that we have ready access to $35 million that can be used to respond to an oil spill from our facilities on the OCS. In addition, to the extent the Company's offshore lease operations affect state waters, the Company may be subject to additional state and local clean-up requirements or incur liability under state and local laws.

Hydraulic fracturing is an important and common practice that is used to stimulate production of natural gas and/or crude oil from dense subsurface rock formations. The hydraulic fracturing process involves the injection of water, sand or other proppant and chemical additives under pressure into targeted subsurface formations to stimulate production. We routinely use hydraulic fracturing techniques in many of our completion programs. Hydraulic fracturing typically is regulated by state oil and natural gas commissions, or other similar state agencies, but several federal agencies have also asserted regulatory authority over, or conducted investigations that focus upon, certain aspects of the process, including a suite of proposed rulemakings and final rules issued by the EPA and the federal Bureau of Land Management (the "BLM"), which legal requirements, to the extent finalized and implemented by the agencies, may impose more stringent requirements relating to the composition of fracturing fluids, emissions and discharges from hydraulic fracturing, chemical disclosures, and performances of fracturing activities on federal and Indian lands. Also, in December 2016, the EPA released its final report on the potential impacts of hydraulic fracturing on drinking water resources, concluding that "water cycle" activities associated with hydraulic fracturing may impact drinking water under certain circumstances.

Congress has from time to time considered, but not enacted, legislation to provide for federal regulation of hydraulic fracturing and to require disclosure of the chemicals used in the hydraulic fracturing process while, at the state level, several states, including Texas and Wyoming, where we operate, have adopted, and other states are considering adopting legal requirements that could impose more stringent permitting, public disclosure, or well construction requirements on hydraulic fracturing activities. States could elect to prohibit high volume hydraulic fracturing altogether, following the approach taken by the State of New York. Local government may also seek to adopt ordinances within their jurisdictions regulating the time, place and manner of drilling activities in general or hydraulic fracturing activities in particular. If new or more stringent federal, state, or local legal restrictions relating to the hydraulic fracturing process are adopted in areas where we operate, we could incur potentially significant added costs to comply with such requirements, experience delays or curtailment in the pursuit of exploration, development, or production activities, and perhaps even be precluded from drilling or completing wells.

Oil and natural gas exploration, development and production activities on federal lands, including Indian lands and lands administered by the BLM, are subject to the National Environmental Policy Act, as amended ("NEPA"). NEPA requires federal agencies, including the BLM, to evaluate major agency actions having the potential to significantly impact the environment. In the course of such evaluations, an agency will prepare an Environmental Assessment that assesses the potential direct, indirect and cumulative impacts of a proposed project and, if necessary, will prepare a

more detailed Environmental Impact Statement that may be made available for public review and comment. Governmental permits or authorizations that are subject to the requirements of NEPA are required for exploration and development projects on federal and Indian lands. This process has the potential to delay, limit or increase the cost of developing oil and natural gas projects. Authorizations under NEPA are also subject to protest, appeal or litigation, any or all of which may delay or halt projects.

Environmental laws such as the Endangered Species Act, as amended ("ESA"), may impact exploration, development and production activities on public or private lands. The ESA provides broad protection for species of fish, wildlife and plants that are listed as threatened or endangered in the United States, and prohibits taking of endangered

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species. Similar protections are offered to migratory birds under the Migratory Bird Treaty Act. Some of our facilities may be located in areas that are designated as habitat for endangered or threatened species. If endangered species are located in areas of the underlying properties where we wish to conduct seismic surveys, development activities or abandonment operations, such work could be prohibited or delayed or expensive mitigation may be required. Moreover, as a result of one or more settlements entered into by the U.S. Fish and Wildlife Service (the "FWS"), the agency is required to make a determination on listing of numerous species as endangered or threatened under the ESA by specified timelines. The designation of previously unprotected species as threatened or endangered in areas where underlying property operations are conducted could cause us to incur increased costs arising from species protection measures, time delays or limitations on our drilling program activities, which costs delays or limitation could have an adverse impact on our ability to develop and produce reserves.

We are subject to the requirements of the federal Occupational Safety and Health Act, as amended, and comparable state statutes, whose purpose is to protect the health and safety of workers. In addition, the U.S. Occupational Safety and Health Administration hazard communication standard, the EPA community right-to-know regulations under Title III of the federal Superfund Amendment and Reauthorization Act and comparable state statutes require that information be maintained concerning hazardous materials used or produced in our operations and that this information be provided to employees, state and local government authorities and citizens.

In recent years, the BOEM and the BSEE, each agencies of the U.S. Department of the Interior, have imposed more stringent permitting procedures and regulatory safety and performance requirements for wells in federal waters. In addition, states may adopt and implement similar or more stringent legal requirements applicable to exploration and production activities in state waters. Compliance with these more stringent regulatory restrictions, together with any uncertainties or inconsistencies in current decisions and rulings by governmental agencies, delays in the processing and approval of drilling permits or exploration, development, oil spill-response and decommissioning plans, and possible additional regulatory initiatives could result in difficult and more costly actions and adversely affect or delay new drilling and ongoing development efforts. In addition, new regulatory initiatives may be adopted or enforced by the BOEM or the BSEE in the future that could result in additional costs, delays, restrictions or obligations with respect to oil and natural gas exploration and production operations conducted offshore. Any new rules, regulations or legal initiatives could delay or disrupt our operations, increase the risk of expired leases due to the time required to develop new technology, result in increased supplemental bonding requirements and limit activities in certain areas, or cause us to incur penalties, fines, or shut-in production at one or more of our facilities. If the BOEM determines that increased financial assurance is required in connection with our offshore facilities but we are unable to provide the necessary supplemental bonds or other forms of financial assurance, the BOEM could impose monetary penalties or require our operations on federal leases to be suspended or cancelled. For example, in April 2016, the BOEM published a proposed rule that would update existing air-emissions requirements relating to offshore oil and natural gas activity on the OCS. Additionally, the BOEM issued a Notice to Lessees and Operators (the "NTL #2016-N01") that became effective in September 2016 and bolsters supplemental bonding procedures for the decommissioning of offshore wells, platforms, pipelines and other facilities. Also, if material spill incidents were to occur, the United States could elect to again issue directives to temporarily cease drilling activities and, in any event, may from time to time issue further safety and environmental laws and regulations regarding offshore oil and natural gas exploration and development, any of which developments could have a material adverse effect on our business. Any one or more of the offshore-related matters described above could have a material adverse effect on our business, financial condition and results of operations.

These regulatory actions, or any new rules, regulations or legal initiatives could delay or disrupt our operations, increase the risk of expired leases due to the time required to develop new technology, result in increased supplemental bonding and costs, and limit activities in certain areas, or cause us to incur penalties, fines, or shut-in production at one or more of our facilities or result in the suspension or cancellation of leases. Moreover, under existing BOEM rules relating to assignment of offshore leases and other legal interests on the OCS, assignors of such

interest may be held jointly and severally liable for decommissioning of OCS facilities existing at the time the assignment was approved by the BOEM, in the event that the assignee is unable or unwilling to conduct required decommissioning. In the event that we, in the role of assignor, receive orders from the BOEM to decommission OCS facilities that one of our assignees of offshore facilities is unwilling or unable to perform, we could incur costs to perform those decommissioning obligations, which costs could be material. If the BOEM determines that increased financial assurance is required in connection with our or any previously assigned offshore facilities but we are unable to provide the necessary supplemental bonds or other forms of financial assurance, the BOEM could impose monetary penalties or require our operations on federal leases to be suspended or cancelled.

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During 2017, however, with the issuance of Order 3350 in May 2017 by U.S. Department of the Interior Secretary Ryan Zinke that directed the BOEM and the BSEE to reconsider a number of regulatory initiatives governing oil and natural gas exploration, development and production activities on the OCS ("Order 3350"), the BSEE and the BOEM have been directed to reconsider a number of regulatory initiatives governing offshore oil and gas safety and performance-related activities, including, for example, NTL #2016-N01 and the rules relating to blow-out preventers and well control, and provide recommendations on whether such regulatory initiatives should continue to be implemented. Moreover, Order 3350 directed the BOEM to immediately cease all activities to promulgate the April 2016 proposed rule relating to offshore air quality control. One consequence of this review is that on December 29, 2017, the BSEE published proposed revisions to its regulations regarding offshore drilling safety equipment, which proposal includes the removal of the requirement for offshore operators to certify through an independent third party that their critical safety and pollution prevention equipment (e.g., subsea safety equipment, including blowout preventers) is operational and functioning as designed in the most extreme conditions. The December 2017 proposed rule has not been finalized, and there remains substantial uncertainty as to the scope and extent of any revisions to existing oil and gas safety and performance-related regulations and other regulatory initiatives that ultimately will be adopted by the BSEE and the BOEM pursuant to those agencies' review process.

See "Item 1A. Risk Factors" for further discussion on hydraulic fracturing; ozone standards; climate change, including methane or other greenhouse gas emissions; releases of regulated substances; and other aspects of compliance with legal or financial assurance requirements or relating to environmental protection, including with respect to offshore leases.

Other Laws and Regulations

Various laws and regulations often require permits for drilling wells and also cover spacing of wells, the prevention of waste of natural gas and oil including maintenance of certain gas/oil ratios, rates of production and other matters. The effect of these laws and regulations, as well as other regulations that could be promulgated by the jurisdictions in which the Company has production, could be to limit the number of wells that could be drilled on the Company's properties and to limit the allowable production from the successful wells completed on the Company's properties, thereby limiting the Company's revenues.

Whereas the BLM administers oil and natural gas leases held by the Company on federal onshore lands, the BOEM administers the natural gas and oil leases held by the Company on federal onshore lands and offshore tracts in the OCS. The Office of Natural Resources Revenue (the "ONRR") collects a royalty interest in these federal leases on behalf of the federal government. While the royalty interest percentage is fixed at the time that the lease is entered into, from time to time the ONRR changes or reinterprets the applicable regulations governing its royalty interests, and such action can indirectly affect the actual royalty obligation that the Company is required to pay. However, the Company believes that the regulations generally do not impact the Company to any greater extent than other similarly situated producers.

To cover the various obligations of lessees on the OCS, such as the cost to plug and abandon wells, decommission or remove platforms and pipelines, and clear the seafloor of obstructions at the end of production (collectively, "decommissioning obligations"), the BOEM generally requires that lessees post supplemental bonds or other acceptable financial assurances that such obligations will be met. Historically, our financial assurance costs to satisfy decommissioning obligations have not had a material adverse effect on our results of operations; however, the BOEM continues to consider imposing more stringent financial assurance requirements on offshore operators on the OCS. For example, the BOEM issued NTL #2016-N01 that went into effect in September 2016 and augments requirements for the posting of additional financial assurance by offshore lessees, among others, to assure that sufficient funds are available to satisfy decommissioning obligations on the OCS. If the BOEM determines under this new NTL that a company does not satisfy the minimum requirements to qualify for providing self-insurance to meet its

decommissioning and other obligations, that company will be required to post additional financial security as assurance. While we do not meet the requirements for self-insurance, we estimated the impact of the requirement to provide additional security under NTL #2016-N01 for our operations in the Gulf of Mexico and do not believe that the revised policy will have a material impact on our operations in the Gulf of Mexico.

During 2017, however, with the issuance of Order 3350, the BSEE and the BOEM have been directed to reconsider a number of regulatory initiatives governing offshore oil and gas safety and performance-related activities, including, for example, NTL #2016-N01. Consequently, during 2017, the BOEM extended the start date for implementing NTL #2016-N01 indefinitely beyond June 30, 2017. This extension currently remains in effect; however,

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the BOEM reserved the right to re-issue sole liability orders in the future, including in the event that it determines there is a substantial risk of nonperformance of the interest holder's decommissioning sole liabilities. Following completion of its review, the BOEM may elect to retain NTL #2016-N01 in its current form or may make revisions thereto and, thus, until the review is completed and the BOEM determines what additional financial assurance may be required by us, we cannot provide assurance that such financial assurance coverage can be obtained. Moreover, the BOEM could in the future make other demands for additional financial assurances covering our obligations under sole liability properties and/or non-sole liability properties. In the event that we are unable to obtain the additional required bonds or assurances as requested, the BOEM may require certain of our operations on federal leases to be suspended or cancelled or otherwise impose monetary penalties.

Risk and Insurance Program

In accordance with industry practice, we maintain insurance against many, but not all, potential perils confronting our operations and in coverage amounts and deductible levels that we believe to be economic. Consistent with that profile, our insurance program is structured to provide us financial protection from significant losses resulting from damages to, or the loss of, physical assets or loss of human life, and liability claims of third parties, including such occurrences as well blowouts and weather events that result in oil spills and damage to our wells and/or platforms. Our goal is to balance the cost of insurance with our assessment of the potential risk of an adverse event. We maintain insurance at levels that we believe are appropriate and consistent with industry practice, and we regularly review our risks of loss and the cost and availability of insurance and revise our insurance program accordingly.

We continuously monitor regulatory changes and regulatory responses and their impact on the insurance market and our overall risk profile, and adjust our risk and insurance program to provide protection at a level that we can afford considering the cost of insurance, against the potential and magnitude of disruption to our operations and cash flows. Changes in laws and regulations regarding exploration and production activities in the Gulf of Mexico could lead to tighter underwriting standards, limitations on scope and amount of coverage, and higher premiums, including possible increases in liability caps for claims of damages from oil spills.

Health, Safety and Environmental Program

Our Health, Safety and Environmental ("HS&E") Program is supervised by an operating committee of senior management to ensure compliance with all state and federal regulations. In support of the operating committee, we have contracted with J. Connor Consulting ("JCC") to coordinate the regulatory process relative to our offshore assets. JCC is a regulatory consulting firm specializing in the offshore Gulf of Mexico. They provide preparation of incident response plans, safety and environmental services and facilitation of comprehensive oil spill response training and drills on behalf of oil and gas companies and pipeline operators.

Additionally, in support of our Gulf of Mexico operations, we have established a Regional Oil Spill Response Plan which has been approved by the BSEE. Our response team is trained annually and is tested through in-house spill drills. We have also contracted with O'Brien's Response Management ("O'Brien's"), who maintains an incident command center on 24 hour alert in Houston, TX. In the event of an oil spill, the Company's response program is initiated by notifying O'Brien's of any reportable incident. While the Company response team is mobilized to focus on source control and containment of the spill, O'Brien's coordinates communications with state and federal agencies and provides subject matter expertise in support of the response team.

We also have contracted with Clean Gulf Associates ("CGA") to assist with equipment and personnel needs in the event of a spill. CGA specializes in onsite control and cleanup and is on 24-hour alert with equipment currently stored at eight bases along the gulf coast, from South Texas to East Louisiana. The CGA equipment stockpile is available to serve member oil spill response needs and includes open seas skimmers, shoreline protection boom, communications

equipment, dispersants with application systems, wildlife rehabilitation and a forward command center. CGA has retainers with aerial dispersant and mechanical recovery equipment contractors for spill response.

In addition to our membership in CGA, the Company has contracted with Wild Well Control for source control at the wellhead, if required. Wild Well Control is one of the world’s leading providers of firefighting and well control services.

We also have a full time health, safety and environmental professional who supports our operations and oversees the implementation of our onshore HS&E policies.

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Safety and Environmental Management System

We have developed and implemented a Safety and Environmental Management System (“SEMS”) to address oil and gas operations in the OCS, as required by the BSEE. Our SEMS identifies and mitigates safety and environmental hazards and the impacts of these hazards on design, construction, start-up, operation, inspection, and maintenance of all new and existing facilities. The Company has established goals, performance measures, training and accountability for SEMS implementation. We also provide the necessary resources to maintain an effective SEMS, and we review the adequacy and effectiveness of the SEMS program annually. Company facilities are designed, constructed, maintained, monitored, and operated in a manner compatible with industry codes, consensus standards, and all applicable governmental regulations. We have contracted with Island Technologies Inc. to coordinate our SEMS program and to track compliance for production operations.

The BSEE enforces the SEMS requirements through regular audits. Failure of an audit may result in an Incident of Non-Compliance and could ultimately require a shut-in our Gulf of Mexico operations if not resolved within the required time.

Employees

On December 31, 2017, we had 63 full time employees, of which 20 were field personnel. We have been able to attract and retain a talented team of industry professionals that have been successful in achieving significant growth and success in the past. As such, we are well-positioned to adequately manage and develop our existing assets and also to increase our proved reserves and production through exploitation of our existing asset base, as well as the continuing identification, acquisition, and development of new growth opportunities. None of our employees are covered by collective bargaining agreements. We believe our relationship with our employees is good.

In addition to our employees, we use the services of independent consultants and contractors to perform various professional services. As a working interest owner, we rely on certain outside operators to drill, produce and market our natural gas and oil where we are a non-operator. In prospects where we are the operator, we rely on drilling contractors to drill and sometimes rely on independent contractors to produce and market our natural gas and oil. In addition, we frequently utilize the services of independent contractors to perform field and on-site drilling and production operation services and independent third party engineering firms to evaluate our reserves.

Corporate Offices

Our corporate offices are located at 717 Texas Avenue in downtown Houston, Texas, under a lease that expires March 31, 2019. Rent, including parking, related to this office space for the year ended December 31, 2017 was approximately $2.2 million. As of January 2017, a portion of our space in the building is being subleased through the lease expiration date for $0.5 million annually.

Code of Ethics

In January 2014, our board of directors adopted our current Code of Business Conduct and Ethics ("Code of Conduct") which applies to all directors, officers and employees of the Company. Our Code of Conduct is available on the Company's website at www.contango.com. Any shareholder who so requests may obtain a copy of the Code of Conduct by submitting a request to the Company's corporate secretary at the address on the cover of this Form 10-K. Changes in and waivers to the Code of Conduct for the Company's directors, chief executive officer and certain senior financial officers will be posted on the Company's website within five business days and maintained for at least 12 months. Information on our website or any other website is not incorporated by reference into, and does not constitute a part of, this Report on Form 10-K.

Available Information

You may read and copy all or any portion of this report on Form 10-K, our quarterly reports on Form 10-Q and current reports on Form 8-K, as well as any amendments and exhibits to those reports, without charge at the office of the Securities and Exchange Commission (the “SEC”) in Public Reference Room, 100 F Street NE, Washington, DC, 20549. Information regarding the operation of the public reference rooms may be obtained by calling the SEC at 1-800-SEC-0330. In addition, filings made with the SEC electronically are publicly available through the SEC's website at http://www.sec.gov, and we make these documents available free of charge at our website at http://www.contango.com

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as soon as reasonably practicable after they are filed or furnished with the SEC. This report on Form 10-K, including all exhibits and amendments, has been filed electronically with the SEC.

Seasonal Nature of Business

The demand for oil and natural gas fluctuates depending on the time of year. Seasonal anomalies such as mild winters or cooler summers sometimes lessen this fluctuation. In addition, pipelines, utilities, local distribution companies, and industrial end users utilize oil and natural gas storage facilities and purchase some of their anticipated winter requirements during the summer, which can also lessen seasonal demand.

Item 1A. Risk Factors

In addition to the other information set forth elsewhere in this Form 10-K, you should carefully consider the following factors when evaluating the Company. An investment in the Company is subject to risks inherent in our business. The trading price of the shares of the Company is affected by the performance of our business relative to, among other things, competition, market conditions and general economic and industry conditions. The value of an investment in the Company may decrease, resulting in a loss.

RISK FACTORS RELATING TO OUR BUSINESS

We have no ability to control the market price for natural gas and oil. Natural gas and oil prices fluctuate widely, and a continued substantial or extended decline in natural gas and oil prices would adversely affect our revenues, profitability and growth and could have a material adverse effect on the business, the results of operations and financial condition of the Company.

Our revenues, profitability and future growth depend significantly on natural gas and crude oil prices. Natural gas and crude oil prices remained relatively low through 2017. While natural gas prices have remained consistent with 2017 levels, crude oil prices increased slightly during the final months of 2017 and throughout early 2018. The markets for these commodities are volatile and prices received affect the amount of future cash flow available for capital expenditures and repayment of indebtedness and our ability to raise additional capital. Lower prices also affect the amount of natural gas and oil that we can economically produce. Factors that can cause price fluctuations include:

- Overall economic conditions, domestic and global.
- The domestic and foreign supply of natural gas and oil.
- The level of consumer product demand.
- Adverse weather conditions and natural disasters.
- The price and availability of competitive fuels such as LNG, heating oil and coal.
- Political conditions in the Middle East and other natural gas and oil producing regions.
- The ability of the members of the Organization of Petroleum Exporting Countries and other oil exporting nations to agree to and maintain oil price and production controls.
- The level of LNG imports and any LNG exports.
- The level of natural gas exports.
- Domestic and foreign governmental regulations.
- Special taxes on production.
- Access to pipelines and gas processing plants.
- The loss of tax credits and deductions.

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A substantial or extended decline in natural gas and oil prices could have a material adverse effect on our access to capital and the quantities of natural gas and oil that may be economically produced by us. The Company may utilize financial derivative contracts, such as swaps, costless collars and puts on commodity prices, to reduce exposure to potential declines in commodity prices, however, these derivative contracts may not be sufficient to mitigate the effect of lower commodity prices.

Part of our strategy involves drilling in new or emerging plays; therefore, our drilling results in these areas are not certain.

The results of our drilling in new or emerging plays are more uncertain than drilling results in areas that are more developed and with longer production history. Since new or emerging plays and new formations have limited production history, we are less able to use past drilling results in those areas to help predict our future drilling results. The ultimate success of these drilling and completion strategies and techniques in these formations will be better evaluated over time as more wells are drilled and production profiles are better established. Accordingly, our drilling results are subject to greater risks in these areas and could be unsuccessful. We may be unable to execute our expected drilling program in these areas because of disappointing drilling results, capital constraints, lease expirations, access to adequate gathering systems or pipeline take-away capacity, availability of drilling rigs and other services or otherwise, and/or crude oil, natural gas and natural gas liquids price declines. To the extent we are unable to execute our expected drilling program in these areas, our return on investment may not be as attractive as we anticipate and our common stock price may decrease. We could incur material write-downs of unevaluated properties, and the value of our undeveloped acreage could decline in the future if our drilling results are unsuccessful.

Initial production rates in shale plays tend to decline steeply in the first twelve months of production and are not necessarily indicative of sustained production rates.

Our future cash flows are subject to a number of variables, including the level of production from existing wells. Initial production rates in shale plays tend to decline steeply in the first twelve months of production and are not necessarily indicative of sustained production rates. As a result, we generally must locate and develop or acquire new crude oil or natural gas reserves to offset declines in these initial production rates. If we are unable to do so, these declines in initial production rates may result in a decrease in our overall production and revenue over time.

Our development and exploration operations require substantial capital, and we may be unable to obtain needed capital or financing on satisfactory terms, which could lead to a loss of undeveloped acreage and/or a decline in our crude oil, natural gas and natural gas liquids reserves.

The oil and gas industry is capital intensive. We make and expect to continue to make substantial capital expenditures in our business and operations for the exploration, development, production and acquisition of crude oil, natural gas and natural gas liquids reserves. We intend to finance our future capital expenditures primarily with cash flow from operations, borrowings under our senior secured revolving credit agreement and/or proceeds from non-core asset sales. Our cash flow from operations and access to capital is subject to a number of variables, including:

- Our proved reserves.
- The level of crude oil, natural gas and natural gas liquids we are able to produce from existing wells.
- The prices at which crude oil, natural gas and natural gas liquids are sold.
- Our ability to acquire, locate and produce new reserves.

If our revenues decrease as a result of lower crude oil, natural gas and natural gas liquids prices, operating difficulties, declines in reserves or for any other reason, we may have limited ability to obtain the capital necessary to sustain our operations at current levels, to further develop and exploit our current properties, or to conduct exploratory activity. In order to fund our capital expenditures, we may need to seek additional financing. Our credit agreements contain

covenants restricting our ability to incur additional indebtedness without the consent of the lenders. Our lenders may withhold this consent in their sole discretion. In addition, if our borrowing base redetermination results in a lower borrowing base under our senior secured revolving credit agreement, we may be unable to obtain financing otherwise currently available under our senior secured revolving credit agreement. As part of the regular redetermination schedule, the borrowing base on our revolving credit agreement was redetermined at $115 million effective November 9, 2017 and

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through May 01, 2018. See “Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations - Capital Resources and Liquidity.”

In addition, our ability to comply with the financial and other restrictive covenants in our indebtedness is uncertain and will be affected by our future performance and events or circumstances beyond our control. For example, at December 31, 2017, we were not in compliance with the Current Ratio covenant under our credit agreement, although we obtained a waiver for such non-compliance. Any future failure to comply with these covenants could result in an event of default under such indebtedness and the potential foreclosure on the collateral securing such debt, and could cause a cross-default under any of our other outstanding indebtedness.

Furthermore, we may not be able to obtain debt or equity financing on terms favorable to us, or at all. In particular, the cost of raising money in the debt and equity capital markets has increased substantially while the availability of funds from those markets generally has diminished significantly. Also, as a result of concerns about the stability of financial markets generally and the solvency of counterparties specifically, the cost of obtaining money from the credit markets generally has increased as many lenders and institutional investors have increased interest rates, enacted tighter lending standards, refused to refinance existing debt at maturity on terms that are similar to existing debt, and reduced, or in some cases ceased, to provide funding to borrowers. The failure to obtain additional financing could result in a curtailment of our operations relating to exploration and development of our prospects, which in turn could lead to a possible loss of properties and a decline in our crude oil, natural gas and natural gas liquids reserves.

We rely on third-party contract operators to drill, complete and manage some of our wells, production platforms, pipelines and processing facilities and, as a result, we have limited control over the daily operations of such equipment and facilities.

We depend upon the services of third-party operators to operate drilling rigs, completion operations, offshore production platforms, pipelines, gas processing facilities and the infrastructure required to produce and market our natural gas, condensate and oil. We have limited influence over the conduct of operations by third-party operators. As a result, we have little control over how frequently and how long our operations are down or our production is shut-in when problems, weather and other production shut-ins occur. Poor performance on the part of, or errors or accidents attributable to, the operator of a project in which we participate may have an adverse effect on our results of operations and financial condition.

Failure of our working interest partners to fund their share of development costs could result in the delay or cancellation of future projects, which could have a materially adverse effect on our financial condition and results of operations.

Natural gas and crude oil prices remained relatively low through most of 2017, and while natural gas prices have remained consistent with 2017 levels, crude oil prices increased slightly during the final months of 2017 and throughout early 2018. An extended or more severe downturn could have material adverse effects on the liquidity of our working interest partners. Our working interest partners must be able to fund their share of investment costs through cash flow from operations, external credit facilities, or other sources. If our partners are not able to fund their share of costs, it could result in the delay or cancellation of future projects, resulting in a reduction of our reserves and production, which could have a materially adverse effect on our financial condition and results of operations.

We are exposed to the credit risks of our customers and derivative counterparties, and any material nonpayment or nonperformance by our customers or derivative counterparties could have a materially adverse effect on our financial condition and results of operations.

We are subject to risks of loss resulting from nonpayment or nonperformance by our customers, which risks may increase during periods of economic uncertainty. Furthermore, some of our customers may be highly leveraged and subject to their own operating and regulatory risks, which increases the risk that they may default on their obligations to us. To the extent one or more of our significant customers is in financial distress or commences bankruptcy proceedings, contracts with these customers may be subject to renegotiation or rejection under applicable provisions of the United States Bankruptcy Code. In addition, our risk management activities are subject to the risks that a counterparty may not perform its obligation under the applicable derivative instrument, the terms of the derivative instruments are imperfect, and our risk management policies and procedures are not properly followed. Any material nonpayment or nonperformance by our customers or our derivative counterparties could have a materially adverse effect on our financial condition and results of operations.

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Repeated offshore production shut-ins can possibly damage our well bores.

Our offshore well bores are required to be shut-in from time to time due to a variety of issues, including a combination of weather, mechanical problems, sand production, bottom sediment, water and paraffin associated with our condensate production, as well as downstream third-party facility and pipeline shut-ins. In addition, shut-ins are necessary from time to time to upgrade and improve the production handling capacity at related downstream platform, gas processing and pipeline infrastructure. In addition to negatively impacting our near term revenues and cash flow, repeated production shut-ins may damage our well bores if repeated excessively or not executed properly. The loss of a well bore due to damage could require us to drill additional wells.

Natural gas and oil reserves are depleting assets and the failure to replace our reserves would adversely affect our production and cash flows.

Our future natural gas and oil production depends on our success in finding or acquiring new reserves. If we fail to replace reserves, our level of production and cash flows will be adversely impacted. Production from natural gas and oil properties decline as reserves are depleted, with the rate of decline depending on reservoir characteristics. Our total proved reserves will decline as reserves are produced unless we conduct other successful exploration and development activities or acquire properties containing proved reserves, or both. Further, the majority of our reserves are proved developed producing. Accordingly, we do not have significant opportunities to increase our production from our existing proved reserves. Our ability to make the necessary capital investment to maintain or expand our asset base of natural gas and oil reserves would be impaired to the extent cash flow from operations is reduced and external sources of capital become limited or unavailable. We may not be successful in exploring for, developing or acquiring additional reserves. If we are not successful, our future production and revenues will be adversely affected.

Reserve estimates depend on many assumptions that may turn out to be inaccurate. Any material inaccuracies in these reserve estimates or underlying assumptions could materially affect the quantities of our reserves.

There are numerous uncertainties in estimating crude oil and natural gas reserves and their value, including many factors that are beyond our control. It requires interpretations of available technical data and various assumptions, including assumptions relating to economic factors. Any significant inaccuracies in these interpretations or assumptions could materially affect the estimated quantities of reserves shown in this report.

In order to prepare these estimates, our independent third-party petroleum engineers must project production rates and timing of development expenditures as well as analyze available geological, geophysical, production and engineering data, and the extent, quality and reliability of this data can vary. The process also requires economic assumptions relating to matters such as natural gas and oil prices, drilling and operating expenses, capital expenditures, taxes and availability of funds.

Actual future production, natural gas and oil prices, revenues, taxes, development expenditures, operating expenses and quantities of recoverable natural gas and oil reserves most likely will vary from our estimates. Any significant variance could materially affect the estimated quantities and pre-tax net present value of reserves shown in a reserve report. In addition, estimates of our proved reserves may be adjusted to reflect production history, results of exploration and development, prevailing natural gas and oil prices and other factors, many of which are beyond our control and may prove to be incorrect over time. As a result, our estimates may require substantial upward or downward revisions if subsequent drilling, testing and production reveal different results. Furthermore, some of the producing wells included in our reserve report have produced for a relatively short period of time. Accordingly, some of our reserve estimates are not based on a multi-year production decline curve and are calculated using a reservoir simulation model together with volumetric analysis. Any downward adjustment could indicate lower future production and thus adversely affect our financial condition, future prospects and market value.

Approximately 35% of our total estimated proved reserves at December 31, 2017 were proved undeveloped reserves. The development of our estimated proved undeveloped reserves may take longer and may require higher levels of capital expenditures than we currently anticipate. Therefore, our estimated proved undeveloped reserves may not be ultimately developed or produced.

Recovery of proved undeveloped reserves requires significant capital expenditures and successful drilling operations. The reserve data included in the reserve engineer reports assumes that substantial capital expenditures are required to develop such reserves. Although cost and reserve estimates attributable to our crude oil, natural gas and natural gas liquids reserves have been prepared in accordance with industry standards, we cannot be sure that the

estimated costs are accurate, that development will occur as scheduled or that the results of such development will be as estimated. Delays in the development of our reserves, increases in costs to drill and develop such reserves, or decreases in commodity prices will reduce the PV-10 value of our estimated proved undeveloped reserves and future net revenues estimated for such reserves and may result in some projects becoming uneconomic. In addition, delays in the development of reserves could cause us to have to reclassify our proved undeveloped reserves as unproved reserves.

The present value of future net cash flows from our proved reserves will not necessarily be the same as the current market value of our estimated crude oil, natural gas and natural gas liquids reserves.

You should not assume that the present value of future net revenues from our proved reserves referred to in this report is the current market value of our estimated crude oil, natural gas and natural gas liquids reserves. In accordance with the requirements of the SEC, the estimated discounted future net cash flows from our proved reserves are based on prices and costs on the date of the estimate, held flat for the life of the properties. Actual future prices and costs may differ materially from those used in the present value estimate. The present value of future net revenues from our proved reserves as of December 31, 2017 was based on the 12-month unweighted arithmetic average of the first-day-of-the-month price for the period January through December 2017. For our condensate and natural gas liquids, the average West Texas Intermediate (Cushing) posted price was $51.34 per barrel for offshore and onshore Southern Delaware Basin volumes, as prepared by Cobb, and the average West Texas Intermediate (Plains) posted price was $47.79 per barrel for all other onshore volumes, as prepared by NSAI. For our natural gas, the average Henry Hub spot price was $2.98 per MMBtu for all offshore and onshore volumes, as prepared by both Cobb and NSAI. Assuming strip pricing as of March 1, 2018 through 2022 and keeping pricing flat thereafter, instead of 2017 SEC pricing, while leaving all other parameters unchanged, the Company's proved reserves would have been 188.6 Bcfe and the PV-10 value of proved reserves would have been $258.3 million. Any adjustments to the estimates of proved reserves or decreases in the price of crude oil or natural gas may decrease the value of our common stock. A reconciliation of our Standardized Measure to PV 10 is provided under "Item 2. Properties – PV-10".

Actual future net cash flows will also be affected by increases or decreases in consumption by oil and gas purchasers and changes in governmental regulations or taxation. The timing of both the production and the incurrence of expenses in connection with the development and production of oil and gas properties affects the timing of actual future net cash flows from proved reserves. The effective interest rate at various times and the risks associated with our business or the oil and gas industry in general will affect the accuracy of the 10% discount factor.

Our use of 2D and 3D seismic data is subject to interpretation and may not accurately identify the presence of crude oil, natural gas and natural gas liquids. In addition, the use of such technology requires greater predrilling expenditures, which could adversely affect the results of our drilling operations.

Our decisions to purchase, explore, develop and exploit prospects or properties depend in part on data obtained through geophysical and geological analyses, production data and engineering studies, the results of which are uncertain. For example, we have over 4,000 square miles of 3D data in the South Texas and Gulf Coast regions. However, even when used and properly interpreted, 3D seismic data and visualization techniques only assist geoscientists and geologists in identifying subsurface structures and hydrocarbon indicators. They do not allow the interpreter to know if hydrocarbons are present or producible economically. Other geologists and petroleum professionals, when studying the same seismic data, may have significantly different interpretations than our professionals.

In addition, the use of 3D seismic and other advanced technologies requires greater predrilling expenditures than traditional drilling strategies, and we could incur losses due to such expenditures. As a result, our drilling activities may not be geologically successful or economical, and our overall drilling success rate or our drilling success rate for

activities in a particular area may not improve.

Drilling for and producing crude oil, natural gas and natural gas liquids are high risk activities with many uncertainties that could adversely affect our business, financial condition or results of operations.

Our drilling and operating activities are subject to many risks, including the risk that we will not discover commercially productive reservoirs. Drilling for crude oil, natural gas and natural gas liquids can be unprofitable, not only from dry holes, but from productive wells that do not produce sufficient revenues to return a profit. In addition, our drilling and producing operations may be curtailed, delayed or canceled as a result of other factors, including:

· unusual or unexpected geological formations and miscalculations;

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· pressures;
·

NUMBER OF STOCKHOLDERS

As of March 15, 2004, there were issued and outstanding 2,384,783 shares of our Class A common stock held by approximately 191 holders of record and 3,385,000 shares of our Class B common stock held by 3 holders of record. Stockholders whose shares are held on their behalf by brokers, banks and other nominees are not included as part of the number of record holders.

DIVIDENDS

Integrity has never declared or paid cash dividends on its common stock and has no plan to pay any cash dividends in the foreseeable future. Integrity s credit facility with LaSalle Bank, N.A. includes restrictions on the payment of dividends. In addition, under the merger agreement, Integrity has agreed not to pay any cash dividends on its common stock before the closing of the merger.

SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The following table shows information as to the number of shares of Integrity Class A and Class B common stock that was beneficially owned as of December 31, 2003 by:

each director of Integrity;

the Chief Executive Officer and the four other most highly compensated executive officers of Integrity;

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- each of the major stockholders;
- all Integrity directors and executive officers, as a group; and
- each person, entity, or group of affiliated persons known by Integrity to be the beneficial owner of more than 5% of Integrity s Class A or Class B common stock, based on that person s or entity s ownership of Integrity Class A or Class B common stock and the number of outstanding shares of Integrity Class A and Class B common stock as of December 31, 2003.

For purposes of this table, beneficial ownership of securities is defined according to the rules of the SEC and means generally the power to vote or exercise investment discretion with respect to securities, regardless of any economic interests therein. Except as otherwise indicated, Integrity believes that the beneficial owners of shares of Integrity Class A and Class B common stock listed below will have sole investment and voting power with respect to such shares, subject to community property laws where applicable. In addition, for purposes of this table, a person or group is deemed to have beneficial ownership of any shares which such person has the right to acquire within 60 days after the date as of which these data are presented. For purposes of calculating the percentage of outstanding shares held by each person named above, any shares which this person has the right to acquire within 60 days after the date as of which these data are presented are deemed to be outstanding, but not for the purpose of calculating the percentage ownership of any other person.

The table also shows the pro forma percentage ownership for each of the above parties, assuming completion of the merger.

The percentages were calculated based on the ratio of the number of shares of Class A and Class B common stock beneficially owned by such beneficial owner as of December 31, 2003, to the sum of:

- 5,769,783, the total number of outstanding shares of Class A and Class B common stock; and
- the number of shares of Class A and Class B common stock issuable upon exercise of options or warrants held by the applicable beneficial owner exercisable within 60 days of December 31, 2003.

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NAME OF BENEFICIAL OWNER(1)	SHARES OF CLASS A COMMON STOCK BENEFICIALLY OWNED		SHARES OF CLASS B COMMON STOCK BENEFICIALLY OWNED		PRO FORMA PERCENTAGE AFTER MERGER
	NUMBER	PERCENTAGE	NUMBER	PERCENTAGE	
Financial & Investment Management Group, Ltd.(2) 417 St. Joseph Street P.O. Box 40 Suttons Bay, MI 49682	535,328	22.4%			0%
Bruce Lev c/o Loeb Partners Corporation(3) 61 Broadway New York, NY 10006	127,590	5.4%			0%
Discover Equity Partners, L.P. (U.S. Bancor Piper Jaffray Discovery Group I, LLC)(4) 233 South Wacker Drive Suite 3620 Chicago, IL 60606	221,300	9.3%			0%
The Coleman Limited Partnership c/o Mr. P. Michael Coleman(5) 8651 Dawes Lake Road Mobile, AL 36619			223,021	6.6%	6.3%
The Coleman Charitable Foundation (6)	55,000	2.3%			0%
P. Michael Coleman(7)	55,100	2.3%	3,385,000	100%	95.3%
Jean C. Coleman(8)	55,100	2.3%	3,385,000	100%	95.3%
Jimmy M. Woodward(9)	14,000	*			0%
Charles V. Simpson(10)	10,500	*			0%
Heeth Varnedoe III(11)	15,500	*			0%
Jerry W. Weimer(12)	203,000	8.5%			8.5%(21)
Donald J. Moen(13)	86,290	3.6%			2.9%(22)
Daniel D. McGuffey(14)	53,000	2.2%			3.5%(23)
Keith J. Manwaring(15)	5,100	*			*(24)
Chris E. Thomason(16)	18,200	*			*(25)
Robert G. Rist(17)	26,297	1.1%			*
Donald S. Ellington(18)	12,000	*			*(26)
William A. Jolly(19)	11,000	*			0%
All directors and executive officers as a group	509,987	21.4%	3,385,000	100%	100%(27)

(13 persons)(20)

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* Less than 1%.

(1) Except as indicated, the address of each executive officer and director is 1000 Cody Road, Mobile, Alabama 36695.

(2) Based on information from a Schedule 13F dated December 31, 2003.

(3) Based on information from a Schedule 13F dated December 31, 2003.

(4) Based on information from a Schedule 13G filed January 30, 2004.

(5) P. Michael Coleman is the General Partner of the Coleman Limited Partnership and has sole voting and dispositive power over 223,021 shares of Class B common stock.

(6) Includes 55,000 shares held by The Coleman Charitable Foundation over which Mr. Coleman as Chairman has shared voting and dispositive power.

(7) Includes 100 shares of Class A common stock and 2,953,346 shares of Class B common stock owned by Mr. Coleman, 55,000 shares of Class A common stock owned by the Coleman Charitable Foundation, 208,633 shares of Class B common stock owned by Mrs. Coleman, and 223,021 shares of Class B common stock owned by the Coleman Limited Partnership.

(8) Includes 208,633 shares of Class B common stock owned by Mrs. Coleman, 100 shares of Class A common stock and 2,953,346 shares of Class B common stock owned by Mr. Coleman, 55,000 shares of Class A common stock owned by the Coleman Charitable Foundation, and 223,021 shares of Class B common stock owned by the Coleman Limited Partnership.

(9) Includes options to purchase 13,000 shares of Class A common stock, which are immediately exercisable.

(10) Includes options to purchase 10,000 shares of Class A common stock, which are immediately exercisable.

(11) Includes options to purchase 11,000 shares of Class A common stock, which are immediately exercisable.

(12) Includes options to purchase 200,000 shares of Class A common stock, 180,000 of which are immediately exercisable and 20,000 of which are exercisable beginning in February 2004, and does not include 100,000 restricted shares of Class A common stock, which Mr. Weimer does not have the right to acquire beneficial ownership of within 60 days of December 31, 2003.

(13) Includes options to purchase 78,890 shares of Class A common stock, which are immediately exercisable, and does not include options to purchase 16,110 shares of Class A common stock, which are not exercisable within 60 days of December 31, 2003.

(14) Includes options to purchase 53,000 shares of Class A common stock, which are immediately exercisable, and does not include options to purchase 22,000 shares of Class A common stock, which are not exercisable within 60 days of December 31, 2003, or 50,000 restricted shares of Class A common stock, which Mr. McGuffey does not have the right to acquire beneficial ownership of within 60 days of December 31, 2003.

(15) Includes options to purchase 5,000 shares of Class A common stock, which are immediately exercisable, and does not include options to purchase 10,000 shares of Class A common stock, which are not exercisable within 60 days of December 31, 2003.

(16) Includes options to purchase 18,200 shares of Class A common stock, which are immediately exercisable, and does not include options to purchase 1,800 shares of Class A common stock, which are not exercisable within 60 days of December 31, 2003.

(17) Includes options to purchase 20,000 shares of Class A common stock, which are immediately exercisable.

(18) Includes options to purchase 12,000 shares of Class A common stock, which are immediately exercisable, and does not include options to purchase 8,000 shares of Class A common stock, which are not exercisable within 60 days of December 31, 2003.

(19) Includes options to purchase 11,000 shares of Class A common stock, which are immediately exercisable.

(20) Includes options to purchase 432,090 shares of Class A common stock, 412,090 of which are immediately exercisable and 20,000 of which are exercisable beginning in February 2004, and does not include options to purchase 57,910 shares of Class A common stock, which are not exercisable within 60 days of December 31, 2003, 150,000 restricted shares of Class A common stock, which the owners do not have the right to acquire beneficial ownership of within 60 days of December 31, 2003, or options to purchase 71,000 shares of Class A common stock held by Jeff Friend, Robert Brenner, Todd Burkhalter, Debra Mayes, Doug Meduna and Joyce O Connor (each an officer of Integrity), 51,623 of which are within 60 days of December 31, 2003, because such owners are not executive officers of Integrity.

(21) Also includes 100,000 restricted shares of Class A common stock, which will vest at the effective time of the merger.

(22) Also includes options to purchase 16,110 shares of Class A common stock, which will be exercisable upon the effectiveness of the merger.

(23) Also includes options to purchase 22,000 shares of Class A common stock, which will be exercisable upon the effectiveness of the merger, and 50,000 restricted shares of Class A common stock, which will vest at the effective time of the merger.

(24) Also includes options to purchase 10,000 shares of Class A common stock, which will be exercisable upon the effectiveness of the merger.

(25) Also includes options to purchase 1,800 shares of Class A common stock, which will be exercisable upon the effectiveness of the merger.

(26) Also includes options to purchase 8,000 shares of Class A common stock, which will be exercisable upon the effectiveness of the merger.

(27) Does not include options to purchase 71,000 shares of Class A common stock held by Jeff Friend, Robert Brenner, Todd Burkhalter, Debra Mayes, Doug Meduna and Joyce O Connor (each an officer of Integrity), which are either currently exercisable or will be exercisable upon the effectiveness of the merger, because such owners are not executive officers of Integrity.

FUTURE STOCKHOLDER PROPOSALS

We do not currently expect to hold a 2004 annual meeting of public stockholders, because upon completion of the merger, we would no longer have public stockholders or any public participation in our stockholder meetings. If the merger is not completed, we will hold a 2004 annual meeting of stockholders on a date which has not been determined at this time. Stockholder proposals for inclusion in our proxy statement for such 2004 annual meeting of stockholders would have to be submitted to our Corporate Secretary in writing and received by us at our corporate headquarters located at 1000 Cody Road, Mobile, Alabama 36695, Attention: Donald S. Ellington, Senior Vice President of Finance and Administration, a reasonable time before we begin to print and mail our proxy materials for that meeting.

WHERE STOCKHOLDERS CAN FIND MORE INFORMATION

We file annual, quarterly and special reports, proxy statements and other information with the SEC. In addition, because the merger may be considered to be a going private transaction, Integrity and Kona have filed a Rule 13e-3 Transaction Statement on Schedule 13E-3 with respect to the merger. The Schedule 13E-3, the exhibits to the Schedule 13E-3 and such reports, proxy statements and other information contain additional information about Integrity. Each exhibit to the Schedule 13E-3 will be made available for inspection and copying at Integrity s executive offices during regular business hours by any Integrity stockholder or a representative of a stockholder as so designated in writing.

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Integrity stockholders may read and copy the Schedule 13E-3 and any reports, statements or other information filed by Integrity at the SEC s public reference room located at 450 Fifth Street, N.W., Washington, D.C. 20549, and at the regional office of the SEC located at 801 Brickell Avenue, Suite 1800, Miami, Florida 33131. Please call the SEC at 1-800-SEC-0330 for further information on the operation of the public reference rooms. Integrity s filings with the SEC are also available to the public from commercial document retrieval services and at the web site maintained by the SEC located at: http://www.sec.gov. Information contained in the SEC s website is not incorporated by reference into this proxy statement. You may also obtain copies of this information by mail from the Public Reference Section of the SEC, 450 Fifth Street, N.W., Room 1024, Washington, DC 20549, at prescribed rates.

ADDITIONAL INFORMATION AND DOCUMENTS INCORPORATED BY REFERENCE

The SEC allows Integrity to incorporate by reference information into this proxy statement. This means that Integrity can disclose important information by referring to another document filed separately with the SEC. The information incorporated by reference is considered to be part of this proxy statement. This proxy statement and the information that Integrity files later with the SEC may update and supersede the information incorporated by reference. Similarly, the information that Integrity later files with the SEC may update and supercede the information in this proxy statement. Integrity incorporates by reference each document it files under Section 13(a), 13(c), or 15(d) of the Exchange Act after the date of this proxy statement and before the special meeting. Integrity also incorporates by reference into this proxy statement the following documents filed by it with the SEC under the Exchange Act:

Annual Report on Form 10-K for the fiscal year ended December 31, 2003

Annual Report on Form 10-K/A for the fiscal year ended December 31, 2003

Proxy Statement on Schedule 14A filed April 18, 2003

Current Report on Form 8-K filed March 2, 2004

Current Report on Form 8-K filed November 21, 2003

The proxy statement does not constitute an offer to sell or to buy, or a solicitation of an offer to sell or to buy, any securities, or the solicitation of a proxy, in any jurisdiction to or from any person to whom it is not lawful to make any offer or solicitation in such jurisdiction. The delivery of this proxy statement should not create an implication that there has been no change in the affairs of Integrity since the date of this proxy statement or that the information herein is correct as of any later date.

Stockholders should not rely on information other than that contained or incorporated by reference in this proxy statement (including its appendices). Integrity has not authorized anyone to provide information that is different from that contained in this proxy statement. This proxy statement is dated May 13, 2004. No assumption should be made that the information contained in this proxy statement is accurate as of any other date, and the mailing or delivery of this proxy statement will not create any implication to the contrary.

Integrity has supplied all information contained in this proxy statement relating to Integrity, its subsidiaries and their respective directors, officers and affiliates, and Kona has supplied all information contained in this proxy statement relating to Kona and its directors, officers and affiliates.

No provisions have been made in connection with the merger to grant stockholders access to Integrity s corporate files or the corporate files of Kona, or to obtain counsel or appraisal services for stockholders at Integrity s expense or the expense of Kona.

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EXECUTION COPY

Appendix A

AGREEMENT AND PLAN OF MERGER

This **AGREEMENT AND PLAN OF MERGER** (this ***Agreement***) is made and entered into as of March 1, 2004, by and among **INTEGRITY MEDIA, INC.**, a Delaware corporation (the ***Company***), **KONA ACQUISITION CORP.**, a Delaware corporation (***Kona***) and P. Michael Coleman (***Coleman***).

WHEREAS, the respective Boards of Directors of the Company and Kona have deemed it advisable and in the best interests of their respective corporations and stockholders to consummate the statutory merger, on the terms and subject to the conditions set forth in this Agreement, of Kona with and into the Company (the ***Merger***);

WHEREAS, the respective Boards of Directors of the Company and Kona have approved, in accordance with the applicable provisions of the laws of the State of Delaware (***Delaware Law***), this Agreement and the transactions contemplated hereby, including the Merger;

WHEREAS, based on the recommendation of the Special Committee (as defined in Section 3.01(e)(ii)), the Board of Directors of the Company has resolved to recommend to its stockholders approval and adoption of this Agreement, approval of the Merger, and approval of the conversion of each issued and outstanding share of the Company s Class A common stock, $0.01 par value per share (the ***Company Class A Common Stock***), other than those issued and outstanding shares of Company Class A Common Stock Held (as defined in Section 8.13) by the Continuing Stockholders (as defined in Section 8.13), to the right to receive a cash payment from the Surviving Corporation (as defined in Section 1.01);

WHEREAS, Coleman beneficially owns 55,100 shares of Company Class A Common Stock and 3,385,000 shares of the Company s Class B common stock, $0.01 par value per share (the ***Company Class B Common Stock***);

WHEREAS, Coleman is the sole stockholder of Kona;

WHEREAS, the sole stockholder of Kona has approved and adopted this Agreement and approved the Merger;

WHEREAS, Coleman has informed the Company that the shares of Company Class A Common Stock and Company Class B Common Stock of which he has a pecuniary interest are not for sale, and that Coleman has no intention of selling, transferring or otherwise disposing of such shares of Company Class A Common Stock and Company Class B Common Stock; and

WHEREAS, the Company, Kona and Coleman desire to make certain representations, warranties, covenants, and agreements in connection with the Merger and also to prescribe various conditions to the Merger;

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NOW, THEREFORE, in consideration of the foregoing and the respective representations, warranties, covenants, and agreements set forth herein, the parties hereto agree as follows:

ARTICLE I

The Merger

SECTION 1.01. **The Merger**. Upon the terms and subject to the conditions set forth in this Agreement, and in accordance with the General Corporation Law of the State of Delaware (the ***DGCL***), Kona shall be merged with and into the Company at the Effective Time (as defined in Section 1.03). At the Effective Time, the separate corporate existence of Kona shall cease and the Company shall continue as the surviving corporation (the ***Surviving Corporation***).

SECTION 1.02. **Closing**. The closing of the Merger (the ***Closing***) will take place at 11:00 a.m., Atlanta time, on a date to be specified by the parties, which shall be not later than the second Business Day (as defined in Section 8.13) after satisfaction or waiver of the conditions set forth in Article VI (other than those that by their terms are to be satisfied or waived at the Closing), at the offices of Alston & Bird LLP, 1201 West Peachtree Street, Atlanta, Georgia, 30309, unless another time, date, or place is agreed to in writing by Kona and the Company. The date on which the Closing occurs is referred to in this Agreement as the ***Closing Date***.

SECTION 1.03. **Effective Time of the Merger**. As soon as practicable on or after the Closing Date, the parties shall: (a) file a certificate of merger (the ***Certificate of Merger***) in such form as is required by, and executed and acknowledged in accordance with, the relevant provisions of the DGCL; and (b) make all other filings or recordings required under the DGCL to effect the Merger. The Merger shall become effective at such date and time as the Certificate of Merger is duly filed with the Secretary of State of the State of Delaware or at such subsequent date and time as Kona and the Company shall agree and specify in the Certificate of Merger. The date and time at which the Merger becomes effective is referred to in this Agreement as the ***Effective Time***.

SECTION 1.04. **Effects of the Merger**. The Merger shall have the effects set forth in Section 259 of the DGCL.

SECTION 1.05. **Certificate of Incorporation and Bylaws of Surviving Corporation**.

(a) At the Effective Time, the Certificate of Incorporation of the Company as in effect immediately prior to the Effective Time shall be the Certificate of Incorporation of the Surviving Corporation from and after the Effective Time until thereafter changed or amended as provided therein or by applicable Delaware Law.

(b) The Bylaws of the Company as in effect immediately prior to the Effective Time shall be the Bylaws of the Surviving Corporation from and after the

Effective Time until thereafter changed or amended as provided therein or by applicable Delaware Law.

SECTION 1.06. **Directors of Surviving Corporation**. The directors of the Company immediately prior to the Effective Time shall be the directors of the Surviving Corporation until the earlier of their resignation or removal or until their respective successors are duly elected and qualified, as the case may be.

SECTION 1.07. **Officers of Surviving Corporation**. The officers of the Company immediately prior to the Effective Time shall be the officers of the Surviving Corporation until the earlier of their resignation or removal or until their respective successors are duly elected and qualified, as the case may be.

ARTICLE II

Conversion of Securities

SECTION 2.01. **Conversion of Securities**.

(a) At the Effective Time, on the terms and subject to the conditions set forth in this Agreement, by virtue of the Merger and without any action on the part of Kona, the Company or any of their respective securityholders:

(i) **Company Class A Common Stock.**

(A) *Non-Continuing Stockholders*. Each share of Company Class A Common Stock, other than those shares of Company Class A Common Stock Held by the Dissenting Stockholders (as defined in Section 2.01(a)(vii)), outstanding at the Effective Time Held by a Non-Continuing Stockholder (as defined in Section 8.13), shall be deemed canceled and converted into the right to receive cash in an amount equal to $6.50, without interest (the ***Per Share Cash Merger Consideration***), and each such share shall no longer be outstanding and shall automatically be canceled and shall cease to exist, and each certificate that immediately prior to the Effective Time evidenced a Non-Continuing Stockholder s ownership of shares of Company Class A Common Stock shall cease to have any rights with respect thereto, except the right to receive the Per Share Cash Merger Consideration.

(B) *Continuing Stockholders*. Each share of Company Class A Common Stock, other than those shares of Company Class A Common Stock Held by the Dissenting Stockholders, outstanding at the Effective Time Held by a Continuing Stockholder, shall continue to represent one share of Class A common stock of the Surviving Corporation, and each certificate that immediately prior to the Effective Time evidenced a Continuing Stockholder s ownership of shares of Company Class A Common Stock shall continue to evidence ownership of the same number of shares of Class A common stock of the Surviving Corporation.

(ii) **Surviving Corporation Class A Shares.** Each share of Company Class B Common Stock outstanding at the Effective Time shall be converted into the right to receive one fully paid and nonassessable share of Class A common stock

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of the Surviving Corporation. All shares of Class A common stock of the Surviving Corporation issued pursuant to this Section 2.01(a)(ii) (the "***Surviving Corporation Class A Shares***) shall be duly authorized and validly issued and free of preemptive rights, with no personal liability attaching to ownership thereof.

(iii) **Company Options.**

(A) *Non-Continuing Stockholders.* Promptly following the execution and delivery of this Agreement, the Compensation Committee of the Board of Directors of the Company shall adopt appropriate resolutions and take all other actions necessary and appropriate to provide, and the Company shall cause (a) on the Business Day prior to the Effective Time, each unvested and unexercisable Company Option (as defined in Section 8.13) held by a Non-Continuing Stockholder to become fully vested and exercisable and (b) immediately prior to the Effective Time, each such unexpired and unexercised Company Option granted under the Integrity Incorporated 1999 Long-Term Incentive Plan and Integrity Media, Inc. 2001 Long-Term Incentive Plan to be cancelled either (i) if the Company Option has an exercise price per share of the Company Class A Common Stock previously subject to such Company Option that is less than the Per Share Cash Merger Consideration (an ***Eligible Option***), in consideration of the right to receive cash in an amount equal to the excess of the Per Share Cash Merger Consideration over the exercise price (the ***Option Payment***) or (ii) if the exercise price of the Company Option is greater than the Per Share Cash Merger Consideration (an ***Ineligible Option***), without the payment of cash or issuance of other securities. From and after the Effective Time, any such cancelled Company Option shall no longer be exercisable by the former holder thereof and shall be of no further force and effect. With regard to any Company Option granted under the Integrity Music, Inc. Long-Term Incentive Plan adopted in 1994, Integrity Music, Inc. 1994 Stock Option Plan for Outside Directors and Integrity Media, Inc. 2002 Stock Option Plan for Outside Directors, the Company shall use its reasonable best efforts to cause (x) each Non-Continuing Stockholder who is also a holder of an Eligible Option to exercise such Eligible Option prior to the Effective Time or to agree to the cancellation of such Eligible Option in exchange for the right to receive an Option Payment as provided for hereinabove and (y) each Non-Continuing Stockholder who is also a holder of an Ineligible Option to consent to the termination of such Ineligible Option prior to the Effective Time (each, an "***Option Termination Consent***). Each Option Termination Consent shall include a confirmation from the holder that, upon the effectiveness of such cancellation or termination, he or she will have no rights relating to such Company Option, except to the extent contemplated hereinabove.

(B) *Continuing Stockholders*. Each Company Option outstanding at the Effective Time held by a Continuing Stockholder shall remain outstanding and become an obligation of the Surviving Corporation.

(iv) **Kona Common Stock.** Each share of common stock of Kona, par value $0.01 per share, issued and outstanding immediately prior to the Effective Time, shall automatically be cancelled and retired and shall cease to exist, and

no cash or other consideration shall be delivered or deliverable in exchange therefore (other than the refund to Coleman of his initial $100 capital contribution).

(v) **Fractional Shares**. No fraction of a share of Company Class A Common Stock will be issued in the Merger, but in lieu thereof, any holder who would otherwise be entitled to a fraction of a share of Company Class A Common Stock (after aggregating all fractional shares of Company Class A Common Stock to be received by such holder) shall be entitled to receive from the Company an amount of cash (rounded to the nearest whole cent) equal to the product of (A) such fraction, multiplied by (B) Per Share Cash Merger Consideration.

(vi) **Adjustments to Merger Consideration**. In the event of any stock split, reverse stock split, stock dividend (including any dividend or distribution of securities convertible into Company Class A Common Stock or Company Class B Common Stock), reorganization, reclassification, combination, recapitalization, or other like change with respect to Company Class A Common Stock or Company Class B Common Stock occurring after the date hereof and prior to the Effective Time, then each of the Per Share Cash Merger Consideration and the Surviving Corporation Class A Shares shall be equitably adjusted to the extent necessary to provide the parties the same economic effect as contemplated by this Agreement prior to such stock split, reverse stock split, stock dividend, reorganization, reclassification, combination, recapitalization or other like change.

(vii) **Dissenting Stockholders**. Any holder of shares of Company Class A Common Stock who perfects such holder s dissenters rights in accordance with and as contemplated by Section 262 of the DGCL (a ***Dissenting Stockholder***) shall be entitled to receive from the Surviving Corporation the value of such shares in cash as determined pursuant to such provision of Delaware Law; provided, that no such payment shall be made to a Dissenting Stockholder unless and until such Dissenting Stockholder has complied with the applicable provisions of Section 262 of the DGCL and surrendered to the Company the certificate or certificates representing the shares for which payment is being made. In the event that after the Effective Time a Dissenting Stockholder fails to perfect, or effectively withdraws or loses, such Dissenting Stockholder s right to appraisal of and payment for such holder s shares, the Surviving Corporation shall issue and deliver the consideration to which such Dissenting Stockholder is entitled under this Article 2 (without interest) upon surrender by such Dissenting Stockholder of the certificate or certificates representing the shares of Company Class A Common Stock held by such Dissenting Stockholder. If and to the extent required by applicable law, the Surviving Corporation will establish (or cause to be established) an escrow account with an amount sufficient to satisfy the maximum aggregate payment that may be required to be paid to Dissenting Stockholders. Upon satisfaction of all claims of Dissenting Stockholders, the remaining escrowed amount, reduced by payment of the fees and expenses of the escrow agent, will be returned to the Surviving Corporation. The Company shall serve prompt notice to Kona of any demands for appraisal of any shares of Company Class A Common Stock, withdrawals of such demands and any other instruments served pursuant to the DGCL received by the Company, and Kona shall have the right to participate in and direct all negotiations and

proceedings with respect to such demands. Prior to the Effective Time, the Company shall not, without the prior written consent of Kona (which consent shall not be withheld unreasonably), make any payment with respect to, or settle or offer to settle, any such demands, or agree to do or commit to do any of the foregoing.

SECTION 2.02. **Surrender of Certificates**.

(a) **Exchange Agent**. The Company s transfer agent shall act as exchange agent (the ***Exchange Agent***) in the Merger.

(b) **Provision of Total Cash Merger Consideration**. Subject to the conditions set forth in Article VI of this Agreement, the total amount of cash to be paid in respect of the shares of Company Class A Common Stock pursuant to Section 2.01(a)(i)(A) and the Eligible Options pursuant to Section 2.01(a)(iii)(A) (the ***Total Cash Merger Consideration***) shall be provided to the Exchange Agent in cash prior to the Effective Time.

(c) **Exchange Procedures**.

(i) Within two Business Days following the Effective Time, the Surviving Corporation shall cause to be mailed to each holder of record of a certificate or certificates that immediately prior to the Effective Time represented outstanding shares of (i) Company Class A Common Stock converted into the right to receive the Per Share Cash Merger Consideration pursuant to Section 2.01(a)(i)(A) (the ***Company Certificates***), and (ii) Company Class B Common Stock converted into the right to receive the Surviving Corporation Class A Shares pursuant to Section 2.01(a)(ii) (the ***Class B Certificates***, together with the Company Certificates, the ***Certificates***): (A) a form of letter of transmittal (the ***Letter of Transmittal***); and (B) instructions for use of the Letter of Transmittal in effecting the surrender of either the Company Certificates in exchange for such holder s pro rata portion of the Total Cash Merger Consideration or the Class B Certificates in exchange for such holder s pro rata portion of the Surviving Corporation Class A Shares. The Letter of Transmittal shall specify that delivery of the Certificates shall be effected, and risk of loss and title to the Certificates shall pass, only upon receipt thereof by the Exchange Agent and shall be in such form and have such other provisions as the Surviving Corporation may reasonably specify. Upon surrender of a Certificate for cancellation to the Exchange Agent or to such other agent or agents as may be appointed by the Surviving Corporation, together with a properly completed and duly executed Letter of Transmittal, (i) the holder of record of such Certificate shall be entitled to receive: (A) if it is a Company Certificate, a check in the amount equal to such holder s pro rata portion of the Total Cash Merger Consideration as calculated pursuant to Section 2.01(a)(i)(A) hereof in respect of such Certificate; or (B) if it is a Class B Certificate, a certificate representing the number of whole shares of Class A common stock of the Surviving Corporation to which such holder is entitled pursuant to Section 2.01(a)(ii) and cash in lieu of fractional shares (if any), to which such holder is entitled pursuant to Section 2.01(a)(v); and (ii) such Certificate shall be canceled. Until so surrendered, each Certificate shall be deemed from and after the Effective Time to represent only the right to receive such holder s pro rata

portion of either (x) the Total Cash Merger Consideration contemplated by Section 2.01(a)(i)(A), or (y) the Surviving Corporation Class A Shares contemplated by Section 2.01(a)(ii). Notwithstanding anything contained herein to the contrary, no interest shall be paid or shall accrue on any cash payable to any holder of a Certificate pursuant to the provisions of this Article II.

(ii) Within two Business Days following the Effective Time, each holder of an Eligible Option converted into the right to receive the Option Payment pursuant to Section 2.01(a)(iii)(A) shall be entitled to receive from the Exchange Agent a check in the amount equal to such holder s pro rata portion of the Total Cash Merger Consideration as calculated pursuant to Section 2.01(a)(iii)(A) hereof. Notwithstanding anything contained herein to the contrary, no interest shall be paid or shall accrue on any cash payable to any holder of an Eligible Option pursuant to the provisions of this Article II.

(d) **No Liability**. Notwithstanding anything to the contrary in this Section 2.02, none of the Exchange Agent, the Surviving Corporation, or any party hereto shall be liable to any Person (as defined in Section 8.13) for any amount properly paid to a public official pursuant to any applicable abandoned property, escheat, or similar law. If any Certificate has not been surrendered prior to the fifth anniversary of the Effective Time (or immediately prior to such earlier date on which the pro rata portion of the Total Cash Merger Consideration contemplated by Section 2.01(a)(i)(A) in respect of such Certificate would otherwise escheat to or become the property of any Governmental Entity (as such term is defined in Section 8.13)), any amounts payable in respect of such Certificate shall, to the extent permitted by applicable law, become the property of the Surviving Corporation, free and clear of all claims or interests of any Person previously entitled thereto.

SECTION 2.03. **No Further Ownership Rights in Company Class A Common Stock or Company Class B Common Stock**. The Per Share Cash Merger Consideration issued or issuable following the surrender for exchange of the Company Certificates in accordance with the terms hereof shall be issued or issuable in full satisfaction of all rights pertaining to the shares of Company Class A Common Stock represented by the Company Certificates, and there shall be no further registration of transfers on the records of the Surviving Corporation of such shares of Company Class A Common Stock that were issued and outstanding immediately prior to the Effective Time. The Surviving Corporation Class A Shares issued or issuable following the surrender for exchange of Class B Certificates representing shares of Company Class B Common Stock in accordance with the terms hereof shall be issued or issuable in full satisfaction of all rights pertaining to such shares of Company Class B Common Stock, and there shall be no further registration of transfers on the records of the Company of such shares of Company Class B Common Stock that were issued and outstanding immediately prior to the Effective Time. If, after the Effective Time, any Certificate for shares of Company Class A Common Stock or Company Class B Common Stock converted into the right to receive Per Share Cash Merger Consideration or the Surviving Corporation Class A Shares, as the case may be, is presented to the Surviving

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Corporation for any reason, such Certificate shall be canceled and exchanged as provided in this Article II.

SECTION 2.04. **Lost, Stolen or Destroyed Certificates**. In the event any Certificate representing shares of Company Class A Common Stock held of record by a Non-Continuing Stockholder shall have been lost, stolen, or destroyed, the Exchange Agent shall issue in exchange for such Certificate, following the making of an affidavit of that fact by the record holder thereof, such holder s pro rata portion of the Total Cash Merger Consideration as may be required pursuant to Section 2.01(a)(i)(A) in respect of such Certificate; ***provided***, ***however***, that the Surviving Corporation, in its discretion and as a condition precedent to the delivery thereof, may require the record holder of such Certificate to deliver a bond in such sum as the Company may reasonably direct as indemnity against any claim that may be made against the Surviving Corporation, the Exchange Agent, or any of their respective representatives or agents with respect to such Certificate.

SECTION 2.05. **Withholding Rights**. The Surviving Corporation shall be entitled to deduct and withhold from the Per Share Cash Merger Consideration or Option Payment otherwise deliverable under this Agreement, and from any other payments otherwise required pursuant to this Agreement, to any Non-Continuing Stockholders, such amounts as the Surviving Corporation is required to deduct and withhold with respect to any such deliveries and payments under the Internal Revenue Code of 1986, as amended (the ***Code***), or any provision of state, local, provincial or foreign tax law. To the extent that amounts are so withheld, such withheld amounts shall be treated for all purposes of this Agreement as having been delivered and paid to such holders in respect of which such deduction and withholding was made.

SECTION 2.06. **Termination of Exchange Agent Funding**. Any portion of funds (including any interest earned thereon) held by the Exchange Agent that has not been delivered to Non-Continuing Stockholders pursuant to this Article II within six months after the Effective Time shall promptly be paid to the Surviving Corporation, and thereafter each holder of a Certificate who has not theretofore complied with the exchange procedures set forth in and contemplated by Section 2.02(c) shall look only to the Surviving Corporation (subject to abandoned property, escheat, and similar laws) for its claim for such holder s pro rata portion of the Total Cash Merger Consideration only as a general creditor thereof.

SECTION 2.07. **Taking of Necessary Action; Further Action**. If, at any time after the Effective Time, any further action is necessary or desirable to carry out the purposes of this Agreement or to vest the Surviving Corporation with full right, title, and interest in, to and under, or possession of, all assets, property, rights, privileges, powers, and franchises of Kona, the officers and directors of the Surviving Corporation are fully authorized in the name and on behalf of the Company or otherwise, to take all lawful action necessary or desirable to accomplish such purpose or acts, so long as such action is not inconsistent with this Agreement.

ARTICLE III

Representations and Warranties

SECTION 3.01. **Representations and Warranties of the Company**. Except as set forth in the letter (with specific reference to the section of this Agreement to which the information stated in such disclosure relates) delivered by the Company to Kona prior to the execution of this Agreement (the "***Disclosure Letter*** "), the Company represents and warrants to Kona as follows:

(a) **Organization, Power, and Standing**. The Company and each Subsidiary (as defined in Section 8.13) of the Company: (i) is a corporation or other entity duly organized, validly existing, and in good standing under the laws of the jurisdiction of its organization (except, in the case of good standing, for entities organized under the laws of any jurisdiction that does not recognize such concept); (ii) has all requisite corporate, company, or partnership power and authority to carry on its business as now being conducted; and (iii) to the Knowledge (as defined in Section 8.13) of the Company, is duly qualified or licensed to do business and is in good standing in each jurisdiction (except, in the case of good standing, any jurisdiction that does not recognize such concept) in which the nature of its business or the ownership, leasing, or operation of its properties makes such qualification or licensing necessary, other than where the failure to be so organized, existing, qualified, or licensed or in good standing (except in the case of clause (i) above with respect to the Company), individually or in the aggregate, is not reasonably likely to have a Material Adverse Effect (as defined in Section 8.13). Each Subsidiary of the Company is listed in Section 3.01(a) of the Disclosure Letter. Each jurisdiction in which the Company and any Subsidiary of the Company is qualified to do business is set forth in Section 3.01(a) of the Disclosure Letter.

(b) **Corporate Power and Authority; Due Authorization**. The Company has all requisite corporate power and authority to enter into this Agreement, to consummate the transactions contemplated hereby, subject, in the case of the Merger, to obtaining the Requisite Approval (as defined in Section 3.01(e)), and to comply with the provisions of this Agreement. All corporate action on the part of the Company, its officers, directors, and stockholders necessary for: (i) the authorization, execution, and delivery of this Agreement; (ii) the performance of all obligations of the Company under this Agreement; (iii) the authorization, issuance, and delivery of the Surviving Corporation Class A Shares; and (iv) the consummation of the transactions contemplated by this Agreement, subject in the case of the Merger, to obtaining the Requisite Approval, has been taken, and this Agreement constitutes a valid and legally binding obligation of the Company, enforceable against the Company in accordance with its terms, except as enforceability thereof may be limited by applicable bankruptcy, insolvency, reorganization, moratorium, or other similar laws affecting creditors rights generally, or by general equitable principles.

(c) **No Conflict.** The execution and delivery by the Company of this Agreement, consummation of the transactions contemplated hereby, and the performance by the Company of its obligations hereunder, do not and will not: (A) violate the

Company s Certificate of Incorporation or Bylaws; or (B) violate any order, writ, injunction, decree, judgment, ruling, law, rule, or regulation of any Governmental Entity applicable to the Company, any Subsidiary of the Company, the business or assets of the Company, except for such violations which would not, individually or in the aggregate, have a Material Adverse Effect.

(d) **Capitalization**. The authorized capital stock of the Company consists of (i) 7,500,000 shares of Company Class A Common Stock, of which 2,384,783 shares are issued and outstanding; (ii) 10,500,000 shares of the Company Class B Common Stock, of which 3,385,000 shares are issued and outstanding; and (iii) 500,000 shares of the Company s preferred stock, $0.01 par value per share, none of which are issued and outstanding. There are no other issued and outstanding shares of capital stock or voting securities of the Company. All outstanding shares of the Company s capital stock have been duly authorized, and are validly issued, fully paid, and nonassessable. No party has any preemptive (whether statutory or contractual) rights in any capital stock of the Company. Except as disclosed in the Company SEC Documents (as defined in Section 3.01(g)(i)), there are no outstanding convertible securities, subscriptions, options, warrants, calls, rights, commitments, or any other agreement to which the Company or any Subsidiary of the Company is a party, or by which the Company or any Subsidiary of the Company is bound that, directly or indirectly, obligate the Company or any Subsidiary of the Company to issue, deliver or sell or cause to be issued, delivered or sold any additional securities or any other capital stock of the Company or any Subsidiary of the Company, or any other securities convertible into, or exercisable or exchangeable for, or evidencing the right to subscribe for any such securities or any other capital stock of the Company or any Subsidiary of the Company. Neither the Company nor any Subsidiary of the Company is a party to any agreement or understanding regarding the voting or the registration under federal or state law of any shares of the Company s capital stock or the equity voting interests of any Subsidiary of the Company. All of the outstanding capital stock or other equity interests in each of the Subsidiaries is owned by the entities reflected in Section 3.01(d) of the Disclosure Letter, free and clear of all liens, claims, charges, or encumbrances. All outstanding shares of capital stock of each corporate Subsidiary have been validly issued and are fully paid and nonassessable. All equity interests of each other Subsidiary have been validly issued and are fully paid.

(e) **Vote Required; Special Independent Committee; Board Approval**.

(i) The adoption of this Agreement at the Stockholders Meeting (as defined in Section 5.01(a)), or any adjournment or postponement thereof, by a majority of the outstanding stock of the Company entitled to vote at the Stockholders Meeting (the ***Requisite Approval***), is the only approval of the holders of any class or series of the Company s capital stock necessary to adopt this Agreement and consummate the transactions contemplated by this Agreement under Delaware Law.

(ii) The special independent committee of the Board of Directors of the Company, comprised of William A. Jolly, Heeth Varnedoe III and Jimmy M. Woodward (the ***Special Committee***), at a meeting duly called and held at

which all members of the Special Committee were present, duly and unanimously adopted resolutions (which have not been modified or rescinded): (A) approving and declaring advisable the Merger, this Agreement, and the transactions contemplated by this Agreement; (B) declaring that (I) it is in the best interests of the Disinterested Stockholders (as defined in Section 8.13) that the Company enter into this Agreement and consummate the Merger on the terms and subject to the conditions set forth in this Agreement, and (II) the terms and conditions of this Agreement and the Merger are fair to the Disinterested Stockholders; and (C) recommending to the Board of Directors of the Company that (I) this Agreement be submitted to a vote for adoption at the Stockholders Meeting, and (II) it recommend that the Company s stockholders adopt this Agreement.

(iii) The Board of Directors of the Company, at a meeting duly called and held at which all directors of the Company were present, duly and unanimously adopted (with Coleman and Jean C. Coleman abstaining) resolutions (which have not been modified or rescinded): (A) approving and declaring advisable the Merger, this Agreement, and the transactions contemplated by this Agreement; (B) declaring that it is in the best interests of the Company s stockholders that the Company enter into this Agreement and consummate the Merger on the terms and subject to the conditions set forth in this Agreement; (C) directing that this Agreement be submitted to a vote for adoption at the Stockholders Meeting; and (iv) recommending that the Company s stockholders adopt this Agreement.

(f) **Opinion of Financial Advisor**. SunTrust Capital Markets, Inc., through its SunTrust Robinson Humphrey Capital Markets Division (the ***Financial Advisor***) has delivered its opinion, dated March 1, 2004, to the Special Committee, to the effect that subject to the assumptions, qualifications and limitations set forth therein the Per Share Cash Merger Consideration to be received by the Disinterested Stockholders is fair, from a financial point of view. A true, correct, and complete copy of such opinion has been provided to Kona prior to or on the date hereof.

(g) **Company SEC Documents; Financial Statements; Liabilities and Obligations of the Company**.

(i) Since December 31, 2002, the Company has timely filed with the SEC all forms, reports, schedules, statements, and other documents required to be filed by it with the SEC (collectively, the ***Company SEC Documents***) pursuant to the Exchange Act, the Securities Act, and the SEC s rules and regulations thereunder. The Company has furnished, or otherwise made available, the Company SEC Documents to Kona. No Subsidiary of the Company is required to file any forms, reports, schedules, statements, or other document with the SEC. As of their respective dates, each of the Company SEC Documents complied in all material respects with the requirements of the Securities Act or the Exchange Act, as the case may be, and the rules and regulations of the SEC promulgated thereunder applicable to such Company SEC Document, and none of the Company SEC Documents at the time it was filed contained any untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary in order to make the statements therein, in light of the circumstances under which they were made, not misleading.

(ii) The financial statements (including the related notes) of the Company included in the Company SEC Documents (including, in each case, balance sheets, statements of operations, and statements of cash flows) (collectively, the "***Company Financial Statements***): (A) comply as to form in all material respects with the accounting requirements applicable at the time the Company SEC Documents were filed and the published rules and regulations of the SEC with respect thereto; (B) have been prepared in accordance with United States generally accepted accounting principles (***GAAP***) (except, in the case of unaudited statements, as permitted by Form 10-Q, applied on a consistent basis during the periods involved (except as may be indicated in the notes thereto)); (C) are consistent with the books and records of the Company in all material respects; (D) fairly present in all material respects the consolidated financial position of the Company and its consolidated subsidiaries as of the dates thereof and their consolidated results of operations and cash flows for the periods then ended (subject, in the case of unaudited statements, to normal and recurring year-end audit adjustments which are immaterial in amount); and (E) disclose all liabilities of the Company, whether absolute, contingent, accrued or otherwise, existing as of the date thereof that are of a nature required to be reflected in financial statements prepared in accordance with GAAP, and except for liabilities that, individually or in the aggregate, would not have a Material Adverse Effect.

(iii) Neither the Company nor any Subsidiary of the Company has any liability or obligation (whether accrued, absolute, contingent or otherwise) that has arisen or accrued or otherwise been incurred since December 31, 2002, including any liability that might result from an audit of its tax returns by any taxing authority, except for: (A) liabilities that, individually or in the aggregate, would not have a Material Adverse Effect; (B) the liabilities and obligations of the Company and each Subsidiary of the Company that are disclosed or reserved against in the balance sheet of the most recent date contained in the Company SEC Documents, to the extent and in the amounts so disclosed or reserved against; and (C) liabilities incurred or accrued in the ordinary course of business thereafter, and liabilities incurred in connection with the transactions contemplated hereby.

(iv) Except as disclosed in the most recent Company Financial Statements, neither the Company nor any Subsidiary of the Company is in default with respect to any liability or obligation that has arisen or accrued or otherwise been incurred since December 31, 2002, except for defaults that, individually or in the aggregate would not have a Material Adverse Effect, and all such liabilities or obligations shown or reflected in the most recent Company Financial Statements and such liabilities incurred or accrued thereafter were incurred in the ordinary course of business, and except for liabilities and obligations, that, individually or in the aggregate, would not have a Material Adverse Effect.

(h) **Absence of Certain Changes**. Except as disclosed in the Company SEC Documents, since December 31, 2002, the Company and each Subsidiary of the Company have conducted its business only in the ordinary course of such business and, to the Knowledge of the Company, neither the Company nor any Subsidiary of the Company has: (i) suffered a Material Adverse Effect, or become aware of any

circumstances which might reasonably be expected to result in such a Material Adverse Effect; or suffered any material casualty loss to its assets (regardless of whether such assets are insured), except for losses that, individually or in the aggregate, would not have a Material Adverse Effect; (ii) incurred any material obligations, except in the ordinary course of business consistent with past practices; (iii) permitted or allowed any assets to be mortgaged, pledged, or subjected to any lien or encumbrance, except for liens for taxes not yet due and payable and liens and encumbrances that, individually or in the aggregate, would not have a Material Adverse Effect; (iv) written down the value of any inventory, contract or other intangible asset, or written off as uncollectible any notes or accounts receivable or any portion thereof, except for write-downs and write-offs in the ordinary course of business, consistent with past practice and at a rate no greater than during the latest completed fiscal year; cancelled any other debts or claims, or waived any rights of substantial value, or sold or transferred any of its material properties or assets, real, personal, or mixed, tangible or intangible, except in the ordinary course of business and consistent with past practice and except for those that, individually or in the aggregate, would not have a Material Adverse Effect; (v) sold, licensed or transferred or agreed to sell, license or transfer, any of its assets, except in the ordinary course of business and consistent with past practice; (vi) to the Company s Knowledge, received notice of any pending or threatened adverse claim or an alleged infringement of proprietary material, whether such claim or infringement is based on trademark, copyright, patent, license, trade secret, contract, or other restrictions on the use or disclosure of proprietary materials; (vii) incurred obligations to refund money to customers, except in the ordinary course of business, all of which will have no Material Adverse Effect; (viii) become aware of any event, condition, or other circumstance relating solely to its assets (as opposed to any such event, condition, or circumstance which is, for example, national or industry-wide in nature) which might reasonably be expected to have a Material Adverse Effect; (ix) made any capital expenditures or commitments, any one of which is more than $500,000, for additions to property, plant, or equipment without prior approval of the Board of Directors of the Company; (x) made any material change in any method of accounting or accounting practice; (xi) paid, loaned, guaranteed, or advanced any material amount to, or sold, transferred, or leased any material properties or assets (real, personal, or mixed, tangible or intangible) to, or entered into any agreement, arrangement, or transaction with any of its officers or directors, or any business or entity in which any officer or director of the Company, or any affiliate or associate of any of such Persons has any direct or indirect interest; or (xii) agreed to take any action described in this Section 3.01(h).

(i) **Litigation**. Except as disclosed in the Company SEC Documents, there are no claims, actions, proceedings or governmental investigations pending or, to the Knowledge of the Company, threatened against the Company or any Subsidiary of the Company, by or before any court or other Governmental Entity, which, if adversely determined, would individually or in the aggregate have a Material Adverse Effect. As of the date hereof, no action or proceeding has been instituted or, to the Knowledge of the Company, threatened before any court or other Governmental Entity by any Person seeking to restrain or prohibit the execution, delivery or performance of this Agreement or the consummation of the transactions contemplated hereby.

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(j) **Brokers and Finders**. Except for payment obligations to the Financial Advisor, as set forth in the engagement letter dated as of December 8, 2003, a true, correct and complete copy of which has been provided to Kona prior to the date hereof, the Company has not, nor will it incur, directly or indirectly, any liability for brokerage or finders fees or agents commissions or investment bankers fees or any similar charges in connection with this Agreement or any transaction contemplated hereby.

(k) **Schedule 13E-3 and Proxy Statement**. Neither the Schedule 13E-3 nor the Proxy Statement will, at the respective times filed with the SEC or first published, sent or given to stockholders, or, in the case of the Proxy Statement, at the date mailed to the Company s stockholders and at the time of the Stockholders Meeting, contain any untrue statement of a material fact or omit to state any material fact required to be stated therein or necessary in order to make the statements therein, in light of the circumstances under which they were made, not misleading. The Schedule 13E-3 and the Proxy Statement will, when filed by the Company with the SEC, comply as to form in all material respects with the applicable provisions of the Exchange Act and the rules and regulations thereunder. Notwithstanding the foregoing, the Company makes no representation or warranty with respect to the statements made in any of the foregoing documents based on information supplied by or on behalf of Kona or any of its affiliates specifically for inclusion therein.

(l) **Accuracy of Representations**. No representation or warranty by the Company contained in this Agreement and no statement contained in any certificate or schedule furnished to Kona pursuant to the provisions hereof contains any untrue statement of a material fact or omits to state a material fact necessary in order to make the statements therein, in light of the circumstances under which they were made, not misleading.

SECTION 3.02. **Representations and Warranties of Kona and Coleman**. Kona and Coleman, jointly and severally, represent and warrant to the Company as follows:

(a) **Organization**. Kona is a corporation duly organized, validly existing, and in good standing under the laws of the jurisdiction of its organization, and has all requisite corporate power and authority to carry on its business as now being conducted.

(b) **Corporate Power and Authority; Due Authorization**. Kona has all requisite corporate power and authority to enter into this Agreement, to consummate the transactions contemplated hereby, and to comply with the provisions of this Agreement. All corporate action on the part of Kona, its officers, directors, and stockholders necessary for: (ii) the authorization, execution and delivery of this Agreement; (ii) the performance of all obligations of Kona under this Agreement; and (iii) the consummation of the transactions contemplated by this Agreement has been taken, and this Agreement constitutes a valid and legally binding obligation of Kona, enforceable against Kona in accordance with its terms, except as enforceability thereof

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may be limited by applicable bankruptcy, insolvency, reorganization, moratorium, or other similar laws affecting creditors rights generally, or by general equitable principles.

(c) **No Conflict; Consents**. Except for the filing of the Certificate of Merger as provided in Section 1.03, the execution and delivery by Kona of this Agreement, consummation of the transactions contemplated hereby, and the performance by Kona of its obligations hereunder, do not and will not: (A) require the consent, approval, action, order, declaration, or authorization of, any filing or notice to, or any registration with, any Person under any statute, law, rule, regulation, permit, license, agreement, indenture, or other instrument to which Kona is a party, or to which any of its respective properties are subject; (B) violate the terms of any instrument, document, or agreement to which Kona is a party or by which Kona, or the Property of Kona is bound, or be in conflict with, result in a breach of, or constitute (upon the giving of notice or lapse of time or both) a default under any such instrument, document or agreement or result in the creation of a lien upon any of the property or assets of Kona, except for such violations, conflicts, breaches, and defaults which individually or in the aggregate, would not have a material adverse effect on Kona; (C) violate Kona s Certificate of Incorporation or Bylaws; or (D) violate any order, writ, injunction, decree, judgment, ruling, law, rule, or regulation of any Governmental Entity applicable to Kona, the business or assets of Kona, except for such violations which would not, individually or in the aggregate, have a material adverse effect on Kona.

(d) **Capitalization**. As of the date of this Agreement, the authorized capital stock of Kona consists of 1,000 shares of Common Stock, of which 100 shares are issued and outstanding. As of the date of this Agreement, there are no other issued and outstanding shares of capital stock or voting securities of Kona. All outstanding shares of Kona s capital stock have been duly authorized, and are validly issued, fully paid and nonassessable. No party has any preemptive (whether statutory or contractual) rights in any capital stock of Kona. There are no outstanding convertible securities, subscriptions, options, warrants, calls, rights, commitments, or any other agreement to which Kona is a party, or by which Kona is bound that, directly or indirectly, obligates Kona to issue, deliver or sell or cause to be issued, delivered or sold, any additional securities or any other capital stock of Kona, or any other securities convertible into, or exercisable or exchangeable for, or evidencing the right to subscribe for any such securities or any other capital stock of Kona.

(e) **Schedule 13E-3 and Proxy Statement**. No document filed or to be filed by or on behalf of Kona with the SEC or any other Governmental Entity in connection with the transactions contemplated by this Agreement nor any information supplied by or on behalf of Kona specifically for inclusion in the Schedule 13E-3 or the Proxy Statement will, at the respective times filed with the SEC or other Governmental Entity, or at any time thereafter when the information included therein is required to be updated pursuant to applicable law, or, in the case of the Proxy Statement, at the date mailed to the Company s stockholders and at the time of the Stockholders Meeting, contain any untrue statement of a material fact or omit to state any material fact required to be stated therein or necessary in order to make the statements made therein, in light of the circumstances under which they were made, not misleading. Notwithstanding the

foregoing, Kona makes no representation or warranty with respect to the statements made in the foregoing documents based on information supplied by or on behalf of the Company or any Subsidiary of the Company, or affiliates (other than Kona) specifically for inclusion therein.

(f) **Interim Operations of Kona**. Kona was formed solely for the purpose of engaging in the transactions contemplated by this Agreement and has engaged in no business other than in connection with the transactions contemplated by this Agreement.

(g) **Financing Arrangements**. Kona has delivered to the Company a true and complete copy of:

(i) the commitment letter, dated February 27, 2004, addressed to the Company (the ***Senior Debt Commitment Letter***) from LaSalle Bank National Association (***LBNA***), pursuant to which LBNA has indicated that it is committed to provide $22,636,666 in debt financing (the ***Senior Debt Financing***), subject to the terms and conditions therein, for purposes of consummating the transactions contemplated hereby. As of the date hereof, the Senior Debt Commitment Letter has not been amended, modified or withdrawn and is in full force and effect. All commitment fees required to be paid thereunder have been paid in full or will be duly paid in full when due, and no event has occurred that (with or without notice, lapse of time, or both) would constitute a default thereunder on the part of the Company or LBNA, as the case may be. As of the date hereof, LBNA has not advised Kona of any facts or circumstances, and Kona knows of no facts or circumstances, that cause Kona to believe the financing contemplated by the Senior Debt Commitment Letter will not be consummated substantially in accordance with the terms thereof.

(ii) the commitment letter, dated February 18, 2004, addressed to Kona (the ***Subordinated Debt Commitment Letter***) from Key Principal Partners, LLC (***KPP***), pursuant to which KPP has indicated that it is committed to provide $15,000,000 in debt financing (the ***Subordinated Debt Financing***), subject to the terms and conditions therein, for purposes of consummating the transactions contemplated hereby. As of the date hereof, the Subordinated Debt Commitment Letter has not been amended, modified or withdrawn and is in full force and effect. All commitment fees required to be paid thereunder have been paid in full or will be duly paid in full when due, and no event has occurred that (with or without notice, lapse of time, or both) would constitute a default thereunder on the part of Kona or KPP, as the case may be. As of the date hereof, KPP has not advised Kona of any facts or circumstances, and Kona knows of no facts or circumstances, that cause Kona to believe the financing contemplated by the Subordinated Debt Commitment Letter will not be consummated substantially in accordance with the terms thereof.

(iii) The aggregate proceeds of the financings contemplated by the Senior Debt Commitment Letter and the Subordinated Debt Commitment Letter, when taken together, are sufficient to pay the Total Cash Merger Consideration.

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(h) **Solvency**. Kona is able to pay its debts generally as they become due and is solvent and will not be, nor will the Surviving Corporation be, as of the Effective Time, rendered insolvent as a result of the transactions contemplated hereby, including the Merger. Kona has not, nor will have the Surviving Corporation as of the Effective Time, either voluntarily or involuntarily, (i) admitted in writing that it is or may become unable to pay its debts generally as they become due, (ii) filed or consented to the filing against it of a petition in bankruptcy or a petition to take advantage of an insolvency act, (iii) made an assignment for the benefit of its creditors, (iv) consented to the appointment of a receiver for itself or for the whole or any substantial part of its property, (v) had a petition in bankruptcy filed against it, (vi) been adjudged as bankrupt or filed a petition or answer seeking reorganization or arrangement under the federal bankruptcy laws or any law or statute of the United States of America or any other jurisdiction, or (vii) incurred or reasonably should have believed it would incur, debts that are or will be beyond its ability to pay as such debts mature. Kona is not engaged, nor currently contemplating being engaged through the Surviving Corporation, in a business or transaction for which any property remaining with it would be insufficient to continue to operate its businesses or to pay its debts generally as they come due.

SECTION 3.03. **Several Representations and Warranties of Coleman**. Coleman represents and warrants to the Company as follows:

(a) **Holdings of Company Capital Stock.** Coleman beneficially owns an aggregate of 55,100 shares of Company Class A Common Stock and an aggregate of 3,385,000 shares of Company Class B Common Stock.

(b) **Title to Kona Capital Stock.** Coleman is the sole holder of record and beneficial owner of all of the outstanding capital stock of Kona.

(c) **Capacity; Due Authorization.** Coleman has capacity to enter into this Agreement, to consummate the transactions contemplated hereby, and to comply with the provisions of this Agreement. This Agreement constitutes a valid and legally binding obligation of Coleman, enforceable against him in accordance with its terms, except as enforceability thereof may be limited by applicable bankruptcy, insolvency, reorganization, moratorium, or other similar laws affecting creditors rights generally, or by general equitable principles.

(d) **Refusal to Sell.** Except as set forth in Section 3.03(d) of the Disclosure Letter, Coleman is unwilling to, and will not, sell, transfer or otherwise dispose of shares of Class A Common Stock or Class B Common Stock that he beneficially owns to a third party.

ARTICLE IV

Covenants Relating to Conduct of Business

SECTION 4.01. **Conduct of Business of the Company**. During the period from the date of this Agreement and continuing until the earlier of the termination of this Agreement and the Effective Time, except as otherwise required or contemplated

hereunder or pursuant to that certain Credit Agreement, dated April 25, 2001, by and between the Company and LBNA, as amended, or as required by applicable law, without the prior consent of Kona (which consent shall not be withheld unreasonably), the Company shall, and shall cause each Subsidiary of the Company to:

(a) use all reasonable efforts to conduct its business in all material respects only in the ordinary course of business and consistent with past practice;

(b) not amend its Certificate or Articles of Incorporation or Bylaws or declare, set aside or pay any dividend, or other distribution or payment in cash, stock, or property in respect of its capital stock or acquire, directly or indirectly, any of its capital stock;

(c) not issue, grant, sell, or pledge or authorize the issuance, grant, sale, or pledge of any shares of, or rights of any kind to acquire any shares of, its capital stock other than the conversion of any convertible securities outstanding on or prior to the date of this Agreement;

(d) not, without the prior approval of the Board of Directors of the Company, (i) sell, transfer, lease, or otherwise dispose of or encumber any assets which are material, individually or in the aggregate, to the Company s business, taken as a whole, except in the ordinary course of business and consistent with past practice; or (ii) acquire or agree to acquire by merging or consolidating with, or by purchasing a substantial portion of the assets of, or by any other manner, any business or any corporation, partnership, association or other business organization or division thereof, or otherwise acquire or agree to acquire any assets which are material, individually or in the aggregate, to its business, taken as a whole, or acquire or agree to acquire any equity securities of any Person;

(e) use all commercially reasonable efforts to preserve intact its business organizations and to keep available the services of its present key officers and employees;

(f) not, without the prior approval of the Board of Directors of the Company, enter into or amend any contract, agreement, commitment or instrument that requires (or is reasonably expected to require) payments or provides (or is reasonably expected to provide) for receipts in excess of $500,000 on an annual basis (a ***Material Contract***), except in the ordinary course of business and consistent with past practice;

(g) not adopt a plan of complete or partial liquidation or adopt resolutions providing for the complete or partial liquidation, dissolution, consolidation, merger, restructuring, or recapitalization of the Company;

(h) except in the ordinary course of business and consistent with past practice, not grant any severance or termination pay (otherwise than pursuant to policies or contracts in effect on the date hereof and described in the Disclosure Letter) to, or enter into any employment agreement with, any of its executive officers or directors;

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(i) not: (i) increase, except as consistent with past practice in the ordinary course of business, the compensation payable or to become payable to its officers or employees; (ii) enter into any contract or other binding commitment in respect of any such increase with any of its directors, officers or other employees, except in the ordinary course of business and consistent with past practice; or (iii) establish, adopt, enter into, make any new grants or awards under, or amend any collective bargaining agreement or employee benefit plan (as defined by Section 3(3) of the Employee Retirement Income Security Act of 1974, as amended), except as required by applicable law, including any obligation to engage in good faith collective bargaining, to maintain tax-qualified status or as may be required by any employee benefit plan as of the date hereof;

(j) not, without the prior approval of the Board of Directors of the Company, settle or compromise any material claims or litigation or, except in the ordinary course of business consistent with past practice, modify, amend, or terminate any of its Material Contracts or waive, release, or assign any material rights or claims, or make any payment, direct or indirect, of any material liability before the same becomes due and payable in accordance with its terms;

(k) not take any action, other than reasonable and usual actions in the ordinary course of business and consistent with past practice with respect to accounting policies or procedures (including tax accounting policies and procedures), except as may be required by the SEC, the Financial Accounting Standards Board or GAAP;

(l) not adjust, split, combine, or reclassify its capital stock;

(m) not create or acquire any subsidiaries;

(n) not make any material tax election or settle or compromise any material tax liability; and

(o) not authorize, or enter into any agreement or arrangement to do any of the foregoing, or otherwise to take any of the foregoing actions, or any action that could reasonably be expected to make any of the Company s representations or warranties contained in this Agreement untrue or incorrect or prevent the Company from performing or cause the Company not to perform one or more covenants required hereunder to be performed by the Company.

SECTION 4.02. **Superior Proposals**.

(a) At any time prior to obtaining the Requisite Approval, the Board of Directors of the Company may, in response to a Superior Proposal:

(i) withdraw or modify in a manner adverse to Kona, or propose publicly to withdraw or modify in a manner adverse to Kona, the recommendation or declaration of advisability by such Board of Directors of this Agreement or the Merger or recommend, or propose publicly to recommend, the approval

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or adoption of any Superior Proposal or resolve or agree to take such action (an ***Adverse Recommendation***); and

(ii) cause the Company to terminate this Agreement;

provided, ***however***, that the Company shall not terminate this Agreement pursuant to this Section 4.02(a), and any purported termination shall be void and of no force or effect, unless the Company shall have complied with all the provisions of this Section 4.02, including the notification provisions in this Section 4.02, and with all applicable requirements of Section 5.08(d) (including the payment of the Kona Expense Reimbursement (as defined in Section 5.08(d)) prior to or concurrently with such termination) in connection with such Superior Proposal; and ***provided further***, ***however***, that the Company shall not exercise its right to terminate this Agreement pursuant to this Section 4.02(a) until after the fifth Business Day following Kona s receipt of written notice (a "***Notice of Superior Proposal***) from the Company advising Kona that the Board of Directors of the Company has received a Superior Proposal, specifying the terms and conditions of the Superior Proposal, identifying the person making such Superior Proposal, stating that the Board of Directors of the Company intends to exercise its right to terminate this Agreement pursuant to this Section 4.02(a), and including copies of all documents and written communications relating to such Superior Proposal exchanged between the Company or any of its officers, directors, investment bankers, attorneys, accountants, or other advisors, on the one hand, and the party making a Superior Proposal or any of its officers, directors, investment banks, attorneys, accountants, or other advisors, on the other hand (it being understood and agreed that, prior to any such termination taking effect, any amendment to the price or any other material term of a Superior Proposal shall require a new Notice of Superior Proposal and a new five Business Day period). For purposes of this Agreement, the term ***Superior Proposal*** means any bona fide written offer made by a third party which, if consummated, would result in such third party (or in the case of a direct merger between such third party and the Company, the stockholders of such third party) acquiring, directly or indirectly, more than 38.44% of the voting power of the Company or all or substantially all the assets of the Company and its subsidiaries, taken as a whole, for consideration consisting of cash and/or securities that the Special Committee determines in its good faith judgment to have a higher value per share than the Per Share Cash Merger Consideration payable in the Merger and which proposal is determined in good faith by the Special Committee to be more favorable to the Disinterested Stockholders than the Merger, in each case taking into account any changes to the terms of this Agreement proposed by Kona in response to such Superior Proposal or otherwise.

(b) Nothing contained in this Section 4.02 or elsewhere in this Agreement shall prohibit the Company from: (i) taking and disclosing to its stockholders a position contemplated by Rule 14d-9 and Rule 14e-2(a) promulgated under the Exchange Act; or (ii) making any disclosure to the Company s stockholders if, in the good faith judgment of the Board of Directors of the Company, failure so to disclose would be inconsistent with applicable Delaware Law.

SECTION 4.03. Company Board Actions. Any action to be taken by the Board of Directors of the Company, or any committee thereof whose members include Coleman or Jean C. Coleman, pertaining to this Agreement or any transaction or action contemplated hereby (including, without limitation, the Merger or actions authorized by Section 4.02(a)) shall be taken by the affirmative vote of a majority of the disinterested directors as contemplated by Section 144 of the DGCL.

ARTICLE V

Additional Agreements

SECTION 5.01. **Stockholders Meeting**. Subject to applicable law and the other provisions of this Agreement, the Company shall, in accordance with Delaware Law, its Certificate of Incorporation and its Bylaws: (a) duly call, give notice of, convene, and hold a special meeting of its stockholders as soon as reasonably practicable for the purpose of considering and taking action upon this Agreement (the ***Stockholders Meeting***); (b) include in the proxy statement or information statement prepared by the Company for distribution to stockholders of the Company in advance of the Stockholders Meeting (the ***Proxy Statement"***) in accordance with Regulation 14A or Regulation 14C promulgated under the Exchange Act, the recommendation of the Board of Directors that the stockholders of the Company adopt this Agreement; and (c) use all reasonable efforts: (i) to obtain and furnish the information required to be included by it in the Proxy Statement, including any information required to be disclosed on Schedule 13E-3 and, after consultation with Kona, respond promptly to any comments made by the SEC with respect to the Proxy Statement and any preliminary version thereof and cause the Proxy Statement to be mailed to its stockholders at the earliest practicable time; and (ii) to obtain the necessary approvals by its stockholders of this Agreement and the transactions contemplated thereby. Kona and Coleman will promptly provide the Company with the information concerning Kona and Coleman required to be included in the Proxy Statement, including any information required to be disclosed on Schedule 13E-3.

SECTION 5.02. **Preparation of Proxy Statement and Schedule 13E-3**.

(a) The Company shall, as soon as reasonably practicable, prepare a preliminary form of the Proxy Statement (the ***Preliminary Proxy Statement***) and the Schedule 13E-3. The Company shall: (i) file the Preliminary Proxy Statement and the Schedule 13E-3 with the SEC promptly after it has been prepared in a form reasonably satisfactory to Kona; (ii) use reasonable efforts to promptly prepare any amendments to the Preliminary Proxy Statement or the Schedule 13E-3 required in response to comments of the SEC or its staff or that the Company or the Special Committee deems necessary or advisable; and (iii) use reasonable efforts to cause the Proxy Statement to be mailed to the Company s stockholders as soon as reasonably practicable after the Preliminary Proxy Statement, as so amended, is cleared by the SEC. After the Proxy Statement shall have been mailed to the Company s stockholders, the Company, if required, shall promptly circulate amended or supplemental proxy material and, if required in connection therewith, resolicit proxies; provided, however, that no such amended or supplemental proxy material will be mailed by the Company without consultation with

and review by Kona and the Special Committee. In addition, the Company shall: (i) promptly notify Kona of the receipt of the comments of the SEC and of any request from the SEC for amendments or supplements to the preliminary proxy statement or Proxy Statement or for additional information, and will promptly supply Kona and the Special Committee with copies of all written correspondence between the Company or its representatives, on the one hand, and the SEC or members of its staff, on the other hand, with respect to the Preliminary Proxy Statement, the Proxy Statement, the Schedule 13E-3 or the Merger; and (ii) promptly inform Kona and the Special Committee if at any time prior to the Stockholders Meeting any event should occur that is required by applicable law to be set forth in an amendment of, or a supplement to, the Proxy Statement, in which case the Company, in consultation with Kona and the Special Committee, will, upon learning of such event, promptly prepare and mail such amendment or supplement.

(b) It is expressly understood and agreed that: (i) Kona and the Company will consult with each other in connection with all aspects of the preparation, filing, and clearance by the SEC of the Proxy Statement, Preliminary Proxy Statement, and Schedule 13E-3 (including any and all amendments or supplements thereto); (ii) the Company shall give Kona and the Special Committee the reasonable opportunity to review and comment on each of the Proxy Statement, Preliminary Proxy Statement and Schedule 13E-3 prior to filing with the SEC and shall give Kona and the Special Committee the reasonable opportunity to review and comment on all amendments and supplements to each of the Proxy Statement, Preliminary Proxy Statement, and Schedule 13E-3 and all responses to requests for additional information and replies to comments prior to filing with the SEC and each of the Company and Kona agrees to use all reasonable efforts, after consultation with the other, to respond promptly to all such comments of and requests by the SEC; and (iii) to the extent practicable and desired by Kona and the Special Committee, the Company and the Special Committee shall permit Kona to participate in all communications with the SEC and its staff (including all meetings and telephone conferences) relating to each of the Proxy Statement, Preliminary Proxy Statement, and Schedule 13E-3 or any of the transactions contemplated thereby (provided that Kona shall not separately communicate with the SEC and in the event that such participation by Kona is not practicable or desired by Kona, the Company shall promptly inform Kona of the content of all such communications and the participants involved therein).

SECTION 5.03. **Access to Information**.

(a) During the period commencing on the date hereof and continuing until the earlier of the termination of this Agreement and the Effective Time, the Company shall: (i) afford Kona and its accountants, counsel, and other representatives reasonable access during normal business hours to (A) all of the Company s properties, books, contracts, commitments, and records, and (B) all other information concerning the business, properties, and personnel of the Company as Kona may reasonably request; and (ii) the Company shall provide to Kona and its accountants, counsel and other representatives true, correct and complete copies of internal financial statements promptly upon request.

(b) Subject to compliance with applicable law, from the date hereof until the earlier of the termination of this Agreement and the Effective Time, the Company shall confer from time to time as requested by Kona with one or more representatives of Kona to discuss any material changes or developments in the operational matters of the Company and the general status of the ongoing operations of the Company.

(c) No information or knowledge obtained in any investigation pursuant to this Section 5.03 shall affect or be deemed to modify any representation or warranty contained herein or the conditions to the obligations of the parties hereto to consummate the Merger.

SECTION 5.04. **Public Disclosure**. Unless otherwise permitted by this Agreement, Kona and the Company shall consult with each other before issuing any press release or otherwise making any public statement or making any other public (or non-confidential) disclosure (regardless of whether it is in response to an inquiry) regarding the terms of this Agreement or the transactions contemplated hereby, and neither party shall issue any such press release or make any such statement or disclosure without the prior approval of the other (which approval shall not be unreasonably withheld), including any press release or public statement or disclosure required by law, by judicial process or by obligations pursuant to any listing agreement with any national securities exchange. If compliance with both of the preceding provisions of this Section 5.04 and such law, judicial process or listing agreement is impractical, the party proposing to issue such press release or make such public statement or disclosure shall use its commercially reasonable efforts to consult with the other party before issuing such press release or making such public statement or disclosure.

SECTION 5.05. **Consents; Cooperation**.

(a) Each of Kona and the Company shall promptly after the execution of this Agreement apply for or otherwise seek, and use its commercially reasonable efforts to obtain, all consents and approvals required to be obtained by it for the consummation of the Merger.

(b) As soon as practicable after the date hereof, the Company shall use its commercially reasonable efforts to obtain prior to the Closing, and deliver to Kona at or prior to the Closing, all consents, waivers and approvals under each contract listed or described in Section 5.05(b) of the Disclosure Letter, each such contract to be that which the Company is a party in respect of which the failure to obtain a novation or consent to assignment in connection with the Merger or any other transaction contemplated by this Agreement, individually or in the aggregate, could reasonably be expected to materially and adversely affect the Company s ability to operate the business of the Company in the same manner as such business was operated by the Company prior to the Effective Time, or required to be obtained in connection with the consummation of the transactions contemplated hereby for the assignment thereof or otherwise.

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SECTION 5.06. Legal Requirements. Each of the parties hereto shall: (a) take all reasonable actions necessary to comply promptly with all legal requirements that may be imposed on him or it with respect to the consummation of the transactions contemplated by this Agreement; (b) cooperate with and furnish information to any party hereto necessary in connection with any such requirements imposed upon such other party in connection with the consummation of the transactions contemplated by this Agreement; and (c) take all reasonable actions necessary to obtain (and shall cooperate with the other parties hereto in obtaining) any consent, approval, order or authorization of, or any registration, declaration or filing with, any Governmental Entity, required to be obtained or made in connection with the taking of any action contemplated by this Agreement.

SECTION 5.07. Commercially Reasonable Efforts; Further Assurances. On the terms and subject to the conditions set forth in this Agreement, each of the parties hereto shall use his or its commercially reasonable efforts, and shall cooperate with each other party hereto, to take, or cause to be taken, all actions, and to do, or cause to be done, all things necessary, appropriate or desirable to consummate and make effective, in the most expeditious manner practicable, the Merger and the other transactions contemplated hereby, including the satisfaction of the respective conditions set forth in Article VI. Without limiting the generality or effect of the foregoing, in the event an injunction or other order preventing the consummation of the Merger shall have been issued by a court of competent jurisdiction, each party hereto shall its use commercially reasonable efforts to have such injunction or other order lifted. Each party hereto, at the reasonable request of another party hereto, shall execute and deliver such other instruments and do and perform such other acts and things as may be necessary or reasonably desirable for effecting completely the consummation of the Merger and the other transactions contemplated hereby.

SECTION 5.08. Fees and Expenses.

(a) Except as expressly set forth in this Section 5.08 and as provided for in Section 8.09, all fees and expenses incurred in connection with this Agreement, the Merger, and the other transactions contemplated by this Agreement shall be paid by the party incurring such fees or expenses, whether or not the Merger is consummated.

(b) In the event that this Agreement is terminated by Kona, Coleman or the Company pursuant to Section 7.01(d), then the Company shall pay to Kona upon demand, payable in same day funds, fifty percent (50%) of the actual, documented out-of-pocket costs and expenses of Kona reasonably incurred in connection with this Agreement and the transactions contemplated by this Agreement (including any financing fees, costs and expenses, and the reasonable fees of attorneys, accountants, brokers, investment advisors and other representatives and advisors).

(c) In the event that this Agreement is terminated by the Company pursuant to Section 7.01(f)(i) and the Company shall not have breached any representation, warranty or covenant contained herein in any material respect, then Kona shall pay to the Company upon demand, payable in same day funds, the actual,

documented out-of-pocket costs and expenses of the Company reasonably incurred in connection with this Agreement and the transactions contemplated by this Agreement (including the reasonable fees of attorneys, accountants, brokers, investment advisors and other representatives and advisors), up to an amount not to exceed $100,000.

(d) In the event that this Agreement is terminated by (i) Kona or Coleman pursuant to Section 7.01(e)(i), Section 7.01(e)(ii), Section 7.01(e)(iii) or Section 7.01(e)(iv) and neither Kona nor Coleman shall have breached any representation, warranty or covenant contained herein in any material respect or (ii) the Company pursuant to Section 7.01(f)(ii), then the Company shall pay to Kona upon demand, payable in same day funds, the actual, documented out-of-pocket costs and expenses of Kona reasonably incurred in connection with this Agreement and the transactions contemplated by this Agreement (including the reasonable fees of attorneys, accountants, brokers, investment advisors and other representatives and advisors), up to an amount not to exceed $400,000 (the ***Kona Expense Reimbursement***).

SECTION 5.09. [INTENTIONALLY OMITTED]

SECTION 5.10. Company Class B Common Stock Restrictions. Until the earlier of the Effective Time or the termination of this Agreement according to its terms, no holder of Company Class B Common Stock shall, directly or indirectly, (i) sell, transfer or otherwise dispose of any shares of Company Class B Common Stock; and (ii) convert any shares of Company Class B Common Stock into shares of Company Class A Common Stock.

SECTION 5.11. Indemnification and Insurance.

(a) All rights to indemnification existing in favor of the present or former directors, officers and employees (or any person who served at the Company s or any of its subsidiaries request as an officer, director or agent) of the Company or any of its subsidiaries (or any other entity or enterprise, such as, a partnership, joint venture, trust or employee benefit plan) as provided in the Company s Certificate of Incorporation or Bylaws, or the articles of organization, bylaws or similar documents of any of the Company s subsidiaries or other entity or enterprise and the indemnification agreements, if any, with such person or persons, as in effect as of the date hereof with respect to matters occurring prior to the Effective Time shall survive the Merger and shall continue in full force and effect without modification (other than modifications that would enlarge the indemnification rights) for a period of not less than five years following the Effective Time, and the Surviving Corporation shall comply fully with its obligations hereunder and thereunder. The Certificate of Incorporation and Bylaws of the Surviving Corporation shall not be amended, repealed or otherwise modified for the period set forth in the preceding sentence in any manner that would adversely affect the rights thereunder of individuals who as of the date hereof were directors, officers or employees of the Company or otherwise entitled to indemnification under the Certificate of Incorporation or Bylaws of the Company (the ***Indemnified Parties***). It is understood and agreed that the Company shall, to the fullest extent permitted under applicable law and regardless of whether the Merger becomes effective, indemnify, defend and hold harmless, and after

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the Effective Time, the Surviving Corporation shall, to the fullest extent permitted under applicable law, indemnify, defend and hold harmless, each Indemnified Party against any costs or expenses (including reasonable attorney s fees), judgments, fines, losses, claims, damages, liabilities, and amounts paid in settlement entered into with the consent of the Surviving Corporation (which consent shall not be unreasonably withheld) in connection with any claim, action, suit, proceeding or investigation, including without limitation, liabilities arising out of this Agreement and the transactions contemplated hereby, to the extent that it was based on the fact that such Indemnified Party is or was a director, officer or employee of the Company and arising out of actions or omissions or alleged actions or omissions occurring at or prior to the Effective Time, and in the event of any such claim, action, suit proceeding or investigation (whether arising before or after the Effective Time), (i) the Company or the Surviving Corporation, as applicable, shall pay the reasonable fees and expenses of one counsel (provided that if different Indemnified Parties are subject to different claims, actions, suits, proceedings or investigations, each Indemnified Party may select his or her own counsel which counsel shall be reasonably satisfactory to the Company or the Surviving Corporation), promptly as statements therefor are received and (ii) the Company and the Surviving Corporation will cooperate in the defense of such matter.

(b) The Company shall maintain in effect until the Effective Time, in respect of acts or omissions occurring prior to the Effective Time and in the current coverage amounts, policies of directors and officers liability insurance and fiduciary insurance covering the persons described in Section 5.11(a). For a period of five years following the Effective Time, the Surviving Corporation shall maintain officers and directors liability insurance and fiduciary insurance covering the Indemnified Parties who currently or at the Effective Time are covered by the Company s officers and directors liability insurance and fiduciary insurance policies on terms not less favorable than those in effect on the date hereof in terms of coverage and amounts; ***provided, however,*** that if the aggregate annual premiums for such insurance at any time during such period exceed 300% of the premium paid by the Company for such insurance as of the date hereof, then the Surviving Corporation shall provide the maximum coverage that will then be available at an annual premium equal to 300% of such per annum rate as of the date hereof.

(c) The Surviving Corporation shall pay all reasonable costs and expenses, including attorney s fees, that may be incurred by any Indemnified Parties in enforcing the indemnity and other obligations provided for in this Section 5.11.

(d) Notwithstanding Section 8.01, this Section 5.11 shall survive the consummation of the Merger and, notwithstanding Section 8.03, is intended to benefit, and shall be enforceable by, any person or entity entitled to be indemnified hereunder. If the Surviving Corporation or any of its successors or assigns (i) consolidates with or merges into any other Person and shall not be the continuing or surviving corporation or entity of such consolidation or merger or (ii) transfers all or substantially all of its assets to any Person, then, and in each such case, proper provision shall be made so that the successors and assigns of the Surviving Corporation shall assume the obligations set forth in this Section 5.11.

SECTION 5.12. No Further Representations or Warranties; Limitation of Liability; Knowledge of Kona and Coleman. In entering into this Agreement, Kona and Coleman: (i) acknowledge that, other than as set forth in this Agreement, the Disclosure Letter or the other documents required to be delivered by the Company or referred to herein, none of the Company, its subsidiaries or any of their respective directors, officers, employees, affiliates, agents or representatives makes any representation or warranty, either express or implied, as to the accuracy or completeness of any of the information provided or made available to Kona or Coleman or their agents or representatives; (ii) agree, to the fullest extent permitted by law (except with respect to fraud), that none of the Company, its subsidiaries or any of their respective directors, officers, employees, stockholders, affiliates, agents or representatives shall have any liability or responsibility whatsoever to Kona or Coleman on any basis (including without limitation in contract, tort or otherwise) based upon any information provided or made available, or statements made, to Kona or Coleman; and (iii) acknowledge that, as of the date hereof, neither they nor any Continuing Stockholder have any knowledge of any representation or warranty of the Company being untrue or inaccurate in any material respect.

SECTION 5.13. Financing.

(a) In the event that the Senior Debt Commitment Letter or the Subordinated Debt Commitment Letter is terminated under circumstances where the conditions set forth in Article VI are otherwise satisfied (other than conditions that can only be satisfied at Closing), Kona shall use its commercially reasonable efforts to obtain alternative debt funding in an amount equal to the amount to be provided pursuant to the Senior Debt Commitment Letter and the Subordinated Debt Commitment Letter, in each case on terms and conditions substantially comparable to those provided in the Senior Debt Commitment Letter or the Subordinated Debt Commitment Letter, as applicable.

(b) Following the date hereof, any amendment, modification, termination or cancellation of the Senior Debt Financing or the Subordinated Financing, or any information (other than information which is known generally in the financial markets) that becomes known to Coleman or to Kona or any of its officers or directors that makes any such Person reasonably believe that it will be unlikely that the Senior Debt Financing or the Subordinated Debt Financing will be obtained on the terms set forth in the Senior Debt Commitment Letter or the Subordinated Debt Commitment Letter, respectively, shall be promptly disclosed to the Special Committee. Neither Coleman nor Kona or any of its officers or directors will knowingly attempt, directly or indirectly, to induce or encourage LBNA or KPP or any other applicable entity not to fund any of the financing provided for in the Senior Debt Commitment Letter or the Subordinated Debt Commitment Letter, as applicable.

(c) In no event shall the proceeds of the financings contemplated by the Senior Debt Commitment Letter and the Subordinated Debt Commitment Letter be used by the Company or the Surviving Corporation directly or indirectly to purchase or redeem shares of (i) Company Class A Common Stock held by the Continuing Stockholders, (ii) Company Class B Common Stock, or (iii) Class A common stock of

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the Surviving Corporation held by the Continuing Stockholders, Jean C. Coleman or The Coleman Limited Partnership.

SECTION 5.14. Continuing Stockholders. Coleman shall vote all shares of Company Class A Common Stock and Company Class B Common Stock that he beneficially owns (including, without limitation, shares held of record by The Coleman Limited Partnership, The Coleman Charitable Foundation and Jean C. Coleman) in favor of the Merger at the Stockholders Meeting. Coleman shall use his best efforts to ensure that all other Continuing Stockholders vote all of their shares of Company Class A Common Stock and Company Class B Common Stock in favor of the Merger at the Stockholders Meeting.

ARTICLE VI
Conditions Precedent

SECTION 6.01. Conditions to Obligations of Each Party to Effect the Merger. The respective obligations of each party hereto to consummate the transactions contemplated hereby shall be subject to the satisfaction at or prior to the Closing of each of the following conditions, any of which may be waived, in writing (such waiver by the Company based solely on approval by the Special Committee), by agreement of all the parties hereto (it being understood that each such condition is solely for the benefit of the parties hereto and may be waived in writing by their mutual agreement without notice, liability, or obligation to any Person):

(a) **Stockholder Approval**. The Requisite Approval shall have been obtained.

(b) **Disinterested Stockholder Approval**. The Company shall have received the affirmative vote of the holders of a majority of the outstanding shares of Company Class A Common Stock Held by the Disinterested Stockholders entitled to vote at the Stockholders Meeting.

(c) **No Injunctions or Restraints; Illegality**. No temporary restraining order, preliminary or permanent injunction or other order issued by any court of competent jurisdiction or other legal or regulatory restraint or prohibition preventing the consummation of the Merger shall be in effect, nor shall any proceeding brought by a Governmental Entity seeking any of the foregoing be pending. No action taken by any Governmental Entity, and no statute, rule, regulation or order shall have been enacted, entered, enforced, or deemed applicable to the Merger, which makes the consummation of the Merger illegal.

(d) **Governmental Approvals**. All consents, authorizations, orders, and approvals of (or filings or registrations with) any Governmental Entity or any other Person required to be obtained or made prior to the Effective Time in connection with the execution, delivery, and performance of this Agreement and the consummation of the transactions contemplated hereby shall have been obtained or made, except for the filing of the Certificate of Merger pursuant to Section 1.03.

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(e) **[INTENTIONALLY OMITTED]**

(f) **Opinion of Financial Advisor**. The Financial Advisor shall not have withdrawn its opinion delivered to the Special Committee of the Company, dated March 1, 2004, or its consent for the Company to include the name of the Financial Advisor and a description of such opinion in the Company s Schedule 13E-3 and Proxy Statement.

SECTION 6.02. Additional Conditions to Obligations of the Company. The obligations of the Company to consummate the transactions contemplated hereby shall be subject to the satisfaction at or prior to the Closing of each of the following conditions, any of which may be waived, in writing, by the Company, such waiver based solely on approval by the Special Committee (it being understood that each such condition is solely for the benefit of the Company and may be waived in writing by the Company in its sole discretion without notice, liability or obligation to any Person):

(a) **Representations, Warranties and Covenants**. For purposes of this Section 6.02(a), the accuracy of the representations and warranties of Kona and Coleman set forth in this Agreement shall be assessed as of the date of this Agreement and as of the Closing with the same effect as though all such representations and warranties had been made on and as of the Closing (provided that representations and warranties which are confined to a specified date shall speak only as of such date). There shall not exist inaccuracies in the representations and warranties of Kona and Coleman set forth in this Agreement such that the aggregate effect of such inaccuracies has, or is reasonably likely to have, a material adverse effect on (A) the business, assets, liabilities, operations, results of operations, properties (including intangible properties), regulatory status or condition (financial or otherwise) of Kona or of the Surviving Corporation; (B) the legality, validity, binding effect or enforceability of this Agreement, or (C) the ability of Kona to perform its obligations under this Agreement; ***provided that***, for purposes of this sentence only, those representations and warranties which are qualified by references to material or Material Adverse Effect or to the Knowledge of any Person shall be deemed not to include such qualifications. Kona shall have performed and complied in all material respects with all covenants, obligations, and conditions of this Agreement required to be performed and complied with by it at or prior to the Closing.

(b) **Receipt of Certificates of Kona**. The Company shall have received certificates executed (i) on behalf of Kona by an authorized officer of Kona and (ii) by Coleman, each certifying that the conditions set forth in Section 6.02(a) shall have been satisfied.

SECTION 6.03. Additional Conditions to Obligations of Kona and Coleman. The obligations of Kona and Coleman to consummate the transactions contemplated hereby shall be subject to the satisfaction at or prior to the Closing of each of the following conditions, any of which may be waived, in writing, by Kona, on its behalf and on behalf of Coleman (it being understood that each such condition is solely for the benefit of Kona and Coleman and may be waived in writing by Kona in its sole

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discretion, on its behalf and on behalf of Coleman, without notice, liability or obligation to any Person):

(a) **Representations, Warranties and Covenants**. For purposes of this Section 6.03(a), the accuracy of the representations and warranties of the Company set forth in this Agreement shall be assessed as of the date of this Agreement and as of the Closing with the same effect as though all such representations and warranties had been made on and as of the Closing (provided that representations and warranties which are confined to a specified date shall speak only as of such date). There shall not exist inaccuracies in the representations and warranties of the Company set forth in Sections 3.01(b), 3.01(d) (solely as it relates to the authorized and outstanding capitalization of the Company), 3.01(e), and 3.01(f). There shall not exist any inaccuracies in the other representations and warranties of the Company set forth in this Agreement such that the aggregate effect of such inaccuracies has, or is reasonably likely to have, a Material Adverse Effect; ***provided that***, for purposes of this sentence only, those representations and warranties which are qualified by references to material or Material Adverse Effect or to the knowledge of any Person shall be deemed not to include such qualifications. The Company shall have performed and complied in all material respects with all covenants, obligations, and conditions of this Agreement required to be performed and complied with by it at or prior to the Closing.

(b) **Receipt of Certificate of the Company**. Kona shall have received a certificate executed on behalf of the Company by an authorized officer of the Company certifying that the conditions set forth in Section 6.03(a) shall have been satisfied.

(c) **Third Party Consents**. Kona shall have received evidence satisfactory to it of the consent or approval of those Persons whose consent or approval shall be required in connection with the Merger under each contract listed in Section 6.03(c) of the Disclosure Letter.

(d) **No Material Adverse Effect**. There shall not have occurred after the date hereof any change, event or condition that, individually or in the aggregate with any other changes, events and conditions, has resulted in, or that could reasonably be expected to result in, a Material Adverse Effect.

(e) **Dissenters**. The aggregate number of shares of Class A Common Stock Held by the Dissenting Stockholders, other than Dissenting Stockholders who are also Continuing Stockholders, shall not exceed 10% of the total number of shares of Company Class A Common Stock on the Closing Date.

(f) **Financing Arrangements**. Kona shall have consummated borrowings from one or more lenders (the ***Lender(s)***) under terms satisfactory to Kona, which borrowings, when taken in the aggregate with other funds available to Kona, are received from the Lenders sufficient to pay the Total Cash Merger Consideration and all expenses and fees of Kona arising out of the negotiation, documentation, and consummation of the transactions contemplated hereby.

ARTICLE VII

Termination, Amendment and Waiver

SECTION 7.01. Termination. This Agreement may be terminated and the Merger abandoned:

(a) by mutual written consent duly authorized by the respective Boards of Directors of Kona and the Company;

(b) by either Kona, Coleman or the Company, if the Effective Time shall not have occurred on or before 182 days from the date hereof, ***provided, however***, that the right to terminate this Agreement under this paragraph (b) shall not be available to any party whose misrepresentation in this Agreement or whose failure to perform any of its covenants and agreements or to satisfy any obligation under this Agreement has been the cause of or resulted in the failure of the Merger to occur on or before such date;

(c) by either Kona, Coleman or the Company, if any federal, state or foreign court of competent jurisdiction or other Governmental Entity shall have issued any judgment, injunction, order or decree prohibiting, enjoining or otherwise restraining the transactions contemplated by this Agreement and such judgment, injunction, order or decree shall have become final and nonappealable (provided however, that the party seeking to terminate this Agreement pursuant to this paragraph (c) shall have used reasonable efforts to remove such judgment injunction, order or decree) or if any statute, rule, regulation or executive order promulgated or enacted by any federal or state governmental authority after the date of this Agreement which prohibits the consummation of the Merger shall be in effect;

(d) by either Kona, Coleman or the Company, if (i) the Requisite Approval is not obtained and (ii) the condition set forth in Section 6.01(b) has not been satisfied, in each case at the Stockholders Meeting (including any adjournment or postponement thereof permitted by this Agreement);

(e) by Kona or Coleman, if: (i) the Company shall have breached any representation, warranty, or covenant contained herein in any material respect, and (A) such breach shall not have been cured within ten Business Days after receipt by the Company of written notice of such breach (***provided, however***, that no such cure period shall be available or applicable to any such breach that by its nature cannot be cured), and (B) if not cured at or prior to the Closing, such breach would result in the failure of any of the conditions set forth in Section 6.03(a) to be satisfied; (ii) the Stockholders Meeting shall not have occurred on or before 180 days from the date hereof; (iii) an Adverse Recommendation has occurred, or (iv) a Material Adverse Effect shall have occurred; and

(f) by the Company: (i) if Kona or Coleman shall have breached any representation, warranty or covenant contained herein in any material respect, and (A) such breach shall not have been cured within ten Business Days after receipt by Kona of written notice of such breach (***provided, however***, that no such cure period shall be

available or applicable to any such breach that by its nature cannot be cured), and (B) if not cured at or prior to the Closing, such breach would result in the failure of any of the conditions set forth in Section 6.02(a) to be satisfied; or (ii) in accordance with the terms and subject to the conditions of Section 4.02(a).

SECTION 7.02. Effect of Termination. In the event of termination of this Agreement by either the Company, Coleman or Kona as provided in Section 7.01, this Agreement shall forthwith become void and have no effect, without any liability or obligation on the part of the Company, Coleman or Kona, other than Section 5.08, Section 5.11 this Section 7.02 and Article VIII and except for any material willful breach of this Agreement by any party hereto (which material willful breach and liability therefor shall not be affected by termination of this Agreement).

SECTION 7.03. Extension, Waiver. At any time prior to the Effective Time, any party hereto may, to the extent legally allowed: (i) extend the time for the performance of any of the obligations or other acts of the other parties hereto; (ii) waive any inaccuracies in the representations and warranties made to such party contained herein or in any document delivered pursuant hereto; and (iii) waive compliance with any of the agreements or conditions for the benefit of such party contained herein. Any such extension or waiver shall be valid only if set forth in an instrument in writing signed on behalf of such party. Without limiting the generality or effect of the preceding sentence, no delay in exercising any right under this Agreement shall constitute a waiver of such right, and no waiver of any breach or default shall be deemed a waiver of any other breach or default of the same or any other provision in this Agreement. No such waiver by the Company shall be valid unless approved in advance by the Special Committee.

ARTICLE VIII

General Provisions

SECTION 8.01. Non Survival of Representations and Warranties. The warranties, representations and covenants of the Company, Kona and Coleman contained in or made pursuant to this Agreement shall not survive the Effective Time; ***provided, however***, that this Section 8.01 shall not limit any covenant or agreement of the parties which by its terms contemplates performance after the Effective Time.

SECTION 8.02. Indemnity by the Company.

(a) **Indemnification**. The Company shall indemnify, defend, and hold harmless Kona, its officers, directors, and stockholders, and their respective successors and permitted assigns (each solely in their capacity as such) and their representatives, attorneys, consultants and agents (individually, an "***Indemnified Party*** and collectively, the ***Indemnified Parties***) from and against any and all actual damages, costs, and expenses actually incurred (including reasonable attorneys fees but excluding claims for consequential damages or claims for lost profit) (***Damages***) resulting from, arising from, or caused by any claims of current or former stockholders of the Company against Kona or its directors made in connection with or related to the Merger or any other transaction contemplated by this Agreement, or the execution and delivery of this

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Agreement; ***provided, however***, that the foregoing indemnity agreement shall not apply to any Damages to the extent, but only to the extent, arising out of or based upon any untrue statement or alleged untrue statement or omission or alleged omission made in reliance upon and in conformity with written information furnished to the Company by Kona expressly for use in the Preliminary Proxy Statement, Proxy Statement, or the Schedule 13E-3 (or any amendment or supplement thereto).

(b) **Claims Procedures**.

(i) If any claim, action at law, or suit in equity is instituted by a current or former stockholder of the Company against an Indemnified Party with respect to which an Indemnified Party would qualify for indemnification for any Damages under paragraph (a) of this Section 8.02 (an ***Assertion***), such Indemnified Party shall give written notice to the Company of such Assertion with reasonable promptness. The failure to give the notice required by this paragraph (b) with reasonable promptness shall not relieve the Company of its indemnification obligations hereunder except to the extent that the Company is actually prejudiced as a result of the failure to give such notice.

(ii) The Company shall have the right to defend the Indemnified Party by appropriate proceedings and shall have the sole power to direct and control the defense of such Assertion. If any Indemnified Party desires to participate in any such defense it may do so at its sole cost and expense; ***provided, however,*** that if the defendants in any such action shall include the Company and/or its officers or directors as well as an Indemnified Party and such Indemnified Party shall have received the written advice of counsel that there exist defenses available to such Indemnified Party that are materially different from those available to the Company and/or such officers or directors, the Indemnified Party shall have the right to select one separate counsel (and one local counsel in such jurisdictions as are necessary), reasonably acceptable to the Company, to participate in the defense of such action on its behalf, at the expense of the Company.

(iii) The Indemnified Party and the Company shall cooperate with each other to the fullest extent possible in regard to all matters relating to the Assertion, including corrective actions required by applicable law, assertion of defenses, the determination, mitigation, negotiation and settlement of all amounts, costs, actions, penalties, damages and the like related thereto, access to the books and records of the Company and its Subsidiaries, and, if necessary, providing the Company and its counsel with any powers of attorney or other documents required to permit the Company and its counsel to act on behalf of the Indemnified Party.

(iv) Neither the Indemnified Party nor the Company shall settle any Assertion without the consent of the other party, which consent shall not be unreasonably withheld; ***provided, however***, that if such settlement involves the payment of money only and the release of all claims and the Indemnified Party is completely indemnified therefore and nonetheless refuses to consent to such settlement, the Company shall cease to be obligated for such Assertion. Any compromise or settlement

of the Assertion under this paragraph (b) shall include as an unconditional term thereof the giving by the claimant in question to the Company and the Indemnified Party of a release of all liabilities in respect of such Assertion.

(c) With respect to any Assertion hereunder, the amount recoverable by any Indemnified Party shall take into account any reimbursements realized by such Indemnified Party from insurance policies or other indemnification sources, arising from the same incident or set of facts or circumstances giving rise to the claim for indemnification. Upon the payment of any Damages by the Company to any Indemnified Party, the Company shall have a right of subrogation with respect to any insurance proceeds or other rights to third party reimbursement for such claims held by such Indemnified Party.

SECTION 8.03. Assignment; Successors and Assigns; No Third Party Beneficiaries. Neither this Agreement nor any of the rights, interests, or obligations hereunder shall be assigned, in whole or in part, by operation of law or otherwise by any of the parties without the prior written consent of the other parties. Subject to the preceding sentence, the terms and conditions of this Agreement shall inure to the benefit of and be binding upon the respective successors and assigns of the parties. Nothing in this Agreement, express or implied, is intended to confer upon any party other than the parties hereto or their respective successors and assigns any rights, remedies, obligations, or liabilities under or by reason of this Agreement, except as expressly provided in this Agreement.

SECTION 8.04. Governing Law. This Agreement shall be governed by and construed under the Delaware Law, without regard to the conflict of law principles of said State.

SECTION 8.05. Counterparts. This Agreement may be executed in one or more counterparts, all of which shall be considered one and the same agreement and shall become effective when one or more counterparts have been signed by each of the parties hereto and delivered to the other parties hereto.

SECTION 8.06. Titles and Subtitles. The titles and subtitles used in this Agreement are used for convenience only and are not to be considered in construing or interpreting this Agreement.

SECTION 8.07. Notices. Unless otherwise provided, any notice required or permitted under this Agreement shall be given in writing and shall be delivered: (a) by hand; (b) by U.S. mail, certified mail, return receipt requested; or (c) by facsimile to the party to be notified, at the following address or facsimile number indicated for such party, or at such other address or facsimile number as such party may designate by ten (10) days advance written notice to the other parties:

If to the Company or the Special Committee:

Integrity Media, Inc.

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1000 Cody Road
Mobile, Alabama 36695
Attention: Jerry W. Weimer
Facsimile Number: (251) 776-5199

Jimmy M. Woodward
c/o Flowers Foods
1919 Flowers Circle
Thomasville, Georgia 31757
Facsimile Number: (229) 225-3808

with copies to:

(prior to April 12, 2004)
Jones Day
3500 SunTrust Plaza
303 Peachtree Street, N.E.
Atlanta, Georgia 30308
Attention: Lizanne Thomas
Facsimile Number: (404) 581-8330

(after April 12, 2004)
Jones Day
Pershing Park Plaza
Suite 800
1420 Peachtree Street, N.E.
Atlanta, Georgia 30309-3053
Attention: Lizanne Thomas
Facsimile Number: (404) 581-8330

If to Kona or Coleman:

Kona Acquisition Corp.
c/o Integrity Media, Inc.
1000 Cody Road
Mobile, Alabama 36695
Attention: P. Michael Coleman
Facsimile Number: (251) 776-5199

with copies to:

Alston & Bird LLP
One Atlantic Center
1201 West Peachtree Street
Atlanta, Georgia 30309
Attention: Alexander W. Patterson

Facsimile Number: (404) 253-8289

Notices shall be deemed to have been given and served: (i) where delivered by hand, at time of delivery; (ii) where delivered by U.S. mail, on acknowledgment of receipt as shown by the date indicated on the return receipt as having been received; and (iii) where delivered by facsimile, 24 hours after transmission confirmation by the transmitting machine unless, within those 24 hours the intended recipient has informed the sender that the transmission was received in an incomplete or garbled form, or the transmission report of the sender indicates a faulty or incomplete transmission. If such receipt is on a day that is not a working day or is later than 5 p.m. (local time) on a working day, the notice shall be deemed to have been given and served on the next working day.

SECTION 8.08. Delays or Omissions. No delay or omission to exercise any right, power, or remedy accruing to Kona or Coleman, on one hand, or the Company on the other hand, upon any breach or default of the other party or parties under this Agreement shall impair any such right, power, or remedy of the non-breaching or non-defaulting party, nor shall it be construed to be a waiver of any such breach or default or an acquiescence thereto, or to any similar breach or default thereafter occurring; nor shall any waiver of any single breach or default be deemed a waiver of any other breach or default theretofore or thereafter occurring. Any waiver, permit, consent or approval of any kind or character on the part of Kona or Coleman, on one hand, or the Company on the other hand, of any breach or default under this Agreement, or any waiver on the part of Kona or Coleman, on one hand, or the Company on the other hand, of any provisions or conditions of this Agreement, must be made in writing and shall be effective only to the extent specifically set forth in such writing.

SECTION 8.09. Expenses. If any action at law or in equity is necessary to enforce or interpret the terms of this Agreement, the prevailing party shall be entitled to reasonable attorneys fees, costs and necessary disbursements in addition to any other relief to which such party may be entitled.

SECTION 8.10. Amendments and Waivers. This Agreement may be amended by the parties at any time prior to the Effective Time; ***provided, however***, that, upon obtaining the Requisite Approval, no amendment shall be made that by law requires further approval by the stockholders of the Company, without such approval. This Agreement may not be amended or modified except by an instrument in writing signed on behalf of each of the parties hereto. At any time prior to the Effective Time, Kona or the Company may, to the extent legally allowed, extend the time specified herein for the performance of any of the obligations or other acts of the other, waive any inaccuracies in the representations and warranties of the other contained herein or in any document delivered pursuant hereto, or waive compliance by the other with any of the agreements or covenants of such other party or parties (as the case may be) contained herein. Any such extension or waiver shall be valid only if set forth in a written instrument signed on behalf of the party or parties to be bound thereby. No such extension or waiver by the Company shall be valid unless approved in advance by the Special Committee. No such extension or waiver shall constitute a waiver of, or estoppel with respect to, any

subsequent or other breach or failure to strictly comply with the provisions of this Agreement. The failure of any party to insist on strict compliance with this Agreement or to assert any of its rights or remedies hereunder or with respect hereto shall not constitute a waiver of such rights or remedies.

SECTION 8.11. Severability. If one or more provisions of this Agreement are held to be unenforceable under applicable law, such provision shall be excluded from this Agreement and the balance of the Agreement shall be interpreted as if such provisions were so excluded and shall be enforceable in accordance with its terms.

SECTION 8.12. Entire Agreement. This Agreement, the documents referred to herein and the documents delivered in connection herewith constitute the entire agreement among the parties and no party shall be liable or bound to any other party in any manner by any warranties, representations, or covenants except as specifically set forth herein or therein.

SECTION 8.13. Definitions. For purposes of this Agreement:

(a) an ***Affiliate*** of any Person means another Person that directly or indirectly, through one or more intermediaries, controls, is controlled by, or is under common control with, such first person;

(b) a ***Business Day*** means a day other than a Saturday, Sunday or federal holiday;

(c) a ***Company Option*** means an option to purchase shares of Company Class A Common Stock issued pursuant to the Integrity Media, Inc. 2002 Stock Option Plan for Outside Directors, Integrity Media, Inc. 2001 Long-Term Incentive Plan, Integrity Incorporated 1999 Long-Term Incentive Plan, Integrity Music, Inc. Long-Term Incentive Plan adopted in 1994 and Integrity Music, Inc. 1994 Stock Option Plan for Outside Directors;

(d) a ***Continuing Stockholder*** means the following holders of Company Class A Common Stock and/or Company Options: Coleman, Jerry W. Weimer, Donald J. Moen, Daniel D. McGuffey, Keith J. Manwaring, Chris E. Thomason, Robert E. Rist, Donald S. Ellington, Jeff Friend, Robert Brenner, Todd Burkhalter, Debra Mayes, Doug Meduna and Joyce O Connor;

(e) a ***Disinterested Stockholder*** means a holder of Company Class A Common Stock that is neither (i) affiliated with the Company as an officer or director, (ii) a Continuing Stockholder, nor (iii) The Coleman Charitable Foundation;

(f) a ***Governmental Entity*** means any supranational, national, state, municipal, local or foreign government, any court, tribunal, arbitrator, administrative agency, commission or other governmental official, authority or instrumentality, in each case whether domestic or foreign, any stock exchange or similar self-regulatory organization or any quasi-governmental or private body exercising any regulatory, taxing or other governmental or quasi-governmental authority;

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(g) ***Held*** means having the power to vote or dispose, or to direct the voting or disposition, of Company Class A Common Stock or Company Class B Common Stock, ***provided, however***, that no Person will be deemed to have Held shares of Company Class A Common Stock or Company Class B Common Stock with respect to which such Person has an obligation to forward communications to beneficial owners pursuant to Rule 14b-1 or Rule 14b-2 promulgated under the Exchange Act;

(h) ***Held of Record*** has the meaning assigned in Rule 12g5-1 under the Exchange Act, as interpreted by the SEC;

(i) as it relates to the Company, ***Knowledge*** or ***Known*** means, with respect to any matter in question, or refers to, the actual knowledge of the Continuing Stockholders;

(j) a ***Material Adverse Effect*** on or with respect to the Company means any state of facts, change, development, effect or occurrence (any such item, an ***Effect***) that is, or is likely to be, materially adverse to (i) the business, assets, liabilities, operations, results of operations, properties (including intangible properties), regulatory status or condition (financial or otherwise) of the Company and its subsidiaries, taken as a whole; (ii) the legality, validity, binding effect or enforceability of this Agreement, or (iii) the ability of the Company to perform its obligations under this Agreement; ***provided, however***, that for purposes of clause (i) of this definition, an Effect shall be deemed to be materially adverse only if it will, or would reasonably be expected to, cost the Company (or reduce its value by) an amount equal to or in excess of $750,000; ***provided, further***, that in no event shall any of the following, alone or in combination, be deemed to constitute, nor shall any of the following be taken into account in determining whether there has been, or will be, a material adverse effect on or with respect to the Company: (A) actions or omissions of the Company or any Subsidiary of the Company taken with the prior consent of Kona or Coleman; (B) any change in the price or trading volume of Company Class A Common Stock in and of itself (but not any Effect underlying such change); (C) any Effect to the extent (I) resulting from changes affecting the United States economy in general or (II) generally affecting the industries in which the Company operates, except, in the case of this clause (C)(II), if the impact on the Company s business is materially disproportionate to the impact on the business of other entities operating in such industries; (D) any Effect to the extent resulting from changes affecting general worldwide economic or capital market conditions; (E) any Effect to the extent resulting from the announcement or pendency of the Merger (except for any suit, action, investigation or proceeding if the underlying claim is not dependent on the announcement or pendency of the Merger); or (F) any changes from the date of this Agreement in any laws, orders, rules or regulations of any Governmental Entity, or accounting regulations and principles, applicable to the Company;

(k) a ***Person*** means an individual, corporation, partnership, limited liability company, joint venture, association, trust, Governmental Entity, unincorporated organization or other entity;

(l) a *Non-Continuing Stockholder* means any holder of Company Class A Common Stock or Company Options that is not a Continuing Stockholder; and

(m) a *Subsidiary* of any Person means another Person (i) of which 50% or more of any class of capital stock, voting securities, other voting ownership or voting partnership interests (or, if there are no such voting interests, 50% or more of the equity interests) are owned or controlled, directly or indirectly, by such first Person or (ii) of which such first Person is a general partner.

SECTION 8.14. Interpretation. When a reference is made in this Agreement to an Article or to a Section, Subsection, Exhibit or Schedule, such reference shall be to an Article of, a Section or Subsection of, or an Exhibit or Schedule to, this Agreement unless otherwise indicated. The headings contained in this Agreement are for reference purposes only and shall not affect in any way the meaning or interpretation of this Agreement. Whenever the words include, includes or including are used in this Agreement, they shall be deemed to be followed by the words without limitation. The words hereof, hereto, hereby, herein and hereunder and words of similar import when used in thi Agreement shall refer to this Agreement as a whole and not to any particular provision of this Agreement. The words date hereof shall refer to the date of this Agreement. The term or is not exclusive. The word extent in the phrase to th extent shall mean the degree to which a subject or other thing extends, and such phrase shall not mean simply if. The definitions contained in this Agreement are applicable to the singular as well as the plural forms of such terms. Any agreement or instrument defined or referred to herein or in any agreement or instrument that is referred to herein means such agreement or instrument as from time to time amended, modified or supplemented. References to a person are also to its permitted successors and assigns.

SECTION 8.15. Consent to Jurisdiction. Each of the parties hereto hereby irrevocably and unconditionally submits, for itself and its property, to the exclusive jurisdiction of any Delaware State court, or federal court of the United States of America, sitting in Delaware, and any appellate court from any thereof, in any action or proceeding arising out of or relating to this Agreement or the agreements delivered in connection herewith or the transactions contemplated hereby or thereby or for recognition or enforcement of any judgment relating thereto, and each of the parties hereby irrevocably and unconditionally (A) agrees not to commence any such action or proceeding except in such courts, (B) agrees that any claim in respect of any such action or proceeding may be heard and determined in such Delaware State court or, to the extent permitted by law, in such federal court, (C) waives, to the fullest extent it may legally and effectively do so, any objection which it may now or hereafter have to the laying of venue of any such action or proceeding in any such Delaware State or federal court, and (D) waives, to the fullest extent permitted by law, the defense of an inconvenient forum to the maintenance of such action or proceeding in any such Delaware State or federal court. Each of the parties hereto agrees that a final judgment in any such action or proceeding shall be conclusive and may be enforced in other jurisdictions by suit on the judgment or in any other manner provided by law. Each party to this Agreement irrevocably consents to service of process in the manner provided for notices in Section 8.07. Nothing in this

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Agreement will affect the right of any party to this Agreement to serve process in any other manner permitted by law.

SECTION 8.16. Waiver of Jury Trial. EACH PARTY ACKNOWLEDGES AND AGREES THAT ANY CONTROVERSY THAT MAY ARISE UNDER THIS AGREEMENT IS LIKELY TO INVOLVE COMPLICATED AND DIFFICULT ISSUES, AND THEREFORE IT HEREBY IRREVOCABLY AND UNCONDITIONALLY WAIVES ANY RIGHT IT MAY HAVE TO A TRIAL BY JURY IN RESPECT OF ANY LITIGATION DIRECTLY OR INDIRECTLY ARISING OUT OF OR RELATING TO THIS AGREEMENT OR THE TRANSACTIONS CONTEMPLATED HEREBY. EACH PARTY CERTIFIES AND ACKNOWLEDGES THAT (A) NO REPRESENTATIVE, AGENT OR ATTORNEY OF ANY OTHER PARTY HAS REPRESENTED, EXPRESSLY OR OTHERWISE, THAT SUCH OTHER PARTY WOULD NOT, IN THE EVENT OF LITIGATION, SEEK TO ENFORCE EITHER OF SUCH WAIVERS, (B) IT UNDERSTANDS AND HAS CONSIDERED THE IMPLICATIONS OF SUCH WAIVERS, (C) IT MAKES SUCH WAIVERS VOLUNTARILY, AND (D) IT HAS BEEN INDUCED TO ENTER INTO THIS AGREEMENT BY, AMONG OTHER THINGS, THE MUTUAL WAIVERS AND CERTIFICATIONS IN THIS SECTION 8.16.

[SIGNATURE PAGE FOLLOWS]

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IN WITNESS WHEREOF, each of the parties hereto has caused this Agreement to be executed personally or by a duly authorized representative thereof, all as of the date first written above.

COMPANY:

Integrity Media, Inc.

By: /s/ Donald S. Ellington

Donald S. Ellington
Senior Vice President of Finance and Administration

KONA:

Kona Acquisition Corp.

By: /s/ P. Michael Coleman

P. Michael Coleman
President

COLEMAN:

/s/ P. Michael Coleman

P. Michael Coleman

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Appendix B

March 1, 2004

The Special Committee of the Board of Directors
Integrity Media, Inc.
1000 Cody Road
Mobile, Alabama 36695

Gentlemen:

We understand that Integrity Media, Inc., a Delaware corporation (the Company), intends to enter into a proposed merger with Kona Acquisition Corp., a Delaware corporation (Kona), pursuant to which Kona will acquire all of the issued and outstanding shares of the Company s Class A common stock, $0.01 par value per share (the Company Class A Common Stock), other than those issued and outstanding shares of the Company Class A Common Stock owned by the Continuing Stockholders (as defined in the Agreement and Plan of Merger by and among the Company, Kona and P. Michael Coleman (Coleman) dated March 1, 2004 (the Agreement)), for $6.50 per share, and Kona will be merged with and into the Company with the Company continuing as the surviving corporation (the Proposed Transaction). The purchase price of $6.50 per share will be comprised of 100% cash consideration (the Consideration). The terms and conditions of the Proposed Transaction are set forth in more detail in the Agreement.

We have been requested by the Special Committee of the Board of Directors of the Company to render our opinion to the Special Committee of the Board of Directors of the Company with respect to the fairness, from a financial point of view, of the Consideration to be received by the stockholders of the Company other than the Continuing Stockholders in the Proposed Transaction (as defined in the Agreement).

In arriving at our opinion, we reviewed and analyzed: (1) the Agreement; (2) certain publicly available information concerning the Company which we believe to be relevant to our inquiry; (3) financial and operating information with respect to the business, operations and prospects of the Company furnished to us by the Company; (4) trading history of the Company Class A Common Stock; (5) a comparison of the historical financial results, projected financial results and present financial condition of the Company with those of publicly traded companies which we deemed relevant; (6) historical data relating to percentage premiums paid in acquisitions of publicly traded companies; and (7) a comparison of the financial terms of the Proposed Transaction with the publicly available financial terms of certain other recent transactions which we deemed relevant. In addition, we have had discussions with the management of the Company concerning its business, operations, assets, present condition and future prospects and undertook such other studies, analyses and investigations as we deemed appropriate.

We have assumed and relied upon, without independent verification, the accuracy and completeness of the financial and other information discussed with or reviewed by us in arriving at our opinion. With respect to the financial forecasts of the Company provided to or discussed with us, we have assumed, at the direction of the management of the Company and without

independent verification or investigation, that such forecasts have been reasonably prepared on bases reflecting the best currently available information, estimates and judgments of the management of the Company as to the future financial performance of the Company. In arriving at our opinion, we have not conducted a physical inspection of the properties and facilities of the Company and have not made, nor obtained any evaluations or appraisals of the assets or liabilities (including, without limitation, any potential environmental liabilities), contingent or otherwise, of the Company. We have assumed that the Proposed Transaction will be consummated in accordance with the terms of the Agreement. We have also assumed that all material governmental, regulatory or other consents and approvals necessary for the consummation of the Proposed Transaction will be obtained without any adverse effect on the Company or on the expected benefits of the Proposed Transaction. In addition, you have not authorized us to solicit, and we have not solicited, any indications of interest from any third party with respect to the purchase of all or a part of the Company s business. We have relied upon Coleman s representation that he is unwilling to, and will not, sell, transfer or otherwise dispose of shares of the Company Class A Common Stock or the Company s Class B common stock in which he has a pecuniary interest to a third party. Our opinion is necessarily based upon market, economic and other conditions as they exist on, and can be evaluated as of, the date of this letter. We express no opinion as to the underlying valuation, future performance or long-term viability of the Company. It should be understood that, although subsequent developments may affect this opinion, we do not have any obligation to update or revise the opinion.

The Company has agreed to indemnify us for certain liabilities arising out of the rendering of this opinion. We and our affiliates (including SunTrust Banks, Inc.) may have other financing and business relationships with the Company in the ordinary course of business.

Based upon and subject to the foregoing, and such other factors as we deemed relevant, we are of the opinion as of the date hereof that the Consideration to be received by the stockholders of the Company other than the Continuing Stockholders in the Proposed Transaction is fair from a financial point of view. This opinion is being rendered at the behest of the Special Committee of the Board of Directors of the Company and is for the benefit of the Special Committee of the Board of Directors in its evaluation of the Proposed Transaction, and does not constitute a recommendation as to how any stockholder should act or vote with respect to any matters relating to the Proposed Transaction. This opinion may be referred to and may be reproduced in full in any filing made by the Company with the Securities and Exchange Commission in connection with the Proposed Transaction.

SUNTRUST CAPITAL MARKETS, INC.

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Appendix C

DELAWARE GENERAL CORPORATION LAW
SECTION 262 APPRAISAL RIGHTS

(a) Any stockholder of a corporation of this State who holds shares of stock on the date of the making of a demand pursuant to subsection (d) of this section with respect to such shares, who continuously holds such shares through the effective date of the merger or consolidation, who has otherwise complied with subsection (d) of this section and who has neither voted in favor of the merger or consolidation nor consented thereto in writing pursuant to § 228 of this title shall be entitled to an appraisal by the Court of Chancery of the fair value of the stockholder s shares of stock under the circumstances described in subsections (b) and (c) of this section. As used in this section, the word stockholder means a holder of record of stock in a stock corporation and also a member of record of a nonstock corporation; the words stock and share mean and include what is ordinarily meant by those words and also membership or membership interest of a member of a nonstock corporation; and the words depository receipt mean a receipt or other instrument issued by a depository representing an interest in one or more shares, or fractions thereof, solely of stock of a corporation, which stock is deposited with the depository.

(b) Appraisal rights shall be available for the shares of any class or series of stock of a constituent corporation in a merger or consolidation to be effected pursuant to § 251 (other than a merger effected pursuant to § 251(g) of this title), § 252, § 254, § 257, § 258, § 263 or § 264 of this title:

(1) Provided, however, that no appraisal rights under this section shall be available for the shares of any class or series of stock, which stock, or depository receipts in respect thereof, at the record date fixed to determine the stockholders entitled to receive notice of and to vote at the meeting of stockholders to act upon the agreement of merger or consolidation, were either (i) listed on a national securities exchange or designated as a national market system security on an interdealer quotation system by the National Association of Securities Dealers, Inc. or (ii) held of record by more than 2,000 holders; and further provided that no appraisal rights shall be available for any shares of stock of the constituent corporation surviving a merger if the merger did not require for its approval the vote of the stockholders of the surviving corporation as provided in subsection (f) of § 251 of this title.

(2) Notwithstanding paragraph (1) of this subsection, appraisal rights under this section shall be available for the shares of any class or series of stock of a constituent corporation if the holders thereof are required by the terms of an agreement of merger or consolidation pursuant to §§ 251, 252, 254, 257, 258, 263 and 264 of this title to accept for such stock anything except:

a. Shares of stock of the corporation surviving or resulting from such merger or consolidation, or depository receipts in respect thereof;

b. Shares of stock of any other corporation, or depository receipts in respect thereof, which shares of stock (or depository receipts in respect thereof) or depository receipts at the effective date of the merger or consolidation will be either listed on a national securities exchange or designated as a national market system security on an interdealer quotation system by the National Association of Securities Dealers, Inc. or held of record by more than 2,000 holders;

c. Cash in lieu of fractional shares or fractional depository receipts described in the foregoing subparagraphs a. and b. of this paragraph; or

d. Any combination of the shares of stock, depository receipts and cash in lieu of fractional shares or fractional depository receipts described in the foregoing subparagraphs a., b. and c. of this paragraph.

(3) In the event all of the stock of a subsidiary Delaware corporation party to a merger effected under § 253 of this title is not owned by the parent corporation immediately prior to the merger, appraisal rights shall be available for the shares of the subsidiary Delaware corporation.

(c) Any corporation may provide in its certificate of incorporation that appraisal rights under this section shall be available for the shares of any class or series of its stock as a result of an amendment to its certificate of incorporation, any merger or consolidation in which the corporation is a constituent corporation or the sale of all or substantially all of the assets of the corporation. If the certificate of incorporation contains such a provision, the procedures of this section, including those set forth in subsections (d) and (e) of this section, shall apply as nearly as is practicable.

(d) Appraisal rights shall be perfected as follows:

(1) If a proposed merger or consolidation for which appraisal rights are provided under this section is to be submitted for approval at a meeting of stockholders, the corporation, not less than 20 days prior to the meeting, shall notify each of its stockholders who was such on the record date for such meeting with respect to shares for which appraisal rights are available pursuant to subsection (b) or (c) hereof that appraisal rights are available for any or all of the shares of the constituent corporations, and shall include in such notice a copy of this section. Each stockholder electing to demand the appraisal of such stockholder s shares shall deliver to the corporation, before the taking of the vote on the merger or consolidation, a written demand for appraisal of such stockholder s shares. Such demand will be sufficient if it reasonably informs the corporation of the identity of the stockholder and that the stockholder intends thereby to demand the appraisal of such stockholder s shares. A proxy or vote against the merger or consolidation shall not constitute such a demand. A stockholder electing to take such action must do so by a separate written demand as herein provided. Within 10 days after the effective date of such merger or consolidation, the surviving or resulting corporation shall notify each stockholder of each constituent corporation who has complied with this subsection and has not voted in favor of or consented to the merger or consolidation of the date that the merger or consolidation has become effective; or

(2) If the merger or consolidation was approved pursuant to § 228 or § 253 of this title, then either a constituent corporation before the effective date of the merger or consolidation or the surviving or resulting corporation within 10 days thereafter, shall notify each of the holders of any class or series of stock of such constituent corporation who are entitled to appraisal rights of the approval of the merger or consolidation and that appraisal rights are available for any or all shares of such class or series of stock of such constituent corporation, and shall include in such notice a copy of this section. Such notice may, and, if given on or after the effective date of the merger or consolidation, shall, also notify such stockholders of the effective date of the merger or consolidation Any stockholder entitled to appraisal rights may, within 20 days after the date of mailing of such notice, demand in writing from the surviving or resulting corporation the appraisal of such holder s shares. Such demand will be sufficient if it reasonably informs the corporation of the identity of the stockholder and that the stockholder intends thereby to demand the appraisal of such holder s shares. If such notice did not notify stockholders of the effective date of the merger or consolidation, either (i) each such constituent corporation shall send a second notice before the effective date of the merger or consolidation notifying each of the holders of any class or series of stock of such constituent corporation that are entitled to appraisal rights of the effective date of the merger or consolidation or (ii) the surviving or resulting corporation shall send such a second notice to all such holders on or within 10 days after such effective date; provided, however, that if such second notice is sent more than 20 days following the sending of the first notice, such second notice need only be sent to each stockholder who is entitled to appraisal rights and who has demanded appraisal of such holder s shares in accordance with this subsection. An affidavit of the secretary or assistant secretary or of the transfer agent of the corporation that is required to give either notice that such notice has been given shall, in the absence of fraud, be prima facie evidence of the facts stated therein. For purposes of determining the stockholders entitled to receive either notice, each constituent corporation may fix, in advance, a record date that shall be not more than 10 days prior to the date the notice is given, provided, that if the notice is given on or after the effective date of the merger or consolidation, the record date shall be such effective date. If no record date is fixed and the notice is given prior to the effective date, the record date shall be the close of business on the day next preceding the day on which the notice is given.

(e) Within 120 days after the effective date of the merger or consolidation, the surviving or resulting corporation or any stockholder who has complied with subsections (a) and (d) hereof and who is otherwise entitled to appraisal rights, may file a petition in the Court of Chancery demanding a determination of the value of the stock of all such stockholders. Notwithstanding the foregoing, at any time within 60 days after the effective date of the

merger or consolidation, any stockholder shall have the right to withdraw such stockholder s demand for appraisal and to accept the terms offered upon the merger or consolidation. Within 120 days after the effective date of the merger or consolidation, any stockholder who has complied with the requirements of subsections (a) and (d) hereof, upon written request, shall be entitled to receive from the corporation surviving the merger or resulting from the consolidation a statement setting forth the aggregate number of shares not voted in favor of the merger or consolidation and with respect to which demands for appraisal have been received and the aggregate number of holders of such shares. Such written statement shall be mailed to the stockholder within 10 days after such stockholder s written request for such a statement is received by the surviving or resulting corporation or within 10 days after expiration of the period for delivery of demands for appraisal under subsection (d) hereof, whichever is later.

(f) Upon the filing of any such petition by a stockholder, service of a copy thereof shall be made upon the surviving or resulting corporation, which shall within 20 days after such service file in the office of the Register in Chancery in which the petition was filed a duly verified list containing the names and addresses of all stockholders who have demanded payment for their shares and with whom agreements as to the value of their shares have not been reached by the surviving or resulting corporation. If the petition shall be filed by the surviving or resulting corporation, the petition shall be accompanied by such a duly verified list. The Register in Chancery, if so ordered by the Court, shall give notice of the time and place fixed for the hearing of such petition by registered or certified mail to the surviving or resulting corporation and to the stockholders shown on the list at the addresses therein stated. Such notice shall also be given by 1 or more publications at least 1 week before the day of the hearing, in a newspaper of general circulation published in the City of Wilmington, Delaware or such publication as the Court deems advisable. The forms of the notices by mail and by publication shall be approved by the Court, and the costs thereof shall be borne by the surviving or resulting corporation.

(g) At the hearing on such petition, the Court shall determine the stockholders who have complied with this section and who have become entitled to appraisal rights. The Court may require the stockholders who have demanded an appraisal for their shares and who hold stock represented by certificates to submit their certificates of stock to the Register in Chancery for notation thereon of the pendency of the appraisal proceedings; and if any stockholder fails to comply with such direction, the Court may dismiss the proceedings as to such stockholder.

(h) After determining the stockholders entitled to an appraisal, the Court shall appraise the shares, determining their fair value exclusive of any element of value arising from the accomplishment or expectation of the merger or consolidation, together with a fair rate of interest, if any, to be paid upon the amount determined to be the fair value. In determining such fair value, the Court shall take into account all relevant factors. In determining the fair rate of interest, the Court may consider all relevant factors, including the rate of interest which the surviving or resulting corporation would have had to pay to borrow money during the pendency of the proceeding. Upon application by the surviving or resulting corporation or by any stockholder entitled to participate in the appraisal proceeding, the Court may, in its discretion, permit discovery or other pretrial proceedings and may proceed to trial upon the appraisal prior to the final determination of the stockholder entitled to an appraisal. Any stockholder whose name appears on the list filed by the surviving or resulting corporation pursuant to subsection (f) of this section and who has submitted such stockholder s certificates of stock to the Register in Chancery, if such is required, may participate fully in all proceedings until it is finally determined that such stockholder is not entitled to appraisal rights under this section.

(i) The Court shall direct the payment of the fair value of the shares, together with interest, if any, by the surviving or resulting corporation to the stockholders entitled thereto. Interest may be simple or compound, as the Court may direct. Payment shall be so made to each such stockholder, in the case of holders of uncertificated stock forthwith, and the case of holders of shares represented by certificates upon the surrender to the corporation of the certificates representing such stock. The Court s decree may be enforced as other decrees in the Court of Chancery may be enforced, whether such surviving or resulting corporation be a corporation of this State or of any state.

(j) The costs of the proceeding may be determined by the Court and taxed upon the parties as the Court deems equitable in the circumstances. Upon application of a stockholder, the Court may order all or a portion

of the expenses incurred by any stockholder in connection with the appraisal proceeding, including, without limitation, reasonable attorney s fees and the fees and expenses of experts, to be charged pro rata against the value of all the shares entitled to an appraisal.

(k) From and after the effective date of the merger or consolidation, no stockholder who has demanded appraisal rights as provided in subsection (d) of this section shall be entitled to vote such stock for any purpose or to receive payment of dividends or other distributions on the stock (except dividends or other distributions payable to stockholders of record at a date which is prior to the effective date of the merger or consolidation); provided, however, that if no petition for an appraisal shall be filed within the time provided in subsection (e) of this section, or if such stockholder shall deliver to the surviving or resulting corporation a written withdrawal of such stockholder s demand for an appraisal and an acceptance of the merger or consolidation, either within 60 days after the effective date of the merger or consolidation as provided in subsection (e) of this section or thereafter with the written approval of the corporation, then the right of such stockholder to an appraisal shall cease. Notwithstanding the foregoing, no appraisal proceeding in the Court of Chancery shall be dismissed as to any stockholder without the approval of the Court, and such approval may be conditioned upon such terms as the Court deems just.

(l) The shares of the surviving or resulting corporation to which the shares of such objecting stockholders would have been converted had they assented to the merger or consolidation shall have the status of authorized and unissued shares of the surviving or resulting corporation.

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Appendix D

Consent of Independent Accountants

We hereby consent to the incorporation by reference in this Solicitation of Proxy on Schedule 14A of our report dated April 14, 2004, relating to the financial statements and financial statements and financial statement schedule of Integrity Media, Inc., which appear in the Form 10-K of Integrity Media, Inc. for the year ended December 31, 2003.

/s/PricewaterhouseCoopers LLP

Atlanta, Georgia

May 11, 2004

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INTEGRITY MEDIA, INC.
SPECIAL MEETING OF STOCKHOLDERS

This Proxy is Solicited on Behalf of the Board of Directors

The undersigned hereby appoints Jerry W. Weimer and Donald S. Ellington as proxies to represent the undersigned at the Special Meeting of Stockholders of Integrity Media, Inc. (Integrity or the Company) to be held at the Company s headquarters at 1000 Cody Road, Mobile, Alabama 36695, on July 8, 2004 at 2:00 p.m. local time and at any adjournment thereof, and to vote the shares of stock the undersigned would be entitled to vote if personally present, as indicated below.

The Board of Directors recommends a vote FOR the Company s proposals set forth in Items 1 and 2 below.

1. The proposal to adopt and approve the Agreement and Plan of Merger, dated as of March 1, 2004, by and among Integrity, Kona Acquisition, Corp. and P. Michael Coleman, pursuant to which, among other things, Kona Acquisition, Corp. will be merged with and into Integrity, with Integrity being the surviving corporation upon the terms and subject to the conditions of the merger agreement described in the accompanying proxy statement.

   FOR o AGAINST o ABSTAIN o

2. In their discretion, the proxies are authorized to vote upon any motion submitted to a vote of the stockholders to adjourn or postpone the meeting to another time and place for the purpose of soliciting additional proxies.

   FOR o AGAINST o ABSTAIN o

In their discretion, the proxies are authorized to vote upon such other business as may be incident to the conduct of the special meeting or any adjournments or postponements thereof.

The shares represented by this proxy will be voted as directed. If no contrary instruction is given, the shares will be voted FOR the approval of the Agreement and Plan of Merger and FOR granting discretion for the designated proxies to vote upon any motion to adjourn or postpone the special meeting to solicit additional proxies as described above.

Dated: ____________________, 2004

____

Signature

____

Signature if held jointly

Please date, sign as name appears at the left, and return promptly. If the shares are registered in the names of two or more persons, each should sign. When signing as Corporate Officer, Partner, Executor, Administrator, Trustee or Guardian,

please give full title. Please note any changes in your address alongside the address as it appears on the proxy.

PLEASE mark, sign, date and mail the Proxy Card promptly using the enclosed postage-paid envelope.