Sanchez Energy Corp
Form 10-Q
August 08, 2016
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10 Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2016
OR
TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to

Commission file number: 1 35372

Sanchez Energy Corporation

(Exact name of registrant as specified in its charter)

Delaware	45 3090102
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
1000 Main Street, Suite 3000	
Houston, Texas	77002
(Address of principal executive offices)	(Zip Code)

(713) 783 8000

(Registrant's telephone number, including area code)

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

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

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

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

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

Number of shares of registrant’s common stock, par value $0.01 per share, outstanding as of August 5, 2016: 65,940,236

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Table of Contents

Sanchez Energy Corporation

Form 10 Q

For the Quarterly Period Ended June 30, 2016

Table of Contents

Table of Contents

CAUTIONARY NOTE REGARDING FORWARD LOOKING STATEMENTS

This Quarterly Report on Form 10 Q contains “forward looking statements” within the meaning of the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. All statements, other than statements of historical facts, included in this Quarterly Report on Form 10 Q that address activities, events or developments that we expect, believe or anticipate will or may occur in the future are forward looking statements. These statements are based on certain assumptions we made based on management’s experience, perception of historical trends and technical analyses, current conditions, anticipated future developments and other factors believed to be appropriate and reasonable by management. When used in this Quarterly Report on Form 10 Q, words such as “will,” “potential,” “believe,” “estimate,” “intend,” “expect,” “may,” “should,” “anticipate,” “could,” “plan,” “predict,” “project,” “profile,” “model,” “strateg negatives or the statements that include these words or other words that convey the uncertainty of future events or outcomes, are intended to identify forward looking statements, although not all forward looking statements contain such identifying words. In particular, statements, express or implied, concerning our future operating results and returns or our ability to replace or increase reserves, increase production, or generate income or cash flows are forward looking statements. Forward looking statements are not guarantees of performance. Such statements are subject to a number of assumptions, risks and uncertainties, many of which are beyond our control. Although we believe that the expectations reflected in our forward looking statements are reasonable and are based on reasonable assumptions, no assurance can be given that these assumptions are accurate or that any of these expectations will be achieved (in full or at all) or will prove to have been correct. Important factors that could cause our actual results to differ materially from the expectations reflected in the forward looking statements include, among others:

- our ability to successfully execute our business and financial strategies;
- our ability to utilize the services, personnel and other assets of Sanchez Oil & Gas Corporation (“SOG”) pursuant to existing services agreements;
- our ability to replace the reserves we produce through drilling and property acquisitions;
- the timing and extent of changes in prices for, and demand for, crude oil and condensate, natural gas liquids (“NGLs”), natural gas and related commodities;
- the realized benefits of the acreage acquired in our various acquisitions and other assets and liabilities assumed in connection therewith;
- the realized benefits of our joint ventures, including with respect to our joint ventures with Targa Resources Corp. (“Targa”);
- the realized benefits of our transactions with Sanchez Production Partners LP (“SPP”), including with respect to the Palmetto escalating working interest sale, divestiture of Western Catarina midstream assets and the Carnero

Gathering Transaction referred to herein;

- the extent to which our drilling plans are successful in economically developing our acreage in, and to produce reserves and achieve anticipated production levels from, our existing and future projects;

- the accuracy of reserve estimates, which by their nature involve the exercise of professional judgment and may, therefore, be imprecise;

- the extent to which we can optimize reserve recovery and economically develop our plays utilizing horizontal and vertical drilling, advanced completion technologies and hydraulic fracturing;

- our ability to successfully execute our hedging strategy and the resulting realized prices therefrom;

- the credit worthiness and performance of our counterparts, including financial institutions, operating partners and other parties;

- competition in the oil and natural gas exploration and production industry for employees and other personnel, equipment, materials and services and, related thereto, the availability and cost of employees and other personnel, equipment, materials and services;

- our ability to access the credit and capital markets to obtain financing on terms we deem acceptable, if at all, and to otherwise satisfy our capital expenditure requirements;

- the availability, proximity and capacity of, and costs associated with, gathering, processing, compression and transportation facilities;

- our ability to compete with other companies in the oil and natural gas industry;

- the impact of, and changes in, government policies, laws and regulations, including tax laws and regulations, environmental laws and regulations relating to air emissions, waste disposal, hydraulic fracturing and access to and use of water, laws and regulations imposing conditions and restrictions on drilling and completion operations and laws and regulations with respect to derivatives and hedging activities;

- developments in oil producing and natural gas producing countries, the actions of the Organization of Petroleum Exporting Countries ("OPEC") and other factors affecting the supply of oil and natural gas;

- our ability to effectively integrate acquired crude oil and natural gas properties into our operations, fully identify existing and potential problems with respect to such properties and accurately estimate reserves, production and costs with respect to such properties;

- the extent to which our crude oil and natural gas properties operated by others are operated successfully and economically;

- the use of competing energy sources and the development of alternative energy sources;

- unexpected results of litigation filed against us;

- the extent to which we incur uninsured losses and liabilities or losses and liabilities in excess of our insurance coverage; and

- the other factors described under "Part I, Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations," "Part II, Item 1A. Risk Factors" and elsewhere in this Quarterly Report on Form 10 Q and in our other public filings with the Securities and Exchange Commission (the "SEC").

In light of these risks, uncertainties and assumptions, the events anticipated by our forward looking statements may not occur, and, if any of such events do, we may not have correctly anticipated the timing of their occurrence or the extent of their impact on our actual results. Accordingly, you should not place any undue reliance on any of our forward looking statements. Any forward looking statement speaks only as of the date on which such statement is made, and we undertake no obligation to correct or update any forward looking statement, whether as a result of new information, future events or otherwise, except as required by applicable law.

Table of Contents

PART I—FINANCIAL INFORMATION

Item 1. Unaudited Financial Statements

Sanchez Energy Corporation

Condensed Consolidated Balance Sheets (Unaudited)

(in thousands, except par value and share amounts)

	June 30, 2016	December 31, 2015
ASSETS		
Current assets:		
Cash and cash equivalents	$ 324,399	$ 435,048
Oil and natural gas receivables	39,191	30,668
Joint interest billings receivables	703	1,259
Accounts receivable - related entities	3,206	3,697
Fair value of derivative instruments	54,266	172,494
Other current assets	16,930	23,452
Total current assets	438,695	666,618
Oil and natural gas properties, at cost, using the full cost method:		
Proved oil and natural gas properties	3,071,240	2,914,867
Unproved oil and natural gas properties	247,505	253,529
Total oil and natural gas properties	3,318,745	3,168,396
Less: Accumulated depreciation, depletion, amortization and impairment	(2,610,137)	(2,412,293)
Total oil and natural gas properties, net	708,608	756,103
Other assets:		
Fair value of derivative instruments	201	5,789
Investments	70,629	49,985
Other assets	22,404	22,809
Total assets	$ 1,240,537	$ 1,501,304
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 2,937	$ 4,184

Other payables	1,830	2,004
Accrued liabilities:		
Capital expenditures	28,604	51,983
Other	78,442	69,974
Deferred premium liability	14,353	24,548
Fair value of derivative instruments	7,377	—
Other current liabilities	16,977	14,813
Total current liabilities	150,520	167,506
Long term debt, net of premium, discount and debt issuance costs	1,708,500	1,705,927
Asset retirement obligations	27,792	25,907
Fair value of derivative instruments	4,885	—
Other liabilities	52,032	58,133
Total liabilities	1,943,729	1,957,473
Commitments and contingencies (Note 16)		
Stockholders' equity:		
Preferred stock ($0.01 par value, 15,000,000 shares authorized; 1,838,985 shares issued and outstanding as of June 30, 2016 and December 31, 2015 of 4.875% Convertible Perpetual Preferred Stock, Series A; 3,527,830 shares issued and outstanding as of June 30, 2016 and December 31, 2015 of 6.500% Convertible Perpetual Preferred Stock, Series B)	53	53
Common stock ($0.01 par value, 150,000,000 shares authorized; 65,452,662 shares issued and outstanding as of June 30, 2016 and 61,928,089 shares issued and outstanding as of December 31, 2015)	658	619
Additional paid-in capital	1,089,068	1,079,513
Accumulated deficit	(1,792,971)	(1,536,354)
Total stockholders' deficit	(703,192)	(456,169)
Total liabilities and stockholders' deficit	$ 1,240,537	$ 1,501,304

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

Table of Contents

Sanchez Energy Corporation

Condensed Consolidated Statements of Operations (Unaudited)

(in thousands, except per share amounts)

	Three Months Ended June 30, 2016	Three Months Ended June 30, 2015	Six Months Ended June 30, 2016	Six Months Ended June 30, 2015
REVENUES:				
Oil sales	$ 65,786	$ 99,498	$ 108,468	$ 175,022
Natural gas liquid sales	21,979	17,694	37,024	31,547
Natural gas sales	23,203	23,936	45,292	45,152
Total revenues	110,968	141,128	190,784	251,721
OPERATING COSTS AND EXPENSES:				
Oil and natural gas production expenses	44,919	35,658	89,612	69,821
Production and ad valorem taxes	6,188	8,303	10,131	16,973
Depreciation, depletion, amortization and accretion	43,342	104,717	90,308	207,374
Impairment of oil and natural gas properties	87,380	468,922	109,464	910,372
General and administrative (inclusive of stock-based compensation expense of $9,877 and $7,875, respectively, for the three months ended June 30, 2016 and 2015, and $13,222 and $15,568, respectively, for the six months ended June 30, 2016 and 2015)	23,983	21,962	43,463	43,439
Total operating costs and expenses	205,812	639,562	342,978	1,247,979
Operating loss	(94,844)	(498,434)	(152,194)	(996,258)
Other income (expense):				
Interest income and other expense	369	773	281	(1,051)
Interest expense	(31,822)	(31,500)	(63,428)	(63,058)
Earnings from equity investments	2,179	—	2,691	—
Net gains (losses) on commodity derivatives	(58,750)	(33,749)	(35,993)	7,554
Total other expense	(88,024)	(64,476)	(96,449)	(56,555)
Loss before income taxes	(182,868)	(562,910)	(248,643)	(1,052,813)
Income tax expense	—	—	—	7,442
Net loss	(182,868)	(562,910)	(248,643)	(1,060,255)
Less:				
Preferred stock dividends	(3,987)	(3,991)	(7,974)	(7,982)
Net income allocable to participating securities	—	—	—	—
Net loss attributable to common stockholders	$ (186,855)	$ (566,901)	$ (256,617)	$ (1,068,237)
Net loss per common share - basic and diluted	$ (3.20)	$ (9.91)	$ (4.38)	$ (18.74)

Weighted average number of shares used to calculate net loss attributable to common stockholders - basic and diluted	58,413	57,184	58,575	56,996

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

6

Table of Contents

Sanchez Energy Corporation

Condensed Consolidated Statement of Stockholders' Equity for the Six Months Ended June 30, 2016 (Unaudited)

(in thousands)

	Series A Preferred Stock		Series B Preferred Stock		Common Stock		Additional Paid-in	Accumulated	Total Stockholders'
	Shares	Amount	Shares	Amount	Shares	Amount	Capital	Deficit	Deficit
BALANCE, December 31, 2015	1,839	$ 18	3,528	$ 35	61,928	$ 619	$ 1,079,513	$ (1,536,354)	$ (456,169)
Preferred stock dividends	—	—	—	—	—	—	—	(7,974)	(7,974)
Restricted stock awards, net of forfeitures	—	—	—	—	3,889	39	(39)	—	—
Stock-based compensation	—	—	—	—	—	—	9,594	—	9,594
Net loss	—	—	—	—	—	—	—	(248,643)	(248,643)
BALANCE, June 30, 2016	1,839	$ 18	3,528	$ 35	65,817	$ 658	$ 1,089,068	$ (1,792,971)	$ (703,192)

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

Sanchez Energy Corporation

Condensed Consolidated Statements of Cash Flows (Unaudited)

(in thousands)

	Six Months Ended June 30, 2016	2015
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	$ (248,643)	$ (1,060,255)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation, depletion, amortization and accretion	90,308	207,374
Impairment of oil and natural gas properties	109,464	910,372
Stock-based compensation expense	13,222	15,568
Net losses (gains) on commodity derivative contracts	35,993	(7,554)
Net cash settlement received on commodity derivative contracts	85,120	56,104
Losses incurred on premiums for derivative contracts	12,207	121
Gain on investment in SPP	—	(31)
Amortization of deferred gain on Western Catarina Midstream Divestiture	(7,406)	—
Amortization of debt issuance costs	3,890	3,563
Accretion of debt discount, net	316	386
Deferred taxes	—	7,442
Loss on inventory market adjustment	479	—
Distributions from equity investments	101	—
Earnings from equity investments	(2,691)	—
Changes in operating assets and liabilities:		
Accounts receivable	(7,967)	34,425
Other current assets	(915)	10,228
Accounts payable	(1,247)	(28,487)
Accounts receivable - related entities	491	(3,505)
Other payables	(174)	3,406
Accrued liabilities	4,481	4,225
Other current liabilities	(159)	(5,166)
Other liabilities	—	1,188
Net cash provided by operating activities	86,870	149,404
CASH FLOWS FROM INVESTING ACTIVITIES:		
Payments for oil and natural gas properties	(172,843)	(422,841)
Payments for other property and equipment	(878)	(2,187)
Proceeds from sale of oil and natural gas properties	—	81,734
Acquisition of oil and natural gas properties	—	342

Payments for investments	(18,053)	—
Net cash used in investing activities	(191,774)	(342,952)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Financing costs	(1,758)	(400)
Preferred dividends paid	(3,987)	(7,982)
Net cash used in financing activities	(5,745)	(8,382)
Decrease in cash and cash equivalents	(110,649)	(201,930)
Cash and cash equivalents, beginning of period	435,048	473,714
Cash and cash equivalents, end of period	$ 324,399	$ 271,784
NON-CASH INVESTING AND FINANCING ACTIVITIES:		
Change in asset retirement obligations	$ 885	$ 1,939
Change in accrued capital expenditures	(23,379)	(77,327)
SUPPLEMENTAL DISCLOSURE:		
Cash paid for taxes	715	—
Cash paid for interest	$ 59,221	$ 62,587

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

Table of Contents

Sanchez Energy Corporation

Notes to the Condensed Consolidated Financial Statements

(Unaudited)

Note 1. Organization

Sanchez Energy Corporation (together with our consolidated subsidiaries, the "Company," "we," "our," "us" or similar terms), a Delaware corporation formed in August 2011, is an independent exploration and production company focused on the acquisition and development of unconventional oil and natural gas resources in the onshore U.S. Gulf Coast, with a current focus on the horizontal development of significant resource potential from the Eagle Ford Shale in South Texas and the Tuscaloosa Marine Shale ("TMS") in Mississippi and Louisiana. We have accumulated net leasehold acreage in the oil and condensate, or black oil and volatile oil, windows of the Eagle Ford Shale and in what we believe to be the core of the TMS.

Note 2. Basis of Presentation and Summary of Significant Accounting Policies

The accompanying condensed consolidated financial statements are unaudited and were prepared from the Company's records. The condensed consolidated financial statements were prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP" or "U.S. GAAP") for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. The Company derived the condensed consolidated balance sheet as of December 31, 2015 from the audited financial statements filed in its Annual Report on Form 10-K for the fiscal year ended December 31, 2015 (the "2015 Annual Report"). Because this is an interim period filing presented using a condensed format, it does not include all of the disclosures required by U.S. GAAP. These condensed consolidated financial statements should be read in connection with the consolidated financial statements and notes thereto included in the 2015 Annual Report, which contains a summary of the Company's significant accounting policies and other disclosures. In the opinion of management, these financial statements include the adjustments and accruals, all of which are of a normal recurring nature, which are necessary for a fair presentation of the results for the interim periods. These interim results are not necessarily indicative of results to be expected for the entire year.

As of June 30, 2016, the Company’s significant accounting policies are consistent with those discussed in Note 2, “Basis of Presentation and Summary of Significant Accounting Policies,” in the notes to the Company’s consolidated financial statements contained in the 2015 Annual Report.

Principles of Consolidation

The Company’s condensed consolidated financial statements include the accounts of the Company and its subsidiaries. All intercompany balances and transactions have been eliminated.

Use of Estimates

The condensed consolidated financial statements are prepared in conformity with U.S. GAAP, which requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. The most significant estimates pertain to proved oil and natural gas reserves and related cash flow estimates used in the calculation of depletion and impairment of oil and natural gas properties, the evaluation of unproved properties for impairment, the fair value of commodity derivative contracts and asset retirement obligations, accrued oil and natural gas revenues and expenses and the allocation of general and administrative expenses. Actual results could differ materially from those estimates.

Recent Accounting Pronouncements

In March 2016, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2016-09 “Improvements to Employee Share-Based Payment Accounting,” effective for annual and interim

Table of Contents

periods for public companies beginning after December 15, 2016, with a cumulative-effect and prospective approach to be used for implementation. ASU 2016-09 changes several aspects of the accounting for share-based payment award transactions including accounting for income taxes, classification of excess tax benefits on the statement of cash flows, forfeitures, minimum statutory tax withholding requirements and classification of employee taxes paid on the statement of cash flows when an employer withholds shares for tax-withholding purposes. We are currently in the process of evaluating the impact of adoption of this guidance on our consolidated financial statements.

In February 2016, the FASB issued ASU No. 2016-02 "Leases (Topic 842)," effective for annual and interim periods for public companies beginning after December 15, 2018, with a modified retrospective approach to be used for implementation. ASU 2016-02 updates the previous lease guidance by requiring the recognition of a right-to-use asset and lease liability on the statement of financial position for those leases previously classified as operating leases under the old guidance. In addition, ASU 2016-02 updates the criteria for a lessee's classification of a finance lease. We are currently in the process of evaluating the impact of adoption of this guidance on our consolidated financial statements.

In April 2015, the FASB issued ASU 2015-03, "Interest—Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs." In August 2015, the FASB issued ASU 2015-15, "Presentation and Subsequent Measurement of Debt Issuance Costs Associated with Line-of-Credit Arrangements," which is effective upon the adoption of ASU 2015-03. This guidance is intended to more closely align the presentation of debt issuance costs under U.S. GAAP with the presentation requirements under the International Financial Reporting Standards. Under this new standard, debt issuance costs related to a recognized debt liability will be presented on the balance sheet as a direct deduction from the debt liability, similar to the presentation of debt discounts, rather than as a separate asset as previously presented. This guidance is effective for fiscal years and interim periods beginning after December 15, 2015. During the first quarter 2016, the Company adopted ASU 2015-03 retrospectively to the comparable periods in this Form 10-Q. Adoption of this guidance affected the balance sheets as of December 31, 2015 as follows (in thousands):

Decrease in Long term debt, net of premium, discount and debt issuance costs of approximately $41,039

Decrease in Debt issuance costs, net (Other Assets) of approximately $41,039

In February 2015, the FASB issued ASU 2015-02, "Consolidation—Amendments to the Consolidation Analysis." This ASU will simplify existing requirements by reducing the number of acceptable consolidation models and placing more emphasis on risk of loss when determining a controlling financial interest. The provisions of this new standard will affect how limited partnerships and similar entities are assessed for consolidation, including the elimination of the presumption that a general partner should consolidate a limited partnership. This guidance is effective for fiscal years and interim periods beginning in 2016. During the first quarter 2016, the Company adopted ASU 2015-02 retrospectively to the comparable periods in this Form 10-Q. See further disclosure around the adoption of ASU 2015-02, and the impact on the Company's consolidated financial statements in Note 19, "Variable Interest Entities."

In July 2015, FASB issued ASU No. 2015-11, “Simplifying the Measurement of Inventory,” effective for annual and interim periods beginning after December 15, 2016. ASU 2015-11 changes the inventory measurement principle for entities using the first-in, first out (FIFO) or average cost methods. For entities utilizing one of these methods, the inventory measurement principle will change from lower of cost or market to the lower of cost and net realizable value. We are currently in the process of evaluating the impact of adoption of this guidance on our consolidated financial statements, but we do not expect the impact to be material.

In May 2014, the FASB issued ASU No. 2014-09, “Revenue from Contracts with Customers (Topic 606).” This guidance outlines a new, single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance, including industry-specific guidance. This new revenue recognition model provides a five-step analysis in determining when and how revenue is recognized. The new model will require revenue recognition to depict the transfer of promised goods or services to customers in an amount that reflects the consideration a company expects to receive in exchange for those goods and services. The new guidance is effective for fiscal years and interim periods beginning after December 15, 2017. Early adoption is not permitted. The guidance may be applied retrospectively to each prior period presented or retrospectively with the cumulative effect recognized as of the date of initial application. We are currently in the process of evaluating the impact of adoption of this guidance on our consolidated financial statements, but we do not expect the impact to be material.

Table of Contents

Note 3. Acquisitions and Divestitures

Our acquisitions are accounted for under the acquisition method of accounting in accordance with Accounting Standards Codification (“ASC”) Topic 805, “Business Combinations.” A business combination may result in the recognition of a gain or goodwill based on the measurement of the fair value of the assets acquired at the acquisition date as compared to the fair value of consideration transferred, adjusted for purchase price adjustments. The initial accounting for acquisitions may not be complete and adjustments to provisional amounts, or recognition of additional assets acquired or liabilities assumed, may occur as more detailed analyses are completed and additional information is obtained about the facts and circumstances that existed as of the acquisition dates. The results of operations of the properties acquired in our acquisitions have been included in the condensed consolidated financial statements since the closing dates of the acquisitions.

Catarina Acquisition

On June 30, 2014, we completed our acquisition of contiguous acreage in Dimmit, LaSalle and Webb Counties, Texas with 176 gross producing wells for an aggregate adjusted purchase price of $557.1 million (the “Catarina Acquisition”). The effective date of the transaction was January 1, 2014. The purchase price was funded with a portion of the proceeds from the Original 6.125% Notes (as defined below in Note 6, “Long-Term Debt”) and cash on hand. The total purchase price was allocated to the assets purchased and liabilities assumed based upon their fair values on the date of acquisition as follows (in thousands):

Proved oil and natural gas properties	$ 446,906
Unproved properties	122,224
Other assets acquired	2,682
Fair value of assets acquired	571,812
Asset retirement obligations	(14,723)
Fair value of net assets acquired	$ 557,089

Palmetto Disposition

On March 31, 2015, we sold escalating working interests in 59 wellbores located in Gonzales County, Texas to a subsidiary of SPP for an adjusted purchase price of approximately $83.4 million (the “Palmetto Disposition”). The effective date of the transaction was January 1, 2015. The aggregate average working interest percentage initially conveyed was 18.25% per wellbore and, upon January 1 of each subsequent year after the closing, the purchaser’s working interest will automatically increase in incremental amounts according to the purchase agreement until January 1, 2019, at which point the purchaser will own a 47.5% working interest and we will own a 2.5% working interest in each of the wellbores. We received consideration consisting of approximately $83.0 million (approximately

$81.4 million as adjusted) cash and 1,052,632 common units of SPP valued at approximately $2.0 million as of the date of the closing (as discussed further in Note 8, “Investments”). The Company did not record any gains or losses related to the Palmetto Disposition. On August 4, 2015, the common units of SPP were subject to a 1-for-10 reverse split, at which time we owned 105,263 common units of SPP.

Western Catarina Midstream Divestiture

On October 14, 2015, the Company and SN Catarina, LLC (“SN Catarina”) completed the sale of SN Catarina’s interests in Catarina Midstream, LLC, a wholly-owned subsidiary of SN Catarina (“Catarina Midstream”), which as of the closing date, owned certain midstream gathering and processing assets located in Dimmit County and Webb County, Texas and 105,263 common units of SPP, to SPP for an adjusted purchase price of $345.8 million in cash (the “Western Catarina Midstream Divestiture”). In connection with the closing of the Western Catarina Midstream Divestiture, SN Catarina and Catarina Midstream entered into a Firm Gathering and Processing Agreement effective October 14, 2015 (the “Gathering Agreement”) for an initial term of 15 years pursuant to which production from approximately 35,000 acres that we operate in Dimmit County and Webb County, Texas will be dedicated for gathering by Catarina Midstream. In addition, for the first five years of the Gathering Agreement, SN Catarina is required to meet a minimum quarterly volume delivery commitment of 10,200 Bbls per day of crude oil and condensate and 142,000 Mcf per day of natural gas, subject to certain adjustments. SN Catarina will be required to pay gathering and processing fees of $0.96 per Bbl for crude oil and condensate and $0.74 per Mcf for natural gas tendered through the gathering system, in each case, subject to an annual escalation for a positive increase in the consumer price index. In addition, SN Catarina

Table of Contents

has, under certain circumstances, a right of first refusal during the term of the Gathering Agreement and afterwards with respect to dispositions by Catarina Midstream of its ownership interest in the gathering system. The Company recorded a deferred gain of approximately $74.1 million as a result of the Gathering Agreement being accounted for as an operating lease. This deferred gain will be amortized straight-line over the firm commitment term of five years as an offset to the transportation fees paid to Catarina Midstream under the Gathering Agreement.

Note 4. Cash and Cash Equivalents

As of June 30, 2016 and December 31, 2015, cash and cash equivalents consisted of the following (in thousands):

	June 30, 2016	December 31, 2015
Cash at banks	$ 243,368	$ 35,600
Money market funds	81,031	399,448
Total cash and cash equivalents	$ 324,399	$ 435,048

Note 5. Oil and Natural Gas Properties

The Company's oil and natural gas properties are accounted for using the full cost method of accounting. All direct costs and certain indirect costs associated with the acquisition, exploration and development of oil and natural gas properties are capitalized. Once evaluated, these costs, as well as the estimated costs to retire the assets, are included in the amortization base and amortized to depletion expense using the units of production method. Depletion is calculated based on estimated proved oil and natural gas reserves. Proceeds from the sale or disposition of oil and natural gas properties are applied to reduce net capitalized costs unless the sale or disposition causes a significant change in the relationship between costs and the estimated quantity of proved reserves.

Full Cost Ceiling Test—Capitalized costs (net of accumulated depreciation, depletion and amortization and deferred income taxes) of proved oil and natural gas properties are subject to a full cost ceiling limitation. The ceiling limits these costs to an amount equal to the present value, discounted at 10%, of estimated future net cash flows from estimated proved reserves less estimated future operating and development costs, abandonment costs (net of salvage value) and estimated related future income taxes. In accordance with SEC rules, the oil and natural gas prices used to calculate the full cost ceiling are the 12-month average prices, calculated as the unweighted arithmetic average of the first-day-of-the-month price for each month within the 12-month period prior to the end of the reporting period, unless prices are defined by contractual arrangements. Prices are adjusted for "basis" or location differentials. Prices are held constant over the life of the reserves. If unamortized costs capitalized within the cost pool exceed the ceiling, the excess is charged to expense and separately disclosed during the period in which the excess occurs. Amounts thus required to be written off are not reinstated for any subsequent increase in the cost center ceiling. During the three and six month periods ended June 30, 2016, the Company recorded a full cost ceiling test impairment after income taxes of $87.4 million and $109.5 million, respectively. Based upon the current NYMEX forward prices, absent a material addition to proved reserves and/or a material reduction in future development costs, we believe that there is a reasonable likelihood that the Company will incur additional impairments to our full cost pool in 2016. The Company recorded impairment expense of $468.9 million and $910.4 million for the three and six month periods ended June 30, 2015, respectively.

Costs associated with unproved properties and properties under development, including costs associated with seismic data, leasehold acreage and the current drilling of wells, are excluded from the full cost amortization base until the properties have been evaluated. Unproved properties are identified on a project basis, with a project being an area in which significant leasehold interests are acquired within a contiguous area. Unproved properties are reviewed periodically by management and when management determines that a project area has been evaluated through drilling operations or a thorough geologic evaluation, the project area is transferred into the full cost pool subject to amortization. The Company assesses the carrying value of its unproved properties that are not subject to amortization for impairment periodically. If the results of an assessment indicate that the properties are impaired, the amount of the asset impaired is added to the full cost pool subject to both periodic amortization and the ceiling test.

Table of Contents

Note 6. Long Term Debt

Long-term debt on June 30, 2016, consisted of $1.15 billion face value of 6.125% senior notes (consisting of $850 million in Original 6.125% Notes (defined below) and $300 million in Additional 6.125% Notes (defined below), which were issued at a premium to face value of $2.3 million), maturing on January 15, 2023, and $600 million principal amount of 7.75% senior notes (consisting of $400 million in Original 7.75% Notes (defined below) and $200 million in Additional 7.75% Notes (defined below), which were issued at a discount to face value of $7.0 million), maturing on June 15, 2021. During the first quarter 2016, the Company adopted ASU 2015-03 retrospectively to the comparable periods in this Form 10-Q. Adoption of this guidance affected the balance sheets as of December 31, 2015 as follows (in thousands):

Decrease in Long term debt, net of premium, discount and debt issuance costs of approximately $41,039

Decrease in Debt issuance costs, net (Other Assets) of approximately $41,039

As of June 30, 2016, and December 31, 2015, the Company's long term debt consisted of the following:

			Amount Outstanding (in thousands) as of	
	Interest Rate	Maturity date	June 30, 2016	December 31, 2015
Second Amended and Restated Credit Agreement	Variable	June 30, 2019	$ —	$ —
7.75% Notes	7.75%	June 15, 2021	600,000	600,000
6.125% Notes	6.125%	January 15, 2023	1,150,000	1,150,000
			1,750,000	1,750,000
Unamortized discount on Additional 7.75% Notes			(4,482)	(4,933)
Unamortized premium on Additional 6.125% Notes			1,764	1,899
Unamortized debt issuance costs			(38,782)	(41,039)
Total long-term debt			$ 1,708,500	$ 1,705,927

The components of interest expense are (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Interest on Senior Notes	$ (29,234)	$ (29,235)	$ (58,470)	$ (58,470)
Interest expense and commitment fees on credit agreement	(455)	(359)	(752)	(640)
Amortization of debt issuance costs	(1,975)	(1,748)	(3,890)	(3,563)
Amortization of discount on Additional 7.75% Notes	(226)	(226)	(451)	(452)
Amortization of premium on Additional 6.125% Notes	68	68	135	67
Total interest expense	$ (31,822)	$ (31,500)	$ (63,428)	$ (63,058)

Credit Facility

Previous Credit Agreement: On May 31, 2013, we and our subsidiaries, SEP Holdings III, LLC (“SEP III”), SN Marquis LLC (“SN Marquis”) and SN Cotulla Assets, LLC (“SN Cotulla”), collectively, as the borrowers, entered into a revolving credit facility represented by a $500 million Amended and Restated Credit Agreement with Royal Bank of Canada, as the administrative agent and collateral agent, and the lenders party thereto (the “Amended and Restated Credit Agreement”). The Amended and Restated Credit Agreement was to mature on May 31, 2018.

On May 12, 2014, the Company borrowed $100 million under the Amended and Restated Credit Agreement. The Company used proceeds from the issuance of the Original 6.125% Notes to repay the $100 million outstanding.

Second Amended and Restated Credit Agreement: On June 30, 2014, the Company, as borrower, and SEP III, SN Marquis, SN Cotulla, SN Operating, LLC, SN TMS, LLC and SN Catarina, LLC as loan parties, entered into a revolving credit facility represented by a $1.5 billion Second Amended and Restated Credit Agreement with Royal Bank of Canada, as the administrative agent and collateral agent, and the lenders party thereto (together with all subsequent amendments, the ‘‘Second Amended and Restated Credit Agreement’’). The Second Amended and Restated Credit

Table of Contents

Agreement provides for the issuance of letters of credit, limited in the aggregate to the lesser of $80 million and the total availability thereunder. As of June 30, 2016, there were no borrowings and no letters of credit outstanding under the Second Amended and Restated Credit Agreement, which had a borrowing base of $350 million and aggregate elected commitments of $300 million. Availability under the Second Amended and Restated Credit Agreement is at all times subject to customary conditions and the then applicable borrowing base and aggregate elected commitment amount. All of the $300 million aggregate elected commitment amount was available for future revolver borrowings as of June 30, 2016.

The Second Amended and Restated Credit Agreement matures on June 30, 2019. The borrowing base under the Second Amended and Restated Credit Agreement is redetermined semi-annually by the lenders based on, among other things, an evaluation of the Company's and its restricted subsidiaries' oil and natural gas reserves. Semi-annual redeterminations of the borrowing base are generally scheduled to occur on or before April 1 and October 1 of each year. The borrowing base is also subject to (i) automatic reduction by 25% of the amount of any increase in the aggregate amount of the Company's high yield debt and second lien debt, other than high yield or second lien debt issued in exchange for or to refinance existing high yield debt, permitted second lien debt incurred to refinance or replace permitted second lien debt, and permitted second lien debt representing the payment of interest in kind, (ii) interim redetermination at the election of the Company once between each scheduled redetermination, (iii) interim redetermination at the election of a majority of the lenders once between each scheduled redetermination, and (iv) if the required lenders so direct, in connection with asset sales and swap terminations during the period since the most recent borrowing base determination with a combined borrowing base value of more than 10% of the value of the proved developed oil and gas properties included in the most recent reserve report, a reduction in an amount equal to the borrowing base value, as determined by the administrative agent in its reasonable judgment, of such assets and swaps.

The Company's obligations under the Second Amended and Restated Credit Agreement are guaranteed by all of the Company's existing and future subsidiaries not designated as "unrestricted subsidiaries" and secured by a first priority lien on substantially all of the Company's assets and the assets of its existing and future subsidiaries, not designated as "unrestricted subsidiaries," including a first priority lien on all ownership interests in existing and future subsidiaries, including the SPV, defined below, an "unrestricted subsidiary" defined below, but excluding other subsidiaries designated as "unrestricted subsidiaries."

At the Company's election, borrowings under the Second Amended and Restated Credit Agreement may be made on an alternate base rate or an adjusted eurodollar rate basis, plus an applicable margin. The applicable margin varies from 1.00% to 2.00% for alternate base rate borrowings and from 2.00% to 3.00% for eurodollar borrowings and letters of credit, if any, depending on the utilization of the borrowing base. The Company is also required to pay a commitment fee of 0.50% per annum on any unused aggregate elected commitment amount.

The Second Amended and Restated Credit Agreement contains various affirmative and negative covenants and events of default that limit the Company's ability to, among other things, incur indebtedness, make restricted payments, grant liens, consolidate or merge, dispose of certain assets, make investments, engage in transactions with affiliates, enter into hedge transactions, and make acquisitions. The Second Amended and Restated Credit Agreement also provides for cross default between the Second Amended and Restated Credit Agreement and the other debt (including debt under the 6.125% Notes and the 7.75% Notes) and obligations in respect of hedging agreements (on a mark-to-market basis), of the Company and its restricted subsidiaries, in an aggregate principal amount in excess of $10 million. Furthermore, the Second Amended and Restated Credit Agreement contains financial covenants that require the Company to satisfy the following tests: (i) current assets plus undrawn borrowing capacity on the Second Amended and Restated Credit Agreement to current liabilities of at least 1.0 to 1.0 at all times, and (ii) net first lien debt (defined as the excess of first lien debt over cash) to consolidated last twelve months EBITDA of not greater than 2.00 to 1.0 as of the last day of any fiscal quarter. As of June 30, 2016, the Company was in compliance with the covenants of the Second Amended and Restated Credit Agreement.

The Second Amended and Restated Credit Amendment, among other things, also (a) permits the repurchase by the Company and its restricted subsidiaries, or by a special purpose unrestricted subsidiary of the Company (the “SPV”), of the Company’s senior unsecured notes and common and preferred equity securities, from cash in excess of lender credit exposure in an aggregate amount up to approximately $298.5 million subject to certain caps on purchases of the Company’s common and preferred equity securities and other limitations; (b) permits (i) the formation and capitalization of the SPV with up to $150 million, (ii) the SPV to purchase, hold and dispose of, including by way of distribution to its immediate parent, up to $150 million of the Company’s senior unsecured notes and common and preferred equity

Table of Contents

securities, (iii) the SPV to hold cash received from its immediate parent in a deposit account maintained with a lender under the Second Amended and Restated Credit Agreement, and (iv) the SPV to distribute cash to its immediate parent; (c) requires (i) the Company to cause the SPV to distribute all cash held by it or in its name as of the close of business on December 31, 2016 to its immediate parent, (ii) the equity interests in the SPV to be pledged in favor of the secured parties and (iii) the Company to maintain all deposits, securities and commodity accounts with lenders or affiliates of lenders under the Second Amended and Restated Credit Agreement and to enter into account control agreements in favor of the administrative agent for the benefit of the secured parties in respect of each of such accounts; (d) provides that, in the event of a borrowing base deficiency, the Company shall use unrestricted cash of the Company and its subsidiaries in excess of $35 million to prepay borrowings and cash collateralize letter of credit exposure, as applicable; and (e) restricts the Company from increasing its aggregate elected commitment amount until the lenders' next regularly scheduled borrowing base redetermination, which is expected to occur in the fourth quarter 2016.

From time to time, the agents, arrangers, book runners and lenders under the Second Amended and Restated Credit Agreement and their affiliates have provided, and may provide in the future, investment banking, commercial lending, hedging and financial advisory services to the Company and its affiliates in the ordinary course of business, for which they have received, or may in the future receive, customary fees and commissions for these transactions.

7.75% Senior Notes Due 2021

On June 13, 2013, we completed a private offering of $400 million in aggregate principal amount of the Company's 7.75% senior notes that will mature on June 15, 2021 (the "Original 7.75% Notes"). Interest on the notes is payable on each June 15 and December 15. We received net proceeds from this offering of approximately $388 million, after deducting initial purchasers' discounts and offering expenses, which we used to repay outstanding indebtedness under our credit facilities. The Original 7.75% Notes are senior unsecured obligations and are guaranteed on a joint and several senior unsecured basis by, with certain exceptions, substantially all of our existing and future subsidiaries.

On September 18, 2013, we issued an additional $200 million in aggregate principal amount of our 7.75% senior notes due 2021 (the "Additional 7.75% Notes" and, together with the Original 7.75% Notes, the "7.75% Notes") in a private offering at an issue price of 96.5% of the principal amount of the Additional 7.75% Notes. We received net proceeds of $188.8 million (after deducting the initial purchasers' discounts and offering expenses of $4.2 million) from the sale of the Additional 7.75% Notes. The Company also received cash for accrued interest from June 13, 2013 through the date of issuance of $4.1 million, for total net proceeds of $192.9 million from the sale of the Additional 7.75% Notes. The Additional 7.75% Notes were issued under the same indenture as the Original 7.75% Notes, and are, therefore, treated as a single class of securities under the indenture. We used the net proceeds from the offering to partially fund our acquisition of contiguous acreage in McMullen County, Texas with 13 gross producing wells (the "Wycross Acquisition") completed in October 2013, a portion of the 2013 and 2014 capital budgets and for general corporate purposes.

The 7.75% Notes are senior unsecured obligations and rank equally in right of payment with all of our existing and future senior unsecured indebtedness. The 7.75% Notes rank senior in right of payment to our future subordinated indebtedness. The 7.75% Notes are effectively junior in right of payment to all of our existing and future secured debt (including under our Second Amended and Restated Credit Agreement) to the extent of the value of the assets securing such debt. The 7.75% Notes are fully and unconditionally guaranteed (except for customary release provisions) on a joint and several senior unsecured basis by the subsidiary guarantors party to the indenture governing the 7.75% Notes. To the extent set forth in the indenture governing the 7.75% Notes, certain of our subsidiaries will be required to fully and unconditionally guarantee the 7.75% Notes on a joint and several senior unsecured basis in the future.

The indenture governing the 7.75% Notes, among other things, restricts our ability and our restricted subsidiaries' ability to: (i) incur, assume, or guarantee additional indebtedness or issue certain types of equity securities; (ii) pay distributions on, purchase or redeem shares or purchase or redeem subordinated debt; (iii) make certain investments; (iv) enter into certain transactions with affiliates; (v) create or incur liens on their assets; (vi) sell assets; (vii) consolidate, merge or transfer all or substantially all of their assets; (viii) restrict distributions or other payments from the Company's restricted subsidiaries; and (ix) designate subsidiaries as unrestricted subsidiaries.

We have the option to redeem all or a portion of the 7.75% Notes at any time on or after June 15, 2017 at the applicable redemption prices specified in the indenture plus accrued and unpaid interest. We may also redeem the 7.75% Notes, in whole or in part, at a redemption price equal to 100% of their principal amount plus a make whole premium, together with accrued and unpaid interest and additional interest, if any, to the redemption date, at any time prior to June 15, 2017. In addition, we may be required to repurchase the 7.75% Notes upon a change of control or if we sell certain of our assets.

On July 18, 2014, we completed an exchange offer of $600 million aggregate principal amount of the 7.75% Notes that had been registered under the Securities Act of 1933, as amended (the "Securities Act"), for an equal amount of the 7.75% Notes that had not been registered under the Securities Act.

6.125% Senior Notes Due 2023

On June 27, 2014, the Company completed a private offering of $850 million in aggregate principal amount senior unsecured 6.125% notes due 2023 (the "Original 6.125% Notes"). Interest on the notes is payable on each July 15 and January 15. The Company received net proceeds from this offering of approximately $829 million, after deducting initial purchasers' discounts and estimated offering expenses, which the Company used to repay all of the $100 million in borrowings outstanding under its Amended and Restated Credit Agreement and to finance a portion of the purchase price of the Catarina Acquisition. We used the remaining proceeds from the offering to fund a portion of the remaining 2014 capital budget and for general corporate purposes. The Original 6.125% Notes are the senior unsecured obligations of the Company and are guaranteed on a joint and several senior unsecured basis by, with certain exceptions, substantially all of the Company's existing and future subsidiaries.

On September 12, 2014, we issued an additional $300 million in aggregate principal amount of our 6.125% senior notes due 2023 (the "Additional 6.125% Notes" and, together with the Original 6.125% Notes, the "6.125% Notes" and, together with the 7.75% Notes, the "Senior Notes") in a private offering at an issue price of 100.75% of the principal amount of the Additional 6.125% Notes. We received net proceeds of $295.9 million, after deducting the initial purchasers' discounts, adding premiums to face value of $2.3 million and deducting estimated offering expenses of $6.4 million. The Company also received cash for accrued interest from June 27, 2014 through the date of the issuance of $3.8 million, for total net proceeds of $299.7 million from the sale of the Additional 6.125% Notes. The Additional 6.125% Notes were issued under the same indenture as the Original 6.125% Notes, and are, therefore, treated as a single class of securities under the indenture. We used a portion of the net proceeds from the offering to fund a portion of the 2014 capital budget and used the remainder of the net proceeds to fund a portion of the 2015 capital budget, and for general corporate purposes.

The 6.125% Notes are senior unsecured obligations and rank equally in right of payment with all of our existing and future senior unsecured indebtedness. The 6.125% Notes rank senior in right of payment to the Company's future subordinated indebtedness. The 6.125% Notes are effectively junior in right of payment to all of the Company's existing and future secured debt (including under the Second Amended and Restated Credit Agreement) to the extent of the value of the assets securing such debt. The 6.125% Notes are fully and unconditionally guaranteed (except for customary release provisions) on a joint and several senior unsecured basis by the subsidiary guarantors party to the indenture governing the 6.125% Notes. To the extent set forth in the indenture governing the 6.125% Notes, certain of our subsidiaries will be required to fully and unconditionally guarantee the 6.125% Notes on a joint and several senior unsecured basis in the future.

The indenture governing the 6.125% Notes, among other things, restricts our ability and our restricted subsidiaries' ability to: (i) incur, assume or guarantee additional indebtedness or issue certain types of equity securities; (ii) pay distributions on, purchase or redeem shares or purchase or redeem subordinated debt; (iii) make certain investments; (iv) enter into certain transactions with affiliates; (v) create or incur liens on their assets; (vi) sell assets; (vii) consolidate, merge or transfer all or substantially all of their assets; (viii) restrict distributions or other payments from the Company's restricted subsidiaries; and (ix) designate subsidiaries as unrestricted subsidiaries.

The Company has the option to redeem all or a portion of the 6.125% Notes, at any time on or after July 15, 2018 at the applicable redemption prices specified in the indenture plus accrued and unpaid interest. The Company may also redeem the 6.125% Notes, in whole or in part, at a redemption price equal to 100% of their principal amount plus a make whole premium, together with accrued and unpaid interest and additional interest, if any, to the redemption date, at any time prior to July 15, 2018. In addition, the Company may redeem up to 35% of the 6.125% Notes prior to July 15, 2017 under certain circumstances with an amount not greater than the net cash proceeds of one or more equity offerings at the redemption price specified in the indenture. The Company may also be required to repurchase the 6.125% Notes upon a change of control or if we sell certain Company assets.

On February 27, 2015, we completed an exchange offer of $1.15 billion aggregate principal amount of the 6.125% Notes that had been registered under the Securities Act for an equal amount of the 6.125% Notes that had not been registered under the Securities Act.

Pursuant to tripartite agreements by and among the Company, U.S. Bank National Association ("U.S. Bank") and Delaware Trust Company ("Delaware Trust"), effective May 20, 2016, U.S. Bank resigned as the Trustee, Notes Custodian, Registar and Paying Agent ("Trustee") under the indentures of the Senior Notes and Delaware Trust was appointed as successor Trustee. No other changes to the indentures for the 6.125% Notes or the 7.75% Notes were made at the time of the change in Trustee.

Note 7. Derivative Instruments

To reduce the impact of fluctuations in oil and natural gas prices on the Company's business and results of operations, and to protect the economics of property acquisitions at the time of execution, the Company periodically enters into derivative contracts with respect to a portion of its projected oil and natural gas production through various transactions that fix or modify the future prices to be realized. The derivative contracts may include fixed-for-floating price swaps (whereby, on the settlement date, the Company will receive or pay an amount based on the difference between a pre-determined fixed price and a variable market price for a notional quantity of production), put options (whereby the Company pays a cash premium in order to establish a fixed floor price for a notional quantity of production and, on the settlement date, receives the excess, if any, of the fixed price floor over a variable market price), and costless collars (whereby, on the settlement date, the Company receives the excess, if any, of a variable market price over a fixed floor price up to a fixed ceiling price for a notional quantity of production). In addition, the Company periodically enters into call swaptions as a way to achieve greater downside price protection than offered under prevailing fixed-for-floating price swaps by agreeing to expand the notional quantity hedged under a fixed-for-floating price swap at the counterparty's election on a designated date.

These hedging activities, which are governed by the terms of our Second Amended and Restated Credit Agreement, are intended to support oil and natural gas prices at targeted levels and manage exposure to oil and natural gas price fluctuations. It is our policy to enter into derivative contracts only with counterparties that are creditworthy and competitive market makers. All of our derivatives with lenders, or affiliates of lenders, in our Second Amended and Restated Credit Agreement are collateralized by the assets securing our Second Amended and Restated Credit Agreement and, therefore, do not currently require the posting of cash collateral. Our existing derivatives with non-lender counterparties, as designated under the Second Amended and Restated Credit Agreement, are unsecured and do not require the posting of cash collateral. It is never the Company's intention to enter into derivative contracts for speculative trading purposes.

All of our derivatives are accounted for as mark-to-market activities. Under ASC Topic 815, "Derivatives and Hedging," these instruments are recorded on the condensed consolidated balance sheets at fair value as either short term or long term assets or liabilities based on their anticipated settlement date. The Company nets derivative assets and liabilities by commodity for counterparties where a legal right to such offset exists. Changes in the derivatives' fair values are recognized in current earnings since the Company has elected not to designate its current derivative contracts as cash flow hedges for accounting purposes.

Table of Contents

The following table presents derivative positions for the periods indicated as of June 30, 2016:

	July 1 - December 31, 2016	2017	2018	2019
Oil positions:				
Fixed-for-floating price swaps (NYMEX WTI):				
Hedged volume (Bbls)	1,288,000	1,460,000	-	-
Average price ($/Bbl)	$ 70.11	$ 52.13	$ -	$ -
Call swaptions (NYMEX WTI):				
Option volume (Bbls) (1)	-	365,000	-	-
Average price ($/Bbl)	$ -	$ 50.00	$ -	$ -
Put options (NYMEX WTI):				
Hedged volume (Bbls)	2,024,000	-	-	-
Average price ($/Bbl)	$ 60.00	$ -	$ -	$ -
Collars (NYMEX WTI):				
Hedged volume (Bbls)	-	730,000	-	-
Average long put price ($/Bbl)	$ -	$ 45.00	$ -	$ -
Average short call price ($/Bbl)	$ -	$ 62.00	$ -	$ -
Natural gas positions:				
Fixed-for-floating price swaps (NYMEX Henry Hub):				
Hedged volume (MMBtu)	17,175,000	27,945,000	14,600,000	7,300,000
Average price ($/MMBtu)	$ 3.15	$ 3.00	$ 3.01	$ 3.02
Call swaptions (NYMEX Henry Hub):				
Option volume (MMBtu) (1)	-	-	3,650,000	-
Average price ($/MMBtu)	$ -	$ -	$ 3.00	$ -

(1) Represent options which settle into fixed-for-floating price swaps for the respective commodity at the counterparty's election on a designated date in the preceding year.

The following table sets forth a reconciliation of the changes in fair value of the Company’s commodity derivatives for the six months ended June 30, 2016, and the year ended December 31, 2015 (in thousands):

Year Ended

	Six Months Ended June 30, 2016	December 31, 2015
Beginning fair value of commodity derivatives	$ 178,283	$ 123,316
Net losses on crude oil derivatives	(36,370)	170,592
Net losses on natural gas derivatives	(11,830)	26,843
Net settlements on derivative contracts:		
Crude oil	(79,849)	(123,946)
Natural gas	(20,236)	(18,522)
Net premiums on derivative contracts:		
Crude oil	12,207	-
Ending fair value of commodity derivatives	$ 42,205	$ 178,283

18

Table of Contents

Balance Sheet Presentation

The Company nets derivative assets and liabilities by commodity for counterparties where legal right to such offset exists. Therefore, the Company's derivatives are presented on a net basis as "Fair value of derivative instruments" on the condensed consolidated balance sheets. The following information summarizes the gross fair values of derivative instruments, presenting the impact of offsetting the derivative assets and liabilities on the Company's condensed consolidated balance sheets (in thousands):

	June 30, 2016		
	Gross Amount of Recognized Assets	Gross Amounts Offset in the Consolidated Balance Sheets	Net Amounts Presented in the Consolidated Balance Sheets
Offsetting Derivative Assets:			
Current asset	$ 56,380	$ (2,114)	$ 54,266
Long-term asset	2,879	(2,678)	201
Total asset	$ 59,259	$ (4,792)	$ 54,467
Offsetting Derivative Liabilities:			
Current liability	$ (9,491)	$ 2,114	$ (7,377)
Long-term liability	(7,563)	2,678	(4,885)
Total liability	$ (17,054)	$ 4,792	$ (12,262)

	December 31, 2015		
	Gross Amount of Recognized Assets	Gross Amounts Offset in the Consolidated Balance Sheets	Net Amounts Presented in the Consolidated Balance Sheets
Offsetting Derivative Assets:			
Current asset	$ 172,518	$ (24)	$ 172,494
Long-term asset	5,821	(32)	5,789
Total asset	$ 178,339	$ (56)	$ 178,283
Offsetting Derivative Liabilities:			
Current liability	$ (24)	$ 24	$ —
Long-term liability	(32)	32	—
Total liability	$ (56)	$ 56	$ —

Note 8. Investments

On October 2, 2015, the Company, through SN Midstream, LLC, a wholly-owned subsidiary of the Company ("SN Midstream"), entered into joint venture agreements with an affiliate of Targa to, among other things, construct a new cryogenic natural gas processing plant (the "Processing Plant") and associated high pressure gathering pipelines near the Company's Catarina asset in the Eagle Ford Shale. The Processing Plant, which will be located in La Salle County, Texas, is expected to have initial capacity of 200 MMcf per day with the ability to increase to 260 MMcf per day. In connection with the Processing Plant joint venture agreement, SN Midstream committed to invest approximately $80 million and received a 50% ownership interest in the joint venture owning the Processing Plant. Construction is expected to be completed in 2017. In connection with the gathering pipelines joint venture agreement, SN Midstream committed to invest approximately $35 million and received a 50% ownership interest in the joint venture, Carnero Gathering, LLC ("Carnero Gathering"), owning the gathering pipelines that will connect the Company's existing Catarina gathering system to the Processing Plant. Construction on the gathering pipelines is scheduled to be completed in two phases, with both phases expected to be completed in 2016. The first phase, which connected the Catarina gathering system to the SOII Facility (defined below), was completed in February 2016. The second phase will connect the new gathering system to the Processing Plant, and is expected to be completed later this year. As of June 30, 2016, the Company had invested $26.0 million in Carnero Gathering joint venture and approximately $29.5 million in the Processing Plant joint venture. The Company is accounting for these activities as equity method investments as Targa is

Table of Contents

the operator of the joint ventures and has the most influence with respect to the normal day-to-day construction and operating decisions. We have included these equity method investment balances in the “Other Assets - Investments” long-term asset line on the balance sheet. The Company recorded earnings of approximately $1.8 million and $2.3 million from equity investments from Carnero Gathering and recorded losses of approximately $16 thousand and $27 thousand from equity investments from the Processing Plant joint venture for the three and six months ended June 30, 2016, respectively. We have included these equity method earnings and losses in the “Earnings from equity investments” line on the statement of operations. On July 5, 2016, the Company sold its interests and any remaining commitment to invest in Carnero Gathering to SPP (see further discussion in Note 20, “Subsequent Events”).

On October 2, 2015, the Company, via SN Catarina, purchased from a subsidiary of Targa a 10% undivided interest in the Silver Oak II Gas Processing Facility (the “SOII Facility”) in Bee County, Texas for a purchase price of $12.5 million. Targa owns the remaining undivided 90% interest in the SOII Facility, which is operated by Targa. Concurrently with the execution of the purchase and sale agreement for the SOII Facility, the Company entered into a firm gas processing agreement, whereby Targa began processing a firm quantity, 125,000 Mcf per day, on March 1, 2016 until the in-service date of the Processing Plant discussed above. The Company is accounting for its interest in the SOII Facility as an equity method investment as Targa is the operator and majority interest owner of the SOII Facility. As of June 30, 2016, the Company had invested $12.5 million in the SOII Facility. The Company recorded earnings of approximately $428 thousand from the equity interest in the SOII Facility for the three and six months ended June 30, 2016.

Note 9. Fair Value of Financial Instruments

Measurements of fair value of derivative instruments are classified according to the fair value hierarchy, which prioritizes the inputs to the valuation techniques used to measure fair value. Fair value is the price that would be received upon the sale of an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value measurements are classified and disclosed in one of the following categories:

Level 1: Measured based on unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities. Active markets are considered those in which transactions for the assets or liabilities occur in sufficient frequency and volume to provide pricing information on an ongoing basis.

Level 2: Measured based on quoted prices in markets that are not active, or inputs which are observable, either directly or indirectly, for substantially the full term of the asset or liability. This category includes those derivative instruments that can be valued using observable market data. Substantially all of these inputs are observable in the marketplace throughout the term of the derivative instrument, can be derived from observable data, or supported by observable levels at which transactions are executed in the marketplace.

Level 3: Measured based on prices or valuation models that require inputs that are both significant to the fair value measurement and less observable from objective sources (i.e. supported by little or no market activity). The valuation models used to value derivatives associated with the Company's oil and natural gas production are primarily industry standard models that consider various inputs including: (a) quoted forward prices for commodities, (b) time value and (c) current market and contractual prices for the underlying instruments, as well as other relevant economic measures. Although third-party quotes are utilized to assess the reasonableness of the prices and valuation techniques, there is not sufficient corroborating evidence to support classifying these assets and liabilities as Level 2.

Financial assets and liabilities are classified based on the lowest level of input that is significant to the fair value measurement. Management's assessment of the significance of a particular input to the fair value measurement requires judgment, and may affect the valuation of the fair value of assets and liabilities and their placement within the fair value hierarchy levels.

Table of Contents

Fair Value on a Recurring Basis

The following tables set forth, by level within the fair value hierarchy, the Company’s financial assets and liabilities that were accounted for at fair value on a recurring basis as of June 30, 2016 and December 31, 2015 (in thousands):

As of June 30, 2016
Active Market