SANDRIDGE ENERGY INC
Form 10-Q
May 09, 2011

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2011

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: 001-33784

SANDRIDGE ENERGY, INC.

(Exact name of registrant as specified in its charter)

Delaware **(State or other jurisdiction of** **incorporation or organization)**	**20-8084793** **(I.R.S. Employer** **Identification No.)**
123 Robert S. Kerr Avenue **Oklahoma City, Oklahoma** **(Address of principal executive offices)**	**73102** **(Zip Code)**

Registrant s telephone number, including area code:

(405) 429-5500

Former name, former address and former fiscal year, if changed since last report: Not applicable

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 x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x 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 x	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 x

The number of shares outstanding of the registrant s common stock, par value $0.001 per share, as of the close of business on April 29, 2011, was 410,005,288.

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SANDRIDGE ENERGY, INC.

FORM 10-Q

Quarter Ended March 31, 2011

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DISCLOSURES REGARDING FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q (Quarterly Report) includes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (the Securities Act), and Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act). These statements express a belief, expectation or intention and generally are accompanied by words that convey projected future events or outcomes. These forward-looking statements may include projections and estimates concerning capital expenditures, our liquidity and capital resources, the timing and success of specific projects, outcomes and effects of litigation, claims and disputes, elements of our business strategy and other statements concerning our operations, economic performance and financial condition. Forward-looking statements are generally accompanied by words such as estimate, project, predict, believe, expect, anticipate, potential, could, may, foresee, plan, other words that convey the uncertainty of future events or outcomes. We have based these forward-looking statements on our current expectations and assumptions about future events. These statements are based on certain assumptions and analyses made by us in light of our experience and our perception of historical trends, current conditions and expected future developments as well as other factors we believe are appropriate under the circumstances. However, whether actual results and developments will conform with our expectations and predictions is subject to a number of risks and uncertainties, as well as the risk factors discussed in Item 1A of our Annual Report on Form 10-K for the fiscal year ended December 31, 2010 (the 2010 Form 10-K). The actual results or developments anticipated may not be realized or, even if substantially realized, they may not have the expected consequences to or effects on our company, business or operations. Such statements are not guarantees of future performance and actual results or developments may differ materially from those projected in such forward-looking statements. We undertake no obligation to publicly update or revise any forward-looking statements.

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PART I. Financial Information

ITEM 1. ***Financial Statements***

SANDRIDGE ENERGY, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except per share data)

	March 31, 2011 (Unaudited)	December 31, 2010
ASSETS		
Current assets		
Cash and cash equivalents	$ 8,537	$ 5,863
Accounts receivable, net	164,087	146,118
Derivative contracts	781	5,028
Inventories	4,278	3,945
Other current assets	21,112	14,636
Total current assets	198,795	175,590
Oil and natural gas properties, using full cost method of accounting		
Proved	8,388,198	8,159,924
Unproved	571,447	547,953
Less: accumulated depreciation, depletion and impairment	(4,554,435)	(4,483,736)
	4,405,210	4,224,141
Other property, plant and equipment, net	506,629	509,724
Restricted deposits	27,876	27,886
Goodwill	235,182	234,356
Other assets	71,776	59,751
Total assets	$ 5,445,468	$ 5,231,448
LIABILITIES AND EQUITY		
Current liabilities		
Current maturities of long-term debt	$ 1,004	$ 7,293
Accounts payable and accrued expenses	376,264	376,922
Billings and estimated contract loss in excess of costs incurred	32,243	31,474
Derivative contracts	234,059	103,409
Asset retirement obligation	25,360	25,360
Total current liabilities	668,930	544,458
Long-term debt	3,171,385	2,901,793
Derivative contracts	260,192	124,173
Asset retirement obligation	94,293	94,517
Other long-term obligations	9,409	19,024

Total liabilities	4,204,209	3,683,965
Commitments and contingencies (Note 15)		
Equity		
SandRidge Energy, Inc. stockholders equity		
Preferred stock, $0.001 par value, 50,000 shares authorized		
8.5% Convertible perpetual preferred stock; 2,650 shares issued and outstanding at March 31, 2011 and December 31, 2010; aggregate liquidation preference of $265,000	3	3
6.0% Convertible perpetual preferred stock; 2,000 shares issued and outstanding at March 31, 2011 and December 31, 2010; aggregate liquidation preference of $200,000	2	2
7.0% Convertible perpetual preferred stock; 3,000 shares issued and outstanding at March 31, 2011 and December 31, 2010; aggregate liquidation preference of $300,000	3	3
Common stock, $0.001 par value, 800,000 shares authorized; 410,649 issued and 410,098 outstanding at March 31, 2011 and 406,830 issued and 406,360 outstanding at December 31, 2010	398	398
Additional paid-in capital	4,539,565	4,528,912
Treasury stock, at cost	(4,145)	(3,547)
Accumulated deficit	(3,305,860)	(2,989,576)
Total SandRidge Energy, Inc. stockholders equity	1,229,966	1,536,195
Noncontrolling interest	11,293	11,288
Total equity	1,241,259	1,547,483
Total liabilities and equity	$ 5,445,468	$ 5,231,448

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

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SANDRIDGE ENERGY, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share data)

	Three Months Ended March 31, 2011	2010
	(Unaudited)	
Revenues		
Oil and natural gas	$ 266,942	$ 169,585
Drilling and services	21,034	5,760
Midstream and marketing	22,258	27,988
Other	2,614	7,661
Total revenues	312,848	210,994
Expenses		
Production	73,957	50,272
Production taxes	10,575	4,838
Drilling and services	15,041	7,209
Midstream and marketing	22,283	25,506
Depreciation and depletion oil and natural gas	73,886	52,278
Depreciation and amortization other	13,093	12,303
General and administrative	34,414	31,674
Loss (gain) on derivative contracts	277,628	(61,952)
Gain on sale of assets	(201)	(304)
Total expenses	520,676	121,824
(Loss) income from operations	(207,828)	89,170
Other income (expense)		
Interest income	5	69
Interest expense	(59,443)	(62,089)
Loss on extinguishment of debt	(36,181)	
Other income, net	1,197	1,236
Total other expense	(94,422)	(60,784)
(Loss) income before income taxes	(302,250)	28,386
Income tax expense	88	12
Net (loss) income	(302,338)	28,374
Less: net income attributable to noncontrolling interest	6	1,138
Net (loss) income attributable to SandRidge Energy, Inc.	(302,344)	27,236
Preferred stock dividends	13,940	8,631
(Loss applicable) income available to SandRidge Energy, Inc. common stockholders	$ (316,284)	$ 18,605

(Loss) earnings per share				
Basic	$	(0.79)	$	0.09
Diluted	$	(0.79)	$	0.09
Weighted average number of common shares outstanding				
Basic		398,251		203,823
Diluted		398,251		207,892

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

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SANDRIDGE ENERGY, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

(In thousands)

	SandRidge Energy, Inc. Stockholders								
	Convertible Perpetual Preferred Stock Shares	Convertible Perpetual Preferred Stock Amount	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Treasury Stock	Accumulated Deficit	Noncontrolling Interest	Total
	(Unaudited)								
Three months ended March 31, 2011									
Balance, December 31, 2010	7,650	$ 8	406,360	$ 398	$ 4,528,912	$ (3,547)	$ (2,989,576)	$ 11,288	$ 1,547,483
Distributions to noncontrolling interest owners								(1)	(1)
Stock issuance expense					(143)				(143)
Purchase of treasury stock						(4,809)			(4,809)
Retirement of treasury stock					(4,809)	4,809			
Stock purchases retirement plans, net of distributions			(81)		1,389	(598)			791
Stock-based compensation					14,206				14,206
Stock-based compensation excess tax benefit					10				10
Issuance of restricted stock awards, net of cancellations			3,819						
Net (loss) income							(302,344)	6	(302,338)
Convertible perpetual preferred stock dividends							(13,940)		(13,940)
Balance, March 31, 2011	7,650	$ 8	410,098	$ 398	$ 4,539,565	$ (4,145)	$ (3,305,860)	$ 11,293	$ 1,241,259

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

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SANDRIDGE ENERGY, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

	Three Months Ended March 31, 2011	2010
	(Unaudited)	
CASH FLOWS FROM OPERATING ACTIVITIES		
Net (loss) income	$ (302,338)	$ 28,374
Adjustments to reconcile net (loss) income to net cash provided by operating activities		
Provision for doubtful accounts	2	84
Depreciation, depletion and amortization	86,979	64,581
Debt issuance costs amortization	2,873	2,218
Discount amortization on long-term debt	575	519
Loss on extinguishment of debt	36,181	
Unrealized loss (gain) on derivative contracts	267,254	(15,511)
Gain on sale of assets	(201)	(304)
Investment income	(150)	(427)
Stock-based compensation	8,806	6,882
Changes in operating assets and liabilities	(20,224)	61,186
Net cash provided by operating activities	79,757	147,602
CASH FLOWS FROM INVESTING ACTIVITIES		
Capital expenditures for property, plant and equipment	(431,382)	(190,580)
Proceeds from sale of assets	159,536	5,606
Refunds of restricted deposits		5,095
Net cash used in investing activities	(271,846)	(179,879)
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from borrowings	1,493,000	273,343
Repayments of borrowings	(1,230,272)	(232,023)
Premium on debt redemption	(28,795)	
Dividends paid preferred	(18,130)	(11,263)
Noncontrolling interest distributions	(1)	(4)
Stock issuance expense	(143)	(87)
Stock-based compensation excess tax benefit	10	12
Purchase of treasury stock	(5,469)	(2,770)
Derivative settlements	3,662	
Debt issuance costs	(19,099)	(221)
Net cash provided by financing activities	194,763	26,987
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	2,674	(5,290)
CASH AND CASH EQUIVALENTS, beginning of year	5,863	7,861
CASH AND CASH EQUIVALENTS, end of period	$ 8,537	$ 2,571

Supplemental Disclosure of Noncash Investing and Financing Activities				
Change in accrued capital expenditures	$	(11,222)	$	38,001
Convertible perpetual preferred stock dividends payable	$	9,185	$	5,814
Adjustment to oil and natural gas properties for estimated contract loss	$	19,000	$	

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

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SANDRIDGE ENERGY, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. Basis of Presentation

Nature of Business. SandRidge Energy, Inc. (including its subsidiaries, the Company or SandRidge) is an independent oil and natural gas company concentrating on development and production activities related to the exploitation of its significant holdings in West Texas and the Mid-Continent area of Oklahoma and Kansas. The Company owns and operates other interests in the Mid-Continent, Cotton Valley Trend in East Texas, Gulf Coast and Gulf of Mexico. The Company also operates businesses that are complementary to its primary development and production activities, including gas gathering and treating facilities, a gas marketing business, an oil field services business, including a drilling rig business, and tertiary oil recovery operations.

Interim Financial Statements. The accompanying condensed consolidated financial statements as of December 31, 2010 have been derived from the audited financial statements contained in the Company s 2010 Form 10-K. The unaudited interim condensed consolidated financial statements have been prepared by the Company in accordance with the accounting policies stated in the audited consolidated financial statements contained in the 2010 Form 10-K. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) have been condensed or omitted, although the Company believes that the disclosures contained herein are adequate to make the information presented not misleading. In the opinion of management, all adjustments, which consist only of normal recurring adjustments, necessary to state fairly the information in the Company s unaudited condensed consolidated financial statements have been included. These condensed consolidated financial statements should be read in conjunction with the financial statements and notes thereto included in the 2010 Form 10-K.

Risks and Uncertainties. The Company s revenue, profitability and future growth are substantially dependent upon the prevailing and future prices for oil and natural gas, each of which depends on numerous factors beyond the Company s control such as economic conditions, regulatory developments and competition from other energy sources. Oil and natural gas prices historically have been volatile, and may be subject to significant fluctuations in the future. The Company s derivative arrangements serve to mitigate a portion of the effect of this price volatility on the Company s cash flows, and while derivative contracts for the majority of expected 2011 through 2013 oil production are in place, fixed price swap contracts are in place for only a portion of expected 2011 and 2012 natural gas production and 2014 and 2015 oil production. No fixed price swap contracts are in place for the Company s natural gas production beyond 2012 or oil production beyond 2015. The Company has natural gas collars in place for a portion of expected natural gas production through 2015. See Note 12 for the Company s open oil and natural gas commodity derivative contracts. The Company has incurred, and will have to continue to incur, capital expenditures to achieve production targets contained in certain gathering and treating arrangements. The Company depends on the availability of borrowings under its senior secured revolving credit facility (the senior credit facility), along with cash flows from operating activities and the proceeds from planned asset sales or other asset monetizations, to fund those capital expenditures. Based on anticipated oil and natural gas prices, availability under the Company s senior credit facility, potential access to the capital markets and anticipated proceeds from sales or other monetizations of assets, the Company expects to be able to fund its planned capital expenditures budget, debt service requirements and working capital needs for 2011. However, a substantial or extended decline in oil or natural gas prices could have a material adverse effect on the Company s financial position, results of operations, cash flows and quantities of oil and natural gas reserves that may be economically produced, which could adversely impact the Company s ability to comply with the financial covenants under its senior credit facility, which in turn would limit further borrowings to fund capital expenditures. See Note 11 for discussion of the financial covenants in the senior credit facility.

2. Recent Accounting Pronouncements

For a description of the Company s significant accounting policies, refer to Note 1 of the consolidated financial statements included in the 2010 Form 10-K.

Recently Adopted Accounting Pronouncements. In January 2010, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update 2010-06, Fair Value Measurements and Disclosures: Improving Disclosures about Fair Value Measurements (ASU 2010-06). ASU 2010-06 requires additional disclosures and clarifies existing disclosure requirements about fair value measurement as set forth in Accounting Standards Codification (ASC) Topic 820, Fair Value Measurements and Disclosures. The new disclosure requirements regarding activity in Level 3 fair value measurements, which are effective for fiscal years beginning after December 15, 2010, were implemented in the first quarter of 2011 by the Company. The implementation of ASU 2010-06 had no impact on the Company s financial position or results of operations. See Note 4.

3. Acquisitions and Divestitures

Arena Acquisition. On July 16, 2010, the Company acquired all of the outstanding common stock of Arena Resources, Inc. (the Arena Acquisition). In connection with the acquisition, the Company issued 4.7771 shares of its common stock and paid $4.50 in cash to Arena Resources, Inc. (Arena) stockholders for each outstanding share of Arena unrestricted common stock. This resulted in the issuance of approximately 190.3 million shares of Company common stock and payment of approximately $177.9 million in cash for an aggregate estimated purchase price to stockholders of Arena equal to approximately $1.4 billion. The Company incurred approximately $0.4 million and $0.6 million in fees related to the acquisition during the three-month periods ended March 31, 2011 and 2010, respectively, which have been included in general and administrative expenses in the accompanying condensed consolidated statements of operations.

The allocation of the purchase price as of July 16, 2010, including updates made in the fourth quarter of 2010 and first quarter of 2011, is still preliminary with respect to final deferred tax amounts, pending completion of the 2010 Arena tax return, and certain accruals, and is based on information that was available to management at the time these condensed consolidated financial statements were prepared. During the fourth quarter of 2010 and first quarter of 2011, the Company updated certain of the estimates used in the purchase price allocation, primarily with respect to deferred taxes and other accruals for which the Company was awaiting confirmatory information, resulting in adjustments of ($5.4) million and $0.8 million, respectively, to goodwill. The Company believes the estimates used are reasonable and the significant effects of the transaction are properly reflected. However, the estimates, primarily the amounts related to deferred taxes, are subject to change as additional information becomes available and is assessed by the Company. Additional changes to the purchase price allocation could result in a change to goodwill. Changes to the deferred tax amounts in the purchase price allocation would result in a corresponding change in the release of the Company s valuation allowance and corresponding income tax expense.

The following table summarizes the estimated values of assets acquired and liabilities assumed in connection with the Arena Acquisition (in thousands):

Current assets	$ 83,411
Oil and natural gas properties(1)	1,587,630
Other property, plant and equipment	5,963
Long-term deferred tax assets	27,425
Other long-term assets	16,181
Goodwill(2)	235,182
Total assets acquired	1,955,792
Current liabilities	45,584
Long-term deferred tax liability(2)	474,925
Other long-term liabilities	8,851
Total liabilities assumed	529,360
Net assets acquired	$ 1,426,432

(1) Weighted average commodity prices utilized in the preliminary determination of the fair value of oil and natural gas properties were $105.58 per barrel of oil and $8.56 per Mcf of natural gas, after adjustment for transportation fees and regional price differentials. The prices utilized were based upon forward commodity strip prices, as of July 16, 2010, for the first four years and escalated for inflation at a rate of 2.5% annually beginning with the fifth year through the end of production, which was more than 50 years. Approximately 91.0% of the fair value allocated to oil and natural gas properties is attributed to oil reserves.

(2) The Company received carryover tax basis in Arena s assets and liabilities because the merger was not a taxable transaction under the Internal Revenue Code (IRC). Based upon the preliminary purchase price allocation, a step-up in basis related to the property acquired from Arena resulted in a net deferred tax liability of approximately $447.5 million, which in turn contributed to an excess of the consideration transferred to acquire Arena over the estimated fair value on the acquisition date of the net assets acquired, or goodwill. See Note 6 for further discussion of goodwill.

The following unaudited pro forma results of operations are provided for the three-month period ended March 31, 2010 as though the Arena Acquisition had been completed as of the beginning of the period. The pro forma information is based on the Company s consolidated results of operations for the three-month period ended March 31, 2010, Arena s historical results of operations and estimates of the effect of the transaction on the combined results. The pro forma combined results of operations for the three months ended March 31, 2010 have been prepared by adjusting the historical results of the Company to include the historical results of Arena, certain reclassifications to conform Arena s presentation to the Company s accounting policies and the impact of the preliminary purchase price allocation. These supplemental pro forma results of operations are provided for illustrative purposes only and do not purport to be indicative of the actual results that would have been achieved by the combined company for the period presented or that may be achieved by the combined company in the future. The pro forma results of operations do not include any cost

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savings or other synergies that resulted from the acquisition or any estimated costs that have been or will be incurred by the Company to integrate Arena. Future results may vary significantly from the results reflected in this pro forma financial information because of future events and transactions, as well as other factors.

	Three Months Ended March 31, 2010	
	Actual	Pro Forma
	(Unaudited)	
Revenues	$ 210,994	$ 262,792
Income available to SandRidge Energy, Inc. common stockholders(1)	$ 18,605	$ 477,711
Earnings per common share		
Basic	$ 0.09	$ 1.21
Diluted	$ 0.09	$ 1.08

(1) Pro forma column reflects a $447.5 million reduction in tax expense related to the release of a portion of the Company s valuation allowance on existing deferred tax assets.

Sale of Wolfberry Assets. In January 2011, the Company sold its Wolfberry assets in the Permian Basin for $153.8 million, net of fees and subject to post-closing adjustments. This asset sale was accounted for as an adjustment to the full cost pool with no gain or loss recognized. The transaction closed on January 6, 2011.

Sale of New Mexico Assets. In February 2011, the Company entered into an agreement to sell certain oil and natural gas properties in Lea County and Eddy County, New Mexico for approximately $198.5 million, net of fees and subject to post-closing adjustments. This asset sale was accounted for as an adjustment to the full cost pool with no gain or loss recognized. The transaction closed on April 1, 2011.

4. Fair Value Measurements

The Company applies the guidance provided under ASC Topic 820 to its financial assets and liabilities and nonfinancial liabilities that are measured and reported on a fair value basis. Pursuant to this guidance, the Company has classified and disclosed its fair value measurements using the following levels of the fair value hierarchy:

Level 1: Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities.

Level 2: 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.

Level 3: Measurement based on prices or valuation models that require inputs that are both significant to the fair value measurement and less observable for objective sources (*i.e.*, supported by little or no market activity).

Assets and liabilities that are measured at fair value are classified based on the lowest level of input that is significant to the fair value measurement. The Company s assessment of the significance of a particular input to the fair value measurement requires judgment, which may affect the valuation of the fair value of assets and liabilities and their placement within the fair value hierarchy levels as described in ASC Topic 820. The determination of the fair values, stated below, takes into account the market for the Company s financial assets and liabilities, the associated credit risk and other factors as required by ASC Topic 820. The Company considers active markets as those in which transactions for the assets or liabilities occur in sufficient frequency and volume to provide pricing information on an ongoing basis. The Company has assets and liabilities it has classified as Level 1 and Level 3, as described below. The Company did not have any assets or liabilities classified as Level 2 at March 31, 2011 or December 31, 2010.

Level 1 Fair Value Measurements

Restricted deposits. The fair value of restricted deposits is based on quoted market prices.

Other long-term assets. The fair value of other long-term assets, consisting of assets attributable to the Company s deferred compensation plan, is based on quoted market prices.

Level 3 Fair Value Measurements

Derivative Contracts. The fair values of the Company s oil and natural gas fixed price swaps, natural gas basis swaps, natural gas collars and interest rate swaps are based upon quotes obtained from counterparties to the derivative contracts. The Company

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reviews other readily available market prices for its derivative contracts as there is an active market for these contracts. However, the Company does not have access to the specific valuation models used by its counterparties or other market participants. Included in these models are discount factors that the Company must estimate in its calculation. Additionally, the Company applies a weighted average credit default risk rating factor for its counterparties or gives effect to its credit risk, as applicable, in determining the fair value of its derivative contracts. Based on the inputs for the fair value measurement, the Company has classified its derivative contract assets and liabilities as Level 3.

The following tables summarize the Company s financial assets and liabilities measured at fair value on a recurring basis by the fair value hierarchy (in thousands):

March 31, 2011

	Fair Value Measurements				
Description	**Level 1**	**Level 2**	**Level 3**	**Netting(1)**	**Assets/ Liabilities at Fair Value**
Assets					
Commodity derivative contracts	$	$	$ 3,649	$ (2,868)	$ 781
Restricted deposits	27,876				27,876
Other long-term assets	4,965				4,965
	$ 32,841	$	$ 3,649	$ (2,868)	$ 33,622
Liabilities					
Commodity derivative contracts	$	$	$ 482,190	$ (2,868)	$ 479,322
Interest rate swaps			14,929		14,929
	$	$	$ 497,119	$ (2,868)	$ 494,251

December 31, 2010

	Fair Value Measurements				
Description	**Level 1**	**Level 2**	**Level 3**	**Netting(1)**	**Assets/ Liabilities at Fair Value**
Assets					
Commodity derivative contracts	$	$	$ 10,576	$ (5,548)	$ 5,028
Restricted deposits	27,886				27,886
Other long-term assets	4,826				4,826
	$ 32,712	$	$ 10,576	$ (5,548)	$ 37,740
Liabilities					
Commodity derivative contracts	$	$	$ 216,436	$ (5,548)	$ 210,888
Interest rate swaps			16,694		16,694
	$	$	$ 233,130	$ (5,548)	$ 227,582

(1) Represents the impact of netting assets and liabilities with counterparties with which the right of offset exists.

The table below sets forth a reconciliation of the Company s financial assets and liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) during the three-month periods ended March 31, 2011 and 2010 (in thousands):

	Three Months Ended March 31,					
	2011			2010		
	Commodity Derivative Contracts	Interest Rate Swaps	Total	Commodity Derivative Contracts	Interest Rate Swaps	Total
Balance of Level 3, December 31	$ (205,860)	$ (16,694)	$ (222,554)	$ 46,153	$ (8,299)	$ 37,854
Total realized and unrealized (losses) gains	(277,628)	(278)	(277,906)	61,952	(5,935)	56,017
Purchases	(3,662)		(3,662)			
Settlements	8,609	2,043	10,652	(42,593)	2,087	(40,506)
Balance of Level 3, March 31	$ (478,541)	$ (14,929)	$ (493,470)	$ 65,512	$ (12,147)	$ 53,365

During the three-month periods ended March 31, 2011 and 2010, the Company did not have any transfers between Level 1, Level 2 or Level 3 fair value measurements.

See Note 12 for further discussion of the Company s derivative contracts.

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Fair Value of Debt

The Company measures the fair value of its long-term debt based on quoted market prices and also considers the effect of the Company s credit risk. The estimated fair values of the Company s senior notes and the carrying value at March 31, 2011 and December 31, 2010 were as follows (in thousands):

	March 31, 2011		December 31, 2010	
	Fair Value	Carrying Value	Fair Value	Carrying Value
Senior Floating Rate Notes due 2014	$ 347,045	$ 350,000	$ 334,751	$ 350,000
8.625% Senior Notes due 2015	37,554	35,776	663,181	650,000
9.875% Senior Notes due 2016(1)	411,686	353,157	394,527	352,707
8.0% Senior Notes due 2018	792,934	750,000	762,849	750,000
8.75% Senior Notes due 2020(2)	495,017	443,181	472,968	443,057
7.5% Senior Notes due 2021	937,485	900,000		

(1) Carrying value is net of $12,343 and $12,793 discount at March 31, 2011 and December 31, 2010, respectively.
(2) Carrying value is net of $6,819 and $6,943 discount at March 31, 2011 and December 31, 2010, respectively.

The carrying values of the Company s senior credit facility and remaining fixed rate debt instrument approximate fair value based on current rates applicable to similar instruments. See Note 11 for further discussion of the Company s long-term debt, including the partial tender of the 8.625% Senior Notes due 2015 and the issuance of the 7.5% Senior Notes due 2021, which occurred during the three months ended March 31, 2011.

5. Property, Plant and Equipment

Property, plant and equipment consists of the following (in thousands):

	March 31, 2011	December 31, 2010
Oil and natural gas properties		
Proved	$ 8,388,198	$ 8,159,924
Unproved	571,447	547,953
Total oil and natural gas properties	8,959,645	8,707,877
Less accumulated depreciation, depletion and impairment	(4,554,435)	(4,483,736)
Net oil and natural gas properties capitalized costs	4,405,210	4,224,141
Land	14,418	14,418
Non oil and natural gas equipment(1)	662,563	666,233
Buildings and structures	93,945	89,813
Total	770,926	770,464
Less accumulated depreciation and amortization	(264,297)	(260,740)
Net capitalized costs	506,629	509,724
Total property, plant and equipment, net	$ 4,911,839	$ 4,733,865

(1) Includes capitalized interest of approximately $4.8 million and $4.7 million at March 31, 2011 and December 31, 2010, respectively. There were no full cost ceiling impairments during either the three months ended March 31, 2011 or 2010. Cumulative full cost ceiling limitation impairment charges of $3,548.3 million at both March 31, 2011 and December 31, 2010 were included in accumulated depreciation, depletion and impairment for oil and natural gas properties in the table above.

6. Goodwill

At March 31, 2011, the Company had $235.2 million of goodwill, including the effects of the $0.8 million and ($5.4) million purchase price adjustments recorded in the first quarter of 2011 and fourth quarter of 2010, respectively, as a result of the excess consideration over the fair value of Arena net assets acquired on July 16, 2010. Goodwill recorded in the Arena Acquisition is primarily attributable to operational and cost synergies expected to be realized from the acquisition by using the Company s current presence in the Permian Basin, its Fort Stockton service base and its existing rig ownership to efficiently increase its drilling and oil production from Arena assets acquired in the Central Basin Platform, as these assets have a proven production history. See Note 3 for additional information on the Arena Acquisition. The Company assigned all of the goodwill related to the Arena Acquisition to its exploration and production segment, which will be the reporting unit for impairment testing purposes. The Company will test goodwill for impairment annually on July 1, beginning in 2011. The Company monitors the existence of potential impairment indicators throughout the year. As of March 31, 2011, no such indicators were noted. Goodwill recognized will not be deductible for tax purposes.

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7. Other Assets

Other assets consist of the following (in thousands):

	March 31, 2011	December 31, 2010
Debt issuance costs, net of amortization	$ 59,477	$ 50,637
Investments	4,965	4,826
Other	7,334	4,288
Total other assets	$ 71,776	$ 59,751

8. Variable Interest Entities

In accordance with the guidance in ASC Topic 810, Consolidation, including the guidance in Accounting Standards Update 2009-17, Consolidations - Improvements to Financial Reporting by Enterprises Involved with Variable Interest Entities (ASU 2009-17), the Company consolidates the activities of variable interest entities (VIEs) of which it is the primary beneficiary. The primary beneficiary of a VIE is that variable interest holder possessing a controlling financial interest through (i) its power to direct the activities of the VIE that most significantly impact the VIE s economic performance and (ii) its obligation to absorb losses or its right to receive benefits from the VIE that could potentially be significant to the VIE. In order to determine whether the Company owns a variable interest in a VIE, the Company performs a qualitative analysis of the entity s design, organizational structure, primary decision makers and related financial agreements.

The Company s significant associated VIEs, including those for which the Company has determined it is the primary beneficiary and those for which it has determined it is not, are described below.

Grey Ranch Plant, L.P. Primarily engaged in treating and transportation of natural gas, Grey Ranch Plant, L.P. (GRLP) is a limited partnership that operates the Company s Grey Ranch plant (the Plant) located in Pecos County, Texas. The Company has long-term operating and gathering agreements with GRLP and also owns a 50% ownership interest in GRLP. Income or losses of GRLP are allocated to the partners based on ownership percentage and any operating or cash shortfalls require contributions from the partners. The Company has determined that GRLP qualifies as a VIE under the provisions of ASC Topic 810. Agreements related to the ownership and operation of GRLP provide for GRLP to pay management fees to the Company to operate the Plant and lease payments for the Plant. Under the operating agreements, lease payments are reduced if throughput volumes are below those expected. The Company has determined that it is the primary beneficiary of GRLP as it has both (i) the power to direct the activities of GRLP that most significantly impact its economic performance as operator of the Plant and (ii) the obligation to absorb losses, as a result of the operating and gathering agreements, that could potentially be significant to GRLP.

At March 31, 2011 and December 31, 2010, consolidated amounts related to GRLP included assets of $23.1 million and $21.1 million, respectively, and liabilities of $0.3 million and $0.4 million, respectively. GRLP s assets can be used to settle its own obligations and not other obligations of the Company. Although GRLP is included in the Company s consolidated financial statements, the Company s legal interest in GRLP s assets is limited to its 50% ownership. At both March 31, 2011 and December 31, 2010, $11.3 million of noncontrolling interest in the accompanying condensed consolidated balance sheets was related to GRLP. GRLP s creditors have no recourse to the general credit of the Company.

Grey Ranch Plant Genpar, LLC. The Company owns a 50% interest in Grey Ranch Plant Genpar, LLC (Genpar), the managing partner and 1% owner of GRLP. Additionally, the Company serves as Genpar s administrative manager. Genpar s ownership interest in GRLP is its only asset.

As managing partner of GRLP, Genpar has the sole right to manage, control and conduct the business of GRLP. However, Genpar is restricted from making certain major decisions, including the decision to remove the Company as operator of the Plant. The rights afforded the Company under the Plant operating agreement and the restrictions on Genpar serve to limit Genpar s ability to make decisions on behalf of GRLP. Therefore, Genpar is considered a VIE. Although both the Company and Genpar s other equity owner share equally in Genpar s economic losses and benefits and also have agreements that may be considered variable interests, the Company determined it was the primary beneficiary due to (i) its ability, as administrative manager, to direct the activities of Genpar that most significantly impact its performance and (ii) its obligation or right, as operator of the Plant, to absorb the losses of or receive benefits from Genpar that could potentially be significant to Genpar. As the primary beneficiary, the Company consolidates Genpar s activity. However, its sole asset, the investment in GRLP, is eliminated in consolidation. Genpar has no liabilities.

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Piñon Gathering Company, LLC. The Company has 20-year gas gathering and operations and maintenance agreements with Piñon Gathering Company, LLC (PGC). Under the gas gathering agreement, the Company is required to compensate PGC for any throughput shortfalls below a required minimum volume. By guaranteeing a minimum throughput, the Company absorbs the risk that lower than projected volumes will be gathered by the gathering system. Therefore, PGC is a VIE. While the Company operates the assets of PGC as directed under the operations and management agreement, the member and managers of PGC have the authority to directly control PGC and make substantive decisions regarding PGC s activities including terminating the Company as operator without cause. As the Company does not have the ability to control the activities of PGC that most significantly impact PGC s economic performance, the Company is not the primary beneficiary of PGC. Therefore, the results of PGC s activities are not consolidated into the Company s financial statements.

9. Century Plant Contract

The Company is constructing the Century Plant, a CO_2 treatment plant in Pecos County, Texas (the Century Plant), and associated compression and pipeline facilities pursuant to an agreement with Occidental Petroleum Corporation (Occidental). Under the terms of the agreement, the Company will construct the Century Plant and Occidental will pay the Company a minimum of 100% of the contract price, or $800.0 million, plus any subsequently agreed-upon revisions, through periodic cost reimbursements based upon the percentage of the project completed by the Company. The Company expects to complete the Century Plant in two phases. Upon completion of each phase of the Century Plant, Occidental will take ownership of the related assets and will operate the Century Plant for the purpose of separating and removing CO_2 from delivered natural gas. Phase I is in the commissioning process with completion and transfer of title to Occidental expected in mid 2011, and Phase II is under construction and expected to be completed in mid 2012. Pursuant to a 30-year treating agreement executed simultaneously with the construction agreement, Occidental will remove CO_2 from the Company s delivered production volumes. The Company will retain all methane gas from the natural gas it delivers to the Century Plant.

The Company accounts for construction of the Century Plant using the completed-contract method, under which contract revenues and costs are recognized when work under both phases of the contract is completed and assets have been transferred to Occidental. In the interim, costs incurred on and billings related to contracts in process are accumulated on the balance sheet. Contract gains or losses will be recorded, as development costs within the Company s oil and natural gas properties as part of the full cost pool, when it is determined that a gain or loss will be incurred. The Company has recorded an addition of $124.0 million ($105.0 million in 2010 and $19.0 million in the first quarter of 2011) to its oil and natural gas properties for the estimated loss identified based on projections of the costs to be incurred in excess of contract amounts. Billings and estimated contract loss in excess of costs incurred of $32.2 million and $31.5 million at March 31, 2011 and December 31, 2010, respectively, are reported as current liabilities in the accompanying condensed consolidated balance sheets.

10. Asset Retirement Obligation

A reconciliation of the beginning and ending aggregate carrying amounts of the asset retirement obligation for the period from December 31, 2010 to March 31, 2011 is as follows (in thousands):

Asset retirement obligation, December 31, 2010	$ 119,877
Liability incurred upon acquiring and drilling wells	1,197
Sales of reserves in place	(3,046)
Liability settled in current period	(800)
Accretion of discount expense	2,425
Asset retirement obligation, March 31, 2011	119,653
Less: current portion	25,360
Asset retirement obligation, net of current	$ 94,293

11. Long-Term Debt

Long-term debt consists of the following (in thousands):

	March 31, 2011	December 31, 2010
Senior credit facility	$ 323,500	$ 340,000
Other notes payable:		
Drilling rig fleet and related oil field services equipment		6,302
Mortgage	16,775	17,020
Senior Floating Rate Notes due 2014	350,000	350,000
8.625% Senior Notes due 2015	35,776	650,000
9.875% Senior Notes due 2016, net of $12,343 and $12,793 discount, respectively	353,157	352,707
8.0% Senior Notes due 2018	750,000	750,000
8.75% Senior Notes due 2020, net of $6,819 and $6,943 discount, respectively	443,181	443,057
7.5% Senior Notes due 2021	900,000	
Total debt	3,172,389	2,909,086
Less: current maturities of long-term debt	1,004	7,293
Long-term debt	$ 3,171,385	$ 2,901,793

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For the three-month periods ended March 31, 2011 and 2010, interest payments were approximately $53.4 million and $9.0 million, respectively. Interest paid for the three-month period ended March 31, 2011 includes $24.1 million of accrued interest paid in connection with the partial redemption of the 8.625% Senior Notes due 2015. See further discussion below.

Senior Credit Facility. The senior credit facility is available to be drawn on subject to limitations based on its terms and certain financial covenants, as described below. The senior credit facility matures on April 15, 2014.

On February 23, 2011, the senior credit facility was amended to, among other things, (a) exclude from the calculation of Consolidated Net Income the net income (or loss) of a Royalty Trust, except to the extent of cash distributions received by the Company, (b) establish that an investment in a Royalty Trust and dispositions to, and of interests in, Royalty Trusts are permitted, (c) clarify that a Royalty Trust is not a Subsidiary, (d) allow the Company to net against its calculation of Consolidated Funded Indebtedness cash balances exceeding $10.0 million in the event no loans are outstanding under the senior credit facility at that time, and (e) establish that, for any fiscal quarter ending prior to March 31, 2012, if its Senior Secured Leverage Ratio is less than 1.5:1.0 then compliance with the Company s Consolidated Leverage Ratio covenant is not required. Terms capitalized in the preceding sentence have the meaning given to them in the senior credit facility, as amended.

As of March 31, 2011, the senior credit facility contained financial covenants, including maintaining agreed levels for the (i) ratio of total funded debt to EBITDAX, which may not exceed 4.5:1.0 at each quarter end, calculated using the last four completed fiscal quarters, unless, for any quarter ending prior to March 31, 2012, the ratio of the Company s secured indebtedness to EBITDAX is less than 1.5:1.0, calculated using the last four completed fiscal quarters (in each case adjusted for annualized amounts of the post-acquisition results of operations of Arena), (ii) ratio of current assets to current liabilities, which must be at least 1.0:1.0 at each quarter end (in the current ratio calculation (as defined in the senior credit facility), any amounts available to be drawn under the senior credit facility are included in current assets, and unrealized assets and liabilities resulting from mark-to-market adjustments on the Company s derivative contracts are disregarded) and (iii) ratio of the Company s secured indebtedness to EBITDAX, which may not exceed 2.0:1.0 at each quarter end, calculated using the last four completed fiscal quarters (adjusted for annualized amounts of the post-acquisition results of operations of Arena). As of and during the three-month period ended March 31, 2011, the Company was in compliance with all of the financial covenants under the senior credit facility.

Additionally, the senior credit facility contains various covenants that limit the ability of the Company and certain of its subsidiaries to grant certain liens; make certain loans and investments; make distributions; redeem stock; redeem or prepay debt; merge or consolidate with or into a third party; or engage in certain asset dispositions, including a sale of all or substantially all of the Company s assets. Additionally, the senior credit facility limits the ability of the Company and certain of its subsidiaries to incur additional indebtedness with certain exceptions.

The obligations under the senior credit facility are guaranteed by certain Company subsidiaries and are secured by first priority liens on all shares of capital stock of each of the Company s material present and future subsidiaries; all intercompany debt of the Company; and substantially all of the Company s assets, including proved oil and natural gas reserves representing at least 80% of the discounted present value (as defined in the senior credit facility) of proved oil and natural gas reserves considered by the lenders in determining the borrowing base for the senior credit facility.

At the Company s election, interest under the senior credit facility is determined by reference to (a) the London Interbank Offered Rate (LIBOR) plus an applicable margin between 2.00% and 3.00% per annum or (b) the base rate, which is the higher of (i) the federal funds rate plus 0.5%, (ii) the prime rate published by Bank of America or (iii) the Eurodollar rate (as defined in the senior credit facility) plus 1.00% per annum, plus, in each case under scenario (b), an applicable margin between 1.00% and 2.00% per annum. Interest is payable quarterly for base rate loans and at the applicable maturity date for LIBOR loans, except that if the interest period for a LIBOR loan is six months, interest is paid at the end of each three-month period. The average annual interest rate paid on amounts outstanding under the senior credit facility was 2.73% and 2.26% for the three-month periods ended March 31, 2011 and 2010, respectively.

Borrowings under the senior credit facility may not exceed the lower of the borrowing base or the committed amount. On March 15, 2011, the borrowing base was reduced from $850.0 million to $790.0 million as a result of the issuance of the 7.5% Senior Notes due 2021, discussed below. The Company s borrowing base is redetermined in April and October of each year. With respect to each redetermination, the administrative agent and the lenders under the senior credit facility consider several factors, including the Company s proved reserves and projected cash requirements, and make assumptions regarding, among other things, oil and natural gas prices and production. Because the value of the Company s proved reserves is a key factor in determining the amount of the borrowing base, changing commodity prices and the Company s success in developing reserves may affect the borrowing base. The Company at times incurs additional costs related to the senior credit facility as a result of amendments to the credit agreement and changes to the borrowing base. During the three-month period ended March 31, 2011, additional costs of approximately $0.3 million were incurred. These costs have been deferred and are included in other assets in the accompanying condensed consolidated balance sheets.

In April 2011, the senior credit facility was amended. The amendment permits the Company to pay cash dividends on its 7.0% convertible perpetual preferred stock and reaffirms the borrowing base at $790.0 million.

At March 31, 2011, the Company had $323.5 million outstanding under the senior credit facility and $34.3 million in outstanding letters of credit, which affect the availability under the senior credit facility on a dollar-for-dollar basis.

Other Notes Payable. The Company financed a portion of its drilling rig fleet and related oil field services equipment through the issuance of notes secured by such equipment. In March 2011, the Company paid the outstanding $4.3 million principal balance on these notes and $0.1 million of accrued interest and prepayment penalties.

The debt incurred to purchase the downtown Oklahoma City property that serves as the Company s corporate headquarters is fully secured by a mortgage on one of the buildings located on the property. The note underlying the mortgage bears interest at 6.08% annually and matures on November 15, 2022. Payments of principal and interest in the amount of approximately $0.5 million are due on a quarterly basis through the maturity date.

Senior Floating Rate Notes Due 2014 and 8.625% Senior Notes Due 2015. The Company s Senior Floating Rate Notes due 2014 (the Senior Floating Rate Notes) and 8.625% Senior Notes due 2015 (the 8.625% Senior Notes) were issued in May 2008, are jointly and severally guaranteed unconditionally on an unsecured basis by certain of the Company s wholly owned subsidiaries and are freely tradable. See Note 20 for condensed financial information of the subsidiary guarantors.

The Senior Floating Rate Notes bear interest at LIBOR plus 3.625% (3.93% at March 31, 2011). Interest is payable quarterly with the principal due on April 1, 2014. The average interest rates paid on the outstanding Senior Floating Rate Notes for the three-month periods ended March 31, 2011 and 2010 were 3.93% and 3.88%, respectively, without consideration of the interest rate swap discussed below. The Company may redeem, at specified redemption prices, some or all of the Senior Floating Rate Notes at any time.

As of March 31, 2011, the Company had two $350.0 million notional interest rate swap agreements to fix the variable interest rate on the Senior Floating Rate Notes through April 1, 2013. The first interest rate swap agreement serves to fix the rate on the Senior Floating Rate Notes at an annual rate of 6.26% through April 1, 2011. The second interest rate swap agreement serves to fix the rate on the Senior Floating Rate Notes at an annual rate of 6.69% for the period from April 1, 2011 to April 1, 2013. The two interest rate swaps effectively serve to fix the Company s variable interest rate on its Senior Floating Rate Notes for the majority of the term of these notes. These swaps have not been designated as hedges.