

Midstates Petroleum Company, Inc.

Form 10-Q

November 06, 2014

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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 September 30, 2014

OR

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

For the transition period from to

Commission File Number: 001-35512

MIDSTATES PETROLEUM COMPANY, INC.

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of
incorporation or organization)

45-3691816

(I.R.S. Employer
Identification No.)

4400 Post Oak Parkway, Suite 2600

Houston, Texas

(Address of principal executive offices)

77027

(Zip Code)

(713) 595-9400

(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 ☐

Non-accelerated filer ☐

(Do not check if a smaller reporting company)

Accelerated filer ☒

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 ☒

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The number of shares outstanding of our common stock at November 4, 2014 is shown below:

Class	Number of shares outstanding
Common stock, \$0.01 par value	70,457,656

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MIDSTATES PETROLEUM COMPANY, INC.

QUARTERLY REPORT ON

FORM 10-Q

FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2014

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GLOSSARY OF OIL AND NATURAL GAS TERMS

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

Boe: Barrels of oil equivalent, with 6,000 cubic feet of natural gas being equivalent to one barrel of oil.

Boe/day: Barrels of oil equivalent per day.

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

Dry hole: A well found to be incapable of producing hydrocarbons in sufficient quantities such that proceeds from the sale of such production do not exceed production expenses and taxes.

Exploratory well: A well drilled to find a new field or to find a new reservoir in a field previously found to be productive of natural gas or oil in another reservoir.

Mcf: One thousand cubic feet of natural gas.

MMBoe: One million barrels of oil equivalent.

MMBtu: One million British thermal units.

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

NYMEX: The New York Mercantile Exchange.

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Proved reserves: Those quantities of oil and gas, which, by analysis of geoscience and engineering data, can be estimated with reasonable certainty to be economically producible from a given date forward, from known reservoirs, and under existing economic conditions, operating methods, and government regulations prior to the time at which contracts providing the right to operate expire, unless evidence indicates that renewal is reasonably certain, regardless of whether deterministic or probabilistic methods are used for the estimation. The project to extract the hydrocarbons must have commenced or the operator must be reasonably certain that it will commence the project within a reasonable time. The area of the reservoir considered as proved includes (i) the area identified by drilling and limited by fluid contacts, if any, and (ii) adjacent undrilled portions of the reservoir that can, with reasonable certainty, be judged to be continuous with it and to contain economically producible oil or gas on the basis of available geoscience and engineering data. In the absence of data on fluid contacts, proved quantities in a reservoir are limited by the lowest known hydrocarbons, as seen in a well penetration unless geoscience, engineering, or performance data and reliable technology establishes a lower contact with reasonable certainty. Where direct observation from well penetrations has defined a highest known oil elevation and the potential exists for an associated gas cap, proved oil reserves may be assigned in the structurally higher portions of the reservoir only if geoscience, engineering, or performance data and reliable technology establish the higher contact with reasonable certainty. Reserves which can be produced economically through application of improved recovery techniques (including, but not limited to, fluid injection) are included in the proved classification when (i) successful testing by a pilot project in an area of the reservoir with properties no more favorable than in the reservoir as a whole, the operation of an installed program in the reservoir or an analogous reservoir, or other evidence using reliable technology establishes the reasonable certainty of the engineering analysis on which the project or program was based; and (ii) the project has been approved for development by all necessary parties and entities, including governmental entities. Existing economic conditions include prices and costs at which economic producibility from a reservoir is to be determined. The price is the average price during the 12-month period prior to the ending date of the period covered by the report, determined as an unweighted arithmetic average of the first-day-of-the-month price for each month within such period, unless prices are defined by contractual arrangements, excluding escalations based upon future conditions.

Reasonable certainty: A high degree of confidence.

Recompletion: The process of re-entering an existing wellbore that is either producing or not producing and completing new reservoirs in an attempt to establish or increase existing production.

Reserves: Estimated remaining quantities of oil and natural gas and related substances anticipated to be economically producible as of a given date by application of development projects to known accumulations.

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

Spud or Spudding: The commencement of drilling operations of a new well.

Wellbore: The hole drilled by the bit that is equipped for oil or gas production on a completed well. Also called well or borehole.

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

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PART I - FINANCIAL INFORMATION

MIDSTATES PETROLEUM COMPANY, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)

(In thousands, except share amounts)

	September 30, 2014	December 31, 2013
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 25,717	\$ 33,163
Accounts receivable:		
Oil and gas sales	97,304	102,483
Joint interest billing	31,138	42,631
Other	11,120	1,090
Commodity derivative contracts	7,333	700
Deferred income taxes	983	11,837
Other current assets	1,256	693
Total current assets	174,851	192,597
PROPERTY AND EQUIPMENT:		
Oil and gas properties, on the basis of full-cost accounting	3,319,257	3,060,661
Other property and equipment	12,805	11,113
Less accumulated depreciation, depletion, amortization and impairment	(1,274,168)	(976,880)
Net property and equipment	2,057,894	2,094,894
OTHER ASSETS:		
Commodity derivative contracts	436	19
Other noncurrent assets	46,788	54,597
Total other assets	47,224	54,616
TOTAL	\$ 2,279,969	\$ 2,342,107
LIABILITIES AND EQUITY		
CURRENT LIABILITIES:		
Accounts payable	\$ 13,511	\$ 21,493
Accrued liabilities	233,147	204,381
Commodity derivative contracts	2,429	27,880
Total current liabilities	249,087	253,754
LONG-TERM LIABILITIES:		
Asset retirement obligations	20,935	26,308
Commodity derivative contracts	101	3,651
Long-term debt	1,669,150	1,701,150
Deferred income taxes	4,341	15,291
Other long-term liabilities	2,078	1,954
Total long-term liabilities	1,696,605	1,748,354
COMMITMENTS AND CONTINGENCIES (Note 13)		

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STOCKHOLDERS' EQUITY:

Preferred stock, \$0.01 par value, 49,675,000 shares authorized; no shares issued or outstanding

Series A mandatorily convertible preferred stock, \$0.01 par value, \$380,204 and \$358,550 liquidation value at September 30, 2014 and December 31, 2013, respectively; 8% cumulative dividends; 325,000 shares issued and outstanding

3

3

Common stock, \$0.01 par value, 300,000,000 shares authorized; 70,606,079 shares issued and 70,169,242 shares outstanding at September 30, 2014 and 68,925,745 shares issued and 68,807,043 shares outstanding at December 31, 2013

705

689

Treasury stock

(2,386)

(664)

Additional paid-in-capital

878,176

871,047

Retained deficit

(542,221)

(531,076)

Total stockholders' equity

334,277

339,999

TOTAL

\$

2,279,969

\$

2,342,107

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

Table of Contents**MIDSTATES PETROLEUM COMPANY, INC.****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS****(Unaudited)****(In thousands, except per share amounts)**

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2014	2013	2014	2013
REVENUES:				
Oil sales	\$ 125,430	\$ 119,049	\$ 372,925	\$ 268,903
Natural gas liquid sales	22,989	18,939	71,528	39,656
Natural gas sales	24,607	18,775	74,986	42,034
Gains (losses) on commodity derivative contracts - net	50,978	(45,296)	(3,162)	(42,999)
Other	757	38	1,136	941
Total revenues	224,761	111,505	517,413	308,535
EXPENSES:				
Lease operating and workover	16,965	21,784	56,813	53,230
Gathering and transportation	3,902	2,583	9,697	2,583
Severance and other taxes	5,780	8,080	19,059	20,614
Asset retirement accretion	406	421	1,335	988
Depreciation, depletion, and amortization	73,109	74,789	211,084	169,595
Impairment in carrying value of oil and gas properties			86,471	
General and administrative	9,879	13,911	34,997	40,209
Acquisition and transaction costs	1,283	194	3,894	11,686
Other	2,346	614	3,285	614
Total expenses	113,670	122,376	426,635	299,519
OPERATING INCOME (LOSS)	111,091	(10,871)	90,778	9,016
OTHER INCOME (EXPENSE):				
Interest income	10	7	29	17
Interest expense net of amounts capitalized	(34,288)	(25,950)	(102,048)	(53,438)
Total other income (expense)	(34,278)	(25,943)	(102,019)	(53,421)
INCOME (LOSS) BEFORE TAXES	76,813	(36,814)	(11,241)	(44,405)
Income tax (expense) benefit	(2,216)	13,208	96	16,188
NET INCOME (LOSS)	\$ 74,597	\$ (23,606)	\$ (11,145)	\$ (28,217)
Preferred stock dividend	(1,908)	(2,569)	(9,334)	(9,254)
Participating securities - Series A Preferred Stock	(23,973)			
Participating securities - Non-vested Restricted Stock	(2,524)			

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**NET INCOME (LOSS) ATTRIBUTABLE
TO COMMON SHAREHOLDERS**

	\$	46,192	\$	(26,175)	\$	(20,479)	\$	(37,471)
Basic and diluted net income (loss) per share attributable to common shareholders	\$	0.69	\$	(0.40)	\$	(0.31)	\$	(0.57)
Basic and diluted weighted average number of common shares outstanding		66,598		65,821		66,340		65,740

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

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MIDSTATES PETROLEUM COMPANY, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

(Unaudited)

(In thousands)

	Series A Preferred Stock	Common Stock	Treasury Stock	Additional Paid-in- Capital	Retained Deficit/ Accumulated Loss	Total Stockholders Equity
Balance as of December 31, 2013	\$ 3	\$ 689	\$ (664)	\$ 871,047	\$ (531,076)	\$ 339,999
Share-based compensation		16		7,129		7,145
Acquisition of treasury stock			(1,722)			(1,722)
Net loss					(11,145)	(11,145)
Balance as of September 30, 2014	\$ 3	\$ 705	\$ (2,386)	\$ 878,176	\$ (542,221)	\$ 334,277

	Series A Preferred Stock	Common Stock	Treasury Stock	Additional Paid-in- Capital	Retained Deficit/ Accumulated Loss	Total Stockholders Equity
Balance as of December 31, 2012	\$ 3	\$ 666	\$	\$ 863,891	\$ (187,091)	\$ 677,469
Share-based compensation		20		6,048		6,068
Acquisition of treasury stock			(605)			(605)
Net loss					(28,217)	(28,217)
Balance as of September 30, 2013	\$ 3	\$ 686	\$ (605)	\$ 869,939	\$ (215,308)	\$ 654,715

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

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MIDSTATES PETROLEUM COMPANY, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(In thousands)

	Nine Months Ended September 30,	
	2014	2013
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	\$ (11,145)	\$ (28,217)
<i>Adjustments to reconcile net loss to net cash provided by operating activities:</i>		
Losses on commodity derivative contracts net	3,162	42,999
Net cash paid for commodity derivative contracts not designated as hedging instruments	(39,213)	(16,002)
Asset retirement accretion	1,335	988
Depreciation, depletion, and amortization	211,084	169,595
Impairment in carrying value of oil and gas properties	86,471	
Share-based compensation, net of amounts capitalized to oil and gas properties	5,358	4,921
Deferred income taxes	(96)	(16,188)
Amortization of deferred financing costs	6,018	4,156
<i>Change in operating assets and liabilities:</i>		
Accounts receivable oil and gas sales	5,179	(52,598)
Accounts receivable JIB and other	10,551	(13,544)
Other current and noncurrent assets	1,815	(2,622)
Accounts payable	503	(3,027)
Accrued liabilities	30,921	89,666
Other	124	(186)
Net cash provided by operating activities	\$ 312,067	\$ 179,941
CASH FLOWS FROM INVESTING ACTIVITIES:		
Investment in property and equipment	(435,363)	(437,521)
Investment in acquired property		(621,748)
Proceeds from the sale of oil and gas properties	150,530	
Net cash used in investing activities	\$ (284,833)	\$ (1,059,269)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from long-term borrowings	99,000	946,450
Repayment of long-term borrowings	(131,000)	(34,300)
Deferred financing costs	(958)	(26,142)
Acquisition of treasury stock	(1,722)	(605)
Net cash (used in) provided by financing activities	\$ (34,680)	\$ 885,403
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(7,446)	6,075
Cash and cash equivalents, beginning of period	\$ 33,163	\$ 18,878
Cash and cash equivalents, end of period	\$ 25,717	\$ 24,953

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SUPPLEMENTAL INFORMATION:

Non-cash transactions investments in property and equipment accrued - not paid	\$	98,000	\$	100,500
Cash paid for interest, net of capitalized interest of \$10.5 million and \$24.6 million, respectively		63,538		11,671

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

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MIDSTATES PETROLEUM COMPANY, INC.

Notes to Unaudited Condensed Consolidated Financial Statements

1. Organization and Business

Midstates Petroleum Company, Inc., through its wholly owned subsidiary Midstates Petroleum Company LLC, engages in the business of drilling for, and production of, oil, natural gas liquids (NGL) and natural gas. Midstates Petroleum Company, Inc. was incorporated pursuant to the laws of the State of Delaware on October 25, 2011 to become a holding company for Midstates Petroleum Company LLC (Midstates Sub), which was previously a wholly owned subsidiary of Midstates Petroleum Holdings LLC (Holdings LLC). Pursuant to the terms of a corporate reorganization that was completed in connection with the closing of Midstates Petroleum Company, Inc.'s initial public offering on April 25, 2012, all of the interests in Midstates Petroleum Holdings LLC were exchanged for newly issued common shares of Midstates Petroleum Company, Inc., and as a result, Midstates Petroleum Company LLC became a wholly owned subsidiary of Midstates Petroleum Company, Inc. and Midstates Petroleum Holdings LLC ceased to exist as a separate entity. The terms Company, we, us, our, and similar terms when used in the present tense, prospectively or for historical periods since April 25, 2012, refer to Midstates Petroleum Company, Inc. and its subsidiary, and for historical periods prior to April 25, 2012, refer to Midstates Petroleum Holdings LLC and its subsidiary, unless the context indicates otherwise. The term Holdings LLC refers solely to Midstates Petroleum Holdings LLC prior to the corporate reorganization.

On May 31, 2013, the Company closed on the acquisition of producing properties and undeveloped acreage in the Anadarko Basin in Texas and Oklahoma from Panther Energy Company, LLC and its partners for approximately \$618 million in cash (the Anadarko Basin Acquisition), before customary post-closing adjustments. The Company funded the purchase price with a portion of the net proceeds from the private placement of \$700 million in aggregate principal amount of 9.25% senior unsecured notes due 2021, which also closed on May 31, 2013 (2021 Senior Notes).

On March 5, 2014, the Company executed a Purchase and Sale Agreement (PSA) to sell all of its ownership interest in developed and undeveloped acreage in the Pine Prairie field area of Evangeline Parish, Louisiana to a private buyer for a purchase price of \$170 million in cash, subject to standard post-closing adjustments (the Pine Prairie Disposition). The PSA had an effective date of November 1, 2013. Acreage subject to the transaction did not include acreage and production in the western part of Louisiana in Beauregard or Calcasieu Parishes or other undeveloped acreage held outside the Pine Prairie field. The sale closed on May 1, 2014.

The Company has oil and gas operations and properties in Oklahoma, Texas and Louisiana. At September 30, 2014, the Company operated oil and natural gas properties as one reportable segment engaged in the exploration, development and production of oil, natural gas liquids and natural gas. The Company's management evaluated performance based on one reportable segment as there were not significantly different economic or operational environments within its oil and natural gas properties.

2. Summary of Significant Accounting Policies

Basis of Presentation

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These interim financial statements are unaudited and have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (SEC) regarding interim financial reporting. Certain disclosures have been condensed or omitted from these financial statements. Accordingly, they do not include all of the information and notes required by accounting principles generally accepted in the United States of America (GAAP) for complete consolidated financial statements, and should be read in conjunction with the audited consolidated financial statements and notes thereto for the year ended December 31, 2013 included in the Company's Annual Report on Form 10-K as filed with the SEC on March 24, 2014.

All intercompany transactions have been eliminated in consolidation. In the opinion of the Company's management, the accompanying unaudited condensed consolidated financial statements include all adjustments, consisting of normal recurring adjustments, necessary to fairly present the financial position as of, and the results of operations for, all periods presented. In preparing the accompanying condensed consolidated financial statements, management has made certain estimates and assumptions that affect reported amounts in the condensed consolidated financial statements and disclosures of contingencies. Actual results may differ from those estimates. The results for interim periods are not necessarily indicative of annual results.

Recent Accounting Pronouncements

The Company reviewed recently issued accounting pronouncements that became effective during the nine months ended September 30, 2014, and determined that none would have a material impact on the Company's condensed consolidated financial statements, with the exception of ASU 2014-09, Revenue from Contracts with Customers and ASU 2014-15, Presentation of Financial Statements - Going Concern, (both effective for annual reporting periods beginning after December 15, 2016), which the Company is still evaluating.

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3. Fair Value Measurements of Financial Instruments

Assets and Liabilities Measured at Fair Value on a Recurring Basis

Derivative Instruments

Commodity derivative contracts reflected in the condensed consolidated balance sheets are recorded at estimated fair value. At September 30, 2014 and December 31, 2013, all of the Company's commodity derivative contracts were with seven bank counterparties and were classified as Level 2 in the fair value input hierarchy.

Derivative instruments listed below are presented gross and include collars and swaps that are carried at fair value. The Company records the net change in the fair value of these positions in Gains (losses) on commodity derivative contracts net in the Company's unaudited condensed consolidated statements of operations. See Note 4 for additional information on the Company's derivative instruments and balance sheet presentation.

Fair Value Measurements at September 30, 2014				
	Quoted Prices in Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
	(in thousands)			
Assets:				
Commodity derivative oil swaps	\$	\$ 6,557	\$	\$ 6,557
Commodity derivative gas swaps		2,421		2,421
Commodity derivative oil collars		30		30
Commodity derivative gas collars		15		15
Commodity derivative differential swaps		221		221
Total assets	\$	\$ 9,244	\$	\$ 9,244
Liabilities:				
Commodity derivative oil swaps	\$	\$ 3,924	\$	\$ 3,924
Commodity derivative gas swaps		75		75
Commodity derivative gas collars		6		6
Total liabilities	\$	\$ 4,005	\$	\$ 4,005

Fair Value Measurements at December 31, 2013				
	Quoted Prices in Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
	(in thousands)			

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Assets:					
Commodity derivative NGL swaps	\$	\$	469	\$	\$ 469
Commodity derivative gas swaps			488		488
Commodity derivative oil collars			64		64
Commodity derivative gas collars			751		751
Commodity derivative differential swaps			806		806
Total assets	\$	\$	2,578	\$	\$ 2,578

Liabilities:					
Commodity derivative oil swaps	\$	\$	32,209	\$	\$ 32,209
Commodity derivative NGL swaps			74		74
Commodity derivative gas swaps			809		809
Commodity derivative oil collars			272		272
Commodity derivative gas collars			26		26
Total liabilities	\$	\$	33,390	\$	\$ 33,390

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4. Risk Management and Derivative Instruments

The Company's production is exposed to fluctuations in crude oil, NGL and natural gas prices. The Company believes it is prudent to manage the variability in cash flows by entering into derivative financial instruments to economically hedge a portion of its crude oil, NGL and natural gas production. The Company utilizes various types of derivative financial instruments, including swaps and collars, to reduce fluctuations in cash flows resulting from changes in commodity prices. These derivative contracts are placed with major financial institutions that the Company believes are minimal credit risks. The oil, NGL and natural gas reference prices, upon which the commodity derivative contracts are based, reflect various market indices that management believes have a high degree of historical correlation with actual prices received by the Company for its crude oil, NGL and natural gas production.

Inherent in the Company's portfolio of commodity derivative contracts are certain business risks, including market risk and credit risk. Market risk is the risk that the price of the commodity will change, either favorably or unfavorably, in response to changing market conditions. Credit risk is the risk of loss from nonperformance by the Company's counterparty to a contract. The Company does not require collateral from its counterparties but does attempt to minimize its credit risk associated with derivative instruments by entering into derivative instruments only with counterparties that are large financial institutions, which management believes present minimal credit risk. In addition, to mitigate its risk of loss due to default, the Company has entered into agreements with its counterparties on its derivative instruments that allow the Company to offset its asset position with its liability position in the event of default by the counterparty. Due to the netting arrangements, had the Company's counterparties failed to perform under existing commodity derivative contracts, the maximum loss at September 30, 2014 would have been approximately \$7.8 million.

Commodity Derivative Contracts

As of September 30, 2014, the Company had the following open commodity derivative contract positions:

		Hedged Volume	Weighted-Average Fixed Price
Oil (Bbls):			
WTI Swaps	2014	1,097,000	\$ 89.04
WTI Swaps	2015	2,908,000	\$ 89.42
WTI Collars	2014	40,200	\$ 86.49 - \$ 97.71