Midstates Petroleum Company, Inc.
Form 10-Q
November 14, 2013
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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, 2013

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 1900 **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 x No o

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 x No o

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 o	Accelerated filer o
Non-accelerated filer x (Do not check if a smaller reporting company)	Smaller reporting company o

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

The number of shares outstanding of our common stock at November 11, 2013 is shown below:

Class	**Number of shares outstanding**
Common stock, $0.01 par value	68,406,750

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MIDSTATES PETROLEUM COMPANY, INC.

QUARTERLY REPORT ON

FORM 10-Q

FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2013

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

Boe/d: 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.

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.

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, 2013	December 31, 2012
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 24,953	$ 18,878
Accounts receivable:		
Oil and gas sales	88,216	35,618
Joint interest billing	28,985	10,815
Other	2,844	3,866
Commodity derivative contracts	3,783	5,695
Deferred income taxes	16,196	6,027
Other current assets	691	8,573
Total current assets	165,668	89,472
PROPERTY AND EQUIPMENT:		
Oil and gas properties, on the basis of full-cost accounting	2,914,422	1,836,664
Other property and equipment	10,029	5,038
Less accumulated depreciation, depletion, and amortization	(443,852)	(274,294)
Net property and equipment	2,480,599	1,567,408
OTHER ASSETS:		
Commodity derivative contracts	300	1,717
Other noncurrent assets	57,903	25,413
Total other assets	58,203	27,130
TOTAL	**$ 2,704,470**	**$ 1,684,010**
LIABILITIES AND EQUITY		
CURRENT LIABILITIES:		
Accounts payable	$ 34,686	$ 29,196
Accrued liabilities	198,695	98,649
Commodity derivative contracts	28,463	7,582
Total current liabilities	261,844	135,427
LONG-TERM LIABILITIES:		
Asset retirement obligations	23,178	15,245
Commodity derivative contracts	6,730	3,943
Long-term debt	1,606,150	694,000
Deferred income taxes	149,991	156,737
Other long-term liabilities	1,862	1,189
Total long-term liabilities	1,787,911	871,114

COMMITMENTS AND CONTINGENCIES (Note 13)				
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, $351,520 and $325,000 liquidation value at September 30, 2013 and December 31, 2012, respectively; 8% cumulative dividends; 325,000 shares issued and outstanding		3		3
Common stock, $0.01 par value, 300,000,000 shares authorized; 68,686,256 shares issued and 68,579,198 outstanding at September 30, 2013 and 66,619,711 shares issued and outstanding at December 31, 2012		686		666
Treasury stock		(605)		
Additional paid-in-capital		869,939		863,891
Retained deficit		(215,308)		(187,091)
Total stockholders equity		654,715		677,469
TOTAL	**$**	**2,704,470**	**$**	**1,684,010**

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 OPERATIONS

(Unaudited)

(In thousands, except per share amounts)

	For the Three Months Ended September 30, 2013	For the Three Months Ended September 30, 2012	For the Nine Months Ended September 30, 2013	For the Nine Months Ended September 30, 2012
REVENUES:				
Oil sales	$ 119,049	$ 53,143	$ 268,903	$ 146,281
Natural gas liquid sales	18,939	4,134	39,656	14,307
Natural gas sales	18,775	2,257	42,034	8,086
Losses on commodity derivative contracts net	(45,296)	(33,726)	(42,999)	(10,249)
Other	38	124	941	331
Total revenues	111,505	25,932	308,535	158,756
EXPENSES:				
Lease operating and workover	21,784	6,569	53,230	18,957
Gathering and transportation	2,583		2,583	
Severance and other taxes	8,080	6,450	20,614	18,098
Asset retirement accretion	421	165	988	463
Depreciation, depletion, and amortization	74,789	30,692	169,595	86,601
General and administrative	13,911	7,948	40,209	18,966
Acquisition and transaction costs	194	2,675	11,686	2,675
Other	614		614	
Total expenses	122,376	54,499	299,519	145,760
OPERATING INCOME (LOSS)	(10,871)	(28,567)	9,016	12,996
OTHER INCOME (EXPENSE)				
Interest income	7	80	17	229
Interest expense net of amounts capitalized	(25,950)	(908)	(53,438)	(3,587)
Total other income (expense)	(25,943)	(828)	(53,421)	(3,358)
INCOME (LOSS) BEFORE TAXES	(36,814)	(29,395)	(44,405)	9,638
Income tax benefit (expense)	13,208	11,592	16,188	(157,326)
NET LOSS	$ (23,606)	$ (17,803)	$ (28,217)	$ (147,688)
Preferred stock dividend (Note 10)	(2,569)		(9,254)	
Participating securities - Series A Preferred Stock				
Participating securities - Non-vested Restricted Stock				
NET LOSS ATTRIBUTABLE TO COMMON SHAREHOLDERS	$ (26,175)	$ (17,803)	$ (37,471)	$ (147,688)

Basic and diluted net loss per share attributable to common shareholders	$	(0.40)	$	(0.27)	$	(0.57)	$	(2.54)
Basic and diluted weighted average number of common shares outstanding		65,821		65,634		65,740		58,080

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

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MIDSTATES PETROLEUM COMPANY, INC.

CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS EQUITY

(Unaudited)

(See Note 10 for Share History)

(In thousands)

	Series A Preferred Stock	Common Stock	Treasury Stock	Additional Paid-in-Capital	Retained Deficit	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, 2013		Nine Months Ended September 30, 2012	
CASH FLOWS FROM OPERATING ACTIVITIES:				
Net loss	$	(28,217)	$	(147,688)
Adjustments to reconcile net loss to net cash provided by operating activities:				
Unrealized losses (gains) on commodity derivative contracts, net		26,997		(5,591)
Asset retirement accretion		988		463
Depreciation, depletion, and amortization		169,595		86,601
Share - based compensation, net of amounts capitalized to oil and gas properties		4,921		1,568
Deferred income taxes		(16,188)		157,326
Amortization of deferred financing costs		4,156		583
Change in operating assets and liabilities:				
Accounts receivable oil and gas sales		(52,598)		1,193
Accounts receivable JIB and other		(13,544)		2,954
Other current and noncurrent assets		(2,622)		(3,547)
Accounts payable		(3,027)		(1,211)
Accrued liabilities		89,666		2,151
Other		(186)		(122)
Net cash provided by operating activities	$	179,941	$	94,680
CASH FLOWS FROM INVESTING ACTIVITIES:				
Investment in property and equipment		(437,521)		(284,875)
Investment in acquired property		(621,748)		
Net cash used in investing activities	$	(1,059,269)	$	(284,875)
CASH FLOWS FROM FINANCING ACTIVITIES:				
Proceeds from long - term borrowings		946,450		84,667
Repayment of long - term borrowings		(34,300)		(103,167)
Proceeds from issuance of mandatorily redeemable convertible preferred units				65,000
Repayment of mandatorily redeemable convertible preferred units				(65,000)
Proceeds from sale of common stock, net of initial public offering expenses of $6.4 million				213,587
Deferred financing costs		(26,142)		(7,562)
Acquisition of treasury stock		(605)		
Net cash provided by financing activities	$	885,403	$	187,525
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS		6,075		(2,670)
Cash and cash equivalents, beginning of period		18,878		7,344

Cash and cash equivalents, end of period	$	24,953	$	4,674
SUPPLEMENTAL INFORMATION:				
Non - cash transactions investments in property and equipment accrued not paid	$	100,500	$	90,614
Cash paid for interest, net of capitalized interest of $24.6 million and $3.2 million, respectively		11,671		3,176

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 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 the Company, we, us, our, and similar terms when used i 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 October 1, 2012, the Company closed on the acquisition of all of Eagle Energy Production, LLC s producing properties as well as its developed and undeveloped acreage primarily in the Mississippian Lime liquids play in Oklahoma and Kansas for $325 million in cash and 325,000 shares of the Company s Series A Preferred Stock with an initial liquidation preference value of $1,000 per share (the Eagle Property Acquisition). The Company funded the cash portion of the Eagle Property Acquisition purchase price with a portion of the net proceeds from the private placement of $600 million in aggregate principal amount of 10.75% senior unsecured notes due 2020, which also closed on October 1, 2012.

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). 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.

Subsequent to the closing of the Eagle Property Acquisition and the Anadarko Basin Acquisition, the Company has oil and gas operations and properties in Louisiana, Oklahoma, Texas and Kansas. At September 30, 2013, 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

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, 2012 included in the Company s Annual Report on Form 10-K as filed with the SEC on March 21, 2013.

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, 2013, and determined that none would have a material impact on the Company s condensed consolidated financial statements with the exception of the adoption of ASU 2011-11, Disclosures About Offsetting Assets and Liabilities , which the Company adopted on January 1, 2013 and applies to the disclosures regarding commodity derivative contracts discussed in Note 4.

Correction of the 2012 Net Deferred Tax Liability

In the third quarter of 2013, the Company determined that its 2012 accounting for the tax impacts of the merger of certain entities that occurred in connection with the Company s initial public offering was in error. The Company identified that certain tax attributes acquired from the merged entities were not properly identified. Because the tax attributes were acquired as a result of a merger of entities under common control, the impacts of these tax attributes should have been recorded through equity at the time the Company became a taxable entity.

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To correct the 2012 tax error, the Company has restated the accompanying Condensed Consolidated Balance Sheet as of December 31, 2012. There was no impact to the Condensed Consolidated Statement of Operations for the year ended December 31, 2012, the three and nine months ended September 30, 2012, or the Condensed Consolidated Statement of Cash Flows for the nine months ended September 30, 2012. The impact of the correction is shown in the table below (in thousands):

	December 31, 2012	
Balance Sheet	**As Previously Reported**	**As Restated**
Deferred income taxes	$ 190,625	$ 156,737
Total long-term liabilities	905,002	871,114
Additional paid-in-capital	830,003	863,891
Total stockholders equity	643,581	677,469

3. Fair Value Measurements of Financial Instruments

The Company uses a valuation framework based upon inputs that market participants use in pricing an asset or liability, which are classified into two categories: observable inputs and unobservable inputs. Observable inputs represent market data obtained from independent sources; whereas, unobservable inputs reflect a company s own market assumptions, which are used if observable inputs are not reasonably available without undue cost and effort. These two types of inputs are further divided into the following fair value input hierarchy:

- **Level 1** Inputs are unadjusted quoted prices in active markets for identical assets or liabilities at the measurement date.

- **Level 2** Inputs, other than quoted prices included in Level 1, are observable for the asset or liability, either directly or indirectly. Level 2 inputs include quoted prices for similar instruments in active markets, and inputs other than quoted prices that are observable for the asset or liability. Fair value assets and liabilities that are generally included in this category are commodity derivative contracts with fair values based on inputs from actively quoted markets. The Company uses a discounted cash flow approach to estimate the fair values of its commodity derivative contracts, utilizing commodity futures price strips for the underlying commodities provided by a reputable third-party. The Company also factors the credit standing of its derivative contract counterparties into the valuation to account for the possible risk of nonperformance.

- **Level 3** Inputs are unobservable for the asset or liability, and include situations where there is little, if any, market activity for the asset or liability.

Assets and liabilities 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, and may affect the valuation of the fair value of assets and liabilities and their placement within the fair value hierarchy levels.

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, 2013 and December 31, 2012, all of the Company s commodity derivative contracts were with nine and five bank counterparties, respectively, and were classified as Level 2.

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.

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	Fair Value Measurements at September 30, 2013			
	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	$	$ 4,432	$	$ 4,432
Commodity derivative NGL swaps		1,345		1,345
Commodity derivative gas swaps		4,294		4,294
Commodity derivative oil collars		68		68
Commodity derivative gas collars		1,349		1,349
Commodity derivative differential swaps		1,254		1,254
Total assets	$	$ 12,742	$	$ 12,742
Liabilities:				
Commodity derivative oil swaps	$	$ 43,079	$	$ 43,079
Commodity derivative NGL swaps		54		54
Commodity derivative oil collars		496		496
Commodity derivative gas collars		21		21
Commodity derivative differential swaps		202		202
Total liabilities	$	$ 43,852	$	$ 43,852

	Fair Value Measurements at December 31, 2012			
	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	$	$ 16,133	$	$ 16,133
Commodity derivative NGL swaps		2,353		2,353
Commodity derivative oil collars		428		428
Commodity derivative gas collars		2,026		2,026
Commodity derivative differential swaps		2,661		2,661
Total assets	$	$ 23,601	$	$ 23,601
Liabilities:				
Commodity derivative oil swaps	$	$ 15,091	$	$ 15,091
Commodity derivative NGL swaps		458		458
Commodity derivative oil collars		287		287
Commodity derivative gas collars		185		185
Commodity derivative differential swaps		11,693		11,693
Total liabilities	$	$ 27,714	$	$ 27,714

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

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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, 2013 would have been approximately $4.1 million.

Commodity Derivative Contracts

As of September 30, 2013, the Company had the following open commodity derivative contract positions:

	Hedged Volume	Weighted-Average Fixed Price			
Oil (Bbls):					
WTI Swaps 2013	1,086,120				$ 94.32
WTI Swaps 2014	4,344,450				$ 88.76
WTI Swaps 2015	1,820,000				$ 86.55
WTI Collars 2013	50,751	$	85.27	-	$ 100.70
WTI Collars 2014	164,400	$	88.49	-	$ 97.94
WTI to LLS Basis Differential Swaps 2013 (1)	330,760				$ 5.80
WTI to LLS Basis Differential Swaps 2014 (1)	501,000				$ 5.35
Natural Gas (Mmbtu):					
Swaps 2013 (2)	3,680,000				$ 4.09
Swaps 2014	9,125,000				$ 4.23
Collars 2013	558,249	$	3.68	-	$ 4.91
Collars 2014	1,685,004	$	3.99	-	$ 5.09
NGL (Bbls):					
NGL Swaps 2013	64,500				$ 63.42
NGL Swaps 2014	151,500				$ 62.16

(1) The Company enters into swap arrangements intended to fix the positive differential between the Louisiana Light Sweet (LLS) pricing and West Texas Intermediate (NYMEX WTI) pricing.

(2) Includes 1,240,000 Mmbtu that priced in the third quarter of 2013, but have yet to be cash settled as of September 30, 2013.

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Balance Sheet Presentation

The following table summarizes the gross fair values of derivative instruments by the appropriate balance sheet classification, even when the derivative instruments are subject to netting arrangements and qualify for net presentation in the Company s unaudited condensed consolidated balance sheets at September 30, 2013 and December 31, 2012, respectively (in thousands):

Type	Balance Sheet Location (1)		September 30, 2013	December 31, 2012
Oil Swaps	Derivative financial instruments	Current Assets	$ 4,405	$ 16,004
Oil Swaps	Derivative financial instruments	Non-Current Assets	27	129
Oil Swaps	Derivative financial instruments	Current Liabilities	(35,941)	(11,485)
Oil Swaps	Derivative financial instruments	Non-Current Liabilities	(7,138)	(3,606)
NGL Swaps	Derivative financial instruments	Current Assets	1,345	1,624
NGL Swaps	Derivative financial instruments	Non-Current Assets		729
NGL Swaps	Derivative financial instruments	Current Liabilities	(54)	(336)
NGL Swaps	Derivative financial instruments	Non-Current Liabilities		(122)
Gas Swaps	Derivative financial instruments	Current Assets	3,746	
Gas Swaps	Derivative financial instruments	Non-Current Assets	548	
Oil Collars	Derivative financial instruments	Current Assets	28	221
Oil Collars	Derivative financial instruments	Non-Current Assets	40	207
Oil Collars	Derivative financial instruments	Current Liabilities	(460)	(238)
Oil Collars	Derivative financial instruments	Non-Current Liabilities	(36)	(49)
Gas Collars	Derivative financial instruments	Current Assets	1,308	1,129
Gas Collars	Derivative financial instruments	Non-Current Assets	41	897
Gas Collars	Derivative financial instruments	Current Liabilities	(18)	(112)
Gas Collars	Derivative financial instruments	Non-Current Liabilities	(3)	(73)
Basis Differential Swaps	Derivative financial instruments	Current Assets	1,163	2,625
Basis Differential Swaps	Derivative financial instruments	Non-Current Assets	91	36
Basis Differential Swaps	Derivative financial instruments	Current Liabilities	(202)	(11,319)
Basis Differential Swaps	Derivative financial instruments	Non-Current Liabilities		(374)
Total			$ (31,110)	$ (4,113)

(1) The fair values of commodity derivative instruments reported in the Company s condensed consolidated balance sheets are subject to netting arrangements and qualify for net presentation. The following table summarizes the location and fair value amounts of all derivative instruments in the unaudited condensed consolidated balance sheets, as well as the gross recognized derivative assets, liabilities and amounts offset in the unaudited condensed consolidated balance sheets at September 30, 2013 and December 31, 2012, respectively (in thousands):

		September 30, 2013		
Not Designated as ASC 815 Hedges:	Balance Sheet Classification	Gross Recognized Assets/ Liabilities	Gross Amounts Offset	Net Recognized Fair Value Assets/ Liabilities
Derivative assets:				
Commodity contracts	Derivative financial instruments - current	$ 11,995	$ 8,212	$ 3,783
Commodity contracts	Derivative financial instruments - noncurrent	747	447	300
		$ 12,742	$ 8,659	$ 4,083
Derivative liabilities:				
Commodity contracts	Derivative financial instruments - current	$ 36,675	$ 8,212	$ 28,463
Commodity contracts	Derivative financial instruments - noncurrent	7,177	447	6,730

		$ 43,852	$ 8,659	$ 35,193

		December 31, 2012		
Not Designated as ASC 815 Hedges:	**Balance Sheet Classification**	**Gross Recognized Assets/ Liabilities**	**Gross Amounts Offset**	**Net Recognized Fair Value Assets/ Liabilities**
Derivative assets:				
Commodity contracts	Derivative financial instruments - current	$ 21,603	$ 15,908	$ 5,695
Commodity contracts	Derivative financial instruments - noncurrent	1,998	281	1,717
		$ 23,601	$ 16,189	$ 7,412
Derivative liabilities:				
Commodity contracts	Derivative financial instruments - current	$ 23,490	$ 15,908	$ 7,582
Commodity contracts	Derivative financial instruments - noncurrent	4,224	281	3,943
		$ 27,714	$ 16,189	$ 11,525

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Gains (losses) on Commodity Derivative Contracts

The Company does not designate its commodity derivative contracts as hedging instruments for financial reporting purposes. Accordingly, commodity derivative contracts are marked-to-market each quarter with the change in fair value during the periodic reporting period recognized currently as a gain or loss in Losses on commodity derivative contracts - net within revenues in the unaudited condensed consolidated statements of operations. Realized gains and losses represent the actual settlements under commodity derivative contracts that require making a payment to or receiving a payment from the counterparty, as well as any deferred premiums payable to the counterparty upon contract settlement. During the three and nine months ended September 30, 2012, the Company paid deferred premiums of $0.8 million and $2.5 million related to put options covering a total of 138,000 and 411,000 barrels of crude oil, respectively.

The following table presents realized net losses and unrealized net (losses) gains recorded by the Company related to the change in fair value of the derivative instruments in Gains (losses) on commodity derivative contracts net for the periods presented:

	For the Three Months Ended September 30, 2013	2012	For the Nine Months Ended September 30, 2013	2012
	(in thousands)			
Realized net losses	$ (9,927)	$ (4,160)	$ (16,002)	$ (15,840)
Unrealized net (losses) gains	(35,369)	(29,566)	(26,997)	5,591

5. Property and Equipment

	September 30, 2013	December 31, 2012
	(in thousands)	
Oil and gas properties, on the basis of full-cost accounting:		
Proved properties	$ 2,488,680	$ 1,522,723
Unevaluated properties	425,742	313,941
Other property and equipment	10,029	5,038
Less accumulated depreciation, depletion, and amortization	(443,852)	(274,294)
Net property and equipment	$ 2,480,599	$ 1,567,408

Oil and Gas Properties

For the three and nine months ended September 30, 2013, the Company capitalized $2.9 million and $6.2 million, respectively, of internal costs directly related to exploration and development activities to oil and gas properties. Note that these amounts are inclusive of $0.5 million and $1.1 million of qualifying share based compensation expense (as discussed in Note 10) for the three and nine months ended September 30, 2013, respectively.

For the three and nine months ended September 30, 2012, the Company capitalized $0.5 million and $0.9 million, respectively, of internal costs to oil and gas properties. Note that these amounts are inclusive of $0.1 million and $0.1 million of qualifying share based compensation expense (as discussed in Note 10) for the three and nine months ended September 30, 2012, respectively.

The Company accounts for its oil and gas properties under the full cost method. Under the full cost method, proceeds from the sale or disposition of oil and gas properties are accounted for as a reduction to capitalized costs unless a significant portion of the Company s reserve quantities are sold that results in a significant alteration of the relationship between capitalized costs and remaining proved reserves, in which case a gain or loss is generally recognized in income.

The Company performs a ceiling test on a quarterly basis. The test establishes a limit (ceiling) on the book value of oil and gas properties. The capitalized costs of oil and gas properties, net of accumulated DD&A and the related deferred income taxes, may not exceed this ceiling. The ceiling limitation is equal to the sum of: (i) the present value of estimated future net revenues from the projected production of proved oil and gas reserves, excluding future cash outflows associated with settling asset retirement obligations (ARO) accrued on the balance sheet, calculated using the average oil and natural gas sales price received by the Company as of the first trading day of each month over the preceding twelve months (such prices are held constant throughout the life of the properties) and a discount factor of 10%; (ii) the cost of unproved and unevaluated properties excluded from the costs being amortized; (iii) the lower of cost or estimated fair value of unproved properties included in the costs being amortized; and (iv) related income tax effects. If capitalized costs exceed this ceiling, the excess is charged to expense in the accompanying consolidated statements of operations.

At September 30, 2013 and 2012, capitalized costs did not exceed the ceiling, and no impairment to oil and gas properties was required; however, the Company s ceiling test calculation at September 30, 2013 indicated the Company s capitalized costs were within 5% of the ceiling.

Depreciation, depletion and amortization is calculated using the Units of Production Method (UOP). The UOP calculation multiplies the percentage of estimated proved reserves produced by the cost of those reserves. The result is to recognize expense at the same pace that the reservoirs are estimated to be depleting. The amortization base in the UOP calculation includes the sum of proved property costs net of accumulated

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depreciation, depletion and amortization (DD&A), estimated future development costs (future costs to access and develop proved reserves) and asset retirement costs that are not already included in oil and gas property, less related salvage value. The following table presents depletion expense related to oil and gas properties for the three and nine months ended September 30, 2013 and 2012:

	For the Three Months Ended September 30, 2013		For the Three Months Ended September 30, 2012		For the Nine Months Ended September 30, 2013		For the Nine Months Ended September 30, 2012	
Depletion expense (in thousands)	$	74,345	$	30,571	$	168,190	$	86,303
Depletion expense (per Boe)	$	28.39	$	40.60	$	28.68	$	38.79

Oil and gas unevaluated properties and properties under development include costs that are not being depleted or amortized. These costs represent investments in unproved properties. The Company excludes these costs until proved reserves are found, until it is determined that the costs are impaired or until major development projects are placed in service, at which time the costs are moved into oil and natural gas properties subject to amortization. All unproved property costs are reviewed at least quarterly to determine if impairment has occurred. Unevaluated property was $425.7 million at September 30, 2013 compared to $313.9 million at December 31, 2012, increasing primarily due to the Anadarko Basin Acquisition which is discussed further below.

Other Property and Equipment

Other property and equipment consists of vehicles, furniture and fixtures, and computer hardware and software and are carried at cost. Depreciation is calculated principally using the straight-line method over the estimated useful lives of the assets, which range from five to seven years. Maintenance and repairs are charged to expense as incurred, while renewals and betterments are capitalized.

Eagle Property Acquisition October 2012

On October 1, 2012, the Company closed on the Eagle Property Acquisition. The assets acquired include certain interests in producing oil and natural gas assets and unevaluated leasehold acreage in Oklahoma and Kansas and related hedging instruments. The Company s results from operations include the results from the properties acquired in the Eagle Property Acquisition beginning October 1, 2012. The fair value of, and the allocation to, the assets acquired and liabilities assumed in the Eagle Property Acquisition, has been finalized and is shown in the following table (in thousands):

	Eagle Property Acquisition	
Oil and gas properties:		
Proved	$	419,549
Unevaluated		244,236
Commodity derivative contracts		8,453
Total assets acquired	**$**	**672,238**

Asset retirement obligations		2,662
Deferred income tax liabilities		25,985
Commodity derivative contracts		
Total liabilities assumed	**$**	**28,647**
Net assets acquired	**$**	**643,591**

The finalized balances in the table above include immaterial changes to the amounts originally allocated to oil and gas properties and deferred income tax liabilities. These changes were required to reflect the final consideration paid after adjustment for certain post-closing purchase price amounts.

Anadarko Basin Acquisition May 2013

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 (before customary post-closing adjustments). The Company funded the purchase price of the Anadarko Basin Acquisition 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.

The transaction was accounted for using the acquisition method of accounting which requires, among other things, that assets acquired and liabilities assumed be recognized at their fair values as of the acquisition date. The final determination of fair value for certain assets and liabilities remains preliminary and will be completed after post-closing purchase price adjustments are finalized no later than one year from the acquisition date.

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Since June 30, 2013 the Company has recorded adjustments to the purchase price to reduce the amounts allocated to proved and unproved properties by $1.0 million and $0.4 million, respectively. The following table reflects the adjusted allocation as of September 30, 2013 (in thousands):

		Anadarko Basin Acquisition
Oil and gas properties		
Proved	$	416,239
Unevaluated		206,989
Total assets acquired	**$**	**623,228**
Asset retirement obligations		6,296
Total liabilities assumed	**$**	**6,296**
Net assets acquired	**$**	**616,932**

Actual and Pro Forma Information

Revenues attributable to the Eagle Property Acquisition and Anadarko Basin Acquisition included in the Company s unaudited condensed consolidated statements of operations for the three months ended September 30, 2013 were $69.3 million and $45.6 million, respectively. Revenues attributable to the Eagle Property Acquisition and Anadarko Basin Acquisition included in the Company s unaudited condensed consolidated statements of operations for the nine months ended September 30, 2013 were $152.5 million and $59.8 million, respectively.

The following table presents unaudited pro forma information for the Company as if the Eagle Property Acquisition and the Anadarko Basin Acquisition occurred on January 1, 2012 (the three and nine month periods ended September 30, 2013 are adjusted for the Anadarko Basin Acquisition only, as the effect of the Eagle Property Acquisition is included in the Company s historical results for these periods, and the effect of the Anadarko Basin Acquisition was not included in the Company s results until May 31, 2013):

		For the Three Months Ended September 30, 2012		For the Nine Months Ended September 30, 2013		For the Nine Months Ended September 30, 2012
Revenues and other	$	85,606	$	378,591	$	360,913
Net income (loss)		(15,790)		(21,401)		(136,656)
Preferred stock dividends		(6,500)		(9,254)		(19,500)
Income (loss) available to common shareholders	$	(22,290)	$	(30,655)	$	(156,156)
Net loss per common share - basic	$	(0.34)	$	(0.47)	$	(2.69)
Net loss per common share - diluted	$	(0.34)	$	(0.47)	$	(2.69)

The historical financial information was adjusted to give effect to the pro forma events that were directly attributable to the Eagle Property Acquisition and the Anadarko Basin Acquisition and are factually supportable. The unaudited pro forma consolidated results are not necessarily indicative of what the Company s consolidated results of operations actually would have been had the acquisitions been completed on January 1, 2012. In addition, the unaudited pro forma consolidated results do not purport to project the future results of operations for the combined

Company.

6. Other Noncurrent Assets

At September 30, 2013, other noncurrent assets consisted of $47.2 million in deferred financing costs, $10.5 million in field inventory, and $0.2 million in other noncurrent assets.

At December 31, 2012, other noncurrent assets consisted of $25.2 million in deferred financing costs and $0.2 million in other noncurrent assets.

7. Asset Retirement Obligations

AROs represent the future abandonment costs of tangible assets, such as wells, service assets and other facilities. The fair value of the ARO at inception is capitalized as part of the carrying amount of the related long-lived assets. AROs approximated $23.2 million and $15.2 million as of September 30, 2013 and December 31, 2012, respectively, and the liability has been accreted to its present value as of September 30, 2013 and December 31, 2012. The Company evaluated its wells and determined a range of abandonment dates through 2071.

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The following table reflects the changes in the Company s AROs for the nine months ended September 30, 2013 (in thousands):

Asset retirement obligations at January 1, 2013	**$**	**15,245**
Liabilities incurred		710
Liabilities assumed in Anadarko Basin Acquisition		6,296
Revisions		
Liabilities settled		(61)
Current period accretion expense		988
Asset retirement obligations at September 30, 2013	**$**	**23,178**

8. Accrued Liabilities

Accrued liabilities at September 30, 2013 consisted of $69.3 million in oil and gas capital expenditures, $53.8 million in accrued interest, $45.0 million in accrued revenue and royalty distributions, $9.5 million in accrued taxes, and $21.1 million in other accrued liabilities.

Accrued liabilities at December 31, 2012 consisted of $69.0 million in oil and gas capital expenditures, $16.2 million in accrued interest and $13.4 million in other accrued liabilities.

9. Long-Term Debt

The Company s long-term debt as of September 30, 2013 and December 31, 2012 is as follows (in thousands):

		September 30, 2013		December 31, 2012
Revolving credit facility, due 2018	$	306,150	$	94,000
Senior notes, due 2020		600,000		600,000
Senior notes, due 2021		700,000		
Long-term debt	**$**	**1,606,150**	**$**	**694,000**

Reserve-based Credit Facility

As of September 30, 2013, the Company s credit facility consisted of a $750 million senior revolving credit facility (the Credit Facility) with a borrowing base of $500 million, as recently redetermined on September 26, 2013, when the borrowing base was increased from $425 million. At September 30, 2013, outstanding letters of credit obligations total $0.2 million.

The Credit Facility matures on May 31, 2018 and borrowings thereunder are secured by substantially all of the Company s oil and natural gas properties and currently bear interest at LIBOR plus an applicable margin, depending upon the Company s borrowing base utilization, between 1.75% and 2.75% per annum. At September 30, 2013 and December 31, 2012, the weighted average interest rate was 2.5% and 2.9%, respectively.

In addition to interest expense, the Credit Facility requires the payment of a commitment fee each quarter. The commitment fee is computed at the rate of either 0.375% or 0.50% per annum based on the average daily amount by which the borrowing base exceeds the outstanding borrowings during each quarter.

The borrowing base under the Credit Facility is subject to semiannual redeterminations in April and October and up to one additional time per six month period following each scheduled borrowing base redetermination, as may be requested by the Company or the administrative agent, acting on behalf of lenders holding at least two-thirds of the outstanding loans and other obligations. The next scheduled borrowing base redetermination date is April 1, 2014.

Under the terms of the Credit Facility, the Company is required to repay the amount by which the principal balance of its outstanding loans and its letter of credit obligations exceed its redetermined borrowing base. The Company is permitted to make such repayment in six equal successive monthly payments commencing 30 days following the administrative agent s notice regarding such borrowing base reduction.

On September 26, 2013, the Company entered into the Assignment and Fourth Amendment to the Second Amended and Restated Credit Agreement among the Company, as parent, Midstates Sub, as borrower, SunTrust Bank as administrative agent, and the other lenders and parties party thereto (the Fourth Amendment).

The Fourth Amendment amended the Credit Facility to provide that the Company s ratio of total net indebtedness to EBITDA for the trailing four fiscal quarter period ending on the last day of such fiscal quarter cannot exceed (i) 4.75:1.0, for the fiscal quarters ending September 30, 2013, December 31, 2013 and March 31, 2014, (ii) 4.50:1.0, for the fiscal quarters ending June 30, 2014, (iii) 4.25:1.0, for the fiscal quarters ending September 30, 2014 and December 31, 2014, and (iv) 4.00:1.0, for the fiscal quarter ending March 31, 2015 and each fiscal quarter thereafter. The Company also agreed to pay a one-time fee of 0.50% to each lender on the portion of their commitment to the borrowing base under the Fourth Amendment in excess of their commitment prior to the Fourth Amendment, and a one-time fee of 0.10% to each lender on the lesser of such lenders commitment immediately prior to, or after giving effect to, the Fourth Amendment.