

SANDRIDGE ENERGY INC
Form 10-Q
August 07, 2014
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2014

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 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 No

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

Large accelerated filer

Accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company)

Smaller reporting company

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

The number of shares outstanding of the registrant's common stock, par value \$0.001 per share, as of the close of business on July 31, 2014, was 494,027,381.

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SANDRIDGE ENERGY, INC.
FORM 10-Q
Quarter Ended June 30, 2014

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PART I. Financial Information

ITEM 1. Financial Statements

SANDRIDGE ENERGY, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except per share data)

	June 30, 2014 (Unaudited)	December 31, 2013
ASSETS		
Current assets		
Cash and cash equivalents	\$918,758	\$814,663
Accounts receivable, net	333,300	349,218
Derivative contracts	115	12,779
Costs in excess of billings and contract loss	3,435	4,079
Prepaid expenses	12,337	39,253
Other current assets	21,671	21,831
Total current assets	1,289,616	1,241,823
Oil and natural gas properties, using full cost method of accounting		
Proved	10,807,088	10,972,816
Unproved	309,043	531,606
Less: accumulated depreciation, depletion and impairment	(6,138,833)	(5,762,969)
	4,977,298	5,741,453
Other property, plant and equipment, net	564,521	566,222
Derivative contracts	2,826	14,126
Other assets	78,558	121,171
Total assets	\$6,912,819	\$7,684,795

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

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SANDRIDGE ENERGY, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS - Continued

(In thousands, except per share data)

	June 30, 2014 (Unaudited)	December 31, 2013
LIABILITIES AND EQUITY		
Current liabilities		
Accounts payable and accrued expenses	\$631,658	\$812,488
Derivative contracts	56,728	34,267
Asset retirement obligations	—	87,063
Other current liabilities	19,171	—
Total current liabilities	707,557	933,818
Long-term debt	3,195,165	3,194,907
Derivative contracts	5,533	20,564
Asset retirement obligations	55,210	337,054
Other long-term obligations	19,152	22,825
Total liabilities	3,982,617	4,509,168
Commitments and contingencies (Note 11)		
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 June 30, 2014 and December 31, 2013; aggregate liquidation preference of \$265,000	3	3
6.0% Convertible perpetual preferred stock; 2,000 shares issued and outstanding at June 30, 2014 and December 31, 2013; aggregate liquidation preference of \$200,000	2	2
7.0% Convertible perpetual preferred stock; 3,000 shares issued and outstanding at June 30, 2014 and December 31, 2013; aggregate liquidation preference of \$300,000	3	3
Common stock, \$0.001 par value, 800,000 shares authorized; 495,687 issued and 494,546 outstanding at June 30, 2014 and 491,609 issued and 490,290 outstanding at December 31, 2013	485	483
Additional paid-in capital	5,307,814	5,298,301
Additional paid-in capital—stockholder receivable	(3,750)	(3,750)
Treasury stock, at cost	(7,295)	(8,770)
Accumulated deficit	(3,640,679)	(3,460,462)
Total SandRidge Energy, Inc. stockholders' equity	1,656,583	1,825,810
Noncontrolling interest	1,273,619	1,349,817
Total equity	2,930,202	3,175,627
Total liabilities and equity	\$6,912,819	\$7,684,795

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

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SANDRIDGE ENERGY, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share data)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
	(Unaudited)			
Revenues				
Oil, natural gas and NGL	\$ 339,906	\$ 454,282	\$ 745,222	\$ 932,299
Drilling and services	18,852	16,078	35,932	33,448
Midstream and marketing	14,874	15,198	32,784	28,230
Construction contract	—	23,253	—	23,253
Other	1,082	4,176	3,832	7,447
Total revenues	374,714	512,987	817,770	1,024,677
Expenses				
Production	58,498	116,811	157,033	249,312
Production taxes	7,840	6,564	15,647	16,003
Cost of sales	10,469	15,348	22,950	31,665
Midstream and marketing	13,254	14,927	29,254	26,730
Construction contract	—	23,253	—	23,253
Depreciation and depletion—oil and natural gas	97,267	138,903	212,452	296,429
Depreciation and amortization—other	15,411	16,022	30,933	31,358
Accretion of asset retirement obligations	1,065	9,800	6,811	19,579
Impairment	3,133	15,643	167,912	15,643
General and administrative	31,102	65,541	61,531	134,587
Employee termination benefits	813	107,720	8,922	118,118
Loss (gain) on derivative contracts	85,292	(103,654)	) 127,783	(62,757)
Loss (gain) on sale of assets	36	(349)	) 17	397,825
Total expenses	324,180	426,529	841,245	1,297,745
Income (loss) from operations	50,534	86,458	(23,475)	) (273,068)
Other income (expense)				
Interest expense	(61,863)	) (61,159)	) (123,906)	) (147,069)
Loss on extinguishment of debt	—	—	—	(82,005)
Other income (expense), net	1,338	(106)	) 3,432	505
Total other expense	(60,525)	) (61,265)	) (120,474)	) (228,569)
(Loss) income before income taxes	(9,991)	) 25,193	(143,949)	) (501,637)
Income tax (benefit) expense	(1,194)	) 508	(1,067)	) 4,937
Net (loss) income	(8,797)	) 24,685	(142,882)	) (506,574)
Less: net income (loss) attributable to noncontrolling interest	15,642	45,121	9,572	(6,798)
Net loss attributable to SandRidge Energy, Inc.	(24,439)	) (20,436)	) (152,454)	) (499,776)
Preferred stock dividends	13,881	13,881	27,763	27,763
Loss applicable to SandRidge Energy, Inc. common stockholders	\$(38,320)	) \$(34,317)	) \$(180,217)	) \$(527,539)
Loss per share				
Basic	\$(0.08)	) \$(0.07)	) \$(0.37)	) \$(1.10)
Diluted	\$(0.08)	) \$(0.07)	) \$(0.37)	) \$(1.10)
Weighted average number of common shares outstanding				
Basic	485,318	479,154	485,059	478,494

Diluted	485,318	479,154	485,059	478,494
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The accompanying notes are an integral part of these condensed consolidated financial statements.

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SANDRIDGE ENERGY, INC.

CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

(In thousands)

	SandRidge Energy, Inc. Stockholders								
	Convertible		Common	Stock	Additional	Treasury	Accumulated	Non-controlling	Total
	Perpetual	Preferred								Paid-In	Stock	Deficit	Interest
	Stock	Stock	Shares	Amount	Capital				
Shares	Amount	Shares	Amount						
(Unaudited)									
Six Months Ended June 30,									
2014									
Balance at									
December 31,	7,650	\$8	490,290	\$483	\$5,294,551	\$(8,770)	\$(3,460,462)	\$ 1,349,817	\$3,175,627
2013									
Acquisition of	—	—	—	—	(2,074)	) —	—	(656)	) (2,730)
ownership interest									
Sale of royalty	—	—	—	—	4,091	—	—	18,028	22,119
trust units									
Distributions to	—	—	—	—	—	—	—	(103,142)	) (103,142)
noncontrolling									
interest owners									
Purchase of	—	—	—	—	—	(3,865)	) —	—	(3,865)
treasury stock									
Retirement of	—	—	—	—	(3,865)	) 3,865	—	—	—
treasury stock									
Stock									
distributions, net	—	—	178	—	(2,138)	) 1,475	—	—	(663)
of purchases -									
retirement plans									
Stock-based	—	—	—	—	13,499	—	—	—	13,499
compensation									
Stock-based	—	—	—	—	2	—	—	—	2
compensation									
excess tax benefit									
Issuance of	—	—	4,078	2	(2)) —	—	—	—
restricted stock									
awards, net of									
cancellations									
Net (loss) income	—	—	—	—	—	—	(152,454)	) 9,572	(142,882)
Convertible									
perpetual	—	—	—	—	—	—	(27,763)	) —	(27,763)
preferred stock									
dividends									
Balance at June	7,650	\$8	494,546	\$485	\$5,304,064	\$(7,295)	\$(3,640,679)	\$ 1,273,619	\$2,930,202
30, 2014									

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

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SANDRIDGE ENERGY, INC.
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
 (In thousands)

	Six Months Ended June 30,	
	2014	2013
	(Unaudited)	
CASH FLOWS FROM OPERATING ACTIVITIES		
Net loss	\$(142,882	) \$(506,574)
Adjustments to reconcile net loss to net cash provided by operating activities		
Depreciation, depletion and amortization	243,385	327,787
Accretion of asset retirement obligations	6,811	19,579
Impairment	167,912	15,643
Debt issuance costs amortization	4,703	5,369
Amortization of discount, net of premium, on long-term debt	258	789
Loss on extinguishment of debt	—	82,005
Deferred income tax provision	—	4,015
Loss (gain) on derivative contracts	127,783	(62,757)
Cash paid on settlement of derivative contracts	(52,261	) (6,075)
Loss on sale of assets	17	397,825
Stock-based compensation	11,625	72,415
Other	(49	) 2,057
Changes in operating assets and liabilities	(136,510	) 32,605
Net cash provided by operating activities	230,792	384,683
CASH FLOWS FROM INVESTING ACTIVITIES		
Capital expenditures for property, plant and equipment	(656,699	) (828,585)
Acquisition of assets	(16,553	) (8,602)
Proceeds from sale of assets	707,799	2,563,886
Net cash provided by investing activities	34,547	1,726,699
CASH FLOWS FROM FINANCING ACTIVITIES		
Repayments of borrowings	—	(1,115,500)
Premium on debt redemption	—	(61,997)
Debt issuance costs	—	(91)
Proceeds from sale of royalty trust units	22,119	—
Noncontrolling interest distributions	(103,142	) (98,716)
Acquisition of ownership interest	(2,730) —
Stock-based compensation excess tax benefit	2	—
Purchase of treasury stock	(5,602	) (28,468)
Dividends paid — preferred	(27,763	) (27,763)
Cash (paid) received on settlement of financing derivative contracts	(44,128	) 5,728
Net cash used in financing activities	(161,244	) (1,326,807)
NET INCREASE IN CASH AND CASH EQUIVALENTS	104,095	784,575
CASH AND CASH EQUIVALENTS, beginning of year	814,663	309,766
CASH AND CASH EQUIVALENTS, end of period	\$918,758	\$1,094,341
Supplemental Disclosure of Cash Flow Information		
Cash paid for interest, net of amounts capitalized	\$(120,339	) \$(156,800)
Cash paid for income taxes	\$(1,932	) \$(2,525)
Supplemental Disclosure of Noncash Investing and Financing Activities		
Deposit on pending sale	\$—	\$(255,000)
Change in accrued capital expenditures	\$3,989	\$52,715

Asset retirement costs capitalized	\$1,944	\$2,421
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The accompanying notes are an integral part of these condensed consolidated financial statements.

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SANDRIDGE ENERGY, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. Basis of Presentation

Nature of Business. SandRidge Energy, Inc. is an oil and natural gas company with a principal focus on exploration and production activities in the Mid-Continent region of the United States. The Company owns and operates additional interests in west Texas. The Company also operates businesses and infrastructure systems that are complementary to its primary exploration and production activities, including gas gathering and processing facilities, marketing operations, a saltwater gathering system, an electrical transmission system and a drilling and related oil field services business.

Principles of Consolidation. The consolidated financial statements include the accounts of the Company and its wholly owned or majority owned subsidiaries and variable interest entities (“VIEs”) for which the Company is the primary beneficiary. Noncontrolling interest represents third-party ownership interests in the Company’s subsidiaries and consolidated VIEs and is included as a component of equity in the consolidated balance sheets and consolidated statement of changes in equity. All significant intercompany accounts and transactions have been eliminated in consolidation.

Variable Interest Entities. An entity is referred to as a VIE if it possesses one of the following criteria: (i) it is thinly capitalized, (ii) the residual equity holders do not control the entity, (iii) the equity holders are shielded from the economic losses, (iv) the equity holders do not participate fully in the entity’s residual economics, or (v) the entity was established with non-substantive voting interests. The Company consolidates a VIE when it has determined it is the primary beneficiary, which requires significant judgment. 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 and the significance of the variable interest, the Company performs a qualitative analysis of the entity’s design, organizational structure, primary decision makers and related financial agreements. In addition to the VIEs that the Company consolidates, the Company also holds a variable interest in another VIE that is not consolidated as it was determined that the Company is not the primary beneficiary. The Company monitors both consolidated and unconsolidated VIEs to determine if any events have occurred that could cause the primary beneficiary to change. See Note 3 for discussion of the Company’s significant associated VIEs.

Interim Financial Statements. The accompanying unaudited condensed consolidated financial statements as of December 31, 2013 have been derived from the audited financial statements contained in the Company’s 2013 Form 10-K. The unaudited 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 2013 Form 10-K. Certain information and 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 accompanying unaudited condensed consolidated financial statements have been included. These unaudited condensed consolidated financial statements should be read in conjunction with the financial statements and notes thereto included in the 2013 Form 10-K.

Significant Accounting Policies. For a description of the Company’s significant accounting policies, see Note 1 of the consolidated financial statements included in the 2013 Form 10-K.

Reclassifications. Certain reclassifications have been made to the prior period financial statements to conform to the current period presentation. These reclassifications have no effect on the Company's previously reported results of operations.

Use of Estimates. The preparation of the accompanying unaudited condensed consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period.

The more significant areas requiring the use of assumptions, judgments and estimates include: oil, natural gas and natural gas liquids ("NGL") reserves; cash flow estimates used in the valuation of guarantees; impairment tests of long-lived assets; depreciation, depletion and amortization; asset retirement obligations; assignments of fair value and allocations of purchase price in connection with business combinations; determinations of significant alterations to the full cost pool and related estimates of fair value used to allocate the full cost pool net book value to divested properties, as necessary; income taxes; valuation of derivative

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SANDRIDGE ENERGY, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

(Unaudited)

instruments; contingencies; and accrued revenue and related receivables. Although management believes these estimates are reasonable, actual results could differ significantly.

Recent Accounting Pronouncements Not Yet Adopted. In May 2014, the FASB issued Accounting Standards Update 2014-09, "Revenue from Contracts with Customers" ("ASU 2014-09"), which outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance, including industry-specific guidance. The core principle requires that an entity recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. Certain of the provisions also amend or supersede existing guidance applicable to the recognition of a gain or loss on transfers of nonfinancial assets that are not an output of an entity's ordinary activities, including sales of property, plant and equipment and real estate. The requirements of ASU 2014-09 are effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period with an option of using either a full retrospective or a modified approach for adoption. The Company is currently evaluating the effect, if any, that the updated standard will have on its consolidated financial statements and related disclosures.

2. Divestitures

Sale of Permian Properties

On February 26, 2013, the Company sold all of its oil and natural gas properties in the Permian Basin in west Texas, excluding the assets attributable to the SandRidge Permian Trust's (the "Permian Trust") area of mutual interest, (the "Permian Properties") for \$2.6 billion. This transaction resulted in a significant alteration of the relationship between the Company's capitalized costs and proved reserves and, accordingly, the Company recorded a \$399.1 million loss on the sale for the six-month period ended June 30, 2013. The loss is included in loss (gain) on sale of assets in the accompanying unaudited condensed consolidated statement of operations for the six-month period ended June 30, 2013. The loss was calculated based on a comparison of proceeds received and the asset retirement obligations attributable to the Permian Properties that were assumed by the buyer to the sum of (i) an allocation of the historical net book value of the Company's proved oil and natural gas properties attributable to the Permian Properties, (ii) the historical cost of unproved acreage sold and (iii) costs incurred by the Company to sell these properties. The allocated net book value attributable to the Permian Properties was calculated based on the relative fair value of the Permian Properties and the remaining proved oil and natural gas properties retained by the Company as of the date of sale. A portion of the loss, totaling \$71.7 million, was allocated to noncontrolling interests and is reflected in net income (loss) attributable to noncontrolling interest in the accompanying unaudited condensed consolidated statement of operations for the six-month period ended June 30, 2013.

The following table presents revenues and direct operating expenses of the Permian Properties included in the accompanying unaudited condensed consolidated statement of operations for the six-month period ended June 30, 2013 (in thousands):

	Six Months Ended June 30, 2013(1)
Revenues	\$68,027
Direct operating expenses	\$17,453

(1) Includes revenues and direct operating expenses through February 26, 2013, the date of sale.

Sale of Gulf of Mexico and Gulf Coast Properties

On February 25, 2014, the Company sold subsidiaries that owned the Company's Gulf of Mexico and Gulf Coast oil and natural gas properties (the "Gulf Properties") for approximately \$703.5 million, net of working capital adjustments and post-closing adjustments, and the buyer's assumption of approximately \$366.0 million of related asset retirement obligations to Fieldwood Energy LLC ("Fieldwood"). This transaction did not result in a significant alteration of the relationship between the Company's capitalized costs and proved reserves and, accordingly, the Company recorded the proceeds as a reduction of its full cost pool with no gain or loss on the sale. See Note 15 for discussion of Fieldwood's related party affiliation with the Company.

In accordance with the terms of the sale, the Company agreed to guarantee on behalf of Fieldwood certain plugging and abandonment obligations associated with the Gulf Properties for a period of up to one year from the date of closing. The Company

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SANDRIDGE ENERGY, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

(Unaudited)

recorded a liability equal to the fair value of these guarantees, or \$9.4 million, at the time the transaction closed. As of June 30, 2014, the fair value of the guarantees was approximately \$12.0 million. See Note 4 for additional discussion of the determination of the guarantees' fair value. The guarantees do not include a limit on the potential future payments for which the Company could be obligated; however, Fieldwood has agreed to indemnify the Company for any costs it may incur as a result of the guarantees and to use its best efforts to pay any amounts sought from the Company by the Bureau of Ocean Energy Management that may arise prior to the expiration of the guarantees. Additionally, Fieldwood will maintain, for a period of up to one year from the closing date, restricted deposits totaling approximately \$28.0 million held in escrow for plugging and abandonment obligations associated with the Gulf Properties. Upon expiration of the guarantees, the Company will receive payment from Fieldwood for half of such restricted deposits, or approximately \$14.0 million. A receivable for this amount is included in other current assets in the accompanying unaudited condensed consolidated balance sheet at June 30, 2014.

The following table presents revenues and expenses, including direct operating expenses, depletion, accretion of asset retirement obligations and general and administrative expenses, for the Gulf Properties included in the accompanying unaudited condensed consolidated statements of operations for the three-month period ended June 30, 2013 and the six-month periods ended June 30, 2014 and 2013 (in thousands):

	Three Months Ended June 30, 2013	Six Months Ended June 30,	
		2014(1)	2013
Revenues	\$ 170,219	\$ 90,920	\$ 345,275
Expenses	\$ 122,222	\$ 63,674	\$ 251,392

(1) Includes revenues and expenses through February 25, 2014, the date of the sale.

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SANDRIDGE ENERGY, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

(Unaudited)

3. Variable Interest Entities

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.

Royalty Trusts. SandRidge owns beneficial interests in three Delaware statutory trusts. SandRidge Mississippian Trust I (the "Mississippian Trust I"), the Permian Trust and SandRidge Mississippian Trust II (the "Mississippian Trust II") (each individually, a "Royalty Trust" and collectively, the "Royalty Trusts") completed initial public offerings of their common units in April 2011, August 2011 and April 2012, respectively. Concurrent with the closing of each offering, the Company conveyed certain royalty interests to each Royalty Trust in exchange for the net proceeds of the offering and units representing beneficial interests in the Royalty Trust. Royalty interests conveyed to the Royalty Trusts are in existing wells and wells to be drilled on oil and natural gas properties leased by the Company in defined areas of mutual interest. The following table summarizes information about each Royalty Trust:

	Mississippian Trust I	Permian Trust	Mississippian Trust II
Total outstanding common units	21,000,000	39,375,000	37,293,750
Total outstanding subordinated units	7,000,000	13,125,000	12,431,250
Liquidation date(1)	12/31/2030	3/31/2031	12/31/2031

At the time each Royalty Trust terminates, 50% of the royalty interests conveyed to the Royalty Trust will (1) automatically revert to the Company, and the remaining 50% will be sold with the proceeds distributed to the Royalty Trust unitholders.

The Royalty Trusts make quarterly cash distributions to unitholders based on calculated distributable income. In order to provide support for cash distributions on the common units, the Company agreed to subordinate a portion of the units it owns in each Royalty Trust (the "subordinated units"), which constitute 25% of the total outstanding units of each Royalty Trust. The subordinated units are entitled to receive pro rata distributions from the Royalty Trusts each quarter if and to the extent there is sufficient cash to provide a cash distribution on the common units that is no less than the applicable quarterly subordination threshold. If there is not sufficient cash to fund such a distribution on all common units, the distribution made with respect to the subordinated units is reduced or eliminated for such quarter in order to make a distribution, to the extent possible, of up to the subordination threshold amount on all common units, including common units held by the Company. In exchange for agreeing to subordinate a portion of its Royalty Trust units, SandRidge is entitled to receive incentive distributions equal to 50% of the amount by which the cash available for distribution on all of the Royalty Trust units exceeds the applicable quarterly incentive threshold.

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SANDRIDGE ENERGY, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

(Unaudited)

The Royalty Trusts declared and paid quarterly distributions during the three and six-month periods ended June 30, 2014 and 2013 as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014(1)	2013	2014(2)	2013
Total distributions	\$59,672	\$68,449	\$127,985	\$144,810
Distributions to third-party unitholders	\$50,024	\$47,459	\$103,142	\$98,716

(1) Subordination thresholds were not met for the Mississippian Trust I's and Mississippian Trust II's distributions, resulting in reduced distributions to the Company on its subordinated units for this period.

(2) Subordination thresholds were not met for the Mississippian Trust I's distributions, resulting in reduced distributions to the Company on its subordinated units for this period.

See Note 19 for discussion of the Royalty Trusts' distributions announced in July 2014.

Pursuant to the trust agreements governing the Royalty Trusts, SandRidge has committed to loan funds to the each Royalty Trust on an unsecured basis, with terms substantially the same as would be obtained in an arm's length transaction between SandRidge and an unaffiliated party, if at any time the Royalty Trust's cash is not sufficient to pay ordinary course administrative expenses as they become due. Any funds loaned may not be used to satisfy indebtedness of the Royalty Trust or to make distributions. There were no amounts outstanding under the loan commitments at June 30, 2014 or December 31, 2013.

The Company and one of its wholly owned subsidiaries entered into a development agreement with each Royalty Trust that obligates the Company to drill, or cause to be drilled, a specified number of wells within respective areas of mutual interest, which are also subject to the royalty interests granted to the Mississippian Trust I, the Permian Trust and the Mississippian Trust II, by December 31, 2015, March 31, 2016 and December 31, 2016, respectively. Following the end of the fourth full calendar quarter subsequent to the Company's satisfaction of its drilling obligation (the "subordination period"), the subordinated units of each Royalty Trust will automatically convert into common units on a one-for-one basis and the Company's right to receive incentive distributions will terminate. One of the Company's wholly owned subsidiaries also granted to each Royalty Trust a lien on the Company's interests in the properties where the development wells will be drilled in order to secure the estimated amount of drilling costs for the Royalty Trust's interests in the wells. As the Company fulfills its drilling obligation to each Royalty Trust, development wells that have been drilled and perforated for completion are released from the lien and the total amount that may be recovered by each Royalty Trust is proportionately reduced. As of June 30, 2014, the total maximum amount recoverable by the Permian Trust and the Mississippian Trust II under the remaining liens was approximately \$48.2 million. The Company fulfilled its drilling obligation to the Mississippian Trust I in the second quarter of 2013 and the related lien was released. See Note 19 for discussion of the conversion of Mississippian Trust I subordinated units to common units.

Additionally, the Company and each Royalty Trust entered into an administrative services agreement, pursuant to which the Company provides certain administrative services to the Royalty Trust, including hedge management services to the Permian Trust and the Mississippian Trust II. The Company also entered into derivatives agreements with each Royalty Trust, pursuant to which the Company provides to the Royalty Trust the economic effects of certain of the Company's derivative contracts. Substantially concurrent with the execution of the derivatives agreements with the Permian Trust and the Mississippian Trust II, the Company novated certain of the derivative contracts underlying the respective derivatives agreements to each of these Royalty Trusts. The Company novated additional derivative

contracts underlying the derivatives agreements to the Permian Trust in April 2012 and to the Permian Trust and the Mississippian Trust II in March 2013. The tables below present the open oil and natural gas commodity derivative contracts at June 30, 2014 underlying the derivatives agreements. The combined volume in the tables below reflects the total volume of the Royalty Trusts' open oil and natural gas commodity derivative contracts.

Oil Price Swaps Underlying the Royalty Trust Derivatives Agreements

	Notional (MBbls)	Weighted Average Fixed Price
July 2014 - December 2014	823	\$101.01
January 2015 - December 2015	904	\$97.78

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SANDRIDGE ENERGY, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

(Unaudited)

Natural Gas Collars Underlying the Royalty Trust Derivatives Agreements

	Notional (MMcf)	Collar Range
July 2014 - December 2014	472	\$4.00 — \$7.78
January 2015 - December 2015	1,010	\$4.00 — \$8.55

Oil Price Swaps Underlying the Derivatives Agreements and Novated to the Royalty Trusts

	Notional (MBbls)	Weighted Average Fixed Price
July 2014 - December 2014	473	\$100.76
January 2015 - March 2015	141	\$100.90

See Note 9 for further discussion of the derivatives agreement between the Company and each Royalty Trust.

The Royalty Trusts are considered VIEs due to the lack of voting or similar decision-making rights of the Royalty Trusts' equity holders regarding activities that have a significant effect on the economic success of the Royalty Trusts. The Company has determined it is the primary beneficiary of the Royalty Trusts as it has (a) the power to direct the activities that most significantly impact the economic performance of the Royalty Trusts through (i) its participation in the creation and structure of the Royalty Trusts, (ii) the manner in which it fulfills its drilling obligations to the Royalty Trusts and (iii) its operation of a majority of the oil and natural gas properties that are subject to the conveyed royalty interests and marketing of the associated production and (b) the obligation to absorb losses and right to receive residual returns, through its variable interests in the Royalty Trusts, including ownership of common and subordinated units, that could potentially be significant to the Royalty Trusts. As a result, the Company consolidates the activities of the Royalty Trusts into its results of operations. Amounts attributable to the common units of the Royalty Trusts owned by third parties are reflected as noncontrolling interest in the consolidated financial statements.

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SANDRIDGE ENERGY, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

(Unaudited)

Each Royalty Trust's assets can be used to settle only that Royalty Trust's obligations and not other obligations of the Company or another Royalty Trust. The Royalty Trusts' creditors have no contractual recourse to the general credit of the Company. Although the Royalty Trusts are included in the Company's consolidated financial statements, the Company's legal interest in the Royalty Trusts' assets is limited to its ownership of the Royalty Trusts' units. At both June 30, 2014 and December 31, 2013, \$1.3 billion of noncontrolling interest in the accompanying unaudited condensed consolidated balance sheets was attributable to the Royalty Trusts. The Royalty Trusts' assets and liabilities, after considering the effects of intercompany eliminations, included in the accompanying unaudited condensed consolidated balance sheets at June 30, 2014 and December 31, 2013 consisted of the following (in thousands):

	June 30, 2014	December 31, 2013
Cash and cash equivalents(1)	\$6,722	\$7,912
Accounts receivable, net	18,887	22,540
Derivative contracts	—	4,983
Total current assets	25,609	35,435
Investment in royalty interests(2)	1,325,942	1,325,942
Less: accumulated depletion and impairment(3)	(258,186	) (186,095)
	1,067,756	1,139,847
Derivative contracts	—	1,476
Total assets	\$1,093,365	\$1,176,758
Accounts payable and accrued expenses	\$2,318	\$3,393
Derivative contracts, current	968	—
Total liabilities	\$3,286	\$3,393

(1) Includes \$3.0 million held by the trustee at June 30, 2014 and December 31, 2013 as reserves for future general and administrative expenses.

(2) Investment in royalty interests is included in oil and natural gas properties in the accompanying unaudited condensed consolidated balance sheets.

(3) Accumulated depletion and impairment at June 30, 2014 includes full cost ceiling limitation impairment allocated to the Royalty Trusts of \$42.3 million. There was no full cost ceiling limitation impairment allocated to the Royalty Trusts as of December 31, 2013.

During the six-month period ended June 30, 2014, the Company sold Permian Trust common units it owned in a transaction exempt from registration pursuant to Rule 144 under the Securities Act for proceeds of approximately \$22.1 million. The sale was accounted for as an equity transaction with no gain or loss recognized. The Company continues to be the primary beneficiary of the Permian Trust after consideration of this transaction and continues to consolidate the activities of the Permian Trust as well as the activities of the Mississippian Trust I and Mississippian Trust II. The Company's beneficial interests in the Royalty Trusts at June 30, 2014 and December 31, 2013 were as follows:

	June 30, 2014	December 31, 2013		
Mississippian Trust I	26.9	% 26.9		%
Permian Trust	25.0	% 28.5		%
Mississippian Trust II	37.6	% 37.6		%

See Note 11 for discussion of the Company's legal proceedings to which the Mississippian Trust I and Mississippian Trust II are also parties.