

Sanchez Energy Corp
Form 10-Q
May 08, 2015

Use these links to rapidly review the document

[Table of Contents](#)

[Table of Contents](#)

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

Form 10-Q

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

For the quarterly period ended March 31, 2015

OR

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

Commission file number: 1-35372

Sanchez Energy Corporation

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of
incorporation or organization)

45-3090102

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

1000 Main Street, Suite 3000

Houston, Texas

(Address of principal executive offices)

77002

(Zip Code)

(713) 783-8000

(Registrant's telephone number, including area code)

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

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

Edgar Filing: Sanchez Energy Corp - Form 10-Q

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 Smaller reporting company

(Do not check if a
smaller reporting company)

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

Number of shares of registrant's common stock, par value \$0.01 per share, outstanding as of May 7, 2015: 61,080,669.

Table of Contents

CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

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

our ability to successfully execute our business and financial strategies;

our ability to replace the reserves we produce through drilling and property acquisitions;

the timing and extent of changes in prices for, and demand for, crude oil and condensate, natural gas liquids ("NGLs"), natural gas and related commodities;

the realized benefits of the acreage acquired in our various acquisitions and other assets and liabilities assumed in connection therewith;

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

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

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

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

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

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

Edgar Filing: Sanchez Energy Corp - Form 10-Q

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

Edgar Filing: Sanchez Energy Corp - Form 10-Q

Table of Contents

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

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

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

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

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

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

unexpected results of litigation filed against us;

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

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

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

Table of Contents

Sanchez Energy Corporation
Form 10-Q
For the Quarterly Period Ended March 31, 2015

Table of Contents

PART I

<u>Item 1.</u>	<u>Unaudited Financial Statements</u>	<u>5</u>
	<u>Condensed Consolidated Balance Sheets as of March 31, 2015 and December 31, 2014</u>	<u>5</u>
	<u>Condensed Consolidated Statements of Operations for the Three Months Ended March 31, 2015 and 2014</u>	<u>6</u>
	<u>Condensed Consolidated Statement of Stockholders' Equity for the Three Months Ended March 31, 2015</u>	<u>7</u>
	<u>Condensed Consolidated Statements of Cash Flows for the Three Months Ended March 31, 2015 and 2014</u>	<u>8</u>
	<u>Notes to the Condensed Consolidated Financial Statements</u>	<u>9</u>
<u>Item 2.</u>	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>40</u>
<u>Item 3.</u>	<u>Quantitative and Qualitative Disclosures About Market Risk</u>	<u>61</u>
<u>Item 4.</u>	<u>Controls and Procedures</u>	<u>62</u>

PART II

<u>Item 1.</u>	<u>Legal Proceedings</u>	<u>62</u>
<u>Item 1A.</u>	<u>Risk Factors</u>	<u>62</u>
<u>Item 2.</u>	<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	<u>65</u>
<u>Item 3.</u>	<u>Defaults Upon Senior Securities</u>	<u>65</u>
<u>Item 4.</u>	<u>Mine Safety Disclosures</u>	<u>65</u>
<u>Item 5.</u>	<u>Other Information</u>	<u>65</u>
<u>Item 6.</u>	<u>Exhibits</u>	<u>65</u>
<u>SIGNATURES</u>		<u>67</u>

Table of Contents**PART I FINANCIAL INFORMATION****Item 1. Unaudited Financial Statements**

Sanchez Energy Corporation
Condensed Consolidated Balance Sheets (Unaudited)
(in thousands, except share amounts)

	March 31, 2015	December 31, 2014
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 345,338	\$ 473,714
Oil and natural gas receivables	45,996	69,795
Joint interest billings receivables	8,553	14,676
Accounts receivable related entities	3,233	386
Fair value of derivative instruments	104,357	100,181
Other current assets	22,129	23,002
Total current assets	529,606	681,754
Oil and natural gas properties, at cost, using the full cost method:		
Unproved oil and natural gas properties	313,675	385,827
Proved oil and natural gas properties	2,784,913	2,582,441
Total oil and natural gas properties	3,098,588	2,968,268
Less: Accumulated depreciation, depletion, amortization and impairment	(1,249,807)	(706,590)
Total oil and natural gas properties, net	1,848,781	2,261,678
Other assets:		
Debt issuance costs, net	46,753	48,168
Fair value of derivative instruments	30,907	24,024
Deferred tax asset		40,685
Investments	2,000	
Other assets	17,904	19,101
Total assets	\$ 2,475,951	\$ 3,075,410
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 25,319	\$ 29,487
Other payables	5,102	4,415
Accrued liabilities:		
Capital expenditures	104,659	162,726
Other	59,342	67,162
Deferred tax liability		33,242
Other current liabilities		5,166
Total current liabilities	194,422	302,198
Long term debt, net of premium (discount)	1,746,490	1,746,263
Asset retirement obligations	27,148	25,694
Fair value of derivative instruments		889

Edgar Filing: Sanchez Energy Corp - Form 10-Q

Other liabilities	1,946	779
Total liabilities	1,970,006	2,075,823
Commitments and Contingencies (Note 15)		
Stockholders' equity:		
Preferred stock (\$0.01 par value, 15,000,000 shares authorized; 1,838,985 shares issued and outstanding as of March 31, 2015 and December 31, 2014 of 4.875% Convertible Perpetual Preferred Stock, Series A, respectively; 3,532,330 shares issued and outstanding as of March 31, 2015 and December 31, 2014 of 6.500% Convertible Perpetual Preferred Stock, Series B, respectively)	53	53
Common stock (\$0.01 par value, 150,000,000 shares authorized; 61,058,170 and 58,580,870 shares issued and outstanding as of March 31, 2015 and December 31, 2014, respectively)	611	586
Additional paid-in capital	1,072,336	1,064,667
Accumulated deficit	(567,055)	(65,719)
Total stockholders' equity	505,945	999,587
Total liabilities and stockholders' equity	\$ 2,475,951	\$ 3,075,410

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

Table of Contents

Sanchez Energy Corporation

Condensed Consolidated Statements of Operations (Unaudited)

(in thousands, except per share amounts)

	Three Months Ended March 31,	
	2015	2014
REVENUES:		
Oil sales	\$ 75,524	\$ 119,675
Natural gas liquid sales	13,853	8,493
Natural gas sales	21,216	6,394
Total revenues	110,593	134,562
OPERATING COSTS AND EXPENSES:		
Oil and natural gas production expenses	34,163	15,912
Production and ad valorem taxes	8,670	10,403
Depreciation, depletion, amortization and accretion	102,657	61,251
Impairment of oil and natural gas properties	441,450	
General and administrative (inclusive of stock-based compensation expense of \$7,694 and \$9,935, respectively, for the three months ended March 31, 2015 and 2014)	21,477	19,309
Total operating costs and expenses	608,417	106,875
Operating income (loss)	(497,824)	27,687
Other income (expense):		
Interest and other income	133	12
Other expense	(1,957)	
Interest expense	(31,558)	(13,272)
Net gains (losses) on commodity derivatives	41,303	(9,117)
Total other income (expense)	7,921	(22,377)
Income (loss) before income taxes	(489,903)	5,310
Income tax expense	7,442	1,865
Net income (loss)	(497,345)	3,445
Less:		
Preferred stock dividends	(3,991)	(18,193)
Net loss attributable to common stockholders	\$ (501,336)	\$ (14,748)
Net loss per common share - basic and diluted	\$ (8.83)	\$ (0.31)
Weighted average number of shares used to calculate net income (loss) attributable to common stockholders - basic and diluted	56,805	47,025

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

Table of Contents

Sanchez Energy Corporation

Condensed Consolidated Statement of Stockholders' Equity
for the Three Months Ended March 31, 2015 (Unaudited)

(in thousands)

	Series A Preferred Stock		Series B Preferred Stock		Common Stock		Additional Paid-in Capital	Retained Earnings (Accumulated Deficit)	Total Stockholders' Equity
	Shares	Amount	Shares	Amount	Shares	Amount			
BALANCE, December 31, 2014	1,839	\$ 18	3,532	\$ 35	58,581	\$ 586	\$ 1,064,667	\$ (65,719)	\$ 999,587
Preferred stock dividends								(3,991)	(3,991)
Restricted stock awards, net of forfeitures					2,477	25	(25)		
Stock-based compensation							7,694		7,694
Net loss								(497,345)	(497,345)
BALANCE, March 31, 2015	1,839	\$ 18	3,532	\$ 35	61,058	\$ 611	\$ 1,072,336	\$ (567,055)	\$ 505,945

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

Table of Contents

Sanchez Energy Corporation

Condensed Consolidated Statements of Cash Flows (Unaudited)

(in thousands)

	Three Months Ended March 31,	
	2015	2014
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income (loss)	\$ (497,345)	\$ 3,445
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation, depletion, amortization and accretion	102,657	61,251
Impairment of oil and natural gas properties	441,450	
Stock-based compensation expense	7,694	9,935
Net (gains) losses on commodity derivative contracts	(41,303)	9,117
Net cash settlement received (paid) on commodity derivative contracts	29,355	(1,806)
Premiums paid on derivative contracts	121	
Amortization of debt issuance costs	1,815	1,132
Accretion of debt discount (premium)	227	226
Deferred taxes	7,442	1,865
Changes in operating assets and liabilities:		
Accounts receivable	29,922	(1,723)
Accounts receivable related entities	(2,847)	(1,030)
Other current assets	873	(2,390)
Accounts payable	(4,168)	(37,221)
Other payables	566	2,428
Accrued liabilities	(8,660)	19,354
Other current liabilities	(5,166)	
Other liabilities	1,167	
Net cash provided by operating activities	63,800	64,583
CASH FLOWS FROM INVESTING ACTIVITIES:		
Payments for oil and natural gas properties	(270,584)	(102,935)
Payments for other property and equipment	828	(791)
Acquisitions of oil and natural gas properties	13	874
Proceeds from sale of oil and natural gas properties	81,958	
Net cash used in investing activities	(187,785)	(102,852)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Financing costs	(400)	(123)
Preferred dividends paid	(3,991)	(4,292)
Net cash used in financing activities	(4,391)	(4,415)
Decrease in cash and cash equivalents	(128,376)	(42,684)
Cash and cash equivalents, beginning of period	473,714	153,531
Cash and cash equivalents, end of period	\$ 345,338	\$ 110,847

Edgar Filing: Sanchez Energy Corp - Form 10-Q

NON-CASH INVESTING AND FINANCING ACTIVITIES:

Asset retirement obligations	\$	979	2,871
Change in accrued capital expenditures		(58,068)	27,863
Capital expenditures in accounts payable			18,409
Common stock issued in exchange for preferred stock			99,118
Investment received for sale of oil and natural gas properties		2,000	

SUPPLEMENTAL DISCLOSURE:

Cash paid for interest	\$	38,978	\$	289
------------------------	----	--------	----	-----

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

Table of Contents

Sanchez Energy Corporation

Notes to the Condensed Consolidated Financial Statements

(Unaudited)

Note 1. Organization

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

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

The accompanying condensed consolidated financial statements are unaudited and were prepared from the Company's records. The condensed consolidated financial statements were prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP" or "U.S. GAAP") for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. The Company derived the condensed consolidated balance sheet as of December 31, 2014 from the audited financial statements filed in its Annual Report on Form 10-K for the fiscal year ended December 31, 2014 (the "2014 Annual Report"). Because this is an interim period filing presented using a condensed format, it does not include all of the disclosures required by U.S. GAAP. These condensed consolidated financial statements should be read in connection with the consolidated financial statements and notes thereto included in the 2014 Annual Report, which contains a summary of the Company's significant accounting policies and other disclosures. In the opinion of management, these financial statements include the adjustments and accruals, all of which are of a normal recurring nature, which are necessary for a fair presentation of the results for the interim periods. These interim results are not necessarily indicative of results to be expected for the entire year.

As of March 31, 2015, the Company's significant accounting policies are consistent with those discussed in Note 2, "Basis of Presentation and Summary of Significant Accounting Policies," in the notes to the Company's consolidated financial statements contained in its 2014 Annual Report.

Principles of Consolidation

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

Use of Estimates

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

Table of Contents

Sanchez Energy Corporation

Notes to the Condensed Consolidated Financial Statements (Continued)

(Unaudited)

Note 2. Basis of Presentation and Summary of Significant Accounting Policies (Continued)

retirement obligations, accrued oil and natural gas revenues and expenses and the allocation of general and administrative expenses. Actual results could differ materially from those estimates.

Recent Accounting Pronouncements

In April 2015, the Financial Accounting Standards Board (the "FASB") issued Accounting Standards Update ("ASU") No. 2015-03, "Interest Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs." This guidance is intended to more closely align the presentation of debt issuance costs under U.S. GAAP with the presentation requirements under the International Financial Reporting Standards. Under this new standard, debt issuance costs related to a recognized debt liability will be presented on the balance sheet as a direct deduction from the debt liability, similar to the presentation of debt discounts, rather than as a separate asset as previously presented. This guidance is effective for fiscal years and interim periods beginning after December 15, 2015. The guidance is to be applied retrospectively to each prior period presented. Early adoption is permitted. The effects of this accounting standard on our financial position, results of operations and cash flows are not expected to be material.

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

Note 3. Acquisitions and Divestitures

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

Table of Contents**Sanchez Energy Corporation****Notes to the Condensed Consolidated Financial Statements (Continued)****(Unaudited)****Note 3. Acquisitions and Divestitures (Continued)***Catarina Acquisition*

On June 30, 2014, we completed our acquisition of contiguous acreage in Dimmit, LaSalle and Webb Counties, Texas with 176 gross producing wells (the "Catarina acquisition") for an aggregate adjusted purchase price of \$557.1 million. The effective date of the transaction was January 1, 2014. The purchase price was funded with a portion of the proceeds from the issuance of the \$850 million senior unsecured 6.125% notes due 2023 (the "Original 6.125% Notes") and cash on hand. The purchase price allocation for the Catarina acquisition is preliminary and is subject to further adjustments and the settlement of certain post-closing adjustments with the seller. The total purchase price was allocated to the assets purchased and liabilities assumed based upon their fair values on the date of acquisition as follows (in thousands):

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

Palmetto Disposition

On March 31, 2015, we completed our disposition to a subsidiary of Sanchez Production Partners LP ("SPP") of escalating amounts of partial working interests in 59 wellbores located in Gonzales County, Texas (the "Palmetto disposition") for an adjusted purchase price of approximately \$83.6 million. The effective date of the transaction was January 1, 2015. The aggregate average working interest percentage initially conveyed was 18.25% per wellbore and, upon January 1 of each subsequent year after the closing, the purchaser's working interest will automatically increase in incremental amounts according to the purchase agreement until January 1, 2019, at which point the purchaser will own a 47.5% working interest and we will own a 2.5% working interest in each of the wellbores. We received consideration consisting of \$83.0 million (approximately \$81.6 million as adjusted) cash and 1,052,632 common units of SPP valued at approximately \$2.0 million (as discussed further in Note 8, "Investments" below). The Company did not record any gains or losses related to the Palmetto disposition for the three months ended March 31, 2015.

Pro Forma Operating Results

The following unaudited pro forma combined results for the three months ended March 31, 2015 and 2014 reflect the consolidated results of operations of the Company as if the Catarina acquisition and related financing had occurred on January 1, 2013 and the Palmetto disposition had occurred on January 1, 2014. The pro forma information includes adjustments primarily for revenues and expenses from the acquired and disposed properties, depreciation, depletion, amortization and accretion, impairment, interest expense and debt issuance cost amortization for acquisition debt, consideration received including cash and common stock, and stock dividends for the issuance of preferred stock.

Table of Contents**Sanchez Energy Corporation****Notes to the Condensed Consolidated Financial Statements (Continued)****(Unaudited)****Note 3. Acquisitions and Divestitures (Continued)**

The unaudited pro forma combined financial statements give effect to the events set forth below:

The Catarina acquisition completed on June 30, 2014.

The Palmetto disposition completed on March 31, 2015.

Issuance of the Original 6.125% Notes (as discussed in Note 6, "Long-Term Debt") to finance a portion of the Catarina acquisition and the related adjustments to interest expense.

	Three Months Ended	
	March 31,	
	2015	2014
Revenues	\$ 107,350	\$ 216,216
Net loss attributable to common stockholders common stockholders	\$ (394,124)	\$ (3,619)
Net loss per common share, basic and diluted	\$ (6.94)	\$ (0.08)

The unaudited pro forma combined financial information is for informational purposes only and is not intended to represent or to be indicative of the combined results of operations that the Company would have reported had the Catarina acquisition and related financings and Palmetto disposition been completed as of the dates set forth in this unaudited pro forma combined financial information and should not be taken as indicative of the Company's future combined results of operations. The actual results may differ significantly from that reflected in the unaudited pro forma combined financial information for a number of reasons, including, but not limited to, differences in assumptions used to prepare the unaudited pro forma combined financial information and actual results.

Note 4. Cash and Cash Equivalents

As of March 31, 2015 and December 31, 2014, cash and cash equivalents consisted of the following (in thousands):

	March 31,	December 31,
	2015	2014
Cash at banks	\$ 145,079	\$ 73,528
Money market funds	200,259	400,186
Total cash and cash equivalents	\$ 345,338	\$ 473,714

Note 5. Oil and Natural Gas Properties

Edgar Filing: Sanchez Energy Corp - Form 10-Q

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

Table of Contents

Sanchez Energy Corporation

Notes to the Condensed Consolidated Financial Statements (Continued)

(Unaudited)

Note 5. Oil and Natural Gas Properties (Continued)

properties are applied to reduce net capitalized costs unless the sale or disposition causes a significant change in the relationship between costs and the estimated quantity of proved reserves.

Full Cost Ceiling Test Capitalized costs (net of accumulated depreciation, depletion and amortization and deferred income taxes) of proved oil and natural gas properties are subject to a full cost ceiling limitation. The ceiling limits these costs to an amount equal to the present value, discounted at 10%, of estimated future net cash flows from estimated proved reserves less estimated future operating and development costs, abandonment costs (net of salvage value) and estimated related future income taxes. In accordance with SEC rules, the oil and natural gas prices used to calculate the full cost ceiling are the 12-month average prices, calculated as the unweighted arithmetic average of the first-day-of-the-month price for each month within the 12-month period prior to the end of the reporting period, unless prices are defined by contractual arrangements. Prices are adjusted for "basis" or location differentials. Prices are held constant over the life of the reserves. If unamortized costs capitalized within the cost pool exceed the ceiling, the excess is charged to expense and separately disclosed during the period in which the excess occurs. Amounts thus required to be written off are not reinstated for any subsequent increase in the cost center ceiling. During the three month period ended March 31, 2015, the Company recorded a full cost ceiling test impairment before income taxes of \$441 million. Based on the sustained decline in average prices throughout the first quarter of 2015 and a current expectation that prices will remain unfavorable during 2015 based upon the current NYMEX forward prices, absent a material addition to proved reserves and/or a material reduction in future development costs, we believe that there is a reasonable likelihood that the Company will incur additional impairments to our full cost pool in 2015. No impairment expense was recorded for the three month period ended March 31, 2014.

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

Note 6. Long-Term Debt

Long-term debt on March 31, 2015 consisted of \$1.15 billion face value of 6.125% senior notes (the "6.125% Notes," consisting of \$850 million in Original 6.125% Notes and \$300 million in Additional 6.125% Notes (defined below), which were issued at a premium to face value of approximately \$2.3 million) maturing on January 15, 2023, and \$600 million principal amount of 7.75% senior notes (the "7.75% Notes," consisting of \$400 million in Original 7.75% Notes (defined below) and \$200 million in Additional 7.75% Notes, which were issued at a discount to face value of

Table of Contents**Sanchez Energy Corporation****Notes to the Condensed Consolidated Financial Statements (Continued)****(Unaudited)****Note 6. Long-Term Debt (Continued)**

approximately \$7.0 million), maturing on June 15, 2021. As of March 31, 2015 and December 31, 2014, the Company's long-term debt consisted of the following:

	Interest Rate	Maturity date	Amount Outstanding (in thousands) as of	
			March 31, 2015	December 31, 2014
Second Amended and Restated Credit Agreement	Variable	June 30, 2019	\$	\$
7.75% Notes	7.75%	June 15, 2021	600,000	600,000
6.125% Notes	6.125%	January 15, 2023	1,150,000	1,150,000
			1,750,000	1,750,000
Unamortized discount on Additional 7.75% Notes			(5,612)	(5,837)
Unamortized premium on Additional 6.125% Notes			2,102	2,100
Total long-term debt			\$ 1,746,490	\$ 1,746,263

The components of interest expense are (in thousands):

	Three Months Ended March 31,	
	2015	2014
Interest on senior notes	\$ (29,235)	\$ (11,625)
Interest expense and commitment fees on credit agreements	(281)	(289)
Amortization of debt issuance costs	(1,815)	(1,132)
Amortization of discount on Additional 7.75% Notes	(226)	(226)
Amortization of premium on Additional 6.125% Notes	(1)	
Total interest expense	\$ (31,558)	\$ (13,272)

Credit Facility

Previous Credit Agreement: On May 31, 2013, we and our subsidiaries, SEP Holdings III, LLC ("SEP III"), SN Marquis LLC ("SN Marquis") and SN Cotulla Assets, LLC ("SN Cotulla"), collectively, as the borrowers, entered into a revolving credit facility represented by a \$500 million Amended and Restated Credit Agreement with Royal Bank of Canada as the administrative agent, Capital One, National Association as the syndication agent and RBC Capital Markets as sole lead arranger and sole book runner and each of the other lenders party thereto (the "Amended and Restated Credit Agreement"). The Amended and Restated Credit Agreement was to mature on May 31, 2018.

Table of Contents

Sanchez Energy Corporation

Notes to the Condensed Consolidated Financial Statements (Continued)

(Unaudited)

Note 6. Long-Term Debt (Continued)

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

Second Amended and Restated Credit Agreement: On June 30, 2014, the Company, as borrower, and SEP III, SN Marquis, SN Cotulla, SN Operating, LLC, SN TMS, LLC and SN Catarina, LLC as other loan parties, entered into a revolving credit facility represented by a \$1.5 billion Second Amended and Restated Credit Agreement with Royal Bank of Canada as the administrative agent, Capital One, National Association as the syndication agent, Compass Bank and SunTrust Bank as documentation agents, RBC Capital Markets as sole lead arranger and sole book runner and the lenders party thereto (the "Second Amended and Restated Credit Agreement"). The Company has elected an aggregated elected commitment amount under the Second Amended and Restated Credit Agreement of \$300 million. Additionally, the Second Amended and Restated Credit Agreement provides for the issuance of letters of credit, limited in an aggregate amount of the lesser of \$50 million and the total availability thereunder. As of March 31, 2015, there were no borrowings and no letters of credit outstanding under the Second Amended and Restated Credit Agreement. Availability under the Second Amended and Restated Credit Agreement is at all times subject to customary conditions and the then applicable borrowing base and aggregate elected commitment amount. The borrowing base under the Second Amended and Restated Credit Agreement was set at \$362.5 million upon issuance of the Additional 6.125% Notes and was increased to \$650 million in connection with the October 1, 2014 redetermination. However, the Company elected a commitment amount of \$300 million, with the ability to increase the available commitment up to the \$650 million approved borrowing base upon written notice from the Company and compliance with certain conditions, including the consent of any lenders whose commitment is increased. On March 31, 2015, pursuant to an amendment of the Second Amended and Restated Credit Agreement, the borrowing base under such agreement was changed to \$550 million, with the elected commitment amount of \$300 million remaining unchanged. The borrowing base was reduced as a result of several factors that included the decrease in reserve value from the decline in commodity prices along with the reduction in reserves in connection with the Palmetto disposition discussed above partially offset by underlying new reserve growth through drilling. All of the elected commitment was available for future revolver borrowings as of March 31, 2015.

The Second Amended and Restated Credit Agreement matures on June 30, 2019. The borrowing base under the Second Amended and Restated Credit Agreement can be subsequently re-determined up or down by the lenders based on, among other things, their evaluation of the Company's and its restricted subsidiaries' oil and natural gas reserves. Redeterminations of the borrowing base are scheduled to occur semi-annually on or before April 1 and October 1 of each year. The borrowing base is also subject to (i) automatic reduction by 25% of the amount of any increase in the Company's high yield debt, (ii) interim redetermination at the election of the Company once between each scheduled redetermination, (iii) interim redetermination at the election of the administrative agent at the direction of a majority of the credit exposures or, if none, the elected commitments of the lenders and (iv) if the required lenders so direct in connection with asset sales and swap terminations involving more than 10% of the value of the proved developed oil and gas properties included in the most recent reserve report, reduction in an amount equal to the borrowing base value, as determined by the administrative agent in its reasonable judgment, of the assets so sold and swaps so terminated.

Table of Contents

Sanchez Energy Corporation

Notes to the Condensed Consolidated Financial Statements (Continued)

(Unaudited)

Note 6. Long-Term Debt (Continued)

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

The obligations under the Second Amended and Restated Credit Agreement are guaranteed by all of the Company's existing and future subsidiaries not designated as "unrestricted subsidiaries." At the Company's election, borrowings under the Second Amended and Restated Credit Agreement may be made on an alternate base rate or an adjusted eurodollar rate basis, plus an applicable margin. The applicable margin varies from 0.50% to 1.50% for alternate base rate borrowings and from 1.50% to 2.50% for eurodollar borrowings, depending on the utilization of the borrowing base. Furthermore, the Company is also required to pay a commitment fee on the unused committed amount at a rate varying from 0.375% to 0.50% per annum, depending on the utilization of the elected commitment.

The Second Amended and Restated Credit Agreement contains various affirmative and negative covenants and events of default that limit the Company's ability to, among other things, incur indebtedness, make restricted payments, grant liens, consolidate or merge, dispose of certain assets, make certain investments, engage in transactions with affiliates, hedge transactions and make certain acquisitions. The Second Amended and Restated Credit Agreement also provides for cross default between the Second Amended and Restated Credit Agreement and the other debt (including debt under the 6.125% Notes and the 7.75% Notes) and obligations in respect of hedging agreements (on a mark to market basis), of the Company and its restricted subsidiaries, in an aggregate principal amount in excess of \$10 million. Furthermore, the Second Amended and Restated Credit Agreement contains financial covenants that require the Company to satisfy the following tests: (i) current assets plus undrawn borrowing capacity on the Second Amended and Restated Credit Agreement to current liabilities of at least 1.0 to 1.0 at all times, (ii) senior secured debt to consolidated last twelve months ("LTM") EBITDA of not greater than 2.25 to 1.0 as of the last day of any fiscal quarter and (iii) consolidated LTM EBITDA to consolidated LTM net interest expense of not less than 2.25 to 1.0 as of the last day of any fiscal quarter; where LTM EBITDA and LTM net interest expense for the quarter ending on March 31, 2015 are the product of 4/3 times the relevant amount for the period commencing on June 30, 2014.

From time to time, the agents, arrangers, book runners and lenders under the Second Amended and Restated Credit Agreement and their affiliates have provided, and may provide in the future, investment banking, commercial lending, hedging and financial advisory services to the Company and its affiliates in the ordinary course of business, for which they have received, or may in the future receive, customary fees and commissions for these transactions. As of March 31, 2015, the Company was in compliance with the covenants of the Second Amended and Restated Credit Agreement.

7.75% Senior Notes Due 2021

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

Table of Contents

Sanchez Energy Corporation

Notes to the Condensed Consolidated Financial Statements (Continued)

(Unaudited)

Note 6. Long-Term Debt (Continued)

the senior unsecured obligations and are guaranteed on a joint and several senior unsecured basis by, with certain exceptions, substantially all of our existing and future subsidiaries.

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

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

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

We have the option to redeem all or a portion of the 7.75% Notes at any time on or after June 15, 2017 at the applicable redemption prices specified in the indenture plus accrued and unpaid interest. We may also redeem the 7.75% Notes, in whole or in part, at a redemption price equal to 100% of their principal amount plus a make whole premium, together with accrued and unpaid interest and additional interest, if any, to the redemption date, at any time prior to June 15, 2017. In addition, we may redeem up to 35% of the 7.75% Notes prior to June 15, 2016 under certain circumstances with an amount not greater than the net cash proceeds of one or more equity offerings at the redemption price specified in the indenture. We may also be required to repurchase the 7.75% Notes upon a change of control or if we sell certain of our assets.

On July 18, 2014, we completed an exchange offer of \$600 million aggregate principal amount of the 7.75% Notes that had been registered under the Securities Act of 1933, as amended (the

Table of Contents

Sanchez Energy Corporation

Notes to the Condensed Consolidated Financial Statements (Continued)

(Unaudited)

Note 6. Long-Term Debt (Continued)

"Securities Act"), for an equal amount of the 7.75% Notes that had not been registered under the Securities Act.

6.125% Senior Notes Due 2023

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

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

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

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

Table of Contents

Sanchez Energy Corporation

Notes to the Condensed Consolidated Financial Statements (Continued)

(Unaudited)

Note 6. Long-Term Debt (Continued)

substantially all of their assets; (viii) restrict distributions or other payments from the Company's restricted subsidiaries; and (ix) designate subsidiaries as unrestricted subsidiaries.

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

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

Note 7. Derivative Instruments

To reduce the impact of fluctuations in oil and natural gas prices on the Company's revenues, or to protect the economics of property acquisitions, the Company periodically enters into derivative contracts with respect to a portion of its projected oil and natural gas production through various transactions that fix or, through options, modify the future prices to be realized. These transactions may include price swaps whereby the Company will receive a fixed price for its production and pay a variable market price to the contract counterparty. Additionally, the Company may enter into collars, whereby it receives the excess, if any, of the fixed floor over the floating rate or pays the excess, if any, of the floating rate over the fixed ceiling price. In addition, the Company enters into option transactions, such as puts or put spreads, as a way to manage its exposure to fluctuating prices. The Company further uses enhanced swaps for a portion of its commodity price hedging activities. An enhanced swap is a product created by simultaneously selling an out of the money put and using the premium value from the sale to modify or "enhance" the value of a swap executed at the same time. The transaction provides an absolute minimum price at the enhanced swap strike price until the put strike price level is reached at which point the Company receives the market price plus the difference between the enhanced swap price and the put strike price. These hedging activities are intended to support oil and natural gas prices at targeted levels and to manage exposure to oil and natural gas price fluctuations. It is never the Company's intention to enter into derivative contracts for speculative trading purposes.

Under ASC Topic 815, "*Derivatives and Hedging*," all derivative instruments are recorded on the condensed consolidated balance sheets at fair value as either short-term or long-term assets or liabilities based on their anticipated settlement date. The Company will net derivative assets and liabilities for counterparties where it has a legal right of offset. Changes in the derivatives' fair values are recognized currently in earnings since the Company has elected not to designate its current derivative contracts as hedges.

Table of Contents

Sanchez Energy Corporation

Notes to the Condensed Consolidated Financial Statements (Continued)

(Unaudited)

Note 7. Derivative Instruments (Continued)

As of March 31, 2015, the Company had the following NYMEX WTI crude oil swaps covering anticipated future production:

Calendar Year	Volumes (Bbls)	Average Price per Bbl	Price Range per Bbl
April - December 2015	3,850,000	\$ 73.23	\$67.00 - \$88.35
2016	2,562,000	\$ 70.11	\$62.00 - \$80.15

As of March 31, 2015, the Company had the following NYMEX Henry Hub natural gas swaps, three-way collars, and enhanced swaps, respectively, covering anticipated future production:

Calendar Year	Swap Volumes (Mmbtu)	Average Price per Mmbtu	Price Range per Mmbtu
April - December 2015	7,640,000	\$ 3.84	\$3.54 - \$4.01
2016	14,640,000	\$ 3.87	\$3.80 - \$3.92
2017	3,650,000	\$ 3.65	\$3.65

Calendar Year	Three-way Collar Volumes (Mmbtu)	Average Short Put Price per Mmbtu	Average Long Put Price per Mmbtu	Average Short Call Price per Mmbtu
April - December 2015	2,750,000	\$ 3.50	\$ 4.00	\$ 4.90

Calendar Year	Enhanced Swap Volumes (Mmbtu)	Average Swap Price per Mmbtu	Average Put Price per Mmbtu
April - December 2015	8,525,000	\$ 4.31	\$ 3.75

On March 31, 2015, the Company novated outstanding NYMEX WTI crude oil swaps and NYMEX Henry Hub natural gas swaps (together, the "novated swaps") that were originally entered into in February 2015 to SPP in association with the Palmetto disposition discussed above. The fair values of the novated swaps of approximately \$3.4 million and the associated receivables of approximately \$3.4 million were removed from the Company's balance sheet as of March 31, 2015. The novated swaps covering anticipated future production through 2019 are listed below:

Calendar Year	Volumes (Bbls)	Price per Bbl
April - December 2015	167,040	\$ 56.85
2016	226,269	\$ 62.60
2017	213,003	\$ 64.80
2018	212,555	\$ 65.40
2019	199,768	\$ 65.65

Table of Contents

Sanchez Energy Corporation

Notes to the Condensed Consolidated Financial Statements (Continued)

(Unaudited)

Note 7. Derivative Instruments (Continued)

Calendar Year	Volumes (Mmbtu)	Price per Mmbtu
April - December 2015	229,645	\$ 2.81
2016	313,524	\$ 3.21
2017	296,048	\$ 3.52
2018	295,683	\$ 3.58
2019	277,888	\$ 3.62

The following table sets forth a reconciliation of the changes in fair value of the Company's commodity derivatives for the three months ended March 31, 2015 and the year ended December 31, 2014 (in thousands):

	Three months ended March 31, 2015	Twelve months ended December 31, 2014
Beginning fair value of commodity derivatives	\$ 123,316	\$ (3,397)
Net gains on crude oil derivatives	33,252	115,602
Net gains on natural gas derivatives	8,051	21,603
Net settlements on derivative contracts:		
Crude oil	(26,733)	(4,503)
Natural gas	(2,622)	(1,097)
Net premiums incurred on derivative contracts:		
Crude oil		(4,892)
Ending fair value of commodity derivatives	\$ 135,264	\$ 123,316

Balance Sheet Presentation

The Company's derivatives are presented on a net basis as "Fair value of derivative instruments" on the condensed consolidated balance sheets. The following information summarizes the gross fair

Table of Contents

Sanchez Energy Corporation

Notes to the Condensed Consolidated Financial Statements (Continued)

(Unaudited)

Note 7. Derivative Instruments (Continued)

values of derivative instruments, presenting the impact of offsetting the derivative assets and liabilities on the Company's condensed consolidated balance sheets (in thousands):

	Gross Amount of Recognized Assets	March 31, 2015 Gross Amounts Offset in the Condensed Consolidated Balance Sheets	Net Amounts Presented in the Condensed Consolidated Balance Sheets
Offsetting Derivative Assets:			
Current asset	\$ 115,010	\$ (10,653)	\$ 104,357
Long-term asset	30,907		30,907
Total asset	\$ 145,917	\$ (10,653)	\$ 135,264

Offsetting Derivative Liabilities:			
Current liability	\$ (10,653)	\$ 10,653	\$
Long-term liability			
Total liability	\$ (10,653)	\$ 10,653	\$

	Gross Amount of Recognized Assets	December 31, 2014 Gross Amounts Offset in the Condensed Consolidated Balance Sheets	Net Amounts Presented in the Condensed Consolidated Balance Sheets
Offsetting Derivative Assets:			
Current asset	\$ 194,953	\$ (94,772)	\$ 100,181
Long-term asset	24,024		24,024
Total asset	\$ 218,977	\$ (94,772)	\$ 124,205

Offsetting Derivative Liabilities:			
Current liability	\$ (94,772)	\$ 94,772	\$
Long-term liability	(889)		(889)
Total liability	\$ (95,661)	\$ 94,772	\$ (889)

Table of Contents

Sanchez Energy Corporation

Notes to the Condensed Consolidated Financial Statements (Continued)

(Unaudited)

Note 8. Investments

On March 31, 2015, a subsidiary of the Company received approximately \$2 million in common units of SPP as part of the consideration paid for the Palmetto disposition described in Note 3, "Acquisitions and Divestitures" above. Rather than accounting for the investment under the equity method, the Company elected the fair value option to account for its interest in SPP.

The Company will record the equity investment in SPP at fair value at the end of each reporting period. Any gains or losses will be recorded as a component of other income (expense) in the consolidated statement of operations. As the Company received the common units in SPP on March 31, 2015, the last day of the reporting period, there was no change in fair value of the equity investment. The Company did not record any gains or losses related to the investment in SPP for the three months ended March 31, 2015.

Note 9. Fair Value of Financial Instruments

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

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

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

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

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

Table of Contents**Sanchez Energy Corporation****Notes to the Condensed Consolidated Financial Statements (Continued)****(Unaudited)****Note 9. Fair Value of Financial Instruments (Continued)*****Fair Value on a Recurring Basis***

The following tables set forth, by level within the fair value hierarchy, the Company's financial assets and liabilities that were accounted for at fair value on a recurring basis as of March 31, 2015 and December 31, 2014 (in thousands):

	As of March 31, 2015			
	Active Market for Identical Assets (Level 1)	Observable Inputs (Level 2)	Unobservable Inputs (Level 3)	Total Carrying Value
<i>Cash and cash equivalents:</i>				
Money market funds	\$ 200,259	\$	\$	\$ 200,259
<i>Equity investment:</i>				
Investment in SPP	\$ 2,000	\$	\$	\$ 2,000
<i>Oil derivative instruments:</i>				
Swaps		109,344		109,344
<i>Gas derivative instruments:</i>				
Swaps		20,186		20,186
Enhanced Swaps			4,477	4,477
Three-way collars			1,257	1,257
Total	\$ 202,259	\$ 129,530	\$ 5,734	\$ 337,523

	As of December 31, 2014			
	Active Market for Identical Assets (Level 1)	Observable Inputs (Level 2)	Unobservable Inputs (Level 3)	Total Carrying Value
<i>Cash and cash equivalents:</i>				
Money market funds	\$ 400,186	\$	\$	\$ 400,186
<i>Oil derivative instruments:</i>				
Swaps		33,975		33,975
Enhanced Swaps			44,586	44,586
Three-way collars			24,264	24,264
<i>Gas derivative instruments:</i>				
Swaps		13,818		13,818
Enhanced Swaps			5,193	5,193
Three-way collars			1,480	1,480
Total	\$ 400,186	\$ 47,793	\$ 75,523	\$ 523,502

Edgar Filing: Sanchez Energy Corp - Form 10-Q

Financial Instruments: The Level 1 instruments presented in the tables above consist of money market funds included in cash and cash equivalents and equity investment on the Company's condensed consolidated balance sheets at March 31, 2015 and December 31, 2014. The Company's money market funds represent cash equivalents backed by the assets of high-quality banks and financial institutions. The Company identified the money market funds as Level 1 instruments due to the fact that the money

Table of Contents

Sanchez Energy Corporation

Notes to the Condensed Consolidated Financial Statements (Continued)

(Unaudited)

Note 9. Fair Value of Financial Instruments (Continued)

market funds have daily liquidity, quoted prices for the underlying investments can be obtained and there are active markets for the underlying investments. A subsidiary of the Company received common units in SPP as part of the consideration received for the Palmetto disposition discussed in Note 3, "Acquisitions and Divestitures." The Company is accounting for these units as an equity method investment utilizing the fair value accounting method. The Company identified the common units as Level 1 instruments due to the fact that SPP is a publicly traded company on the NYSE MKT with daily quoted prices that can be easily obtained.

The Company's derivative instruments, which consist of swaps, enhanced swaps, collars and puts, are classified as either Level 2 or Level 3 in the table above. The fair values of the Company's derivatives are based on third-party pricing models which utilize inputs that are either readily available in the public market, such as forward curves, or can be corroborated from active markets of broker quotes. These values are then compared to the values given by the Company's counterparties for reasonableness. Since swaps do not include optionality and therefore generally have no unobservable inputs, they are classified as Level 2. The Company's enhanced swaps, puts, collars and three-way collars include some level of unobservable inputs, such as volatility curves, and are therefore classified as Level 3. Derivative instruments are also subject to the risk that counterparties will be unable to meet their obligations. Such non-performance risk is considered in the valuation of the Company's derivative instruments, but to date has not had a material impact on estimates of fair values. Significant changes in the quoted forward prices for commodities and changes in market volatility generally lead to corresponding changes in the fair value measurement of the Company's derivative instruments.

The fair values of the Company's derivative instruments classified as Level 3 as of March 31, 2015 and December 31, 2014 were \$5.7 million and \$75.5 million, respectively. The significant unobservable inputs for Level 3 contracts include unpublished forward prices of commodities, market volatility and credit risk of counterparties. Changes in these inputs will impact the fair value measurement of the Company's derivative contracts.

Table of Contents**Sanchez Energy Corporation****Notes to the Condensed Consolidated Financial Statements (Continued)****(Unaudited)****Note 9. Fair Value of Financial Instruments (Continued)**

The following table sets forth a reconciliation of changes in the fair value of the Company's derivative instruments classified as Level 3 in the fair value hierarchy (in thousands):

	Significant Unobservable Inputs (Level 3) Three Months Ended March 31,	
	2015	2014
Beginning balance	\$ 75,523	\$ (519)
Total gains (losses) included in earnings	418	(2,409)
Net settlements on derivative contracts ⁽¹⁾	(14,277)	412
Derivative contracts transferred to Level 2	(55,930)	
Ending balance	\$ 5,734	\$ (2,516)
Losses included in earnings related to derivatives still held as of March 31, 2015 and 2014	\$ (940)	\$ (1,996)

⁽¹⁾ Includes (\$12,919) of net settlements in Level 2 at 3/31/15 that were transferred from Level 3 during Q1 2015.

In February 2015, the Company modified certain of its crude oil enhanced swap and three-way collar transactions to create crude oil swaps on a costless transactional basis. As of December 31, 2014, these crude oil enhanced swaps and three-way collar transactions had fair values classified as Level 3. When the transactions were modified to swaps during the first quarter of 2015, the fair values of the transactions were classified as Level 2.

Fair Value on a Non-Recurring Basis

The Company follows the provisions of ASC 820-10 for nonfinancial assets and liabilities measured at fair value on a non-recurring basis. Fair-value measurements of assets acquired and liabilities assumed in business combinations are based on inputs that are not observable in the market and thus represent Level 3 inputs. The fair value of acquired properties is based on market and cost approaches. Our purchase price allocation for the Catarina acquisition is presented in Note 3, "Acquisitions and Divestitures." Liabilities assumed include asset retirement obligations existing at the date of acquisition. Asset retirement obligation estimates are derived from historical costs as well as management's expectation of future cost environments. As there is no corroborating market activity to support the assumptions, the Company has designated these liabilities as Level 3. A reconciliation of the beginning and ending balances of the Company's asset retirement obligations is presented in Note 10, "Asset Retirement Obligations."

In connection with the exchange agreements entered into in February, May and August 2014 by the Company with certain holders of the Company's Series A Convertible Perpetual Preferred Stock and Series B Convertible Perpetual Preferred Stock, the Company issued common stock according to the conversion rate pursuant to each agreement and additional shares to induce the holders of the preferred stock to convert prior to the date