MDC PARTNERS INC
Form 10-Q
August 04, 2011

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2011

or

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

For the transition period from ______________ to ______________

Commission file number: 001-13178

MDC Partners Inc.
(Exact name of registrant as specified in its charter)

Canada (State or other jurisdiction of incorporation or organization)	98-0364441 (IRS Employer Identification No.)
745 Fifth Avenue New York, New York (Address of principal executive offices)	10151 (Zip Code)

(646) 429-1800
Registrant's telephone number, including area code:

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

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

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 x
Non-accelerated Filer ¨ (Do not check if a smaller reporting company.)	Smaller reporting company ¨

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

The numbers of shares outstanding as of July 25, 2011 were: 30,034,774 Class A subordinate voting shares and 2,503 Class B multiple voting shares.

Website Access to Company Reports

MDC Partners Inc.'s internet website address is www.mdc-partners.com. The Company's annual reports on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K, and any amendments to those reports filed or furnished pursuant to section 13(a) or 15(d) of the Exchange Act, will be made available free of charge through the Company's website as soon as reasonably practical after those reports are electronically filed with, or furnished to, the Securities and Exchange Commission. The information found on, or otherwise accessible through, the Company's website is not incorporated into, and does not form a part of, this quarterly report on Form 10-Q.

MDC PARTNERS INC.

QUARTERLY REPORT ON FORM 10-Q

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Item 1. Financial Statements

MDC PARTNERS INC. AND SUBSIDIARIES

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(thousands of United States dollars, except share and per share amounts)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2011	2010	2011	201
Revenue:				
Services	$240,476	$169,890	$457,978	$305,8
Operating Expenses:				
Cost of services sold	162,408	116,364	321,552	212,9
Office and general expenses	53,777	39,101	99,508	73,37
Depreciation and amortization	9,736	8,029	20,119	13,84
	225,921	163,494	441,179	300,1
Operating profit	14,555	6,396	16,799	5,647
Other Income (Expenses):				
Other income (expense), net	444	(289)	755	(877
Interest expense	(10,666)	(8,425)	(20,230)	(15,4
Interest income	28	69	60	100
	(10,194)	(8,645)	(19,415)	(16,2
Income (loss) from continuing operations before income taxes, equity in affiliates	4,361	(2,249)	(2,616)	(10,5
Income tax expense	590	552	946	801
Income (loss) from continuing operations before equity in affiliates	3,771	(2,801)	(3,562)	(11,3
Equity in earnings (loss) of non-consolidated affiliates	79	(39)	334	(143
Income (loss) from continuing operations	3,850	(2,840)	(3,228)	(11,5
Loss from discontinued	—	(932)	—	(1,40

operations attributable to MDC Partners Inc., net of taxes						
Net income (loss)	3,850	(3,772	)	(3,228	)	(12,9
Net income attributable to the noncontrolling interests	(2,527)	(2,033	)	(4,132	)	(3,05
Net income (loss) attributable to MDC Partners Inc.	$1,323	$(5,805	)	$(7,360	)	$(15,9
Income (loss) Per Common Share:						
Basic:						
Income (loss) from continuing operations attributable to MDC Partners Inc. common shareholders	$0.05	$(0.18	)	$(0.25	)	$(0.53
Discontinued operations attributable to MDC Partners Inc. common shareholders	—	(0.03	)	—		(0.05
Net income (loss) attributable to MDC Partners Inc. common shareholders	$0.05	$(0.21	)	$(0.25	)	$(0.58
Diluted:						
Income (loss) from continuing operations attributable to MDC Partners Inc. common shareholders	$0.04	(0.18	)	$		

Production of oil, natural gas and natural gas liquids could be materially and adversely affected by natural disasters or severe or unseasonable weather.

Production of oil, natural gas and natural gas liquids could be materially and adversely affected by natural disasters or severe weather. Repercussions of natural disasters or severe weather conditions may include:

- evacuation of personnel and curtailment of operations;
- damage to drilling rigs or other facilities, resulting in suspension of operations;

inability to deliver materials to worksites; and

damage to, or shutting in of, pipelines and other transportation facilities.

In addition, our hydraulic fracturing operations require significant quantities of water. Regions in which we operate have recently experienced drought conditions. Any diminished access to water for use in hydraulic fracturing, whether due to usage restrictions or drought or other weather conditions, could curtail our operations or otherwise result in delays in operations or increased costs.

Volatility in the capital markets could affect our ability to obtain capital, cause us to incur additional financing expense or affect the value of certain assets.

In recent periods, global financial markets and economic conditions have been volatile due to multiple factors, including significant write-offs in the financial services sector and weak economic conditions. In some cases, the markets have produced downward pressure on stock prices and credit capacity for certain issuers without regard to those issuers underlying financial and/or operating strength. Due to this volatility, for many companies the cost of raising money in the debt and equity capital markets has been greater in recent periods than has historically been the case. Continued market volatility may from time to time adversely affect our ability to access capital and credit markets or to obtain funds at low interest rates or on other advantageous terms. These factors may adversely affect our business, results of operations or liquidity.

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These factors may adversely affect the value of certain of our assets and our ability to draw on our senior credit facility. Adverse credit and capital market conditions may require us to reduce the carrying value of assets associated with derivative contracts to account for non-performance by, or increased credit risk from, counterparties to those contracts. If financial institutions that have extended credit commitments to us are adversely affected by volatile conditions of the United States and international capital markets, they may become unable to fund borrowings under their credit commitments to us, which could have a material adverse effect on our financial condition and our ability to borrow additional funds, if needed, for working capital, capital expenditures and other corporate purposes.

Properties that we buy may not produce as projected, and we may be unable to determine reserve potential, identify liabilities associated with the properties or obtain protection from sellers against them.

Our initial technical reviews of properties we acquire are inherently incomplete because an in-depth review of every individual property involved in each acquisition generally is not feasible. Even a detailed review of records and properties may not necessarily reveal existing or potential problems, nor will it permit a buyer to become sufficiently familiar with the properties to assess fully their deficiencies and potential. Inspections may not always be performed on every well and environmental problems, such as soil or ground water contamination, are not necessarily observable even when an inspection is undertaken. Even when problems are identified, we may assume certain environmental and other risks and liabilities in connection with acquired properties, and such risks and liabilities could have a material adverse effect on our results of operations and financial condition.

The development of our proved undeveloped reserves may take longer and may require higher levels of capital expenditures than we currently anticipate.

As of December 31, 2011, 51% of our total reserves were proved undeveloped reserves. Development of these reserves may take longer and require higher levels of capital expenditures than we currently anticipate. Therefore, ultimate recoveries from these fields may not match current expectations. Delays in the development of our reserves or increases in costs to drill and develop such reserves will reduce the PV-10 value of our estimated proved undeveloped reserves and future net revenues estimated for such reserves.

A significant portion of our operations are located in northwest Oklahoma, Kansas, west Texas and the Gulf of Mexico, making us vulnerable to risks associated with operating in a limited number of major geographic areas.

As of June 30, 2012, approximately 96.9% of our production was located in the Mid-Continent, Permian Basin and Gulf of Mexico. This concentration could disproportionately expose us to operational and regulatory risk in these areas. This relative lack of diversification in location of our key operations could expose us to adverse developments in these areas or the oil and natural gas markets, including, for example, transportation or treatment capacity constraints, curtailment of production or treatment plant closures for scheduled maintenance. These factors could have a significantly greater impact on our financial condition, results of operations and cash flows than if our properties were more diversified.

Our development and exploration operations require substantial capital, and we may be unable to obtain needed capital or financing on satisfactory terms, which could lead to a loss of properties and a decline in our oil and natural gas reserves.

The oil and natural gas industry is capital intensive. We make substantial capital expenditures in our business and operations for the exploration, development, production and acquisition of oil and natural gas reserves. Historically, we have financed capital expenditures primarily with proceeds from asset sales and from the sale of equity, debt and cash generated by operations. We expect to finance our future capital expenditures with the sale of equity and debt securities, cash flow from operations, asset sales and other financing arrangements. Our cash flow from operations and access to capital are subject to a number of variables, including:

- our proved reserves;
- the level of oil and natural gas we are able to produce from existing wells;
- the prices at which oil and natural gas are sold; and
- our ability to acquire, locate and produce new reserves.

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If our revenues decrease as a result of lower oil and natural gas prices, operating difficulties, declines in reserves or for any other reason, we may have limited ability to obtain the capital necessary to sustain our operations at current levels. In order to fund our capital expenditures, we may seek additional financing. However, our senior credit facility contains covenants limiting our ability to incur additional indebtedness, which our lenders may withhold in their sole discretion. Our senior note indentures also contain covenants that may restrict our ability to incur additional indebtedness if we do not satisfy certain financial metrics. If we are unable to obtain additional financing, it may be necessary for us to reduce or suspend our capital expenditures.

Disruptions in the global financial and capital markets also could adversely affect our ability to obtain debt or equity financing on favorable terms, or at all. The failure to obtain additional financing could result in a curtailment of our operations relating to exploration and development of our prospects, which in turn could lead to a possible loss of properties and a decline in our oil and natural gas reserves.

The agreements governing our existing indebtedness have restrictions, financial covenants and borrowing base redeterminations which could adversely affect our operations.

Our senior credit facility and the indentures governing our senior notes restrict our ability to obtain additional financing, make investments, lease equipment, sell assets and engage in business combinations. We also are required to comply with certain financial covenants and ratios. Our ability to comply with these restrictions and covenants in the future is uncertain and could be affected by the levels of cash flow from our operations and events or circumstances beyond our control. If commodity prices decline, this could adversely affect our ability to meet such restrictions and covenants. Our failure to comply with any of the restrictions and covenants under the senior credit facility, senior notes or other debt financing could result in a default under those instruments, which could cause all of our existing indebtedness to be immediately due and payable.

Our senior credit facility limits the amounts we can borrow to a borrowing base amount. The borrowing base is subject to review semi-annually; however, the lenders reserve the right to have one additional re-determination of the borrowing base per calendar year. Unscheduled re-determinations may be made at our request, but are limited to two requests per year. Borrowing base determinations are based upon proved developed producing reserves, proved developed non-producing reserves and proved undeveloped reserves. Outstanding borrowings exceeding the borrowing base must be repaid promptly, or we must pledge other oil and natural gas properties as additional collateral. We may not have the financial resources in the future to make any mandatory principal prepayments under the senior credit facility, which are required, for example, when the committed line of credit is exceeded, proceeds of asset sales in new oil and natural gas properties are not reinvested, or indebtedness that is not permitted by the terms of the senior credit facility is incurred. If the indebtedness under our senior credit facility and senior notes were to be accelerated, our assets may not be sufficient to repay such indebtedness in full.

Our derivative activities could result in financial losses and could reduce our earnings.

To achieve a more predictable cash flow and to reduce our exposure to adverse fluctuations in the prices of oil and natural gas, we currently have entered, and may in the future enter, into derivative contracts for a portion of our oil and natural gas production, including fixed price swaps, collars and basis swaps. We have not and do not plan to designate any of our derivative contracts as hedges for accounting purposes and, as a result, record all derivative contracts on our balance sheet at fair value with changes in the fair value recognized in current period earnings. Accordingly, our earnings may fluctuate significantly as a result of changes in fair value of our derivative contracts. Derivative contracts also expose us to the risk of financial loss in some circumstances, including

when:

- production is less than expected;
- the counterparty to the derivative contract defaults on its contract obligations; or
- there is a change in the expected differential between the underlying price in the derivative contract and actual prices received.

In addition, these types of derivative contracts limit the benefit we would receive from increases in the prices for oil and natural gas.

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All of our consolidated drilling and services revenues are derived from companies in the oil and natural gas industry.

Companies to which we provide drilling and related services are affected by the oil and natural gas industry risks mentioned above. Market prices of oil and natural gas, limited access to capital and reductions in capital expenditures could result in oil and natural gas companies canceling or curtailing their drilling programs, which could reduce the demand for our drilling and related services. Any prolonged reduction in the overall level of exploration and development activities, whether resulting from changes in oil and natural gas prices or otherwise, could impact our drilling and services segment by negatively affecting:

- revenues, cash flow and profitability;
- our ability to retain skilled rig personnel whom we would need in the event of an upturn in the demand for drilling and related services; and
- the fair value of our rig fleet.

Our use of 2-D and 3-D seismic data is subject to interpretation and may not accurately identify the presence of oil and natural gas. In addition, the use of such technology requires greater predrilling expenditures, which could adversely affect the results of our drilling operations.

A significant aspect of our exploration and development plan involves seismic data. Even when properly used and interpreted, 2-D and 3-D seismic data and visualization techniques are only tools used to assist geoscientists in identifying subsurface structures and hydrocarbon indicators and do not enable the interpreter to know whether hydrocarbons are present in those structures. Other geologists and petroleum professionals, when studying the same seismic data, may have significantly different interpretations than our professionals.

In addition, the use of 2-D and 3-D seismic and other advanced technologies requires greater predrilling expenditures than traditional drilling strategies, and we could incur losses due to such expenditures. As a result, our drilling activities may not be geologically successful or economical, and our overall drilling success rate or our drilling success rate for activities in a particular area may not improve.

We may often gather 2-D and 3-D seismic data over large areas. Our interpretation of seismic data delineates for us those portions of an area that we believe are desirable for drilling. Therefore, we may choose not to acquire option or lease rights prior to acquiring seismic data, and in many cases, we may identify hydrocarbon indicators before seeking option or lease rights in the location. If we are not able to lease those locations on acceptable terms, we will have made substantial expenditures to acquire and analyze 2-D and 3-D seismic data without having an opportunity to attempt to benefit from those expenditures.

Oil and natural gas wells are subject to operational hazards that can cause substantial losses for which we may not be adequately insured.

There are a variety of operating risks inherent in oil and natural gas production and associated activities, such as fires, leaks, explosions, mechanical problems, major equipment failures, blowouts, uncontrollable flow of oil, natural gas and natural gas

liquids, water or drilling fluids, casing collapses, abnormally pressurized formations and natural disasters. The occurrence of any of these or similar accidents that temporarily or permanently halt the production and sale of oil and natural gas at any of our properties could have a material adverse impact on our business activities, financial condition and results of operations.

Additionally, if any of such risks or similar accidents occur, we could incur substantial losses as a result of injury or loss of life, severe damage or destruction of property, natural resources and equipment, regulatory investigation and penalties and environmental damage and clean-up responsibility. If we experience any of these problems, our ability to conduct operations could be adversely affected. While we maintain insurance coverage that we deem appropriate for these risks, our operations may result in liabilities exceeding such insurance coverage or liabilities not covered by insurance.

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Shortages or increases in costs of equipment, services and qualified personnel could adversely affect our ability to execute our exploration and development plans on a timely basis and within our budget.

The demand for qualified and experienced personnel to conduct field operations, geologists, geophysicists, engineers and other professionals in the oil and natural gas industry can fluctuate significantly, often in correlation with oil and natural gas prices, causing periodic shortages. Historically, there have been shortages of drilling rigs and other equipment as demand for rigs and equipment has increased along with the number of wells being drilled. These factors also cause significant increases in costs for equipment, services and personnel. Higher oil and natural gas prices generally stimulate demand and result in increased prices for drilling rigs, crews and associated supplies, equipment and services. Shortages of field personnel and equipment or price increases could significantly affect our ability to execute our exploration and development plans as projected.

Market conditions or operational impediments may hinder our access to oil and natural gas markets or delay our production.

Market conditions or a lack of satisfactory oil and natural gas transportation arrangements may hinder our access to oil and natural gas markets or delay our production. The availability of a ready market for our oil and natural gas production depends on a number of factors, including the demand for and supply of oil and natural gas and the proximity of reserves to pipelines and terminal facilities. Our ability to market our production depends, in substantial part, on the availability and capacity of gathering systems, pipelines and treating facilities. Our failure to obtain such services on acceptable terms in the future or to expand our midstream assets could have a material adverse effect on our business. We may be required to shut in wells for a lack of a market or because access to natural gas pipelines, gathering system capacity or treating facilities may be limited or unavailable. We would be unable to realize revenue from any shut-in wells until production arrangements were made to deliver the production to market.

Competition in the oil and natural gas industry is intense, which may adversely affect our ability to succeed.

The oil and natural gas industry is intensely competitive, and we compete with companies that have greater resources than we do. Many of these companies not only explore for and produce oil and natural gas, but also conduct refining operations and market petroleum and other products on a regional, national or worldwide basis. These companies may be able to pay more for productive oil and natural gas properties and exploratory prospects or identify, evaluate, bid for and purchase a greater number of properties and prospects than our financial or human resources permit. In addition, these companies may have a greater ability to continue exploration activities during periods of low oil and natural gas market prices. Our larger competitors may be able to absorb the burden of present and future federal, state, local and other laws and regulations more easily than we can, which would adversely affect our competitive position. Our ability to acquire additional properties and to discover reserves in the future will be dependent upon our ability to evaluate and select suitable properties and to consummate transactions in a highly competitive environment. In addition, because we have fewer financial and human resources than many companies in our industry, we may be at a disadvantage in bidding for exploratory prospects and producing oil and natural gas properties.

Downturns in oil and natural gas prices can result in decreased oil field activity which, in turn, can result in an oversupply of service providers and drilling rigs. This oversupply can result in severe reductions in prices received for oil field services or a complete lack of work for crews and equipment.

Many of our prospects in the WTO may contain natural gas that is high in CO_2 content, which can negatively affect our economics.

The reservoirs of many of our prospects in the WTO may contain natural gas that is high in CO_2 content. The natural gas produced from these reservoirs must be treated for the removal of CO_2 prior to marketing. If we cannot obtain sufficient capacity at treatment facilities for our natural gas with a high CO_2 concentration, or if the cost to obtain such capacity significantly increases, we could be forced to delay production and development or experience increased production costs. We will not know the amount of CO_2 that we will encounter in any well until it is drilled. As a result, sometimes we encounter CO_2 levels in our wells that are higher than expected. Since the treatment expenses are incurred on a Mcf basis, we will incur a higher effective treating cost per MMBtu of natural gas sold for natural gas with a higher CO_2 content. As a result, high CO_2 gas wells must produce at much higher rates than low CO_2 gas wells to be economic, especially in a low natural gas price environment.

Furthermore, when we treat the gas for the removal of CO_2, some of the methane is used to run the treatment plant as fuel gas and other methane and heavier hydrocarbons, such as ethane, propane and butane, cannot be separated from the CO_2 and is lost. This is known as plant shrink. During 2012, our plant shrink has been approximately 5% in the WTO. After giving effect to plant shrink, as many as 3.3 Mcf of high CO_2 natural gas must be produced to sell one MMBtu of natural gas. We report our volumes of natural gas reserves and production net of CO_2 volumes that are removed prior to sales.

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The cost to construct the Century Plant may exceed estimated costs.

We are constructing the Century Plant, a CO_2 treatment plant in Pecos County, Texas, and associated compression and pipeline facilities pursuant to an agreement with a subsidiary of Occidental Petroleum Corporation (Occidental). The Century Plant will be owned and operated by Occidental for the purpose of separating and removing CO_2 from natural gas delivered by us. The cost to construct the Century Plant may exceed current estimated costs, which as of June 30, 2012 were expected to exceed the contract amount by approximately $140.0 million. In addition, there are significant risks associated with the operation and performance of a facility such as the Century Plant, and no guarantee that the Century Plant will operate at its designed capacity or otherwise perform as anticipated.

Significant or prolonged decreases in natural gas production in the WTO, due to declines in production from existing wells, depressed commodity prices or otherwise, adversely affect our ability to satisfy certain contractual obligations and revenues and cash flow from our midstream gas services segment.

We have entered into a 20-year gas gathering agreement with Piñon Gathering Company, LLC (PGC) and a 30-year gas treating agreement with Occidental. These agreements require us annually to deliver certain minimum volumes of natural gas to PGC and CO_2 to Occidental and to compensate PGC and Occidental to the extent we do not satisfy the contractual delivery requirements. A material decrease in production in the WTO, where the applicable natural gas assets are located, would result in a decline in the volume of natural gas and CO_2 delivered to PGC and Occidental, respectively, and to our own pipelines and facilities for gathering, transporting and treating. We have no control over many factors affecting production activity in the WTO, including prevailing and projected energy prices, demand for hydrocarbons, the level of reserves, geological considerations, governmental regulation and the availability and cost of capital. As a consequence of these factors, we may not be able to find, produce and deliver sufficient quantities of natural gas or CO_2 to meet our contractual delivery obligations. In addition, if we fail to connect new wells to our gathering systems, the amount of natural gas we gather, transport and treat will decline substantially over time and could, upon exhaustion of the current wells, cause us to abandon our gathering systems and, possibly cease gathering, transporting and treating operations.

We are subject to complex federal, state, local and other laws and regulations that could adversely affect the cost, manner or feasibility of conducting our operations or expose us to significant liabilities.

Our oil and natural gas exploration, production, transportation and treatment operations are subject to complex and stringent laws and regulations. In order to conduct our operations in compliance with these laws and regulations, we must obtain and maintain numerous permits, approvals and certificates from various federal, state and local governmental authorities. We may incur substantial costs in order to maintain compliance with these existing laws and regulations. Further, in light of the explosion and fire on the drilling rig Deepwater Horizon in the Gulf of Mexico, as well as recent incidents involving the release of oil and natural gas and fluids as a result of drilling activities in the United States, there have been a variety of regulatory initiatives at the federal and state levels to restrict oil and natural gas drilling operations in certain locations. Any increased regulation or suspension of oil and natural gas exploration and production, or revision or reinterpretation of existing laws and regulations, that arises out of these incidents or otherwise could result in delays and higher operating costs. Such costs or significant delays could have a material adverse effect on our business, financial condition and results of operations. We must also comply with laws and regulations prohibiting fraud and market manipulations in energy markets. To the extent we are a shipper on interstate pipelines, we must comply with the tariffs of such pipelines and with federal policies related to the use of interstate capacity.

Laws and regulations governing oil and natural gas exploration and production may also affect production levels. We are required to comply with federal and state laws and regulations governing conservation matters, including provisions related to the unitization or pooling of the oil and natural gas properties; the establishment of maximum rates of production from wells; the spacing of wells; and the plugging and abandonment of wells. These and other laws and regulations can limit the amount of oil and natural gas we can produce from our wells, limit the number of wells we can drill, or limit the locations at which we can conduct drilling operations.

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New laws or regulations, or changes to existing laws or regulations may unfavorably impact us, could result in increased operating costs and have a material adverse effect on our financial condition and results of operations. For example, Congress has recently considered, and may continue to consider, legislation that, if adopted in its proposed form, would subject companies involved in oil and natural gas exploration and production activities to, among other items, additional regulation of and restrictions on hydraulic fracturing of wells, and the elimination of most U.S. federal tax incentives and deductions available to oil and natural gas exploration and production activities. In addition, the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act) and rules promulgated thereunder could reduce trading positions in the energy futures or swaps markets and materially reduce hedging opportunities for us, which could adversely affect our revenues and cash flows during periods of low commodity prices, and which could adversely affect our ability to restructure our hedges when it might be desirable to do so.

Additionally, state and federal regulatory authorities may expand or alter applicable pipeline safety laws and regulations, compliance with which may increase capital costs for us and third party downstream oil and natural gas transporters. These and other potential regulations could increase our operating costs, reduce our liquidity, delay our operations, increase direct and third party post production costs or otherwise alter the way we conducts our business, which could have a material adverse effect on our financial condition, results of operations and cash flows and which could reduce cash received by or available for distribution, including any amounts paid by us for transportation on downstream interstate pipelines.

Our operations are subject to environmental laws and regulations that could adversely affect the cost, manner or feasibility of conducting operations or result in significant costs and liabilities.

Our oil and natural gas exploration and production operations are subject to stringent and comprehensive federal, state and local laws and regulations governing the discharge of materials into the environment or otherwise relating to environmental protection. These laws and regulations may impose numerous obligations that are applicable to our operations, including the acquisition of a permit before conducting drilling; water withdrawal or waste disposal activities; the restriction of types, quantities and concentration of materials that can be released into the environment; the limitation or prohibition of drilling activities on certain lands lying within wilderness, wetlands and other protected areas; the imposition of regulations designed to protect employees from exposure to hazardous substances; and the imposition of substantial liabilities for pollution resulting from operations. Numerous governmental authorities, such as the Environmental Protection Agency (EPA) and analogous state agencies, have the power to enforce compliance with these laws and regulations and the permits issued under them, often requiring difficult and costly actions. Failure to comply with these laws and regulations may result in litigation; the assessment of administrative, civil or criminal penalties; the imposition of investigatory or remedial obligations; and the issuance of injunctions limiting or preventing some or all of our operations.

There is inherent risk of incurring significant environmental costs and liabilities in the performance of our operations due to our handling of petroleum hydrocarbons and wastes, because of air emissions and wastewater discharges related to our operations, and as a result of historical industry operations and waste disposal practices. Under certain environmental laws and regulations, we could be subject to joint and several strict liability for the investigation, removal or remediation of previously released materials or property contamination regardless of whether we were responsible for the release or contamination or if the operations were not in compliance with all applicable laws at the time those actions were taken. Private parties, including the owners of properties upon which our wells are drilled and facilities where our petroleum hydrocarbons or wastes are taken for reclamation or disposal may also have the right to pursue legal actions to enforce compliance, as well as to seek damages for contamination even in the absence of

non-compliance, with environmental laws and regulations or for personal injury, natural resources damage or property damage. In addition, the risk of accidental spills or releases could expose us to significant liabilities that could have a material adverse effect on our financial condition or results of operations. Changes in environmental laws and regulations occur frequently, and any changes that result in more stringent or costly construction, drilling, water management, completion, waste handling, storage, transport, disposal or cleanup requirements could require us to incur significant expenditures to attain and maintain compliance and may otherwise have a material adverse effect on our results of operations, competitive position or financial condition. We may not be able to recover some or any of these costs from insurance. As a result of the increased cost of compliance, we may decide to discontinue drilling.

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Repercussions from terrorist activities or armed conflict could harm our business.

Terrorist activities, anti-terrorist efforts or other armed conflict involving the United States or its interests abroad may adversely affect the United States and global economies and could prevent us from meeting our financial and other obligations. If events of this nature occur and persist, the attendant political instability and societal disruption could reduce overall demand for oil and natural gas, potentially putting downward pressure on prevailing oil and natural gas prices and causing a reduction in our revenues. Oil and natural gas production facilities, transportation systems and storage facilities could be direct targets of terrorist attacks, and or operations could be adversely impacted if infrastructure integral to our operations is destroyed by such an attack. Costs for insurance and other security may increase as a result of these threats, and some insurance coverage may become more difficult to obtain, if available at all.

If we fail to maintain an adequate system of internal control over financial reporting, it could adversely affect our ability to accurately report our results.

Management is responsible for establishing and maintaining adequate internal control over financial reporting. Our internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements in accordance with generally accepted accounting principles. A material weakness is a deficiency, or a combination of deficiencies, in our internal control over financial reporting that results in a reasonable possibility that a material misstatement of the annual or interim financial statements will not be prevented or detected on a timely basis. Effective internal controls are necessary for us to provide reliable financial reports and deter and detect any material fraud. If we cannot provide reliable financial reports or prevent material fraud, our reputation and operating results would be harmed. Our efforts to develop and maintain our internal controls may not be successful, and we may be unable to maintain adequate controls over our financial processes and reporting in the future, including future compliance with the obligations under Section 404 of the Sarbanes-Oxley Act of 2002. Any failure to develop or maintain effective controls, or difficulties encountered in their implementation, including those related to acquired businesses, or other effective improvement of our internal controls could harm our operating results. Ineffective internal controls could also cause investors to lose confidence in our reported financial information.

Certain U.S. federal income tax preferences currently available with respect to oil and natural gas production may be eliminated as a result of future legislation.

In recent years, the Obama administration s budget proposals and other proposed legislation have included the elimination of certain key U.S. federal income tax incentives currently available to oil and gas exploration and production. If enacted into law, these proposals would eliminate certain tax preferences applicable to taxpayers engaged in the exploration or production of natural resources. These changes include, but are not limited to (i) the repeal of the percentage depletion allowance for oil and gas properties, (ii) the elimination of current deductions for intangible drilling and development costs, (iii) the elimination of the deduction for U.S. production activities and (iv) the increase in the amortization period from two years to seven years for geophysical costs paid or incurred in connection with the exploration for, or development of, oil and gas within the United States. It is unclear whether any such changes will be enacted or how soon any such changes would become effective. The passage of any legislation as a result of these proposals or any other similar changes in U.S. federal income tax laws could negatively affect our financial condition and results of operations.

New derivatives legislation and regulation could adversely affect our ability to hedge risks associated with our business.

The Dodd-Frank Act creates a new regulatory framework for oversight of derivatives transactions by the Commodity Futures Trading Commission (the CFTC) and the SEC. Among other things, the Dodd-Frank Act subjects certain swap participants to new capital, margin and business conduct standards. In addition, the Dodd-Frank Act contemplates that where appropriate in light of outstanding exposures, trading liquidity and other factors, swaps (broadly defined to include most hedging instruments other than futures) will be required to be cleared through a registered clearing facility and traded on a designated exchange or swap execution facility. The Dodd-Frank Act also establishes a new Energy and Environmental Markets Advisory Committee to make recommendations to the CFTC regarding matters of concern to exchanges, firms, end users and regulators with respect to energy and environmental markets and also expands the CFTC s power to impose position limits on specific categories of swaps (excluding swaps entered into for *bona fide* hedging purposes).

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There are some exceptions to these requirements for entities that use swaps to hedge or mitigate commercial risk. However, although we may qualify for exceptions, our derivatives counterparties may be subject to new capital, margin and business conduct requirements imposed as a result of the new legislation, which may increase our transaction costs or make it more difficult for us to enter into hedging transactions on favorable terms. Our inability to enter into hedging transactions on favorable terms, or at all, could increase our operating expenses and put us at increased exposure to risks of adverse changes in oil and natural gas prices, which could adversely affect the predictability of cash flows from sales of oil and natural gas.

In November 2011, the CFTC finalized rules to establish a position limits regime on certain core physical-delivery contracts and their economically equivalent derivatives, some of which reference major energy commodities, including oil and natural gas. The final rules became effective on January 17, 2012 and compliance with the rules was to have become mandatory on October 12, 2012. However, on September 28, 2012 the District Court of the District of Columbia vacated the CFTC s rulemaking and remanded to the CFTC for further proceedings. It is not clear what action if any the CFTC will take in response to the court s decision. However, regulations that subject us or our derivatives counterparties to limits on commodity positions could have an adverse effect on our ability to hedge risks associated with our business or on the cost of our hedging activity.

Federal and state legislative and regulatory initiatives as well as governmental reviews relating to hydraulic fracturing could result in increased costs and additional operating restrictions or delays as well as adversely affect our level of production.

Hydraulic fracturing is an important and common practice that is used to stimulate production of hydrocarbons from tight formations, such as shales. The process involves the injection of water, sand and chemicals under pressure into formations to fracture the surrounding rock and stimulate production. The process is typically regulated by state oil and gas commissions. Certain states in which we operate, including Texas and Oklahoma, and municipalities have adopted, or are considering adopting, regulations that have imposed, or that could impose, more stringent permitting, disclosure, disposal and well construction requirements on hydraulic fracturing operations. For example, in December 2011, the Railroad Commission of Texas finalized regulations requiring public disclosure of all the chemicals in fluids used in the hydraulic fracturing process. Local ordinances or other regulations may regulate or prohibit the performance of well drilling in general and hydraulic fracturing in particular. If new laws or regulations that significantly restrict or regulate hydraulic fracturing are adopted, such legal requirements could cause project delays and make it more difficult or costly for us to perform fracturing to stimulate production from a formation. These delays or additional costs could adversely affect the determination of whether a well is commercially viable. Restrictions on hydraulic fracturing could also reduce the amount of oil and natural gas that we are ultimately able to produce in commercial quantities.

In addition, a number of federal entities are analyzing, or have been requested to review, a variety of environmental issues associated with hydraulic fracturing. In April 2012, President Obama issued an executive order that established a working group for the purpose of coordinating policy, information sharing, and planning among federal agencies and offices regarding unconventional natural gas production, including hydraulic fracturing. In April 2012, the EPA issued final Clean Air Act regulations governing performance standards, including standards for the capture of air emissions released during hydraulic fracturing that will take effect in 2015. The EPA also has commenced a study of the potential environmental effects of hydraulic fracturing on drinking water and groundwater, with initial results expected to be available by late 2012 and final results by 2014, and a study regarding wastewater resulting from hydraulic fracturing activities. Moreover, the EPA plans to propose by 2014 standards that such wastewater must meet before being transported to a treatment plant. In May 2012, the U.S. Department of the Interior issued a proposed rule addressing disclosure of chemicals used, flowback fluid

management requirements and other mandates for hydraulic fracturing on federal lands. Additionally, a committee of the United States House of Representatives has conducted an investigation of hydraulic fracturing practices, and certain members of Congress have called upon the U.S. Government Accountability Office to investigate how hydraulic fracturing might adversely affect water resources; the SEC to investigate the natural gas industry and any possible misleading of investors or the public regarding the economic feasibility of pursuing natural gas deposits in shales by means of hydraulic fracturing; and the U.S. Energy Information Administration to provide a better understanding of that agency s estimates regarding natural gas reserves, including reserves from shale formations, as well as uncertainties associated with those estimates. Bills introduced in both the Senate and the House of Representatives in 2011 would, among other things, amend the federal Safe Drinking Water Act to repeal provisions that currently exempt hydraulic fracturing operations from restrictions that otherwise would apply to underground injection of fluids or propping agents. The studies and initiatives described above, depending on their degree of pursuit and any meaningful results obtained, could spur efforts to further regulate hydraulic fracturing under the Safe Drinking Water Act or other regulatory mechanisms.

Climate change laws and regulations restricting emissions of greenhouse gases could result in increased operating costs and reduced demand for the oil and natural gas that we produce while the physical effects of climate change could disrupt our production and cause us to incur significant costs in preparing for or responding to those effects.

In December 2009, the EPA published its findings that emissions of greenhouse gases (GHGs) present a danger to public health and the environment. These findings allow the agency to adopt and implement regulations that would restrict emissions of GHGs under existing provisions of the federal Clean Air Act. Accordingly, the EPA has adopted rules that require a reduction in emissions of GHGs from motor vehicles and also trigger Clean Air Act construction and operating permit review for GHG emissions from certain stationary sources. The EPA s rules relating to emissions of GHGs from stationary sources of emissions are currently subject to a number of political and legal challenges, but the federal courts have thus far declined to issue any injunctions to prevent EPA from implementing, or requiring state environmental agencies to implement, the rules. In addition, the EPA has adopted rules requiring the reporting of GHG emissions from onshore oil and natural gas production facilities in the United States on an annual basis. Both houses of Congress have from time to time considered legislation to reduce emissions of GHGs and almost one-half of the states, either individually or through multi-state regional initiatives, already have begun implementing legal measures to reduce emissions of GHGs. The adoption and implementation of any regulations imposing reporting obligations on, or limiting emissions of GHGs from, our equipment and operations could require us to incur additional costs to reduce emissions of GHGs associated with our operations or could adversely affect demand for the oil and natural gas that we produce. Finally, some scientists have concluded that increasing concentrations of GHGs in the Earth s atmosphere may produce climate changes that could have significant physical effects, such as increased frequency and severity of storms, droughts, and floods and other climatic events; if any such effects were to occur, they could have an adverse effect on our assets and operations.

We may not realize the anticipated benefits of our acquisitions of Dynamic and the Gulf of Mexico Properties or other future acquisitions, and integration of acquisitions may disrupt our business and management.

We acquired Dynamic and the Gulf of Mexico Properties in the second quarter of 2012, and we may acquire other companies or large asset packages in the future as we have done in the past. We may not realize the anticipated benefits of these acquisitions or other future acquisitions, and each acquisition has numerous risks. These risks include:

- difficulty in assimilating the operations and personnel of the acquired company;
- difficulty in maintaining controls, procedures and policies during the transition and integration;
- disruption of our ongoing business and distraction of our management and employees from other opportunities and challenges;
- difficulty integrating the acquired company s accounting, management information, human resources and other administrative systems;

- inability to retain key personnel of the acquired business;
- inability to achieve the financial and strategic goals for the acquired and combined businesses;
- inability to take advantage of anticipated tax benefits;
- potential failure of the due diligence processes to identify significant problems, liabilities or other shortcomings or challenges of an acquired business;
- exposure to litigation and other potential liabilities in connection with environmental laws regulating exploration and production activities related to entities that we acquire, or that were previously acquired by such entities;
- exposure to litigation or other claims in connection with, or inheritance of claims or litigation risk as a result of, an acquisition, including but not limited to, claims from terminated employees, customers, former stockholders or other third-parties;
- potential inability to assert that internal controls over financial reporting are effective; and
- potential incompatibility of business cultures.

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Offshore operations involve special risks that could adversely affect operations.

Offshore operations are subject to a variety of operating risks specific to the marine environment, such as capsizing, collisions and damage or loss from hurricanes or other adverse weather conditions. These conditions can cause substantial damage to facilities and interrupt production. As a result, our acquisition of Dynamic and the Gulf of Mexico Properties could cause us to incur substantial liabilities that could reduce or eliminate the funds available for exploration, development or leasehold acquisitions or result in loss of equipment and properties.

In addition, as a result of our acquisition of Dynamic and the Gulf of Mexico Properties, an oil spill on or related to offshore properties and operations could expose us to joint and several strict liability, without regard to fault, under applicable law for all containment and oil removal costs and a variety of public and private damages including, but not limited to, the costs of responding to a release of oil, natural resource damages, and economic damages suffered by persons adversely affected by an oil spill. If an oil discharge or substantial threat of discharge were to occur, we may be liable for costs and damages, which costs and damages could be material to our business, financial condition or results of operations.

Reserves associated with Gulf of Mexico properties will have relatively short production periods or reserve lives.

High production rates generally result in recovery of a relatively higher percentage of reserves from properties in the Gulf of Mexico during the initial few years when compared to other regions in the United States. Due to high initial production rates, production of reserves from reservoirs in the Gulf of Mexico generally decline more rapidly than from other producing reservoirs. As a result, our reserve replacement needs from new prospects in the Gulf of Mexico may be greater than reserve replacement needs for other properties with longer-life reserves in other producing areas. Also, expected revenue and return on capital for Gulf of Mexico properties will depend on prices prevailing during these relatively short production periods.

Our operations in the Gulf of Mexico may face broad adverse consequences resulting from increased regulation of offshore drilling operations as a result of the Deepwater Horizon incident, some of which may be unforeseeable.

The April 2010 explosion and fire on the drilling rig Deepwater Horizon and resulting major oil spill produced significant economic, environmental and natural resource damage in the Gulf Coast region. In response to the explosion and spill, there have been many proposals by governmental and private constituencies to address the direct impact of the disaster and to prevent similar disasters in the future. The Bureau of Ocean Energy, Management, Regulation and Enforcement (the BOEMRE), the agency within the U.S. Department of Interior formerly responsible for regulation of offshore energy production, issued a series of Notices to Lessees and Operators (NTLs), which imposed a variety of new safety measures and permitting requirements, and implemented a temporary moratorium on deepwater drilling activities in the Gulf of Mexico that effectively shut down deepwater drilling activities for six months in 2010. Despite the fact that the drilling moratorium was lifted, this spill and its aftermath have led to delays in obtaining drilling permits. We must interact with both the Bureau of Energy Management and the Bureau of Safety and Environmental Enforcement, which assumed the responsibilities of BOEMRE on October 1, 2011, to obtain approval of exploration and development plans and issuance of drilling permits for our Gulf of Mexico properties, which may result in added plan approval or drilling permit delays. While legislation has been introduced in the U.S. Congress to expedite the process for obtaining offshore permits that include limitations on the timeframe for environmental and judicial review, there is no guarantee that this or similar legislation will pass.

In addition to the drilling restrictions, new safety measures and permitting requirement, there have been numerous additional proposed changes in laws, regulations, guidance and policy in response to the Deepwater Horizon explosion and oil spill that could affect offshore operations and cause us to incur substantial losses or expenditures. Implementation of any one or more of the various proposed responses to the disaster could materially adversely affect operations in the Gulf of Mexico by raising operating costs, increasing insurance premiums, delaying drilling operations and increasing regulatory costs and, further, could lead to a wide variety of other unforeseeable consequences that could make operations in the Gulf of Mexico more difficult, time consuming and costly.

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New regulatory requirements could significantly delay our ability to obtain permits to drill new wells in offshore waters.

Following the Deepwater Horizon incident, the BOEMRE issued a series of NTLs and other regulatory requirements imposing new standards and permitting procedures for new wells to be drilled in federal waters of the Outer Continental Shelf. These requirements include the following:

The Environmental NTL, which imposes new and more stringent requirements for documenting the environmental impacts potentially associated with the drilling of a new offshore well and significantly increases oil spill response requirements.

The Compliance and Review NTL, which imposes requirements for operators to secure independent reviews of well design, construction and flow intervention processes, and also requires certifications of compliance from senior corporate officers.

The Drilling Safety Rule, which prescribes tighter cementing and casing practices, imposes standards for the use of drilling fluids to maintain wellbore integrity, and stiffens oversight requirements relating to blowout preventers and their components, including shear and pipe rams.

The Workplace Safety Rule, which requires operators to have a comprehensive safety and environmental management system (SEMS) in order to reduce human and organizational errors as root causes of work-related accidents and offshore spills.

On September 14, 2011, BOEMRE proposed rules that would amend the Workplace Safety Rule by requiring the imposition of certain added safety procedures to a company s SEMS not covered by the original rule and revising existing obligations that a company s SEMS be audited by requiring the use of an independent third party auditor who has been pre-approved by the agency to perform the auditing task.

As a result of the issuance of these new regulatory requirements, the Bureau of Safety and Environmental Enforcement has been taking much longer than in the past to review and approve permits for drilling operations. As a result, we may encounter increased costs associated with regulatory compliance and delays in obtaining permits for other operations such as recompletions, workovers and abandonment activities. We are unsure what long-term effect, if any, additional regulatory requirements and permitting procedures will have on offshore operations. Consequently, as a result of our acquisition of Dynamic, we may become subject to a variety of unforeseen adverse consequences arising directly or indirectly from the Deepwater Horizon incident.

As a result of our acquisition of Dynamic and the Gulf of Mexico Properties, new regulatory requirements could have a significant impact on our estimates of future asset retirement obligations from period to period.

We are responsible for plugging and abandoning wellbores and decommissioning associated platforms, pipelines and facilities on our acquired oil and natural gas properties. In addition to the NTLs discussed previously, the BOEMRE issued an NTL that became effective in October 2010, which establishes more stringent requirements for the timely decommissioning of wells, platforms and pipelines that are no longer producing or serving

exploration or support functions related to an operator s lease in the Gulf of Mexico. This NTL requires that any well that has not been used during the past five years for exploration or production on an active lease and is no longer capable of producing in paying quantities must be permanently plugged or temporarily abandoned within three years. Plugging or abandonment of wells may be delayed by two years if all of the well s hydrocarbon and sulphur zones are appropriately isolated. Similarly, platforms or other facilities that are no longer useful for operations must be removed within one year of the cessation of operations. These new regulations affecting plugging, abandonment and removal activities may serve to increase, perhaps materially, the future plugging, abandonment and removal costs associated with Dynamic s properties, which may translate into a need to increase our estimate of future asset retirement obligations required to meet such increased costs. Moreover, implementation of this NTL could likely result in increased demand for salvage contractors and equipment, resulting in increased estimates of plugging, abandonment and removal costs and increases in related asset retirement obligations.

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Our estimates of future asset retirement obligations may increase significantly and become more variable from period to period due to our increased operations in the Gulf of Mexico.

We are required to record a liability for the present value of asset retirement obligations to plug and abandon inactive, non-producing wells, to remove inactive or damaged platforms, facilities and equipment, and to restore the land or seabed at the end of oil and natural gas production operations. These costs are typically considerably more expensive for offshore operations as compared to most land-based operations, due to increased regulatory scrutiny and the logistical issues associated with working in waters of various depths. Estimating future restoration and removal costs in the Gulf of Mexico is especially difficult because most of the removal obligations may be many years in the future, regulatory requirements are subject to change or more restrictive interpretation, and asset removal technologies are constantly evolving, which may result in additional or increased costs. As a result, our acquisitions of Dynamic and the Gulf of Mexico Properties may require us to make significant increases or decreases to estimated asset retirement obligations in future periods. For example, our platforms, facilities and equipment in the Gulf of Mexico are subject to damage or destruction as a result of hurricanes. The estimated cost to plug and abandon a well or dismantle a platform can change dramatically if the host platform from which the work was anticipated to be performed is damaged or toppled, rather than structurally intact. Accordingly, our increased operations in the Gulf of Mexico could cause our estimates of future asset retirement obligations to differ dramatically from what we may ultimately incur as a result of damage from a hurricane.

Insurance may not protect us against business and operating risks associated with our Gulf of Mexico properties.

We maintain insurance for some, but not all, of the potential risks and liabilities associated with Dynamic s business. For some risks, we may not obtain insurance if we believe the cost of available insurance is excessive relative to the risks presented. Due to market conditions, premiums and deductibles for certain insurance policies can increase substantially and, in some instances, certain insurance policies are economically unavailable or available only for reduced amounts of coverage. Although we will maintain insurance at levels we believe are appropriate and consistent with industry practice, we will not be fully insured against all risks, including high-cost business interruption insurance and drilling and completion risks that are generally not recoverable from third parties or insurance. In addition, pollution and environmental risks generally are not fully insurable. Losses and liabilities from uninsured and underinsured events and delay in the payment of insurance proceeds could have a material adverse effect on our business, financial condition and results of operations.

Insurance costs have generally risen in recent years due to a number of catastrophic events, including Hurricanes Ivan, Katrina, Rita, Gustav and Ike, the Deepwater Horizon incident, the September 11, 2001 terrorist attacks and the 2011 Japanese tsunami. The offshore oil and natural gas industry suffered extensive damage from the previously mentioned hurricanes and, as a result, insurance costs related to offshore oil and gas operations have increased significantly compared to the cost of insuring onshore oil and gas production. Insurers are requiring higher retention levels and limit the amount of insurance proceeds that are available after a major windstorm in the event that damages are incurred. If storm activity in the future is as severe as it was in 2005 or 2008, insurance underwriters may no longer insure Gulf of Mexico assets against weather-related damage. In addition, we do not have in place, and do not intend to put in place, business interruption insurance due to its high cost. If an accident or other event results in damage to offshore operations, including severe weather, terrorist acts, war, civil disturbances, pollution or environmental damage, and such damage is not fully covered by insurance or a recoverable indemnity from a vendor, it could adversely affect our business, financial condition and results of operations. Moreover, we may not be able to maintain adequate insurance in the future at rates we consider reasonable or be able to obtain insurance against certain risks.

Risks Relating to the Exchange Offer

If you fail to exchange your old notes, they will continue to be restricted securities and may become less liquid.

Because we anticipate that most holders of old notes will elect to exchange their old notes, we expect that the liquidity of the market for any old notes remaining after the completion of the exchange offer may be substantially limited. Any old note tendered and exchanged in the exchange offer will reduce the aggregate principal amount of the old notes outstanding. Following the exchange offer, if you did not validly tender your old notes, you generally will not have any further registration rights and your old notes will continue to be subject to transfer restrictions. Old notes that you do not tender or that we do not accept will, following the exchange offer, continue to be restricted securities. You may not offer of sell any old notes you own following the exchange offer except under

an applicable exemption from, or in a transaction not subject to, the registration requirements of the Securities Act and applicable state securities laws. Accordingly, the liquidity of the market for any old notes could be adversely affected.

You may not receive new notes in the exchange offer if the procedures for the exchange offer are not followed.

We will issue the new notes in exchange for your old notes only if you tender the old notes and deliver a properly completed and duly executed letter of transmittal and consent or the electronic transmittal through DTC s Automated Tender Offer Program, which binds holders of the old notes to the terms of the letter of transmittal and consent, and other required documents before expiration of the exchange offer. You should allow sufficient time to ensure timely delivery of the necessary documents. Neither the exchange agent nor we are under any duty to give notification of defects or irregularities with respect to the tenders of old notes for exchange. If you are the beneficial owner of old notes that are registered in the name of your broker, dealer, commercial bank, trust company or other nominee and you wish to tender in the exchange offer, you should promptly contact the person in whose name your old notes are registered and instruct that person to tender on your behalf.

We may repurchase any old notes that are not tendered in the exchange offer on terms that are more favorable to the holders of the old notes than the terms of the exchange offer.

Although we do not currently intend to do so, we may, to the extent permitted by applicable law, purchase old notes in the open market, in privately negotiated transactions, through subsequent tender or exchange offers or otherwise. Any other purchases may be made on the same terms or on terms that are more or less favorable to holders than the terms of this exchange offer. We also reserve the right to repurchase any existing notes not tendered. If we decide to repurchase old notes on terms that are more favorable than the terms of the exchange offer, those holders who decide not to participate in the exchange offer could be better off than those who participate in the exchange offer.

Risks Relating to the New Notes

We may incur substantial additional indebtedness, including debt ranking equal to the new notes.

Subject to the restrictions in the indenture governing the new notes and in other instruments governing our other outstanding debt (including our senior credit facility), we and our subsidiaries may be able to incur substantial additional debt in the future. Although the indenture governing the new notes and the instruments governing certain of our other outstanding debt contain restrictions on the incurrence of additional debt, these restrictions are subject to a number of significant qualifications and exceptions, and debt incurred in compliance with these restrictions could be substantial. To the extent new debt is added to our current debt levels, the substantial leverage-related risks described above would increase.

If we or any of our subsidiaries that is a guarantor of the new notes incur any additional debt that ranks equally with the new notes (or with the guarantee thereof), including trade payables, the holders of that debt will be entitled to share ratably with noteholders in any proceeds distributed in connection with any insolvency, liquidation, reorganization, dissolution or other winding-up of us or such guarantor. This may have the effect of reducing the amount of proceeds paid to holders of the new notes in connection with such a distribution.

We may not be able to generate sufficient cash to service all of our indebtedness, including the new notes, and may be forced to take other actions to satisfy our obligations under our indebtedness, which may not be successful.

Our ability to make scheduled payments on or to refinance our debt obligations depends on our financial condition and operating performance, which is subject to prevailing economic and competitive conditions and to certain financial, business and other factors beyond our control. We may not be able to maintain a level of cash flows from operating activities sufficient to permit us to pay the principal, premium, if any, and interest on our indebtedness, including the new notes.

If our cash flows and capital resources are insufficient to fund our debt service obligations, we may be forced to reduce or delay investments and capital expenditures, or to sell assets, seek additional capital or restructure or refinance our indebtedness, including the new notes. Our ability to restructure or refinance our debt will depend on the condition of the capital markets and our financial condition at such time. Any refinancing of our debt could be at higher interest rates and may require us to comply with more onerous covenants, which could further restrict our business operations. The terms of existing or future debt instruments and the indenture governing the new notes may restrict us from adopting some of these alternatives. In addition, any failure to make payments of interest and principal on our outstanding indebtedness on a timely basis would likely result in a reduction of our credit rating, which could harm our ability to incur additional indebtedness. In the absence of such operating results and resources, we could face substantial liquidity problems and might be required to dispose of material assets or operations to meet our debt service and other obligations. Our senior credit facility and indentures, including the indenture governing the new notes offered for exchange hereby, restrict our ability to dispose of assets and use the proceeds from the disposition. We may not be able to consummate those dispositions or to obtain the proceeds that we could realize from them and these proceeds may not be adequate to meet any debt service obligations then due. These alternative measures may not be successful and may not permit us to meet our scheduled debt service obligations.

Your right to receive payments on the new notes is effectively junior to the right of lenders who have a security interest in our assets to the extent of the value of those assets.

Our obligations under the new notes and the guarantors obligations under their guarantees of the new notes will be unsecured, but our obligations under our senior credit facility and each guarantor s obligations under its guarantee of our senior credit facility are secured by a security interest in substantially all of our domestic tangible and intangible assets, including the stock of substantially all of our wholly-owned subsidiaries. If we are declared bankrupt or insolvent, or if we default under our senior credit facility, the funds borrowed thereunder, together with accrued interest, could become immediately due and payable. If we were unable to repay such indebtedness, the lenders under our senior credit facility could foreclose on the pledged assets to the exclusion of holders of the new notes, even if an event of default exists under the indenture governing the new notes at such time. Furthermore, if the lenders foreclose and sell the pledged equity interests in any guarantor in a transaction permitted under the terms of the indenture governing the new notes, then such guarantor will be released from its guarantee of the new notes automatically and immediately upon such sale. In any such event, because the new notes are not secured by any of such assets or by the equity interests in any such guarantor, it is possible that there would be no assets from which your claims could be satisfied or, if any assets existed, they might be insufficient to satisfy your claims in full.

We have no current borrowings under our senior credit facility, which has a borrowing base of $775.0 million. Please see Description of Other Indebtedness. As of June 30, 2012, we had approximately $3.5 billion of other outstanding secured long-term debt (or approximately $4.3 billion on an as adjusted basis to give effect to the issuance of the 2023 notes and additional 2021 notes and the extinguishment of the 2014 notes). Subject to the limits set forth in the indenture, we may also incur additional secured debt.

Our ability to repay our debt, including the new notes, is affected by the cash flow generated by our subsidiaries.

Our subsidiaries own some of our assets and conduct some of our operations. Accordingly, repayment of our indebtedness, including the new notes, will be dependent on the generation of cash flow by our subsidiaries and their ability to make such cash available to us, by dividend, debt repayment or otherwise. Unless they are guarantors, our subsidiaries

will not have any obligation to pay amounts due on the new notes or to make funds available for that purpose. Our subsidiaries may not be able to, or may not be permitted to, make distributions to enable us to make payments in respect of our indebtedness, including the new notes. Each subsidiary is a distinct legal entity and, under certain circumstances, legal and contractual restrictions may limit our ability to obtain cash from our subsidiaries. While the indenture governing the new notes limits the ability of our subsidiaries to incur consensual encumbrances or restrictions on their ability to pay dividends or make other intercompany payments to us, these limitations are subject to certain qualifications and exceptions. In the event that we do not receive distributions from our subsidiaries, we may be unable to make required principal and interest payments on our indebtedness, including the new notes.

Claims of new noteholders will be structurally subordinated to claims of creditors of certain of our subsidiaries that will not guarantee the new notes.

We conduct some of our operations through our subsidiaries, and certain of our immaterial domestic subsidiaries did not guarantee the old notes and will not guarantee the new notes. Subject to certain limitations, the indenture governing the new notes permits us to form or acquire additional subsidiaries that are not guarantors of the new notes and to permit such non-guarantor subsidiaries to acquire additional assets and incur additional indebtedness. Noteholders would not have any claim as a creditor against any of our non-guarantor subsidiaries to the assets and earnings of those entities. The claims of the creditors of those subsidiaries, including their trade creditors, banks and other lenders, would have priority over any of our claims or those of our other subsidiaries as equity holders of the non-guarantor subsidiaries. Consequently, in any insolvency, liquidation, reorganization, dissolution or other winding-up of any of the non-guarantor subsidiaries, creditors of those subsidiaries would be paid before any amounts would be distributed to us or to any of the guarantors as equity, and thus be available to satisfy our obligations under the new notes and other claims against us or the guarantors.

For the quarter ended June 30, 2012, our non-guarantor subsidiaries and variable interest entities accounted for approximately $76.2 million, or 15.9%, of our revenues. As of June 30, 2012, these entities accounted for approximately $1,458.3 million, or 15.9%, of our consolidated total assets and approximately $21.4 million, or 0.4%, of our total liabilities, in each case after giving effect to intercompany eliminations. The indenture governing the new notes permits these entities to incur certain additional debt and does not limit their ability to incur other liabilities that are not considered indebtedness under the indenture.

If we default on our obligations to pay our other indebtedness, we may not be able to make payments on the new notes.

Any default under the agreements governing our indebtedness, including a default under our senior credit facility, that is not waived by the required lenders, and the remedies sought by the holders of such indebtedness, could prevent us from paying principal, premium, if any, and interest on the new notes and substantially decrease the market value of the new notes. If we are unable to generate sufficient cash flow and are otherwise unable to obtain funds necessary to meet required payments of principal, premium, if any, and interest on our indebtedness, or if we otherwise fail to comply with the various covenants, including financial and operating covenants in the instruments governing our indebtedness (including covenants in our senior credit facility and the indenture governing the new notes), we could be in default under the terms of the agreements governing such indebtedness, including our senior credit facility and the indenture governing the new notes. In the event of such default:

- the holders of such indebtedness could elect to declare all the funds borrowed thereunder to be due and payable, together with accrued and unpaid interest;
- the lenders under our senior credit facility could elect to terminate their commitments thereunder, cease making further loans and institute foreclosure proceedings against our assets; and
- we could be forced into bankruptcy or liquidation.

If our operating performance declines, we may in the future need to obtain waivers from the required lenders under our senior credit facility to avoid being in default. If we breach our covenants under our senior credit facility and seek a waiver, we may not be able to obtain a waiver from the required lenders. If this occurs, we would be in default under our senior credit facility, the lenders could exercise their rights, as described above, and we could be forced into bankruptcy or liquidation.

We may not be able to repurchase the new notes upon a change of control.

Upon the occurrence of specific kinds of change of control events, we may be required to offer to repurchase all outstanding new notes at 101% of their principal amount plus accrued and unpaid interest, if any. The source of funds for any such purchase of the new notes will be our available cash or cash generated from our operations or the operations of our subsidiaries or other sources, including borrowings, sales of assets or sales of equity. We may not be able to repurchase the new notes upon a change of control because we may not have sufficient financial resources to purchase all of the new notes that are tendered upon a change of control. Our failure to repurchase the new notes upon a change of control would cause a default under the indenture governing the new notes and could lead to a cross default under our senior credit facility.

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The Chancery Court of Delaware has raised the possibility that a change of control put right occurring as a result of a failure to have continuing directors comprising a majority of a board of directors might be unenforceable on public policy grounds. Therefore, you may not be entitled to receive this protection under the indenture.

The term change of control is limited to certain specified transactions and may not include other events that might adversely affect our financial condition. Our obligation to repurchase the notes upon a change of control would not necessarily provide holders of the notes with protection.

Insolvency and fraudulent transfer laws and other limitations may preclude the recovery of payment under the new notes and the guarantees.

Federal and state fraudulent transfer laws permit a court, if it makes certain findings, to avoid all or a portion of the obligations of the guarantors pursuant to their guarantees of the new notes, or to subordinate a guarantor s obligations under such guarantee to claims of its other creditors, reducing or eliminating the noteholders ability to recover under such guarantees. Although laws differ among these jurisdictions, in general, under applicable fraudulent transfer or conveyance laws, the new notes or guarantees could be voided as a fraudulent transfer or conveyance if: (1) we or any of the guarantors, as applicable, issued the new notes or incurred the guarantees with the intent of hindering, delaying or defrauding creditors; or (2) we or any of the guarantors, as applicable, received less than reasonably equivalent value or fair consideration in return for either issuing the new notes or incurring the guarantees and, in the case of (2) only, one of the following is also true:

- we or any of the guarantors, as applicable, were insolvent or rendered insolvent by reason of the issuance of the new notes or the incurrence of the guarantees or subsequently become insolvent for other reasons;

- the issuance of the new notes or the incurrence of the guarantees left us or any of the guarantors, as applicable, with an unreasonably small amount of capital to carry on the business;

- we or any of the guarantors intended to, or believed that we or such guarantor would, incur debts beyond our or such guarantor s ability to pay such debts as they mature; or

- we or any of the guarantors were a defendant in an action for money damages, or had a judgment for money damages docketed against us or such guarantor if, in either case, after final judgment, the judgment is unsatisfied.

Many of the covenants contained in the indenture will be suspended if the notes are rated investment grade by either Standard & Poor s or Moody s and no default has occurred and is continuing.

Many of the covenants in the indenture governing the notes will be suspended if the notes are rated investment grade by either Standard & Poor s or Moody s, provided at such time no default or event of default has occurred and is continuing. The covenants will restrict, among other things, our ability to pay dividends, incur debt and to enter into certain other transactions. There can be no assurance that the notes will ever be rated investment grade. However, suspension of these covenants would allow us to engage in certain transactions that would not be permitted while these covenants were in force, and the effects of any

such transactions will be permitted to remain in place even if the notes are subsequently downgraded below investment grade. Please read Description of the Notes Suspension of Covenants when Notes Rated Investment Grade.

An active trading market for the new notes may not develop.

There is no existing market for the old notes. The new notes will not be listed on any securities exchange, and we do not intend to apply for listing of the new notes in the future. There can be no assurance that a trading market for the new notes will ever develop or will be maintained. Further, there can be no assurance as to the liquidity of any market that may develop for the new notes, your

ability to sell your new notes or the price at which you will be able to sell your new notes. Future trading prices of the new notes will depend on many factors, including prevailing interest rates, our financial condition and results of operations, the then-current ratings assigned to the new notes and the market for similar securities. Any trading market that develops would be affected by many factors independent of and in addition to the foregoing, including:

- time remaining to the maturity of the new notes;
- outstanding amount of the new notes;
- the terms related to optional redemption of the new notes; and
- level, direction and volatility of market interest rates generally.

The future trading price of the notes is subject to fluctuation.

The future trading price of the new notes will depend on many factors, including prevailing interest rates, the liquidity of the market for the notes and the market for similar securities. The future trading price of the notes will likely also be affected by our business, results of operations and credit ratings. Accordingly, there can be no assurance as to the price at which noteholders will be able to sell their notes.

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USE OF PROCEEDS

The exchange offer is intended to satisfy our obligations under the registration rights agreement we entered into in connection with the issuance of the old notes. We will not receive any cash proceeds from the issuance of the new notes in the exchange offer. In consideration for issuing the new notes as contemplated in this prospectus, we will receive in exchange old notes in like principal amount. We will cancel and retire all old notes surrendered in exchange for new notes in the exchange offer. As a result, the issuance of the new notes will not result in any increase or decrease in our indebtedness.

We received net proceeds of approximately $730.7 million, after deducting the initial purchasers discounts and our expenses, from the April 17, 2012 private placement of the old notes. Proceeds received in the private placement were used to finance the cash consideration payable in connection with our acquisition of Dynamic and to pay related costs and expenses, with any remaining amount being used for general corporate purposes.

RATIO OF EARNINGS TO FIXED CHARGES

We have computed our ratio of earnings to fixed charges for the six months ended June 30, 2012 and 2011 and for each of our fiscal years ended December 31, 2011, 2010, 2009, 2008 and 2007. The computation of earnings to fixed charges is set forth on Exhibit 12.1 to the registration statement of which this prospectus forms a part.

Ratio of earnings to fixed charges is calculated by dividing earnings by fixed charges from operations for the periods indicated. For purposes of calculating the ratio of earnings to fixed charges, (a) earnings represents pre-tax income from continuing operations plus fixed charges and (b) fixed charges represents interest expensed and capitalized, amortization of financing costs and required dividends on preference securities.

You should read the ratio information below in conjunction with the Management s Discussion and Analysis of Financial Condition and Results of Operations and the financial statements and the notes thereto contained in our Annual Report on Form 10-K for the year ended December 31, 2011 and Quarterly Report on Form 10-Q for the period ended June 30, 2012, which are incorporated by reference in this prospectus.

	Six months ended June 30,		Twelve months ended December 31,				
	2012	**2011**	**2011**	**2010**	**2009**	**2008**	**2007**
Consolidated Ratio of Earnings to Fixed Charges	4.4	(a)	1.4	(a)	(a)	(a)	1.6

(a) Due to our loss for the six months ended June 30, 2011 and the years ended December 31, 2010, 2009 and 2008, the ratio of earnings to fixed charges was less than 1:1 for these periods. We would have needed to generate additional earnings of $99.9 million, $257.1 million, $1,785.1 million and $1,480.9 million to achieve a ratio of 1:1 for the six months ended June 30, 2011 and the years ended December 31, 2010, 2009 and 2008, respectively.

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CAPITALIZATION

The following table sets forth our consolidated cash and cash equivalents and our consolidated capitalization as of June 30, 2012:

on an actual basis; and

on an as adjusted basis to give effect to (i) the issuance of the 2023 notes and additional 2021 notes on August 20, 2012 and (ii) the application of the net proceeds of that offering, including to purchase all of the outstanding 2014 notes pursuant to the tender offer for and subsequent redemption of the remaining notes of such series.

You should read the following table in conjunction with our consolidated financial statements and related notes incorporated by reference in this prospectus. The as adjusted information may not reflect our cash, debt and capitalization in the future.

	As of June 30, 2012	
	Actual	**As Adjusted**
	(in thousands)	
Cash and cash equivalents	$ 421,073	$ 1,150,740
Long term debt, including current maturities:		
Senior credit facility	$	$
Senior Floating Rate Notes due 2014	350,000	
9.875% Senior Notes due 2016, net	355,591	355,591
8.0% Senior Notes due 2018	750,000	750,000
8.75% Senior Notes due 2020, net	443,841	443,841
7.5% Senior Notes due 2021	900,000	1,179,469[1]
8.125% Senior Notes due 2022	750,000	750,000
7.5% Senior Notes due 2023, net		820,875[2]
Total Debt	3,549,432	4,299,776
Stockholders equity:		
Preferred stock, $0.001 par value; 50,000 shares authorized;		
8.5% Convertible perpetual preferred stock 2,650 shares issued and outstanding; aggregate liquidation preference of $265,000	3	3
6.0% Convertible perpetual preferred stock 2,000 shares issued and outstanding; aggregate liquidation preference of $200,000	2	2
7.0% Convertible perpetual preferred stock 3,000 shares issued	3	3

and outstanding; aggregate liquidation preference of $300,000		
Common stock, $0.001 par value; 800,000 shares authorized; 490,161 issued and 489,191 outstanding	475	475
Additional paid-in capital	5,202,119	5,202,119
Treasury stock, at cost	(6,925)	(6,925)
Accumulated deficit	(2,360,172)	(2,360,732)
Total SandRidge Energy, Inc. stockholders equity	2,835,505	2,834,945
Noncontrolling interest	1,586,573	1,586,573
Total equity	4,422,078	4,421,518
Total capitalization	$ 7,971,510	$ 8,721,294

[1] Includes $900.0 million aggregate principal amount of 2021 notes issued on March 15, 2011 at par and $275.0 million aggregate principal amount of additional 2021 notes issued in our August 2012 offering with approximately $4.5 million of issue premium, which will be amortized over the life of the 2021 notes.

[2] Net of approximately $4.1 million of issue discount, which will be amortized over the life of the 2023 notes.

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SELECTED HISTORICAL CONSOLIDATED FINANCIAL DATA

Set forth below is our selected historical consolidated financial data for each of the six-month periods ended June 30, 2012 and 2011 and for each of the five years in the period ended December 31, 2011. The selected financial data as of June 30, 2012 and for the six-month periods ended June 30, 2012 and 2011 is derived from the unaudited condensed consolidated financial statements included in our Quarterly Report on Form 10-Q for the period ended June 30, 2012, which is incorporated by reference in this prospectus and, in the opinion of management, such data includes all adjustments necessary for a fair statement of the results for the applicable interim period. The selected financial data as of December 31, 2011 and 2010 and for the years ended December 31, 2011, 2010 and 2009 is derived from the audited consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2011, which is incorporated by reference in this prospectus. The selected financial data as of June 30, 2011 and December 31, 2008 and 2007, and portions of the data as of December 31, 2009, is derived from financial information that we have filed with the SEC, but that is not incorporated by reference in this prospectus. The selected historical financial data should be read in conjunction with Management s Discussion and Analysis of Financial Condition and Results of Operations and our historical consolidated financial statements and the notes thereto, each of which is incorporated by reference in this prospectus from our 2011 Annual Report on Form 10-K and Quarterly Report on Form 10-Q for the period ended June 30, 2012. The historical results presented are not necessarily indicative of future results.

	Six Months Ended June 30,		Year Ended December 31,				
	2012	2011	2011	2010	2009	2008	2007
			(in thousands, except per share data)				
Statement of Operations Data:							
Revenues	$ 860,069	$ 677,621	$ 1,415,213	$ 931,736	$ 591,044	$ 1,181,814	$ 677,452
Expenses:							
Production	205,791	155,791	322,877	237,863	169,880	159,545	106,192
Production taxes	23,255	23,242	46,069	29,170	4,010	30,594	19,557
Drilling and services	36,802	33,099	65,654	22,368	28,380	22,872	44,211
Midstream and marketing	16,513	38,156	66,007	90,149	80,608	189,428	94,253
Depreciation and depletion oil and natural gas	226,326	145,286	317,246	265,914	168,919	285,644	169,431
Depreciation and amortization other	29,860	26,368	53,630	50,776	50,865	70,448	53,541
Accretion of asset retirement obligation	10,572	4,786	9,368	9,421	7,108	5,273	4,137
Impairment			2,825		1,707,150	1,867,497	
General and administrative	112,017	72,091	148,643	179,565	100,256	109,372	61,780
(Gain) loss on derivative contracts	(415,204)	107,640	(44,075)	50,872	(147,527)	(211,439)	(60,732)
Loss (gain) on sale of assets	3,380	(725)	(2,044)	2,424	26,419	(9,273)	(1,777)
Total expenses	249,312	605,734	986,200	938,522	2,196,068	2,519,961	490,593
	610,757	71,887	429,013	(6,786)	(1,605,024)	(1,338,147)	186,859

Income (loss) from operations							
Other income (expense):							
Interest expense	(135,534)	(121,124)	(237,332)	(247,442)	(185,316)	(143,458)	(112,491)
Bargain purchase gain	124,446						
Loss on extinguishment of debt		(38,232)	(38,232)				
Income from equity investments					1,020	1,398	4,372
Other income, net	2,387	1,335	3,122	2,558	7,272	1,454	729
Total other expense	(8,701)	(158,021)	(272,442)	(244,884)	(177,024)	(140,606)	(107,390)
Income (loss) before income taxes	602,056	(86,134)	156,571	(251,670)	(1,782,048)	(1,478,753)	79,469
Income tax (benefit) expense	(103,587)	(6,967)	(5,817)	(446,680)	(8,716)	(38,328)	29,524
Net income (loss)	705,643	(79,167)	162,388	195,010	(1,773,332)	(1,440,425)	49,945
Less: net income (loss) attributable to noncontrolling interest	100,958	13,161	54,323	4,445	2,258	855	(276)
Net income (loss) attributable to SandRidge Energy, Inc.	604,685	(92,328)	108,065	190,565	(1,775,590)	(1,441,280)	50,221
Preferred stock dividends and accretion	27,763	27,821	55,583	37,442	8,813	16,232	39,888
Income available (loss applicable) to SandRidge Energy, Inc. common stockholders	$ 576,922	$ (120,149)	$ 52,482	$ 153,123	$ (1,784,403)	$ (1,457,512)	$ 10,333