SANDRIDGE ENERGY INC
Form 10-Q
August 06, 2012
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2012

OR

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

For the transition period from to

Commission File Number: 001-33784

SANDRIDGE ENERGY, INC.
(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	20-8084793 (I.R.S. Employer Identification No.)
123 Robert S. Kerr Avenue Oklahoma City, Oklahoma (Address of principal executive offices)	73102 (Zip Code)

Registrant’s telephone number, including area code:
(405) 429-5500

Former name, former address and former fiscal year, if changed since last report: Not applicable

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes R 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	R		Accelerated filer	£
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 R

The number of shares outstanding of the registrant's common stock, par value $0.001 per share, as of the close of business on July 31, 2012, was 491,077,348.

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DISCLOSURES REGARDING FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q (“Quarterly Report”) of SandRidge Energy, Inc. (the "Company") includes “forward-looking statements” within the meaning of Section 27A of the Securities Act of 1933, as amended (the “Securities Act”), and Section 21E of the Securities Exchange Act of 1934, as amended (the “Exchange Act”). These statements express a belief, expectation or intention and generally are accompanied by words that convey projected future events or outcomes. These forward-looking statements may include projections and estimates concerning capital expenditures, the Company’s liquidity and capital resources, the timing and success of specific projects, outcomes and effects of litigation, claims and disputes, elements of the Company’s business strategy, the effects of the acquisition of Dynamic Offshore Resources, LLC on the Company's financial condition and other statements concerning the Company’s operations, economic performance and financial condition. Forward-looking statements are generally accompanied by words such as “estimate,” “assume,” “target,” “project,” “predict,” “believe,” “expect,” “anticipate,” “potential,” “could,” “may,” “foresee,” “plan,” “goal,” “should,” “intend” or other words that convey the uncertainty of future outcomes. The Company has based these forward-looking statements on its current expectations and assumptions about future events. These statements are based on certain assumptions and analyses made by the Company in light of its experience and perception of historical trends, current conditions and expected future developments as well as other factors the Company believes are appropriate under the circumstances. The actual results or developments anticipated may not be realized or, even if substantially realized, they may not have the expected consequences to or effects on the Company’s business or operations. Such statements are not guarantees of future performance and actual results or developments may differ materially from those projected in such forward-looking statements. The forward-looking statements in this respect speak only as of the date hereof. The Company disclaims any obligation to update or revise any forward-looking statements, unless required by law, and it cautions readers not to rely on them unduly. While the Company’s management considers these expectations and assumptions to be reasonable, they are inherently subject to significant business, economic, competitive, regulatory and other risks, contingencies and uncertainties relating to, among other matters, the risks discussed in “Risk Factors” in Item 1A of the Company’s Annual Report on Form 10-K for the fiscal year ended December 31, 2011 (the “2011 Form 10-K”).

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SANDRIDGE ENERGY, INC.
FORM 10-Q
Quarter Ended June 30, 2012

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PART I. Financial Information

ITEM 1. Financial Statements
SANDRIDGE ENERGY, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands, except per share data)

	June 30, 2012 (Unaudited)	December 31, 2011
ASSETS		
Current assets		
Cash and cash equivalents	$421,073	$207,681
Accounts receivable, net	288,332	206,336
Derivative contracts	204,202	4,066
Inventories	4,055	6,903
Costs in excess of billings	14,768	—
Prepaid expenses	33,648	14,099
Other current assets	14,707	2,755
Total current assets	980,785	441,840
Oil and natural gas properties, using full cost method of accounting		
Proved	11,197,054	8,969,296
Unproved	948,369	689,393
Less: accumulated depreciation, depletion and impairment	(5,011,661)	(4,791,534)
	7,133,762	4,867,155
Other property, plant and equipment, net	595,250	522,269
Restricted deposits	27,941	27,912
Derivative contracts	98,237	26,415
Goodwill	235,396	235,396
Other assets	107,164	98,622
Total assets	$9,178,535	$6,219,609
LIABILITIES AND EQUITY		
Current liabilities		
Current maturities of long-term debt	$—	$1,051
Accounts payable and accrued expenses	669,362	506,784
Billings and estimated contract loss in excess of costs incurred	6,321	43,320
Derivative contracts	6,962	115,435
Asset retirement obligation	140,789	32,906
Total current liabilities	823,434	699,496
Long-term debt	3,549,432	2,813,125
Derivative contracts	19,833	49,695
Asset retirement obligation	349,192	95,210
Other long-term obligations	14,566	13,133
Total liabilities	4,756,457	3,670,659
Commitments and contingencies (Note 11)		
Equity		
SandRidge Energy, Inc. stockholders' equity		
Preferred stock, $0.001 par value, 50,000 shares authorized		
8.5% Convertible perpetual preferred stock; 2,650 shares issued and outstanding at June 30, 2012 and December 31, 2011; aggregate liquidation preference of $265,000	3	3

6.0% Convertible perpetual preferred stock; 2,000 shares issued and outstanding at June 30, 2012 and December 31, 2011; aggregate liquidation preference of $200,000	2	2
7.0% Convertible perpetual preferred stock; 3,000 shares issued and outstanding at June 30, 2012 and December 31, 2011; aggregate liquidation preference of $300,000	3	3
Common stock, $0.001 par value, 800,000 shares authorized; 490,161 issued and 489,191 outstanding at June 30, 2012 and 412,827 issued and 411,953 outstanding at December 31, 2011	475	399
Additional paid-in capital	5,202,119	4,568,856
Treasury stock, at cost	(6,925)	(6,158)
Accumulated deficit	(2,360,172)	(2,937,094)
Total SandRidge Energy, Inc. stockholders' equity	2,835,505	1,626,011
Noncontrolling interest	1,586,573	922,939
Total equity	4,422,078	2,548,950
Total liabilities and equity	$9,178,535	$6,219,609

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

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SANDRIDGE ENERGY, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except per share data)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
	(Unaudited)			
Revenues				
Oil and natural gas	$429,758	$312,111	$771,123	$579,053
Drilling and services	33,632	28,537	62,941	49,571
Midstream and marketing	8,852	16,313	17,158	38,570
Other	6,192	7,813	8,847	10,427
Total revenues	478,434	364,774	860,069	677,621
Expenses				
Production	122,481	81,834	205,791	155,791
Production taxes	11,001	12,666	23,255	23,242
Drilling and services	19,241	18,058	36,802	33,099
Midstream and marketing	8,559	15,873	16,513	38,156
Depreciation and depletion — oil and natural gas	139,260	73,826	226,326	145,286
Depreciation and amortization — other	15,348	13,275	29,860	26,368
Accretion of asset retirement obligation	7,965	2,360	10,572	4,786
General and administrative	61,716	37,678	112,017	72,091
(Gain) loss on derivative contracts	(669,850)	(169,988)	(415,204)	107,640
Loss (gain) on sale of assets	300	(524)	3,380	(725)
Total expenses	(283,979)	85,058	249,312	605,734
Income from operations	762,413	279,716	610,757	71,887
Other income (expense)				
Interest expense	(68,569)	(61,687)	(135,534)	(121,124)
Bargain purchase gain	124,446	—	124,446	—
Loss on extinguishment of debt	—	(2,051)	—	(38,232)
Other (expense) income, net	(81)	138	2,387	1,335
Total other income (expense)	55,796	(63,600)	(8,701)	(158,021)
Income (loss) before income taxes	818,209	216,116	602,056	(86,134)
Income tax benefit	(103,658)	(7,054)	(103,587)	(6,967)
Net income (loss)	921,867	223,170	705,643	(79,167)
Less: net income attributable to noncontrolling interest	99,004	13,154	100,958	13,161
Net income (loss) attributable to SandRidge Energy, Inc.	822,863	210,016	604,685	(92,328)
Preferred stock dividends	13,881	13,881	27,763	27,821
Income available (loss applicable) to SandRidge Energy, Inc. common stockholders	$808,982	$196,135	$576,922	$(120,149)
Earnings (loss) per share				
Basic	$1.75	$0.49	$1.34	$(0.30)
Diluted	$1.47	$0.42	$1.14	$(0.30)
Weighted average number of common shares outstanding				
Basic	461,008	398,435	430,802	398,343
Diluted	560,640	495,982	530,378	398,343

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

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SANDRIDGE ENERGY, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY
(In thousands)

	SandRidge Energy, Inc. Stockholders								
	Convertible Perpetual Preferred Stock		Common Stock		Additional Paid-In Capital	Treasury Stock	Accumulated Deficit	Non-controlling Interest	Total
	Shares	Amount	Shares	Amount					
	(Unaudited)								
Six Months Ended June 30, 2011									
Balance at December 31, 2010	7,650	$8	406,360	$398	$4,528,912	$(3,547)	$(2,989,576)	$ 11,288	$1,547,483
Issuance of units by royalty trust	—	—	—	—	—	—	—	336,892	336,892
Distributions to noncontrolling interest owners	—	—	—	—	—	—	—	(1,501)	(1,501)
Stock issuance expense	—	—	—	—	(231)	—	—	—	(231)
Purchase of treasury stock	—	—	—	—	—	(4,984)	—	—	(4,984)
Retirement of treasury stock	—	—	—	—	(4,984)	4,984	—	—	—
Stock purchases — retirement plans, net of distributions	—	—	(110)	—	1,998	(978)	—	—	1,020
Stock-based compensation	—	—	—	—	24,987	—	—	—	24,987
Stock-based compensation excess tax benefit	—	—	—	—	7	—	—	—	7
Issuance of restricted stock awards, net of cancellations	—	—	3,668	—	—	—	—	—	—
Net (loss) income	—	—	—	—	—	—	(92,328)	13,161	(79,167)
Convertible perpetual preferred stock dividends	—	—	—	—	—	—	(27,821)	—	(27,821)
Balance at June 30, 2011	7,650	$8	409,918	$398	$4,550,689	$(4,525)	$(3,109,725)	$ 359,840	$1,796,685

Six Months Ended June 30, 2012									
Balance at December 31, 2011	7,650	$8	411,953	$399	$4,568,856	$(6,158)	$(2,937,094)	$ 922,939	$2,548,950
Issuance of common stock in acquisition	—	—	73,962	74	542,064	—	—	—	542,138
Issuance of units by royalty trust	—	—	—	—	—	—	—	587,086	587,086
Sale of royalty trust units	—	—	—	—	71,158	—	—	52,391	123,549
Distributions to royalty trust unitholders	—	—	—	—	—	—	—	(76,801)	(76,801)
Purchase of treasury stock	—	—	—	—	—	(6,704)	—	—	(6,704)
Retirement of treasury stock	—	—	—	—	(6,704)	6,704	—	—	—
Stock purchases — retirement plans, net of distributions	—	—	(96)	—	1,193	(767)	—	—	426
Stock-based compensation	—	—	—	—	25,546	—	—	—	25,546
Stock-based compensation excess tax benefit	—	—	—	—	8	—	—	—	8
Issuance of restricted stock awards, net of cancellations	—	—	3,372	2	(2)	—	—	—	—
Net income	—	—	—	—	—	—	604,685	100,958	705,643
Convertible perpetual preferred stock dividends	—	—	—	—	—	—	(27,763)	—	(27,763)
Balance at June 30, 2012	7,650	$8	489,191	$475	$5,202,119	$(6,925)	$(2,360,172)	$ 1,586,573	$4,422,078

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

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

	Six Months Ended June 30, 2012	2011
	(Unaudited)	
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income (loss)	$705,643	$(79,167)
Adjustments to reconcile net income (loss) to net cash provided by operating activities		
Depreciation, depletion and amortization	256,186	171,654
Accretion of asset retirement obligation	10,572	4,786
Debt issuance costs amortization	5,401	5,748
Discount amortization on long-term debt	1,285	1,162
Bargain purchase gain	(124,446)	—
Loss on extinguishment of debt	—	38,232
Deferred income taxes	(103,328)	(6,986)
Unrealized (gain) loss on derivative contracts	(455,138)	79,350
Realized loss on amended derivative contracts	117,108	—
Realized (gain) loss on financing derivatives	(21,125)	1,576
Loss (gain) on sale of assets	3,380	(725)
Investment income	(97)	(67)
Stock-based compensation	23,277	18,301
Changes in operating assets and liabilities	(1,012)	23,678
Net cash provided by operating activities	417,706	257,542
CASH FLOWS FROM INVESTING ACTIVITIES		
Capital expenditures for property, plant and equipment	(1,123,040)	(857,714)
Acquisitions, net of cash received	(761,575)	(9,149)
Proceeds from sale of assets	420,859	369,251
Net cash used in investing activities	(1,463,756)	(497,612)
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from borrowings	750,000	1,725,000
Repayments of borrowings	(16,029)	(1,741,795)
Premium on debt redemption	—	(30,338)
Debt issuance costs	(27,316)	(19,640)
Proceeds from issuance of royalty trust units	587,086	336,892
Proceeds from the sale of royalty trust units	123,549	—
Distributions to royalty trust unitholders	(76,801)	—
Noncontrolling interest distributions	—	(1,501)
Stock issuance expense	—	(231)
Stock-based compensation excess tax benefit	8	7
Purchase of treasury stock	(7,980)	(6,030)
Dividends paid — preferred	(27,763)	(28,980)
Cash (paid) received on settlement of financing derivatives	(45,312)	5,438
Net cash provided by financing activities	1,259,442	238,822
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	213,392	(1,248)
CASH AND CASH EQUIVALENTS, beginning of year	207,681	5,863
CASH AND CASH EQUIVALENTS, end of period	$421,073	$4,615
Supplemental Disclosure of Noncash Investing and Financing Activities		

Change in accrued capital expenditures	$8,672	$2,351
Convertible perpetual preferred stock dividends payable	$16,572	$16,572
Adjustment to oil and natural gas properties for estimated contract loss	$10,000	$19,000
Common stock issued in connection with acquisition	$542,138	$—

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

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SANDRIDGE ENERGY, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. Basis of Presentation

Nature of Business. SandRidge Energy, Inc. (the “Company” or “SandRidge”) is an independent oil and natural gas company concentrating on development and production activities in the Mid-Continent, west Texas and Gulf of Mexico. The Company’s primary areas of focus are the Mississippian formation in the Mid-Continent area of Oklahoma and Kansas and the Permian Basin in west Texas. The Company owns and operates additional interests in the Mid-Continent, Gulf of Mexico, West Texas Overthrust (“WTO”) and Gulf Coast. The Company also operates businesses that are complementary to its primary development and production activities, including gas gathering and processing facilities, an oil and gas marketing business and an oil field services business, including a drilling rig business.

Interim Financial Statements. The accompanying condensed consolidated financial statements as of December 31, 2011 have been derived from the audited financial statements contained in the Company’s 2011 Form 10-K. The unaudited interim condensed consolidated financial statements have been prepared by the Company in accordance with the accounting policies stated in the audited consolidated financial statements contained in the 2011 Form 10-K. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) have been condensed or omitted, although the Company believes that the disclosures contained herein are adequate to make the information presented not misleading. In the opinion of management, all adjustments, which consist only of normal recurring adjustments, necessary to state fairly the information in the Company’s unaudited condensed consolidated financial statements have been included. These unaudited condensed consolidated financial statements should be read in conjunction with the financial statements and notes thereto included in the 2011 Form 10-K.

Significant Accounting Policies. For a description of the Company’s significant accounting policies, refer to Note 1 of the consolidated financial statements included in the 2011 Form 10-K.

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

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

The more significant areas requiring the use of assumptions, judgments and estimates include: oil and natural gas reserves; cash flow estimates used in impairment tests of goodwill and other long-lived assets; depreciation, depletion and amortization; asset retirement obligations; assigning fair value and allocating purchase price in connection with business combinations; income taxes; valuation of derivative instruments; and accrued revenue and related receivables. Although management believes these estimates are reasonable, actual results could differ significantly from these estimates.

Risks and Uncertainties. The Company’s revenue, profitability and future growth are substantially dependent upon the prevailing and future prices for oil and natural gas, each of which depends on numerous factors beyond the Company’s control such as overall oil and natural gas production and inventories in relevant markets, economic conditions, the global political environment, regulatory developments and competition from other energy sources. Oil and natural gas prices historically have been volatile, and may be subject to significant fluctuations in the future. The Company’s derivative arrangements serve to mitigate a portion of the effect of this price volatility on the Company’s cash flows. See Note 9 for the Company’s open oil and natural gas commodity derivative contracts.

The Company has incurred, and will have to continue to incur, capital expenditures to achieve production targets contained in certain gathering and treating agreements. Additionally, the Company has a drilling obligation to each of SandRidge Mississippian Trust I (the “Mississippian Trust I”), SandRidge Permian Trust (the “Permian Trust”) and SandRidge Mississippian Trust II (the "Mississippian Trust II"). See Note 3 for discussion of these drilling obligations. The Company depends on cash flows from operating activities, funding commitments for drilling carry, the sale of non-core assets and the availability of borrowings under its senior secured revolving credit facility (the “senior credit facility”) to fund its capital expenditures. Based on current cash balances, anticipated oil and natural gas prices and production, availability under the senior credit facility, potential access to capital markets, potential sales of royalty trust units and potential sales of working interests, including those with associated drilling carries, the Company expects to be able to fund its planned capital expenditures budget, debt service requirements and working capital needs for 2012. However, a substantial or extended decline in oil or natural gas prices could have a material adverse effect on the Company's financial position, results of operations, cash flows and quantities of oil and natural gas reserves that may be economically produced. A substantial or extended decline in oil or natural gas prices could also adversely impact the Company's ability to comply with the financial covenants under its senior credit facility, which in turn would limit further borrowings to fund capital expenditures. See Note 8 for discussion of the financial covenants in the senior credit facility.

Recent Accounting Pronouncements. In May 2011, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update 2011-04, "Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRS" ("ASU 2011-04"), which clarifies the FASB's intent regarding the application of existing fair value measurements and requires additional disclosure of information regarding valuation processes and inputs used. The new disclosure requirements, which are effective for interim and annual reporting periods beginning after December 15, 2011, were implemented by the Company in the first quarter of 2012. The implementation of ASU 2011-04 had no impact on the Company's financial position or results of operations. See Note 4 for discussion of the Company's fair value measurements.

In September 2011, the FASB issued Accounting Standards Update 2011-08, "Testing Goodwill for Impairment" ("ASU 2011-08"), which allows an entity the option of performing a qualitative assessment to determine whether it is necessary to perform the current two-step annual impairment test. If an entity determines, on the basis of qualitative factors, that the fair value of the reporting unit more-likely-than-not exceeds the carrying amount, the two-step impairment test is not required. ASU 2011-08 does not change how goodwill is calculated or assigned to reporting units, nor does it revise the requirement to test goodwill annually for impairment or amend the requirement to test goodwill for impairment between annual tests if events or circumstances warrant. ASU 2011-08 is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011, with early adoption permitted. The Company will implement ASU 2011-08 for its 2012 goodwill impairment test and does not expect this pronouncement to have any impact on the value of its goodwill.

2. Acquisitions and Divestitures

2011 Divestitures

The Company completed the following divestitures in 2011, all of which were accounted for as adjustments to the full cost pool with no gain or loss recognized:

- In July 2011, the Company sold its Wolfberry assets in the Permian Basin for $151.6 million, net of fees and post-closing adjustments.
- In August 2011, the Company sold certain oil and natural gas properties in Lea County and Eddy County, New Mexico, for $199.0 million, net of fees and post-closing adjustments.
- In November 2011, the Company sold its east Texas natural gas properties in Gregg, Harrison, Rusk and Panola counties for $225.4 million, net of fees and post-closing adjustments.

2012 Acquisitions and Divestitures

Dynamic Acquisition. The Company acquired 100% of the equity interests of Dynamic Offshore Resources, LLC ("Dynamic") on April 17, 2012 for total consideration of approximately $1.2 billion, comprised of approximately $680.0 million in cash and approximately 74 million shares of the Company's common stock (the "Dynamic

Acquisition”). Dynamic is an oil and natural gas exploration, development and production company with operations in the Gulf of Mexico. The Dynamic Acquisition expanded the Company's presence in the Gulf of Mexico, adding oil and natural gas reserves and production to its existing asset base in this area. On April 18, 2012, the Company filed a registration statement with the Securities and Exchange Commission that registers under the Securities Act the resale of the shares of common stock issued as consideration in the Dynamic Acquisition.

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SANDRIDGE ENERGY, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED
(Unaudited)

The purchase price allocation presented below is preliminary and includes the use of estimates. This preliminary allocation is based on information that was available to management at the time these unaudited condensed consolidated financial statements were prepared. The Company believes the estimates used are reasonable and the significant effects of the Dynamic Acquisition are properly reflected. However, the estimates are subject to change as additional information becomes available and is assessed by the Company. The Company recorded a net deferred tax liability associated with the Dynamic Acquisition which resulted in the release of a portion of the previously recorded valuation allowance on the Company's net deferred tax asset. The Company will monitor the need to further adjust the Company's valuation allowance on its net deferred tax asset as the purchase price allocation is finalized and the full impact of the acquisition is determined. Changes to the purchase price allocation may result in a corresponding change to the bargain purchase gain in the period of change. The following table summarizes the estimated values of assets acquired and liabilities assumed in the accompanying unaudited condensed consolidated balance sheets and the resulting bargain purchase gain recognized in the accompanying unaudited condensed consolidated statements of operations (in thousands, except stock price):

Consideration(1)	
Shares of SandRidge common stock issued	73,962
SandRidge common stock price	$7.33
Fair value of common stock issued	542,138
Cash consideration(2)	680,000
Cash balance adjustment(3)	13,091
Total purchase price	$1,235,229
Estimated Fair Value of Liabilities Assumed	
Current liabilities	$125,588
Asset retirement obligation(4)	315,922
Long-term deferred tax liability(5)	103,328
Other non-current liabilities	4,469
Amount attributable to liabilities assumed	549,307
Total purchase price plus liabilities assumed	1,784,536
Estimated Fair Value of Assets Acquired	
Current assets	143,042
Oil and natural gas properties(6)	1,746,753
Other property, plant and equipment	1,296
Other non-current assets	17,891
Amount attributable to assets acquired	1,908,982
Bargain purchase gain(7)	$(124,446)

(1) Consideration paid by SandRidge consisted of 73,961,554 shares of SandRidge common stock and cash of approximately $680.0 million. The value of the stock consideration is based upon the closing price of $7.33 per share of SandRidge common stock on April 17, 2012, which was the closing date of the Dynamic Acquisition. Under the acquisition method of accounting, the purchase price is determined based on the total cash paid and the fair value of SandRidge common stock issued on the acquisition date.

(2) Cash consideration paid, including amounts paid to retire Dynamic’s long-term debt, was funded through a portion of the net proceeds from the Company’s issuance of $750.0 million of unsecured 8.125% Senior Notes due 2022 (the “8.125% Senior Notes”).

(3) In accordance with the Equity Purchase Agreement dated February 1, 2012, the Company remitted to the seller a cash payment equal to Dynamic's average daily cash balance for the 30-day period ending on the second day prior

to closing. This resulted in an additional cash payment by SandRidge of $13.1 million at closing.

(4) The estimated fair value of the acquired asset retirement obligation was determined using SandRidge's credit adjusted risk free rate.

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SANDRIDGE ENERGY, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED
(Unaudited)

(5) The net deferred tax liability is primarily a result of the difference between the estimated fair value and the Company's expected tax basis in the assets acquired and liabilities assumed. The net deferred tax liability also includes the effects of deferred tax assets associated with net operating losses and other tax attributes acquired as a result of the Dynamic Acquisition.

(6) The fair value of oil and natural gas properties acquired was estimated using a discounted cash flow model, with future cash flows estimated based upon projections of oil and natural gas reserve quantities and weighted average oil and natural gas prices of $113.62 per barrel of oil and $3.83 per Mcf of natural gas, after adjustment for transportation fees and regional price differentials. The commodity prices utilized were based upon commodity strip prices as of April 17, 2012 for the first four years and escalated for inflation at a rate of 2.0% annually beginning with the fifth year through the end of production. Future cash flows were discounted using an industry weighted average cost of capital rate.

(7) The bargain purchase gain results from the excess of the fair value of net assets acquired over consideration paid and, as additional information becomes available, is subject to adjustment. The Company was able to acquire Dynamic for less than the estimated fair value of its net assets due to less competition to acquire Dynamic's properties due to their offshore location.

The market assumptions as to future commodity prices, projections of estimated quantities of oil and natural gas reserves, expectations for timing and amount of future development and operating costs, projections of future rates of production, expected recovery rates and risk adjusted discount rates used by the Company to estimate the fair market value of the oil and natural gas properties acquired represent Level 3 inputs.

The following unaudited pro forma combined results of operations are provided for the three and six-month periods ended June 30, 2012 and June 30, 2011 as though the Dynamic Acquisition had been completed as of the beginning of the earliest period presented, or January 1, 2011. The pro forma combined results of operations for the three and six-month periods ended June 30, 2012 and 2011 have been prepared by adjusting the historical results of the Company to include the historical results of Dynamic, certain reclassifications to conform Dynamic's presentation and accounting policies to the Company's and the impact of the bargain purchase gain resulting from the preliminary purchase price allocation. These supplemental pro forma results of operations are provided for illustrative purposes only and do not purport to be indicative of the actual results that would have been achieved by the combined company for the periods presented or that may be achieved by the combined company in the future. The pro forma results of operations do not include any cost savings or other synergies that resulted, or may result, from the Dynamic Acquisition or any estimated costs that will be incurred to integrate Dynamic. Future results may vary significantly from the results reflected in this pro forma financial information because of future events and transactions, as well as other factors.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012 (1)	2011	2012 (1)	2011 (2)
	(In thousands, except per share data)			
Revenues	$508,198	$493,445	$1,038,003	$906,399
Net income	$712,007	$285,245	$493,282	$160,426
Income available to SandRidge Energy, Inc. common stockholders	$599,122	$258,217	$364,561	$118,984
Pro forma net income per common share				
Basic	$1.26	$0.55	$0.77	$0.25
Diluted	$1.07	$0.48	$0.68	$0.25

(1) Pro forma net income, income available to SandRidge Energy, Inc. common stockholders and net income per common share exclude $9.9 million and $12.4 million of transaction costs incurred and included in general and administrative expenses for the three and six-month periods ended June 30, 2012, respectively, a $124.4 million bargain purchase gain and a $103.3 million partial valuation allowance release, included in income tax benefit, in the accompanying unaudited condensed consolidated statements of operations for both the three and six-month periods ended June 30, 2012. Pro forma net income, income available to SandRidge Energy, Inc. common stockholders and net income per common share exclude $10.9 million of fees to secure financing for the Dynamic Acquisition incurred and included in interest expense in the accompanying unaudited condensed consolidated statements of operations for the six-month period ended June 30, 2012.

(2) Pro forma net income, income applicable to SandRidge Energy, Inc. common stockholders and net income per common share include a $124.4 million bargain purchase gain, $13.0 million of estimated transaction costs, $10.9 million of fees to secure financing for the Dynamic Acquisition and a partial valuation allowance release of $103.3 million.

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Revenues of $108.0 million and income from operations of $28.5 million associated with Dynamic for the period from April 18, 2012 through June 30, 2012 have been included in the accompanying unaudited condensed consolidated statements of operations for the three and six-month periods ended June 30, 2012. Additionally, the Company has incurred $9.9 million and $12.4 million in acquisition-related costs for the Dynamic Acquisition, which have been included in general and administrative expenses in the accompanying unaudited condensed consolidated statements of operations for the three and six-month periods ended June 30, 2012, respectively.

Sale of Tertiary Recovery Properties. In June 2012, the Company sold its tertiary recovery properties located in the Permian Basin area of west Texas for approximately $130.0 million, subject to post-closing adjustments. The sale of the acreage and working interests in wells was accounted for as an adjustment to the full cost pool with no gain or loss recognized. As a result of the sale, the Company was relieved of its commitment to purchase CO_2 for use in these operations. The Company's obligation under this commitment was $22.8 million as of December 31, 2011.

Acquisition of Gulf of Mexico Properties. In June 2012, the Company acquired oil and natural gas properties in the Gulf of Mexico located on approximately 184,000 gross (103,000 net) acres for approximately $38.5 million, net of purchase price adjustments and subject to post-closing adjustments. This acquisition expanded the Company's presence in the Gulf of Mexico, adding oil and natural gas reserves and production to its existing asset base in this area.

This acquisition qualifies as a business combination for accounting purposes and, as such, the Company estimated the fair value of the acquired properties as of the June 20, 2012 acquisition date, which is the date on which the Company obtained control of the properties. The fair value was estimated using a discounted cash flow model based upon market assumptions as to future commodity prices, projections of estimated quantities of oil and natural gas reserves, expectations for timing and amount of future development and operating costs, projections of future rates of production, expected recovery rates and risk adjusted discount rates. These assumptions represent Level 3 inputs.

The Company estimates the fair value of these properties approximates the fair value that would be paid by a typical market participant. As a result, no goodwill or bargain purchase gain has been recognized in conjunction with the purchase of these properties. Acquisition-related costs totaling $0.1 million have been expensed as incurred in general and administrative expenses in the accompanying unaudited condensed consolidated statements of operations for the three and six-month periods ended June 30, 2012. Revenues of $0.6 million and earnings of $0.2 million generated by the acquired properties from June 21, 2012 to June 30, 2012 have been included in the accompanying unaudited condensed consolidated statements of operations for the three and six-month periods ended June 30, 2012.

The following table summarizes the consideration paid to acquire the properties and the amounts of the assets acquired and liabilities assumed as of June 20, 2012. The purchase price allocation is preliminary and subject to adjustment upon the final closing settlement to be completed during 2012.

	(in thousands)
Consideration paid	
Cash, net of purchase price adjustment	$38,458
Fair value of identifiable assets acquired and liabilities assumed	
Proved developed and undeveloped properties	93,901
Asset retirement obligation	(55,443)
Total identifiable net assets	$38,458

The following unaudited pro forma combined results of operations are provided for the three and six-month periods ended June 30, 2012 and June 30, 2011 as though the Company acquired the Gulf of Mexico properties as of the beginning of the earliest period presented, or January 1, 2011. The pro forma combined results of operations for the three and six-month periods ended June 30, 2012 and 2011 have been prepared by adjusting the historical results of the Company to include the historical results of the acquired properties and estimates of the effect of the transaction on the combined results. These supplemental pro forma results of operations are provided for illustrative purposes only and do not purport to be indicative of the actual results that would have been achieved had the transaction been in effect for the periods presented or that may be achieved by the Company in the future. Future results may vary significantly from the results reflected in this pro forma financial information because of future events and transactions, as well as other factors.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
	(In thousands, except per share data)			
Revenues	$492,233	$388,248	$888,485	$722,247
Net income (loss)	$923,010	$233,710	$707,923	$(60,835)
Income available (loss applicable) to SandRidge Energy, Inc. common stockholders	$810,125	$206,675	$579,202	$(101,817)
Pro forma net income (loss) per common share				
Basic	$1.76	$0.52	$1.34	$(0.26)
Diluted	$1.47	$0.44	$1.14	$(0.26)

Sale of Working Interests and Associated Drilling Carry Commitments

During 2011 and the first quarter of 2012, the Company entered into two transactions whereby the Company sold non-operated working interests in the Mississippian formation. In these transactions, the Company received aggregate cash proceeds of $500.0 million for the sale of working interests and received drilling carry commitments to fund a portion of its future drilling and completion costs totaling $1.0 billion. For accounting purposes, initial cash proceeds from these transactions were reflected as a reduction of oil and natural gas properties with no gain or loss recognized, and amounts received or billed during 2011 and 2012 attributable to the drilling carry reduced the Company’s capital expenditures. These transactions, as well as drilling carry amounts received or billed and remaining as of June 30, 2012, are as follows:

Partner	Closing Date	Proceeds Received At Closing(1)	Drilling Carry Recorded	Drilling Carry Remaining
		(in millions)		
Atinum MidCon I, LLC	September 2011	$287.0	$ 82.8	$167.2
Repsol E&P USA, Inc.	January 2012	272.5	78.2	671.8
		$559.5	$ 161.0	$839.0

(1) Includes amounts related to the drilling carry.

In September 2011, the Company sold to Atinum MidCon I, LLC (“Atinum”) non-operated working interests equal to approximately 113,000 net acres in the Mississippian formation in northern Oklahoma and southern Kansas for approximately $250.0 million. In addition, Atinum agreed to pay the development costs related to its working interest, as well as a portion of the Company’s development costs equal to Atinum’s working interest for wells within an area of mutual interest up to $250.0 million. The Company expects Atinum's funding of the Company's development cost for wells within the area of mutual interest to occur over a period not to exceed three years.

In January 2012, the Company sold (i) non-operated working interests equal to approximately 250,000 net acres, in the Mississippian formation in western Kansas and (ii) non-operated working interests equal to approximately 114,000 net acres, and a proportionate share of existing salt water disposal facilities in the Mississippian formation in northern Oklahoma and southern Kansas to Repsol E&P USA Inc. ("Repsol") for approximately $250.0 million. In addition, Repsol agreed to pay the development costs related to its working interests, as well as a portion of the Company's development costs equal to 200% of Repsol's working interests for wells within an area of mutual interest up to $750.0 million. The Company expects Repsol’s funding of the Company’s development cost for wells within the area of mutual interest to occur over a three-year period.

During the six-month period ended June 30, 2012, the Company recorded approximately $142.1 million of Atinum and Repsol's drilling carry, which reduced the Company’s capital expenditures for the period.

3. Variable Interest Entities

The Company consolidates the activities of variable interest entities (“VIEs”) of which it is the primary beneficiary. The primary beneficiary of a VIE is that variable interest holder possessing a controlling financial interest through (i) its power to direct the activities of the VIE that most significantly impact the VIE’s economic performance and (ii) its obligation to absorb losses or its right to receive benefits from the VIE that could potentially be significant to the VIE. In order to determine whether the Company owns a variable interest in a VIE, the Company performs a qualitative analysis of the entity’s design, organizational structure, primary decision makers and related financial agreements.

The Company’s significant associated VIEs, including those for which the Company has determined it is the primary beneficiary and those for which it has determined it is not, are described below.

Grey Ranch Plant, L.P. Primarily engaged in treating and transportation of natural gas, Grey Ranch Plant, L.P. (“GRLP”) is a limited partnership that operates the Company’s Grey Ranch plant (the “Plant”) located in Pecos County, Texas. The Company has long-term operating and gathering agreements with GRLP and also owns a 50% interest in GRLP, which represents a variable interest. Income or losses of GRLP are allocated to the partners based on ownership percentage and any operating or cash shortfalls require contributions from the partners. The Company has determined that GRLP qualifies as a VIE because certain equity holders lack the ability to participate in decisions impacting GRLP. Agreements related to the ownership and operation of GRLP provide for GRLP to pay management fees to the Company to operate the Plant and lease payments for the Plant. Under the operating agreements, lease payments are reduced if throughput volumes are below those expected. The Company determined that it is the primary beneficiary of GRLP as it has both (i) the power to direct the activities of GRLP that most significantly impact its economic performance as operator of the Plant and (ii) the obligation to absorb losses, as a result of the operating and gathering agreements, that could potentially be significant to GRLP and, therefore, consolidates the activity of GRLP in its consolidated financial statements. The 50% ownership interest not held by the Company is presented as noncontrolling interest in the consolidated financial statements.

GRLP’s assets can be used to settle only its own obligations and not other obligations of the Company. GRLP’s creditors have no recourse to the general credit of the Company. Although GRLP is included in the Company’s consolidated financial statements, the Company’s legal interest in GRLP’s assets is limited to its 50% ownership. At June 30, 2012 and December 31, 2011, $7.8 million and $8.2 million, respectively, of noncontrolling interest in the accompanying unaudited condensed consolidated balance sheets were related to GRLP. GRLP’s assets and liabilities, after considering the effects of intercompany eliminations, included in the accompanying unaudited condensed consolidated balance sheets at June 30, 2012 and December 31, 2011 consisted of the following (in thousands):

	June 30, 2012	December 31, 2011
Cash and cash equivalents	$1,052	$1,702
Accounts receivable, net	21	24
Inventory	109	109

Prepaid expenses	59	176
Total current assets	1,241	2,011
Other property, plant and equipment, net	14,411	14,985
Total assets	$15,652	$16,996
Accounts payable and accrued expenses	$152	$280
Total liabilities	$152	$280

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SANDRIDGE ENERGY, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED
(Unaudited)

Grey Ranch Plant Genpar, LLC. The Company owns a 50% interest in Grey Ranch Plant Genpar, LLC ("Genpar"), the managing partner and 1% owner of GRLP. Additionally, the Company serves as Genpar's administrative manager. Genpar's ownership interest in GRLP is its only asset. As managing partner of GRLP, Genpar has the sole right to manage, control and conduct the business of GRLP. However, Genpar is restricted from making certain major decisions, including the decision to remove the Company as operator of the Plant. The rights afforded the Company under the Plant operating agreement and the restrictions on Genpar limit Genpar's ability to make decisions on behalf of GRLP. Therefore, Genpar is considered a VIE. Although both the Company and Genpar's other equity owner share equally in Genpar's economic losses and benefits and also have agreements that may be considered variable interests, the Company determined it was the primary beneficiary of Genpar due to (i) its ability, as administrative manager and operator of the Plant, to direct the activities of Genpar that most significantly impact its economic performance and (ii) its obligation or right, as operator of the Plant, to absorb the losses of or receive benefits from Genpar that could potentially be significant to Genpar. As the primary beneficiary, the Company consolidates Genpar's activity. However, its sole asset, the investment in GRLP, is eliminated in consolidation. Genpar has no liabilities.

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

	Mississippian Trust I	Permian Trust	Mississippian Trust II
Net proceeds of offering (in millions)	$336.9	$580.6	$587.1
Total outstanding common units	21,000,000	39,375,000	37,293,750
Total outstanding subordinated units	7,000,000	13,125,000	12,431,250
Beneficial interest owned by Company(1)	38.4 %	34.3 %	39.9 %
Liquidation date(2)	12/31/2030	3/31/2031	12/31/2031

(1) The Company sold common units of the Mississippian Trust I and the Permian Trust in transactions exempt from registration under Rule 144 under the Securities Act subsequent to their initial public offerings during the three and six-month periods ended June 30, 2012. These transactions decreased the Company's beneficial interest in the Royalty Trusts. See further discussion of the unit sales below.

(2) At the time each Royalty Trust terminates, 50% of the royalty interests conveyed to the Royalty Trust will automatically revert to the Company.

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

such quarter in order to make a distribution, to the extent possible, of up to the subordination threshold amount on all common units, including common units held by the Company. In exchange for agreeing to subordinate a portion of its Royalty Trust units, SandRidge is entitled to receive incentive distributions equal to 50% of the amount by which the cash available for distribution on all of the Royalty Trust units exceeds the applicable quarterly incentive threshold.
The Royalty Trusts declared and paid quarterly distributions during the three and six-month periods ended June 30, 2012 as follows (in millions):

	Three Months Ended June 30, 2012	Six Months Ended June 30, 2012
Total distributions	$65.9	$118.0
Distributions to third-party unitholders	$44.1	$76.8

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There were no quarterly distributions declared and paid during the three or six-month periods ended June 30, 2011. See Note 18 for discussion of the Royalty Trusts' distribution declarations in July 2012.

Pursuant to the trust agreements governing the Royalty Trusts, SandRidge has a loan commitment to each Royalty Trust, whereby SandRidge will loan funds to the Royalty Trust on an unsecured basis, with terms substantially the same as would be obtained in an arm's length transaction between SandRidge and an unaffiliated party, if at any time the Royalty Trust's cash is not sufficient to pay ordinary course administrative expenses as they become due. Any funds loaned may not be used to satisfy indebtedness of the Royalty Trust or to make distributions. There were no amounts outstanding under the loan commitments at June 30, 2012 or December 31, 2011.

The Company and one of its wholly owned subsidiaries entered into development agreements with the Royalty Trusts that obligate the Company to drill, or cause to be drilled, a specified number of wells within respective areas of mutual interest, which are also subject to the royalty interests granted to the Mississippian Trust I, Permian Trust and Mississippian Trust II, by December 31, 2014, March 31, 2015 and December 31, 2016, respectively. In the event of delays, the Company will have until December 31, 2015 and March 31, 2016 to fulfill its drilling obligations to the Mississippian Trust I and Permian Trust, respectively. At the end of the fourth full calendar quarter following satisfaction of the Company's drilling obligation (the “subordination period”), the subordinated units of each Royalty Trust will automatically convert into common units on a one-for-one basis and the Company's right to receive incentive distributions will terminate. One of the Company's wholly-owned subsidiaries also granted to each Royalty Trust a lien on the Company's interests in the properties where the development wells will be drilled in order to secure the estimated amount of drilling costs for the Royalty Trust's interests in the wells. As the Company fulfills its drilling obligation to each Royalty Trust, development wells that have been drilled and perforated for completion are released from the lien (subject to completion of an initial minimum number of wells for the Mississippian Trust II) and the total amount that may be recovered by each Royalty Trust is proportionately reduced. As of June 30, 2012, the total maximum amount recoverable by the Royalty Trusts under the liens was approximately $508.3 million. Additionally, the Company and each Royalty Trust entered into an administrative services agreement, pursuant to which the Company provides certain administrative services to the Royalty Trust, including hedge management services to the Permian Trust and the Mississippian Trust II. The Company also entered into derivatives agreements with each Royalty Trust, pursuant to which the Company provides to the Royalty Trust the economic effects of certain of the Company's derivative contracts. Substantially concurrent with the execution of the derivatives agreements with the Permian Trust and the Mississippian Trust II, the Company novated certain of the derivative contracts underlying the respective derivatives agreements to the Permian Trust and the Mississippian Trust II. In April 2012, the Company novated certain additional derivative contracts underlying the derivatives agreement to the Permian Trust. The tables below present the open oil and natural gas commodity derivative contracts at June 30, 2012 underlying the derivatives agreements, including the contracts novated to the Permian Trust and the Mississippian Trust II. The combined volume in the tables below reflects the total volume of the Royalty Trusts' open oil and natural gas commodity derivative contracts. See Note 9 for further discussion of the derivatives agreement between the Company and each Royalty Trust.

Oil Price Swaps Underlying the Derivatives Agreements

	Notional (MBbl)	Weighted Avg. Fixed Price
July 2012 — December 2012	595	$104.19
January 2013 — December 2013	1,814	$103.03
January 2014 — December 2014	2,053	$100.78

January 2015 — December 2015	667	$101.02

Natural Gas Collars Underlying the Derivatives Agreements

	Notional (MMBtu)	Collar Range
July 2012 — December 2012	402	$4.00 - 6.20
January 2013 — December 2013	858	$4.00 - 7.15
January 2014 — December 2014	937	$4.00 - 7.78
January 2015 — December 2015	1,010	$4.00 - 8.55

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

	Notional (MBbl)	Weighted Avg. Fixed Price
July 2012 — December 2012	674	$104.39
January 2013 — December 2013	1,021	$103.35
January 2014 — December 2014	799	$100.59
January 2015 — March 2015	104	$100.90

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

Each Royalty Trust's assets can be used to settle only that Royalty Trust's obligations and not other obligations of the Company or another Royalty Trust. The Royalty Trusts' creditors have no contractual recourse to the general credit of the Company. Although the Royalty Trusts are included in the Company's consolidated financial statements, the Company's legal interest in the Royalty Trusts' assets are limited to its ownership of the Royalty Trusts units. At June 30, 2012 and December 31, 2011, $1,578.8 million and $914.7 million, respectively, of noncontrolling interest in the accompanying unaudited condensed consolidated balance sheets were attributable to the Royalty Trusts. The Royalty Trusts' assets and liabilities, after considering the effects of intercompany eliminations, included in the accompanying unaudited condensed consolidated balance sheets at June 30, 2012 and December 31, 2011 consisted of the following (in thousands):

	June 30, 2012	December 31, 2011
Cash and cash equivalents(1)	$3,844	$3,151
Accounts receivable	26,199	18,357
Derivative contracts	19,538	1,499
Total current assets	49,581	23,007
Investment in royalty interests(2)	1,325,942	858,795
Less: accumulated depletion	(55,799)	(24,404)
	1,270,143	834,391
Derivative contracts	18,312	5,668
Total assets	$1,338,036	$863,066
Accounts payable and accrued expenses	$2,364	$486
Total liabilities	$2,364	$486

(1) Includes $3.0 million held by the trustee as reserves for future general and administrative expenses.

(2) Investment in royalty interests is included in oil and natural gas properties in the accompanying unaudited condensed consolidated balance sheets, and was determined by allocating the historical net book value of the Company's full cost pool based on the fair value of each Royalty Trust's royalty interests relative to the fair value of the Company's full cost pool.

The Company sold Mississippian Trust I and Permian Trust common units in transactions exempt from registration pursuant to Rule 144 under the Securities Act during the three and six-month periods ended June 30, 2012 for total proceeds of $24.7 million and $123.5 million, respectively. The unit sales were accounted for as equity transactions with no gain or loss recognized. The Company continues to be the primary beneficiary of the Mississippian Trust I and the Permian Trust, as discussed above, and continues to consolidate the activities of the Royalty Trusts. The Company's beneficial interests in the Royalty Trusts at June 30, 2012 and December 31, 2011 were as follows:

	Beneficial Interest Owned by Company			
	June 30, 2012		December 31, 2011	
Mississippian Trust I	29.3	%	38.4	%
Permian Trust	30.5	%	34.3	%
Mississippian Trust II	39.9	%	N/A	

Piñon Gathering Company, LLC. The Company has a gas gathering and operations and maintenance agreement with Piñon Gathering Company, LLC (“PGC”) through June 30, 2029. Under the gas gathering agreement, the Company is required to compensate PGC for any throughput shortfalls below a required minimum volume. By guaranteeing a minimum throughput, the Company absorbs the risk that lower than projected volumes will be gathered by the gathering system. Therefore, PGC is a VIE. Other than as required under the gas gathering and operations and maintenance agreements, the Company has not provided any support to PGC. While the Company operates the assets of PGC as directed under the operations and management agreement, the member and managers of PGC have the authority to directly control PGC and make substantive decisions regarding PGC’s activities including terminating the Company as operator without cause. As the Company does not have the ability to control the activities of PGC that most significantly impact PGC’s economic performance, the Company is not the primary beneficiary of PGC. Therefore, the results of PGC’s activities are not consolidated into the Company’s financial statements. The amounts due from and due to PGC as of June 30, 2012 and December 31, 2011, respectively, included in the accompanying unaudited condensed consolidated balance sheets are as follows (in thousands):

	June 30, 2012	December 31, 2011
Accounts receivable due from PGC	$2,621	$3,205
Accounts payable due to PGC	$5,861	$4,603

4. Fair Value Measurements

The Company measures and reports certain assets and liabilities on a fair value basis and has classified and disclosed its fair value measurements using the following levels of the fair value hierarchy:

Level 1	Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities.
Level 2	Quoted prices in markets that are not active, or inputs which are observable, either directly or indirectly, for substantially the full term of the asset or liability.
Level 3	Measurement based on prices or valuation models that require inputs that are both significant to the fair value measurement and less observable for objective sources (i.e., supported by little or no market activity).

Assets and liabilities that are measured at fair value are classified based on the lowest level of input that is significant to the fair value measurement. The Company's assessment of the significance of a particular input to the fair value measurement requires judgment, which may affect the valuation of the fair value of assets and liabilities and their placement within the fair value hierarchy levels. The determination of the fair values, stated below, considers the market for the Company's financial assets and liabilities, the associated credit risk and other factors. The Company considers active markets as those in which transactions for the assets or liabilities occur in sufficient frequency and volume to provide pricing information on an ongoing basis. The Company has assets and liabilities classified as Level 1, Level 2 and Level 3, as described below.

Level 1 Fair Value Measurements

Restricted deposits. The fair value of restricted deposits invested in mutual funds or municipal bonds is based on quoted market prices. For restricted deposits held in savings accounts, carrying value is deemed to approximate fair value.

Other assets. The fair value of other long-term assets, consisting of assets attributable to the Company's deferred compensation plan, is based on quoted market prices.

Level 2 Fair Value Measurements

Derivative contracts. The fair values of the Company's oil and natural gas fixed price swaps, natural gas collars and interest rate swap are based upon inputs that are either readily available in the public market, such as oil and natural gas futures prices, interest rates and discount rates, or can be corroborated from active markets. Fair value is determined through the use of a discounted cash flow model using the applicable inputs, discussed above. The Company applies a weighted average credit default risk rating factor for its counterparties or gives effect to its credit default risk rating, as applicable, in determining the fair value of these derivative contracts. Credit default risk ratings are based on current published credit default swap rates.

Level 3 Fair Value Measurements

Derivative contracts. The fair values of the Company's diesel fixed price swaps and oil and natural gas basis swaps are based upon quotes obtained from counterparties to the derivative contracts. These values are reviewed internally for reasonableness through the use of a discounted cash flow model using non-exchange traded regional pricing information. Additionally, the Company applies a weighted average credit default risk rating factor for its counterparties or gives effect to its credit risk, as applicable, in determining the fair value of these derivative contracts. The significant unobservable input used in the fair value measurement of the Company's diesel fixed price swaps is the estimate of diesel prices. Significant (increases) decreases in diesel prices could result in a significantly (lower) higher fair value measurement. The significant unobservable inputs used in the fair value measurement of the Company's oil and natural gas basis swaps is the estimate of future oil and natural gas basis differentials. Significant increases (decreases) in oil and natural gas basis differentials could result in a significantly higher (lower) fair value measurement. The significant unobservable inputs and the range and weighted average of these inputs used in the Company's level three fair value measurements at June 30, 2012 are included in the table below.

Derivative Type	Unobservable Input	Range			Weighted Average		Fair Value (in thousands)
Diesel fixed price swaps	Diesel price forward curve inputs	$2.74	–$2.83	per gallon	$2.78	per gallon	$(113)
Oil basis swaps	Oil basis differential forward curve inputs	$8.70	–$12.57	per barrel	$10.64	per barrel	$5,126

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(Unaudited)

The following tables summarize the Company's assets and liabilities measured at fair value on a recurring basis by the fair value hierarchy (in thousands):

June 30, 2012

	Fair Value Measurements			Netting(1)	Assets/Liabilities at
	Level 1	Level 2	Level 3		Fair Value
Assets					
Restricted deposits	$27,941	$—	$—	$—	$ 27,941
Commodity derivative contracts	—	328,844	5,126	(31,531)	302,439
Other assets	7,996	—	—	—	7,996
	$35,937	$328,844	$5,126	$(31,531)	$ 338,376
Liabilities					
Commodity derivative contracts	$—	$51,364	$113	$(31,531)	$ 19,946
Interest rate swap	—	6,849	—	—	6,849
	$—	$58,213	$113	$(31,531)	$ 26,795

December 31, 2011

	Fair Value Measurements			Netting(1)	Assets/Liabilities at
	Level 1	Level 2	Level 3		Fair Value
Assets					
Restricted deposits	$27,912	$—	$—	$—	$ 27,912
Commodity derivative contracts	—	62,746	397	(32,662)	30,481
Other assets	7,138	—	—	—	7,138
	$35,050	$62,746	$397	$(32,662)	$ 65,531
Liabilities					
Commodity derivative contracts	$—	$182,694	$4,650	$(32,662)	$ 154,682
Interest rate swap	—	10,448	—	—	10,448
	$—	$193,142	$4,650	$(32,662)	$ 165,130

(1)Represents the impact of netting assets and liabilities with counterparties with which the right of offset exists.

Fair values related to the Company's oil and natural gas fixed price swaps, natural gas collars and interest rate swap were transferred from Level 3 to Level 2 in the fourth quarter of 2011 due to enhancements to the Company's internal valuation process, including the use of observable inputs to assess the fair value. During the three and six-month periods ended June 30, 2012 and 2011, the Company did not have any transfers between Level 1, Level 2 or Level 3 fair value measurements. The Company's policy is to recognize transfers in and/or out of fair value hierarchy levels as of the end of the quarterly reporting period in which the event or change in circumstances causing the transfer occurred.

The tables below set forth a reconciliation of the Company's financial assets and liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) during the three and six-month periods ended June 30, 2012 and 2011 (in thousands):

	Three Months Ended June 30,			
	2012	2011		
	Commodity Derivative Contracts	Commodity Derivative Contracts	Interest Rate Swaps	Total
Balance of Level 3, March 31	$(2,675)	$(478,541)	$(14,929)	$(493,470)
Total gain or losses (realized/unrealized)	(1,643)	169,988	(2,798)	167,190
Purchases	5,697	—	—	—
Settlements	3,634	14,920	2,442	17,362
Balance of Level 3, June 30	$5,013	$(293,633)	$(15,285)	$(308,918)

	Six Months Ended June 30,			
	2012	2011		
	Commodity Derivative Contracts	Commodity Derivative Contracts	Interest Rate Swaps	Total
Balance of Level 3, December 31	$(4,253)	$(205,860)	$(16,694)	$(222,554)
Total gain or losses (realized/unrealized)	389	(107,640)	(3,076)	(110,716)
Purchases	5,697	—	—	—
Settlements	3,180	19,867	4,485	24,352
Balance of Level 3, June 30	$5,013	$(293,633)	$(15,285)	$(308,918)

Unrealized gains on the Company's Level 3 commodity derivative contracts of $2.1 million and $3.7 million for the three and six-month periods ended June 30, 2012, respectively, have been included in (gain) loss on derivative contracts in the accompanying unaudited condensed consolidated statements of operations.

See Note 9 for further discussion of the Company's derivative contracts.

Fair Value of Debt

The Company measures the fair value of its senior notes using pricing for the Company's senior notes that is readily available in the public market. The Company classifies these inputs as Level 2 in the fair value hierarchy. The estimated fair values and carrying values of the Company's senior notes at June 30, 2012 and December 31, 2011 were as follows (in thousands):

	June 30, 2012		December 31, 2011	
	Fair Value	Carrying Value	Fair Value	Carrying Value
Senior Floating Rate Notes due 2014	$346,833	$350,000	$339,381	$350,000
9.875% Senior Notes due 2016(1)	400,223	355,591	396,568	354,579
8.0% Senior Notes due 2018	765,000	750,000	765,000	750,000
8.75% Senior Notes due 2020(2)	470,250	443,841	475,875	443,568
7.5% Senior Notes due 2021	893,250	900,000	909,000	900,000
8.125% Senior Notes due 2022	761,250	750,000	—	—

(1)Carrying value is net of $9,909 and $10,921 discount at June 30, 2012 and December 31, 2011, respectively.
(2)Carrying value is net of $6,159 and $6,432 discount at June 30, 2012 and December 31, 2011, respectively.

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The carrying values of the Company's senior credit facility and remaining fixed rate debt instruments approximate fair value based on current rates applicable to similar instruments. See Note 8 for discussion of the Company's long-term debt.

5. Property, Plant and Equipment

Property, plant and equipment consists of the following (in thousands):

	June 30, 2012	December 31, 2011
Oil and natural gas properties		
Proved	$11,197,054	$8,969,296
Unproved	948,369	689,393
Total oil and natural gas properties	12,145,423	9,658,689
Less accumulated depreciation, depletion and impairment	(5,011,661)	(4,791,534)
Net oil and natural gas properties capitalized costs	7,133,762	4,867,155
Land	15,723	14,196
Non-oil and natural gas equipment(1)	713,769	668,391
Buildings and structures	167,009	133,147
Total	896,501	815,734
Less accumulated depreciation and amortization	(301,251)	(293,465)
Other property, plant and equipment, net	595,250	522,269
Total property, plant and equipment, net	$7,729,012	$5,389,424

(1) Includes cumulative capitalized interest of approximately $8.7 million and $6.7 million at June 30, 2012 and December 31, 2011, respectively.

There were no full cost ceiling impairments during the three or six-month periods ended June 30, 2012 or 2011. Cumulative full cost ceiling limitation impairment charges of $3,548.3 million at both June 30, 2012 and December 31, 2011 were included in accumulated depreciation, depletion and impairment for oil and natural gas properties in the table above.

6. Other Assets

Other assets consist of the following (in thousands):

	June 30, 2012	December 31, 2011
Debt issuance costs, net of amortization	$73,639	$51,724
Notes receivable on asset retirement obligations	11,001	—
Investments	7,996	7,138
Production tax credit receivable	7,665	7,665
Lease broker advances	1,448	13,086
Development advance	—	16,777
Other	5,415	2,232
Total other assets	$107,164	$98,622

7. Construction Contracts

The Company accounts for its two construction contracts using the completed-contract method, under which contract revenues and costs are recognized when work under the contract is completed and assets have been transferred. In the interim, costs incurred on and billings related to contracts in process are accumulated on the balance sheet. Contract gains or losses will be recorded as development costs within the Company's oil and natural gas properties as part of the full cost pool, when it is determined that a loss will be incurred. Contract gains, if any, are recorded at the end of the project.

Century Plant. The Company is constructing the Century Plant, a CO_2 treatment plant in Pecos County, Texas (the “Century Plant”), and associated compression and pipeline facilities pursuant to an agreement with Occidental Petroleum Corporation (“Occidental”). Under the terms of the agreement, the Company is constructing the Century Plant and Occidental is paying the Company a minimum of 100% of the contract price, or $800.0 million, plus any subsequently agreed-upon revisions, through periodic cost reimbursements based upon the percentage of the project completed by the Company. The Company expects to complete the Century Plant in two phases. Upon completion of each phase of the Century Plant, Occidental will take ownership of the related assets and will operate the Century Plant for the purpose of separating and removing CO_2 from delivered natural gas. Phase I is in the commissioning process with completion and transfer of title to Occidental expected in the third quarter of 2012, and Phase II is under construction and expected to be completed by the end of 2012. The Company has recorded additions of $140.0 million (including $10.0 million during the six-month period ended June 30, 2012) to its oil and natural gas properties for the estimated loss identified based on current projections of the costs to be incurred in excess of contract amounts. Billings and estimated contract loss in excess of costs incurred of $6.3 million and $43.3 million at June 30, 2012 and December 31, 2011, respectively, are reported as current liabilities in the accompanying unaudited condensed consolidated balance sheets.

Pursuant to a 30-year treating agreement executed simultaneously with the construction agreement, Occidental will remove CO_2 from the Company’s delivered natural gas production volumes. Under this agreement, the Company will be required to deliver certain minimum CO_2 volumes annually once Occidental takes title, and will have to compensate Occidental to the extent such requirements are not met. See Note 11 for additional discussion of this volume requirement. The Company will retain all methane gas from the natural gas it delivers to the Century Plant.

Transmission Expansion Projects. The Company entered into a construction services agreement in November 2011 to manage the design, engineering and construction of a series of transmission expansion and upgrade projects in northern Oklahoma. Under the terms of the agreement, the Company will be reimbursed for costs incurred on these projects up to approximately $22.0 million. Construction on these projects began in 2012 and is expected to be completed by the end of the year. Costs in excess of billings on these projects of $14.8 million at June 30, 2012 is reported as a current asset in the accompanying unaudited condensed consolidated balance sheets. There were no amounts related to these projects included in the accompanying unaudited condensed consolidated balance sheets at December 31, 2011.

8. Long-Term Debt

Long-term debt consists of the following (in thousands):

	June 30, 2012	December 31, 2011
Senior Floating Rate Notes due 2014	$350,000	$350,000
Senior credit facility	—	—
9.875% Senior Notes due 2016, net of $9,909 and $10,921 discount, respectively	355,591	354,579
8.0% Senior Notes due 2018	750,000	750,000
8.75% Senior Notes due 2020, net of $6,159 and $6,432 discount, respectively	443,841	443,568
7.5% Senior Notes due 2021	900,000	900,000
8.125% Senior Notes due 2022	750,000	—

Mortgage	—	16,029
Total debt	3,549,432	2,814,176
Less: current maturities of long-term debt	—	1,051
Long-term debt	$3,549,432	$2,813,125

For the three and six-month periods ended June 30, 2012, interest payments, excluding amounts capitalized, were approximately $63.4 million and $120.6 million, respectively. Interest payments for the six-month period ended June 30, 2012 included $10.9 million of fees incurred to secure financing for the Dynamic Acquisition. For the three and six-month periods ended June 30, 2011, interest payments, excluding amounts capitalized, were approximately $56.3 million and $109.5 million, respectively. Interest payments for the three and six-months ended June 30, 2011 included $1.5 million and $25.7 million, respectively, of accrued interest paid in connection with the partial redemption of the 8.625% Senior Notes due 2015, discussed further below.

Senior Floating Rate Notes Due 2014. The Company’s Senior Floating Rate Notes due 2014 (the “Senior Floating Rate Notes”) were issued in May 2008. The Senior Floating Rate Notes are jointly and severally guaranteed unconditionally, in full, on an unsecured basis by certain of the Company’s wholly owned subsidiaries and are freely tradable. See Note 17 for condensed financial information of the subsidiary guarantors.

The Senior Floating Rate Notes bear interest at the London Interbank Offered Rate ("LIBOR") plus 3.625%. Interest is payable quarterly with the principal due on April 1, 2014. The average interest rate paid on the outstanding Senior Floating Rate Notes for the three-month periods ended June 30, 2012 and 2011 was 4.09% and 3.93%, respectively, without consideration of the interest rate swap discussed below. The average interest rate paid on the outstanding Senior Floating Rate Notes for the six-month periods ended June 30, 2012 and 2011 was 4.15% and 3.93%, respectively, without consideration of the interest rate swap discussed below. The Company may redeem, at specified redemption prices, some or all of the Senior Floating Rate Notes at any time.

The $9.4 million of debt issuance costs associated with the Senior Floating Rate Notes is included in other assets in the accompanying unaudited condensed consolidated balance sheets and is being amortized to interest expense over the term of the notes.

As of June 30, 2012, the Company had a $350.0 million notional interest rate swap agreement to effectively fix the variable interest rate on the Senior Floating Rate Notes to an annual rate of 6.69% through April 1, 2013. This swap has not been designated as a hedge.

Senior Credit Facility. The senior credit facility is available to be drawn on subject to limitations based on its terms and certain financial covenants, as described below. The senior credit facility matures on March 29, 2017, if the Company has repaid or refinanced the Senior Floating Rate Notes or the Company’s 9.875% Senior Notes due 2016 prior to September 30, 2015 with a source of funds other than the senior credit facility. If either series of notes is not repaid or refinanced prior to such date, the senior credit facility will mature on November 15, 2015.

On March 29, 2012, the senior credit facility was amended and restated to, among other things, (a) increase the borrowing base to $1.0 billion from $790.0 million, (b) allow for the incurrence or issuance of additional debt (including up to $750.0 million of unsecured debt to finance the cash portion of the Dynamic purchase price and related costs and expenses), (c) permit the Company to designate certain of its subsidiaries as unrestricted subsidiaries, and (d) effective on and after June 30, 2012, establish the financial covenants as maintaining agreed upon levels for (i) ratio of total funded debt to EBITDA, which may not exceed 4.5:1.0 at each quarter end, calculated using the last four completed fiscal quarters and (ii) ratio of current assets to current liabilities, which must be at least 1.0:1.0 at each quarter end. If no amounts are drawn under the senior credit facility when calculating the ratio of total funded debt to EBITDA, the Company’s debt is reduced by its cash balance in excess of $10.0 million. In the current ratio calculation, any amounts available to be drawn under the senior credit facility are included in current assets, and unrealized assets and liabilities resulting from mark-to-market adjustments on the Company’s derivative contracts are disregarded.

Additionally, the senior credit facility contains various covenants that limit the ability of the Company and certain of its subsidiaries to grant certain liens; make certain loans and investments; make distributions; redeem stock; redeem or prepay debt; merge or consolidate with or into a third party; or engage in certain asset dispositions, including a sale of all or substantially all of the Company’s assets. Additionally, the senior credit facility limits the ability of the Company and certain of its subsidiaries to incur additional indebtedness with certain exceptions. As of and during the three and six-month periods ended June 30, 2012, the Company was in compliance with all applicable financial covenants under the senior credit facility.

The obligations under the senior credit facility are guaranteed by certain Company subsidiaries and are secured by first priority liens on all shares of capital stock of certain of the Company's material present and future subsidiaries; certain intercompany debt of the Company; and substantially all of the Company's assets, including proved oil and natural gas reserves representing at least 80.0% of the discounted present value (as defined in the senior credit facility) of proved oil and natural gas reserves considered by the lenders in determining the borrowing base for the senior credit facility.

At the Company's election, interest under the senior credit facility is determined by reference to (a) LIBOR plus an applicable margin between 1.75% and 2.75% per annum or (b) the "base rate," which is the highest of (i) the federal funds rate plus 0.5%, (ii) the prime rate published by Bank of America or (iii) the Eurodollar rate (as defined in the senior credit facility) plus 1.00% per annum, plus, in each case under scenario (b), an applicable margin between 0.75% and 1.75% per annum. Interest is payable quarterly for base rate loans and at the applicable maturity date for LIBOR loans, except that if the interest period for a LIBOR loan is six months, interest is paid at the end of each three-month period. The Company made no interest payments during the three and six-month periods ended June 30, 2012 as there were no amounts outstanding under the senior credit facility during the period. The average annual interest rate paid on amounts outstanding under the senior credit facility was 2.51% and 2.70%, respectively, for the three and six-month periods ended June 30, 2011.

Borrowings under the senior credit facility may not exceed the lower of the borrowing base or the committed amount. The Company's borrowing base is redetermined in April and October of each year. The next borrowing base redetermination will be in October 2012. With respect to each redetermination, the administrative agent and the lenders under the senior credit facility consider several factors, including the Company's proved reserves and projected cash requirements, and make assumptions regarding, among other things, oil and natural gas prices and production. Because the value of the Company's proved reserves is a key factor in determining the amount of the borrowing base, changing commodity prices and the Company's success in developing reserves may affect the borrowing base. The Company at times incurs additional costs related to the senior credit facility as a result of amendments to the credit agreement and changes to the borrowing base. During the six-month period ended June 30, 2012, additional costs of approximately $7.4 million were incurred. These costs have been deferred, and are included in other assets in the accompanying unaudited condensed consolidated balance sheets and are being amortized to interest expense over the term of the senior credit facility.

At June 30, 2012, the Company had no amount outstanding under the senior credit facility and $29.5 million in outstanding letters of credit. Letters of credit, excluding a $1.5 million Dynamic letter of credit, reduce the availability under the senior credit facility on a dollar-for-dollar basis.

8.625% Senior Notes Due 2015. The Company's 8.625% Senior Notes due 2015 (the "8.625% Senior Notes") were issued in May 2008. In March 2011, the Company purchased approximately 94.5%, or $614.2 million, of the aggregate principal amount of its 8.625% Senior Notes pursuant to a tender offer, which expired on March 28, 2011. On April 1, 2011, the Company redeemed the remaining outstanding $35.8 million aggregate principal amount of its 8.625% Senior Notes. All holders whose notes were purchased or redeemed received accrued and unpaid interest from October 1, 2010. The premium paid to purchase these notes and the unamortized debt issuance costs associated with the notes, totaling $2.0 million and $38.2 million, respectively, were recorded as a loss on extinguishment of debt in the accompanying unaudited condensed consolidated statements of operations for the three and six-month periods ended June 30, 2011, respectively.

9.875% Senior Notes Due 2016. The Company's unsecured 9.875% Senior Notes due 2016 (the "9.875% Senior Notes") were issued in May 2009 and bear interest at a fixed rate of 9.875% per annum, payable semi-annually, with the principal due on May 15, 2016. The 9.875% Senior Notes were issued at a discount, which is amortized to interest expense over the term of the notes. The 9.875% Senior Notes are redeemable, in whole or in part, prior to their maturity at specified redemption prices and are jointly and severally guaranteed unconditionally, in full, on an unsecured basis by certain of the Company's wholly owned subsidiaries and are freely tradable.

Debt issuance costs of $7.9 million incurred in connection with the offering of the 9.875% Senior Notes are included in other assets in the accompanying unaudited condensed consolidated balance sheets and are being amortized to interest expense over the term of the notes.

8.0% Senior Notes Due 2018. The Company's unsecured 8.0% Senior Notes due 2018 (the "8.0% Senior Notes") were issued in May 2008 and bear interest at a fixed rate of 8.0% per annum, payable semi-annually, with the principal due on June 1, 2018. The notes are redeemable, in whole or in part, prior to their maturity at specified redemption prices and are jointly and severally guaranteed unconditionally, in full, on an unsecured basis by certain of the Company's wholly owned subsidiaries and are freely tradable.

The Company incurred $16.0 million of debt issuance costs in connection with the offering of the 8.0% Senior Notes. These costs are included in other assets in the accompanying unaudited condensed consolidated balance sheets and are being amortized to interest expense over the term of the notes.

8.75% Senior Notes Due 2020. The Company's unsecured 8.75% Senior Notes due 2020 (the "8.75% Senior Notes") were issued in December 2009 and bear interest at a fixed rate of 8.75% per annum, payable semi-annually, with the principal due on January 15, 2020. The 8.75% Senior Notes were issued at a discount, which is being amortized to interest expense over the term of the notes. The 8.75% Senior Notes are redeemable, in whole or in part, prior to their maturity at specified redemption prices and are jointly and severally guaranteed unconditionally, in full, on an unsecured basis by certain of the Company’s wholly owned subsidiaries and are freely tradable. See Note 17 for condensed financial information of the subsidiary guarantors.

Debt issuance costs of $9.7 million incurred in connection with the offering and subsequent registered exchange of the 8.75% Senior Notes are included in other assets in the accompanying unaudited condensed consolidated balance sheets and are being amortized to interest expense over the term of the notes.

7.5% Senior Notes Due 2021. In March 2011, the Company issued $900.0 million of unsecured 7.5% Senior Notes due 2021 (the “7.5% Senior Notes”) to qualified institutional buyers eligible under Rule 144A of the Securities Act and to persons outside the United States under Regulation S under the Securities Act. Net proceeds from the offering were used to fund the tender offer for the 8.625% Senior Notes, including any accrued and unpaid interest, the redemption of the 8.625% Senior Notes that remained outstanding following the conclusion of the tender offer, including accrued and unpaid interest (each as described above) and to repay borrowings under the Company’s senior credit facility. The 7.5% Senior Notes bear interest at a fixed rate of 7.5% per annum, payable semi-annually, with the principal due on March 15, 2021. Prior to March 15, 2016, the 7.5% Senior Notes are redeemable, in whole or in part, at a specified redemption price plus accrued and unpaid interest. On or after March 15, 2016, the 7.5% Senior Notes are redeemable, in whole or in part, prior to their maturity at other various specified redemption prices. The notes are jointly and severally guaranteed unconditionally, in full, on an unsecured basis by certain of the Company’s wholly owned subsidiaries. See Note 17 for condensed financial information of the subsidiary guarantors.

In November 2011, pursuant to an exchange offer, the Company replaced a substantial majority of the 7.5% Senior Notes with 7.5% Senior Notes registered under the Securities Act. The exchange offer did not result in the incurrence of any additional indebtedness.

Debt issuance costs of $19.4 million incurred in connection with the offering and subsequent exchange of the 7.5% Senior Notes are included in other assets in the accompanying unaudited condensed consolidated balance sheets and are being amortized to interest expense over the term of the notes.

8.125% Senior Notes Due 2022. In April 2012, the Company issued $750.0 million of unsecured 8.125% Senior Notes to qualified institutional buyers eligible under Rule 144A of the Securities Act and to persons outside the United States under Regulation S under the Securities Act. Net proceeds from the offering were approximately $730.1 million after deducting offering expenses, and were used to finance the cash portion of the Dynamic Acquisition purchase price and to pay related fees and expenses, with any remaining amount being used for general corporate purposes. The 8.125% Senior Notes bear interest at a fixed rate of 8.125% per annum, payable semi-annually, with the principal due on October 15, 2022. Prior to 2017, the 8.125% Senior Notes are redeemable, in whole or in part, at a specified redemption price plus accrued and unpaid interest. The notes are jointly and severally guaranteed unconditionally, in full, on an unsecured basis by certain of the Company's wholly owned subsidiaries.

In conjunction with the issuance of the 8.125% Senior Notes, the Company entered into a registration rights agreement requiring the Company to commence a registered exchange offer for these notes no later than April 17, 2013. Under certain circumstances, in lieu of a registered exchange offer, the Company may be required to file a shelf registration statement relating to the resale of the 8.125% Senior Notes and to use its commercially reasonable best efforts to keep such registration statement effective until two years after its effective date (or such shorter period that will terminate when all of the 8.125% Senior Notes covered thereby have been resold pursuant thereto or in certain other circumstances). The Company would be required to pay additional interest as liquidated damages of 0.25%, increasing 0.25% each 90 days to a maximum of 0.50% if it fails to fulfill its obligations under the agreement within the specified time periods.

The Company incurred $19.9 million of debt issuance costs in connection with the offering of the 8.125% Senior Notes. These costs are included in other assets in the accompanying unaudited condensed consolidated balance sheets and are being amortized to interest expense over the term of the notes.

Indentures. The indentures governing the Company’s senior notes contain covenants which restrict the Company's ability to take a variety of actions, including limitations on the incurrence of indebtedness, payment of dividends, investments, asset sales, certain asset purchases, transactions with related parties and consolidations or mergers. As of and during the three and six-month periods ended June 30, 2012, the Company was in compliance with all of the covenants contained in the indentures governing its senior notes.

Other Notes Payable. The debt incurred to purchase the downtown Oklahoma City property that serves as the Company’s corporate headquarters was fully secured by a mortgage on one of the buildings located on the property. In May 2012, the Company paid the outstanding $15.8 million principal balance on the note underlying the mortgage.

9. Derivatives

The Company has not designated any of its derivative contracts as hedges for accounting purposes. The Company records all derivative contracts, which include commodity derivatives and an interest rate swap, at fair value. Changes in derivative contract fair values are recognized in earnings. Cash settlements and valuation gains and losses are included in (gain) loss on derivative contracts for commodity derivative contracts and in interest expense for interest rate swaps in the consolidated statements of operations. Commodity derivative contracts are settled on a monthly or quarterly basis. Settlements on interest rate swaps occur quarterly. Derivative assets and liabilities arising from the Company’s derivative contracts with the same counterparty that provide for net settlement are reported on a net basis in the consolidated balance sheets.

Commodity Derivatives. The Company is exposed to commodity price risk, which impacts the predictability of its cash flows from the sale of oil and natural gas. The Company seeks to manage this risk through the use of commodity derivative contracts. These derivative contracts allow the Company to limit its exposure to commodity price volatility on a portion of its forecasted oil and natural gas sales. Additionally, the Company uses derivative contracts to manage commodity price risk associated with diesel fuel used in its operations. None of the Company’s derivative contracts may be terminated early solely as a result of a downgrade in the credit rating of a party to the contract. At June 30, 2012, the Company’s commodity derivative contracts consisted of fixed price swaps, collars and basis swaps, which are described below:

Fixed price swaps	The Company receives a fixed price for the contract and pays a floating market price to the counterparty over a specified period for a contracted volume.
Collars	Collars contain a fixed floor price (put) and a fixed ceiling price (call). If the market price exceeds the call strike price or falls below the put strike price, the Company receives the fixed price and pays the market price. If the market price is between the call and the put strike price, no payments are due from either party.
Basis swaps	The Company receives a payment from the counterparty if the settled price differential is greater than the stated terms of the contract and pays the counterparty if the settled price differential is less than the stated terms of the contract, which guarantees the Company a price differential for oil and natural gas from a specified delivery point.

Interest Rate Swaps. The Company is exposed to interest rate risk on its long-term fixed and variable interest rate borrowings. Fixed rate debt, where the interest rate is fixed over the life of the instrument, exposes the Company to (i) changes in market interest rates reflected in the fair value of the debt and (ii) the risk that the Company may need to refinance maturing debt with new debt at a higher rate. Variable rate debt, where the interest rate fluctuates, exposes the Company to short-term changes in market interest rates as the Company’s interest obligations on these instruments are periodically redetermined based on prevailing market interest rates, primarily LIBOR and the federal funds rate.

The Company has an interest rate swap agreement that effectively converts the variable interest rate on its Senior Floating Rate Notes to a fixed rate through April 1, 2013. See Note 8 for further discussion of the Company’s interest rate swap.

Derivatives Agreements with Royalty Trusts. Effective April 1, 2011, the Company entered into a derivatives agreement with the Mississippian Trust I. The agreement provides the Mississippian Trust I with the economic effect of certain oil and natural gas derivative contracts previously entered into by the Company with third parties. The underlying commodity derivative contracts cover volumes of oil and natural gas production through December 31, 2015. Under this arrangement, the Company will pay the Mississippian Trust I amounts it receives from its counterparties in accordance with the underlying contracts, and the Mississippian Trust I will pay the Company any amounts that the Company is required to pay its counterparties under such contracts.

Effective August 1, 2011, the Company entered into a derivatives agreement with the Permian Trust. The agreement provides the Permian Trust with the economic effect of certain oil derivative contracts previously entered into by the Company with third parties. The underlying commodity derivative contracts cover volumes of oil production through March 31, 2015. Under this arrangement, the Company will pay the Permian Trust amounts it receives from its counterparty in accordance with the underlying contracts, and the Permian Trust will pay the Company any amounts that the Company is required to pay its counterparty under such contracts. Substantially concurrent with the execution of the derivatives agreement, the Company novated certain of the derivatives contracts underlying the derivatives agreement to the Permian Trust. As a party to these contracts, the Permian Trust will receive payment directly from the counterparty and pay any amounts owed directly to the counterparty. To secure the Permian Trust's obligations under these novated contracts, the Permian Trust has given the counterparty a lien on its royalty interests. Under the derivatives agreement, as development wells are drilled for the benefit of the Permian Trust, the Company will have the right, under certain circumstances, to assign or novate to the Permian Trust additional derivative contracts. In April 2012, the Company novated to the Permian Trust certain additional derivative contracts underlying the derivatives agreement with the Permian Trust.

Effective April 1, 2012, the Company entered into a derivatives agreement with the Mississippian Trust II. The agreement provides the Mississippian Trust II with the economic effect of certain oil derivative contracts previously entered into by the Company with third parties. The underlying commodity derivative contracts cover volumes of oil production through December 31, 2014. Under this arrangement, the Company will pay the Mississippian Trust II amounts it receives from its counterparties in accordance with the underlying contracts, and the Mississippian Trust II will pay the Company any amounts that the Company is required to pay its counterparties under such contracts. Substantially concurrent with the execution of the derivatives agreement, the Company novated certain of the derivatives contracts underlying the derivatives agreement to the Mississippian Trust II. As a party to these contracts, the Mississippian Trust II will receive payment directly from the counterparty and pay any amounts owed directly to the counterparty. To secure the Mississippian Trust II's obligations under these novated contracts, the Mississippian Trust II has given the counterparties a lien on its royalty interests. Under the derivatives agreement, as development wells are drilled for the benefit of the Mississippian Trust II, the Company will have the right, under certain circumstances, to assign or novate to the Mississippian Trust II additional derivative contracts.

All contracts underlying the derivatives agreements with the Royalty Trusts, including those novated to the Permian Trust and Mississippian Trust II, have been included in the Company's consolidated derivative disclosures. See Note 3 for additional discussion of the Royalty Trusts.

Fair Value of Derivatives. The following table presents the fair value of the Company's derivative contracts as of June 30, 2012 and December 31, 2011 on a gross basis without regard to same-counterparty netting (in thousands):

Type of Contract	Balance Sheet Classification	June 30, 2012	December 31, 2011
Derivative assets			
Oil price swaps	Derivative contracts-current	$191,637	$6,095
Natural gas price swaps	Derivative contracts-current	4,248	6,585
Oil basis swaps	Derivative contracts-current	5,126	—
Oil collars	Derivative contracts-current	626	—
Natural gas collars	Derivative contracts-current	7,020	313
Diesel price swaps	Derivative contracts-current	—	397
Oil price swaps	Derivative contracts-noncurrent	122,165	48,718
Oil collars	Derivative contracts-noncurrent	178	—
Natural gas collars	Derivative contracts-noncurrent	2,970	1,035
Derivative liabilities			
Oil price swaps	Derivative contracts-current	(777)	(116,243)
Natural gas price swaps	Derivative contracts-current	(3,677)	—
Diesel price swaps	Derivative contracts-current	(113)	(41)

Interest rate swap	Derivative contracts-current	(6,849)	(8,475)
Oil price swaps	Derivative contracts-noncurrent	(46,910)	(66,451)
Natural gas basis swaps	Derivative contracts-noncurrent	—	(4,609)
Interest rate swap	Derivative contracts-noncurrent	—	(1,973)
Total net derivative contracts		$275,644	$(134,649)

Refer to Note 4 for additional discussion of the fair value measurement of the Company's derivative contracts.

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The following table summarizes the effect of the Company’s derivative contracts on the accompanying unaudited condensed consolidated statements of operations for the three and six-month periods ended June 30, 2012 and 2011 (in thousands):

Type of Contract	Location of (Gain) Loss Recognized in Income	Three Months Ended June 30, 2012	Three Months Ended June 30, 2011	Six Months Ended June 30, 2012	Six Months Ended June 30, 2011
Commodity derivatives	(Gain) loss on derivative contracts	$(669,850)	$(169,988)	$(415,204)	$107,640
Interest rate swap	Interest expense	49	2,798	895	3,076
Total		$(669,801)	$(167,190)	$(414,309)	$110,716

The following tables summarize the cash settlements and valuation gains and losses on the Company’s commodity derivative contracts and interest rate swaps for the three and six-month periods ended June 30, 2012 and 2011 (in thousands):

	Three Months Ended June 30, 2012	Three Months Ended June 30, 2011	Six Months Ended June 30, 2012	Six Months Ended June 30, 2011
Commodity Derivatives				
Realized (gain) loss(1)	$(89,120)	$18,273	$36,336	$26,881
Unrealized (gain) loss	(580,730)	(188,261)	(451,540)	80,759
(Gain) loss on commodity derivative contracts	$(669,850)	$(169,988)	$(415,204)	$107,640
Interest Rate Swap				
Realized loss	$2,294	$2,442	$4,494	$4,485
Unrealized (gain) loss	(2,245)	356	(3,599)	(1,409)
Loss on interest rate swap	$49	$2,798	$895	$3,076

(1) The three and six-month periods ended June 30, 2012 included $57.3 million of realized gains related to settlements of commodity derivative contracts with contractual maturities after the quarterly period in which they were settled ("early settlements"). The six-month period ended June 30, 2012 also included $117.1 million non-cash realized losses on derivative contracts amended in January 2012. The three and six-month periods ended June 30, 2011 included $25.8 million and $38.2 million, respectively, of realized gains from early settlements.

At June 30, 2012, the Company’s open commodity derivative contracts consisted of the following:

Oil Price Swaps

	Notional (MBbl)	Weighted Avg. Fixed Price
July 2012 — December 2012	8,253	$100.59
January 2013 — December 2013	17,420	$96.40
January 2014 — December 2014	6,781	$92.15
January 2015 — December 2015	5,076	$83.69

Oil Basis Swaps

	Notional (MBbl)	Weighted Avg. Fixed Price
July 2012 — December 2012	745	$17.49

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Oil Collars

	Notional (MBbl)	Collar Range
July 2012 — December 2012	108	$85.00 - $114.00
January 2013 — December 2013	168	$80.00 - $102.50

Natural Gas Price Swaps

	Notional (MMBtu)	Weighted Avg. Fixed Price
July 2012 — December 2012	42,897	$2.98

Natural Gas Collars

	Notional (MMBtu)	Collar Range
July 2012 — December 2012	4,432	$4.06 - $6.58
January 2013 — December 2013	6,858	$3.78 - $6.71
January 2014 — December 2014	937	$4.00 - $7.78
January 2015 — December 2015	1,010	$4.00 - $8.55

Diesel Price Swaps

	Notional (Thousands of Gallons)	Weighted Avg. Fixed Price
July 2012 — December 2012	3,024	$2.82

10. Asset Retirement Obligation

A reconciliation of the beginning and ending aggregate carrying amounts of the asset retirement obligation for the period from December 31, 2011 to June 30, 2012 is as follows (in thousands):

Asset retirement obligation, December 31, 2011	$128,116
Liability incurred upon acquiring and drilling wells	3,232
Liability assumed in acquisitions(1)	371,365
Revisions in estimated cash flows	1,308
Liability settled or disposed in current period	(24,612)
Accretion of discount expense	10,572
Asset retirement obligation, June 30, 2012	489,981
Less: current portion	140,789
Asset retirement obligation, net of current	$349,192

(1) Includes amounts assumed in the Dynamic Acquisition in April 2012 and in the acquisition of Gulf of Mexico properties in June 2012.

11. Commitments and Contingencies

Legal Proceedings

On or about June 27, 2008 and November 6, 2008, there were fires at the Company’s Grey Ranch Plant and a nearby compressor station. The Company, as owner of the Plant and compressor station, recovered approximately $24.5 million from its insurance carriers for damages caused by the fires. At the time of the Plant fire, the Plant was operated by Southern Union Gas Services, Ltd. (“Southern Union Gas”). On June 4, 2010, November 10, 2010, and March 15, 2011, the Company’s insurance carriers filed lawsuits against Southern Union Gas and its parent, Southern Union Company (together with Southern Union Gas, “Southern Union”) seeking recovery for amounts paid under the Company’s insurance policies. Southern Union, in turn, has tendered indemnity requests to GRLP, of which the Company is a 50% owner. GRLP has not accepted or acknowledged any responsibility to indemnify Southern Union. To the extent the Company, as a 50% owner of GRLP, is required to fund any indemnification of Southern Union, it will pursue coverage for such liability under its general liability insurance policy. An estimate of reasonably possible losses associated with these claims is approximately $12.3 million. As the loss is not probable, the Company has not established any reserves relating to these claims.

On February 14, 2011, Aspen Pipeline, II, L.P. (“Aspen”) filed a complaint in the District Court of Harris County, Texas, against Arena Resources, Inc. ("Arena") and SandRidge Energy, Inc. claiming damages based upon alleged representations by Arena in connection with Aspen’s construction of a natural gas pipeline in west Texas. On October 14, 2011, the complaint was amended to add Odessa Fuels, LLC, Odessa Fuels Marketing, LLC and Odessa Field Services and Compression, LLC as plaintiffs. The plaintiffs’ amended claims seek damages relating to the construction of the pipeline and performance under a related gas purchase agreement, which damages are alleged to approach $100.0 million. The Company intends to defend this lawsuit vigorously. This case is in the discovery stage and, accordingly, an estimate of reasonably possible losses associated with this claim, if any, cannot be made until the facts, circumstances and legal theories relating to the plaintiffs’ claims and the Company’s defenses are fully disclosed and analyzed. The Company has not established any reserves relating to this claim.

On April 5, 2011, Wesley West Minerals, Ltd. and Longfellow Ranch Partners, LP filed suit against SandRidge Energy, Inc. and SandRidge Exploration and Production, LLC (collectively, the “SandRidge Entities”) in the 83rd District Court of Pecos County, Texas. The plaintiffs, who have leased mineral rights to the SandRidge Entities in Pecos County, allege that the SandRidge Entities have not properly paid royalties on all volumes of natural gas (including carbon dioxide, or “CO_2”) produced from the acreage leased from the plaintiffs. The plaintiffs also allege that the SandRidge Entities have inappropriately failed to pay royalties on CO_2 produced from the plaintiffs’ acreage that results from the treatment of natural gas at the Century Plant. The plaintiffs seek unspecified actual damages, punitive damages and a declaration that the SandRidge Entities must pay royalties on CO_2 produced from plaintiffs’ acreage that results from treatment of natural gas at the Century Plant. The Commissioner of the General Land Office of the State of Texas (“GLO”) is named as an additional defendant in the lawsuit as some of the affected oil and natural gas leases described in the plaintiffs’ allegations cover mineral classified lands in which the GLO is entitled to one-half of the royalties attributable to such leases. The GLO has filed a cross-claim against the SandRidge Entities asserting the same claims as the plaintiffs with respect to the leases covering mineral classified lands. The Company intends to defend this lawsuit vigorously. This case is in the discovery stage and, accordingly, an estimate of reasonably possible losses associated with these claims, if any, cannot be made until the facts, circumstances and legal theories relating to the plaintiffs’ claims and the Company’s defenses are fully disclosed and analyzed. The Company has not established any reserves relating to these claims.

On August 4, 2011, Patriot Exploration, LLC, Jonathan Feldman, Redwing Drilling Partners, Mapleleaf Drilling Partners, Avalanche Drilling Partners, Penguin Drilling Partners and Gramax Insurance Company Ltd. filed a lawsuit against SandRidge Energy, Inc., SandRidge Exploration and Production, LLC (“SandRidge E&P”) and certain directors and senior executive officers of SandRidge Energy, Inc. (collectively, the “defendants”) in the U.S. District Court for the District of Connecticut. The plaintiffs allege that the defendants made false and misleading statements to U.S. Drilling

Capital Management LLC and the plaintiffs prior to the entry into a participation agreement among Patriot Exploration, LLC, U.S. Drilling Capital Management LLC and SandRidge E&P, which provided for the investment by the plaintiffs in certain of SandRidge E&P's oil and natural gas properties. To date, the plaintiffs have invested approximately $15.0 million under the participation agreement. The plaintiffs seek compensatory and punitive damages and rescission of the participation agreement. The Company intends to defend this lawsuit vigorously and believes the plaintiffs' claims are without merit. This case is in the early stages and, accordingly, an estimate of reasonably possible losses associated with this claim, if any, cannot be made until the facts, circumstances and legal theories relating to the plaintiffs' claims and the Company's defenses are fully disclosed and analyzed. The Company has not established any reserves relating to this claim.

In addition, the Company is a defendant in lawsuits from time to time in the normal course of business. While the results of litigation and claims cannot be predicted with certainty, the Company believes the reasonably possible losses of such matters, individually and in the aggregate, are not material. Additionally, the Company believes the probable final outcome of such matters will not have a material adverse effect on the Company's consolidated results of operations, financial position, cash flows or liquidity.

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Treating Agreement Commitment

In conjunction with the Century Plant construction agreement, the Company entered into a 30-year treating agreement with Occidental for CO_2 to be removed from the Company's delivered production volumes. The Company is required to deliver a total of approximately 3,200 Bcf of CO2 volumes during the agreement period. If the Company does not meet the CO2 volume requirements, the Company will have to pay a fee for any volume shortfalls. Based upon current natural gas production levels, the Company expects to incur between approximately $11.5 million and $14.5 million at December 31, 2012 for amounts related to the Company's shortfall in meeting its annual delivery obligations based on the projected completion date of Phase I. Due to the sensitivity of natural gas production to prevailing market prices, the Company is unable to estimate additional amounts it may be required to pay under this agreement in subsequent periods.

12. Equity

Preferred Stock. The following table presents information regarding the Company's preferred stock (in thousands):

	June 30, 2012	December 31, 2011
Shares authorized	50,000	50,000
Shares outstanding at end of period		
8.5% Convertible perpetual preferred stock	2,650	2,650
6.0% Convertible perpetual preferred stock	2,000	2,000
7.0% Convertible perpetual preferred stock	3,000	3,000

The Company is authorized to issue 50,000,000 shares of preferred stock, $0.001 par value, of which 7,650,000 shares are designated as convertible perpetual preferred stock at June 30, 2012. All of the outstanding shares of the Company's convertible perpetual preferred stock were issued in private transactions and none of these shares is listed on a stock exchange. However, all of the outstanding shares of convertible perpetual preferred stock are freely tradable.

8.5% Convertible perpetual preferred stock. The Company's 8.5% convertible perpetual preferred stock was issued in January 2009. Each share of 8.5% convertible perpetual preferred stock has a liquidation preference of $100.00 and is convertible at the holder's option at any time initially into approximately 12.4805 shares of the Company's common stock, subject to customary adjustments in certain circumstances. Each holder of the convertible perpetual preferred stock is entitled to an annual dividend of $8.50 per share to be paid semi-annually in cash, common stock or a combination thereof, at the Company's election. The 8.5% convertible perpetual preferred stock is not redeemable by the Company at any time. After February 20, 2014, the Company may cause all outstanding shares of the convertible perpetual preferred stock to convert automatically into common stock at the then-prevailing conversion rate if certain conditions are met.

6.0% Convertible perpetual preferred stock. The Company's 6.0% convertible perpetual preferred stock was issued in December 2009. Each share of the 6.0% convertible perpetual preferred stock has a liquidation preference of $100.00 and is entitled to an annual dividend of $6.00 payable semi-annually in cash, common stock or any combination thereof, at the Company's election. The 6.0% convertible perpetual preferred stock is not redeemable by the Company at any time. Each share is initially convertible into approximately 9.2115 shares of the Company's common stock, at the holder's option, subject to customary adjustments in certain circumstances. On December 21, 2014, all outstanding shares of the 6.0% convertible preferred stock will be converted automatically into shares of the Company’s common stock at the then-prevailing conversion price as long as all dividends accrued at that time have been paid.

7.0% Convertible perpetual preferred stock. The Company’s 7.0% convertible perpetual preferred stock was issued in November 2010. Each share of the 7.0% convertible preferred stock has a liquidation preference of $100.00 per share and became convertible at the holder’s option on February 15, 2011, initially into approximately 12.8791 shares of the Company’s common stock, subject to customary adjustments in certain circumstances. The annual dividend on each share of the 7.0% convertible preferred stock is $7.00 payable semi-annually, in cash, common stock or a combination thereof, at the Company’s election. The 7.0% convertible perpetual preferred stock is not redeemable by the Company at any time. After November 20, 2015, the Company may cause all outstanding shares of the 7.0% convertible perpetual preferred stock to convert automatically into common stock at the then-prevailing conversion rate if certain conditions are met.

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Preferred stock dividends. All dividend payments to date on the Company's 8.5%, 6.0% and 7.0% convertible perpetual preferred stock have been paid in cash. Paid and unpaid dividends included in the calculation of income available (loss applicable) to the Company's common stockholders and the Company's basic earnings per share calculation for the three and six-month periods ended June 30, 2012 and 2011 as presented in the accompanying unaudited condensed consolidated statements of operations, are included in tables below (in thousands):

	Three Months Ended June 30,					
	2012			2011		
	Dividends Paid	Dividends Unpaid	Total	Dividends Paid	Dividends Unpaid	Total
8.5% Convertible Perpetual Preferred Stock	$—	$5,631	$5,631	$—	$5,631	$5,631
6.0% Convertible Perpetual Preferred Stock	—	3,000	3,000	—	3,000	3,000
7.0% Convertible Perpetual Preferred Stock	2,625	2,625	5,250	2,625	2,625	5,250
Total	$2,625	$11,256	$13,881	$2,625	$11,256	$13,881

	Six Months Ended June 30,					
	2012			2011		
	Dividends Paid	Dividends Unpaid	Total	Dividends Paid	Dividends Unpaid	Total
8.5% Convertible Perpetual Preferred Stock	$2,816	$8,447	$11,263	$2,816	$8,447	$11,263
6.0% Convertible Perpetual Preferred Stock	500	5,500	6,000	500	5,500	6,000
7.0% Convertible Perpetual Preferred Stock	7,875	2,625	10,500	7,933	2,625	10,558
Total	$11,191	$16,572	$27,763	$11,249	$16,572	$27,821

Common Stock. The following table presents information regarding the Company's common stock (in thousands):

	June 30, 2012	December 31, 2011
Shares authorized	800,000	800,000
Shares outstanding at end of period	489,191	411,953
Shares held in treasury	970	874

On April 17, 2012, the Company issued approximately 74 million shares of SandRidge common stock to satisfy the stock portion of the consideration paid in the Dynamic Acquisition. See Note 2 for further discussion of the Dynamic Acquisition.

Treasury Stock. The Company makes required statutory tax payments on behalf of employees when their restricted stock awards vest and then withholds a number of vested shares of common stock having a value on the date of vesting equal to the tax obligation. As a result of such transactions, the Company withheld approximately 825,000 shares having a total value of $6.7 million and approximately 617,000 shares having a total value of $5.0 million during the six-month periods ended June 30, 2012 and 2011, respectively. These shares were accounted for as treasury stock when withheld, and subsequently retired.

Shares of Company common stock held as assets in a trust for the Company's non-qualified deferred compensation plan are accounted for as treasury shares. These shares are not included as outstanding shares of common stock in this report. For corporate purposes, including for the purpose of voting at Company stockholder meetings, these shares are considered outstanding and have voting rights, which are exercised by the Company.

Equity Compensation. The Company awards restricted common stock under incentive compensation plans that vest over specified periods of time, subject to certain conditions and are valued based upon the market value of common stock on the date of grant. Awards issued prior to 2006 had vesting periods of one, four or seven years. Awards issued during and after 2006 generally have four-year vesting periods. Shares of restricted common stock are subject to restriction on transfer. Unvested restricted stock awards are included in the Company's outstanding shares of common stock.

Equity compensation provided to employees directly involved in oil and natural gas exploration and development activities is capitalized to the Company's oil and natural gas properties. Equity compensation not capitalized is reflected in general and administrative expenses, production expenses, midstream and marketing expenses and drilling and services expenses in the consolidated statements of operations. For the three and six-month periods ended June 30, 2012, the Company recognized equity compensation expense of $11.1 million and $21.6 million, net of $2.1 million and $4.0 million capitalized, respectively, related to restricted common stock. For the three and six-month periods ended June 30, 2011, the Company recognized equity compensation expense of $8.9 million and $17.1 million, net of $1.9 million and $3.7 million capitalized, respectively, related to restricted common stock.

Noncontrolling Interest. Noncontrolling interests in the Company's subsidiaries and VIEs of which the Company was the primary beneficiary as of and for the three and six-month periods ended June 30, 2012 (see Note 3), represent third-party ownership interests in the consolidated entity and are included as a component of equity in the accompanying unaudited condensed consolidated balance sheets and accompanying unaudited condensed consolidated statements of changes in equity.

13. Income Taxes

The Company estimates for each interim reporting period the effective tax rate expected for the full fiscal year and uses that estimated rate in providing for income taxes on a current year-to-date basis. The (benefit) provision for income taxes consisted of the following components for the three and six-month periods ended June 30, 2012 and 2011 (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
Current				
Federal	$11	$(137)	$(72)	$(116)
State	(341)	69	(187)	135
	(330)	(68)	(259)	19
Deferred				
Federal	(100,385)	(6,385)	(100,385)	(6,385)
State	(2,943)	(601)	(2,943)	(601)
	(103,328)	(6,986)	(103,328)	(6,986)
Total benefit	(103,658)	(7,054)	(103,587)	(6,967)
Less: income tax provision attributable to noncontrolling interest	67	—	157	2
Total benefit attributable to SandRidge Energy, Inc.	$(103,725)	$(7,054)	$(103,744)	$(6,969)

Deferred income taxes are provided to reflect the future tax consequences of temporary differences between the tax basis of assets and liabilities and their reported amounts in the financial statements. Deferred tax assets are reduced by a valuation allowance when a determination is made that it is more likely than not that some or all of the deferred assets will not be realized based on the weight of all available evidence. As of December 31, 2008, the Company determined it was appropriate to record a full valuation allowance against its net deferred tax asset. During the three-month period ended June 30, 2012, the Company recorded a net deferred tax liability associated with the Dynamic Acquisition which resulted in the Company releasing a portion of the previously recorded valuation allowance. The partial release of the valuation allowance was based on management's assessment that it is more likely than not that the Company will realize a benefit from more of its existing deferred tax assets as the Dynamic deferred tax liabilities are available to offset the reversal of the Company's deferred tax assets. Although the Company continued to have a full valuation allowance against its net deferred tax asset at June 30, 2012, the release of a portion of the valuation allowance resulted in an income tax benefit of $103.3 million for the three and six-month periods ended June 30, 2012. The Company continues to closely monitor all available evidence in making its determination for the need to maintain a valuation allowance against its net deferred tax asset.

Internal Revenue Code (“IRC”) Section 382 addresses company ownership changes and specifically limits the utilization of certain deductions and other tax attributes on an annual basis following an ownership change. The Company experienced an ownership change within the meaning of IRC Section 382 on December 31, 2008. The ownership change subjected certain of the

Company’s tax attributes, including $298.4 million of federal net operating loss carryforwards, to the IRC Section 382 limitation. The Company experienced a subsequent ownership change within the meaning of IRC Section 382 on July 16, 2010 as a result of the acquisition of Arena. The subsequent ownership change resulted in a more restrictive limitation on certain of the Company’s tax attributes than with the December 31, 2008 ownership change. The more restrictive limitation applies not only to the $298.4 million of federal net operating loss carryforwards and certain other tax attributes existing at December 31, 2008, but also to net operating losses of approximately $554.3 million and certain other tax attributes generated in periods following the December 31, 2008 ownership change. The subsequent limitation could result in a material amount of existing loss carryforwards expiring unused. Arena also experienced an ownership change on July 16, 2010 as a result of its acquisition by the Company. This ownership change resulted in a limitation on Arena’s net operating loss carryforwards of $119.9 million available to the Company. None of the limitations discussed above resulted in a current federal tax liability at June 30, 2012 or December 31, 2011.

At June 30, 2012, the Company had a liability of approximately $1.3 million for unrecognized tax benefits, compared to a liability of approximately $1.8 million at December 31, 2011. If recognized, approximately $0.9 million, net of federal tax expense, would be recorded as a reduction of income tax expense and would affect the effective tax rate.

Consistent with the Company’s policy to record interest and penalties on income taxes as a component of the income tax provision, the Company has included $0.01 million and $0.03 million of accrued gross interest with respect to unrecognized tax benefits in the accompanying unaudited condensed consolidated statements of operations during the three and six-month periods ended June 30, 2012, respectively. The Company included $0.02 million and $0.07 million of accrued gross interest with respect to unrecognized tax benefits in the accompanying unaudited condensed consolidated statements of operations during the three and six-month periods ended June 30, 2011, respectively. The Company had a corresponding accrued liability of $0.2 million for interest and penalties relating to uncertain tax positions at June 30, 2012 and December 31, 2011.

The Company’s only taxing jurisdiction is the United States (federal and state). The Company’s tax years 2008 to present remain open for federal examination. Additionally, various tax years remain open beginning with tax year 2003 due to federal net operating loss carryforwards. The number of years open for state tax audits varies, depending on the state, but are generally from three to five years. Currently, several examinations are in progress. The Company does not anticipate that any federal or state audits will have a significant impact on the Company’s results of operations or financial position. As a result of ongoing negotiations pertaining to the Company’s current state audits, it is reasonably possible that the Company’s gross unrecognized tax benefits balance may decrease within the next twelve months by approximately $1.1 million.

For the three and six-month periods ended June 30, 2012, income tax payments, net of refunds, were approximately $1.4 million and $1.3 million, respectively. For the three-month period ended June 30, 2011, income tax refunds, net of payments, were approximately $0.04 million. For the six-month period ended June 30, 2011, income tax payments, net of refunds, were $0.9 million.

14. Earnings Per Share

Basic earnings per share are computed using the weighted average number of common shares outstanding during the period. Diluted earnings per share are computed using the weighted average shares outstanding during the period, but also include the dilutive effect of awards of restricted stock, using the treasury stock method, and outstanding convertible preferred stock. Under the treasury stock method, the amount of unrecognized compensation expense related to unvested stock-based compensation grants are assumed to be used to repurchase common shares. The following table summarizes the calculation of weighted average common shares outstanding used in the computation of diluted earnings per share, for the three and six-month periods ended June 30, 2012 and 2011 (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
Weighted average basic common shares outstanding	461,008	398,435	430,802	398,343
Effect of dilutive securities				
Restricted stock	9,499	7,414	9,443	—
Convertible preferred stock	90,133	90,133	90,133	—
Weighted average diluted common and potential common shares outstanding	560,640	495,982	530,378	398,343

For the six-month period ended June 30, 2011, restricted stock awards covering 7.3 million shares were excluded from the computation of loss per share because their effect would have been antidilutive.

In computing diluted earnings per share, the Company evaluated the if-converted method with respect to its outstanding 8.5% convertible perpetual preferred stock, 6.0% convertible perpetual preferred stock and 7.0% convertible perpetual preferred stock for the three and six-month periods ended June 30, 2012 and 2011. Under the if-converted method, the Company assumes the conversion of the preferred stock to common stock and determines if this is more dilutive than including the preferred stock dividends (paid and unpaid) in the computation of income available (loss applicable) to common stockholders. For the three-month periods ended June 30, 2012 and 2011, and the six-month period ended June 30, 2012, the Company determined the if-converted method was more dilutive and did not include the 8.5%, 6.0% and 7.0% preferred stock dividends in the determination of income available to common stockholders. For the six-month period ended June 30, 2011, the Company determined the if-converted method was not more dilutive and included the 8.5%, 6.0% and 7.0% preferred stock dividends in the determination of loss applicable to common stockholders.

15. Related Party Transactions

The Company enters into transactions in the ordinary course of business with certain related parties. These transactions primarily consist of purchases related to drilling and completion activities, gas treating services and drilling equipment and sales of oil field services, equipment and natural gas. During the three-month periods ended June 30, 2012 and 2011, sales by the Company to related parties were $3.2 million and $6.9 million, respectively. During the six-month periods ended June 30, 2012 and 2011, sales by the Company to related parties were $7.0 million and $11.7 million, respectively. Accounts receivable due from related parties totaled $1.2 million and $1.6 million at June 30, 2012 and December 31, 2011, respectively. These amounts primarily relate to sales of natural gas to Southern Union, the Company’s partner in GRLP.

Oklahoma City Thunder Agreements. The Company’s Chairman and Chief Executive Officer and one of its independent directors own minority interests in a limited liability company that owns and operates the Oklahoma City Thunder basketball team. The Company is party to a sponsorship agreement, through the 2013 season, whereby it pays approximately $3.3 million per year for advertising and promotional activities related to the Oklahoma City Thunder. Additionally, the Company entered into an agreement to license a suite at the arena where the Oklahoma City Thunder plays its home games. Under this four-year agreement, the Company pays an annual license fee of $0.2 million through 2013. At June 30, 2012, the Company had $0.6 million due under these agreements. At December 31, 2011, the Company had no amounts due under these agreements.

16. Business Segment Information

The Company has three business segments: exploration and production, drilling and oil field services and midstream gas services. These segments represent the Company’s three main business units, each offering different products and services. The exploration and production segment is engaged in the acquisition, development and production of oil and natural gas properties and includes the activities of the Mississippian Trust I, the Permian Trust and the Mississippian Trust II. The drilling and oil field services segment is engaged in the contract drilling of oil and natural gas wells. The midstream gas services segment is engaged in the purchasing, gathering, treating and selling of natural gas. The All Other column in the tables below includes items not related to the Company’s reportable segments, including CO2 gathering and sales and corporate operations.

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Management evaluates the performance of the Company's business segments based on income (loss) from operations, which is defined as segment operating revenues less operating expenses and depreciation, depletion, amortization and accretion. Summarized financial information concerning the Company's segments is shown in the following table (in thousands):

	Exploration and Production	Drilling and Oil Field Services	Midstream Gas Services	All Other	Consolidated Total
Three Months Ended June 30, 2012					
Revenues	$434,834	$104,076	$24,798	$1,543	$565,251
Inter-segment revenue	(77)	(70,444)	(16,296)	—	(86,817)
Total revenues	$434,757	$33,632	$8,502	$1,543	$478,434
Income (loss) from operations(1)	$786,335	$4,678	$(3,631)	$(24,969)	$762,413
Interest income (expense)	416	—	(137)	(68,848)	(68,569)
Bargain purchase gain	124,446	—	—	—	124,446
Other income (expense), net	242	—	—	(323)	(81)
Income (loss) before income taxes	$911,439	$4,678	$(3,768)	$(94,140)	$818,209
Capital expenditures(2)	$518,343	$5,836	$17,754	$20,121	$562,054
Depreciation, depletion, amortization and accretion	$147,479	$8,624	$1,717	$4,753	$162,573
Three Months Ended June 30, 2011					
Revenues	$317,768	$96,443	$48,278	$2,886	$465,375
Inter-segment revenue	(66)	(67,906)	(32,473)	(156)	(100,601)
Total revenues	$317,702	$28,537	$15,805	$2,730	$364,774
Income (loss) from operations(1)	$301,197	$4,098	$(2,570)	$(23,009)	$279,716
Interest income (expense)	15	4	(141)	(61,565)	(61,687)
Loss on extinguishment of debt	—	—	—	(2,051)	(2,051)
Other income (expense), net	3	—	216	(81)	138
Income (loss) before income taxes	$301,215	$4,102	$(2,495)	$(86,706)	$216,116
Capital expenditures(2)	$413,529	$8,030	$4,462	$17,875	$443,896
Depreciation, depletion, amortization and accretion	$76,734	$7,998	$1,291	$3,438	$89,461
Six Months Ended June 30, 2012					
Revenues	$777,955	$202,408	$50,960	$2,949	$1,034,272
Inter-segment revenue	(155)	(139,467)	(34,591)	10	(174,203)
Total revenues	$777,800	$62,941	$16,369	$2,959	$860,069
Income (loss) from operations(3)	$662,499	$8,157	$(6,358)	$(53,541)	$610,757
Interest income (expense)	559	—	(293)	(135,800)	(135,534)
Bargain purchase gain	124,446	—	—	—	124,446
Other income, net	2,010	—	—	377	2,387
Income (loss) before income taxes	$789,514	$8,157	$(6,651)	$(188,964)	$602,056
Capital expenditures(2)	$1,010,248	$13,752	$41,729	$65,983	$1,131,712
Depreciation, depletion, amortization and accretion	$237,531	$17,174	$3,128	$8,925	$266,758

At June 30, 2012					
Total assets	$8,003,601	$214,471	$180,193	$780,270	$9,178,535

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	Exploration and Production	Drilling and Oil Field Services	Midstream Gas Services	All Other	Consolidated Total
Six Months Ended June 30, 2011					
Revenues	$585,004	$163,992	$104,256	$6,106	$859,358
Inter-segment revenue	(133)	(114,421)	(66,511)	(672)	(181,737)
Total revenues	$584,871	$49,571	$37,745	$5,434	$677,621
Income (loss) from operations(3)	$116,990	$3,990	$(5,098)	$(43,995)	$71,887
Interest income (expense)	120	(101)	(313)	(120,830)	(121,124)
Loss on extinguishment of debt	—	—	—	(38,232)	(38,232)
Other income (expense), net	1,679	—	(485)	141	1,335
Income (loss) before income taxes	$118,789	$3,889	$(5,896)	$(202,916)	$(86,134)
Capital expenditures(2)	$812,626	$14,793	$8,635	$24,011	$860,065
Depreciation, depletion, amortization and accretion	$151,206	$15,727	$2,388	$7,119	$176,440
At December 31, 2011					
Total assets	$5,345,527	$219,101	$138,844	$516,137	$6,219,609

(1) Exploration and production segment income from operations includes net gains of $669.8 million and $170.0 million on commodity derivative contracts for the three-month periods ended June 30, 2012 and 2011, respectively.

(2) On an accrual basis.

(3) Exploration and production segment income from operations includes a net gain of $415.2 million and a net loss of $107.6 million on commodity derivative contracts for the six-month periods ended June 30, 2012 and 2011, respectively.

17. Condensed Consolidating Financial Information

The Company provides condensed consolidating financial information for its subsidiaries that are guarantors of its registered debt. The subsidiary guarantors are wholly owned and have jointly and severally guaranteed, on a full, unconditional and unsecured basis, the Company’s Senior Floating Rate Notes, 8.75% Senior Notes and 7.5% Senior Notes. Prior to their purchase and redemption in 2011, the 8.625% Senior Notes were also jointly and severally guaranteed, on a full, unconditional and unsecured basis by the wholly owned subsidiary guarantors. The subsidiary guarantees (i) rank equally in right of payment with all of the existing and future senior debt of the subsidiary guarantors; (ii) rank senior to all of the existing and future subordinated debt of the subsidiary guarantors; (iii) are effectively subordinated in right of payment to any existing or future secured obligations of the subsidiary guarantors to the extent of the value of the assets securing such obligations; (iv) are structurally subordinated to all debt and other obligations of the subsidiaries of the guarantors who are not themselves guarantors; and (v) are only released under certain customary circumstances. The Company’s subsidiary guarantors guarantee payments of principal and interest under the Company’s registered notes.

The following unaudited condensed consolidating financial information represents the financial information of SandRidge Energy, Inc., its wholly owned subsidiary guarantors and its non-guarantor subsidiaries, prepared on the equity basis of accounting. The non-guarantor subsidiaries, including consolidated VIEs, are included in the non-guarantors column in the tables below. The financial information may not necessarily be indicative of the financial position, results of operations or cash flows had the subsidiary guarantors operated as independent entities.

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Condensed Consolidating Balance Sheets

	June 30, 2012 Parent (In thousands)	Guarantors	Non-Guarantors	Eliminations	Consolidated
ASSETS					
Current assets					
Cash and cash equivalents	$410,870	$5,219	$4,984	$—	$421,073
Accounts receivable, net	1,485,828	711,971	676,005	(2,585,472)	288,332
Derivative contracts	—	184,664			