Gastar Exploration Inc.
Form 10-Q
August 06, 2015
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
FOR THE QUARTERLY PERIOD ENDED June 30, 2015
OR
o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
FOR THE TRANSITION PERIOD FROM TO

Commission File Number: 001-35211

GASTAR EXPLORATION INC.
(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	38-3531640 (I.R.S. Employer Identification No.)
1331 Lamar Street, Suite 650 Houston, Texas (Address of principal executive offices)	77010 (Zip Code)

(713) 739-1800
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes ý No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes ý No o

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

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes o No ý

The total number of outstanding common shares, $0.001 par value per share, as of August 3, 2015 was 80,142,118.

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GASTAR EXPLORATION INC.
QUARTERLY REPORT ON FORM 10-Q
FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2015
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On November 14, 2013, Gastar Exploration Ltd., an Alberta, Canada corporation, changed its jurisdiction of incorporation to the State of Delaware and changed its name to “Gastar Exploration, Inc.” On January 31, 2014, Gastar Exploration, Inc. merged with and into Gastar Exploration USA, Inc., its direct subsidiary, as part of a reorganization to eliminate Gastar Exploration, Inc.’s holding company corporate structure. Pursuant to the merger agreement, shares of Gastar Exploration, Inc.’s common stock were converted into an equal number of shares of common stock of Gastar Exploration USA, Inc., and Gastar Exploration USA, Inc. changed its name to “Gastar Exploration Inc.” Gastar Exploration Inc. owns and continues to conduct Gastar Exploration, Inc.’s business in substantially the same manner as was being conducted prior to the merger.

Unless otherwise indicated or required by the context, (i) for any date or period prior to the January 31, 2014 merger described above, “Gastar,” the “Company,” “we,” “us,” “our” and similar terms refer collectively to Gastar Exploration, Inc.(formerly known as Gastar Exploration Ltd.) and its subsidiaries, including Gastar Exploration Inc. (formerly known as Gastar Exploration USA, Inc.), and for any date or period after January 31, 2014, such terms refer collectively to Gastar Exploration Inc. and its subsidiaries, (ii) “Gastar USA” refers to Gastar Exploration USA, Inc., which until January 31, 2014 was a first-tier subsidiary of Gastar Exploration, Inc. and its primary operating company, (iii) “Parent” refers to Gastar Exploration, Inc., (iv) all dollar amounts appearing in this Form 10-Q are stated in United States dollars (“U.S. dollars”) unless otherwise noted and (v) all financial data included in this Form 10-Q have been prepared in accordance with generally accepted accounting principles in the United States of America (“U.S. GAAP”).

General information about us can be found on our website at www.gastar.com. The information available on or through our website, or about us on any other website, is neither incorporated into, nor part of, this report. Our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and other filings that we make with the U.S. Securities and Exchange Commission (“SEC”), as well as any amendments and exhibits to those reports, will be available free of charge through our website as soon as reasonably practicable after we file or furnish them to the SEC. Information is also available on the SEC website at www.sec.gov for our U.S. filings.

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Glossary of Terms

AMI	Area of mutual interest, an agreed designated geographic area where joint venturers or other industry partners have a right of participation in acquisitions and operations
Bbl	Barrel of oil, condensate or NGLs
Bbl/d	Barrels of oil, condensate or NGLs per day
Bcf	One billion cubic feet of natural gas
Bcfe	One billion cubic feet of natural gas equivalent, calculated by converting liquids volumes on the basis of 1/6th of a barrel of oil, condensate or NGLs per Mcf
Boe	One barrel of oil equivalent determined using the ratio of six thousand cubic feet of natural gas to one barrel of oil, condensate or NGLs
Boe/d	Barrels of oil equivalent per day
Btu	British thermal unit, typically used in measuring natural gas energy content
CRP	Central receipt point
FASB	Financial Accounting Standards Board
Gross acres	Refers to acres in which we own a working interest
Gross wells	Refers to wells in which we have a working interest
MBbl	One thousand barrels of oil, condensate or NGLs
MBbl/d	One thousand barrels of oil, condensate or NGLs per day
MBoe	One thousand barrels of oil equivalent, calculated by converting natural gas volumes on the basis of 6 Mcf of natural gas per barrel
MBoe/d	One thousand barrels of oil equivalent per day
Mcf	One thousand cubic feet of natural gas
Mcf/d	One thousand cubic feet of natural gas per day
Mcfe	One thousand cubic feet of natural gas equivalent, calculated by converting liquids volumes on the basis of 1/6th of a barrel of oil, condensate or NGLs per Mcf
MMBtu/d	One million British thermal units per day
MMcf	One million cubic feet of natural gas

MMcf/d	One million cubic feet of natural gas per day
MMcfe	One million cubic feet of natural gas equivalent, calculated by converting liquids volumes on the basis of 1/6th of a barrel of oil, condensate or NGLs per Mcf
MMcfe/d	One million cubic feet of natural gas equivalent per day
Net acres	Refers to our proportionate interest in acreage resulting from our ownership in gross acreage
Net wells	Refers to gross wells multiplied by our working interest in such wells
NGLs	Natural gas liquids
NYMEX	New York Mercantile Exchange
PBU	Performance based unit comprising one of our compensation plan awards
psi	Pounds per square inch
U.S.	United States of America
U.S. GAAP	Accounting principles generally accepted in the United States of America

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements
GASTAR EXPLORATION INC.
CONDENSED CONSOLIDATED BALANCE SHEETS

	June 30, 2015 (Unaudited)	December 31, 2014
	(in thousands, except share data)	
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$9,378	$ 11,008
Accounts receivable, net of allowance for doubtful accounts of $0, respectively	16,431	30,841
Commodity derivative contracts	13,159	19,687
Prepaid expenses	686	2,083
Total current assets	39,654	63,619
PROPERTY, PLANT AND EQUIPMENT:		
Oil and natural gas properties, full cost method of accounting:		
Unproved properties, excluded from amortization	123,162	128,274
Proved properties	1,208,229	1,124,367
Total oil and natural gas properties	1,331,391	1,252,641
Furniture and equipment	3,055	3,010
Total property, plant and equipment	1,334,446	1,255,651
Accumulated depreciation, depletion and amortization	(694,054)	(563,351)
Total property, plant and equipment, net	640,392	692,300
OTHER ASSETS:		
Commodity derivative contracts	9,996	7,815
Deferred charges, net	2,889	2,586
Advances to operators and other assets	795	9,474
Total other assets	13,680	19,875
TOTAL ASSETS	$693,726	$ 775,794
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Accounts payable	$13,333	$ 28,843
Revenue payable	6,770	9,122
Accrued interest	3,553	3,528
Accrued drilling and operating costs	6,351	5,977
Advances from non-operators	—	1,820
Commodity derivative contracts	166	—
Commodity derivative premium payable	1,515	2,481
Asset retirement obligation	86	82
Other accrued liabilities	9,251	3,175
Total current liabilities	41,025	55,028
LONG-TERM LIABILITIES:		
Long-term debt	411,545	360,303
Commodity derivative contracts	616	—
Commodity derivative premium payable	4,051	4,702
Asset retirement obligation	5,873	5,475

Total long-term liabilities	422,085	370,480
Commitments and contingencies (Note 11)		
STOCKHOLDERS' EQUITY:		
Preferred stock, 40,000,000 shares authorized		
Series A Preferred stock, par value $0.01 per share; 10,000,000 shares designated; 4,045,000 shares issued and outstanding at June 30, 2015 and December 31, 2014, respectively, with liquidation preference of $25.00 per share	41	41
Series B Preferred stock, par value $0.01 per share; 10,000,000 shares designated; 2,140,000 shares issued and outstanding at June 30, 2015 and December 31, 2014, respectively, with liquidation preference of $25.00 per share	21	21
Common stock, par value $0.001 per share; 275,000,000 shares authorized; 80,144,934 and 78,632,810 shares issued and outstanding at June 30, 2015 and December 31, 2014, respectively	78	78
Additional paid-in capital	569,788	568,440
Accumulated deficit	(339,312)	(218,294)
Total stockholders' equity	230,616	350,286
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$693,726	$775,794

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

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GASTAR EXPLORATION INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2015	2014	2015	2014
	(in thousands, except share and per share data)			
REVENUES:				
Oil and condensate	$17,584	$22,342	$32,937	$39,120
Natural gas	3,950	17,559	10,650	32,978
NGLs	2,184	4,906	4,280	11,550
Total oil, condensate, natural gas and NGLs revenues	23,718	44,807	47,867	83,648
(Loss) gain on commodity derivatives contracts	(1,790)	(8,910)	8,433	(15,424)
Total revenues	21,928	35,897	56,300	68,224
EXPENSES:				
Production taxes	822	2,037	1,662	3,931
Lease operating expenses	7,242	4,877	13,261	8,921
Transportation, treating and gathering	542	2,146	1,039	2,771
Depreciation, depletion and amortization	16,080	10,280	30,551	22,662
Impairment of oil and natural gas properties	100,152	—	100,152	—
Accretion of asset retirement obligation	131	125	256	247
General and administrative expense	4,421	3,893	8,669	8,656
Total expenses	129,390	23,358	155,590	47,188
(LOSS) INCOME FROM OPERATIONS	(107,462)	12,539	(99,290)	21,036
OTHER INCOME (EXPENSE):				
Interest expense	(6,936)	(6,912)	(14,497)	(13,803)
Investment income and other	3	4	6	11
Foreign transaction loss	—	(4)	—	(6)
(LOSS) INCOME BEFORE PROVISION FOR INCOME TAXES	(114,395)	5,627	(113,781)	7,238
Provision for income taxes	—	—	—	—
NET (LOSS) INCOME	(114,395)	5,627	(113,781)	7,238
Dividends on preferred stock	(3,619)	(3,611)	(7,237)	(7,187)
NET (LOSS) INCOME ATTRIBUTABLE TO COMMON STOCKHOLDERS	$(118,014)	$2,016	$(121,018)	$51
NET (LOSS) INCOME PER SHARE OF COMMON STOCK ATTRIBUTABLE TO COMMON STOCKHOLDERS:				
Basic	$(1.52)	$0.03	$(1.56)	$—
Diluted	$(1.52)	$0.03	$(1.56)	$—
WEIGHTED AVERAGE SHARES OF COMMON STOCK OUTSTANDING:				
Basic	77,611,167	58,702,982	77,364,368	58,462,124
Diluted	77,611,167	61,922,874	77,364,368	61,674,267

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

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GASTAR EXPLORATION INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	For the Six Months Ended June 30,	
	2015	2014
	(in thousands)	
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net (loss) income	$(113,781)	$7,238
Adjustments to reconcile net (loss) income to net cash provided by operating activities:		
Depreciation, depletion and amortization	30,551	22,662
Impairment of oil and natural gas properties	100,152	—
Stock-based compensation	2,773	2,532
Mark to market of commodity derivatives contracts:		
Total (gain) loss on commodity derivatives contracts	(8,433)	15,424
Cash settlements of matured commodity derivatives contracts, net	11,408	(6,061)
Cash premiums paid for commodity derivatives contracts	(45)	(155)
Amortization of deferred financing costs	1,736	1,491
Accretion of asset retirement obligation	256	247
Settlement of asset retirement obligation	(80)	(546)
Changes in operating assets and liabilities:		
Accounts receivable	15,887	(2,827)
Prepaid expenses	1,397	112
Accounts payable and accrued liabilities	(4,806)	9,649
Net cash provided by operating activities	37,015	49,766
CASH FLOWS FROM INVESTING ACTIVITIES:		
Development and purchase of oil and natural gas properties	(84,724)	(55,295)
Advances to operators	(1,225)	(20,657)
Acquisition of oil and natural gas properties - refund	—	4,209
Proceeds from sale of oil and natural gas properties	2,008	3,077
Deposit for sale of oil and natural gas properties	6,620	—
(Payments to) proceeds from non-operators	(1,820)	526
Purchase of furniture and equipment	(45)	(158)
Net cash used in investing activities	(79,186)	(68,298)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from revolving credit facility	55,000	35,000
Repayment of revolving credit facility	(5,000)	(15,000)
Proceeds from issuance of preferred stock, net of issuance costs	—	2,064
Dividends on preferred stock	(7,237)	(7,187)
Deferred financing charges	(797)	(319)
Tax withholding related to restricted stock and performance based unit award vestings	(1,425)	(3,656)
Net cash provided by financing activities	40,541	10,902
NET DECREASE IN CASH AND CASH EQUIVALENTS	(1,630)	(7,630)
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	11,008	32,393
CASH AND CASH EQUIVALENTS, END OF PERIOD	$9,378	$24,763

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

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GASTAR EXPLORATION INC.
NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. Description of Business

Gastar Exploration Inc. (the "Company" or "Gastar," and before January 31, 2014, "Gastar USA") is an independent energy company engaged in the exploration, development and production of oil, condensate, natural gas and NGLs in the U.S. Gastar's principal business activities include the identification, acquisition, and subsequent exploration and development of oil and natural gas properties with an emphasis on unconventional reserves, such as shale resource plays. In Oklahoma, Gastar is developing the primarily oil-bearing reservoirs of the Hunton Limestone horizontal oil play and expects to test other prospective formations on the same acreage, including the Meramec Shale (middle Mississippi Lime) and the Woodford Shale, which Gastar refers to as the STACK Play. In West Virginia, Gastar is developing liquids-rich natural gas in the Marcellus Shale and has drilled and completed its first two successful dry gas Utica Shale/Point Pleasant wells on its acreage.

All references to "Gastar," the "Company" and similar terms refer collectively to Gastar Exploration Inc. Unless otherwise stated or the context requires otherwise, all references in these notes to "Gastar USA" refer collectively to Gastar Exploration Inc. (formerly known as Gastar Exploration USA, Inc.) and its wholly-owned subsidiaries and all references to "Parent" refer solely to Gastar Exploration, Inc. (formerly known as Gastar Exploration Ltd.).

2. Summary of Significant Accounting Policies

The accounting policies followed by the Company are set forth in the notes to the Company's audited consolidated financial statements included in its Annual Report on Form 10-K for the year ended December 31, 2014 (the "2014 Form 10-K") filed with the SEC. Please refer to the notes to the consolidated financial statements included in the 2014 Form 10-K for additional details of the Company's financial condition, results of operations and cash flows. No material item included in those notes has changed except as a result of normal transactions in the interim or as disclosed within this report.

The unaudited interim condensed consolidated financial statements of the Company included herein are stated in U.S. dollars and were prepared from the records of the Company by management in accordance with U.S. GAAP applicable to interim financial statements and reflect all normal and recurring adjustments, which are, in the opinion of management, necessary to provide a fair presentation of the results of operations and financial position for the interim periods. Such financial statements conform to the presentation reflected in the 2014 Form 10-K. The current interim period reported herein should be read in conjunction with the financial statements and accompanying notes, including Item 8. "Financial Statements and Supplementary Data, Note 2 – Summary of Significant Accounting Policies," included in the 2014 Form 10-K.

The preparation of financial statements in conformity with U.S. 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. Actual results could differ from those estimates. Significant estimates with regard to these financial statements include the estimate of proved oil and natural gas reserve quantities and the related present value of estimated future net cash flows.

The unaudited interim condensed consolidated financial statements of the Company include the consolidated accounts of all of its subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation. Certain reclassifications of prior year balances have been made to conform to the current year presentation; these reclassifications have no impact on net income (loss).

The results of operations for the three and six months ended June 30, 2015 are not necessarily indicative of the results that may be expected for the year ending December 31, 2015. In preparing these financial statements, the Company has evaluated events and transactions for potential recognition or disclosure through the date the financial statements were issued and has disclosed certain subsequent events in these condensed consolidated financial statements, as appropriate.

Recent Accounting Developments

The following recently issued accounting pronouncement may impact the Company in future periods:

Debt Issuance Costs. In April 2015, the FASB issued updated guidance regarding simplification of the presentation of debt issuance costs. The updated guidance requires debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of the related debt liability instead of being presented as an asset. Debt disclosures will include the face amount of the debt liability and the effective interest rate. The update requires retrospective application and represents a change in accounting principle. The update is effective for fiscal years beginning after December 15, 2015. Early adoption is permitted for financial statements that have not been previously issued. The Company does not expect the adoption of this guidance to have a material impact on its consolidated financial statements.

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Going Concern. In August 2014, the FASB issued updated guidance related to determining whether substantial doubt exists about an entity's ability to continue as a going concern. The amendment provides guidance for determining whether conditions or events give rise to substantial doubt that an entity has the ability to continue as a going concern within one year following issuance of the financial statements, and requires specific disclosures regarding the conditions or events leading to substantial doubt. The updated guidance is effective for annual reporting periods and interim periods within those annual periods beginning after December 15, 2016. Earlier adoption is permitted. The Company does not expect the adoption of this guidance to have a material impact on its consolidated financial statements.

Revenue Recognition. In May 2014, the FASB issued an amendment to previously issued guidance regarding the recognition of revenue. The FASB and the International Accounting Standards Board initiated a joint project to clarify the principles for recognizing revenue and to develop a common standard that would (i) remove inconsistencies and weaknesses in revenue requirements, (ii) provide a more robust framework for addressing revenue issues, (iii) improve comparability of revenue recognition practices across entities, industries, jurisdictions and capital markets, (iv) provide more useful information to users of financial statements through improved disclosure requirements and (v) simplify the preparation of financial statements by reducing the number of requirements to which an entity must refer. The core principle of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. To achieve this core principle, an entity should apply the following steps: (1) identify the contract(s) with the customer; (2) identify the performance obligations in the contract; (3) determine the transaction price; (4) allocate the transaction price to the performance obligations in the contract; and (5) recognize revenue when (or as) the entity satisfies a performance obligation. This guidance supersedes prior revenue recognition requirements and most industry-specific guidance throughout the FASB Accounting Standards Codification. This guidance is effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period. In April 2015, the FASB proposed to delay the effective date one year, beginning in fiscal year 2018. The proposal will be subject to the FASB's due process requirement, which includes a period for public comments. The Company is currently evaluating the effect that adopting this guidance will have on its financial position, results of operations or cash flows and does not expect the adoption of this guidance to materially impact its operating results, financial position or cash flows.

3. Property, Plant and Equipment

The amount capitalized as oil and natural gas properties was incurred for the purchase and development of various properties in the U.S., located in the states of Oklahoma, Pennsylvania and West Virginia.

The following table summarizes the components of unproved properties excluded from amortization at the dates indicated:

	June 30, 2015	December 31, 2014
	(in thousands)	
Unproved properties, excluded from amortization:		
Drilling in progress costs	$14,895	$29,193
Acreage acquisition costs	98,278	91,362
Capitalized interest	9,989	7,719
Total unproved properties excluded from amortization	$123,162	$128,274

The full cost method of accounting for oil and natural gas properties requires a quarterly calculation of a limitation on capitalized costs, often referred to as a full cost ceiling calculation. The ceiling is the present value (discounted at 10% per annum) of estimated future cash flow from proved oil, condensate, natural gas and NGLs reserves reduced by future operating expenses, development expenditures, abandonment costs (net of salvage) to the extent not included in oil and natural gas properties pursuant to authoritative guidance and estimated future income taxes thereon. To the extent that the Company's capitalized costs (net of accumulated depletion and deferred taxes) exceed the ceiling at the end of the reported period, the excess must be written off to expense for such period. Once incurred, this impairment of oil and natural gas properties is not reversible at a later date even if oil and natural gas prices increase. The ceiling calculation is determined using a mandatory trailing 12-month unweighted arithmetic average of the first-day-of-the-month commodities pricing and costs in effect at the end of the period, each of which are held constant indefinitely (absent specific contracts with respect to future prices and costs) with respect to valuing future net cash flows from proved reserves for this purpose. The 12-month unweighted arithmetic average of the first-day-of-the-month commodities prices are adjusted for basis and quality differentials in determining the present value of the proved reserves. The table below sets forth relevant pricing assumptions utilized in the quarterly ceiling test computations for the respective periods noted before adjustment for basis and quality differentials:

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	2015 Total Impairment	June 30	March 31
Henry Hub natural gas price (per MMBtu)(1)		$3.39	$3.88
West Texas Intermediate oil price (per Bbl)(1)		$71.68	$82.72
Impairment recorded (pre-tax) (in thousands)	$100,152	$100,152	$—

	2014 Total Impairment	June 30	March 31
Henry Hub natural gas price (per MMBtu)(1)		$4.10	$3.99
West Texas Intermediate oil price (per Bbl)(1)		$100.11	$98.30
Impairment recorded (pre-tax) (in thousands)	$—	$—	$—

(1) For the respective periods, oil and natural gas prices are calculated using the trailing 12-month unweighted arithmetic average of the first-day-of-the-month prices based on Henry Hub spot natural gas prices and West Texas Intermediate spot oil prices.

Future declines in the trailing 12-month average of oil, condensate, natural gas and NGLs prices will likely result in the recognition of significant additional ceiling impairments in 2015.

Mid-Continent Divestiture

On July 6, 2015, the Company sold to an undisclosed private third party certain non-core assets comprised of 38 gross (16.7 net) wells producing approximately net 170 Boe/d (41% oil) for the three months ended March 31, 2015 and approximately 29,500 gross (19,200 net) acres in Kingfisher County, Oklahoma for approximately $46.1 million, reflecting an effective date of April 1, 2015 and customary closing adjustments. Of the total purchase price, $6.6 million was deposited during the second quarter of 2015 and accounted for in other liabilities at June 30, 2015. The sale will be reflected as a reduction to the full cost pool and the Company will not record a gain or loss related to the divestiture as it is not significant to the full cost pool.

Atinum Joint Venture

In September 2010, the Company entered into a joint venture (the “Atinum Joint Venture”) pursuant to which the Company ultimately assigned to an affiliate of Atinum Partners Co., Ltd. (“Atinum”), for total consideration of $70.0 million, a 50% working interest in certain undeveloped acreage and wells. Effective June 30, 2011, an area of mutual interest (“AMI”) was established for additional acreage acquisitions in Ohio, New York, Pennsylvania and West Virginia, excluding the counties of Pendleton, Pocahontas, Preston, Randolph and Tucker, West Virginia. Within this AMI, the Company acts as operator and is obligated to offer any future lease acquisitions within the AMI to Atinum on a 50/50 basis, and Atinum will pay the Company on an annual basis an amount equal to 10% of lease bonuses and third party leasing costs up to $20.0 million and 5% of such costs on activities above $20.0 million.

The Atinum Joint Venture pursued an initial three-year development program that called for the partners to drill a minimum of 60 operated horizontal wells by year-end 2013. Due to natural gas price declines, Atinum and the Company agreed to reduce the minimum wells to be drilled requirements from the originally agreed upon 60 gross wells to 51 gross wells. At June 30, 2015, 74 gross operated horizontal Marcellus Shale wells and two gross operated horizontal Utica Shale/Point Pleasant well were capable of production under the Atinum Joint Venture. The Atinum Joint Venture Agreement expires on November 1, 2015.

4. Long-Term Debt

Second Amended and Restated Revolving Credit Facility

On June 7, 2013, the Company entered into the Second Amended and Restated Credit Agreement among the Company, Wells Fargo Bank, National Association, as Administrative Agent, Collateral Agent, Swing Line Lender and Issuing Lender and the lenders named therein (the “Revolving Credit Facility”). At the Company's election, borrowings bear interest at the reference rate or the Eurodollar rate plus an applicable margin. The reference rate is the greater of (i) the rate of interest publicly announced by the administrative agent, (ii) the federal funds rate plus 50 basis points and (iii) LIBOR plus 1.0%. The applicable interest rate margin varies from 1.0% to 2.0% in the case of borrowings based on the reference rate and from 2.0% to 3.0% in the case of borrowings based on the Eurodollar rate, depending on the utilization percentage in relation to the

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borrowing base and subject to adjustments based on the Company's leverage ratio. An annual commitment fee of 0.5% is payable quarterly on the unutilized balance of the borrowing base. The Revolving Credit Facility has a scheduled maturity of November 14, 2017.

The Revolving Credit Facility will be guaranteed by all of the Company's future domestic subsidiaries formed during the term of the Revolving Credit Facility. Borrowings and related guarantees are secured by a first priority lien on certain domestic oil and natural gas properties currently owned by or later acquired by the Company and its subsidiaries, excluding de minimis value properties as determined by the lender. The Revolving Credit Facility is secured by a first priority pledge of the capital stock of each domestic subsidiary, a first priority interest on all accounts receivable, notes receivable, inventory, contract rights, general intangibles and material property of the issuer and 65% of the stock of any foreign subsidiary of the Company.

The Revolving Credit Facility contains various covenants, including, among others:

- Restrictions on liens, incurrence of other indebtedness without lenders' consent and common stock dividends and other restricted payments;
- Maintenance of a minimum consolidated current ratio as of the end of each quarter of not less than 1.0 to 1.0, as adjusted;
- Maintenance of a maximum ratio of net indebtedness to EBITDA of not greater than 4.0 to 1.0, subject to the modifications in Amendment No. 5 set forth below; and
- Maintenance of an interest coverage ratio on a rolling four quarters basis, as adjusted, of EBITDA to interest expense, as of the end of each quarter, to be less than 2.5 to 1.0, subject to the modifications in Amendment No. 5 set forth below.

All outstanding amounts owed become due and payable upon the occurrence of certain usual and customary events of default, including, among others:

- Failure to make payments;
- Non-performance of covenants and obligations continuing beyond any applicable grace period; and
- The occurrence of a change in control of the Company, as defined under the Revolving Credit Facility.

On March 9, 2015, the Company, together with the parties thereto, entered into a Master Assignment, Agreement and Amendment No. 5 (“Amendment No. 5”) to Second Amended and Restated Credit Agreement. Amendment No. 5 amended the Revolving Credit Facility to, among other things, (i) increase the borrowing base from $145.0 million to $200.0 million, (ii) adjust the total leverage ratio for each fiscal quarter ending on or after March 31, 2015 but prior to September 30, 2016, to 5.25 to 1.00; for the fiscal quarter ending on September 30, 2016, to 5.00 to 1.00; for the fiscal quarter ending on December 31, 2016, to 4.75 to 1.00; for the fiscal quarter ending on March 31, 2017, to 4.25 to 1.00; and for each fiscal quarter ending on or after June 30, 2017, to 4.00 to 1.00, (iii) adjust the interest coverage ratio for each fiscal quarter ending on or after March 31, 2015 but prior to March 31, 2016, to 2.00 to 1.00 and for each fiscal quarter ending on or after March 31, 2016, to 2.50 to 1.00, and (iv) add the senior secured leverage ratio covenant, such ratio not to exceed, (a) for each fiscal quarter ending on or after March 31, 2015 but prior to June 30, 2016, 2.25 to 1.00 and (b) for each fiscal quarter ending on or after June 30, 2016, 2.00 to 1.00 provided that this senior secured leverage ratio shall cease to apply commencing with the first fiscal quarter end occurring after June 30, 2016 for which the total leverage ratio is equal to or less than 4.00 to 1.00.

Borrowing base redeterminations are scheduled semi-annually in May and November of each calendar year. The Company and its lender group may each request one additional unscheduled redetermination during any six-month period between scheduled redeterminations. At June 30, 2015, the Revolving Credit Facility had a borrowing base of $200.0 million, with $95.0 million borrowings outstanding and availability of $105.0 million. The next regularly scheduled redetermination is set for November 2015. Future increases in the borrowing base in excess of the original $50.0 million are limited to 17.5% of the increase in adjusted consolidated net tangible assets as defined in the indenture pursuant to which the Company's senior secured notes are issued (as discussed below in “Senior Secured Notes”).

At June 30, 2015, the Company was in compliance with all financial covenants under the Revolving Credit Facility.

Senior Secured Notes

The Company has $325.0 million aggregate principal amount of 8 5/8% Senior Secured Notes due May 15, 2018 (the "Notes") outstanding under an indenture (the "Indenture") by and among the Company, the Guarantors named therein (the "Guarantors"), Wells Fargo Bank, National Association, as Trustee (in such capacity, the "Trustee") and Collateral Agent (in such capacity, the "Collateral Agent"). The Notes bear interest at a rate of 8.625% per year, payable semi-annually in arrears on May 15 and November 15 of each year. The Notes mature on May 15, 2018.

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In the event of a change of control, as defined in the Indenture, each holder of the Notes will have the right to require the Company to repurchase all or any part of their notes at an offer price in cash equal to 101% of the aggregate principal amount thereof, plus accrued and unpaid interest, if any, to the date of purchase.

The Notes will be guaranteed, jointly and severally, on a senior secured basis by certain future domestic subsidiaries (the “Guarantees”). The Notes and Guarantees will rank senior in right of payment to all of the Company's and the Guarantors' future subordinated indebtedness and equal in right of payment to all of the Company's and the Guarantors' existing and future senior indebtedness. The Notes and Guarantees also will be effectively senior to the Company's unsecured indebtedness and effectively subordinated to the Company's and Guarantors' under the Revolving Credit Facility, any other indebtedness secured by a first-priority lien on the same collateral and any other indebtedness secured by assets other than the collateral, in each case to the extent of the value of the assets securing such obligation.

The Indenture contains covenants that, among other things, limit the Company's ability and the ability of its subsidiaries to:

- Transfer or sell assets or use asset sale proceeds;
- Pay dividends or make distributions, redeem subordinated debt or make other restricted payments;
- Make certain investments; incur or guarantee additional debt or issue preferred equity securities;
- Create or incur certain liens on the Company's assets;
- Incur dividend or other payment restrictions affecting future restricted subsidiaries;
- Merge, consolidate or transfer all or substantially all of the Company's assets;
- Enter into certain transactions with affiliates; and
- Enter into certain sale and leaseback transactions.

These and other covenants that are contained in the Indenture are subject to important limitations and qualifications that are described in the Indenture.

At June 30, 2015, the Notes reflected a balance of $316.5 million, net of unamortized discounts of $8.5 million, on the condensed consolidated balance sheets.

5. Fair Value Measurements

The Company’s financial assets and liabilities are measured at fair value on a recurring basis. The Company discloses its recognized non-financial assets and liabilities, such as asset retirement obligations, unproved properties and other property and equipment, at fair value on a non-recurring basis. For non-financial assets and liabilities, the Company is required to disclose information that enables users of its financial statements to assess the inputs used to develop these measurements. The Company assesses its unproved properties for impairment whenever events or circumstances indicate the carrying value of those properties may not be recoverable. The fair value of the unproved properties is measured using an income approach based upon internal estimates of future production levels, current and future prices, drilling and operating costs, discount rates, current drilling plans and favorable and unfavorable drilling activity on the properties being evaluated and/or adjacent properties or estimated market data based on area transactions, which are Level 3 inputs. For the three and six months ended June 30, 2015, management's evaluation of unproved properties resulted in an impairment. Due to continued lower natural gas prices for dry gas and no current plans to drill or extend leases in Marcellus East, the Company reclassified $26,000 and $60,000, respectively, of unproved properties to proved properties for the three and six months ended June 30, 2015 related to acreage in Marcellus East. For the three and six months ended June 30, 2014, management's evaluation of unproved properties resulted in an impairment of $234,000 and $428,000, respectively, related to Marcellus East. As no other fair value measurements are required to be recognized on a non-recurring basis at June 30, 2015, no additional disclosures are provided at June 30, 2015.

As defined in the guidance, fair value is the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (an exit price). To estimate fair value, the Company utilizes market data or assumptions that market participants would use in pricing the asset or liability, including assumptions about risk and the risks inherent in the inputs to the valuation technique. These inputs can be readily observable, market corroborated or generally unobservable. The guidance establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted market prices in active markets for identical assets or liabilities ("Level 1") and the lowest priority to unobservable inputs ("Level 3"). The three levels of the fair value hierarchy are as follows:

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- Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities. The Company's cash equivalents consist of short-term, highly liquid investments, which have maturities of 90 days or less, including sweep investments and money market funds.
- Level 2 inputs are quoted prices for similar assets and liabilities in active markets or inputs that are observable for the asset or liability, either directly or indirectly through market corroboration, for substantially the full term of the financial instrument.
- Level 3 inputs are measured based on prices or valuation models that require inputs that are both significant to the fair value measurement and less observable from objective sources. These inputs may be used with internally developed methodologies or third party broker quotes that result in management's best estimate of fair value. The Company's valuation models consider various inputs including (a) quoted forward prices for commodities, (b) time value, (c) volatility factors and (d) current market and contractual prices for the underlying instruments. Significant increases or decreases in any of these inputs in isolation would result in a significantly higher or lower fair value measurement. Level 3 instruments are commodity costless collars, index swaps, basis and fixed price swaps and put and call options to hedge natural gas, oil and NGLs price risk. At each balance sheet date, the Company performs an analysis of all applicable instruments and includes in Level 3 all of those whose fair value is based on significant unobservable inputs. The fair values derived from counterparties and third-party brokers are verified by the Company using publicly available values for relevant NYMEX futures contracts and exchange traded contracts for each derivative settlement location. Although such counterparty and third-party broker quotes are used to assess the fair value of its commodity derivative instruments, the Company does not have access to the specific assumptions used in its counterparties valuation models. Consequently, additional disclosures regarding significant Level 3 unobservable inputs were not provided and the Company does not currently have sufficient corroborating market evidence to support classifying these contracts as Level 2 instruments.

As required, financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement. The Company's assessment of the significance of a particular input to the fair value measurement requires judgment and may affect the valuation of fair value assets and liabilities and their placement within the fair value hierarchy levels. The determination of the fair values below incorporates various factors, including the impact of the counterparty's non-performance risk with respect to the Company's financial assets and the Company's non-performance risk with respect to the Company's financial liabilities. The Company has not elected to offset the fair value amounts recognized for multiple derivative instruments executed with the same counterparty, but reports them gross on its consolidated balance sheets.

Transfers between levels are recognized at the end of the reporting period. There were no transfers between levels during the 2015 and 2014 periods.

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The following tables set forth by level within the fair value hierarchy the Company’s financial assets and liabilities that were accounted for at fair value on a recurring basis as of June 30, 2015 and December 31, 2014:

	Fair value as of June 30, 2015			
	Level 1	Level 2	Level 3	Total
	(in thousands)			
Assets:				
Cash and cash equivalents	$9,378	$—	$—	$9,378
Commodity derivative contracts	—	—	23,155	23,155
Liabilities:				
Commodity derivative contracts	—	—	(782)	(782)
Total	$9,378	$—	$22,373	$31,751

	Fair value as of December 31, 2014			
	Level 1	Level 2	Level 3	Total
	(in thousands)			
Assets:				
Cash and cash equivalents	$11,008	$—	$—	$11,008
Commodity derivative contracts	—	—	27,502	27,502
Liabilities:				
Commodity derivative contracts	—	—	—	—
Total	$11,008	$—	$27,502	$38,510

The table below presents a reconciliation of the assets and liabilities classified as Level 3 in the fair value hierarchy for the three and six months ended June 30, 2015 and 2014. Level 3 instruments presented in the table consist of net derivatives that, in management’s opinion, reflect the assumptions a marketplace participant would have used at June 30, 2015 and 2014.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
	(in thousands)			
Balance at beginning of period	$31,823	$620	$27,502	$3,764
Total (losses) gains included in earnings	(1,790)	(8,910)	8,433	(15,424)
Purchases	45	268	911	339
Issuances	(1,127)	—	(1,313)	—
Settlements[(1)]	(6,578)	3,394	(13,160)	6,693
Balance at end of period	$22,373	$(4,628)	$22,373	$(4,628)
The amount of total losses for the period included in earnings attributable to the change in mark to market of commodity derivatives contracts still held at June 30, 2015 and 2014	$(7,777)	$(5,418)	$(3,525)	$(8,573)

(1) Included in gain (loss) on commodity derivatives contracts on the condensed consolidated statements of operations.

At June 30, 2015, the estimated fair value of accounts receivable, prepaid expenses, accounts and revenue payables and accrued liabilities approximates their carrying value due to their short-term nature. The estimated fair value of the Company’s long-term debt at June 30, 2015 was $399.8 million based on quoted market prices of the Notes (Level 1) and the respective carrying value of the Revolving Credit Facility because the interest rate approximates the current market rate (Level 2).

The Company has consistently applied the valuation techniques discussed above in all periods presented.
The fair value guidance, as amended, establishes that every derivative instrument is to be recorded on the balance sheet as either an asset or liability measured at fair value. See Note 6, "Derivative Instruments and Hedging Activity."

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6. Derivative Instruments and Hedging Activity

The Company maintains a commodity price risk management strategy that uses derivative instruments to minimize significant, unanticipated earnings fluctuations that may arise from volatility in commodity prices. The Company uses costless collars, index, basis and fixed price swaps and put and call options to hedge oil, condensate, natural gas and NGLs price risk.

All derivative contracts are carried at their fair value on the balance sheet and all changes in value are recorded in the condensed consolidated statements of operations in (loss) gain on commodity derivatives contracts. For the three months ended June 30, 2015 and 2014, the Company reported losses of $7.8 million and $5.4 million, respectively, in the condensed consolidated statements of operations related to the change in the fair value of its commodity derivative contracts still held at June 30, 2015 and 2014. For the six months ended June 30, 2015 and 2014, the Company reported losses of $3.5 million and $8.6 million, respectively, in the condensed consolidated statements of operations related to the change in the fair value of its commodity derivative contracts still held at June 30, 2015 and 2014.

As of June 30, 2015, the following crude derivative transactions were outstanding with the associated notional volumes and weighted average underlying hedge prices:

Settlement Period	Derivative Instrument	Average Daily Volume(1) (in Bbls)	Total of Notional Volume	Floor (Long)	Short Put	Ceiling (Short)
2015	Costless three-way collar	400	73,600	$85.00	$70.00	$96.50
2015	Costless three-way collar	325	59,800	$85.00	$65.00	$97.80
2015	Costless three-way collar	50	9,200	$85.00	$65.00	$96.25
2015	Costless collar	750	130,000	$52.50	$—	$62.05
2015	Costless collar	300	55,200	$52.50	$—	$68.10
2015	Fixed price swap	600	110,400	$72.54	$—	$—
2015						