HALCON RESOURCES CORP
Form 10-Q
August 01, 2018

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# UNITED STATES
# SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C. 20549**

# FORM 10-Q

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

**For the quarterly period ended June 30, 2018**

**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: 001-35467**

# Halcón Resources Corporation

(Exact name of registrant as specified in its charter)

| | | |
|---|---|---|
| **Delaware** | **1311** | **20-0700684** |
| (State or other jurisdiction of incorporation or organization) | (Primary Standard Industrial Classification Code Number) | (I.R.S. Employer Identification Number) |

**1000 Louisiana Street, Suite 1500, Houston, TX 77002**
(Address of principal executive offices)

**(832) 538-0300**
(Registrant's telephone number, including area code)
(Former name, former address and former fiscal year, if changed since last report)

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 twelve 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, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

| | | | |
|---|---|---|---|
| Large accelerated filer o | Accelerated filer ý | Non-accelerated filer o<br>(Do not check if a smaller reporting company) | Smaller reporting company o<br>Emerging growth company o |

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. 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

At July 27, 2018, 160,654,853 shares of the Registrant's Common Stock were outstanding.

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**Special note regarding forward-looking statements**

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of the federal securities laws. All statements, other than statements of historical facts, concerning, among other things, planned capital expenditures, potential increases in oil and natural gas production, potential costs to be incurred, future cash flows and borrowings, business strategy and other plans and objectives for future operations, are forward-looking statements. These forward-looking statements are identified by their use of terms and phrases such as "may," "expect," "estimate," "project," "plan," "objective," "believe," "predict," "intend," "achievable," "anticipate," "will," "continue," "potential," "should," "could" and similar terms and phrases. Although we believe that the expectations reflected in these forward-looking statements are reasonable, they do involve certain assumptions, risks and uncertainties. Actual results could differ materially from those anticipated in these forward-looking statements. Readers should consider carefully the risks described under the "Risk Factors" section of our previously filed Annual Report on Form 10-K for the fiscal year ended December 31, 2017, as well as the other disclosures contained herein and therein, which describe factors that could cause our actual results to differ from those anticipated in the forward-looking statements, including, but not limited to, the following factors:

- volatility in commodity prices for oil, natural gas and NGLs;
- our ability to generate sufficient cash flow from operations, borrowings or other sources to enable us to fund our operations, satisfy our obligations and develop our undeveloped acreage positions;
- our ability to replace our oil and natural gas reserves and production;
- the possibility that acquisitions may involve unexpected costs or delays, and that acquisitions may not achieve intended benefits and may divert management's time and energy;
- our ability to successfully integrate acquired oil and natural gas businesses and operations;
- we have historically had substantial indebtedness and we may incur more debt in the future;
- higher levels of indebtedness make us more vulnerable to economic downturns and adverse developments in our business;
- the presence or recoverability of estimated oil and natural gas reserves attributable to our properties and the actual future production rates and associated costs of producing those oil and natural gas reserves;
- our ability to successfully develop our large inventory of undeveloped acreage;
- our ability to retain key members of senior management, the board of directors, and key technical employees;
- access to and availability of water and other treatment materials to carry out fracture stimulations in our resource play;
- access to adequate gathering systems, processing and treating facilities and transportation take-away capacity to move our production to market and marketing outlets to sell our production at market prices;

the cost and availability of goods and services, such as drilling rigs, fracture stimulation services and tubulars;

contractual limitations that affect our management's discretion in managing our business, including covenants that, among other things, limit our ability to incur debt, make investments and pay cash dividends;

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- the potential for production decline rates for our wells to be greater than we expect;
- competition, including competition for acreage in our resource play;
- environmental risks;
- drilling and operating risks;
- exploration and development risks;
- the possibility that the industry may be subject to future regulatory or legislative actions (including additional taxes and changes in environmental regulations);
- general economic conditions, whether internationally, nationally or in the regional and local market areas in which we do business, may be less favorable than expected, including the possibility that economic conditions in the United States will worsen and that capital markets are disrupted, which could adversely affect demand for oil and natural gas and make it difficult to access capital;
- social unrest, political instability or armed conflict in major oil and natural gas producing regions outside the United States, such as the Middle East, and armed conflict or acts of terrorism or sabotage;
- other economic, competitive, governmental, regulatory, legislative, including federal and state regulations and laws, geopolitical and technological factors that may negatively impact our business, operations or oil and natural gas prices;
- our insurance coverage may not adequately cover all losses that we may sustain;
- title to the properties in which we have an interest may be impaired by title defects; and
- senior management's ability to execute our plans to meet our goals.

All forward-looking statements are expressly qualified in their entirety by the cautionary statements in this paragraph and elsewhere in this document. Other than as required under the securities laws, we do not assume a duty to update these forward-looking statements, whether as a result of new information, subsequent events or circumstances, changes in expectations or otherwise.

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**PART I. FINANCIAL INFORMATION**

**Item 1. Condensed Consolidated Financial Statements (Unaudited)**

**HALCÓN RESOURCES CORPORATION**

**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (Unaudited)**

**(In thousands, except per share amounts)**

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2018 | 2017 | 2018 | 2017 |
| **Operating revenues:** | | | | |
| Oil, natural gas and natural gas liquids sales: | | | | |
| Oil | $ 48,756 | $ 108,695 | $ 91,825 | $ 231,216 |
| Natural gas | 1,560 | 5,946 | 3,879 | 12,165 |
| Natural gas liquids | 4,991 | 5,306 | 8,703 | 11,331 |
| Total oil, natural gas and natural gas liquids sales | 55,307 | 119,947 | 104,407 | 254,712 |
| Other | 108 | 190 | 263 | 1,023 |
| Total operating revenues | 55,415 | 120,137 | 104,670 | 255,735 |
| **Operating expenses:** | | | | |
| Production: | | | | |
| Lease operating | 5,314 | 20,380 | 10,229 | 41,024 |
| Workover and other | 1,956 | 7,128 | 3,317 | 18,569 |
| Taxes other than income | 3,226 | 10,727 | 6,255 | 22,303 |
| Gathering and other | 5,956 | 11,812 | 12,378 | 23,754 |
| Restructuring | 27 | 50 | 128 | 805 |
| General and administrative | 14,255 | 26,922 | 29,465 | 47,771 |
| Depletion, depreciation and accretion | 16,096 | 31,962 | 32,087 | 64,848 |
| (Gain) loss on sale of oil and natural gas properties | 2,225 | (4,500) | 5,904 | (235,690) |
| Total operating expenses | 49,055 | 104,481 | 99,763 | (16,616) |
| **Income (loss) from operations** | 6,360 | 15,656 | 4,907 | 272,351 |
| **Other income (expenses):** | | | | |
| Net gain (loss) on derivative contracts | (12,100) | 24,156 | (6,197) | 50,554 |
| Interest expense and other | (10,534) | (19,635) | (17,582) | (44,478) |
| Gain (loss) on extinguishment of debt | | | | (56,898) |
| Total other income (expenses) | (22,634) | 4,521 | (23,779) | (50,822) |
| Income (loss) before income taxes | (16,274) | 20,177 | (18,872) | 221,529 |
| Income tax benefit (provision) | | | | (12,000) |
| **Net income (loss)** | (16,274) | 20,177 | (18,872) | 209,529 |
| Non-cash preferred dividend | | (47,206) | | (48,007) |
| **Net income (loss) available to common stockholders** | $ (16,274) | $ (27,029) | $ (18,872) | $ 161,522 |

| | | | | |
|---|---|---|---|---|
| **Net income (loss) per share of common stock:** | | | | |
| Basic | $ (0.10) | $ (0.19) | $ (0.12) | $ 1.37 |
| Diluted | $ (0.10) | $ (0.19) | $ (0.12) | $ 1.37 |
| **Weighted average common shares outstanding:** | | | | |
| Basic | 157,943 | 143,545 | 155,925 | 117,554 |
| Diluted | 157,943 | 143,545 | 155,925 | 118,209 |

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

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**HALCÓN RESOURCES CORPORATION**

**CONDENSED CONSOLIDATED BALANCE SHEETS (Unaudited)**

**(In thousands, except share and per share amounts)**

| | June 30, 2018 | December 31, 2017 |
|---|---|---|
| **Current assets:** | | |
| Cash and cash equivalents | $ 95,870 | $ 424,071 |
| Accounts receivable | 36,882 | 36,416 |
| Receivables from derivative contracts | 19,391 | 677 |
| Prepaids and other | 12,240 | 10,628 |
| Total current assets | 164,383 | 471,792 |
| **Oil and natural gas properties (full cost method):** | | |
| Evaluated | 1,163,297 | 877,316 |
| Unevaluated | 1,073,595 | 765,786 |
| Gross oil and natural gas properties | 2,236,892 | 1,643,102 |
| Less accumulated depletion | (598,905) | (570,155) |
| Net oil and natural gas properties | 1,637,987 | 1,072,947 |
| **Other operating property and equipment:** | | |
| Other operating property and equipment | 153,123 | 101,282 |
| Less accumulated depreciation | (7,093) | (4,092) |
| Net other operating property and equipment | 146,030 | 97,190 |
| **Other noncurrent assets:** | | |
| Receivables from derivative contracts | 1,446 | |
| Funds in escrow and other | 1,963 | 1,691 |
| **Total assets** | $ 1,951,809 | $ 1,643,620 |
| **Current liabilities:** | | |
| Accounts payable and accrued liabilities | $ 135,541 | $ 131,087 |
| Liabilities from derivative contracts | 53,513 | 19,248 |
| Total current liabilities | 189,054 | 150,335 |
| **Long-term debt, net** | 612,353 | 409,168 |
| **Other noncurrent liabilities:** | | |
| Liabilities from derivative contracts | 20,973 | 7,751 |
| Asset retirement obligations | 6,546 | 4,368 |
| **Commitments and contingencies (Note 9)** | | |
| **Stockholders' equity:** | | |
| Common stock: 1,000,000,000 shares of $0.0001 par value authorized; 160,599,853 and 149,379,491 shares issued and outstanding as of June 30, 2018 and December 31, 2017, respectively | 16 | 15 |

| | | | | |
|---|---|---|---|---|
| Additional paid-in capital | | 1,086,037 | | 1,016,281 |
| Retained earnings (accumulated deficit) | | 36,830 | | 55,702 |
| Total stockholders' equity | | 1,122,883 | | 1,071,998 |
| **Total liabilities and stockholders' equity** | $ | 1,951,809 | $ | 1,643,620 |

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

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**HALCÓN RESOURCES CORPORATION**

**CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY (Unaudited)**

**(In thousands)**

| | Preferred Stock | | Common Stock | | Additional Paid-In Capital | Retained Earnings (Accumulated Deficit) | Stockholders' Equity |
|---|---|---|---|---|---|---|---|
| | Shares | Amount | Shares | Amount | | | |
| **Balances at December 31, 2016** | | $ | 92,991 | $ 9 | $ 592,663 | $ (479,984) | $ 112,688 |
| Net income (loss) | | | | | | 535,686 | 535,686 |
| Sale of preferred stock | 6 | | | | 352,048 | | 352,048 |
| Preferred beneficial conversion feature | | | | | 48,007 | | 48,007 |
| Conversion of preferred stock | (6) | | 55,180 | 6 | (6) | | |
| Offering costs | | | | | (11,919) | | (11,919) |
| Long-term incentive plan grants | | | 2,022 | | | | |
| Long-term incentive plan forfeitures | | | (498) | | | | |
| Reduction in shares to cover individuals' tax withholding | | | (316) | | (1,995) | | (1,995) |
| Stock-based compensation | | | | | 37,483 | | 37,483 |
| **Balances at December 31, 2017** | | | 149,379 | 15 | 1,016,281 | 55,702 | 1,071,998 |
| Net income (loss) | | | | | | (18,872) | (18,872) |
| Common stock issuance | | | 9,200 | 1 | 63,479 | | 63,480 |
| Offering costs | | | | | (3,044) | | (3,044) |
| Stock option exercises | | | 42 | | 323 | | 323 |
| Long-term incentive plan grants | | | 2,242 | | | | |
| Long-term incentive plan forfeitures | | | (210) | | | | |
| Reduction in shares to cover individuals' tax withholding | | | (53) | | (262) | | (262) |
| Stock-based compensation | | | | | 9,260 | | 9,260 |
| **Balances at June 30, 2018** | | $ | 160,600 | $ 16 | $ 1,086,037 | $ 36,830 | $ 1,122,883 |

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

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**HALCÓN RESOURCES CORPORATION**

**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)**

**(In thousands)**

| | Six Months Ended June 30, 2018 | Six Months Ended June 30, 2017 |
|---|---|---|
| **Cash flows from operating activities:** | | |
| Net income (loss) | $ (18,872) | $ 209,529 |
| Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities: | | |
| Depletion, depreciation and accretion | 32,087 | 64,848 |
| (Gain) loss on sale of oil and natural gas properties | 5,904 | (235,690) |
| Stock-based compensation, net | 7,818 | 21,290 |
| Unrealized loss (gain) on derivative contracts | 26,761 | (42,219) |
| Amortization of deferred loan costs | 651 | 896 |
| Amortization of discount and premium | 183 | 1,887 |
| Loss (gain) on extinguishment of debt | | 56,898 |
| Accrued settlements on derivative contracts | 1,588 | (3,520) |
| Other income (expense) | (1,479) | (1,004) |
| Change in assets and liabilities: | | |
| Accounts receivable | 331 | 34,982 |
| Prepaids and other | (1,612) | 91 |
| Accounts payable and accrued liabilities | (9,782) | 14,655 |
| Net cash provided by (used in) operating activities | 43,578 | 122,643 |
| **Cash flows from investing activities:** | | |
| Oil and natural gas capital expenditures | (251,961) | (121,210) |
| Proceeds received from sale of oil and natural gas properties | 1,779 | 477,306 |
| Acquisition of oil and natural gas properties | (332,901) | (907,487) |
| Acquisition of other operating property and equipment | | (25,538) |
| Other operating property and equipment capital expenditures | (53,242) | (13,735) |
| Proceeds received from sale of other operating property and equipment | 1,899 | 10,352 |
| Funds held in escrow and other | 155 | 285 |
| Net cash provided by (used in) investing activities | (634,271) | (580,027) |
| **Cash flows from financing activities:** | | |
| Proceeds from borrowings | 206,000 | 1,235,000 |
| Repayments of borrowings | | (1,118,000) |
| Cash payments to Noteholders | | (30,917) |
| Debt issuance costs | (4,005) | (16,823) |
| Preferred stock issued | | 400,055 |
| Common stock issued | 63,480 | |
| Offering costs and other | (2,983) | (11,934) |
| Net cash provided by (used in) financing activities | 262,492 | 457,381 |
| **Net increase (decrease) in cash and cash equivalents** | (328,201) | (3) |
| Cash and cash equivalents at beginning of period | 424,071 | 24 |
| Cash and cash equivalents at end of period | $ 95,870 | $ 21 |

| | | | | |
|---|---|---|---|---|
| **Disclosure of non-cash investing and financing activities:** | | | | |
| Asset retirement obligations | $ | 2,047 | $ | (5,972) |
| Accretion of non-cash preferred dividend | | | | 48,007 |

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

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**HALCÓN RESOURCES CORPORATION**

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

## 1. FINANCIAL STATEMENT PRESENTATION

### Basis of Presentation and Principles of Consolidation

Halcón Resources Corporation (Halcón or the Company) is an independent energy company focused on the acquisition, production, exploration and development of onshore liquids-rich oil and natural gas assets in the United States. The unaudited condensed consolidated financial statements include the accounts of all majority-owned, controlled subsidiaries. The Company operates in one segment which focuses on oil and natural gas acquisition, production, exploration and development. Allocation of capital is made across the Company's entire portfolio without regard to operating area. All intercompany accounts and transactions have been eliminated. These unaudited condensed consolidated financial statements reflect, in the opinion of the Company's management, all adjustments, consisting of normal and recurring adjustments, necessary to present fairly the financial position as of, and the results of operations for, the periods presented. During interim periods, Halcón follows the accounting policies disclosed in its Annual Report on Form 10-K, as filed with the United States Securities and Exchange Commission (SEC) on March 1, 2018. Please refer to the notes in the 2017 Annual Report on Form 10-K when reviewing interim financial results.

### Use of Estimates

The preparation of the Company's unaudited condensed consolidated financial statements in conformity with accounting principles generally accepted in the United States requires the Company's management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities, if any, at the date of the unaudited condensed consolidated financial statements and the reported amounts of revenues and expenses during the respective reporting periods. Estimates and assumptions that, in the opinion of the Company's management, are significant include oil and natural gas revenue accruals, capital and operating expense accruals, oil and natural gas reserves, depletion relating to oil and natural gas properties, asset retirement obligations, fair value estimates, including estimates of the fair values of assets acquired and liabilities assumed in connection with the Pecos County Acquisition and the fair value of assets sold in connection with the Williston Divestiture and the El Halcón Divestiture (see Note 3, *"Acquisitions and Divestitures, "* for information on the Pecos County Acquisition, the Williston Divestiture and the El Halcón Divestiture), including the gains on sales recorded and income taxes. The Company bases its estimates and judgments on historical experience and on various other assumptions and information believed to be reasonable under the circumstances. Estimates and assumptions about future events and their effects cannot be predicted with certainty and, accordingly, these estimates may change as new events occur, as more experience is acquired, as additional information is obtained and as the Company's operating environment changes. Actual results may differ from the estimates and assumptions used in the preparation of the Company's unaudited condensed consolidated financial statements.

Interim period results are not necessarily indicative of results of operations or cash flows for the full year and accordingly, certain information normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States, has been condensed or omitted. The Company has evaluated events or transactions through the date of issuance of these unaudited condensed consolidated financial statements.

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**HALCÓN RESOURCES CORPORATION**

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**1. FINANCIAL STATEMENT PRESENTATION (Continued)**

**Cash and Cash Equivalents**

The Company considers all highly liquid short-term investments with a maturity of three months or less at the time of purchase to be cash equivalents. These investments are carried at cost, which approximates fair value.

**Accounts Receivable and Allowance for Doubtful Accounts**

The Company's accounts receivable are primarily receivables from joint interest owners and oil and natural gas purchasers. Accounts receivable are recorded at the amount due, less an allowance for doubtful accounts, when applicable. The Company establishes provisions for losses on accounts receivable if it determines that collection of all or part of the outstanding balance is doubtful. The Company regularly reviews collectability and establishes or adjusts the allowance for doubtful accounts as necessary using the specific identification method. As of June 30, 2018 and December 31, 2017, allowances for doubtful accounts were approximately $0.1 million and $0.7 million, respectively.

**Other Operating Property and Equipment**

Other operating property and equipment additions are recorded at cost. Depreciation is calculated using the straight-line method over the following estimated useful lives: gas and water gathering systems, thirty years; water disposal and recycling facilities, twenty years; automobiles and computers, three years; computer software, fixtures, furniture and equipment, five years or the lesser of lease term; trailers, seven years; heavy equipment, eight to ten years; buildings, twenty years and leasehold improvements, lease term. Upon disposition, the cost and accumulated depreciation are removed and any gains or losses are reflected in current operations. Maintenance and repair costs are charged to operating expense as incurred. Material expenditures which increase the life or productive capacity of an asset are capitalized and depreciated over the estimated remaining useful life of the asset.

The Company reviews its other operating property and equipment for impairment in accordance with Accounting Standards Codification (ASC) No. 360, *Property, Plant, and Equipment* (ASC 360). ASC 360 requires the Company to evaluate other operating property and equipment for impairment as events occur or circumstances change that would more likely than not reduce the fair value below the carrying amount. If the carrying amount is not recoverable from its undiscounted cash flows, then the Company would recognize an impairment loss for the difference between the carrying amount and the current fair value. Further, the Company evaluates the remaining useful lives of its other operating property and equipment at each reporting period to determine whether events and circumstances warrant a revision to the remaining depreciation periods.

**Income Taxes**

On December 22, 2017, Staff Accounting Bulletin No. 118 (SAB 118) was issued to address the application of accounting principles generally accepted in the United States in situations when a registrant does not have the necessary information available, prepared or analyzed (including computations) in reasonable detail to complete the accounting for certain income tax effects of the Tax Cuts Job Act of 2017. In accordance with SAB 118, the Company has determined that the $280.9 million income tax provision and corresponding decrease in the Company's valuation allowance was a provisional amount and a reasonable estimate for the year ended December 31, 2017. Any subsequent adjustments to these amounts will be recorded to current tax benefit (provision) in the quarter of 2018 when the analysis is complete.

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**HALCÓN RESOURCES CORPORATION**

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**1. FINANCIAL STATEMENT PRESENTATION (Continued)**

**Related Party Transactions**

***Gas Purchase and Processing Agreement***

On November 16, 2017, a subsidiary of the Company entered into a gas purchase and processing agreement with Salt Creek Midstream, LLC (Salt Creek) pursuant to which the Company agreed to dedicate, for a term of 15 years, all natural gas production from its acreage in Ward County, Texas (that is not otherwise previously dedicated) and certain sections in Winkler County, Texas to a natural gas gathering pipeline and processing facilities to be constructed by Salt Creek. The facilities were completed and placed in service in May 2018. As of June 30, 2018, the Company recorded a $0.3 million receivable from Salt Creek. For the three and six months ended June 30, 2018, the Company received $0.4 million from Salt Creek under the gas purchase and processing agreement.

Certain funds under the control of Ares Management LLC (Ares) are the majority owners and controlling parties of Salt Creek. Ares also controls other funds which own in excess of ten percent (10%) of the stock of the Company. No Ares fund that is a stockholder of the Company has an interest in Salt Creek but one of the Company's directors, who is employed by Ares, also serves on the board of directors of Salt Creek's parent company.

***Crude Oil Gathering Agreement***

On July 27, 2018, a subsidiary of the Company entered into a crude oil gathering agreement with SCM Crude, LLC (SCM) pursuant to which the Company agreed to dedicate, for a term of 15 years, production of crude oil from its currently owned, or later acquired acreage in designated areas in Ward and Winkler Counties, Texas (excluding certain specific wells) for the receipt, gathering and transportation on a gathering system to be designed, engineered and constructed by SCM. The gathering system will be implemented in two phases with the first phase expected to be operational by October 1, 2018 and the second phase expected to be operational December 1, 2018.

The agreement with SCM was the culmination of a lengthy process during which the Company analyzed the most effective method of gathering and transportation of its future oil production in these areas. During the course of its investigation, the Company considered a variety of alternatives and solicited and received numerous third party proposals. The Company received and evaluated proposals from eleven companies covering some or all of its oil production in the region and determined that among the proposals it received, SCM's was superior for economic and strategic reasons.

Because certain funds under the control of Ares are the majority owners and controlling parties of SCM, the Audit Committee of the board of directors of the Company and the disinterested members of the Company's board of directors evaluated and approved (in a vote that excluded the Company director who is employed by Ares) the process by which the Company determined the SCM proposal to be superior to other alternatives, as well as the principal terms of the agreement, in accordance with applicable Company policies, including its Code of Conduct and Corporate Governance Guidelines (copies of which are available through the company's website at *www.halconresources.com*) and the Company's procedures for the review and approval of transactions with related parties. Ares also controls other funds which own in excess of ten percent (10%) of the stock of the Company. No Ares fund that is a stockholder of the Company has an interest in SCM but one of the Company's directors, who is employed by Ares, also serves on the board of directors of SCM's parent company.

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**HALCÓN RESOURCES CORPORATION**

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**1. FINANCIAL STATEMENT PRESENTATION (Continued)**

***Charter of Aircraft***

In the ordinary course of its business, the Company occasionally charters a private aircraft for business use. Floyd C. Wilson, Halcón's Chairman, Chief Executive Officer and President, indirectly owns an aircraft which the Company has chartered from time to time. For a portion of 2017, Mr. Wilson's aircraft was managed by an independent air charter company unaffiliated with both Mr. Wilson and Halcón. The aircraft in the air charter company's fleet are available to the public for charter based upon a standard fee schedule established by the air charter company, with the fees dependent primarily upon the type and size of the aircraft utilized and the duration of the flight. Because the air charter company established fees for the use of the aircraft in its fleet, Mr. Wilson did not receive any greater benefit from Halcón's charter of the aircraft indirectly owned by him than he would have if any third party were to charter the aircraft. During the course of 2017, Mr. Wilson terminated the independent air charter company and removed his aircraft from the charter company's fleet, pending his search for a new charter company to manage his aircraft. During the search period for a new charter company, fees for the use of Mr. Wilson's aircraft by the Company were based upon comparable costs that the Company would have incurred in chartering the same type and size of aircraft from an independent third party utilizing data from several independent third party aircraft leasing companies. The terms for this use were evaluated and approved by the Audit Committee of the Company, and subsequently by the disinterested members of the Company's board of directors upon the recommendation of the Audit Committee, in accordance with the Company's procedures for the review and approval of transactions with related parties. During the three and six months ended June 30, 2018, the Company paid approximately $0.1 million and $0.6 million, respectively, to Mr. Wilson for the Company use of the aircraft. As of June 30, 2018, the Company recorded a $0.2 million payable to Mr. Wilson.

**Recently Issued Accounting Pronouncements**

In January 2017, the FASB issued Accounting Standards Update (ASU) No. 2017-01, *Business Combinations (Topic 805): Clarifying the Definition of a Business* (ASU 2017-01). For public business entities, ASU 2017-01 is effective for fiscal years and interim periods within those fiscal years, beginning after December 15, 2017. The amendments in this ASU should be applied prospectively on or after the effective date. The ASU was issued to clarify the definition of a business with the objective of adding guidance to assist entities with evaluating whether transactions should be accounted for as acquisitions of assets or businesses. The Company applied the provisions of ASU 2017-01 to the acquisition of the West Quito Draw Properties, which is discussed further in Note 3, "*Acquisitions and Divestitures.*"

In August 2016, the FASB issued ASU No. 2016-15, *Statement of Cash Flows (Topic 230)* (ASU 2016-15). For public business entities, ASU 2016-15 is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2017 and early adoption is permitted. The areas for simplification in this ASU involve addressing eight specific classification issues in the statement of cash flows. An entity should apply the amendments in this ASU using a retrospective transition method. The adoption of ASU 2016-15 did not have an impact on the Company's unaudited condensed consolidated statement of cash flows.

In February 2016, the FASB issued ASU No. 2016-02, *Leases (Topic 842)* (ASU 2016-02). For public business entities, ASU 2016-02 is effective for fiscal years, and interim periods within those fiscal

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**HALCÓN RESOURCES CORPORATION**

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**1. FINANCIAL STATEMENT PRESENTATION (Continued)**

years, beginning after December 15, 2018 and early adoption is permitted. The FASB issued ASU 2016-02 to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. In January 2018, ASU 2016-02 was updated with ASU No. 2018-01, *Lease (Topic 842) Land Easement Practical Expedient for Transition to Topic 842* (ASU 2018-01), which provides an optional transition practical expedient to not evaluate under Topic 842 existing or expired land easements that were not previously accounted for as leases under Topic 840, *Leases*. An entity that elects this practical expedient should evaluate new or modified land easements under Topic 842 beginning at the date that the entity adopts Topic 842. An entity that does not elect this practical expedient should evaluate all existing or expired land easements in connection with the adoption of the new lease requirements in Topic 842 to assess whether they meet the definition of a lease. An entity should apply the amendments in this ASU on a modified retrospective basis. The transition will require application of the new guidance at the beginning of the earliest comparative period presented in the financial statements. The Company is in the early stages of assessing the effects of the application of the new guidance and the financial statement and disclosure impacts. The Company will adopt ASU 2016-02 no later than January 1, 2019.

In May 2014, the FASB issued ASU No. 2014-09, *Revenue from Contracts with Customers* (ASU 2014-09). ASU 2014-09 states that an entity should recognize revenue to depict the transfer of promised goods or services to customers in amounts that reflect the consideration to which the entity expects to be entitled in exchange for those goods or services. The standard provides five steps an entity should apply in determining its revenue recognition. In March 2016, ASU 2014-09 was updated with ASU No. 2016-08, *Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net)* (ASU 2016-08), and collectively with ASU 2014-09, ASC 606), which provides further clarification on the principal versus agent evaluation. The Company adopted ASC 606 effective January 1, 2018 using the modified retrospective approach. See Note 2, "*Operating Revenues*," for further details.

**2. OPERATING REVENUES**

**Adoption of ASC 606, *Revenue from Contracts with Customers***

On January 1, 2018, the Company adopted ASC 606 using the modified retrospective approach applied to all contracts as of the date of adoption. Reporting periods beginning after January 1, 2018 are presented under ASC 606, while prior period amounts are not adjusted and continue to be reported under the accounting standards in effect for those periods. The adoption of ASC 606 resulted in offsetting changes to revenues and expenses associated with certain natural gas gathering and processing agreements, and therefore there was no cumulative effect of applying ASC 606 to the opening balance of "*Retained earnings (accumulated deficit)*." The net impact of adopting ASC 606 for the three and six months ended June 30, 2018 was a decrease of $0.2 million and $0.4 million to "*Natural gas*" and an offsetting decrease of $0.2 million and $0.4 million to "*Gathering and other*", respectively, on the unaudited condensed consolidated statements of operations.

These changes result from principal versus agent considerations under ASC 606 for the Company's natural gas gathering and processing arrangements in place with midstream companies. Under contracts where it is determined that control of the natural gas transfers at the wellhead, any fees incurred to gather or process the unprocessed natural gas are a reduction of the sales price of unprocessed natural

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**HALCÓN RESOURCES CORPORATION**

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**2. OPERATING REVENUES (Continued)**

gas, and therefore revenues from such transactions are presented on a net basis. Under contracts where it is determined that control of the natural gas transfers at the tailgate of the midstream entity's processing plant, the Company is the principal and the midstream entity is the agent in the sale transaction with the third party purchaser of processed commodities. In these instances, revenues are presented on a gross basis for amounts expected to be received from the midstream company or third party purchasers through the gathering and treating process and presented as "*Natural gas*" or "*Natural gas liquids*" and any fees incurred to gather or process the natural gas are presented as "*Gathering and other*."

**Revenue Recognition**

Revenue is measured based on consideration specified in a contract with a customer and excludes amounts collected on behalf of third parties. Taxes assessed by a governmental authority that are both imposed on and concurrent with a specific revenue-producing transaction that are collected by the Company from a customer are excluded from revenue. Revenues from the sale of crude oil, natural gas and natural gas liquids are recognized, at a point in time, when a performance obligation is satisfied by the transfer of control of the commodity to the customer. Because the Company's performance obligations have been satisfied and an unconditional right to consideration exists as of the balance sheet date, the Company recognized amounts due from contracts with customers of $29.4 million and $24.1 million as of June 30, 2018 and December 31, 2017, respectively, as *"Accounts Receivable"* on the unaudited condensed consolidated balance sheets.

Substantially all of the Company's revenues are derived from its single basin operations, the Delaware Basin in Pecos, Reeves, Ward and Winkler Counties, Texas. The following table disaggregates the Company's revenues by major source, in order to depict how the nature, timing, and uncertainty of revenue and cash flows are affected by economic factors in the Company's single basin operations, for the periods indicated (in thousands):

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| | **2018** | **2017**[(1)] | **2018** | **2017**[(1)] |
| | (Unaudited) | | (Unaudited) | |
| **Operating revenues:** | | | | |
| Oil, natural gas and natural gas liquids sales: | | | | |
| Oil | $ 48,756 | $ 108,695 | $ 91,825 | $ 231,216 |
| Natural gas | 1,560 | 5,946 | 3,879 | 12,165 |
| Natural gas liquids | 4,991 | 5,306 | 8,703 | 11,331 |
| Total oil, natural gas and natural gas liquids sales | 55,307 | 119,947 | 104,407 | 254,712 |
| Other | 108 | 190 | 263 | 1,023 |
| Total operating revenues | $ 55,415 | $ 120,137 | $ 104,670 | $ 255,735 |

*(1)* *As noted above, prior period amounts have not been adjusted under the modified retrospective method of adoption.*

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**HALCÓN RESOURCES CORPORATION**

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**2. OPERATING REVENUES (Continued)**

***Oil Sales***

The Company generally markets its crude oil production directly to the customer using two methods. Under the first method, crude oil is sold at the wellhead at an index price adjusted for pricing differentials and other deductions. Revenue is recognized at the wellhead, where control of the crude oil transfers to the customer, at the net price received. Under the second method, crude oil is delivered to the customer at a contractual delivery point at which the customer takes custody, title and risk of loss of the product. The Company receives a specified index price from the customer, net of transportation costs and other market-related adjustments. Revenue is recognized when control of the crude oil transfers at the delivery point at the net price received.

Settlement statements for the Company's crude oil production are typically received within the month following the date of production and therefore the amount of production delivered to the customer and the price that will be received for that production are known at the time the revenue is recorded. Payment under the Company's crude oil contracts is typically due on or before the 20$^{th}$ of the month following the delivery month.

***Natural Gas and Natural Gas Liquids Sales***

The Company evaluates its natural gas gathering and processing arrangements in place with midstream companies to determine when control of the natural gas is transferred. Under contracts where it is determined that control of the natural gas transfers at the wellhead, any fees incurred to gather or process the unprocessed natural gas are treated as a reduction of the sales price of unprocessed natural gas, and therefore revenues from such transactions are presented on a net basis. Under contracts where it is determined that control of the natural gas transfers at the tailgate of the midstream entity's processing plant, revenues are presented on a gross basis for amounts expected to be received from the midstream company or third party purchasers, and therefore any fees incurred to gather or process the natural gas are presented separately as "*Gathering and other*."

Under certain contracts, the Company may elect to take its residue gas and/or natural gas liquids in-kind at the tailgate of the midstream entity's processing plant. The Company then sells the products to a customer at contractual delivery points at prices based on an index. In these instances, revenues are presented on a gross basis and any fees incurred to gather, process or transport the commodities are presented separately as "*Gathering and other*."

Settlement statements for the Company's natural gas and natural gas liquids production are typically received 30 days after the date of production and therefore the Company estimates the amount of production delivered to the customer and the price that will be received for that production. Historically, differences between the Company's estimates and the actual revenue received have not been material. Payment under the Company's natural gas gathering and processing contracts is typically due on or before the fifth day of the second month following the delivery month.

***Concentrations of Credit Risk***

The purchasers of the Company's oil and natural gas production consist primarily of independent marketers, major oil and natural gas companies and gas pipeline companies. Historically, the Company has not experienced any significant losses from uncollectible accounts. For the six months ended June 30, 2018, two individual purchasers of the Company's production, Sunoco, Inc. and Andeavor,

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**HALCÓN RESOURCES CORPORATION**

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**2. OPERATING REVENUES (Continued)**

formerly Western Refining, Inc., each accounted for more than 10% of total sales, collectively representing 86% of the Company's total sales for the period. In 2017, two individual purchasers of the Company's production, Crestwood Midstream Partners, formerly Arrow Field Services, LLC, and Suncor Energy Marketing, Inc., each accounted for more than 10% of total sales, collectively representing 58% of the Company's total sales for the year.

The Company operates a substantial portion of its oil and natural gas properties. As the operator of a property, the Company makes full payments for costs associated with the property and seeks reimbursement from the other working interest owners in the property for their share of those costs. The Company's joint interest partners consist primarily of independent oil and natural gas producers. If the oil and natural gas exploration and production industry in general was adversely affected, the ability of the Company's joint interest partners to reimburse the Company could be adversely affected.

***Practical Expedients***

The Company does not disclose the transaction price of unsatisfied performance obligations for i) contracts with an original expected duration of one year or less and ii) contracts where variable consideration is allocated entirely to a wholly unsatisfied performance obligation (each unit of product typically represents a separate performance obligation, and therefore, future volumes under the Company's long-term contracts are wholly unsatisfied).

**3. ACQUISITIONS AND DIVESTITURES**

***Acquisitions***

**West Quito Draw Properties**

On February 6, 2018, a wholly owned subsidiary of the Company entered into a Purchase and Sale Agreement (the Shell PSA) with SWEPI LP (Shell), an affiliate of Shell Oil Company, pursuant to which the Company purchased acreage and related assets in the Delaware Basin located in Ward County, Texas (the West Quito Draw Properties) for a total adjusted purchase price of $199.1 million, subject to customary post-closing adjustments. The effective date of the acquisition was February 1, 2018, and the Company closed the transaction on April 4, 2018. The Company funded the cash consideration for the acquisition of the West Quito Draw Properties with the net proceeds from the issuance of the Additional 2025 Notes and common stock, which are discussed in Note 5, "*Long-term Debt*," and Note 10, "*Stockholders' Equity*," respectively.

**Monument Draw Assets (Ward and Winkler Counties, Texas)**

On December 9, 2016, the Company entered into an agreement with a private company, pursuant to which the Company acquired the rights to purchase acreage in the Monument Draw area of the Delaware Basin, located in Ward and Winkler Counties, Texas (the Ward County Assets) prospective for the Wolfcamp and Bone Spring formations for an initial purchase price of $11,000 per acre. The Ward County Assets are divided into two tracts (the Southern Tract and the Northern Tract) with separate options for each tract. The agreement was subsequently amended on June 14, 2017 to increase the purchase price of the Southern Tract and the Northern Tract acreage, from $11,000 per acre to $13,000 per acre, for rights to additional depths in the acreage under option. Pursuant to the terms of the agreement, on June 15, 2017, the Company purchased the Southern Tract acreage for

**HALCÓN RESOURCES CORPORATION**

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**3. ACQUISITIONS AND DIVESTITURES (Continued)**

approximately $87.4 million and on January 9, 2018, the Company purchased the Northern Tract acreage for approximately $108.2 million.

**Acquisition of Additional Properties in Monument Draw (Ward and Winkler Counties, Texas)**

On December 13, 2017, the Company acquired undeveloped acreage and related assets in the Delaware Basin, in an area contiguous to the western and southern areas of the Company's existing Monument Draw properties in Ward County, Texas from a private company, for a total cash purchase price of $101.6 million, subject to customary post-closing adjustments. The effective date of the acquisition was September 1, 2017.

**Hackberry Draw Assets (Pecos and Reeves Counties, Texas)**

On January 18, 2017, Halcón Energy Properties, Inc., a wholly owned subsidiary of the Company, entered into a Purchase and Sale Agreement with Samson Exploration, LLC (Samson), pursuant to which it acquired acreage and related assets in the Hackberry Draw area of the Delaware Basin located in Pecos and Reeves Counties, Texas (collectively, the Pecos County Assets), for a total adjusted purchase price of $699.2 million (the Pecos County Acquisition). The Pecos County Acquisition closed on February 28, 2017. The transaction had an effective date of November 1, 2016. The Company funded the Pecos County Acquisition with the net proceeds from the private placement of new 8% automatically convertible preferred stock and borrowings under its Senior Credit Agreement. Refer to Note 10, *"Stockholders' Equity,"* for further discussion of the Company's issuance of the preferred stock.

**Pro Forma Impact of Acquisition (Unaudited)**

As disclosed in the Company's Annual Report included in the Form 10-K for the year ended December 31, 2017, the acquisition of the Pecos County Assets was accounted for as a business combination in accordance with ASC No. 805, *Business Combinations* (ASC 805) which, among other things, requires assets acquired and liabilities assumed to be measured at their acquisition date fair values. Certain assets and liabilities may be adjusted as additional information is obtained, but no later than one year from the respective acquisition dates. During the six months ended June 30, 2018, there were no adjustments to the purchase price of the Pecos County Assets. The purchase price allocation for the Pecos County Assets is complete.

The following unaudited pro forma combined results of operations are provided for the six months ended June 30, 2017 as though the Pecos County Acquisition had been completed as of the beginning of the comparable prior annual reporting period, or January 1, 2016. The pro forma combined results of operations for the six months ended June 30, 2017 have been prepared by adjusting the historical results of the Company to include the historical results of the Pecos County Assets. 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 period 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 Pecos County Acquisition, or any estimated costs that will be incurred to integrate the Pecos County Assets. Future results may vary significantly from the results reflected in this unaudited pro forma financial information because of future events and transactions, as well as other factors.

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**HALCÓN RESOURCES CORPORATION**

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**3. ACQUISITIONS AND DIVESTITURES (Continued)**

The Company's historical financial information was adjusted to give effect to the pro forma events that were directly attributable to the Pecos County Acquisition, and that were factually supportable. Adjustments and assumptions made for this pro forma calculation are consistent with those used in the Company's annual pro forma information, as more fully described in Item 8. *Consolidated Financial Statements and Supplementary Data* Note 5, "*Acquisitions and Divestitures*," to the Company's Annual Report on Form 10-K for the year ended December 31, 2017. Amounts included in the table below are rounded to thousands, except per share amounts.

| | Six Months Ended June 30, 2017 (Unaudited) |
|---|---|
| Revenue | $ 263,637 |
| Net income (loss) | 216,553 |
| Net income (loss) available to common stockholders | 168,546 |
| Pro forma net income (loss) per share of common stock: | |
| Basic | $ 1.43 |
| Diluted | $ 1.43 |

***Divestitures***

**Williston Basin Non-Operated Assets**

On September 19, 2017, certain wholly owned subsidiaries of the Company entered into an agreement with a privately-owned company pursuant to which the Company sold its non-operated properties and related assets located in the Williston Basin in North Dakota and Montana (the Non-Operated Williston Assets) for a total adjusted sales price of approximately $103.4 million. The effective date of the transaction was April 1, 2017 and the transaction closed on November 9, 2017. Proceeds from the sale were recorded as a reduction to the carrying value of the Company's full cost pool with no gain or loss recorded.

**Williston Basin Operated Assets**

On July 10, 2017, the Company and certain of its subsidiaries entered into an agreement with Bruin Williston Holdings, LLC for the sale of all of the Company's operated oil and natural gas leases, oil and natural gas wells and related assets located in the Williston Basin in North Dakota, as well as 100% of the membership interests in two of its subsidiaries (the Williston Assets) for a total adjusted sales price of approximately $1.4 billion (the Williston Divestiture). The effective date of the sale was June 1, 2017 and the transaction closed on September 7, 2017. The Company used the net proceeds from the sale to repay borrowings outstanding under its Senior Credit Agreement, repurchase approximately $425.0 million principal amount of the then outstanding $850.0 million principal amount of its 6.75% senior notes, redeem all of its outstanding 12% senior secured second lien notes and for general corporate purposes.

The net proceeds from the sale were allocated between the Company's oil and natural gas properties, other operating property and equipment and liabilities transferred on a fair value basis. Approximately $1.39 billion was allocated to the Company's oil and natural gas properties and approximately $10.9 million was allocated to other operating property and equipment.

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**HALCÓN RESOURCES CORPORATION**

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**3. ACQUISITIONS AND DIVESTITURES (Continued)**

As discussed further in Note 4, "*Oil and Natural Gas Properties*," the Company uses the full cost method of accounting for its investment in oil and natural gas properties. Under this method of accounting, sales of oil and gas properties are accounted for as adjustments to capitalized costs with no gain or loss recognized, unless the adjustment significantly alters the relationship between capitalized costs and proved reserves. If the Williston Divestiture was accounted for as an adjustment of capitalized costs with no gain or loss recognized, the adjustment would have significantly altered the relationship between capitalized costs and proved reserves. Accordingly, the Company recognized a gain on the sale of the Williston Assets of $485.9 million during the year ended December 31, 2017. This gain was reduced by $5.9 million during the six months ended June 30, 2018 as the result of customary post-closing adjustments. The carrying value of the properties sold was determined by allocating total capitalized costs within the full cost pool between properties sold and properties retained based on their relative fair values. The gain (loss) was recorded in *"Gain (loss) on sale of oil and natural gas properties,"* on the Company's unaudited condensed consolidated statements of operations.

**East Texas Eagle Ford Assets**

On January 24, 2017, certain of the Company's subsidiaries entered into an agreement with a subsidiary of Hawkwood Energy, LLC (Hawkwood) for the sale of all of its oil and natural gas properties and related assets located in the Eagle Ford formation of East Texas (the El Halcón Assets) for a total adjusted sales price of $491.1 million (the El Halcón Divestiture). The effective date of the sale was January 1, 2017 and the transaction closed on March 9, 2017. The Company used the net proceeds from the sale to repay borrowings outstanding under its Senior Credit Agreement and for general corporate purposes.

The net proceeds from the sale were allocated between the Company's oil and natural gas properties, other operating property and equipment and liabilities transferred on a fair value basis. Approximately $484.1 million was allocated to the Company's oil and natural gas properties and $10.2 million was allocated to other operating property and equipment.

Under the full cost method of accounting, sales of oil and gas properties are accounted for as adjustments of capitalized costs with no gain or loss recognized, unless the adjustment significantly alters the relationship between capitalized costs and prov="margin-left: 0%; margin-right: 0%; text-indent: 4%; font-size: 10pt; font-family: 'Times New Roman', Times; color: #000000; background: #FFFFFF"> In addition, we may elect to have our obligations released with respect to certain covenants in the indenture ( covenant defeasance ). Any omission to comply with these obligations will not constitute a default or an event of default with respect to the debt securities of any series. In the event covenant defeasance occurs, certain events, not including non-payment, bankruptcy and insolvency events, described under Events of Default above will no longer constitute an event of default for that series.

In order to exercise either legal defeasance or covenant defeasance with respect to outstanding debt securities of any series:

we must irrevocably have deposited or caused to be deposited with the trustee as trust funds for the purpose of making the following payments, specifically pledged as security for, and dedicated solely to the benefits of the holders of the debt securities of a series:

money in an amount;

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U.S. government obligations (or equivalent government obligations in the case of debt securities denominated in other than U.S. dollars or a specified currency) that will provide, not later than one day before the due date of any payment, money in an amount; or

a combination of money and U.S. government obligations (or equivalent government obligations, as applicable),

in each case sufficient, in the written opinion (with respect to U.S. or equivalent government obligations or a combination of money and U.S. or equivalent government obligations, as applicable) of a nationally recognized firm of independent registered public accountants to pay and discharge, and which shall be applied by the trustee to pay and discharge, all of the principal (including mandatory sinking fund payments), interest and any premium at due date or maturity;

in the case of legal defeasance, we have delivered to the trustee an opinion of counsel stating that, under then applicable Federal income tax law, the holders of the debt securities of that series will not recognize income, gain or loss for federal income tax purposes as a result of the deposit, defeasance and discharge to be effected and will be subject to the same federal income tax as would be the case if the deposit, defeasance and discharge did not occur;

in the case of covenant defeasance, we have delivered to the trustee an opinion of counsel to the effect that the holders of the debt securities of that series will not recognize income, gain or loss for U.S. federal income tax purposes as a result of the deposit and covenant defeasance to be effected and will be subject to the same federal income tax as would be the case if the deposit and covenant defeasance did not occur;

no event of default or default with respect to the outstanding debt securities of that series has occurred and is continuing at the time of such deposit after giving effect to the deposit or, in the case of legal defeasance, no default relating to bankruptcy or insolvency has occurred and is continuing at any time on or before the 91st day after the date of such deposit, it being understood that this condition is not deemed satisfied until after the 91st day;

the legal defeasance or covenant defeasance will not cause the trustee to have a conflicting interest within the meaning of the Trust Indenture Act, assuming all debt securities of a series were in default within the meaning of such Act;

the legal defeasance or covenant defeasance will not result in a breach or violation of, or constitute a default under, any other agreement or instrument to which we are a party;

the legal defeasance or covenant defeasance will not result in the trust arising from such deposit constituting an investment company within the meaning of the Investment Company Act of 1940, as amended, unless the trust is registered under such Act or exempt from registration; and

we have delivered to the trustee an officers certificate and an opinion of counsel stating that all conditions precedent with respect to the defeasance or covenant defeasance have been complied with.

**Concerning our Relationship with the Trustee**

We and our subsidiaries maintain ordinary banking relationships and credit facilities with Union Bank and its affiliates.

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## DESCRIPTION OF DEBT WARRANTS

We may issue warrants to purchase our debt securities. Warrants may be issued independently or together with any other securities and may be attached to, or separate from, such securities. Each series of warrants will be issued under a separate warrant agreement to be entered into between us and a warrant agent. The terms of any warrants to be issued and a description of the material provisions of the applicable warrant agreement will be set forth in the applicable prospectus supplement.

The applicable prospectus supplement will describe the following terms of any warrants in respect of which this prospectus is being delivered:

- the title of such warrants;
- the aggregate number of such warrants;
- the price or prices at which such warrants will be issued;
- the currency or currencies in which the price of such warrants will be payable;
- the price at which and the currency or currencies in which the securities or other rights purchasable upon exercise of such warrants may be purchased;
- the date on which the right to exercise such warrants shall commence and the date on which such right shall expire;
- if applicable, the minimum or maximum amount of such warrants which may be exercised at any one time;
- if applicable, the designation and terms of the securities with which such warrants are issued and the number of such warrants issued with each such security;
- if applicable, the date on and after which such warrants and the related securities will be separately transferable;
- information with respect to book-entry procedures, if any;
- if applicable, a discussion of any material United States Federal income tax considerations; and
- any other terms of such warrants, including terms, procedures and limitations relating to the exchange and exercise of such warrants.

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## DESCRIPTION OF UNITS

As specified in the applicable prospectus supplement, we may issue units consisting of one or more warrants, debt securities, shares of common or preferred stock or any combination of such securities. The applicable prospectus supplement will describe:

- the terms of the units and of the warrants, debt securities, common stock and preferred stock comprising the units, including whether and under what circumstances the securities comprising the units may be traded separately;
- a description of the terms of any unit agreement governing the units; and
- a description of the provisions for the payment, settlement, transfer or exchange of the units.

## FORMS OF SECURITIES

Each debt security, warrant, and unit will be represented either by a certificate issued in definitive form to a particular investor or by one or more global securities representing the entire issuance of securities. Certificated securities in definitive form and global securities will be issued in registered form. Definitive securities name you or your nominee as the owner of the security, and in order to transfer or exchange these securities or to receive payments other than interest or other interim payments, you or your nominee must physically deliver the securities to the trustee, registrar, paying agent or other agent, as applicable. Global securities name a depositary or its nominee as the owner of the debt securities, warrants, or units represented by these global securities. The depositary maintains a computerized system that will reflect each investor s beneficial ownership of the securities through an account maintained by the investor with its broker/dealer, bank, trust company or other representative, as we explain more fully below.

### Global Securities

*Registered Global Securities.* We may issue the registered debt securities, warrants, and units in the form of one or more fully registered global securities that will be deposited with a depositary or its custodian identified in the applicable prospectus supplement and registered in the name of that depositary or its nominee. In those cases, one or more registered global securities will be issued in a denomination or aggregate denominations equal to the portion of the aggregate principal or face amount of the securities to be represented by registered global securities. Unless and until it is exchanged in whole for securities in definitive registered form, a registered global security may not be transferred except as a whole by and among the depositary for the registered global security, the nominees of the depositary or any successors of the depositary or those nominees.

If not described below, any specific terms of the depositary arrangement with respect to any securities to be represented by a registered global security will be described in the prospectus supplement relating to those securities. We anticipate that the following provisions will apply to all depositary arrangements.

Ownership of beneficial interests in a registered global security will be limited to persons, called participants, that have accounts with the depositary or persons that may hold interests through participants. Upon the issuance of a registered global security, the depositary will credit, on its book-entry registration and transfer system, the participants accounts with the respective principal or face amounts of the securities beneficially owned by the participants. Any dealers, underwriters or agents participating in the distribution of the securities will designate the accounts to be credited. Ownership of beneficial interests in a registered global security will be shown on, and the transfer of ownership interests will be effected only through, records maintained by the depositary, with respect to interests of participants, and on the records of participants, with respect to interests of persons holding through participants. The laws of some states may require that some purchasers of securities take physical delivery of these securities in definitive form. These laws may impair your ability to own, transfer or pledge beneficial interests in registered global securities.

So long as the depositary, or its nominee, is the registered owner of a registered global security, that depositary or its nominee, as the case may be, will be considered the sole owner or holder of the securities represented by the registered global security for all purposes under the applicable indenture, warrant agreement or unit agreement. Except as described below, owners of beneficial interests in a registered global security will not be entitled to have the securities represented by the registered global security registered in their names, will not receive or be entitled to receive physical delivery of the securities in definitive form and will not be considered the owners or holders of the securities under the applicable indenture, warrant agreement or unit agreement. Accordingly, each person owning a beneficial interest in a registered global security must rely on the procedures of the depositary for that registered global security and, if that person is not a participant, on the procedures of the participant through which the person owns its interest, to exercise any rights of a holder under the applicable indenture, warrant agreement or unit agreement. We understand that under existing industry practices, if we request any action of holders or if an owner of a beneficial interest in a registered global security desires to give or take any action that a holder is entitled to give or take under the applicable indenture, warrant agreement or unit agreement, the depositary for the registered global security would authorize the participants holding the relevant beneficial interests to give or take that action, and the participants would authorize beneficial owners owning through them to give or take that action or would otherwise act upon the instructions of beneficial owners holding through them.

Principal, premium, if any, and interest payments on debt securities, and any payments to holders with respect to warrants or units, represented by a registered global security registered in the name of a depositary or its nominee will be made to the depositary or its nominee, as the case may be, as the registered owner of the registered global security. None of the Company, the trustee, the warrant agents, the unit agents or any other agent of the Company, agent of the trustee or agent of the warrant agents or unit agents will have any responsibility or liability for any aspect of the records relating to payments made on account of beneficial ownership interests in the registered global security or for maintaining, supervising or reviewing any records relating to those beneficial ownership interests.

We expect that the depositary for any of the securities represented by a registered global security, upon receipt of any payment of principal, premium, interest or other distribution of underlying securities or other property to holders on that registered global security, will immediately credit participants accounts in amounts proportionate to their respective beneficial interests in that registered global security as shown on the records of the depositary. We also expect that payments by participants to owners of beneficial interests in a registered global security held through participants will be governed by standing customer instructions and customary practices, as is now the case with the securities held for the accounts of customers in bearer form or registered in street name, and will be the responsibility of those participants.

If the depositary for any of these securities represented by a registered global security is at any time unwilling or unable to continue as depositary or ceases to be a clearing agency registered under the Securities Exchange Act of 1934, and a successor depositary registered as a clearing agency under the Securities Exchange Act of 1934 is not appointed by us within 90 days, we will issue securities in definitive form in exchange for the registered global security that had been held by the depositary. Any securities issued in definitive form in exchange for a registered global security will be registered in the name or names that the depositary gives to the relevant trustee, warrant agent, unit agent or other relevant agent of ours or theirs. It is expected that the depositary s instructions will be based upon directions received by the depositary from participants with respect to ownership of beneficial interests in the registered global security that had been held by the depositary.

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## PLAN OF DISTRIBUTION

We may sell the securities offered pursuant to this prospectus in any of the following ways:

- directly to one or more purchasers;
- through agents;
- through underwriters, brokers or dealers; or
- through a combination of any of these methods of sale.

We will identify the specific plan of distribution, including any underwriters, brokers, dealers, agents or direct purchasers and their compensation in a prospectus supplement.

## LEGAL MATTERS

The validity of the securities offered by this prospectus and any prospectus supplement will be passed upon for us by Simpson Thacher & Bartlett LLP, New York, New York and Baker & Daniels LLP. Counsel for any underwriters, agents or dealers will be named in the accompanying prospectus supplement.

## EXPERTS

The financial statements incorporated in this prospectus by reference from the Company s Annual Report on Form 10-K, and the effectiveness of the Company s internal control over financial reporting have been audited by Deloitte & Touche LLP, an independent registered public accounting firm, as stated in their reports, which are incorporated herein by reference. Such financial statements have been so incorporated in reliance upon the reports of such firm given upon their authority as experts in accounting and auditing.