

Edgar Filing: Memorial Resource Development Corp. - Form 10-Q

Memorial Resource Development Corp.  
Form 10-Q  
July 28, 2016

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended June 30, 2016

OR

Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the transition period from \_\_\_\_\_ to \_\_\_\_\_.

Commission File Number: 001-36490

MEMORIAL RESOURCE DEVELOPMENT CORP.

(Exact name of registrant as specified in its charter)

Delaware  
(State or other jurisdiction of incorporation or organization) 46-4710769  
(I.R.S. Employer Identification No.)

500 Dallas Street, Suite 1800, Houston, TX  
(Address of principal executive offices) 77002  
(Zip Code)

Registrant's telephone number, including area code: (713) 588-8300

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

Edgar Filing: Memorial Resource Development Corp. - Form 10-Q

required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

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

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 definition of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act. Check one:

Large accelerated filer

Accelerated filer

Non-accelerated filer  (Do not check if a smaller reporting company)

Smaller reporting company

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

As of July 13, 2016, the registrant had 206,038,313 shares of common stock, \$.01 par value, outstanding

---

## MemORIAL RESOURCE DEVELOPMENT CORP.

## Table of Contents

	Page
<u>Glossary of Oil and Natural Gas Terms</u>	2
<u>Names of Entities</u>	5
<u>Cautionary Note Regarding Forward-Looking Statements</u>	6
<u>PART I—FINANCIAL INFORMATION</u>	
Item 1. <u>Financial Statements</u>	
<u>Unaudited Condensed Consolidated Balance Sheets as of June 30, 2016 and December 31, 2015</u>	8
<u>Unaudited Condensed Statements of Consolidated Operations for the Three and Six Months Ended June 30, 2016 and 2015</u>	9
<u>Unaudited Condensed Statements of Consolidated Cash Flows for the Six Months Ended June 30, 2016 and 2015</u>	10
<u>Unaudited Condensed Statements of Consolidated Equity for the Six Months Ended June 30, 2016 and 2015</u>	11
<u>Notes to Unaudited Condensed Consolidated Financial Statements</u>	
<u>Note 1 – Background, Organization and Basis of Presentation</u>	12
<u>Note 2 – Summary of Significant Accounting Policies</u>	13
<u>Note 3 – Discontinued Operations</u>	15
<u>Note 4 – Acquisitions and Divestitures</u>	16
<u>Note 5 – Fair Value Measurements of Financial Instruments</u>	17
<u>Note 6 – Risk Management and Derivative and Other Financial Instruments</u>	18
<u>Note 7 – Asset Retirement Obligations</u>	20
<u>Note 8 – Long Term Debt</u>	21
<u>Note 9 – Stockholders’ Equity and Noncontrolling Interests</u>	22
<u>Note 10 – Earnings per Share</u>	23
<u>Note 11 – Long-Term Incentive Plans</u>	23
<u>Note 12 – Incentive Units</u>	24
<u>Note 13 – Related Party Transactions</u>	24
<u>Note 14 – Commitments and Contingencies</u>	25
<u>Note 15 – Income Taxes</u>	27
Item 2. <u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	28
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	35
Item 4. <u>Controls and Procedures</u>	36
<u>PART II—OTHER INFORMATION</u>	
Item 1. <u>Legal Proceedings</u>	37
Item 1A. <u>Risk Factors</u>	37
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	38
Item 3. <u>Defaults Upon Senior Securities</u>	38
Item 4. <u>Mine Safety Disclosures</u>	38
Item 5. <u>Other Information</u>	38

Item 6. Exhibits  
Signatures

38  
39

## GLOSSARY OF OIL AND NATURAL GAS TERMS

**Analogous Reservoir:** Analogous reservoirs, as used in resource assessments, have similar rock and fluid properties, reservoir conditions (depth, temperature, and pressure) and drive mechanisms, but are typically at a more advanced stage of development than the reservoir of interest and thus may provide concepts to assist in the interpretation of more limited data and estimation of recovery. When used to support proved reserves, analogous reservoir refers to a reservoir that shares all of the following characteristics with the reservoir of interest: (i) the same geological formation (but not necessarily in pressure communication with the reservoir of interest); (ii) the same environment of deposition; (iii) similar geologic structure; and (iv) the same drive mechanism.

**Bbl:** One stock tank barrel, or 42 U.S. gallons liquid volume, used in reference to oil or other liquid hydrocarbons.

**Bcfe:** One billion cubic feet of natural gas equivalent.

**BOEM:** Bureau of Ocean Energy Management.

**Btu:** One British thermal unit, the quantity of heat required to raise the temperature of a one-pound mass of water by one degree Fahrenheit.

**COPAS:** Council of Petroleum Accountants Societies.

**Dry Hole or Dry Well:** A well found to be incapable of producing hydrocarbons in sufficient quantities such that proceeds from the sale of such production would exceed production expenses and taxes.

**Economically Producing:** The term economically producing, as it relates to a resource, means a resource which generates revenue that exceeds, or is reasonably expected to exceed, the costs of the operation. For this determination, the value of the products that generate revenue are determined at the terminal point of oil and natural gas producing activities.

**Exploitation:** A development or other project which may target proven or unproven reserves (such as probable or possible reserves), but which generally has a lower risk than that associated with exploration projects.

**Field:** An area consisting of a single reservoir or multiple reservoirs all grouped on or related to the same individual geological structural feature and/or stratigraphic condition. The field name refers to the surface area, although it may refer to both the surface and the underground productive formations.

**Gross Acres or Gross Wells:** The total acres or wells, as the case may be, in which we have working interest.

**MBbl:** One thousand Bbls.

**Mcf:** One thousand cubic feet of natural gas.

**MMBtu:** One million British thermal units.

**MMcf:** One million cubic feet of natural gas.

**MMcfe:** One million cubic feet of natural gas equivalent.

**Net Production:** Production that is owned by us less royalties and production due others.

Edgar Filing: Memorial Resource Development Corp. - Form 10-Q

NGLs: The combination of ethane, propane, butane and natural gasolines that when removed from natural gas become liquid under various levels of higher pressure and lower temperature.

NYMEX: New York Mercantile Exchange.

Oil: Oil and condensate.

Operator: The individual or company responsible for the exploration and/or production of an oil or natural gas well or lease.

Play: A geographic area with hydrocarbon potential.

Possible Reserves: Reserves that are less certain to be recovered than probable reserves.

Probable Reserves: Reserves that are less certain to be recovered than proved reserves but that, together with proved reserves, are as likely as not to be recovered.

**Proved Reserves:** Those quantities of oil and natural gas, which, by analysis of geoscience and engineering data, can be estimated with reasonable certainty to be economically producible, from a given date forward, from known reservoirs, and under existing economic conditions, operating methods, and government regulations, prior to the time at which contracts providing the right to operate expire, unless evidence indicates that renewal is reasonably certain, regardless of whether deterministic or probabilistic methods are used for the estimation. The project to extract the hydrocarbons must have commenced, or the operator must be reasonably certain that it will commence the project, within a reasonable time. The area of the reservoir considered as proved includes (i) the area identified by drilling and limited by fluid contacts, if any, and (ii) adjacent undrilled portions of the reservoir that can, with reasonable certainty, be judged to be continuous with it and to contain economically producible oil or natural gas on the basis of available geoscience and engineering data. In the absence of data on fluid contacts, proved quantities in a reservoir are limited by the lowest known hydrocarbons, as seen in a well penetration, unless geoscience, engineering or performance data and reliable technology establishes a lower contact with reasonable certainty. Where direct observation from well penetrations has defined a highest known oil elevation and the potential exists for an associated natural gas cap, proved oil reserves may be assigned in the structurally higher portions of the reservoir only if geoscience, engineering, or performance data and reliable technology establish the higher contact with reasonable certainty. Reserves which can be produced economically through application of improved recovery techniques (including fluid injection) are included in the proved classification when (i) successful testing by a pilot project in an area of the reservoir with properties no more favorable than in the reservoir as a whole, the operation of an installed program in the reservoir, or an analogous reservoir or other evidence using reliable technology establishes the reasonable certainty of the engineering analysis on which the project or program was based; and (ii) the project has been approved for development by all necessary parties and entities, including governmental entities. Existing economic conditions include prices and costs at which economic producibility from a reservoir is to be determined. The price used is the average price during the twelve-month period prior to the ending date of the period covered by the report, determined as an unweighted arithmetic average of the first-day-of-the-month price for each month within such period, unless prices are defined by contractual arrangements, excluding escalations based upon future conditions.

**PUDs: Proved Undeveloped Reserves.**

**Proved Undeveloped Reserves:** Proved oil and natural gas reserves that are expected to be recovered from new wells on undrilled acreage or from existing wells where a relatively major expenditure is required for recompletion. Reserves on undrilled acreage are limited to those drilling units offsetting productive units that are reasonably certain of production when drilled. Proved reserves for other undrilled units can be claimed only where it can be demonstrated with certainty that there is continuity of production from the existing productive formation. Under no circumstances should estimates for proved undeveloped reserves be attributable to any acreage for which an application of fluid injection or other improved recovery technique is contemplated, unless such techniques have been proved effective by actual tests in the area and in the same reservoir.

**Recompletion:** The completion for production of an existing wellbore in another formation from that which the well has been previously completed.

**Reliable Technology:** Reliable technology is a grouping of one or more technologies (including computational methods) that has been field tested and has been demonstrated to provide reasonably certain results with consistency and repeatability in the formation being evaluated or in an analogous formation.

**Reserve Life:** A measure of the productive life of an oil and natural gas property or a group of properties, expressed in years. Reserve life is calculated by dividing proved reserve volumes at year-end by production volumes. In our calculation of reserve life, production volumes are adjusted, if necessary, to reflect property acquisitions and dispositions.

Reserves: Reserves are estimated remaining quantities of oil and natural gas and related substances anticipated to be economically producible, as of a given date, by application of development projects to known accumulations. In addition, there must exist, or there must be a reasonable expectation that there will exist, the legal right to produce or a revenue interest in the production, installed means of delivering oil and natural gas or related substances to market and all permits and financing required to implement the project. Reserves should not be assigned to adjacent reservoirs isolated by major, potentially sealing, faults until those reservoirs are penetrated and evaluated as economically producible. Reserves should not be assigned to areas that are clearly separated from a known accumulation by a non-productive reservoir (i.e., absence of reservoir, structurally low reservoir or negative test results). Such areas may contain prospective resources (i.e., potentially recoverable resources from undiscovered accumulations).

Reservoir: A porous and permeable underground formation containing a natural accumulation of producible oil and/or natural gas that is confined by impermeable rock or water barriers and is individual and separate from other reserves.

Resources: Resources are quantities of oil and natural gas estimated to exist in naturally occurring accumulations. A portion of the resources may be estimated to be recoverable and another portion may be considered unrecoverable. Resources include both discovered and undiscovered accumulations.



Standardized Measure: The present value of estimated future net revenue to be generated from the production of proved reserves, determined in accordance with the rules, regulations or standards established by the United States Securities and Exchange Commission (“SEC”) and the Financial Accounting Standards Board (“FASB”) (using prices and costs in effect as of the date of estimation), less future development, production and income tax expenses, and discounted at 10% per annum to reflect the timing of future net revenue. Because we are a corporation, we are subject to federal or state income taxes and thus make provisions for federal or state income taxes in the calculation of our standardized measure. Standardized measure does not give effect to derivative transactions.

Wellbore: The hole drilled by the bit that is equipped for oil or natural gas production on a completed well. Also called well or borehole.

Working Interest: An interest in an oil and natural gas lease that gives the owner of the interest the right to drill for and produce oil and natural gas on the leased acreage and requires the owner to pay a share of the costs of drilling and production operations.

WTI: West Texas Intermediate.

## NAMES OF ENTITIES

As used in this Form 10-Q, unless we indicate otherwise:

- Unless the context requires otherwise, references to “we,” “us,” “our,” “MRD,” or “the Company” or like terms are intended mean the business and operations of Memorial Resource Development Corp. and its consolidated subsidiaries;
- “Memorial Production Partners,” “MEMP” and “the Partnership” refer to Memorial Production Partners LP individually and collectively with its subsidiaries, as the context requires;
- “MEMP GP” refers to Memorial Production Partners GP LLC, the general partner of the Partnership;
  - “the Funds” refers collectively to Natural Gas Partners VIII, L.P., Natural Gas Partners IX, L.P. and NGP IX Offshore Holdings, L.P., which collectively control MRD Holdco;
- “MRD Holdco” refers to MRD Holdco LLC, a holding company controlled by the Funds that, together with a group, owns a majority of our common stock;
- “NGP” refers to Natural Gas Partners, a family of private equity funds organized to make direct equity investments in the energy industry, including the Funds; and
- “Classic Pipeline” refers to Classic Pipeline & Gathering, LLC, a subsidiary of MRD Holdco that owned certain immaterial midstream assets in Texas.

## CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

This quarterly report contains “forward-looking statements” within the meaning of Section 27A of the Securities Act of 1933, as amended (the “Securities Act”), and Section 21E of the Securities Exchange Act of 1934, as amended (the “Exchange Act”). Forward-looking statements are subject to a number of risks and uncertainties, many of which are beyond our control, may include statements about our:

- risks related to the proposed merger with Range Resources Corporation;
- business strategy;
- estimated reserves and the present value thereof;
- technology;
- cash flows and liquidity;
- financial strategy, budget, projections and future operating results;
- realized commodity prices;
- timing and amount of future production of reserves;
- ability to procure drilling and production equipment;
- ability to procure oilfield labor;
  - the amount, nature and timing of capital expenditures, including future development costs;
- ability to access, and the terms of, capital;
- drilling of wells, including statements made about future horizontal drilling activities;
- competition;
- expectations regarding government regulations;
- marketing of production and the availability of pipeline capacity;
- exploitation or property acquisitions;
- costs of exploiting and developing our properties and conducting other operations;
- expectations regarding general economic and business conditions;
- competition in the oil and natural gas industry;
- effectiveness of our risk management activities;
- environmental and other liabilities;
- counterparty credit risk;
- expectations regarding taxation of the oil and natural gas industry;
- expectations regarding developments in other countries that produce oil and natural gas;
- future operating results;
- plans and objectives of management; and
- plans, objectives, expectations and intentions contained in this report that are not historical.

These types of statements, other than statements of historical fact included in this quarterly report, are forward-looking statements. In some cases, you can identify forward-looking statements by terminology such as “may,” “will,” “could,” “should,” “expect,” “plan,” “project,” “forecast,” “intend,” “anticipate,” “believe,” “estimate,” “predict,” “potential,” “target,” “outlook,” “continue,” the negative of such terms or other comparable terminology. These statements discuss future expectations, contain projections of results of operations or of financial condition or include other “forward-looking” information. These forward-looking statements involve risks and uncertainties. Important factors that could cause our actual results or financial condition to differ materially from our expectations include, but are not limited to, the following risks and uncertainties:

- variations in the market demand for, and prices of, oil, natural gas and NGLs;
- uncertainties about our estimated reserves;
- the adequacy of our capital resources and liquidity including, but not limited to, access to additional borrowing capacity under our revolving credit facility;
- general economic and business conditions;
- risks associated with negative developments in the capital markets;
- failure to realize expected value creation from property acquisitions;
- uncertainties about our ability to replace reserves and economically develop our current reserves;
- drilling results;
  - potential financial losses or earnings reductions from our commodity price risk management programs;
- adoption or potential adoption of new governmental regulations;
- the availability of capital on economic terms to fund our capital expenditures and acquisitions;
- risks associated with our substantial indebtedness;
- our ability to satisfy future cash obligations and environmental costs; and
- potential changes to certain favorable tax deductions available to oil and natural gas exploration and production operations due to future legislative actions.

The forward-looking statements contained in this quarterly report are largely based on our expectations, which reflect estimates and assumptions made by our management. These estimates and assumptions reflect our best judgment based on currently known market conditions and other factors. Although we believe such estimates and assumptions to be reasonable, they are inherently uncertain and involve a number of risks and uncertainties that are beyond our control. In addition, management’s assumptions about future events may prove to be inaccurate. All readers are cautioned that the forward-looking statements contained in this quarterly report are not guarantees of future performance, and we cannot assure any reader that such statements will be realized or that the events or circumstances described in any forward-looking statement will occur. Actual results may differ materially from those anticipated or implied in the forward-looking statements due to factors described in the “Part I—Item 1A. Risk Factors” of our Annual Report on Form 10-K for the year ended December 31, 2015 (our “2015 Form 10-K”) and “Part II—Item 1A. Risk Factors” appearing within this quarterly report and elsewhere in this quarterly report. All forward-looking statements speak only as of the date of this quarterly report. We do not intend to update or revise any forward-looking statements as a result of new information, future events or otherwise. These cautionary statements qualify all forward-looking statements attributable to us or persons acting on our behalf.

## PART I—FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS.  
MEMORIAL RESOURCE DEVELOPMENT CORP.

## UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except outstanding shares)

	June 30, 2016	December 31, 2015
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 10	\$—
Accounts receivable	62,174	52,691
Short-term derivative instruments	98,594	227,991
Other financial instruments (Note 6)	27,253	46,106
Prepaid expenses and other current assets	3,381	3,375
Assets of discontinued operation (Note 3)	—	345,541
Total current assets	191,412	675,704
Property and equipment, at cost:		
Oil and natural gas properties, successful efforts method (Note 2)	2,409,611	2,160,008
Other	12,256	22,822
Accumulated depreciation, depletion and impairment	(559,930 )	(438,383 )
Property and equipment, net	1,861,937	1,744,447
Long-term derivative instruments	36,514	91,291
Other long-term assets	10,833	4,976
Assets of discontinued operation (Note 3)	—	2,566,431
Total assets	\$2,100,696	\$5,082,849
<b>LIABILITIES AND EQUITY</b>		
Current liabilities:		
Accounts payable	\$25,697	\$25,057
Accounts payable - affiliates	8,062	5,016
Revenues payable	34,117	34,026
Accrued liabilities (Note 2)	72,064	68,876
Liabilities of discontinued operation (Note 3)	—	91,779
Total current liabilities	139,940	224,754
Long-term debt	1,103,902	1,012,064
Asset retirement obligations	10,779	10,079
Deferred tax liabilities	149,355	193,733
Other long-term liabilities	3,083	7,195
Liabilities of discontinued operation (Note 3)	—	2,167,103
Total liabilities	1,407,059	3,614,928
Commitments and contingencies (Note 14)		
Equity:		

Edgar Filing: Memorial Resource Development Corp. - Form 10-Q

Stockholders' equity:

Preferred stock, \$.01 par value: 50,000,000 shares authorized; no shares issued and outstanding	—	—
Common stock, \$.01 par value: 600,000,000 shares authorized; 206,038,313 shares issued and outstanding at June 30, 2016; 205,293,743 shares issued and outstanding at December 31, 2015	2,060	2,053
Additional paid-in capital	1,627,780	1,560,949
Accumulated earnings (deficit)	(936,203 )	(740,175 )
Total stockholders' equity	693,637	822,827
Noncontrolling interests	—	645,094
Total equity	693,637	1,467,921
Total liabilities and equity	\$2,100,696	\$5,082,849

See Accompanying Notes to Unaudited Condensed Consolidated Financial Statements

## MEMORIAL RESOURCE DEVELOPMENT CORP.

## UNAUDITED CONDENSED STATEMENTS OF CONSOLIDATED OPERATIONS

(In thousands, except per share amounts)

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2016	2015	2016	2015
<b>Revenues:</b>				
Oil & natural gas sales	\$98,986	\$78,605	\$180,064	\$165,628
Total revenues	98,986	78,605	180,064	165,628
<b>Costs and expenses:</b>				
Lease operating	8,189	3,854	14,903	9,076
Gathering, processing, and transportation	23,353	14,289	45,294	29,052
Gathering, processing, and transportation - affiliate (Note 13)	13,456	3,813	27,643	3,813
Exploration	4,612	2,230	7,058	2,956
Taxes other than income	2,991	3,140	5,855	5,915
Depreciation, depletion, and amortization	65,558	35,827	125,357	76,359
Incentive unit compensation expense (benefit) (Note 12)	74,329	16,116	52,569	26,340
General and administrative	24,021	10,323	35,154	23,299
Accretion of asset retirement obligations	156	93	295	216
(Gain) loss on commodity derivative instruments	90,617	30,463	54,175	(77,727 )
(Gain) loss on sale of properties	—	50	50	50
Total costs and expenses	307,282	120,198	368,353	99,349
Operating income (loss)	(208,296)	(41,593 )	(188,289)	66,279
<b>Other income (expense):</b>				
Interest expense, net	(12,767 )	(9,613 )	(24,124 )	(19,369 )
Other, net	(112 )	(52 )	(108 )	(101 )
Total other income (expense)	(12,879 )	(9,665 )	(24,232 )	(19,470 )
Income (loss) before income taxes	(221,175)	(51,258 )	(212,521)	46,809
Income tax benefit (expense)	25,342	24,644	22,405	(22,914 )
Net income (loss) from continuing operations	(195,833)	(26,614 )	(190,116)	23,895
<b>Discontinued Operations: (Note 3)</b>				
Income (loss) before income taxes	(122,425)	(112,983)	(160,426)	(278,011)
Income tax benefit (expense)	—	(876 )	(96 )	1,494
Net income (loss) from discontinued operations	(122,425)	(113,859)	(160,522)	(276,517)
Net income (loss)	(318,258)	(140,473)	(350,638)	(252,622)
Net income (loss) attributable to noncontrolling interest	(122,297)	(113,771)	(160,354)	(274,666)
Net income (loss) attributable to Memorial Resource Development Corp.	(195,961)	(26,702 )	(190,284)	22,044
Net (income) allocated to participating restricted stockholders	—	—	—	(150 )
Net (income) loss from discontinued operations	128	88	168	227
	\$(195,833)	\$(26,614 )	\$(190,116)	\$22,121

Net income (loss) from continuing operations available to common stockholders

Earnings per common share-basic: (Note 10)

Income (loss) from continuing operations	\$(0.96 )	\$(0.14 )	\$(0.93 )	\$0.12
Income (loss) from discontinued operations	\$—	\$—	\$—	\$—
Net income (loss)	\$(0.96 )	\$(0.14 )	\$(0.93 )	\$0.12

Earnings per common share-diluted: (Note 10)

Income (loss) from continuing operations	\$(0.96 )	\$(0.14 )	\$(0.93 )	\$0.12
Income (loss) from discontinued operations	\$—	\$—	\$—	\$—
Net income (loss)	\$(0.96 )	\$(0.14 )	\$(0.93 )	\$0.12

Weighted average common and common

equivalent shares outstanding:

Basic	203,948	189,628	203,807	190,163
Diluted	203,948	189,628	203,807	190,163

See Accompanying Notes to Unaudited Condensed Consolidated Financial Statements.



## MEMORIAL RESOURCE DEVELOPMENT CORP.

## UNAUDITED CONDENSED STATEMENTS OF CONSOLIDATED CASH FLOWS

(In thousands)

	For the Six Months Ended June 30,	
	2016	2015
<b>Cash flows from operating activities:</b>		
Net income (loss)	\$(350,638)	\$(252,622)
<b>Adjustments to reconcile net income (loss) to net cash provided by operating activities:</b>		
(Income) loss from discontinued operations	160,522	276,517
Depreciation, depletion, and amortization	125,357	76,359
(Gain) loss on derivatives	54,175	(77,727 )
Cash settlements (paid) received on expired derivative instruments	130,000	70,288
Amortization of deferred financing costs	1,560	1,333
Accretion of asset retirement obligations	295	216
Amortization of equity awards	13,673	3,443
(Gain) loss on sale of properties	50	50
Non-cash compensation expense	52,569	26,340
Deferred income tax expense (benefit)	(44,301 )	15,197
Exploration costs	236	—
<b>Changes in operating assets and liabilities:</b>		
Accounts receivable	(6,849 )	3,396
Prepaid expenses and other assets	(6,678 )	4,538
Payables and accrued liabilities	23,691	37,537
Other	(1,715 )	(1,166 )
Net cash provided by continuing operations	151,947	183,699
Net cash provided by discontinued operations	139,770	118,088
Net cash provided by operating activities	291,717	301,787
<b>Cash flows from investing activities:</b>		
Additions to oil and gas properties	(265,532)	(207,103)
Additions to other property and equipment	(438 )	(3,309 )
Other financial instruments	16,220	—
Proceeds from the sale of other property and equipment	4,219	—
Proceeds from the sale of oil and natural gas properties	—	13,612
Other	24	—
Net cash used in continuing operations	(245,507)	(196,800)
Net cash used in discontinued operations	(33,014 )	(127,644)
Net cash used in investing activities	(278,521)	(324,444)
<b>Cash flows from financing activities:</b>		
Advances on revolving credit facilities	229,000	181,000
Payments on revolving credit facilities	(138,000)	(199,000)
Deferred financing costs	(38 )	—
Proceeds from sale of subsidiaries	750	—

Edgar Filing: Memorial Resource Development Corp. - Form 10-Q

MRD equity repurchases	(5,748 )	(51,197 )
Net cash used in continuing operations	85,964	(69,197 )
Net cash provided by (used in) discontinued operations	(86,365 )	90,597
Net cash provided by (used in) financing activities	(401 )	21,400
Net change in cash and cash equivalents	12,795	(1,257 )
Add: cash balance included in assets of discontinued operations at beginning of period	2,175	2,594
Less: cash balance included in assets of discontinued operations at May 31, 2016 and June 30, 2015	14,960	4,701
Cash and cash equivalents, beginning of period	—	3,364
Cash and cash equivalents, end of period	\$ 10	\$—
See Accompanying Notes to Unaudited Condensed Consolidated Financial Statements		

## MEMORIAL RESOURCE DEVELOPMENT CORP.

## UNAUDITED CONDENSED STATEMENTS OF CONSOLIDATED EQUITY

(In thousands)

	Stockholders' Equity				
	Common stock	Additional paid in capital	Accumulated earnings (deficit)	Noncontrolling Interest	Total
Balance, January 1, 2015	\$1,935	\$1,367,346	\$ (786,871 )	\$ 1,120,554	\$1,702,964
Net income (loss)	—	—	22,044	(274,666 )	(252,622 )
Share repurchase	(28 )	—	(47,757 )	—	(47,785 )
Restricted stock awards	9	(9 )	—	—	—
Amortization of restricted stock awards	—	3,443	—	—	3,443
Contribution related to MRD Holdco incentive unit compensation expense (Note 12)	—	26,340	—	—	26,340
Net equity deemed contribution (distribution) related to MEMP property exchange (Note 1)	—	(127,149 )	—	127,149	—
Deferred tax effect of MEMP property exchange (Note 15)	—	28,020	—	—	28,020
Distributions	—	—	—	(92,477 )	(92,477 )
Amortization of MEMP equity awards	—	—	—	4,906	4,906
MRD restricted shares repurchased	(1 )	—	(1,195 )	—	(1,196 )
MEMP common units repurchased	—	—	—	(45,117 )	(45,117 )
Other	—	(47 )	—	30	(17 )
Balance, June 30, 2015	\$1,915	\$1,297,944	\$ (813,779 )	\$ 840,379	\$1,326,459
Balance, January 1, 2016	\$2,053	\$1,560,949	\$ (740,175 )	\$ 645,094	\$1,467,921
Net income (loss)	—	—	(190,284 )	(160,354 )	(350,638 )
Restricted stock awards	11	(11 )	—	—	—
Amortization of restricted stock awards	—	13,673	—	—	13,673
Contribution (distribution) related to MRD Holdco incentive units (Note 12)	—	52,569	—	—	52,569
Distributions	—	—	—	(8,295 )	(8,295 )
Restricted stock awards returned to plan	(4 )	—	(5,744 )	—	(5,748 )
Amortization of MEMP equity awards	—	—	—	4,218	4,218
MEMP restricted units repurchased	—	—	—	(90 )	(90 )
Adjustments from deconsolidation of subsidiaries (Note 9)	—	—	—	(480,165 )	(480,165 )
Other	—	600	—	(408 )	192
Balance, June 30, 2016	\$2,060	\$1,627,780	\$ (936,203 )	\$ —	\$693,637

See Accompanying Notes to Unaudited Condensed Consolidated Financial Statements.



MEMORIAL RESOURCE DEVELOPMENT CORP.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Note 1. Background, Organization and Basis of Presentation

Overview

Memorial Resource Development Corp. (the “Company”) is a publicly traded Delaware corporation, the common shares of which are listed on the NASDAQ Global Market (“NASDAQ”) under the symbol “MRD.” Unless the context requires otherwise, references to “we,” “us,” “our,” “MRD,” or “the Company” are intended to mean the business and operations of Memorial Resource Development Corp. and its consolidated subsidiaries.

References to: (i) “Memorial Production Partners,” “MEMP” and “the Partnership” refer to Memorial Production Partners LP individually and collectively with its subsidiaries, as the context requires; (ii) “MEMP GP” refer to Memorial Production Partners GP LLC, the general partner of the Partnership; (iii) “MRD Holdco” refer to MRD Holdco LLC, a holding company controlled by the Funds (defined below) that, together as part of a group, owns a majority of our common stock; (iv) “the Funds” refer collectively to Natural Gas Partners VIII, L.P., Natural Gas Partners IX, L.P. and NGP IX Offshore Holdings, L.P., which collectively control MRD Holdco; and (v) “NGP” refer to Natural Gas Partners, a family of private equity investment funds organized to make direct equity investments in the energy industry, including the Funds.

Basis of Presentation

Our consolidated financial statements include our accounts and those of our subsidiaries in which we have a controlling interest. Under the amended consolidation guidance that we adopted on January 1, 2016 (see Note 2), a limited partnership is considered a variable interest entity (“VIE”) unless a single limited partner or a simple majority of all partners have substantive kick-out or participating rights. The Company determined that MEMP was a VIE and we were deemed the primary beneficiary. On June 1, 2016, we completed the sale of MEMP GP, Beta Operating Company, LLC (“Beta Operating”) and MEMP Services LLC (“Services”) (collectively, the “Disposition Entities”), to MEMP for \$0.75 million in cash. This sale was a reconsideration event under the amended consolidation guidance which resulted in the deconsolidation of the Partnership. Our equity statement reflects a loss of \$0.1 million related to the deconsolidation of the Disposition Entities and their subsidiaries. Our financial statements have been retrospectively revised to reflect the Disposition Entities and their subsidiaries as discontinued operations for all periods presented (see Note 3). After the completion of the sale, we have one reportable business segment, which is engaged in the acquisition, exploration and development of oil and natural gas properties.

All material intercompany transactions and balances have been eliminated in preparation of our consolidated financial statements. Our results of operations for the three and six months ended June 30, 2016 are not necessarily indicative of results expected for the full year. In our opinion, the accompanying unaudited condensed consolidated financial statements include all adjustments of a normal recurring nature necessary for fair presentation. Although we believe the disclosures in these financial statements are adequate and make the information presented not misleading, certain information and footnote disclosures normally included in annual financial statements prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) have been condensed or omitted pursuant to the rules and regulations of the United States Securities and Exchange Commission (“SEC”).

Our equity statement reflects a \$127.1 million equity transfer from stockholders’ equity to noncontrolling interest related to the acquisition by MEMP of certain assets from the Company in East Texas in February 2015 for certain properties in North Louisiana (the “Property Swap”).

Proposed Merger with Range Resources Corporation

On May 15, 2016, the Company entered into an Agreement and Plan of Merger (the “Merger Agreement”) with Range Resources Corporation (“Range”), a Delaware corporation, and Medina Merger Sub, Inc., a Delaware corporation and a direct wholly-owned subsidiary of Range (“Merger Sub”). The Merger Agreement provides that, upon the terms and subject to the conditions set forth, the Merger Sub will be merged with and into the Company, with the Company continuing as the surviving entity and a wholly owned subsidiary of Range (“the Merger”).

If the Merger is completed, each share of our common stock outstanding immediately before that time (including outstanding shares of our restricted common stock, all of which will become fully vested and unrestricted under the terms of the Merger Agreement) will automatically be converted into the right to receive 0.375 of a share of Range common stock, par value of \$0.01 per share (“Range Common Stock”). The Merger is subject to customary closing conditions, including the approval by both Memorial and Range stockholders. We expect the closing of the Merger will occur late in the third quarter of 2016.

MEMORIAL RESOURCE DEVELOPMENT CORP.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

In connection with the execution of the Merger Agreement, MRD Holdco, Jay Graham (our chief executive officer), Anthony Bahr and WHR Incentive LLC (a limited liability company controlled by Mr. Graham and Mr. Bahr) (collectively, the “Memorial Stockholders”) entered into a voting and support agreement with Range and have agreed to vote all of the shares held by them in favor of the approval and adoption of the Merger Agreement and the transactions contemplated by the Merger Agreement, including the merger. As of June 30, 2016, the Memorial Stockholders hold and are entitled to vote in the aggregate approximately 47.7% of the issued and outstanding shares of our common stock entitled to vote at our special meeting. In addition, certain other stockholders of the Company who are not party to the voting and support agreement are party to an existing voting agreement, as discussed in our 2015 Form 10-K, pursuant to which those stockholders are required to vote all of the shares of our common stock that they own as directed by MRD Holdco. As of June 30, 2016, those additional stockholders hold and are entitled to vote in the aggregate approximately 2.7% of the outstanding shares of our common stock entitled to vote at our special meeting.

Upon completion of the Merger, our common stock currently listed on the NASDAQ will cease to be listed for trading on the NASDAQ and will subsequently be deregistered under the Securities Exchange Act of 1934, as amended.

Use of Estimates

The preparation of the accompanying unaudited condensed consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Significant estimates include, but are not limited to, oil and natural gas reserves; depreciation, depletion, and amortization of proved oil and natural gas properties; future cash flows from oil and natural gas properties; impairment of long-lived assets; realization of long-term prepaid processing fees; fair value of derivatives; fair value of equity compensation; fair values of assets acquired and liabilities assumed in business combinations, income taxes and asset retirement obligations.

Note 2. Summary of Significant Accounting Policies

A discussion of our critical accounting policies and estimates is included in our 2015 Form 10-K.

Oil and Natural Gas Properties

Oil and natural gas properties consisted of the following at the dates indicated (in thousands):

	December
June 30,	31,

Edgar Filing: Memorial Resource Development Corp. - Form 10-Q

	2016	2015
	(In thousands)	
Proved oil and natural gas properties	\$1,984,500	\$1,740,530
Support equipment and facilities	7,191	4,719
Unproved oil and natural gas properties	417,920	414,759
Total oil and natural gas properties	\$2,409,611	\$2,160,008

At June 30, 2016 and December 31, 2015, we had \$147.4 million and \$174.0 million, respectively, capitalized in proved oil and natural gas properties related to wells in various stages of drilling and completion, which have been excluded from the depletion base.



## MEMORIAL RESOURCE DEVELOPMENT CORP.

## NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

## Accrued liabilities

Current accrued liabilities consisted of the following at the dates indicated (in thousands):

	June 30, 2016	December 31, 2015
Accrued capital expenditures	\$24,084	\$ 40,197
Accrued interest payable	17,665	17,657
Accrued lease operating expense	1,414	2,031
Accrued general and administrative expenses	5,871	4,030
Accrued ad valorem taxes	1,619	157
Accrued current income taxes	20,007	1,911
Other miscellaneous, including operator advances	1,404	2,893
Total accrued liabilities	\$72,064	\$ 68,876

## Supplemental Cash Flow Information

Supplemental cash flow from continuing operations for the periods presented (in thousands):

	For the Six Months Ended June 30,	
	2016	2015
<b>Supplemental cash flows:</b>		
Cash paid for interest, net of capitalized interest	\$22,418	\$35,650
Cash paid for taxes	3,800	2,000
<b>Noncash investing and financing activities:</b>		
Increase (decrease) in capital expenditures in payables and accrued liabilities	(16,113)	25,560
(Increase) decrease in accounts receivable related to other financial instruments	2,633	—
Assumptions of asset retirement obligations related to properties acquired or drilled	530	—

## New Accounting Pronouncements

**Improvements to Employee Share-Based Payment Accounting.** In March 2016, the Financial Accounting Standards Board (“FASB”) issued an accounting standards update to simplify the guidance on employee share-based payment accounting. The update involves several aspects of accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification in the statement of cash flows. Entities will no longer record excess tax benefits and certain tax deficiencies in additional paid-in capital (“APIC”). Instead, they will record all excess tax benefits and tax deficiencies as income tax expense or benefit in the income statement and the APIC pools will be eliminated. In addition, the new guidance eliminates the requirement

that excess tax benefits be realized before companies can recognize them and requires companies to present excess tax benefits as an operating activity on the statement of cash flows rather than as a financing activity. Furthermore, the new guidance will increase the amount an employer can withhold to cover income taxes on awards and still qualify for the exception to liability classification for shares used to satisfy the employer's statutory income tax withholding obligation. The new guidance requires a company to classify the cash paid to a tax authority when shares are withheld to satisfy its statutory income tax withholding obligation as a financing activity on the statement of cash flows. In addition, companies will now have to elect whether to account for forfeitures on share-based payments by: (i) recognizing forfeitures of awards as they occur or (ii) estimating the number of awards expected to be forfeited and adjusting the estimate when it is likely to change, as is currently required.

The new guidance is effective for reporting periods beginning after December 15, 2016, and interim periods within those fiscal years. Early adoption is permitted, but all of the guidance must be adopted in the same period. The Company is currently assessing the impact the adoption of this new guidance will have on our consolidated financial statements and related disclosures. For the amendments that change the recognition and measurement of share-based payment awards, the new guidance requires transition under a modified retrospective approach, with a cumulative-effect adjustment made to retained earnings as of the beginning of the fiscal period in which the guidance is adopted. Prospective application is required for the accounting for excess tax benefits and tax deficiencies. Entities should apply the new guidance retrospectively for all periods presented related to the classification of employee taxes paid on the statement of cash flows when an employer withholds shares to meet the minimum statutory withholding requirements. Entities may apply the presentation changes for excess tax benefits in the statement of cash flows either prospectively or retrospectively.

## MEMORIAL RESOURCE DEVELOPMENT CORP.

## NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

**Leases.** In February 2016, the FASB issued a revision to its lease accounting guidance. The FASB retained a dual model, requiring leases to be classified as either direct financing or operating leases. The classification will be based on criteria that are similar to the current lease accounting treatment. The revised guidance requires lessees to recognize a right-of-use asset and lease liability for all leasing transactions regardless of classification. For leases with a term of 12 months or less, a lessee is permitted to make an accounting policy election by class of underlying asset not to recognize lease assets and lease liabilities. If a lessee makes this election, it should recognize lease expense for such leases generally on a straight-line basis over the lease term. The amendments are effective for financial statements issued for annual periods beginning after December 15, 2018 and interim periods within those fiscal years. Early adoption is permitted for all entities as of the beginning of an interim or annual reporting period. The revised guidance must be adopted using a modified retrospective transition and provides for certain practical expedients. Transition will require application of the new guidance at the beginning of the earliest comparative period presented. The Company is currently evaluating the standard and the impact on the Company's financial statements and related footnote disclosures.

**Amendments to Consolidation Analysis.** In February 2015, the FASB issued an accounting standards update to improve consolidation guidance for certain types of legal entities. The guidance modifies the evaluation of whether limited partnerships and similar legal entities are variable interest entities ("VIEs") or voting interest entities, eliminates the presumption that a general partner should consolidate a limited partnership, affects the consolidation analysis of reporting entities that are involved with VIEs, particularly those that have fee arrangements and related party relationships, and provides a scope exception from consolidation guidance for certain money market funds. We adopted this guidance on January 1, 2016 and determined that MEMP was a VIE for which the Company is the primary beneficiary for accounting purposes. The adoption of this guidance did not have a material impact on the Company's consolidated financial statements. On June 1, 2016, we completed the sale of the Disposition Entities to MEMP as discussed in Note 1, which triggered a reconsideration event under the guidance which resulted in the deconsolidation of the Partnership.

Other accounting standards that have been issued by the FASB or other standards-setting bodies are not expected to have a material impact on the Company's financial position, results of operations and cash flows.

### Note 3. Discontinued Operations

As previously discussed in Note 1, we sold the Disposition Entities and their subsidiaries on June 1, 2016 to MEMP. Below is a reconciliation of carrying amounts of major classes of assets and liabilities included as part of discontinued operations as reflected on the balance sheet associated with this disposal transaction (in thousands):

	December 31, 2015
<b>ASSETS</b>	

Current assets:	
Cash and cash equivalents	\$2,175
Accounts receivable	61,404
Short-term derivative instruments	272,320
Prepaid expenses and other current assets	9,642
Total current assets	345,541
Property and equipment, net	1,946,937
Long-term derivative instruments	461,810
Restricted investments	152,631
Other long-term assets	5,053
Total assets	\$2,911,972

#### LIABILITIES AND EQUITY

Current liabilities:	
Accounts payable	\$8,792
Accounts payable - affiliates	193
Revenues payable	27,021
Accrued liabilities	52,923
Short-term derivative instruments	2,850
Total current liabilities	91,779
Long-term debt	2,000,579
Asset retirement obligations	162,989
Long-term derivative instruments	1,441
Deferred tax liabilities	2,094
Total liabilities	\$2,258,882

## MEMORIAL RESOURCE DEVELOPMENT CORP.

## NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Below is a reconciliation of major line items constituting pretax profit (loss) of discontinued operations to the after tax profit (loss) of discontinued operations that are presented in the statement of operations (in thousands):

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2016	2015	2016	2015
<b>Revenues:</b>				
Oil & natural gas sales	\$43,806	\$97,221	\$104,429	\$189,170
Other revenues	186	917	429	1,786
Total revenues	43,992	98,138	104,858	190,956
<b>Costs and expenses:</b>				
Lease operating	19,347	44,888	55,043	85,366
Gathering, processing, and transportation	6,166	9,548	15,375	18,214
Exploration	3	32	125	122
Taxes other than income	2,534	6,058	6,542	12,713
Depreciation, depletion, and amortization	29,954	46,286	74,383	97,552
Impairment of proved oil and natural gas properties	—	—	8,342	251,347
General and administrative (1)	9,092	14,377	22,616	28,888
Accretion of asset retirement obligations	1,828	1,686	4,535	3,320
(Gain) loss on commodity derivative instruments	104,365	61,403	52,620	(84,056 )
(Gain) loss on sale of properties	—	—	(96 )	—
Other, net	—	(943 )	119	(943 )
Total costs and expenses	173,289	183,335	239,604	412,523
Operating income (loss)	(129,297)	(85,197 )	(134,746)	(221,567)
<b>Other income (expense):</b>				
Interest expense, net	(19,142 )	(27,910 )	(51,694 )	(56,728 )
Other, net	26,014	124	26,014	284
Total other income (expense)	6,872	(27,786 )	(25,680 )	(56,444 )
Pretax profit (loss) of discontinued operations	(122,425)	(112,983)	(160,426)	(278,011)
Income tax benefit (expense)	—	(876 )	(96 )	1,494
Net income (loss) from discontinued operations	\$(122,425)	\$(113,859)	\$(160,522)	\$(276,517)

(1) Included \$4.4 million and \$12.2 million, for the three and six months ended June 30, 2016; and \$8.5 million and \$17.0 million for the three and six months ended June 30, 2015 that was allocated to discontinued operations under an omnibus agreement. This omnibus agreement was terminated on June 1, 2016, and we entered into a transition services agreement (“TSA”) with MEMP to manage post-closing separation costs and activities through February 2017. At June 30, 2016, we owed MEMP approximately \$1.9 million under the TSA.

In connection with the sale of the Disposition Entities, we received \$4.2 million from MEMP for the sale of furniture, fixtures, and other property and equipment. We also received an additional \$5.4 million from MEMP related to both

the settlement of a receivable that had been previously eliminated in consolidation and prepaid expenses. We paid MEMP approximately \$1.9 million, which represented a settlement related to corporate office space.

Note 4. Acquisitions and Divestitures

Transaction-related costs, which include costs associated with our proposed Merger with Range, are included in general and administrative expenses in the accompanying statements of operations for the periods indicated below (in thousands):

For the Three		For the Six	
Months		Months	
Ended		Ended	
June 30,		June 30,	
2016	2015	2016	2015
\$6,179	\$126	\$6,209	\$1,407

2016 Acquisitions and Divestitures

There were no material acquisitions during the three and six months ended June 30, 2016. In addition, there were no material divestitures during the three and six months ended June 30, 2016, except for the Disposition Entities and their subsidiaries as discussed in Note 1.

2015 Acquisition and Divestitures

On April 17, 2015, we sold certain oil and natural gas properties to a third party in Colorado and Wyoming for approximately \$13.6 million (the “Rockies Divestiture”) and recorded a gain of less than \$0.1 million related to the sale.

MEMORIAL RESOURCE DEVELOPMENT CORP.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

On June 1, 2015, we entered into an oil and gas lease option agreement with a third party pursuant to which we have the right to obtain one or more oil and gas leases in North Louisiana. The option is exercisable through February 2017. The purchase price of this option was approximately \$4.0 million. The purchase price has been capitalized as part of unproved properties and will be expensed if the option is not exercised.

Note 5. Fair Value Measurements of Financial Instruments

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at a specified measurement date. Fair value estimates are based on either (i) actual market data or (ii) assumptions that other market participants would use in pricing an asset or liability, including estimates of risk. A three-tier hierarchy has been established that classifies fair value amounts recognized or disclosed in the financial statements. The hierarchy considers fair value amounts based on observable inputs (Levels 1 and 2) to be more reliable and predictable than those based primarily on unobservable inputs (Level 3). All of the derivative instruments reflected on the accompanying balance sheets were considered Level 2.

The carrying values of accounts receivables, accounts payables (including accrued liabilities), restricted investments and amounts outstanding under long-term debt agreements with variable rates included in the accompanying balance sheets approximated fair value at June 30, 2016 and December 31, 2015. The fair value estimates are based upon observable market data and are classified within Level 2 of the fair value hierarchy. These assets and liabilities are not presented in the following tables. See Note 8 for the estimated fair value of our outstanding fixed-rate debt.

Assets and Liabilities Measured at Fair Value on a Recurring Basis

The fair market values of the derivative financial instruments reflected on the balance sheets as of June 30, 2016 and December 31, 2015 were based on estimated forward commodity prices (including nonperformance risk) and forward interest rate yield curves. Nonperformance risk is the risk that the obligation related to the derivative instrument will not be fulfilled. Financial assets and liabilities are classified based on the lowest level of input that is significant to the fair value measurement in its entirety. The significance of a particular input to the fair value measurement requires judgment and may affect the valuation of the fair value of assets and liabilities and their placement within the fair value hierarchy levels.

The following table presents the gross derivative assets and liabilities that are measured at fair value on a recurring basis at June 30, 2016 and December 31, 2015 for each of the fair value hierarchy levels:

	Fair Value Measurements at June 30, 2016	
	Using	
	Quoted	
	Prices	Significant
	in Other	Significant
	Observable	Unobservable
	Market	Inputs

Edgar Filing: Memorial Resource Development Corp. - Form 10-Q

	(Level 1)	(Level 2)	(Level 3)	Fair Value
(In thousands)				
<b>Assets:</b>				
Commodity derivatives	\$—	\$ 135,658	\$ —	\$ 135,658
<b>Liabilities:</b>				
Commodity derivatives	\$—	\$ 550	\$ —	\$ 550

	Quoted Prices in Active Markets (Level 1)	Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Fair Value
Fair Value Measurements at December 31, 2015 Using				
Significant Unobservable Inputs				
(In thousands)				
<b>Assets:</b>				
Commodity derivatives	\$—	\$ 319,762	\$ —	\$ 319,762
<b>Liabilities:</b>				
Commodity derivatives	\$—	\$ 480	\$ —	\$ 480

See Note 6 for additional information regarding our derivative instruments.



MEMORIAL RESOURCE DEVELOPMENT CORP.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis

Certain assets and liabilities are reported at fair value on a nonrecurring basis as reflected on the balance sheets. The following methods and assumptions are used to estimate the fair values:

- The fair value of asset retirement obligations (“AROs”) is based on discounted cash flow projections using numerous estimates, assumptions, and judgments regarding factors such as the existence of a legal obligation for an ARO; amounts and timing of settlements; the credit-adjusted risk-free rate; and inflation rates. See Note 7 for a summary of changes in AROs.
- If sufficient market data is not available, the determination of the fair values of proved and unproved properties acquired in transactions accounted for as business combinations are prepared by utilizing estimates of discounted cash flow projections. The factors to determine fair value include, but are not limited to, estimates of: (i) economic reserves; (ii) future operating and development costs; (iii) future commodity prices; and (iv) a market-based weighted average cost of capital. To compensate for the inherent risk of estimating and valuing unproved properties, the discounted future net revenues of probable and possible reserves are reduced by additional risk-weighting factors. The fair value of supporting equipment, such as plant assets, acquired in transactions accounted for as business combinations are commonly estimated using the depreciated replacement cost approach.
- Proved oil and natural gas properties are reviewed for impairment when events and circumstances indicate a possible decline in the recoverability of the carrying value of such properties. The factors used to determine fair value include, but are not limited to, estimates of proved reserves, future commodity prices, the timing of future production and capital expenditures and a discount rate commensurate with the risk reflective of the lives remaining for the respective oil and natural gas properties.

Note 6. Risk Management and Derivative and Other Financial Instruments

Derivative and other financial instruments are utilized to manage exposure to commodity price and interest rate fluctuations and achieve a more predictable cash flow in connection with natural gas and oil sales from production and borrowing related activities. These instruments limit exposure to declines in prices or increases in interest rates, but also limit the benefits that would be realized if prices increase or interest rates decrease.

Certain inherent business risks are associated with commodity and interest derivative contracts and other financial instruments, including market risk and credit risk. Market risk is the risk that the price of natural gas or oil will change, either favorably or unfavorably, in response to changing market conditions. Credit risk is the risk of loss from nonperformance by the counterparty to a contract. It is our policy to enter into derivative contracts, including interest rate swaps, and other financial instruments only with creditworthy counterparties, which generally are financial institutions, deemed by management as competent and competitive market makers. Some of the lenders, or certain of their affiliates, under our credit agreements are counterparties to our derivative contracts. While collateral is generally not required to be posted by counterparties, credit risk associated with derivative and other financial instruments is minimized by limiting exposure to any single counterparty and entering into derivative and other financial instruments only with counterparties that are large financial institutions, which management believes present minimal credit risk. Additionally, master netting agreements are used to mitigate risk of loss due to default with counterparties on derivative or other financial instruments. We have also entered into the International Swaps and Derivatives

Association Master Agreements (“ISDA Agreements”) with each of our counterparties. The terms of the ISDA Agreements provide us and each of our counterparties with rights of set-off upon the occurrence of defined acts of default by either us or our counterparty to a derivative or other financial instrument, whereby the party not in default may set-off all liabilities owed to the defaulting party against all net derivative asset receivables from the defaulting party.

At June 30, 2016, we had net derivative and other financial assets of \$162.4 million. After taking into effect netting arrangements, we had counterparty exposure of \$16.6 million related to derivative and other financial instruments of which all was with a single counterparty. Had all counterparties failed completely to perform according to the terms of their existing contracts, we would have the right to offset \$145.8 million against amounts outstanding under our revolving credit facility at June 30, 2016. See Note 8 for additional information regarding our revolving credit facility.

#### Commodity Derivatives and Other Financial Instruments

We may use a combination of commodity derivatives and other financial instruments (e.g., floating-for-fixed swaps, put options, costless collars and basis swaps) to manage exposure to commodity price volatility. We recognize all derivative instruments at fair value; however, certain of our derivative instruments have a deferred premium. The deferred premium is factored into the fair value measurement and the Company agrees to defer the premium paid or received until the time of settlement. Cash settlements received on settled derivative positions during the six months ended June 30, 2016 is net of deferred premiums of \$10.5 million.

## MEMORIAL RESOURCE DEVELOPMENT CORP.

## NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

During the year ended December 31, 2015, we restructured our existing 2018 crude oil and natural gas hedges for crude oil and NGL swaps that will settle in 2016. Cash settlements of approximately \$92.3 million from the terminated 2018 positions were received and applied as premiums for the new crude oil and NGL swaps. Certain contracts are classified as other financial instruments, which required bifurcation, based on the relationship between the fixed swap price and the market price at the restructure dates. Due to bifurcation, \$27.3 million of the restructured contracts represents other financial assets at June 30, 2016.

We enter into natural gas derivative contracts that are indexed to NYMEX-Henry Hub and regional indices such as TGT Z1 in proximity to our areas of production. We also enter into oil derivative contracts indexed primarily to NYMEX-WTI. Our NGL derivative contracts are primarily indexed to OPIS Mont Belvieu.

At June 30, 2016, we had the following open commodity positions (excluding embedded derivatives):

	Remaining 2016	2017
<b>Natural Gas Derivative Contracts:</b>		
Fixed price swap contracts:		
Average Monthly Volume (MMBtu)	3,120,000	1,770,000
Weighted-average fixed price	\$4.06	\$4.24
Collar contracts:		
Average Monthly Volume (MMBtu)	1,000,000	1,050,000
Weighted-average floor price	\$4.00	\$4.00
Weighted-average ceiling price	\$4.71	\$5.06
Purchased put option contracts:		
Average Monthly Volume (MMBtu)	6,700,000	5,350,000
Weighted-average strike price	\$3.54	\$3.48
Weighted-average deferred premium	\$(0.34 )	\$(0.32 )
TGT Z1 basis swaps:		
Average Monthly Volume (MMBtu)	1,120,000	200,000
Spread - Henry Hub	\$(0.10 )	\$(0.08 )
Crude Oil Derivative Contracts:		
Fixed price swap contracts:		
Average Monthly Volume (Bbls)	32,833	28,000
Weighted-average fixed price	\$83.91	\$84.70
Collar contracts:		
Average Monthly Volume (Bbls)	26,600	—
Weighted-average floor price	\$80.00	\$—
Weighted-average ceiling price	\$99.70	\$—

[REDACTED]  
NGL Derivative Contracts:

Fixed price swap contracts:

Average Monthly Volume (Bbls) 366,758 —

Weighted-average fixed price \$39.93 \$—

## MEMORIAL RESOURCE DEVELOPMENT CORP.

## NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

At June 30, 2016, we had the following open embedded derivative positions:

	Remaining 2016
<b>Oil Hybrid Contracts:</b>	
Fixed price swap contracts:	
Average Monthly Volume (Bbls)	27,211
Weighted-average fixed price	\$ 46.50
Initial net investment price	62.29
Total contract swap price	\$ 108.79
<b>NGL Hybrid Contracts:</b>	
Fixed price swap contracts:	
Average Monthly Volume (Bbls)	111,175
Weighted-average fixed price	\$ 15.77
Initial net investment price	25.61
Total contract swap price	\$ 41.38

## Balance Sheet Presentation

The following table summarizes both: (i) the gross fair value of derivative instruments by the appropriate balance sheet classification even when the derivative instruments are subject to netting arrangements and qualify for net presentation in the balance sheet and (ii) the net recorded fair value as reflected on the balance sheet at June 30, 2016 and December 31, 2015. There was no cash collateral received or pledged associated with our derivative instruments since most of the counterparties, or certain of their affiliates, to our derivative contracts are lenders under our collective credit agreements.

Type	Balance Sheet Location	Asset Derivatives		Liability Derivatives	
		June 30, 2016	December 31, 2015	June 30, 2016	December 31, 2015
(In thousands)					
Commodity contracts	Short-term derivative instruments	\$98,937	\$228,349	\$343	\$ 358
Netting arrangements	Short-term derivative instruments	(343 )	(358 )	(343)	(358 )
Net recorded fair value	Short-term derivative instruments	\$98,594	\$227,991	\$—	\$ —
Commodity contracts	Long-term derivative instruments	\$36,721	\$91,413	\$207	\$ 122
Netting arrangements	Long-term derivative instruments	(207 )	(122 )	(207)	(122 )
Net recorded fair value	Long-term derivative instruments	\$36,514	\$91,291	\$—	\$ —

## (Gains) Losses on Derivatives

All gains and losses, including changes in the derivative instruments' fair values, have been recorded in the accompanying statements of operations since derivative instruments are not designated as hedging instruments for accounting and financial reporting purposes. The following table details the gains and losses related to derivative instruments for the periods indicated (in thousands):

Statements of Operations Location	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2016	2015	2016	2015
Commodity derivative contracts (Gain) loss on commodity derivatives	\$90,617	\$30,463	\$54,175	\$(77,727)

## Note 7. Asset Retirement Obligations

Asset retirement obligations primarily relate to our portion of future plugging and abandonment costs for wells and related facilities. The following table presents the changes in the asset retirement obligations for the six months ended June 30, 2016 (in thousands):

Asset retirement obligations at beginning of period	\$10,079
Liabilities added from acquisitions or drilling	530
Revision of estimates	(125 )
Accretion expense	295
Asset retirement obligations at end of period	\$10,779

## MEMORIAL RESOURCE DEVELOPMENT CORP.

## NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

## Note 8. Long Term Debt

The following table presents our consolidated debt obligations at the dates indicated:

	June 30, 2016	December 31, 2015
	(In thousands)	
\$2.0 billion revolving credit facility, variable-rate, due June 2019	\$514,000	\$423,000
5.875% senior unsecured notes, due July 2022 ("Senior Notes") (1) (2)	600,000	600,000
Unamortized debt issuance costs	(10,098 )	(10,936 )
Total long-term debt	\$1,103,902	\$1,012,064

(1) The estimated fair value of this fixed-rate debt was \$598.5 million and \$525.0 million at June 30, 2016 and December 31, 2015, respectively.

(2) The estimated fair value is based on quoted market prices and is classified as Level 2 within the fair value hierarchy.

On May 31, 2016, we entered into a sixth amendment to our revolving credit facility to, among other things, permit the sale of MEMP GP, Beta Operating and Services to MEMP. Effective June 1, 2016, Beta Operating was automatically released as a guarantor and discharged from any and all obligations under or in connection with our revolving credit facility or other related loan documents. The liens on and security interests in the equity interests owned by us in each of MEMP GP, Beta Operating, and Services, and the mortgaged property owned by Beta Operating were automatically released.

## Senior Notes

Effective June 1, 2016, the guarantor subsidiaries are 100% owned by the Company; the Company has no material assets or operations independent of the guarantor subsidiaries; and there are no significant restrictions upon the ability of the guarantor subsidiaries to distribute funds to the Company. Additionally, our Senior Notes are jointly and severally, fully and unconditional guaranteed (subject to customary release provisions) by the guarantor subsidiaries.

## Borrowing Base

Credit facilities tied to borrowing base are common throughout the oil and gas industry. Our revolving credit facility borrowing base is subject to redetermination, on at least a semi-annual basis, primarily based on estimated proved reserves. The borrowing base for our credit facility was the following at the date indicated (in thousands):

	June 30, 2016
\$2.0 billion revolving credit facility, variable-rate, due June 2019	\$1,000,000

## Weighted-Average Interest Rates

The following table presents the weighted-average interest rates paid on our consolidated variable-rate debt obligations for the periods presented:

Credit Facility	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2016	2015	2016	2015
Revolving credit facility (1)	2.49%	1.70%	2.38%	1.80%

(1) As noted in the 2015 10-K, the Applicable Margin (as defined in our revolving credit facility), or credit spread, varies based on the total commitment usage (which is the ratio of outstanding borrowings and letters of credit to the borrowing base then in effect). The Applicable Margin for the three months and six months ended for June 30, 2016 was 2.00% and 1.90%, respectively. The Applicable Margin for the three months and six months ended June 30, 2015, was 1.50% and 1.57%, respectively.

## Unamortized Deferred Financing Costs

Unamortized deferred financing costs associated with our consolidated debt obligations were as follows at the dates indicated:

	December	
	June 30, 2016	31, 2015
	(In thousands)	
Revolving credit facility	\$4,292	\$ 4,976
Senior Notes	10,098	10,936
Total unamortized deferred financing costs	14,390	15,912



## MEMORIAL RESOURCE DEVELOPMENT CORP.

## NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

## Note 9. Stockholders' Equity and Noncontrolling Interests

## Common Stock

The Company's authorized capital stock includes 600,000,000 shares of common stock, \$0.01 par value per share. The following is a summary of the changes in our common shares issued for the six months ended June 30, 2016:

Balance December 31, 2015	205,293,743
Restricted common shares issued (Note 11)	1,117,606
Restricted common shares repurchased (1)	(363,159 )
Restricted common shares forfeited	(9,877 )
Balance June 30, 2016	206,038,313

(1) Restricted common shares are generally net-settled by shareholders to cover the required withholding tax upon vesting. Participants surrendered shares with value equivalent to the employee's minimum statutory obligation for the applicable income and other employment taxes. Total payments remitted for the employees' tax obligations to the appropriate taxing authorities were approximately \$5.7 million. These net-settlements had the effect of shares repurchased by the Company as they reduced the number of shares that would have otherwise been outstanding as a result of the vesting and did not represent an expense to the Company.

See Note 11 for additional information regarding restricted common shares. Restricted shares of common stock are considered issued and outstanding on the grant date of the restricted stock award.

## Share Repurchase Program

The Company repurchased 2,764,887 shares of common stock under the December 2014 repurchase program for an aggregate price of \$47.8 million through March 16, 2015, which exhausted the December 2014 repurchase program. We have retired all of the shares of common stock repurchased and the shares of common stock are no longer issued or outstanding.

In April 2015, the board of directors ("Board") of the Company authorized the repurchase of up to \$50.0 million of the Company's outstanding common stock from time to time on the open market, through block trades or otherwise. The Company was not obligated to repurchase any dollar amount or specific number of shares of its common stock under the program, which could have been suspended or discontinued at any time. The Company did not repurchase any shares of common stock under the April 2015 repurchase program. The April 2015 repurchase program expired in April 2016.

## Noncontrolling Interests

Noncontrolling interests is the portion of equity ownership in the Company's consolidated subsidiaries not attributable to the Company and primarily consisted of the equity interests held by: (i) the limited partners of MEMP prior to June 1, 2016 (see Note 1) and (ii) a third party investor in the San Pedro Bay Pipeline Company prior to November 3, 2015.

Distributions paid to the limited partners of MEMP primarily represent the quarterly cash distributions paid to MEMP's unitholders. Contributions received from limited partners of MEMP primarily represent net cash proceeds received from common unit offerings. These distributions and contributions are a component of net cash provided by discontinued operations from financing activities as presented on our cash flow statement.

## MEMORIAL RESOURCE DEVELOPMENT CORP.

## NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

## Note 10. Earnings per Share

The following sets forth the calculation of earnings (loss) per share, or EPS, for the periods indicated (in thousands, except per share amounts):

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2016	2015	2016	2015
<b>Numerator:</b>				
Net income (loss) from continuing operations available to common stockholders	\$(195,833)	\$(26,614)	\$(190,116)	\$22,121
Net income (loss) from discontinued operations available to common stockholders	128	88	168	227
<b>Denominator:</b>				
Weighted average common shares outstanding	203,948	189,628	203,807	190,163
Incremental treasury stock method shares (1)	310	364	39	329
Basic EPS from continuing operations	\$(0.96)	\$(0.14)	\$(0.93)	\$0.12
Diluted EPS from continuing operations (1)	\$(0.96)	\$(0.14)	\$(0.93)	\$0.12
Basic EPS from discontinued operations	\$—	\$—	\$—	\$—
Diluted EPS from discontinued operations (1)	\$—	\$—	\$—	\$—

(1) The Company determines the more dilutive of either the two-class method or the treasury stock method for diluted EPS. The two-class method was more dilutive for each period presented. The incremental treasury stock method shares were excluded from the computation of diluted EPS because the inclusion of such shares would have been anti-dilutive.

## Note 11. Long-Term Incentive Plans

The following table summarizes information regarding restricted common share awards granted under the Memorial Resource Development Corp. 2014 Long-Term Incentive Plan ("LTIP") for the periods presented:

Number of Shares	Weighted-Average Grant Date Fair Value per Share
---------------------	--

		(1)	
Restricted common shares outstanding at December 31, 2015	1,668,845	\$	18.89
Granted (2)	1,117,606	\$	13.13
Forfeited	(9,877 )	\$	18.84
Vested	(1,145,885)	\$	18.87
Restricted common shares outstanding at June 30, 2016 (3)	1,630,689	\$	14.96

(1) Determined by dividing the aggregate grant date fair value of awards issued.

(2) The aggregate grant date fair value of restricted common share awards issued in 2016 was \$14.7 million based on a grant date market price ranging from \$13.08 to \$15.58 per share.

(3) Effective immediately prior to the effective time of the Merger, each outstanding share of our unvested restricted common stock will fully vest and any applicable restrictions will lapse and, at the effective time of the Merger, each such share will be treated as a share of our common stock, including with respect to the right to receive 0.375 of a fully vested share of Range Common Stock.

The following table summarizes the amount of recognized compensation expense associated with these awards that are reflected in the accompanying statements of operations for the periods presented (in thousands):

For the Three Months Ended		For the Six Months Ended	
June 30, 2016	2015	June 30, 2016	2015
\$10,521	\$1,957	\$13,673	\$3,443

The unrecognized compensation cost associated with restricted common share awards was \$23.2 million at June 30, 2016. We expect to recognize the unrecognized compensation cost for these awards over a weighted-average period of 2.44 years.

MEMORIAL RESOURCE DEVELOPMENT CORP.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

LTIP Modification. On March 9, 2016, certain employees were impacted by an involuntary termination which, upon the Board’s approval, accelerated the vesting schedule of unvested awards under the LTIP that otherwise would have been forfeited upon a voluntary termination. The acceleration of the LTIP vesting schedule represents an improbable-to-probable modification. The grant-date fair value compensation cost of approximately \$0.5 million was reversed and the modified-date grant fair value compensation cost of \$1.1 million was recognized.

On June 1, 2016, with the completion of the sale of the Disposition Entities and their subsidiaries to MEMP as discussed in Note 1, we accelerated the vesting schedule of unvested awards under the LTIP for the employees that remained with the Disposition Entities and their subsidiaries. The grant-date fair value compensation cost of approximately \$2.5 million was reversed and the modified-date grant fair value compensation cost of \$9.8 million was recognized.

Note 12. Incentive Units

MRD Holdco

MRD Holdco’s governing documents authorize the issuance of 1,000 incentive units, of which 930 incentive units were granted in exchange for cancelled predecessor awards (the “Exchanged Incentive Units”). Subsequent to our initial public offering, MRD Holdco granted the remaining 70 incentive units to certain key employees (the “Subsequent Incentive Units”).

We recognized compensation expense of \$74.3 million and \$52.6 million for the three and six months ended June 30, 2016, respectively, offset by a deemed capital contribution to MRD Holdco. The unrecognized compensation expense of approximately \$6.2 million as of June 30, 2016 will be recognized over the remaining expected service period of 0.25 years.

The fair value of the Exchanged Incentive Units and Subsequent Incentive Units will be remeasured on a quarterly basis until all payments have been made. The settlement obligation rests with MRD Holdco. Accordingly, no payments will ever be made by us related to these incentive units; however, adjustments to non-cash compensation expense will be allocated to us in future periods offset by deemed capital contributions or distributions. As such, these awards are not dilutive to our stockholders.

The fair value of the incentive units was estimated using a Monte Carlo simulation valuation model with the following assumptions:

	Exchanged Incentive Units	Subsequent Incentive Units
Valuation date	6/30/2016	6/30/2016

Dividend yield	0	%	0	%
Expected volatility	55.00	%	55.00	%
Risk-free rate	0.26	%	0.26	%
Expected life (years)	0.25		0.25	

#### Note 13. Related Party Transactions

Amounts due to MRD Holdco and certain affiliates of NGP at June 30, 2016 and December 31, 2015 are presented as “Accounts payable – affiliates” in the accompanying balance sheets.

#### NGP Affiliated Companies

During the three and six months ended June 30, 2016, we paid approximately \$0.5 million and \$3.8 million, respectively, to Cretic Energy Services, LLC, a NGP affiliated company, for services related to our drilling and completion activities.

During the three and six months ended June 30, 2016, we paid approximately \$1.1 million and \$3.5 million, respectively, to Multi-Shot, LLC, a NGP affiliated company, for services related to our drilling and completion activities, of which less than \$0.1 million was attributable to discontinued operations.

During the three months ended June 30, 2016, we also paid a NGP affiliate company approximately \$1.1 million for mineral interests located in North Louisiana.

#### Related Party Agreements

We and certain of our affiliates have entered into various documents and agreements. These agreements have been negotiated among affiliated parties and, consequently, are not the result of arm’s-length negotiations.

#### Registration Rights Agreement and Voting Agreement

A discussion of these agreements is included in our 2015 Form 10-K.

MEMORIAL RESOURCE DEVELOPMENT CORP.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Services Agreement

A discussion of this agreement is included in our 2015 Form 10-K. The services agreement was terminated effective March 1, 2015. During the six months ended June 30, 2015, we recognized approximately \$2.0 million of general and administrative expenses under this agreement.

Midstream Agreements

We have various midstream service agreements with affiliates of PennTex Midstream Partners, LP (“PennTex”), an affiliate of NGP, for the gathering, processing and transportation of natural gas and NGLs. Additionally, we entered into an area of mutual interest and exclusivity agreement (“AMI”) with PennTex pursuant to which PennTex has the exclusive right to provide midstream services to support our current and future production in North Louisiana on our operated acreage within such area (other than production subject to existing third-party commitments). A discussion of these agreements is included in our 2015 Form 10-K.

Pursuant to the gas processing agreement, any deficiency payments made by the Company under this agreement will be treated as prepaid processing fees by PennTex (except for the June 2015 deficiency payment) because we may utilize these deficiency payments as credit for fees owed if we have delivered the total minimum volume commitment under the processing agreement within the initial term of the agreement. We must pay a quarterly deficiency payment based on the firm-commitment fixed fee if the cumulative minimum volume commitment as of the end of such quarter exceeds the sum of (i) the cumulative volumes processed (or credited with respect to plant interruptions) under the processing agreement as of the end of such quarter plus (ii) volumes corresponding to deficiency payments incurred prior to such quarter. During the three and six months ended June 30, 2016, we incurred \$3.2 million and \$6.5 million, respectively, of deficiency payments. As of June 30, 2016, we had \$6.5 million of prepaid processing fees on our balance sheet in the “Other long-term assets” line.

All net costs associated with these agreements are reflected in the statement of operations in the “Gathering, processing, and transportation – affiliate” line.

Classic Pipeline Gas Gathering Agreement & Water Disposal Agreement

A discussion of these agreements is included in our 2015 Form 10-K. The amended gas gathering agreement was terminated in November 2015 in connection with a third party’s acquisition of Classic Pipeline and Gathering, LLC’s (“Classic Pipeline”) Joaquin gathering system. Additionally, Classic Pipeline assigned its salt water disposal system to MEMP in November 2015. For the three and six months ended June 30, 2015, MEMP incurred gathering and salt water disposal fees of approximately \$1.1 million and \$2.0 million, respectively, under these agreements. These fees are a component of net income (loss) from discontinued operations as presented on our statement of operations.

Note 14. Commitments and Contingencies

Litigation & Environmental

As part of our normal business activities, we may be named as defendants in litigation and legal proceedings, including those arising from regulatory and environmental matters. Although we are insured against various risks to the extent we believe it is prudent, there is no assurance that the nature and amount of such insurance will be adequate, in every case, to indemnify us against liabilities arising from future legal proceedings. We are not aware of any litigation, pending or threatened, that we believe is reasonably likely to have a significant adverse effect on our financial position, results of operations or cash flows.



MEMORIAL RESOURCE DEVELOPMENT CORP.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Subsequent event. In July 2016, alleged stockholders (“Plaintiffs”) of the Company, filed two class action lawsuits against us and the members of our board of directors relating to the Merger. These lawsuits are styled (i) Roger Mariani v. Memorial Resource Development Corp., et al., Case No. 4:16-cv-2042, in the United States District Court for the Southern District of Texas, Houston Division; and (ii) Joel Morris v. Memorial Resource Development Corp., et al., Case No. 4:16-cv-02183, in the United States District Court for the Southern District of Texas, Houston Division. The Morris action also names Range and Merger Sub as additional defendants. Plaintiffs allege that the joint proxy statement/prospectus filed in connection with the Merger omits allegedly material information concerning, in general and among other things, (i) the valuation analyses prepared by Barclays Capital Inc. (“Barclays”) and Morgan Stanley & Co. LLC (“Morgan Stanley”) in connection with their fairness opinions regarding the Merger, (ii) the financial projections utilized by Barclays and Morgan Stanley and (iii) the background of the Merger. Based on these allegations, Plaintiffs allege that (i) the defendants have violated Section 14(a) of the Exchange Act and Rule 14a-9 promulgated thereunder and (ii) members of our board of directors have violated Section 20(a) of the Exchange Act. Plaintiffs also allege, in general and among other things, that the terms of the Merger are (i) unfair to our stockholders and (ii) the result of an inadequate process. Based on these allegations, Plaintiffs seek to enjoin us from proceeding with or consummating the Merger. To the extent that the Merger is consummated before injunctive relief is granted, Plaintiffs seek to have the Merger rescinded. Plaintiffs also seek attorneys’ fees. Plaintiffs have not yet served the defendants, and our date to answer, move to dismiss, or otherwise respond to the lawsuit has not yet been set. We cannot predict the outcome of the lawsuits or any others that might be filed, nor can we predict the amount of time and expense that will be required to resolve the lawsuits. We intend to vigorously defend the lawsuits.

There were no environmental reserves recorded on our balance sheet at June 30, 2016 and December 31, 2015 associated with continuing operations.

#### Third Party Midstream Service Agreements (Gathering & Processing)

The Company has an existing amended and restated midstream service agreement with ETC Field Services LLC (formerly known as Regency Field Services LLC) (“ETC”) for the gathering and processing of natural gas in North Louisiana as discussed in our 2015 Form 10-K. ETC is entitled to receive a payback demand fee from us and other third parties equal to 110% of certain infrastructure improvement costs. The payback demand fee is based upon actual volumes gathered, but not less than a specified monthly demand quantity. Until payout is achieved, there is also a monthly demand quantity associated with gathering and processing fees.

We have the right to request that gas gathered by ETC be delivered to alternative delivery points for processing (e.g., PennTex). Under these circumstances, ETC assesses us a \$0.25 per MMBtu gathering only fee to take gas off its system.

#### Firm Gas Transportation Service Agreement

The Company entered into a long-term firm transportation agreement with Regency Intrastate Gas LP (“RIGS”) to assure the delivery of its natural gas to market. This agreement’s primary term terminates on December 31, 2025, subject to one-year extensions at either party’s election. This commitment requires a minimum monthly reservation charge that escalates annually by two percent regardless of whether the contracted capacity is used or not. An overrun charge that also escalates annually by two percent applies to gas received in excess of the contracted capacity. In addition to the demand and overrun fees, RIGS retains 1.25% of gas received for fuel. The following table summarizes the reserved capacity and applicable fees associated with this agreement:

Period	Reserved Capacity (MMBtu/d)	Reservation	
		Demand Charge (\$/MMBtu)	Overrun Charge (\$/MMBtu)
January 1, 2016 to December 31, 2022	300,000	0.075	0.150
January 1, 2023 to December 31, 2025	200,000	0.075	0.150

In the future, additional receipt points may be developed. The following pricing grid, subject to annual escalation, would apply to gas received at any of these future receipt points.

	Reservation		
	Demand Charge (\$/MMBtu)	Commodity Charge (\$/MMBtu)	Overrun Charge (\$/MMBtu)
Total gas receipts $\leq$ contracted reserved capacity	0.075	0.075	n/a
Total gas receipts $>$ contracted reserved capacity	n/a	n/a	0.150

MEMORIAL RESOURCE DEVELOPMENT CORP.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Sales Delivery Commitment

Recently, the Company and a third party entered into a contract whereby the Company agreed to sell and deliver NGLs produced at gas processing plants owned and operated by PennTex. The NGLs are delivered to a pipeline owned by an affiliate of the third party. The initial term of the contract terminates on December 31, 2022, subject to one-year extensions at either party's election. The price we receive is tied to published indices, net of transportation and fractionation deductions. Commencing April 1, 2016, through the end of the initial term of the agreement, the minimum sales volume commitment is 6,000 BPD. If we fail to deliver the minimum sales volume commitment, we will be required to pay a deficiency payment equal to transportation and fractionation deductions on undelivered volumes. Currently, transportation and fractionation deductions are approximately \$4.39 per barrel.

Related Party Agreements

See Note 13 for additional information.

Note 15. Income Taxes

The Company is a corporation subject to federal and state income taxes. The compensation expense associated with the incentive units of MRD Holdco (discussed in Note 12) creates a nondeductible permanent difference for income tax purposes.

The Company's income tax benefit from continuing operations for the three and six months ended June 30, 2016 was \$25.3 million and \$22.4 million, respectively, compared to \$24.6 million of income tax benefit and \$22.9 million of income tax expense for the three and six months ended June 30, 2015, respectively. The Company's effective tax rate from continuing operations for the three and six months ended June 30, 2016 was 11.5% and 10.5%, respectively, compared to 48.1% and 49.0% for the three and six months ended June 30, 2015, respectively. The change in the effective tax rate from 2015 to 2016 was primarily due to a change in non-deductible incentive unit compensation as discussed in Note 12. The effective tax rate for the three and six months ended June 30, 2016 and 2015 differed from the statutory federal income tax rate primarily due to non-deductible incentive unit compensation expense, state income tax, net of federal benefit, and long-term incentive plan compensation expense.

We reported no liability for unrecognized tax benefits as of June 30, 2016 and expect no significant change to the unrecognized tax benefits in the next twelve months.

Consistent with establishing the deferred tax liability through stockholders' equity in our initial public offering, we reversed a deferred tax liability of approximately \$28.0 million through stockholders' equity in 2015 attributable to the deferred tax effects of the Property Swap in 2015.



ITEM MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF  
2. OPERATIONS.

Management's Discussion and Analysis of Financial Condition and Results of Operations should be read in conjunction with the unaudited condensed financial statements and accompanying notes in "Item 1. Financial Statements" contained herein and our 2015 Form 10-K filed with the SEC on February 24, 2016. The following discussion contains forward-looking statements that reflect our future plans, estimates, beliefs and expected performance. The forward-looking statements are dependent upon events, risks and uncertainties that may be outside our control. Our actual results could differ materially from those discussed in these forward-looking statements. See "Cautionary Note Regarding Forward-Looking Statements" in the front of this report.

#### Overview

We are an independent natural gas and oil company focused on the acquisition, exploration and development of natural gas and oil properties with a majority of our activity in the Terryville Complex of North Louisiana, where we are targeting over-pressured, liquids-rich natural gas opportunities in multiple zones in the Cotton Valley formation. We are focused on creating shareholder value primarily through the development of our sizeable horizontal inventory.

As discussed under Note 2 of the Notes to Unaudited Condensed Consolidated Financial Statements included under "Item 1. Financial Statements," the FASB issued an accounting standards update in February 2015 to improve consolidation guidance for certain types of legal entities. The guidance, among other things, modifies the evaluation of whether limited partnerships and similar legal entities are variable interest entities ("VIEs") or voting interest entities and eliminates the presumption that a general partner should consolidate a limited partnership. We adopted this guidance on January 1, 2016 and determined that MEMP was a VIE for which we are the primary beneficiary. On June 1, 2016, we completed the sale of MEMP GP, Beta Operating Company, LLC and MEMP Services LLC (collectively, the "Disposition Entities"), to MEMP for \$0.75 million in cash. This sale was a reconsideration event under the amended consolidation guidance which resulted in the deconsolidation of the Partnership.

Prior to the sale of the Disposition Entities and its subsidiaries we had two reportable segments, one of which was MEMP and its subsidiaries. Effective June 1, 2016, we now have one reportable business segment, which is engaged in the acquisition, exploration and development of oil and natural gas properties. Accordingly, we have retrospectively revised our segment disclosures for all periods presented.

#### Recent Developments

##### Proposed Merger with Range Resource Corporation

On May 15, 2016, the Company entered into an Agreement and Plan of Merger (the "Merger Agreement"), with Range Resources Corporation, a Delaware corporation ("Range") and a direct wholly-owned subsidiary of Range ("Merger Sub"). The Merger Agreement provides that, upon the terms and subject to the conditions set forth, the Merger Sub will be merged with and into the Company, with the Company continuing as the surviving entity and a wholly owned subsidiary of Range (the "Merger"). If the Merger is completed, each share of our common stock outstanding immediately before that time (including outstanding shares of our restricted common stock, all of which will become fully vested and unrestricted under the terms of the Merger Agreement) will automatically be converted into the right to receive 0.375 of a share of Range common stock, par value \$0.01 per share. The Merger is subject to customary closing conditions, including the approval by both Memorial and Range stockholders. We expect the closing of the Merger will occur late in the third quarter of 2016. See Note 1 and Note 14 of the Notes to Unaudited Condensed Consolidated Financial Statements included under "Item 1. Financial Statements" of this quarterly report for additional information regarding the Merger.

Divestiture of MEMP GP and Related Entities

On June 1, 2016, we closed the previously announced divestiture of the Disposition Entities and their subsidiaries to MEMP for \$0.75 million in cash. Our financial statements have been retrospectively revised to reflect the Disposition Entities and their subsidiaries as discontinued operations for all periods presented. See Note 1 of the Notes to Unaudited Condensed Consolidated Financial Statements included under “Item 1. Financial Statements” of this quarterly report for additional information.

Borrowing Base Reaffirmation

In April 2016, the lenders under our revolving credit facility reaffirmed the borrowing base under our revolving credit facility at \$1.0 billion, to remain at such level until the next scheduled redetermination, the next interim redetermination or other adjustment to the borrowing base, whichever occurs first.

## Sources of Revenues

Our revenues are derived from the sale of natural gas and oil production, as well as the sale of NGLs that are extracted from natural gas during processing. Production revenues are derived entirely from the continental United States. Natural gas, NGL and oil prices are inherently volatile and are influenced by many factors outside our control. In order to reduce the impact of fluctuations in natural gas and oil prices on revenues, or to protect the economics of property acquisitions, we intend to periodically enter into derivative contracts with respect to a significant portion of estimated natural gas and oil production through various transactions that fix the future prices received. At the end of each period the fair value of these commodity derivative instruments are estimated and, because hedge accounting is not elected, the changes in the fair value of unsettled commodity derivative instruments are recognized in earnings at the end of each accounting period.

## Principal Components of Cost Structure

- Lease operating expenses. These are the day to day costs incurred to maintain production of our natural gas, NGLs and oil. Such costs include utilities, direct labor, water injection and disposal, materials and supplies, compression, repairs and workover expenses. Cost levels for these expenses can vary based on supply and demand for oilfield services.
- Gathering, processing and transportation. These are costs incurred to deliver production of our natural gas, NGLs and oil to the market. Cost levels of these expenses can vary based on the volume of natural gas, NGLs and oil production as well as the cost of commodity processing.
- Taxes other than income. These consist of severance, ad valorem taxes, and franchise taxes. Production taxes are paid on produced natural gas, NGLs and oil based on a percentage of market prices and at fixed per unit rates established by state or local taxing authorities. The Company takes full advantage of all credits and exemptions in the various taxing jurisdictions where we operate. Ad valorem taxes are generally tied to the valuation of the oil and natural properties. Franchise taxes are privilege taxes levied by states that are imposed on companies, including limited liability companies and partnerships, which gives the businesses the right to be chartered or operate within that state.
- Exploration expense. These are geological and geophysical costs and include seismic costs, costs of unsuccessful exploratory dry holes, delay rentals and unsuccessful leasing efforts.
  - Impairment of proved properties. Proved properties are impaired whenever the carrying value of the properties exceed their estimated undiscounted future cash flows.
- Depreciation, depletion and amortization. Depreciation, depletion and amortization, or DD&A, includes the systematic expensing of the capitalized costs incurred to acquire, exploit and develop natural gas and oil properties. As a “successful efforts” company, all costs associated with acquisition and development efforts and all successful exploration efforts are capitalized, and these costs are depleted using the units of production method.
- Incentive unit compensation expense. For more information regarding compensation expense recognized associated with incentive units, see Note 12 of the Notes to Unaudited Condensed Consolidated Financial Statements included under “Item 1. Financial Statements” of this quarterly report.
- General and administrative expense. These costs include overhead, including payroll and benefits for employees, costs of maintaining headquarters, costs of managing production and development operations, compensation expense associated with certain long-term incentive-based plans, audit and other professional fees, and legal compliance expenses.
- Interest expense. The Company finances a portion of its working capital requirements and acquisitions with borrowings under its revolving credit facility and senior note issuances. As a result, we incur substantial interest expense that is affected by both fluctuations in interest rates and financing decisions. We expect to continue to incur significant interest expense in future periods.
- Income tax expense. We are a corporation subject to federal and state income taxes.

## Critical Accounting Policies and Estimates

Significant estimates include, but are not limited to, oil and natural gas reserves; depreciation, depletion, and amortization of proved oil and natural gas properties; future cash flows from oil and natural gas properties; impairment of long-lived assets; realization of long-term prepaid processing fees; fair value of derivatives; fair value of equity compensation; fair value of incentive unit compensation; fair values of assets acquired and liabilities assumed in business combinations and asset retirement obligations. These estimates, in our opinion, are subjective in nature, require the exercise of professional judgment and involve complex analysis.

When used in the preparation of our consolidated financial statements, such estimates are based on our current knowledge and understanding of the underlying facts and circumstances and may be revised as a result of actions we take in the future. Changes in these estimates will occur as a result of the passage of time and the occurrence of future events. Subsequent changes in these estimates may have a significant impact on our consolidated financial position, results of operations and cash flows.



A discussion of our critical accounting policies and estimates is included in our 2015 Form 10-K. There have been no significant changes to our critical accounting policies and estimates except for the realization of long-term prepaid processing fees. Pursuant to a gas processing agreement with a related party, any deficiency payments made by the Company under this agreement will be treated as prepaid processing fees by our related party because we may utilize these deficiency payments as credit for fees owed if we have delivered the total minimum volume commitment under the processing agreement within the initial term of the agreement. We must pay a quarterly deficiency payment based on the firm-commitment fixed fee if the cumulative minimum volume commitment as of the end of such quarter exceeds the sum of (i) the cumulative volumes processed (or credited with respect to plant interruptions) under the processing agreement as of the end of such quarter plus (ii) volumes corresponding to deficiency payments incurred prior to such quarter. During the three and six months ended June 30, 2016, we incurred \$3.2 million and \$6.5 million, respectively, of deficiency payments. As of June 30, 2016, we had \$6.5 million of prepaid processing fees on our balance sheet in the "Other long-term assets" line. We expect to make periodic deficiency payments from time-to-time. On a quarterly basis we will make an assessment on whether the long-term asset is recoverable. See Note 13 of the Notes to Unaudited Condensed Consolidated Financial Statements included under "Item 1. Financial Statements" of this quarterly report for additional information.

## Results of Operations

Our results of operations for the three and six months ended June 30, 2016 and 2015 presented below have been derived from our consolidated financial statements.

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2016	2015	2016	2015
	(in thousands)			
Oil & natural gas sales	\$98,986	\$78,605	\$180,064	\$165,628
Lease operating	8,189	3,854	14,903	9,076
Gathering, processing, and transportation (including affiliate)	36,809	18,102	72,937	32,865
Taxes other than income	2,991	3,140	5,855	5,915
Depreciation, depletion, and amortization	65,558	35,827	125,357	76,359
Incentive unit compensation expense (benefit)	74,329	16,116	52,569	26,340
General and administrative	24,021	10,323	35,154	23,299
(Gain) loss on commodity derivative and other financial instruments	90,617	30,463	54,175	(77,727)
Interest expense, net	(12,767)	(9,613)	(24,124)	(19,369)
Income tax benefit (expense) from continuing operations	25,342	24,644	22,405	(22,914)
Net income (loss) from continuing operations	(195,833)	(26,614)	(190,116)	23,895
Net income (loss) from discontinued operations	(122,425)	(113,859)	(160,522)	(276,517)
Net income (loss) attributable to Memorial Resource Development Corp.	(195,961)	(26,702)	(190,284)	22,044
Natural gas and oil revenue:				
Oil sales	\$14,855	\$16,752	\$25,750	\$30,145
NGL sales	22,729	14,042	38,123	25,496

Edgar Filing: Memorial Resource Development Corp. - Form 10-Q

Natural gas sales	61,402	47,811	116,191	109,987
Total natural gas and oil revenue	\$98,986	\$78,605	\$180,064	\$165,628

Production Volumes:

Oil (MBbls)	353	315	715	598
NGLs (MBbls)	1,250	669	2,612	1,172
Natural gas (MMcf)	31,377	18,469	59,227	