HALCON RESOURCES CORP
Form 10-Q
May 06, 2015

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# UNITED STATES
# SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C. 20549**

# FORM 10-Q

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

**For the quarterly period ended March 31, 2015**

**OR**

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

**For the transition period from to**
**Commission File Number: 001-35467**

# Halcón Resources Corporation

(Exact name of registrant as specified in its charter)

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

**1000 Louisiana Street, Suite 6700, Houston, TX 77002**
(Address of principal executive offices)

**(832) 538-0300**
(Registrant's telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

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

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

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

| | | | |
|---|---|---|---|
| Large Accelerated Filer ý | Accelerated Filer o | Non-Accelerated Filer o<br>(Do not check if a smaller reporting company) | Smaller Reporting Company o |

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

At May 1, 2015, 570,675,110 shares of the Registrant's Common Stock were outstanding.

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**Special note regarding forward-looking statements**

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of the federal securities laws. All statements, other than statements of historical facts, concerning, among other things, planned capital expenditures, potential increases in oil and natural gas production, the number and location of wells to be drilled in the future, future cash flows and borrowings, pursuit of potential acquisition or divestiture opportunities, our financial position, business strategy and other plans and objectives for future operations, are forward-looking statements. These forward-looking statements are identified by their use of terms and phrases such as "may," "expect," "estimate," "project," "plan," "objective," "believe," "predict," "intend," "achievable," "anticipate," "will," "continue," "potential," "should," "could" and similar terms and phrases. Although we believe that the expectations reflected in these forward-looking statements are reasonable, they do involve certain assumptions, risks and uncertainties. Actual results could differ materially from those anticipated in these forward-looking statements. Readers should consider carefully the risks described under the "Risk Factors" section of our previously filed Annual Report on Form 10-K for the fiscal year ended December 31, 2014 and the other disclosures contained herein and therein, which describe factors that could cause our actual results to differ from those anticipated in the forward-looking statements, including, but not limited to, the following factors:

- volatility in commodity prices for oil and natural gas, including continued declines in the price for oil;
- our ability to generate sufficient cash flow from operations and to borrow or access other sources of capital to enable us to fund our operations, satisfy our obligations and fully develop our undeveloped acreage positions;
- we have substantial indebtedness and may incur more debt;
- higher levels of indebtedness make us more vulnerable to economic downturns and adverse developments in our business;
- our ability to replace our oil and natural gas reserves;
- our ability to successfully integrate acquired oil and natural gas businesses and operations;
- the possibility that acquisitions and divestitures may involve unexpected costs or delays, and that acquisitions may not achieve intended benefits and may divert management's time and energy;
- our ability to successfully develop our large inventory of undeveloped acreage in our resource plays;
- access to and availability of water and other treatment materials to carry out fracture stimulations in our resource plays;
- access to adequate gathering systems, processing facilities, transportation take-away capacity to move our production to market and marketing outlets to sell our production at market prices;
- the presence or recoverability of estimated oil and natural gas reserves and the actual future production rates and associated costs;
- contractual limitations that affect our management's discretion in managing our business, including covenants that, among other things, limit our ability to incur debt, make investments and pay cash dividends;

the potential for production decline rates for our wells to be greater than we expect;

our ability to retain key members of senior management, board members, and key technical employees;

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

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

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**PART I. FINANCIAL INFORMATION**

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

**HALCÓN RESOURCES CORPORATION**

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

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

| | Three Months Ended March 31, 2015 | Three Months Ended March 31, 2014 |
|---|---|---|
| **Operating revenues:** | | |
| Oil, natural gas and natural gas liquids sales: | | |
| Oil | $ 124,413 | $ 256,029 |
| Natural gas | 6,959 | 9,409 |
| Natural gas liquids | 4,068 | 8,759 |
| Total oil, natural gas and natural gas liquids sales | 135,440 | 274,197 |
| Other | 754 | 952 |
| Total operating revenues | 136,194 | 275,149 |
| **Operating expenses:** | | |
| Production: | | |
| Lease operating | 33,785 | 36,638 |
| Workover and other | 3,114 | 2,789 |
| Taxes other than income | 12,241 | 24,160 |
| Gathering and other | 13,746 | 5,073 |
| Restructuring | 1,921 | 987 |
| General and administrative | 24,409 | 32,798 |
| Depletion, depreciation and accretion | 119,144 | 119,908 |
| Full cost ceiling impairment | 554,003 | 61,165 |
| Total operating expenses | 762,363 | 283,518 |
| **Income (loss) from operations** | (626,169) | (8,369) |
| **Other income (expenses):** | | |
| Net gain (loss) on derivative contracts | 99,748 | (33,656) |
| Interest expense and other, net | (61,307) | (30,939) |
| Total other income (expenses) | 38,441 | (64,595) |
| Income (loss) before income taxes | (587,728) | (72,964) |
| Income tax benefit (provision) | 87 | |
| **Net income (loss)** | (587,641) | (72,964) |
| Series A preferred dividends | (4,901) | (4,959) |
| Preferred dividends and accretion on redeemable noncontrolling interest | (8,651) | |
| **Net income (loss) available to common stockholders** | $ (601,193) | $ (77,923) |

| | | |
|---|---|---|
| **Net income (loss) per share of common stock:** | | |
| Basic | $ (1.43) | $ (0.19) |
| Diluted | $ (1.43) | $ (0.19) |
| **Weighted average common shares outstanding:** | | |
| Basic | 419,684 | 413,521 |
| Diluted | 419,684 | 413,521 |

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

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**HALCÓN RESOURCES CORPORATION**

**CONDENSED CONSOLIDATED BALANCE SHEETS (Unaudited)**

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

| | March 31, 2015 | December 31, 2014 |
|---|---|---|
| **Current assets:** | | |
| Cash | $ 18,611 | $ 43,713 |
| Accounts receivable | 219,790 | 276,559 |
| Receivables from derivative contracts | 351,785 | 352,530 |
| Restricted cash | 16,322 | 16,131 |
| Inventory | 4,379 | 4,693 |
| Prepaids and other | 10,235 | 9,079 |
| Total current assets | 621,122 | 702,705 |
| **Oil and natural gas properties (full cost method):** | | |
| Evaluated | 6,526,440 | 6,390,820 |
| Unevaluated | 1,838,093 | 1,829,786 |
| Gross oil and natural gas properties | 8,364,533 | 8,220,606 |
| Less accumulated depletion | (3,623,652) | (2,953,038) |
| Net oil and natural gas properties | 4,740,881 | 5,267,568 |
| **Other operating property and equipment:** | | |
| Gas gathering and other operating assets | 129,116 | 126,804 |
| Less accumulated depreciation | (16,779) | (14,798) |
| Net other operating property and equipment | 112,337 | 112,006 |
| **Other noncurrent assets:** | | |
| Receivables from derivative contracts | 135,428 | 151,324 |
| Debt issuance costs, net | 53,659 | 55,904 |
| Deferred income taxes | 136,627 | 136,826 |
| Equity in oil and natural gas partnership | 4,315 | 4,309 |
| Funds in escrow and other | 2,094 | 3,833 |
| **Total assets** | $ 5,806,463 | $ 6,434,475 |

| | | |
|---|---|---|
| **Current liabilities:** | | |
| Accounts payable and accrued liabilities | $ 415,378 | $ 607,750 |
| Asset retirement obligations | 142 | 106 |
| Current portion of deferred income taxes | 136,627 | 136,826 |
| Total current liabilities | 552,147 | 744,682 |
| **Long-term debt** | 3,892,321 | 3,746,736 |
| **Other noncurrent liabilities:** | | |
| Liabilities from derivative contracts | 747 | 9,387 |
| Asset retirement obligations | 39,895 | 38,371 |
| Other | 5,755 | 5,964 |
| **Commitments and contingencies (Note 8)** | | |
| **Mezzanine equity:** | | |

| | | | | |
|---|---|---|---|---|
| Redeemable noncontrolling interest | | 125,817 | | 117,166 |
| **Stockholders' equity:** | | | | |
| Preferred stock: 1,000,000 shares of $0.0001 par value authorized; 340,960 and 345,000 shares of 5.75% Cumulative Perpetual Convertible Series A, issued and outstanding at March 31, 2015 and December 31, 2014, respectively | | | | |
| Common stock: 1,340,000,000 shares of $0.0001 par value authorized; 436,192,820 and 427,808,306 shares issued and outstanding at March 31, 2015 and December 31, 2014, respectively | | 42 | | 42 |
| Additional paid-in capital | | 3,014,207 | | 2,995,402 |
| Accumulated deficit | | (1,824,468) | | (1,223,275) |
| Total stockholders' equity | | 1,189,781 | | 1,772,169 |
| **Total liabilities and stockholders' equity** | $ | 5,806,463 | $ | 6,434,475 |

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

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**HALCÓN RESOURCES CORPORATION**

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

**(In thousands)**

| | Preferred Stock | | Common Stock | | Additional Paid-In Capital | Accumulated Deficit | Stockholders' Equity |
|---|---|---|---|---|---|---|---|
| | Shares | Amount | Shares | Amount | | | |
| **Balances at December 31, 2013** | 345 | $ | 415,730 | $ 41 | $ 2,953,786 | $ (1,506,217) | $ 1,447,610 |
| Net income (loss) | | | | | | 315,956 | 315,956 |
| Dividends on Series A preferred stock | | | 3,262 | | 14,878 | (19,838) | (4,960) |
| Preferred dividends on redeemable noncontrolling interest | | | | | | (6,543) | (6,543) |
| Accretion of redeemable noncontrolling interest | | | | | | (6,633) | (6,633) |
| Offering costs | | | | | 39 | | 39 |
| Long-term incentive plan grants | | | 9,388 | 1 | (1) | | |
| Long-term incentive plan forfeitures | | | (455) | | | | |
| Reduction in shares to cover individuals' tax withholding | | | (117) | | (453) | | (453) |
| Share-based compensation | | | | | 27,153 | | 27,153 |
| **Balances at December 31, 2014** | 345 | | 427,808 | 42 | 2,995,402 | (1,223,275) | 1,772,169 |
| Net income (loss) | | | | | | (587,641) | (587,641) |
| Dividends on Series A preferred stock | | | 2,528 | | 4,901 | (4,901) | |
| Conversion of Series A preferred stock | (4) | | 656 | | | | |
| Preferred dividends on redeemable noncontrolling interest | | | | | | (3,019) | (3,019) |
| Accretion of redeemable noncontrolling interest | | | | | | (5,632) | (5,632) |
| Common stock issuance | | | 4,979 | | 8,201 | | 8,201 |
| Offering costs | | | | | (168) | | (168) |
| Long-term incentive plan grants | | | 1,373 | | | | |
| Long-term incentive plan forfeitures | | | (756) | | | | |
| Reduction in shares to cover individuals' tax withholding | | | (395) | | (762) | | (762) |
| Share-based compensation | | | | | 6,633 | | 6,633 |
| **Balances at March 31, 2015** | 341 | $ | 436,193 | $ 42 | $ 3,014,207 | $ (1,824,468) | $ 1,189,781 |

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

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**HALCÓN RESOURCES CORPORATION**

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

**(In thousands)**

| | Three Months Ended March 31, 2015 | Three Months Ended March 31, 2014 |
|---|---|---|
| **Cash flows from operating activities:** | | |
| Net income (loss) | $ (587,641) | $ (72,964) |
| Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities: | | |
| Depletion, depreciation and accretion | 119,144 | 119,908 |
| Full cost ceiling impairment | 554,003 | 61,165 |
| Share-based compensation, net | 4,772 | 4,332 |
| Unrealized loss (gain) on derivative contracts | 8,001 | 26,021 |
| Amortization and write-off of deferred loan costs | 1,559 | 842 |
| Non-cash interest and amortization of discount and premium | 1,107 | 554 |
| Accrued settlements on derivative contracts | (37,592) | |
| Other income (expense) | 2,541 | 354 |
| Change in assets and liabilities, net of acquisitions: | | |
| Accounts receivable | 56,276 | 12,062 |
| Inventory | 314 | 280 |
| Prepaids and other | (1,156) | 4,662 |
| Accounts payable and accrued liabilities | (27,393) | 2,284 |
| Net cash provided by (used in) operating activities | 93,935 | 159,500 |
| **Cash flows from investing activities:** | | |
| Oil and natural gas capital expenditures | (264,626) | (432,783) |
| Proceeds received from sale of oil and natural gas assets | 964 | 1,533 |
| Advance on carried interest | | (62,500) |
| Other operating property and equipment capital expenditures | (4,345) | (16,036) |
| Funds held in escrow and other | (5) | 288 |
| Net cash provided by (used in) investing activities | (268,012) | (509,498) |
| **Cash flows from financing activities:** | | |
| Proceeds from borrowings | 361,000 | 614,000 |
| Repayments of borrowings | (217,000) | (266,000) |
| Debt issuance costs | | (126) |
| Common stock issued | 6,019 | |
| Restricted cash | (191) | |
| Offering costs and other | (853) | (344) |
| Net cash provided by (used in) financing activities | 148,975 | 347,530 |
| **Net increase (decrease) in cash** | (25,102) | (2,468) |
| Cash at beginning of period | 43,713 | 2,834 |
| Cash at end of period | $ 18,611 | $ 366 |

| | | |
|---|---|---|
| **Disclosure of non-cash investing and financing activities:** | | |
| Accrued capitalized interest | $ (8,270) | $ (4,763) |
| Asset retirement obligations | 1,120 | (730) |
| Series A preferred dividends paid in common stock | 4,901 | 4,959 |
| Accretion of redeemable noncontrolling interest | 5,632 | |
| Preferred dividends on redeemable noncontrolling interest paid-in-kind | 3,019 | |
| Common stock issued | 2,182 | |
| Offering costs | (78) | |

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

**HALCÓN RESOURCES CORPORATION**

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

## 1. FINANCIAL STATEMENT PRESENTATION

### Basis of Presentation and Principles of Consolidation

Halcón Resources Corporation (Halcón or the Company) is an independent energy company focused on the acquisition, production, exploration and development of onshore liquids-rich assets in the United States. The unaudited condensed consolidated financial statements include the accounts of all majority-owned, controlled subsidiaries and an equity method investment. The Company operates in one segment which focuses on oil and natural gas acquisition, production, exploration and development. The Company's oil and natural gas properties are managed as a whole rather than through discrete operating areas. Operational information is tracked by operating area; however, financial performance is assessed as a whole. Allocation of capital is made across the Company's entire portfolio without regard to operating area. All intercompany accounts and transactions have been eliminated. These unaudited condensed consolidated financial statements reflect, in the opinion of the Company's management, all adjustments, consisting of normal and recurring adjustments, necessary to present fairly the financial position as of, and the results of operations for, the periods presented. During interim periods, Halcón follows the accounting policies disclosed in its 2014 Annual Report on Form 10-K, as filed with the United States Securities and Exchange Commission (SEC) on February 26, 2015. Please refer to the notes in the 2014 Annual Report on Form 10-K when reviewing interim financial results.

### Use of Estimates

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

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

### Accounts Receivable and Allowance for Doubtful Accounts

The Company's accounts receivable are primarily receivables from joint interest owners and oil and natural gas purchasers. Accounts receivable are recorded at the amount due, less an allowance for

**HALCÓN RESOURCES CORPORATION**

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

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

doubtful accounts, when applicable. The Company establishes provisions for losses on accounts receivable if it determines that collection of all or part of the outstanding balance is doubtful. The Company regularly reviews collectability and establishes or adjusts the allowance for doubtful accounts as necessary using the specific identification method. There were no material allowances for doubtful accounts as of March 31, 2015 or December 31, 2014.

**Other Operating Property and Equipment**

Gas gathering systems and equipment are recorded at cost. Depreciation is calculated using the straight-line method over a 30-year or 10-year estimated useful life applicable to gas gathering systems and a compressed natural gas facility, respectively. Upon disposition, the cost and accumulated depreciation are removed and any gains or losses are reflected in current operations. Maintenance and repair costs are charged to operating expense as incurred. Material expenditures which increase the life or productive capacity of an asset are capitalized and depreciated over the estimated remaining useful life of the asset. The Company capitalized $84.3 million and $83.1 million as of March 31, 2015 and December 31, 2014, respectively, related to the construction of its gas gathering systems, after any amounts impaired.

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

The Company reviews its gas gathering systems and equipment and other operating assets for impairment in accordance with ASC 360, *Property, Plant, and Equipment* (ASC 360). ASC 360 requires the Company to evaluate gas gathering systems and equipment and other operating assets for impairment as events occur or circumstances change that would more likely than not reduce the fair value below the carrying amount. If the carrying amount is not recoverable from an asset's undiscounted cash flows, then the Company recognizes an impairment loss for the difference between the carrying amount and the current fair value. The Company also evaluates the remaining useful lives of its gas gathering systems and other operating assets at each reporting period to determine whether events and circumstances warrant a revision to the remaining depreciation periods.

**Recently Issued Accounting Pronouncements**

In April 2015, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2015-05, *Intangibles-Goodwill and Other-Internal-Use Software* (ASU 2015-05). ASU 2015-05 provides guidance to customers about whether a cloud computing arrangement includes a software license. If a cloud computing arrangement includes a software license, then the customer should account for the software license element of the arrangement consistent with the acquisition of other software licenses. If a cloud computing arrangement does not include a software license, the customer should account for the arrangement as a service contract. For public business entities, the guidance is effective for annual periods, including interim periods within those annual periods,

**HALCÓN RESOURCES CORPORATION**

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

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

beginning after December 15, 2015. Early adoption is permitted. The Company is in the process of assessing the effects of the application of the new guidance.

In April 2015, the FASB issued ASU No. 2015-03, *Simplifying the Presentation of Debt Issuance Costs* (ASU 2015-03). To simplify presentation of debt issuance costs, ASU 2015-03 requires that debt issuance costs be presented in the balance sheet as a direct deduction from the carrying amount of the debt liability, consistent with debt discounts. ASU 2015-03 is effective for public entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. Early adoption is permitted. The Company is in the process of assessing the effects of the application of the new guidance.

In February 2015, the FASB issued ASU No. 2015-02, *Amendments to the Consolidation Analysis* (ASU 2015-02). The amendments in ASU 2015-02 eliminate the previous presumption that a general partner controls a limited partner. ASU 2015-02 may impact the Company's accounting for its general partner interest in SBE Partners LP (SBE Partners), which is currently accounted for as an equity method investment. ASU 2015-02 is effective for public entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. Early adoption is permitted. The Company is currently assessing the impact of ASU 2015-02 on its accounting for its general partner interest in SBE Partners.

In August 2014, the FASB issued ASU No. 2014-15, *Presentation of Financial Statements Going Concern* (ASU 2014-15). ASU 2014-15 is effective for annual reporting periods (including interim periods within those periods) ending after December 15, 2016. Early application is permitted. The amendments in ASU 2014-15 create a new ASC Sub-topic 205-40, *Presentation of Financial Statements Going Concern* and require management to assess for each annual and interim reporting period if conditions exist that raise substantial doubt about an entity's ability to continue as a going concern. The rule requires various disclosures depending on the facts and circumstances surrounding an entity's ability to continue as a going concern. The Company is in the process of assessing the effects of the application of the new guidance.

In May 2014, the FASB issued ASU No. 2014-09, *Revenue from Contracts with Customers* (ASU 2014-09). ASU 2014-09 states that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The standard provides five steps an entity should apply in determining its revenue recognition. ASU 2014-09 must be applied retrospectively and is effective for annual reporting periods, and interim periods with that reporting period, beginning after December 15, 2016. Early adoption is not permitted. The Company is currently assessing the impact of the adoption of ASU 2014-09 on the Company's operating results, financial position and disclosures.

**2. ACQUISITIONS AND DIVESTITURES**

***Divestiture***

**East Texas Assets**

On May 9, 2014, the Company completed the divestiture of certain non-core assets in East Texas (the East Texas Assets) to a privately-owned company for a total purchase price of $424.5 million after closing adjustments for operating expenses, capital expenditures and revenues between the effective

**HALCÓN RESOURCES CORPORATION**

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

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

date and the closing date, title and environmental defects, and other purchase price adjustments customary in oil and gas purchase and sale agreements. The effective date of the transaction was April 1, 2014. Proceeds from the sale were recorded as a reduction to the carrying value of the Company's full cost pool with no gain or loss recorded.

**3. OIL AND NATURAL GAS PROPERTIES**

The Company uses the full cost method of accounting for its investment in oil and natural gas properties. Under this method of accounting, all costs of acquisition, exploration and development of oil and natural gas reserves (including such costs as leasehold acquisition costs, geological expenditures, dry hole costs, tangible and intangible development costs and direct internal costs) are capitalized as the cost of oil and natural gas properties when incurred. To the extent capitalized costs of evaluated oil and natural gas properties, net of accumulated depletion, exceed the discounted future net revenues of proved oil and natural gas reserves, net of deferred taxes, such excess capitalized costs are charged to expense.

The Company assesses all properties classified as unevaluated property on a quarterly basis for possible impairment or reduction in value. The Company assesses properties on an individual basis or as a group, if properties are individually insignificant. The assessment includes consideration of the following factors, among others: intent to drill; remaining lease term; geological and geophysical evaluations; drilling results and activity; the assignment of proved reserves; and the economic viability of development if proved reserves are assigned. During any period in which these factors indicate impairment, the cumulative drilling costs incurred to date for such property and all or a portion of the associated leasehold costs are transferred to the full cost pool and are then subject to depletion and the full cost ceiling test limitation.

Investments in unevaluated oil and natural gas properties and exploration and development projects for which depletion expense is not currently recognized, and for which exploration or development activities are in progress, qualify for interest capitalization. The capitalized interest is determined by multiplying the Company's weighted-average borrowing cost on debt by the average amount of qualifying costs incurred that are excluded from the full cost pool; however, the amount of capitalized interest cannot exceed the amount of gross interest expense incurred in any given period. The capitalized interest amounts are recorded as additions to unevaluated oil and natural gas properties on the unaudited condensed consolidated balance sheets. As the costs excluded are transferred to the full cost pool, the associated capitalized interest is also transferred to the full cost pool. For the three months ended March 31, 2015 and 2014, the Company capitalized interest costs of $24.6 million and $46.6 million, respectively.

At March 31, 2015, the ceiling test value of the Company's reserves was calculated based on the first-day-of-the-month average for the 12-months ended March 31, 2015 of the West Texas Intermediate (WTI) spot price of $82.71 per barrel, adjusted by lease or field for quality, transportation fees, and regional price differentials, and the first-day-of-the-month average for the 12-months ended March 31, 2015 of the Henry Hub price of $3.88 per million British thermal units (MMBtu), adjusted by lease or field for energy content, transportation fees, and regional price differentials. Using these prices, the Company's net book value of oil and natural gas properties at March 31, 2015 exceeded the ceiling amount by $554.0 million ($348.8 million after taxes) which resulted in a ceiling test impairment of that amount for the quarter. The ceiling test impairment was driven by a 13% decrease in the first-day-of-

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**HALCÓN RESOURCES CORPORATION**

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

**3. OIL AND NATURAL GAS PROPERTIES (Continued)**

the-month average prices for crude oil used in the ceiling test calculation, which were $94.99 and $82.71 per barrel at December 31, 2014 and March 31, 2015, respectively.

At March 31, 2014, the ceiling test value of the Company's reserves was calculated based on the first-day-of-the-month average for the 12-months ended March 31, 2014 of the WTI spot price of $98.46 per barrel, adjusted by lease or field for quality, transportation fees, and regional price differentials, and the first-day-of-the-month average for the 12-months ended March 31, 2014 of the Henry Hub price of $3.99 per MMBtu, adjusted by lease or field for energy content, transportation fees, and regional price differentials. Using these prices, the Company's net book value of oil and natural gas properties at March 31, 2014 exceeded the ceiling amount by $61.2 million ($39.0 million after taxes) which resulted in a ceiling test impairment of that amount for the quarter.

The Company recorded the full cost ceiling test impairments in *"Full cost ceiling impairment"* in the Company's unaudited condensed consolidated statements of operations and in *"Accumulated depletion"* in the Company's unaudited condensed consolidated balance sheets. Changes in commodity prices, production rates, levels of reserves, future development costs, transfers of unevaluated properties, and other factors will determine the Company's ceiling test calculations and impairment analyses in future periods.

**4. LONG-TERM DEBT**

Long-term debt as of March 31, 2015 and December 31, 2014 consisted of the following:

| | March 31, 2015 | December 31, 2014 |
|---|---|---|
| | (In thousands) | |
| Senior revolving credit facility | $ 701,000 | $ 557,000 |
| 9.25% senior notes due 2022 | 400,000 | 400,000 |
| 8.875% senior notes due 2021[(1)] | 1,369,422 | 1,370,032 |
| 9.75% senior notes due 2020[(2)] | 1,151,750 | 1,151,821 |
| 8.0% convertible note due 2017[(3)] | 270,149 | 267,883 |
| | $ 3,892,321 | $ 3,746,736 |

(1) *Amounts are net of a $4.5 million and a $4.6 million unamortized discount at March 31, 2015 and December 31, 2014, respectively, related to the issuance of the original 2021 Notes. The unamortized premium related to the additional 2021 Notes was approximately $23.9 million and $24.6 million at March 31, 2015 and December 31, 2014, respectively. See "8.875% Senior Notes" below for more details.*

(2) *Amounts are net of a $7.6 million and a $7.9 million unamortized discount at March 31, 2015 and December 31, 2014, respectively, related to the issuance of the original 2020 Notes. The unamortized premium related to the additional 2020 Notes was approximately $9.3 million and $9.7 million at March 31, 2015 and December 31, 2014, respectively. See "9.75% Senior Notes" below for more details.*

(3) *Amount is net of a $19.5 million and a $21.8 million unamortized discount at March 31, 2015 and December 31, 2014, respectively. See "8.0% Convertible Note" below for more details.*

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**HALCÓN RESOURCES CORPORATION**

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

**4. LONG-TERM DEBT (Continued)**

**Senior Revolving Credit Facility**

On February 8, 2012, the Company entered into a senior secured revolving credit agreement (the Senior Credit Agreement) with JPMorgan Chase Bank, N.A., as administrative agent, and the other lenders party thereto. The Senior Credit Agreement currently provides for a $1.5 billion facility with a borrowing base of $900.0 million. Amounts borrowed under the Senior Credit Agreement will mature on August 1, 2019. The borrowing base will be redetermined semi-annually, with the lenders and the Company each having the right to one interim unscheduled redetermination between any two consecutive semi-annual redeterminations. The borrowing base takes into account the Company's oil and natural gas properties, proved reserves, total indebtedness, and other relevant factors consistent with customary oil and natural gas lending criteria. The borrowing base is subject to a reduction (in most cases, equal to the product of 0.25 multiplied by the stated principal amount (without regard to any initial issue discount)) of any future notes or other long-term debt securities that the Company may issue. Funds advanced under the Senior Credit Agreement may be paid down and re-borrowed during the term of the facility. Amounts outstanding under the Senior Credit Agreement bear interest at specified margins over the base rate of 0.75% to 1.75% for ABR-based loans or at specified margins over LIBOR of 1.75% to 2.75% for Eurodollar-based loans. These margins fluctuate based on the Company's utilization of the facility. Advances under the Senior Credit Agreement are secured by liens on substantially all of the Company's and its restricted subsidiaries' properties and assets. The Senior Credit Agreement contains customary representations, warranties and covenants including, among others, restrictions on the payment of dividends on the Company's capital stock and financial covenants, including minimum working capital levels (the ratio of current assets plus the unused commitment under the Senior Credit Agreement to current liabilities) of not less than 1.0 to 1.0 and a ratio of total secured debt to EBITDA of no greater than 2.75 to 1.0.

On May 1, 2015, the Company entered into the Tenth Amendment to the Senior Credit Agreement (the Tenth Amendment) which among other things, replaced the interest coverage test and reduced the borrowing base. See Note 15, *"Subsequent Events,"* for further information regarding the Tenth Amendment. Prior to the Tenth Amendment, under the Ninth Amendment executed on February 25, 2015, the Senior Credit Agreement had a required minimum coverage of interest expenses of not less than 2.0 to 1.0 through March 31, 2016 and not less than 2.5 to 1.0 for subsequent periods.

At March 31, 2015, under the then effective borrowing base of $1.05 billion, the Company had $701.0 million of indebtedness outstanding, $1.1 million of letters of credit outstanding and approximately $347.9 million of borrowing capacity available under the Company's Senior Credit Agreement.

At March 31, 2015, the Company was in compliance with the financial covenants under the Senior Credit Agreement.

**9.25% Senior Notes**

On August 13, 2013, the Company issued at par $400.0 million aggregate principal amount of 9.25% senior notes due 2022 (the 2022 Notes). The net proceeds from the offering of approximately $392.1 million (after deducting commissions and offering expenses) were used to repay a portion of the then outstanding borrowings under the Company's Senior Credit Agreement.

**HALCÓN RESOURCES CORPORATION**

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

**4. LONG-TERM DEBT (Continued)**

The 2022 Notes bear interest at a rate of 9.25% per annum, payable semi-annually on February 15 and August 15 of each year, beginning on February 15, 2014. The 2022 Notes will mature on February 15, 2022. The 2022 Notes are senior unsecured obligations of the Company, rank equally with all of its current and future senior indebtedness and are jointly and severally, fully and unconditionally guaranteed on a senior unsecured basis by the Company's existing 100% owned subsidiaries, except for the subsidiary, HK TMS, LLC. Halcón, the issuer of the 2022 Notes, has no material independent assets or operations apart from the assets and operations of its subsidiaries.

**8.875% Senior Notes**

On November 6, 2012, the Company issued $750.0 million aggregate principal amount of its 8.875% senior notes due 2021 (the 2021 Notes), at a price to the initial purchasers of 99.247% of par. The net proceeds from the offering of approximately $725.6 million (after deducting the initial purchasers' discounts, commissions and offering expenses) were used to fund a portion of the cash consideration paid in the acquisition of two wholly-owned subsidiaries of Petro-Hunt Holdings, LLC and Pillar Holdings, LLC, which owned acreage prospective for the Bakken / Three Forks formations located in North Dakota, in Williams, Mountrail, McKenzie and Dunn Counties.

On January 14, 2013, the Company issued an additional $600.0 million aggregate principal amount of the 2021 Notes at a price to the initial purchasers of 105% of par. The net proceeds from the sale of the additional 2021 Notes of approximately $619.5 million (after the initial purchasers' premiums, commissions and offering expenses) were used to repay all of the then outstanding borrowings under the Senior Credit Agreement and for general corporate purposes, including funding a portion of the Company's 2013 capital expenditures program. These notes were issued as "additional notes" under the indenture governing the 2021 Notes and under the indenture are treated as a single series with substantially identical terms as the 2021 Notes previously issued.

The 2021 Notes bear interest at a rate of 8.875% per annum, payable semi- annually on May 15 and November 15 of each year, beginning on May 15, 2013. The Notes will mature on May 15, 2021. The 2021 Notes are senior unsecured obligations of the Company and rank equally with all of its current and future senior indebtedness. The 2021 Notes are jointly and severally, fully and unconditionally guaranteed on a senior unsecured basis by the Company's existing 100% owned subsidiaries, except for the subsidiary, HK TMS, LLC. Halcón, the issuer of the 2021 Notes, has no material independent assets or operations apart from the assets and operations of its subsidiaries.

In conjunction with the issuance of the 2021 Notes, the Company recorded a discount of approximately $5.7 million to be amortized over the remaining life of the 2021 Notes using the effective interest method. The remaining unamortized discount was $4.5 million at March 31, 2015. In conjunction with the issuance of the additional 2021 Notes, the Company recorded a premium of approximately $30.0 million to be amortized over the remaining life of the additional 2021 Notes using the effective interest method. The remaining unamortized premium was $23.9 million at March 31, 2015.

The Company exchanged a portion of the principal amount of the 2021 Notes for shares of its common stock in April 2015. See Note 15, *"Subsequent Events,"* for a further discussion of the exchanged notes.

**HALCÓN RESOURCES CORPORATION**

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

**4. LONG-TERM DEBT (Continued)**

**9.75% Senior Notes**

On July 16, 2012, the Company issued $750.0 million aggregate principal amount of 9.75% senior notes due 2020 issued at 98.646% of par (the 2020 Notes). The net proceeds from the offering were approximately $723.1 million after deducting the initial purchasers' discounts, commissions and offering expenses and were used to fund a portion of the cash consideration paid in the merger with GeoResources, Inc., and the acquisition of certain oil and gas leaseholds located in East Texas.

On December 19, 2013, the Company issued an additional $400.0 million aggregate principal amount of the 2020 Notes at a price to the initial purchasers of 102.750% of par. The net proceeds from the sale of the additional 2020 Notes of approximately $406.3 million (after the initial purchasers' fees, commissions and offering expenses) were used to repay a portion of the then outstanding borrowings under the Senior Credit Agreement. These notes were issued as "additional notes" under the indenture governing the 2020 Notes and under the indenture are treated as a single series with substantially identical terms as the 2020 Notes previously issued.

The 2020 Notes bear interest at a rate of 9.75% per annum, payable semi- annually on January 15 and July 15 of each year, beginning on January 15, 2013. The 2020 Notes will mature on July 15, 2020. The 2020 Notes are senior unsecured obligations of the Company and rank equally with all of its current and future senior indebtedness. The 2020 Notes are jointly and severally, fully and unconditionally guaranteed on a senior unsecured basis by the Company's existing 100% owned subsidiaries, except for the subsidiary, HK TMS, LLC. Halcón, the issuer of the 2020 Notes, has no material independent assets or operations apart from the assets and operations of its subsidiaries.

In conjunction with the issuance of the 2020 Notes, the Company recorded a discount of approximately $10.2 million to be amortized over the remaining life of the 2020 Notes using the effective interest method. The remaining unamortized discount was $7.6 million at March 31, 2015. In conjunction with the issuance of the additional 2020 Notes, the Company recorded a premium of approximately $11.0 million to be amortized over the remaining life of the additional 2020 Notes using the effective interest method. The remaining unamortized premium was approximately $9.3 million at March 31, 2015.

The Company exchanged a portion of the principal amount of the 2020 Notes for shares of its common stock in April 2015. See Note 15, *"Subsequent Events,"* for a further discussion of the exchanged notes.

**8.0% Convertible Note**

On February 8, 2012, the Company issued to HALRES, LLC (HALRES), a note in the principal amount of $275.0 million due 2017 (the Convertible Note) together with five year warrants (February 2012 Warrants) for an aggregate purchase price of $275.0 million. The Convertible Note bears interest at a rate of 8% per annum, payable quarterly on March 31, June 30, September 30 and December 31 of each year. Through the March 31, 2014 interest payment date, the Company was permitted to elect to pay the interest in kind, by adding to the principal of the Convertible Note, all or any portion of the interest due on the Convertible Note. The Company elected to pay the interest in kind on March 31, June 30 and September 30, 2012, and added $3.2 million, $5.7 million and $5.8 million of interest incurred, respectively, to the Convertible Note, increasing the principal amount to $289.7 million. The

**HALCÓN RESOURCES CORPORATION**

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

**4. LONG-TERM DEBT (Continued)**

Company did not elect to pay-in-kind interest for the quarterly payments subsequently. The Convertible Note is a senior unsecured obligation of the Company.

On March 9, 2015, the Company entered into an amendment (the HALRES Note Amendment) to its Convertible Note. The HALRES Note Amendment extends the maturity date of the Convertible Note by three years, from February 8, 2017 to February 8, 2020. The Convertible Note originally provided for prepayment without premium or penalty at any time after February 8, 2014, at which time it also became convertible into shares of the Company's common stock at a conversion price of $4.50 per share. These dates have been extended pursuant to the HALRES Note Amendment and the conversion price has been adjusted, such that at any time after February 8, 2017, the Company may prepay the Convertible Note without premium or penalty, and HALRES may elect to convert all or any portion of unpaid principal and interest outstanding under the Convertible Note to shares of the Company's common stock at a conversion price of $2.44 per share, subject to adjustments for stock splits and other customary anti-dilution provisions as set forth in the Convertible Note. At the same time, the Company also entered into an amendment to the February 2012 Warrants (the Warrant Amendment) which extends the term of the February 2012 Warrants from February 8, 2017 to February 8, 2020 and adjusts the exercise price of the February 2012 Warrants to $2.44 per share.

In connection with the HALRES Note Amendment and the Warrant Amendment (the Amendments), the Company and HALRES also amended and restated the Registration Rights Agreement, dated February 8, 2012, as amended (the Amended Registration Rights Agreement), which provides for certain demand and piggyback registration rights for the shares of the Company's common stock issuable upon conversion of the Convertible Note and exercise of the February 2012 Warrants.

The Amendments are subject to approval by the Company's stockholders, in accordance with the rules of the New York Stock Exchange. In the event the Company's stockholders do not approve the Amendment on or before December 31, 2015, the Amendments will never become effective and the original terms of the Convertible Note and February 2012 Warrants shall continue in effect.

The Company allocated the proceeds received for the Convertible Note and February 2012 Warrants on a relative fair value basis. Consequently, the Company recorded a discount of $43.6 million to be amortized over the remaining life of the Convertible Note utilizing the effective interest rate method. The remaining unamortized discount was $19.5 million at March 31, 2015.

**Issuance of Senior Secured Notes due 2020**

On May 1, 2015, the Company completed the issuance of $700 million aggregate principal amount of its 8.625% senior secured notes due 2020 (the Secured Notes) in a private offering. The Secured Notes were issued at par. The net proceeds from the sale of the Secured Notes were approximately $687.8 million (after deducting offering fees and expenses). The Company used the net proceeds from the offering to repay outstanding borrowings under its Senior Credit Agreement. See Note 15, *"Subsequent Events*, " for further details.

**Debt Issuance Costs**

The Company capitalizes certain direct costs associated with the issuance of long-term debt and amortizes such costs over the lives of the respective debt. At March 31, 2015 and December 31, 2014,

**HALCÓN RESOURCES CORPORATION**

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

**4. LONG-TERM DEBT (Continued)**

the Company had approximately $53.7 million and $55.9 million, respectively, of unamortized debt issuance costs.

**5. FAIR VALUE MEASUREMENTS**

Pursuant to ASC 820, the Company's determination of fair value incorporates not only the credit standing of the counterparties involved in transactions with the Company resulting in receivables on the Company's unaudited condensed consolidated balance sheets, but also the impact of the Company's nonperformance risk on its own liabilities. ASC 820 defines fair value 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 the measurement date (exit price). ASC 820 establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy assigns the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). Level 2 measurements are inputs that are observable for assets or liabilities, either directly or indirectly, other than quoted prices included within Level 1. The Company utilizes market data or assumptions that market participants would use in pricing the asset or liability, including assumptions about risk and the risks inherent in the inputs to the valuation technique. These inputs can be readily observable, market corroborated, or generally unobservable. The Company classifies fair value balances based on the observability of those inputs.

The following tables set forth by level within the fair value hierarchy the Company's financial assets and liabilities that were accounted for at fair value as of March 31, 2015 and December 31, 2014. As required by ASC 820, a financial instrument's level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement. The Company's assessment of the significance of a particular input to the fair value measurement requires judgment, and may affect the valuation of fair value assets and liabilities and their placement within the fair value hierarchy levels. There were no transfers between fair value hierarchy levels for the three months ended March 31, 2015.

| | March 31, 2015 | | | |
|---|---|---|---|---|
| | Level 1 | Level 2 | Level 3 | Total |
| | (In thousands) | | | |
| Assets | | | | |
| Receivables from derivative contracts | $ | $ 487,213 | $ | $ 487,213 |
| Liabilities | | | | |
| Liabilities from derivative contracts | $ | $ 560 | $ 187 | $ 747 |

| | December 31, 2014 | | | |
|---|---|---|---|---|
| | Level 1 | Level 2 | Level 3 | Total |
| | (In thousands) | | | |
| Assets | | | | |
| Receivables from derivative contracts | $ | $ 503,854 | $ | $ 503,854 |
| Liabilities | | | | |
| Liabilities from derivative contracts | $ | $ 8,068 | $ 1,319 | $ 9,387 |

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**HALCÓN RESOURCES CORPORATION**

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

**5. FAIR VALUE MEASUREMENTS (Continued)**

Derivative contracts listed above as Level 2 include collars, swaps and put options that are carried at fair value. The Company records the net change in the fair value of these positions in *"Net gain (loss) on derivative contracts"* in the Company's unaudited condensed consolidated statements of operations. The Company is able to value the assets and liabilities based on observable market data for similar instruments, which resulted in the Company reporting its derivatives as Level 2. This observable data includes the forward curves for commodity prices based on quoted market prices and implied volatility factors related to changes in the forward curves. See Note 6, *"Derivative and Hedging Activities"* for additional discussion of derivatives.

Derivative contracts listed above as Level 3 include extendable collars that are carried at fair value. The significant unobservable inputs for these Level 3 contracts include unpublished forward strip prices and market volatilities. The following table sets forth a reconciliation of changes in the fair value of the Company's extendable collar contracts classified as Level 3 in the fair value hierarchy (in thousands):

| | Significant Unobservable Inputs (Level 3) | |
|---|---|---|
| | **March 31, 2015** | **December 31, 2014** |
| Beginning Balance | $ (1,319) | $ (2,816) |
| Net gain (loss) on derivative contracts | 1,132 | 1,497 |
| Settlements | | |
| Purchase of derivative contracts | | |
| Buy out of derivative contracts | | |
| Ending Balance | $ (187) | $ (1,319) |
| Change in unrealized gains (losses) included in earnings related to derivatives still held at March 31, 2015 and December 31, 2014 | $ 1,132 | $ 1,497 |

As of March 31, 2015 and December 31, 2014, the Company's derivative contracts were with major financial institutions with investment grade credit ratings which are believed to have a minimal credit risk. As such, the Company is exposed to credit risk to the extent of nonperformance by the counterparties in the derivative contracts; however, the Company does not anticipate such nonperformance. As of March 31, 2015, each of the counterparties to the Company's current derivative contracts was a lender or an affiliate of a lender in the Company's Senior Credit Agreement. The Company did not post collateral under any of these contracts as they are secured under the Senior Credit Agreement.

The following disclosure of the estimated fair value of financial instruments is made in accordance with the requirements of ASC 825, *Financial Instruments*. The estimated fair value amounts have been determined at discrete points in time based on relevant market information. These estimates involve uncertainties and cannot be determined with precision. The estimated fair value of cash, accounts receivable and accounts payable approximates their carrying value due to their short-term nature. The estimated fair value of the Company's Senior Credit Agreement approximates carrying value because the interest rates approximate current market rates. The following table presents the estimated fair

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**HALCÓN RESOURCES CORPORATION**

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

**5. FAIR VALUE MEASUREMENTS (Continued)**

values of the Company's fixed interest rate, long-term debt instruments as of March 31, 2015 and December 31, 2014 (excluding discounts and premiums):

| Debt | March 31, 2015 Carrying Amount | March 31, 2015 Estimated Fair Value | December 31, 2014 Carrying Amount | December 31, 2014 Estimated Fair Value |
|---|---|---|---|---|
| | (In thousands) | | | |
| 9.25% $400 million senior notes | $ 400,000 | $ 278,252 | $ 400,000 | $ 300,000 |
| 8.875% $1.35 billion senior notes | 1,350,000 | 945,000 | 1,350,000 | 1,005,750 |
| 9.75% $1.15 billion senior notes | 1,150,000 | 816,500 | 1,150,000 | 872,862 |
| 8.0% $289.7 million convertible note | 289,669 | 255,294 | 289,669 | 260,643 |
| | $ 3,189,669 | $ 2,295,046 | $ 3,189,669 | $ 2,439,255 |

The fair value of the Company's fixed interest debt instruments was calculated using Level 2 criteria at March 31, 2015 and December 31, 2014. The fair value of the Company's senior notes is based on quoted market prices from trades of such debt. The fair value of the Company's convertible note is based on published market prices for similar instruments and risk-free rates.

On June 16, 2014, the Company entered into a transaction to develop its Tuscaloosa Marine Shale assets with funds and accounts managed by affiliates of Apollo Global Management, LLC. See Note 9, *"Mezzanine Equity,"* for a discussion of the valuation approach used to allocate the investment proceeds to the transaction's components, for the classification of the estimate within the fair value hierarchy, and for a reconciliation of the beginning and ending liability balances for the tranche rights and the embedded derivative.

The Company follows the provisions of ASC 820 for nonfinancial assets and liabilities measured at fair value on a non-recurring basis. These provisions apply to the Company's initial recognition of asset retirement obligations for which fair value is used. The asset retirement obligation estimates are derived from historical costs and management's expectation of future cost environments; consequently, the Company has designated these liabilities as Level 3. See Note 7, "*Asset Retirement Obligations,"* for a reconciliation of the beginning and ending balances of the liability for the Company's asset retirement obligations.

**6. DERIVATIVE AND HEDGING ACTIVITIES**

The Company is exposed to certain risks relating to its ongoing business operations, such as commodity price risk and interest rate risk. Derivative contracts are utilized to economically hedge the Company's exposure to price fluctuations and reduce the variability in the Company's cash flows associated with anticipated sales of future oil and natural gas production. The Company generally hedges a substantial, but varying, portion of anticipated oil and natural gas production for future periods. Derivatives are carried at fair value on the unaudited condensed consolidated balance sheets as assets or liabilities, with the changes in the fair value included in the unaudited condensed consolidated statements of operations for the period in which the change occurs. The Company's hedge policies and objectives may change significantly as its operational profile changes and/or commodities prices change. The Company does not enter into derivative contracts for speculative trading purposes.

It is the Company's policy to enter into derivative contracts only with counterparties that are creditworthy financial institutions deemed by management as competent and competitive market

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**HALCÓN RESOURCES CORPORATION**

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

**6. DERIVATIVE AND HEDGING ACTIVITIES (Continued)**

makers. As March 31, 2015, each of the counterparties to the Company's derivative contracts was a lender or an affiliate of a lender in its Senior Credit Agreement. The Company did not post collateral under any of these contracts as they are secured under the Company's Senior Credit Agreement.

At March 31, 2015 and December 31, 2014, the Company's crude oil and natural gas derivative positions consisted of swaps, swaptions, costless put/call "collars," and extendable costless collars. Swaps are designed so that the Company receives or makes payments based on a differential between fixed and variable prices for crude oil and natural gas. Swaptions are swap contracts that may be extended annually at the option of the counterparty on a designated date. A costless collar consists of a sold call, which establishes a maximum price the Company will receive for the volumes under contract and a purchased put that establishes a minimum price. Extendable collars are costless put/call contracts that may be extended annually at the option of the counterparty on a designated date. The Company has elected not to designate any of its derivative contracts for hedge accounting. Accordingly, the Company records the net change in the mark-to-market valuation of these derivative contracts, as well as all payments and receipts on settled derivative contracts, in *"Net gain (loss) on derivative contracts"* on the unaudited condensed consolidated statements of operations.

At March 31, 2015, the Company had 76 open commodity derivative contracts summarized in the following tables: four natural gas collar arrangements, 44 crude oil collar arrangements, 18 crude oil swaps, eight crude oil swaptions and two crude oil extendable collars.

At December 31, 2014, the Company had 72 open commodity derivative contracts summarized in the following tables: four natural gas collar arrangements, 42 crude oil collar arrangements, 16 crude oil swaps, eight crude oil swaptions and two crude oil extendable collars.

All derivative contracts are recorded at fair market value in accordance with ASC 815 and ASC 820 and included in the unaudited condensed consolidated balance sheets as assets or liabilities. The following table summarizes the location and fair value amounts of all derivative contracts in the unaudited condensed consolidated balance sheets as of March 31, 2015 and December 31, 2014:

| | | **Asset derivative contracts** | | | **Liability derivative contracts** | |
|---|---|---|---|---|---|---|
| **Derivatives not designated as hedging contracts under ASC 815** | **Balance sheet location** | **March 31, 2015** | **December 31, 2014** | **Balance sheet location** | **March 31, 2015** | **December 31, 2014** |
| | | **(In thousands)** | | | **(In thousands)** | |
| Commodity contracts | Current assets receivables from derivative contracts | $ 351,785 | $ 352,530 | Current liabilities liabilities from derivative contracts | $ | $ |
| Commodity contracts | Other noncurrent assets receivables from derivative contracts | 135,428 | 151,324 | Other noncurrent liabilities liabilities from derivative contracts | (747) | (9,387) |
| **Total derivatives not designated as hedging contracts under ASC 815** | | $ 487,213 | $ 503,854 | | $ (747) | $ (9,387) |

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**HALCÓN RESOURCES CORPORATION**

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

**6. DERIVATIVE AND HEDGING ACTIVITIES (Continued)**

The following table summarizes the location and amounts of the Company's realized and unrealized gains and losses on derivative contracts in the Company's unaudited condensed consolidated statements of operations:

| Derivatives not designated as hedging contracts under ASC 815 | Location of gain or (loss) recognized in income on derivative contracts | Amount of gain or (loss) recognized in income on derivative contracts for the Three Months Ended March 31, 2015 | 2014 |
|---|---|---|---|
| | | (In thousands) | |
| **Commodity contracts:** | | | |
| Unrealized gain (loss) on commodity contracts | Other income (expenses) net gain (loss) on derivative contracts | $ (8,001) | $ (26,916) |
| Realized gain (loss) on commodity contracts | Other income (expenses) net gain (loss) on derivative contracts | 107,749 | (6,740) |
| **Total net gain (loss) on derivative contracts** | | $ 99,748 | $ (33,656) |

At March 31, 2015 and December 31, 2014, the Company had the following open crude oil and natural gas derivative contracts:

| | | | | March 31, 2015 | | | |
|---|---|---|---|---|---|---|---|
| | | | | Floors | | Ceilings | |
| Period | Instrument | Commodity | Volume in Mmbtu's/ Bbl's | Price / Price Range | Weighted Average Price | Price / Price Range | Weighted Average Price |
| April 2015 - June 2015 | Collars | Crude Oil | 796,250 | $ 85.00 - 90.00 | $ 86.29 | $ 91.00 - 98.50 | $ 93.14 |
| April 2015 - December 2015[(1)] | Collars | Crude Oil | 5,362,500 | 82.50 - 90.00 | 86.60 | 90.00 - 100.25 | 94.14 |
| April 2015 - December 2015 | Collars | Natural Gas | 4,812,500 | 4.00 | 4.00 | 4.55 - 4.85 | 4.68 |
| April 2015 - December 2015[(2)] | Swaps | Crude Oil | 1,375,000 | 91.00 - 92.75 | 91.76 | | |
| July 2015 - December 2015 | Collars | Crude Oil | 1,104,000 | 85.00 - 87.50 | 85.83 | 90.00 - 92.50 | 90.92 |
| January 2016 - June 2016 | Collars | Crude Oil | 182,000 | 90.00 | 90.00 | 96.85 | 96.85 |
| January 2016 - December 2016 | Collars | Crude Oil | 2,562,000 | 60.00 - 90.00 | 80.42 | 65.00 - 95.10 | 85.63 |
| January 2016 - December 2016 | Collars | Natural Gas | 732,000 | 4.00 | 4.00 | 4.22 | 4.22 |
| January 2016 - December 2016[(3)] | Swaps | Crude Oil | 4,758,000 | 62.00 - 91.73 | 85.43 | | |

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**HALCÓN RESOURCES CORPORATION**

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

**6. DERIVATIVE AND HEDGING ACTIVITIES (Continued)**

| | | | December 31, 2014 | | | | |
|---|---|---|---|---|---|---|---|
| | | | | Floors | | Ceilings | |
| **Period** | **Instrument** | **Commodity** | **Volume in Mmbtu's/ Bbl's** | **Price / Price Range** | **Weighted Average Price** | **Price / Price Range** | **Weighted Average Price** |
| January 2015 - June 2015 | Collars | Crude Oil | 1,583,750 | $ 85.00 - 90.00 | $ 86.29 | $ 91.00 - 98.50 | $ 93.14 |
| January 2015 - December 2015[(1)] | Collars | Crude Oil | 6,205,000 | 82.50 - 90.00 | 86.47 | 90.00 - 100.25 | 94.39 |
| January 2015 - December 2015 | Collars | Natural Gas | 6,387,500 | 4.00 | 4.00 | 4.55 - 4.85 | 4.68 |
| January 2015 - December 2015[(2)] | Swaps | Crude Oil | 1,825,000 | 91.00 - 92.75 | 91.76 | | |
| March 2015 - December 2015 | Collars | Crude Oil | 306,000 | 87.50 | 87.50 | 92.50 | 92.50 |
| April 2015 - December 2015 | Collars | Crude Oil | 412,500 | 87.50 | 87.50 | 92.50 | 92.50 |
| July 2015 - December 2015 | Collars | Crude Oil | 1,104,000 | 85.00 - 87.50 | 85.83 | 90.00 - 92.50 | 90.92 |
| January 2016 - June 2016 | Collars | Crude Oil | 182,000 | 90.00 | 90.00 | 96.85 | 96.85 |
| January 2016 - December 2016 | Collars | Crude Oil | 1,830,000 | 87.50 - 90.00 | 88.55 | 92.70 - 95.10 | 93.84 |
| January 2016 - December 2016 | Collars | Natural Gas | 732,000 | 4.00 | 4.00 | 4.22 | 4.22 |
| January 2016 - December 2016[(3)] | Swaps | Crude Oil | 4,026,000 | 88.00 - 91.73 | 89.65 | | |

(1) *Includes an outstanding crude oil collar which may be extended by the counterparty at a floor of $85.00 per Bbl and a ceiling of $96.20 per Bbl for a total of 732,000 Bbls for the year ended December 31, 2016. Also includes an outstanding crude oil collar which may be extended by the counterparty at a floor of $85.00 per Bbl and a ceiling of $96.00 per Bbl for a total of 366,000 Bbls for the year ended December 31, 2016.*

(2) *Includes an outstanding crude oil swap of which may be extended by the counterparty at a price of $91.25 per Bbl for 732,000 Bbls for the year ended December 31, 2016. Also includes certain outstanding crude oil swaps which may be extended by the counterparty at a price of $91.00 per Bbl totaling 366,000 Bbls for the year ended December 31, 2016.*

(3) *Includes an outstanding crude oil swap which may be extended by the counterparty at a price of $88.25 per Bbl for a total of 730,000 Bbls for the year ended December 31, 2017. Also includes certain outstanding crude oil swaps which may be extended by the counterparty at a price of $88.00 per Bbl totaling 912,500 Bbls for the year ended December 31, 2017. Includes an outstanding crude oil swap which may be extended by the counterparty at a price of $88.87 per Bbl totaling 547,500 Bbls for the year ended December 31, 2017.*

The Company presents the fair value of its derivative contracts at the gross amounts in the unaudited condensed consolidated balance sheets. The following table shows the potential effects of master netting arrangements on the fair value of the Company's derivative contracts at March 31, 2015 and December 31, 2014:

| | Derivative Assets | | Derivative Liabilities | |
|---|---|---|---|---|
| **Offsetting of Derivative Assets and Liabilities** | **March 31, 2015** | **December 31, 2014** | **March 31, 2015** | **December 31, 2014** |
| | (In thousands) | | (In thousands) | |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Gross Amounts Presented in the Consolidated Balance Sheet | $ | 487,213 | $ | 503,854 | $ | (747) | $ | (9,387) |
| Amounts Not Offset in the Consolidated Balance Sheet | | (768) | | (9,655) | | 747 | | 9,387 |
| Net Amount | $ | 486,445 | $ | 494,199 | $ | | $ | |

The Company enters into an International Swap Dealers Association Master Agreement (ISDA) with each counterparty prior to a derivative contract with such counterparty. The ISDA is a standard contract that governs all derivative contracts entered into between the Company and the respective counterparty. The ISDA allows for offsetting of amounts payable or receivable between the Company

**HALCÓN RESOURCES CORPORATION**

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

**6. DERIVATIVE AND HEDGING ACTIVITIES (Continued)**

and the counterparty, at the election of both parties, for transactions that occur on the same date and in the same currency.

**7. ASSET RETIREMENT OBLIGATIONS**

The Company records an asset retirement obligation (ARO) when it can reasonably estimate the fair value of an obligation to perform site reclamation, dismantle facilities or plug and abandon costs. For gas gathering systems and equipment, the Company records an ARO when the system is placed in service and it can reasonably estimate the fair value of an obligation to perform site reclamation and other necessary work when it is required. The Company records the ARO liability on the unaudited condensed consolidated balance sheets and capitalizes a portion of the cost in *"Oil and natural gas properties"* or *"Other operating property and equipment"* during the period in which the obligation is incurred. The Company records the accretion of its ARO liabilities in *"Depletion, depreciation and accretion"* expense in the unaudited condensed consolidated statements of operations. The additional capitalized costs are depreciated on a unit-of-production basis or straight-line basis.

The Company recorded the following activity related to its ARO liability for the three months ended March 31, 2015 (in thousands, inclusive of the current portion):

| | |
|---|---|
| Liability for asset retirement obligations as of December 31, 2014 | $ 38,477 |
| Additions | 1,120 |
| Accretion expense | 440 |
| Liability for asset retirement obligations as of March 31, 2015 | $ 40,037 |

**8. COMMITMENTS AND CONTINGENCIES**

**Commitments**

The Company leases corporate office space in Houston, Texas; and Denver, Colorado as well as a number of other field office locations. Rent expense was approximately $2.0 million and $1.9 million for the three months ended March 31, 2015 and 2014, respectively. As of March 31, 2015, the amount of commitments under office and equipment lease agreements is consistent with the levels at December 31, 2014, as disclosed in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2014, approximating $57.7 million in the aggregate, and containing various expiration dates through 2024.

In addition, the Company has commitments for certain equipment under long-term operating lease agreements, namely drilling rigs as well as pipeline and well equipment, with various expiration dates through 2018. In January 2015, the Company made the decision to early terminate a drilling rig contract in response to the recent decline in crude oil prices, and as such, the Company will incur an early termination fee of $6.0 million, payable over the first half of 2015. If certain requirements are not met by two separate trigger dates, the first being January 1, 2017 and the second being January 12, 2020, the Company may incur up to an additional $3.0 million in connection with this drilling rig contract. In addition, the Company has a new drilling rig commitment, scheduled to begin in the second quarter of 2015, for which the Company expects to incur a stacking fee of $17,000 per day. The current rig contract term extends through the second quarter of 2018. Early termination of the Company's other drilling rig commitments would result in termination penalties approximating

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**HALCÓN RESOURCES CORPORATION**

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

**8. COMMITMENTS AND CONTINGENCIES (Continued)**

$44.3 million, which would be in lieu of the remaining $67.1 million of drilling rig commitments as of March 31, 2015.

The Company has entered into various long-term gathering, transportation and sales contracts in its Bakken / Three Forks formations in North Dakota. As of March 31, 2015, the Company had in place ten long-term crude oil contracts and six long-term natural gas contracts in this area. Under the terms of these contracts, the Company has committed a substantial portion of its Bakken / Three Forks production for periods ranging from one to ten years from the date of first production. The sales prices under these contracts are based on posted market rates. The Company believes that there are sufficient available reserves and production in the Bakken / Three Forks formations to meet its commitments. Historically, the Company has been able to meet its delivery commitments.

On December 20, 2013, the Company entered into a carry and earning agreement, as amended (the Agreement) with an independent third party (Seller) associated with the acquisition of certain properties believed to be prospective for the Tuscaloosa Marine Shale (TMS), primarily in Wilkinson County, Mississippi and in West Feliciana and East Feliciana Parishes, Louisiana. The Agreement required the Company to fund up to $189.4 million (the Carry Amount) in exchange for approximately 117,870 net acres. The Company paid $62.5 million of the Carry Amount at closing on February 28, 2014 and the remaining $126.9 million during the three months ended June 30, 2014, reflected as *"Advance on carried interest"* in the accompanying unaudited condensed consolidating statements of cash flows. The Carry Amount is to be used by the Seller to fund wells prospective for the TMS to be drilled by the Seller (the Carry Wells) on the Seller's retained acreage. As part of the transaction, the Company will also receive a 5% working interest in the Carry Wells. Any portion of the Carry Amount not spent by the Seller, in accordance with the Agreement, on or before August 31, 2017, will be returned to the Company.

On June 16, 2014, the Company entered into a transaction to develop its TMS assets with funds and accounts managed by affiliates of Apollo Global Management, LLC. See Note 9, "*Mezzanine Equity,"* for a discussion of the drilling obligation associated with the transaction.

**Contingencies**

From time to time, the Company may be a plaintiff or defendant in a pending or threatened legal proceeding arising in the normal course of its business. While the outcome and impact of currently pending legal proceedings cannot be determined, the Company's management and legal counsel believe that the resolution of these proceedings through settlement or adverse judgment will not have a material effect on the Company's unaudited condensed consolidated operating results, financial position or cash flows.

**9. MEZZANINE EQUITY**

On June 16, 2014, funds and accounts managed by affiliates of Apollo Global Management, LLC (Apollo) contributed $150 million in cash to HK TMS, LLC, a wholly owned Delaware limited liability company (HK TMS), that, as of June 16, 2014 held all of the Company's undeveloped acreage in Mississippi and Louisiana that management believes is prospective for the TMS formation, in exchange for the issuance by HK TMS of 150,000 preferred shares. At the closing, the Company also contributed $50 million in cash to HK TMS. Holders of the HK TMS preferred shares will receive quarterly cash dividends of 8% cumulative perpetual per annum, subject to HK TMS' option to pay such dividends

**HALCÓN RESOURCES CORPORATION**

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

**9. MEZZANINE EQUITY (Continued)**

"in-kind" through the issuance of additional preferred shares. For the three months ended March 31, 2015, HK TMS issued 3,019 additional preferred shares to Apollo for dividends paid-in-kind. These dividends are presented within "*Preferred dividends and accretion on redeemable noncontrolling interest"* on the unaudited condensed consolidated statements of operations. Upon the election of in-kind dividends, HK TMS must pay a fee of $5.00 per preferred share then outstanding (PIK Exit Fee). Such fees will be due upon redemption of the preferred shares. For the three months ended March 31, 2015, HK TMS incurred PIK Exit Fees totaling $0.8 million, which were recorded at fair value within *"Other noncurrent liabilities"* on the unaudited condensed consolidated balance sheets. The preferred shares will be automatically redeemed and cancelled when the holders receive cash dividends and distributions on the preferred shares equating to the greater of a 12% annual rate of return plus principal and 1.25 times their investment plus applicable fees (the Redemption Price), subject to adjustment under certain circumstances. The preferred shares have a liquidation preference in the event of dissolution in an amount equal to the redemption price plus any unpaid dividends not otherwise included in the calculation of the redemption price through the date of liquidation payment. HK TMS may also redeem the preferred shares at any time after December 31, 2016 by paying the Redemption Price, or may be required to redeem the preferred shares for the Redemption Price plus certain fees under certain circumstances.

The preferred shares have been classified as "*Redeemable noncontrolling interest*" and included in *"Mezzanine equity"* between total liabilities and stockholders' equity on the unaudited condensed consolidated balance sheets pursuant to ASC 480-10-S99-3A. The preferred shares, while not currently redeemable, are considered probable of becoming redeemable and therefore will be subsequently remeasured each reporting period by accreting the initial value to the estimated required redemption value through March 31, 2017. The accretion is presented as a deemed dividend and recorded in "*Redeemable noncontrolling interest*" on the unaudited condensed consolidated balance sheet and within "*Preferred dividends and accretion on redeemable noncontrolling interest"* on the unaudited condensed consolidated statements of operations. In accordance with ASC 480-10-S99-3A, an adjustment to the carrying amount presented in mezzanine equity will be recognized as charges against retained earnings and will reduce income available to common shareholders in the calculation of earnings per share. Adjustments to the carrying amount may not be necessary if the application of ASC No. 810, *Consolidation* (ASC 810) results in a noncontrolling interest balance in excess of what is required pursuant to ASC 480-10-S99-3A.

Under certain circumstances, Apollo could have acquired up to an additional 250,000 preferred shares of HK TMS on the same terms, with HK TMS receiving up to an additional $250 million in cash proceeds (Tranche Rights). The Tranche Rights were recognized separately as a liability instrument within *"Other noncurrent liabilities"* in the unaudited condensed consolidated balance sheets, as of December 31, 2014, in accordance with ASC 480 as the shares underlying the Tranche Rights were redeemable equity instruments. The Tranche Rights were subsequently remeasured at fair value each reporting period in accordance with ASC 480, with fair value changes recorded in *"Interest expense and other, net"* on the unaudited condensed consolidated statements of operations. In March 2015, Apollo delivered a withdrawal notice to HK TMS indicating their election not to participate in the Tranche Rights (the Withdrawal Notice). As such, the fair value of the liability associated with the Tranche Rights was expensed during the three months ended March 31, 2015. Upon issuance of the Withdrawal Notice, HK TMS incurs a fee escalating from $2.50 per share to $20.00 per share for the next eight full fiscal quarters for any preferred shares then outstanding, beginning in the three months

**HALCÓN RESOURCES CORPORATION**

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

**9. MEZZANINE EQUITY (Continued)**

ended June 30, 2015 (the Withdrawal Exit Fee). The Withdrawal Exit Fee is payable upon redemption of the preferred shares. The Withdrawal Exit Fee was recorded at fair value within *"Other noncurrent liabilities"* on the unaudited condensed consolidated balance sheets as of March 31, 2015.

In conjunction with the issuance of the preferred shares, HK TMS conveyed a 4.0% overriding royalty interest (ORRI), subject to reduction to 2.0% under certain circumstances, in 75 net wells to be drilled and completed on its TMS acreage. The number of wells subject to the ORRI would have increased to the extent that Apollo subscribed for additional preferred shares, with a maximum of 200 net operated wells subject to such ORRI if Apollo subscribed for the full additional 250,000 preferred shares. However, upon issuance of the Withdrawal Notice, Apollo forfeited the rights to the ORRI in the additional 125 wells. The ORRI has been recognized separately as a conveyance of oil and natural gas properties in *"Unevaluated properties"* on the unaudited condensed consolidated balance sheets. HK TMS has committed to drill a minimum of 6.5 net wells in each of the six consecutive twelve month periods beginning June 16, 2014. For any commitment period in which HK TMS does not meet its drilling obligation, HK TMS must use available cash, above the minimum cash balance discussed further below, to redeem the preferred shares at the Redemption Price.

Of the $150 million initial investment proceeds from Apollo, the Company allocated the proceeds as follows (in thousands):

| | |
|---|---|
| HK TMS, LLC preferred stock | $ 110,051 |
| Tranche rights | 4,516 |
| Overriding royalty interest | 34,576 |
| Embedded derivative | 857 |
| Total initial investment proceeds | $ 150,000 |

For purposes of estimating the fair values of the transaction components, an income approach was used that estimated fair value based on the anticipated cash flows associated with the Company's proved reserves, discounted using a weighted average cost of capital rate. The estimation of the fair value of these components includes the use of unobservable inputs, such as estimates of proved reserves, the weighted average cost of capital (discount rate), estimated future revenues, and estimated future capital and operating costs. The use of these unobservable inputs results in the fair value estimates being classified as Level 3. Although the Company believes the assumptions and estimates used in the fair value calculation of the transaction components are reasonable and appropriate, different assumptions and estimates could materially impact the analysis and resulting conclusions. The assumptions used in estimating the fair value of the transaction components are inherently uncertain and require management judgment.

The following table sets forth a reconciliation of the changes in fair value of the Tranche Rights and embedded derivative classified as Level 3 in the fair value hierarchy (in thousands):

| | Tranche rights | Embedded derivative |
|---|---|---|
| Balances at December 31, 2014 | $ (2,634) | $ 5,963 |
| Change in fair value | 2,634 | (204) |
| Balances at March 31, 2015 | $ | $ 5,759 |

**9. MEZZANINE EQUITY (Continued)**

As part of the transaction, there are certain restrictions on the transfer of assets, including cash, to the Company from HK TMS. HK TMS is required to maintain a minimum cash balance equal to two quarterly dividend payments, of approximately $3.0 million each, plus $10.0 million, which is presented on the consolidated balance sheets in *"Restricted cash."* Additionally, the quarterly 8% dividends paid to holders of the HK TMS preferred shares have priority over other cash distributions. No dividends shall be paid to the Company from HK TMS prior to December 31, 2016. HK TMS is restricted from transferring more than 20% of its maximum net acres and from transferring any assets exceeding 20% of HK TMS's proved reserves at any one time. Finally, proceeds from any such transfers of acres or other assets must be used for HK TMS's capital or operating expenditures, or to redeem the preferred shares.

The Company recorded the following activity related to the preferred shares recorded in *"Mezzanine equity"* for the three months ended March 31, 2015 (in thousands, except share amounts):

| | Redeemable noncontrolling interest | |
|---|---|---|
| | Shares | Amount |
| Balances at December 31, 2014 | 153,025 | $ 117,166 |
| Dividends paid in-kind | 3,019 | 3,019 |
| Accretion of redeemable noncontrolling interest | | 5,632 |
| Balances at March 31, 2015 | 156,044 | $ 125,817 |

**10. STOCKHOLDERS' EQUITY**

**5.75% Series A Convertible Perpetual Preferred Stock**

On June 18, 2013, the Company completed its offering of 345,000 shares of its 5.75% Series A Convertible Perpetual Preferred Stock (the Series A Preferred Stock) at a public offering price of $1,000 per share (the Liquidation Preference). The net proceeds to the Company were approximately $335.2 million, after deducting the underwriting discount and offering expenses. The Company used the net proceeds to repay a portion of the outstanding borrowings under its Senior Credit Agreement.

Holders of the Series A Preferred Stock are entitled to receive, when, as and if declared by the Company's Board of Directors, cumulative dividends at the rate of 5.75% per annum (the dividend rate) on the Liquidation Preference per share of the Series A Preferred Stock, payable quarterly in arrears on each dividend payment date. Dividends may be paid in cash or, where freely transferable by any non-affiliate recipient thereof, in common stock of the Company, or a combination thereof, and are payable on March 1, June 1, September 1 and December 1 of each year. During the three months ended March 31, 2015, the Company incurred cumulative, declared dividends of $4.9 million by issuing approximately 2.5 million shares of common stock. As of March 31, 2015, cumulative, undeclared dividends on the Series A Preferred Stock amounted to approximately $1.6 million.

The Series A Preferred Stock has no maturity date, is not redeemable by the Company at any time, and will remain outstanding unless converted by the holders or mandatorily converted by the Company. Each share of Series A Preferred Stock is convertible, at the holder's option at any time, into approximately 162.4431 shares of common stock of the Company (which is equivalent to a conversion price of approximately $6.16 per share), subject to specified adjustments as set forth in the

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**HALCÓN RESOURCES CORPORATION**

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

**10. STOCKHOLDERS' EQUITY (Continued)**

Series A Designation. Based on the initial conversion rate and preferred shares outstanding, approximately 56.0 million shares of common stock of the Company would be issuable upon conversion of all the shares of Series A Preferred Stock. On or after June 6, 2018, the Company may, at its option, give notice of its election to cause all outstanding shares of the Series A Preferred Stock to be automatically converted into shares of common stock of the Company at the conversion rate (as defined in the Series A Designation), if the closing sale price of the Company's common stock equals or exceeds 150% of the conversion price for at least 20 trading days in a period of 30 consecutive trading days. As of March 31, 2015, 4,040 shares of Series A Preferred Stock have been converted into 656,269 shares of common stock.

If the Company undergoes a fundamental change (as defined in the Series A Designation) and a holder converts its shares of the Series A Preferred Stock at any time beginning at the opening of business on the trading day immediately following the effective date of such fundamental change and ending at the close of business on the 30th trading day immediately following such effective date, the holder will receive, for each share of the Series A Preferred Stock surrendered for conversion, a number of shares of common stock of the Company equal to the greater of: (1) the sum of (i) the conversion rate and (ii) the make-whole premium, if any, as described in the Series A Designation; and (2) the conversion rate which will be increased to equal (i) the sum of the $1,000 liquidation preference plus all accumulated and unpaid dividends to, but excluding, the settlement date for such conversion, divided by (ii) the average of the closing sale prices of the Company's common stock for the five consecutive trading days ending on the third business day prior to such settlement date; provided that the prevailing conversion rate as adjusted pursuant to this will not exceed 292.3977 shares of common stock of the Company per share of the Series A Preferred Stock (subject to adjustment in the same manner as the conversion rate).

Except as required by Delaware law, holders of the Series A Preferred Stock will have no voting rights unless dividends are in arrears and unpaid for six or more quarterly periods. Until such arrearage is paid in full, the holders (voting as a single class with the holders of any other preferred shares having similar voting rights) will be entitled to elect two additional directors and the number of directors on the Company's Board of Directors will increase by that same number.

**Common Stock**

On March 18, 2015, the Company entered into an Equity Distribution Agreement (the Equity Distribution Agreement) with BMO Capital Markets Corp., Jefferies LLC and MLV & Co. LLC (collectively, the Managers). Pursuant to the terms of the Equity Distribution Agreement, the Company may sell, from time to time through the Managers, shares of its common stock having an aggregate offering price of up to $150 million (the Shares). Sales of the Shares, if any, will be made by means of ordinary brokers' transactions through the facilities of the New York Stock Exchange at market prices, or as otherwise agreed by the Company and the Managers. For the three months ended March 31, 2015, the Company sold approximately 5.0 million shares for net proceeds of approximately $8.1 million, after deducting offering expenses. Of the net proceeds of $8.1 million, approximately $2.1 million was recorded as a receivable at March 31, 2015 and was collected in April 2015. The shares sold have been registered under the Securities Act pursuant to a Registration Statement on Form S-3 (No. 333-188640), which was filed with the SEC and became effective March 13, 2015. The Company plans to use any net proceeds from the offering to repay a portion of outstanding borrowings under its Senior Credit Agreement and general corporate purposes.

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**HALCÓN RESOURCES CORPORATION**

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

**10. STOCKHOLDERS' EQUITY (Continued)**

On May 22, 2014, with stockholder approval, the Company filed a Certificate of Amendment of the Amended and Restated Certificate of Incorporation with the Delaware Secretary of State to increase its authorized common stock by approximately 670.0 million shares for a total of 1.34 billion authorized shares of common stock.

On August 13, 2013, the Company completed the issuance and sale of 43.7 million shares of its common stock in an underwritten public offering. The shares of common stock sold have been registered under the Securities Act pursuant to a Registration Statement on Form S-3 (No. 333-188640), which was filed with the SEC and became automatically effective on May 16, 2013. The net proceeds to the Company from the offering of common stock were approximately $215.2 million, after deducting the underwriting discount and estimated offering expenses. The Company used the net proceeds from the offering to repay a portion of the then outstanding borrowings under its Senior Credit Agreement.

On January 17, 2013, with stockholder approval, the Company filed a Certificate of Amendment of the Amended and Restated Certificate of Incorporation with the Delaware Secretary of State to increase its authorized common stock by approximately 333.3 million shares for a total of 670.0 million authorized shares of common stock.

**Warrants**

In February 2012, in conjunction with the issuance of the Convertible Notes, the Company issued warrants to purchase 36.7 million shares of the Company's common stock at an exercise price of $4.50 per share of common stock, which the Company refers to as the February 2012 Warrants. The Company allocated $43.6 million to the February 2012 Warrants which is reflected in additional paid-in capital in stockholders' equity, net of $0.6 million in issuance costs. The February 2012 Warrants entitle the holders to exercise the warrants in whole or in part at any time prior to the expiration date of February 8, 2017.

On March 9, 2015, in conjunction with an amendment to its Convertible Notes, the Company entered into an amendment to the February 2012 Warrants (the Amendments), which extends the term of the February 2012 Warrants from February 8, 2017 to February 8, 2020 and adjusts the exercise price of the February 2012 Warrants to $2.44 per share. The Amendments are subject to approval by the Company's stockholders, in accordance with the rules of the New York Stock Exchange. See Note 4*, "Long-term debt,"* for a further discussion of the Amendments.

**Incentive Plan**

On May 8, 2006, the Company's stockholders first approved the 2006 Long-Term Incentive Plan (the Plan). On May 23, 2013, shareholders last approved an increase in authorized shares under the Plan from 11.5 million to 41.5 million. As of March 31, 2015 and December 31, 2014, a maximum of 2.1 million and 5.1 million shares of common stock, respectively, remained reserved for issuance under the Plan.

The Company accounts for share-based payment accruals under authoritative guidance on stock compensation, as set forth in ASC Topic 718. The guidance requires all share-based payments to employees and directors, including grants of performance units, stock options, and restricted stock, to be recognized in the financial statements based on their fair values.

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**HALCÓN RESOURCES CORPORATION**

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

**10. STOCKHOLDERS' EQUITY (Continued)**

For the three months ended March 31, 2015 and 2014, the Company recognized $4.8 million and $4.3 million, respectively, of share-based compensation expense as a component of "*General and administrative*" on the unaudited condensed consolidated statements of operations.

**Performance Share Units**

During the three months ended March 31, 2014, the Company granted performance share units (PSU) under the Plan covering 1.6 million shares of common stock to senior management of the Company. The PSU provides that the number of shares of common stock received upon vesting will vary if the market price of the Company's common stock exceeds certain pre-established target thresholds as measured by the average of the adjusted closing price of a share of the Company's common stock during the sixty trading days preceding the third anniversary of issuance, or the measurement date. The PSU utilizes $4.00 as the floor price, below which the PSU will not vest and will expire. If the average market price at the measurement date is equal to $4.00, the PSU will vest and represent the right to receive 50% of the number of shares of common stock underlying the PSU. At $7.00, the PSU will vest and represent the right to receive the full number of shares of common stock underlying the PSU; and at $10.00, the PSU will vest and represent the right to receive 200% of the number of shares of common stock underlying the PSU. All stock price targets are subject to customary adjustments based upon changes in the Company's capital structure. In the event the average market price falls between targeted price thresholds, the PSU will represent the right to receive a proportionate number of shares, e.g., 75% of the number of shares of common stock underlying the PSU if the average market price at such time is $5.50, 150% of the number of shares of common stock underlying the PSU if the average market price at such time is $8.50, and so forth. The Company has reserved for issuance under the Plan the maximum number of shares that participants might have the right to receive upon vesting of the PSU, or 3.2 million shares of common stock. At March 31, 2015, the Company had $3.1 million of unrecognized compensation expense related to non-vested PSU to be recognized over a weighted-average period of 1.9 years.

**Stock Options**

During the three months ended March 31, 2015, the Company granted stock options under the Plan covering 3.2 million shares of common stock to employees of the Company. These stock options have an exercise price of $1.97. These awards typically vest over a three year period at a rate of one-third on the annual anniversary date of the grant and expire ten years from the grant date. At March 31, 2015, the Company had $11.0 million of unrecognized compensation expense related to non-vested stock options to be recognized over a weighted-average period of 1.5 years.

During the three months ended March 31, 2014, the Company granted stock options under the Plan covering 6.1 million shares of common stock to employees of the Company. The stock options have exercise prices ranging from $3.67 to $4.33 with a weighted average exercise price of $3.67. These awards typically vest over a three year period at a rate of one-third on the annual anniversary date of the grant and expire ten years from the grant date. At March 31, 2014, the Company had $20.4 million of unrecognized compensation expense related to non-vested stock options to be recognized over a weighted-average period of 1.6 years.

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**HALCÓN RESOURCES CORPORATION**

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

**10. STOCKHOLDERS' EQUITY (Continued)**

**Restricted Stock**

During the three months ended March 31, 2015, the Company granted 1.4 million shares of restricted stock under the Plan to directors and employees of the Company. These restricted shares were granted at prices ranging from $1.22 to $1.97 with a weighted average price of $1.97. Employee shares vest over a three year period at a rate of one-third on the annual anniversary date of the grant, and the non-employee directors' shares vest six-months from the date of grant. At March 31, 2015, the Company had $15.4 million of unrecognized compensation expense related to non-vested restricted stock awards to be recognized over a weighted-average period of 1.6 years.

During the three months ended March 31, 2014, the Company granted 3.6 million shares of restricted stock under the Plan to directors and employees of the Company. These restricted shares were granted at prices ranging from $3.67 to $4.33 with a weighted average price of $3.67. Employee shares vest over a three year period at a rate of one-third on the annual anniversary date of the grant, and the non-employee directors' shares vest six-months from the date of grant. At March 31, 2014, the Company had $19.7 million of unrecognized compensation expense related to non-vested restricted stock awards to be recognized over a weighted-average period of 1.7 years.

**11. INCOME TAXES**

Under guidance contained in ASC Topic 740, deferred taxes are determined by applying the provisions of enacted tax laws and rates for the jurisdictions in which the Company operates to the estimated future tax effects of the differences between the tax basis of assets and liabilities and their reported amounts in the Company's financial statements. A valuation allowance is established to reduce deferred tax assets if it is more likely than not that the related tax benefits will not be realized.

In assessing the need for a valuation allowance on the Company's deferred tax assets, the Company considers possible sources of taxable income that may be available to realize the benefit of deferred tax assets, including projected future taxable income, the reversal of existing temporary differences, taxable income in carryback years and available tax planning strategies. The Company considers all available evidence (both positive and negative) in determining whether a valuation allowance is required. A significant item of objective negative evidence considered was the cumulative book loss over the three-year period ended December 31, 2014 driven primarily by the full cost ceiling impairments over that period, which limits the ability to consider other subjective evidence such as the Company's anticipated future growth. Based upon the evaluation of the available evidence the Company continued to record a valuation allowance against its net deferred tax assets as of March 31, 2015.

The Company recorded an income tax benefit of $0.1 million on a pre-tax loss of $587.7 million for the three months ended March 31, 2015 primarily due to the valuation allowance offset by an increase to the refund related to the IRS audit of the 2010-2012 GeoResources returns. For the three months ended March 31, 2014, the Company recorded no income tax expense or benefit on a pre-tax loss of $73.0 million due to the valuation allowance. The effective tax rate was 0.0% for the three months ended March 31, 2015 and 2014.

During the first quarter of 2014, the Internal Revenue Service commenced an audit of GeoResources' tax returns for the tax years ending December 31, 2010 through August 1, 2012. The audit closed during April 2015 resulting in a favorable adjustment to the Company.

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**HALCÓN RESOURCES CORPORATION**

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

**12. EARNINGS PER COMMON SHARE**

The following represents the calculation of earnings (loss) per share (in thousands, except per share amounts):

| | Three Months Ended March 31, | |
|---|---|---|
| | 2015 | 2014 |
| **Basic:** | | |
| Net income (loss) available to common stockholders | $ (601,193) | $ (77,923) |
| Weighted average basic number of common shares outstanding | 419,684 | 413,521 |
| Basic net income (loss) per share of common stock | $ (1.43) | $ (0.19) |
| **Diluted:** | | |
| Net income (loss) available to common stockholders | $ (601,193) | $ (77,923) |
| Net income from assumed conversions | | |
| Net income (loss) available to common stockholders after assumed conversions | $ (601,193) | $ (77,923) |