

UNIT CORP

Form 10-Q

November 05, 2013

Table of Contents

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

☒ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)

OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2013

OR

☐ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d)

OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____

[Commission File Number 1-9260]

UNIT CORPORATION

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of incorporation)

73-1283193

(I.R.S. Employer Identification No.)

7130 South Lewis, Suite 1000, Tulsa, Oklahoma

(Address of principal executive offices)

(918) 493-7700

(Registrant's telephone number, including area code)

None

(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 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes ☒ No ☐

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

Yes ☒ No ☐

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

Large accelerated filer ☒

Accelerated filer ☐

Non-accelerated filer ☐

Smaller

reporting company ☐

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

Yes ☐ No ☒

As of October 25, 2013, 49,106,378 shares of the issuer's common stock were outstanding.

Table of Contents

TABLE OF CONTENTS

	Page Number
<u>PART I. Financial Information</u>	
Item 1. <u>Financial Statements (Unaudited)</u>	
<u>Unaudited Condensed Consolidated Balance Sheets</u> <u>September 30, 2013 and December 31, 2012</u>	3
<u>Unaudited Condensed Consolidated Statements of Income</u> <u>Three and Nine Months Ended September 30, 2013 and 2012</u>	5
<u>Unaudited Condensed Consolidated Statements of Comprehensive Income</u> <u>Three and Nine Months Ended September 30, 2013 and 2012</u>	6
<u>Unaudited Condensed Consolidated Statements of Cash Flows</u> <u>Nine Months Ended September 30, 2013 and 2012</u>	7
<u>Notes to Unaudited Condensed Consolidated Financial Statements</u>	8
<u>Report of Independent Registered Public Accounting Firm</u>	26
Item 2. <u>Management's Discussion and Analysis of Financial</u> <u>Condition and Results of Operations</u>	27
Item 3. <u>Quantitative and Qualitative Disclosure About Market Risk</u>	47
Item 4. <u>Controls and Procedures</u>	48
<u>PART II. Other Information</u>	
Item 1. <u>Legal Proceedings</u>	48
Item 1A. <u>Risk Factors</u>	49
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	49
Item 3. <u>Defaults Upon Senior Securities</u>	50
Item 4. <u>Mine Safety Disclosures</u>	50
Item 5. <u>Other Information</u>	50
Item 6. <u>Exhibits</u>	50
<u>Signatures</u>	51

Table of Contents

Forward-Looking Statements

This quarterly report contains “forward-looking statements” within the meaning of Section 27A of the Securities Act and Section 21E of the Exchange Act. All statements, other than statements of historical facts, included in this quarterly report, which address activities, events, or developments which we expect or anticipate will or may occur in the future, are forward-looking statements. The words “believes,” “intends,” “expects,” “anticipates,” “projects,” “estimates,” “predicts,” and similar expressions are used to identify forward-looking statements.

These forward-looking statements include, among others, such things as:

- the amount and nature of our future capital expenditures and how we expect to fund our capital expenditures;
- the number of wells we plan to drill or rework;
- prices for oil, NGLs, and natural gas;
- demand for oil, NGLs, and natural gas;
- our exploration and drilling prospects;
- the estimates of our proved oil, NGLs, and natural gas reserves;
- oil, NGLs, and natural gas reserve potential;
- development and infill drilling potential;
- expansion and other development trends of the oil and natural gas industry;
- our business strategy;
- our plans to maintain or increase production of oil, NGLs, and natural gas;
- the number of gathering systems and processing plants we plan to construct or acquire;
- volumes and prices for natural gas gathered and processed;
- expansion and growth of our business and operations;
- demand for our drilling rigs and drilling rig rates;
- our belief that the final outcome of our legal proceedings will not materially affect our financial results;
- our ability to timely secure third-party services used in completing our wells;
- our ability to transport or convey our oil, NGLs, or natural gas production to established pipeline systems;
- impact of federal and state legislative and regulatory actions impacting our costs and increasing operating restrictions or delays as well as other adverse impacts on our business;
- our projected production guidelines for the year;
- our anticipated capital budgets; and
- the number of wells our oil and natural gas segment plans to drill during the year.

These statements are based on certain assumptions and analyses made by us in light of our experience and our perception of historical trends, current conditions, and expected future developments as well as other factors we believe are appropriate in the circumstances. Whether actual results and developments will conform to our expectations and predictions is subject to a number of risks and uncertainties any one or combination of which could cause our actual results to differ materially from our expectations and predictions, including:

- the risk factors discussed in this document and in the documents (if any) we incorporate by reference;
- general economic, market, or business conditions;
- the availability of and nature of (or lack of) business opportunities that we pursue;
- demand for our land drilling services;
- changes in laws or regulations;
- decreases or increases in commodity prices; and
- other factors, most of which are beyond our control.

You should not place undue reliance on any of these forward-looking statements. Except as required by law, we disclaim any current intention to update forward-looking information and to release publicly the results of any future revisions we may make to forward-looking statements to reflect events or circumstances after the date of this document to reflect the occurrence of unanticipated events.

Table of Contents

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

UNIT CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)

	September 30, 2013	December 31, 2012
	(In thousands except share amounts)	
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 1,741	\$ 974
Accounts receivable, net of allowance for doubtful accounts of \$5,342 and \$5,343 at September 30, 2013 and at December 31, 2012, respectively	141,817	146,046
Materials and supplies	10,330	8,563
Current derivative asset (Note 10)	4,514	16,552
Current income tax receivable	1,389	901
Current deferred tax asset	9,371	8,765
Prepaid expenses and other	12,413	13,843
Total current assets	181,575	195,644
Property and equipment:		
Oil and natural gas properties on the full cost method:		
Proved properties	4,061,108	3,822,381
Undeveloped leasehold not being amortized	589,227	521,659
Drilling equipment	1,484,928	1,478,645
Gas gathering and processing equipment	538,258	461,629
Transportation equipment	39,286	37,728
Other	74,802	62,840
	6,787,609	6,384,882
Less accumulated depreciation, depletion, amortization, and impairment	3,133,717	2,907,660
Net property and equipment	3,653,892	3,477,222
Debt issuance cost	12,241	13,432
Goodwill	62,808	62,808
Other intangible assets, net	—	680
Non-current derivative asset (Note 10)	1,133	—
Other assets	13,046	11,334
Total assets	\$ 3,924,695	\$ 3,761,120

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

Table of ContentsUNIT CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED) - CONTINUED

	September 30, 2013	December 31, 2012
	(In thousands except share amounts)	
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 132,633	\$ 138,811
Accrued liabilities (Note 5)	78,557	54,098
Current portion of derivative liabilities (Note 10)	6,480	1,948
Current portion of other long-term liabilities (Note 6)	11,985	12,282
Total current liabilities	229,655	207,139
Long-term debt (Note 6)	645,584	716,359
Non-current derivative liabilities (Note 10)	938	562
Other long-term liabilities (Note 6)	158,161	166,983
Deferred income taxes	773,412	695,776
Shareholders' equity:		
Preferred stock, \$1.00 par value, 5,000,000 shares authorized, none issued	—	—
Common stock, \$.20 par value, 175,000,000 shares authorized, 49,091,928 and 48,581,948 shares issued, respectively	9,655	9,594
Capital in excess of par value	441,291	423,603
Accumulated other comprehensive income (loss) (Note 12)	(963)	7,587
Retained earnings	1,666,962	1,533,517
Total shareholders' equity	2,116,945	1,974,301
Total liabilities and shareholders' equity	\$ 3,924,695	\$ 3,761,120

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

Table of ContentsUNIT CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
	(In thousands except per share amounts)			
Revenues:				
Oil and natural gas	\$157,320	\$135,435	\$475,728	\$402,366
Contract drilling	100,647	133,420	313,180	421,198
Gas gathering and processing	75,809	52,935	203,821	159,977
Total revenues	333,776	321,790	992,729	983,541
Expenses:				
Oil and natural gas:				
Operating costs	50,139	36,147	138,171	105,035
Depreciation, depletion, and amortization	56,294	44,489	163,612	153,839
Impairment of oil and natural gas properties (Note 2)	—	—	—	115,874
Contract drilling:				
Operating costs	58,988	72,988	188,580	223,980
Depreciation	17,402	20,094	52,570	62,660
Gas gathering and processing:				
Operating costs	63,098	46,267	172,065	136,243
Depreciation and amortization	8,773	5,884	24,143	16,330
General and administrative	9,936	8,434	28,288	23,814
Gain on disposition of assets	(4,345)	(44)	(7,744)	(1,283)
Total operating expenses	260,285	234,259	759,685	836,492
Income from operations	73,491	87,531	233,044	147,049
Other income (expense):				
Interest, net	(3,625)	(7,087)	(11,777)	(11,455)
Loss on derivatives not designated as hedges and hedge ineffectiveness, net	(13,760)	(4,015)	(3,340)	(4,621)
Other	(14)	(59)	(171)	(123)
Total other income (expense)	(17,399)	(11,161)	(15,288)	(16,199)
Income before income taxes	56,092	76,370	217,756	130,850
Income tax expense:				
Current	2,111	2,516	6,745	450
Deferred	19,749	27,268	77,566	50,677
Total income taxes	21,860	29,784	84,311	51,127
Net income	\$34,232	\$46,586	\$133,445	\$79,723
Net income per common share:				
Basic	\$0.71	\$0.97	\$2.77	\$1.66
Diluted	\$0.70	\$0.97	\$2.75	\$1.66

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

Table of ContentsUNIT CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

	Nine Months Ended September 30,	
	2013	2012
	(In thousands)	
OPERATING ACTIVITIES:		
Net income	\$ 133,445	\$ 79,723
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation, depletion, and amortization	242,590	234,350
Impairment of oil and natural gas properties (Note 2)	—	115,874
Loss on derivatives	1,765	4,621
Deferred tax expense	77,566	50,677
Gain on disposition of assets	(7,744)	(1,283)
Stock compensation plans	16,652	12,271
Other, net	4,263	3,376
Changes in operating assets and liabilities increasing (decreasing) cash:		
Accounts receivable	1,888	4,516
Accounts payable	320	(11,753)
Material and supplies	(1,767)	(1,949)
Accrued liabilities	31,041	23,195
Other, net	942	(1,478)
Net cash provided by operating activities	500,961	512,140
INVESTING ACTIVITIES:		
Capital expenditures	(512,574)	(584,858)
Producing property and other acquisitions (Note 3)	—	(600,321)
Proceeds from disposition of assets	89,916	296,582
Net cash used in investing activities	(422,658)	(888,597)
FINANCING ACTIVITIES:		
Borrowings under credit agreement	222,500	543,700
Payments under credit agreement	(293,600)	(593,700)
Proceeds from issuance of senior subordinated notes, net of debt issuance costs and discount	—	386,274
Proceeds from exercise of stock options	578	90
Book overdrafts	(7,014)	40,281
Net cash provided by (used in) financing activities	(77,536)	376,645
Net increase in cash and cash equivalents	767	188
Cash and cash equivalents, beginning of period	974	835
Cash and cash equivalents, end of period	\$ 1,741	\$ 1,023
Supplemental disclosure of cash flow information:		
Changes in accounts payable and accrued liabilities related to purchases of property, plant, and equipment	\$(516)	\$ 26,477
Non-cash additions (reductions) to oil and natural gas properties related to asset retirement obligations	\$(16,417)	\$ 45,188

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

Table of Contents

UNIT CORPORATION AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 – BASIS OF PREPARATION AND PRESENTATION

The accompanying unaudited condensed consolidated financial statements in this quarterly report include the accounts of Unit Corporation and all its subsidiaries and affiliates and have been prepared under the rules and regulations of the SEC. The terms “company,” “Unit,” “we,” “our,” “us,” or like terms refer to Unit Corporation, a Delaware corporation, and, as appropriate, one or more of its subsidiaries and affiliates, except as otherwise indicated or as the context otherwise requires.

The accompanying condensed consolidated financial statements are unaudited and do not include all the notes in our annual financial statements. This quarterly report should be read in conjunction with the audited consolidated financial statements and notes included in our Form 10-K, filed February 26, 2013, for the year ended December 31, 2012. In our management's opinion, the accompanying unaudited condensed consolidated financial statements contain all normal recurring adjustments (including the elimination of all intercompany transactions) necessary to fairly state the following:

- Balance Sheets at September 30, 2013 and December 31, 2012;
- Statements of Income for the three and nine months ended September 30, 2013 and 2012;
- Statements of Comprehensive Income for the three and nine months ended September 30, 2013 and 2012; and
- Statements of Cash Flows for the nine months ended September 30, 2013 and 2012.

Our financial statements are prepared in conformity with generally accepted accounting principles in the United States (GAAP). GAAP requires us to make certain estimates and assumptions that may affect the amounts reported in our unaudited condensed consolidated financial statements and accompanying notes. Actual results may differ from those estimates. Results for the nine months ended September 30, 2013 and 2012 are not necessarily indicative of the results to be realized for the full year in the case of 2013, or that we realized for the full year of 2012.

Certain amounts in the accompanying unaudited condensed consolidated financial statements for prior periods have been reclassified to conform to current year presentation. Certain financial statement captions were expanded or combined with no impact to consolidated net income or shareholders' equity.

With respect to the unaudited financial information for the three and nine month periods ended September 30, 2013 and 2012, our auditors, PricewaterhouseCoopers LLP, reported that it applied limited procedures in accordance with professional standards in reviewing that information. Its separate report, dated November 5, 2013, which is included in this quarterly report, states that it did not audit and it does not express an opinion on that unaudited financial information. Accordingly, the degree of reliance placed on its report should be restricted in light of the limited review procedures applied. PricewaterhouseCoopers LLP is not subject to the liability provisions of Section 11 of the Securities Act of 1933 (Act) for its report on the unaudited financial information because that report is not a “report” or a “part” of a registration statement prepared or certified by PricewaterhouseCoopers LLP within the meaning of Sections 7 and 11 of the Act.

NOTE 2 – OIL AND NATURAL GAS PROPERTIES

Full cost accounting rules require us to review the carrying value of our oil and natural gas properties at the end of each quarter. Under those rules, the maximum amount allowed as the carrying value is referred to as the ceiling. The ceiling is the sum of the present value (using a 10% discount rate) of the estimated future net revenues from our proved reserves (using the unescalated 12-month average price of our oil, NGLs, and natural gas adjusted for any cash flow hedges), plus the cost of properties not being amortized, plus the lower of cost or estimated fair value of unproved properties included in the costs being amortized, less related income taxes. In the event the net book value of the oil, NGLs, and natural gas properties being amortized exceeds the full cost ceiling, the excess amount is charged to expense in the period during which the excess occurs, even if prices are depressed for only a short period of time. Once incurred, a write-down of oil and natural gas properties is not reversible.

For the quarter ended June 30, 2012, the 12-month average commodity prices, including the discounted value of our cash flow hedges, decreased significantly resulting in a non-cash ceiling test write down of \$115.9 million pre-tax

(\$72.1 million, net of tax). Our qualifying cash flow hedges used in the ceiling test determination as of June 30, 2012, consisted of swaps

Table of Contents

covering 2.9 MMBoe in 2012 and 4.5 MMBoe in 2013. The effect of those hedges on the June 30, 2012 ceiling test was a \$32.5 million pre-tax increase in the discounted net cash flows of our oil and natural gas properties.

At September 30, 2013, the 12-month average commodity prices, including the discounted value of our cash flow hedges, were at levels that did not require us to take a write-down of our oil and natural gas properties. If there are declines in the 12-month average prices, including the discounted value of our cash flow hedges, we may be required to record a write-down in future periods.

Our qualifying cash flow hedges used in the ceiling test determination as of September 30, 2013, consisted of swaps and collars covering 1.7 MMBoe in 2013. The effect of those hedges on the September 30, 2013 ceiling test was a \$2.1 million pre-tax increase in the discounted net cash flows of our oil and natural gas properties. Even without the impact of those hedges, we would not have been required to take a write-down for the quarter. Our oil, NGLs, and natural gas hedging is discussed in Note 10 of the Notes to our Unaudited Condensed Consolidated Financial Statements.

NOTE 3 – ACQUISITIONS AND DIVESTITURES

On September 17, 2012, we closed on the acquisition of certain oil and natural gas assets from Noble Energy, Inc. (Noble). The acquisition included approximately 83,000 net acres primarily in the Granite Wash, Cleveland, and various other plays in western Oklahoma and the Texas Panhandle. The amount paid after final closing adjustments was \$592.6 million.

As of April 1, 2012, the effective date of the Noble acquisition, the estimated proved reserves of the acquired properties were 44 million barrels of oil equivalent (MMBoe). The acquisition added approximately 24,000 net acres to our Granite Wash core area in the Texas Panhandle with significant resource potential including approximately 600 horizontal drilling locations. The total acreage acquired in western Oklahoma was approximately 59,000 net acres and is characterized by high working interest and operatorship, 95% of which is held by production. We also received four gathering systems as part of the transaction and other miscellaneous assets.

The Noble acquisition was accounted for using the acquisition method under ASC 805, Business Combinations, which requires that the acquired assets and liabilities be recorded at their fair values as of the acquisition date. The following table summarizes the purchase price and the estimated values of assets acquired and liabilities assumed. It was based on information available to us at the time the unaudited condensed consolidated financial statements were prepared.

We believe these estimates are reasonable; however, the estimates are subject to change as additional information becomes available and is assessed by us (in thousands):

Adjusted Purchase Price	
Total consideration given	\$592,627
Adjusted Allocation of Purchase Price	
Oil and natural gas properties included in the full cost pool:	
Proved oil and natural gas properties	\$260,799
Undeveloped oil and natural gas properties	353,343
Total oil and natural gas properties included in the full cost pool ⁽¹⁾	614,142
Equipment and facilities	25,163
Asset retirement obligation	(46,678)
Fair value of net assets acquired	\$592,627

(1) We used a discounted cash flow model and made market assumptions as to future commodity prices, projections of estimated quantities of oil and natural gas reserves, expectations for timing and amount of future development and operating costs, projections of future rates of production, expected recovery rates and risk adjusted discount rates.

Pro Forma Financial Information

The following unaudited pro forma financial information is presented to reflect the operations of the acquired assets as if the acquisition had been completed on January 1, 2011. The unaudited pro forma financial information was derived from the historical accounting records of the seller adjusted for estimated transaction costs, depreciation, depletion and amortization, ceiling test impact, general and administrative expenses, capitalized interest, and interest on the 400.0

million of bonds issued along with additional borrowings under our credit facility to finance the acquisition. The unaudited pro forma financial

Table of Contents

information does not purport to be indicative of results of operations that would have occurred had the transaction occurred on the basis assumed above, nor is such information indicative of our expected future results of operations. The pro forma results of operations do not include any cost savings or other synergies that resulted, or may result, from the acquisition or any estimated costs that will be incurred to integrate these assets. Future results may vary significantly from the results reflected in this pro forma financial information because of future events and transactions, as well as other factors.

	Three Months Ended September 30, 2012 (In thousands, except per share data)	Nine Months Ended September 30, 2012
Pro forma:		
Revenues	\$335,394	\$1,041,350
Net income	\$47,186	\$140,670
Net income per common share:		
Basic	\$0.98	\$2.94
Diluted	\$0.98	\$2.92

2012 Divestitures

We completed the following divestitures in 2012, all of which were accounted for as adjustments to the full cost pool with no gain or loss recognized:

• In September 2012, we sold our interest in certain Bakken properties (located in North Dakota). The proceeds, net of related expenses, were \$226.6 million.

• In September 2012, we sold certain oil and natural gas assets located in Brazos and Madison counties of Texas, for approximately \$44.1 million.

2013 Divestitures

In August 2013, we sold additional Bakken property interests. The proceeds, net of related expenses, were \$57.1 million. These proceeds were accounted for as adjustments to the full cost pool with no gain or loss recognized.

Other

The acquisition and divestitures completed in the third quarter 2012, were structured to allow us to secure like-kind exchange tax treatment for the transactions under Section 1031 of the Internal Revenue Code.

NOTE 4 – EARNINGS PER SHARE

Information related to the calculation of earnings per share follows:

	Income (Numerator)	Weighted Shares (Denominator)	Per-Share Amount
	(In thousands except per share amounts)		
For the three months ended September 30, 2013			
Basic earnings per common share	\$34,232	48,254	\$0.71
Effect of dilutive stock options, restricted stock, and stock appreciation rights (SARs)	—	404	(0.01)
Diluted earnings per common share	\$34,232	48,658	\$0.70
For the three months ended September 30, 2012			
Basic earnings per common share	\$46,586	47,938	\$0.97
Effect of dilutive stock options, restricted stock, and SARs	—	263	—
Diluted earnings per common share	\$46,586	48,201	\$0.97

Table of Contents

The following table shows the number of stock options and SARs (and their average exercise price) not included in the prior calculation because their option exercise prices were greater than the average market price of our common stock:

	Three Months Ended September 30,	
	2013	2012
Stock options and SARs	149,665	278,901
Average exercise price	\$58.41	\$51.57

	Income (Numerator)	Weighted Shares (Denominator)	Per-Share Amount
	(In thousands except per share amounts)		
For the nine months ended September 30, 2013			
Basic earnings per common share	\$133,445	48,193	\$2.77
Effect of dilutive stock options, restricted stock, and SARs	—	317	(0.02)
Diluted earnings per common share	\$133,445	48,510	\$2.75
For the nine months ended September 30, 2012			
Basic earnings per common share	\$79,723	47,891	\$1.66
Effect of dilutive stock options, restricted stock, and SARs	—	215	—
Diluted earnings per common share	\$79,723	48,106	\$1.66

The following table shows the number of stock options and SARs (and their average exercise price) not included in the prior calculation because their option exercise prices were greater than the average market price of our common stock:

	Nine Months Ended September 30,	
	2013	2012
Stock options and SARs	149,665	250,901
Average exercise price	\$58.41	\$52.72

NOTE 5 – ACCRUED LIABILITIES

Accrued liabilities consisted of the following:

	September 30, 2013	December 31, 2012
	(In thousands)	
Employee costs	\$23,944	\$24,632
Interest payable	17,747	6,568
Lease operating expenses	14,738	10,903
Taxes	11,563	7,308
Other	10,565	4,687
Total accrued liabilities	\$78,557	\$54,098

Table of Contents

NOTE 6 – LONG-TERM DEBT AND OTHER LONG-TERM LIABILITIES

Long-Term Debt

Our long-term debt consisted of (or arose under) the following:

	September 30, 2013 (In thousands)	December 31, 2012
Credit agreement with an average interest rate of 2.9% at December 31, 2012	\$—	\$71,100
6.625% senior subordinated notes due 2021, net of unamortized discount of \$4.4 million	645,584	645,259
at September 30, 2013 and \$4.7 million at December 31, 2012		
Total long-term debt	\$645,584	\$716,359

Credit Agreement. On September 5, 2012, we amended our Senior Credit Agreement (credit agreement). The amount available to be borrowed is the lesser of the amount we elect (from time to time) as the commitment amount (currently \$500.0 million) or the value of the borrowing base as determined by the lenders (currently \$800.0 million), but in either event not to exceed the maximum credit agreement amount of \$900.0 million. We are charged a commitment fee ranging from 0.375 to 0.50 of 1% on the amount available but not borrowed. That fee varies based on the amount borrowed as a percentage of the amount of the total borrowing base. In connection with the amendment, we paid \$1.5 million in origination, agency, syndication, and other related fees. We are amortizing these fees over the life of the credit agreement. The credit agreement is currently scheduled to mature on September 13, 2016.

The amount of the borrowing base—which is subject to redetermination by the lenders on April 1st and October 1st of each year—is based primarily on a percentage of the discounted future value of our oil and natural gas reserves. There was no change to the borrowing base as of the October 1, 2013 redetermination. We or the lenders may request a onetime special redetermination of the borrowing base between each scheduled redetermination. In addition, we may request a redetermination following the completion of an acquisition that meets the requirements set forth in the credit agreement.

At our election, any part of the outstanding debt under the credit agreement may be fixed at a London Interbank Offered Rate (LIBOR). LIBOR interest is computed as the sum of the LIBOR base for the applicable term plus 1.75% to 2.50% depending on the level of debt as a percentage of the borrowing base and is payable at the end of each term, or every 90 days, whichever is less. Borrowings not under LIBOR bear interest at the prime rate specified in the credit agreement that in any event cannot be less than LIBOR plus 1.00%. Interest is payable at the end of each month and the principal may be repaid in whole or in part at anytime, without a premium or penalty. At September 30, 2013, there were no outstanding borrowings under our credit agreement.

Funds under the credit agreement can be used to finance general working capital requirements for (a) exploration, development, production, and acquisition of oil and gas properties, (b) acquisitions and operation of mid-stream assets, (c) issuance of standby letters of credit, (d) contract drilling services, and (e) general corporate purposes.

The credit agreement prohibits, among other things:

- the payment of dividends (other than stock dividends) during any fiscal year in excess of 30% of our consolidated net income for the preceding fiscal year;
- the incurrence of additional debt with certain limited exceptions; and
- the creation or existence of mortgages or liens, other than those in the ordinary course of business, on any of our properties, except in favor of our lenders.

The credit agreement also requires that we have at the end of each quarter:

- a current ratio (as defined in the credit agreement) of not less than 1 to 1; and
- a leverage ratio of funded debt to consolidated EBITDA (as defined in the credit agreement) for the most recently ended rolling four fiscal quarters of no greater than 4 to 1.

As of September 30, 2013, we were in compliance with the covenants contained in the credit agreement.

6.625% Senior Subordinated Notes. On May 18, 2011, we completed the sale of \$250.0 million of our 6.625% Senior Subordinated Notes (the 2011 Notes). The 2011 Notes were issued at par and mature on May 15, 2021. We received net

Table of Contents

proceeds of approximately \$244.0 million after deducting fees of approximately \$6.0 million. Those fees are being amortized as debt issuance cost over the life of the 2011 Notes. We used the net proceeds to repay outstanding borrowings under our credit agreement, which was \$220.3 million on May 18, 2011. The remaining proceeds were used for general working capital purposes.

On July 24, 2012, we completed the sale of \$400.0 million aggregate principal amount of senior subordinated notes (the 2012 Notes) due May 15, 2021. Those notes also bear interest at a rate of 6.625% per year. The 2012 Notes were sold at 98.75% of par plus accrued interest from May 15, 2012. We used the net proceeds from the offering to partially finance our acquisition of certain oil and natural gas properties. We incurred \$8.7 million of fees that are being amortized as debt issuance cost over the life of the 2012 Notes.

On November 13, 2012, we registered with the SEC an offer on Form S-4 to exchange the 2012 Notes for additional notes with materially identical terms to our existing registered 2011 Notes. On January 7, 2013, the exchange of all the 2012 Notes was completed. The notes issued in exchange for the 2012 Notes are now registered and treated as a single series of debt securities with the 2011 Notes, bringing the total of the aggregate principal amount of 6.625% senior subordinated notes to \$650.0 million (the Notes). Interest on the Notes is payable semi-annually (in arrears) on May 15 and November 15 of each year. The Notes will mature on May 15, 2021.

The Notes are guaranteed by our 100% owned domestic direct and indirect subsidiaries (the Guarantors). Unit, as the parent company, has no independent assets or operations. The guarantees are full and unconditional and joint and several, subject to certain automatic customary releases, including sale, disposition, or transfer of the capital stock or substantially all of the assets of a subsidiary guarantor, exercise of legal defeasance option or covenant defeasance option, and designation of a subsidiary guarantor as unrestricted in accordance with their respective Indentures described below. Any subsidiaries of Unit other than the Guarantors are minor. There are no significant restrictions on the ability of Unit to receive funds from its subsidiaries through dividends, loans, advances, or otherwise.

The Notes are subject to an Indenture dated as of May 18, 2011, between us and Wilmington Trust, National Association (successor to Wilmington Trust FSB), as Trustee (the Trustee). The Indenture was supplemented by the First Supplemental Indenture dated as of May 18, 2011 and further supplemented by the Second Supplemental Indenture dated as of January 7, 2013. As supplemented, the Indenture establishes the terms and provides for the issuance of the Notes. The discussion of the Notes is qualified by and subject to the actual terms of the Indenture.

On and after May 15, 2016, we may redeem all or, from time to time, a part of the Notes at certain redemption prices, plus accrued and unpaid interest. Before May 15, 2014, we may on any one or more occasions redeem up to 35% of the original principal amount of the Notes with the net cash proceeds of one or more equity offerings at a redemption price of 106.625% of the principal amount, plus accrued and unpaid interest, if any, to the redemption date, provided that at least 65% of the original principal amount of the Notes remains outstanding after each redemption. In addition, at any time before May 15, 2016, we may redeem the Notes, in whole or in part, at a redemption price equal to 100% of the principal amount plus a “make whole” premium, plus accrued and unpaid interest, if any, to the redemption date. If a “change of control” occurs, subject to certain conditions, we must offer to repurchase from each holder all or any part of that holder’s Notes at a purchase price in cash equal to 101% of the principal amount of the Notes plus accrued and unpaid interest, if any, to the date of purchase. The Indenture contains customary events of default. The Indenture contains covenants that, among other things, limit our ability and the ability of certain of our subsidiaries to incur or guarantee additional indebtedness; pay dividends on our capital stock or redeem capital stock or subordinated indebtedness; transfer or sell assets; make investments; incur liens; enter into transactions with our affiliates; and merge or consolidate with other companies. We were in compliance with all covenants of the Notes as of September 30, 2013.

Table of Contents

Other Long-Term Liabilities

As of the dates indicated, other long-term liabilities consisted of the following:

	September 30, 2013	December 31, 2012
	(In thousands)	
Asset retirement obligation (ARO) liability	\$133,894	\$146,159
Workers' compensation	20,207	18,517
Separation benefit plans	8,991	7,972
Gas balancing liability	3,838	3,838
Deferred compensation plan	3,216	2,779
	170,146	179,265
Less current portion	11,985	12,282
Total other long-term liabilities	\$158,161	\$166,983

Estimated annual principal payments under the terms of debt and other long-term liabilities during each of the five successive twelve month periods beginning October 1, 2013 (and through 2018) are \$12.0 million, \$40.8 million, \$5.2 million, \$3.9 million, and \$3.8 million, respectively.

NOTE 7 – ASSET RETIREMENT OBLIGATIONS

We are required to record the estimated fair value of the liabilities relating to the future retirement of our long-lived assets. Our oil and natural gas wells are plugged and abandoned when the oil and natural gas reserves in those wells are depleted or the wells are no longer able to produce. The plugging and abandonment liability for a well is recorded in the period in which the obligation is incurred (at the time the well is drilled or acquired). None of our assets are restricted for purposes of settling these AROs. All of our AROs relate to the plugging costs associated with our oil and gas wells.

The following table shows certain information about our AROs:

	Nine Months Ended September 30,	
	2013	2012
	(In thousands)	
ARO liability, January 1:	\$146,159	\$96,446
Accretion of discount	4,152	3,215
Liability incurred	3,820	52,306
Liability settled	(4,071)	(1,606)
Revision of estimates ⁽¹⁾	(16,166)	(4,254)
ARO liability, September 30:	133,894	146,107
Less current portion	2,954	2,857
Total long-term ARO	\$130,940	\$143,250

Plugging liability estimates were revised in both 2013 and 2012 for updates in the cost of services used to plug (1) wells over the preceding year. We had various upward and downward adjustments as well as changes in estimated timing of cash flows.

NOTE 8 – NEW ACCOUNTING PRONOUNCEMENTS

Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists. In July 2013, ASU 2013-11 was issued because GAAP does not include explicit guidance on the financial statement presentation of an unrecognized tax benefit when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists. The amendment provides explicit guidance on the financial statement presentation of an unrecognized tax benefit when a net operating loss carryforward, a similar tax loss, or a

tax credit carryforward exists. The amendments in this Update are effective for fiscal years, and interim periods within those years, beginning after December 15, 2013. Early adoption is permitted. The amendments should be applied prospectively to all unrecognized tax benefits that exist

Table of Contents

at the effective date. Retrospective application is permitted. We anticipate there will be no effect on our financial position or results of operations when adopted.

Inclusion of the Fed Funds Effective Swap Rate (or Overnight Index Swap Rate) as a Benchmark Interest Rate for Hedge Accounting Purposes. The FASB has issued ASU 2013-10, the amendments in this update permit the Fed Funds Effective Swap Rate (OIS) to be used as a U.S. benchmark interest rate for hedge accounting purposes under Topic 815, in addition to U.S. Treasury and LIBOR. The amendments also remove the restriction on using different benchmark rates for similar hedges. The amendments are effective prospectively for qualifying new or redesignated hedging relationships entered into on or after July 17, 2013. We currently do not have any interest rate hedges at this time.

Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income. In February 2013, the FASB issued ASU 2013-02 to address the presentation of comprehensive income related to ASU 2011-05. The standard requires that companies present, either in a single note or parenthetically on the face of the financial statements, the effect of significant amounts reclassified from each component of accumulated other comprehensive income based on its source (e.g., the release due to cash flow hedges from interest rate contracts) and the income statement line items affected by the reclassification (e.g., interest income or interest expense). The amendments are effective for fiscal years, and interim periods within those years, beginning after December 15, 2012. We chose to present the information in a single note (Note 11 of the Notes to our Unaudited Condensed Consolidated Financial Statements).

Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities. In January 2013, the FASB issued ASU 2013-01 to limit the scope of balance sheet offsetting disclosures contained in previously issued guidance in ASU 2011-11—Disclosures about Offsetting Assets and Liabilities. Specifically, ASU 2011-11 applies only to derivatives, repurchase agreements and reverse purchase agreements, and securities borrowing and securities lending transactions that are either offset in accordance with specific criteria contained in the FASB Accounting Standards or subject to a master netting arrangement or similar agreement.

Unlike IFRS, GAAP allows companies the option to present net in their balance sheets derivatives that are subject to a legally enforceable netting arrangement with the same party where rights of set-off are only available in the event of default or bankruptcy. To address these differences between IFRS and GAAP, the FASB and the IASB (the Boards) issued an exposure draft that proposed new criteria for netting that were narrower than the current conditions currently in GAAP. Nevertheless, in response to feedback from their respective stakeholders, the Boards decided to retain their existing offsetting models. Instead, the Boards have issued common disclosure requirements related to offsetting arrangements to allow investors to better compare financial statements prepared in accordance with IFRS or GAAP. The amendments in this ASU require an entity to disclose information about offsetting and related arrangements to enable users of its financial statements to understand the effect of those arrangements on its financial position. An entity is required to apply the amendments for annual reporting periods beginning on or after January 1, 2013, and interim periods within those annual periods. An entity should provide the disclosures required by those amendments retrospectively for all comparative periods presented. Derivatives subject to a master netting agreement are the only transactions in this accounting standard that affect us. We provide the effect of netting on our financial position in Note 11 of the Notes to our Unaudited Condensed Consolidated Financial Statements.

NOTE 9 – STOCK-BASED COMPENSATION

For the three and nine months ended September 30, 2013, we recognized stock compensation expense for restricted stock awards of \$4.4 million and \$12.0 million, respectively. For the same period we also capitalized stock compensation cost for oil and natural gas properties of \$1.0 million and \$2.6 million, respectively. For these same periods, the tax benefit related to this stock based compensation was \$1.8 million and \$4.7 million, respectively. The remaining unrecognized compensation cost related to unvested awards at September 30, 2013 is approximately \$20.7 million of which \$3.3 million is anticipated to be capitalized. The weighted average period of time over which this cost will be recognized is 0.8 of a year.

For the three and nine months ended September 30, 2012, we recognized stock compensation expense for restricted stock awards of \$2.9 million and \$8.2 million, respectively. For the same period we also capitalized stock compensation cost for oil and natural gas properties of \$0.7 million and \$2.0 million, respectively. For these same

periods, the tax benefit related to this stock based compensation was \$1.2 million and \$3.2 million, respectively. We grant stock-based and cash-based compensation to our employees (including employees of subsidiaries) as well as to non-employee directors under our Unit Corporation Stock and Incentive Compensation Plan Amended and Restated May 2, 2012 (the amended plan). A total of 3,300,000 shares of the company's common stock is authorized for issuance to eligible participants under the amended plan. The amended plan succeeds our previous Non-employee Directors' 2000 Stock Option Plan (the option plan).

Table of Contents

We did not grant any SARs or stock options during either of the three or nine month periods ending September 30, 2013 and 2012. The following table shows the fair value of the restricted stock awards granted to employees and non-employee directors:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Shares granted:				
Employees	—	2,509	448,549	370,445
Non employee directors	—	—	21,128	24,606
	—	2,509	469,677	395,051
Estimated fair value (in millions):				
Employees	\$—	\$0.1	\$21.0	\$15.7
Non employee directors	—	—	0.9	1.0
	\$—	\$0.1	\$21.9	\$16.7
Percentage of shares granted expected to be distributed:				
Employees	N/A	95 %	94 %	94 %
Non employee directors	N/A	— %	100 %	100 %

The restricted stock awards granted during the three and nine months ended September 30, 2013 and 2012 are being recognized over a three year vesting period, except for a portion of those awards made to certain executive officers. As to those executive officers, 30% of the shares granted, or 57,405 shares in 2013 and 46,441 shares in 2012 (the performance shares), will cliff vest in the first half of 2016 and 2015, respectively. The actual number of performance shares that vest in 2015 and 2016 will be based on the company's achievement of certain performance criteria over a three-year period, and will range from 50% to 150% of the restricted shares granted as performance shares. Based on the performance criteria, the participants could receive more than 100% of the performance based shares. The total aggregate stock compensation expense and capitalized cost related to oil and natural gas properties for 2013 awards for the first nine months of 2013 was \$7.1 million.

NOTE 10 – DERIVATIVES**Commodity Derivatives**

We have entered into various types of derivative transactions covering some of our projected natural gas, NGLs, and oil production. These transactions are intended to reduce our exposure to market price volatility by setting the price(s) we will receive for that production. Our decisions on the price(s), type, and quantity of our production hedged is based, in part, on our view of current and future market conditions. As of September 30, 2013, our derivative transactions consisted of the following types of hedges:

Swaps. We receive or pay a fixed price for the hedged commodity and pay or receive a floating market price to the counterparty. The fixed-price payment and the floating-price payment are netted, resulting in a net amount due to or from the counterparty.

Collars. A collar contains a fixed floor price (put) and a ceiling price (call). If the market price exceeds the call strike price or falls below the put strike price, we receive the fixed price and pay the market price. If the market price is between the call and the put strike price, no payments are due from either party.

We have documented policies and procedures to monitor and control the use of derivative transactions. We do not engage in derivative transactions for speculative purposes. In August 2012, we determined—on a prospective basis—that we would no longer elect to use cash flow hedge accounting for our economic hedges. Therefore, the change in fair value on all commodity derivatives entered into after that determination will be reflected in the income statement and not in accumulated other comprehensive income (OCI).

Table of Contents

At September 30, 2013, we had the following outstanding cash flow hedges:

Term	Commodity	Hedged Volume	Weighted Average Fixed Price for Swaps	Hedged Market
Oct'13 - Dec'13	Crude oil – swap	5,500 Bbl/day	\$99.71	WTI – NYMEX
Oct'13 - Dec'13	Natural gas – swap	60,000 MMBtu/day	\$3.56	IF – NYMEX (HH)
Oct'13 - Dec'13	Natural gas – collar	20,000 MMBtu/day	\$3.25-3.72	IF – NYMEX (HH)

At September 30, 2013, we had the following outstanding non-designated hedges:

Term	Commodity	Hedged Volume	Weighted Average Fixed Price for Swaps	Hedged Market
Oct'13 - Dec'13	Crude oil – swap	3,000 Bbl/day	\$94.59	WTI – NYMEX
Jan'14 - Dec'14	Crude oil – swap	3,000 Bbl/day	\$91.77	WTI – NYMEX
Jan'14 - Jun'14	Crude oil – swap	500 Bbl/day	\$100.03	WTI – NYMEX
Jan'14 - Dec'14	Crude oil – collar	4,000 Bbl/day	\$90.00-96.08	WTI – NYMEX
Oct'13 - Dec'13	Natural gas – swap	20,000 MMBtu/day	\$3.94	IF – NYMEX (HH)
Jan'14 - Dec'14	Natural gas – swap	50,000 MMBtu/day	\$4.24	IF – NYMEX (HH)

The following tables present the fair values and locations of the derivative transactions recorded in our Unaudited Condensed Consolidated Balance Sheets:

		Derivative Assets	
		Fair Value	
	Balance Sheet Location	September 30, 2013	December 31, 2012
		(In thousands)	
Derivatives designated as hedging instruments			
Commodity derivatives:			
Current	Current derivative asset	\$486	\$13,674
Long-term	Non-current derivative asset	—	—
Total derivatives designated as hedging instruments		486	13,674
Derivatives not designated as hedging instruments			
Commodity derivatives:			
Current	Current derivative asset	4,028	2,878
Long-term	Non-current derivative asset	1,133	—
Total derivatives not designated as hedging instruments		5,161	2,878
Total derivative assets		\$5,647	\$16,552

Derivatives in Cash Flow Hedging Relationships	Amount of Gain or (Loss) Recognized in Accumulated OCI on Derivative (Effective Portion) ⁽¹⁾	
	2013	2012
	(In thousands)	
Commodity derivatives	\$ (963)	\$ 9,912

(1) Net of taxes.

18

Table of Contents

This table shows the effect of derivative instruments on our Unaudited Condensed Consolidated Statements of Income (cash flow hedges) for the three months ended September 30:

Derivative Instrument	Location of Gain or (Loss) Reclassified from Accumulated OCI into Income & Location of Gain or (Loss) Recognized in Income	Amount of Gain or (Loss) Reclassified from Accumulated OCI into Income ⁽¹⁾		Amount of Gain or (Loss) Recognized in Income ⁽²⁾	
		2013	2012	2013	2012
		(In thousands)			
Commodity derivatives	Oil and natural gas revenue	\$ (3,210)	\$ 14,243	\$—	\$—
Commodity derivatives	Loss on derivatives not designated as hedges and hedge ineffectiveness, net	—	—	(252)	(4,015)
Total		\$ (3,210)	\$ 14,243	\$ (252)	\$ (4,015)

(1) Effective portion of gain (loss).

(2) Ineffective portion of gain (loss).

This table shows the effect of derivative instruments on our Unaudited Condensed Consolidated Statements of Income (derivatives not designated as hedging instruments) for the three months ended September 30:

Derivatives Not Designated as Hedging Instruments	Location of Gain or (Loss) Recognized in Income on Derivative	Amount of Gain or (Loss) Recognized in Income on Derivative ⁽¹⁾	
		2013	2012
		(In thousands)	
Commodity derivatives	Loss on derivatives not designated as hedges and hedge ineffectiveness, net	\$ (13,508)	\$—
Total		\$ (13,508)	\$—

(1) Amount settled during the period is a loss of (\$2.434) and \$0, respectively.

This table shows the effect of derivative instruments on our Unaudited Condensed Consolidated Statements of Income (cash flow hedges) for the nine months ended September 30:

Derivative Instrument	Location of Gain or (Loss) Reclassified from Accumulated OCI into Income & Location of Gain or (Loss) Recognized in Income	Amount of Gain or (Loss) Reclassified from Accumulated OCI into Income ⁽¹⁾		Amount of Gain or (Loss) Recognized in Income ⁽²⁾	
		2013	2012	2013	2012
		(In thousands)			
Commodity derivatives	Oil and natural gas revenue	\$ (202)	\$ 38,088	\$—	\$—
Commodity derivatives	Loss on derivatives not designated as hedges and hedge ineffectiveness, net	—	—	116	(4,621)
Total		\$ (202)	\$ 38,088	\$ 116	\$ (4,621)

(1) Effective portion of gain (loss).

(2) Ineffective portion of gain (loss).

This table shows the effect of derivative instruments on our Unaudited Condensed Consolidated Statements of Income (derivatives not designated as hedging instruments) for the nine months ended September 30:

