

LEGACY RESERVES LP
Form 10-Q
August 07, 2018

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2018

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 1-33249
Legacy Reserves LP
(Exact name of registrant as specified in its charter)

Delaware 16-1751069
(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)

303 W. Wall, Suite 1800 79701
Midland, Texas
(Address of principal executive offices) (Zip code)
(432) 689-5200
(Registrant's telephone number, including area code)

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

Yes 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

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

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

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

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

76,929,029 units representing limited partner interests in the registrant were outstanding as of July 31, 2018.

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GLOSSARY OF TERMS

Bbl. One stock tank barrel or 42 U.S. gallons liquid volume.

Bcf. Billion cubic feet.

Boe. One barrel of oil equivalent, determined using a ratio of six Mcf of natural gas to one Bbl of crude oil, condensate or natural gas liquids.

Boe/d. Barrels of oil equivalent per day.

Btu. British thermal unit, which is the heat required to raise the temperature of a one-pound mass of water from 58.5 to 59.5 degrees Fahrenheit.

Developed acreage. The number of acres that are allocated or assignable to productive wells or wells capable of production.

Development project. A drilling or other project which may target proven reserves, but which generally has a lower risk than that associated with exploration projects.

Development well. A well drilled within the proved area of an oil or natural gas reservoir to the depth of a stratigraphic horizon known to be productive.

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

Field. An area consisting of a single reservoir or multiple reservoirs all grouped on or related to the same individual geological structural feature and/or stratigraphic condition.

Gross acres or gross wells. The total acres or wells, as the case may be, in which a working interest is owned.

Hydrocarbons. Oil, NGL and natural gas are all collectively considered hydrocarbons.

Liquids. Oil and NGLs.

MBbls. One thousand barrels of crude oil or other liquid hydrocarbons.

MBoe. One thousand barrels of crude oil equivalent, using a ratio of six Mcf of natural gas to one Bbl of crude oil, condensate or natural gas liquids.

Mcf. One thousand cubic feet.

MGal. One thousand gallons of natural gas liquids or other liquid hydrocarbons.

MMBbls. One million barrels of crude oil or other liquid hydrocarbons.

MMSBoe. One million barrels of crude oil equivalent, using a ratio of six Mcf of natural gas to one Bbl of crude oil, condensate or natural gas liquids.

MMBtu. One million British thermal units.

MMcf. One million cubic feet.

Net acres or net wells. The sum of the fractional working interests owned in gross acres or gross wells, as the case may be.

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

NYMEX. New York Mercantile Exchange.

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Oil. Crude oil and condensate.

Productive well. A well that is found to be capable of producing hydrocarbons in sufficient quantities such that proceeds from the sale of such production exceed production expenses and taxes.

Proved developed reserves or PDPs. Reserves that can be expected to be recovered through: (i) existing wells with existing equipment and operating methods or in which the cost of the required equipment is relatively minor compared to the cost of a new well; and (ii) through installed extraction equipment and infrastructure operational at the time of the reserves estimate if the extraction is by means not involving a well.

Proved developed non-producing reserves or PDNPs. Proved oil and natural gas reserves that are developed behind pipe, shut-in or that can be recovered through improved recovery only after the necessary equipment has been installed, or when the costs to do so are relatively minor. Shut-in reserves are expected to be recovered from (1) completion intervals which are open at the time of the estimate but which have not started producing, (2) wells that were shut-in for market conditions or pipeline connections, or (3) wells not capable of production for mechanical reasons. Behind-pipe reserves are expected to be recovered from zones in existing wells that will require additional completion work or future recompletion prior to the start of production.

Proved reserves. Proved oil and gas reserves are those quantities of oil and gas, which by analysis of geoscience and engineering data, can be estimated with reasonable certainty to be economically producible—from a given date forward, from known reservoirs, and under existing economic conditions, operating methods, and government regulations—prior to the time at which contracts providing the right to operate expire, unless evidence indicates that renewal is reasonably certain, regardless of whether deterministic or probabilistic methods are used for the estimation.

Proved undeveloped drilling location. A site on which a development well can be drilled consistent with spacing rules for purposes of recovering proved undeveloped reserves.

Proved undeveloped reserves or PUDs. Proved undeveloped oil and gas reserves that are expected to be recovered from new wells on undrilled acreage, or from existing wells where a relatively major expenditure is required for recompletion.

(i) Proved reserves on undrilled acreage shall be limited to those directly offsetting development spacing areas that are reasonably certain of production when drilled, unless evidence using reliable technology exists that establishes reasonable certainty of economic producibility at greater distances.

(ii) Proved undrilled locations can be classified as having undeveloped reserves only if a development plan has been adopted indicating that they are scheduled to be drilled within five years, unless the specific circumstances, justify a longer time.

(iii) Under no circumstances shall estimates for proved undeveloped reserves be attributable to any acreage for which an application of fluid injection or other improved recovery technique is contemplated, unless such techniques have been proved effective by actual projects in the same reservoir or an analogous reservoir or by other evidence using reliable technology establishing reasonable certainty.

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

Reserve acquisition cost. The total consideration paid for an oil and natural gas property or set of properties, which includes the cash purchase price and any value ascribed to units issued to a seller adjusted for any post-closing items.

R/P ratio (reserve life). The reserves as of the end of a period divided by the production volumes for the same period.

Reserve replacement. The replacement of oil and natural gas produced with reserve additions from acquisitions, reserve additions and reserve revisions.

Reserve replacement cost. An amount per Boe equal to the sum of costs incurred relating to oil and natural gas property acquisition, exploitation, development and exploration activities (as reflected in our year-end financial statements for the relevant year) divided by the sum of all additions and revisions to estimated proved reserves, including reserve purchases. The calculation of reserve additions for each year is based upon the reserve report of our independent engineers. Management uses reserve replacement cost to compare our company to others in terms of our historical ability to increase our reserve base in an economic manner. However, past performance does not necessarily reflect future reserve replacement cost performance. For example, increases in oil and natural gas prices in recent years have increased the economic life of reserves, adding additional reserves with

no required capital expenditures. On the other hand, increases in oil and natural gas prices have increased the cost of reserve purchases and reserves added through development projects. The reserve replacement cost may not be indicative of the economic value added of the reserves due to differing lease operating expenses per barrel and differing timing of production.

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

Standardized measure. The present value of estimated future net revenues to be generated from the production of proved reserves, determined in accordance with assumptions required by the Financial Accounting Standards Board and the Securities and Exchange Commission (using the average annual prices based on the unweighted arithmetic average of the first-day-of-the-month price for each month) without giving effect to non-property related expenses such as general and administrative expenses, debt service and future income tax expenses or to depreciation, depletion and amortization and discounted using an annual discount rate of 10%. Because we are a limited partnership that allocates our taxable income to our unitholders, no provisions for federal or state income taxes have been provided for in the calculation of standardized measure. Standardized measure does not give effect to derivative transactions.

Undeveloped acreage. Lease acreage on which wells have not been drilled or completed to a point that would permit the production of commercial quantities of oil and natural gas regardless of whether such acreage contains proved reserves.

Working interest. The operating interest that gives the owner the right to drill, produce and conduct operating activities on the property and a share of production.

Workover. Operations on a producing well to restore or increase production.

Part I – FINANCIAL INFORMATION

Item 1. Financial Statements.

LEGACY RESERVES LP
 CONDENSED CONSOLIDATED BALANCE SHEETS
 (UNAUDITED)
 ASSETS

	June 30, 2018	December 31, 2017
	(In thousands)	
Current assets:		
Cash	\$5,948	\$ 1,246
Accounts receivable, net:		
Oil and natural gas	57,676	62,755
Joint interest owners	16,515	27,420
Other	6	2
Fair value of derivatives (Notes 8 and 9)	28,046	13,424
Prepaid expenses and other current assets (Note 1)	10,457	7,757
Total current assets	118,648	112,604
Oil and natural gas properties using the successful efforts method, at cost:		
Proved properties	3,497,220	3,529,971
Unproved properties	31,661	28,023
Accumulated depletion, depreciation, amortization and impairment	(2,157,542)	(2,204,638)
	1,371,339	1,353,356
Other property and equipment, net of accumulated depreciation and amortization of \$11,971 and \$11,467, respectively	2,532	2,961
Operating rights, net of amortization of \$5,944 and \$5,765, respectively	1,072	1,251
Fair value of derivatives (Notes 8 and 9)	9,968	14,099
Other assets	6,991	8,811
Total assets	\$1,510,550	\$ 1,493,082

See accompanying notes to condensed consolidated financial statements.

LEGACY RESERVES LP
CONDENSED CONSOLIDATED BALANCE SHEETS
(UNAUDITED)
LIABILITIES AND PARTNERS' DEFICIT

	June 30, 2018	December 31, 2017
	(In thousands)	
Current liabilities:		
Current debt, net (Notes 1 and 2)	\$ 505,222	\$ —
Accounts payable	6,626	13,093
Accrued oil and natural gas liabilities (Note 1)	119,086	81,318
Fair value of derivatives (Notes 8 and 9)	27,740	18,013
Asset retirement obligation (Note 10)	3,214	3,214
Other	46,538	29,172
Total current liabilities	708,426	144,810
Long-term debt, net (Notes 1 and 2)	784,753	1,346,769
Asset retirement obligation (Note 10)	261,031	271,472
Fair value of derivatives (Notes 8 and 9)	6,682	1,075
Other long-term liabilities	643	643
Total liabilities	1,761,535	1,764,769
Commitments and contingencies (Note 7)		
Partners' deficit (Note 11):		
Series A Preferred equity - 2,300,000 units issued and outstanding at June 30, 2018 and December 31, 2017	55,192	55,192
Series B Preferred equity - 7,200,000 units issued and outstanding at June 30, 2018 and December 31, 2017	174,261	174,261
Incentive distribution equity - 100,000 units issued and outstanding at June 30, 2018 and December 31, 2017	30,814	30,814
Limited partners' deficit - 76,793,940 and 72,594,620 units issued and outstanding at June 30, 2018 and December 31, 2017, respectively	(511,095)	(531,794)
General partner's deficit (approximately 0.02%)	(157)	(160)
Total partners' deficit	(250,985)	(271,687)
Total liabilities and partners' deficit	\$ 1,510,550	\$ 1,493,082
See accompanying notes to condensed consolidated financial statements.		

LEGACY RESERVES LP
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
	(In thousands, except per unit data)			
Revenues:				
Oil sales	\$99,799	\$46,096	\$193,210	\$95,238
Natural gas liquids (NGL) sales	5,735	4,921	13,131	9,971
Natural gas sales	33,747	41,830	70,419	87,185
Total revenues	139,281	92,847	276,760	192,394
Expenses:				
Oil and natural gas production	49,431	44,802	97,398	96,019
Production and other taxes	7,658	4,145	14,984	8,304
General and administrative	22,496	8,581	46,586	19,133
Depletion, depreciation, amortization and accretion	38,139	27,689	74,686	56,485
Impairment of long-lived assets	35,381	1,821	35,381	9,883
(Gains) losses on disposal of assets	(1,145)	11,049	(21,540)	5,525
Total expenses	151,960	98,087	247,495	195,349
Operating (loss) income	(12,679)	(5,240)	29,265	(2,955)
Other income (expense):				
Interest income	3	8	15	9
Interest expense (Notes 2, 8 and 9)	(28,589)	(20,614)	(55,957)	(40,747)
Gain on extinguishment of debt (Note 2)	—	—	51,693	—
Equity in income of equity method investees	3	1	20	12
Net gains (losses) on commodity derivatives (Notes 8 and 9)	(9,315)	14,516	(11,019)	49,185
Other	(2)	402	273	362
Income (loss) before income taxes	(50,579)	(10,927)	14,290	5,866
Income tax expense	(130)	(150)	(617)	(571)
Net income (loss)	\$(50,709)	\$(11,077)	\$13,673	\$5,295
Distributions to preferred unitholders	(4,750)	(4,750)	(9,500)	(9,500)
Net income (loss) attributable to unitholders	\$(55,459)	\$(15,827)	\$4,173	\$(4,205)
Income (loss) per unit - basic & diluted (Note 11)	\$(0.72)	\$(0.22)	\$0.05	\$(0.06)
Weighted average number of units used in computing net income (loss) per unit -				
Basic	76,725	72,354	76,539	72,229
Diluted	76,725	72,354	77,433	72,229
See accompanying notes to condensed consolidated financial statements.				

LEGACY RESERVES LP
 CONDENSED CONSOLIDATED STATEMENT OF PARTNERS' DEFICIT
 FOR THE SIX MONTHS ENDED JUNE 30, 2018
 (UNAUDITED)

	Series A Preferred Equity		Series B Preferred Equity		Incentive Distribution Equity		Partners' Deficit		General Partner Amount	Total Partners' Deficit
	Units	Amount	Units	Amount	Units	Amount	Limited Partner Units	Limited Partner Amount		
(In thousands)										
Balance, December 31, 2017	2,300	\$55,192	7,200	\$174,261	100	\$30,814	72,595	\$(531,794)	\$(160)	\$(271,687)
Units issued to Legacy Board of Directors for services	—	—	—	—	—	—	60	522	—	522
Unit-based compensation	—	—	—	—	—	—	—	579	—	579
Vesting of restricted and phantom units	—	—	—	—	—	—	339	—	—	—
Units issued in exchange for Standstill Agreement	—	—	—	—	—	—	3,800	5,928	—	5,928
Net income	—	—	—	—	—	—	—	13,670	3	13,673
Balance, June 30, 2018	2,300	\$55,192	7,200	\$174,261	100	\$30,814	76,794	\$(511,095)	\$(157)	\$(250,985)

See accompanying notes to condensed consolidated financial statements.

LEGACY RESERVES LP
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

	Six Months Ended June 30,	
	2018	2017
	(In thousands)	
Cash flows from operating activities:		
Net income	\$ 13,673	\$ 5,295
Adjustments to reconcile net income to net cash provided by operating activities:		
Depletion, depreciation, amortization and accretion	74,686	56,485
Amortization of debt discount and issuance costs	10,752	3,713
Gain on extinguishment of debt	(51,693)	—
Impairment of long-lived assets	35,381	9,883
(Gain) loss on derivatives	10,052	(49,942)
Unit-based compensation	24,994	2,827
(Gain) loss on disposal of assets	(21,540)	5,525
Changes in assets and liabilities:		
Decrease in accounts receivable, oil and natural gas	5,079	1,003
Decrease (increase) in accounts receivable, joint interest owners	10,905	(3,259)
Increase in accounts receivable, other	(4)	(399)
(Increase) decrease in other assets	(880)	148
Decrease in accounts payable	(6,467)	(109)
Increase in accrued oil and natural gas liabilities	12,035	8,519
Decrease in other liabilities	(1,989)	(4,558)
Total adjustments	101,311	29,836
Net cash provided by operating activities	114,984	35,131
Cash flows from investing activities:		
Investment in oil and natural gas properties	(118,324)	(61,910)
Proceeds (costs) associated with sale of assets	29,235	(199)
Investment in other equipment	(130)	(110)
Net cash settlements (paid) received on commodity derivatives	(5,209)	10,807
Net cash used in investing activities	(94,428)	(51,412)
Cash flows from financing activities:		
Proceeds from long-term debt	382,626	211,000
Payments of long-term debt	(375,384)	(196,000)
Payments of debt issuance costs	(23,096)	(60)
Net cash (used in) provided by financing activities	(15,854)	14,940
Net increase (decrease) in cash and cash equivalents	4,702	(1,341)
Cash, beginning of period (1)	4,450	5,747
Cash, end of period (1)	\$ 9,152	\$ 4,406
Non-cash investing and financing activities:		
Asset retirement obligation costs and liabilities	\$ 39	\$ —
Asset retirement obligations associated with properties sold	\$(16,107)	\$(5,650)
Asset retirement obligations associated with property acquisitions	\$ 156	\$ —
Note receivable received in exchange for sale of oil and natural gas properties	\$ —	\$ 748
Units issued in exchange for Standstill Agreement	\$ 5,928	\$ —
Change in accrued capital expenditures	\$ 25,733	\$ —
See accompanying notes to condensed consolidated financial statements.		

(1) Inclusive of \$3.2 million of restricted cash as of June 30, 2018 and 2017. See "—Footnote 1—Summary of Significant Accounting Policies" for further discussion.

LEGACY RESERVES LP
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

(1) Summary of Significant Accounting Policies

(a) Organization, Basis of Presentation and Description of Business

Legacy Reserves LP ("LRLP," "Legacy" or the "Partnership") and, unless the context indicates otherwise, its affiliated entities, are referred to as Legacy in these consolidated financial statements.

The accompanying condensed consolidated financial statements have been prepared on the accrual basis of accounting whereby revenues are recognized when earned, and expenses are recognized when incurred. These condensed consolidated financial statements as of June 30, 2018 and for the three and six months ended June 30, 2018 and 2017 are unaudited. In the opinion of management, such financial statements include the adjustments and accruals, all of which are of a normal recurring nature, which are necessary for a fair presentation of the results for the interim periods. These interim results are not necessarily indicative of results for a full year.

Certain information and footnote disclosures normally included in the financial statements prepared in accordance with generally accepted accounting principles in the United States ("GAAP") have been condensed or omitted in this Form 10-Q pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC"). These condensed consolidated financial statements should be read in connection with the consolidated financial statements and notes thereto included in the Partnership's Annual Report on Form 10-K for the year ended December 31, 2017.

LRLP, a Delaware limited partnership, was formed by its general partner, Legacy Reserves GP, LLC ("LRGPLLC"), on October 26, 2005 to own and operate oil and natural gas properties. LRGPLLC is a Delaware limited liability company formed on October 26, 2005, and owns an approximate 0.02% general partner interest in LRLP.

Significant information regarding rights of unitholders includes the following:

- Right to receive, within 45 days after the end of each quarter, distributions of available cash, if distributions are declared.
- No limited partner shall have any management power over LRLP's business and affairs; the general partner shall conduct, direct and manage LRLP's activities.
- The general partner may be removed if such removal is approved by the unitholders holding at least 66 2/3 percent of the outstanding units, including units held by LRGPLLC and its affiliates, provided that a unit majority has elected a successor general partner.
- Right to receive information reasonably required for tax reporting purposes within 90 days after the close of the calendar year.

In the event of liquidation, after making required payments to Legacy's preferred unitholders, all property and cash in excess of that required to discharge all liabilities will be distributed to the unitholders and LRGPLLC in proportion to their capital account balances, as adjusted to reflect any gain or loss upon the sale or other disposition of Legacy's assets in liquidation.

Legacy owns and operates oil and natural gas producing properties located primarily in the Permian Basin (West Texas and Southeast New Mexico), East Texas, Rocky Mountain and Mid-Continent regions of the United States.

(b) Recent Developments

On March 26, 2018, the Partnership announced its intent to consummate a transaction, pursuant to an agreement and plan of merger (the "Initial Merger Agreement"), that would result in the Partnership and LRGPLLCC becoming subsidiaries of a newly formed Delaware corporation, Legacy Reserves Inc. ("New Legacy"), and the Partnership's unitholders and preferred unitholders becoming common stockholders of New Legacy (such Transaction referred to herein collectively as the "Corporate Reorganization"). Upon the consummation of the Corporate Reorganization:

New Legacy, which is currently a wholly owned subsidiary of LRGPLL, will acquire all of the issued and outstanding limited liability company interests in LRGPLL and will become the sole member of LRGPLL; and

the Partnership will merge with Legacy Reserves Merger Sub LLC, a Delaware limited liability company and a wholly owned subsidiary of New Legacy ("Merger Sub"), with the Partnership continuing as the surviving entity and as a subsidiary of New Legacy (the "Merger"), the limited partner interests of the Partnership other than the incentive distribution units in the Partnership being exchanged for New Legacy common stock and the general partner interest remaining outstanding.

On June 22, 2018, the Partnership, New Legacy, LRGPLL and the plaintiff in a consolidated class action challenging the Merger that was filed in the Court of Chancery of the State of Delaware (the "Court") reached an agreement in principal to settle the consolidated action. The parties submitted a stipulation and agreement of settlement (the "Settlement Agreement") to the Court on July 6, 2018. The Court has entered a scheduling order setting September 12, 2018 as the date for a hearing for consideration of the Settlement Agreement. See Note 7 and Note 14 for further discussion of the Settlement Agreement. The Settlement Agreement, if approved by the Court, will grant holders of Series A Preferred Units and Series B Preferred Units approximately 10,730,000 shares of common stock in New Legacy in addition to the approximately 16,913,592 shares those holders would collectively receive pursuant to the exchange ratios that were included in the Initial Merger Agreement.

On July 9, 2018, New Legacy, the Partnership, LRGPLL and Merger Sub entered into an Amended and Restated Agreement and Plan of Merger (the "A&R Merger Agreement"). The A&R Merger Agreement amends the Initial Merger Agreement to provide, among other things, that (i) with respect to the 8% Series A Fixed-to-Floating Rate Cumulative Redeemable Perpetual Preferred Units of the Partnership (the "Series A Preferred Units"), each Series A Preferred Unit will be converted into the right to receive 2.92033118 shares of common stock in New Legacy, (ii) with respect to the 8% Series B Fixed-to-Floating Rate Cumulative Redeemable Perpetual Preferred Units of the Partnership (the "Series B Preferred Units"), each Series B Preferred Unit will be converted into the right to receive 2.90650421 shares of common stock in New Legacy, (iii) for the purposes of clarification, phantom units that settle in units representing limited partner interests in the Partnership are included in the definition of "Restricted Unit", and (iv) the board of directors of LRGPLL shall take all necessary actions to allow the Partnership's unitholders to vote at a special meeting of the unitholders (the "Special Meeting") on a proposal to approve the classification of the board of directors of New Legacy, to be in effect following the closing of the A&R Merger Agreement (the "Classified Board Proposal").

As of June 30, 2018, Legacy's ratio of consolidated current assets to consolidated current liabilities was less than 1.0 to 1.0, in violation of a covenant contained in the Current Credit Agreement. On July 31, 2018, Legacy received a waiver with respect to compliance with such covenant for the fiscal quarter ended June 30, 2018. Except with respect to compliance with the financial covenant that has been waived, as of June 30, 2018, Legacy was in compliance with all financial and other covenants of the Current Credit Agreement.

Legacy's Revolving Credit Agreement became a current liability as of April 1, 2018 as the credit facility matures on April 1, 2019. Legacy expects to refinance or extend the maturity of this obligation prior to its expiration date and Legacy believes that the consummation of the Corporate Reorganization will improve its ability to do so; however, there is no assurance that Legacy will be able to execute this refinancing or extension or, if Legacy is able to refinance or extend this obligation, that the terms of such refinancing or extension would be as favorable as the terms of Legacy's existing Revolving Credit Agreement. If the Corporate Reorganization is not consummated, Legacy believes its ability to refinance or extend the maturity of the Revolving Credit Agreement will be limited. Legacy anticipates that the Corporate Reorganization will close in September of 2018, but there is no assurance of any timing, if at all.

(c) Accrued Oil and Natural Gas Liabilities

Below are the components of accrued oil and natural gas liabilities as of June 30, 2018 and December 31, 2017:

	June 30, 2018	December 31, 2017
	(In thousands)	
Accrued capital expenditures	\$58,931	\$ 33,198
Accrued lease operating expense	18,493	18,179
Revenue payable to joint interest owners	26,831	18,510
Accrued ad valorem tax	8,956	5,807
Other	5,875	5,624
	\$119,086	\$ 81,318

(d) Restricted Cash

Restricted cash on our Consolidated Balance Sheet as of June 30, 2018 and December 31, 2017 is \$3.2 million in the "Prepaid expenses and other current assets" line. The restricted cash amounts represent various deposits to secure the performance of contracts, surety bonds and other obligations incurred in the ordinary course of business. Legacy adopted Accounting Standards Update ("ASU") No. 2016-18, "Restricted Cash" as of January 1, 2018.

(e) Recent Accounting Pronouncements

In February 2016, the FASB issued ASU No. 2016-02, "Leases" ("ASU 2016-02"). ASU 2016-02 establishes a right-of-use (ROU) model that requires a lessee to record a ROU asset and a lease liability on the balance sheet for all leases with terms longer than 12 months. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the income statement. ASU 2016-02 is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. A modified retrospective transition approach is currently required for lessees for capital and operating leases existing at, or entered into after, the beginning of the earliest comparative period presented in the consolidated financial statements, with certain practical expedients available.

In January 2018, the FASB issued an Exposure Draft titled "Leases (Topic 842): Targeted Improvements," which includes a proposed amendment to ASU 2016-02 allowing entities an additional transition method to the existing requirements. Under this additional transition method, an entity could adopt the provisions of ASU 2016-02 by recognizing a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption without adjustment to the financial statements for periods prior to adoption.

Legacy is currently evaluating the impact of its pending adoption of ASU 2016-02 on its consolidated financial statements. Legacy's ASU 2016-02 implementation approach includes educating key stakeholders within the organization, analyzing systems reports to identify the types and volume of contracts that may meet the definition of a lease under ASU 2016-02 and performing a detailed review of material contracts identified through that analysis. Based on the results obtained, Legacy will assess what impacts ASU 2016-02 could have on its financial statements and disclosures, existing accounting policies and internal controls, as well as whether a financial lease accounting system solution will need to be implemented to comply.

Legacy is also in the process of evaluating ASU 2016-02's currently available and proposed practical expedients upon transition.

(2)Debt

Debt consists of the following as of June 30, 2018 and December 31, 2017:

	June 30, 2018	December 31, 2017
	(In thousands)	
Current debt		
Credit Facility due 2019	\$508,000	\$—
Unamortized debt issuance costs	(2,778) —
Total current debt, net	505,222	—
Long-term debt		
Credit Facility due 2019	—	499,000
Second Lien Term Loans due 2020	338,626	205,000
8% Senior Notes due 2020	232,989	232,989
6.625% Senior Notes due 2021	245,579	432,656
	817,194	1,369,645
Unamortized discount on Second Lien Term Loans and Senior Notes	(12,228) (13,101
Unamortized debt issuance costs	(20,213) (9,775
Total long-term debt, net	\$784,753	\$1,346,769
Total debt, net	\$1,289,975	\$1,346,769
Credit Facility		

On April 1, 2014, Legacy entered into a five-year \$1.5 billion secured revolving credit facility with Wells Fargo Bank, National Association, as administrative agent, Compass Bank, as syndication agent, UBS Securities LLC and U.S. Bank National Association, as co-documentation agents and the lenders party thereto (as amended, the “Current Credit Agreement”). Borrowings under the Current Credit Agreement mature on April 1, 2019. Legacy's obligations under the Current Credit Agreement are secured by mortgages on over 95% of the total value of its oil and natural gas properties as well as a pledge of all of its ownership interests in its operating subsidiaries. The amount available for borrowing at any one time is limited to the borrowing base and contains a \$2 million sub-limit for letters of credit. The borrowing base was reaffirmed at \$575 million as part of the spring 2018 redetermination. The borrowing base is subject to semi-annual redeterminations on or about April 1 and October 1 of each year with the next redetermination scheduled for October 2018. Additionally, either Legacy or the lenders may, once during each calendar year, elect to redetermine the borrowing base between scheduled redeterminations. Legacy also has the right, once during each calendar year, to request the redetermination of the borrowing base upon the proposed acquisition of certain oil and natural gas properties where the purchase price is greater than 10% of the borrowing base then in effect. Any increase in the borrowing base requires the consent of all the lenders and any decrease in or maintenance of the borrowing base must be approved by the lenders holding at least 66-2/3% of the outstanding aggregate principal amounts of the loans or participation interests in letters of credit issued under the Current Credit Agreement. If the requisite lenders do not agree on an increase or decrease, then the borrowing base will be the highest borrowing base acceptable to the lenders holding 66-2/3% of the outstanding aggregate principal amounts of the loans or participation interests in letters of credit issued under the Current Credit Agreement so long as it does not increase the borrowing base then in effect. The Current Credit Agreement contains a covenant that prohibits Legacy from paying distributions to its limited partners, including holders of its preferred units, if (i) Total Debt to EBITDA for the four fiscal quarters ending on the last day of the fiscal quarter immediately preceding the date of determination for which financial statements are available is greater than 4.00 to 1.00 or (ii) Legacy has unused lender commitments of not less than 15% of the total lender commitments then in effect.

The Current Credit Agreement also contains covenants that, among other things, require us to maintain specified ratios or conditions as follows:

as of any day, first lien debt to EBITDA for the four fiscal quarters ending on the last day of the fiscal quarter immediately preceding the date of determination for which financial statements are available to not be greater than 2.50 to 1.00;

as of the last day of any fiscal quarter, secured debt to EBITDA as of the last day of any fiscal quarter for the four fiscal quarters then ending of not more than 4.5 to 1.0, beginning with the fiscal quarter ending on December 31, 2018;

as of the last day of any fiscal quarter, total EBITDA over the last four quarters to total interest expense over the last four quarters to be greater than 2.0 to 1.0;

consolidated current assets, as of the last day of the most recent quarter and including the unused amount of the total commitments, to consolidated current liabilities as of the last day of the most recent quarter of not less than 1.0 to 1.0, excluding non-cash assets and liabilities under FASB Accounting Standards Codification 815, which includes the current portion of oil, natural gas and interest rate derivatives; and

as of the last day of any fiscal quarter, the ratio of (a) the sum of (i) the net present value using NYMEX forward pricing, discounted at 10 percent per annum, of Legacy's proved developed producing oil and gas properties as reflected in the most recent reserve report delivered either July 1 or December 31 of each year, as the case may be (giving pro forma effect to material acquisitions or dispositions since the date of such reports) ("PDP PV-10"), (ii) the net mark to market value of Legacy's swap agreements and (iii) Legacy's cash and cash equivalents, in each case as of such date to (b) Secured Debt as of such day to be equal to or less than 1.00 to 1.00.

On March 23, 2018, the Partnership entered into an amendment to the Current Credit Agreement (the "Current Credit Agreement Amendment"). The Current Credit Agreement Amendment, subject to certain conditions, among which is the consummation of the Corporate Reorganization, amends certain provisions set forth in the Current Credit Agreement to, among other items:

• permit the Corporate Reorganization and modify certain provisions to reflect the new corporate structure;

• provide that New Legacy and LRGPLLC will guarantee the debt outstanding under the Current Credit Agreement;

• provide that the Partnership may make unlimited restricted payments, subject to no default or event of default, pro forma availability under the Current Credit Agreement of at least 20%, and pro forma total leverage of not more than 3.00 to 1.00, as well as to pay taxes and ordinary course overhead expenses of New Legacy;

• waive any "Change in Control" (as defined in the Current Credit Agreement) triggered by the Corporate Reorganization; and

• permit redemptions of the 2020 Senior Notes, 2021 Senior Notes and loans under the Second Lien Term Loan Credit Agreement (as defined below) with the cash proceeds from the sale of equity interests (or exchanges for equity interests) of New Legacy.

All capitalized terms not defined in the foregoing description have the meaning assigned to them in the Current Credit Agreement Amendment.

As of June 30, 2018, Legacy's ratio of consolidated current assets to consolidated current liabilities was less than 1.0 to 1.0, in violation of a covenant contained in the Current Credit Agreement. On July 31, 2018, Legacy received a waiver with respect to compliance with such covenant for the fiscal quarter ended June 30, 2018. Except with respect to compliance with the financial covenant that has been waived, as of June 30, 2018, Legacy was in compliance with all financial and other covenants of the Current Credit Agreement. Depending on future oil and natural gas prices, Legacy could breach certain financial covenants under its Current Credit Agreement, which would constitute a default under its Current Credit Agreement. Such default, if not remedied, would require a waiver from Legacy's lenders in order for

it to avoid an event of default and, subject to certain limitations, subsequent acceleration of all amounts outstanding under its Current Credit Agreement and potential foreclosure on its oil and natural gas properties. If the lenders under Legacy's Current Credit Agreement were to accelerate the indebtedness under its Current Credit Agreement as a result of a default, such acceleration could cause a cross-default of all of its other outstanding indebtedness, including its Second Lien Term Loans (as defined below), its 8% Senior Notes due 2020 (the "2020 Senior Notes") and its 6.625% Senior Notes due 2021 (the "2021 Senior Notes" and, together with the 2020 Senior Notes, the "Senior Notes"), and permit the holders of such indebtedness to accelerate the maturities of such indebtedness. While no assurances can be made that, in the event of a covenant breach, such a waiver will be granted, Legacy believes the long-term global outlook for commodity prices and its efforts to date will be viewed positively by its lenders. The Current Credit Agreement contains a covenant that currently prohibits us from paying distributions to our limited partners, including holders of our preferred units.

As of June 30, 2018, Legacy had approximately \$508 million drawn under the Current Credit Agreement at a weighted-average interest rate of 4.76%, leaving approximately \$66.2 million of availability under the Current Credit Agreement. For the six-month period ended June 30, 2018, Legacy paid in cash \$12.7 million of interest expense on the Current Credit Agreement.

Second Lien Term Loan Credit Agreement

On October 25, 2016, Legacy entered into a Term Loan Credit Agreement (as amended, the "Second Lien Term Loan Credit Agreement") among Legacy, as borrower, Cortland Capital Market Services LLC, as administrative agent and second lien collateral agent, and the lenders party thereto, providing for term loans up to an aggregate principal amount of \$300.0 million (the "Second Lien Term Loans"). The Second Lien Term Loans under the Second Lien Term Loan Credit Agreement are issued with an upfront fee of 2% and bear interest at a rate of 12.00% per annum payable quarterly in cash or, prior to the 18 month anniversary of the Second Lien Term Loan Credit Agreement, Legacy may elect to pay in kind up to 50% of the interest payable. GSO Capital Partners L.P. ("GSO") and certain funds and accounts managed, advised or sub-advised, by GSO are the initial lenders thereunder. The Second Lien Term Loan Credit Agreement matures on August 31, 2021; provided that, if on July 1, 2020, Legacy has greater than or equal to a face amount of \$15.0 million of Senior Notes that were outstanding on the date the Term Loan Credit Agreement was entered into or any other senior notes with a maturity date that is earlier than August 31, 2021, the Term Loan Credit Agreement will mature on August 1, 2020. The Second Lien Term Loans are secured on a second lien priority basis by the same collateral that secures Legacy's Current Credit Agreement and are unconditionally guaranteed on a joint and several basis by the same wholly owned subsidiaries of Legacy that are guarantors under the Current Credit Agreement. As of June 30, 2018, Legacy had approximately \$338.6 million drawn under the Second Lien Term Loan Credit Agreement. On December 31, 2017, Legacy entered into the Third Amendment to the Second Lien Term Loan Credit Agreement (the "Third Amendment") among Legacy, as borrower, Cortland Capital Market Services LLC, as administrative agent and second lien collateral agent, and the lenders party thereto, including GSO and certain funds and accounts managed, advised or sub-advised by GSO, which, among other things, increased the maximum amount available for borrowing under the Second Lien Term Loans to \$400.0 million, extended the availability of undrawn principal (\$61.4 million of availability as of June 30, 2018) to October 25, 2019 and relaxed the asset coverage ratio to 0.85 to 1.00 until the fiscal quarter ended December 31, 2018. The Third Amendment became effective on January 5, 2018. The Second Lien Term Loan Credit Agreement contains a covenant that prohibits Legacy from paying distributions to its limited partners, including holders of its preferred units, if (i) Total Debt to EBITDA for the four fiscal quarters ending on the last day of the fiscal quarter immediately preceding the date of determination for which financial statements are available is greater than 4.00 to 1.00 or (ii) Legacy has unused lender commitments of not less than 15% of the total lender commitments then in effect.

The Second Lien Term Loan Credit Agreement also contains covenants that, among other things, requires Legacy to: not permit, as of the last day of any fiscal quarter, the ratio of the sum of (i) the net present value using NYMEX forward pricing of Legacy's PDP PV-10, (ii) the net mark to market value of Legacy's swap agreements and (iii) Legacy's cash and cash equivalents to Secured Debt to be less than 0.85 to 1.00 until the fiscal quarter ended December 31, 2018 and 1.00 to 1.00 thereafter; and

not permit, as of the last day of any fiscal quarter beginning with the fiscal quarter ending December 31, 2018, Legacy's ratio of Secured Debt as of such day to EBITDA for the four fiscal quarters then ending to be greater than 4.50 to 1.00.

On March 23, 2018, the Partnership entered into the Fourth Amendment to the Second Lien Term Loan Credit Agreement (the "Term Loan Amendment"). The Term Loan Amendment, subject to certain conditions, among which is the consummation of the Corporate Reorganization, amends certain provisions set forth in the Second Lien Term Loan Credit Agreement to, among other items:

• permit the Corporate Reorganization and modify certain provisions to reflect the new corporate structure;

• provide that New Legacy and LRGPLLC will guarantee the debt outstanding under the Second Lien Term Loan Credit Agreement;

• provide that the Partnership may make unlimited restricted payments, subject to no default or event of default, pro forma availability under the Second Lien Term Loan Credit Agreement of at least 20%, and pro forma total leverage of not more than 3.00 to 1.00, as well as to pay taxes and ordinary course overhead expenses of New Legacy;

• waive any “Change in Control” (as defined in the Second Lien Term Loan Credit Agreement) triggered by the Corporate Reorganization;

waive any requirement to prepay the Term Loans using the Partnership's Free Cash Flow or limit Capital Expenditures (each as defined in the Second Lien Term Loan Credit Agreement) prior to March 31, 2019; and

permit redemptions of the 2020 Senior Notes and the 2021 Senior Notes with the cash proceeds from the sale of equity interests (or exchanges for equity interests) of New Legacy.

All capitalized terms used but not defined in the foregoing description have the meaning assigned to them in the Second Lien Term Loan Credit Agreement.

In connection with the Second Lien Term Loan Credit Agreement, a customary intercreditor agreement was entered into by Wells Fargo Bank National Association, as priority lien agent, and Cortland Capital Markets Services LLC, as junior lien agent, and acknowledged and accepted by Legacy and the subsidiary guarantors.

As of June 30, 2018, Legacy was in compliance with all financial and other covenants of the Second Lien Term Loan Credit Agreement.

8% Senior Notes Due 2020 ("2020 Senior Notes")

On December 4, 2012, Legacy and its 100% owned subsidiary Legacy Reserves Finance Corporation completed a private placement offering to eligible purchasers of an aggregate principal amount of \$300 million of its 2020 Senior Notes, which were subsequently registered through a public exchange offer that closed on January 8, 2014. The 2020 Senior Notes were issued at 97.848% of par.

Legacy has the option to redeem the 2020 Senior Notes, in whole or in part, at any time at the specified redemption prices set forth below together with any accrued and unpaid interest, if any, to the date of redemption if redeemed during the twelve-month period beginning on December 1 of the years indicated below.

Year	Percentage
2017	102.000 %
2018 and thereafter	100.000 %

Legacy may be required to offer to repurchase the 2020 Senior Notes at a purchase price of 101% of the principal amount, plus accrued and unpaid interest, if any, to the redemption date, in the event of a change of control as defined by the indenture as supplemented. Legacy's and Legacy Reserves Finance Corporation's obligations under the 2020 Senior Notes are guaranteed by its 100% owned subsidiaries Legacy Reserves Operating GP LLC, Legacy Reserves Operating LP and Legacy Reserves Services, Inc., Legacy Reserves Energy Services LLC, Dew Gathering LLC and Pinnacle Gas Treating LLC, which constitute all of Legacy's wholly-owned subsidiaries other than Legacy Reserves Finance Corporation. In the future, the guarantees may be released or terminated under the following circumstances: (i) in connection with any sale or other disposition of all or substantially all of the properties of the guarantor; (ii) in connection with any sale or other disposition of sufficient capital stock of the guarantor so that it no longer qualifies as our Restricted Subsidiary (as defined in the indenture); (iii) if designated to be an unrestricted subsidiary; (iv) upon legal defeasance, covenant defeasance or satisfaction and discharge of the indenture; (v) upon the liquidation or dissolution of the guarantor provided no default or event of default has occurred or is occurring; (vi) at such time the guarantor does not have outstanding guarantees of its, or any other guarantor's, other, debt; or (vii) upon merging into, or transferring all of its properties to Legacy or another guarantor and ceasing to exist. Refer to "—Footnote 13—Subsidiary Guarantors" for further details on Legacy's guarantors.

The indenture governing the 2020 Senior Notes (the "2020 Notes Indenture") limits Legacy's ability and the ability of certain of its subsidiaries to (i) sell assets; (ii) pay distributions on, repurchase or redeem equity interests or purchase or redeem Legacy's subordinated debt, provided that such subsidiaries may pay dividends to the holders of their equity

interests (including Legacy) and Legacy may pay distributions to the holders of its equity interests subject to the absence of certain defaults, the satisfaction of a fixed charge coverage ratio test and so long as the amount of such distributions does not exceed the sum of available cash (as defined in the partnership agreement) at Legacy, net proceeds from the sales of certain securities and return of or reductions to capital from restricted investments; (iii) make certain investments; (iv) incur or guarantee additional indebtedness or issue preferred units; (v) create or incur certain liens; (vi) enter into agreements that restrict distributions or other payments from certain of its subsidiaries to Legacy; (vii) consolidate, merge or transfer all or substantially all of Legacy's assets; (viii) engage in certain transactions with affiliates; (ix) create unrestricted subsidiaries; and (x) engage in certain business activities. These covenants are subject to a number of important exceptions and qualifications. If at any time when the 2020 Senior Notes are rated investment

grade by each of Moody's Investors Service, Inc. and Standard & Poor's Ratings Services and no Default (as defined in the indenture) has occurred and is continuing, many of such covenants will terminate and Legacy and its subsidiaries will cease to be subject to such covenants. The indenture also includes customary events of default. The Partnership is in compliance with all financial and other covenants of the 2020 Senior Notes. However, if the lenders under Legacy's Current Credit Agreement were to accelerate the indebtedness under Legacy's Current Credit Agreement as a result of a default, such acceleration could cause a cross-default of all of the 2020 Senior Notes and permit the holders of such notes to accelerate the maturities of such indebtedness.

On April 2, 2018, following receipt of the requisite consents of the holders of the 2020 Senior Notes, the Partnership entered into the Second Supplemental Indenture (the "2020 Notes Supplemental Indenture"), to the 2020 Notes Indenture. Pursuant to the 2020 Notes Supplemental Indenture, the 2020 Notes Indenture was amended to, among other things, (i) exclude the Corporate Reorganization from the definition of "Change of Control" in the 2020 Notes Indenture, (ii) permit the Corporate Reorganization, (iii) provide for the issuance of an unconditional and irrevocable guarantee of the 2020 Senior Notes by New Legacy and LRGPLLC, (iv) provide that certain covenants and other provisions under the 2020 Notes Indenture previously applicable to the Partnership and its restricted subsidiaries will apply to New Legacy and its restricted subsidiaries, (v) make certain changes to the restricted payments covenant to reflect that the Partnership will no longer be a publicly traded master limited partnership following the Corporate Reorganization and (vi) effect certain other conforming changes.

Interest is payable on June 1 and December 1 of each year.

During the fiscal year ended December 31, 2016, Legacy repurchased a face amount of \$52.0 million of its 2020 Senior Notes on the open market.

On June 1, 2016, Legacy exchanged 2,719,124 units representing limited partner interests in the Partnership for \$15.0 million of face amount of its outstanding 2020 Senior Notes.

6.625% Senior Notes Due 2021 ("2021 Senior Notes")

On May 28, 2013, Legacy and its 100% owned subsidiary Legacy Reserves Finance Corporation completed a private placement offering to eligible purchasers of an aggregate principal amount of \$250 million of its 2021 Senior Notes, which were subsequently registered through a public exchange offer that closed on March 18, 2014. The 2021 Senior Notes were issued at 98.405% of par.

On May 13, 2014, Legacy and its 100% owned subsidiary Legacy Reserves Finance Corporation completed a private placement offering to eligible purchasers of an aggregate principal amount of an additional \$300 million of the 2021 Senior Notes, which were subsequently registered through a public exchange offer that closed on February 10, 2015. These 2021 Senior Notes were issued at 99.0% of par.

The terms of the 2021 Senior Notes, including details related to Legacy's guarantors, are substantially identical to the terms of the 2020 Senior Notes with the exception of the interest rate and redemption provisions noted below. Legacy will have the option to redeem the 2021 Senior Notes, in whole or in part, at the specified redemption prices set forth below together with any accrued and unpaid interest, if any, to the date of redemption if redeemed during the twelve-month period beginning on June 1 of the years indicated below.

Year	Percentage
2018	101.656 %
2019 and thereafter	100.000 %

Legacy may be required to offer to repurchase the 2021 Senior Notes at a purchase price of 101% of the principal amount, plus accrued and unpaid interest, if any, to the redemption date, in the event of a change of control as defined by the indenture, as supplemented. The Partnership is in compliance with all financial and other covenants of the 2021 Senior Notes. However, if the lenders under Legacy's Current Credit Agreement were to accelerate the indebtedness under Legacy's Current Credit Agreement as a result of a default, such acceleration could cause a cross-default of all of the 2021 Senior Notes and permit the holders of such notes to accelerate the maturities of such indebtedness.

On April 2, 2018, following receipt of the requisite consents of the holders of the 2021 Senior Notes, the Partnership entered into the Second Supplemental Indenture (the "2021 Notes Supplemental Indenture") to the initial indenture governing the 2021 Notes (the "2021 Notes Indenture").

Pursuant to the 2021 Notes Supplemental Indenture, the 2021 Notes Indenture was amended to, among other things, (i) exclude the Corporate Reorganization from the definition of “Change of Control” in the 2021 Notes Indenture, (ii) permit the Corporate Reorganization, (iii) provide for the issuance of an unconditional and irrevocable guarantee of the 2021 Senior Notes by New Legacy and LRGPLLC, (iv) provide that certain covenants and other provisions under the 2021 Notes Indenture previously applicable to the Partnership and its restricted subsidiaries will apply to New Legacy and its restricted subsidiaries, (v) make certain changes to the restricted payments covenant to reflect that the Partnership will no longer be a publicly traded master limited partnership following the Corporate Reorganization and (vi) effect certain other conforming changes.

Interest is payable on June 1 and December 1 of each year.

During the fiscal year ended December 31, 2016, Legacy repurchased a face amount of \$117.3 million of its 2021 Senior Notes on the open market.

On December 31, 2017, Legacy entered into a definitive agreement with certain funds managed by Fir Tree Partners (“Fir Tree”) pursuant to which Legacy acquired \$187.0 million of the 6.625% Notes for a price of approximately \$132 million inclusive of accrued but unpaid interest with a settlement date of January 5, 2018. Legacy treated these repurchases for accounting purposes as an extinguishment of debt. Accordingly, Legacy recognized a gain of \$51.7 million for the difference between (1) the face amount of the 2021 Senior Notes repurchased net of the unamortized portion of both the original issuer's discount and issuance costs and (2) the repurchase price.

(3) Impact of ASC 606 Adoption

On January 1, 2018, Legacy adopted ASU No. 2014-09, “Revenue from Contracts with Customers” (“ASU 2014-09”) using the modified retrospective method of transition applied to all contracts. ASU 2014-09 created ASC 606 - Revenue from Contracts with Customers (“ASC 606”), which supersedes nearly all existing revenue recognition guidance under U.S. GAAP and includes a five step process to recognize revenues when promised goods or services are transferred to customers in an amount that reflects the consideration to which an entity expects to be entitled for those goods or services.

The impact of adoption on Legacy's current period results is as follows (in thousands):

	Three Months Ended June 30, 2018			Six Months Ended June 30, 2018		
	Under ASC 606	Under ASC 605	Change	Under ASC 606	Under ASC 605	Change
	(In thousands)					
Revenues:						
Oil Sales	\$99,799	\$99,936	\$(137)	\$193,210	\$193,379	\$(169)
Natural gas liquids (NGL) sales	5,735	5,898	(163)	13,131	13,443	(312)
Natural gas sales	33,747	35,452	(1,705)	70,419	73,585	(3,166)
	\$139,281	\$141,286	\$(2,005)	\$276,760	\$280,407	\$(3,647)
Costs and expenses:						
Oil and natural gas production	\$49,431	\$51,436	\$(2,005)	\$97,398	\$101,045	\$(3,647)
Net income (loss)	\$(50,709)	\$(50,709)	\$—	\$13,673	\$13,673	\$—
Partners' deficit, as of January 1, 2018	\$(271,687)	\$(271,687)	\$—	\$(271,687)	\$(271,687)	\$—

The change to oil sales and a related change to oil production expense are due to the conclusion that Legacy transfers control of oil production to purchasers at or near the wellhead. As such, certain transportation expenses that are deducted from the sales price Legacy receives from the purchaser are presented net in revenue in accordance with ASC 606. This represents a change from Legacy's prior practice under ASC 605 of presenting those transportation costs gross as an oil and natural gas production expense.

The change to natural gas and NGL sales and the related change to natural gas production expense are due to the conclusion that Legacy represents an agent in certain gas processing agreements with midstream entities in accordance with the control model in ASC 606. This represents a change from Legacy's previous conclusion utilizing the principal versus agent indicators under ASC 605 that Legacy acted as the principal in those arrangements. As a result, Legacy is required to present certain gathering and processing expenses net in natural gas and NGL sales under ASC 606.

(4) Revenue from Contracts with Customers

Oil, NGL and natural gas sales revenues are generally recognized at the point in time that control of the product is transferred to the customer and collectability is reasonably assured. This generally occurs when oil or natural gas has been delivered to a pipeline or truck. A more detailed summary of the sale of each product type is included below.

Oil Sales

Legacy's oil sales contracts are generally structured such that Legacy sells its oil production to the purchaser at a contractually specified delivery point at or near the wellhead. The crude oil production is priced on the delivery date based upon prevailing index prices less certain deductions related to oil quality and physical location. Legacy recognizes revenue when control transfers to the purchaser upon delivery at the net price received from purchaser.

NGL and Natural Gas Sales

Under Legacy's gas processing contracts, Legacy delivers wet gas to a midstream processing entity at the wellhead or the inlet of the midstream processing entity's system. The midstream processing entity processes the natural gas and remits proceeds to Legacy for the resulting sales of NGLs and residue gas. In these scenarios, Legacy evaluates whether it is the principal or the agent in the transaction. In virtually all of Legacy's gas processing contracts, Legacy has concluded that it is the agent, and the midstream processing entity is Legacy's customer. Accordingly, Legacy recognizes revenue upon delivery based on the net amount of the proceeds received from the midstream processing entity. Proceeds are generally tied to the prevailing index prices for residue gas and NGLs less deductions for gathering, processing, transportation and other expenses.

Under Legacy's dry gas sales that do not require processing, Legacy sells its natural gas production to third party purchasers at a contractually specified delivery point at or near the wellhead. Pricing provisions are tied to a market index, with certain deductions based on, among other factors, whether a well delivers to a gathering or transmission line, quality of natural gas, and prevailing supply and demand conditions, so that the price of the natural gas fluctuates to remain competitive with other available natural gas supplies. Legacy recognizes revenue upon delivery of the natural gas to third party purchasers based on the relevant index price net of deductions.

Imbalances

Natural gas imbalances occur when Legacy sells more or less than its entitled ownership percentage of total natural gas production. Any amount received in excess of its share is treated as a liability. If Legacy receives less than its entitled share, the underproduction is recorded as a receivable. Legacy did not have any significant natural gas imbalance positions as of December 31, 2017 and 2016.

Disaggregation of Revenue

Legacy has identified three material revenue streams in its business: oil sales, NGL sales, and natural gas sales. Revenue attributable to each of Legacy's identified revenue streams is disaggregated in the table below.

Three	Six
Months	Months
Ended	Ended
June 30,	
2018	2018
(In thousands)	

Revenues:

Oil sales	\$99,799	\$193,210
Natural gas liquids (NGL) sales	5,735	13,131
Natural gas sales	33,747	70,419
Total revenues	139,281	276,760

Significant Judgments

Principal versus agent

Legacy engages in various types of transactions in which midstream entities process its gas and subsequently market resulting NGLs and residue gas to third-party customers on Legacy's behalf, such as Legacy's percentage-of-proceeds and gas purchase contracts. These types of transactions require judgment to determine whether Legacy is the principal or the agent in the contract and, as a result, whether revenues are recorded gross or net.

Transaction price allocated to remaining performance obligations

A significant number of Legacy's product sales are short-term in nature with a contract term of one year or less. For those contracts, Legacy has utilized the practical expedient in ASC 606 that exempts it from disclosure of the transaction price allocated to remaining performance obligations if the performance obligation is part of a contract that has an original expected duration of one year or less.

For Legacy's product sales that have a contract term greater than one year, Legacy has utilized the practical expedient in ASC 606 that states that it is not required to disclose the transaction price allocated to remaining performance obligations if the variable consideration is allocated entirely to a wholly unsatisfied performance obligation. Under these sales contracts, each unit of product represents a separate performance obligation; therefore future volumes are wholly unsatisfied and disclosure of the transaction price allocated to remaining performance obligations is not required.

Contract balances

Under Legacy's product sales contracts, it is entitled to payment from purchasers once its performance obligations have been satisfied upon delivery of the product, at which point payment is unconditional, and record invoiced amounts as "Accounts receivable - oil and natural gas" in its consolidated balance sheet.

To the extent actual volumes and prices of oil and natural gas are unavailable for a given reporting period because of timing or information not received from third parties, the expected sales volumes and prices for those properties are estimated and also recorded as "Accounts receivable - oil and natural gas" in the accompanying consolidated balance sheets. In this scenario, payment is also unconditional, as Legacy has satisfied its performance obligations through delivery of the relevant product. As a result, Legacy has concluded that its product sales do not give rise to contract assets or liabilities under ASC 606.

Prior-period performance obligations

Legacy records revenue in the month production is delivered to the purchaser. However, settlement statements for certain oil, natural gas and NGL sales may not be received for 30 to 60 days after the date production is delivered, and as a result, Legacy is required to estimate the amount of production that was delivered to the midstream purchaser and the price that will be received for the sale of the product. Additionally, to the extent actual volumes and prices of oil are unavailable for a given reporting period because of timing or information not received from third party purchasers, the expected sales volumes and prices for those barrels of oil are also estimated.

Legacy records the differences between its estimates and the actual amounts received for product sales in the month that payment is received from the purchaser. Legacy has existing internal controls in place for its estimation process, and any identified differences between its revenue estimates and actual revenue received historically have not been significant. For the three months ended June 30, 2018, revenue recognized in the reporting period related to

performance obligations satisfied in prior reporting periods was not material.

(5) Asset Acquisition and Dispositions

On August 1, 2017, Legacy made a payment in the amount of \$141 million (the “Acceleration Payment”) in connection with its First Amended and Restated Development Agreement (the “Restated Agreement”) with Jupiter JV, LP (“Jupiter”). The Acceleration Payment caused the reversion to Legacy of additional working interests in all wells and associated personal property and infrastructure (collectively, the “Wells”) and all undeveloped assets subject to the Restated Agreement. The transaction was accounted for as an asset acquisition in accordance with ASU 2017-01. Therefore, the acquired interests were recorded based upon the cash consideration paid, with all value assigned to proved oil and natural gas properties.

During the six months ended June 30, 2018, Legacy divested certain individually immaterial oil and natural gas assets for net cash proceeds of \$29.2 million. These dispositions were treated as asset sales and resulted in a gain on disposition of assets of \$21.5 million during the period.

(6) Related Party Transactions

Blue Quail Energy Services, LLC (“Blue Quail”), a company specializing in water transfer services, is an affiliate of Moriah Energy Services LLC, an entity which Cary D. Brown and Dale A. Brown, both directors of Legacy, are principals. Legacy has contracted with Blue Quail to provide water transfer services and paid \$120,241 and \$9,758 in the six month periods ended June 30, 2018 and 2017, respectively, to Blue Quail for such services. Blue Quail charged Legacy prices consistent with that of other vendors for services rendered.

(7) Commitments and Contingencies

On March 28, 2018, a purported holder of the Partnership’s Preferred Units filed a putative class action challenging the Merger against the Partnership, LRGPLL and New Legacy (the “Doppelt Action”). The Doppelt Action contains two causes of action challenging the Merger, including breach of the Fifth Amended and Restated Agreement of Limited Partnership of the Partnership (the “Partnership Agreement”) and breach of the implied covenant of good faith and fair dealing. The plaintiff in the Doppelt Action seeks injunctive relief prohibiting consummation of the Merger or, in the event the Merger is consummated, rescission or rescissory damages, as well as reasonable attorneys’ and experts’ fees and expenses. Additionally, on April 4, 2018, a motion to expedite was filed in connection with the Doppelt Action, by which the plaintiff sought a hearing on a motion for a preliminary injunction prior to the close of the Merger and requested that the court set an expedited discovery schedule prior to any such hearing. The plaintiff in the Doppelt Action also filed a lawsuit against the Partnership and the LRGPLL in 2017 for breach of the Partnership Agreement based on the treatment of the accrued but unpaid preferred distributions as “guaranteed payments” for tax purposes. A second putative class action lawsuit challenging the Merger was filed on April 3, 2018 against the Partnership, the LRGPLL and New Legacy (the “Chammah Ventures Action”). The Chammah Ventures Action contains the same causes of action and that plaintiff seeks substantially the same relief as the plaintiff in the Doppelt Action. On April 13, 2018, the Court issued an order consolidating the Doppelt and Chammah actions (together, the “Consolidated Actions”) and appointing Plaintiff Doppelt as lead plaintiff and his counsel as lead counsel for the putative class action. On April 13, 2018, the Court also granted the motion to expedite the consolidated action. On April 23, 2018 Plaintiff Doppelt filed an Amended Complaint, adding an additional count for breach of the Partnership Agreement. A hearing on Plaintiff’s motion for a preliminary injunction and Legacy’s motion to dismiss occurred on June 4, 2018.

On June 22, 2018, the Partnership, New Legacy, LRGPLL and the plaintiff in the Consolidated Action reached an agreement in principle to settle the Consolidated Action. The parties submitted a Settlement Agreement to the Court on July 6, 2018. The Court has entered a scheduling order setting September 12, 2018 as the date for a hearing for consideration of the Settlement Agreement. See Note 1 and Note 14 for further discussion of the Settlement Agreement.

A third putative class action lawsuit challenging the Merger was filed against the Partnership, LRGPLL, New Legacy and Merger Sub on April 27, 2018 by Patrick Irish in the District Court in Midland County, Texas (the “Irish Action”). The Irish Action contains the same general causes of action as the initial complaint filed in the Doppelt Action and the Chammah Ventures Action and seeks the same relief. The Partnership, LRGPLL, New Legacy and the plaintiff’s counsel in the Consolidated Action have agreed to coordinate efforts to obtain a dismissal of the Irish Action following the consummation of the Merger.

The Partnership cannot predict the outcome of these or any other lawsuits that might be filed subsequent to the date of the filing of this quarterly report, nor can the Partnership predict the amount of time and expense that will be required

to resolve such litigation. The Partnership believes the lawsuits are without merit and intends to vigorously defend against the lawsuits.

Legacy is also, from time to time, involved in litigation and claims arising out of its operations in the normal course of business. Management does not believe that it is probable that the outcome of these actions will have a material adverse effect on Legacy's consolidated financial position, results of operations or cash flow, although the ultimate outcome and impact of such legal proceedings on Legacy cannot be predicted with certainty.

Legacy is subject to numerous laws and regulations governing the discharge of materials into the environment or otherwise relating to environmental protection. To the extent laws are enacted or other governmental action is taken that restricts drilling or imposes environmental protection requirements that result in increased costs to the oil and natural gas industry in general, the business and prospects of Legacy could be adversely affected.

Legacy has employment agreements with its officers and retention bonus agreements with certain other employees. The employment agreements with its officers specify that if the officer is terminated by Legacy for other than cause or following a change in control, the officer shall receive severance pay ranging from 24 to 36 months salary plus bonus and COBRA benefits, respectively. The retention bonus agreements provide for fixed bonus amounts to be paid to employees contingent upon various criteria including their continuous employment or a change in control.

(8) Fair Value Measurements

Fair value is defined as the price that would be received upon the sale of an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value measurements are classified and disclosed in one of the following categories:

Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted Level assets or liabilities. Legacy considers active markets as those in which transactions for the assets or liabilities 1: occur in sufficient frequency and volume to provide pricing information on an ongoing basis.

Quoted prices in markets that are not active, or inputs which are observable, either directly or indirectly, for substantially the full term of the asset or liability. This category includes those derivative instruments that Legacy values using observable market data. Substantially all of these inputs are observable in the marketplace throughout the term of the derivative instrument, can be derived from observable data, or are supported by Level observable levels at which transactions are executed in the marketplace. Instruments in this category include 2: non-exchange traded derivatives such as over-the-counter commodity price swaps and collars and interest rate swaps as well as long-term incentive plan liabilities calculated using the Black-Scholes model to estimate the fair value as of the measurement date.

Measured based on prices or valuation models that require inputs that are both significant to the fair value measurement and less observable from objective sources (i.e. supported by little or no market activity). Legacy's valuation models are primarily industry standard models that consider various inputs including: (a) quoted Level forward prices for commodities, (b) time value, and (c) current market and contractual prices for the underlying 3: instruments, as well as other relevant economic measures. Level 3 instruments currently are limited to Midland-Cushing crude oil differential swaps. Although Legacy utilizes third party broker quotes to assess the reasonableness of its prices and valuation techniques, Legacy does not have sufficient corroborating evidence to support classifying these assets and liabilities as Level 2.

Financial assets and liabilities are classified based on the lowest level of input that is significant to the fair value measurement. Legacy's assessment of the significance of a particular input to the fair value measurement requires judgment and may affect the valuation of the fair value of assets and liabilities and their placement within the fair value hierarchy levels.

Fair Value on a Recurring Basis

The following tables summarize (i) the valuation of each of Legacy's financial instruments by required fair value hierarchy levels and (ii) the gross fair value by the appropriate balance sheet classification, even when the financial instruments are subject to netting arrangements and qualify for net presentation in the Legacy's consolidated balance sheets at June 30, 2018 and December 31, 2017. Legacy nets the fair value of derivative instruments by counterparty in its consolidated balance sheets.

	June 30, 2018 Fair Value Measurements Using Quoted Prices in Active Markets for Identical Assets (Level 1)			Significant Unobservable Inputs (Level 3)	Total Fair Value	Gross Amounts Offset in the Consolidated Balance Sheets	Net Amounts Presented in the Consolidated Balance Sheets
(In thousands)							
Assets:							
Current							
Commodity derivatives	\$ 12,703	\$ 30,134	\$ 42,837	\$ (12,703)	\$ 30,134		
Interest rate derivatives	2,300	—	2,300	—	2,300		
Noncurrent							
Commodity derivatives	7,701	1,482	9,183	(4,388)	4,795		
Interest rate derivatives	784	—	784	—	784		
Liabilities:							
Current							
Commodity derivatives	(44,830)	—	(44,830)	12,703	(32,127)		
LTIP liability	(25,840)	—	(25,840)	—	(25,840)		
Noncurrent							
Commodity derivatives	(6,682)	—	(6,682)	4,388	(2,294)		
Net fair value instruments	\$(53,864)	\$ 31,616	\$(22,248)	\$ —	\$ (22,248)		

(a) See Note 12 for further discussion on unit-based compensation expenses and the related Long-Term Incentive Plan ("LTIP") liability for certain grants accounted for under the liability method.

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December 31, 2017

Fair Value Measurements

Using

Quoted

Prices

in

Active

Markets

for

Identical

Assets

(Level

1)

(In thousands)

Significant
Other
Markets
Observable
Inputs
(Level 2)

Significant
Unobservable
Inputs
(Level 3)

Total
Fair
Value

Gross
Amounts
Offset in the
Consolidated
Balance
Sheets

Net Amounts
Presented in
the
Consolidated
Balance
Sheets

Assets:

Current

Commodity derivatives \$-19,792 \$ — \$19,792 \$ (7,204) \$ 12,588

Interest rate derivatives —837 — 837 (1) 836

Noncurrent

Commodity derivatives —14,278 — 14,278 (1,460) 12,818

Interest rate derivatives —1,281 — 1,281 1,281

Liabilities:

Current

Commodity derivatives —(21,027) (4,191) (25,218) 7,204 (18,014)

Interest rate derivatives —(1) — (1) 1 —

LTIP liability —(1,947) — (1,947) (1,947)

Noncurrent

Commodity derivatives —(1,637) (897) (2,534) 1,460 (1,074)

Net fair value instruments \$-11,576 \$ (5,088) \$6,488 \$ — \$ 6,488

(a) See Note 12 for further discussion on unit-based compensation expenses and the related Long-Term Incentive Plan ("LTIP") liability for certain grants accounted for under the liability method.

Legacy estimates the fair values of the swaps based on published forward commodity price curves for the underlying commodities as of the date of the estimate for those commodities for which published forward pricing is readily available. For those commodity derivatives for which forward commodity price curves are not readily available, Legacy estimates, with the assistance of third-party pricing experts, the forward curves as of the date of the estimate. Legacy validates the data provided by third parties by understanding the pricing models used, obtaining market values from other pricing sources, analyzing pricing data in certain situations and confirming, where applicable, that those securities trade in active markets. Legacy estimates the option value of puts and calls combined into hedges, including three-way collars and enhanced swaps, using an option pricing model which takes into account market volatility, market prices, contract parameters and discount rates based on published London interbank offered rates ("LIBOR") and interest rate swaps. Due to the lack of an active market for periods beyond one-month from the balance sheet date for its oil price differential swaps, Legacy has reviewed historical differential prices and known economic influences to estimate a reasonable forward curve of future pricing scenarios based upon these factors. In order to estimate the fair value of our interest rate swaps, Legacy uses a yield curve based on money market rates and interest rate swaps, extrapolates a forecast of future interest rates, estimates each future cash flow, derives discount factors to value the

fixed and floating rate cash flows of each swap, and then discounts to present value all known (fixed) and forecasted (floating) swap cash flows. Curve building and discounting techniques used to establish the theoretical market value of interest bearing securities are based on readily available money market rates and interest swap market data. The determination of the fair values above incorporates various factors including the impact of our non-performance risk and the credit standing of the counterparties involved in the Partnership's derivative contracts. The risk of nonperformance by the Partnership's counterparties is mitigated by the fact that most of our current counterparties (or their affiliates) are also current or former bank lenders under the Partnership's revolving credit facility. In addition, Legacy routinely monitors the creditworthiness of its counterparties. As the factors described above are based on significant assumptions made by management, these assumptions are the most sensitive to change.

The following table sets forth a reconciliation of changes in the fair value of financial assets and liabilities classified as Level 3 in the fair value hierarchy:

	Significant Unobservable Inputs (Level 3)			
	Three Months Ended June 30, 2018		Six Months Ended June 30, 2017	
	2018	2017	2018	2017
	(In thousands)			
Beginning balance	\$9,909	\$1,666	\$(5,088)	\$