Laredo Petroleum, Inc.
Form 10-Q
August 08, 2017

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
Form 10-Q
ý QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2017
or
o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to
Commission File Number: 001-35380
Laredo Petroleum, Inc.
(Exact name of registrant as specified in its charter)

Delaware	45-3007926
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

15 W. Sixth Street, Suite 900

Tulsa, Oklahoma	74119
(Address of principal executive offices)	(Zip code)

(918) 513-4570
(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 ý No o

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

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

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

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

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

Number of shares of registrant's common stock outstanding as of August 3, 2017: 242,505,312

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CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

Various statements contained in or incorporated by reference into this Quarterly Report on Form 10-Q (this "Quarterly Report") are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). These forward-looking statements include statements, projections and estimates concerning our operations, performance, business strategy, oil and natural gas reserves, drilling program capital expenditures, liquidity and capital resources, the timing and success of specific projects, outcomes and effects of litigation, claims and disputes, derivative activities and potential financing. Forward-looking statements are generally accompanied by words such as "estimate," "project," "predict," "believe," "expect," "anticipate," "potential," "could," "may," "will," "foresee," "plan," "goal," "should," "intend," "pursue," "target," "continue," "suggest" or the negative thereof or other variations thereof or other words that convey the uncertainty of future events or outcomes. Forward-looking statements are not guarantees of performance. 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 under the circumstances. Among the factors that significantly impact our business and could impact our business in the future are:

- the volatility of, and substantial decline in, oil, natural gas liquids ("NGL") and natural gas prices, which remain at low levels;
- revisions to our reserve estimates as a result of changes in commodity prices and other uncertainties;
- impacts to our financial statements as a result of impairment write-downs;
- our ability to discover, estimate, develop and replace oil, NGL and natural gas reserves;
- changes in domestic and global production, supply and demand for oil, NGL and natural gas;
- the ongoing instability and uncertainty in the United States and international financial and consumer markets that could adversely affect the liquidity available to us and our customers and the demand for commodities, including oil, NGL and natural gas;
- capital requirements for our operations and projects;
- our ability to maintain the borrowing capacity under our Senior Secured Credit Facility (as defined below) or access other means of obtaining capital and liquidity, especially during periods of sustained low commodity prices;
- restrictions contained in our debt agreements, including our Senior Secured Credit Facility and the indentures governing our senior unsecured notes, as well as debt that could be incurred in the future;
- our ability to generate sufficient cash to service our indebtedness, fund our capital requirements and generate future profits;
- our ability to hedge and regulations that affect our ability to hedge;
- the potentially insufficient refining capacity in the United States Gulf Coast to refine all of the light sweet crude oil being produced in the United States, which could result in widening price discounts to world crude prices and potential shut-in of production due to lack of sufficient markets;
- regulations that prohibit or restrict our ability to apply hydraulic fracturing to our oil and natural gas wells and to access and dispose of water used in these operations;
- legislation or regulations that prohibit or restrict our ability to drill new allocation wells;
- our ability to execute our strategies;
- competition in the oil and natural gas industry;
- changes in the regulatory environment and changes in United States or international legal, political, administrative or economic conditions;
- drilling and operating risks, including risks related to hydraulic fracturing activities;
- risks related to the geographic concentration of our assets;
- the availability and costs of drilling and production equipment, labor and oil and natural gas processing and other services;
- the availability of sufficient pipeline and transportation facilities and gathering and processing capacity;

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- the ability to successfully identify and consummate strategic acquisitions at purchase prices that are accretive to our financial results and to successfully integrate acquired businesses, assets and properties;
- our ability to comply with federal, state and local regulatory requirements; and
- our ability to recruit and retain the qualified personnel necessary to operate our business.

These forward-looking statements involve a number of risks and uncertainties that could cause actual results to differ materially from those suggested by the forward-looking statements. Forward-looking statements should, therefore, be considered in light of various factors, including those set forth under "Part I, Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations" and elsewhere in this Quarterly Report, under "Part I, Item 1A. Risk Factors" and "Part II, Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations" in our Annual Report on Form 10-K for the fiscal year ended December 31, 2016 (the "2016 Annual Report"), and those set forth from time to time in our other filings with the Securities and Exchange Commission (the "SEC"). These documents are available through our website or through the SEC's Electronic Data Gathering and Analysis Retrieval system at http://www.sec.gov. In light of such risks and uncertainties, we caution you not to place undue reliance on these forward-looking statements. These forward-looking statements speak only as of the date of this Quarterly Report, or if earlier, as of the date they were made. We do not intend to, and disclaim any obligation to, update or revise any forward-looking statements unless required by securities law.

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Part I

Item 1. Consolidated Financial Statements (Unaudited)

Laredo Petroleum, Inc.
Consolidated balance sheets
(in thousands, except share data)
(Unaudited)

	June 30, 2017	December 31, 2016
Assets		
Current assets:		
Cash and cash equivalents	$35,024	$32,672
Accounts receivable, net	72,107	86,867
Derivatives	42,985	20,947
Other current assets	17,548	14,291
Total current assets	167,664	154,777
Property and equipment:		
Oil and natural gas properties, full cost method:		
Evaluated properties	5,703,873	5,488,756
Unevaluated properties not being depleted	203,888	221,281
Less accumulated depletion and impairment	(4,578,831)	(4,514,183)
Oil and natural gas properties, net	1,328,930	1,195,854
Midstream service assets, net	128,941	126,240
Other fixed assets, net	41,415	44,773
Property and equipment, net	1,499,286	1,366,867
Derivatives	12,807	8,718
Investment in equity method investee	249,492	243,953
Other assets, net	12,005	8,031
Total assets	$1,941,254	$1,782,346
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable	$10,777	$15,054
Undistributed revenue and royalties	32,166	26,838
Accrued capital expenditures	53,700	30,845
Derivatives	653	20,993
Other current liabilities	74,787	94,215
Total current liabilities	172,083	187,945
Long-term debt, net	1,390,277	1,353,909
Derivatives	—	5,694
Asset retirement obligations	51,034	50,604
Other noncurrent liabilities	3,457	3,621
Total liabilities	1,616,851	1,601,773
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, $0.01 par value, 50,000,000 shares authorized and zero issued as of June 30, 2017 and December 31, 2016	—	—
Common stock, $0.01 par value, 450,000,000 shares authorized and 242,534,185 and 241,929,070 issued and outstanding as of June 30, 2017 and December 31, 2016,	2,425	2,419

respectively		
Additional paid-in capital	2,410,674	2,396,236
Accumulated deficit	(2,088,696)	(2,218,082)
Total stockholders' equity	324,403	180,573
Total liabilities and stockholders' equity	$ 1,941,254	$ 1,782,346

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

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Laredo Petroleum, Inc.
Consolidated statements of operations
(in thousands, except per share data)
(Unaudited)

	Three months ended June 30,		Six months ended June 30,	
	2017	2016	2017	2016
Revenues:				
Oil, NGL and natural gas sales	$141,837	$102,526	$280,573	$175,668
Midstream service revenues	2,703	1,632	5,702	3,433
Sales of purchased oil	42,461	42,615	89,732	74,229
Total revenues	187,001	146,773	376,007	253,330
Costs and expenses:				
Lease operating expenses	20,104	19,225	37,096	39,743
Production and ad valorem taxes	8,472	7,982	17,253	14,417
Midstream service expenses	896	1,178	1,812	1,787
Costs of purchased oil	44,020	44,012	94,276	76,958
General and administrative	22,008	20,502	47,605	39,953
Depletion, depreciation and amortization	38,003	34,177	72,115	75,655
Impairment expense	—	963	—	162,027
Other operating expenses	1,437	860	2,463	1,704
Total costs and expenses	134,940	128,899	272,620	412,244
Operating income (loss)	52,061	17,874	103,387	(158,914)
Non-operating income (expense):				
Gain (loss) on derivatives, net	28,897	(68,518)	65,568	(50,633)
Income from equity method investee	2,471	3,696	5,539	5,994
Interest expense	(23,173)	(23,512)	(45,893)	(47,217)
Interest and other income	49	11	194	110
Write-off of debt issuance costs	—	(842)	—	(842)
Gain (loss) on disposal of assets, net	805	(141)	591	(301)
Non-operating income (expense), net	9,049	(89,306)	25,999	(92,889)
Income (loss) before income taxes	61,110	(71,432)	129,386	(251,803)
Income tax:				
Deferred	—	—	—	—
Total income tax	—	—	—	—
Net income (loss)	$61,110	$(71,432)	$129,386	$(251,803)
Net income (loss) per common share:				
Basic	$0.26	$(0.33)	$0.54	$(1.17)
Diluted	$0.25	$(0.33)	$0.53	$(1.17)
Weighted-average common shares outstanding:				
Basic	239,231	217,564	238,870	214,562
Diluted	244,417	217,564	244,385	214,562

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

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Laredo Petroleum, Inc.
Consolidated statement of stockholders' equity
(in thousands)
(Unaudited)

	Common Stock		Additional paid-in capital	Treasury Stock (at cost)		Accumulated deficit	Total
	Shares	Amount		Shares	Amount		
Balance, December 31, 2016	241,929	$2,419	$2,396,236	—	$ —	$(2,218,082)	$180,573
Restricted stock awards	1,185	12	(12)	—	—	—	—
Restricted stock forfeitures	(232)	(2)	2	—	—	—	—
Performance share conversion	150	2	(2)	—	—	—	—
Vested stock exchanged for tax withholding	—	—	—	542	(7,597)	—	(7,597)
Retirement of treasury stock	(542)	(6)	(7,591)	(542)	7,597	—	—
Exercise of stock options	44	—	358	—	—	—	358
Stock-based compensation	—	—	21,683	—	—	—	21,683
Net income	—	—	—	—	—	129,386	129,386
Balance, June 30, 2017	242,534	$2,425	$2,410,674	—	$ —	$(2,088,696)	$324,403

The accompanying notes are an integral part of this unaudited consolidated financial statement.

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Laredo Petroleum, Inc.
Consolidated statements of cash flows
(in thousands)
(Unaudited)

	Six months ended June 30, 2017	Six months ended June 30, 2016
Cash flows from operating activities:		
Net income (loss)	$129,386	$(251,803)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depletion, depreciation and amortization	72,115	75,655
Impairment expense	—	162,027
Non-cash stock-based compensation, net of amounts capitalized	17,911	9,911
Mark-to-market on derivatives:		
(Gain) loss on derivatives, net	(65,568)	50,633
Cash settlements received for matured derivatives, net	21,156	113,319
Cash settlements received for early terminations of derivatives, net	4,234	80,000
Change in net present value of derivative deferred premiums	111	133
Cash premiums paid for derivatives	(12,094)	(84,263)
Amortization of debt issuance costs	2,094	2,187
Write-off of debt issuance costs	—	842
Income from equity method investee	(5,539)	(5,994)
Cash settlement of performance unit awards	—	(6,394)
Other, net	1,414	2,009
Decrease (increase) in accounts receivable	14,760	(844)
Increase in other assets	(3,516)	(117)
(Decrease) increase in accounts payable	(4,277)	319
Increase (decrease) in undistributed revenues and royalties	5,328	(9,088)
(Decrease) increase in other accrued liabilities	(20,449)	295
Decrease in other noncurrent liabilities	(165)	(196)
Net cash provided by operating activities	156,901	138,631
Cash flows from investing activities:		
Capital expenditures:		
Oil and natural gas properties	(232,219)	(197,042)
Midstream service assets	(6,117)	(3,425)
Other fixed assets	(2,683)	(832)
Investment in equity method investee	—	(42,681)
Proceeds from dispositions of capital assets, net of selling costs	63,441	350
Net cash used in investing activities	(177,578)	(243,630)
Cash flows from financing activities:		
Borrowings on Senior Secured Credit Facility	90,000	120,000
Payments on Senior Secured Credit Facility	(55,000)	(144,682)
Proceeds from issuance of common stock, net of offering costs	—	119,310
Purchase of treasury stock	(7,597)	(1,541)
Proceeds from exercise of employee stock options	358	67
Payments for debt issuance costs	(4,732)	—
Net cash provided by financing activities	23,029	93,154
Net increase (decrease) in cash and cash equivalents	2,352	(11,845)
Cash and cash equivalents, beginning of period	32,672	31,154

Cash and cash equivalents, end of period	$35,024	$19,309

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

Note 1—Organization

Laredo Petroleum, Inc. ("Laredo"), together with its wholly-owned subsidiaries, Laredo Midstream Services, LLC ("LMS") and Garden City Minerals, LLC ("GCM"), is an independent energy company focused on the acquisition, exploration and development of oil and natural gas properties, and the gathering of oil and liquids-rich natural gas from such properties, primarily in the Permian Basin in West Texas. LMS and GCM (together, the "Guarantors") guarantee all of Laredo's debt instruments. In these notes, the "Company" refers to Laredo, LMS and GCM collectively, unless the context indicates otherwise. All amounts, dollars and percentages presented in these unaudited consolidated financial statements and the related notes are rounded and therefore approximate.

LMS holds 49% of the ownership units of Medallion Gathering & Processing, LLC, a Texas limited liability company formed on October 12, 2012, which, together with its wholly-owned subsidiaries (collectively, "Medallion"), is focused on developing midstream solutions and providing midstream infrastructure in the Midland Basin. The Company accounts for Medallion as an equity method investment.

The Company operates in two business segments: (i) exploration and production and (ii) midstream and marketing. The exploration and production segment is engaged in the acquisition, exploration and development of oil and natural gas properties. The midstream and marketing segment provides Laredo's exploration and production segment and third parties with products and services that need to be delivered by midstream infrastructure, including oil and liquids-rich natural gas gathering services as well as rig fuel, natural gas lift and water delivery and takeaway.

Note 2—Basis of presentation and significant accounting policies

a. Basis of presentation

The accompanying unaudited consolidated financial statements were derived from the historical accounting records of the Company and reflect the historical financial position, results of operations and cash flows for the periods described herein. The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP"). All material intercompany transactions and account balances have been eliminated in the consolidation of accounts. The Company uses the equity method of accounting to record its net interests when the Company holds 20% to 50% of the voting rights and/or has the ability to exercise significant influence but does not control the entity. Under the equity method, the Company's proportionate share of the investee's net income is included in the unaudited consolidated statements of operations. See Note 2.h for additional discussion of the Company's equity method investment.

The accompanying consolidated financial statements have not been audited by the Company's independent registered public accounting firm, except that the consolidated balance sheet as of December 31, 2016 is derived from audited consolidated financial statements. In the opinion of management, the accompanying unaudited consolidated financial statements reflect all necessary adjustments to present fairly the Company's financial position as of June 30, 2017, results of operations for the three and six months ended June 30, 2017 and 2016 and cash flows for the six months ended June 30, 2017 and 2016.

Certain disclosures have been condensed or omitted from these unaudited consolidated financial statements. Accordingly, these unaudited consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in the 2016 Annual Report.

b. Use of estimates in the preparation of interim unaudited consolidated financial statements

The preparation of the accompanying unaudited consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions about future events. These estimates and the underlying assumptions affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Although management believes these estimates are reasonable, actual results could differ. The interim results reflected in the unaudited consolidated financial statements are not necessarily indicative of the results that may be expected for other interim periods or for the full year.

Significant estimates include, but are not limited to, (i) estimates of the Company's reserves of oil, NGL and natural gas, (ii) future cash flows from oil and natural gas properties, (iii) depletion, depreciation and amortization, (iv) impairments, (v) asset retirement obligations, (vi) stock-based compensation, (vii) deferred income taxes, (viii) fair value of assets acquired and liabilities assumed in an acquisition, (ix) fair value of derivatives and deferred premiums and (x) contingent liabilities. As fair value is a market-based measurement, it is determined based on the assumptions that would be used by market participants.

These estimates and assumptions are based on management's best judgment. Management evaluates its estimates and assumptions on an ongoing basis using historical experience and other factors, including the current economic environment. Such estimates and assumptions are adjusted when facts and circumstances dictate. Illiquid credit markets and volatile equity and energy markets have combined to increase the uncertainty inherent in such estimates and assumptions. Management believes its estimates and assumptions to be reasonable under the circumstances. As future events and their effects cannot be determined with precision, actual values and results could differ from these estimates. Any changes in estimates resulting from future changes in the economic environment will be reflected in the financial statements in future periods.

c. Reclassifications

Certain amounts in the accompanying unaudited consolidated financial statements have been reclassified to conform to the 2017 presentation. These reclassifications had no impact to previously reported balance sheets or stockholders' equity.

d. Accounts receivable

The Company sells produced oil, NGL and natural gas and purchased oil to various customers and participates with other parties in the development and operation of oil and natural gas properties. The majority of the Company's accounts receivable are unsecured. Accounts receivable for joint interest billings are recorded as amounts billed to customers less an allowance for doubtful accounts.

The Company maintains an allowance for doubtful accounts for estimated losses inherent in its accounts receivable portfolio. In establishing the required allowance, management considers historical losses, current receivables aging and existing industry and economic data. The Company reviews its allowance for doubtful accounts quarterly. Past due amounts greater than 90 days and greater than a specified amount are reviewed individually for collectability. Account balances are charged off against the allowance after all means of collection have been exhausted and the potential for recovery is remote.

Accounts receivable consisted of the following components as of the dates presented:

(in thousands)	June 30, 2017	December 31, 2016
Oil, NGL and natural gas sales	$45,495	$ 46,999
Sales of purchased oil and other products	11,518	16,213
Joint operations, net[(1)]	8,973	12,175
Matured derivatives	5,982	11,059
Other	139	421
Total	$72,107	$ 86,867

(1) Accounts receivable for joint operations are presented net of an allowance for doubtful accounts of $0.1 million and $0.2 million as of June 30, 2017 and December 31, 2016, respectively. As the operator of the majority of its wells, the Company has the ability to realize some or all of these receivables through the netting of production revenues.

e. Derivatives

The Company uses derivatives to reduce exposure to fluctuations in the prices of oil, NGL and natural gas. By removing a significant portion of the price volatility associated with future production, the Company expects to mitigate, but not eliminate, the potential effects of variability in cash flows from operations due to fluctuations in commodity prices. These transactions are in the form of puts, swaps, collars and call spreads.

Derivatives are recorded at fair value and are presented on a net basis on the unaudited consolidated balance sheets as assets and/or liabilities. The Company nets the fair value of derivatives by counterparty where the right of offset exists. The Company determines the fair value of its derivatives by utilizing pricing models for substantially similar instruments. Inputs to the pricing models include publicly available prices and forward price curves generated from a compilation of data gathered from third parties. See Note 8.a for discussion regarding the fair value of the Company's derivatives.

The Company's derivatives were not designated as hedges for accounting purposes for any of the periods presented. Accordingly, the changes in fair value are recognized in the unaudited consolidated statements of operations in the period of change. Gains and losses on derivatives are included in cash flows from operating activities. See Notes 7 and 8.a for discussion regarding the Company's derivatives.

f. Other current assets and liabilities

Other current assets consisted of the following components as of the dates presented:

(in thousands)	June 30, 2017	December 31, 2016
Prepaid expenses and other	$ 8,958	$ 6,228
Inventory[1]	8,590	8,063
Total other current assets	$ 17,548	$ 14,291

(1) See Note 2.i for discussion of inventory held by the Company.

Other current liabilities consisted of the following components as of the dates presented:

(in thousands)	June 30, 2017	December 31, 2016
Accrued interest payable	$ 24,354	$ 24,152
Purchased oil payable	11,971	17,213
Accrued compensation and benefits	9,122	25,947
Lease operating expense payable	8,814	10,572
Other accrued liabilities	20,526	16,331
Total other current liabilities	$ 74,787	$ 94,215

g. Property and equipment

The following table sets forth the Company's property and equipment as of the dates presented:

(in thousands)	June 30, 2017	December 31, 2016
Evaluated oil and natural gas properties	$ 5,703,873	$ 5,488,756
Less accumulated depletion and impairment	(4,578,831)	(4,514,183)
Evaluated oil and natural gas properties, net	1,125,042	974,573
Unevaluated properties not being depleted	203,888	221,281
Midstream service assets	157,645	150,629
Less accumulated depreciation and impairment	(28,704)	(24,389)
Midstream service assets, net	128,941	126,240
Depreciable other fixed assets	48,997	52,491
Less accumulated depreciation and amortization	(22,496)	(22,632)
Depreciable other fixed assets, net	26,501	29,859
Land	14,914	14,914
Total property and equipment, net	$ 1,499,286	$ 1,366,867

For the three months ended June 30, 2017 and 2016, depletion expense was $6.44 per barrel of oil equivalent ("BOE") sold and $7.06 per BOE sold, respectively. For the six months ended June 30, 2017 and 2016, depletion expense was $6.44 per BOE sold and $8.01 per BOE sold, respectively.

The Company uses the full cost method of accounting for its oil and natural gas properties. Under this method, all acquisition, exploration and development costs, including certain related employee costs, incurred for the purpose of exploring for or developing oil and natural gas properties, are capitalized and depleted on a composite unit of production method based on proved oil, NGL and natural gas reserves. Such amounts include the cost of drilling and equipping productive wells, dry hole costs, lease acquisition costs, delay rentals and other costs related to such activities. Costs, including related employee costs, associated with production and general corporate activities are expensed in the period incurred. Sales of oil and natural gas properties, whether or not being depleted currently, are accounted for as adjustments of capitalized costs, with no gain or loss recognized, unless such adjustments would significantly alter the relationship between capitalized costs and proved reserves of oil, NGL and natural gas.

The following table presents capitalized employee-related costs for the periods presented:

	Three months ended June 30,		Six months ended June 30,	
(in thousands)	2017	2016	2017	2016
Capitalized employee-related costs	$5,763	$3,253	$10,973	$6,449

The Company excludes the costs directly associated with acquisition and evaluation of unevaluated properties from the depletion calculation until it is determined whether or not proved reserves can be assigned to the properties. The Company capitalizes a portion of its interest costs to its unevaluated properties. Capitalized interest becomes a part of the cost of the unevaluated properties and is subject to depletion when proved reserves can be assigned to the associated properties. All items classified as unevaluated properties are assessed on a quarterly basis for possible impairment. The assessment includes consideration of the following factors, among others: intent to drill, remaining lease term, geological and geophysical evaluations, drilling results and activity, the assignment of evaluated reserves and the economic viability of development if proved reserves are assigned. During any period in which these factors indicate an impairment, the cumulative drilling costs incurred to date for such property and all or a portion of the associated leasehold costs are transferred to the full cost pool and are then subject to depletion.

The full cost ceiling is based principally on the estimated future net revenues from proved oil and natural gas properties discounted at 10%. The SEC guidelines require companies to use the unweighted arithmetic average first-day-of-the-month price for each month within the 12-month period prior to the end of the reporting period before differentials ("Benchmark Prices"). The Benchmark Prices are then adjusted for quality, transportation fees, geographical differentials, marketing bonuses or deductions and other factors affecting the price received at the wellhead ("Realized Prices"). The Realized Prices are utilized to calculate the discounted future net revenues in the full cost ceiling calculation.

In the event the unamortized cost of evaluated oil and natural gas properties being depleted exceeds the full cost ceiling, as defined by the SEC, the excess is charged to expense in the period such excess occurs. Once incurred, a write-down of oil and natural gas properties is not reversible.

Full cost ceiling impairment expense for the six months ended June 30, 2016 was $161.1 million and is included in the "Impairment expense" line item in the unaudited consolidated statements of operations and in the financial information provided for the Company's exploration and production segment presented in Note 13. There were no full cost ceiling impairments recorded during the six months ended June 30, 2017.

h. Variable interest entity

Medallion was established for the purpose of developing midstream solutions and providing midstream infrastructure to bring oil to market in the Midland Basin. LMS holds 49% of Medallion's ownership units. LMS and the third-party 51% interest-holder have agreed that the voting rights of Medallion, the profit and loss sharing and the additional capital contribution requirements shall be equal to the ownership unit percentage held. Additionally, Medallion requires a super-majority vote of 75% for many key operating and business decisions. The Company has determined that Medallion is a variable interest entity ("VIE"). However, LMS is not considered to be the primary beneficiary of the VIE because LMS does not have the power to direct the activities that most significantly affect Medallion's economic performance. As such, Medallion is accounted for under the equity method of accounting. The Company's proportionate share of Medallion's net income is reflected in the unaudited consolidated statements of operations as "Income from equity method investee" and the carrying amount is reflected in the unaudited consolidated balance sheets as "Investment in equity method investee." The Company has elected to classify distributions received from Medallion using the cumulative earnings approach. No such distributions have been received through June 30, 2017.

LMS contributed $16.0 million and $42.7 million during the three and six months ended June 30, 2016, respectively, to Medallion. There were no contributions to Medallion during the six months ended June 30, 2017. Medallion continued expansion activities on existing portions of its pipeline infrastructure in order to gather and transport additional third-party oil production during each of the six months ended June 30, 2017 and 2016. See Note 12.a for discussion of items included in the Company's unaudited consolidated financial statements related to Medallion. See Note 16.b for discussion regarding a capital call received from Medallion subsequent to June 30, 2017.

The third-party 51% interest-holder has initiated a process to potentially sell 100% of the ownership interests in Medallion within the next 12 months.

i. Long-lived assets and inventory

Impairment losses are recorded on property and equipment used in operations and other long-lived assets when indicators of impairment are present and the undiscounted cash flows estimated to be generated by those assets are less than the assets' carrying amount. Impairment is measured based on the excess of the carrying amount over the fair value of the asset.

Materials and supplies inventory, which is used in the Company's production activities of oil and natural gas properties and midstream service assets, is carried at the lower of cost or net realizable value ("NRV"), with cost determined using the weighted-average cost method, and is included in "Other current assets" and "Other assets, net" on the unaudited consolidated balance sheets. The NRV for materials and supplies inventory is determined utilizing a replacement cost approach (Level 2).

The Company has frac pit water inventory, which is used in developing oil and natural gas properties and is carried at lower of cost or NRV, with cost determined using the weighted-average cost method, and is included in "Other current assets" on the unaudited consolidated balance sheets. The NRV for frac pit water inventory is determined utilizing a replacement cost approach (Level 2).

The minimum volume of product in a pipeline system that enables the system to operate is known as line-fill and is generally not available to be withdrawn from the pipeline system until the expiration of the transportation contract. The Company owns oil line-fill in third-party pipelines, which is accounted for at lower of cost or NRV, with cost determined using the weighted-average cost method, and is included in "Other assets, net" on the unaudited consolidated balance sheets. The NRV is determined utilizing a quoted market price adjusted for regional price differentials (Level 2).

There were no long-lived assets impairments recorded during the six months ended June 30, 2017 or 2016. Inventory impairments of $1.0 million were recorded for each of the three and six months ended June 30, 2016. There were no inventory impairments recorded during the six months ended June 30, 2017.

j. Debt issuance costs

Debt issuance fees, which are recorded at cost, net of amortization, are amortized over the life of the respective debt agreements utilizing the effective interest and straight-line methods. The Company capitalized $4.7 million of debt issuance costs during the six months ended June 30, 2017 as a result of entering into the Fifth Amended and Restated Credit Agreement (as amended, the "Senior Secured Credit Facility"). No debt issuance costs were capitalized during the six months ended June 30, 2016. The Company had total debt issuance costs of $21.4 million and $18.8 million, net of accumulated amortization of $23.4 million and $21.3 million, as of June 30, 2017 and December 31, 2016, respectively.

No debt issuance costs were written off during the six months ended June 30, 2017. The Company wrote-off $0.8 million of debt issuance costs during the six months ended June 30, 2016 as a result of changes in the borrowing base and aggregate elected commitment of the Senior Secured Credit Facility, which are included in the unaudited consolidated statements of operations in the "Write-off of debt issuance costs" line item. Debt issuance costs related to the Company's senior unsecured notes are presented in "Long-term debt, net" on the Company's unaudited consolidated balance sheets. Debt issuance costs related to the Senior Secured Credit Facility are presented in "Other assets, net" on the Company's unaudited consolidated balance sheets. See Note 4.f for additional discussion of debt issuance costs.

Future amortization expense of debt issuance costs as of June 30, 2017 for the periods presented is as follows:

(in thousands)	June 30, 2017
Remaining 2017	$2,082
2018	4,223

2019	4,308
2020	4,396
2021	4,493
Thereafter	1,947
Total	$21,449

k. Asset retirement obligations

Asset retirement obligations associated with the retirement of tangible long-lived assets are recognized as a liability in the period in which they are incurred and become determinable. The associated asset retirement costs are part of the carrying

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amount of the long-lived asset. Subsequently, the asset retirement cost included in the carrying amount of the related long-lived asset is charged to expense through depletion, or for midstream service assets through depreciation, of the associated asset. Changes in the liability due to the passage of time are recognized as an increase in the carrying amount of the liability and as corresponding accretion expense.

The fair value of additions to the asset retirement obligation liability is measured using valuation techniques consistent with the income approach, which converts future cash flows into a single discounted amount. Significant inputs to the valuation include: (i) estimated plug and abandonment cost per well based on Company experience, (ii) estimated remaining life per well, (iii) estimated removal and/or remediation costs for midstream service assets, (iv) estimated remaining life of midstream service assets, (v) future inflation factors and (vi) the Company's average credit adjusted risk-free rate. Inherent in the fair value calculation of asset retirement obligations are numerous assumptions and judgments including, in addition to those noted above, the ultimate settlement of these amounts, the ultimate timing of such settlement and changes in legal, regulatory, environmental and political environments. To the extent future revisions to these assumptions impact the fair value of the existing asset retirement obligation liability, a corresponding adjustment will be made to the asset balance.

The Company is obligated by contractual and regulatory requirements to remove certain pipeline and gathering assets and perform other remediation of the sites where such pipeline and gathering assets are located upon the retirement of those assets. However, the fair value of the asset retirement obligation cannot currently be reasonably estimated because the settlement dates are indeterminate. The Company will record an asset retirement obligation for pipeline and gathering assets in the periods in which settlement dates are reasonably determinable.

The following reconciles the Company's asset retirement obligation liability for the periods presented:

(in thousands)	Six months ended June 30, 2017	Year ended December 31, 2016
Liability at beginning of period	$52,207	$46,306
Liabilities added due to acquisitions, drilling, midstream service asset construction and other	320	1,528
Accretion expense	1,871	3,483
Liabilities settled upon plugging and abandonment	(363)	(1,242)
Liabilities removed due to sale of property	(871)	—
Revision of estimates	5	2,132
Liability at end of period	$53,169	$52,207

l. Fair value measurements

The carrying amounts reported in the unaudited consolidated balance sheets for cash and cash equivalents, accounts receivable, accounts payable, undistributed revenue and royalties, accrued capital expenditures and other accrued assets and liabilities approximate their fair values. See Note 4.e for fair value disclosures related to the Company's debt obligations. The Company carries its derivatives at fair value. See Note 8.a for details regarding the fair value of the Company's derivatives.

m. Treasury stock

Laredo's employees may elect to have the Company withhold shares of stock to satisfy their tax withholding obligations that arise upon the lapse of restrictions on their stock awards. Such treasury stock is recorded at cost and retired upon acquisition.

n. Compensation awards

Stock-based compensation expense, net of amounts capitalized, is included in "General and administrative" in the unaudited consolidated statements of operations over the awards' vesting periods and is based on the awards' grant date fair value. The Company utilizes the closing stock price on the grant date, less an expected forfeiture rate, to determine the fair values of service vesting restricted stock awards and a Black-Scholes pricing model to determine the fair values of service vesting restricted stock option awards. The Company utilizes a Monte Carlo simulation prepared by an independent third party to determine the fair values of the performance share awards and, in prior periods, the performance unit awards. The Company capitalizes a portion of stock-based compensation for employees who are directly involved in the acquisition, exploration and development of its oil and natural gas properties into the full cost pool. Capitalized stock-based compensation is included as an addition to "Oil and natural gas properties" in the unaudited consolidated balance sheets. See Note 5 for further discussion regarding the restricted stock awards, stock option awards, performance share awards and performance unit awards.

o. May 2016 Equity Offering

On May 16, 2016, the Company completed the sale of 10,925,000 shares of Laredo's common stock (the "May 2016 Equity Offering") for net proceeds of $119.3 million, after underwriting discounts, commissions and offering expenses. There were no comparative offerings of Laredo's stock during the six months ended June 30, 2017.

p. Environmental

The Company is subject to extensive federal, state and local environmental laws and regulations. These laws, among other things, regulate the discharge of materials into the environment and may require the Company to remove or mitigate the environmental effects of the disposal or release of petroleum or chemical substances at various sites. Environmental expenditures are expensed in the period incurred. Liabilities for expenditures of a non-capital nature are recorded when environmental assessment or remediation is probable and the costs can be reasonably estimated. Such liabilities are generally undiscounted unless the timing of cash payments is fixed and readily determinable. Management believes no materially significant liabilities of this nature existed as of June 30, 2017 or December 31, 2016.

q. Non-cash investing and supplemental cash flow information

The following presents the non-cash investing and supplemental cash flow information for the periods presented:

	Six months ended June 30,	
(in thousands)	2017	2016
Non-cash investing information:		
Change in accrued capital expenditures	$22,855	$(22,012)
Change in accrued capital contribution to equity method investee(1)	$—	$(27,583)
Capitalized asset retirement cost	$325	$253
Supplemental cash flow information:		
Capitalized interest	$490	$115

(1) See Notes 2.h and 12.a for additional discussion of the Company's equity method investee.

Note 3—Divestiture

In January 2017, the Company completed the sale of 2,900 net acres and working interests in 16 producing vertical wells in the Midland Basin to a third-party buyer for a purchase price of $59.7 million. After transaction costs reflecting an economic effective date of October 1, 2016, the proceeds were $59.5 million, net of working capital and post-closing adjustments. The Company completed the closing adjustments for this divestiture in May 2017. A portion of these proceeds were used to pay down borrowings on the Senior Secured Credit Facility. The purchase price was recorded as an adjustment to oil and natural gas properties pursuant to the rules governing full cost accounting. Effective at closing, the operations and cash flows of these properties were eliminated from the ongoing operations of the Company, and the Company has no continuing involvement in the properties. This divestiture does not represent a strategic shift and will not have a major effect on the Company's operations or financial results.

Note 4—Debt

a. March 2023 Notes

On March 18, 2015, the Company completed an offering of $350.0 million in aggregate principal amount of 6 1/4% senior unsecured notes due 2023 (the "March 2023 Notes"). The March 2023 Notes will mature on March 15, 2023 and bear an interest rate of 6 1/4% per annum, payable semi-annually, in cash in arrears on March 15 and September 15 of each year, commencing September 15, 2015. The March 2023 Notes are fully and unconditionally guaranteed on a senior unsecured basis by LMS, GCM and certain of the Company's future restricted subsidiaries, subject to certain automatic customary releases, including the sale, disposition or transfer of all of the capital stock or of all or substantially all of the assets of a subsidiary guarantor to one or more persons that are not the Company or a restricted subsidiary, exercise of legal defeasance or covenant defeasance options or satisfaction and discharge of the applicable indenture, designation of a subsidiary guarantor as a non-guarantor restricted subsidiary or as an unrestricted subsidiary in accordance with the applicable indenture, release from guarantee under the Senior Secured Credit Facility, or liquidation or dissolution (collectively, the "Releases"). The March 2023

Notes are callable by the Company beginning March 15, 2018 at a price of 104.688% of face value with call premiums declining over time to 100% of face value on March 15, 2021 and thereafter.

b. January 2022 Notes

On January 23, 2014, the Company completed an offering of $450.0 million in aggregate principal amount of 5 5/8% senior unsecured notes due 2022 (the "January 2022 Notes"). The January 2022 Notes will mature on January 15, 2022 and bear an interest rate of 5 5/8% per annum, payable semi-annually, in cash in arrears on January 15 and July 15 of each year, commencing July 15, 2014. The January 2022 Notes are fully and unconditionally guaranteed on a senior unsecured basis by LMS, GCM and certain of the Company's future restricted subsidiaries, subject to certain Releases. The January 2022 Notes became callable by the Company on January 15, 2017 at a price of 104.219% of face value with call premiums declining over time to 100% of face value on January 15, 2020 and thereafter.

c. May 2022 Notes

On April 27, 2012, the Company completed an offering of $500.0 million in aggregate principal amount of 7 3/8% senior unsecured notes due 2022 (the "May 2022 Notes"). The May 2022 Notes will mature on May 1, 2022 and bear an interest rate of 7 3/8% per annum, payable semi-annually, in cash in arrears on May 1 and November 1 of each year, commencing November 1, 2012. The May 2022 Notes are fully and unconditionally guaranteed on a senior unsecured basis by LMS, GCM and certain of the Company's future restricted subsidiaries, subject to certain Releases. The May 2022 Notes became callable by the Company on May 1, 2017 at a price of 103.688% of face value with call premiums declining over time to 100% of face value on May 1, 2020 and thereafter.

d. Senior Secured Credit Facility

As of June 30, 2017, the Senior Secured Credit Facility, had a maximum credit amount of $2.0 billion, a borrowing base and an aggregate elected commitment each of $1.0 billion with $105.0 million outstanding and was subject to an interest rate of 3.13%. The Senior Secured Credit Facility has a maturity date of May 2, 2022, provided that if either the January 2022 Notes or May 2022 Notes have not been redeemed or refinanced on or prior to the date 90 days before their respective stated maturity dates (as applicable, the "Early Maturity Date"), the Senior Secured Credit Facility will mature on such Early Maturity Date. The Senior Secured Credit Facility contains both financial and non-financial covenants, all of which the Company was in compliance with as of June 30, 2017. Laredo is required to pay an annual commitment fee on the unused portion of the financial institutions' commitment of 0.375% to 0.5%, based on the ratio of outstanding revolving credit to the total commitment under the Senior Secured Credit Facility. Additionally, the Senior Secured Credit Facility provides for the issuance of letters of credit, limited to the lesser of total capacity or $20.0 million. No letters of credit were outstanding as of June 30, 2017 or 2016. See Note 16.a for discussion of an additional borrowing on the Senior Secured Credit Facility subsequent to June 30, 2017.

e. Fair value of debt

The Company has not elected to account for its debt instruments at fair value. The following table presents the carrying amounts and fair values of the Company's debt as of the dates presented:

(in thousands)	June 30, 2017		December 31, 2016	
	Long-term debt	Fair value	Long-term debt	Fair value
January 2022 Notes	$450,000	$440,479	$450,000	$456,382
May 2022 Notes	500,000	509,575	500,000	521,413
March 2023 Notes	350,000	347,351	350,000	365,649
Senior Secured Credit Facility	105,000	105,026	70,000	69,975
Total	$1,405,000	$1,402,431	$1,370,000	$1,413,419

The fair values of the debt outstanding on the January 2022 Notes, the May 2022 Notes and the March 2023 Notes were determined using the June 30, 2017 and December 31, 2016 quoted market price (Level 1) for each respective instrument. The fair values of the outstanding debt on the Senior Secured Credit Facility as of June 30, 2017 and December 31, 2016 were estimated utilizing pricing models for similar instruments (Level 2). See Note 8 for information about fair value hierarchy levels.

f. Long-term debt, net

The following table summarizes the net presentation of the Company's long-term debt and debt issuance costs on the unaudited consolidated balance sheets as of the dates presented:

	June 30, 2017			December 31, 2016		
(in thousands)	Long-term debt	Debt issuance costs, net	Long-term debt, net	Long-term debt	Debt issuance costs, net	Long-term debt, net
January 2022 Notes	$450,000	$(4,475)	$445,525	$450,000	$(4,963)	$445,037
May 2022 Notes	500,000	(5,687)	494,313	500,000	(6,164)	493,836
March 2023 Notes	350,000	(4,561)	345,439	350,000	(4,964)	345,036
Senior Secured Credit Facility[1]	105,000	—	105,000	70,000	—	70,000
Total	$1,405,000	$(14,723)	$1,390,277	$1,370,000	$(16,091)	$1,353,909

(1) Debt issuance costs, net related to our Senior Secured Credit Facility of $6.7 million and $2.7 million as of June 30, 2017 and December 31, 2016, respectively, are reported in "Other assets, net" on the unaudited consolidated balance sheets.

Note 5—Employee compensation

The Company has a Long-Term Incentive Plan (the "LTIP"), which provides for the granting of incentive awards in the form of restricted stock awards, stock option awards, performance share awards, performance unit awards and other awards. The LTIP provides for the issuance of up to 24,350,000 shares of Laredo's common stock.

The Company recognizes the fair value of stock-based compensation awards expected to vest over the requisite service period as a charge against earnings, net of amounts capitalized. The Company's stock-based compensation awards are accounted for as equity instruments, and in prior periods, its performance unit awards were accounted for as liability awards. Stock-based compensation is included in "General and administrative" in the unaudited consolidated statements of operations. The Company capitalizes a portion of stock-based compensation for employees who are directly involved in the acquisition, exploration and development of oil and natural gas properties into the full cost pool. Capitalized stock-based compensation is included as an addition to "Oil and natural gas properties" in the unaudited consolidated balance sheets.

a. Restricted stock awards

All service vesting restricted stock awards are treated as issued and outstanding in the accompanying unaudited consolidated financial statements. Per the award agreement terms, if an employee terminates employment prior to the restriction lapse date for reasons other than death or disability, the awarded shares are forfeited and canceled and are no longer considered issued and outstanding. If the employee's termination of employment is by reason of death or disability, all of the holder's restricted stock will automatically vest. Historically, restricted stock awards granted to officers and employees vest in a variety of vesting schedules including (i) 33%, 33% and 34% per year beginning on the first anniversary date of the grant, (ii) fully on the first anniversary of the grant date and (iii) fully on the third anniversary of the grant date. Restricted stock awards granted to non-employee directors vest fully on the first anniversary of the grant date.

The following table reflects the restricted stock award activity for the six months ended June 30, 2017:

(in thousands, except for weighted-average grant date fair values)	Restricted stock awards	Weighted-average grant date fair value (per award)
Outstanding as of December 31, 2016	3,878	$ 12.88
Granted	1,185	$ 13.97

Forfeited	(232	) $	12.88
Vested[1]	(1,588	) $	13.75
Outstanding as of June 30, 2017	3,243	$	12.85

(1) The total intrinsic value of vested restricted stock awards for the six months ended June 30, 2017 was $22.0 million.

The Company utilizes the closing stock price on the grant date to determine the fair value of service vesting restricted stock awards. As of June 30, 2017, unrecognized stock-based compensation related to the restricted stock awards expected to vest was $31.7 million. Such cost is expected to be recognized over a weighted-average period of 1.91 years.

b. Stock option awards

Stock option awards granted under the LTIP vest and become exercisable in four equal installments on each of the four annual anniversaries of the grant date. The following table reflects the stock option award activity for the six months ended June 30, 2017: