Memorial Resource Development Corp.
Form 10-Q
November 05, 2014

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10–Q

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

For the quarterly period ended September 30, 2014

OR

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

For the transition period from to .

Commission File Number: 001-36490

MEMORIAL RESOURCE DEVELOPMENT CORP.

(Exact name of registrant as specified in its charter)

Delaware	46-4710769
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
500 Dallas Street, Suite 1800, Houston, TX	77002
(Address of principal executive offices)	(Zip Code)

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

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes þ 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 þ No ¨

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

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

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

As of October 31, 2014, the registrant had 193,559,211 shares of common stock, $.01 par value, outstanding

MemORIAL RESOURCE DEVELOPMENT CORP.

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GLOSSARY OF OIL AND NATURAL GAS TERMS

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

API Gravity: A system of classifying oil based on its specific gravity, whereby the greater the gravity, the lighter the oil.

Basin: A large depression on the earth's surface in which sediments accumulate.

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

Bbl/d: One Bbl per day.

Bcf: One billion cubic feet of natural gas.

Bcfe: One billion cubic feet of natural gas equivalent.

Boe: One barrel of oil equivalent, calculated by converting natural gas to oil equivalent barrels at a ratio of six Mcf of natural gas to one Bbl of oil.

Boe/d: One Boe per day.

BOEM: Bureau of Ocean Energy Management.

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

COPAS: Council of Petroleum Accountants Societies.

Deterministic Estimate: The method of estimating reserves or resources is called deterministic when a single value for each parameter (from the geoscience, engineering or economic data) in the reserves calculation is used in the reserves estimation procedure.

Developed Acreage: The number of acres which are allocated or assignable to producing wells or wells capable of production.

Development Project: A development project is the means by which petroleum resources are brought to the status of economically producible. As examples, the development of a single reservoir or field, an incremental development in a producing field or the integrated development of a group of several fields and associated facilities with a common ownership may constitute a development project.

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.

Differential: An adjustment to the price of oil or natural gas from an established spot market price to reflect differences in the quality and/or location of oil or natural gas.

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

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

Estimated Ultimate Recovery: Estimated ultimate recovery is the sum of reserves remaining as of a given date and cumulative production as of that date.

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

Exploratory Well: A well drilled to find and produce oil and natural gas reserves not classified as proved, to find a new reservoir in a field previously found to be productive of oil or natural gas in another reservoir or to extend a known reservoir.

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

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

ICE: Inter-Continental Exchange.

MBbl: One thousand Bbls.

MBbls/d: One thousand Bbls per day.

MBoe: One thousand Boe.

MBoe/d: One thousand Boe per day.

MBtu: One thousand Btu.

MBtu/d: One thousand Btu per day.

Mcf: One thousand cubic feet of natural gas.

Mcf/d: One Mcf per day.

MMBtu: One million British thermal units.

MMcf: One million cubic feet of natural gas.

MMcfe: One million cubic feet of natural gas equivalent.

Net Acres or Net Wells: Gross acres or wells, as the case may be, multiplied by our working interest ownership percentage.

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

Net Revenue Interest: A working interest owner’s gross working interest in production less the royalty, overriding royalty, production payment and net profits interests.

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

NYMEX: New York Mercantile Exchange.

Oil: Oil and condensate.

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

OPIS: Oil Price Information Service.

Play: A geographic area with hydrocarbon potential.

Probabilistic Estimate: The method of estimation of reserves or resources is called probabilistic when the full range of values that could reasonably occur for each unknown parameter (from the geoscience and engineering data) is used to generate a full range of possible outcomes and their associated probabilities of occurrences.

Productive Well: A well that produces commercial quantities of hydrocarbons, exclusive of its capacity to produce at a reasonable rate of return.

Proved Developed Reserves: Proved reserves that can be expected to be recovered from existing wells with existing equipment and operating methods.

Proved Reserve Additions: The sum of additions to proved reserves from extensions, discoveries, improved recovery, acquisitions and revisions of previous estimates.

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

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

Realized Price: The cash market price less all expected quality, transportation and demand adjustments.

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

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

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

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

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

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

Spacing: The distance between wells producing from the same reservoir. Spacing is often expressed in terms of acres (e.g., 40-acre spacing) and is often established by regulatory agencies.

Spot Price: The cash market price without reduction for expected quality, transportation and demand adjustments.

Standardized Measure: The present value of estimated future net revenue to be generated from the production of proved reserves, determined in accordance with the rules, regulations or standards established by the United States Securities and Exchange Commission (“SEC”) and the Financial Accounting Standards Board (“FASB”) (using prices and costs in effect as of the date of estimation), less future development, production and income tax expenses, and discounted at 10% per annum to reflect the timing of future net revenue. 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.

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

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

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

WTI: West Texas Intermediate.

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NAMES OF ENTITIES

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

- Unless the context requires otherwise, references to "we," "us," "our," "MRD," or "the Company" or like terms are intended t mean the business and operations of Memorial Resource Development Corp. and its consolidated subsidiaries;
- "MRD LLC" refers to Memorial Resource Development LLC, which has historically owned our predecessor's business and which was merged into MRD Operating LLC, our subsidiary, subsequent to our initial public offering;
- "Memorial Production Partners," "MEMP" and "the Partnership" refer to Memorial Production Partners LP individually and collectively with its subsidiaries, as the context requires;
- "MEMP GP" refers to Memorial Production Partners GP LLC, the general partner of the Partnership;
- "our predecessor" refers collectively to: (i) MRD LLC and its former consolidated subsidiaries, consisting of Classic Hydrocarbons Holdings, L.P. ("Classic"), Classic Hydrocarbons GP Co., L.L.C. ("Classic GP"), Black Diamond Minerals, LLC ("Black Diamond"), Beta Operating Company, LLC ("Beta Operating"), MEMP GP, BlueStone Natural Resources Holdings, LLC ("BlueStone"), MRD Operating LLC, WildHorse Resources, LLC ("WildHorse Resources") Tanos Energy, LLC ("Tanos"), and each of their respective subsidiaries, including MEMP and its subsidiaries and (ii) the previous owners as defined below;
- "the Funds" refers collectively to Natural Gas Partners VIII, L.P., Natural Gas Partners IX, L.P. and NGP IX Offshore Holdings, L.P., which collectively control MRD Holdco;
- "MRD Holdco" refers to MRD Holdco LLC, a holding company controlled by the Funds that, together with a group, owns a majority of our common stock;
- "the previous owners" for accounting and financial reporting purposes refers collectively to:
  - certain oil and natural gas properties and related assets primarily in the Permian Basin, East Texas and the Rockies that MEMP acquired through equity transactions on October 1, 2013 from certain affiliates of NGP. On October 1, 2013, MEMP acquired Boaz Energy, LLC ("Boaz"), Crown Energy Partners, LLC ("Crown"), the Crown net profits interest and overriding royalty interest ("Crown NPI/ORRI"), Propel Energy SPV LLC ("Propel SPV"), together with its wholly-owned subsidiary Propel Energy Services, LLC ("Propel Energy Services"), and Stanolind Oil and Gas SPV LLC ("Stanolind SPV") from: (a) Boaz Energy Partners, LLC ("Boaz Energy Partners"), Crown Energy Partners Holdings, LLC ("Crown Holdings"), Propel Energy, LLC ("Propel Energy") and Stanolind Oil and Gas LP ("Stanolind"), all of which are primarily owned by two of the Funds; and
  - carved-out net profits interest created from working interests in certain oil and natural gas properties that WildHorse Resources originally acquired in 2010 from third parties and immediately sold to NGP Income Co-Investment Fund II, L.P. ("NGPCIF"), a NGP controlled entity, and subsequently reacquired from NGPCIF on February 28, 2014; and
- "NGP" refers to Natural Gas Partners, a family of private equity funds organized to make direct equity investments in the energy industry, including the Funds.

CAUTIONARY NOTE REGARDING FORWARD–LOOKING STATEMENTS

This quarterly report contains “forward-looking statements” within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Forward-looking statements are subject to a number of risks and uncertainties, many of which are beyond our control. All statements, other than statements of historical fact included in this quarterly report, are forward-looking statements. When used in this quarterly report, the words “could,” “should,” “will,” “believe,” “anticipate,” “intend,” “estimate,” “expect,” “may,” “continue, “plan,” “potential,” “pursue,” “target,” “project,” “forecast,” the negative of such terms, or other similar expressions are intend identify forward-looking statements, although not all forward-looking statements contain such identifying words.

Forward-looking statements may include statements about:

- our business strategy;
- our estimated reserves and the present value thereof;
- our technology;
- our cash flows and liquidity;
- our financial strategy, budget, projections and future operating results;
- realized commodity prices;
- timing and amount of future production of reserves;
- availability of drilling and production equipment;
- availability of pipeline capacity;
- availability of oilfield labor;
- the amount, nature and timing of capital expenditures, including future development costs;
- availability and terms of capital;
- drilling of wells, including statements made about future horizontal drilling activities;
- competition;
- government regulations;
- marketing of production;
- exploitation or property acquisitions;
- costs of exploiting and developing our properties and conducting other operations;
- general economic and business conditions;
- competition in the oil and natural gas industry;
- effectiveness of our risk management activities;
- environmental and other liabilities;
- counterparty credit risk;

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- taxation of the oil and natural gas industry;
- developments in other countries that produce oil and natural gas;
- uncertainty regarding future operating results; and
- plans, objectives, expectation and intentions.

These types of statements, other than statements of historical fact included in this quarterly report, are forward-looking statements. These forward-looking statements may be found in "Part II—Item 1A. Risk Factors," "Part II—Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations" and other sections of this quarterly report. These statements discuss future expectations, contain projections of results of operations or of financial condition or include other "forward-looking" information. These forward-looking statements involve risks and uncertainties. Important factors that could cause our actual results or financial condition to differ materially from our expectations include, but are not limited to, the following risks and uncertainties:

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

The forward-looking statements contained in this quarterly report are largely based on our expectations, which reflect estimates and assumptions made by our management. These estimates and assumptions reflect our best judgment based on currently known market conditions and other factors. Although we believe such estimates and assumptions to be reasonable, they are inherently uncertain and involve a number of risks and uncertainties that are beyond our control. In addition, management's assumptions about future events may prove to be inaccurate. All readers are cautioned that the forward-looking statements contained in this quarterly report are not guarantees of future performance, and we cannot assure any reader that such statements will be realized or that the events or circumstances described in any forward-looking statement will occur. Actual results may differ materially from those anticipated or implied in the forward-looking statements due to factors described in the "Risk Factors" section of our initial public offering prospectus dated June 12, 2014 filed with the SEC on June 16, 2014 and "Part II—Item 1A. Risk Factors" appearing within this quarterly report and elsewhere in this quarterly report. All forward-looking statements speak only as of the date of this quarterly report. We do not intend to update or revise any forward-looking statements as a result of new information, future events or otherwise. These cautionary statements qualify all forward-looking statements attributable to us or persons acting on our behalf.

PART I—FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS.

MEMORIAL RESOURCE DEVELOPMENT CORP.

UNAUDITED CONDENSED CONSOLIDATED AND COMBINED BALANCE SHEETS

(In thousands, except outstanding shares)

	September 30, 2014	December 31, 2013
ASSETS		
Current assets:		
Cash and cash equivalents	$10,316	$77,721
Restricted cash	—	35,000
Accounts receivable:		
Oil and natural gas sales	102,578	68,764
Joint interest owners and other	19,116	19,958
Affiliates	—	4,652
Short-term derivative instruments	37,421	9,289
Prepaid expenses and other current assets	20,696	19,513
Total current assets	190,127	234,897
Property and equipment, at cost:		
Oil and natural gas properties, successful efforts method	4,544,176	3,037,298
Other	15,477	10,331
Accumulated depreciation, depletion and impairment	(877,843)	(627,925)
Oil and natural gas properties, net	3,681,810	2,419,704
Long-term derivative instruments	34,515	48,616
Restricted investments	76,268	73,385
Restricted cash	260	15,506
Other long-term assets	38,687	37,053
Total assets	$4,021,667	$2,829,161
LIABILITIES AND EQUITY		
Current liabilities:		
Accounts payable	$16,846	$20,734
Accounts payable - affiliates	810	1,975
Revenues payable	59,512	56,091
Accrued liabilities	179,381	98,130
Short-term derivative instruments	5,109	9,711
Total current liabilities	261,658	186,641
Long-term debt-MRD Segment	628,000	871,150
Long-term debt-MEMP Segment	1,483,800	792,067

Asset retirement obligations	119,510	111,679
Long-term derivative instruments	15,275	6,080
Deferred tax liabilities	50,643	3,106
Other long-term liabilities	3,782	306
Total liabilities	2,562,668	1,971,029
Commitments and contingencies (Note 15)		
Equity:		
Stockholders' equity (deficit):		
Preferred stock, $.01 par value: 50,000,000 shares authorized; no shares issued and outstanding	—	—
Common stock, $.01 par value: 600,000,000 shares authorized; 193,559,211 shares issued and outstanding at September 30, 2014; no shares authorized, issued or outstanding at December 31, 2013	1,936	—
Additional paid-in capital	1,386,143	—
Accumulated earnings (deficit)	(951,801)	—
Total stockholders' equity	436,278	—
Members' equity:		
Members	—	237,186
Previous owners (Note 1)	—	40,331
Total members' equity	—	277,517
Noncontrolling interests	1,022,721	580,615
Total equity	1,458,999	858,132
Total liabilities and equity	$4,021,667	$2,829,161

See Accompanying Notes to Unaudited Condensed Consolidated and Combined Financial Statements.

MEMORIAL RESOURCE DEVELOPMENT CORP.

UNAUDITED CONDENSED STATEMENTS OF

CONSOLIDATED AND COMBINED OPERATIONS

(In thousands, except per share amounts)

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2014	2013	2014	2013
Revenues:				
Oil & natural gas sales	$244,161	$152,762	$669,301	$420,857
Pipeline tariff income and other	1,332	753	3,584	1,884
Total revenues	245,493	153,515	672,885	422,741
Costs and expenses:				
Lease operating	46,211	29,395	111,887	81,746
Pipeline operating	431	394	1,596	1,343
Exploration	175	1,292	1,465	2,265
Production and ad valorem taxes	14,040	7,422	33,623	23,478
Depreciation, depletion, and amortization	84,447	45,136	215,906	132,328
Impairment of proved oil and natural gas properties	67,181	21	67,181	21
Incentive unit compensation expense (Note 12)	25,550	19,069	969,390	19,069
General and administrative	21,196	19,646	61,061	55,982
Accretion of asset retirement obligations	1,553	1,354	4,601	4,016
(Gain) loss on commodity derivative instruments	(189,492)	2,028	11,580	(29,556)
(Gain) loss on sale of properties	—	(90,063)	3,057	(86,218)
Other, net	—	24	(12)	622
Total costs and expenses	71,292	35,718	1,481,335	205,096
Operating income (loss)	174,201	117,797	(808,450)	217,645
Other income (expense):				
Interest expense, net	(36,345)	(20,615)	(104,928)	(41,994)
Loss on extinguishment of debt	—	—	(37,248)	—
Other, net	15	24	102	81
Total other income (expense)	(36,330)	(20,591)	(142,074)	(41,913)
Income (loss) before income taxes	137,871	97,206	(950,524)	175,732
Income tax benefit (expense)	(25,834)	(1,244)	(14,398)	(1,432)
Net income (loss)	112,037	95,962	(964,922)	174,300
Net income (loss) attributable to noncontrolling interest	102,109	11,235	(34,851)	42,134
Net income (loss) attributable to Memorial Resource Development Corp.	9,928	84,727	(930,071)	132,166
Net (income) loss allocated to members	—	(84,754)	(20,305)	(122,639)
Net (income) loss allocated to previous owners	—	27	(1,425)	(9,527)
Net income (loss) available to common stockholders	$9,928	$—	$(951,801)	$—

Earnings per common share: (Note 10)				
Basic	$0.05	$—	$(4.94)	$—
Diluted	$0.05	$—	$(4.94)	$—
Weighted average common and common equivalent shares outstanding:				
Basic	192,500	—	192,500	—
Diluted	192,716	—	192,500	—

See Accompanying Notes to Unaudited Condensed Consolidated and Combined Financial Statements.

MEMORIAL RESOURCE DEVELOPMENT CORP.

UNAUDITED CONDENSED STATEMENTS OF

CONSOLIDATED AND COMBINED CASH FLOWS

(In thousands)

	For the Nine Months Ended September 30, 2014	2013
Cash flows from operating activities:		
Net income (loss)	$(964,922)	$174,300
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation, depletion, and amortization	215,906	132,328
Impairment of proved oil and natural gas properties	67,181	21
(Gain) loss on derivatives	12,737	(29,487)
Cash settlements (paid) received on derivative instruments	(22,174)	21,356
Loss on extinguishment of debt	30,248	—
Amortization of deferred financing costs	5,492	6,193
Accretion of senior notes net discount	1,888	161
Accretion of asset retirement obligations	4,601	4,016
Amortization of equity awards	6,874	2,322
(Gain) loss on sale of properties	3,057	(86,218)
Non-cash compensation expense	941,659	1,057
Exploration costs	868	—
Deferred income tax expense (benefit)	13,916	—
Changes in operating assets and liabilities:		
Accounts receivable	(22,117)	560
Prepaid expenses and other assets	297	(2,562)
Payables and accrued liabilities	67,324	13,034
Other	2,625	95
Net cash provided by operating activities	365,460	237,176
Cash flows from investing activities:		
Acquisitions of oil and natural gas properties	(1,083,167)	(104,926)
Additions to oil and gas properties	(457,838)	(257,513)
Additions to other property and equipment	(9,134)	(1,184)
Additions to restricted investments	(2,883)	(4,263)
Deposits for property acquisitions	—	(25,310)
Decrease (increase) in restricted cash	49,946	653
Proceeds from the sale of oil and natural gas properties	6,700	156,799
Other	(301)	(139)
Net cash used in investing activities	(1,496,677)	(235,883)
Cash flows from financing activities:		
Advances on revolving credit facilities	2,464,800	478,055
Payments on revolving credit facilities	(2,441,900)	(900,368)
Borrowings under second lien credit facility	—	325,000

Redemption of second lien credit facility	(328,282)	—
Proceeds from the issuances of senior notes	1,092,425	397,563
Redemption of senior notes	(351,808)	—
Deferred financing costs	(30,284)	(23,839)
Purchase of additional interests in consolidated subsidiaries	(3,292)	(1,270)
Contributions from previous owners	—	1,214
Proceeds from initial public offering	408,500	—
Costs incurred in conjunction with initial public offering	(28,198)	—
Proceeds from MEMP public offering	553,288	179,371
Costs incurred in conjunction with MEMP public offering	(12,222)	(7,592)
Contributions from NGP affiliates related to sale of properties	1,165	2,013
Distributions to the Funds	—	(363,437)
Distributions to MRD Holdco	(59,803)	—
Distributions to noncontrolling interests	(101,327)	(51,319)
Distribution to NGP affiliates related to purchase of assets	(66,693)	—
Distribution to NGP affiliates related to sale of assets, net of cash received	(32,770)	—
Distributions made by previous owners	—	(3,130)
Other	213	—
Net cash provided by financing activities	1,063,812	32,261
Net change in cash and cash equivalents	(67,405)	33,554
Cash and cash equivalents, beginning of period	77,721	49,391
Cash and cash equivalents, end of period	$10,316	$82,945
Supplemental cash flows:		
Cash paid for interest	$67,449	$22,959
Noncash investing and financing activities:		
Change in capital expenditures in payables and accrued liabilities	29,137	25,017
Assumptions of asset retirement obligations related to properties acquired or drilled	5,053	3,478
Accounts receivable related to acquisitions and divestitures	4,271	—

See Accompanying Notes to Unaudited Condensed Consolidated and Combined Financial Statements.

MEMORIAL RESOURCE DEVELOPMENT CORP.

UNAUDITED CONDENSED STATEMENTS OF CONSOLIDATED AND COMBINED EQUITY

(In thousands)

	For the Nine Months Ended September 30, 2014	2013
STOCKHOLDERS' EQUITY		
Preferred stock		
Balance, beginning and end of period	$—	$—
Common stock		
Balance, beginning of period	—	—
Issuance of shares in connection with restructuring transactions (see Note 1)	1,710	—
Issuance of shares in connection with initial public offering (see Note 1)	215	—
Restricted stock awards	11	—
Balance, end of period	1,936	—
Additional paid-in capital		
Balance, beginning of period	—	—
Issuance of shares in connection with restructuring transactions (see Note 1)	913,152	—
Issuance of shares in connection with initial public offering (see Note 1)	379,962	—
Tax related effects in connection with restructuring transactions and initial public offering	(43,251)	—
Restricted stock awards	(11)	—
Amortization of restricted stock awards	1,487	—
Contribution related to MRD Holdco incentive unit compensation expense (see Note 12)	137,307	—
Purchase of noncontrolling interests	(2,881)	—
Other	378	—
Balance, end of period	1,386,143	—
Accumulated earnings (deficit)		
Balance, beginning of period	—	—
Net income (loss) allocation	(951,801)	—
Balance, end of period	(951,801)	—
Total stockholders' equity	436,278	—
MEMBERS' EQUITY		
Members		
Balance, beginning of period	237,186	811,614
Net income (loss) allocation	20,305	122,639
Contribution related to sale of assets to NGP affiliate	1,165	—
Net book value of assets sold to NGP affiliate	(621)	—
Net book value of assets acquired from NGP affiliates	45,059	—
Distribution to NGP affiliates in connection with acquisition of assets	(66,693)	—
Distribution of net assets to MRD Holdco	(123,078)	—
Distribution of shares received in connection with restructuring transactions to MRD Holdco	(110,510)	—
Distributions	—	(363,437)
Net equity deemed contribution (distribution) related to net assets transferred to MEMP	(2,659)	2,560

Impact of equity transactions of MEMP	—	24,024
Other	(154)	(47)
Balance, end of period	—	597,353
Previous Owners		
Balance, beginning of period	40,331	233,433
Net income (loss) allocation	1,425	9,527
Contributions	—	1,214
Distributions	—	(3,130)
Net book value of assets acquired from NGP affiliates	(41,756)	—
Other	—	(2,299)
Balance, end of period	—	238,745
Total members' equity	—	836,098
NONCONTROLLING INTERESTS		
Noncontrolling interests		
Balance, beginning of period	580,615	231,662
Net income (loss) allocation	(34,851)	42,134
Net proceeds from MEMP public equity offering	540,987	171,779
Distributions	(101,327)	(51,319)
Net equity deemed contribution (distribution) related to net assets transferred to MEMP	2,659	(2,560)
Purchase of noncontrolling interests	(411)	(1,270)
Impact of equity transactions of MEMP	—	(24,024)
Amortization of MEMP equity awards	5,387	2,321
Distribution of net assets to MRD Holdco	29,994	—
Other	(332)	—
Balance, end of period	1,022,721	368,723
TOTAL EQUITY		
Total equity	1,458,999	1,204,821

See Accompanying Notes to Unaudited Condensed Consolidated and Combined Financial Statements.

MEMORIAL RESOURCE DEVELOPMENT CORP.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED AND COMBINED FINANCIAL STATEMENTS

Note 1. Background, Organization and Basis of Presentation

Overview

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

The Company was formed by Memorial Resource Development LLC ("MRD LLC") in January 2014 to exploit, develop and acquire natural gas, NGL and oil properties in North America. MRD LLC was a Delaware limited liability company formed on April 27, 2011 by Natural Gas Partners VIII, L.P. ("NGP VIII"), Natural Gas Partners IX, L.P. ("NGP IX") and NGP IX Offshore Holdings, L.P. ("NGP IX Offshore") (collectively, the "Funds") to exploit, develop and acquire natural gas, NGL and oil properties. The Funds are private equity funds managed by Natural Gas Partners ("NGP"). MRD LLC's consolidated and combined financial statements represent our predecessor for accounting and financial reporting purposes prior to our initial public offering.

Initial Public Offering and Restructuring Transactions

On June 18, 2014, the Company completed its initial public offering of 21,500,000 common units at a price of $19.00 per share, which generated net proceeds to the Company of approximately $380.2 million after deducting underwriting discounts and commissions and other offering related fees and expenses. The following restructuring events and transactions occurred in connection with our initial public offering:

- The Funds contributed all of their interests in MRD LLC to MRD Holdco LLC ("MRD Holdco") and the members of our management who owned incentive units in MRD LLC exchanged those incentive units for substantially identical incentive units in MRD Holdco, after which MRD Holdco owned 100% of MRD LLC;
- WildHorse Resources, LLC ("WildHorse Resources") sold its subsidiary, WildHorse Resources Management Company, LLC ("WHR Management Company"), to an affiliate of the Funds for approximately $0.2 million in cash, and WHR Management Company entered into a services agreement with the Company and WildHorse Resources pursuant to which WHR Management Company will provide transition services to WildHorse Resources;
- Classic Hydrocarbons Holdings, L.P. ("Classic") and Classic Hydrocarbons GP Co., L.L.C. ("Classic GP") distributed to MRD LLC the ownership interests in Classic Pipeline & Gathering, LLC ("Classic Pipeline"), which owns certain midstream assets in Texas, and Black Diamond Minerals, LLC ("Black Diamond") distributed to MRD LLC its ownership interests in Golden Energy Partners LLC ("Golden Energy"), which sold all of its assets in May 2014;
- MRD LLC contributed to us substantially all of its assets, comprised of: (i) 100% of the ownership interests in Classic, Classic GP, Black Diamond, Beta Operating Company, LLC ("Beta Operating"), Memorial Resource Finance Corp., MRD Operating LLC ("MRD Operating"), Memorial Production Partners GP LLC ("MEMP GP") (including MEMP GP's ownership of 50% of Memorial Production Partners LP's ("MEMP") incentive distribution rights) and (ii) 99.9% of the membership interests in WildHorse Resources;
- We issued 128,665,677 shares of our common stock to MRD LLC, which MRD LLC immediately distributed to MRD Holdco;
-

We assumed the obligations of MRD LLC under the indenture governing the $350 million in aggregate principal amount of 10.00% / 10.75% Senior PIK Toggle Notes due 2018 (the “PIK notes”) and reimbursed MRD LLC for the June 15, 2014 interest payment made on the PIK notes;

- Certain former management members of WildHorse Resources contributed to us their outstanding incentive units in WildHorse Resources, as well as the remaining 0.1% of the membership interests in WildHorse Resources, and we issued 42,334,323 shares of our common stock and paid cash consideration of $30.0 million to such former management members of WildHorse Resources;

MEMORIAL RESOURCE DEVELOPMENT CORP.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED AND COMBINED FINANCIAL STATEMENTS

- We entered into a registration rights agreement and a voting agreement with MRD Holdco and certain former management members of WildHorse Resources;
- We entered into a new $2.0 billion revolving credit facility (see Note 8) and used approximately $614.5 million in borrowings under that facility to repay all amounts outstanding under WildHorse Resources' credit agreements, to partially fund the cash consideration payable to the former management members of WildHorse Resources and to reimburse MRD LLC for the June 15, 2014 interest payment made on the PIK notes;
- Notice of redemption was given to the PIK notes trustee (see Note 8) specifying a redemption date of July 16, 2014 and indicating that a portion of the net proceeds from our initial public offering, which temporarily reduced amounts outstanding under our new revolving credit facility, would be used to redeem the PIK notes at a redemption price of 102% of the principal amount of the PIK notes plus accrued and unpaid interest thereon to the date of redemption;
- MRD Operating entered into a merger agreement with MRD LLC pursuant to which after the termination or earlier discharge of the PIK notes MRD LLC would merge into MRD Operating;
- MRD LLC distributed to MRD Holdco the following: (i) BlueStone Natural Resources Holdings, LLC ("BlueStone"), which sold substantially all of its assets in July 2013 for $117.9 million, MRD Royalty LLC, which owns certain leasehold interests and overriding royalty interests in Texas and Montana, MRD Midstream LLC, which owns an indirect interest in certain midstream assets in North Louisiana, Golden Energy and Classic Pipeline; (ii) 5,360,912 subordinated units of MEMP; (iii) the right to the remaining cash to be released from the debt service reserve account in connection with the redemption or earlier discharge of the PIK notes plus the cash received from us in reimbursement of the interest paid on June 15, 2014 in respect of the PIK notes; and (iv) approximately $6.7 million of cash received by MRD LLC in connection with the sale of Golden Energy's assets in May 2014;
- We irrevocably deposited with the PIK notes trustee approximately $360.0 million on June 27, 2014, which was an amount sufficient to fund the redemption of the PIK notes on the redemption date and to satisfy and discharge our obligations under the PIK notes and the related indenture. The discharge became effective upon the irrevocable deposit of the funds with the PIK notes trustee; and
- MRD LLC merged into MRD Operating.

Previous Owners

References to "the previous owners" for accounting and financial reporting purposes refer collectively to:

- Certain oil and natural gas properties and related assets primarily in the Permian Basin, East Texas and the Rockies that MEMP acquired through equity transactions on October 1, 2013 from certain affiliates of NGP. On October 1, 2013, MEMP acquired Boaz Energy, LLC ("Boaz"), Crown Energy Partners, LLC ("Crown"), the Crown net profits interest and overriding royalty interest ("Crown NPI/ORRI"), Propel Energy SPV LLC ("Propel SPV"), together with its wholly-owned subsidiary Propel Energy Services, LLC ("Propel Energy Services"), and Stanolind Oil and Gas SPV LLC ("Stanolind SPV") from Boaz Energy Partners, LLC ("Boaz Energy Partners"), Crown Energy Partners Holdings, LLC ("Crown Holdings"), Propel Energy, LLC ("Propel Energy") and Stanolind Oil and Gas LP ("Stanolind"), all of which are primarily owned by two of the Funds.
- A net profits interest that WildHorse Resources purchased from NGP Income Co-Investment Fund II, L.P. ("NGPCIF") on February 28, 2014 ("NGPCIF NPI"). NGPCIF is controlled by NGP. Upon the completion of the 2010 Petrohawk and Clayton Williams acquisitions, WildHorse Resources sold a net profits interest in these properties to NGPCIF. Since WildHorse Resources sold the net profits interest, the historical results are accounted for as a working interest for all periods.

Our unaudited financial statements reported herein include the financial position and results attributable to: (i) those certain oil and natural gas properties and related assets that MEMP acquired through equity transactions on October 1, 2013 from Boaz Energy Partners, Crown Holdings, Propel Energy and Stanolind and (ii) NGPCIF NPI.

MEMORIAL RESOURCE DEVELOPMENT CORP.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED AND COMBINED FINANCIAL STATEMENTS

Basis of Presentation

The financial statements reported herein include the financial position and results attributable to both our predecessor and the previous owners on a combined basis for periods prior to our initial public offering. For periods after the completion of our public offering, our consolidated financial statements include our accounts and those of our majority-owned subsidiaries in which we have a controlling interest. Due to our control of MEMP through our ownership of MEMP GP, we are required to consolidate MEMP for accounting and financial reporting purposes. MEMP is owned 99.9% by its limited partners and 0.1% by MEMP GP.

All material intercompany transactions and balances have been eliminated in preparation of our consolidated and combined financial statements. Our results of operations for the three and nine months ended September 30, 2014 are not necessarily indicative of results expected for the full year. In our opinion, the accompanying unaudited condensed consolidated and combined financial statements include all adjustments of a normal recurring nature necessary for fair presentation. Although we believe the disclosures in these financial statements are adequate and make the information presented not misleading, certain information and footnote disclosures normally included in annual financial statements prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) have been condensed or omitted pursuant to the rules and regulations of the United States Securities and Exchange Commission (“SEC”).

We have two reportable business segments, both of which are engaged in the acquisition, exploitation, development and production of oil and natural gas properties (See Note 14). Our reportable business segments are as follows:

- MRD—reflects the combined operations of the Company, MRD LLC, WildHorse Resources and its previous owners, Classic and Classic GP, Black Diamond, BlueStone, Beta Operating and MEMP GP.
- MEMP—reflects the combined operations of MEMP, its previous owners, and historical dropdown transactions that occurred between MEMP and other MRD LLC consolidating subsidiaries.

Segment financial information has been retrospectively revised for the following common control transactions for comparability purposes:

- acquisition by MEMP of all the outstanding membership interests in Tanos Energy, LLC (“Tanos”) from MRD LLC for a purchase price of approximately $77.4 million on October 1, 2013;
- acquisition by MEMP of all the outstanding membership interests in Prospect Energy, LLC (“Prospect Energy”) from Black Diamond for a purchase price of approximately $16.3 million on October 1, 2013;
- acquisition by MEMP of certain of the oil and natural gas properties in Jackson County, Texas from MRD LLC for a purchase price of approximately $2.6 million on October 1, 2013; and
- acquisition by MEMP of all the outstanding membership interests in WHT Energy Partners LLC (“WHT”) from WildHorse Resources and Tanos for a purchase price of approximately $200.0 million on March 28, 2013.

Note 2. Summary of Significant Accounting Policies

Use of Estimates

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

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

MEMORIAL RESOURCE DEVELOPMENT CORP.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED AND COMBINED FINANCIAL STATEMENTS

Principles of Consolidation and Combination

Our consolidated financial statements include our accounts and those of our subsidiaries in which we have a controlling interest. Likewise, the combined financial statements include those of our predecessor and the previous owners.

Cash and Cash Equivalents

Cash and cash equivalents represent unrestricted cash on hand and all highly liquid investments with original contractual maturities of three months or less.

Concentrations of Credit Risk

Cash balances, accounts receivable, restricted investments and derivative financial instruments are financial instruments potentially subject to credit risk. Cash and cash equivalents are maintained in bank deposit accounts which, at times, may exceed the federally insured limits. Management periodically reviews and assesses the financial condition of the banks to mitigate the risk of loss. Various restricted investment accounts fund certain long-term contractual and regulatory asset retirement obligations and collateralize certain regulatory bonds associated with MEMP’s offshore Southern California oil and gas properties. These restricted investments may consist of money market deposit accounts, money market mutual funds, commercial paper, and U.S. Government securities, all held with credit-worthy financial institutions. Derivative financial instruments are generally executed with major financial institutions that expose us to market and credit risks and which may, at times, be concentrated with certain counterparties. The creditworthiness of the counterparties is subject to continual review. We rely upon netting arrangements with counterparties to reduce credit exposure. We have not experienced any losses from such instruments.

Oil and natural gas are sold to a variety of purchasers, including intrastate and interstate pipelines or their marketing affiliates and independent marketing companies. Accounts receivable from joint operations are from a number of oil and natural gas companies, partnerships, individuals, and others who own interests in the properties operated by us and our predecessor. Generally, operators of crude oil and natural gas properties have the right to offset future revenues against unpaid charges related to operated wells, minimizing the credit risk associated with these receivables. Additionally, management believes that any credit risk imposed by a concentration in the oil and natural gas industry is mitigated by the creditworthiness of its customer base. An allowance for doubtful accounts is recorded after all reasonable efforts have been exhausted to collect or settle the amount owed. Any amounts outstanding longer than the contractual terms are considered past due. Management determined that an allowance for uncollectible accounts was unnecessary at both September 30, 2014 and December 31, 2013, respectively.

If we were to lose any one of our customers, the loss could temporarily delay production and the sale of oil and natural gas in the related producing region. If we were to lose any single customer, we believe that a substitute customer to purchase the impacted production volumes could be identified.

Oil and Natural Gas Properties

Oil and natural gas exploration, development and production activities are accounted for in accordance with the successful efforts method of accounting. Under this method, costs of acquiring properties, costs of drilling successful exploration wells, and development costs are capitalized. The costs of exploratory wells are initially capitalized pending a determination of whether proved reserves have been found. At the completion of drilling activities, the costs of exploratory wells remain capitalized if determination is made that proved reserves have been found. If no proved reserves have been found, the costs of each of the related exploratory wells are charged to expense. In some cases, a determination of proved reserves cannot be made at the completion of drilling, requiring additional testing and evaluation of the wells. The costs of such exploratory wells are expensed if a determination of proved reserves has not been made within a twelve-month period after drilling is complete. Exploration costs such as geological, geophysical, and seismic costs are expensed as incurred.

As exploration and development work progresses and the reserves on these properties are proven, capitalized costs attributed to the properties are subject to depreciation and depletion. Depletion of capitalized costs is provided using the units-of-production method based on proved oil and gas reserves related to the associated field. Capitalized drilling and development costs of producing oil and natural gas properties are depleted over proved developed reserves and leasehold costs are depleted over total proved reserves.

On the sale or retirement of a complete or partial unit of a proved property or pipeline and related facilities, the cost and related accumulated depreciation, depletion, and amortization are removed from the property accounts, and any gain or loss is recognized.

MEMORIAL RESOURCE DEVELOPMENT CORP.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED AND COMBINED FINANCIAL STATEMENTS

Impairments

Proved oil and natural gas properties are reviewed for impairment when events and circumstances indicate a possible decline in the recoverability of the carrying value of such properties, such as a downward revision of the reserve estimates, less than expected production, drilling results, higher operating and development costs, or lower commodity prices. The estimated undiscounted future cash flows expected in connection with the property are compared to the carrying value of the property to determine if the carrying amount is recoverable. If the carrying value of the property exceeds its estimated undiscounted future cash flows, the carrying amount of the property is reduced to its estimated fair value using Level 3 inputs. The factors used to determine fair value include, but are not limited to, estimates of proved reserves, future commodity prices, the timing of future production and capital expenditures and a discount rate commensurate with the risk reflective of the lives remaining for the respective oil and gas properties.

Unproved oil and natural gas properties are assessed for impairment on a property-by-property basis. A loss is recognized by providing a valuation allowance if the assessment indicates an impairment. The impairment assessment is affected by economic factors such as the results of exploration activities, commodity price outlooks, remaining lease terms, and potential shifts in business strategy employed by management.

Asset Retirement Obligations

An asset retirement obligation associated with retiring long-lived assets is recognized as a liability on a discounted basis in the period in which the legal obligation is incurred and becomes determinable, with an equal amount capitalized as an addition to oil and natural gas properties, which is allocated to expense over the useful life of the asset. Generally, oil and gas producing companies incur such a liability upon acquiring or drilling a well. Accretion expense is recognized over time as the discounted liabilities are accreted to their expected settlement value. Upon settlement of the liability, a gain or loss is recognized as a component of exploration costs to the extent the actual costs differ from the recorded liability. See Note 6 for further discussion of asset retirement obligations.

Oil and Gas Reserves

The estimates of proved oil and natural gas reserves utilized in the preparation of the consolidated and combined financial statements are estimated in accordance with the rules established by the SEC and the Financial Accounting Standards Board (“FASB”). These rules require that reserve estimates be prepared under existing economic and operating conditions using a trailing 12-month average price with no provision for price and cost escalations in future years except by contractual arrangements.

Reserve estimates are inherently imprecise. Accordingly, the estimates are expected to change as more current information becomes available. It is possible that, because of changes in market conditions or the inherent imprecision of reserve estimates, the estimates of future cash inflows, future gross revenues, the amount of oil and natural gas reserves, the remaining estimated lives of oil and natural gas properties, or any combination of the above may be increased or reduced. Increases in recoverable economic volumes generally reduce per unit depletion rates while decreases in recoverable economic volumes generally increase per unit depletion rates.

Other Property & Equipment

Other property and equipment is stated at historical costs and is comprised primarily of vehicles, furniture, fixtures, and computer hardware and software. Depreciation of other property and equipment is calculated using the straight-line method generally based on estimated useful lives of three to five years.

Restricted Investments

Various restricted investment accounts fund certain long-term contractual and regulatory asset retirement obligations and collateralize certain regulatory bonds associated with MEMP's offshore Southern California oil and gas properties. These investments are classified as held-to-maturity, and such investments are stated at amortized cost. Interest earned on these investments is included in interest expense – net in the statement of operations. The amortized cost of such investments is adjusted for amortization of premiums and accretion of discounts to maturity. At September 30, 2014, these restricted investments consisted of money market deposit accounts, money market mutual funds, commercial paper, and U.S. Government securities. See Note 7 for additional information.

Debt Issuance Costs

These costs are recorded on the balance sheet and amortized over the term of the associated debt using the straight-line method which approximates the effective yield method.

MEMORIAL RESOURCE DEVELOPMENT CORP.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED AND COMBINED FINANCIAL STATEMENTS

Revenue Recognition

Revenue from the sale of oil and natural gas is recognized when title passes, net of royalties due to third parties. Oil and natural gas revenues are recorded using the sales method. Under this method, revenues are recognized based on actual volumes of oil and natural gas sold to purchasers, regardless of whether the sales are proportionate to our ownership in the property. An asset or a liability is recognized to the extent that we have an imbalance in excess of our proportionate share of the remaining recoverable reserves on the underlying properties.

Derivative Instruments

Commodity derivative financial instruments (e.g., swaps, collars, and put options) are used to reduce the impact of natural gas and oil price fluctuations. Interest rate swaps are used to manage exposure to interest rate volatility, primarily as a result of variable rate borrowings under the credit facilities. Every derivative instrument is recorded on the balance sheet as either an asset or liability measured at its fair value. Changes in the derivative's fair value are recognized in earnings as we have not elected hedge accounting for any of our derivative positions.

Income Tax

Prior to our initial public offering, MRD LLC was organized as a pass-through entity for federal income tax purposes and was not subject to federal income taxes; however, certain of its consolidating subsidiaries were taxed as corporations and subject to federal income taxes. We are organized as a taxable C corporation and subject to federal and certain state income taxes. We are also subject to the Texas margin tax and certain aspects of the tax make it similar to an income tax as the tax is assessed on 1% of taxable margin apportioned to operations in Texas.

Deferred federal and state income taxes are provided on temporary differences between the financial statement carrying amounts of assets and liabilities and their respective tax basis. If it is more likely than not that some of the deferred tax assets will not be realized, the tax asset is reduced by a valuation allowance. A tax benefit from an uncertain tax position is recognized when it is more likely than not that the position will be sustained upon examination, based on the technical merits of the position. The tax benefit recorded is equal to the largest amount that is greater than 50% likely to be realized through final settlement with a taxing authority. There were no uncertain tax positions that required recognition in the financial statements at both September 30, 2014 and December 31, 2013, respectively.

In June 2014, we recorded a deferred tax liability of approximately $43.3 million in stockholders' equity in connection with our initial public offering and the related restructuring transactions. The tax bases of our assets and liabilities changed as a result our initial public offering and the related restructuring transactions, which represented a transaction among stockholders.

Earnings Per Share

Basic earnings per share ("EPS") is computed based on the average number of shares of common stock outstanding for the period. Diluted EPS includes the effect of the Company's outstanding restricted stock awards if the inclusion of these awards is dilutive. See Note 10 for additional information.

Incentive-Based Compensation Arrangements

The fair value of equity-classified awards (e.g., restricted stock awards) is amortized to earnings over the requisite service or vesting period. Compensation expense for liability-classified awards are recognized over the requisite service or vesting period of an award based on the fair value of the award re-measured at each reporting period. Generally, no compensation expense is recognized for equity instruments that do not vest.

Prior to the restructuring transactions, the governing documents of MRD LLC and certain of its subsidiaries, including WildHorse Resources and BlueStone, provided for the issuance of incentive units. The incentive units were subject to performance conditions that affected their vesting. Compensation cost was recognized only if the performance condition was probable of being satisfied at each reporting date.

MEMORIAL RESOURCE DEVELOPMENT CORP.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED AND COMBINED FINANCIAL STATEMENTS

In connection with the restructuring transactions, the MRD LLC incentive units were exchanged for substantially identical units in MRD Holdco, and such incentive units entitle holders thereof to portions of future distributions by MRD Holdco. While any such distributions made by MRD Holdco will not involve any cash payment by us, we will be required to recognize non-cash compensation expense, which may be material, in future periods. The compensation expense recognized by us related to the incentive units will be offset by a deemed capital contribution from MRD Holdco.

See Notes 11 and 12 for further information.

Current Liabilities – Accrued liabilities

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

	September 30, 2014	December 31, 2013
Accrued capital expenditures	$ 77,716	$ 48,579
Accrued lease operating expense	18,142	13,240
Accrued general and administrative expenses	11,986	14,485
Accrued ad valorem and production taxes	26,466	3,541
Accrued interest payable	41,857	11,934
Accrued environmental	571	577
Other miscellaneous, including operator advances	2,643	5,774
	$ 179,381	$ 98,130

New Accounting Pronouncements

Revenue from Contracts with Customers. In May 2014, the FASB issued a comprehensive new revenue recognition standard for contracts with customers that will supersede most current revenue recognition guidance, including industry-specific guidance. The core principle of this standard is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. To achieve this core principle, the standard provides a five-step analysis of transactions to determine when and how revenue is recognized. Other major provisions include the capitalization and amortization of certain contract costs, ensuring the time value of money is considered in the transaction price, and allowing estimates of variable consideration to be recognized before contingencies are resolved in certain circumstances. This guidance also requires enhanced disclosures regarding the nature, amount, timing and uncertainty of revenue and cash flows arising from an entity's contracts with customers. The new standard is effective for fiscal years, and interim periods within those years, beginning after December 15, 2016. Early application is prohibited. The standard permits the use of either the retrospective or cumulative effect transition method. This guidance will be applicable to the Company beginning on January 1, 2017. The Company is currently assessing the impact that adopting this new accounting guidance will have on its financial consolidated financial statements and footnote disclosures.

Reporting Discontinued Operations. In April 2014, the FASB issued an accounting standards update that changes the criteria for determining when disposals can be presented as discontinued operations and modifies discontinued operations disclosures. The new guidance now defines a "discontinued operation" as (i) a disposal of a component or group of components that is disposed of or is classified as held for sale and "represents a strategic shift that has (or will have) a major effect on an entity's operations and financial results" or (ii) an acquired business or nonprofit activity that is classified as held for sale on the date of acquisition. We will adopt this guidance and apply the disclosure requirements prospectively beginning on January 1, 2015.

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

MEMORIAL RESOURCE DEVELOPMENT CORP.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED AND COMBINED FINANCIAL STATEMENTS

Note 3. Acquisitions and Divestitures

Acquisition-related costs are included in general and administrative expenses in the accompanying statements of operations for the periods indicated below (in thousands):

For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
2014	2013	2014	2013
$1,425	$2,977	$5,480	$5,073

2014 Acquisitions

On July 1, 2014, MEMP consummated a transaction to acquire certain oil and natural gas liquids properties from a third party in Wyoming for an aggregate purchase price of approximately $911.7 million, including estimated post-closing adjustments (the "Wyoming Acquisition"). Revenues of $41.6 million were recorded in the statement of operations generated earnings of approximately $16.5 million related to the Wyoming Acquisition subsequent to the closing date.

On March 25, 2014, MEMP closed a transaction to acquire certain oil and natural gas producing properties from a third party in the Eagle Ford for approximately $168.1 million, including estimated customary post-closing adjustments (the "Eagle Ford Acquisition"). In addition, MEMP acquired a 30% interest in the seller's Eagle Ford leasehold. During the three and nine months ended September 30, 2014, revenues of approximately $11.5 million and $25.9 million, respectively, were recorded in the statement of operations related to the Eagle Ford Acquisition subsequent to the closing date and MEMP generated earnings of approximately $5.3 million and $13.3 million, respectively.

The following table summarizes the preliminary fair value assessment of the assets acquired and liabilities assumed as of the acquisition date (in thousands):

	Eagle Ford Acquisition	Wyoming Acquisition
Oil and gas properties	$ 168,606	$ 922,686
Asset retirement obligations	(285)	(3,328)
Revenue Payable	—	(444)
Accrued liabilities	(250)	(7,237)
Total identifiable net assets	$ 168,071	$ 911,677

The following unaudited pro forma combined results of operations are provided for the three months ended September 30, 2013 and nine months ended September 30, 2014 and 2013 as though the Wyoming Acquisition had been completed on January 1, 2013. The unaudited pro forma financial information was derived from the historical combined statements of operations of the Company and the previous owners and adjusted to include: (i) the revenues and direct operating expenses associated with oil and gas properties acquired, (ii) depletion expense applied to the adjusted basis of the properties acquired and (iii) interest expense on additional borrowings necessary to finance the acquisition. The unaudited pro forma financial information does not purport to be indicative of results of operations that would have occurred had the transaction occurred on the basis assumed above, nor is such information indicative of expected future results of operations.

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2014	2013	2014	2013
	(In thousands, except per unit amounts)			
Revenues	n/a	$203,461	$764,084	