SANDRIDGE ENERGY INC
Form 10-Q
November 06, 2008

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

Form 10-Q

(Mark One)

þ	**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934** **For the quarterly period ended September 30, 2008**
	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: 001-33784

SANDRIDGE ENERGY, INC.
(Exact name of registrant as specified in its charter)

Delaware *(State or other jurisdiction of incorporation or organization)*	**20-8084793** *(I.R.S. Employer Identification No.)*
123 Robert S. Kerr Avenue **Oklahoma City, Oklahoma** *(Address of principal executive offices)*	**73102** *(Zip Code)*

Registrant s telephone number, including area code:
(405) 429-5500

Former name, former address and former fiscal year, if changed since last report: Not applicable

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 o

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

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

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

As of October 31, 2008, 166,061,227 shares of the registrant s common stock, par value $0.001 per share, were outstanding.

SANDRIDGE ENERGY, INC.
FORM 10-Q
Quarter Ended September 30, 2008

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DISCLOSURES REGARDING FORWARD-LOOKING STATEMENTS

This quarterly report on Form 10-Q includes 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. Various statements contained in this report, including those that express a belief, expectation, or intention, as well as those that are not statements of historical fact, are forward-looking statements. The forward-looking statements include projections and estimates concerning 2008 capital expenditures, our liquidity and capital resources, the timing and success of specific projects, outcomes and effects of litigation, claims and disputes and elements of our business strategy. Our forward-looking statements are generally accompanied by words such as estimate, project, predict, believe, expect, anticipate, potential, could, may, foresee, plan, goal or other words that convey the u future events or outcomes. We have based these forward-looking statements on our current expectations and assumptions about future events. 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. However, whether actual results and developments will conform with our expectations and predictions is subject to a number of risks and uncertainties, including the risk factors discussed in the prospectus we filed with the Securities and Exchange Commission on September 17, 2008, and in Item 1A of Part II of this quarterly report, the opportunities that may be presented to and pursued by us, competitive actions by other companies, changes in laws or regulations and other factors, many of which are beyond our control. Consequently, all of the forward-looking statements made in this report are qualified by these cautionary statements. The actual results or developments anticipated may not be realized or, even if substantially realized, they may not have the expected consequences to or effects on our company or our business or operations. Such statements are not guarantees of future performance and actual results or developments may differ materially from those projected in the forward-looking statements. We undertake no obligation to publicly update or revise any forward-looking statements.

PART I. Financial Information

ITEM 1. *Financial Statements*

SandRidge Energy, Inc. and Subsidiaries

Condensed Consolidated Balance Sheets

	September 30, 2008	December 31, 2007
	(Unaudited) (In thousands)	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 898	$ 63,135
Accounts receivable, net:		
Trade	99,062	94,741
Related parties	13,874	20,018
Derivative contracts	87,751	21,958
Inventories	7,318	3,993
Deferred income taxes	3,528	1,820
Other current assets	29,858	20,787
Total current assets	242,289	226,452
Natural gas and crude oil properties, using full cost method of accounting		
Proved	4,155,044	2,848,531
Unproved	211,314	259,610
Less: accumulated depreciation and depletion	(434,561)	(230,974)
	3,931,797	2,877,167
Other property, plant and equipment, net	612,428	460,243
Derivative contracts	16,080	270
Investments	9,311	7,956
Restricted deposits	32,745	31,660
Other assets	45,852	26,818
Total assets	$ 4,890,502	$ 3,630,566
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Current maturities of long-term debt	$ 16,227	$ 15,350
Accounts payable and accrued expenses:		
Trade	314,444	215,497

Related parties		575		395
Asset retirement obligation		1,524		864
Billings in excess of costs incurred		11,885		
Total current liabilities		344,655		232,106
Long-term debt		1,956,044		1,052,299
Other long-term obligations		11,817		16,817
Asset retirement obligation		64,574		57,716
Deferred income taxes		134,283		49,350
Total liabilities		2,511,373		1,408,288
Commitments and contingencies (Note 12)				
Minority interest		28		4,672
Redeemable convertible preferred stock, $0.001 par value, 2,625 shares authorized; 0 and 2,184 issued and outstanding at September 30, 2008 and December 31, 2007, respectively				450,715
Stockholders equity:				
Preferred stock, $0.001 par value; 47,375 shares authorized; no shares issued and outstanding in 2008 and 2007				
Common stock, $0.001 par value, 400,000 shares authorized; 166,973 issued and 165,648 outstanding at September 30, 2008 and 141,847 issued and 140,391 outstanding at December 31, 2007		163		140
Additional paid-in capital		2,161,891		1,686,113
Treasury stock, at cost		(19,315)		(18,578)
Retained earnings		236,362		99,216
Total stockholders equity		2,379,101		1,766,891
Total liabilities and stockholders equity	$	4,890,502	$	3,630,566

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

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SandRidge Energy, Inc. and Subsidiaries

Condensed Consolidated Statements of Operations

	Three Months Ended September 30, 2008	Three Months Ended September 30, 2007	Nine Months Ended September 30, 2008	Nine Months Ended September 30, 2007
	(Unaudited) (In thousands, except per share amounts)			
Revenues:				
Natural gas and crude oil	$ 259,141	$ 113,106	$ 756,762	$ 319,556
Drilling and services	12,054	16,684	36,345	56,928
Midstream and marketing	58,343	19,030	174,240	71,131
Other	4,485	4,828	13,812	14,160
Total revenues	334,023	153,648	981,159	461,775
Expenses:				
Production	41,070	28,689	115,512	77,707
Production taxes	6,717	4,402	29,456	12,328
Drilling and services	8,191	6,809	20,426	30,935
Midstream and marketing	51,908	14,444	157,059	61,191
Depreciation, depletion and amortization natural gas and crude oil	71,964	45,177	209,296	115,876
Depreciation, depletion and amortization other	17,597	14,282	51,342	36,545
General and administrative	29,235	20,421	76,432	45,781
(Gain) loss on derivative contracts	(292,526)	(39,247)	4,086	(55,228)
Gain on sale of assets	(1,420)	(1,045)	(9,131)	(1,704)
Total expenses	(67,264)	93,932	654,478	323,431
Income from operations	401,287	59,716	326,681	138,344
Other income (expense):				
Interest income	923	544	3,068	3,671
Interest expense	(41,026)	(28,522)	(88,421)	(88,630)
Minority interest	(2)	(164)	(853)	(321)
(Loss) income from equity investments	(60)	1,235	1,355	3,399
Other (expense) income, net	(83)	31	856	530
Total other (expense) income	(40,248)	(26,876)	(83,995)	(81,351)
Income before income tax expense	361,039	32,840	242,686	56,993
Income tax expense	130,693	11,920	89,308	21,002
Net income	230,346	20,920	153,378	35,991
Preferred stock dividends and accretion		9,313	16,232	30,573

Income available to common stockholders	$ 230,346	$ 11,607	$ 137,146	$ 5,418
Income per share available to common stockholders:				
Basic	$ 1.41	$ 0.11	$ 0.90	$ 0.05
Diluted	$ 1.40	$ 0.11	$ 0.89	$ 0.05
Weighted average number of common shares outstanding:				
Basic	163,020	107,554	153,125	102,562
Diluted	164,554	109,049	154,489	103,778

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

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SandRidge Energy, Inc. and Subsidiaries

Condensed Consolidated Statement of Changes in Stockholders Equity

	Common Stock	Additional Paid-In Capital	Treasury Stock (Unaudited) (In thousands)	Retained Earnings	Total
Nine months ended September 30, 2008:					
Balance, December 31, 2007	$ 140	$ 1,686,113	$ (18,578)	$ 99,216	$ 1,766,891
Purchase of treasury stock			(3,536)		(3,536)
Common stock issued under retirement plans		3,167	2,799		5,966
Accretion on redeemable convertible preferred stock				(7,636)	(7,636)
Redeemable convertible preferred stock dividend				(8,596)	(8,596)
Stock-based compensation, net of tax		14,283			14,283
Conversion of redeemable convertible preferred stock to common stock	23	458,328			458,351
Net income				153,378	153,378
Balance, September 30, 2008	$ 163	$ 2,161,891	$ (19,315)	$ 236,362	$ 2,379,101

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

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SandRidge Energy, Inc. and Subsidiaries

Condensed Consolidated Statements of Cash Flows

	Nine Months Ended September 30, 2008	Nine Months Ended September 30, 2007
	(Unaudited) (In thousands)	
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 153,378	$ 35,991
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for doubtful accounts	1,623	
Depreciation, depletion and amortization	260,638	152,421
Debt issuance cost amortization	4,026	14,903
Deferred income taxes	83,225	20,004
Unrealized gain on derivative contracts	(81,603)	(36,052)
Gain on sale of assets	(9,131)	(1,704)
Interest income restricted deposits	(304)	(1,024)
Income from equity investments	(1,355)	(3,399)
Stock-based compensation, net of tax	14,283	4,962
Minority interest	853	321
Changes in operating assets and liabilities	108,735	53,133
Net cash provided by operating activities	534,368	239,556
CASH FLOWS FROM INVESTING ACTIVITIES:		
Capital expenditures for property, plant and equipment	(1,609,355)	(895,160)
Acquisition of assets		(3,001)
Proceeds from sale of assets	158,534	6,458
Loans to unconsolidated investees	(5,500)	
Fundings of restricted deposits	(781)	(5,638)
Net cash used in investing activities	(1,457,102)	(897,341)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from borrowings	1,768,722	1,262,769
Repayments of borrowings	(864,100)	(879,592)
Dividends paid preferred	(17,552)	(24,366)
Minority interest (distributions) contributions	(5,497)	192
Proceeds from issuance of common stock		319,966
Purchase of treasury stock	(3,536)	(1,579)
Debt issuance costs	(17,540)	(26,540)
Net cash provided by financing activities	860,497	650,850
NET DECREASE IN CASH AND CASH EQUIVALENTS	(62,237)	(6,935)

CASH AND CASH EQUIVALENTS, beginning of year		63,135		38,948
CASH AND CASH EQUIVALENTS, end of period	$	898	$	32,013
Supplemental Disclosure of Noncash Investing and Financing Activities:				
Insurance premiums financed	$		$	1,496
Accretion on redeemable convertible preferred stock	$	7,636	$	1,062
Redeemable convertible preferred stock dividends, net of dividends paid	$		$	8,956
Property, plant, and equipment addition due to settlement	$		$	4,500

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

SandRidge Energy, Inc. and Subsidiaries

Notes to Condensed Consolidated Financial Statements
(Unaudited)

1. Basis of Presentation

Nature of Business. SandRidge Energy, Inc., together with its subsidiaries (collectively, the Company or SandRidge), is a natural gas and crude oil company with its principal focus on exploration, development and production. SandRidge also owns and operates natural gas gathering and processing facilities and CO_2 treating and transportation facilities and has marketing and tertiary oil recovery operations. In addition, Lariat Services, Inc., (LSI) a wholly owned subsidiary of SandRidge, owns and operates drilling rigs and a related oil field services business. SandRidge s primary exploration, development and production areas are concentrated in West Texas. The Company also operates interests in the Mid-Continent, the Cotton Valley Trend in East Texas, the Gulf Coast and the Gulf of Mexico.

Interim Financial Statements. The accompanying condensed consolidated financial statements as of December 31, 2007 have been derived from the audited financial statements contained in the Company s annual report on Form 10-K for the fiscal year ended December 31, 2007 (the 2007 Form 10-K). The unaudited interim condensed consolidated financial statements have been prepared by the Company in accordance with the accounting policies stated in the audited consolidated financial statements contained in the 2007 Form 10-K. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) have been condensed or omitted, although the Company believes that the disclosures contained herein are adequate to make the information presented not misleading. In the opinion of management, all adjustments (consisting only of normal recurring adjustments) necessary to state fairly the information in the Company s unaudited condensed consolidated financial statements have been included. These condensed financial statements should be read in conjunction with the financial statements and notes thereto included in the 2007 Form 10-K.

2. Significant Accounting Policies

For a description of the Company s accounting policies, refer to Note 1 of the consolidated financial statements included in the 2007 Form 10-K.

Reclassifications. Certain reclassifications have been made to prior period financial statements to conform with current period presentation.

Recent Accounting Pronouncements. Effective January 1, 2008, SandRidge implemented Statement of Financial Accounting Standards (SFAS) No. 157, Fair Value Measurements. SFAS No. 157 defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. SFAS No. 157 does not require new fair value measurements. SFAS No. 157 did not have an effect on the Company s financial statements other than requiring additional disclosures regarding fair value measurements. See Note 4.

In February 2008, the Financial Accounting Standards Board (FASB) issued FASB Staff Position FAS 157-2, Effective Date of FASB Statement No. 157 (FSP 157-2). FSP 157-2 delays the effective date of SFAS No. 157 to fiscal years beginning after November 15, 2008 for all nonfinancial assets and nonfinancial liabilities, except those recognized or disclosed at fair value in the financial statements on a recurring basis, at least annually. The Company plans to implement this standard on January 1, 2009. The adoption of FSP 157-2 is not expected to have a material impact on the Company s financial condition, operations or cash flows.

In October 2008, the FASB issued FASB Staff Position FAS 157-3, Determining the Fair Value of a Financial Asset When the Market for That Asset is Not Active (FSP 157-3). FSP 157-3 clarifies the application of SFAS No. 157 in determining the fair value of a financial asset when the market for that financial asset is not active. As of September 30, 2008, the Company has no financial assets with a market that is not active. Accordingly, FSP 157-3 has no effect on the Company s current financial statements.

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SandRidge Energy, Inc. and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Continued)

In December 2007, the FASB issued SFAS No. 141(R), Business Combinations, which replaces SFAS No. 141. SFAS No. 141(R) establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, any noncontrolling interest in the acquiree and the goodwill acquired. The Statement also establishes disclosure requirements that will enable users to evaluate the nature and financial effects of the business combination. SFAS No. 141(R) is effective for business combinations with acquisition dates on or after fiscal years beginning after December 15, 2008. The Company will evaluate this standard with respect to business combinations with acquisition dates on or after January 1, 2009.

In December 2007, the FASB issued SFAS No. 160, Noncontrolling Interests in Consolidated Financial Statements an Amendment of Accounting Research Bulletin No. 51, which establishes accounting and reporting standards for ownership interests in subsidiaries held by parties other than the parent, the amount of consolidated net income attributable to the parent and to the noncontrolling interest, changes in a parent s ownership interest and the valuation of retained noncontrolling equity investments when a subsidiary is deconsolidated. The Statement also establishes disclosure requirements to clearly identify and distinguish between the interests of the parent and the interests of the noncontrolling owners. SFAS No. 160 is effective for fiscal years beginning after December 15, 2008. The Company plans to implement this standard on January 1, 2009. The Company is currently evaluating the potential impact of this standard.

In March 2008, the FASB issued SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities, which changes disclosure requirements for derivative instruments and hedging activities. The Statement requires enhanced disclosure, including qualitative disclosures about objectives and strategies for using derivatives, quantitative disclosures about fair value amounts of gains and losses on derivative instruments and disclosures about credit-risk-related contingent features in derivative agreements. SFAS No. 161 is effective for fiscal years beginning after November 15, 2008. The Company plans to implement this standard on January 1, 2009. The Company is currently evaluating the provisions of this standard. As SFAS No. 161 pertains to disclosure requirements, no effect to the Company s financial condition or operations is expected.

3. Property, Plant and Equipment

Property, plant and equipment consists of the following (in thousands):

	September 30, 2008	December 31, 2007
Natural gas and crude oil properties:		
Proved	$ 4,155,044	$ 2,848,531
Unproved	211,314	259,610
Total natural gas and crude oil properties	4,366,358	3,108,141
Less accumulated depreciation and depletion	(434,561)	(230,974)
Net natural gas and crude oil properties capitalized costs	3,931,797	2,877,167

Land	9,929	1,149
Non natural gas and crude oil equipment	713,525	539,893
Buildings and structures	60,070	38,288
Total	783,524	579,330
Less accumulated depreciation, depletion and amortization	(171,096)	(119,087)
Net capitalized costs	612,428	460,243
Total property, plant and equipment	$ 4,544,225	$ 3,337,410

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SandRidge Energy, Inc. and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Continued)

The Company completed the sale of all its assets located in the Piceance Basin of Colorado in May 2008. Net proceeds to the Company were approximately $147.2 million after closing adjustments. Assets sold included undeveloped acreage, working interests in wells, gathering and compression systems and other facilities related to the wells. The portion of the Company s net proceeds attributable to its gathering and compression systems and facilities disposed exceeded the book basis of those assets resulting in a gain on sale of approximately $7.5 million. The sale of its acreage and working interests in wells was accounted for as an adjustment to the full cost pool with no gain or loss recognized.

The amount of capitalized interest included in the above non natural gas and crude oil equipment balance at September 30, 2008 and December 31, 2007 was $3.8 million and $3.4 million, respectively.

4. Fair Value Measurements

Effective January 1, 2008, the Company implemented SFAS No. 157 for its financial assets and liabilities measured on a recurring basis. SFAS No. 157 applies to all financial assets and liabilities that are being measured and reported on a fair value basis. In February 2008, the FASB issued FSP 157-2, which delayed the effective date of SFAS No. 157 by one year for certain nonfinancial assets and liabilities.

As defined in SFAS No. 157, fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. SFAS No. 157 requires disclosure that establishes a framework for measuring fair value and expands disclosure about fair value measurements. The Statement requires fair value measurements to be classified and disclosed in one of the following categories:

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

Level 2: Quoted prices in markets that are not active, or inputs which are observable, either directly or indirectly, for substantially the full term of the asset or liability.

Level 3: Measured based on prices or valuation models that required inputs that are both significant to the fair value measurement and less observable for objective sources (i.e., supported by little or no market activity).

As required by SFAS No. 157, financial assets and liabilities are classified based on the lowest level of input that is significant to the fair value measurement. The Company s assessment of the significance of a particular input to the fair value measurement requires judgment, and may affect the valuation of the fair value of assets and liabilities and their placement within the fair value hierarchy levels. The determination of the fair values below takes into account the market for the Company s financial assets and liabilities, the associated credit risk and other factors as required under SFAS No. 157.

Per SFAS No. 157, the Company has classified its derivative contracts into one of three levels based upon the data relied upon to determine the fair value. The fair values of the Company s natural gas and crude oil swaps, crude oil collars and interest rate swap are based upon quotes obtained from counterparties to the derivative contracts. The Company reviews other readily available market prices for its derivative contracts as there is an active market for these contracts; however, the Company does not have access to specific valuation models used by the counterparties. Included in these models are discount factors that the Company must estimate in its calculation. Therefore,

SandRidge Energy, Inc. and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Continued)

these derivative contract assets and liabilities are classified as Level 3. The following table summarizes the valuation of the Company s financial assets and liabilities as of September 30, 2008 (in thousands):

	Fair Value Measurements Using:			
Description	**Quoted Prices in Active Markets for Identical Assets or Liabilities (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**	**Assets/ (Liabilities) at Fair Value**
Assets (liabilities):				
Natural gas and crude oil derivative contracts	$	$	$ 96,095	$ 96,095
Interest rate swap			7,736	7,736
	$	$	$ 103,831	$ 103,831

The table below sets forth a reconciliation of the Company s financial assets and liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) during the three months ended September 30, 2008 (in thousands):

	Derivatives
Balance of Level 3, June 30, 2008	$ (213,261)
Total gains or losses (realized/unrealized)	289,813
Purchases, issuances and settlements	27,279
Transfers in and out of Level 3	
Balance of Level 3, September 30, 2008	$ 103,831
Changes in unrealized gains (losses) on derivative contracts held as of September 30, 2008	$ 317,092

The table below sets forth a reconciliation of the Company s financial assets and liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) during the nine months ended September 30, 2008 (in thousands):

		Derivatives
Balance of Level 3, December 31, 2007	$	22,228
Total gains or losses (realized/unrealized)		3,649
Purchases, issuances and settlements		77,954
Transfers in and out of Level 3		
Balance of Level 3, September 30, 2008	$	103,831
Changes in unrealized gains (losses) on derivative contracts held as of September 30, 2008	$	81,603

SandRidge Energy, Inc. and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Continued)

5. Asset Retirement Obligation

A reconciliation of the beginning and ending aggregate carrying amounts of the asset retirement obligation for the period from December 31, 2007 to September 30, 2008 is as follows (in thousands):

Asset retirement obligation, December 31, 2007	$ 58,580
Liability incurred upon acquiring and drilling wells	4,350
Revisions in estimated cash flows	
Liability settled in current period	(764)
Accretion of discount expense	3,932
Asset retirement obligation, September 30, 2008	66,098
Less: current portion	1,524
Asset retirement obligation, net of current	$ 64,574

6. Billings in Excess of Costs Incurred

In June 2008, the Company entered into an agreement with a subsidiary of Occidental Petroleum Corporation (Occidental) to construct a CO_2 extraction plant (the Century Plant) located in Pecos County, Texas and associated compression and pipeline facilities for $800.0 million. Occidental will pay a minimum of 100% of the contract price, plus any subsequent agreed-upon revisions, to the Company through periodic cost reimbursements based upon the percentage of the project completed. Upon start-up, the Century Plant will be owned and operated by Occidental for the purpose of extracting CO_2 from delivered natural gas. The Company will deliver high CO_2 natural gas to the Century Plant. Pursuant to a 30-year treating agreement executed simultaneously with the construction agreement, Occidental will extract CO_2 from the Company s delivered natural gas. The Company will retain all methane from the Century Plant and its other existing plants.

The Company accounts for construction of the Century Plant using the completed-contract method, under which contract revenues and costs are recognized when work under the contract is completed or substantially completed. In the interim, costs incurred on and billings related to contracts in process are accumulated on the balance sheet. Provisions for a contract loss are recognized when it has been determined that a loss will be incurred. During July 2008, the Company issued and received payment for a progress billing in the amount of $68.1 million. Billings in excess of costs incurred during the nine months ended September 30, 2008 were $11.9 million and are reported in the accompanying condensed consolidated balance sheet.

SandRidge Energy, Inc. and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Continued)

7. Long-Term Debt

Long-term debt consists of the following (in thousands):

	September 30, 2008	December 31, 2007
Senior credit facility	$ 166,486	$
Other notes payable:		
Drilling rig fleet and related oil field services equipment	36,747	47,836
Mortgage	19,038	19,651
Other equipment and vehicles		162
8.625% Senior Term Loan		650,000
Senior Floating Rate Term Loan		350,000
8.625% Senior Notes due 2015	650,000	
Senior Floating Rate Notes due 2014	350,000	
8.0% Senior Notes due 2018	750,000	
Total debt	1,972,271	1,067,649
Less: current maturities of long-term debt	16,227	15,350
Long-term debt	$ 1,956,044	$ 1,052,299

Senior Credit Facility. On November 21, 2006, the Company entered into a $750.0 million senior secured revolving credit facility (the senior credit facility). As discussed further below, the borrowing base was $1.1 billion at September 30, 2008. The senior credit facility matures on November 21, 2011 and is available to be drawn on and repaid without restriction so long as the Company is in compliance with its terms, including certain financial covenants.

The senior credit facility contains various covenants that limit the ability of the Company and certain of its subsidiaries to grant certain liens; make certain loans and investments; make distributions; redeem stock; redeem or prepay debt; merge or consolidate with or into a third party; or engage in certain asset dispositions, including a sale of all or substantially all of the Company s assets. Additionally, the senior credit facility limits the ability of the Company and certain of its subsidiaries to incur additional indebtedness with certain exceptions, including under the senior notes (as discussed below).

The senior credit facility also contains financial covenants, including maintenance of agreed upon levels for the (i) ratio of total funded debt to EBITDAX (as defined in the senior credit facility), (ii) ratio of EBITDAX to interest expense plus current maturities of long-term debt and (iii) current ratio. The Company was in compliance with all of the financial covenants under the senior credit facility as of September 30, 2008.

The obligations under the senior credit facility are secured by first priority liens on all shares of capital stock of each of the Company s present and future subsidiaries; all intercompany debt of the Company and its subsidiaries; and substantially all of the Company s assets and the assets of its guarantor subsidiaries, including proved natural gas and crude oil reserves representing at least 80% of the present discounted value (as defined in the senior credit facility) of proved natural gas and crude oil reserves reviewed in determining the borrowing base for the senior credit facility. Additionally, the obligations under the senior credit facility are guaranteed by certain Company subsidiaries.

At the Company s election, interest under the senior credit facility is determined by reference to (i) the London Interbank Offered Rate (LIBOR) plus an applicable margin between 1.25% and 2.00% per annum or (ii) the higher of the federal funds rate plus 0.5% or the prime rate plus, in either case, an applicable margin between 0.25% and 1.00% per annum. Interest is payable quarterly for prime rate loans and at the applicable maturity date for

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Notes to Condensed Consolidated Financial Statements (Continued)

LIBOR loans, except that if the interest period for a LIBOR loan is six months, interest is paid at the end of each three-month period. The average interest rate paid on amounts outstanding under our senior credit facility was 4.52% and 4.32% for the three-month and nine-month periods ended September 30, 2008, respectively.

Borrowings under the senior credit facility may not exceed the lower of the borrowing base or the committed loan amount, which was increased to $1.75 billion on April 4, 2008. The borrowing base of proved reserves was initially set at $300.0 million. The borrowing base was subsequently increased to $400.0 million on May 2, 2007, $700.0 million on September 14, 2007 and $1.2 billion on April 4, 2008. The Company incurred additional costs related to the senior credit facility as a result of changes to the borrowing base. These costs have been deferred and are included in other assets on the accompanying condensed consolidated balance sheets. As a result of the private placement of $750.0 million of senior notes in May 2008 discussed below, the borrowing base was reduced to $1.1 billion. At September 30, 2008, the Company had $166.5 million outstanding and approximately $906.5 million undrawn under this facility.

On October 3, 2008, Lehman Brothers Commodity Services, Inc. (Lehman Brothers), who is a lender under the Company s senior credit facility, filed for bankruptcy. At the time of the declaration of bankruptcy by its parent, Lehman Brothers Holdings, Inc., on September 15, 2008, Lehman Brothers elected not to fund its pro rata share, or 0.29%, of borrowings requested by the Company under the senior credit facility. As a result, the Company does not anticipate that Lehman Brothers will fund its pro rata share of any future borrowing requests. The Company currently does not expect this reduced availability of amounts under the senior credit facility to impact its liquidity or business operations.

Other Indebtedness. The Company has financed a portion of its drilling rig fleet and related oil field services equipment through notes. At September 30, 2008, the aggregate outstanding balance of these notes was $36.7 million, with an annual fixed interest rate ranging from 7.64% to 8.67%. The notes have a final maturity date of December 1, 2011, require aggregate monthly installments of principal and interest in the amount of $1.2 million and are secured by the equipment. The notes have a prepayment penalty (currently ranging from 1% to 3%) that is triggered if the Company repays the notes prior to maturity.

On November 15, 2007, the Company entered into a note payable in the amount of $20.0 million with a lending institution as a mortgage on the downtown Oklahoma City property purchased by the Company in July 2007 to serve as its corporate headquarters. This note is fully secured by one of the buildings and a parking garage located on the downtown property, bears interest at 6.08% annually and matures on November 15, 2022. Payments of principal and interest in the amount of approximately $0.5 million are due on a quarterly basis through the maturity date. During 2008, the Company expects to make payments of principal and interest on this note totaling $0.8 million and $1.2 million, respectively.

Prior to 2007, the Company financed the purchase of various vehicles, oil field services equipment and other equipment through various notes payable. The aggregate outstanding balance of these notes as of December 31, 2006 was $4.5 million. These notes were substantially repaid during 2007. As of September 30, 2008, there were no amounts outstanding under these notes. The Company financed its insurance premium payment made in 2007. Also, in 2007, the Company repaid a $4.0 million loan incurred in 2005 for the purpose of completing a gas processing plant and pipeline in Colorado.

8.625% Senior Term Loan and Senior Floating Rate Term Loan. On March 22, 2007, the Company issued $1.0 billion of unsecured senior term loans. The closing of the senior term loans was generally contingent upon closing the private placement of common equity as described in Note 14. A portion of the proceeds from the senior term loans was used to repay the Company s $850.0 million senior bridge facility, which was repaid in full in March 2007. The senior term loans included both a floating rate term loan and a fixed rate term loan, as described below.

The Company issued a $350.0 million senior term loan at a variable rate with interest payable quarterly and principal due on April 1, 2014. The variable rate term loan bore interest, at the Company s option, at LIBOR plus 3.625% or the higher of (i) the federal funds rate, as defined, plus 3.125% or (ii) a bank s prime rate plus 2.625%.

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Notes to Condensed Consolidated Financial Statements (Continued)

The Company issued a $650.0 million senior term loan at a fixed rate of 8.625% with the principal due on April 1, 2015. Under the terms of the fixed rate term loan, interest was payable quarterly and during the first four years interest was payable, at the Company s option, either entirely in cash or entirely with additional fixed rate term loans.

8.625% Senior Notes Due 2015 and Senior Floating Rate Notes Due 2014. In May 2008, the Company completed an offer to exchange the senior term loans for senior unsecured notes with registration rights, as required under the senior term loan credit agreement. The Company issued $650.0 million of 8.625% Senior Notes due 2015 in exchange for an equal outstanding principal amount of its fixed rate term loan and $350.0 million of Senior Floating Rate Notes due 2014 in exchange for an equal outstanding principal amount of its variable rate term loan. The exchange was made pursuant to a non-public exchange offer that commenced on March 28, 2008 and expired on April 28, 2008. The newly issued senior notes have terms that are substantially identical to those of the exchanged senior term loans, except that the senior notes were issued with registration rights. These senior notes are jointly and severally, unconditionally guaranteed on an unsecured basis by all of the Company s wholly owned subsidiaries except certain minor subsidiaries. See Note 16.

In conjunction with the issuance of the senior notes, the Company agreed to file a registration statement with the SEC in connection with its offer to exchange the notes for substantially identical notes that are registered under the Securities Act of 1933, as amended (Securities Act). The Company filed a registration statement relating to the exchange offer during the third quarter 2008, and all unregistered notes had been exchanged for registered notes by October 27, 2008.

The 8.625% Senior Notes due 2015 bear interest at a fixed rate of 8.625% per annum with the principal due on April 1, 2015. Under the terms of the fixed rate senior notes, interest is payable semi-annually and, through the interest payment due on April 1, 2011, interest may be paid, at the Company s option, either entirely in cash or entirely with additional fixed rate senior notes. If the Company elects to pay the interest due during any period in additional fixed rate senior notes, the interest rate will increase to 9.375% during that period. All interest payments made to date related to the fixed rate notes have been paid in cash. The Senior Floating Rate Notes due 2014 bear interest at LIBOR plus 3.625%, except for the period from April 1, 2008 to June 30, 2008, for which the interest rate was 6.323%. Interest is payable quarterly with principal due on April 1, 2014. The average interest rate paid on amounts outstanding under the Company s floating rate senior notes for the three-month period ended September 30, 2008 was 6.42%.

In January 2008, the Company entered into an interest rate swap to fix the variable LIBOR interest rate on the variable rate term loan for the period from April 1, 2008 to April 1, 2011. As a result of the exchange of the variable rate term loan to Senior Floating Rate Notes, the interest rate swap is now being used to fix the variable LIBOR interest rate on the Senior Floating Rate Notes at an annual rate of 6.26% through April 2011. This swap has not been designated as a hedge.

On or after April 1, 2011, the Company may redeem some or all of the 8.625% Senior Notes at specified redemption prices. On or after April 1, 2009, the Company may redeem some or all of the Senior Floating Rate Notes at specified redemption prices.

The Company incurred $26.1 million of debt issuance costs in connection with the senior term loans. As the senior term loans were exchanged for senior notes with substantially identical terms, the remaining unamortized debt issuance costs on the senior term loans will be amortized over the terms of the 8.625% Senior Notes and the Senior Floating Rate Notes. These costs are included in other assets on the accompanying condensed consolidated balance sheets.

8.0% Senior Notes Due 2018. In May 2008, the Company issued $750.0 million of unsecured 8.0% Senior Notes due 2018. The Company used $478.0 million of the $735.0 million net proceeds from the offering to repay the total balance outstanding on the senior credit facility at that time. The remaining proceeds were used to fund a portion of the Company s 2008 capital expenditure program. The notes bear interest at a fixed rate of 8.0% per annum, payable

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Notes to Condensed Consolidated Financial Statements (Continued)

semi-annually, with the principal due on June 1, 2018. The notes are redeemable, in whole or in part, prior to their maturity at specified redemption prices.

In conjunction with the issuance of the 8.0% Senior Notes, the Company entered into a Registration Rights Agreement requiring the Company to register these notes by May 19, 2009 if they are not already freely tradable at that time. The Company expects the notes to become freely tradable 180 days after their issuance pursuant to Rule 144 under the Securities Act. The Company is required to pay additional interest if it fails to fulfill its obligations under the agreement within the specified time periods.

The Company incurred $15.8 million of debt issuance costs in connection with the offering of the 8.0% Senior Notes. These costs are included in other assets on the accompanying condensed consolidated balance sheet and amortized over the term of the notes.

Debt covenants under all of the senior notes include financial covenants similar to those of the senior credit facility and include limitations on the incurrence of indebtedness, payment of dividends, asset sales, certain asset purchases, transactions with related parties and consolidation or merger agreements. The Company was in compliance with all of the covenants under the senior notes as of September 30, 2008.

Senior Bridge Facility. On November 21, 2006, the Company entered into an $850.0 million senior unsecured bridge facility (the senior bridge facility). Together with borrowings under the senior credit facility, the proceeds from the senior bridge facility were used to (i) partially finance the NEG Oil & Gas LLC (NEG) acquisition, (ii) refinance the existing senior secured revolving credit facility and NEG s existing credit facility, and (iii) pay fees and expenses related to the NEG acquisition and the existing credit facility. The senior bridge facility was repaid in March 2007. The Company expensed remaining unamortized debt issuance costs related to the senior bridge facility of approximately $12.5 million to interest expense in March 2007.

Interest Paid. For the three months ended September 30, 2008 and 2007, interest payments, net of amounts capitalized, were $9.4 million and $28.8 million, respectively. For the nine months ended September 30, 2008 and 2007, interest payments, net of amounts capitalized, were $60.2 million and $58.2 million, respectively.

8. Other Long-Term Obligations

The Company has recorded a long-term obligation for amounts to be paid under a settlement agreement with Conoco, Inc. entered into in January 2007. The Company agreed to pay approximately $25.0 million plus interest, payable in $5.0 million increments on April 1, 2007, July 1, 2008, July 1, 2009, July 1, 2010 and July 1, 2011. The payment made on July 1, 2008 was included in accounts payable-trade in the accompanying condensed consolidated balance sheets as of December 31, 2007, and the payment to be made on July 1, 2009 has been included in accounts payable-trade in the accompanying condensed consolidated balance sheets as of September 30, 2008. The non-current unpaid settlement amounts of approximately $10.0 million and $15.0 million have been included in other long-term obligations in the accompanying condensed consolidated balance sheets as of September 30, 2008 and December 31, 2007, respectively.

9. Derivative Contracts

The Company has entered into various derivative contracts including collars, fixed price swaps, basis swaps and interest rate swaps with counterparties. The contracts expire on various dates through December 31, 2011.

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Notes to Condensed Consolidated Financial Statements (Continued)

At September 30, 2008, the Company s open commodity derivative contracts consisted of the following:

Natural Gas

Period and Type of Contract	Notional (MMcf)(1)	Weighted Avg. Fixed Price
October 2008 December 2008		
Price swap contracts	17,480	$ 8.67
Basis swap contracts	14,720	$ (0.65)
January 2009 March 2009		
Price swap contracts	16,200	$ 9.60
Basis swap contracts	16,200	$ (0.74)
April 2009 June 2009		
Price swap contracts	10,920	$ 8.79
Basis swap contracts	16,380	$ (0.74)
July 2009 September 2009		
Price swap contracts	8,590	$ 8.97
Basis swap contracts	16,560	$ (0.74)
October 2009 December 2009		
Price swap contracts	8,280	$ 9.40
Basis swap contracts	16,560	$ (0.74)
January 2010 March 2010		
Basis swap contracts	8,100	$ (0.71)
April 2010 June 2010		
Basis swap contracts	8,190	$ (0.71)
July 2010 September 2010		
Basis swap contracts	8,280	$ (0.71)
October 2010 December 2010		
Basis swap contracts	8,280	$ (0.71)
January 2011 March 2011		
Basis swap contracts	1,350	$ (0.47)
April 2011 September 2011		
Basis swap contracts	1,365	$ (0.47)
July 2011 September 2011		
Basis swap contracts	1,380	$ (0.47)
October 2011 December 2011		
Basis swap contracts	1,380	$ (0.47)

(1) Assumes ratio of 1:1 for Mcf to MMBtu

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Notes to Condensed Consolidated Financial Statements (Continued)

Crude Oil

Period and Type of Contract	Notional (in MBbls)	Weighted Avg. Fixed Price
October 2008 December 2008		
Price swap contracts	225	$ 93.17
Collar contracts	27	$ 50.00 82.60
January 2009 March 2009		
Price swap contracts	45	$ 126.38
April 2009 June 2009		
Price swap contracts	46	$ 126.71
July 2009 September 2009		
Price swap contracts	46	$ 126.61
October 2009 December 2009		
Price swap contracts	46	$ 126.51

In January 2008, the Company entered into an interest rate swap to fix the variable LIBOR interest rate on its variable rate term loan at 6.26% per annum for the period April 1, 2008 to April 1, 2011. Due to the exchange of the variable rate term loan for Senior Floating Rate Notes, the interest rate swap is now being used to fix the variable LIBOR interest rate on the Senior Floating Rate Notes at 6.26% per annum through April 2011.

The Company s derivatives have not been designated as hedges. The Company records all derivatives on the balance sheet at fair value. Changes in derivative fair values are recognized in earnings. Cash settlements and valuation gains and losses for commodity derivative contracts are included in (gain) loss on derivative contracts in the condensed consolidated statements of operations. The following table summarizes the cash settlements and valuation gains and losses on commodity derivative contracts for the three- and nine-month periods ended September 30, 2008 and 2007 (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
Realized loss (gain)	$ 27,279	$ (19,969)	$ 77,954	$ (19,176)
Unrealized gain	(319,805)	(19,278)	(73,868)	(36,052)
(Gain) loss on derivative contracts	$ (292,526)	$ (39,247)	$ 4,086	$ (55,228)

An unrealized loss of $2.7 million and an unrealized gain of $7.7 million related to the interest rate swap are included in interest expense in the condensed consolidated statements of operations for the three- and nine-month periods ended September 30, 2008, respectively.

A counterparty to one of the Company s derivative contracts, Lehman Brothers, declared bankruptcy on October 3, 2008. The Company s position on this derivative contract is immaterial. Due to Lehman Brothers bankruptcy and the declaration of bankruptcy by its parent, Lehman Brothers Holdings, Inc. on September 15, 2008, the Company has not assigned any value to this derivative contract as of September 30, 2008.

10. Income Taxes

In accordance with GAAP, the Company estimates for each interim reporting period the effective tax rate expected for the full fiscal year and uses that estimated rate in providing income taxes on a current year-to-date basis.

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Notes to Condensed Consolidated Financial Statements (Continued)

For the three months ended September 30, 2008 and 2007, income tax payments were $0.1 million and $1.4 million, respectively. For the nine months ended September 30, 2008 and 2007, income tax payments were $2.0 million and $2.7 million, respectively.

11. Earnings Per Share

Basic earnings per share are computed using the weighted average number of common shares outstanding during the period. Diluted earnings per share are computed using the weighted average shares outstanding during the period, but also include the dilutive effect of awards of restricted stock. The following table summarizes the calculation of weighted average common shares outstanding used in the computation of diluted earnings per share for the three- and nine-month periods ended September 30, 2008 and 2007 (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
Weighted average basic common shares outstanding	163,020	107,554	153,125	102,562
Effect of dilutive securities:				
Restricted stock	1,534	1,495	1,364	1,216
Weighted average diluted common and potential common shares outstanding	164,554	109,049	154,489	103,778

In computing diluted earnings per share, the Company evaluated the if-converted method with respect to its outstanding redeemable convertible preferred stock for the nine-month period ended September 30, 2008 and three- and nine-month periods ended September 30, 2007. (See Note 13.) Under this method, the Company assumes the conversion of the preferred stock to common stock and determines if this is more dilutive than including the preferred stock dividends (paid and unpaid) in the computation of income available to common stockholders. The Company determined the if-converted method is not more dilutive and has included preferred stock dividends in the determination of income available to common stockholders for the nine months ended September 30, 2008 and the 2007 periods presented. No shares of redeemable convertible preferred stock were outstanding during the three-month period ended September 30, 2008.

12. Commitments and Contingencies

The Company is a defendant in certain lawsuits from time to time in the normal course of business. In management s opinion, the Company is not currently involved in any legal proceedings that, individually or in the aggregate, could have a material effect on its financial condition, operations or cash flows.

BP Pipelines v. Panaco. During the second quarter 2008, the Company received notice of a motion to set trial for an administrative claim that was filed in December 2004 by BP Pipelines (BP) against Panaco (part of the NEG entities acquired in November 2006) in Panaco s bankruptcy proceeding. In the administrative claim, BP seeks to recover unpaid charges billed to Panaco for repairs made by BP to a segment of offshore pipeline originally owned by Panaco and transferred by merger to National Offshore, LP, now SandRidge Offshore, LLC. In September 2008, the Company and BP signed a settlement agreement the approval of which is currently pending before the bankruptcy court. Under the terms of this agreement, the Company will remit $0.7 million to BP and BP will release the Company from further liability related to this claim. The Company has established a contingency reserve for amounts to be paid under the settlement agreement.

The Company, through its subsidiary LSI, has entered into a revolving promissory note with Larclay, L.P. for an aggregate principal amount of up to $15.0 million. See Note 15.

SemGroup, L.P. Bankruptcy Filing. The Company s customer, SemGroup, L.P., and certain of its subsidiaries (SemGroup), filed for bankruptcy on July 22, 2008. During the third quarter, the Company established an

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Notes to Condensed Consolidated Financial Statements (Continued)

allowance for doubtful recovery in the amount of $1.5 million for all amounts due from SemGroup after the Company was unable to enter into a supplier protection agreement with SemGroup.

13. Redeemable Convertible Preferred Stock

In November 2006, the Company sold 2,136,667 shares of redeemable convertible preferred stock to finance a portion of the NEG acquisition and received net proceeds of approximately $439.5 million after deducting offering expenses of approximately $9.3 million. Each holder of redeemable convertible preferred stock was entitled to quarterly cash dividends at the annual rate of 7.75% of the accreted value, $210 per share, of their redeemable convertible preferred stock. Each share of redeemable convertible preferred stock was initially convertible into ten (10.2 ultimately) shares of common stock at the option of the holder, subject to certain anti-dilution adjustments. A summary of dividends declared and paid on the redeemable convertible preferred stock is as follows (in thousands, except per share data):

Declared	Dividend Period	Dividends per Share	Total	Payment Date
January 31, 2007	November 21, 2006 February 1, 2007	$ 3.21	$ 6,859	February 15, 2007
May 8, 2007	February 2, 2007 May 1, 2007	3.97	8,550	May 15, 2007
June 8, 2007	May 2, 2007 August 1, 2007	4.10	8,956	August 15, 2007
September 24, 2007	August 2, 2007 November 1, 2007	4.10	8,956	November 15, 2007
December 16, 2007	November 2, 2007 February 1, 2008	4.10	8,956	February 15, 2008
March 7, 2008	February 2, 2008 May 1, 2008	4.01	8,095	(1)
May 7, 2008	May 2, 2008 May 7, 2008	4.01	501	May 7, 2008

(1) Includes $0.6 million of prorated dividends paid to holders of redeemable convertible preferred shares at the time their shares converted to common stock in March 2008. The remaining dividends of $7.5 million were paid during May 2008.

Approximately $9.0 million in paid and unpaid dividends has been included in the Company s earnings per share calculations for the three-month period ended September 30, 2007 as presented in the accompanying condensed consolidated statements of operations. Approximately $8.6 million and $29.5 million in paid and unpaid dividends have been included in the Company s earnings per share calculations for the nine-month periods ended September 30, 2008 and 2007, respectively, as presented in the accompanying condensed consolidated statements of operations. No shares of redeemable convertible preferred stock were outstanding during the three-month period ended September 30, 2008.

On March 30, 2007, certain holders of the Company s common units (consisting of shares of common stock and a warrant to purchase redeemable convertible preferred stock upon the surrender of common stock) exercised warrants to purchase redeemable convertible preferred stock. The holders converted 526,316 shares of common stock into 47,619 shares of redeemable convertible preferred stock.

During March 2008, holders of 339,823 shares of the Company s redeemable convertible preferred stock elected to convert those shares into 3,465,593 shares of the Company s common stock. Additionally, during May 2008, the Company converted the remaining outstanding 1,844,464 shares of its redeemable convertible preferred stock into 18,810,260 shares of its common stock as permitted under the terms of the redeemable convertible preferred stock. These conversions resulted in increases to additional paid-in capital totaling $452.2 million, which represents the difference between the par value of the common stock issued and the carrying value of the redeemable convertible shares converted. The Company also recorded charges to retained earnings totaling $7.2 million in accelerated accretion expense related to the converted redeemable convertible preferred shares. Prorated dividends totaling $0.5 million for the period from May 2, 2008 to the date of conversion (May 7, 2008) were paid to the holders of the converted shares on May 7, 2008. On and after the conversion date, dividends ceased to accrue and the rights of common unit holders to exercise outstanding warrants to purchase redeemable convertible preferred shares terminated.

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Notes to Condensed Consolidated Financial Statements (Continued)

14. Stockholders Equity

The following table presents information regarding the Company s common stock (in thousands):

	September 30, 2008	December 31, 2007
Shares authorized	400,000	400,000
Shares outstanding at end of period	165,648	140,391
Shares held in treasury	1,325	1,456

The Company is authorized to issue 50,000,000 shares of preferred stock, $0.001 par value, of which 2,625,000 shares are designated as redeemable convertible preferred stock. As of December 31, 2007, there were 2,184,286 shares of redeemable convertible preferred stock outstanding and no other shares of preferred stock were outstanding. All shares of redeemable convertible preferred stock outstanding were converted to shares of the Company s common stock during the first six months of 2008. (See Note 13.) There were no shares of preferred stock outstanding as of September 30, 2008.

Common Stock Issuance. In March 2007, the Company sold approximately 17.8 million shares of common stock for net proceeds of $318.7 million after deducting offering expenses of approximately $1.4 million. The stock was sold in private sales to various investors including Tom L. Ward, the Company s Chairman and Chief Executive Officer, who invested $61.4 million in exchange for approximately 3.4 million shares of common stock.

On November 9, 2007, the Company completed the initial public offering of its common stock. The Company sold 32,379,500 shares of its common stock, including 4,710,000 shares sold directly to an entity controlled by Tom L. Ward, at a price of $26 per share. After deducting underwriting discounts of approximately $44.0 million and offering expenses of approximately $3.1 million, the Company received net proceeds of approximately $794.7 million. The Company used the net proceeds from the offering as follows (in millions):

Repayment of outstanding balance and accrued interest on senior credit facility	$ 515.9
Repayment of note payable and accrued interest incurred in connection with recent acquisition	49.1
Excess cash to fund future capital expenditures	229.7
Total	$ 794.7

During March 2008, the Company issued 3,465,593 shares of common stock upon the conversion of 339,823 shares of its redeemable convertible preferred stock. In May 2008, the Company converted the remaining outstanding 1,844,464 shares of its redeemable convertible preferred stock into 18,810,260 shares of its common stock as permitted under the terms of the redeemable convertible preferred stock. See additional discussion in Note 13.

Treasury Stock. The Company makes required tax payments on behalf of employees as their restricted stock awards vest and then withholds a number of vested shares of common stock having a value on the date of vesting equal to the tax obligation. As a result of such transactions, the Company withheld approximately 79,000 and 41,000 shares at a total value of $3.5 million and $0.7 million during the nine-month periods ended September 30, 2008 and 2007, respectively. These shares were accounted for as treasury stock.

In February 2008, the Company transferred 184,484 shares of its treasury stock into an account established for the benefit of the Company s 401(k) Plan. The transfer was made in order to satisfy the Company s $5.0 million accrued payable to match employee contributions made to the plan during 2007. The historical cost of the shares transferred totaled approximately $2.4 million and resulted in an increase to the Company s additional paid-in capital of approximately $2.6 million.

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Notes to Condensed Consolidated Financial Statements (Continued)

During July 2008, the Company transferred 26,058 shares of its treasury stock into an account established for the benefit of the Company s non-qualified deferred compensation plan. This transfer was made in order to satisfy the Company s $1.0 million accrued payable to match participant contributions made to the non-qualified plan through March 31, 2008. The historical cost of the shares transferred totaled approximately $0.4 million and resulted in an increase to the Company s additional paid-in capital of approximately $0.6 million.

Restricted Stock. Under incentive compensation plans, the Company makes restricted stock awards which vest over specified periods of time. Awards made prior to 2006 had vesting periods of one, four or seven years. Each award made during and after 2006 vests ratably over a four-year period. Shares of restricted common stock are subject to restriction on transfer and certain conditions to vesting.

For the three months ended September 30, 2008 and 2007, the Company recognized stock-based compensation expense related to restricted stock of $5.5 million and $2.7 million, respectively. For the nine months ended September 30, 2008 and 2007, the Company recognized stock-based compensation expense related to restricted stock of $12.8 million and $5.0 million, respectively. Stock-based compensation expense is reflected in general and administrative expense in the condensed consolidated statements of operations.

15. Related Party Transactions

In the ordinary course of business, the Company engages in transactions with certain stockholders and other related parties. These transactions primarily consist of purchases of drilling equipment and sales of oil field service supplies. Following is a summary of significant transactions with such related parties for the three- and nine-month periods ended September 30, 2008 and 2007 (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
Sales to and reimbursements from related parties	$ 24,552	$ 27,355	$ 76,978	$ 72,434
Purchases of equipment and services from related parties	$ 11,380	$ 32,093	$ 50,441	$ 42,544

The Company leases office space in Oklahoma City from a member of its Board of Directors. The Company believes that the payments made under this lease are at fair market rates. Rent expense related to the lease totaled $0.3 million and $1.1 million for the three-month periods ended September 30, 2008 and 2007, respectively. For the nine-month periods ended September 30, 2008 and 2007, rent expense under this lease was $1.0 million and $1.7 million, respectively. The lease expires in August 2009.

Larclay, L.P. LSI and Clayton Williams Energy, Inc. (CWEI) each own a 50% interest in Larclay, L.P. (Larclay), a limited partnership formed in 2006 to acquire drilling rigs and provide land drilling services. Larclay currently owns 12 rigs, one of which has not yet been assembled. LSI operates the rigs owned by the partnership. Under the partnership agreement, CWEI was responsible for rig financing and purchasing.

If Larclay has an operating shortfall, LSI and CWEI are obligated to provide loans to the partnership. In April 2008, LSI and CWEI each made loans of $2.5 million to Larclay under promissory notes. The notes bear interest at a floating rate based on a LIBOR average plus 3.25% (5.75% at September 30, 2008) as provided in the partnership agreement. In June 2008, Larclay executed a $15.0 million revolving promissory note with each LSI and CWEI. Amounts drawn under each revolving promissory note bear interest at a floating rate based on a LIBOR average plus 3.25% (5.75% at September 30, 2008) as provided in the partnership agreement. Amounts advanced to Larclay by LSI under the revolving promissory note during 2008 were $3.0 million. The advances outstanding to Larclay, totaling $5.5 million ($2.5 million promissory note and $3.0 million drawn on revolving promissory note) at September 30, 2008 are included in other assets on the accompanying condensed consolidated balance sheets. Larclay s current cash shortfall is a result of principal payments pursuant to its rig loan agreement.

SandRidge Energy, Inc. and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Continued)

The following table summarizes the Company s other transactions with Larclay for the three- and nine-month periods ended September 30, 2008 and 2007 (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	**2007**	**2008**	**2007**
Sales to and reimbursements from Larclay	$ 11,259	$ 22,176	$ 34,232	$ 48,885
Purchases of services from Larclay	$ 7,118	$ 20,053	$ 31,076	$ 25,595

	As of September 30, 2008	As of December 31, 2007
Accounts receivable from Larclay	$ 8,867	$ 16,625
Accounts payable to Larclay	$ 575	$ 274

16. Condensed Consolidating Financial Information

The Company is providing condensed consolidating financial information for its subsidiaries that are guarantors of its public debt registered in October 2008. Subsidiary guarantors are wholly owned and have, jointly and severally, unconditionally guaranteed on an unsecured basis the Company s 8.625% Senior Notes due 2015 and Senior Floating Rate Notes due 2014. The subsidiary guarantees (i) rank equally in right of payment with all of the existing and future senior debt of the subsidiary guarantors; (ii) rank senior to all of the existing and future subordinated debt of the subsidiary guarantors; (iii) are effectively subordinated in right of payment to any existing or future secured obligations of the subsidiary guarantors to the extent of the value of the assets securing such obligations; and (iv) are structurally subordinated to all debt and other obligations of the subsidiaries of the guarantors who are not themselves guarantors.

The Company has not presented separate financial and narrative information for each of the subsidiary guarantors because it believes that such financial and narrative information would not provide any additional information that would be material in evaluating the sufficiency of the guarantees.

The following condensed consolidating financial information represents the financial information of SandRidge Energy, Inc. and its wholly owned subsidiary guarantors, prepared on the equity basis of accounting. The non-guarantor subsidiaries are minor and, therefore, not presented separately. The information is presented in accordance with the requirements of Rule 3-10 under the SEC s Regulation S-X. The financial information may not necessarily be indicative of results of operations, cash flows, or financial position had the subsidiary guarantors operated as independent entities.

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SandRidge Energy, Inc. and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Continued)

Condensed Consolidating Balance Sheet
(Unaudited)
(In Thousands)

	September 30, 2008				December 31, 2007			
	Parent Company	Guarantor Subsidiaries	Eliminations	Consolidated	Parent Company	Guarantor Subsidiaries	Eliminations	Consolidated
ASSETS								
Current assets:								
Cash and cash equivalents	$ 28	$ 870	$	$ 898	$ 62,967	$ 168	$	$ 63,135
Accounts and notes receivable, net	681,734	76,895	(645,693)	112,936	557,527	85,947	(528,715)	114,759
Derivative contracts	87,751			87,751	21,958			21,958
Other current assets	6,819	33,885		40,704	5,936	20,664		26,600