LRR Energy, L.P.
Form 10-Q
August 06, 2014
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2014

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: 001-35344

LRR Energy, L.P.

(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	**90-0708431** (I.R.S. Employer Identification No.)
Heritage Plaza 1111 Bagby, Suite 4600 Houston, Texas (Address of principal executive offices)	**77002** (Zip code)

Telephone Number: **(713) 292-9510**

(Registrant s telephone number, including area code)

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

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 x 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.

Large accelerated filer o	Accelerated filer x
Non-accelerated filer o (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 x

There were 22,969,599 Common Units, 4,480,000 Subordinated Units and 22,400 General Partner Units outstanding as of July 31, 2014. The Common Units trade on the New York Stock Exchange under the ticker symbol LRE .

Table of Contents

LRR Energy, L.P.

TABLE OF CONTENTS

Table of Contents

PART I FINANCIAL INFORMATION

Item 1. Financial Statements.

LRR Energy, L.P.

Consolidated Condensed Balance Sheets

(Unaudited)

(in thousands, except unit amounts)

	June 30, 2014	December 31, 2013
ASSETS		
Current assets:		
Cash and cash equivalents	$ 2,871	$ 4,417
Accounts receivable	9,792	9,867
Commodity derivative instruments	8,022	9,726
Due from affiliates	5,737	
Prepaid expenses	1,717	1,603
Total current assets	28,139	25,613
Property and equipment (successful efforts method)	895,352	876,674
Accumulated depletion, depreciation and impairment	(449,054)	(431,837)
Total property and equipment, net	446,298	444,837
Commodity derivative instruments	5,569	16,746
Deferred financing costs, net of accumulated amortization and other	1,039	1,154
TOTAL ASSETS	$ 481,045	$ 488,350
LIABILITIES AND UNITHOLDERS EQUITY		
Current liabilities:		
Accrued liabilities	$ 4,797	$ 2,300
Accrued capital cost	4,115	2,574
Due to affiliates		255
Commodity derivative instruments	5,783	2,217
Interest rate derivative instruments	1,304	648
Asset retirement obligations	503	488
Total current liabilities	16,502	8,482
Long-term liabilities:		
Commodity derivative instruments	3,643	174
Interest rate derivative instruments	1,915	1,554
Term loan	50,000	50,000
Revolving credit facility	195,000	200,000
Asset retirement obligations	36,933	35,838
Deferred tax liabilities	83	44
Total long-term liabilities	287,574	287,610
Total liabilities	304,076	296,092
Unitholders equity:		
General partner (22,400 units issued and outstanding as of June 30, 2014 and December 31, 2013)	277	303

Public common unitholders (18,584,790 units issued and outstanding as of June 30, 2014 and 17,710,334 units issued and outstanding as of December 31, 2013)		175,920		181,290
Affiliated common unitholders (4,089,600 units issued and outstanding as of June 30, 2014 and 1,849,600 issued and outstanding as of December 31, 2013)		216		2,093
Subordinated unitholders (4,480,000 units issued and outstanding as of June 30, 2014 and 6,720,000 units issued and outstanding as of December 31, 2013)		556		8,572
Total unitholders equity		176,969		192,258
TOTAL LIABILITIES AND UNITHOLDERS EQUITY	$	481,045	$	488,350

See accompanying notes to the unaudited consolidated condensed financial statements.

Table of Contents

LRR Energy, L.P.

Consolidated Condensed Statements of Operations

(Unaudited)

(in thousands, except per unit amounts)

	Three Months Ended June 30, 2014	Three Months Ended June 30, 2013	Six Months Ended June 30, 2014	Six Months Ended June 30, 2013
Revenues:				
Oil sales	$ 20,354	$ 19,012	$ 40,510	$ 34,475
Natural gas sales	7,565	7,720	15,664	13,800
Natural gas liquids sales	2,760	2,275	6,124	4,510
Gain (loss) on commodity derivative instruments, net	(13,328)	12,354	(18,950)	6,287
Other income	40	18	71	87
Total revenues	17,391	41,379	43,419	59,159
Operating expenses:				
Lease operating expense	6,829	5,270	12,664	12,067
Production and ad valorem taxes	2,248	2,198	4,648	4,044
Depletion and depreciation	8,680	10,129	17,145	20,239
Accretion expense	510	477	1,013	947
Loss (gain) on settlement of asset retirement obligations	21	360	61	335
General and administrative expense	2,699	2,768	5,881	6,197
Total operating expenses	20,987	21,202	41,412	43,829
Operating income (loss)	(3,596)	20,177	2,007	15,330
Other income (expense), net				
Interest expense	(2,575)	(2,249)	(5,116)	(4,514)
Gain (loss) on interest rate derivative instruments, net	(1,128)	2,657	(1,422)	2,772
Other income (expense), net	(3,703)	408	(6,538)	(1,742)
Income (loss) before taxes	(7,299)	20,585	(4,531)	13,588
Income tax expense	(38)	(62)	(112)	(67)
Net income (loss)	$ (7,337)	$ 20,523	$ (4,643)	$ 13,521
Net loss (income) attributable to common control operations				(448)
Net income (loss) available to unitholders	$ (7,337)	$ 20,523	$ (4,643)	$ 13,073
Computation of net income (loss) per limited partner unit:				
General partner s interest in net income (loss)	$ (7)	$ 21	$ (4)	$ 13
Limited partners interest in net income (loss)	$ (7,330)	$ 20,502	$ (4,639)	$ 13,060
Net income (loss) per limited partner unit (basic and diluted)	$ (0.27)	$ 0.78	$ (0.17)	$ 0.53

Weighted average number of limited partner units outstanding (basic and diluted)	26,733	26,169	26,539	24,555

See accompanying notes to the unaudited consolidated condensed financial statements.

Table of Contents

LRR Energy, L.P.

Consolidated Condensed Statement of Changes in Unitholders Equity

(Unaudited)

(in thousands)

		Limited Partners			
	General Partner	Public Common	Affiliated Common	Affiliated Subordinated	Total
Balance, December 31, 2013	$ 303	$ 181,290	$ 2,093	$ 8,572	$ 192,258
Equity offering, net of expenses		14,810			14,810
Amortization of equity awards		534			534
Conversion of subordinated units			623	(623)	
Distribution	(22)	(17,548)	(1,832)	(6,588)	(25,990)
Net income (loss)	(4)	(3,166)	(668)	(805)	(4,643)
Balance, June 30, 2014	$ 277	$ 175,920	$ 216	$ 556	$ 176,969

See accompanying notes to the unaudited consolidated condensed financial statements.

Table of Contents

LRR Energy, L.P.

Consolidated Condensed Statements of Cash Flows

(Unaudited)

(in thousands)

	Six Months Ended June 30, 2014	Six Months Ended June 30, 2013
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income (loss)	$ (4,643)	$ 13,521
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depletion and depreciation	17,145	20,239
Accretion expense	1,013	947
Amortization of equity awards	534	253
Amortization of derivative contracts	330	508
Amortization of deferred financing costs and other	208	187
Loss (gain) on settlement of asset retirement obligations	61	335
Changes in operating assets and liabilities:		
Change in receivables	75	(2,568)
Change in prepaid expenses	(209)	(279)
Change in derivative assets and liabilities	20,605	(3,163)
Change in amounts due to/from affiliates	(5,992)	(5,446)
Change in accrued liabilities and deferred tax liabilities	2,536	2,581
Net cash provided by (used in) operating activities	31,663	27,115
CASH FLOWS FROM INVESTING ACTIVITIES		
Development of oil and natural gas properties	(17,094)	(14,375)
Disposition of oil and natural gas properties	65	
Net cash provided by (used in) investing activities	(17,029)	(14,375)
CASH FLOWS FROM FINANCING ACTIVITIES		
Borrowings under revolving credit facility	20,000	38,000
Principal payments on revolving credit facility	(25,000)	(24,000)
Equity offering, net of expenses	14,810	59,513
Distributions	(25,990)	(23,422)
Distribution to Lime Rock Resources		(60,672)
Contribution to Lime Rock Resources		(734)
Net cash provided by (used in) financing activities	(16,180)	(11,315)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(1,546)	1,425
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	4,417	3,467
CASH AND CASH EQUIVALENTS, END OF PERIOD	$ 2,871	$ 4,892
Supplemental disclosure of non-cash items to reconcile investing and financing activities		
Property and equipment:		
Accrued capital costs	$ 1,735	$ 4,662
Asset retirement obligations	(181)	(313)

See accompanying notes to the unaudited consolidated condensed financial statements.

Table of Contents

LRR Energy, L.P.

Notes to Consolidated Condensed Financial Statements

(unaudited)

1. Organization and Description of Business

LRR Energy, L.P. (we, us, our, or the Partnership) is a Delaware limited partnership formed in April 2011 by Lime Rock Management LP (Li Rock Management), an affiliate of Lime Rock Resources A, L.P. (LRR A), Lime Rock Resources B, L.P. (LRR B) and Lime Rock Resources C, L.P. (LRR C), to operate, acquire, exploit and develop producing oil and natural gas properties in North America with long-lived, predictable production profiles. As used herein, references to Fund I refer collectively to LRR A, LRR B and LRR C; references to Fund II refer collectively to Lime Rock Resources II-A, L.P. and Lime Rock Resources II-C, L.P.; and references to Fund III refer collectively to Lime Rock Resources III-A, L.P. and Lime Rock Resources III-C, L.P. References to Lime Rock Resources refer collectively to Fund I, Fund II and Fund III.

Our properties are located in the Permian Basin region in West Texas and Southeast New Mexico, the Mid-Continent region in Oklahoma and East Texas and the Gulf Coast region in Texas. We conduct our operations through our wholly owned subsidiary, LRE Operating, LLC (OLLC).

We own 100% of LRE Finance Corporation (LRE Finance). LRE Finance was organized for the purpose of co-issuing our debt securities and has no material assets or liabilities other than as co-issuer of our debt securities, if and when issued. Its activities will be limited to co-issuing our debt securities and engaging in activities related thereto.

2. Summary of Significant Accounting Policies

Our accounting policies are set forth in the audited consolidated/combined financial statements in our Annual Report on Form 10-K for the year ended December 31, 2013 (2013 Annual Report) and are supplemented by the notes to these unaudited consolidated condensed financial statements. There have been no significant changes to these policies, and these unaudited consolidated condensed financial statements should be read in conjunction with the audited consolidated/combined financial statements and notes in our 2013 Annual Report.

Basis of presentation

These interim financial statements are unaudited and have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (SEC) regarding interim financial reporting. Accordingly, they do not include all of the information and notes required by accounting principles generally accepted in the United States of America (GAAP) for complete consolidated financial statements and should be read in conjunction with the audited consolidated/combined financial statements in our 2013 Annual Report. While the year-end condensed balance sheet data was derived from audited financial statements, this interim report does not include all disclosures required by GAAP for annual periods. These unaudited interim consolidated condensed financial statements reflect all adjustments that are, in the opinion of management, necessary for a fair statement of the results for the periods presented.

Certain reclassifications were made to the historical financial statements to conform to the 2014 presentation. The effects of the reclassification were not material to our unaudited interim consolidated condensed financial statements.

Recent accounting pronouncements

On May 28, 2014, the Financial Accounting Standards Board issued Accounting Standards Update (ASU) 2014-09, Revenue from Contracts with Customers. ASU No. 2014-09 outlined a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance. The core principle of the revenue model is that an entity recognizes revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity

Table of Contents

expects to be entitled in exchange for those goods or services. ASU No. 2014-09 is effective for annual reporting periods beginning after December 15, 2016 and early adoption is not permitted. We are still evaluating the impact of our adoption of ASU No. 2014-09.

3. Acquisitions

Acquisition between Entities under Common Control

On January 3, 2013, we completed an acquisition from Fund I of certain oil and natural gas properties located in the Mid-Continent region in Oklahoma for a purchase price of $21.0 million, subject to customary purchase price adjustments (the January 2013 Acquisition). In addition, as part of the January 2013 Acquisition, we acquired in the money commodity hedge contracts valued at approximately $1.7 million as of the closing of the January 2013 Acquisition. The January 2013 Acquisition was effective October 1, 2012. In June 2013, we paid $0.4 million in cash to Fund I related to post-closing adjustments to the purchase price. We funded the January 2013 Acquisition with borrowings under our revolving credit facility (Note 7).

The following table presents the net assets conveyed by Fund I to us in the January 2013 Acquisition (in thousands):

Property and equipment, net	$	23,998
Oil and natural gas commodity hedge contracts		1,742
Asset retirement obligations and other liabilities		(1,067)
Net assets	$	24,673

On April 1, 2013, we completed an acquisition of certain oil and natural gas properties located in the Mid-Continent region in Oklahoma and crude oil hedges from Fund II for a purchase price of $38.2 million (the April 2013 Acquisition). As part of the April 2013 Acquisition, we acquired in the money crude oil hedges valued at approximately $0.4 million as of the closing of the April 2013 Acquisition. The April 2013 Acquisition was effective April 1, 2013. We funded the April 2013 Acquisition with proceeds from our equity offering (Note 10).

The following table presents the net assets conveyed by Fund II to us in the April 2013 Acquisition (in thousands):

Property and equipment, net	$	36,586
Oil and natural gas commodity hedge contracts		386
Asset retirement obligations and other liabilities		(990)
Net assets	$	35,982

The net assets of the January 2013 Acquisition and April 2013 Acquisition were recorded using carryover book value of Fund I and Fund II, as the acquisitions were deemed transactions between entities under common control. Our historical financial statements were revised to include the results attributable to previous acquisitions from Fund I and Fund II as if we owned the properties for all periods presented in our consolidated condensed financial statements.

4. Fair Value Measurements

Our financial instruments, including cash and cash equivalents and accounts receivable, are carried at cost, which approximates fair value due to the short-term maturity of these instruments. All such financial instruments are considered Level 1 instruments. The carrying value of our senior secured revolving credit facility and term loan, including the current portion, approximates fair value, as interest rates are variable based on prevailing market rates and are therefore considered Level 1 instruments. Our financial and non-financial assets and liabilities that are measured on a recurring basis are measured and reported at fair value.

Fair value is defined as 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. GAAP establishes a three-tier fair value hierarchy, which prioritizes the inputs used to measure fair value. The hierarchy gives the highest priority to

Table of Contents

unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of fair value hierarchy are as follows:

Level 1 Defined as inputs such as unadjusted quoted prices in active markets for identical assets or liabilities.

Level 2 Defined as inputs other than quoted prices in active markets that are either directly or indirectly observable for the asset or liability.

Level 3 Defined as unobservable inputs for use when little or no market data exists, requiring an entity to develop its own assumptions for the asset or liability.

We utilize the most observable inputs available for the valuation technique used. The financial assets and liabilities are classified in their entirety based on the lowest level of input that is of significance to the fair value measurement. The following table describes, by level within the hierarchy, the fair value of our financial assets and liabilities that were accounted for at fair value on a recurring basis as of June 30, 2014 and December 31, 2013 (in thousands).

	Level 1	Level 2	Level 3	Total
June 30, 2014				
Assets:				
Commodity derivative instruments	$	$ 13,591	$	$ 13,591
Liabilities:				
Commodity derivative instruments		9,426		9,426
Interest rate derivative instruments		3,219		3,219
December 31, 2013				
Assets:				
Commodity derivative instruments	$	$ 26,472	$	$ 26,472
Liabilities:				
Commodity derivative instruments		2,391		2,391
Interest rate derivative instruments		2,202		2,202

All fair values reflected in the table above and on the consolidated condensed balance sheets have been adjusted for non-performance risk. The following methods and assumptions were used to estimate the fair values of the assets and liabilities in the table above.

Commodity Derivative Instruments The fair value of the commodity derivative instruments is estimated using a combined income and market valuation methodology based upon forward commodity price and volatility curves. The curves are obtained from independent pricing services reflecting broker market quotes.

Interest Rate Derivative Instruments The fair value of the interest rate derivative instruments is estimated using a combined income and market valuation methodology based upon forward interest rates and volatility curves. The curves are obtained from independent pricing services reflecting broker market quotes.

Table of Contents

5. Property and Equipment

Property and equipment is stated at cost less accumulated depletion, depreciation and impairment and consisted of the following (in thousands):

	June 30, 2014	December 31, 2013
Oil and natural gas properties (successful efforts method)	$ 893,825	$ 875,126
Unproved properties	1,238	1,258
Other property and equipment	289	290
	895,352	876,674
Accumulated depletion, depreciation and impairment	(449,054)	(431,837)
Total property and equipment, net	$ 446,298	$ 444,837

We recorded $8.7 million and $10.1 million of depletion and depreciation expense for the three months ended June 30, 2014 and 2013, respectively. We recorded $17.1 million and $20.2 million of depletion and depreciation expense for the six months ended June 30, 2014 and 2013, respectively.

We perform an impairment analysis of our oil and natural gas properties on a quarterly basis due to the volatility in commodity prices. We did not record any impairment charges in the three or six months ended June 30, 2014 or 2013. If future oil or natural gas prices or our reserves decline, the estimated undiscounted future cash flows for the oil and natural gas properties may not exceed the net capitalized costs for our properties and a non-cash impairment charge may be required to be recognized in future periods.

6. Asset Retirement Obligations

The following is a summary of our asset retirement obligations as of and for the six months ended June 30, 2014 (in thousands):

Beginning of period	$ 36,326
Dispositions	(84)
Liabilities incurred	181
Accretion expense	1,013
End of period	37,436
Current portion of asset retirement obligations	(503)
Asset retirement obligations non-current	$ 36,933

7. Long-Term Debt

Credit Agreement

In July 2011, subject to consummation of our initial public offering, we, as guarantor, and our wholly owned subsidiary, OLLC, as borrower, entered into a five-year, $500.0 million senior secured revolving credit facility, as amended (the Credit Agreement), that matures in July 2016. The Credit Agreement is reserve-based and we are permitted to borrow under our credit facility an amount up to the borrowing base, which was $235.0 million as of June 30, 2014. Our borrowing base, which is primarily based on the estimated value of our oil, NGL, and natural gas properties and our commodity derivative contracts, is subject to redetermination semi-annually by our lenders at their sole discretion. As of June 30, 2014, we were in compliance with all covenants contained in the Credit Agreement.

Term Loan Agreement

On June 28, 2012, we, as parent guarantor, and our wholly owned subsidiary, OLLC, as borrower, entered into a Second Lien Credit Agreement (the Term Loan Agreement). The Term Loan Agreement provides for a $50.0 million senior secured second lien term loan to OLLC. OLLC borrowed $50.0 million under the Term Loan Agreement and used the borrowings to repay outstanding borrowings under the Credit Agreement. As of June 30, 2014, we were in compliance with all covenants contained in the Term Loan Agreement. The Term Loan Agreement was amended in June 2014 (Note 10).

Table of Contents

The obligations under the Term Loan Agreement and the Credit Agreement are governed by an Intercreditor Agreement with OLLC as borrower and the Partnership as parent guarantor, which (i) provides that any liens on the assets and properties of OLLC, the Partnership or any of their subsidiaries securing the indebtedness under the Term Loan Agreement are subordinate to liens on the assets and properties of OLLC, the Partnership or any of their subsidiaries securing indebtedness under the Credit Agreement and derivative contracts with lenders and their affiliates and (ii) sets forth the respective rights, obligations and remedies of the lenders under the Credit Agreement with respect to their first-priority liens and the lenders under the Term Loan Agreement with respect to their second-priority liens.

As of June 30, 2014, we had $245.0 million of outstanding debt and accrued interest was approximately $0.2 million. As of December 31, 2013, we had $250.0 million of outstanding debt and accrued interest was approximately $0.2 million.

Interest expense for the three months ended June 30, 2014 and 2013 was $2.6 million and $2.2 million, respectively. Interest expense for the six months ended June 30, 2014 and 2013 was $5.1 million and $4.5 million, respectively. As of June 30, 2014 and December 31, 2013, our weighted average interest rate on our outstanding indebtedness was 4.21% and 3.88%, respectively. Please refer to Note 8 below for a discussion of our interest rate derivative contracts.

8. Derivatives

We are exposed to commodity price and interest rate risk and consider it prudent to periodically reduce our exposure to cash flow variability resulting from commodity price changes and interest rate fluctuations. Accordingly, we enter into derivative instruments to manage our exposure to commodity price fluctuations, locational differences between a published index and the NYMEX futures on natural gas or crude oil productions, and interest rate fluctuations.

Our open positions typically consist of contracts such as (i) crude oil and natural gas financial collar contracts, (ii) crude oil, natural gas liquids (NGL) and natural gas financial swaps, (iii) crude oil and natural gas basis financial swaps, (iv) crude oil and natural gas puts and (v) interest rate swap agreements. Our derivative instruments are with the counterparties that are also lenders in our Credit Agreement.

Swaps and options are used to manage our exposure to commodity price risk and basis risk inherent in our oil and natural gas production. Commodity price swap agreements are used to fix the price of expected future oil and natural gas sales at major industry trading locations such as Henry Hub Louisiana (HH) for gas and Cushing Oklahoma (WTI) for oil. Basis swaps are used to fix the price differential between the product price at one location versus another. Options are used to establish a floor and a ceiling price (collar) for expected oil or gas sales. Interest rate swaps are used to fix interest rates on existing indebtedness.

Under commodity swap agreements, we exchange a stream of payments over time according to specified terms with another counterparty. Specifically for commodity price swap agreements, we agree to pay an adjustable or floating price tied to an agreed upon index for the commodity, either gas or oil, and in return receive a fixed price based on notional quantities. Under basis swap agreements, we agree to pay an adjustable or floating price tied to two agreed upon indices for gas and in return receive the differential between a floating index and fixed price based on notional quantities. A collar is a combination of a put purchased by us and a call option written by us. In a typical collar transaction, if the floating price based on a market index is below the floor price, we receive from the counterparty an amount equal to this difference multiplied by the specified volume, effectively a put option. If the floating price exceeds the floor price and is less than the ceiling price, no payment is required by either party. If the floating price exceeds the ceiling price, we must pay the counterparty an amount equal to the difference multiplied by the specific quantity, effectively a call option.

The interest rate swap agreements effectively fix our interest rate on amounts borrowed under the credit facility. The purpose of these instruments is to mitigate our existing exposure to unfavorable interest rate changes. Under interest rate swap agreements, we pay a fixed interest rate payment on a notional amount in exchange for receiving a floating amount based on LIBOR on the same notional amount.

Table of Contents

We elected not to designate any positions as cash flow hedges for accounting purposes and, accordingly, recorded the net change in the mark-to-market valuation of these derivative contracts in the consolidated condensed statements of operations. We record our derivative activities on a mark-to-market or fair value basis. Fair values are based on pricing models that consider various assumptions, including quoted forward prices for commodities, the time value of money and volatility, and are comparable to values obtained from counterparties. We present the fair value of derivative financial instruments on a net basis in the consolidated condensed balance sheets.

At June 30, 2014, we had the following open commodity derivative contracts:

	Index	2014	2015	2016	2017
Natural gas positions					
Price swaps (MMBTUs)	NYMEX-HH	2,961,198	5,500,236	5,433,888	5,045,760
Weighted average price		$ 5.56	$ 5.72	$ 4.29	$ 4.61
Basis swaps (MMBTUs)	(1)	2,860,739	5,326,559	2,877,047	
Weighted average price		$ (0.1530)	$ (0.1661)	$ (0.1115)	$
Oil positions					
Price swaps (BBLs)	NYMEX-WTI	378,675	683,286	397,488	198,744
Weighted average price		$ 96.18	$ 93.39	$ 86.02	$ 85.75
Basis swaps (BBLs)	Argus-	195,605			
Weighted average price	Midland-Cushing	$ (1.00)	$	$	$
NGL positions					
Price swaps (BBLs)	Mont Belvieu	137,760	236,149		
Weighted average price		$ 34.72	$ 34.46	$	$

(1) Our natural gas basis swaps are traded on the following indices: Centerpoint East, Houston Ship Channel, WAHA and TEXOK.

At December 31, 2013, we had the following open commodity derivative contracts:

	Index	2014	2015	2016	2017
Natural gas positions					
Price swaps (MMBTUs)	NYMEX-HH	6,077,016	5,500,236	5,433,888	5,045,760
Weighted average price		$ 5.53	$ 5.72	$ 4.29	$ 4.61
Basis swaps (MMBTUs)	(1)	5,876,098	5,326,559	2,877,047	
Weighted average price		$ (0.1521)	$ (0.1661)	$ (0.1115)	$
Oil positions					
Price swaps (BBLs)	NYMEX-WTI	723,634	561,833	397,488	198,744
Weighted average price		$ 95.76	$ 93.16	$ 86.02	$ 85.75
Basis swaps (BBLs)	Argus-	410,400			
Weighted average price	Midland-Cushing	$ (1.00)	$	$	$

NGL positions					
Price swaps (BBLs)	Mont Belvieu	183,857	147,823		
Weighted average price		$ 34.11	$ 34.50	$	$

(1) Our natural gas basis swaps are traded on the following indices: Centerpoint East, Houston Ship Channel, WAHA and TEXOK.

Table of Contents

At June 30, 2014 and December 31, 2013, we had the following interest rate swap derivative contracts (in thousands):

Effective	Maturity		Notional Amount	Average %	Index
February 2012	February 2015	$	150,000	0.51750%	LIBOR
February 2015	February 2017		75,000	1.72500%	LIBOR
February 2015	February 2017		75,000	1.72750%	LIBOR
June 2012	June 2015		70,000	0.52375%	LIBOR
June 2015	June 2017		70,000	1.42750%	LIBOR

Effect of Derivative Instruments Balance Sheet

The fair value of our commodity and interest rate derivative instruments is included in the tables below (in thousands):

	As of June 30, 2014							
		Current Assets		Long-term Assets		Current Liabilities		Long-term Liabilities
Interest rate								
Swaps	$		$		$	1,304	$	1,915
Gross fair value						1,304		1,915
Netting arrangements								
Net recorded fair value	$		$		$	1,304	$	1,915
Sale of natural gas production								
Price swaps	$	7,374	$	5,563	$	240	$	3
Basis swaps		2		49		413		379
Sale of crude oil production								
Price swaps		40		458		4,621		3,629
Basis swaps		648						
Sale of NGLs								
Price swaps		65		4		616		137
Gross fair value		8,129		6,074		5,890		4,148
Netting arrangements		(107)		(505)		(107)		(505)
Net recorded fair value	$	8,022	$	5,569	$	5,783	$	3,643

	As of December 31, 2013							
		Current Assets		Long-term Assets		Current Liabilities		Long-term Liabilities
Interest rate								
Swaps	$		$	637	$	648	$	2,191
Gross fair value				637		648		2,191
Netting arrangements				(637)				(637)
Net recorded fair value	$		$		$	648	$	1,554
Sale of natural gas production								
Price swaps	$	8,250	$	11,937	$	196	$	73
Basis swaps		56		211		317		65

Sale of crude oil production								
Price swaps		1,564		5,042		1,519		331
Basis swaps		227						
Sale of NGLs								
Price swaps		106		4		662		153
Gross fair value		10,203		17,194		2,694		622
Netting arrangements		(477)		(448)		(477)		(448)
Net recorded fair value	$	9,726	$	16,746	$	2,217	$	174

Table of Contents

Effect of Derivative Instruments Statements of Operations

The net gain (loss) amounts and classification related to derivative instruments for the periods indicated are as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Commodity derivatives (revenue)	$ (13,328)	$ 12,354	$ (18,950)	$ 6,287
Interest rate derivatives (other income (expense), net)	(1,128)	2,657	(1,422)	2,772

Credit Risk

All of our derivative transactions have been carried out in the over-the-counter market. The use of derivative instruments involves the risk that the counterparties may be unable to meet the financial terms of the transactions. We monitor the creditworthiness of each of our counterparties and assess the possibility of whether each counterparty to the derivative contract would default by failing to make any contractually required payments as scheduled in the derivative instrument in determining the fair value. We also have netting arrangements in place with each counterparty to reduce credit exposure. The derivative transactions are placed with major financial institutions that present minimal credit risks to us. Additionally, we consider ourselves to be of substantial credit quality and have the financial resources and willingness to meet our potential repayment obligations associated with the derivative transactions.

9. Related Parties

Ownership in Our General Partner by Lime Rock Management and its Affiliates

As of June 30, 2014, Lime Rock Management, an affiliate of Fund I, owned all of the Class A member interests in our general partner, Fund I owned all of the Class B member interests in our general partner and Fund II owned all of the Class C member interests in our general partner. In addition, Fund I owned an aggregate of approximately 18.0% of our outstanding common units and all of our subordinated units, representing an approximate 31.5% limited partner interest in us. As of June 30, 2014, our general partner owned an approximate 0.1% general partner interest in us, represented by 22,400 general partner units, and all of our incentive distribution rights.

As more fully described in our 2013 Annual Report, three separate one-third tranches of the subordinated units may convert on the first business day after the distribution to unitholders in respect of any quarter ending on or after December 31, 2012, December 31, 2013 and December 31, 2014, respectively, provided that an aggregate amount equal to the minimum quarterly distribution payable with respect to all units that would be payable on four, eight or twelve consecutive quarters, as applicable, has been earned and paid prior to the applicable date, in each case provided there are no arrearages in the minimum quarterly distribution on our common units at that time. We converted 2,240,000 subordinated units on a one-for-one basis into common units pursuant to the terms of our partnership agreement on May 16, 2014. We do not expect the second tranche of the subordinated units to convert pursuant to the provisions of our partnership agreement following our distribution for the second quarter of 2014 that will be paid on August 14, 2014. Each quarter, we will determine whether the test for conversion of the subordinated units has been met until the subordinated units convert pursuant to the provisions of our partnership agreement.

Contracts with our General Partner and its Affiliates

As more fully described in our 2013 Annual Report, we have entered into agreements with our general partner and its affiliates. For the three months ended June 30, 2014 and 2013, we paid Lime Rock Management approximately $0.4 million and $0.2 million either directly or indirectly related to these agreements, respectively. For the six months ended June 30, 2014 and 2013, we paid Lime Rock Management approximately $0.6 million and $0.5 million either directly or indirectly related to these agreements, respectively.

Table of Contents

In connection with the management of our business, Lime Rock Resources Operating Company, Inc. (ServCo), an affiliate of our general partner, provides services for invoicing and processing of payments to our vendors. Periodically, ServCo remits cash to us for the net working capital received on our behalf. Changes in the affiliates (payable)/receivable balances during the six months ended June 30, 2014 are included below (in thousands):

	ServCo	Lime Rock Resources	Total
Balance as of December 31, 2013	$ (518)	$ 263	$ (255)
Expenditures	(51,549)		(51,549)
Cash paid for expenditures	66,718		66,718
Revenues and other	(9,175)	(2)	(9,177)
Balance as of June 30, 2014	$ 5,476	$ 261	$ 5,737

Distributions of Available Cash to Our General Partner and Affiliates

We will generally make cash distributions to our unitholders and our general partner pro rata. As of June 30, 2014, our general partner and its affiliates held 4,089,600 of our common units, all of our subordinated units and 22,400 general partner units. During the six months ended June 30, 2014 and 2013, we paid cash distributions of $26.0 million and $23.4 million, respectively, to all unitholders as of the respective record dates.

We announced our second quarter 2014 distribution on July 18, 2014 as discussed in Note 14.

10. Unitholders Equity

At-the-Market Offering Program

On February 4, 2014, we launched an at-the-market offering program (the ATM Program) with MLV & Co. LLC (MLV) as sales agent. We may sell from time to time through MLV our common units representing limited partner interests having an aggregate offering amount of up to $75.0 million. Any sales of common units under the ATM Program may be made by any method permitted by law deemed to be an at-the-market offering defined by Rule 415 of the Securities Act, including, without limitation, sales made directly on the New York Stock Exchange, or any other existing trading market for our common units or to or through a market maker.

Our second lien term loan requires that 50% of the net cash proceeds from any equity offering be used to repay borrowings outstanding under the term loan. On June 6, 2014, we entered into an amendment to our Term Loan to waive this requirement through September 30, 2014. During the six months ended June 30, 2014, we received net proceeds from the sale of 885,135 newly issued common units of $14.8 million, after deducting underwriting discounts and commissions and offering expenses of approximately $0.5 million, and used the proceeds for general partnership purposes. During the six months ended June 30, 2014, we paid approximately $0.3 million of aggregate compensation to MLV for sales under the ATM Program.

Equity Offering

On March 22, 2013, we closed a public equity offering of 3,700,000 common units representing limited partner interests in the Partnership at a price to the public of $16.84 per common unit, or $16.1664 per common unit after payment of the underwriting discount. We received net proceeds from the sale of 3,700,000 newly issued common units of $59.5 million, after deducting underwriting discounts and commissions and offering expenses of $0.3 million. We used the net proceeds of the offering to fund our April 2013 Acquisition discussed in Note 3 and repay borrowings outstanding on our Credit Agreement.

Fund I sold 3,200,000 common units in the equity offering at a price to the public of $16.84 per common unit, or $16.1664 per common unit after payment of the underwriting discount. We did not receive any proceeds from the sale of common units by Fund I; however, the equity balance of Fund I was adjusted for its reduced ownership interest in us.

Table of Contents

Units Outstanding

As of June 30, 2014, we had 22,674,390 common units, 4,480,000 subordinated units and 22,400 general partner units outstanding. As of June 30, 2014, Fund I owned 4,089,600 common units and all of our subordinated units, representing an approximate 31.5% limited partner interest in us.

11. Net Income (Loss) Per Limited Partner Unit

The following sets forth the calculation of net income (loss) per limited partner unit for the following periods (in thousands, except per unit amounts):

	Three Months Ended June 30,				Six Months Ended June 30,			
	2014		2013		2014		2013	
Net income (loss)	$	(7,337)	$	20,523	$	(4,643)	$	13,521
Net income (loss) attributable to common control operations								(448)
Net income (loss) available to unitholders		(7,337)		20,523		(4,643)		13,073
Less: General partner s interest in net loss (income)		7		(21)		4		(13)
Limited partners interest in net income (loss)	$	(7,330)	$	20,502	$	(4,639)	$	13,060
Weighted average limited partner units outstanding:								
Common units		21,121		19,449		20,376		17,835
Subordinated units		5,612		6,720		6,163		6,720
Total		26,733		26,169		26,539		24,555
Net income (loss) per limited partner unit (basic and diluted)	$	(0.27)	$	0.78	$	(0.17)	$	0.53

Our subordinated units and restricted unit awards are considered to be participating securities for purposes of calculating our net income (loss) per limited partner unit, and accordingly, are included in basic computation as such. Net income (loss) per limited partner unit is determined by dividing the net income (loss) available to the common unitholders, after deducting our general partner s approximate 0.1% interest in net income (loss), by the weighted average number of common units and subordinated units outstanding as of June 30, 2014 and 2013. The aggregate number of common units and subordinated units outstanding was 22,674,390 and 4,480,000, respectively, as of June 30, 2014. The aggregate number of common units and subordinated units outstanding was 19,448,539 and 6,720,000, respectively, as of June 30, 2013.

12. Equity-Based Compensation

On November 10, 2011, our General Partner adopted a long-term incentive plan (2011 LTIP) for employees, consultants and directors of our General Partner and its affiliates, including Lime Rock Management and ServCo, who perform services for us. The 2011 LTIP consists of unit options, restricted units, phantom units, unit appreciation rights, distribution equivalent rights, unit awards and other unit-based awards. The 2011 LTIP initially limits the number of units that may be delivered pursuant to vested awards to 1,500,000 common units. As of June 30, 2014, there were 1,308,345 units available for issuance under the 2011 LTIP. The 2011 LTIP is currently administered by our General Partner s board of directors or a committee thereof.

The fair value of restricted units is determined based on the fair market value of the units on the date of grant. The outstanding restricted units vest in equal amounts (subject to rounding) over a three-year period following the date of grant and are entitled to receive quarterly distributions during the vesting period.

Table of Contents

A summary of the status of the non-vested restricted units as of June 30, 2014, is presented below:

	Number of Non-vested Restricted Units	Weighted Average Grant-Date Fair Value
Non-vested restricted units at December 31, 2013	165,262	$
Granted	3,012	16.60
Vested	(12,341)	17.92
Forfeited	(13,691)	16.54
Non-vested restricted units at June 30, 2014	142,242	

As of June 30, 2014, there was approximately $2.1 million of unrecognized compensation cost related to non-vested restricted units. The cost is expected to be recognized over a weighted average period of approximately 2.2 years. There were 49,410 vested restricted units as of June 30, 2014.

13. Subsidiary Guarantors

We and LRE Finance, our 100 percent-owned subsidiary, filed a registration statement on Form S-3 with the SEC on August 28, 2013, and the SEC declared the registration statement effective on September 10, 2013. Securities that may be offered and sold include debt securities that are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933. LRE Finance may co-issue any debt securities issued by us pursuant to the registration statement. LRE Finance was formed solely for the purpose of co-issuing our debt securities and has no material assets or liabilities other than as co-issuer of our debt securities, if and when issued. OLLC, our 100 percent-owned subsidiary, may guarantee any debt securities issued by us and such guarantee will be full and unconditional, subject to customary release provisions. The guarantee will be released (i) automatically upon any sale, exchange or transfer of our equity interests in OLLC, (ii) automatically upon the liquidation and dissolution of OLLC, (iii) following delivery of notice to the trustee under the indenture related to the debt securities of the release of OLLC of its obligations under our revolving credit facility, and (iv) upon legal or covenant defeasance or other satisfaction of the obligations under the related debt securities. Other than LRE Finance, OLLC is our sole subsidiary, and thus, no other subsidiary will guarantee our debt securities.

Furthermore, we have no assets or operations independent of OLLC, and there are no significant restrictions upon the ability of OLLC to distribute funds to us by dividend or loan. Finally, none of our or OLLC s assets represents restricted net assets pursuant to Rule 4-08(e)(3) of Regulation S-X.

14. Subsequent Events

Unit Distribution

On July 18, 2014, we announced that the board of directors of our general partner declared a cash distribution for the second quarter of 2014 of $0.4950 per outstanding unit, or $1.98 on an annualized basis. The distribution will be paid on August 14, 2014 to all unitholders of record as of the close of business on July 31, 2014. The aggregate amount of the distribution will be $13.6 million.

Commodity Hedges

Subsequent to June 30, 2014, we acquired the following commodity hedges:

	Index		2015
Oil positions			
Basis swaps (BBLs)	Argus-		397,035
Weighted average price	Midland-Cushing	$	(3.41)

Table of Contents

Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations.

Cautionary Note Regarding Forward-Looking Statements

This Quarterly Report on Form 10-Q contains forward-looking statements that are subject to a number of risks and uncertainties, many of which are beyond our control, which may include statements about our:

- *business strategies;*
- *ability to replace the reserves we produce through drilling and property acquisitions;*
- *drilling locations;*
- *oil and natural gas reserves;*
- *technology;*
- *realized oil and natural gas prices;*
- *production volumes;*
- *lease operating expenses;*
- *general and administrative expenses;*
- *future operating results;*
- *cash flows and liquidity;*
- *availability of drilling and production equipment;*
- *general economic conditions;*
- *effectiveness of risk management activities; and*
- *plans, objectives, expectations and intentions.*

All statements, other than statements of historical fact, are forward-looking statements. These forward-looking statements can be identified by their use of terms and phrases such as may, predict, pursue, expect, estimate, project, plan, believe, intend, achievable, anti continue, potential, should, could and similar terms and phrases. Although we believe that the expectations reflected in these forward-looking *statements are reasonable, they do involve certain assumptions, risks and uncertainties some of which are beyond our control. Actual results could differ materially from those anticipated in these forward-looking statements. One should consider carefully the risk factors described in Item 1A. Risk Factors of our Annual Report on Form 10-K for the year ended December 31, 2013 (2013 Annual Report) that describe factors that could cause our actual results to differ from those anticipated in the forward-looking statements, including, but not limited to, the following factors:*

- *our ability to generate sufficient cash to pay quarterly distributions on our common units;*
- *our ability to replace the oil and natural gas reserves we produce;*
- *our substantial future capital expenditures, which may reduce our cash available for distribution and could materially affect our ability to make distributions on our common units;*
- *a decline in, or substantial volatility of, oil, natural gas or natural gas liquids (NGL) prices;*
- *the differential between the NYMEX or other benchmark prices of oil and natural gas and the wellhead price we receive for our production;*
- *the risk that our hedging strategy may be ineffective or may reduce our income;*
- *uncertainty inherent in estimating our reserves;*
- *the risks and uncertainties involved in developing and producing oil and natural gas;*
- *risks related to potential acquisitions, including our ability to make accretive acquisitions on economically acceptable terms or to integrate acquired properties;*
- *competition in the oil and natural gas industry;*
- *cash flows and liquidity;*
- *restrictions and financial covenants in our credit facility and term loan;*
- *the availability of pipelines, transportation and gathering systems and processing facilities owned by third parties;*
- *electronic, cyber, and physical security breaches;*
- *general economic conditions; and*

Table of Contents

- *legislation and governmental regulations, including climate change legislation and federal or state regulation of hydraulic fracturing.*

All forward-looking statements are expressly qualified in their entirety by the cautionary statements in this paragraph and elsewhere in this document and speak only as of the date of this report. Other than as required under the securities laws, we do not assume a duty to update these forward-looking statements, whether as a result of new information, subsequent events or circumstances, changes in expectations or otherwise.

Overview

LRR Energy, L.P. (we, us, our, or the Partnership) is a Delaware limited partnership formed in April 2011 by Lime Rock Management LP (Li Rock Management), an affiliate of Lime Rock Resources A, L.P. (LRR A), Lime Rock Resources B, L.P. (LRR B) and Lime Rock Resources C, L.P. (LRR C), to operate, acquire, exploit and develop producing oil and natural gas properties in North America with long-lived, predictable production profiles. LRR A, LRR B and LRR C were formed by Lime Rock Management in July 2005 for the purpose of acquiring mature, low-risk producing oil and natural gas properties with long-lived production profiles. As used herein, references to Fund I refer collectively to LRR A, LRR B and LRR C; references to Fund II refer collectively to Lime Rock Resources II-A, L.P. and Lime Rock Resources II-C, L.P; and references to Fund III refer collectively to Lime Rock Resources III-A, L.P. and Lime Rock Resources III-C, L.P. References to Lime Rock Resources refer collectively to Fund I, Fund II and Fund III.

Our properties are located in the Permian Basin region in West Texas and Southeast New Mexico, the Mid-Continent region in Oklahoma and East Texas and the Gulf Coast region in Texas.

Contribution of Properties

On January 3, 2013, we completed an acquisition from Fund I of certain oil and natural gas properties located in the Mid-Continent region in Oklahoma for a purchase price of $21.0 million, subject to customary purchase price adjustments (the January 2013 Acquisition). In addition, as part of the January 2013 Acquisition, we acquired in the money commodity hedge contracts valued at approximately $1.7 million at the closing of the January 2013 Acquisition. The January 2013 Acquisition was effective October 1, 2012. In June 2013, we paid $0.4 million in cash to Fund I related to post-closing adjustments to the purchase price.

On April 1, 2013, we completed an acquisition of certain oil and natural gas properties located in the Mid-Continent region in Oklahoma and crude oil hedges from Fund II for a purchase price of $38.2 million (the April 2013 Acquisition). As part of the April 2013 Acquisition, we acquired in the money crude oil hedges valued at approximately $0.4 million as of the closing of the April 2013 Acquisition. The April 2013 Acquisition was effective April 1, 2013. We funded the April 2013 Acquisition with proceeds from our equity offering described in Note 10 to the consolidated condensed financial statements included in this report.

Results of Operations

	Three Months Ended June 30, 2014	Three Months Ended June 30, 2013	Six Months Ended June 30, 2014	Six Months Ended June 30, 2013
Revenues (in thousands):				
Oil sales	$ 20,354	$ 19,012	$ 40,510	$ 34,475
Natural gas sales	7,565	7,720	15,664	13,800
Natural gas liquids sales	2,760	2,275	6,124	4,510
Gain (loss) on commodity derivative instruments, net	(13,328)	12,354	(18,950)	6,287
Other income	40	18	71	87
Total revenues	17,391	41,379	43,419	59,159

Table of Contents

	Three Months Ended June 30, 2014	Three Months Ended June 30, 2013	Six Months Ended June 30, 2014	Six Months Ended June 30, 2013
Expenses (in thousands):				
Lease operating expense	6,829	5,270	12,664	12,067
Production and ad valorem taxes	2,248	2,198	4,648	4,044
Depletion and depreciation	8,680	10,129	17,145	20,239
General and administrative expense	2,699	2,768	5,881	6,197
Interest expense	2,575	2,249	5,116	4,514
Loss (gain) on interest rate derivative instruments, net	1,128	(2,657)	1,422	(2,772)
Production:				
Oil (MBbls)	216	210	434	398
Natural gas (MMcf)	1,666	1,843	3,288	3,651
NGLs (MBbls)	90	73	175	145
Total (MBoe)	584	590	1,157	1,152
Average net production (Boe/d)	6,418	6,484	6,392	6,365
Average sales price:				
Oil (per Bbl):				
Sales price	$ 94.23	$ 90.53	$ 93.34	$ 86.62
Effect of settled commodity derivative instruments	(3.50)	0.39	(2.14)	0.80
Realized price	$ 90.73	$ 90.92	$ 91.20	$ 87.42
Natural gas (per Mcf):				
Sales price	$ 4.54	$ 4.19	$ 4.76	$ 3.78
Effect of settled commodity derivative instruments	0.71	0.87	0.62	1.41
Realized price	$ 5.25	$ 5.06	$ 5.38	$ 5.19
NGLs (per Bbl):				