

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2019

OR

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

For the transition period from _____ to _____

Commission file number: 001-35245



SRC Energy Inc.

(Exact name of registrant as specified in its charter)

Colorado

(State or other jurisdiction of incorporation or organization)

20-2835920

(I.R.S. Employer Identification No.)

1675 Broadway, Suite 2600

Denver, Colorado 80202

(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: (720) 616-4300

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Trading Symbol(s)	Name of each exchange on which registered
Common stock \$.001 par value	SRCI	NYSE American

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted 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 such files). Yes No

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

Large accelerated filer Accelerated filer

Non-accelerated filer Smaller reporting company

Emerging growth company

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

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: 243,563,280 outstanding shares of common stock as of November 4, 2019.

SRC ENERGY INC.

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SRC ENERGY INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(unaudited; in thousands, except share data)

<u>ASSETS</u>	September 30, 2019	December 31, 2018
Current assets:		
Cash and cash equivalents	\$ 69,496	\$ 49,609
Accounts receivable:		
Oil, natural gas, and NGL sales	60,611	100,973
Trade	19,698	39,415
Commodity derivative assets	15,166	34,906
Other current assets	14,616	7,537
Total current assets	<u>179,587</u>	<u>232,440</u>
Property and equipment:		
Oil and gas properties, full cost method:		
Proved properties, net of accumulated depletion	1,804,476	1,545,445
Wells in progress	200,326	227,262
Unproved properties and land, not subject to depletion	666,439	740,453
Oil and gas properties, net	2,671,241	2,513,160
Other property and equipment, net	4,395	5,540
Total property and equipment, net	<u>2,675,636</u>	<u>2,518,700</u>
Commodity derivative assets	3,287	—
Other assets	9,062	3,574
Total assets	<u>\$ 2,867,572</u>	<u>\$ 2,754,714</u>
<u>LIABILITIES AND SHAREHOLDERS' EQUITY</u>		
Current liabilities:		
Accounts payable and accrued expenses	\$ 104,840	\$ 150,010
Revenue payable	94,130	97,030
Production taxes payable	92,752	95,099
Asset retirement obligations	4,832	11,694
Total current liabilities	<u>296,554</u>	<u>353,833</u>
Revolving credit facility	165,000	195,000
Notes payable, net of issuance costs	540,293	539,360
Asset retirement obligations	43,802	40,052
Deferred taxes	87,279	37,967
Other liabilities	3,467	2,210
Total liabilities	<u>1,136,395</u>	<u>1,168,422</u>
Commitments and contingencies (See Note 15)		
Shareholders' equity:		
Preferred stock - \$0.01 par value, 10,000,000 shares authorized: no shares issued and outstanding	—	—
Common stock - \$0.001 par value, 400,000,000 shares authorized: 243,511,005 and 242,608,284 shares issued and outstanding as of September 30, 2019 and December 31, 2018, respectively	244	243
Additional paid-in capital	1,502,977	1,492,107
Retained earnings	227,956	93,942
Total shareholders' equity	<u>1,731,177</u>	<u>1,586,292</u>
Total liabilities and shareholders' equity	<u>\$ 2,867,572</u>	<u>\$ 2,754,714</u>

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

SRC ENERGY INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(unaudited; in thousands, except share and per share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
Oil, natural gas, and NGL revenues	\$ 134,094	\$ 160,978	\$ 486,151	\$ 455,298
Expenses:				
Lease operating expenses	13,377	10,360	43,967	29,868
Transportation and gathering	4,021	1,994	12,739	5,729
Production taxes	10,843	12,824	31,114	41,325
Depreciation, depletion, and accretion	57,401	45,188	176,346	124,146
General and administrative	16,671	10,685	35,383	29,691
Total expenses	<u>102,313</u>	<u>81,051</u>	<u>299,549</u>	<u>230,759</u>
Operating income	<u>31,781</u>	<u>79,927</u>	<u>186,602</u>	<u>224,539</u>
Other income (expense):				
Commodity derivative gain (loss)	10,924	(8,529)	(3,704)	(28,604)
Interest expense, net of amounts capitalized	—	—	—	—
Interest income	76	23	237	37
Other income	55	125	191	152
Total other income (expense)	<u>11,055</u>	<u>(8,381)</u>	<u>(3,276)</u>	<u>(28,415)</u>
Income before income taxes	42,836	71,546	183,326	196,124
Income tax expense	13,041	8,918	49,312	18,076
Net income	<u>\$ 29,795</u>	<u>\$ 62,628</u>	<u>\$ 134,014</u>	<u>\$ 178,048</u>
Net income per common share:				
Basic	<u>\$ 0.12</u>	<u>\$ 0.26</u>	<u>\$ 0.55</u>	<u>\$ 0.74</u>
Diluted	<u>\$ 0.12</u>	<u>\$ 0.26</u>	<u>\$ 0.55</u>	<u>\$ 0.73</u>
Weighted-average shares outstanding:				
Basic	243,479,734	242,536,781	243,392,487	242,184,348
Diluted	244,547,642	243,560,046	244,134,202	243,207,058

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

SRC ENERGY INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(unaudited; in thousands)

	Nine Months Ended September 30,	
	2019	2018
Cash flows from operating activities:		
Net income	\$ 134,014	\$ 178,048
Adjustments to reconcile net income to net cash provided by operating activities:		
Depletion, depreciation, and accretion	176,346	124,146
Settlement of asset retirement obligations	(5,689)	(5,234)
Provision for deferred taxes	49,312	18,076
Stock-based compensation expense	9,914	9,347
Mark-to-market of commodity derivative contracts:		
Total loss on commodity derivatives contracts	3,704	28,604
Cash settlements on commodity derivative contracts	13,105	(13,263)
Cash premiums paid for commodity derivative contracts	(1,474)	—
Changes in operating assets and liabilities	50,073	3,830
Net cash provided by operating activities	<u>429,305</u>	<u>343,554</u>
Cash flows from investing activities:		
Acquisition of oil and gas properties and leaseholds, net of post-closing adjustments	(4,120)	(129,069)
Capital expenditures for drilling and completion activities	(351,407)	(331,702)
Other capital expenditures	(33,969)	(26,439)
Acquisition of land and other property and equipment	(329)	(2,914)
Proceeds from sales of oil and gas properties and other	12,109	1,233
Net cash used in investing activities	<u>(377,716)</u>	<u>(488,891)</u>
Cash flows from financing activities:		
Proceeds from the employee exercise of stock options	—	4,302
Payment of employee payroll taxes in connection with shares withheld	(1,167)	(1,106)
Proceeds from the revolving credit facility	—	115,000
Principal repayments on the revolving credit facility	(30,000)	—
Fees on debt and equity issuances and revolving credit facility amendments	(379)	(2,173)
Lease payments	(156)	(222)
Net cash provided by (used in) financing activities	<u>(31,702)</u>	<u>115,801</u>
Net increase (decrease) in cash and cash equivalents	19,887	(29,536)
Cash and cash equivalents at beginning of period	49,609	48,772
Cash and cash equivalents at end of period	<u>\$ 69,496</u>	<u>\$ 19,236</u>
Supplemental Cash Flow Information (See Note 16)		

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

SRC ENERGY INC.
CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
(unaudited; in thousands, except share data)

	Number of Common Shares	Par Value Common Stock	Additional Paid-In Capital	Retained Earnings (Deficit)	Total Shareholders' Equity
Balance, December 31, 2017	241,365,522	\$ 241	\$ 1,474,273	\$ (166,080)	\$ 1,308,434
Shares issued under stock bonus and equity incentive plans	268,676	1	(1)	—	—
Shares issued for exercise of stock options	268,303	—	1,064	—	1,064
Stock-based compensation	—	—	3,395	—	3,395
Payment of tax withholdings using withheld shares	—	—	(705)	—	(705)
Other activity	—	—	(73)	—	(73)
Net income	—	—	—	65,796	65,796
Balance, March 31, 2018	241,902,501	242	1,477,953	(100,284)	1,377,911
Shares issued under stock bonus and equity incentive plans	69,420	—	—	—	—
Shares issued for exercise of stock options	524,159	—	3,127	—	3,127
Stock-based compensation	—	—	3,768	—	3,768
Payment of tax withholdings using withheld shares	—	—	(305)	—	(305)
Net income	—	—	—	49,624	49,624
Balance, June 30, 2018	242,496,080	242	1,484,543	(50,660)	1,434,125
Shares issued under stock bonus and equity incentive plans	58,519	—	—	—	—
Shares issued for exercise of stock options	17,600	1	111	—	112
Stock-based compensation	—	—	4,030	—	4,030
Payment of tax withholdings using withheld shares	—	—	(96)	—	(96)
Net income	—	—	—	62,628	62,628
Balance, September 30, 2018	242,572,199	\$ 243	\$ 1,488,588	\$ 11,968	\$ 1,500,799

SRC ENERGY INC.
CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
(unaudited; in thousands, except share data)

	Number of Common Shares	Par Value Common Stock	Additional Paid-In Capital	Retained Earnings	Total Shareholders' Equity
Balance, December 31, 2018	242,608,284	\$ 243	\$ 1,492,107	\$ 93,942	\$ 1,586,292
Shares issued under stock bonus and equity incentive plans	709,042	—	—	—	—
Stock-based compensation	—	—	4,413	—	4,413
Payment of tax withholdings using withheld shares	—	—	(876)	—	(876)
Net income	—	—	—	49,751	49,751
Balance, March 31, 2019	243,317,326	243	1,495,644	143,693	1,639,580
Shares issued under stock bonus and equity incentive plans	110,880	—	—	—	—
Stock-based compensation	—	—	3,819	—	3,819
Payment of tax withholdings using withheld shares	—	—	(250)	—	(250)
Net income	—	—	—	54,468	54,468
Balance, June 30, 2019	243,428,206	243	1,499,213	198,161	1,697,617
Shares issued under stock bonus and equity incentive plans	82,799	1	(1)	—	—
Stock-based compensation	—	—	3,806	—	3,806
Payment of tax withholdings using withheld shares	—	—	(41)	—	(41)
Net income	—	—	—	29,795	29,795
Balance, September 30, 2019	243,511,005	\$ 244	\$ 1,502,977	\$ 227,956	\$ 1,731,177

SRC ENERGY INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

1. Organization and Summary of Significant Accounting Policies

Organization: SRC Energy Inc. (the "Company") is an independent oil and natural gas company engaged in the acquisition, development, and production of oil, natural gas, and natural gas liquids ("NGLs") in the Denver-Julesburg Basin ("D-J Basin") of Colorado. The Company's common stock is listed and traded on the NYSE American under the symbol "SRCL."

Basis of Presentation: The Company operates in one business segment, and all of its operations are located in the United States of America.

At the directive of the Securities and Exchange Commission ("SEC") to use "plain English" in public filings, the Company will use such terms as "we," "our," "us," or the "Company" in place of SRC Energy Inc. When such terms are used in this manner throughout this document, they are in reference only to the corporation, SRC Energy Inc., and are not used in reference to the Board of Directors, corporate officers, management, or any individual employee or group of employees.

The condensed consolidated financial statements include the accounts of the Company, including its wholly-owned subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation. The Company prepares its condensed consolidated financial statements in accordance with accounting principles generally accepted in the United States of America ("US GAAP").

Merger: On August 25, 2019, the Company entered into an Agreement and Plan of Merger ("PDC Merger Agreement") with PDC Energy, Inc., a Delaware corporation ("PDC"), which provides that, among other things, and subject to the terms and conditions of the PDC Merger Agreement, SRC will be merged with and into PDC, with PDC continuing as the surviving corporation (the "PDC Merger"). Pursuant to the PDC Merger Agreement, at the effective time of the PDC Merger, the Company's shareholders will receive 0.158 of a share of PDC common stock for each outstanding share of the Company's common stock, plus cash in lieu of any fractional PDC shares that otherwise would have been issued (the "Merger Consideration"). The PDC Merger Agreement also addresses the treatment of SRC equity awards in the PDC Merger. PDC's common stock is listed and traded on the NASDAQ Global Select Market under the symbol PDCE. The transaction was unanimously approved by the Boards of Directors of both companies. Completion of the PDC Merger is expected to occur early in the first quarter of 2020, subject to the approval of the Company's shareholders and PDC's stockholders and other customary closing conditions. For three and nine months ended September 30, 2019, the Company has incurred \$8.0 million of merger transaction costs recognized in general and administrative expense of the condensed consolidated statements of operations.

Interim Financial Information: The unaudited condensed consolidated interim financial statements included herein have been prepared by the Company pursuant to the rules and regulations of the SEC as promulgated in Rule 10-01 of Regulation S-X. The condensed consolidated balance sheet as of December 31, 2018 was derived from the Company's annual consolidated financial statements included within its Annual Report on Form 10-K for the year ended December 31, 2018 as filed with the SEC on February 20, 2019. Accordingly, certain information and footnote disclosures normally included in financial statements prepared in accordance with US GAAP have been condensed or omitted pursuant to such SEC rules and regulations. The Company believes that the disclosures included are adequate to make the information presented not misleading and recommends that these condensed financial statements be read in conjunction with the audited financial statements and notes thereto for the year ended December 31, 2018.

In our opinion, the unaudited condensed consolidated financial statements contained herein reflect all adjustments, consisting solely of normal recurring items, which are necessary for the fair presentation of the Company's financial position, results of operations, and cash flows on a basis consistent with that of its prior audited financial statements. However, the results of operations for interim periods may not be indicative of results to be expected for the full fiscal year.

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Major Customers: The Company sells production to a small number of customers as is customary in the industry. Customers representing 10% or more of our oil, natural gas, and NGL revenues (“major customers”) for each of the periods presented are shown in the following table:

Major Customers	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
Company A	26%	14%	26%	11%
Company B	14%	21%	20%	19%
Company C	24%	23%	17%	13%
Company D	12%	14%	10%	28%
Company E	*	14%	*	16%

* less than 10%

Based on the current demand for oil and natural gas, the availability of other buyers, the multiple contracts for sales of our products, and the Company having the option to sell to other buyers if conditions warrant, the Company believes that the loss of our existing customers or individual contracts would not have a material adverse effect on us. Our oil and natural gas production is a commodity with a readily available market, and we sell our products under many distinct contracts. In addition, there are several oil and natural gas purchasers and processors within our area of operations to whom our production could be sold.

Accounts receivable consist primarily of receivables from oil, natural gas, and NGL sales and amounts due from other working interest owners who are liable for their proportionate share of well costs. The Company typically has the right to withhold future revenue disbursements to recover outstanding joint interest billings on outstanding receivables from joint interest owners.

Customers with balances greater than 10% of total receivable balances as of each of the periods presented are shown in the following table (these companies do not necessarily correspond to those presented above):

Major Customers	As of	As of
	September 30, 2019	December 31, 2018
Company A	13%	15%
Company B	18%	12%
Company C	*	13%
Company D	11%	*
Company E	15%	12%

* less than 10%

The Company operates exclusively within the United States of America, and except for cash and cash equivalents, all of the Company’s assets are utilized in, and all of our revenues are derived from, the oil and gas industry.

Recently Adopted Accounting Pronouncements:

In February 2016, the Financial Accounting Standards Board (“FASB”) issued Accounting Standard Update (“ASU”) No. 2016-02, Leases (Topic 842), followed by other related ASUs that provided targeted improvements and additional practical expedient options (collectively “ASC 842”). ASC 842 requires lessees to recognize right-of-use (“ROU”) assets and lease payment liabilities in the balance sheet for leases representing the Company’s right to use the underlying assets over the lease term. Each lease that is recognized in the balance sheet will be classified as either finance or operating, with such classification affecting the pattern and classification of expense recognition in the consolidated statements of operations and presentation within the statements of cash flows.

The Company adopted ASC 842 on January 1, 2019 using the modified retrospective method. The Company elected as part of its adoption to also use the optional transition methodology whereby previously reported periods continue to be reported in accordance with historical accounting guidance for leases that were in effect for those prior periods. Policy elections and practical expedients that the Company has implemented as part of adopting ASC 842 include (a) excluding from the balance sheet leases with terms that are less than or equal to one year, (b) for all existing asset classes that contain both lease and non-lease components, combining these components together and accounting for them as a single lease component, (c) the package of practical expedients, which among other things allows the Company to avoid reassessing contracts that commenced prior to

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adoption that were properly evaluated under legacy GAAP, and (d) excluding land easements, which were not accounted for under the previous leasing guidance, that existed or expired before adoption of ASC 842. ASC 842 does not apply to leases used in the exploration or use of minerals, oil, and natural gas.

The Company's adoption of ASC 842 resulted in an increase in other assets, accounts payable and accrued expenses, and other liabilities line items on the accompanying condensed consolidated balance sheets as a result of the additional ROU assets and related lease liabilities. Upon adoption on January 1, 2019, the Company recognized approximately \$2.4 million in ROU assets and \$4.3 million in liabilities for its operating leases. There was no cumulative effect to retained earnings upon the adoption of this guidance. See Note 14 for the new disclosures required by ASC 842.

Recently Issued Accounting Pronouncements: There were various updates recently issued by the FASB, most of which represented technical corrections to the accounting literature or application to specific industries and are not expected to have a material impact on our reported financial position, results of operations, or cash flows.

Change in estimate: Production taxes are comprised primarily of two elements: severance tax and ad valorem tax. During the three months ended March 31, 2019, the Company reduced its estimate for 2018 severance taxes. When preparing the 2018 severance tax return, the credit for ad valorem taxes was greater than originally estimated, resulting in a reduction of 2018 severance taxes. Based on this analysis, the Company's prior year accrual was reduced, resulting in an approximate \$7.9 million reduction to our production taxes, which increased our operating income for the three months ended March 31, 2019 by a corresponding amount, or \$0.03 per basic and diluted common share.

2. Property and Equipment

The capitalized costs related to the Company's oil and gas producing activities were as follows (in thousands):

	As of September 30, 2019	As of December 31, 2018
Oil and gas properties, full cost method:		
Costs of proved properties:		
Producing and non-producing	\$ 2,817,646	\$ 2,385,958
Less, accumulated depletion and full cost ceiling impairments	(1,013,170)	(840,513)
Subtotal, proved properties, net	<u>1,804,476</u>	<u>1,545,445</u>
Costs of wells in progress	200,326	227,262
Costs of unproved properties and land, not subject to depletion:		
Lease acquisition and other costs	657,044	731,058
Land	9,395	9,395
Subtotal, unproved properties and land	<u>666,439</u>	<u>740,453</u>
Costs of other property and equipment:		
Other property and equipment	10,060	9,642
Less, accumulated depreciation	(5,665)	(4,102)
Subtotal, other property and equipment, net	<u>4,395</u>	<u>5,540</u>
Total property and equipment, net	<u>\$ 2,675,636</u>	<u>\$ 2,518,700</u>

For proved producing and non-producing properties, the Company performs a ceiling test each quarter to determine whether there has been an impairment to its capitalized costs. At September 30, 2019 and December 31, 2018, the calculated value of the ceiling limitation exceeded the carrying value of our oil and gas properties subject to the test, and no impairments were necessary.

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Capitalized Overhead: A portion of the Company's overhead expenditures are directly attributable to acquisition, exploration, and development activities. Under the full cost method of accounting, these expenditures, in the amounts shown in the table below, were capitalized in the full cost pool (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
Capitalized overhead	\$ 3,485	\$ 3,129	\$ 10,635	\$ 9,522

3. Depletion, depreciation, and accretion ("DD&A")

DD&A consisted of the following (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
Depletion of oil and gas properties	\$ 55,984	\$ 44,230	\$ 172,009	\$ 121,259
Depreciation and accretion	1,417	958	4,337	2,887
Total DD&A Expense	\$ 57,401	\$ 45,188	\$ 176,346	\$ 124,146

Capitalized costs of proved oil and gas properties are depleted quarterly using the units-of-production method based on a depletion rate, which is calculated by comparing production volumes for the quarter to estimated total reserves at the beginning of the quarter.

4. Asset Retirement Obligations

The Company recognizes obligations for its oil and natural gas operations for anticipated costs to remove and dispose of surface equipment, remediate the well, and reclaim the drilling site to its original use. The estimated present value of such obligations is determined using several assumptions and judgments about the ultimate settlement amounts, inflation factors, credit-adjusted discount rates, timing of settlement, and changes in regulations. Changes in estimates are reflected in the obligations as they occur. If the fair value of a recorded asset retirement obligation changes, a revision is recorded to both the asset retirement obligation and the capitalized asset retirement cost. The following table summarizes the changes in asset retirement obligations associated with the Company's oil and gas properties (in thousands):

	Nine Months Ended September 30, 2019
Asset retirement obligations, December 31, 2018	\$ 51,746
Obligations incurred with development activities	1,616
Accretion expense	2,645
Obligations discharged with asset retirements and divestitures	(7,373)
Asset retirement obligation, September 30, 2019	\$ 48,634
Less, current portion	(4,832)
Long-term portion	\$ 43,802

5. Revolving Credit Facility

On April 2, 2018, the Company entered into a second amended and restated credit agreement (the "Restated Credit Agreement") with certain banks and other lenders. The Restated Credit Agreement provides a revolving credit facility (sometimes referred to as the "Revolver") and a \$25 million swingline facility with a maturity date of April 2, 2023. The Revolver is available for working capital for exploration and production operations, acquisitions of oil and gas properties, and general corporate purposes and to support letters of credit. At September 30, 2019, the terms of the Revolver provided for up to \$1.5 billion in borrowings, an aggregate elected commitment of \$550 million, and a borrowing base limitation of \$700 million. As of September 30, 2019 and December 31, 2018, the outstanding principal balance was \$165.0 million and \$195.0 million, respectively. At September 30, 2019 and December 31, 2018, the Company had \$11.6 million and nil letters of credit issued, respectively. The average annual interest rate for borrowings during the nine months ended September 30, 2019 was 4.3%.

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Certain of the Company's assets, including substantially all of its producing wells and developed oil and gas leases, have been designated as collateral under the Restated Credit Agreement. The amount available to be borrowed is subject to scheduled redeterminations on a semi-annual basis. On September 18, 2019, the lenders consented to a postponement of the redetermination scheduled for November 2019 to the earlier of (i) the termination of the PDC Merger Agreement and (ii) January 1, 2020, which is expected to be extended. If certain events occur or if the bank syndicate or the Company so elects in certain circumstances, an unscheduled redetermination could be undertaken. Completion of the PDC Merger would give rise to an event of default under the terms of the Restated Credit Agreement. To avoid an event of default, PDC will need to obtain waivers or consents from the lenders under the Restated Credit Agreement, or the Revolver will need to be repaid in full and terminated in connection with the PDC Merger.

The Restated Credit Agreement contains covenants that, among other things, restrict the payment of dividends, limit our overall commodity derivative positions, and require the Company to maintain compliance with certain financial and liquidity ratio covenants. As of September 30, 2019, the most recent compliance date, the Company was in compliance with these loan covenants and expects to remain in compliance throughout the next 12-month period.

6. Notes Payable

2025 Senior Notes

In November 2017, the Company issued \$550 million aggregate principal amount of 6.25% Senior Notes due 2025 (the "2025 Senior Notes") in a private placement to qualified institutional buyers. The maturity for the payment of principal is December 1, 2025. Interest on the 2025 Senior Notes accrues at 6.25%. Interest is payable on June 1 and December 1 of each year. The 2025 Senior Notes were issued pursuant to an indenture dated as of November 29, 2017. The associated expenses and underwriting discounts and commissions are amortized using the effective interest method at an effective interest rate of 6.6%.

The Indenture contains covenants that restrict the Company's ability and the ability of certain of its subsidiaries to, among other restrictions and limitations: (i) incur additional indebtedness; (ii) incur liens; (iii) pay dividends; (iv) consolidate, merge, or transfer all or substantially all of its or their assets; (v) engage in transactions with affiliates; or (vi) engage in certain restricted business activities. These covenants are subject to a number of exceptions and qualifications. If the PDC Merger is completed, PDC may be required to make a change of control offer to repurchase the 2025 Senior Notes from the holders at 101% of the principal amount of the 2025 Senior Notes, together with any accrued and unpaid interest to the date of purchase. The indenture governing the 2025 Senior Notes provides that, in certain circumstances, the notes will be guaranteed by one or more subsidiaries of the Company, in which case such guarantee would be made on a full and unconditional and joint and several senior unsecured basis. As of September 30, 2019, none of the Company's subsidiaries met the criteria in the Indenture to be considered a guarantor of the 2025 Senior Notes.

As of September 30, 2019, the most recent compliance date, the Company was in compliance with the Indenture covenants and expects to remain in compliance throughout the next 12-month period.

7. Commodity Derivative Instruments

The Company has entered into commodity derivative instruments as described below. Our commodity derivative instruments may include but are not limited to "collars," "swaps," and "put" positions. Our derivative strategy, including the volumes and commodities covered and the relevant strike prices, is based in part on our view of expected future market conditions and our analysis of well-level economic return potential. In addition, our use of derivative contracts is subject to stipulations set forth in the Revolver.

The Company may, from time to time, add incremental derivatives to cover additional production, restructure existing derivative contracts, or enter into new transactions to modify the terms of current contracts in order to realize the current value of the Company's existing positions. The Company does not enter into derivative contracts for speculative purposes.

The Company's commodity derivative instruments are measured at fair value and are included in the accompanying condensed consolidated balance sheets as commodity derivative assets or liabilities. Unrealized gains and losses are recorded based on the changes in the fair values of the derivative instruments. Both the unrealized and realized gains and losses are recorded in the condensed consolidated statements of operations. The Company's cash flow is only impacted when the actual settlements under commodity derivative contracts result in it making or receiving a payment to or from the counterparty. Actual cash settlements can occur at either the scheduled maturity date of the contract or at an earlier date if the contract is liquidated prior to its scheduled maturity. These settlements under the commodity derivative contracts are reflected as operating activities in the Company's condensed consolidated statements of cash flows.

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The Company's commodity derivative contracts as of September 30, 2019 are summarized below:

Settlement Period	Derivative Instrument	Volumes (Bbls per day)	Weighted-Average Floor Price / Fixed Price	Weighted-Average Ceiling Price
Crude Oil - NYMEX WTI				
Oct 1, 2019 - Dec 31, 2019	Collar	16,000	\$ 55.00	\$ 70.65
Jan 1, 2020 - Dec 31, 2020	Swap	8,000	\$ 55.04	

Settlement Period	Derivative Instrument	Volumes (MMBtu per day)	Weighted-Average Floor Price	Weighted-Average Ceiling Price
Natural Gas - NYMEX Henry Hub				
Oct 1, 2019 - Dec 31, 2019	Collar	30,000	\$ 3.00	\$ 3.50

Settlement Period	Derivative Instrument	Volumes (MMBtu per day)	Fixed Basis Difference
Natural Gas - CIG Rocky Mountain			
Oct 1, 2019 - Dec 31, 2019	Swap	30,000	\$ (0.75)

Settlement Period	Derivative Instrument	Volumes (Bbls per day)	Weighted-Average Fixed Price
Propane - Mont Belvieu			
Oct 1, 2019 - Dec 31, 2019	Swap	2,000	\$ 37.52

Offsetting of Derivative Assets and Liabilities

As of September 30, 2019 and December 31, 2018, all derivative instruments held by the Company were subject to enforceable master netting arrangements held by various financial institutions. In general, the terms of the Company's agreements provide for offsetting of amounts payable or receivable between the Company and the counterparty, at the election of either party, for transactions that occur on the same date and in the same currency. The Company's agreements also provide that, in the event of an early termination, each party has the right to offset amounts owed or owing under that and any other agreement with the same counterparty. The Company's accounting policy is to offset these positions in its condensed consolidated balance sheets.

The following table provides a reconciliation between the net assets and liabilities reflected on the accompanying condensed consolidated balance sheets of the Company's derivative contracts (in thousands):

Underlying	Balance Sheet Location	As of September 30, 2019		
		Gross Amounts of Recognized Assets and Liabilities	Gross Amounts Offset in the Balance Sheet	Net Amounts of Assets and Liabilities Presented in the Balance Sheet
Commodity derivative contracts	Current assets	\$ 44,510	\$ (29,344)	\$ 15,166
Commodity derivative contracts	Noncurrent assets	12,382	(9,095)	3,287
Commodity derivative contracts	Current liabilities	29,344	(29,344)	—
Commodity derivative contracts	Noncurrent liabilities	\$ 9,095	\$ (9,095)	\$ —

Underlying	Balance Sheet Location	As of December 31, 2018		
		Gross Amounts of Recognized Assets and Liabilities	Gross Amounts Offset in the Balance Sheet	Net Amounts of Assets and Liabilities Presented in the Balance Sheet
Commodity derivative contracts	Current assets	\$ 39,485	\$ (4,579)	\$ 34,906
Commodity derivative contracts	Noncurrent assets	—	—	—
Commodity derivative contracts	Current liabilities	4,579	(4,579)	—
Commodity derivative contracts	Noncurrent liabilities	\$ —	\$ —	\$ —

The amount of gain (loss) recognized in the condensed consolidated statements of operations related to derivative financial instruments was as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
Realized gain (loss) on commodity derivatives	\$ 4,532	\$ (8,273)	\$ 12,749	\$ (16,228)
Unrealized gain (loss) on commodity derivatives	6,392	(256)	(16,453)	(12,376)
Total gain (loss)	\$ 10,924	\$ (8,529)	\$ (3,704)	\$ (28,604)

Realized gains and losses represent the monthly settlement of derivative contracts at their scheduled maturity date, net of the premiums attributable to settled commodity contracts. The following table summarizes derivative realized gains and losses during the periods presented (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
Monthly settlement	\$ 5,029	\$ (8,273)	\$ 14,223	\$ (16,228)
Premiums paid	(497)	—	(1,474)	—
Total realized gain (loss)	\$ 4,532	\$ (8,273)	\$ 12,749	\$ (16,228)

Credit-Related Contingent Features

As of September 30, 2019, all of the counterparties to the Company's derivative instruments were members of the Company's credit facility syndicate. The Company's obligations under the Revolver and its derivative contracts are secured by liens on substantially all of the Company's producing oil and gas properties.

8. Fair Value Measurements

ASC 820, *Fair Value Measurements and Disclosure*, establishes a hierarchy for inputs used in measuring fair value for financial assets and liabilities that maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that the most observable inputs be used when available. Observable inputs are inputs that market participants would use in pricing the asset or liability based on market data obtained from sources independent of the Company. Unobservable inputs are inputs that reflect the Company's assumptions of what market participants would use in pricing the asset or liability based on the best information available in the circumstances. The hierarchy is broken down into three levels based on the reliability of the inputs as follows:

- Level 1: Quoted prices available in active markets for identical assets or liabilities;
- Level 2: Quoted prices in active markets for similar assets and liabilities that are observable for the asset or liability; and
- Level 3: Unobservable pricing inputs that are generally less observable from objective sources, such as discounted cash or valuation models.

The 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.

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The Company's non-recurring fair value measurement includes asset retirement obligations. The Company determines the estimated fair value of its asset retirement obligations by calculating the present value of estimated cash flows related to plugging and reclamation liabilities using Level 3 inputs. The significant inputs used to calculate such liabilities include estimates of costs to be incurred, the Company's credit-adjusted risk-free rate, inflation rates, and estimated dates of reclamation. The asset retirement liability is accreted to its present value each period, and the capitalized asset retirement cost is depleted as a component of the full cost pool using the units-of-production method. See Note 4 for additional information.

The following table presents the Company's financial assets and liabilities that were accounted for at fair value on a recurring basis by level within the fair value hierarchy (in thousands):

	Fair Value Measurements at September 30, 2019			
	Level 1	Level 2	Level 3	Total
Financial assets and liabilities:				
Commodity derivative asset	\$ —	\$ 18,453	\$ —	\$ 18,453
Commodity derivative liability	\$ —	\$ —	\$ —	\$ —
	Fair Value Measurements at December 31, 2018			
	Level 1	Level 2	Level 3	Total
Financial assets and liabilities:				
Commodity derivative asset	\$ —	\$ 34,906	\$ —	\$ 34,906
Commodity derivative liability	\$ —	\$ —	\$ —	\$ —

Commodity Derivative Instruments

The Company determines its estimate of the fair value of commodity derivative instruments using a market approach based on several factors, including quoted market prices in active markets, quotes from third parties, the credit rating of each counterparty, and the Company's own credit standing. In consideration of counterparty credit risk, the Company assessed the possibility of whether the counterparties to its derivative contracts would default by failing to make any contractually required payments. The Company considers the counterparties to be of substantial credit quality and believes that they have the financial resources and willingness to meet their potential repayment obligations associated with the derivative transactions. At September 30, 2019, derivative instruments utilized by the Company consist of swaps and collars. The oil and natural gas derivative markets are highly active. Although the Company's derivative instruments are valued based on several factors including public indices, the instruments themselves are traded with third-party counterparties. As such, the Company has classified these instruments as Level 2.

Fair Value of Financial Instruments

The Company's financial instruments consist primarily of cash and cash equivalents, accounts receivable, accounts payable, commodity derivative instruments (discussed above), notes payable, and credit facility borrowings. The carrying values of cash and cash equivalents, accounts receivable, and accounts payable are representative of their fair values due to their short-term maturities. Due to the variable interest rate paid on the credit facility borrowings, the carrying value is representative of its fair value.

The fair value of the 2025 Senior Notes is estimated to be \$548.6 million at September 30, 2019. The Company determined the fair value of the 2025 Senior Notes at September 30, 2019 by using observable market-based information for these debt instruments. The Company has classified this fair value estimate as Level 1.

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9. Interest Expense

The components of interest expense are (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
Revolving credit facility	\$ 1,768	\$ 376	\$ 6,073	\$ 461
2025 Senior Notes	8,593	8,593	25,781	25,781
Amortization of issuance costs and other	937	905	2,585	2,905
Less: interest capitalized	(11,298)	(9,874)	(34,439)	(29,147)
Interest expense, net of amounts capitalized	\$ —	\$ —	\$ —	\$ —

10. Stock-Based Compensation

As of September 30, 2019, there were 10,500,000 common shares authorized for grant under the 2015 Equity Incentive Plan, of which 1,000,173 shares were available for future grant. The shares available for future grant exclude 1,973,768 shares which have been reserved for future vesting of performance-vested stock units in the event that these awards meet the criteria to vest at their maximum multiplier.

The amount of stock-based compensation was as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
Stock options	\$ 447	\$ 1,072	\$ 2,269	\$ 3,470
Performance-vested stock units	1,272	1,187	3,601	3,216
Restricted stock units and stock bonus shares	2,087	1,771	6,168	4,507
Total stock-based compensation	\$ 3,806	\$ 4,030	\$ 12,038	\$ 11,193
Less: stock-based compensation capitalized	(717)	(625)	(2,124)	(1,846)
Total stock-based compensation expense	\$ 3,089	\$ 3,405	\$ 9,914	\$ 9,347

Stock options

No stock options were granted during the three and nine months ended September 30, 2019 or 2018. The following table summarizes activity for stock options for the period presented:

	Number of Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Life	Aggregate Intrinsic Value (thousands)
Outstanding, December 31, 2018	4,652,634	\$ 10.06	6.4 years	\$ 49
Granted	—	—		
Exercised	—	—		—
Expired	(24,000)	9.01		
Forfeited	(58,800)	8.28		
Outstanding, September 30, 2019	4,569,834	\$ 10.09	5.6 years	\$ 47
Outstanding, Exercisable at September 30, 2019	3,949,534	\$ 10.27	5.5 years	\$ 47

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The following table summarizes information about issued and outstanding stock options as of September 30, 2019:

Range of Exercise Prices	Outstanding Options			Exercisable Options		
	Options	Weighted-Average Exercise Price per Share	Weighted-Average Remaining Contractual Life	Options	Weighted-Average Exercise Price per Share	Weighted-Average Remaining Contractual Life
Under \$5.00	35,000	\$ 3.31	2.8 years	35,000	\$ 3.31	2.8 years
\$5.00 - \$6.99	671,000	6.29	5.6 years	472,000	6.28	5.2 years
\$7.00 - \$10.99	1,360,334	9.42	5.6 years	1,121,934	9.48	5.5 years
\$11.00 - \$13.46	2,503,500	11.57	5.6 years	2,320,600	11.57	5.6 years
Total	4,569,834	\$ 10.09	5.6 years	3,949,534	\$ 10.27	5.5 years

The estimated unrecognized compensation cost from stock options not vested as of September 30, 2019, which will be recognized ratably over the remaining vesting period, is as follows:

Unrecognized compensation (in thousands)	\$ 1,977
Remaining vesting period	1.3 years

Completion of the PDC Merger will result in each then in-the-money stock option becoming fully vested and converted into the right to receive the Merger Consideration equal to the difference between (i) the number of shares of SRC common stock subject to the option less (ii) a number of shares of SRC common stock equivalent to the value of the aggregate exercise price (less required withholdings). Each out-the-money stock option will be cancelled in exchange for no consideration.

Restricted stock units and stock bonus awards

The following table summarizes activity for restricted stock units and stock bonus awards for the nine months ended September 30, 2019:

	Number of Shares	Weighted-Average Grant-Date Fair Value
Not vested, December 31, 2018	1,639,918	\$ 8.07
Granted	1,733,634	4.88
Vested	(674,909)	8.50
Forfeited	(71,787)	6.36
Not vested, September 30, 2019	2,626,856	\$ 5.90

The estimated unrecognized compensation cost from restricted stock units and stock bonus awards not vested as of September 30, 2019, which will be recognized ratably over the remaining vesting period, is as follows:

Unrecognized compensation cost (in thousands)	\$ 10,828
Remaining vesting period	2.0 years

Completion of the PDC Merger will result in each then outstanding restricted stock unit and stock bonus award becoming fully vested and converted into the right to receive the Merger Consideration in respect of each share of SRC common stock subject to the award (less required withholdings).

Performance-vested stock units

The Company has granted three types of performance-vested stock units ("PSUs") to certain executives under its long-term incentive plan. The number of shares of the Company's common stock that may be issued to settle PSUs ranges from zero to two times the number of PSUs awarded. The shares issued for PSUs are determined based on the Company's performance over a three-year measurement period and vest in their entirety at the end of the measurement period. For the years prior to 2019, the PSUs will be settled in shares of the Company's common stock. For PSUs granted in 2019, if the PSUs vested

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are in an amount equal to or less than the target amount, they will be settled in shares of the Company's common stock. If the PSUs vested are in an amount greater than the target amount, then at the discretion of the Board of Directors, the value of the vested amount of PSUs in excess of the value of the PSU target amount may be paid wholly or partially in cash. All PSUs are settled at the end of the three-year performance cycle. Any PSUs that have not vested at the end of the applicable measurement period are forfeited.

Goal-Based PSUs - These PSUs are earned and vested after 2020 based on a discretionary assessment by the Compensation Committee. This assessment is anticipated to measure the performance of the Company and the executives over the defined vesting period. As vesting is based on the discretion of the Compensation Committee, we have not yet met the requirements of establishing an accounting grant date for these awards. This will occur when the Compensation Committee determines and communicates the vesting percentage to the award recipients, which will then trigger the service inception date, the measurement date for determining the fair value of the awards, and the associated expense recognition period. As of September 30, 2019, 274,898 Goal-Based PSUs had been awarded to certain executives.

Relative Total Shareholder Return ("Relative TSR") PSUs -The vesting criterion for the Relative TSR PSUs is based on a comparison of the Company's total shareholder return ("TSR") for the measurement period compared with the TSRs of a group of peer companies for the same measurement period. As the vesting criterion is linked to the Company's share price, it is considered a market condition for purposes of calculating the grant-date fair value of the awards.

Absolute Total Shareholder Return ("Absolute TSR") PSUs -The vesting criterion for the Absolute TSR PSUs is based on a comparison of the Company's TSR for the measurement period compared to the TSR goals outlined in the award. As the vesting criterion is linked to the Company's share price, it is considered a market condition for purposes of calculating the grant-date fair value of the awards.

The assumptions used in valuing the TSR PSUs granted were as follows:

	Nine Months Ended September 30,	
	2019	2018
Weighted-average expected term	2.9 years	2.8 years
Weighted-average expected volatility	48%	52%
Weighted-average risk-free rate	2.49%	2.41%

As of September 30, 2019, unrecognized compensation cost for TSR PSUs was \$6.4 million and will be amortized through 2021. The following table summarizes activity for TSR PSUs for the nine months ended September 30, 2019.

	Number of Units ¹	Weighted-Average Grant-Date Fair Value
Not vested, December 31, 2018	780,028	\$ 11.73
Granted	918,842	5.74
Vested	—	—
Forfeited	—	—
Not vested, September 30, 2019	1,698,870	\$ 8.49

¹ The number of awards assumes that the associated vesting condition is met at the target amount. The final number of shares of the Company's common stock issued may vary depending on the performance multiplier, which ranges from zero to two, depending on the level of satisfaction of the vesting condition.

Completion of the PDC Merger will result in each then outstanding PSU awards becoming vested at the target level and converted into the right to receive the Merger Consideration in respect of each share of SRC common stock subject to the award (less required withholdings). Certain additional PSU awards are expected to be made prior to the completion of the PDC Merger as described in the PDC Merger Agreement.

11. Weighted-Average Shares Outstanding

The following table sets forth the Company's outstanding equity grants which have a dilutive effect on earnings per share:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
Weighted-average shares outstanding — basic	243,479,734	242,536,781	243,392,487	242,184,348
Potentially dilutive common shares from:				
Stock options	9,365	230,067	11,603	332,953
TSR PSUs ¹	752,984	411,738	424,659	336,882
Restricted stock units and stock bonus shares	305,559	381,460	305,453	352,875
Weighted-average shares outstanding — diluted	<u>244,547,642</u>	<u>243,560,046</u>	<u>244,134,202</u>	<u>243,207,058</u>

¹ The number of awards assumes that the associated vesting condition is met at the respective period end based on market prices as of the respective period end. The final number of shares of the Company's common stock issued may vary depending on the performance multiplier, which ranges from zero to two, depending on the level of satisfaction of the vesting condition.

The following potentially dilutive securities outstanding for the periods presented were not included in the respective weighted-average shares outstanding-diluted calculations above:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
Potentially dilutive common shares from:				
Stock options ¹	4,534,834	3,456,300	4,534,834	3,438,167
TSR PSUs ^{1,2}	773,954	160,754	773,954	160,754
Goal-Based PSUs ^{2,3}	274,898	281,872	274,898	281,872
Restricted stock units and stock bonus shares ¹	565,183	13,907	668,862	13,907
Total	<u>6,148,869</u>	<u>3,912,833</u>	<u>6,252,548</u>	<u>3,894,700</u>

¹ Potential common shares excluded from the weighted-average shares outstanding-diluted calculation as the securities had an anti-dilutive effect on earnings per share.

² The number of awards reflects the target amount of shares granted. The final number of shares of the Company's common stock issued may vary depending on the performance multiplier, which ranges from zero to two, depending on the level of satisfaction of the vesting condition.

³ Potential common shares excluded from the weighted-average shares outstanding-diluted calculation as the securities are considered contingently issuable, and the performance criteria are not considered met as of period end.

12. Income Taxes

We evaluate and update our estimated annual effective income tax rate on a quarterly basis based on current and forecasted operating results and tax laws. Consequently, based upon the mix and timing of our actual earnings compared to annual projections, our effective tax rate may vary quarterly and may make quarterly comparisons not meaningful. The quarterly income tax provision is generally comprised of tax expense on income or benefit on loss at the most recent estimated annual effective tax rate, adjusted for the effect of discrete items.

The effective combined U.S. federal and state income tax rates for the three and nine months ended September 30, 2019 were 30% and 27%, respectively. For the three and nine months ended September 30, 2018, the effective tax rates were 12% and 9%, respectively. The effective tax rates for the three and nine months ended September 30, 2019 differed from the statutory rate primarily due to state income taxes, non-deductible expenses, and tax deficiencies recognized in connection with the vesting of stock awards. The 2018 rates differed from the statutory rates due primarily to the release of valuation allowances previously recorded against deferred tax assets.

As of September 30, 2019, we had no liability for unrecognized tax benefits. The Company believes that there are no new items or changes in facts or judgments that should impact the Company's tax position. No significant uncertain tax positions were identified as of any date on or before September 30, 2019. The Company's policy is to recognize interest and penalties related to uncertain tax benefits in income tax expense. As of September 30, 2019, the Company has not recognized any interest or penalties related to uncertain tax benefits.

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Each period, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. As of September 30, 2019, the Company believes it will be able to generate sufficient future positive income within the carryforward periods and, accordingly, believes that it is more likely than not that its deferred income tax assets will be fully realized. In addition to the future positive net income, the temporary deferred tax liabilities exceed the deferred tax assets, resulting in the ability to utilize all deferred tax assets to offset future taxable income resulting from the reversal of the deferred tax liabilities.

13. Revenue from Contracts with Customers

Sales of oil, natural gas, and NGLs are recognized at the point control of the product is transferred to the customer and collectability is reasonably assured. All of our contracts' pricing provisions are tied to a market index, with certain adjustments based on, among other factors, whether a well delivers to a gathering or transmission line, quality of the oil or natural gas, and prevailing supply and demand conditions. As a result, the price of the oil, natural gas, and NGLs fluctuates to remain competitive with other available oil, natural gas, and NGLs supplies.

Revenues (in thousands):	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
Oil	\$ 113,411	\$ 123,540	\$ 392,589	\$ 354,601
Natural Gas and NGLs	20,683	37,438	93,562	100,697
	<u>\$ 134,094</u>	<u>\$ 160,978</u>	<u>\$ 486,151</u>	<u>\$ 455,298</u>

14. Leases

The Company evaluates contractual arrangements at inception to determine if the agreement is a lease or contains an identifiable lease component as defined by ASC 842. When evaluating contracts to determine appropriate classification and recognition under ASC 842, significant judgment may be necessary to determine, among other criteria, if an embedded leasing arrangement exists, the length of the term, classification as either an operating or financing lease, whether renewal or termination options are reasonably certain to be exercised, and future lease payments to be included in the initial measurement of the ROU asset. Certain assumptions and judgments made by the Company when evaluating contracts that meet the definition of a lease under ASC 842 include:

- Discount Rate - Unless implicitly defined, the Company will determine the present value of future lease payments using an estimated incremental secured borrowing rate based on a yield curve analysis that factors in certain assumptions, including the term of the lease and credit rating of the Company at lease commencement.
- Lease Term - The Company evaluates each contract containing a lease arrangement at inception to determine the length of the lease term when recognizing a ROU asset and corresponding lease liability. When determining the lease term, options available to extend or early terminate the arrangement are evaluated and included when it is reasonably certain these options will be exercised. There are no available options to extend that the Company is reasonably certain to exercise.

Currently, the Company has operating leases for asset classes that include office space, drilling rigs, and equipment rentals primarily used in development and field operations. The Company has financing leases for vehicles. We have provided a residual value guarantee for our vehicle leases. Certain leases also contain optional extension periods that allow for lease terms to be extended for up to an additional 5 years.

Costs associated with the Company's operating leases are either expensed or capitalized depending on how the underlying asset is utilized. For example, costs associated with drilling rigs are capitalized as part of the development of the Company's oil and gas properties. Refer to the Company's 2018 Form 10-K for additional information on its accounting policies for oil and gas development and production activities. When calculating the Company's ROU asset and liability, the Company considers all the necessary payments made or that are expected to be made upon commencement of the lease. Excluded from the initial measurement are certain variable lease payments.

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The Company's total lease costs were as follows (in thousands):

	Three Months Ended September 30, 2019	Nine Months Ended September 30, 2019
Finance lease cost:		
Amortization of ROU assets	\$ 66	\$ 189
Interest on lease liabilities	8	23
Operating lease cost		
	1,215	2,992
Variable lease cost	420	420
Short-term lease cost ¹	22,997	92,843
Total Lease Cost	\$ 24,706	\$ 96,467

¹ Costs associated with short-term lease agreements relate primarily to operational activities where underlying lease terms are less than or equal to one year. These costs primarily include drilling activities and field equipment rentals. It is expected that this amount will fluctuate primarily with the number of drilling rigs that the Company is operating under short-term agreements.

Other information related to the Company's leases is as follows (in thousands, except lease terms and discount rates):

	Three Months Ended September 30, 2019	Nine Months Ended September 30, 2019
Cash paid for amounts included in the measurement of lease liabilities		
Operating cash flows from operating leases	\$ 1,215	\$ 2,992
Financing cash flows from finance leases	51	156
ROU assets obtained in exchange for new finance lease liabilities	48	186
ROU assets obtained in exchange for new operating lease liabilities	—	8,538

	As of September 30, 2019
Weighted-average remaining lease term - finance leases	2.8 years
Weighted-average remaining lease term - operating leases	1.8 years
Weighted-average discount rate - finance leases	4.75%
Weighted-average discount rate - operating leases	4.75%

As of September 30, 2019 and through the date of issuance of these financial statements, the Company has no material lease arrangements which are scheduled to commence in the future. Maturities for the Company's operating and finance lease liabilities included in the accompanying condensed balance sheets as of September 30, 2019 were as follows (in thousands):

Year	Finance Leases	Operating Leases
2019	\$ 49	\$ 1,178
2020	197	4,450
2021	224	1,530
2022	194	500
2023	38	—
Thereafter	—	—
Total lease payments	\$ 702	\$ 7,658
Less imputed interest	(53)	(314)
Total lease liability	\$ 649	\$ 7,344

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As of December 31, 2018, minimum future contractual payments were as follows (in thousands):

Year	Rig Contracts	Capital Leases	Operating Leases
2019	\$ 11,102	\$ 183	\$ 896
2020	—	186	916
2021	—	204	913
2022	—	167	500
2023	—	—	—
Thereafter	—	—	—

Amounts recorded in the Company's accompanying condensed balance sheets were as follows (in thousands):

As of September 30, 2019	Financing Leases	Operating Leases
Other property and equipment, net	\$ 737	\$ —
Other assets	—	5,842
Accounts payable and accrued expenses	171	4,355
Other liabilities	478	2,989
	<u>\$ 649</u>	<u>\$ 7,344</u>

15. Other Commitments and Contingencies

Oil Commitments

The Company has entered into firm sales agreements for its oil production with five counterparties. Deliveries under the sales agreements have commenced. Pursuant to these agreements, we must deliver specific amounts of oil either from our own production or from oil that we acquire from third parties. If we are unable to fulfill all of our contractual obligations, we may be required to pay penalties or damages pursuant to these agreements. Our commitments, excluding the contingent commitment described below, are as follows:

Year ending December 31, 2019	Oil (MBbls)
Remainder of 2019	2,682
2020	9,493
2021	7,147
2022	5,475
2023	5,475
2024	5,490
Thereafter	9,120
Total	<u>44,882</u>

During the third quarter of 2019, we were able to meet all of our delivery obligations, and we anticipate that our current gross operated production will continue to meet our future delivery obligations. However, this cannot be guaranteed.

Natural Gas Commitments

In collaboration with several other producers and DCP Midstream, LP ("DCP Midstream"), we entered into two facilities expansion agreements with DCP Midstream to expand and improve its natural gas gathering pipelines and processing facilities. DCP Midstream completed and turned on line the first of the two 200 MMcf per day plants in August 2018. The second plant was placed into service during the third quarter of 2019. We are bound to the volume requirements in these agreements on the first day of the calendar month following the actual in-service date of the relevant plant. Both agreements require baseline volume commitments, consisting of our gross wellhead volume delivered in November 2016 to DCP Midstream, and incremental wellhead volume commitments of 46.4 MMcf per day and 43.8 MMcf per day for the first and second agreements, respectively, for 7 years.

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If we are unable to fulfill all of our contractual obligations and our obligations are not sufficiently reduced by the collective volumes delivered by other producers, we may be required to pay penalties or damages pursuant to these agreements. We are also required for the first three years of the contracts to guarantee a certain target profit margin to DCP Midstream on these incremental volumes. Payments made to date for such quantities have not been significant.

Litigation

From time to time, the Company is a party to various commercial and regulatory claims, pending or threatened legal action, and other proceedings that arise in the ordinary course of business. Except as discussed below, it is the opinion of management that none of the current proceedings are reasonably likely to have a material adverse impact on the Company's business, financial position, results of operations, or cash flows.

On October 4, 2019 and October 11, 2019, purported shareholders of SRC filed putative class action lawsuits against the members of the SRC board, SRC, and PDC in Colorado District Court in Arapahoe County and Denver County, captioned *Robert Garfield v. Lynn A. Peterson, et al.*, Case No. 2019CV32360 and *George Korol v. SRC Energy Inc., et al.*, Case No. 2019CV33933. The plaintiffs in these complaints generally claim that (i) SRC and the members of the SRC board breached their fiduciary duties to SRC shareholders by authorizing the PDC Merger for what the plaintiffs assert is inadequate consideration and pursuant to an unfair process and with inadequate disclosures and (ii) PDC aided and abetted the other defendants' alleged breach of duties. The plaintiffs seek, among other things, to rescind the transaction or obtain rescissory damages if the PDC Merger is consummated, to recover other unspecified damages, including recover attorneys' fees and costs, and to obtain injunctive relief.

On October 8, 2019 and October 11, 2019, purported shareholders of SRC filed putative class action lawsuits against SRC, the members of the SRC board, and PDC in the United States District Court, District of Delaware, captioned *Patrick Plumley v. SRC Energy Inc., et al.*, Case No. 1:19-cv-01912 and *Juan Aguirre v. SRC Energy Inc., et al.*, Case No. 1:19-mc-01934. The plaintiffs in these complaints generally claim that the defendants disseminated a false or misleading registration statement regarding the PDC Merger in violation of Section 14(a) and Section 20(a) of the Exchange Act and/or Rule 14a-9 promulgated under the Exchange Act. The plaintiffs seek, among other things, injunctive relief to prevent consummation of the PDC Merger until the alleged disclosure violations are cured, damages in the event the PDC Merger is consummated, and an award of attorney's fees.

Although the Company believes these actions are without merit, it is not possible at this time to predict the outcome of these matters nor can the amount of possible losses be reasonably estimated.

16. Supplemental Schedule of Information to the Condensed Consolidated Statements of Cash Flows

The following table supplements the cash flow information presented in the condensed consolidated financial statements for the periods presented (in thousands):

Supplemental cash flow information:	Nine Months Ended September 30,	
	2019	2018
Interest paid	\$ 22,931	\$ 17,701
Non-cash investing and financing activities:		
Accrued well costs as of period end	\$ 72,381	\$ 143,015
Asset retirement obligations incurred with development activities	1,616	1,488
Asset retirement obligations assumed with acquisitions	—	26,150
Obligations discharged with asset retirements and divestitures	\$ (7,373)	\$ (8,944)
Net changes in operating assets and liabilities:		
Accounts receivable	\$ 54,934	\$ (31,170)
Accounts payable and accrued expenses	165	(842)
Revenue payable	(2,917)	15,858
Production taxes payable	(3,001)	20,504
Other	892	(520)
Changes in operating assets and liabilities	\$ 50,073	\$ 3,830

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Introduction

The following discussion and analysis was prepared to supplement information contained in the accompanying condensed consolidated financial statements and is intended to explain certain items regarding the Company's financial condition as of September 30, 2019 and its results of operations for the three and nine months ended September 30, 2019 and 2018. It should be read in conjunction with the accompanying audited consolidated financial statements and related notes thereto contained in the Annual Report on Form 10-K for the year ended December 31, 2018 filed with the SEC on February 20, 2019. Unless the context otherwise requires, references to "SRC Energy," "we," "us," "our," or the "Company" in this report refer to the registrant, SRC Energy Inc., and its subsidiaries.

This section and other parts of this Quarterly Report on Form 10-Q contain forward-looking statements that involve risks and uncertainties. See the "Cautionary Statement Concerning Forward-Looking Statements" elsewhere in this Quarterly Report on Form 10-Q. Forward-looking statements are not guarantees of future performance, and our actual results may differ significantly from the results discussed in the forward-looking statements. Factors that might cause such differences include, but are not limited to, those discussed and referenced in "Risk Factors." We assume no obligation to revise or update any forward-looking statements for any reason, except as required by law.

Overview

SRC Energy is an independent oil and gas company engaged in the acquisition, development, and production of oil, natural gas, and NGLs in the D-J Basin, which we believe to be one of the premier, liquids-rich oil and natural gas resource plays in the United States. Our oil and natural gas activities are focused in the Wattenberg Field, an area that covers the western flank of the D-J Basin. All of our activities and planned drilling locations are located in Weld County, Colorado, and we are focused on the horizontal development of the Codell formation as well as the three benches of the Niobrara formation, which are all characterized by relatively high liquids content.

In order to maintain operational focus while preserving developmental flexibility, we strive to attain operational control of a majority of the wells in which we have a working interest. We currently operate approximately 91% of our proved developed reserves and anticipate operating a majority of our future net drilling locations.

Merger

On August 25, 2019, the Company entered into an Agreement and Plan of Merger ("PDC Merger Agreement") with PDC Energy, Inc., a Delaware corporation ("PDC"), which provides that, among other things, and subject to the terms and conditions of the PDC Merger Agreement, SRC will be merged with and into PDC, with PDC continuing as the surviving corporation (the "PDC Merger"). Pursuant to the PDC Merger Agreement, at the effective time of the PDC Merger, the Company's shareholders will receive 0.158 of a share of PDC common stock for each outstanding share of the Company's common stock, plus cash in lieu of any fractional PDC shares that otherwise would have been issued (the "Merger Consideration"). The PDC Merger Agreement also addresses the treatment of SRC equity awards in the PDC Merger. PDC's common stock is listed and traded on the NASDAQ Global Select Market under the symbol PDCE. The transaction was unanimously approved by the Boards of Directors of both companies. Completion of the PDC Merger is expected to occur early in the first quarter of 2020, subject to the approval of the Company's shareholders and PDC's stockholders and other customary closing conditions. For the three and nine months ended September 30, 2019, the Company has incurred \$8.0 million of merger transaction costs recognized in general and administrative expense of the condensed consolidated statements of operations.

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Market Conditions

Market prices for our products significantly impact our revenues, net income, cash flow, future growth, and carrying value of our oil and gas properties. The market prices for oil, natural gas, and NGLs are inherently volatile. To provide historical perspective, the following table presents the average annual NYMEX prices for oil and natural gas for each of the last four years.

	Year Ended December 31,			
	2018	2017	2016	2015
Average NYMEX prices				
Oil (per Bbl)	\$ 64.94	\$ 50.93	\$ 43.20	\$ 48.73
Natural gas (per Mcf)	\$ 3.09	\$ 3.00	\$ 2.52	\$ 2.58

For the periods presented in this report, the following table presents the average NYMEX prices as well as the differential between the NYMEX prices and the prices realized by us.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
Oil (NYMEX-WTI)				
Average NYMEX Price	\$ 56.37	\$ 69.76	\$ 56.99	\$ 66.89
Realized Price *	49.39	63.48	50.05	60.13
Differential *	\$ (6.98)	\$ (6.28)	\$ (6.94)	\$ (6.76)
Natural Gas (NYMEX-Henry Hub)				
Average NYMEX Price	\$ 2.23	\$ 2.90	\$ 2.67	\$ 2.90
Realized Price *	1.21	1.79	1.75	1.84
Differential *	\$ (1.02)	\$ (1.11)	\$ (0.92)	\$ (1.06)
NGL Realized Price	\$ 4.65	\$ 19.93	\$ 8.84	\$ 18.91

* Adjusted to include the effect of transportation and gathering expenses.

Market conditions in the Wattenberg Field can require us to sell oil at prices less than the prices posted by the NYMEX. The differential between the prices actually received by us and the published indices reflects deductions imposed upon us by the purchasers for location and quality adjustments. To the extent the Company's oil production exceeded its firm sales commitments during the nine months ended September 30, 2019, the surplus oil production was sold at a reduced differential as compared to our committed volumes.

Our natural gas sales tend to trend closely with Colorado Interstate Gas – Rocky Mountains as published in Inside FERC's Gas Market Report, published by Platts ("CIG"). Average CIG prices for the third quarter of 2019 decreased to \$1.67 from \$1.95 in the second quarter of 2019, resulting in the basis differential for CIG to NYMEX-Henry Hub decreasing from \$0.69 to \$0.56.

A decline in oil and natural gas prices will adversely affect our financial condition and results of operations. Furthermore, low oil and natural gas prices can result in an impairment of the value of our properties and impact the calculation of the "ceiling test" required under the accounting principles for companies following the "full cost" method of accounting. At September 30, 2019, the calculated value of the ceiling limitation exceeded the carrying value of our oil and gas properties subject to the test, and no impairment was necessary.

[Table of Contents](#)**Core Operations**

The following table provides details about our ownership interests with respect to vertical and horizontal producing wells as of September 30, 2019:

Vertical Wells					
Operated Wells		Non-Operated Wells		Totals	
Gross	Net	Gross	Net	Gross	Net
497	481	159	42	656	523

Horizontal Wells					
Operated Wells		Non-Operated Wells		Totals	
Gross	Net	Gross	Net	Gross	Net
445	421	338	59	783	480

In addition to the producing wells summarized in the preceding table, as of September 30, 2019, we were the operator of 78 gross (72 net) horizontal wells in progress. As of September 30, 2019, we are participating in 26 gross (4 net) non-operated horizontal wells in progress.

As we develop our acreage through horizontal drilling, we have an active program for the remediation and reclamation of the vast majority of the operated vertical wellbores. During the nine months ended September 30, 2019, we reclaimed 74 wells and returned the associated acreage to the property owners.

Drilling and Completion Operations

We are currently operating with one drilling rig and one completion crew, which is driven by the availability of processing capacity. As additional gas processing capacity becomes available, we may choose to accelerate drilling and completion activities, assuming commodity prices and operating conditions are favorable.

During the nine months ended September 30, 2019, we drilled 83 operated horizontal wells and turned 70 operated horizontal wells to sales. As of September 30, 2019, the Company had 18 gross (17 net) wells that were drilled and completed, but not producing. As of September 30, 2019, we are the operator of 78 gross (72 net) horizontal wells in progress. All of this activity was funded through cash flows from operations.

For the nine months ended September 30, 2019, we participated in the completion of 31 gross (2 net) non-operated horizontal wells. As of September 30, 2019, we are participating in 26 gross (4 net) non-operated horizontal wells in progress.

Production

For the three months ended September 30, 2019, our average daily production was 58,745 BOED as compared to 49,165 BOED for the three months ended September 30, 2018. During the first nine months of 2019, our average net daily production was 61,757 BOED. By comparison, during the nine months ended September 30, 2018, our average production rate was 47,416 BOED. As of September 30, 2019, approximately 98% of our daily production was from horizontal wells. See "-Trends and Outlook" for further discussion regarding current midstream capacity constraints that continue to impact production.

Significant Developments**Operations**

In light of current midstream constraints in the D-J basin and our focus on capital efficiency, we released one of our drilling rigs in August 2019. All of our year-to-date investing activities were funded through cash flows from operations.

Legislative Matters

New legislation governing oil and gas development in Colorado, referred to as SB19-181, and titled "Protect Public Welfare Oil and Gas Operations," became law in April 2019. Among other things, SB19-181 provides that local governments have land use authority to regulate the siting of oil and gas locations, states that it is in the public interest to regulate the development

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of oil and gas resources in a manner that protects public health, safety, and welfare, including protection of the environment and wildlife resources, and modifies requirements related to statutory pooling. There is ongoing rulemaking associated with this legislation that will affect the implementation and effects of the law. SB19-181 could have a variety of effects on our operations, but we believe that some of these impacts may be mitigated by the fact that the statute places a significant emphasis on local control of oil and gas regulatory matters, and all of our development activities are in Weld County. Weld County commissioners have created a Weld County Oil and Gas Energy Department with the intent to use the additional local authority granted to it in SB19-181 to ensure that oil and gas production continues.

Trends and Outlook

Multiple midstream companies that operate natural gas processing facilities and gathering pipelines in the Wattenberg Field continue to make significant capital investments to increase the capacity of their systems. Until such time as these facilities are operational, our production has been, and most likely will continue to be, adversely impacted by a lack of available processing capacity.

To address the growing volumes of natural gas production in the D-J Basin, DCP Midstream has been developing multiple projects including new processing plants, an expansion of its low- and high-pressure gathering systems, additional compression, and plant bypass infrastructure. Most notably, in collaboration with DCP Midstream, we and several other producers agreed to support the expansion of natural gas gathering and processing capacity through agreements that impose baseline and incremental volume commitments, which we are currently exceeding. DCP Midstream's second expansion under this arrangement is the O'Connor processing complex, which has been expanded by 200 MMcf per day of processing capacity along with the ability to bypass an incremental 100 MMcf per day. During the third quarter of 2019, DCP Midstream also announced an offload agreement with Western Midstream Partners, LP ("Western") for up to 225 MMcf per day of incremental processing capacity in 2020 at Western's facility. Further, DCP Midstream has secured the land and permits for the development of another facility ("Bighorn"), where DCP Midstream could add processing capacity of up to 1 Bcf per day, including bypass.

Although the O'Connor processing complex expansion was placed in service during the third quarter of 2019, capacity constraints stemming from delays to residue gas and NGLs takeaway expansions, coupled with planned maintenance and downtime across the DCP Midstream system, reduced the overall impact of the expansion. As a result, the system-wide volume allocation limiting each producer's throughput has not been increased materially. This limitation has required us to continue to shut-in and curtail our production longer than expected. The aggregate volumes shut-in as of September 30, 2019 were approximately 23,000 BOED with an approximate 33% oil cut. This estimate of volume and oil cut is based on what the wells were producing at the time they were shut in. While we expected an increase in our allocation in the fourth quarter of 2019, we now believe that a larger increase will likely not occur until after the residue gas and NGL takeaway expansions have been placed into service, allowing a full utilization of processing and bypass capacity. Further, as these events have impacted all operators, our share of production from non-operated properties has also declined.

Throughout 2019, oil and gas investor sentiment has increasingly stressed the importance of slower growth, capital discipline, and free cash flow. In this investment environment and due to the continuing midstream constraints discussed above, we have reduced our drilling and completion program versus our original budget by releasing one of our two drilling rigs and delaying completion activities. The result of this operational reduction is reflected in our third quarter 2019 capital expenditures, and we expect our fourth quarter 2019 expenditures to be a similar amount. Consequently, we estimate that our fourth quarter 2019 production will remain similar to our third quarter 2019 volumes with any growth dependent on incremental midstream capacity. Overall, we expect year-over-year production growth of approximately 20% with all drilling and completions activities during the year funded by cash flows from operations.

NYMEX-WTI oil traded at \$45.15 per Bbl on December 28, 2018 and increased approximately 20% as of September 30, 2019 to \$54.09. NYMEX-Henry Hub natural gas traded at \$3.25 per Mcf on December 28, 2018 and declined approximately 27% as of September 30, 2019 to \$2.37. Although NYMEX-WTI oil prices had increased by the end of the third quarter of 2019, they continue to be volatile and are out of our control. If oil prices decrease, this could (i) reduce our cash flow, which could, in turn, reduce the funds available for the exploration and replacement of oil and natural gas reserves, (ii) reduce our Revolver borrowing base capacity and increase the difficulty of obtaining equity and debt financing and worsen the terms on which such financing may be obtained, (iii) reduce the number of oil and gas prospects which have reasonable economic returns, (iv) cause us to allow leases to expire based upon the value of potential oil and natural gas reserves in relation to the costs of exploration, (v) result in marginally productive oil and natural gas wells being shut-in as non-commercial, and (vi) cause ceiling test impairments.

Other than the foregoing, we do not know of any trends, events, or uncertainties that have had, during the periods covered by this report, or are reasonably expected to have, a material impact on our sales, revenues, expenses, liquidity, or capital resources.

Results of Operations

Material changes to certain items in our condensed consolidated statements of operations included in our condensed consolidated financial statements for the periods presented are discussed below.

For the three months ended September 30, 2019 compared to the three months ended September 30, 2018

For the three months ended September 30, 2019, we reported net income of \$29.8 million compared to net income of \$62.6 million during the three months ended September 30, 2018. Net income per basic and diluted share was \$0.12 for the three months ended September 30, 2019 compared to net income per basic and diluted share of \$0.26 for the three months ended September 30, 2018.

Oil, Natural Gas, and NGL Production and Revenues - For the three months ended September 30, 2019, we recorded total oil, natural gas, and NGL revenues of \$134.1 million compared to \$161.0 million for the three months ended September 30, 2018, a decrease of \$26.9 million or 17%. The following table summarizes key production and revenue statistics:

	Three Months Ended September 30,		Percentage Change
	2019	2018	
Production:			
Oil (MBbls) ¹	2,224	1,915	16 %
Natural Gas (MMcf) ²	12,556	9,471	33 %
NGLs (MBbls) ¹	1,088	1,030	6 %
MBOE ³	5,405	4,523	20 %
BOED ⁴	58,745	49,165	19 %
Revenues (in thousands):			
Oil	\$ 113,411	\$ 123,540	(8)%
Natural Gas	15,622	16,908	(8)%
NGLs	5,061	20,530	(75)%
	<u>\$ 134,094</u>	<u>\$ 160,978</u>	(17)%
Average sales price:			
Oil ⁵	\$ 49.39	\$ 63.48	(22)%
Natural Gas ⁵	1.21	1.79	(32)%
NGLs	4.65	19.93	(77)%
BOE ⁵	\$ 24.07	\$ 35.15	(32)%

¹ "MBbl" refers to one thousand stock tank barrels, or 42,000 U.S. gallons liquid volume in reference to crude oil or other liquid hydrocarbons.

² "MMcf" refers to one million cubic feet of natural gas.

³ "MBOE" refers to one thousand barrels of oil equivalent, which combines MBbls of oil and MMcf of natural gas by converting each six MMcf of natural gas to one MBbl of oil.

⁴ "BOED" refers to the average number of barrels of oil equivalent produced in a day for the period.

⁵ Adjusted to include the effect of transportation and gathering expenses.

Net oil, natural gas, and NGL production for the three months ended September 30, 2019 averaged 58,745 BOED, an increase of 19% over average production of 49,165 BOED in the three months ended September 30, 2018. From September 30, 2018 to September 30, 2019, our well count increased by 83 net horizontal wells, growing our reserves and daily production totals. The 20% increase in production was more than offset by the 32% decrease in average sales prices, resulting in a decrease in revenues.

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LOE - Direct operating costs of producing oil and natural gas are reported as follows (in thousands):

	Three Months Ended September 30,	
	2019	2018
Production costs	\$ 12,877	\$ 10,181
Workover	500	179
Total LOE	\$ 13,377	\$ 10,360
Per BOE:		
Production costs	\$ 2.38	\$ 2.25
Workover	0.09	0.04
Total LOE	\$ 2.47	\$ 2.29

Lease operating and workover costs tend to increase or decrease primarily in relation to the number and type of wells, to a lesser extent, on fluctuations in oil field service costs and changes in the production mix of oil and natural gas. During the three months ended September 30, 2019, we experienced increased production expense per BOE compared to the three months ended September 30, 2018 due to an increase in net operated wells without a proportional increase in production volume due to current midstream capacity constraints.

Transportation and gathering - Transportation and gathering costs were \$4.0 million, or \$0.74 per BOE, for the three months ended September 30, 2019, compared to \$2.0 million, or \$0.44 per BOE, for the three months ended September 30, 2018. Coinciding with the increase in its production in 2019, the Company has increased the volume of its production that is sold and delivered at the downstream interconnect. This has the effect of increasing both the net price received for the production and transportation and gathering costs. While costs attributable to volumes sold at the interconnect of the pipeline are reported as an expense, the Company analyzes these charges on a net basis within revenue for comparability with wellhead sales.

Production taxes - Production taxes are comprised primarily of two elements: severance tax and ad valorem tax. Production taxes were \$10.8 million, or \$2.01 per BOE, for the three months ended September 30, 2019, compared to \$12.8 million, or \$2.83 per BOE, during the three months ended September 30, 2018. As a percentage of revenues, production taxes were 8.1% and 8.0% for the three months ended September 30, 2019 and 2018, respectively.

DD&A - The following table summarizes the components of DD&A:

(in thousands)	Three Months Ended September 30,	
	2019	2018
Depletion of oil and gas properties	\$ 55,984	\$ 44,230
Depreciation and accretion	1,417	958
Total DD&A	\$ 57,401	\$ 45,188
DD&A expense per BOE	\$ 10.62	\$ 9.99

For the three months ended September 30, 2019, DD&A was \$10.62 per BOE compared to \$9.99 per BOE for the three months ended September 30, 2018. The increase in the DD&A rate was the result of recent drilling and completion activities which increased the amortization base. Capitalized costs of proved oil and gas properties are depleted quarterly using the units-of-production method based on estimated reserves, whereby the ratio of production volumes for the quarter to the beginning of the quarter estimated total reserves determines the depletion rate.

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General and Administrative ("G&A") - The following table summarizes G&A expenses incurred and capitalized during the periods presented:

(in thousands)	Three Months Ended September 30,	
	2019	2018
Total Non-Cash G&A	\$ 3,806	\$ 4,030
Total Cash G&A	16,379	9,806
Capitalized G&A Costs	(3,514)	(3,151)
Total G&A Expense	\$ 16,671	\$ 10,685
Non-Cash G&A Expense	\$ 3,089	\$ 3,405
Cash G&A Expense	13,582	7,280
Total G&A Expense	\$ 16,671	\$ 10,685
Non-Cash G&A Expense per BOE	\$ 0.57	\$ 0.75
Cash G&A Expense per BOE	2.51	1.61
G&A Expense per BOE	\$ 3.08	\$ 2.36

G&A includes overhead costs associated with employee compensation and benefits, insurance, facilities, professional fees, and regulatory costs, among others. Total G&A costs of \$16.7 million for the third quarter of 2019 were 56% higher than G&A for the same period of 2018, primarily because the Company incurred \$8.0 million of transaction costs in the third quarter of 2019 relating to the PDC Merger.

Our G&A expense for the three months ended September 30, 2019 includes stock-based compensation of \$3.1 million compared to \$3.4 million for the three months ended September 30, 2018.

Pursuant to the requirements under the full cost accounting method for oil and gas properties, we identify all general and administrative costs that relate directly to the acquisition of undeveloped mineral leases and the exploration and development of properties. Those costs are reclassified from G&A expenses and capitalized into the full cost pool.

Commodity derivative gains (losses) - As more fully described in Item 1. Financial Statements – Note 7, *Commodity Derivative Instruments*, we use commodity contracts to help mitigate the risks inherent in the price volatility of oil and natural gas. For the three months ended September 30, 2019, we realized a settlement gain of \$4.5 million. For the prior comparable period, we realized a settlement loss of \$8.3 million.

In addition, for the three months ended September 30, 2019, we recorded an unrealized gain of \$6.4 million to recognize the mark-to-market change in the fair value of our commodity contracts. By comparison, in the three months ended September 30, 2018, we reported an unrealized loss of \$0.3 million. Unrealized gains and losses are non-cash items.

Income taxes - As more fully described in Item 1. Financial Statements – Note 12, *Income Taxes*, we reported income tax expense of \$13.0 million for the three months ended September 30, 2019 as compared to \$8.9 million for the comparable prior year period. The effective combined U.S. federal and state income tax rates for the three months ended September 30, 2019 and 2018 were 30% and 12%, respectively. The effective tax rates for the three months ended September 30, 2019 differed from the statutory rate primarily due to state income taxes, non-deductible expenses, and tax deficiencies recognized in connection with the vesting of stock awards. The effective tax rate for the three months ended September 30, 2018 differed from the statutory rates due primarily to the release of valuation allowances previously recorded against deferred tax assets.

For the nine months ended September 30, 2019 compared to the nine months ended September 30, 2018

For the nine months ended September 30, 2019, we reported net income of \$134.0 million compared to net income of \$178.0 million during the nine months ended September 30, 2018. Net income per basic and diluted share was \$0.55 for the nine months ended September 30, 2019 compared to net income per basic and diluted share of \$0.74 and \$0.73, respectively, for the nine months ended September 30, 2018.

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Oil, Natural Gas, and NGL Production and Revenues - For the nine months ended September 30, 2019, we recorded total oil, natural gas, and NGL revenues of \$486.2 million compared to \$455.3 million for the nine months ended September 30, 2018, an increase of \$30.9 million or 7%. The following table summarizes key production and revenue statistics:

	Nine Months Ended September 30,		Percentage Change
	2019	2018	
Production:			
Oil (MBbls)	7,632	5,802	32 %
Natural Gas (MMcf)	35,852	26,177	37 %
NGLs (MBbls)	3,253	2,780	17 %
MBOE	16,860	12,945	30 %
BOED	61,757	47,416	30 %
Revenues (in thousands):			
Oil	\$ 392,589	\$ 354,601	11 %
Natural Gas	64,795	48,139	35 %
NGLs	28,767	52,558	(45)%
	<u>\$ 486,151</u>	<u>\$ 455,298</u>	7 %
Average sales price:			
Oil	\$ 50.05	\$ 60.13	(17)%
Natural Gas	1.75	1.84	(5)%
NGLs	8.84	18.91	(53)%
BOE	\$ 28.08	\$ 34.73	(19)%

Net oil, natural gas, and NGL production for the nine months ended September 30, 2019 averaged 61,757 BOED, an increase of 30% over average production of 47,416 BOED in the nine months ended September 30, 2018. From September 30, 2018 to September 30, 2019, our well count increased by 83 net horizontal wells, growing our reserves and daily production totals. The effect of the 30% increase in production was partially offset by the 19% decrease in average sales prices.

LOE - Direct operating costs of producing oil and natural gas are reported as follows (in thousands):

	Nine Months Ended September 30,	
	2019	2018
Production costs	\$ 43,121	\$ 29,328
Workover	846	540
Total LOE	<u>\$ 43,967</u>	<u>\$ 29,868</u>
Per BOE:		
Production costs	\$ 2.56	\$ 2.27
Workover	0.05	0.04
Total LOE	<u>\$ 2.61</u>	<u>\$ 2.31</u>

Lease operating and workover costs tend to increase or decrease primarily in relation to the number and type of wells, to a lesser extent, on fluctuations in oil field service costs and changes in the production mix of oil and natural gas. During the nine months ended September 30, 2019, we experienced increased production expense per BOE compared to the nine months ended September 30, 2018 primarily due to an increase in net operated wells without a proportional increase in production volume due to current midstream capacity constraints.

Transportation and gathering - Transportation and gathering costs were \$12.7 million, or \$0.76 per BOE, for the nine months ended September 30, 2019, compared to \$5.7 million, or \$0.44 per BOE, for the nine months ended September 30, 2018. Coinciding with the increase in its production in 2019, the Company has increased the volume of its production that is sold and delivered at the downstream interconnect. This has the effect of increasing both the net price received for the production and

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transportation and gathering costs. While costs attributable to volumes sold at the interconnect of the pipeline are reported as an expense, the Company analyzes these charges on a net basis within revenue for comparability with wellhead sales.

Production taxes - Production taxes are comprised primarily of two elements: severance tax and ad valorem tax. During the three months ended March 31, 2019, the Company reduced its estimate for 2018 severance taxes. When preparing the 2018 severance tax return, we determined that the credit for ad valorem taxes would be greater than originally estimated, resulting in a reduction of 2018 severance taxes. Based on this analysis, the Company's prior year accrual was reduced, resulting in an approximate \$7.9 million reduction to our production taxes. Production taxes were \$31.1 million, or \$1.85 per BOE, for the nine months ended September 30, 2019, compared to \$41.3 million, or \$3.19 per BOE, for the nine months ended September 30, 2018. Taxes tend to increase or decrease primarily based on the value of production sold. As a percentage of revenues, production taxes were 6.4% and 9.1% for the nine months ended September 30, 2019 and 2018, respectively, with the 2019 period reflecting the effect of the change in estimate.

DD&A - The following table summarizes the components of DD&A:

(in thousands)	Nine Months Ended September 30,	
	2019	2018
Depletion of oil and gas properties	\$ 172,009	\$ 121,259
Depreciation and accretion	4,337	2,887
Total DD&A	\$ 176,346	\$ 124,146
DD&A expense per BOE	\$ 10.46	\$ 9.59

For the nine months ended September 30, 2019, DD&A was \$10.46 per BOE compared to \$9.59 per BOE for the nine months ended September 30, 2018. The increase in the DD&A rate was the result of recent drilling and completion activities which increased the amortization base. Capitalized costs of proved oil and gas properties are depleted quarterly using the units-of-production method based on estimated reserves, whereby the ratio of production volumes for the quarter to the beginning of the quarter estimated total reserves determines the depletion rate.

G&A - The following table summarizes G&A expenses incurred and capitalized during the periods presented:

(in thousands)	Nine Months Ended September 30,	
	2019	2018
Total Non-Cash G&A	\$ 12,038	\$ 11,193
Total Cash G&A	34,061	28,105
Capitalized G&A Costs	(10,716)	(9,607)
Total G&A Expense	\$ 35,383	\$ 29,691
Non-Cash G&A Expense	\$ 9,914	\$ 9,347
Cash G&A Expense	25,469	20,344
Total G&A Expense	\$ 35,383	\$ 29,691
Non-Cash G&A Expense per BOE	\$ 0.59	\$ 0.72
Cash G&A Expense per BOE	1.51	1.57
G&A Expense per BOE	\$ 2.10	\$ 2.29

G&A includes all overhead costs associated with employee compensation and benefits, insurance, facilities, professional fees and regulatory costs, among others. Total G&A costs of \$35.4 million for the nine months ended September 30, 2019 were 19% higher than G&A for the same period of 2018. Cash G&A for the nine months ended September 30, 2018 was elevated by expenses incurred in support of Colorado oil and gas legislative activities during the second and third quarters of 2018. In addition, the Company incurred \$8.0 million of transaction costs relating to the PDC Merger in the nine months ended September 30, 2019.

Our G&A expense for the nine months ended September 30, 2019 includes stock-based compensation of \$9.9 million compared to \$9.3 million for the nine months ended September 30, 2018.

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Pursuant to the requirements under the full cost accounting method for oil and gas properties, we identify all general and administrative costs that relate directly to the acquisition of undeveloped mineral leases and the exploration and development of properties. Those costs are reclassified from G&A expenses and capitalized into the full cost pool. The increase in capitalized costs from the nine months ended September 30, 2018 to the nine months ended September 30, 2019 reflects our increased headcount of individuals performing activities to maintain and acquire leases and develop our properties.

Commodity derivatives - As more fully described in Item 1. Financial Statements – Note 7, *Commodity Derivative Instruments*, we use commodity contracts to help mitigate the risks inherent in the price volatility of oil and natural gas. For the nine months ended September 30, 2019, we realized a settlement gain of \$12.7 million. For the prior comparable period, we realized a settlement loss of \$16.2 million, net of previously incurred premiums attributable to the settled commodity contracts.

In addition, for the nine months ended September 30, 2019, we recorded an unrealized loss of \$16.5 million to recognize the mark-to-market change in the fair value of our commodity contracts. In comparison, in the nine months ended September 30, 2018, we reported an unrealized loss of \$12.4 million. Unrealized losses are non-cash items.

Income taxes - We reported income tax expense of \$49.3 million for the nine months ended September 30, 2019 as compared to \$18.1 million of income tax expense for the comparable prior year period. The effective combined U.S. federal and state income tax rates for the nine months ended September 30, 2019 and 2018 were 27% and 9%, respectively. The effective tax rates for the nine months ended September 30, 2019 differed from the statutory rate primarily due to state income taxes, non-deductible expenses, and tax deficiencies recognized in connection with the vesting of stock awards. The effective tax rate for the nine months ended September 30, 2018 differed from the statutory rates due primarily to the release of valuation allowances previously recorded against deferred tax assets.

Liquidity and Capital Resources

Historically, our primary sources of capital have been net cash provided by cash flow from operations, the sale of equity and debt securities, borrowings under revolving credit facilities, and proceeds from the sale of properties. Our primary use of capital has been for the exploration, development, and acquisition of oil and gas properties. Our future success in growing proved reserves and production will be highly dependent on the capital resources available to us.

We believe that our current capital resources, including cash flows from operating activities, cash on hand, and amounts available under our revolving credit facility, will be sufficient to fund our planned capital expenditures and operating expenses. During the nine months ended September 30, 2019, our cash provided by operating activities of \$429.3 million exceeded the \$377.7 million spent on investing activities. To the extent actual operating results differ from our anticipated results, available borrowings under our credit facility are reduced, or we experience other unfavorable events, our liquidity could be adversely impacted. Our liquidity would also be affected if the PDC Merger is not completed or we increase our capital expenditures or complete one or more additional acquisitions. Terms of future financings may be unfavorable, and we cannot assure investors that funding will be available on acceptable terms.

As operator of the majority of our wells and undeveloped acreage, we control the timing and selection of new wells to be drilled. This allows us to modify our capital spending as our financial resources allow and market conditions, including midstream availability, support. Additionally, our relatively low utilization of debt enhances our financial flexibility as it provides a potential source of future liquidity while currently not overly burdening us with restrictive financial covenants and mandatory repayment schedules.

Sources and Uses

Our sources and uses of capital are heavily influenced by the prices that we receive for our production. Oil and gas markets will likely continue to be volatile in the future. To deal with the volatility in commodity prices, we maintain a flexible capital investment program and seek to maintain a high operating interest in our leaseholds with limited long-term capital commitments. This enables us to accelerate or decelerate our activities quickly in response to changing industry environments.

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At September 30, 2019, we had cash and cash equivalents of \$69.5 million, \$550.0 million outstanding on our 2025 Senior Notes, and a \$165.0 million balance outstanding under our revolving credit facility. Our sources and (uses) of funds for the nine months ended September 30, 2019 and 2018 are summarized below (in thousands):

	Nine Months Ended September 30,	
	2019	2018
Net cash provided by operations	\$ 429,305	\$ 343,554
Capital expenditures	(389,825)	(490,124)
Net cash provided by other investing activities	12,109	1,233
Net cash provided by (used in) equity financing activities	(1,167)	3,039
Net cash provided by (used in) debt financing activities	(30,535)	112,762
Net increase (decrease) in cash and cash equivalents	\$ 19,887	\$ (29,536)

Net cash provided by operating activities was \$429.3 million and \$343.6 million for the nine months ended September 30, 2019 and 2018, respectively. The increase in cash from operating activities reflects the growth in our production.

Credit Facility

The Revolver has a maturity date of April 2, 2023. The Revolver has a maximum loan commitment of \$1.5 billion; however, the maximum amount available to be borrowed at any one time is subject to a borrowing base limitation, which stipulates that we may borrow up to the least of the aggregate maximum credit amount, the aggregate elected commitment, or the borrowing base. The borrowing base can increase or decrease based upon the value of the collateral which secures amounts borrowed under the Revolver. The value of the collateral will generally be derived with reference to the estimated discounted future net cash flows from our proved oil and natural gas reserves. The collateral includes substantially all of our producing wells and developed oil and gas leases.

In April 2019, the borrowing base was increased from \$650 million to \$700 million, and our elected commitment amount was increased to \$550 million from \$500 million. As of September 30, 2019, there was a \$165.0 million principal balance outstanding and \$11.6 million letters of credit outstanding, leaving \$373.4 million available to us for future borrowings. On September 18, 2019, the lenders consented to a postponement of the redetermination scheduled for November 2019 to the earlier of (i) the termination of the PDC Merger Agreement and (ii) January 1, 2020, which is expected to be extended. Completion of the PDC Merger would give rise to an event of default under the terms of the Restated Credit Agreement. To avoid an event of default, PDC will need to obtain waivers or consents from the lenders under the Restated Credit Agreement, or the Revolver will need to be repaid in full and terminated in connection with the PDC Merger. Interest on the Revolver accrues at a variable rate. The interest rate pricing grid provides for an escalation in applicable margin based on increased utilization of the Revolver. The Revolver requires the Company to maintain compliance with certain financial and liquidity ratio covenants. In particular, the Company must not (a) permit its ratio of total funded debt to EBITDAX, as defined in the agreement, to be greater than or equal to 4.0 to 1.0 as of the last day of any fiscal quarter or (b) permit its ratio of current assets to current liabilities, each as defined in the agreement, to be less than 1.0 to 1.0 as of the last day of any fiscal quarter.

2025 Senior Notes

In November 2017, the Company issued \$550 million aggregate principal amount of 6.25% Senior Notes due 2025 (the "2025 Senior Notes") in a private placement to qualified institutional buyers. The maturity for the payment of principal is December 1, 2025. Interest on the 2025 Senior Notes accrues at 6.25%. Interest is payable on June 1 and December 1 of each year.

The 2025 Senior Notes were issued pursuant to an indenture dated as of November 29, 2017 (the "Indenture") and will be guaranteed on a senior unsecured basis by the Company's existing and future subsidiaries that incur or guarantee certain indebtedness, including indebtedness under the Revolver. The Indenture contains covenants that restrict the Company's ability and the ability of certain of its subsidiaries to, among other restrictions and limitations: (i) incur additional indebtedness; (ii) incur liens; (iii) pay dividends; (iv) consolidate, merge, or transfer all or substantially all of its or their assets; (v) engage in transactions with affiliates; or (vi) engage in certain restricted business activities. These covenants are subject to a number of exceptions and qualifications. If the PDC Merger is completed, PDC may be required to make a change of control offer to repurchase the 2025 Senior Notes from the holders at 101% of the principal amount of the 2025 Senior Notes, together with any accrued and unpaid interest to the date of purchase.

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Capital Expenditures

Capital expenditures for drilling and completion activities totaled \$290.1 million and \$408.3 million for the nine months ended September 30, 2019 and 2018, respectively. The following table summarizes our capital expenditures for oil and gas properties (in thousands):

	Nine Months Ended September 30,	
	2019	2018
Capital expenditures for drilling and completion activities	\$ 290,136	\$ 408,334
Acquisitions of oil and gas properties and leasehold ¹	4,805	162,081
Capitalized interest, capitalized G&A, and other	47,876	40,037
Accrual basis capital expenditures ²	\$ 342,817	\$ 610,452

¹ Acquisitions of oil and gas properties and leasehold reflects the full purchase price of the relevant acquisitions, including non-cash additions for liabilities assumed in the transaction such as asset retirement obligations.

² Capital expenditures reported in the condensed consolidated statement of cash flows are calculated on a cash basis, which differs from the accrual basis used to calculate the capital expenditures.

During the nine months ended September 30, 2019, we drilled 83 operated horizontal wells and turned 70 operated horizontal wells to sales. As of September 30, 2019, the Company had 18 gross (17 net) wells that were drilled and completed, but not producing. As of September 30, 2019, we are the operator of 78 gross (72 net) horizontal wells in progress. All of our drilling and completion activity was funded through cash flows from operations.

For the nine months ended September 30, 2019, we participated in 57 gross (6 net) non-operated horizontal wells.

Capital Requirements

Our level of exploration, development, and acreage expenditures is largely discretionary, and the amount of funds devoted to any particular activity may increase or decrease significantly depending on available opportunities, commodity prices, cash flows, development results, acquisitions and divestitures, and downstream infrastructure and commitments, among other factors. Our primary need for capital will be to fund our anticipated drilling and completion activities and any acquisitions that we may complete during 2019. For the near term, we believe that we have sufficient liquidity to fund our needs through cash on hand, cash flow from operations, and additional borrowings available under the Revolver.

Oil and Natural Gas Commodity Contracts

We use derivative contracts to help protect against the variability in cash flows created by short-term price fluctuations associated with the sale of future oil and natural gas production. At September 30, 2019, we had open positions covering 4.4 million barrels of oil and 5.5 Bcf of natural gas. We do not use derivative instruments for speculative purposes.

Our commodity derivative instruments may include but are not limited to “collars,” “swaps,” and “put” positions. Our derivative strategy, including the volumes and commodities covered and the relevant strike prices, is based in part on our view of expected future market conditions and our analysis of well-level economic return potential. In addition, our use of derivative contracts is subject to stipulations set forth in our credit facility.

During the nine months ended September 30, 2019, we reported an unrealized commodity activity loss of \$16.5 million. Unrealized losses are non-cash items. We also reported a realized gain of \$12.7 million, representing the settlement of commodity contracts during the period.

At September 30, 2019, we estimated that the fair value of our various commodity derivative contracts was a net asset of \$18.5 million. See Item 1. Financial Statements – Note 8, *Fair Value Measurements*, for a description of the methods we use to estimate the fair values of commodity derivative instruments.

Non-GAAP Financial Measure

In addition to financial measures presented on the basis of accounting principles generally accepted in the United States of America (“US GAAP”), we present certain financial measures which are not prescribed by US GAAP (“non-GAAP”). The following is a summary of the measure that we currently report.

[Table of Contents](#)**Adjusted EBITDA**

We use "adjusted EBITDA," a non-GAAP financial measure, for internal managerial purposes because it allows us to evaluate our operating performance and compare the results of our operations from period to period without regard to our financing methods or capital structure. We exclude the items listed in the table below from net income in arriving at adjusted EBITDA. We exclude those items because they can vary substantially from company to company within our industry depending upon accounting methods and book values of assets, capital structures, and the method by which the assets were acquired. Adjusted EBITDA is not a measure of financial performance under US GAAP and should be considered in addition to, not as a substitute for, net income. We believe that adjusted EBITDA is widely used in our industry as a measure of operating performance and may also be used by investors to measure our ability to meet debt covenant requirements. However, our definition of adjusted EBITDA may not be fully comparable to measures with similar titles reported by other companies. We define adjusted EBITDA as net income adjusted to exclude the impact of the items set forth in the table below (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
Adjusted EBITDA:				
Net income	\$ 29,795	\$ 62,628	\$ 134,014	\$ 178,048
Depreciation, depletion, and accretion	57,401	45,188	176,346	124,146
Stock-based compensation expense	3,089	3,405	9,914	9,347
Mark-to-market of commodity derivative contracts:				
Total (gain) loss on commodity derivatives contracts	(10,924)	8,529	3,704	28,604
Cash settlements on commodity derivative contracts	5,390	(7,142)	13,105	(13,263)
Cash premiums paid for commodity derivative contracts	(497)	—	(1,474)	—
Interest income	(76)	(23)	(237)	(37)
Income tax expense	13,041	8,918	49,312	18,076
Adjusted EBITDA	\$ 97,219	\$ 121,503	\$ 384,684	\$ 344,921

Critical Accounting Policies

We prepare our condensed consolidated financial statements and the accompanying notes in conformity with US GAAP, which requires management to make estimates and assumptions about future events that affect the reported amounts in the condensed consolidated financial statements and the accompanying notes. We identify certain accounting policies as critical based on, among other things, their impact on the portrayal of our financial condition, results of operations, or liquidity and the degree of difficulty, subjectivity, and complexity in their deployment. Critical accounting policies cover accounting matters that are inherently uncertain because the future resolution of such matters is unknown. Management discusses the development, selection, and disclosure of each of the critical accounting policies.

There have been no significant changes to our critical accounting policies and estimates or in the underlying accounting assumptions and estimates used from those disclosed in the "Management's Discussion and Analysis of Financial Condition and Results of Operations" section of the Annual Report on Form 10-K filed with the SEC on February 20, 2019 and in the financial statements and accompanying notes contained in that report. Item 1. Financial Statements – Note 1, *Organization and Summary of Significant Accounting Policies*, to the accompanying condensed consolidated financial statements included elsewhere in this report provides information regarding recently issued accounting pronouncements.

Cautionary Statement Concerning Forward-Looking Statements

This report contains "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. These statements are subject to risks and uncertainties and are based on the beliefs and assumptions of management and information currently available to management. The use of words such as "believes," "expects," "anticipates," "intends," "plans," "estimates," "should," "likely," or similar expressions indicate forward-looking statements. Forward-looking statements included in this report include statements relating to future capital expenditures and projects, the adequacy and nature of future sources of financing, midstream capacity issues and planned capacity expansion projects, future production (including production relative to volume commitments), covenant compliance, matters related to the pending merger transaction with PDC, and the implementation and effects of SB19-181 and our responses thereto.

The identification in this report of factors that may affect our future performance and the accuracy of forward-looking statements is meant to be illustrative and by no means exhaustive. All forward-looking statements should be evaluated with the understanding of their inherent uncertainty.

See "*Risk Factors*" in this report and in Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2018 filed with the SEC on February 20, 2019 for a discussion of risk factors that affect our business, financial condition, and results of operations. These risks include, among others, those associated with the following:

- declines in oil and natural gas prices;
- the effects of, changes in and the costs of compliance with federal, state, and local regulations applicable to our business, including those related to hydraulic stimulation and SB19-181;
- operating hazards that adversely affect our ability to conduct business;
- uncertainties in the estimates of proved reserves;
- the availability and capacity of gathering and processing systems, pipelines, and other midstream infrastructure for our production;
- the effect of seasonal weather conditions and wildlife and plant species restrictions on our operations;
- our ability to fund, develop, produce, and acquire additional oil and natural gas reserves that are economically recoverable;
- our ability to obtain adequate financing;
- the effect of local and regional factors on oil and natural gas prices;
- incurrence of ceiling test write-downs;
- our inability to control operations on properties that we do not operate;
- the strength and financial resources of our competitors;
- our ability to successfully identify, execute, and integrate acquisitions;
- our ability to market our production;
- the effect of environmental liabilities;
- changes in U.S. tax laws;
- our ability to satisfy our contractual obligations and commitments;
- the amount of our indebtedness and our ability to maintain compliance with debt covenants;
- the effectiveness of our disclosure controls and our internal controls over financial reporting;
- the geographic concentration of our principal properties;
- our ability to protect critical data and technology systems;
- the availability of water for use in our operations;
- the completion of the pending merger transaction with PDC, including the possibility that we may incur significant transaction and other costs in connection with the merger, risks related to disruption of ongoing business operations due to the merger, the outcome of litigation relating to the merger, and the risk the parties may not be able to satisfy the conditions to the completion of the merger in a timely matter or at all; and
- the risks and uncertainties described and referenced in "Risk Factors" in this report and other filings with the SEC.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISKS

Commodity Price Risk - Our financial condition, results of operations, and capital resources are highly dependent upon the prevailing market prices of oil and natural gas. The volatility of oil prices affects our results to a greater degree than the volatility of natural gas prices, as approximately 85% and 81% of our revenue during the three and nine months ended September 30, 2019, respectively, was from the sale of oil. A \$5 per barrel change in our realized oil price would have resulted in an \$11.1 million and \$38.2 million change in revenues during the three and nine months ended September 30, 2019, respectively; a \$0.25 per Mcf change in our realized natural gas price would have resulted in a \$3.1 million and \$9.0 million change in our natural gas revenues for the three and nine months ended September 30, 2019, respectively; and a \$5 per barrel change in our realized NGL price would have resulted in a \$5.4 million and \$16.3 million change in our NGL revenues for the three and nine months ended September 30, 2019, respectively.

During the three months ended September 30, 2019, the average prices for oil, natural gas and NGLs were lower than they were in the second quarter of 2019. These commodity prices are subject to wide fluctuations and market uncertainties due to a variety of factors that are beyond our control. Factors influencing oil, natural gas, and NGL prices include the levels of demand and supply for oil (in global or local markets), the establishment of and compliance with production quotas by oil exporting countries, weather conditions which influence the demand for natural gas, the price and availability of alternative fuels, the strength of the US dollar compared to other currencies, and overall economic conditions. It is impossible to predict future oil, natural gas, and NGLs prices with any degree of certainty. Sustained weakness in oil, natural gas, and NGL prices may adversely affect our financial condition and results of operations and may also reduce the amount of oil, natural gas, and NGL reserves that we can produce economically. Any reduction in our oil, natural gas, and NGL reserves, including reductions due to price fluctuations, can have an adverse effect on our ability to obtain capital for our exploration and development activities. Similarly, any improvements in oil, natural gas, and NGL prices can have a favorable impact on our financial condition, results of operations, and capital resources.

We attempt to mitigate fluctuations in short-term cash flow resulting from changes in commodity prices by entering into derivative positions on a portion of our expected oil and natural gas production. Under the Revolver, we can use derivative contracts to cover up to 85% of expected proved developed producing production as projected in our semi-annual reserve report, generally over a period of two years. We do not enter into derivative contracts for speculative or trading purposes. As of September 30, 2019, we had open oil and natural gas derivatives in a net asset position with a fair value of \$18.5 million. A hypothetical upward shift of 10% in the NYMEX forward curve of oil and natural gas prices would decrease the fair value of our position by \$19.6 million. A hypothetical downward shift of 10% in the NYMEX forward curve of oil and natural gas prices would increase the fair value of our position by \$20.2 million.

Interest Rate Risk - At September 30, 2019, we had \$165.0 million outstanding under our revolving credit facility. Interest on amounts borrowed under our credit facility accrues at a variable rate, based upon either the Prime Rate or LIBOR plus an applicable margin. During the three and nine months ended September 30, 2019, we incurred interest expense of \$1.8 million and \$6.1 million, respectively, on our revolving credit facility. When we have balances outstanding under the revolving credit facility, we are exposed to interest rate risk if the variable reference rates increase. If interest rates increase, our interest payments would increase, and our available cash flow would decrease. We estimate that if market interest rates increased or decreased by 1%, our interest expense in the three and nine months ended September 30, 2019 would have changed by approximately \$0.4 million and \$1.4 million, respectively.

Under current market conditions, we do not anticipate significant changes in prevailing interest rates for the next year, and we have not undertaken any activities to mitigate potential interest rate risk due to restrictions imposed by the Revolver.

Counterparty Risk - As described in "Commodity Price Risk" above, we enter into commodity derivative agreements to mitigate short-term price volatility. These derivative financial instruments present certain counterparty risks. We are exposed to potential loss if a counterparty fails to perform according to the terms of the agreement. The failure of any of the counterparties to fulfill their obligations to us could adversely affect our results of operations and cash flows. We do not require collateral or other security to be furnished by counterparties. We seek to manage the counterparty risk associated with these contracts by limiting transactions to well-capitalized, well-established, and well-known counterparties that have been approved by our senior officers. There can be no assurance, however, that our practice effectively mitigates counterparty risk.

We believe that our exposure to counterparty risk increased slightly during the third quarter of 2019 as the amounts due to us from counterparties increased.

**ITEM 4. CONTROLS AND
PROCEDURES**

Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act") as of the end of the period covered by this report on Form 10-Q (the "Evaluation Date"). Based on such evaluation, our Chief Executive Officer and Chief Financial Officer concluded that, as of the Evaluation Date, our disclosure controls and procedures were effective.

Changes in Internal Control over Financial Reporting

There have been no changes in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the most recently completed fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II

Item 1. Legal Proceedings

During the quarter ended September 30, 2019, there were no material developments regarding the legal matters, previously described under Item 3, *Legal Proceedings*, of the Annual Report on Form 10-K filed with the Securities and Exchange Commission on February 20, 2019. This information should be considered carefully together with other information in this report and other reports and materials we file with the SEC. We are subject to various legal proceedings from time to time in the ordinary course of our business, but there are currently no pending legal proceedings to which we are subject that we believe to be material to the Company other than as described below. However, the valuation of pending claims and prediction of litigation results in inherently uncertain.

On October 4, 2019 and October 11, 2019, purported shareholders of SRC filed putative class action lawsuits against the members of the SRC board, SRC, and PDC in Colorado District Court in Arapahoe County and Denver County, captioned *Robert Garfield v. Lynn A. Peterson, et al.*, Case No. 2019CV32360 and *George Korol v. SRC Energy Inc., et al.*, Case No. 2019CV33933. The plaintiffs in these complaints generally claim that (i) SRC and the members of the SRC board breached their fiduciary duties to SRC shareholders by authorizing the PDC Merger for what the plaintiffs assert is inadequate consideration and pursuant to an unfair process and with inadequate disclosures and (ii) PDC aided and abetted the other defendants' alleged breach of duties. The plaintiffs seek, among other things, to rescind the transaction or obtain rescissory damages if the PDC Merger is consummated, to recover other unspecified damages, including recover attorneys' fees and costs, and to obtain injunctive relief.

On October 8, 2019 and October 11, 2019, purported shareholders of SRC filed putative class action lawsuits against SRC, the members of the SRC board, and PDC in the United States District Court, District of Delaware, captioned *Patrick Plumley v. SRC Energy Inc., et al.*, Case No. 1:19-cv-01912 and *Juan Aguirre v. SRC Energy Inc., et al.*, Case No. 1:19-mc-01934. The plaintiffs in these complaints generally claim that the defendants disseminated a false or misleading registration statement regarding the proposed merger in violation of Section 14(a) and Section 20(a) of the Exchange Act and/or Rule 14a-9 promulgated under the Exchange Act. The plaintiffs seek, among other things, injunctive relief to prevent consummation of the PDC Merger until the alleged disclosure violations are cured, damages in the event the PDC Merger is consummated, and an award of attorney's fees.

Although the Company believes these actions are without merit, it is not possible at this time to predict the outcome of these matters.

Item 1A. Risk Factors

We face many risks. Factors that could materially adversely affect our business, financial condition, operating results or liquidity and the trading price of our common stock are described under Item 1A, Risk Factors, of the Annual Report on Form 10-K filed with the SEC on February 20, 2019. Except as described in the preceding sentence, including the following additional risk factors, there have been no material changes in our risk factors from those described in our Annual Report on Form 10-K. This information should be considered carefully together with other information in this report and other reports and materials that we file with the SEC.

Because the exchange ratio is fixed and because the market price of PDC common stock will fluctuate, SRC shareholders cannot be certain of the precise value of the Merger Consideration they will receive in the PDC Merger.

If the PDC Merger is completed, at the effective time of the Merger, each issued and outstanding eligible share of SRC common stock will be converted into the right to receive the Merger Consideration. The exchange ratio for the Merger Consideration is fixed at 0.158 of a share of PDC common stock for each share of SRC common stock, and there will be no adjustment to the Merger Consideration for changes in the market price of PDC common stock or SRC common stock prior to the completion of the PDC Merger. The actual value of any Merger Consideration received by SRC shareholders at the completion of the PDC Merger will depend on the market value of the shares of PDC common stock at that time.

The PDC Merger may not be completed and the PDC Merger Agreement may be terminated in accordance with its terms. Failure to complete the PDC Merger could negatively impact the price of shares of SRC common stock as well as SRC's future business and financial results.

The PDC Merger is subject to a number of conditions that must be satisfied, including the approval by PDC stockholders of the PDC Merger Agreement and the issuance of PDC shares in connection with the PDC Merger and approval by SRC shareholders of the PDC Merger Agreement, in each case prior to the completion of the PDC Merger. These conditions to the completion of the PDC Merger, some of which are beyond the control of PDC and SRC, may not be satisfied (or, where permitted,

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waived) in a timely manner or at all, and, accordingly, the PDC Merger may be delayed or may not be completed. The PDC Merger Agreement may also be terminated under certain circumstances. If the transactions contemplated by the PDC Merger Agreement are not completed for any reason, SRC's ongoing business and financial results may be adversely affected. In addition, if the PDC Merger Agreement is terminated and SRC's board of directors seeks another merger or business combination, SRC may not be able to find a party willing to offer equivalent or more attractive consideration than the consideration PDC has agreed to provide in the PDC Merger.

Current SRC shareholders will have a reduced ownership and voting interest in PDC after the PDC Merger compared to their current ownership in SRC on a standalone basis and will exercise less influence over management.

Currently, SRC shareholders have the right to vote in the election of the SRC board of directors and on other matters requiring shareholder approval under Colorado law and the SRC certificate of incorporation and bylaws. As a result of the PDC Merger, current SRC shareholders will own a smaller percentage of the combined company than they currently own of SRC, and as a result will have less influence on the management and policies of the combined company after the merger than they now have on the management and policies of SRC.

SRC will be subject to business uncertainties while the PDC Merger is pending, which could adversely affect our business.

In connection with the pendency of the PDC Merger, it is possible that certain persons with whom SRC has a business relationship may delay or defer certain business decisions or might decide to seek to terminate, change or renegotiate their relationships with SRC as a result of the PDC Merger, which could negatively affect our revenues, earnings and cash flows, as well as the market price of our common stock, regardless of whether the PDC Merger is completed.

Under the terms of the PDC Merger Agreement, we are subject to certain restrictions on the conduct of our business prior to the closing of the PDC Merger, which may adversely affect our ability to execute certain of our business strategies. Restrictions on us include, among other things, the ability to issue capital stock, modify or enter into material contracts in certain cases, acquire or dispose of assets, hire or terminate certain key employees, incur indebtedness, incur encumbrances or incur capital expenditures.

The PDC Merger Agreement contains provisions that limit our ability to pursue alternatives to the PDC Merger, could discourage a potential competing acquiror from making a favorable alternative transaction proposal and, in specified circumstances, could require us to pay a termination fee to PDC.

The PDC Merger Agreement contains certain provisions that restrict our ability to initiate, solicit or knowingly encourage or knowingly facilitate any inquiries, proposals, or offers regarding, or the making of a competing proposal, engage in any discussions or negotiations with respect to a competing proposal or furnish any non-public information or access to our assets to any person in connection with a competing proposal, or enter into any letter of intent or agreement in principle concerning a competing proposal. In some circumstances, upon termination of the PDC Merger Agreement, we will be required to pay a termination fee of \$35 million to PDC. These and other provisions of the PDC Merger Agreement could discourage a potential third-party acquiror or merger partner that might have an interest in acquiring all or a significant portion of SRC or pursuing an alternative transaction with us from considering or proposing such a transaction. In particular, the provisions could discourage a potential third-party acquiror or merger partner that was prepared to pay consideration with a higher per share price than the per share price proposed to be received in the PDC Merger, or might result in a potential third-party acquiror or merger partner proposing to pay a lower per share price than it might otherwise have proposed to pay because of the added expense of the termination fee that is payable in certain circumstances.

Uncertainties associated with the PDC Merger may cause a loss of management personnel and other key employees, which could adversely affect the future business and operations of SRC or the combined company.

Whether or not the PDC Merger is completed, the announcement and pendency of the PDC Merger could disrupt the businesses of SRC. We are dependent on the experience and industry knowledge of our senior management and other key employees to execute our business plans. Current and prospective employees of SRC may experience uncertainty about their roles in the combined company following the PDC Merger, which may have an adverse effect on our current ability to attract or retain key management and other key personnel regardless of whether the PDC Merger is completed.

Investigations regarding the PDC Merger have resulted in lawsuits against the SRC board, SRC, and PDC and other lawsuits may be filed against SRC, PDC and/or their respective boards challenging the PDC Merger. An adverse ruling in any such lawsuit may prevent the PDC Merger from being completed.

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Following the public announcement of the PDC Merger, investigations were launched by several law firms regarding whether (i) the SRC board failed to satisfy its duties to its shareholders, including whether the board adequately pursued alternatives to the acquisition and whether the board obtained the best price possible for SRC shares of common stock, (ii) PDC aided and abetted the alleged breach of fiduciary duties, and (iii) the disclosures by SRC, the SRC board, and PDC in the joint proxy statement/prospectus concerning the PDC Merger are adequate. In addition to the currently pending complaints, there is a possibility that one or more of these investigations could result in further lawsuits against the SRC board, SRC, and PDC seeking, among other things injunctive relief, including a request to enjoin the merger, and damages.

Lawsuits have been filed against SRC, the directors of SRC and PDC regarding the PDC Merger, which could result in substantial costs and may delay or prevent the PDC Merger from being completed.

As discussed in “Legal Proceedings” above, several lawsuits have been filed against SRC, its directors, and PDC regarding the PDC Merger. Even if the lawsuits are without merit, as the defendants believe these lawsuits to be, defending against these claims can result in substantial costs and divert management time and resources. An adverse judgment could result in monetary damages, which could have a negative impact on PDC's and SRC's respective liquidity and financial condition. The plaintiffs in the state law complaints seek, among other things, to rescind the transaction or obtain rescissory damages if the merger is consummated, to recover other unspecified damages, including recover attorneys' fees and costs, and to obtain injunctive relief. The plaintiffs in the federal law complaints seek, among other things, injunctive relief to prevent consummation of the merger until the alleged disclosure violations are cured, damages in the event the merger is consummated, and an award of attorney's fees. Any other lawsuit that may be filed in the future could also seek, among other things, injunctive relief or other equitable relief, including a request to rescind parts of the merger agreement already implemented and to otherwise enjoin the parties from consummating the merger. If a plaintiff is successful in obtaining an injunction prohibiting completion of the merger, then that injunction may delay or prevent the merger from being completed, which may adversely affect PDC's and SRC's respective business, financial position and results of operation.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Purchases of equity securities by the Company

<u>Period</u>	<u>Total Number of Shares Purchased</u>	<u>Average Price Paid per Share</u>
July 1, 2019 - July 31, 2019 ⁽¹⁾	—	\$ —
August 1, 2019 - August 31, 2019 ⁽¹⁾	6,597	4.15
September 1, 2019 - September 30, 2019 ⁽¹⁾	2,898	\$ 5.02
Total	9,495	

(1) Pursuant to statutory minimum withholding requirements, certain of our employees exercised their right to "withhold to cover" as a tax payment method for the vesting and exercise of certain shares. These elections were outside of any publicly announced repurchase plan.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

None.

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Item 6. Exhibits

Exhibit Number	Exhibit
2.1	Agreement and Plan of Merger, dated as of August 25, 2019, by and between PDC Energy, Inc. and SRC Energy Inc. (the "Company") (incorporated by reference to Exhibit 2.1 to the Current Report on Form 8-K of the Company filed on August 26, 2019) †
31.1	Certification of the Principal Executive Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act of 1934, as adopted, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 *
31.2	Certification of the Principal Financial Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act of 1934, as adopted, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 *
32.1	Certifications of the Principal Executive Officer and Principal Financial Officer pursuant to 18 USC 1350, as adopted, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 **
101.INS	XBRL Instance Document - the instance document does not appear in the Interactive Data File because its XBRL tags are embedded within the Inline XBRL document.
101.SCH	XBRL Taxonomy Extension Schema
101.CAL	XBRL Taxonomy Extension Calculation Linkbase
101.DEF	XBRL Taxonomy Extension Definition Linkbase
101.LAB	XBRL Taxonomy Extension Label Linkbase
101.PRE	XBRL Taxonomy Extension Presentation Linkbase
104	Cover Page Interactive Data File (embedded within the Inline XBRL document)

* Filed herewith

** Furnished herewith

† Schedules have been omitted pursuant to Item 601(a)(5) of Regulation S-K. The registrant hereby undertakes to furnish supplementally copies of any of the omitted schedules upon request by the Securities and Exchange Commission.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(a) of the Securities Exchange Act of 1934, the Registrant has duly caused this Report to be signed on its behalf by the undersigned, thereunto duly authorized on the 6th day of November, 2019.

SRC Energy Inc.

/s/ Lynn A. Peterson

Lynn A. Peterson, President and Chief Executive Officer
(Principal Executive Officer)

/s/ James P. Henderson

James P. Henderson, Executive Vice President and Chief Financial Officer
(Principal Financial Officer)

/s/ Jared C. Grenzenbach

Jared C. Grenzenbach, Vice President and Chief Accounting Officer
(Principal Accounting Officer)

CERTIFICATION OF PRINCIPAL EXECUTIVE OFFICER
PURSUANT TO 15 U.S.C. SECTION 7241, AS
ADOPTED PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Lynn A. Peterson, certify that;

1. I have reviewed this quarterly report on Form 10-Q of SRC Energy Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by the report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

November 6, 2019

/s/ Lynn A. Peterson

Lynn A. Peterson

Principal Executive Officer

CERTIFICATION OF PRINCIPAL FINANCIAL OFFICER
PURSUANT TO 15 U.S.C. SECTION 7241, AS
ADOPTED PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, James P. Henderson, certify that;

1. I have reviewed this quarterly report on Form 10-Q of SRC Energy Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by the report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

November 6, 2019

/s/ James P. Henderson
James P. Henderson,
Principal Financial Officer

CERTIFICATIONS OF
PRINCIPAL EXECUTIVE AND FINANCIAL OFFICERS
PURSUANT TO 18 U.S.C. SECTION 1350, AS
ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the quarterly report of SRC Energy Inc., (the "Company") on Form 10-Q for the quarter ended September 30, 2019 as filed with the Securities Exchange Commission on the date hereof (the "Report") Lynn A. Peterson, Principal Executive Officer of the Company, and James P. Henderson, Principal Financial Officer of the Company, certify pursuant to 18 U.S.C. Sec. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to the best of their knowledge:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operation of the Company.

Date: November 6, 2019

By: /s/ Lynn A. Peterson
Lynn A. Peterson, Principal Executive Officer

Date: November 6, 2019

By: /s/ James P. Henderson
James P. Henderson, Principal Financial Officer