Parsley Energy, Inc.
Form 10-Q
May 06, 2016

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 31, 2016

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: 001-36463

PARSLEY ENERGY, INC.

(Exact name of registrant as specified in its charter)

Delaware	46-4314192
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
	78701

303 Colorado Street, Suite 3000

Austin, Texas
(Address of principal executive offices) (Zip Code)

(737) 704-2300

(Registrant's telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

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

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

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

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

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

As of May 6, 2016, the registrant had 157,613,283 shares of Class A common stock and 32,145,296 shares of Class B common stock outstanding.

PARSLEY ENERGY, INC.

FORM 10-Q

QUARTERLY PERIOD ENDED MARCH 31, 2016

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CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q (the "Quarterly Report") includes "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended (the "Securities Act") and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). All statements, other than statements of historical fact included in this Quarterly Report, regarding our strategy, future operations, financial position, estimated revenues and losses, projected costs, prospects, plans and objectives of management are forward-looking statements. When used in this Quarterly Report, the words "could," "believe," "anticipate," "intend," "estimate," "expect," "project" and similar expressi intended to identify forward-looking statements, although not all forward-looking statements contain such identifying words. These forward-looking statements are based on our current expectations and assumptions about future events and are based on currently available information as to the outcome and timing of future events. When considering forward-looking statements, you should keep in mind the risk factors and other cautionary statements described under, but not limited to, the heading "Item 1A. Risk Factors" and elsewhere in our Annual Report on Form 10-K for the year ended December 31, 2015 (the "Annual Report") and other filings with the United States Securities and Exchange Commission ("SEC"). These forward-looking statements are based on management's current belief, based on currently available information, as to the outcome and timing of future events.

Forward-looking statements may include statements about our:

- business strategy;
- reserves;
- exploration and development drilling prospects, inventories, projects and programs;
- ability to replace the reserves we produce through drilling and property acquisitions;
- financial strategy, liquidity and capital required for our development program;
- realized oil, natural gas and natural gas liquids (NGLs) prices;
- timing and amount of future production of oil, natural gas and NGLs;
- hedging strategy and results;
- future drilling plans;
- competition and government regulations;
- ability to obtain permits and governmental approvals;
- pending legal or environmental matters;
- marketing of oil, natural gas and NGLs;
- leasehold or business acquisitions;
- costs of developing our properties;
- general economic conditions;
- credit markets;
- uncertainty regarding our future operating results; and
- plans, objectives, expectations and intentions contained in this Quarterly Report that are not historical.

All forward-looking statements speak only as of the date of this Quarterly Report. You should not place undue reliance on these forward-looking statements. These forward-looking statements are subject to a number of risks, uncertainties and assumptions. Moreover, we operate in a very competitive and rapidly changing environment. New risks emerge from time to time. It is not possible for our management to predict all risks, nor can we assess the impact of all factors on our business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements we may make. Although we believe that our plans, intentions and expectations reflected in or suggested by the forward-looking statements we make in this Quarterly Report are reasonable, we can give no assurance that these plans, intentions or expectations will be achieved or occur, and actual results could differ materially and adversely from those anticipated or implied in the forward-looking statements.

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GLOSSARY OF CERTAIN TERMS AND CONVENTIONS USED HEREIN

The terms defined in this section are used throughout this Quarterly Report:

(1) Bbl. One stock tank barrel, of 42 U.S. gallons liquid volume, used in reference to crude oil, condensate or natural gas liquids.
(2) Boe. One barrel of oil equivalent, with 6,000 cubic feet of natural gas being equivalent to one barrel of oil.
(3) Boe/d. One barrel of oil equivalent per day.
(4) British thermal unit or Btu. The heat required to raise the temperature of a one-pound mass of water from 58.5 to 59.5 degrees Fahrenheit.
(5) Completion. The process of treating a drilled well followed by the installation of permanent equipment for the production of oil or natural gas, or in the case of a dry hole, the reporting of abandonment to the appropriate agency.
(6) Condensate. A mixture of hydrocarbons that exists in the gaseous phase at original reservoir temperature and pressure, but that, when produced, is in the liquid phase at surface pressure and temperature.
(7) Dry hole. A well found to be incapable of producing hydrocarbons in sufficient quantities such that proceeds from the sale of such production exceed production expenses and taxes.
(8) Exploitation. A development or other project which may target proven or unproven reserves (such as probable or possible reserves), but which generally has a lower risk than that associated with exploration projects.
(9) Exploration costs. Costs incurred in identifying areas that may warrant examination and in examining specific areas that are considered to have prospects of containing oil and gas reserves, including costs of drilling exploratory wells and exploratory-type stratigraphic test wells. Exploration costs may be incurred both before acquiring the related property and after acquiring the property. Principal types of exploration costs, which include depreciation and applicable operating costs of support equipment and facilities and other costs of exploration activities, are:
   (i) Costs of topographical, geographical and geophysical studies, rights of access to properties to conduct those studies, and salaries and other expenses of geologists, geophysical crews, and others conducting those studies. Collectively, these are referred to as geological and geophysical or G&G costs.
   (ii) Costs of carrying and retaining undeveloped properties, such as delay rentals, ad valorem taxes on properties, legal costs for title deference, and the maintenance of land and lease records.
   (iii) Dry hole contributions and bottom hole contributions.
   (iv) Costs of drilling and equipping exploratory wells.
   (v) Costs of drilling exploratory-type stratigraphic test wells.
   (vi) Idle drilling rig fees which are not chargeable to joint operations.
(10) Exploratory well. A well drilled to find a new field or to find a new reservoir in a field previously found to be productive of oil or natural gas in another reservoir.
(11) Field. An area consisting of a single reservoir or multiple reservoirs all grouped on or related to the same individual geological structural feature and/or stratigraphic condition. The field name refers to the surface area, although it may refer to both the surface and the underground productive formations. For a complete definition of field, refer to the SEC’s Regulation S-X, Rule 4-10(a)(15).
(12) Formation. A layer of rock which has distinct characteristics that differ from nearby rock.
(13) GAAP. Accounting principles generally accepted in the United States.
(14) Gross acres or gross wells. The total acres or wells, as the case may be, in which an entity owns a working interest.
(15) Horizontal drilling. A drilling technique where a well is drilled vertically to a certain depth and then drilled laterally within a specified target zone.
(16) Lease operating expense. All direct and allocated indirect costs of lifting hydrocarbons from a producing formation to the surface constituting part of the current operating expenses of a working interest. Such costs include labor, superintendence, supplies, repairs, maintenance, allocated overhead charges, workover, insurance

and other expenses incidental to production, but exclude lease acquisition or drilling or completion expenses.

(17) LIBOR. London Interbank Offered Rate.

(18) MBbl. One thousand barrels of crude oil, condensate or NGLs.

(19) MBoe. One thousand barrels of oil equivalent.

(20) Mcf. One thousand cubic feet of natural gas.

(21) MMBtu. One million British thermal units.
(22) MMcf. One million cubic feet of natural gas.
(23) Natural gas liquids or NGLs. The combination of ethane, propane, butane, isobutane and natural gasolines that when removed from natural gas become liquid under various levels of higher pressure and lower temperature.
(24) Net acres or net wells. The percentage of total acres or wells, as the case may be, an owner has out of a particular number of gross acres or wells. For example, an owner who has 50% interest in 100 gross acres owns 50 net acres.
(25) NYMEX. The New York Mercantile Exchange.
(26) Operator. The entity responsible for the exploration, development and production of a well or lease.
(27) PE Units. The single class of units in which all of the membership interests (including outstanding incentive units) in Parsley Energy, LLC were converted to in connection with our initial public offering.
(28) Proved developed reserves. Proved reserves that can be expected to be recovered:
(i) Through existing wells with existing equipment and operating methods or in which the cost of the required equipment is relatively minor compared with the cost of a new well; or
(ii) Through installed extraction equipment and infrastructure operational at the time of the reserves estimate if the extraction is by means not involving a well.
(29) Proved reserves. Those quantities of oil and natural gas, which, by analysis of geoscience and engineering data, can be estimated with reasonable certainty to be economically producible—from a given date forward, from known reservoirs, and under existing economic conditions, operating methods, and government regulations—prior to the time at which contracts providing the right to operate expire, unless evidence indicates that renewal is reasonably certain, regardless of whether deterministic or probabilistic methods are used for the estimation. The project to extract the hydrocarbons must have commenced, or the operator must be reasonably certain that it will commence, the project within a reasonable time. For a complete definition of proved oil and natural gas reserves, refer to the SEC's Regulation S-X, Rule 4-10(a)(22).
(30) Proved undeveloped reserves or PUDs. Proved reserves that are expected to be recovered from new wells on undrilled acreage, or from existing wells where a relatively major expenditure is required for recompletion.
Reserves on undrilled acreage shall be limited to those directly offsetting development spacing areas that are reasonably certain of production when drilled, unless evidence using reliable technology exists that establishes reasonable certainty of economic producibility at greater distances.

Undrilled locations can be classified as having undeveloped reserves only if a development plan has been adopted indicating that they are scheduled to be drilled within five years, unless the specific circumstances justify a longer time.

Under no circumstances shall estimates for proved undeveloped reserves be attributable to any acreage for which an application of fluid injection or other improved recovery technique is contemplated, unless such techniques have been proved effective by actual projects in the same reservoir or an analogous reservoir, or by other evidence using reliable technology establishing reasonable certainty.

(31) Reasonable certainty. A high degree of confidence. For a complete definition of reasonable certainty, refer to the SEC's Regulation S-X, Rule 4-10(a)(24).
(32) Recompletion. The process of re-entering an existing wellbore that is either producing or not producing and completing new reservoirs in an attempt to establish or increase existing production.
(33) Reliable technology. A grouping of one or more technologies (including computational methods) that have been field tested and have been demonstrated to provide reasonably certain results with consistency and repeatability in the formation being evaluated or in an analogous formation.
(34) Reserves. Estimated remaining quantities of oil and natural gas and related substances anticipated to be economically producible, as of a given date, by application of development prospects to known accumulations. In addition, there must exist, or there must be a reasonable expectation that there will exist, the legal right to produce

or a revenue interest in the production, installed means of delivering oil and natural gas or related substances to market and all permits and financing required to implement the project.

(35) Reservoir. A porous and permeable underground formation containing a natural accumulation of producible hydrocarbons that is confined by impermeable rock or water barriers and is separate from other reservoirs.

(36) SEC. The United States Securities and Exchange Commission.

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

(38) Undeveloped acreage. Lease acreage on which wells have not been drilled or completed to a point that would permit the production of economic quantities of oil or natural gas regardless of whether such acreage contains proved reserves.

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

(40) Working interest. The right granted to the lessee of a property to explore for and to produce and own oil, natural gas or other minerals. The working interest owners bear the exploration, development and operating costs on either a cash, penalty or carried basis.

(41) Workover. Operations on a producing well to restore or increase production.

(42) WTI. West Texas Intermediate crude oil, which is a light, sweet crude oil, characterized by an American Petroleum Institute gravity, or API gravity, between 39 and 41 and a sulfur content of approximately 0.4 weight percent that is used as a benchmark for other crude oils.

PART 1: FINANCIAL INFORMATION

Item 1: Financial Statements

PARSLEY ENERGY, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)

	March 31, 2016	December 31, 2015
	(In thousands)	
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$28,310	$343,084
Restricted cash	1,607	1,139
Accounts receivable:		
Joint interest owners and other	24,755	14,998
Oil and gas	26,195	21,219
Related parties	1,247	390
Short-term derivative instruments, net	72,081	83,262
Other current assets	18,346	24,234
Total current assets	172,541	488,326
PROPERTY, PLANT AND EQUIPMENT		
Oil and natural gas properties, successful efforts method	2,566,038	2,246,161
Accumulated depreciation, depletion and impairment	(338,199)	(290,186)
Total oil and natural gas properties, net	2,227,839	1,955,975
Other property, plant and equipment, net	31,413	29,778
Total property, plant, and equipment, net	2,259,252	1,985,753
NONCURRENT ASSETS		
Long-term derivative instruments, net	20,119	25,839
Other noncurrent assets	4,622	5,182
Total noncurrent assets	24,741	31,021
TOTAL ASSETS	$2,456,534	$2,505,100
LIABILITIES AND EQUITY		
CURRENT LIABILITIES		
Accounts payable and accrued expenses	$142,856	$151,221
Revenue and severance taxes payable	35,584	37,109
Current portion of long-term debt	997	951
Short-term derivative instruments, net	30,610	34,518
Current portion of asset retirement obligations	4,986	4,698
Total current liabilities	215,033	228,497
NONCURRENT LIABILITIES		
Long-term debt	546,817	546,832
Asset retirement obligations	14,079	13,522

Deferred tax liability	53,335	62,962
Payable pursuant to tax receivable agreement	51,504	51,504
Long-term derivative instruments, net	11,981	15,142
Total noncurrent liabilities	677,716	689,962
COMMITMENTS AND CONTINGENCIES		
STOCKHOLDERS' EQUITY		
Preferred stock, $0.01 par value, 50,000,000 shares authorized, none issued and outstanding	—	—
Common stock		
Class A, $0.01 par value, 600,000,000 shares authorized, 136,732,438 shares issued and 136,625,783 shares outstanding at March 31, 2016 and 136,728,906 shares issued and 136,623,407 shares outstanding at December 31, 2015	1,360	1,360
Class B, $0.01 par value, 125,000,000 shares authorized, 32,145,296 issued and outstanding at March 31, 2016 and December 31, 2015	321	321
Additional paid in capital	1,254,809	1,252,020
(Accumulated deficit) retained earnings	(8,427)	10,868
Treasury stock, at cost, 106,655 shares and 105,421 at March 31, 2016 and December 31, 2015	(96)	(77)
Total stockholders' equity	1,247,967	1,264,492
Noncontrolling interest	315,818	322,149
Total equity	1,563,785	1,586,641
TOTAL LIABILITIES AND EQUITY	$2,456,534	$2,505,100

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

PARSLEY ENERGY, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

	Three Months Ended March 31,	
	2016	2015
	(In thousands, except per share data)	
REVENUES		
Oil sales	$52,031	$43,688
Natural gas sales	5,543	6,956
Natural gas liquids sales	4,694	4,567
Total revenues	62,268	55,211
OPERATING EXPENSES		
Lease operating expenses	13,898	16,398
Production and ad valorem taxes	4,195	4,495
Depreciation, depletion and amortization	49,384	37,381
General and administrative expenses (including stock-based compensation of $2,759 and $1,641 for the three months ended March 31, 2016 and 2015)	19,299	12,981
Exploration costs	688	3,219
Accretion of asset retirement obligations	170	249
Rig termination costs	—	5,100
Other operating expenses	896	—
Total operating expenses	88,530	79,823
OPERATING LOSS	(26,262)	(24,612)
OTHER INCOME (EXPENSE)		
Interest expense, net	(11,289)	(11,841)
Gain on sale of property	350	—
Derivative income	2,088	7,142
Other income (expense)	(146)	279
Total other income (expense), net	(8,997)	(4,420)
LOSS BEFORE INCOME TAXES	(35,259)	(29,032)
INCOME TAX BENEFIT	9,568	5,474
NET LOSS	(25,691)	(23,558)
LESS: NET LOSS ATTRIBUTABLE TO NONCONTROLLING INTERESTS	6,337	6,534
NET LOSS ATTRIBUTABLE TO PARSLEY ENERGY, INC. STOCKHOLDERS	$(19,354)	$(17,024)

Net loss per common share:		
Basic	$(0.14)	$(0.17)
Diluted	$(0.14)	$(0.17)
Weighted average common shares outstanding:		
Basic	135,963	101,273
Diluted	135,963	101,273

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

PARSLEY ENERGY, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

(Unaudited)

	Issued Shares						Shares				
(In thousands)	Class A Common Stock	Class B Common Stock	Class A Common Stock	Class B Common Stock	Additional paid in capital	(Accumulated deficit) retained earnings	Treasury stock	Treasury stock	Total stockholders' equity	Noncontrolling interest	Total equity
Balance at December 31, 2015	136,729	32,145	$1,360	$321	$1,252,020	$10,868	105	$(77)	$1,264,492	$322,149	$1,586,641
Adoption of ASU 2016-09	—	—	—	—	—	59	—	—	59	—	59
Restated balance	136,729	32,145	1,360	321	1,252,020	10,927	105	(77)	1,264,551	322,149	1,586,700
Issuance costs, net of underwriters discount and expenses	—	—	—	—	36	—	—	—	36	—	36
Change in equity due to issuance of PE Units by Parsley LLC	—	—	—	—	(6)	—	—	—	(6)	6	—
Vesting of restricted stock unit	4	—	—	—	—	—	—	—	—	—	—
Repurchase of	(1)	—	—	—	—	—	1	(19)	(19)	—	(19)

restricted stock											
Stock-based compensation	—	—	—	—	2,759	—	—	—	2,759	—	2,759
Net loss	—	—	—	—	—	(19,354)	—	—	(19,354)	(6,337)	(25,691)
Balance at March 31, 2016	136,732	32,145	$1,360	$321	$1,254,809	$(8,427)	106	$(96)	$1,247,967	$315,818	$1,563,785

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

PARSLEY ENERGY, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	Three Months Ended March 31, 2016	2015
	(In thousands)	
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	$(25,691)	$(23,558)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation, depletion and amortization	49,384	37,381
Exploration costs	82	1,716
Accretion of asset retirement obligations	170	249
Amortization and write off of deferred loan origination costs	588	1,108
Amortization of bond premium	(191)	(191)
Deferred income tax benefit	(9,568)	(5,474)
Stock-based compensation	2,759	1,641
Derivative income	(2,088)	(7,142)
Net cash received for derivative settlements	21,988	13,196
Net cash (paid) received for option premiums	(488)	17,398
Net premiums received (paid) on options that settled during the period	10,414	(136)
Changes in operating assets and liabilities, net of acquisitions:		
Restricted cash	(468)	—
Accounts receivable	(14,733)	4,547
Accounts receivable—related parties	(857)	1,822
Materials and supplies	—	(575)
Other current assets	(14,108)	2
Other noncurrent assets	347	(97)
Accounts payable and accrued expenses	3,889	(22,865)
Revenue and severance taxes payable	(1,524)	(661)
Other noncurrent liabilities	—	(374)
Net cash provided by operating activities	19,905	17,987
CASH FLOWS FROM INVESTING ACTIVITIES:		
Development of oil and natural gas properties	(122,623)	(117,930)
Acquisitions of oil and natural gas properties	(208,832)	(21,722)
Additions to other property and equipment	(3,004)	(4,567)
Other investing activities	—	(925)
Net cash used in investing activities	(334,459)	(145,144)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Payments on long-term debt	(236)	(120,164)
Debt issuance costs	(1)	—
Proceeds from issuance of common stock, net	36	224,007
Repurchase of restricted stock	(19)	—
Net cash (used in) provided by financing activities	(220)	103,843

Net decrease in cash and cash equivalents	(314,774)	(23,314)
Cash and cash equivalents at beginning of period	343,084	50,550
Cash and cash equivalents at end of period	$28,310	$27,236
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Cash paid for interest	$21,211	$21,262
Cash paid for income taxes	$315	$—
SUPPLEMENTAL DISCLOSURE OF NON-CASH ACTIVITIES:		
Asset retirement obligations incurred, including changes in estimate	$675	$73
(Reductions) additions to oil and natural gas properties - change in capital accruals	$(12,254)	$3,802
Additions to other property and equipment funded by capital lease borrowings	$84	$—

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

PARSLEY ENERGY, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

NOTE 1. ORGANIZATION AND NATURE OF OPERATIONS

Parsley Energy, Inc. (either individually or together with its subsidiaries, as the context requires, the "Company") was formed on December 11, 2013, pursuant to the laws of the State of Delaware, and is engaged in the acquisition and development of unconventional oil and natural gas reserves located in the Permian Basin, which is located in West Texas and Southeastern New Mexico.

Public Offering of Common Stock

On April 4, 2016, the Company entered into an agreement to sell 20,987,500 shares of Class A Common Stock, par value $0.01 per share ("Class A Common Stock"), (including 2,737,500 shares issued pursuant to the underwriters' option to purchase additional shares) at a price of $21.40 per share to in an underwritten public offering (the "April Offering"). The April Offering closed on April 8, 2016 and resulted in gross proceeds of approximately $449.1 million to the Company and net proceeds, after deducting underwriting discounts and commissions and offering expenses, of approximately $433.1 million. Please refer to Note 14—Subsequent Events for additional discussion.

NOTE 2. BASIS OF PRESENTATION

These condensed consolidated financial statements include the accounts of Parsley Energy, Inc. and its majority-owned subsidiary, Parsley Energy, LLC ("Parsley LLC"), and its wholly owned subsidiaries: (i) Parsley Energy, L.P. ("Parsley LP"), (ii) Parsley Energy Management, LLC (the "General Partner"), (iii) Parsley Energy Operations, LLC ("Operations") and its wholly owned subsidiary, Parsley Energy Aviation, LLC, and (iv) Parsley Finance Corp ("Finance Corp"). These condensed consolidated financial statements also include the accounts of Pacesetter Drilling, LLC, a majority-owned subsidiary of Operations. Parsley LP owns a 42.5% noncontrolling interest in Spraberry Production Services, LLC ("SPS"). The Company accounts for its investment in SPS using the equity method of accounting. All significant intercompany and intra-company balances and transactions have been eliminated.

Certain information and footnote disclosures normally included in annual financial statements prepared in accordance with GAAP have been condensed or omitted. We believe the disclosures made are adequate to make the information not misleading. We recommend that these condensed consolidated financial statements should be read in conjunction with the Company's audited consolidated financial statements and related notes thereto included in the Annual Report.

In the opinion of management, the interim data includes all adjustments, consisting only of normal recurring adjustments, necessary for a fair presentation of the results for the interim period. The results of operations for the three months ended March 31, 2016, is not necessarily indicative of the operating results of the entire fiscal year ending December 31, 2016.

PARSLEY ENERGY, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Use of Estimates

These condensed consolidated financial statements and related notes are presented in accordance with GAAP. Preparation in accordance with GAAP requires us to (1) adopt accounting policies within accounting rules set by the Financial Accounting Standards Board ("FASB") and by the SEC and (2) make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Our management believes the major estimates and assumptions impacting our condensed consolidated financial statements are the following:

- estimates of proved reserves of oil and natural gas, which affect the calculations of depletion, depreciation and amortization ("DD&A") and impairment of capitalized costs of oil and natural gas properties;
- estimates of asset retirement obligations;
- estimates of the fair value of oil and natural gas properties we own, particularly properties that we have not yet explored, or fully explored, by drilling and completing wells;
- impairment of undeveloped properties and other assets;
- depreciation of property and equipment; and
- valuation of commodity derivative instruments.

Actual results may differ from estimates and assumptions of future events and these revisions could be material. Future production may vary materially from estimated oil and natural gas proved reserves. Actual future prices may vary significantly from price assumptions used for determining proved reserves and for financial reporting.

Significant Accounting Policies

For a complete description of the Company's significant accounting policies, see Note 2—Summary of Significant Accounting Policies in the Annual Report.

Change in Accounting Principle

The Company adopted Accounting Standards Update ("ASU") 2015-03, Interest—Imputation of Interest (Subtopic 935-30): Simplifying the Presentation of Debt Issuance Costs, effective January 1, 2016. This standard requires companies that have historically presented debt issuance costs as an asset to present those costs as a direct deduction from the carrying amount of the underlying debt liability. To the extent that there are no borrowings under the amended and restated credit agreement with Wells Fargo Bank, National Association, as administrative agent (as amended, the "Revolving Credit Agreement"), the related deferred loan costs will continue to be classified as an asset. The guidance required retrospective application in the condensed consolidated financial statements. The Company had no borrowings outstanding under the Revolving Credit Agreement at March 31, 2016 and December 31, 2015, as such, approximately \$2.1 million and \$2.3 million, respectively, of deferred loan costs related to the Revolving Credit Agreement are included in "Other noncurrent assets." The Company's 7.500% senior notes due 2022 (the "Notes") are presented net of approximately \$8.7 million and \$9.1 million of deferred loan costs at March 31, 2016 and December 31, 2015, respectively.

The Company adopted ASU 2016-09, Compensation—Stock Compensation (Topic 718)—Improvements to Employee Share-Based Payment Accounting, effective January 1, 2016. This ASU is intended to simplify the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. The amendments in this update are effective for financial statements issued for annual periods beginning after December 15, 2016, including interim periods within those annual periods, and early application is permitted as of the beginning of an interim or annual reporting period. The ASU did not have a material effect on the Company's financial statements and related disclosures.

Reclassifications

Certain reclassifications have been made to prior period amounts to conform to the current presentation.

PARSLEY ENERGY, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Recent Accounting Pronouncements

In May 2014, March 2016 and April 2016, the FASB issued ASU Nos. 2014-09, 2016-08 and 2016-10, respectively, Revenue from Contracts with Customers, which requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers amongst other things. The ASUs will replace most existing revenue recognition guidance in GAAP when it becomes effective. The new standard will be effective for the Company on January 1, 2018. Early application is not permitted. The standard permits the use of either the retrospective or cumulative effect transition method. The Company is evaluating the effect that ASU 2014-09, 2016-08 and 2016-10 will have on its condensed consolidated financial statements and related disclosures. The Company has not yet selected a transition method nor has it determined the effect of the standard on its ongoing financial reporting.

In May 2015, the FASB issued ASU No. 2015-11, Inventory (Topic 330): Simplifying the Measurement of Inventory, which requires entities that value inventory using the first-in, first-out or average cost method to measure inventory at the lower of cost and net realizable value. The amended guidance will be effective for the Company for fiscal years beginning after December 15, 2016, and for interim periods within those years. The amended guidance must be applied on a prospective basis and is not expected to materially affect the Company’s condensed consolidated financial statements or notes to the condensed consolidated financial statements.

In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842), which modifies the recognition of lease assets and lease liabilities for lease assets and lease liabilities by lessees for those leases classified as operating leases under previous GAAP. The amended guidance will be effective for the Company for annual periods beginning after December 15, 2018. Early adoption is permitted. The Company is evaluating the effect that ASU 2016-02 will have on its condensed consolidated financial statements and related disclosures. The Company has not yet selected a transition method nor has it determined the effect of the standard on its ongoing financial reporting.

In March 2016, the FASB issued ASU No. 2016-07, Investments—Equity Method and Joint Ventures (Topic 323) as part of the simplification initiative, which eliminates the requirement that when an investment qualifies for use of the equity method as a result of an increase in the level of ownership interest or degree of influence, an investor must adjust the investment, results of operations, and retained earnings retroactively on a step-by-step basis as if the equity method had been in effect during all previous periods that the investment had been held. The amended guidance will be effective for the Company for annual periods beginning after December 15, 2016. The amendments should be applied prospectively upon their effective date to increases in the level of ownership interest or degree of influence that result in the adoption of the equity method. Early adoption is permitted for any entity in any interim or annual period. The amended guidance is not expected to materially affect the Company’s condensed consolidated financial statements or notes to the condensed consolidated financial statements.

NOTE 3. DERIVATIVE FINANCIAL INSTRUMENTS

Commodity Derivative Instruments and Concentration of Risk

Objective and Strategy

The Company utilizes basis swap contracts and put spread options to (i) reduce the effect of price volatility on the commodities the Company produces and sells or consumes, (ii) support the Company's annual capital budgeting and expenditure plans and (iii) reduce commodity price risk associated with certain capital projects.

The Company uses put spread options to manage commodity price risk for NYMEX WTI. A put spread option is a combination of two options: a purchased put and a sold put. The purchased put establishes the minimum price that the Company will receive for the contracted volumes unless the market price for the commodity falls below the sold put strike price, at which point the minimum price equals the reference price plus the excess of the purchased put strike price over the sold put strike price.

Additionally, the Company uses basis swap contracts to mitigate basis risk caused by the volatility of the Company’s basis differentials. The basis swap contracts establish the differential between Cushing WTI prices and the relevant price index at which oil production is sold.

PARSLEY ENERGY, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Oil Production Derivative Activities

All material physical sales contracts governing the Company's oil production are tied directly to, or are highly correlated with, NYMEX WTI oil prices. The Company uses put spread options to manage oil price volatility and basis swap contracts to reduce basis risk between NYMEX prices and the actual index prices at which the oil is sold.

The following table sets forth the volumes associated with the Company's outstanding oil derivative contracts expiring during the periods indicated and the weighted average oil prices for those contracts:

Crude Options	Nine Months Ending December 31, 2016	Year Ending December 31, 2017
Purchased:		
Puts [1]		
Notional (MBbl)	5,875	4,134
Weighted average strike price	$ 49.78	$ 46.88
Sold:		
Puts [1]		
Notional (MBbl)	(5,875)	(4,134)
Weighted average strike price	$ 35.47	$ 32.96
Basis swap contracts: [2]		
Midland-Cushing index swap volume (MBbl)	1,516	4,290
Price differential ($/Bbl)	$ (0.87)	$ (1.03)

(1) The Company excluded from the tables above 11,199 notional MBbls with a fair value of $221.0 million related to amounts recognized under master netting agreements with derivative counterparties.

(2) Represents swaps that fix the basis differentials between the index prices at which the Company sells its oil produced in the Permian Basin and the Cushing WTI price.

Effect of Derivative Instruments on the Condensed Consolidated Financial Statements

All of the Company’s derivatives are accounted for as non-hedge derivatives and therefore all changes in the fair values of its derivative contracts are recognized as gains or losses in the earnings of the periods in which they occur. The Company recognized income from its derivative activities of $2.1 million and $7.1 million for the three months ended March 31, 2016 and 2015, respectively. The income is included in the condensed consolidated statements of operations line item, “Derivative income.” The fair value of the derivative instruments is discussed in Note 13—Disclosures about Fair Value of Financial Instruments.

The Company classifies the fair value amounts of derivative assets and liabilities as gross current or noncurrent derivative assets or gross current or noncurrent derivative liabilities, whichever the case may be, excluding those amounts netted under master netting agreements. The Company has agreements in place with all of its counterparties that allow for the financial right of offset for derivative assets and liabilities at settlement or in the event of default under the agreements. Additionally, the Company maintains accounts with its brokers to facilitate financial derivative transactions in support of its risk management activities. Based on the value of the Company's positions in these accounts and the associated margin requirements, the Company may be required to deposit cash into these broker accounts. During the three months ended March 31, 2016 and 2015, the Company did not receive or post any margins in connection with collateralizing its derivative positions.

PARSLEY ENERGY, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

The following table presents the Company’s net exposure from its offsetting derivative asset and liability positions, as well as cash collateral on deposit with the brokers as of the reporting dates indicated (in thousands):

	Gross Amount	Netting Adjustments	Net Exposure
March 31, 2016			
Derivative assets with right of offset or master netting agreements	$313,177	$ (220,977)	$92,200
Derivative liabilities with right of offset or master netting agreements	(263,568)	220,977	(42,591)
December 31, 2015			
Derivative assets with right of offset or master netting agreements	$407,052	$ (297,951)	$109,101
Derivative liabilities with right of offset or master netting agreements	(347,611)	297,951	(49,660)

Concentration of Credit Risk

The financial integrity of the Company’s exchange-traded contracts is assured by NYMEX through systems of financial safeguards and transaction guarantees, and is therefore subject to nominal credit risk. Over-the-counter traded options expose the Company to counterparty credit risk. These over-the-counter options are entered into with a large multinational financial institution with investment grade credit rating or through brokers that require all the transaction parties to collateralize their open option positions. The gross and net credit exposure from our commodity derivative contracts as of March 31, 2016 and December 31, 2015 is summarized in the table above.

The Company monitors the creditworthiness of its counterparties, establishes credit limits according to the Company’s credit policies and guidelines, and assesses the impact on fair values of its counterparties’ creditworthiness. The Company has entered into International Swap Dealers Association Master Agreements (“ISDA Agreements”) with each of its derivative counterparties. The terms of the ISDA Agreements provide the Company and its counterparties and brokers with rights of net settlement of gross commodity derivative assets against gross commodity derivative liabilities. The Company routinely exercises its contractual right to offset realized gains against realized losses when settling with derivative counterparties. The Company did not incur any losses due to counterparty bankruptcy filings during the three months ended March 31, 2016 or the year ended December 31, 2015.

Credit Risk Related Contingent Features in Derivatives

Certain commodity derivative instruments contain provisions that require the Company to either post additional collateral or immediately settle any outstanding liability balances upon the occurrence of a specified credit risk related event. These events, which are defined by the existing commodity derivative contracts, are primarily downgrades in the credit ratings of the Company and its affiliates. None of the Company’s commodity derivative instruments were in a net liability position with respect to any individual counterparty at March 31, 2016 or December 31, 2015.

PARSLEY ENERGY, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

NOTE 4. PROPERTY, PLANT AND EQUIPMENT

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

	March 31, 2016	December 31, 2015
Oil and natural gas properties:		
Subject to depletion	$1,822,014	$1,627,367
Not subject to depletion		
Incurred in 2016	198,231	—
Incurred in 2015	54,130	118,101
Incurred in 2014 and prior	491,663	500,693
Total not subject to depletion	744,024	618,794
Gross oil and natural gas properties	2,566,038	2,246,161
Accumulated depreciation, depletion and impairment	(338,199)	(290,186)
Oil and natural gas properties, net	2,227,839	1,955,975
Other property and equipment	40,340	37,253
Less accumulated depreciation	(8,927)	(7,475)
Other property and equipment, net	31,413	29,778
Total property, plant, and equipment, net	$2,259,252	$1,985,753

Costs subject to depletion are proved costs and costs not subject to depletion are unproved costs and current drilling projects. At March 31, 2016 and December 31, 2015, the Company had excluded $744.0 million and $618.8 million, respectively, of capitalized costs from depletion.

As the Company's exploration and development work progresses and the reserves on the Company's properties are proven, capitalized costs attributed to the properties are subject to DD&A. Depletion of capitalized costs is provided using the units-of-production method based on proved oil and gas reserves related to the associated reservoir. Depletion expense on capitalized oil and gas property was $47.9 million and $36.4 million for the three months ended March 31, 2016 and 2015, respectively. The Company had no exploratory wells in progress at March 31, 2016 or December 31, 2015.

NOTE 5. ACQUISITIONS OF OIL AND GAS PROPERTIES

The Company acquired $12.9 million and $20.1 million of leasehold during the three months ended March 31, 2016 and 2015, respectively. The Company reflected $12.1 million and $19.1 million of the acquisition costs as part of costs not subject to depletion and $0.8 million and $1.0 million as part of its cost subject to depletion within its oil and gas properties for the periods ended March 31, 2016 and 2015, respectively.

In addition, during the three months ended March 31, 2016 and 2015, the Company acquired certain working interests as described below. These working interest acquisitions were accounted for using the acquisition method under ASC Topic 805, "Business Combinations," which requires the acquired assets and liabilities to be recorded at fair values as of the respective acquisition dates.

During the three months ended March 31, 2016 and 2015, the Company acquired, from unaffiliated individuals and entities, working interests in wells through a number of separate, individually negotiated transactions for an aggregate total cash consideration of $195.9 million and $1.6 million, respectively. The Company reflected $41.8 million and $1.3 million of the total consideration paid as part of its cost subject to depletion within its oil and gas properties and $154.1 million and $0.3 million as unproved leasehold costs within its oil and gas periods for the periods ended March 31, 2016 and 2015, respectively. The revenues and operating expenses attributable to the working interest acquisitions during the three months ended March 31, 2016 and 2015, were not material.

PARSLEY ENERGY, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

NOTE 6. ASSET RETIREMENT OBLIGATIONS

Asset retirement obligations relate to future plugging and abandonment expenses on oil and natural gas properties and related facilities disposal.

The following table summarizes the changes in the Company's asset retirement obligations for the three months ended March 31, 2016 (in thousands):

	March 31, 2016
Asset retirement obligations, beginning of period	$18,220
Additional liabilities incurred	664
Accretion expense	170
Revision of estimates	11
Asset retirement obligations, end of period	$19,065

NOTE 7. DEBT

The Company's debt consists of the following (in thousands):

	March 31, 2016	December 31, 2015
Revolving Credit Agreement	$—	$—
7.500% senior unsecured notes due 2022	550,000	550,000
Capital leases	2,065	2,215
Total debt	552,065	552,215
Debt issuance costs on 7.500% senior unsecured notes due 2022	(8,719)	(9,092)
Premium on 7.500% senior unsecured notes due 2022	4,468	4,660
Less: current portion	(997)	(951)
Total long-term debt	$546,817	$546,832

Revolving Credit Agreement

As of March 31, 2016, the Borrowing Base (as defined therein) under the Revolving Credit Agreement was $575.0 million, with a commitment level of $575.0 million. There were no borrowings outstanding and $0.3 million in letters of credit outstanding as of March 31, 2016, resulting in availability of $574.7 million.

As of March 31, 2016, letters of credit under the Revolving Credit Agreement had a weighted average interest rate of 1.5%.

Covenant Compliance

The Revolving Credit Agreement and the indenture governing the Notes restrict our ability and the ability of certain of our subsidiaries to, among other things: (i) incur or guarantee additional indebtedness or issue certain types of preferred stock; (ii) pay dividends on capital stock or redeem, repurchase or retire our capital stock or subordinated indebtedness; (iii) transfer or sell assets; (iv) make investments; (v) create certain liens; (vi) enter into agreements that restrict dividends or other payments from our restricted subsidiaries to us; (vii) consolidate, merge or transfer all or substantially all of our assets; (viii) engage in transactions with affiliates; and (ix) create unrestricted subsidiaries. These covenants are subject to a number of important exceptions and qualifications. If at any time when the Notes are rated investment grade by either Moody’s Investors Service, Inc. or Standard & Poor’s Ratings Services and no default or event of default (as defined in the indenture) has occurred and is continuing, many of the foregoing covenants pertaining to the Notes will be suspended. If the ratings on the Notes were to decline subsequently to below investment grade, the suspended covenants would be reinstated.

As of March 31, 2016, the Company was in compliance with all required covenants under the Revolving Credit Agreement and the indenture governing the Notes.

PARSLEY ENERGY, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Principal Maturities of Debt

Principal maturities of debt outstanding at March 31, 2016 are as follows (in thousands):

2016	$738
2017	1,027
2018	294
2019	6
2020	—
Thereafter	550,000
Total	$552,065

Interest Expense

The following amounts have been incurred and charged to interest expense for the three months ended March 31, 2016 and 2015 (in thousands):

	Three Months Ended March 31,	
	2016	2015
Cash payments for interest	$21,211	$21,262
Change in interest accrual	(10,313)	(10,380)
Amortization of deferred loan origination costs	588	494
Write-off of deferred loan origination costs	—	614
Amortization of bond premium	(191)	(191)
Other interest (expense) income	(6)	42
Total interest expense, net	$11,289	$11,841

NOTE 8. EQUITY

Earnings per Share

Basic earnings per share ("EPS") measures the performance of an entity over the reporting period. Diluted earnings per share measures the performance of an entity over the reporting period while giving effect to all potentially dilutive common shares that were outstanding during the period. The Company uses the "if-converted" method to determine the potential dilutive effect of its Class B common stock, par value $0.01 per share ("Class B Common Stock") and the treasury stock method to determine the potential dilutive effect of outstanding restricted stock and restricted stock units. For the three months ended March 31, 2016 and 2015, Class B Common Stock, unvested restricted stock and restricted stock unit awards were not recognized in dilutive earnings per share calculations for that period as they would be antidilutive.

PARSLEY ENERGY, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

The following table reflects the allocation of net income to common stockholders and EPS computations for the periods indicated based on a weighted average number of common stock outstanding for the period:

	Three Months Ended March 31,	
	2016	2015
Basic EPS (in thousands, except per share data)		
Numerator:		
Basic net loss attributable to Parsley Energy, Inc. Stockholders	$(19,354)	$(17,024)
Denominator:		
Basic weighted average shares outstanding	135,963	101,273
Basic EPS attributable to Parsley Energy, Inc. Stockholders	$(0.14)	$(0.17)
Diluted EPS		
Numerator:		
Net loss attributable to Parsley Energy, Inc. Stockholders	(19,354)	(17,024)
Effect of conversion of the shares of Company's Class B Common Stock to shares of the Company's Class A Common Stock	—	—
Diluted net loss attributable to Parsley Energy, Inc. Stockholders	$(19,354)	$(17,024)
Denominator:		
Basic weighted average shares outstanding	135,963	101,273
Effect of dilutive securities:		
Class B Common Stock	—	—
Restricted Stock and Restricted Stock Units	—	—
Diluted weighted average shares outstanding (1)	135,963	101,273
Diluted EPS attributable to Parsley Energy, Inc. Stockholders	$(0.14)	$(0.17)

(1) There were 453,863 and 211,935 shares related to performance-based restricted stock units that could be converted to common shares in the future based on predetermined performance and market goals. These units were not included in the computation of EPS for the three months ended March 31, 2016 and 2015, respectively, because the performance and market conditions had not been met, assuming the end of the reporting period was the end of the contingency period.

Noncontrolling Interest

The following table summarizes the noncontrolling interest income (loss):

	Three Months Ended March 31, 2016	2015
	(In thousands)	
Net income (loss) attributable to the noncontrolling interests of:		
Parsley LLC	$(6,357)	$(6,534)
Pacesetter Drilling, LLC	20	—
Total net loss attributable to noncontrolling interest	$(6,337)	$(6,534)

PARSLEY ENERGY, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

NOTE 9. STOCK-BASED COMPENSATION

In connection with the Company's initial public offering (the "IPO") in May 2014, the Company adopted the Parsley Energy, Inc. 2014 Long Term Incentive Plan for employees, consultants, and directors of the Company who perform services for the Company. Refer to "Compensation Discussion and Analysis—Elements of Compensation —2014 Long-Term Incentive Plan" in the Company's Proxy Statement filed on Schedule 14A for the 2016 Annual Meeting of Stockholders for additional information related to this equity based compensation plan.

Performance Units

In February 2016, additional performance-based, stock-settled restricted stock units, which we refer to as performance units, were granted with a performance period of three years. The number of shares of Class A Common Stock actually vesting pursuant to these performance units depends on the performance of the Company's Class A Common Stock over the three-year performance period relative to the performance of the stock of predetermined peer group companies. The Company granted a target number of 241,928 performance units, but the conditions of the grants allow for an actual payout ranging between no payout and 200% of target. The fair value of such performance units was determined using a Monte Carlo simulation and will be recognized over the next three years.

The following table summarized the Company's restricted stock, restricted stock unit, and performance unit activity for the three months ended March 31, 2016 (in thousands):

	Restricted Stock	Restricted Stock Units	Performance Units
Outstanding at January 1, 2016	661	513	212
Awards granted [1]	—	549	242
Vested	—	(4)	—
Repurchased		1	
Outstanding at March 31, 2016	661	1,059	454
[1] Weighted average grant date fair value	$ —	$ 16.70	$ 25.82

Stock-based compensation expense related to restricted stock, restricted stock units, and performance units was $2.8 million and $1.6 million for the three months ended March 31, 2016 and 2015, respectively. There was approximately $29.3 million of unamortized compensation expense relating to outstanding restricted stock, restricted stock units, and performance units at March 31, 2016.

NOTE 10. INCOME TAXES

The Company is a corporation and it is subject to U.S. federal income tax. The tax implications of the IPO and the Company's concurrent corporate reorganization, and the tax impact of the Company's status as a taxable corporation subject to U.S. federal income tax have been reflected in the accompanying condensed consolidated financial statements. The effective combined U.S. federal and state income tax rate as of March 31, 2016 was 27.1%. During the three months ended March 31, 2016 and 2015, the Company recognized an income tax benefit of $9.6 million and $5.5 million, respectively. Total income tax expense for the three months ended March 31, 2016 differed from amounts computed by applying the U.S. federal statutory tax rate of 35% due primarily to the impact of loss attributable to noncontrolling ownership interests.

The Company early adopted ASU 2016-09 effective January 1, 2016, which resulted in a favorable adjustment for the net excess income tax benefits from stock-based compensation during the three months ended March 31, 2016. The adoption was on a prospective basis and therefore had no impact on prior years. The Company also recorded an adjustment to opening retained earnings of $0.1 million to recognize U.S. net operating loss carryforwards attributable to excess tax benefits on stock-based compensation that had not been previously recognized to additional paid in capital because they did not reduce income taxes payable.

PARSLEY ENERGY, INC. AND SUBSIDIARIES

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NOTE 11. RELATED PARTY TRANSACTIONS

Well Operations

During the three months ended March 31, 2016 and 2015, several of the Company's directors, officers, 10% stockholders, their immediate family members, and entities affiliated or controlled by such parties ("Related Party Working Interest Owners") owned non-operated working interests in certain of the oil and natural gas properties that the Company operates. The revenues disbursed to such Related Party Working Interest Owners for the three months ended March 31, 2016 and 2015, totaled $0.8 million and $1.8 million, respectively.

As a result of this ownership, from time to time, the Company will be in a net receivable or net payable position with these individuals and entities. The Company does not consider any net receivables from these parties to be uncollectible.

Spraberry Production Services, LLC

As defined in Note 2—Basis of Presentation, the Company owns a 42.5% interest in SPS. Using the equity method of accounting results in transactions between the Company and SPS and its subsidiaries being accounted for as related party transactions. During the three months ended March 31, 2016 and 2015, the Company incurred charges totaling $1.3 million and $1.8 million, respectively, for services performed by SPS for the Company's well operations and drilling activities.

Lone Star Well Service, LLC

The Company makes purchases of equipment used in its drilling operations from Lone Star Well Service, LLC ("Lone Star"), which is controlled by SPS. During the three months ended March 31, 2016 and 2015, the Company incurred charges totaling $1.1 million and $0.9 million, respectively, for services performed by Lone Star for the Company's wells operations and drilling activities.

Exchange Right

In accordance with the terms of the First Amended and Restated Limited Liability Company Agreement of Parsley LLC Agreement, the PE Unit Holders generally have the right to exchange their PE Units (and a corresponding number of shares of the Company's Class B Common Stock), for shares of the Company's Class A Common Stock at an exchange ratio of one share of Class A Common Stock for each PE Unit (and a corresponding share of Class B Common Stock) exchanged (subject to conversion rate adjustments for stock splits, stock dividends and reclassifications) or cash (pursuant to the Cash Option). As a PE Unit Holder exchanges its PE Units, the Company's interest in Parsley LLC will be correspondingly increased.

Tax Receivable Agreement

In connection with the IPO, on May 29, 2014, the Company entered into a Tax Receivable Agreement (the "TRA") with Parsley LLC and certain holders of PE Units prior to the IPO (each such person a "TRA Holder"), including certain executive officers. This agreement generally provides for the payment by the Company of 85% of the net cash savings, if any, in U.S. federal, state, and local income tax or franchise tax that the Company actually realizes (or is deemed to realize in certain circumstances) in periods after the IPO as a result of (i) any tax basis increases resulting from the contribution in connection with the IPO by such TRA Holder of all or a portion of its PE Units to the Company in exchange for shares of Class A Common Stock, (ii) the tax basis increases resulting from the exchange by such TRA Holder of PE Units for shares of Class A Common Stock pursuant to the Exchange Right (or resulting from an exchange of PE Units for cash pursuant to the Cash Option) and (iii) imputed interest deemed to be paid by the Company as a result of, and additional tax basis arising from, any payments the Company makes under the TRA. The term of the TRA commenced on May 29, 2014, and continues until all such tax benefits have been utilized or expired, unless the Company exercises its right to terminate the TRA. If the Company elects to terminate the TRA early, it would be required to make an immediate payment equal to the present value of the anticipated future tax benefits subject to the TRA (based upon certain assumptions and deemed events set forth in the TRA). In addition, payments due under the TRA will be similarly accelerated following certain mergers or other changes of control.

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NOTE 12. SIGNIFICANT CUSTOMERS

For the three months ended March 31, 2016 and 2015, each of the following purchasers accounted for more than 10% of the Company's revenue:

	Three Months Ended March 31,	
	2016	2015
Shell Trading (US) Company	38%	10%
BML, Inc.	22%	17%
Targa Pipeline Mid-Continent, LLC	14%	19%
TransOil Marketing, LLC	11%	13%
Permian Marketing, LLC	1%	10%
Sunoco Logistics Partners L.P.	1%	10%

The Company does not require collateral and does not believe the loss of any single purchaser would materially impact its operating results, as crude oil and natural gas are fungible products with well-established markets and numerous purchasers.

NOTE 13. DISCLOSURES ABOUT FAIR VALUE OF FINANCIAL INSTRUMENTS

The Company uses a valuation framework based upon inputs that market participants use in pricing an asset or liability, which are classified into two categories: observable inputs and unobservable inputs. Observable inputs represent market data obtained from independent sources, whereas unobservable inputs reflect a company's own market assumptions, which are used if observable inputs are not reasonably available without undue cost and effort. These two types of inputs are further prioritized into the following fair value input hierarchy:

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

Level 2:

Quoted prices in markets that are not active, or inputs which are observable, either directly or indirectly, for substantially the full term of the asset or liability. This category includes those derivative instruments that the Company values using observable market data. Substantially all of these inputs are observable in the marketplace throughout the full term of the derivative instrument, can be derived from observable data, or supported by observable levels at which transactions are executed in the marketplace. Level 2 instruments primarily include non-exchange traded derivatives such as over-the-counter commodity price swaps, basis swaps, collars and floors, investments and interest rate swaps. The Company's valuation models are primarily industry-standard models that consider various inputs including: (i) quoted forward prices for commodities, (ii) time value and (iii) current market and contractual prices for the underlying instruments, as well as other relevant economic measures.

Level 3: Measured based on prices or valuation models that require inputs that are both significant to the fair value measurement and less observable from objective sources (supported by little or no market activity). The Company's valuation models are primarily industry-standard models that consider various inputs including: (i) quoted forward prices for commodities, (ii) time value, (iii) volatility factors and (iv) current market and contractual prices for the underlying instruments, as well as other relevant economic measures.

Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis

Certain assets and liabilities are measured at fair value on a nonrecurring basis. These assets and liabilities are not measured at fair value on an ongoing basis, but are subject to fair value adjustments in whenever events or circumstances indicate that the carrying value of those assets may not be recoverable. These assets and liabilities can include inventory, proved and unproved oil and natural gas properties, and other long-lived assets that are written down to fair value when they are impaired.

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Proved oil and natural gas properties. During the three months ended March 31, 2016, reductions in management's long-term commodity price outlooks provided indications of possible impairment. As a result of management's assessments, during the three months ended March 31, 2016 and 2015, the Company did not recognize impairment charges to reduce the carrying values of any oil and gas properties to their estimated fair values.

The Company calculates the estimated fair values using a discounted future cash flow model. Management's assumptions associated with the calculation of discounted future cash flows include commodity prices based on NYMEX futures price strips (Level 1), as well as Level 3 assumptions including (i) pricing adjustments for differentials, (ii) production costs, (iii) capital expenditures, (iv) production volumes and (v) estimated reserves.

It is reasonably possible that the estimate of undiscounted future net cash flows may change in the future resulting in the need to impair carrying values. The primary factors that may affect estimates of future cash flows are (i) commodity futures prices, (ii) increases or decreases in production and capital costs, (iii) future reserve adjustments, both positive and negative, to proved reserves and appropriate risk-adjusted probable and possible reserves and (iv) results of future drilling activities.

Financial Assets and Liabilities Measured at Fair Value

Commodity derivative contracts are marked-to-market each quarter and are thus stated at fair value in the accompanying condensed consolidated Balance Sheets and in Note 3—Derivative Financial Instruments. The fair values of the Company's commodity derivative instruments are classified as Level 2 measurements as they are calculated using industry standard models using assumptions and inputs which are substantially observable in active markets throughout the full term of the instruments. These include market price curves, contract terms and prices, credit risk adjustments, implied market volatility and discount factors. The following summarizes the fair value of the Company's derivative assets and liabilities according to their fair value hierarchy as of the reporting dates indicated (in thousands):

	March 31, 2016	
	Level 1	Level 2