US ENERGY CORP
Form 10-Q
May 14, 2018

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, 2018

[ ] 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 000-6814

U.S. ENERGY CORP.
(Exact Name of Registrant as Specified in its Charter)

Wyoming	**83-0205516**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

950 S Cherry St, Unit 1515, Denver, CO 80246

(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: **(303) 993-3200**

Not Applicable

(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 (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES [X] NO [ ]

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 [ ] Accelerated filer [ ] Non-accelerated filer [ ] Smaller reporting company [X] Emerging growth 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]

The registrant had 12,590,815 shares of its $0.01 par value common stock outstanding as of May 1, 2018.

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Item 1. Financial Statements

U.S. ENERGY CORP. AND SUBSIDIARIES

UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS

(In Thousands, Except Share and Per Share Amounts)

	March 31, 2018	December 31, 2017
ASSETS		
Current assets:		
Cash and equivalents	$2,095	$3,277
Oil and gas sales receivable	1,078	687
Discontinued operations - assets of mining segment	114	114
Assets available for sale	-	653
Marketable securities	798	876
Transaction deposit	374	250
Other current assets	316	61
Total current assets	4,775	5,918
Oil and gas properties under full cost method:		
Unevaluated properties	4,664	4,664
Evaluated properties	86,356	86,313
Less accumulated depreciation, depletion and amortization	(83,500)	(83,362)
Net oil and gas properties	7,520	7,615
Other assets:		
Property and equipment, net	2,340	1,717
Other assets	62	66
Total other assets	2,402	1,783
Total assets	$14,697	$15,316
LIABILITIES AND SHAREHOLDERS' EQUITY		

Current liabilities:		
Accounts payable and accrued liabilities:		
Oil and gas payables	464	707
Related party payable	-	50
Accrued compensation and benefits	82	64
Liabilities from derivative contracts	107	161
Current portion of long-term debt	-	600
Total current liabilities	653	1,582
Noncurrent liabilities:		
Asset retirement obligations	919	913
Revolving credit facility	937	937
Warrant liability	930	1,200
Other liabilities	28	22
Total noncurrent liabilities	2,814	3,072
Commitments and contingencies (Note 8)		
Shareholders' equity:		
Preferred stock, par value $0.01 per share. Authorized 100,000 shares, 50,000 shares of series A Convertible Preferred Stock as of 3/31/2018; liquidation preference of $2,606 as of 3/31/2018.	1	1
Common stock, $0.01 par value; unlimited shares authorized; 12,460,220 and 6,134,506 shares issued and outstanding as of 3/31/2018 and 12/31/2017, respectively	124	118
Additional paid-in capital	137,515	136,631
Accumulated deficit	(125,429)	(125,185)
Other comprehensive loss	(981)	(903)
Total shareholders' equity	11,230	10,662
Total liabilities and shareholders' equity	$14,697	$15,316

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

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U.S. ENERGY CORP. AND SUBSIDIARIES

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

FOR THE THREE MONTHS ENDED MARCH 31, 2018 AND 2017

(In Thousands, Except Share and Per Share Amounts)

	2018		2017	
Revenue:				
Oil	$1,230		$1,240	
Natural gas and liquids	325		507	
Total revenue	1,555		1,747	
Operating expenses:				
Oil and gas operations:				
Production costs	633		1,053	
Depreciation, depletion and amortization	145		270	
General and administrative:				
Compensation and benefits, including directors and contract employees	783		176	
Stock-based compensation	13		106	
Professional fees, insurance and other	320		880	
Total operating expenses	1,894		2,485	
Operating loss	(339	)	(738	)
Other income (expense):				
Realized loss on oil price risk derivatives	(179	)	-	
Unrealized gain on oil price risk derivatives	54		-	
Rental and other loss	(14	)	(216	)
Warrant fair value adjustment	270		340	
Interest expense	(36	)	(125	)
Other expense	-		(1	)
Total other income (expense)	95		(2	)
Net loss	(244	)	(740	)
Change in fair value of marketable equity securities, net of tax	(78	)	(86	)
Comprehensive loss	$(322	)	$(826	)
Loss applicable to common shareholders				

Loss from operations	(244)	(740)
Accrued dividends related to Series A Convertible Preferred Stock	(79)	(69)
Loss applicable to common shareholders	(323)	(809)
Loss per share- basic & diluted		
Total	$(0.03)	$(0.14)
Weighted average shares outstanding		
Basic & diluted	12,148,527	5,834,568

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

U.S. ENERGY CORP. AND SUBSIDIARIES

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE THREE MONTHS ENDED MARCH 31, 2018 AND 2017

(In Thousands)

	2018	2017
Cash flows from operating activities:		
Net loss	$(244)	$(740)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation, depletion and amortization	178	304
Change in fair value of oil price risk derivative	(54)	-
Stock-based compensation and services	13	106
Warrant fair value adjustment	(270)	(340)
Other	8	28
Changes in operating assets and liabilities:		
Decrease (increase) in:		
Oil and gas sales receivable	(391)	(96)
Other assets	(5)	(140)
Transaction deposit	(374)	-
Increase (decrease) in:		
Accounts payable and accrued liabilities	(293)	533
Accrued compensation and benefits	19	12
Net cash used in operating activities	(1,413)	(333)
Cash flows from investing activities:		
Capital expenditures	(46)	(21)
Net cash used in investing activities:	(46)	(21)
Cash flows from financing activities:		
Payment on short-term debt	(600)	-
Proceeds from issuance of common stock, net	877	-
Net cash provided by financing activities	277	-
Net decrease in cash and equivalents	(1,182)	(354)
Cash and equivalents, beginning of period	3,277	2,518

Cash and equivalents, end of period	$2,095	$2,164
Non-cash investing and financing activities:		
Unrealized loss on marketable securities	78	86

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

1. ORGANIZATION, OPERATIONS AND SIGNIFICANT ACCOUNTING POLICIES

Organization and Operations

U.S. Energy Corp. (collectively with its subsidiaries referred to as the “Company” or “U.S. Energy”) was incorporated in the State of Wyoming on January 26, 1966. The Company’s principal business activities are focused in the acquisition, exploration and development of oil and gas properties in the United States.

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements are presented in accordance with U.S. generally accepted accounting principles (“GAAP”) and have been prepared by the Company pursuant to the rules and regulations of the Securities and Exchange Commission (the “SEC”) regarding interim financial reporting. Accordingly, certain information and footnote disclosures required by GAAP for complete financial statements have been condensed or omitted in accordance with such rules and regulations. In the opinion of management, all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation of the consolidated financial statements have been included.

For further information, refer to the consolidated financial statements and footnotes thereto included in our Annual Report on Form 10-K and 10K/A for the year ended December 31, 2017. Our financial condition as of March 31, 2018, and operating results for the three months ended March 31, 2018 are not necessarily indicative of the financial condition and results of operations that may be expected for any future interim period or for the year ending December 31, 2018.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Significant estimates include oil and gas reserves that are used in the calculation of depreciation, depletion, amortization and impairment of the carrying value of evaluated oil and gas properties; production and commodity price estimates used to record accrued oil and gas sales receivable; valuation of commodity derivative instruments; and the cost of future asset retirement obligations. The Company evaluates its estimates on an on-going basis and bases its estimates on historical experience and on various other assumptions the Company believes to be reasonable.

Due to inherent uncertainties, including the future prices of oil and gas, these estimates could change in the near term and such changes could be material.

Principles of Consolidation

The accompanying financial statements include the accounts of the Company and its wholly-owned subsidiary Energy One LLC ("Energy One"). All inter-company balances and transactions have been eliminated in consolidation. Certain prior period amounts have been reclassified to conform to the current period presentation of the accompanying financial statements.

Comprehensive Income (Loss)

Comprehensive income (loss) is used to refer to net income (loss) plus other comprehensive income (loss). Other comprehensive income (loss) is comprised of revenues, expenses, gains, and losses that under GAAP are reported as separate components of shareholders' equity instead of net income (loss).

Recent Accounting Pronouncements

Revenue recognition. In May 2014, the FASB issued a comprehensive new revenue recognition standard that supersedes the revenue recognition requirements in Topic 605, Revenue Recognition, and industry-specific guidance in Subtopic 932-605, Extractive Activities-Oil and Gas-Revenue Recognition. The core principle of the new guidance is that a company should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for transferring those goods or services. The new standard also requires significantly expanded disclosure regarding the qualitative and quantitative information of an entity's nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. The standard creates a five-step model that requires companies to exercise judgment when considering the terms of a contract and all relevant facts and circumstances. The standard allows for several transition methods: (a) a full retrospective adoption in which the standard is applied to all of the periods presented, or (b) a modified retrospective adoption in which the standard is applied only to the most current period presented in the financial statements, including additional disclosures of the standard's application impact to individual financial statement line items. In March, April, May and December 2016, the FASB issued new guidance in Topic 606, Revenue from Contracts with Customers, to address the following potential implementation issues of the new revenue standard: (a) to clarify the implementation guidance on principal versus agent considerations, (b) to clarify the identification of performance obligations and the licensing implementation guidance and (c) to address certain issues in the guidance on assessing collectability, presentation of sales taxes, noncash consideration, and completed contracts and contract modifications at transition. This standard is effective for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period. The Company follows the sales method of accounting for oil and natural gas production, which is generally consistent with the revenue recognition provision of the new standard. The Company has completed the process of evaluating the effect of the adoption and determined there were no changes required to our reported revenues as a result of the adoption. The majority of our revenue arrangements generally consist of a single performance obligation to transfer promised goods or services. Based on our evaluation process and review of our contracts with customers, the timing and amount of revenue recognized based on the standard is consistent with our revenue recognition policy under previous guidance. The Company adopted the new standard effective January 1, 2018, using the modified retrospective approach, and has expanded its financial statement disclosures in order to comply with the standard. The Company implemented processes and controls to ensure new contracts are reviewed for the appropriate accounting treatment and to generate the disclosures required under the new standard in the first quarter of 2018. We have determined the adoption of the standard will not have a material impact on our results of operations, cash flows, or financial position.

Leases. In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842). The standard requires lessees to recognize the assets and liabilities that arise from leases on the balance sheet. A lessee should recognize in the statement of financial position a liability to make lease payments (the lease liability) and a right-of-use asset representing its right to use the underlying asset for the lease term. The new guidance is effective for annual and interim reporting periods beginning after December 15, 2018. The amendments should be applied at the beginning of the earliest period presented using a modified retrospective approach with earlier application permitted as of the beginning of an interim or annual reporting period. The Company is currently evaluating the impact of the new guidance on its financial statements, however, based on its current operating leases, it is not expected to have a material impact.

Statement of cash flows. In August 2016, the FASB issued ASU No. 2016-15, Statement of Cash Flows: Classification of Certain Cash Receipts and Cash Payments. This guidance provides guidance of eight specific cash flow issues. This amendment is effective for periods beginning after December 15, 2017, with early adoption permitted. The Company adopted this standard on January 1, 2018 and it is not expected to have a material impact on its financial statements and related disclosures.

Business combinations. In January 2017, the FASB issued Accounting Standards Update No. 2017-01, *Clarifying the Definition of a Business* ("ASU 2017-01"), which provides guidance to assist entities with evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. ASU 2017-01 requires entities to use a screen test to determine when an integrated set of assets and activities is not a business or if the integrated set of assets and activities needs to be further evaluated against the framework. ASU 2017-01 is effective for fiscal years beginning after December 15, 2017, including interim periods within those years. The Company adopted this standard on January 1, 2018 and it is not expected to have a material impact on its financial statements and related disclosures.

Hedging activities. On August 28, 2017, the FASB issued Accounting Standards Update (ASU) 2017-12, Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities. The amendments in ASU 2017-12 apply to any entity that elects to apply hedge accounting in accordance with U.S. generally accepted accounting principles (U.S. GAAP). The amendments in ASU 2017-12 take effect for public business entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. For all other entities, the amendments take effect for fiscal years beginning after December 15, 2019, and interim periods beginning after December 15, 2020. Early adoption is permitted. The Company is currently evaluating the effect that adopting this guidance will have on its financial position, cash flows and results of operations.

Financial instruments with characteristics of liabilities and equity. On July 13, 2017, the FASB has issued a two-part Accounting Standards Update (AS), No. 2017-11, I. Accounting for Certain Financials Instruments with Down Round Features and II. Replacement of the Indefinite Deferral for Mandatorily Redeemable Financial Instruments of Certain Nonpublic Entities and Certain Mandatorily Redeemable Noncontrolling Interest with a Scope Exception. The ASU is effective for public business entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. The Company is currently evaluating the effect that adopting this guidance will have on its financial position, cash flows and results of operations.

2. REVENUE RECOGNITION

The Company adopted ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606) and the series of related accounting standard updates that followed, on January 1, 2018 using the modified retrospective method of adoption. Adoption of the ASU did not require an adjustment to the opening balance of equity and did not change the Company’s amount and timing of revenues.

The Company’s revenues are primarily derived from its interests in the sale of oil and natural gas production. The Company recognizes revenue from its interests in the sales of oil and natural gas in the period that its performance obligations are satisfied. Performance obligations are satisfied when the customer obtains control of product, when the Company has no further obligations to perform related to the sale, when the transaction price has been determined and when collectability is probable. The sales of oil and natural gas are made under contracts which the third-party operators of the wells have negotiated with customers, which typically include variable consideration that is based on pricing tied to local indices and volumes delivered in the current month. The Company receives payment from the sale of oil and natural gas production from one to three months after delivery. At the end of each month when the performance obligation is satisfied, the variable consideration can be reasonably estimated and amounts due from customers are accrued in trade receivables, net in the balance sheets. Variances between the Company’s estimated revenue and actual payments are recorded in the month the payment is received, however, differences have been and are insignificant. Accordingly, the variable consideration is not constrained.

The Company’s oil is typically sold at delivery points under contracts terms that are common in our industry. The Company’s natural gas produced is delivered by the well operators to various purchasers at agreed upon delivery points under a limited number of contract types that are also common in our industry. However, under these contracts, the natural gas may be sold to a single purchaser or may be sold to separate purchasers. Regardless of the contract type, the terms of these contracts compensate the well operators for the value of the oil and natural gas at specified prices, and then the well operators will remit payment to the Company for its share in the value of the oil and natural gas sold.

The following table presents our disaggregated revenue by major source and geographic area for the three months ended March 31, 2018, and 2017 (in thousands).

	Three Months Ended March 31,	
	2018	2017
Revenue (000's):		
North Dakota		
Oil	$805	$934
Natural gas and liquids	90	57
Total	$895	$991
Texas		
Oil	$425	$306
Natural gas and liquids	75	188
Total	$500	$494
Louisiana		
Oil	$-	$-
Natural gas and liquids	160	262
Total	$160	$262

3. PROPERTIES AND EQUIPMENT

As of March 31, 2018, the Company did not have any assets available for sale as compared to $0.7 million of assets available for sale at December 31, 2017. The Company reclassified $0.7 million of "assets available for sale" on the consolidated balance sheet to "property and equipment, net" as of March 31, 2018. These assets are comprised of land parcels owned by the Company in Riverton, Wyoming. Management believes that it is not probable that the assets will be sold within the next 12 months and will continue to be held by the Company. The main drivers behind this belief are (1) the improved financial condition and liquidity position of the Company caused by the completion of Company initiatives and improved global commodity prices, and (2) the rural real estate market where the properties are located traditionally has unpredictable timelines in the completion of real estate transactions.

4. LIQUIDITY

As of March 31, 2018, the Company has working capital of $4.1 million and an accumulated deficit of $125.4 million. Additionally, the Company incurred a net loss of $0.2 million for the three months ended March 31, 2018.

As of March 31, 2018, the Company had cash and equivalents of $2.1 million. Management believes that overhead reductions combined with the reduction in the Company's outstanding debt have poised the Company to survive in the current commodity price environment. Our strategy is to continue to (1) maintain adequate liquidity and selectively participate in new drilling and completion activities, subject to economic and industry conditions, (2) pursue acquisition and disposition opportunities, and (3) evaluate various avenues to strengthen our balance sheet and improve our liquidity position. We expect to fund any near-term capital requirements and working capital needs from existing cash on hand. Because production from existing oil and natural gas wells declines over time, further reductions of capital expenditures used to drill and complete new oil and natural gas wells would likely result in lower levels of oil and natural gas production in the future.

5. COMMODITY RISK DERIVATIVES

The Company's wholly-owned subsidiary Energy One has entered into commodity price derivative contracts ("economic hedges") with BP Energy, a third-party hedge counterparty. The derivative contracts are priced based on West Texas Intermediate ("WTI") quoted prices for crude oil and Henry Hub quoted prices for natural gas. The Company is a guarantor of Energy One's obligations under the economic hedges. The objective of utilizing the economic hedges is to reduce the effect of price changes on a portion of the Company's future oil production, achieve more predictable cash flows in an environment of volatile oil and gas prices and to manage the Company's exposure to commodity price risk. The use of these derivative instruments limits the downside risk of adverse price movements. However, there is a risk that such use may limit the Company's ability to benefit from favorable price movements. Energy One may, from time to time, add incremental derivatives to hedge 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 its existing positions. The Company does not engage in speculative derivative activities or derivative trading activities, nor does it use derivatives with leveraged features. The Company had a net liability from commodity risk derivatives of $0.1 million at March 31, 2018. Presented below is a summary of outstanding crude oil and natural gas swaps as of March 31, 2018.

	Position	Begin	End	**Quantity (bbls/d)**	**Price**
Crude oil price swaps	Bought	4/1/18	6/30/18	150	52.20
Crude oil call option	Bought	4/1/18	4/30/18	150	60.00

	Position	Begin	End	**Quantity (mcf/d)**	**Price**
Natural gas price swaps	Bought	4/1/18	12/31/18	500	3.01

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Derivatives are recorded at fair value in the consolidated balance sheet. Changes in fair value are included in the “change in unrealized gain (loss) on oil price risk derivatives” in the consolidated statements of operations. For the three months ended March 31, 2018 and 2017, the Company’s unrealized gains (losses) from derivatives amounted to $0.1 and $0.0 million, respectively. Derivative contract settlements are included in the “realized gain (loss) on oil price risk derivatives” in the consolidated statement of operations. For the three months ended March 31, 2018 and 2017, the Company’s realized gain (loss) from derivatives amounted to $(0.2) and $0.0 million, respectively. All derivative positions are carried at their fair value on the condensed consolidated balance sheet and are included in “Commodity price risk derivatives.” The following table summarizes the fair value of our open commodity derivatives as of March 31, 2018, and December 31, 2017 (in thousands). Please see Note 13 for further disclosure.

	March 31, 2018			December 31, 2017		
Fair Value of Oil and Natural Gas Derivatives (in thousands)	Gross Amount	Amount Offset	As Presented	Gross Amount	Amount Offset	As Presented
Fair value of oil and natural gas derivatives – Current Assets	$126	$(126)	$ -	$168	$(168)	$ -
Fair value of oil and natural gas derivatives – Current Liabilities	(170)	63	(107)	(216)	55	(161)

6. OIL AND GAS PRODUCING ACTIVITIES

Ceiling Test and Impairment

The reserves used in the Company’s full cost ceiling test incorporate assumptions regarding pricing and discount rates in the determination of present value. In the calculation of the ceiling test as of March 31, 2018, the Company used a price of $50.27 per barrel for oil and $3.93 per MMbtu for natural gas (in each case adjusted for transportation, quality, and basis differentials applicable to our properties on a weighted average basis) to compute the future cash flows of the Company’s producing properties. These prices compare to $47.01 per barrel for oil and $2.98 per MMbtu for natural gas used in the calculation of the ceiling test as of December 31, 2017. The discount factor used was 10%.

For the three months ended March 31, 2018 and 2017, the Company recorded no impairment charges.

7. DEBT

On December 27, 2017, U.S. Energy Corp. received shareholder approval for the exchange agreement ("Exchange Agreement") by and among the Company, the Company's wholly owned subsidiary Energy One LLC and APEG Energy II, L.P., ("APEG"), an entity controlled by Angelus Private Equity Group, LLC pursuant to which, on the terms and subject to the conditions of the Exchange Agreement, APEG exchanged $4,463,380 of outstanding borrowings under the Company's Credit Facility, for 5,819,270 new shares of common stock of the Company, par value $0.01 per share, with an exchange price of $0.767 representing a 1.3% premium over the 30-day volume weighted average price of the Company's common stock on September 20, 2017 (the "Exchange Shares"). Accrued, unpaid interest on the Credit Facility held by APEG was paid in cash at the closing of the transaction. As of March 31, 2018, APEG holds approximately 47% of the outstanding Common Stock of U.S. Energy.

Energy One, a wholly-owned subsidiary of the Company, has a Credit Facility (the "Credit Facility") with APEG Energy II, L.P. ("APEG") which matures in July 2019. As of March 31, 2018, outstanding borrowings under the Credit Facility amounted to $0.9 million. Borrowings under the Credit Facility are secured by Energy One's oil and gas producing properties. The interest rate on the Credit Facility is currently fixed at 8.75%.

Energy One is required to comply with customary affirmative covenants and with certain negative covenants. The principal negative financial covenants do not permit (as the following terms are defined in the Fifth Amendment to the Credit Agreement) (i) Proved Developed Producing Coverage Ratio to be less than 1.2 to 1; and (ii) the current ratio to be less than 1.0 to 1.0. Additionally, the Credit Agreement prohibits or limits Energy One's ability to incur additional debt, pay cash dividends and other restricted payments, sell assets, enter into transactions with affiliates, and to merge or consolidate with another company. The Company is a guarantor of Energy One's obligations under the Credit Agreement. As of March 31, 2018, the Company was in compliance with all Credit Facility covenants.

8. COMMITMENTS AND CONTINGENCIES

Commitments

Lessee Operating Leases. In August 2017, the Company entered into a lease agreement for office space in Denver, Colorado. The future minimum rental commitment under this sublease requires payments of $0.4 million

Year	Cash Commitment
2018	$ 52,819
2019	71,716
2020	73,125
2021	74,533
2022	75,941
2023	6,338

Contingencies

From time to time, the Company is party to certain legal actions and claims arising in the ordinary course of business. While the outcome of these events cannot be predicted with certainty, management does not expect these matters to have a materially adverse effect on the Company's financial position or results of operations. As of March 31, 2018, the Company was not subject to any contingent liabilities that would have a material impact to the financials.

9. SHAREHOLDERS' EQUITY

Preferred Stock

The Company's articles of incorporation authorize the issuance of up to 100,000 shares of preferred stock, $0.01 par value. Shares of preferred stock may be issued with such dividend, liquidation, voting and conversion features as may be determined by the Board of Directors without shareholder approval. The Company is authorized to issue 50,000 shares of Series P preferred stock in connection with a shareholder rights plan that expired in 2011. In February 2016 the Board of Directors approved the designation of 50,000 shares of Series A Convertible Preferred Stock in connection with the disposition of the Company's mining segment.

Common Stock

On January 5, 2018, we entered into a common stock sales agreement with a financial institution pursuant to which we may offer and sell, through the sales agent, common stock representing an aggregate offering price of up to $2.5 million through an at-the-market continuous offering program. During the quarter ended March 31, 2018 we issued an aggregate of 640,163 shares of common stock through our continuous at-the-market offering program at an average price of $1.47 per share for total proceeds of approximately $0.9 million.

Warrants

On December 21, 2016, the Company completed a registered direct offering of 1,000,000 shares of common stock at a net gross price of $1.50 per share. Concurrently, the investors received warrants to purchase 1,000,000 shares of Common Stock of the Company at an exercise price of $2.05 per share, subject to adjustment, for a period of five years from closing. The total net proceeds received by the Company was approximately $1.32 million. The fair value of the warrants upon issuance was $1.24 million, with the remaining $0.08 million being attributed to common stock. The warrants contain a dilutive issuance and other liability provisions which cause the warrants to be accounted for as a liability. Such warrant instruments are initially recorded as a liability and are accounted for at fair value with changes in fair value reported in earnings. As of March 31, 2018, the Company had a warrant liability of $0.9 million. As a result of common stock issuances made during the three months ended March 31, 2018, the warrant exercise price was reduced from $2.05 to $1.13 per share pursuant to the original warrant agreement.

Stock Options

From time to time, the Company grants stock options under its incentive plan covering shares of common stock to employees of the Company. Stock options, when exercised, are settled through the payment of the exercise price in exchange for new shares of stock underlying the option. These awards typically expire ten years from the grant date.

For the three months ended March 31, 2018 and 2017, total stock-based compensation expense related to stock options was $0.01 million and $0.1 million respectively. As of March 31, 2018, there was $0.08 million of unrecognized expense related to unvested stock options, which will be recognized as stock-based compensation expense through November 2019. For the three months ended March 31, 2018, no stock options were granted, exercised, forfeited or expired. Presented below is information about stock options outstanding and exercisable as of March 31, 2018 and December 31, 2017:

	March 31, 2018		December 31, 2017	
	Shares	**Price (1)**	Shares	**Price (1)**
Stock options outstanding	389,687	$8.05	389,687	$8.05
Stock options exercisable	279,687	$10.76	274,132	$10.79

(1) Represents the weighted average price.

The following table summarizes information for stock options outstanding and exercisable at March 31, 2018:

Options Outstanding					Options Exercisable	
Number of Shares	Exercise Price Range Low	High	Weighted Average	Remaining Contractual Term (years)	Number of Shares	Weighted Average Exercise Price
56,786	$9.00	$9.00	$ 9.00	6.8	56,786	$ 9.00
49,504	12.48	12.48	12.48	5.3	49,504	12.48
98,396	13.92	17.10	15.01	1.6	98,396	15.01

15,001	22.62	30.24	24.03	5.3	15,001	24.03
60,000	0.72	0.72	0.72	9.4	60,000	0.72
110,000	1.16	1.16	1.16	9.6	-	-
389,687	$0.72	$30.24	$ 8.05	6.4	279,687	$ 10.76

As of March 31, 2018, 981,008 shares are available for future grants under the Company’s stock option plans.

10. INCOME TAXES

The Company has estimated the applicable effective tax rate expected for the full fiscal year. The Company’s effective tax rate used to estimate income taxes on a current year-to-date basis for the three months ended March 31, 2018, and 2017, is 0% and 0%, respectively.

On December 27, 2017, as a result of a stock issuance (see Note 7) the gross deferred tax assets are subject to limitations under I.R.C. Section 382. The Company still maintains a gross deferred tax asset position that is subject to a valuation allowance.

Deferred tax assets (“DTAs”) are recognized for the expected future tax consequences of temporary differences between the financial reporting and tax basis of assets and liabilities and for operating losses and tax credit carry forwards. We review our DTAs and valuation allowance on a quarterly basis. As part of our review, we consider positive and negative evidence, including cumulative results in recent years. Consistent with the position at December 31, 2017, the Company maintains a full valuation allowance recorded against all DTAs. The Company therefore had no recorded DTAs as of March 31, 2018. We anticipate that we will continue to record a valuation allowance against our DTAs in all jurisdictions of the Company until such time as we are able to determine that it is “more-likely-than-not” that those DTAs will be realized.

The Company recognizes, measures, and discloses uncertain tax positions whereby tax positions must meet a “more-likely-than-not” threshold to be recognized. During the quarters ended March 31, 2018 and 2017, no adjustments were recognized for uncertain tax positions.

The Company does not expect to pay any federal or state income taxes for the fiscal year ended December 31, 2018.

11. EARNINGS (LOSS) PER SHARE

Basic earnings (loss) per share is computed based on the weighted average number of common shares outstanding. For the three months ended March 31, 2018 and 2017, common stock equivalents excluded from the calculation of weighted average shares because they were antidilutive are as follows:

	2018	2017
Stock options	389,687	390,525
Unvested shares of restricted common stock	-	356,555
Total	389,687	747,080

12. SIGNIFICANT CONCENTRATIONS

The Company has exposure to credit risk in the event of nonpayment by the joint interest operators of the Company’s oil and gas properties. Approximately 84% of the Company’s proved developed oil and gas reserve value is associated with properties that are operated by three operators: Operator A: 62%, Operator B: 13% and Operator C: 9%.

13. FAIR VALUE MEASUREMENTS

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. In determining fair value, the Company uses various methods including market, income and cost approaches. Based on these approaches, the Company often utilizes certain assumptions that market participants would use in pricing the asset or liability, including assumptions about risk and the risks inherent in the inputs to the valuation technique. These inputs can be readily observable, market corroborated, or generally unobservable inputs. The Company utilizes valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs. Based on the observability of the inputs used in the valuation techniques the Company is required to provide the following information according to the fair value hierarchy. The fair value hierarchy ranks the quality and reliability of the information used to determine fair values. Financial assets and liabilities carried at fair value will be classified and disclosed in one of the following three categories:

Level 1 - Quoted prices for identical assets and liabilities traded in active exchange markets, such as the New York Stock Exchange.

Level 2 - Observable inputs other than Level 1 including quoted prices for similar assets or liabilities, quoted prices in less active markets, or other observable inputs that can be corroborated by observable market data. Level 2 also includes derivative contracts whose value is determined using a pricing model with observable market inputs or can be derived principally from or corroborated by observable market data.

Level 3 - Unobservable inputs supported by little or no market activity for financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation; also includes observable inputs for nonbinding single dealer quotes not corroborated by observable market data.

The Company has processes and controls in place to attempt to ensure that fair value is reasonably estimated. The Company performs due diligence procedures over third-party pricing service providers in order to support their use in the valuation process. Where market information is not available to support internal valuations, independent reviews of the valuations are performed and any material exposures are evaluated through a management review process.

While the Company believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different estimate of fair value at the reporting date. The following is a description of the valuation methodologies used for complex financial instruments measured at fair value:

Marketable Equity Securities Valuation Methodologies

The fair value of available for sale securities is based on quoted market prices obtained from independent pricing services. Accordingly, the Company has classified these instruments as Level 1.

Derivative Assets and Liabilities

Derivative assets and liabilities, at fair value, are included on our consolidated balance sheets as current or non-current assets or liabilities based on the anticipated timing of cash settlements under the related contracts. Changes in the fair value of our commodity derivative contracts, not designated as cash-flow hedges, are recorded in earnings as they occur and included in income (expense) on our consolidated statements of operations. We estimate the fair values of swap contracts based on the present value of the difference in exchange-quoted forward price curves and contractual settlement prices multiplied by notional quantities. Accordingly, the Company has classified these instruments as Level 2.

Warrant Valuation Methodologies

The warrants contain a dilutive issuance and other liability provisions which cause the warrants to be accounted for as a liability. Such warrant instruments are initially recorded and valued as a level 3 liability and are accounted for at fair value with changes in fair value reported in earnings.

The Company estimated the value of the warrants issued in connection with the closing of its registered direct offering on December 21, 2016 on March 31, 2017 to be $1,030,000, or $1.03 per warrant, using the Monte Carlo model with the following assumptions: a term expiring June 21, 2022, exercise price of $2.05, stock price of $1.28, average volatility rate of 90%, and a risk-free interest rate of 2.01%. The Company re-measured the warrants as of March 31, 2018, using the same Monte Carlo model, using the following assumptions: a term expiring June 21, 2022, exercise price of $1.13, stock price of $1.23, average volatility rate of 95%, and a risk-free interest rate of 2.5%. The "ratchet" anti-dilution provision in the warrants may result in the downward adjustment of the exercise price of the warrants. If the Company issues common stock, options or common stock equivalents at a price less than the exercise price of the warrants, subject to certain customary exceptions, the exercise price of the warrants is reduced to that lower price, however in no event will the exercise price be reduced below $.392 per share. As of March 31, 2018, the fair value of the warrants was $930,000, or $0.93 per warrant, and was recorded as a liability on the accompanying consolidated balance sheets. An increase in any of the variables would cause an increase in the fair value of the warrants. Likewise, a decrease in any variable would cause a decrease in the value of the warrants.

Other Financial Instruments

The carrying amount of cash and equivalents, oil and gas sales receivable, other current assets, accounts payable and accrued expenses approximate fair value because of the short-term nature of those instruments. The recorded amounts for the Credit Facility discussed in Note 7 approximates the fair market value due to the variable nature of the interest rates, and the fact that market interest rates have remained substantially the same since the latest amendment to the Credit Facility.

Recurring Fair Value Measurements

Recurring measurements of the fair value of assets and liabilities as of March 31, 2018 and December 31, 2017 are as follows:

	March 31, 2018				December 31, 2017			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
Marketable equity securities:								