

US ENERGY CORP
Form 10-K
March 13, 2009

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-K

(Mark One)

- Annual report pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year Ended December 31, 2008
- 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 Company as Specified in its Charter)

Wyoming
(State or other jurisdiction of
incorporation or organization)

83-0205516
(I.R.S. Employer
Identification No.)

877 North 8th West, Riverton, WY
(Address of principal executive offices)

82501
(Zip Code)

Registrant's telephone number, including area
code:

(307) 856-9271

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

None

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

Common Stock, \$0.01 par value

(Title of Class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. YES NO

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. YES NO

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 Company was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES NO

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

Large accelerated filer Accelerated filer Non-accelerated filer

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

State the aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold, or the average bid and ask price of such common equity, as of the last business day of the registrant's most recently completed second fiscal quarter (June 30, 2008) \$69,971,930.

Class	Outstanding at March 9, 2009
Common stock, \$.01 par value	21,521,329

Documents incorporated by reference: None.

Indicate by check mark if disclosure of delinquent filers, pursuant to Item 405 of Regulation S-K is not contained herein and will not be contained, to the best of the Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K .

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DISCLOSURE REGARDING FORWARD-LOOKING STATEMENTS

This Annual Report on Form 10-K includes "forward-looking statements" within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). All statements other than statements of historical fact are forward-looking statements, including without limitation the statements under Management's Discussion and Analysis of Financial Condition and Results of Operations; the disclosures about possible exploration, development and operation of our molybdenum and oil and gas and geothermal properties; and future business plans. Whenever words like "expect," "anticipate" or "believe" are used, we are making forward-looking statements.

Although we believe that our forward-looking statements are reasonable, we don't know if our expectations will prove to be correct. Where we express an expectation or belief as to future events or results, such expectation or belief is expressed in good faith and believed to have a reasonable basis. However, our forward-looking statements are subject to risks and uncertainties, which could cause actual results to differ materially from future results expressed, projected or implied by those forward-looking statements.

The forward-looking statements should be considered in the context of all the information in this Annual Report, including the statements in ITEM 1A, RISK FACTORS below.

PART I

ITEM 1 - BUSINESS

General

Business Objective and Strategy

U.S. Energy Corp. (“USE” or the “Company”), a Wyoming corporation organized in 1966, acquires and develops energy-related and other mineral properties. Our corporate objective is to diversify capital investments across two sectors (primarily oil and gas and geothermal energy) while proceeding with development of our molybdenum property in Colorado. In 2009 and following years, we are seeking to increase recurring revenues from oil and gas production over a period of up to ten years, we look to develop our geothermal properties and will be working to develop the Mount Emmons molybdenum project (“Mount Emmons”) into a major operating mine with Thompson Creek Metals Company (USA). Geothermal properties are being acquired for exploration and development and eventual sale or joint venture or operation; revenues from this investment would not be expected to be realized until three to five years from date of investment. A multifamily apartment project serving the residential market in Gillette, Wyoming was completed by us in 2008 and is generating positive cash flow. We do not intend to make more investments in the housing sector.

In general, with the exception of the one housing complex, our strategy now is to partner with (or acquire) other companies that have the experience and technical staff to acquire and explore for oil and gas, mineral or renewable resource properties and to develop Mount Emmons. We will hire geologists and engineers as needed. Additionally we may buy field equipment and assume responsibilities related to operations as we acquire producing properties. In the interim we will continue to utilize independent consultants to assist us in evaluations.

All business is conducted through USE, except for the multifamily apartment project in Gillette, Wyoming, which is conducted through the wholly-owned subsidiary Remington Village, LLC.

Traditional Energy

Oil and Gas. In 2008, we initiated investment activities with three separate industry partners.

- Two on shore Gulf Coast wells were drilled with PetroQuest Energy, Inc. (NYSE “PQ”). One was drilled and successfully completed as an oil and gas producer, and the second was a dry hole. More wells may be drilled with PetroQuest in 2009 and subsequent years.
- A drilling program for up to ten wells with Texas Land & Petroleum Company, LLC (a private company) is proposed to begin in first or second quarter 2009 on acreage located east of Dallas, Texas.
- A combination lease acquisition and seismic analysis program with Yuma Exploration and Production Company, Inc. (also a private company) for acreage located in South Louisiana is underway with drilling expected to begin in fourth quarter 2009.

The abrupt oil price decline in 2008 and the lack of liquidity in the capital markets are presenting opportunities for continued investment in traditional energy. Land acquisition and exploration costs are expected to decrease in 2009 and possibly beyond, as major and independent oil and gas companies in the United States reduce exploration budgets. We intend to continue screening the many available opportunities, including drilling programs, production purchases, and possible equity investments in established companies. Our intent is to build production while entry and exploration costs are low, anticipating that oil prices will increase when global consumption returns to the mid-2008 level. Investment decisions for oil and gas projects are made on the basis of risk-adjusted expected returns using current commodity prices. Industry accepted forecasts for commodity prices are also used in our risk assessments for each project.

Renewable Energy - Geothermal

On December 17, 2008, we bought a minority interest (25% for \$3,455,000) in Standard Steam Trust, LLC (“SST”), a Denver, Colorado based private geothermal resource acquisition and development company. Current capitalization of SST is \$13.8 million (with other partners), which now includes approximately 60,000 acres of BLM, state and fee land in seven prospect areas in three states. Substantial additional capital is expected to be raised in 2009 through capital calls and/or admission of new partners. Dilution, but no penalty, would be associated with a partner’s non-participation in a capital call. SST is managed by Terra Caliente, LLC (“Terra”), also a private Denver based company, with oversight by an advisory board (USE is one of three members) as to budgets, major expenditures, sale or other disposition of prospects, and similar matters. Terra has substantial cash invested for its own account. In addition, Terra will receive a substantial back-in interest (25%), at such time as all other investors (including Terra) receive cash or securities equal to their investment.

Today, there are 66 geothermal-powered electrical generation plants in the United States, providing 2,960 MW of baseload (constant) power to utilities, which represents less than 1% of the electrical generation nationwide. Twenty-six states have implemented mandatory renewable energy portfolio standards, requiring utilities to generate from 5% to 33% of their power from renewable sources. The deadlines for compliance with these standards take effect from 2009 to 2025 depending on the state.

Geothermal power plants are “zero emission” and thus meet the renewable energy mandates. The plants use existing technology to circulate hot water from wells through binary or flash heat exchangers to produce the power to drive turbines that generate green energy. All the water in the binary system is injected back into the earth to recharge the resource.

We intend to advance each individual prospect through the exploration and feasibility stages before determining whether to: 1) sell a prospect to a utility, 2) bring an industry partner on a joint venture basis, or 3) pursue further financing with institutional capital to further advance revenue generating capabilities, which may include the operation of power plants. The first phase of the project (through 2009) will be assembling a portfolio of industrial scale prospects with a total targeted power resource of approximately 2,000 MW; individual prospects are targeted at 100 to 500 MW. The second phase consisting of early science of geology, geophysics and temperature gradient drilling is also expected to be completed in 2009. The third phase of work is scheduled for 2010 and will consist of production well drilling on one of the prospects to quantify the geothermal resource present there. Permitting and construction could follow beginning as early as the end of 2011.

Energy-Related Housing

At year end 2008, we completed construction of a nine building multifamily apartment complex in Gillette, Wyoming (216 units). Occupancy was 88% at December 31, 2008 (93% at March 9, 2009). Given the extremely low interest rates available on U.S. Treasury Bills, we elected to pay off the construction loan in January 2009 with internal funds (\$16.8 million including interest), instead of obtaining permanent financing with interest in the range of 6.2% to 6.7%. Additionally, the Company had previously invested \$7.7 million in the project and will also pay \$487,700 as its final payment to the construction contractor. The total all-in cost of the project was therefore \$24.5 million. Pending a possible sale of the project in the next three to five years, we expect that net rental income will provide an annual return of up to 8% on the \$25 million total investment, assuming current high occupancy rates continue.

Molybdenum

The Company owns 100% of a molybdenum property in Colorado – the “Mount Emmons” property. In March 2008, a prior partner (Kobex Resources, Ltd.) terminated its agreement to develop the property with U.S. Energy. In August 2008, the Company signed an agreement with Thompson Creek Metals Company USA (“TCM”), a major molybdenum mining and refining company, for TCM to earn up to a 75% interest in the property after TCM spends up to \$400 million in expenditures and option payments. This is expected to be a long-term (up to 10 years) project.

Industry Segments/Principal Products

At December 31, 2008, we have three operating segments: Minerals, oil and gas and real estate.

Minerals: We are involved primarily in the acquisition, exploration and development of mineral properties, and (in 2008, from oil and gas properties) mineral production. In third quarter 2008, the Company sold most of its equity stake in Sutter Gold Mining Inc. for cash, and received an option payment from TCM related to the Mount Emmons property. In December 2008, we expanded our involvement in minerals to the acquisition, exploration and development of geothermal properties.

Oil and Gas: In fourth quarter 2008, our first oil and gas revenues were recorded from ownership of a minority working interest in a U.S. Gulf Coast region well. Working interests in other prospects are planned to be acquired, and additional exploratory wells are expected to be drilled in 2009.

Real Estate: Rental revenue was received in 2008 from the apartment complex in Gillette, Wyoming, which is held by Remington Village, LLC., a 100% owned subsidiary. The Company also holds 13.84 undeveloped acres in Riverton, Wyoming (adjacent to our corporate headquarters); this property was acquired in late 2007 for possible commercial development but is now for sale without development.

Office Location and Website

Principal executive offices are located in the Glen L. Larsen building at 877 North 8th West, Riverton, Wyoming 82501, telephone 307-856-9271.

Our website is www.usnrg.com. We make available on this website, through a direct link to the Securities and Exchange Commission’s website at <http://www.sec.gov>, free of charge, our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, proxy statements and Forms 3, 4 and 5 for stock ownership by directors and executive officers. You may also find information related to our corporate governance, board committees and code of ethics on our website.

Corporate Developments in 2008

Mount Emmons Project (molybdenum), formerly known as Lucky Jack - Agreement with Thompson Creek Mining Company (USA)

In March 2008, Kobex Resources Ltd. terminated its October 2006 agreement with USE to earn up to a 65% interest in the Mount Emmons Project for option payments and property expenditures of \$65 million. Kobex reported that its decision was based upon its perception that the Project's regulatory and legal uncertainties were incompatible with Kobex' further investment. The termination was made without penalty to either party, or any credit to Kobex for the approximate \$8 million it had spent for option payments to USE and property expenditures. At December 31, 2008, USE owned 267,932 shares of Kobex common stock which it received as a portion of Kobex's participation payments.

On August 19, 2008, USE and Thompson Creek Metals Company USA ("TCM"), a Colorado corporation headquartered in Englewood, Colorado, entered into an Exploration, Development and Mine Operating Agreement for USE's Mount Emmons molybdenum property. TCM assigned the agreement to Mt. Emmons Moly Company, a Colorado corporation and wholly owned subsidiary of TCM effective September 11, 2008. Under the terms of the agreement TCM may acquire up to a 75% interest for \$400 million (option payments of \$6.5 million and project expenditures of \$393.5 million).

The Agreement covers two distinct periods of time: The Option Period, during which TCM may exercise an option ("the Option") to acquire up to a 50% interest in Mount Emmons; and the Joint Venture Period, during which TCM will form a joint venture with USE and also have an option to acquire up to an additional 25% interest in Mount Emmons.

The Option Period:

TCM paid USE \$500,000 at closing (not refundable) and the first \$1.0 million option payment on January 2, 2009. Under the terms of the agreement, TCM has the option to pay USE an additional five annual payments of \$1.0 million each beginning on January 1, 2010 for the Option.

The Option is exercisable in two stages:

First Stage - For 15%. At TCM's election within 36 months of incurring a minimum of \$15,000,000 in expenditures on or related to Mount Emmons (including the option payments to USE), TCM may acquire an undivided working interest of 15% in Mount Emmons and the business of the project. Following is a table of the options and expenditures due from TCM through 2011:

Option Payments to USE or Expenditure Amount, and Deadline			
\$	500,000	Option Payment	At Closing* December 31,
\$	2,000,000	Expenditures	2008*
\$	1,000,000	Option Payment	January 1, 2009** December 31,
\$	4,000,000	Expenditures	2009
\$	1,000,000	Option Payment	January 1, 2010 December 31,
\$	4,000,000	Expenditures	2010
\$	1,000,000	Option Payment	January 1, 2011
\$	1,500,000	Expenditures	June 30, 2011

\$ 15,000,000

* Paid in 2008

** Paid in 2009

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Costs to operate the water treatment plant at the property will be paid solely by USE until TCM elects to exercise its option to own an interest in the property.

Second Stage - For an Additional 35%. If by July 31, 2018, TCM has incurred a total of at least \$43,500,000 of expenditures (including amounts during the first stage) and paid USE the \$6,500,000 of option payments (for a total of \$50,000,000), TCM may elect to acquire an additional 35% (for a total of 50% after it exercised the first stage option for 15%). None of the interests acquired by TCM will be subject to any overriding royalties to the Company.

Failure by TCM to incur the required amount of expenditures by a deadline, or make an Option Payment to USE, subject to the terms of the Agreement, the Agreement may be terminated without further obligation to USE from TCM. TCM may terminate the Agreement at any time, but if earned and elected to accept, TCM will retain the interest earned and be responsible for that share of all costs and expenses related to Mount Emmons.

The Joint Venture Period; Joint Venture Terms:

Within six months of TCM's election to acquire the 50% interest, TCM, in its sole discretion, shall elect to form a Joint Venture and either: (i) participate on a 50%-50% basis with USE, with each party to bear their own share of expenditures from formation date; or (ii) acquire up to an additional 25% interest in the project by paying 100% of all expenditures equal to \$350,000,000 (for a total of \$400,000,000, including the \$50,000,000 to earn the 50% interest in the second stage of the Option Period), at which point the participation would be 75% TCM and 25% USE. Provided however, if TCM makes expenditures of at least \$70 million of the \$350 million in expenditures and TCM decides not to fund the additional \$280 million in expenditures, TCM will have earned an additional 2.5% (for a total of 52.5%). Thereafter, TCM will earn an incremental added percentage interest for each dollar it spends toward the total \$350,000,000 amount.

At any time before incurring the entire \$350,000,000, TCM in its sole discretion, may determine to cease funding 100% of expenditures, in which event USE and TCM then would share expenditures in accordance with their participation interests at that date, in accordance with the Joint Venture. With certain exceptions, either party's interest is subject to dilution in the event of non-participation in funding the Joint Venture's budgets.

Management of the Property

TCM is the Project Manager of Mount Emmons. A four person Management Committee governs the projects' operations, with two representatives each from USE and TCM. TCM will have the deciding vote in the event of a committee deadlock.

If and when Mount Emmons goes into production, TCM will purchase USE's share of the molybdenic oxide produced at an average price as published in Platt's Metals Weekly price less a discount with a cap and a floor. The discount band will be adjusted every five years based upon the United States' gross domestic product.

Sale of Majority Position in Sutter Gold Mining Inc.

In August 2008, we sold 39,062,720 common shares of Sutter Gold Mining Inc. ("SGMI"), which until the sale was a majority-owned subsidiary of USE. The shares (which were sold to RMB Resources Ltd. ("RMB") as trustee for the Telluride Investment Trust for Cdn \$5.4 million) represented 49.9% of the outstanding shares of SGMI. The transaction was closed in accordance with the June 2008 share purchase agreement. We retained an equity position of 3,550,361 shares.

In conjunction with the closing, we also participated in a private placement by SGMI, purchasing 4,545,455 units at Cdn. \$0.11 per unit for total Cdn. \$500,000. Each unit was comprised of two shares and a 24-month warrant (each for one share at Cdn. \$0.15). As additional consideration for participating in the private placement USE received 24 month warrants to purchase an additional 2,272,728 of SGMI at a exercise price of Cdn \$0.15 per share. As a result of the private placement, USE owns 8,095,816 shares or approximately 8.4% of the outstanding shares of SGMI plus the warrants. We also have retained a 5% net profits royalty on the project, which will be reduced to a 1% net profits royalty on the project after USE receives an additional US \$4.6 million from production. This royalty is limited to the California property, and does not apply to SGMI properties in Mexico or elsewhere.

SGMI has exploration properties in California and Mexico. USE owns a minority equity position in SGMI after it sold its controlling interest to RMB. USE has no representation on SGMI's board of directors. Allen Winters continues to serve as a director of USE and of SGMI, but Mr. Winters does not represent USE as a director of SGMI. None of the USE officers or other employees are officers or employees of SGMI.

Exercise of Warrants and Options

In 2008, we issued a total of 364,198 shares of common stock pursuant to the exercise of warrants; 82,500 shares from the exercise of director options; 85,000 shares pursuant to the 2001 stock compensation plan as compensation to officers; and 126,878 shares for the annual funding of the Employee Stock Ownership Plan. We also cancelled 2,160,129 shares purchased through the stock buyback plan and 155,811 shares held by the ESOP as undistributed shares.

Research and Development

No research and development expenditures have been incurred, either on the Company's account or sponsored by a customer of the Company, during the past three fiscal years.

Environmental

Operations are subject to various federal, state and local laws and regulations regarding the discharge of materials into the environment or otherwise relating to the protection of the environment, including the National Environmental Policy Act ("NEPA"), Clean Air Act, the Clean Water Act, the Resource Conservation and Recovery Act ("RCRA"), and the Comprehensive Environmental Response Compensation Liability Act ("CERCLA"). With respect to proposed mining operations at the Mount Emmons property, Colorado's mine permitting statute, Abandoned Mine Reclamation Act, and industrial development and siting laws and regulations, also may affect the project. Management believes the Company complies in all material respects with existing environmental regulations. For information on the approximate reclamation costs (decommissioning, decontamination and other reclamation efforts for which we are primarily responsible or potentially responsible) related to the Mount Emmons project, see the consolidated financial statements included in PART III of this Annual Report.

Gas and oil operations also are subject to various federal, state and local governmental and environmental regulations, including regulations governing natural gas and oil production, federal and state regulations for environmental quality and pollution control, and state limits on allowable rates of production by well. These regulations may affect the amount of natural gas and oil available for sale, the availability of adequate pipeline and other regulated transportation and processing facilities, and other matters. State and federal regulations generally are intended to prevent waste of natural gas and oil, protect rights to produce natural gas and oil between owners in a common reservoir, control the amount produced by assigning allowable rates of production and control contamination of the environment. Pipelines are subject to the jurisdiction of various federal, state and local agencies. From time to time, various proposals are made by regulatory agencies and legislative bodies. Regulatory changes can adversely impact the permitting and exploration and development of mineral and oil and gas properties including the availability of capital.

Although we own only non-operated oil and gas interests as of the date of this Annual Report, our activities are still subject to environmental protection regulations. Operators are required to obtain drilling permits, restrict substances that can be released into the environment, and require remedial work to mitigate pollution from operations (such as pollution from operations), close and cover disposal pits, and plug abandoned wells. Violations by the operator could result in substantial liabilities, and we would have to pay our share. Based on the current regulatory environment in those states where we have current oil and gas investments, we don't expect to make any material capital expenditures for environmental control facilities.

Failure to comply with these regulations could result in substantial fines, environmental remediation orders and/or potential shut down of a project until compliance is achieved. Failure to timely obtain required permits to start operations at a project could cause delay and/or the failure of the project resulting in a potential write-off of the investments made.

Employees

As of March 13, 2008, we had 19 full-time employees.

Mining Claim Holdings