US ENERGY CORP
Form 10-Q
August 10, 2015

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

Quarterly report pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended June 30, 2015 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: 0-6814

U.S. ENERGY CORP.
(Exact name of registrant 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

Not Applicable
(Former name, address and 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 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 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 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 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	(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

At August 5, 2015 there were 28,047,661 outstanding shares of the Company's common stock, $0.01 par value.

U.S. ENERGY CORP. and SUBSIDIARIES

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PART I. FINANCIAL INFORMATION

ITEM 1. Financial Statements

U.S. ENERGY CORP.
CONDENSED CONSOLIDATED BALANCE SHEETS
ASSETS
(Unaudited)
(In thousands, except shares)

	June 30, 2015	December 31, 2014
Current assets:		
Cash and cash equivalents	$4,067	$4,010
Available for sale securities	30	25
Accounts receivable trade	1,778	3,177
Other current assets	234	288
Total current assets	6,109	7,500
Oil and gas properties under full cost method,		
Proved oil and gas properties	130,172	147,486
Unproved oil and gas properties	8,190	10,188
Exploratory wells in progress	--	2,357
less depletion, depreciation and amortization	(76,691)	(71,762)
Net oil and gas properties	61,671	88,269
Undeveloped mining claims	21,942	21,942
Property, plant and equipment, net of accumulated depreciation of $4,509 and $4,404	3,811	3,942
Other assets	1,885	1,870
Total assets	$95,418	$123,523

The accompanying notes are an integral part of these statements.

U.S. ENERGY CORP.
CONDENSED CONSOLIDATED BALANCE SHEETS
LIABILITIES AND SHAREHOLDERS' EQUITY
(Unaudited)
(In thousands, except shares)

	June 30, 2015	December 31, 2014
Current liabilities:		
Accounts payable	$8,696	$7,441
Accrued compensation	504	441
Commodity risk management liability	335	--
Current portion of debt	6,000	--
Other current liabilities	70	84
Total current liabilities	15,605	7,966
Noncurrent liabilities:		
Long-term debt	--	6,000
Asset retirement obligations	1,218	1,133
Other accrued liabilities	955	1,029
Total noncurrent liabilities	2,173	8,162
Commitments and contingencies:		
Shareholders' equity:		
Common stock, $0.01 par value; unlimited shares authorized 28,388,372 shares issued and 28,047,661 outstanding at June 30, 2015, 28,047,661 issued and outstanding at December 31, 2014	280	280
Additional paid-in capital	124,203	123,980
Accumulated deficit	(46,792)	(16,809)
Other comprehensive loss	(51)	(56)
Total shareholders' equity	77,640	107,395
Total liabilities and shareholders' equity	$95,418	$123,523

The accompanying notes are an integral part of these statements.

U.S. ENERGY CORP.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)
(In thousands except share and per share data)

	Three months ended June 30,		Six months ended June 30,	
	2015	2014	2015	2014
Revenues:				
Oil sales	$2,934	$7,949	$5,231	$15,523
Gas sales	269	872	600	1,353
NGL sales	82	307	133	508
Total revenues	3,285	9,128	5,964	17,384
Operating expenses:				
Oil and gas	2,021	2,586	3,873	4,558
Oil and gas depreciation, depletion and amortization	2,055	3,583	4,929	6,877
Impairment of oil and gas properties	3,208	--	22,448	--
Water treatment plant	455	452	913	909
Mineral holding costs	252	205	547	505
General and administrative	1,221	1,533	2,700	3,139
Total operating expenses	9,212	8,359	35,410	15,988
(Loss) income from operations	(5,927)	769	(29,446)	1,396
Other income and (expenses):				
Realized (loss) on risk management activities	(25)	(374)	(139)	(532)
Unrealized (loss) on risk management activities	(272)	(238)	(335)	(411)
Gain on the sale of assets	--	--	16	28
Miscellaneous income	9	47	48	68
Interest income	1	1	2	2
Interest expense	(66)	(149)	(129)	(245)
Total other income and (expenses)	(353)	(713)	(537)	(1,090)
(Loss) income before income taxes	(6,280)	56	(29,983)	306

The accompanying notes are an integral part of these statements.

U.S. ENERGY CORP.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)
(In thousands except share and per share data)

	Three months ended June 30,		Six months ended June 30,	
	2015	2014	2015	2014
Income taxes:				
Current (provision for)	--	--	--	--
Deferred benefit from	--	--	--	--
	--	--	--	--
Net (loss) income	$(6,280)	$56	$(29,983)	$306
(Loss) income per share basic and diluted	$(0.22)	$--	$(1.07)	$0.01
Weighted average shares outstanding				
Basic	28,047,661	27,785,280	28,047,661	27,761,837
Diluted	28,047,661	28,237,883	28,047,661	28,195,116

The accompanying notes are an integral part of these statements.

U.S. ENERGY CORP.
CONDENSED CONSOLIDATED STATEMENTS OF
COMPREHENSIVE INCOME (LOSS)
(Unaudited)
(In thousands)

	Three months ended June 30,		Six months ended June 30,	
	2015	2014	2015	2014
Net (loss) income:	$(6,280)	$ 56	$(29,983)	$306
Other comprehensive (loss):				
Marketable securities, net of tax	5	(4)	5	(29)
Total comprehensive (loss) income	$(6,275)	$ 52	$(29,978)	$277

The accompanying notes are an integral part of these statements.

U.S. ENERGY CORP.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)
(In thousands)

	For the six months ended June 30, 2015	2014
Cash flows from operating activities:		
Net (loss) income	$(29,983)	$306
Adjustments to reconcile net (loss) income to net cash provided by operations		
Depreciation, depletion & amortization	5,063	7,013
Change in fair value of commodity price risk management activities, net	335	411
Impairment of oil and gas properties	22,448	--
(Gain) on sale of assets	(16)	(28)
Noncash compensation	301	235
Noncash services	36	61
Accounts payable	2,023	58
Overpayment by operators	557	359
Net changes in assets and liabilities	1,354	310
Net cash provided by operating activities	2,118	8,725
Cash flows from investing activities:		
Acquisition and development of oil and gas properties	(3,543)	(19,540)
Acquisition of property, plant and equipment	(4)	(1,213)
Proceeds from sale of oil and gas properties	--	11,515
Proceeds from settlement of lawsuit	1,500	--
Proceeds from sale of property and equipment	16	28
Net change in restricted investments	(30)	(61)
Net cash (used in) investing activities:	(2,061)	(9,271)

The accompanying notes are an integral part of these statements.
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U.S. ENERGY CORP.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)
(In thousands)

	For the six months ended June 30,	
	2015	2014
Cash flows from financing activities:		
Issuance of common stock	--	(55)
Proceeds from new debt	--	8,000
Repayments of debt	--	(9,000)
Net cash (used in) financing activities	--	(1,055)
Net increase (decrease) in cash and cash equivalents	57	(1,601)
Cash and cash equivalents at beginning of period	4,010	5,855
Cash and cash equivalents at end of period	$4,067	$4,254
Supplemental disclosures:		
Interest paid	$129	$245
Non-cash investing and financing activities:		
Acquisition and development of oil and gas properties through accounts payable	$1,325	$2,375
Increase in oil and gas properties through asset retirement obligations	$61	$128

The accompanying notes are an integral part of these statements.

U.S. ENERGY CORP.
Notes to Condensed Consolidated Financial Statements (Unaudited)

1) Basis of Presentation

The accompanying unaudited condensed consolidated financial statements for the periods ended June 30, 2015 and June 30, 2014 have been prepared by U.S. Energy Corp. ("we," "us," "U.S. Energy" or the "Company") in accordance with generally accepted accounting principles in the United States of America ("U.S. GAAP"). The financial statements at June 30, 2015, June 30, 2014 and December 31, 2014 include the Company's wholly owned subsidiary Energy One LLC ("Energy One"), which owns the majority of the Company's oil and gas assets. The Condensed Consolidated Balance Sheet at December 31, 2014 was derived from audited financial statements. In the opinion of the Company, the accompanying condensed consolidated financial statements contain all adjustments (consisting of only normal recurring adjustments) necessary to present fairly the financial position of the Company for the reported periods. Entities in which the Company holds at least 20% ownership or in which there are other indicators of significant influence are accounted for under the equity method, whereby the Company records its proportionate share of the entities' results of operations. Certain information and footnote disclosures normally included in financial statements prepared in accordance with U.S. GAAP have been condensed or omitted and certain prior period amounts have been reclassified to conform to the current period presentation. The unaudited condensed consolidated financial statements should be read in conjunction with the Company's Annual Report on Form 10-K for the year ended December 31, 2014 (the "2014 10-K"). Subsequent events have been evaluated for financial reporting purposes through the date of the filing of this Form 10-Q.

2) Summary of Significant Accounting Policies

We follow accounting standards set by the Financial Accounting Standards Board, commonly referred to as the "FASB." The FASB determines GAAP, which we follow to ensure we consistently report our financial condition, results of operations, and cash flows.

For detailed descriptions of our significant accounting policies, please see the 2014 10-K (Note B, pages 87 to 96).

Use of Estimates

The preparation of financial statements in conformity with U.S. 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 used for depletion and impairment considerations, accrued revenue and related receivables, 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 under the circumstances. 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.

U.S. ENERGY CORP.
Notes to Condensed Consolidated Financial Statements (Unaudited)
(Continued)
Oil and Gas Properties

The Company follows the full cost method in accounting for its oil and gas properties. Under the full cost method, all costs associated with the acquisition, exploration and development of oil and gas properties are capitalized and accumulated in a country-wide cost center. This includes any internal costs that are directly related to development and exploration activities, but does not include any costs related to production, general corporate overhead or similar activities. Proceeds received from property disposals are credited against accumulated cost except when the sale represents a significant disposal of reserves, in which case a gain or loss is recognized. The sum of net capitalized costs and estimated future development and dismantlement costs for each cost center is depleted on the equivalent unit-of-production method, based on proved oil and gas reserves. Excluded from amounts subject to depletion are costs associated with unproved properties.

Full Cost Pool - Full cost pool capitalized costs are amortized over the life of production of proven properties. Capitalized costs at June 30, 2015 and December 31, 2014 which were not included in the amortized cost pool were $8.2 million and $12.5 million, respectively. These costs consist of exploratory wells in progress, seismic costs that are being analyzed for potential drilling locations and land costs related to unevaluated properties. No capitalized costs related to unevaluated properties are included in the amortization base at June 30, 2015 or December 31, 2014.

Ceiling Test Analysis - Under the full cost method, net capitalized costs are limited to the lower of unamortized cost reduced by the related net deferred tax liability and asset retirement obligations or the cost center ceiling. The cost center ceiling is defined as the sum of (i) estimated future net revenue, discounted at 10% per annum, from proved reserves, based on unescalated average prices per barrel of oil and per MMbtu of natural gas at the first day of each month in the 12-month period prior to the end of the reporting period and costs, adjusted for contract provisions and financial derivatives that hedge our oil and gas revenue and asset retirement obligations, (ii) the cost of properties not being amortized, and (iii) the lower of cost or market value of unproved properties included in the cost being amortized, reduced by (iv) the income tax effects related to differences between the book and tax basis of the crude oil and natural gas properties. If the net book value reduced by the related net deferred income tax liability and asset retirement obligations exceeds the cost center ceiling limitation, a non-cash impairment charge is required in the period in which the impairment occurs.

We perform a quarterly ceiling test for each of our oil and gas cost centers. There is only one such cost center in 2015. The reserves used in the ceiling test and the ceiling test itself incorporate assumptions regarding pricing and discount rates over which management has no influence in the determination of present value. In arriving at the ceiling test for the quarter ended June 30, 2015, we used prices of $71.68 per barrel for oil and $3.390 per MMbtu for natural gas (and adjusted for property specific gravity, quality, local markets and distance from markets) to compute the future cash flows of our producing properties. The discount factor used was 10%.

Primarily due to the lower oil prices, the Company recorded proved property impairments of $3.2 and $22.4 million related to its oil and gas assets during the three and six months ended June 30, 2015, respectively. Management will continue to review our unproved properties based on market conditions and other changes and, if appropriate, unproved property amounts may be reclassified to the amortized base of properties within the full cost pool. Recent declines in the price of oil have significantly increased the risk of ceiling test write-downs in future periods.

U.S. ENERGY CORP.
Notes to Condensed Consolidated Financial Statements (Unaudited)
(Continued)

Wells in Progress - Wells in progress represent the costs associated with unproved wells that have not reached total depth or have not been completed as of period end. They are classified as wells in progress and are withheld from the depletion calculation. The costs for these wells are transferred to evaluated property when the wells reach total depth and are completed and the costs become subject to depletion and the ceiling test calculation in future periods.

Mineral Properties

We capitalize all costs incidental to the acquisition of mineral properties. Mineral exploration costs are expensed as incurred. When exploration work indicates that a mineral property can be economically developed as a result of establishing proved and probable reserves, costs for the development of the mineral property as well as capital purchases and capital construction are capitalized and amortized using units of production over the estimated recoverable proved and probable reserves. Costs and expenses related to general corporate overhead are expensed as incurred. All capitalized costs are charged to operations if we subsequently determine that the property is not economical due to permanent decreases in market prices of commodities, excessive production costs or depletion of the mineral resource. Mineral properties at June 30, 2015 and December 31, 2014 reflect capitalized costs associated with our Mt. Emmons molybdenum property near Crested Butte, Colorado.

Our carrying balance in the Mt. Emmons property at June 30, 2015 and December 31, 2014 is as follows:

	(In thousands)	
	June 30, 2015	December 31, 2014
Costs associated with Mount Emmons beginning of year	$21,942	$ 20,739
Property purchase [1]	--	1,203
Costs at the end of the period	$21,942	$ 21,942

[1] On January 21, 2014, the Company acquired Thompson Creek Metals' ("TCM") 50% interest in 160 acres of fee land in the vicinity of the Mt. Emmons project mining claims for $1.2 million. The property was originally acquired jointly by the Company and TCM in January 2009.

Properties and Equipment

Components of Property, Plant and Equipment as of June 30, 2015 and December 31, 2014 are as follows:

	(In thousands)	
	June 30, 2015	December 31, 2014
Property, plant and equipment	$8,320	$ 8,346
Less accumulated depreciation	(4,509)	(4,404)
Net book value	$3,811	$ 3,942

U.S. ENERGY CORP.
Notes to Condensed Consolidated Financial Statements (Unaudited)
(Continued)

Land, buildings, improvements, machinery and equipment are carried at cost. Depreciation of buildings, improvements, machinery and equipment is provided principally by the straight-line method over estimated useful lives ranging from 3 to 45 years.

Derivative Instruments

The Company uses derivative instruments, typically fixed-rate swaps and costless collars, to manage price risk relating to its oil and gas production. All derivative instruments are recorded in the consolidated balance sheets at fair value. The Company offsets fair value amounts recognized for derivative instruments executed with the same counterparty. Although the Company does not designate any of its derivative instruments as cash flow hedges, such derivative instruments provide an economic hedge of our exposure to commodity price risk associated with forecasted future oil and gas production. These contracts are accounted for using the mark-to-market accounting method and accordingly, the Company recognizes all unrealized and realized gains and losses related to these contracts currently in earnings and classifies them as gain (loss) on derivative instruments, on a net basis, in our consolidated statements of operations. The Company may also use puts, calls and basis swaps from time to time.

The Company's Board of Directors sets all risk management policies and reviews the status and results of derivative activities, including volumes, types of instruments and counterparties on a quarterly basis. These policies require that derivative instruments be executed only by the Chief Executive Officer or President. The agreements with approved counterparties identify the Chief Executive Officer and President as the only Company representatives authorized to execute trades. Please see Note 4, Commodity Price Risk Management, for further discussion.

Revenue Recognition

The Company records oil and natural gas revenue under the sales method of accounting. Under the sales method, we recognize revenues based on the amount of oil or natural gas sold to purchasers, which may differ from the amounts to which we are entitled based on our interest in the properties. Natural gas balancing obligations as of June 30, 2015 were not significant.

Recent Accounting Pronouncements

In April 2015, the FASB issued Accounting Standards Update No. 2015-03, Simplifying the Presentation of Debt Issuance Costs ("ASU 2015-03"). The objective of ASU 2015-03 is to simplify the presentation of debt issuance costs in financial statements by presenting such costs in the balance sheet as a direct deduction from the related debt liability rather than as an asset. ASU 2015-03 is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015 and should be applied retrospectively. Early adoption is permitted. The adoption of this standard will not have an impact on the Company's consolidated financial statements, other than balance sheet reclassifications.

In August 2014, the FASB issued Accounting Standards Update No. 2014-15, Presentation of Financial Statements – Going Concern ("ASU 2014-15"). The objective of ASU 2014-15 is to provide guidance on management's responsibility to evaluate whether there is substantial doubt about a company's ability to continue as a going concern and to provide related footnote disclosures. ASU 2014-15 is effective for fiscal years ending after December 15, 2016, and annual and interim periods thereafter. The Company is currently evaluating the provisions of this guidance and assessing its impact on the Company's consolidated financial statements and disclosures.

U.S. ENERGY CORP.
Notes to Condensed Consolidated Financial Statements (Unaudited)
(Continued)

In May 2014, the FASB issued Accounting Standards Update No. 2014-09, Revenue from Contracts with Customers ("ASU 2014 09"). The objective of ASU 2014-09 is to clarify the principles for recognizing revenue and to develop a common revenue standard for U.S. GAAP and International Financial Reporting Standards. ASU 2014 09 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2017. The Company is currently evaluating the impact of adopting ASU 2014 09, but the standard is not expected to have a significant effect on its consolidated financial statements.

There are no other new significant accounting standards applicable to the Company that have been issued but not yet adopted by the Company as of June 30, 2015.

3) Asset Retirement Obligations

We record the fair value of the reclamation liability for our inactive mining properties and our operating oil and gas properties as of the date that the liability is incurred. We review the liability each quarter and determine if a change in estimate is required, and we accrete the discounted liability on a quarterly basis for the future liability. Final determinations are made during the fourth quarter of each year. We deduct any actual funds expended for reclamation during the quarter in which it occurs.

The following is a reconciliation of the total liability for asset retirement obligations:

	(In thousands)	
	June 30, 2015	December 31, 2014
Beginning asset retirement obligation	$1,133	$ 812
Accretion of discount	24	40
Liabilities incurred	61	310
Liabilities settled	--	(29)
Ending asset retirement obligation	$1,218	$ 1,133
Mineral properties	$196	$ 187
Oil and Gas wells	1,022	946
Ending asset retirement obligation	$1,218	$ 1,133

U.S. ENERGY CORP.
Notes to Condensed Consolidated Financial Statements (Unaudited)
(Continued)

4) Commodity Price Risk Management

Through our wholly-owned subsidiary Energy One, we have entered into commodity derivative contracts ("economic hedges") with Wells Fargo, as described below. The derivative contracts are priced using West Texas Intermediate ("WTI") quoted prices. 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 our future oil production, achieve more predictable cash flows in an environment of volatile oil and gas prices and manage our 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 our 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 use of derivatives involves the risk that the counterparties to such instruments will be unable to meet the financial terms of such contracts. The Company's derivative contracts are currently held with a single counterparty. The Company has a netting arrangement with the counterparty that provides for the offset of payables against receivables from separate derivative arrangements with the counterparty in the event of contract termination. The derivative contracts may be terminated by a non-defaulting party in the event of default by one of the parties to the agreement.

The Company's commodity derivative instruments are measured at fair value and are included in the accompanying balance sheets as commodity price risk management assets and liabilities. Derivative instruments are recorded at fair value on the condensed consolidated balance sheet and changes in fair value are recognized in the unrealized gain (loss) on risk management activities line on the condensed consolidated statement of operations. Realized gains and losses resulting from the settlement of derivatives are recorded in the realized (loss) gain on risk management activities line on the condensed consolidated statement of income.

Energy One's commodity derivative contracts as of June 30, 2015 are summarized below:

Settlement Period	Counterparty	Basis	Quantity (Bbls/day)	Strike Price
Crude Oil Costless Collar				
05/01/15 - 12/31/15	Wells Fargo	WTI	500	Put: $45.00 Call: $58.79
Crude Oil Costless Collar				
01/01/16 - 06/30/16	Wells Fargo	WTI	350	Put: $57.50 Call: $66.80

U.S. ENERGY CORP.
Notes to Condensed Consolidated Financial Statements (Unaudited)
(Continued)

The following table details the fair value of the Company's derivative instruments, including the gross amounts and adjustments made to net the derivative instruments for the presentation in the condensed consolidated balance sheet (in thousands):

		As of June 30, 2015 (In thousands)		
Underlying Commodity	Location on Balance Sheet	Gross amounts of recognized assets and liabilities	Gross amounts offset in the condensed consolidated balance sheet	Net amounts of assets and liabilities presented in the condensed consolidated balance sheet
Crude oil derivative contract	Current assets	$352	$ (352)	$ --
Crude oil derivative contract	Current liabilities	$687	$ (352)	$ 335

The following table summarizes the unrealized and realized gains and losses presented in the accompanying statements of operations:

	(In thousands) Three months ended June 30,		(In thousands) Six months ended June 30,	
	2015	2014	2015	2014
Realized derivative (loss)	$			