US ENERGY CORP
Form 10-Q
May 09, 2011

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

x Quarterly report pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarter ended March 31, 2011 or

o 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 x NO o

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 Regulations 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 o NO o

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

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

At May 6, 2011, there were issued and outstanding 27,196,495 shares of the Company’s common stock, $.01 par value.

U.S. ENERGY CORP. and SUBSIDIARIES

INDEX

-3-

PART I. FINANCIAL INFORMATION

ITEM 1. Financial Statements

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

	March 31, 2011	December 31, 2010
CURRENT ASSETS:		
Cash and cash equivalents	$7,476	$5,812
Marketable securities		
Held to maturity - treasuries	6,850	17,843
Available for sale securities	1,350	1,364
Accounts receivable		
Trade	3,461	3,890
Reimbursable project costs	70	114
Income taxes	104	104
Assets held for sale	21,002	20,979
Other current assets	400	456
Total current assets	40,713	50,562
INVESTMENT	2,770	2,834
PROPERTIES AND EQUIPMENT:		
Oil & gas properties under full cost method,		
net of $17,348 and $14,563 accumulated		
depletion, depreciation and amortization	77,090	70,374
Undeveloped mining claims	21,077	21,077
Property, plant and equipment, net	9,199	9,336
Net properties and equipment	107,366	100,787
OTHER ASSETS	1,837	1,833
Total assets	$152,686	$156,016

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)

	March 31, 2011	December 31, 2010
CURRENT LIABILITIES:		
Accounts payable	$12,751	$14,830
Accrued compensation	670	1,669
Commodity risk management liability	2,966	1,725
Current portion of debt	3,200	200
Liabilities held for sale	283	323
Other current liabilities	44	16
Total current liabilities	19,914	18,763
LONG-TERM DEBT, net of current portion	400	400
DEFERRED TAX LIABILITY	2,559	5,015
ASSET RETIREMENT OBLIGATIONS	312	303
OTHER ACCRUED LIABILITIES	872	847
SHAREHOLDERS' EQUITY:		
Common stock, $.01 par value; unlimited shares		
authorized; 27,196,495 and 27,068,610		
shares issued, respectively	272	271
Additional paid-in capital	121,220	121,062
Accumulated surplus	6,504	8,713
Unrealized gain on marketable securities	633	642
Total shareholders' equity	128,629	130,688
Total liabilities and shareholders' equity	$152,686	$156,016

The accompanying notes are an integral part of these statements.

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

	Three months ended March 31, 2011	Three months ended March 31, 2010
REVENUES:		
Oil and gas	$6,679	$7,709
Realized (loss) on risk management activities	(555)	--
Unrealized (loss) on risk management activities	(1,241)	--
	4,883	7,709
OPERATING EXPENSES:		
Oil and gas	4,079	1,130
Oil and gas depreciation depletion and amortization	2,785	2,255
Water treatment plant	429	349
Mineral holding costs	43	57
General and administrative	2,411	2,668
	9,747	6,459
OPERATING (LOSS) INCOME	(4,864)	1,250
OTHER INCOME AND (EXPENSES):		
Gain on the sale of assets	--	115
Equity gain/(loss) in unconsolidated investment	(64)	963
Miscellaneous income and (expenses)	(1)	(30)
Interest income	20	59
Interest expense	(23)	(17)
	(68)	1,090
(LOSS) INCOME BEFORE INCOME TAXES AND DISCONTINUED OPERATIONS	(4,932)	2,340

The accompanying notes are an integral part of these statements.

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

	Three months ended March 31,	
	2011	2010
Income taxes:		
Deferred benefit from (provision for)	2,594	(888)
	2,594	(888)
(LOSS) INCOME FROM CONTINUING OPERATIONS	(2,338)	1,452
DISCONTINUED OPERATIONS, net of taxes	129	75
NET (LOSS) INCOME	$(2,209)	$1,527
NET (LOSS) INCOME PER SHARE		
(Loss) income from continuing operations, basic	$(0.08)	$0.06
Income from discontinued operations, basic	--	--
Net (loss) income, basic	$(0.08)	$0.06
(Loss) income from continuing operations, diluted	$(0.08)	$0.05
Income from discontinued operations, diluted	--	--
Net (loss) income, diluted	$(0.08)	$0.05
Weighted average shares outstanding		
Basic	27,186,438	26,487,162
Diluted	27,186,438	27,785,572

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 three months ended March 31, 2011	2010
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net (loss) income	$(2,209)	$1,527
(Income) from discontinued operations	(129)	(75)
(Loss) income from continuing operations	(2,338)	1,452
Adjustments to reconcile net (loss) income to net cash provided by operations		
Depreciation, depletion & amortization	2,937	2,398
Change in fair value of commodity price risk management activities, net	1,241	--
Accretion of discount on treasury investment	(15)	(22)
Equity (gain)/loss from Standard Steam	64	(963)
Net change in deferred income taxes	(2,452)	930
(Gain) on sale of assets	--	(115)
Noncash compensation	376	376
Noncash services	(30)	15
Net changes in assets and liabilities	1,626	(1,350)
NET CASH PROVIDED BY OPERATING ACTIVITIES	1,409	2,721
CASH FLOWS FROM INVESTING ACTIVITIES:		
Net redemption (investment in) treasury investments	11,009	(3,398)
Acquisition & development of oil & gas properties	(13,584)	(13,803)
Acquisition of property and equipment	(16)	(167)
Proceeds from sale of property and equipment	--	118
Net change in restricted investments	(33)	(20)
NET CASH USED IN INVESTING ACTIVITIES	(2,624)	(17,270)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Issuance of common stock	(186)	219
Proceeds from new debt	3,000	--
NET CASH PROVIDED BY FINANCING ACTIVITIES	2,814	219

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 three months ended March 31, 2011	2010
Net cash provided by operating activities of discontinued operations	66	299
Net cash used in investing activities of discontinued operations	(1)	(22)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	1,664	(14,053)
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	5,812	33,403
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$7,476	$19,350
SUPPLEMENTAL DISCLOSURES:		
Income tax received	$--	$--
Interest paid	$5	$5
NON-CASH INVESTING AND FINANCING ACTIVITIES:		
Unrealized gain	$633	$62
Acquisition and development of oil and gas properties through accounts payable	$4,088	$1,269
Acquisition and development of oil and gas through asset retirement obligations	$4	$13

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 March 31, 2011 and March 31, 2010 have been prepared by U.S. Energy Corp. ("USE" or the "Company") in accordance with generally accepted accounting principles ("GAAP") in the United States of America. The financial statements at March 31, 2011 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, 2010 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 generally accounted for by 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 GAAP have been condensed or omitted. The unaudited condensed consolidated financial statements should be read in conjunction with the Company's December 31, 2010 Annual Report on Form 10-K. Subsequent events have been evaluated for financial reporting purposes through the date of the filing of this Form 10-Q. See Note 13.

2) Summary of Significant Accounting Policies

For detailed descriptions of our significant accounting policies, please see Form 10-K for the year ended December 31, 2010 (Note B pages 85 to 92).

We follow accounting standards set by the Financial Accounting Standards Board, commonly referred to as the "FASB." The FASB sets generally accepted accounting principles (GAAP) that we follow to ensure we consistently report our financial condition, results of operations, and cash flows.

The FASB recognized the complexity of its standard-setting process and embarked on a revised process in 2004 that culminated in the release on July 1, 2009, of the FASB Accounting Standards Codification, sometimes referred to as the Codification or ASC. The Codification does not change how the Company accounts for its transactions or the nature of related disclosures made. However, when referring to guidance issued by the FASB, the Company refers to topics in the ASC. The above change was made effective by the FASB for periods ending on or after September 15, 2009.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles in the United States of America 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 and the cost of future asset retirement obligations. 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

USE 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.

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, 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 the (iv) income tax effects related to differences between the book and tax basis of the natural gas and crude oil 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. At March 31, 2011, the book value of our oil and gas properties did not exceed the cost center ceiling.

Derivative Instruments

The Company uses derivative instruments, typically fixed-rate swaps and costless collars to manage price risk underlying its oil and gas production. The Company may also use puts, calls and basis swaps in the future. 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 a cash flow hedge, 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 are classified as gain (loss) on derivative instruments, net in our consolidated statements of operations.

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 President or Chief Financial Officer after consultation and concurrence by the President, Chief Financial Officer and Chairman of the Board. The master contracts with approved counterparties identify the President and Chief Financial Officer as the only Company representatives authorized to execute trades. See Note 6, Commodity Price Risk Management, for further discussion.

U.S. ENERGY CORP.

Notes to Condensed Consolidated Financial Statements (Unaudited)
(Continued)

Revenue Recognition

USE 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 to based on our interest in the properties. Natural gas balancing obligations as of March 31, 2011 were not significant.

Revenues from real estate operations are reported on a gross revenue basis and are recorded at the time the service is provided.

Recent Accounting Pronouncements

As of March 31, 2011, there have been no recent accounting pronouncements currently relevant to USE in addition to those discussed on pages 91 to 92 of our Annual Report on Form 10-K for the year ended December 31, 2010. We continue to review current outstanding statements from the FASB and do not believe that any of those statements will have a material effect on our financial statements when adopted.

3) Properties and Equipment

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.

Components of Property and Equipment as of March 31, 2011 and December 31, 2010 are as follows:

	(In thousands)	
	March 31, 2011	December 31, 2010
Oil & Gas properties		
Unproved	$ 19,902	$ 17,926
Wells in progress	7,787	3,694
Proved	66,749	63,317
	94,438	84,937
Less accumulated depreciation		
depletion and amortization	(17,348)	(14,563)
Net book value	77,090	70,374
Mining properties	21,077	21,077
	14,580	14,564

Building, land and equipment				
Less accumulated depreciation		(5,381)		(5,228)
Net book value		9,199		9,336
Totals	$	107,366	$	100,787

-12-

U.S. ENERGY CORP.

Notes to Condensed Consolidated Financial Statements (Unaudited)
(Continued)

Oil and Gas Activities

Full Cost Pool - Full cost pool capitalized costs are amortized over the life of production of proven properties. Capitalized costs at March 31, 2011 and December 31, 2010 which were not included in the amortized cost pool were $27.7 and $21.6 million, respectively. These costs consist of exploratory wells in progress, seismic costs that are being analyzed for potential drilling locations as well as land costs related to unproved properties. No capitalized costs related to unproved properties are included in the amortization base at March 31, 2011 and December 31, 2010. It is anticipated that these costs will be added to the full cost amortization pool in the next two years as properties are proved, drilled or abandoned.

Ceiling Test Analysis - We perform a quarterly ceiling test for each of our oil and gas cost centers, which in 2010, there was only one. 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 March 31, 2011, we used $83.54 per barrel for oil and $4.11 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%.

At March 31, 2011 and 2010, the ceiling was in excess of the net capitalized costs as adjusted for related deferred income taxes and no impairment was required. 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.

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 withheld from the depletion calculation. The costs for these wells are then transferred to proved property when the wells reach total depth and are cased 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 March 31, 2011 and December 31, 2010 reflect capitalized costs associated with our Mt. Emmons molybdenum property near Crested Butte, Colorado. On August 19, 2008, we entered into an agreement with Thompson Creek Metals Company USA ("TCM") to develop this property. Under the terms of the agreement, TCM could have earned up to a 75% interest in the project for the investment of $400 million. On April 21, 2011, Thompson Creek Metals Company Inc. terminated its option agreement with U.S. Energy to develop the Mount Emmons molybdenum deposit (see Note 13, Subsequent Events).

U.S. ENERGY CORP.

Notes to Condensed Consolidated Financial Statements (Unaudited)
(Continued)

Our carrying balance in the Mt. Emmons property at March 31, 2011 and December 31, 2010 is as follows:

	(In thousands)	
	March 31, 2011	December 31, 2010
Costs associated with Mount Emmons beginning of year	$ 21,077	$ 21,969
Development costs during the year	--	108
Option payment from Thompson Creek	--	(1,000)
Costs at end of year	$ 21,077	$ 21,077

4) Assets Held for Sale

In accordance with property, plant, and equipment authoritative guidance, assets are classified as held for sale when the Company commits to a plan to sell the assets and there is reasonable certainty that the sale will take place within one year. Upon classification as held for sale, long-lived assets are no longer depreciated or depleted, and a measurement for impairment is performed to determine if there is any excess of carrying value over fair value less costs to sell. Subsequent changes to estimated fair value less the cost to sell will impact the measurement of assets held for sale if the fair value is determined to be less than the carrying value of the assets.

In January 2011, we decided to sell the Remington Village multifamily project in Gillette, Wyoming and plan to use the proceeds to further the development of our oil and gas business. At December 31, 2010, we recorded a $1.5 million impairment to adjust the carrying value of the multifamily project to the December 31, 2010 appraised value less anticipated selling costs. As of March 31, 2011, the accompanying condensed consolidated balance sheets present $21.0 million in book value of assets held for sale, net of accumulated depreciation, and $283,000 in liabilities held for sale. Because Remington Village has been classified as an asset held for sale, the scheduled depreciation of $237,000 was not recorded during the first quarter of 2011.

At March 31, 2011, management determined that no further impairment is needed as the carrying value remains at appraisal less anticipated selling costs. Operations related to Remington Village are shown in discontinued operations on the accompanying condensed consolidated statements of operations.

5) Asset Retirement Obligations

We account for our asset retirement obligations under FASB ASC 410-20, "Asset Retirement Obligations." We record the fair value of the reclamation liability on 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 as well as 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.

U.S. ENERGY CORP.

Notes to Condensed Consolidated Financial Statements (Unaudited)
(Continued)

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