

US ENERGY CORP
Form 10-Q
May 10, 2012

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 quarter ended March 31, 2012 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

Edgar Filing: US ENERGY CORP - Form 10-Q

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)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

YES NO

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

At May 09, 2012 there were issued and outstanding 27,460,978 shares of the Company's common stock, \$0.01 par value.

U.S. ENERGY CORP. and SUBSIDIARIES

INDEX

	Page No.
PART I. FINANCIAL INFORMATION	
Item 1. Financial Statements.	
Condensed Consolidated Balance Sheets as of March 31, 2012 (unaudited) and December 31, 2011 (unaudited)	4-5
Condensed Consolidated Statements of Operations for the Three Months Ended March 31, 2012 and 2011 (unaudited)	6-7
Condensed Consolidated Statements of Other Comprehensive Loss for the Three Months Ended March 31, 2012 and 2011 (unaudited)	8
Condensed Consolidated Statements of Cash Flows for the Three Months Ended March 31, 2012 and 2011 (unaudited)	9-10
Notes to Condensed Consolidated Financial Statements (unaudited)	11-23
Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations	24-35
Item 3. Quantitative and Qualitative Disclosures About Market Risk	35-36
Item 4. Controls and Procedures	37
PART II. OTHER INFORMATION	
Item 1. Legal Proceedings	37
Item 1A. Risk Factors	37
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds	37
Item 3. Defaults Upon Senior Securities	37
Item 4. Mine Safety Disclosures	38
Item 5. Other Information	38
Item 6. Exhibits	38

Signatures

39

Certifications

See Exhibits

PART I. FINANCIAL INFORMATION

ITEM 1. Financial Statements

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

	March 31, 2012	December 31, 2011
Current assets:		
Cash and cash equivalents	\$7,784	\$12,874
Available for sale securities	179	166
Accounts receivable		
Trade	4,751	5,496
Income taxes	9	113
Commodity risk management asset	101	3
Assets held for sale	18,075	18,132
Other current assets	282	352
Total current assets	31,181	37,136
Investment	2,563	2,623
Properties and equipment		
Oil & gas properties under full cost method, net of \$32,202 and \$28,561 accumulated depletion, depreciation and amortization	82,856	90,942
Undeveloped mining claims	20,739	20,739
Property, plant and equipment, net	9,031	9,196
Net properties and equipment	112,626	120,877
Other assets	1,851	1,803
Total assets	\$148,221	\$162,439

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, 2012	December 31, 2011
Current liabilities:		
Accounts payable	\$7,892	\$9,370
Accrued compensation	343	501
Commodity risk management liability	758	601
Current portion of debt	200	200
Liabilities held for sale	10,147	10,241
Other current liabilities	24	24
Total current liabilities	19,364	20,937
Long-term debt, net of current portion	200	12,200
Deferred tax liability	744	1,189
Asset retirement obligations	564	510
Other accrued liabilities	809	822
Commitment and contingencies		
Shareholders' equity		
Common stock, \$.01 par value; unlimited shares authorized; 27,445,978 and 27,409,908 shares issued, respectively	274	274
Additional paid-in capital	122,645	122,523
Accumulated surplus	3,525	3,906
Unrealized gain on marketable securities	96	78
Total shareholders' equity	126,540	126,781
Total liabilities and shareholders' equity	\$148,221	\$162,439

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,	
	2012	2011
Oil, gas, and NGL production revenues:	\$8,335	\$6,679
Operating expenses:		
Oil and gas	2,893	4,079
Oil and gas depreciation, depletion and amortization	3,641	2,785
Water treatment plant	509	429
Mineral holding costs	110	43
General and administrative	1,894	2,411
	9,047	9,747
Loss from operations	(712)	(3,068)
Other income and expenses:		
Realized loss on risk management activities	(143)	(555)
Unrealized loss on risk management activities	(59)	(1,241)
Gain on the sale of assets	10	--
Equity loss in unconsolidated investment	(60)	(64)
Gain on sale of marketable securities	47	--
Miscellaneous income and (expenses)	118	(1)
Interest income	5	20
Interest expense	(39)	(23)
	(121)	(1,864)
Loss before income taxes and discontinued operations	(833)	(4,932)

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,	
	2012	2011
Income taxes:		
Current benefit from (provision for)	(104)	--
Deferred benefit from (provision for)	492	2,594
	388	2,594
Loss from continuing operations	(445)	(2,338)
Discontinued operations:		
Discontinued operations, net of taxes	64	129
	64	129
Net loss	\$(381)	\$(2,209)
Net loss per share basic and diluted		
Loss from continuing operations	\$(0.01)	\$(0.08)
Income from discontinued operations	--	--
Net loss	\$(0.01)	\$(0.08)
Weighted average shares outstanding		
Basic and Diluted	27,438,584	27,186,438

The accompanying notes are an integral part of these statements.

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

	Three months ended March 31,	
	2012	2011
Net loss	\$(381)	\$(2,209)
Other comprehensive income (loss):		
Marketable securities, net of tax	18	(9)
Total comprehensive loss	(363)	(2,218)

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,	
	2012	2011
Cash flows from operating activities:		
Net loss	\$(381)	\$(2,209)
(Gain) from discontinued operations	(64)	(129)
Loss from continuing operations	(445)	(2,338)
Adjustments to reconcile net loss to net cash provided by operations		
Depreciation, depletion & amortization	3,798	2,937
Change in fair value of commodity price risk management activities, net	59	1,241
Accretion of discount on treasury investment	--	(15)
Gain on sale of marketable securities	(47)	--
Equity loss from Standard Steam	60	64
Net change in deferred income taxes	(455)	(2,452)
(Gain) on sale of assets	(10)	--
Noncash compensation	50	376
Noncash services	23	(30)
Net changes in assets and liabilities	(2,269)	1,626
Net cash provided by operating activities	764	1,409
Cash flows from investing activities:		
Net redemption of treasury investments	--	11,009
Acquisition & development of oil & gas properties	(12,047)	(13,584)
Acquisition of property and equipment	(3)	(16)
Proceeds from sale of oil and gas properties	18,119	--
Proceeds from sale of marketable securities	62	--
Proceeds from sale of property and equipment	22	--
Net change in restricted investments	(84)	(33)
Net cash provided by (used in) investing activities:	6,069	(2,624)

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,	
	2012	2011
Cash flows from financing activities:		
Issuance of common stock	50	(186)
Tax benefit from the exercise of stock options	--	3,000
Repayments of debt	(12,065)	--
Net cash (used in) provided by financing activities	(12,015)	2,814
Net cash provided by operating activities of discontinued operations		
	92	66
Net cash used in investing activities of discontinued operations		
	--	(1)
Net (decrease) increase in cash and cash equivalents	(5,090)	1,664
Cash and cash equivalents at beginning of period	12,874	5,812
Cash and cash equivalents at end of period	\$7,784	\$7,476
Supplemental disclosures:		
Income tax paid	\$--	\$--
Interest paid	\$64	\$5
Non-cash investing and financing activities:		
Unrealized gain	\$96	\$633
Acquisition and development of oil and gas properties through accounts payable	\$1,581	\$4,088
Acquisition and development of oil and gas through asset retirement obligations	\$45	\$4

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, 2012 and March 31, 2011 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 March 31, 2012 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, 2011 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 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 U.S. GAAP have been condensed or omitted. The unaudited condensed consolidated financial statements should be read in conjunction with the Company’s December 31, 2011 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, 2011 (Note B pages 86 to 94).

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

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 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.

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.

U.S. ENERGY CORP.

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

Components of Property and Equipment as of March 31, 2012 and December 31, 2011 are as follows:

	(In thousands)	
	March 31, 2012	December 31, 2011
Oil & Gas properties		
Unproved	\$ 11,667	\$ 17,098
Wells in progress	5,795	2,909
Proved	97,596	99,496
	115,058	119,503
Less accumulated depreciation		
depletion and amortization	(32,202)	(28,561)
Net book value	82,856	90,942
Mining properties	20,739	20,739
Building, land and equipment	14,972	14,984
Less accumulated depreciation	(5,941)	(5,788)
Net book value	9,031	9,196
Totals	\$ 112,626	\$ 120,877

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 March 31, 2012 and December 31, 2011 which were not included in the amortized cost pool were \$17.5 million and \$20.0 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 unevaluated properties. No capitalized costs related to unevaluated properties are included in the amortization base at March 31, 2012 and December 31, 2011. 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.

U.S. ENERGY CORP.

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

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. At March 31, 2012, the book value of our oil and gas properties did not exceed the cost center ceiling.

We perform a quarterly ceiling test for each of our oil and gas cost centers. There was only one such cost center in 2012. 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, 2012, we used \$98.15 per barrel for oil and \$3.73 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, 2012 and 2011, 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 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 March 31, 2012 and December 31, 2011 reflect capitalized costs associated with our Mt. Emmons molybdenum property near Crested Butte, Colorado.

U.S. ENERGY CORP.

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

Our carrying balance in the Mt. Emmons property at March 31, 2012 and December 31, 2011 is as follows:

	(In thousands)	
	March 31, 2012	December 31, 2011
Costs associated with Mount Emmons		
beginning of year	\$ 20,739	\$ 21,077
Development costs	--	16
Option payment from Thompson Creek	--	(354)
Costs at the end of the period	\$ 20,739	\$ 20,739

Derivative Instruments

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

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 master contracts with approved counterparties identify the Chief Executive Officer and President as the only Company representatives authorized to execute trades. See Note 6, 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 March 31, 2012 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.

U.S. ENERGY CORP.

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

Recent Accounting Pronouncements

On January 1, 2012, the Company adopted Accounting Standards Update No. 2011-05 (“ASC No. 2011-05”), an update to ASC Topic 220 issued by the FASB that states that an entity that reports items of other comprehensive income has the option to present the components of comprehensive income in either one continuous financial statement, or two consecutive financial statements, including reclassification adjustments. Subsequent to the issuance of the authoritative guidance, the FASB issued additional authoritative accounting guidance (“ASC No. 2011-12”) that effectively deferred the requirement to present the reclassification adjustments on the face of the financial statements, as well as the requirement to present the individual components of other comprehensive income for interim periods. The Company has elected to present a separate statement of comprehensive income, including the individual components, titled Condensed Consolidated Statements of Comprehensive Loss, as part of Item 1 to this report.

In December 2011, the FASB issued Accounting Standards Update No. 2011-11, Balance Sheet: Disclosures about Offsetting Assets and Liabilities (“ASU 2011-11”). The objective of ASU 2011-11 is to require an entity to provide enhanced disclosures that will enable users of its financial statements to evaluate the effect or potential effect of netting arrangements on an entity’s financial position. ASU 2011-11 is effective for interim and annual reporting periods beginning on or after January 1, 2013 and should be applied retrospectively. The adoption of this standard is not expected to have an impact on the Company’s consolidated financial statements.

In May 2011, the FASB issued Accounting Standards Update No. 2011-04, Fair Value Measurement: Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs (“ASU 2011-04”), which provides amendments to FASB ASC Topic 820, Fair Value Measurement. The objective of ASU 2011-04 is to create common fair value measurement and disclosure requirements between GAAP and International Financial Reporting Standards (“IFRS”). The amendments clarify existing fair value measurement and disclosure requirements and make changes to particular principles or requirements for measuring or disclosing information about fair value measurements. These amendments are not expected to have a significant impact on companies applying GAAP. ASU 2011-04 is effective for interim and annual periods beginning after December 15, 2011. The adoption of this standard did not have an impact on the Company’s consolidated financial statements other than additional disclosures.

3) Mineral Property Transactions

Bakken/Three Forks Shale Sale. On January 24, 2012 (but effective December 1, 2011), we sold an undivided 75% of our undeveloped acreage with Zavanna, LLC (“Zavanna”) in the Yellowstone and SEHR prospects to GeoResources, Inc. (56.25%) and Yuma Exploration and Production Company, Inc. (18.75%) for \$16.7 million and \$1.4 million in reimbursed well costs. These amounts were recorded as credits to our full cost pool. In addition we transferred \$5.3 million in costs from unevaluated properties to proved properties as a result of this sale. Under the terms of the agreement, we retained the remaining 25% of our interest in the undeveloped acreage and our original working interest in the initial 10 developed wells in the prospects. Our average working interest in the remaining locations will be approximately 8.75% and net revenue interests in new wells after the sale are expected to be in the range of 6.7375% to 7.0%, proportionately reduced depending on Zavanna’s actual working interest percentages.

U.S. ENERGY CORP.

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

4) Assets Held for Sale

In January 2011, we made the decision to sell our 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, 2011 and 2010, we recorded a \$3.1 million and \$1.5 million, respectively, impairment to adjust the carrying value of the multifamily project to the approximate appraised value. At March 31, 2012, management has determined that no further impairment is needed. As of March 31, 2012, the accompanying condensed consolidated balance sheets present \$18.1 million in book value of assets held for sale, net of accumulated depreciation, and \$10.1 million in liabilities held for sale. Because Remington Village has been classified as an asset held for sale, the scheduled depreciation of \$224,000 for the first three months of 2012 or the \$237,000 for the first three months of 2011 was not recorded. Remington is pledged as collateral on a \$10.0 million note. At such time as Remington is sold, the debt balance will be retired.

Operations related to Remington Village are shown in discontinued operations on the accompanying condensed consolidated statements of operations.

5) 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 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.

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

	(In thousands)	
	March 31, 2012	December 31, 2011
Beginning asset retirement obligation	\$ 510	\$ 303
Accretion of discount	9	23
Liabilities incurred	45	187
Liabilities sold	--	(3)
Ending asset retirement obligation	\$ 564	\$ 510
Mining properties	\$ 153	\$ 149
Oil & Gas wells	411	361
Ending asset retirement obligation	\$ 564	\$ 510

U.S. ENERGY CORP.

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

6) Commodity Price Risk Management

Through our wholly-owned subsidiary Energy One, we have entered into commodity derivative contracts (“economic hedges”) with BNP Paribas (“BNP”), 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 to 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.

Energy One's commodity derivative contracts as of March 31, 2012 are summarized below:

Settlement Period	Counterparty	Basis (Bbl/d)	Quantity	Strike Price
Crude Oil				
Costless				
Collar				
10/01/11 - 09/30/12	BNP Parabis	WTI	400	Put: \$ 80.00 Call: \$ 99.00
Crude Oil				
Costless				
Collar				
01/01/12 - 12/31/12	BNP Parabis	WTI	200	Put: \$ 90.00 Call: \$ 106.50
Crude Oil				
Costless				
Collar				
10/01/12 - 09/30/13	BNP Parabis	WTI	200	Put: \$ 95.00 Call: \$ 116.60

The following table details the fair value of the derivatives recorded in the applicable condensed consolidated balance sheet, by category:

(in thousands)

Edgar Filing: US ENERGY CORP - Form 10-Q

	Derivative Assets		Derivative Liabilities	
	Balance Sheet Classification	Fair Value	Balance Sheet Classification	Fair Value
Crude oil costless collars	Current Asset	\$ 101	Current Liability	\$ 758

Unrealized gains and losses resulting from derivatives 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 contract settlement of derivatives are recorded in the commodity price risk management activities line on the condensed consolidated statement of income.

U.S. ENERGY CORP.

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

7) Fair Value Measurements

We follow authoritative guidance regarding fair value measurements for all assets and liabilities measured at fair value. That guidance establishes a fair value hierarchy that prioritizes the inputs the Company uses to measure fair value based on the significance level of the following inputs:

- Level 1 - Quoted prices (unadjusted) for identical assets or liabilities in active markets.
- Level 2 - Quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, and model-derived valuations whose inputs or significant value drivers are observable.
- Level 3 - Significant inputs to the valuation model are unobservable.

Our assessment of the significance of a particular input to the fair value measurement requires judgment and may affect the valuation of the nonfinancial assets and liabilities and their placement in the fair value hierarchy levels. As of March 31, 2012, we held \$179,000 of investments in marketable securities. We determine our estimate of the fair value of derivative instruments using a market approach based on several factors, including quoted prices in active markets, and quotes from third parties. The fair values of our other accrued liabilities that are reflected on the balance sheet are detailed below. Other accrued liabilities decreased to \$809,000 at March 31, 2012 as a result of payments of the liability. The other accrued liabilities are the long term portion of the executive retirement program.

Description	March 31 2012	(In thousands) Fair Value Measurements at March 31, 2012 Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Commodity risk management assets	\$ 101	\$ --	\$ 101	\$ --
Available for sale securities	179	179	--	--
Total assets	\$ 280	\$ 179	\$ 101	\$ --
Commodity risk management liability	\$ 758	\$ --	\$ 758	\$ --

Edgar Filing: US ENERGY CORP - Form 10-Q

Other accrued liabilities	809	--	--	809
Total	\$ 1,567	\$ --	\$ 758	\$ 809

U.S. ENERGY CORP.

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

The following table summarizes, by major security type, the fair value and any unrealized gain of our available for sale securities. The unrealized gain is recorded on the condensed consolidated balance sheets as other comprehensive income, a component of shareholders' equity.

(In thousands)						
March 31, 2012						
Description of Securities	Less Than 12 Months Unrealized		12 Months or Greater Unrealized		Total Unrealized	
	Fair Value	Gain	Fair Value	Gain	Fair Value	Gain
Available for sale securities	\$ 179	\$ 150	\$ --	\$ --	\$ 179	\$ 150
Total	\$ 179	\$ 150	\$ --	\$ --	\$ 179	\$ 150

Our other financial instruments include cash and cash equivalents, accounts receivable, accounts payable, other current liabilities and long-term debt. The carrying amount of cash and cash equivalents, accounts receivable, accounts payable and other current liabilities approximate fair value because of their immediate or short-term maturities. The carrying value of our debt approximates its fair market value since interest rates have remained generally unchanged from the issuance of the debt. The fair value and carrying value of our debt was \$10.2 million as of March 31, 2012.

8) Debt

At March 31, 2012, total debt in the amount of \$10.2 million consists of debt on our multifamily housing project and the purchase of land near our Mt. Emmons molybdenum property. The debt on our multifamily housing project has an interest rate of 5.50% and the land debt bears an interest rate of 6.0% per annum.

On May 5, 2011 we borrowed \$10.0 million from a commercial bank against Remington Village. At March 31, 2012, the balance due on this note is \$9.8 million. The note is collateralized by the Company's multi-family property in Gillette, Wyoming. The note is amortized over 20 years with a balloon payment at the end of five years with an interest rate of 5.50% per annum. Proceeds of the note were used to fund general business obligations. When Remington is sold, the proceeds from the sale will first be applied to the retirement of the debt and the remainder applied to general corporate overhead and project development. Therefore, the debt is included in current liabilities held for sale.

The land debt of \$400,000 is due in two equal annual payments of \$200,000 plus accrued interest. The next payment is due on January 2, 2013.

9) Shareholders' Equity

Common Stock

During the three months ended March 31, 2012, the Company issued 36,070 shares of common stock. These shares consist of (a) 15,000 shares issued to officers of the Company pursuant to the 2001 Stock Compensation Plan, (b) 20,000 shares issued as a result of options being exercised by a former director of the Company and (c) a net of 1,070 shares issued as a result of the exercise of options by employees of the Company.

U.S. ENERGY CORP.

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

The following table details the changes in common stock during the three months ended March 31, 2012:

(Amounts in thousands, except for share amounts)

	Common Stock Shares	Amount	Additional Paid-In Capital
Balance January 1, 2012	27,409,908	\$ 274	\$ 122,523
2001 stock compensation plan	15,000	--	48
Exercise of employee stock options	1,070	--	--
Exercise of outside director options	20,000	--	50
Expense of employee options vesting	--	--	2
Expense of outside director warrants vesting	--	--	22
Balance March 31, 2012	27,445,978	\$ 274	\$ 122,645

Employee Stock Option Plans

All options outstanding at March 31, 2012 were granted pursuant to the U.S. Energy Corp. 2001 Incentive Stock Option Plan (the "2001 ISOP"). The 2001 ISOP had a term of 10 years, and expired on December 6, 2011. Options issued prior to that date will survive to their expiration date which does not exceed a ten year period from date of grant and are subject to vesting and forfeiture provisions.

The Company recorded \$2,000 and \$251,000 of related compensation expense for the three months ended March 31, 2012 and 2011, respectively. As of March 31, 2012, there was no unrecognized compensation expense related to stock option awards. As a result of the exercise of 4,167 options held by a former employee, 1,070 shares of common stock were issued during the three months ended March 31, 2012.

Director Option Plans

From time to time we issue stock options to non-employee directors for services. During the three months ended March 31, 2012, we issued 70,000 options to non-employee directors. The options were issued at the closing price of \$2.85 on the date of grant, 60,000 options vest over a three year period and expire ten years from the date of grant or one year after the Board member no longer serves on the Board and 10,000 options vested immediately and expire ten years from the date of grant or one year after the Board member no longer serves on the Board. The options were valued under Black-Scholes using a risk free interest rate of 1.13% to 1.41%, expected life of 5 to 6 years and

expected volatility of 62.75% to 63.59%.

During the three months ended March 31, 2012, we recorded \$23,000 in expense for options issued to non-employee directors. We will recognize an additional \$145,000 in expense over the vesting period of the outstanding options. During the three months ended March 31, 2012, we issued 20,000 shares of common stock to directors of the Company as the result of the exercise of 20,000 outstanding options.

U.S. ENERGY CORP.

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

The following table represents the activity in employee stock options and non-employee director stock options for the three months ended March 31, 2012:

	March 31, 2012			
	Employee Stock Options		Director Stock Options	
	Options	Weighted Average Exercise Price	Options	Weighted Average Exercise Price
Outstanding balance at December 31, 2011	2,318,399	\$ 3.94	210,000	\$ 3.10
Granted	--	\$ --	70,000	\$ 2.85
Forfeited	--	\$ --	--	\$ --
Expired	(50,000)	\$ 4.97	--	\$ --
Exercised	(4,167)	\$ 2.52	(20,000)	\$ 2.52
Outstanding at March 31, 2012	2,264,232	\$ 3.92	260,000	\$ 3.08
Exercisable at March 31, 2012	2,264,232	\$ 3.92	173,334	\$ 2.96
Weighted Average Remaining Contractual Life - Years		4.67		4.82
Aggregate intrinsic value of options outstanding		\$ 558,000		\$ 95,000

10) Income Taxes

The Company uses the asset and liability method of accounting for deferred income taxes. Deferred tax assets and liabilities are determined based on the temporary differences between the financial statement and tax basis of assets and liabilities. Deferred tax assets or liabilities at the end of each period are determined using the tax rate in effect at that time.

The deferred income tax liability for an oil and gas exploration company is dependent on many variables such as estimating the economic lives of depleting oil and gas reserves and commodity prices. Accordingly, the liability is subject to continual recalculation, revision of the numerous estimates required, and may change significantly in the

event of such things as major acquisitions, divestitures, product price changes, changes in reserve estimates, changes in reserve lives, and changes in tax rates or tax laws.

-21-

U.S. ENERGY CORP.

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

11) Segment Information

As of March 31, 2012, we had two reportable segments: Oil and Gas and Maintenance of Mineral Properties. A summary of results of operations for the three months ended March 31, 2012, and 2011, and total assets as of March 31, 2012 and December 31, 2011 by segment are as follows:

	(In thousands)	
	For the three months ended	
	March 31,	
	2012	2011
Revenues:		
Oil and gas	\$ 8,335	\$ 6,679
Total revenues:	8,335	6,679
Operating expenses:		
Oil and gas	6,534	6,864
Mineral properties	619	472
Total operating expenses:	7,153	7,336
Interest expense		
Oil and gas	30	9
Mineral properties	6	9
Total interest expense:	36	18
Operating (loss) income		
Oil and gas	\$ 1,771	\$ (194)
Mineral properties	(625)	(481)
Operating income (loss) from identified segments	1,146	(675)
General and administrative expenses	(1,894)	(2,411)
Add back interest expense	36	18
Other revenues and expenses:	(121)	(1,864)
Loss before income taxes		

Edgar Filing: US ENERGY CORP - Form 10-Q

and discontinued operations	\$ (833)	\$ (4,932)
Depreciation depletion and amortization expense:		
Oil and gas	\$ 3,641	\$ 2,785
Mineral properties	32	26
Corporate	125	126
Total depreciation expense	\$ 3,798	\$ 2,937

U.S. ENERGY CORP.

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

	(In thousands)	
	March 31, 2012	December 31, 2011
Assets by segment		
Oil and Gas	\$ 94,507	\$ 109,141
Mineral	20,755	20,755
Corporate	32,959	32,543
Total assets	\$ 148,221	\$ 162,439

12) Equity Income in Unconsolidated Investment

We recorded an equity loss from our unconsolidated investment in Standard Steam, LLC (“SST”) during the three months ended March 31, 2012 and 2011, of \$60,000 and \$64,000, respectively.

13) Subsequent Events

Montana Acreage Sale. On May 9, 2012, the Company signed a Letter Agreement to sell an undivided 87.5% of its acreage in Daniels County, Montana to a third party for \$3.68 million. The agreement is conditioned upon execution of a mutually acceptable Purchase and Sale Agreement and will be effective on June 1, 2012. Under the terms of the agreement, the Company will retain a 12.5% working interest in the acreage and reserved overriding royalty interests (“ORRI”) in excess of 81%. The purchaser will also commit to drill a vertical test well to depths sufficient to core the Bakken and Three Forks formations on or before December 31, 2015. The Company will deliver an 80% NRI to the purchaser and 1% ORRI to a land broker. The Company will also pay the land broker a 10% commission for the cash consideration paid by the purchaser.

ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following is Management's Discussion and Analysis of significant factors that have affected liquidity, capital resources and results of operations during the three months ended March 31, 2012 and 2011. The following also updates information as to our financial condition provided in our 2011 Annual Report on Form 10-K. Statements in the following discussion may be forward-looking and involve risk and uncertainty. The following discussion should also be read in conjunction with our condensed financial statements and the notes thereto.

General Overview

We are an independent energy company focused on the acquisition and development of oil and gas producing properties in the continental United States. Our business is currently focused in the Rocky Mountain region (specifically the Williston Basin of North Dakota and Montana), Texas and Louisiana, however, we do not intend to limit our focus to these geographic areas. We continue to focus on increasing production, reserves, revenues and cash flow from operations while managing our level of debt.

We currently explore for and produce oil and gas through a non-operator business model; however, we operated our Colorado oil and gas property for our own account and may expand our operations to other areas. As a non-operator, we rely on our operating partners to propose, permit and manage wells. Before a well is drilled, the operator is required to provide all oil and gas interest owners in the designated well the opportunity to participate in the drilling costs and revenues of the well on a pro-rata basis. After the well is completed, our operating partners also transport, market and account for all production.

We are also involved in the exploration for and development of minerals (molybdenum) through our ownership of the Mt. Emmons Molybdenum Project in Colorado. Gross capitalized dollar amounts invested in each of these areas at March 31, 2012 and December 31, 2011 were as follows:

	(In thousands)	
	March 31, 2012	December 31, 2011
Unproved oil and gas properties	\$ 17,462	\$ 17,098
Proved oil and gas properties	97,596	73,844
Undeveloped mining properties	20,739	20,739
	\$ 135,797	\$ 111,681

Oil and Gas Activities

We have active agreements with several oil and gas exploration and production companies. Our working interest varies by project, but typically ranges from approximately 5% to 65%. These projects may result in numerous wells being drilled over the next three to five years. We are also actively pursuing the potential acquisition of additional exploration, development or production stage oil and gas properties or companies. The following table details our interests in producing wells as of March 31, 2012 and 2011.

Edgar Filing: US ENERGY CORP - Form 10-Q

	March 31,			
	2012		2011	
	Gross	Net	Gross	Net
Williston Basin:				
Productive wells	27.00	8.95	13.00	4.40
Wells being drilled or awaiting completion	7.00	1.08	8.00	2.08
Gulf Coast/South Texas:				
Productive wells	5.00	1.12	5.00	0.99
Wells being drilled or awaiting completion	1.00	0.13	2.00	0.27
Eagle Ford:				
Productive wells	2.00	0.60	--	--
Wells being drilled or awaiting completion	1.00	0.30	--	--
Austin Chalk:				
Productive wells	11.00	2.98	--	--
Wells being drilled or awaiting completion	--	--	--	--
Total:				
Productive wells	45.00	13.65	18.00	5.39
Wells being drilled or awaiting completion	9.00	1.51	10.00	2.35

Williston Basin, North Dakota

Rough Rider Prospect. We participate in fifteen 1,280 acre drilling units in the Rough Rider prospect with Brigham Oil & Gas, L.P. ("Brigham"), a subsidiary of Brigham Exploration Company. From August 24, 2009 to March 31, 2012, we have drilled and completed 19 gross Bakken Formation wells (7.30 net) and one gross Three Forks

formation well (0.18 net) under the Drilling Participation Agreement with Brigham. Three additional gross wells (0.15 net) are expected to be drilled during the balance of 2012. Brigham operates all of the wells.

During the first three months of 2012, the Company completed two gross wells (0.41 net) in the Rough Rider prospect. Our net investment in the Rough Rider prospect wells was \$2.7 million for the three months ended March 31, 2012.

Yellowstone and SEHR Prospects. We participate in 27 gross 1,280 acre spacing units in the Yellowstone and SEHR prospects with Zavanna, LLC ("Zavanna"). Through March 31, 2012, we have drilled and completed seven gross Bakken formation wells (1.47 net) in these prospects, including two gross wells (0.12 net) operated by Murex Petroleum. Zavanna operates the remaining wells. At March 31, 2012, two additional gross wells (0.10 net) were being drilled five 5 gross wells (0.98 net) were awaiting completion.

During the first three months of 2012, we completed two gross wells (0.45 net) and drilled three gross wells (0.25 net) in the Yellowstone and SEHR prospects. Our net investment in the Yellowstone and SEHR prospect wells was \$6.5 million during the quarter ended March 31, 2012.

On January 24, 2012 (but effective December 1, 2011), we sold an undivided 75% of our undeveloped acreage in the Yellowstone and SEHR prospects to GeoResources, Inc. (56.25%) and Yuma Exploration and Production Company, Inc. (18.75%) for \$16.7 million. Under the terms of the agreement, we retained the remaining 25% of our interest in the undeveloped acreage and our original working interest in the initial 10 developed wells in the prospects. Our average working interest in the remaining locations will be approximately 8.75% and net revenue interests in new wells after the sale are expected to be in the range of 6.7375% to 7.0%, proportionately reduced depending on Zavanna's actual working interest percentages.

U.S. Gulf Coast (Onshore) / South Texas

We participate with several different operators in the U.S. Gulf Coast (onshore). At March 31, 2012, we had five gross producing wells (1.12 net) in this region. During the three months ended March 31, 2012, we drilled one gross well (0.10 net) that was deemed to be nonproductive. Our net costs for this well through March 31, 2012 were \$174,000. One gross well (0.13 net) was in progress at March 31, 2012 and commenced production in the second quarter of 2012. Our net investment in Gulf Coast / South Texas wells was \$220,000 during the three months ended March 31, 2012.

Eagle Ford Shale

We participate in up to 114 gross (34 net) drilling locations in the Leona River and Booth-Tortuga Eagle Ford prospects with Crimson Exploration Inc. ("Crimson"). During the three months ended March 31, 2012, we drilled and completed one gross well (0.30 net) and drilled one gross well (0.30 net) that is expected to be completed during the second quarter of 2012. Our net investment in these wells during the first quarter of 2012 was \$2.7 million.

2012 Production Results

The following table provides a regional breakdown of our production during the first quarter of 2012:

	Williston Basin	Gulf Coast / South Texas	Eagle Ford	Austin Chalk	Total
First Three Months of 2012 Production					
Oil (Bbl)	87,335	996	2,305	1,946	92,582
Gas (Mcf)	33,730	49,234	5,582	1,226	89,772
NGLs (BBs)	4,053	335	--	104	4,492
Equivalent (BOE)	97,009	9,537	3,236	2,254	112,036