

PANHANDLE OIL & GAS INC  
Form 10-Q  
February 08, 2016

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  
~~December~~ 31,  
~~2015~~  
period  
ended

Transition Report Pursuant to Section 13  
or 15(d) of the Securities Exchange Act  
of 1934  
For \_\_\_\_\_ to \_\_\_\_\_  
the  
transition  
period  
from

~~00123750~~  
File  
Number

PANHANDLE OIL AND GAS INC.  
(Exact name of registrant as specified in its  
charter)

OKLAHOMA 73-1055775  
(I.R.S. Employer)

(State  
or  
other  
jurisdiction  
of  
incorporation Identification No.)  
or  
organization)

Grand Centre Suite 300, 5400 N Grand  
Blvd., Oklahoma City, Oklahoma 73112  
(Address of principal executive offices)

Registered telephone  
number  
including  
area  
code

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

YesNo

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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

YesNo

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 definition of "large accelerated filer",

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“accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  
Accelerated filer                      Non-accelerated  
filer                      Smaller reporting company

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

YesNo

Outstanding shares    16,578,411  
of Class A Common  
stock (voting) at  
February 8, 2016:

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The following defined terms are used in this report:

“Bbl” barrel.

“Board” board of directors.

“BTU” British Thermal Units.

“Company” Panhandle Oil and Gas Inc.

“completion” the process of treating a drilled well followed by the installation of permanent equipment for the production of crude oil and/or natural gas.

“DD&A” depreciation, depletion and amortization.

“dry hole” exploratory or development well that does not produce crude oil and/or natural gas in economic quantities.

“ESOP” the Panhandle Oil and Gas Inc. Employee Stock Ownership and 401(k) Plan, a tax qualified, defined contribution plan.

“exploratory well” a well drilled to find a new field or to find a new reservoir in a field previously found to be productive of crude oil or natural gas in another reservoir.

“FASB” the Financial Accounting Standards Board.

“field” an area consisting of a single reservoir or multiple reservoirs all grouped on, or related to, the same individual geological structural feature or stratigraphic condition. The field name refers to the surface area, although it may refer to both the surface and the underground productive formations.

“G&A” general and administrative costs.

“gross acres” the total acres in which an interest is owned.

“held by production” or “HBP” an oil and gas lease continued into effect into its secondary term for so long as a producing oil and/or gas well is located on any portion of the leased premises or lands pooled therewith.

“horizontal drilling” a drilling technique used in certain formations where a well is drilled vertically to a certain depth and then drilled horizontally within a specified interval.

“IDC” intangible drilling costs.

“Independent Consulting Petroleum Engineer(s)” or “Independent Consulting Petroleum Engineering Firm” DeGolyer and MacNaughton of Dallas, Texas.

“LOE” lease operating expense.

“Mcf” thousand cubic feet.

“Mcf” natural gas stated on an Mcf basis and crude oil and natural gas liquids converted to a thousand cubic feet of natural gas equivalent by using the ratio of one Bbl of crude oil or natural gas liquids to six Mcf of natural gas.

“Mmbtu” million BTU.

“minerals”, “mineral acres” or “mineral interests” fee mineral acreage owned in perpetuity by the Company.

“net acres” the sum of the fractional interests owned in gross acres.

“NGL” natural gas liquids.

“NYMEX” New York Mercantile Exchange.

“Panhandle” Panhandle Oil and Gas Inc.

“play” term applied to identified areas with potential oil and/or natural gas reserves.

“proved reserves” the quantities of crude oil and natural gas, which, by analysis of geoscience and engineering data, can be estimated with reasonable certainty to be economically producible from a given date forward, from known reservoirs and under existing economic conditions, operating methods, and government regulations prior to the time at which contracts providing the right to operate expire, unless evidence indicates renewal is reasonably certain.

“royalty interest” well interests in which the Company does not pay a share of the costs to drill, complete and operate a well, but receives a much smaller proportionate share (as compared to a working interest) of production.

“SEC” the United States Securities and Exchange Commission.

“undeveloped acreage” lease acreage on which wells have not been drilled or completed to a point that would permit the production of commercial quantities of crude oil and/or natural gas.

“working interest” well interests in which the Company pays a share of the costs to drill, complete and operate a well and receives a proportionate share of production.

“WTI” West Texas Intermediate.

#### Fiscal year references

All references to years in this report, unless otherwise noted, refer to the Company’s fiscal year end of September 30. For example, references to 2016 mean the fiscal year ended September 30, 2016.

#### References to oil and natural gas properties

References to oil and natural gas properties inherently include natural gas liquids associated with such properties.





## PART 1 FINANCIAL INFORMATION

## PANHANDLE OIL AND GAS INC.

## CONDENSED BALANCE SHEETS

	December 31, 2015 (unaudited)	September 30, 2015
Assets		
Current assets:		
Cash and cash equivalents	\$ 1,503,691	\$ 603,915
Oil, NGL and natural gas sales receivables (net of allowance for uncollectable accounts)	5,540,926	7,895,591
Refundable income taxes	-	345,897
Refundable production taxes	474,839	476,001
Derivative contracts, net	636,114	4,210,764
Other	911,340	252,016
Total current assets	9,066,910	13,784,184
Properties and equipment at cost, based on successful efforts accounting:		
Producing oil and natural gas properties	441,316,100	441,141,337
Non-producing oil and natural gas properties	7,694,635	8,293,997
Other	1,055,935	1,393,559
	450,066,670	450,828,893
Less accumulated depreciation, depletion and amortization	(234,432,151)	(228,036,803)
Net properties and equipment	215,634,519	222,792,090
Investments	173,423	2,248,999
Total assets	\$ 224,874,852	\$ 238,825,273
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	\$ 2,397,076	\$ 2,028,746
Deferred income taxes	863,100	1,517,100
Income taxes payable	1,073,551	-
Accrued liabilities and other	1,491,077	1,330,901
Total current liabilities	5,824,804	4,876,747
Long-term debt	57,000,000	65,000,000
Deferred income taxes	36,025,907	39,118,907
Asset retirement obligations	2,861,160	2,824,944
Stockholders' equity:		
Class A voting common stock, \$.0166 par value; 24,000,000 shares authorized, 16,863,004 issued at		

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December 31, 2015, and September 30, 2015	280,938	280,938
Capital in excess of par value	2,915,219	2,993,119
Deferred directors' compensation	3,170,219	3,084,289
Retained earnings	121,309,373	125,446,473
	127,675,749	131,804,819
Less treasury stock, at cost; 284,593 shares at December 31, 2015, and 302,623 shares at September 30, 2015	(4,512,768)	(4,800,144)
Total stockholders' equity	123,162,981	127,004,675
Total liabilities and stockholders' equity	\$ 224,874,852	\$ 238,825,273

(See accompanying notes)

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## PANHANDLE OIL AND GAS INC.

## CONDENSED STATEMENTS OF OPERATIONS

	Three Months Ended December 31,	
	2015	2014
	(unaudited)	
Revenues:		
Oil, NGL and natural gas sales	\$ 9,055,288	\$ 19,519,700
Lease bonuses and rentals	2,425,504	29,291
Gains (losses) on derivative contracts	(34,936)	11,250,265
Income from partnerships	16,269	199,914
	11,462,125	30,999,170
Costs and expenses:		
Lease operating expenses	3,566,536	4,785,350
Production taxes	321,841	622,512
Exploration costs	27,790	25,352
Depreciation, depletion and amortization	6,957,652	6,139,019
Provision for impairment	3,733,273	2,191,997
Loss (gain) on asset sales and other	(269,706)	(1,982)
Interest expense	360,562	402,733
General and administrative	1,912,079	1,958,428
Bad debt expense (recovery)	19,216	-
	16,629,243	16,123,409
Income (loss) before provision (benefit) for income taxes	(5,167,118)	14,875,761
Provision (benefit) for income taxes	(2,368,000)	4,642,000
Net income (loss)	\$ (2,799,118)	\$ 10,233,761
Basic and diluted earnings (loss) per common share (Note 3)	\$ (0.17)	\$ 0.61
Basic and diluted weighted average shares outstanding:		
Common shares	16,563,942	16,494,805
Unissued, directors' deferred compensation shares	255,060	262,121
	16,819,002	16,756,926
Dividends declared per share of common stock and paid in period	\$ 0.04	\$ 0.04
Dividends declared per share of common stock and to be paid in quarter ended March 31	\$ 0.04	\$ 0.04

(See accompanying notes)

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## PANHANDLE OIL AND GAS INC.

## STATEMENTS OF STOCKHOLDERS' EQUITY

Three Months Ended December 31, 2015

	Class A voting Common Stock Shares	Amount	Capital in Excess of Par Value	Deferred Directors' Compensation	Retained Earnings	Treasury Shares	Treasury Stock	Total
Balances at September 30, 2015	16,863,004	\$ 280,938	\$ 2,993,119	\$ 3,084,289	\$ 125,446,473	(302,623)	\$ (4,800,144)	\$ 127,004,000
Purchase of treasury stock	-	-	-	-	-	(7,477)	(117,165)	(117,165)
Restricted stock awards	-	-	371,407	-	-	-	-	371,407
Net income (loss)	-	-	-	-	(2,799,118)	-	-	(2,799,118)
Dividends (\$ .08 per share)	-	-	-	-	(1,337,982)	-	-	(1,337,982)
Distribution of restricted stock to officers and directors	-	-	(449,307)	-	-	25,507	404,541	(44,766)
Increase in deferred directors' compensation charged to expense	-	-	-	85,930	-	-	-	85,930
Balances at December 31, 2015 (unaudited)	16,863,004	\$ 280,938	\$ 2,915,219	\$ 3,170,219	\$ 121,309,373	(284,593)	\$ (4,512,768)	\$ 123,162,900

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Three Months Ended December 31, 2014

	Class A voting Common Stock Shares	Amount	Capital in Excess of Par Value	Deferred Directors' Compensation	Retained Earnings	Treasury Shares	Treasury Stock	Total
Balances at September 30, 2014	16,863,004	\$ 280,938	\$ 2,861,343	\$ 3,110,351	\$ 118,794,188	(372,364)	\$ (5,858,167)	\$ 119,188,6
Purchase of treasury stock	-	-	-	-	-	(7,177)	(120,611)	(120,611)
Restricted stock awards	-	-	165,111	-	-	-	-	165,111
Net income (loss)	-	-	-	-	10,233,761	-	-	10,233,76
Dividends (\$0.08 per share)	-	-	-	-	(1,333,023)	-	-	(1,333,02
Distribution of restricted stock to officers and directors	-	-	(436,303)	-	-	23,983	377,502	(58,801)
Increase in deferred directors' compensation charged to expense	-	-	-	101,589	-	-	-	101,589
Balances at December 31, 2014 (unaudited)	16,863,004	\$ 280,938	\$ 2,590,151	\$ 3,211,940	\$ 127,694,926	(355,558)	\$ (5,601,276)	\$ 128,176,0

(See accompanying notes)

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## PANHANDLE OIL AND GAS INC.

## CONDENSED STATEMENTS OF CASH FLOWS

	Three months ended December 31,	
	2015	2014
	(unaudited)	
Operating Activities		
Net income (loss)	\$ (2,799,118)	\$ 10,233,761
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation, depletion and amortization	6,957,652	6,139,019
Impairment	3,733,273	2,191,997
Provision for deferred income taxes	(3,747,000)	1,184,000
Exploration costs	27,790	25,352
Gain from leasing fee mineral acreage	(2,425,131)	(29,162)
Net (gain) loss on sales of assets	(271,080)	-
Income from partnerships	(16,269)	(199,914)
Distributions received from partnerships	36,253	256,017
Directors' deferred compensation expense	85,930	101,589
Restricted stock awards	371,407	165,111
Bad debt expense (recovery)	19,216	-
Cash provided (used) by changes in assets and liabilities:		
Oil, NGL and natural gas sales receivables	2,335,449	2,672,119
Fair value of derivative contracts	3,574,650	(10,431,194)
Refundable production taxes	1,162	13,205
Other current assets	(659,324)	99,085
Accounts payable	(484,882)	565,409
Income taxes receivable	345,897	-
Income taxes payable	1,073,551	2,891,600
Accrued liabilities	(509,208)	(692,505)
Total adjustments	10,449,336	4,951,728
Net cash provided by operating activities	7,650,218	15,185,489
Investing Activities		
Capital expenditures, including dry hole costs	(1,286,114)	(14,901,631)
Proceeds from leasing fee mineral acreage	2,693,812	29,798
Investments in partnerships	44,842	(173,103)
Proceeds from sales of assets	627,547	-
Net cash provided by (used in) investing activities	2,080,087	(15,044,936)
Financing Activities		
Borrowings under debt agreement	2,958,515	12,335,774



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Payments of loan principal	(10,958,515)	(11,620,667)
Purchases of treasury stock	(117,165)	(120,611)
Payments of dividends	(668,364)	(666,199)
Excess tax benefit on stock-based compensation	(45,000)	(59,000)
Net cash provided by (used in) financing activities	(8,830,529)	(130,703)
Increase (decrease) in cash and cash equivalents	899,776	9,850
Cash and cash equivalents at beginning of period	603,915	509,755
Cash and cash equivalents at end of period	\$ 1,503,691	\$ 519,605
Supplemental Schedule of Noncash Investing and Financing Activities:		
Dividends declared and unpaid	\$ 669,618	\$ 666,824
Additions to asset retirement obligations	\$ 4,524	\$ 26,452
Gross additions to properties and equipment	\$ 3,455,245	\$ 13,469,206
Net (increase) decrease in accounts payable for properties and equipment additions	(2,169,131)	1,432,425
Capital expenditures and acquisitions, including dry hole costs	\$ 1,286,114	\$ 14,901,631

(See accompanying notes)

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PANHANDLE OIL AND GAS INC.

NOTES TO CONDENSED FINANCIAL STATEMENTS

(Unaudited)

NOTE 1: Accounting Principles and Basis of Presentation

The accompanying unaudited condensed financial statements of Panhandle Oil and Gas Inc. have been prepared in accordance with the instructions to Form 10-Q as prescribed by the SEC. Management of the Company believes that all adjustments necessary for a fair presentation of the financial position and results of operations and cash flows for the periods have been included. All such adjustments are of a normal recurring nature. The results are not necessarily indicative of those to be expected for the full year. The Company's fiscal year runs from October 1 through September 30.

Certain amounts and disclosures have been condensed or omitted from these financial statements pursuant to the rules and regulations of the SEC. Therefore, these condensed financial statements should be read in conjunction with the financial statements and related notes thereto included in the Company's 2015 Annual Report on Form 10-K.

NOTE 2: Income Taxes

The Company's provision for income taxes differs from the statutory rate primarily due to estimated federal and state benefits generated from estimated excess federal and Oklahoma percentage depletion, which are permanent tax benefits. Excess percentage depletion, both federal and Oklahoma, can only be taken in the amount that it exceeds cost depletion which is calculated on a unit-of-production basis.

Both excess federal percentage depletion, which is limited to certain production volumes and by certain income levels, and excess Oklahoma percentage depletion, which has no limitation on production volume, reduce estimated taxable income or add to estimated taxable loss projected for any year. Due to the lower expected 2016 oil and natural gas prices, fiscal 2016 percentage depletion is not expected to exceed cost depletion as much as in past years. Therefore, the permanent tax benefit in 2016 is not expected to be as significant as in 2015. The federal and Oklahoma excess percentage depletion estimates will be updated throughout the year until finalized with detailed well-by-well calculations at fiscal year-end. Federal and Oklahoma excess percentage depletion, when a provision for income taxes is recorded, decreases the effective tax rate, while the effect is to increase the effective tax rate when a benefit for income taxes is recorded. The benefits of federal and Oklahoma excess percentage depletion are not directly related to the amount of pre-tax income recorded in a period. Accordingly, in periods where a recorded pre-tax income or loss is relatively small, the proportional effect of these items on the effective tax rate may be significant. The effective tax rate for the quarter ended December 31, 2015, was 46% as compared to 31% for the quarter ended December 31, 2014.

NOTE 3: Basic and Diluted Earnings (Loss) per Share

Basic and diluted earnings (loss) per share is calculated using net income (loss) divided by the weighted average number of voting common shares outstanding, including unissued, vested directors' deferred compensation shares during the period.

NOTE 4: Long-term Debt

The Company has a \$200,000,000 credit facility with a group of banks headed by Bank of Oklahoma (BOK) with a current borrowing base of \$100,000,000 and a maturity date of November 30, 2018. The credit facility is subject to a semi-annual borrowing base determination, wherein BOK applies their own current commodity pricing forecast and an 8% discount rate to the Company's proved reserves as calculated by the Company's Independent Consulting Petroleum Engineering Firm. The facility is secured by certain of the Company's properties with a net book value of \$185,342,249 at December 31, 2015. The interest rate is based on BOK prime plus from 0.375% to 1.125%, or 30 day LIBOR plus from 1.875% to 2.625%. The election of BOK prime or LIBOR is at the Company's discretion. The interest rate spread from BOK prime or LIBOR will be charged based on the ratio of the loan balance to the borrowing base. The interest rate spread from LIBOR or the prime rate increases as a larger percent of the borrowing base is advanced. At December 31, 2015, the effective interest rate was 2.43%.

The Company's debt is recorded at the carrying amount on its balance sheet. The carrying amount of the Company's revolving credit facility approximates fair value because the interest rates are reflective of market rates.

On December 10, 2015, the borrowing base was adjusted by the banks from \$120,000,000 to \$100,000,000. Determinations of the borrowing base are made semi-annually or whenever the banks, in their discretion, believe that there has been a material change in the value of the oil and natural gas properties. The loan agreement contains customary covenants which, among other things, require periodic financial and reserve reporting and place certain limits on the Company's incurrence of indebtedness, liens, payment of dividends and acquisitions of treasury stock, and require the Company to maintain certain financial ratios. At December 31, 2015, the Company was in compliance with the covenants of the loan

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agreement and has \$43,000,000 of availability under its outstanding credit facility.

NOTE 5: Deferred Compensation Plan for Non-Employee Directors

Annually, non-employee directors may elect to be included in the Deferred Compensation Plan for Non-Employee Directors. The Deferred Compensation Plan for Non-Employee Directors provides that each outside director may individually elect to be credited with future unissued shares of Company common stock rather than cash for all or a portion of the annual retainers, Board meeting fees and committee meeting fees, and may elect to receive shares, when issued, over annual time periods up to ten years. These unissued shares are recorded to each director's deferred compensation account at the closing market price of the shares (i) on the dates of the Board and committee meetings, and (ii) on the payment dates of the annual retainers. Only upon a director's retirement, termination, death, or a change-in-control of the Company will the shares recorded for such director under the Deferred Compensation Plan for Non-Employee Directors be issued to the director. The promise to issue such shares in the future is an unsecured obligation of the Company.

NOTE 6: Restricted Stock Plan

In March 2010, shareholders approved the Panhandle Oil and Gas Inc. 2010 Restricted Stock Plan (2010 Stock Plan), which made available 200,000 shares of common stock to provide a long-term component to the Company's total compensation package for its officers and to further align the interest of its officers with those of its shareholders. In March 2014, shareholders approved an amendment to increase the number of shares of common stock reserved for issuance under the 2010 Stock Plan from 200,000 shares to 500,000 shares and to allow the grant of shares of restricted stock to our directors. The 2010 Stock Plan, as amended, is designed to provide as much flexibility as possible for future grants of restricted stock so that the Company can respond as necessary to provide competitive compensation in order to retain, attract and motivate directors and officers of the Company and to align their interests with those of the Company's shareholders.

Effective in May 2014, the board of directors adopted resolutions to allow management, at their discretion, to purchase the Company's common stock up to an amount equal to the aggregate number of shares of common stock awarded pursuant to the Company's Amended 2010 Restricted Stock Plan, contributed by the Company to its ESOP and credited to the accounts of directors pursuant to the Deferred Compensation Plan for Non-Employee Directors.

On December 9, 2015, the Company awarded 13,482 non-performance based shares and 40,446 performance based shares of the Company's common stock as restricted stock to certain officers. The restricted stock vests at the end of a three year period and contains nonforfeitable rights to receive dividends and voting rights during the vesting period. The non-performance and performance based shares had a fair value on their award date of \$223,397 and \$376,915, respectively. The Company recognized \$211,363 of compensation expense on the award date for performance based shares for officers that were eligible for retirement. The remaining fair value for the performance based awards as well as the entire fair value of the non-performance based awards will be recognized as compensation expense ratably over

the vesting period. The fair value of the performance based shares on their award date is calculated by simulating the Company's stock prices as compared to the Dow Jones Select Oil Exploration and Production Index (DJSOEP) prices utilizing a Monte Carlo model covering the performance period (December 9, 2015, through December 9, 2018).

On December 31, 2015, the Company awarded 12,996 non-performance based shares of the Company's common stock as restricted stock to its non-employee directors. The restricted stock vests quarterly over one year starting on March 31, 2016. The restricted stock contains nonforfeitable rights to receive dividends and voting rights during the vesting period. These non-performance based shares had a fair value on their award date of \$210,018.

The following table summarizes the Company's pre-tax compensation expense for the three months ended December 31, 2015 and 2014, related to the Company's performance based and non-performance based restricted stock.

	Three Months Ended	
	December 31,	
	2015	2014
Performance based, restricted stock	\$ 269,510	\$ 64,174
Non-performance based, restricted stock	101,897	100,937
Total compensation expense	\$ 371,407	\$ 165,111

A summary of the Company's unrecognized compensation cost for its unvested performance based and non-performance based restricted stock and the weighted-average periods over which the compensation cost is expected to be recognized are shown in the following table.

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	As of December 31, 2015	
	Unrecognized Compensation	
	Cost	Weighted Average Period (in years)
Performance based, restricted stock	\$ 329,001	2.28
Non-performance based, restricted stock	593,336	1.91
Total	\$ 922,337	

Upon vesting, shares are expected to be issued out of shares held in treasury.

#### NOTE 7: Oil, NGL and Natural Gas Reserves

Management considers the estimation of the Company's crude oil, NGL and natural gas reserves to be the most significant of its judgments and estimates. Changes in crude oil, NGL and natural gas reserve estimates affect the Company's calculation of DD&A, provision for retirement of assets and assessment of the need for asset impairments. On an annual basis, with a semi-annual update, the Company's Independent Consulting Petroleum Engineer, with assistance from Company staff, prepares estimates of crude oil, NGL and natural gas reserves based on available geological and seismic data, reservoir pressure data, core analysis reports, well logs, analogous reservoir performance history, production data and other available sources of engineering, geological and geophysical information. Between periods in which reserves would normally be calculated, the Company updates the reserve calculations utilizing appropriate prices for the current period. The estimated oil, NGL and natural gas reserves were computed using the 12-month average price calculated as the unweighted arithmetic average of the first-day-of-the-month oil, NGL and natural gas price for each month within the 12-month period prior to the balance sheet date, held flat over the life of the properties. However, projected future crude oil, NGL and natural gas pricing assumptions are used by management to prepare estimates of crude oil, NGL and natural gas reserves and future net cash flows used in asset impairment assessments and in formulating management's overall operating decisions. Crude oil, NGL and natural gas prices are volatile and affected by worldwide production and consumption and are outside the control of management.

#### NOTE 8: Impairment

All long-lived assets, principally oil and natural gas properties, are monitored for potential impairment when circumstances indicate that the carrying value of the asset may be greater than its estimated future net cash flows. The evaluations involve significant judgment since the results are based on estimated future events, such as: inflation rates; future drilling and completion costs; future sales prices for oil, NGL and natural gas; future production costs; estimates of future oil, NGL and natural gas reserves to be recovered and the timing thereof; the economic and regulatory climates and other factors. The need to test a property for impairment may result from significant declines in sales prices or unfavorable adjustments to oil, NGL and natural gas reserves. Between periods in which reserves would normally be calculated, the Company updates the reserve calculations to reflect any material changes since the prior report was issued and then utilizes updated projected future price decks current with the period. For the three months ended December 31, 2015 and 2014, the assessment resulted in impairment provisions of \$3,733,273 and

\$2,191,997, respectively. The impairment provision for the three months ended December 31, 2015, is principally the result of lower projected future prices for oil, NGL and natural gas. A further reduction in oil, NGL and natural gas prices or a decline in reserve volumes may lead to additional impairment in future periods that may be material to the Company.

NOTE 9: Capitalized Costs

As of December 31, 2015 and 2014, non-producing oil and natural gas properties include costs of \$14,520 and \$908,872, respectively, on exploratory wells which were drilling and/or testing.

NOTE 10: Derivatives

The Company has entered into commodity price derivative agreements including fixed swap contracts and costless collar contracts. These instruments are intended to reduce the Company's exposure to short-term fluctuations in the price of oil and natural gas. Fixed swap contracts set a fixed price and provide payments to the Company if the index price is below the fixed price, or require payments by the Company if the index price is above the fixed price. Collar contracts set a fixed floor price and a fixed ceiling price and provide payments to the Company if the index price falls below the floor or require payments by the Company if the index price rises above the ceiling. These contracts cover only a portion of the Company's natural gas and oil production and provide only partial price protection against declines in natural gas and oil prices. These derivative instruments may expose the Company to risk of financial loss and limit the benefit of future increases in prices. All of the Company's derivative contracts are with Bank of Oklahoma and are secured under its credit facility with Bank of Oklahoma. The derivative instruments have settled or will settle based on the prices below.

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Derivative contracts in place as of December 31, 2015

Contract period	Production volume covered per month	Index	Contract price
Natural gas costless collars			
December 2015 - May 2016	80,000 Mmbtu	NYMEX Henry Hub	\$2.50 floor / \$3.10 ceiling
January - September 2016	80,000 Mmbtu	NYMEX Henry Hub	\$2.15 floor / \$2.50 ceiling
April - October 2016	200,000 Mmbtu	NYMEX Henry Hub	\$1.95 floor / \$2.40 ceiling
January - March 2016	100,000 Mmbtu	NYMEX Henry Hub	\$1.75 floor / \$1.90 ceiling
February - March 2016	100,000 Mmbtu	NYMEX Henry Hub	\$2.00 floor / \$2.60 ceiling
June - September 2016	80,000 Mmbtu	NYMEX Henry Hub	\$2.15 floor / \$2.90 ceiling
Natural gas fixed price swaps			
January - September 2016	80,000 Mmbtu	NYMEX Henry Hub	\$2.43

Derivative contracts in place as of September 30, 2015

Contract period	Production volume covered per month	Index	Contract price
Natural gas costless collars			
January - December 2015	100,000 Mmbtu	NYMEX Henry Hub	\$3.50 floor / \$4.10 ceiling
January - December 2015	70,000 Mmbtu	NYMEX Henry Hub	\$3.25 floor / \$4.00 ceiling
April - October 2015	50,000 Mmbtu	NYMEX Henry Hub	\$3.50 floor / \$4.00 ceiling
May - October 2015	70,000 Mmbtu	NYMEX Henry Hub	\$3.50 floor / \$3.95 ceiling
Oil costless collars			
July - December 2015	10,000 Bbls	NYMEX WTI	\$80.00 floor / \$86.50 ceiling
Oil fixed price swaps			
April - December 2015	5,000 Bbls	NYMEX WTI	\$94.56
July - December 2015	7,000 Bbls	NYMEX WTI	\$93.91

The Company has elected not to complete all of the documentation requirements necessary to permit these derivative contracts to be accounted for as cash flow hedges. The Company's fair value of derivative contracts was a net asset of



\$636,114 as of December 31, 2015, and a net asset of \$4,210,764 as of September 30, 2015.

The fair value amounts recognized for the Company's derivative contracts executed with the same counterparty under a master netting arrangement may be offset. The Company has the choice to offset or not, but that choice must be applied consistently. A master netting arrangement exists if the reporting entity has multiple contracts with a single counterparty that are subject to a contractual agreement that provides for the net settlement of all contracts through a single payment in a single currency in the event of default on or termination of any one contract. Offsetting the fair values recognized for the derivative contracts outstanding with a single counterparty results in the net fair value of the transactions being reported as an asset or a liability in the Condensed Balance Sheets.

The following table summarizes and reconciles the Company's derivative contracts' fair values at a gross level back to net fair value presentation on the Company's Condensed Balance Sheets at December 31, 2015, and September 30, 2015. The Company has offset all amounts subject to master netting agreements in the Company's Condensed Balance Sheets at December 31, 2015, and September 30, 2015.

	December 31, 2015		September 30, 2015
	Fair Value (a)		Fair Value
	Commodity Contracts		Commodity Contracts
	Current Assets	Current Liabilities	Current Assets
Gross amounts recognized	\$ 1,196,007	\$ 559,893	\$ 4,210,764
Offsetting adjustments	(559,893)	(559,893)	-
Net presentation on Condensed Balance Sheets	\$ 636,114	\$ -	\$ 4,210,764

(8)

(a) See Fair Value Measurements section for further disclosures regarding fair value of financial instruments.

The fair value of derivative assets and derivative liabilities is adjusted for credit risk. The impact of credit risk was immaterial for all periods presented.

NOTE 11: Fair Value Measurements

Fair value is defined as the amount that would be received from the sale of an asset or paid for the transfer of a liability in an orderly transaction between market participants, i.e., an exit price. To estimate an exit price, a three-level hierarchy is used. The fair value hierarchy prioritizes the inputs, which refer broadly to assumptions market participants would use in pricing an asset or a liability, into three levels. Level 1 inputs are unadjusted quoted prices in active markets for identical assets and liabilities. Level 2 inputs are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. If the asset or liability has a specified (contractual) term, a Level 2 input must be observable for substantially the full term of the asset or liability. Level 2 inputs include the following: (i) quoted prices for similar assets or liabilities in active markets; (ii) quoted prices for identical or similar assets or liabilities in markets that are not active; (iii) inputs other than quoted prices that are observable for the asset or liability; or (iv) inputs that are derived principally from or corroborated by observable market data by correlation or other means. Level 3 inputs are unobservable inputs for the financial asset or liability.

The following table provides fair value measurement information for financial assets and liabilities measured at fair value on a recurring basis as of December 31, 2015.

	Fair Value Measurement at December 31, 2015			
	Quoted Prices in Active Markets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Fair Value
Financial Assets (Liabilities):				
Derivative Contracts - Swaps				