TORCHLIGHT ENERGY RESOURCES INC
Form 10-Q
August 15, 2016

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

Quarterly report under Section 13 or 15(d) of the Securities Exchange Act of 1934
For the Quarter Ended June 30, 2016

Transition report under Section 13 or 15(d) of the Securities Exchange Act of 1934
For the transition period from _______ to _______.

Commission file number: 001-36247

TORCHLIGHT ENERGY RESOURCES, INC.

(Name of registrant in its charter)

Nevada	74-3237581
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)

5700 West Plano Pkwy, Suite 3600
Plano, Texas 75093

(Address of Principal Executive Offices)

(214) 432-8002

(Registrant's 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. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company" in Rule 12b-2 of the Exchange Act.:

Large accelerated filer Accelerated filer
Non-accelerated filer 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

As of August 10, 2016, there were 47,519,173 shares of the registrant's common stock outstanding (the only class of voting common stock).

FORM 10-Q

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NOTE ABOUT FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These statements include, among other things, statements regarding plans, objectives, goals, strategies, future events or performance and underlying assumptions and other statements, which are other than statements of historical facts. Forward-looking statements may appear throughout this report, including without limitation, Item 2 “Management’s Discussion and Analysis of Financial Condition and Results of Operations.” Forward-looking statements generally can be identified by words such as “anticipates,” “believes,” “estimates,” “expects,” “intends,” “plans,” “predicts,” “projects,” “will be,” “will continue,” “will likely result,” and similar expressions. These forward-looking statements are based on current expectations and assumptions that are subject to risks and uncertainties, which could cause our actual results to differ materially from those reflected in the forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those discussed in this report and in our Annual Report on Form 10-K for the year ended December 31, 2015 and in particular, the risks discussed in our Form 10-K under the caption “Risk Factors” in Item 1A therein, and those discussed in other documents we file with the Securities and Exchange Commission (“SEC”). Important factors that in our view could cause material adverse effects on our financial condition and results of operations include, but are not limited to, risks associated with the company's ability to obtain additional capital in the future to fund planned expansion, the demand for oil and natural gas, general economic factors, competition in the industry and other factors that may cause actual results to be materially different from those described herein as anticipated, believed, estimated or expected. We undertake no obligation to revise or publicly release the results of any revision to any forward-looking statements, except as required by law. Given these risks and uncertainties, readers are cautioned not to place undue reliance on such forward-looking statements.

As used herein, the “Company,” “we,” “Torchlight,” “our,” and similar terms include Torchlight Energy Resources, Inc. and its subsidiaries, unless the context indicates otherwise.

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PART I FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

TORCHLIGHT ENERGY RESOURCES, INC.

CONSOLIDATED CONDENSED BALANCE SHEETS (Unaudited)

	June 30, 2016	December 31, 2015
ASSETS		
Current assets:		
Cash	$318,011	$1,026,600
Accounts receivable	662,580	741,653
Production revenue receivable	8,817	199,317
Note receivable	-	613
Prepayments - development costs	150,362	-
Prepaid expenses	-	38,776
Total current assets	1,139,770	2,006,959
Investment in oil and gas properties, net	9,312,719	7,057,671
Office equipment	34,334	43,110
Debt issuance costs, net	5,479	8,224
Other assets	43,361	72,082
TOTAL ASSETS	$10,535,663	$9,188,046
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$1,707,289	$1,114,409
Accrued liabilities	671,364	628,876
Related party payables	276,112	130,000
Convertible promissory notes, (Series B) net of discount of		

$185,155 at June 30, 2016	3,384,345	0
Notes payable within one year - related party	131,250	205,000
Notes payable within one year	105,020	129,741
Due to working interest owners	216,476	103,364
Interest payable	161,759	173,710
Total current liabilities	6,653,615	2,485,100
Convertible promissory notes, (Series B) net of discount of $277,911 at December 31, 2015	-	3,291,589
Asset retirement obligation	1,670	29,083
Commitments and contingencies	-	-
Stockholders’ equity:		
Preferred stock, par value $.001, 10,000,000 shares authorized;		
37,000 issued and outstanding at June 30, 2016	35	134
134,000 issued and outstanding at December 31, 2015		
Common stock, par value $0.001 per share; 100,000,000 shares authorized; 45,793,587 issued and outstanding at June 30, 2016 33,166,344 issued and outstanding at December 31, 2015	45,800	33,168
Additional paid-in capital	63,976,768	61,921,450
Warrants outstanding	20,546,667	16,330,961
Accumulated deficit	(80,688,892)	(74,903,439)
Total stockholders' equity (deficit)	3,880,378	3,382,274
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$10,535,663	$9,188,046

The accompanying notes are an integral part of these consolidated financial statements.

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TORCHLIGHT ENERGY RESOURCES, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

	THREE MONTHS ENDED June 30, 2016	THREE MONTHS ENDED June 30, 2015	SIX MONTHS ENDED June 30, 2016	SIX MONTHS ENDED June 30, 2015
Revenue				
Oil and gas sales	$105,220	$508,265	$303,513	$1,042,827
SWD and royalties		374	-	57,070
Cost of revenue	(139,116)	(279,646)	(245,300)	(510,544)
Gross income	-33,896	228,993	58,213	589,353
Operating expenses:				
General and administrative expense	3,796,418	8,207,314	4,747,704	8,896,025
Depreciation, depletion and amortization	100,082	204,330	722,054	698,805
Impairment expense	57,912	22,438,114	57,912	22,438,114
Loss on sale	146,138	-	146,138	-
Total operating expenses	4,100,550	30,849,758	5,673,808	32,032,944
Other income (expense)				
Other income	-	962	-	962
Interest income	-	-	-	-
Interest and accretion expense	(47,481)	(239,667)	(169,858)	(1,631,109)
Total other income (expense)	(47,481)	(238,705)	(169,858)	(1,630,147)

Net loss before taxes	(4,181,927)	(30,859,470)	(5,785,453)	(33,073,738)
Provision for income taxes	-	-	-	-
Net (loss)	$(4,181,927)	$(30,859,470)	$(5,785,453)	$(33,073,738)
Loss per share:				
Basic and Diluted	$(0.16)	$(1.44)	$(0.35)	$(2.02)
Weighted average shares outstanding:				
Basic and Diluted	26,062,804	21,428,769	16,506,672	16,342,225

The accompanying notes are an integral part of these consolidated financial statements.

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TORCHLIGHT ENERGY RESOURCES, INC.

CONSOLIDATED STATEMENTS OF CASH FLOW (Unaudited)

	SIX MONTHS ENDED June 30, 2016	SIX MONTHS ENDED June 30, 2015
Cash Flows From Operating Activities		
Net (loss)	$(5,785,453)	$(33,073,738)
Adjustments to reconcile net loss to net cash from operations:		
Stock based compensation	3,214,690	7,078,791
Accretion of convertible note discounts	95,979	1,163,091
Loss on sale of assets	146,138	-
Impairment expense	57,912	22,438,114
Depreciation, depletion and amortization	722,054	698,805
Change in:		
Accounts receivable	79,073	49,392
Note receivable	613	2,627
Production revenue receivable	190,500	(163,977)
Prepayment of development costs	(150,362)	10,602
Debt issuance costs	2,745	-
Prepaid expenses	38,776	29,634
Other assets	28,720	(23,938)
Accounts payable and accrued liabilities	635,368	3,165,044
Due to working interest owners	113,113	(30,231)
Asset retirement obligation	(27,413)	774
Interest payable	(15,174)	447,014
Capitalized interest	(157,581)	(395,738)
Net cash provided by (used) in operating activities	(810,302)	1,396,266
Cash Flows From Investing Activities		
Investment in oil and gas properties	(1,700,209)	(4,618,743)
Proceeds from Sale of Leases	1,572,000	951,918
Net cash used in investing activities	(128,209)	(3,666,825)
Cash Flows From Financing Activities		
Proceeds from short term advance	150,000	-
Proceeds from sale of common stock	-	1,300,000
Proceeds from sale of preferred stock	-	9,800,000
Preferred dividends paid in cash	(224,260)	-

Proceeds from warrant exercise	406,541	-
Proceeds from promissory notes	511,270	212,000
Repayment of convertible notes	-	(8,859,011)
Repayment of promissory notes	(613,629)	(150,000)
Net cash provided by financing activities	229,922	2,302,989
Net increase (decrease) in cash	(708,589)	32,430
Cash - beginning of period	1,026,600	179,787
Cash - end of period	$318,011	$212,217

Supplemental disclosure of cash flow information:

Non cash transactions:		
Common stock issued for services	$410,474	$1,594,871
Common stock issued for mineral interests	$1,484,166	$26,400
Warrants issued for services	$2,716,125	$5,562,919
Common stock issued in conversion of preferred stock	$9,700,000	$-
Warrants issued in connection with promissory notes	$80,750	$-
Common stock issued in warrant exercises	$397,471	$-
Warrants issued for mineral interests	$1,409,761	-
Cash paid for interest	$266,259	$931,011

The accompanying notes are an integral part of these consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

1. NATURE OF BUSINESS

Torchlight Energy Resources, Inc. was incorporated in October 2007 under the laws of the State of Nevada as Pole Perfect Studios, Inc. ("PPS"). From its incorporation to November 2010, the company was primarily engaged in business start-up activities.

On November 23, 2010, we entered into and closed a Share Exchange Agreement (the "Exchange Agreement") between the major shareholders of PPS and the shareholders of Torchlight Energy, Inc. ("TEI"). As a result of the transactions effected by the Exchange Agreement, at closing TEI became our wholly-owned subsidiary, and the business of TEI became our sole business. TEI was incorporated under the laws of the State of Nevada in June 2010. We are engaged in the acquisition, exploitation and/or development of oil and natural gas properties in the United States. In addition to TEI, we also operate our business through our wholly-owned subsidiaries Torchlight Energy Operating, LLC, a Texas limited liability company and Hudspeth Oil Corporation, a Texas corporation.

On December 10, 2010, we effected a 4-for-1 forward split of our shares of common stock outstanding. All owners of record at the close of business on December 10, 2010 (record date) received three additional shares for every one share they owned. All share amounts reflected throughout this report take into account the 4-for-1 forward split.

Effective February 8, 2011, we changed our name to "Torchlight Energy Resources, Inc." In connection with the name change, our ticker symbol changed from "PPFT" to "TRCH."

The Company is engaged in the acquisition, exploration, development and production of oil and gas properties within the United States. The Company's success will depend in large part on its ability to obtain and develop profitable oil and gas interests.

2. GOING CONCERN

These consolidated financial statements have been prepared in accordance with generally accepted accounting principles applicable to a going concern, which assumes that the Company will be able to meet its obligations and continue its operations for its next fiscal year.

At June 30, 2016, the Company had not yet achieved profitable operations. We had a net loss of approximately $5.8 million for the six months ended June 30, 2016 and had accumulated losses of $80,688,892 since our inception to June 30, 2016, and expect to incur further losses in the development of our business. Working Capital as of June 30, 2016 was negative $5,513,845. Negative working capital is exacerbated by the inclusion in current liabilities of the $3,384,345 outstanding balance of subordinated convertible notes which have a maturity date of June 30, 2017 and are therefore included in current liabilities as of June 30, 2016.

The Company's ability to continue as a going concern is dependent on its ability to generate future profitable operations and/or to obtain the necessary financing to meet its obligations and repay its liabilities arising from normal business operations when they come due. Management's plan to address the Company's ability to continue as a going concern includes: (1) obtaining debt or equity funding from private placement or institutional sources; (2) obtain loans from financial institutions, where possible; (3) participating in joint venture transactions with third parties; or (4) sale of assets. Although management believes that it will be able to obtain the necessary funding to allow the Company to remain a going concern through the methods discussed above, there can be no assurances that such methods will prove successful. The accompanying consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

3. SIGNIFICANT ACCOUNTING POLICIES

The Company maintains its accounts on the accrual method of accounting in accordance with accounting principles generally accepted in the United States of America. Accounting principles followed and the methods of applying those principles, which materially affect the determination of financial position, results of operations and cash flows are summarized below:

Use of estimates – The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and certain assumptions that affect the amounts reported in these consolidated financial statements and accompanying notes. Actual results could differ from these estimates.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

3. SIGNIFICANT ACCOUNTING POLICIES - continued

Basis of presentation—The financial statements are presented on a consolidated basis and include all of the accounts of Torchlight Energy Resources Inc. and its wholly owned subsidiaries, Torchlight Energy, Inc., Torchlight Energy Operating, LLC, and Hudspeth Oil Corporation. All significant intercompany balances and transactions have been eliminated.

Risks and uncertainties – The Company’s operations are subject to significant risks and uncertainties, including financial, operational, technological, and other risks associated with operating an emerging business, including the potential risk of business failure.

Concentration of risks – The Company’s cash is placed with a highly rated financial institution, and the Company periodically reviews the credit worthiness of the financial institutions with which it does business. At times the Company’s cash balances are in excess of amounts guaranteed by the Federal Deposit Insurance Corporation.

Fair value of financial instruments – Financial instruments consist of cash, accounts receivable, accounts payable, notes payable to related party, and convertible promissory notes. The estimated fair values of cash, accounts receivable, accounts payable, and related party payables approximate the carrying amount due to the relatively short maturity of these instruments. The carrying amounts of the convertible promissory notes approximate their fair value giving affect for the term of the note and the effective interest rates.

For assets and liabilities that require re-measurement to fair value the Company categorizes them in a three-level fair value hierarchy as follows:

·Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities.
·Level 2 inputs are quoted prices for similar assets and liabilities in active markets or inputs that are observable for the asset or liability, either directly or indirectly through market corroboration.
·Level 3 inputs are unobservable inputs based on management’s own assumptions used to measure assets and liabilities at fair value.

A financial asset or liability’s classification within the hierarchy is determined based on the lowest level input that is significant to the fair value measurement.

Accounts receivable – Accounts receivable consist of uncollateralized oil and natural gas revenues due under normal trade terms, as well as amounts due from working interest owners of oil and gas properties for their share of expenses paid on their behalf by the Company. Management reviews receivables periodically and reduces the carrying amount by a valuation allowance that reflects management’s best estimate of the amount that may not be collectible. As of June 30, 2016 and December 31, 2015 no valuation allowance was considered necessary.

As of December 31, 2015, the Company had a $419,839 account receivable from Husky Ventures for the estimated balance of the sale proceeds from the sale of the Chisholm Trail properties in fourth quarter, 2015. The Chisholm Trail properties were sold to Husky Ventures who then included them with the Husky interests in Chisholm Trail and then entered into a sale agreement with Gastar Exploration Inc. for the combined Torchlight and Husky interests. Receipt of the balance of the sale proceeds was subject to final determination of mineral lease classification and was to occur by February 28, 2016.

On June 14, 2016, after the lawsuit that is described in Part II Item 1. Legal Proceedings regarding the Hunton Play, the Company received and subsequently deposited a check from Husky Ventures in the amount of $520,400. Husky Ventures designated that the check was in full satisfaction of its obligations under the transaction in which the Company sold the Chisholm Trail properties as described above. The Company does not believe the check is in full satisfaction of Husky Ventures's obligations, including but not limited to that Husky Ventures has provided insufficient information for the Company regarding this transaction. The Company is currently pursuing claims against Husky Ventures, and others, related to this transaction and intends to continue to pursue those claims as described further in Part II Item 1. Legal Proceedings regarding the Hunton Play.

Investment in oil and gas properties – The Company uses the full cost method of accounting for exploration and development activities as defined by the Securities and Exchange Commission ("SEC"). Under this method of accounting, the costs of unsuccessful, as well as successful, exploration and development activities are capitalized as properties and equipment. This includes any internal costs that are directly related to property acquisition, exploration and development activities but does not include any costs related to production, general corporate overhead or similar activities. Gain or loss on the sale or other disposition of oil and gas properties is not recognized, unless the gain or loss would significantly alter the relationship between capitalized costs and proved reserves.

Oil and gas properties include costs that are excluded from costs being depleted or amortized. Oil and natural gas property costs excluded represent investments in unevaluated properties and include non-producing leasehold, geological, and geophysical costs associated with leasehold or drilling interests and exploration drilling costs. The Company allocates a portion of its acquisition costs to unevaluated properties based on relative value. Costs are transferred to the full cost pool as the properties are evaluated over the life of the reservoir.

As of June 30, 2016 the Company performed an assessment of evaluated and unevaluated costs in the cost pool to conform the cumulative value of the Full Cost Pool to the combined amount of Reserve Value of evaluated, producing properties (as determined by independent analysis at December 31, 2015), plus the lesser of cumulative historical cost or estimated realizable value of unevaluated leases and projects expected to commence production in future operating periods. The results of the assessment was an additional charge to Impairment Expense of $57,912.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

3. SIGNIFICANT ACCOUNTING POLICIES - continued

Capitalized interest – The Company capitalizes interest on unevaluated properties during the periods in which they are excluded from costs being depleted or amortized. During the periods ended June 30, 2016 and June 30, 2015, the Company capitalized $157,581 and $395,738, respectively, of interest on unevaluated properties.

Depreciation, depletion, and amortization – The depreciable base for oil and natural gas properties includes the sum of all capitalized costs net of accumulated depreciation, depletion, and amortization ("DD&A"), estimated future development costs and asset retirement costs not included in oil and natural gas properties, less costs excluded from amortization. The depreciable base of oil and natural gas properties is amortized on a unit-of-production method.

Ceiling test – Future production volumes from oil and gas properties are a significant factor in determining the full cost ceiling limitation of capitalized costs. Under the full cost method of accounting, the Company is required to periodically perform a "ceiling test" that determines a limit on the book value of oil and gas properties. If the net capitalized cost of proved oil and gas properties, net of related deferred income taxes, plus the cost of unproved oil and gas properties, exceeds the present value of estimated future net cash flows discounted at 10 percent, net of related tax affects, plus the cost of unproved oil and gas properties, the excess is charged to expense and reflected as additional accumulated DD&A. The ceiling test calculation uses a commodity price assumption which is based on the unweighted arithmetic average of the price on the first day of each month for each month within the prior 12 month period and excludes future cash outflows related to estimated abandonment costs. The Company recognized impairment of $22,438,114 on its oil and gas properties during the three months ended June 30, 2015 and an additional impairment at December 31, 2015 of $3,236,009 for a total impairment adjustment for 2015 of $25,674,123. Impairment in the amount of $57,912 was recognized at June 30, 2016 as a result of the Company's assessment. Due to the volatility of commodity prices, should oil and natural gas prices decline in the future, it is possible that a write-down could occur. Proved reserves are estimated quantities of crude oil, natural gas, and natural gas liquids, which geological and engineering data demonstrate with reasonable certainty to be recoverable from known reservoirs under existing economic and operating conditions. The independent engineering estimates include only those amounts considered to be proved reserves and do not include additional amounts which may result from new discoveries in the future, or from application of secondary and tertiary recovery processes where facilities are not in place or for which transportation and/or marketing contracts are not in place. Estimated reserves to be developed through secondary or tertiary recovery processes are classified as unevaluated properties.