

TORCHLIGHT ENERGY RESOURCES INC

Form 10-Q

November 10, 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 September 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

(State or Other Jurisdiction of Incorporation or Organization)

74-3237581

(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 November 10, 2016, there were 50,336,762 shares of the registrant's common stock outstanding (the only class of voting common stock).



FORM 10-Q

TABLE OF CONTENTS

Note About Forward-Looking Statements	3
<b>PART I FINANCIAL INFORMATION</b>	<b>4</b>
Item 1. Consolidated Financial Statements	4
Consolidated Balance Sheets (Unaudited)	4
Consolidated Statements of Operations (Unaudited)	5
Consolidated Statements of Cash Flows (Unaudited)	6
Notes to Consolidated Financial Statements (Unaudited)	7
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations	15
Item 3. Quantitative and Qualitative Disclosures About Market Risk	21
Item 4. Controls and Procedures	21
<b>PART II OTHER INFORMATION</b>	<b>21</b>
Item 1. Legal Proceedings	21
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds	21
Item 6. Exhibits	22
Signatures	24



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



## PART I FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS

## TORCHLIGHT ENERGY RESOURCES, INC.

## CONSOLIDATED CONDENSED BALANCE SHEETS (Unaudited)

	September 30,	December 31,
	2016	2015
<b>ASSETS</b>		
Current assets:		
Cash	\$218,470	\$1,026,600
Accounts receivable	655,618	741,653
Production revenue receivable	5,213	199,317
Note receivable	-	613
Prepayments - development costs	1,000,000	-
Prepaid expenses	-	38,776
Total current assets	1,879,301	2,006,959
Investment in oil and gas properties, net	9,550,419	7,057,671
Office equipment, net	31,206	43,110
Debt issuance costs, net	4,092	8,224
Other assets	18,362	72,082
<b>TOTAL ASSETS</b>	<b>\$11,483,380</b>	<b>\$9,188,046</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$557,444	\$1,114,409
Funds received pending settlement	520,400	-
Accrued liabilities	840,114	628,876
Related party payables	81,112	130,000
Convertible promissory notes, (Series B) net of discount of \$138,267 at September 30, 2016	3,431,233	-
Notes payable within one year - related party	134,375	205,000
Notes payable within one year	-	129,741
Due to working interest owners	66,845	103,364
Interest payable	-	173,710
Total current liabilities	5,631,523	2,485,100



Edgar Filing: TORCHLIGHT ENERGY RESOURCES INC - Form 10-Q

Convertible promissory notes, (Series B) net of discount of \$277,911 at December 31, 2015	-	3,291,589
Asset retirement obligation	1,711	29,083
Commitments and contingencies	-	-
Stockholders' equity:		
Preferred stock, par value \$.001, 10,000,000 shares authorized; 10,000 issued and outstanding at September 30, 2016 134,000 issued and outstanding at December 31, 2015	10	134
Common stock, par value \$0.001 per share; 100,000,000 shares authorized; 50,336,762 issued and outstanding at September 30, 2016 33,166,344 issued and outstanding at December 31, 2015	50,340	33,168
Additional paid-in capital	66,544,240	61,921,450
Warrants outstanding	20,819,937	16,330,961
Accumulated deficit	(81,564,381)	(74,903,439)
Total stockholders' equity	5,850,146	3,382,274
<b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>	<b>\$11,483,380</b>	<b>\$9,188,046</b>

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



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

	THREE MONTHS ENDED September 30, 2016	THREE MONTHS ENDED September 30, 2015	NINE MONTHS ENDED September 30, 2016	NINE MONTHS ENDED September 30, 2015
Revenue				
Oil and gas sales	\$34,284	\$400,030	\$337,798	\$1,442,857
SWD and royalties	-	415	-	57,485
Cost of revenue	(49,908)	(159,082)	(295,208)	(669,626)
Gross income	(15,624)	241,363	42,590	830,717
Operating expenses:				
General and administrative expense	787,228	3,359,679	5,534,933	12,255,704
Depreciation, depletion and amortization	18,005	203,348	740,059	902,153
Impairment expense	-	-	57,912	22,438,114
Loss on sale	-	-	146,138	-
Total operating expenses	805,233	3,563,027	6,479,042	35,595,971
Other income (expense)				
Other income	30	-	30	962
Interest and accretion expense	(54,662)	(60,958)	(224,520)	(1,692,067)
Total other income (expense)	(54,632)	(60,958)	(224,490)	(1,691,105)
Net loss before taxes	(875,489)	(3,382,622)	(6,660,942)	(36,456,359)

Edgar Filing: TORCHLIGHT ENERGY RESOURCES INC - Form 10-Q

Provision for income taxes	-	-	-	-
Net (loss)	\$(875,489)	\$(3,382,622)	\$(6,660,942)	\$(36,456,359)
Loss per share:				
Basic and Diluted	\$(0.03)	\$(0.16)	\$(0.40)	\$(2.23)
Weighted average shares outstanding:				
Basic and Diluted	28,427,672	21,533,966	16,551,858	16,349,023

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



## TORCHLIGHT ENERGY RESOURCES, INC.

## CONSOLIDATED STATEMENTS OF CASH FLOW (Unaudited)

	NINE MONTHS ENDED September 30, 2016	NINE MONTHS ENDED September 30, 2015
<b>Cash Flows From Operating Activities</b>		
Net (loss)	\$(6,660,942)	\$(36,456,359)
Adjustments to reconcile net loss to net cash from operation		
Stock based compensation	3,410,731	9,382,259
Accretion of convertible note discounts	142,867	1,228,161
Loss on sale of assets	146,138	-
Impairment expense	57,912	22,438,114
Depreciation, depletion and amortization	740,059	902,153
Change in:		
Accounts receivable	86,036	48,975
Note receivable	613	8,594
Production revenue receivable	194,104	(91,461)
Prepayment of development costs	(1,000,000)	10,602
Debt issuance costs	4,132	-
Prepaid expenses	38,776	29,634
Other assets	53,721	(59,999)
Accounts payable and accrued liabilities	(290,229)	1,198,036
Due to working interest owners	(36,519)	(36,092)
Funds received pending settlement	520,400	
Asset retirement obligation	(27,372)	1,593
Interest payable	(176,933)	467,550
Capitalized interest	(106,388)	(577,576)
Net cash provided by (used) in operating activities	(2,902,894)	(1,505,816)
<b>Cash Flows From Investing Activities</b>		
Investment in oil and gas properties	(1,544,220)	(4,369,187)
Acquisition of office equipment	-	(1,191)
Proceeds from Sale of Leases	1,572,000	1,951,918
Net cash used in investing activities	27,780	(2,418,460)
<b>Cash Flows From Financing Activities</b>		
Proceeds from short term advance	150,000	-
Repayment of short term advance	(150,000)	
Proceeds from sale of common stock	-	1,300,000

Edgar Filing: TORCHLIGHT ENERGY RESOURCES INC - Form 10-Q

Proceeds from sale of preferred stock	1,000,000	13,500,000
Preferred dividends paid in cash	(320,724)	-
Proceeds from warrant exercise	1,486,942	-
Proceeds from promissory notes	514,395	412,000
Repayment of convertible notes	-	(8,859,011)
Repayment of promissory notes	(613,629)	(716,893)
Net cash provided by financing activities	2,066,984	5,636,096
Net increase (decrease) in cash	(808,130)	1,711,820
Cash - beginning of period	1,026,600	179,787
Cash - end of period	\$218,470	\$1,891,607
Supplemental disclosure of cash flow information: (Non Cash Items)		
Common stock issued for services	\$587,473	\$783,668
Common stock issued for mineral interests	\$1,816,096	\$-
Warrants issued for services	\$2,716,125	\$1,080,000
Common stock issued in conversion of preferred stock	\$13,399,991	\$-
Common stock issued in conversion of promissory notes	\$-	\$150,000
Warrants issued in connection with promissory notes	\$80,750	\$439,800
Common stock issued in warrant exercises	\$1,557,004	\$-
Warrants issued for mineral interests	\$1,630,761	\$-
Cash paid for interest	\$536,410	\$1,108,059

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.

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 September 30, 2016, the Company had not yet achieved profitable operations. We had a net loss of \$6,660,942 for the nine months ended September 30, 2016 and had accumulated losses of \$81,564,381 since our inception to September 30, 2016, and expect to incur further losses in the development of our business. Working Capital as of September 30, 2016 was negative \$3,752,222. Negative working capital is exacerbated by the inclusion in current liabilities of the \$3,431,233 outstanding balance of subordinated convertible notes which have a maturity date of June 30, 2017 and are therefore included in current liabilities as of September 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.

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.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

3. SIGNIFICANT ACCOUNTING POLICIES - continued

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 September 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 on June 30, 2016. No further adjustments were required at September 30, 2016.

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 September 30, 2016 and September 30, 2015, the Company capitalized \$106,388 (net of full cost pool adjustments) and \$577,576, 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.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

## 3. SIGNIFICANT ACCOUNTING POLICIES - continued

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. . No further adjustments were required at September 30, 2016. 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.

The determination of oil and gas reserves is a subjective process, and the accuracy of any reserve estimate depends on the quality of available data and the application of engineering and geological interpretation and judgment. Estimates of economically recoverable reserves and future net cash flows depend on a number of variable factors and assumptions that are difficult to predict and may vary considerably from actual results. In particular, reserve estimates for wells with limited or no production history are less reliable than those based on actual production. Subsequent re-evaluation of reserves and cost estimates related to future development of proved oil and gas reserves could result in significant revisions to proved reserves. Other issues, such as changes in regulatory requirements, technological advances, and other factors which are difficult to predict could also affect estimates of proved reserves in the future.

Gains and losses on the sale of oil and gas properties are not generally reflected in income unless the gain or loss would significantly alter the relationship between capitalized costs and proved reserves. Sales of less than 100% of the Company’s interest in the oil and gas property are treated as a reduction of the capital cost of the field, with no gain or loss recognized, as long as doing so does not significantly affect the unit-of-production depletion rate. Costs of retired equipment, net of salvage value, are usually charged to accumulated depreciation.

Asset retirement obligations – Accounting principles require that the fair value of a liability for an asset’s retirement obligation (“ARO”) be recorded in the period in which it is incurred if a reasonable estimate of fair value can be made, and that the corresponding cost be capitalized as part of the carrying amount of the related long-lived asset. The liability is accreted to its then-present value each subsequent period, and the capitalized cost is depleted over the useful life of the related asset. Abandonment cost incurred is recorded as a reduction to the ARO liability.

Inherent in the fair value calculation of an ARO are numerous assumptions and judgments including the ultimate settlement amounts, inflation factors, credit adjusted discount rates, timing of settlement, and changes in the legal,

regulatory, environmental, and political environments. To the extent future revisions to these assumptions impact the fair value of the existing ARO liability, a corresponding adjustment is made to the oil and gas property balance. Settlements greater than or less than amounts accrued as ARO are recorded as a gain or loss upon settlement.

Asset retirement obligation activity is disclosed in Note 10.

Share-based compensation – Compensation cost for equity awards is based on the fair value of the equity instrument on the date of grant and is recognized over the period during which an employee is required to provide service in exchange for the award. Compensation cost for liability awards is based on the fair value of the vested award at the end of each period.

Revenue recognition – The Company recognizes oil and gas revenues when production is sold at a fixed or determinable price, persuasive evidence of an arrangement exists, delivery has occurred and title has transferred, and collectability is reasonably assured.

Basic and diluted earnings (loss) per share – Basic earnings (loss) per common share is computed by dividing net income (loss) available to common shareholders by the weighted average number of common shares outstanding during the period. Diluted earnings (loss) per common share is computed in the same way as basic earnings (loss) per common share except that the denominator is increased to include the number of additional common shares that would be outstanding if all potential common shares had been issued and if the additional common shares were dilutive. The Company has not included potentially dilutive securities in the calculation of loss per share for any periods presented as the effects would be anti-dilutive.

Environmental laws and regulations – The Company is subject to extensive federal, state, and local environmental laws and regulations. Environmental expenditures are expensed or capitalized depending on their future economic benefit. The Company believes that it is in compliance with existing laws and regulations.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

### 3. SIGNIFICANT ACCOUNTING POLICIES - continued

#### Recent accounting pronouncements –

On August 27, 2014, the FASB issued ASU 2014-15, which provides guidance on determining when and how to disclose going-concern uncertainties in the financial statements. The new standard requires management to perform interim and annual assessments of the Company's ability to continue as a going concern within one year of the date the financial statements are issued. An entity must provide certain disclosures if conditions or events raise substantial doubt about the entity's ability to continue as a going concern. The ASU applies to all entities and is effective for annual periods ending after December 15, 2016, and interim periods thereafter, with early adoption permitted.

In May 2014, the FASB issued ASU 2014-09 that introduces a new five-step revenue recognition model in which an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. This ASU also requires disclosures sufficient to enable users to understand the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers, including qualitative and quantitative disclosures about contracts with customers, significant judgments and changes in judgments, and assets recognized from the costs to obtain or fulfill a contract. This standard is effective for fiscal years beginning after December 15, 2017, including interim periods within that reporting period. The Company is currently evaluating the new guidance to determine the impact it will have on its consolidated financial statements.

In April 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2014-08, Reporting Discontinued Operations and Disclosures of Components of an Entity ("ASU 2014-08"). ASU 2014-08 revises the definition of discontinued operations by limiting discontinued operations reporting to disposals of components of an entity that represent strategic shifts that have (or will have) a major effect on an entity's operations and financial results, removing the lack of continuing involvement criteria and requiring discontinued operations reporting for the disposal of an equity method investment that meets the definition of discontinued operations. The update also requires expanded disclosures for discontinued operations, including disclosure of pretax profit or loss of an individually significant component of an entity that does not qualify for discontinued operations reporting. The update is effective prospectively to all periods beginning after December 15, 2014. Currently, the Company does not expect the adoption of ASU 2014-08 to have a material impact on our financial statements or results of operations.

Other recently issued or adopted accounting pronouncements are not expected to have, or did not have, a material impact on the Company's financial position or results from operations.

Subsequent events – The Company evaluated subsequent events through November 10, 2016, the date of issuance of the financial statements. Subsequent events are disclosed in Note 11.

### 4. RELATED PARTY PAYABLES

As of September 30, 2016, related party payables consisted of accrued and unpaid compensation of \$45,000 to one of our executive officers and a Director Fee payable to one of our Directors, Mr. Edward J. Devereaux of \$36,112. Mr. Devereaux elected to receive \$50,000 of the Director Fee in cash when funds are available. As of September 30, 2016 \$13,888 had been paid to Mr. Devereaux.

On November 4, 2014, Eunis L. Shockey, a member of the Board of directors, loaned us \$500,000 under a 30 day promissory note. The promissory note accrues interest at an annual rate of 10%. The balance of the note at September

30, 2016 was \$134,375. The due date of the note is December 31, 2016.

#### 5. COMMITMENTS AND CONTINGENCIES

The Company is subject to contingencies as a result of environmental laws and regulations. Present and future environmental laws and regulations applicable to the Company's operations could require substantial capital expenditures or could adversely affect its operations in other ways that cannot be predicted at this time. As of September 30, 2016, no amounts had been recorded because no specific liability has been identified that is reasonably probable of requiring the Company to fund any future material amounts.

#### 6. STOCKHOLDERS' EQUITY

During the three months ended September 30, 2016 the Company issued 150,000 shares of common stock as compensation for consulting services, with total value of \$177,000.

During the three months ended September 30, 2016 the Company issued 251,456 shares of common stock in connection with oil and gas lease related costs of \$331,930.



## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

## 6. STOCKHOLDERS' EQUITY - continued

During the three months ended September 30, 2016 the Company issued 10,000 shares of Series C Convertible Preferred Stock (the "Series C Preferred") to certain investors at a purchase price of \$100 per share for total consideration of \$1,000,000 cash. We filed the Certificate of Designation for the Series C Preferred with the Secretary of State of Nevada on July 8, 2016. The designations, preferences, limitations, restrictions and relative rights of the Series C Preferred are as follows: (i) a stated value of \$100 per share; (ii) mandatory conversion on the earlier of 92 days after the spud date of Hazel Prospect or October 13, 2016, with each holder having the right to convert at its election any time before that; (iii) a conversion price of \$1.01 per share of common stock; (iv) each holder has the right to convert its shares into a proportionate heads up working interest in the Hazel Prospect, provided such election is made prior to the mandatory stock conversion date described in "(ii)" above, which working interest will be determined by dividing the number of shares the holder is converting by 10,000 and multiplying the result by one-third; (v) no rights to dividends; (vi) no voting rights; and (vii) in the event of any voluntary or involuntary liquidation, dissolution or winding up, the holders will be entitled to be paid out of the assets available for distribution to our stockholders, before any payment is to be made to the holders of common stock, but after the payment to the holders of Series B Convertible Preferred Stock.

During the three months ended September 30, 2016, the Company issued 1,822,656 shares of common stock in conversion of preferred stock (Series "B") valued at \$3,699,991.

During the three months ended September 30, 2016, the Company issued 2,069,065 shares of common stock in exercise of warrants at \$.50 per share in connection with an offering to warrant holders dated June 16, 2016 to exercise warrants at the reduced exercise price of \$.50 per share regardless of the original exercise price of warrants they were holding. The offering was scheduled to close on June 30, 2016, however the Company elected to extend the expiration of the offering to July 15, 2016. Any warrants not exercised within the offering period retained their original terms including the original exercise price. The exercise price adjustment was considered as a debt agreement modification for accounting purposes. The adjustment arising from the comparison of the fair value of the warrants at their original grant date to the fair value recalculated at the modification date (the re pricing date) was \$52,270 for the three months ended September 30, 2016.

During the three months ended September 30, 2016, the Company issued 250,000 shares of common stock in exercise of warrants at \$.50 per share in connection with the termination of a consulting agreement.

During the three months ended September 30, 2016, the Company issued 425,000 warrants in connection with oil and gas lease related costs of \$221,000.

A summary of stock options and warrants outstanding as of September 30, 2016 by exercise price and year of expiration is presented below:

Exercise    Expiration Date in

Price	2016	2017	2018	2019	2020	2021	Total
-------	------	------	------	------	------	------	-------

Edgar Filing: TORCHLIGHT ENERGY RESOURCES INC - Form 10-Q

\$0.50			800,000				800,000
\$0.70					1,275,000		1,275,000
\$0.77				100,000			100,000
\$1.00	-	150,000	-	54,366		1,500,000	1,704,366
\$1.08				37,500			37,500
\$1.40					1,643,475		1,643,475
\$1.57					5,625,000		5,625,000
\$1.73			100,000				100,000
\$1.79					337,500		337,500
\$1.80					500,000		500,000
\$2.00		126,000	1,906,249	-			2,032,249
\$2.03			2,000,000				2,000,000
\$2.09	-	-	2,800,000	-			2,800,000
\$2.23					832,512		832,512
\$2.29			120,000				120,000
\$2.50		-	-	35,211			35,211
\$2.82	-	-	38,174	-			38,174
\$3.50				15,000			15,000
\$4.50	-	-	-	700,000			700,000
\$5.00	8,391	170,000	-	-			178,391
\$5.05		40,000					40,000
\$6.00	-	-	523,123	22,580			545,703
\$7.00	-	-	-	700,000			700,000
	8,391	486,000	8,287,546	1,664,657	10,213,487	1,500,000	22,160,081

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

## 6. STOCKHOLDERS' EQUITY - continued

At September 30, 2016 the Company had reserved 22,160,081 shares for future exercise of warrants and stock options.

Warrants issued in relation to the promissory notes issued (see note 9) were valued using the Black Scholes Option Pricing Model. The assumptions used in calculating the fair value of the warrants issued are as follows:

Risk-free interest rate	0.78%
Expected volatility of common stock	191% - 253%
Dividend yield	0.00%
Discount due to lack of marketability	20-30%
Expected life of warrant	3 years - 5 years

## 7. CAPITALIZED COSTS

The following table presents the capitalized costs of the Company as of September 30, 2016 and December 31, 2015:

Evaluated costs subject to amortization	\$9,799,760	\$24,177,851
Unevaluated costs	12,998,656	9,677,425
Accumulated impairment expense	(10,279,142)	(22,783,989)
Total capitalized costs	12,519,274	11,071,287
Less accumulated depreciation, depletion and amortization	(2,968,855)	(4,013,616)
Net capitalized costs	\$9,550,419	\$7,057,671

Unevaluated costs as of September 30, 2016 include cumulative costs on developing projects including the Orogrande and Hazel Projects in West Texas and adjusted costs of nonproducing leases in Oklahoma.

## 8. INCOME TAXES

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss carry forwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. A valuation allowance is established to reduce deferred tax assets if it is more likely than not that the related tax benefits will not be realized. The Company has placed a 100% valuation allowance against the net deferred tax asset because future realization of these assets is not assured.

Authoritative guidance for uncertainty in income taxes requires that the Company recognize the financial statement benefit of a tax position only after determining that the relevant tax authority would more likely than not sustain the position following an examination. Management has reviewed the Company's tax positions and determined there were no uncertain tax positions requiring recognition in the consolidated financial statements. The Company's tax returns remain subject to Federal and State tax examinations for the years 2012 through 2015. Generally, the applicable statutes of limitation are three to four years from their respective filings.

Estimated interest and penalties related to potential underpayment on any unrecognized tax benefits are classified as a component of tax expense in the statement of operation. The Company has not recorded any interest or penalties associated with unrecognized tax benefits for any periods covered by these financial statements.

The Company had a net deferred tax asset related to federal net operating loss carry forwards at September 30, 2016 of \$36,802,748 available to offset future taxable income. The federal net operating loss carry forward will begin to expire in 2030. Realization of the deferred tax asset is dependent, in part, on generating sufficient taxable income prior to expiration of the loss carry forwards. The Company has placed a 100% valuation allowance against the net deferred tax asset because future realization of these assets is not assured.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

## 9. PROMISSORY NOTES

During the quarter ended June 30, 2014, the Company issued \$3,197,500 in principal value of 12% Series B Convertible Unsecured Promissory Notes. The 12% Notes are due and payable on June 30, 2017 and provide for conversion into common stock at a price of \$4.50 per share and included the issuance of one warrant for each \$22.50 of principal amount purchased. The Company issued a total of 142,111 of these five-year warrants to purchase common stock at an exercise price of \$6.00 per share. The value of the warrant shares was \$405,016 and the amount recorded for the beneficial conversion feature was \$195,466. These amounts were recorded as a discount on the 12% Notes.

During the quarter ended September 30, 2014, the Company issued an additional \$1,372,000 in principal value of 12% Series B Convertible Unsecured Promissory Notes. The 12% Notes are due and payable on June 30, 2017 and provide for conversion into common stock at a price of \$4.50 per share and included the issuance of one warrant for each \$22.50 of principal amount purchased. The Company issued a total of 60,974 of these five-year warrants to purchase common stock at an exercise price of \$6.00 per share. The value of the warrant shares was \$157,388 and the amount recorded for the beneficial conversion feature was \$-0-. These amounts were recorded as a discount on the 12% Notes.

During the fourth quarter of 2015, \$1 million in note principal was converted into common stock. The total outstanding balance of Series "B" Notes at September 30, 2016 was \$3,569,500.

Note Payable within one year – related party

The note payable to a related party of \$134,375 is payable with interest to a Director on December 31, 2016.

## 10. ASSET RETIREMENT OBLIGATIONS

The following is a reconciliation of the asset retirement obligation liability through September 30, 2016:

Asset retirement obligation – December 31, 2014	\$35,951
Accretion Expense	1,107
Asset retirement obligation – March 31, 2015	\$37,058
Accretion Expense	819
Removal of ARO for wells sold	(1,152)
Asset retirement obligation – June 30, 2015	\$36,725
Accretion Expense	819
Asset retirement obligation – September 30, 2015	\$37,544
Accretion Expense	747
Removal of ARO for wells sold	(9,208)
Asset retirement obligation – December 31, 2015	\$29,083
Accretion Expense	747
Asset retirement obligation – March 31, 2016	\$29,830
Removal of ARO for wells sold	(28,201)
Accretion Expense	41
Asset retirement obligation – June 30, 2016	\$1,670
Accretion Expense	41
Asset retirement obligation – September 30, 2016	\$1,711



NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

11. SUBSEQUENT EVENTS

Divestiture of Assets

Effective October 1, 2016, the Company sold all its interest in the Marcelina Project in Wilson County, Texas including 1,060 leased acres and three producing wells. The sale price was \$550,000 of which \$207,000 was received in cash and responsibility for payment of \$343,000 in vendor accounts payable related to the properties was transferred to the purchaser. Additionally, the Company issued 50,000 shares of common stock to Bayshore Operating Corporation, LLC, the operator of the properties, in connection with the sale. A loss on the sale of approximately \$64,000 will be recognized in the fourth quarter, 2016.

Series C Preferred Conversion

On July 8, 2016, we sold a total of 10,000 shares of Series C Convertible Preferred Stock (the "Series C Preferred") to certain investors at a purchase price of \$100 per share for total consideration of \$1,000,000. See Note 6, "Stockholder's Equity," above.

As of September 30, 2016, Torchlight owned a 66.66% working interest in approximately 12,000 acres in the Hazel Prospect AMI in the Midland Basin having acquired it from McCabe Petroleum Corporation in exchange for 1,500,000 warrants to purchase our common stock. On October 10, 2016, all of the holders of the Series C Preferred converted into an aggregate 33% working interest in the Hazel Prospect AMI including the Flying "B" Ranch #1 well under the terms of the Certificate of Designation. The Series C Preferred holders, in the case of electing to convert the Series C Preferred into a working interest in the Flying "B" Ranch well, were also entitled to a capital credit (with the operator of the property) toward development expenses equal to their invested amount into the Series C Preferred. The Company had transferred the entire \$1,000,000 in proceeds from the issuance of the Series C Preferred to the operator as a prepayment of development costs. Since the Series C Preferred holders elected to convert into the Flying "B" working interest, they also received capital credit on the records of the operator for the balance of any part of the prepayment placed by the Company not applied to the development cost of the Flying "B" well. The conversion by the Series C Preferred holders and related capital credit transfer results in the Company incurring a liability during fourth quarter, 2016 of \$339,624 for its share of development cost related to its remaining 33.34% working interest in the well.

Letter of Intent for Additional Hazel Project Acreage

On November 10, 2016, Torchlight entered into a nonbinding letter of intent ("LOI") with Torchlight's Chairman, Greg McCabe, to purchase an entity he owns which holds an additional 40.66% Working Interest in the Hazel Prospect. Upon entering into and closing a definitive agreement, Torchlight's total ownership would increase to 74% Working Interest. Under the proposed terms of the transaction, Torchlight would pay Mr. McCabe 3,301,379 shares of Torchlight common stock and concurrently therewith Mr. McCabe would cancel or cause to be cancelled 3,301,379 outstanding warrants. Additionally, closing of the transaction would be subject to Torchlight paying certain related costs.

Resignation of Officer

Effective October 5, 2016, Willard G. McAndrew III resigned his position as Chief Operating Officer. Pursuant to the Resignation and Settlement Agreement, Mr. McAndrew was entitled to cash compensation under his Employment Agreement of \$789,454 all of which was applied to the exercise price of a portion of Stock Options owned by him and

resulting in the issuance of 502,837 shares of common stock. Mr. McAndrew also surrendered 750,000 unvested Stock Options and 250,000 vested Stock Options to the Company. The remaining Stock Options held by Mr. McAndrew totaling 2,000,000 (before exercise of the 502,837 above) were all vested in full and reset to expire on June 11, 2019.





## ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

### Overview

We are engaged in the acquisition, exploration, exploitation, and/or development of oil and natural gas properties in the United States. We operate our business through our subsidiaries Torchlight Energy Inc., Torchlight Energy Operating, LLC, and Hudspeth Oil Corporation.

During the quarter ended June 30, 2016 the Board of Directors initiated a review of Company operations in view of the divestiture of its Oklahoma properties, beginning with the sale of the Chisholm Trail properties in fourth quarter, 2015 and the sale of the Cimarron properties in second quarter, 2016. During this same time development had continued on the Orogrande Project in West Texas and in April, 2016, the Company acquired the Hazel Project in the Midland Basin also in West Texas. These West Texas properties demonstrate significant potential and future production capabilities based upon the analysis of scientific data being gathered in the day by day development activity. Therefore, the Board has determined to focus its efforts and capital on these two projects to maximize shareholder value for the long run.

During the quarter ended June 30, 2016, in accordance with this new emphasis, remaining projects in other locations were offered for sale. The result has been the closing on August 10, 2016 of the assignment of the Company's Ring Properties in Kansas to our joint venture partner. Further, the Marcelina properties in South Texas have been sold effective October 1, 2016. The Company's remaining assets in Oklahoma consisting of three AMI's (the Viking, Rosedale, and the Thunderbird) and four wells (two are producing) are held pending the outcome of the lawsuit filed by Torchlight against the operator, Husky Ventures, in May, 2016.

The strategy in divesting of projects other than the Orogrande and the Hazel Projects is to refocus on the greatest potential future value for the Company while systematically eliminating debt as noncore assets are sold and operations are streamlined.

The following discussion of our financial condition and results of operations should be read in conjunction with our unaudited financial statements included herewith and our audited financial statements included with our Form 10-K for the year ended December 31, 2015. This discussion should not be construed to imply that the results discussed herein will necessarily continue into the future, or that any conclusion reached herein will necessarily be indicative of actual operating results in the future. Such discussion represents only the best present assessment by our management.

### Current Projects

As of September 30, 2016 the Company had interests in four oil and gas projects: the Marcelina Creek Field Development in Wilson County, Texas, (sold effective October 1, 2016) Hunton wells operated by Husky Ventures in Central Oklahoma, the Orogrande Project in Hudspeth County, Texas, and the Hazel Project in the Midland Basin in West Texas.

#### Hunton Play, Central Oklahoma

As of September 30, 2016, we were actively producing from one well in Viking, and one in Prairie Grove.

### Legal Proceeding

As previously disclosed, in May, 2016, Torchlight Energy Resources, Inc. and its subsidiary Torchlight Energy, Inc. filed a lawsuit in the 429th judicial district court in Collin County, Texas against Husky Ventures, Inc., Charles V. Long, April Glidewell, Silverstar of Nevada, Inc., Maximus Exploration, LLC, Atwood Acquisitions, LLC, Gastar Exploration Inc., J. Russell Porter, Michael A. Gerlich, Jerry R. Schuyler, and John M. Selser, Sr.

Since the filing, the claims against the defendants April Glidewell, Maximus Exploration, LLC, Atwood Acquisitions, LLC and John M. Selser, Sr. have been non-suited without prejudice to re-filing the claims. The claims remain pending against the remaining defendants.

Reference Part II. Item 1. Legal Proceedings regarding the Hunton Play for further detail.

#### Viking AMI

In the fourth quarter of 2013 we entered into an Area of Mutual Interest (AMI) with Husky Ventures, the Viking Prospect. We acquired a 25% interest in 3,945 acres in the Viking AMI. We subsequently acquired an additional 5% in May, 2014. We had an interest in 8,800 total acres as of September 30, 2016. (Net undeveloped acres = 2,600) Husky drilled the first two wells in the AMI in second quarter, 2014. One well is currently producing nominal quantities of oil. Our net cumulative investment through September 30, 2016 in undeveloped acres in the Viking AMI was \$1,387,928.



ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS - continued

Rosedale AMI

In January of 2014 we contracted for a 25% Working Interest in approximately 5,000 acres in the Rosedale AMI in South Central Oklahoma. We acquired an additional 5% in May, 2014. The Company had an interest in 11,600 total acres as of September 30, 2016 (Net undeveloped acres = 3,500). Our cumulative investment through September 30, 2016 in the Rosedale AMI was \$2,834,514.

Prairie Grove – Judy Well

In February of 2014, we acquired a 10% Working Interest in a well in the Prairie Grove AMI from a non-consenting third party who elected not to participate in the well. The well is producing approximately 12 BOE per day.

Thunderbird AMI

In July of 2014, we contracted for a 25% Working Interest in the Thunderbird AMI. The total acres in which the Company had an interest at September 30, 2016 totals 4,300 acres (Net undeveloped acres = 1,100). Our cumulative investment through September 30, 2016 in the Thunderbird AMI was \$949,530.

Orogrande Project, West Texas

On August 7, 2014, we entered into a Purchase Agreement with Hudspeth Oil Corporation (“Hudspeth”), McCabe Petroleum Corporation (“MPC”), and Greg McCabe. Mr. McCabe was the sole owner of both Hudspeth and MPC. Under the terms and conditions of the Purchase Agreement, at closing, we purchased 100% of the capital stock of Hudspeth which holds certain oil and gas assets, including a 100% working interest in 172,000 mostly contiguous acres in the Orogrande Basin in West Texas. This acreage is in the primary term under five-year leases that carry additional five-year extension provisions. As consideration, at closing we issued 868,750 shares of our common stock to Mr. McCabe and paid a total of \$100,000 in geologic origination fees to third parties. Additionally, Mr. McCabe will have an optional 10% working interest back-in after payout and a reversionary interest if drilling obligations are not met, all under the terms and conditions of a participation and development agreement. Closing of the transactions contemplated by the Purchase Agreement occurred on September 23, 2014.

The Company finalized an agreement to sell a 5% working interest in the Orogrande acreage on June 30, 2015 with an effective date of April 1, 2015. Sale proceeds were \$500,000 which were received in April, 2015. In addition, the Company issued 250,000 three year warrants with an exercise price of \$.50 to the purchaser.

On September 23, 2015, our subsidiary, Hudspeth Oil Corporation (“HOC”), entered into a Farmout Agreement by and between HOC, Pandora Energy, LP (“Pandora”), Founders Oil & Gas, LLC (“Founders”), McCabe Petroleum Corporation and Greg McCabe (McCabe Petroleum Corporation and Greg McCabe are parties to the Farmout Agreement for limited purposes) for the entire Orogrande Project in Hudspeth County, Texas. The Farmout Agreement provides for Founders to earn from HOC and Pandora (collectively, the “Farmor”) an undivided 50% of the leasehold interest in the Orogrande Project by Founder’s spending a minimum of \$45 million on actual drilling operations on the Orogrande Project in the next two years. Founders is to pay Farmor a total cost reimbursement of \$5,000,000 in multiple installments as follows: (1) \$1,000,000 at the signing of the Farmout Agreement, the balance of which was received on September 24, 2015; (2) within 90 days from the closing, Founders will frac and complete the Rich A-11 No. 1 Well; and (3) within five days of the spudding of each of the next eight wells drilled by Founders, Founders will pay to Farmor \$500,000 resulting in the payment of the remaining amount; provided that, in the event that within 90 days

after the fracing of the Rich Well, Founders notifies Farmor of its election not to drill any additional wells, Founders shall have no further obligation to make further payment. Upon payment of the first \$1,000,000, Farmor assigned to Founders an undivided 50% of the leasehold interest and a 37.5% net revenue interest in the leases subject to the terms of the Farmout Agreement (including obligations to re-assign to HOC and Pandora if the 50% interest in the entire Orogrande Project is not earned) and a proportionate share of the McCabe 10% BIAPO (back in after pay out) interest; provided, however, that for each well that Founders drills prior to earning the acreage, it will be assigned a 50% working interest in the wellbore and in the lease on which it sits.

Under a joint operating agreement (on A.A.P.L. Form 610 – 1989 Model Form Operating Agreement with COPAS 2005 Accounting Procedures) (“JOA”) also entered into on September 23, 2015, Founders Oil & Gas Operating, LLC is designated as operator of the leases. Any variance to the operating plan will be determined by a Development Committee, which committee will be made up of members from Founders and Farmor, or their designees, to discuss and recommend the location of the drill wells, data to be gathered and the form of same. As contemplated under the Farmout Agreement, starting within 90 days of the completion of the fracing on the Rich Well, and at all times subject to the 90 day continuous drilling clause, Founders has the option, but not the obligation, to retain the assigned interest as follows: (1) if Founders spends a minimum of \$45 million on actual drilling operations while maintaining compliance with the continuous drilling clause, subject to reasonable delays resulting from reasonable Force Majeure conditions, Founders will have fulfilled its farmout obligations and will be entitled to retain the assigned interests. If Founders does not meet such obligations, it will reassign to Farmor the assigned interest except it will be entitled to retain its interest in the leases covering all wells drilled by Founders and the sections in which such wells are located. Additionally, Founders will resign as operator of the JOA as to all lands reassigned; and (2) Farmor will be carried in all drilling operations during the first two years and/or \$45 million in drilling operations, whichever comes last, subject to Founders’ right to recoup certain expenses on “Gap Wells.” After three years and after Founders has earned its working interest, either party may elect to market the acreage as an entire block, including operatorship. Should an acceptable bid arise, and both parties agree, the block will be sold 100% working interest to that third party bidder. However, if only one party wants to accept the outside offer, the other party (the party who wishes not to sell) has the right to purchase the working interest from the selling party.



## ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Torchlight Energy and Founders have elected to move forward on planning the next phase of drilling in the Orogrande Project. The project operator planned to permit three new wells starting with the University Founders B-19 #1 well. The new wells would be drilled vertically for test purposes and would have sufficient casing size to support lateral entry into any pay zone(s) encountered once the well is tested vertically. Torchlight and the project operator would then run a battery of tests on each well to gain information for future development of the field. The B-19 #1 well had been drilled and tested and pipe set at June 30, 2016. During the third quarter, 2016 development continued on the B-19 and the well was in testing phase as of September 30, 2016.

### Hazel Project in the Midland Basin in West Texas

Effective April 1, 2016, Torchlight Energy Inc. acquired from McCabe Petroleum Corporation a 66.66% working interest in approximately 12,000 acres in the Midland Basin in exchange for 1,500,000 warrants to purchase our common stock with an exercise price of \$1.00 for five years and a back-in after payout of a 25% working interest to the seller.

Initial development of the first well on the Property, the Flying "B" Ranch #1, began July 10, 2016 and development continued through September 30, 2016. The well was in testing phase as of September 30, 2016.

Historical Results for the nine months ended September 30, 2016 and 2015:

### Revenues and Cost of Revenues

For the nine months ended September 30, 2016, we had production revenue of \$337,798 compared to \$1,442,857 for the nine months ended September 30, 2015. Refer to the table of production and revenue included below for quarterly changes in revenue. Our cost of revenue, consisting of lease operating expenses and production taxes, was \$295,208, and \$669,626 for the nine months ended September 30, 2016 and 2015, respectively.





## ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Property	Quarter	Oil Production {BBLs}	Gas Production {MCF}	Oil Revenue	Gas Revenue	Total Revenue
Marcelina	Q1 - 2015	2,425	0	\$98,787	\$-	\$98,787
Oklahoma	Q1 - 2015	5,931	37,226	\$277,574	\$117,521	\$395,095
Kansas	Q1 - 2015	979	0	\$40,680	\$-	\$40,680
Total Q1-2015		9,335	37,226	417,041	117,521	534,562
Marcelina	Q2 - 2015	1,957	0	\$101,291	\$-	\$101,291
Oklahoma	Q2 - 2015	5,495	32,348	\$290,540	\$97,374	\$387,914
Kansas	Q2 - 2015	889	0	\$19,060	\$-	\$19,060
Total Q2-2015		8,341	32,348	\$410,891	\$97,374	\$508,265
Marcelina	Q3 - 2015	2,177	0	\$86,845	\$-	\$86,845
Oklahoma	Q3 - 2015	4,550	31,275	\$212,156	\$87,791	\$299,947
Kansas	Q3 - 2015	370	0	\$13,238	\$-	\$13,238
Total Q3-2015		7,097	31,275	\$312,239	\$87,791	\$400,030
Marcelina	Q4 - 2015	1,337	0	\$44,391	\$-	\$44,391
Oklahoma	Q4 - 2015	1,624	12,380	\$93,864	\$37,349	\$131,213
Kansas	Q4 - 2015	247	0	\$9,573	\$-	\$9,573
Total Q4-2015		3,208	12,380	\$147,828	\$37,349	\$185,177
Year Ended 12/31/15		27,981	113,229	\$1,287,999	\$340,035	\$1,628,034
Marcelina	Q1 - 2016	3,000	0	\$92,546	\$-	\$92,546
Oklahoma	Q1 - 2016	2,026	21,148	\$54,211	\$38,624	\$92,835
Kansas	Q1 - 2016	312	0	\$12,913	\$-	\$12,913
Total Q1-2016		5,338	21,148	159,670	38,624	198,294

Edgar Filing: TORCHLIGHT ENERGY RESOURCES INC - Form 10-Q

Marcelina	Q2 - 2016	917	0	\$38,812	\$-	\$38,812
Oklahoma	Q2 - 2016	675	9,689	\$30,411	\$11,142	\$41,553
Kansas	Q2 - 2016	608	0	\$24,855	\$-	\$24,855
Total Q2-2016		2,200	9,689	\$94,078	\$11,142	\$105,220
Marcelina	Q3 - 2016	464	0	\$20,189	\$-	\$20,189
Oklahoma	Q3 - 2016	180	2,830	\$7,925	\$6,170	\$14,095
Kansas	Q3 - 2016	0	0	\$-	\$-	\$-
Total Q3-2016		644	2,830	\$28,114	\$6,170	\$34,284



## ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS - continued

We recorded depreciation, depletion, and amortization expense of \$740,059 for the nine months ended September 30, 2016 compared to \$902,153 for the nine months ended June 30, 2015.

The decline in revenue, cost of revenue and depreciation, depletion, and amortization expense is attributable to the divestiture of oil and gas producing properties beginning in the fourth quarter, 2015 and continuing through September 30, 2016.

## General and Administrative Expenses

Our general and administrative expenses for the nine months ended September 30, 2016 and 2015 were \$5,534,933 and \$12,255,704, respectively, a decrease of \$6,720,771. Our general and administrative expenses consisted of consulting and compensation expense, substantially all of which was non-cash or deferred, accounting and administrative costs, professional consulting fees, and other general corporate expenses. The change in general and administrative expenses for the nine months ended September 30, 2016 compared to 2015 is detailed as follows:

Increase(decrease) in non cash stock and warrant compensation	\$(5,971,528)
Increase(decrease) in consulting expense	\$(287,914)
Increase(decrease) in professional fees	\$(179,781)
Increase(decrease) in investor relations	\$60,938
Increase(decrease) in travel expense	\$(17,838)
Increase(decrease) in salaries and compensation	\$(288,505)
Increase(decrease) in legal fees	\$(7,034)
Increase(decrease) in insurance	\$(23,365)
Increase(decrease) in general corporate expenses	\$(5,744)
 Total (Decrease) in General and Administrative Expenses	 \$(6,720,771)

Substantially all of the decrease is related to reduced reliance on outside consultants who were compensated principally with stock and warrants.

Historical Results for the three months ended September 30, 2016 and 2015:

## Revenues and Cost of Revenues

For the three months ended September 30, 2016, we had production revenue of \$34,284 compared to \$400,030 for the three months ended September 30, 2015. Refer to the table of production and revenue history above. Our cost of revenue, consisting of lease operating expenses and production taxes, was \$49,908, and \$159,082 for the three months ended September 30, 2016 and 2015, respectively.

## General and Administrative Expenses

Our general and administrative expenses for the three months ended September 30, 2016 and 2015 were \$787,228 and \$3,359,679, respectively, a decrease of \$2,572,451. Our general and administrative expenses consisted of consulting and compensation expense, substantially all of which was non-cash or deferred, accounting and administrative costs, professional consulting fees, and other general corporate expenses. The change in general and administrative expenses for the three months ended September 30, 2016 compared to 2015 is detailed as follows:





## ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS - continued

Increase(decrease) in non cash stock and warrant compensation	\$(2,107,427)
Increase(decrease) in consulting expense	\$(190,046)
Increase(decrease) in professional fees	\$66,624
Increase(decrease) in investor relations	\$14,142
Increase(decrease) in travel expense	\$(32,917)
Increase(decrease) in salaries and compensation	\$(400,999)
Increase(decrease) in legal fees	\$105,968
Increase(decrease) in insurance	\$(1,059)
Increase(decrease) in general corporate expenses	\$(26,737)
 Total (Decrease) in General and Administrative Expenses	 \$(2,572,451)

Substantially all of the decrease is related to reduced reliance on outside consultants who were compensated principally with stock and warrants.

## Liquidity and Capital Resources

At September 30, 2016, we had working capital of (\$3,752,222), current assets of \$1,879,301 consisting of cash, accounts receivable, notes receivable, and prepaid expenses and total assets of \$11,483,380 consisting of current assets, investments in oil and gas properties, and other assets. As of September 30, 2016, we had current liabilities of \$5,631,523, consisting of, accounts payable (principally for development costs), payables to related parties, notes payable, and accrued interest. Negative working capital is exacerbated by the inclusion in current liabilities of the \$3,431,233 outstanding balance of subordinated convertible notes which have a maturity date of June 30, 2017 and are therefore included in current liabilities as of September 30, 2016. Stockholders' equity was \$5,850,146.

Cash flow provided by (used) in operating activities for the nine months ended September 30, 2016 was \$(2,902,894) compared to \$(1,505,816) for the nine months ended September 30, 2015, an increase of \$397,078. Cash flow provided (used) by operating activities for the nine months ended September 30, 2016 can be primarily attributed to net losses from operations of \$6,660,942 which consists primarily of \$5,534,933 in general and administrative expenses, depreciation, depletion and amortization of \$740,059, and accretion of convertible note discounts of \$142,867. Cash flow provided (used) by operating activities for the nine months ended September 30, 2015 can be primarily attributed to net losses from operations of \$36,456,359, which consists primarily of \$12,255,704 in general and administrative expenses, depreciation, depletion, and amortization of \$902,153, accretion of convertible note discounts of \$1,228,161, and impairment expense of \$22,438,114. We expect to continue to use cash flow in operating activities until such time as we achieve sufficient commercial oil and gas production to cover all of our cash costs.

Cash flow used in investing activities for the nine months ended September 30, 2016 was \$27,780 compared to \$2,418,460 for the nine months ended September 30, 2015. Cash flow used in investing activities consists primarily of oil and gas investments in Texas properties during the nine months ended September 30, 2016.

Cash flow provided by financing activities for the nine months ended September 30, 2016 was \$2,066,984 as compared to \$5,636,096 for the nine months ended September 30, 2015. Cash flow provided by financing activities consists primarily of proceeds from common stock issues, promissory notes, and warrant exercises. We expect to continue to have cash flow provided by financing activities as we seek new rounds of financing and continue to develop our oil and gas investments.



Our current assets are insufficient to meet our current obligations or to satisfy our cash needs over the next twelve months and as such we will require additional debt or equity financing to meet our plans and needs. We face obstacles in continuing to attract new financing due to industry conditions and our history and current record of net losses and working capital deficits. Despite our efforts, we can provide no assurance that we will be able to obtain the financing required to meet our stated objectives or even to continue as a going concern.

We do not expect to pay cash dividends on our common stock in the foreseeable future.



## ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS - continued

### Commitments and Contingencies

We are subject to contingencies as a result of environmental laws and regulations. Present and future environmental laws and regulations applicable to our operations could require substantial capital expenditures or could adversely affect our operations in other ways that cannot be predicted at this time. As of September 30, 2016 and September 30, 2015, no amounts have been recorded because no specific liability has been identified that is reasonably probable of requiring us to fund any future material amounts.

As of September 30, 2016 the Company had interests in four oil and gas projects: the Marcelina Creek Field Development in Wilson County, Texas, the Hunton play in Central Oklahoma, the Orogrande Project in Hudspeth County, Texas, and the Hazel Project in the Midland Basin in West Texas. See the description under "Current Projects" above under "Overview" for more information and disclosure regarding commitments and contingencies relating to these projects.

## ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Not Applicable.

## ITEM 4. CONTROLS AND PROCEDURES

### Disclosure Controls and Procedures

Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we evaluated the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act, as of September 30, 2016. Based on this evaluation, our principal executive officer and principal financial officer concluded that, as of the end of the period covered by this report, our disclosure controls and procedures were effective to ensure that the information required to be disclosed by us in the reports we submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the applicable rules and forms and that such information was accumulated and communicated to our principal executive officer and principal financial officer, in a manner that allowed for timely decisions regarding disclosure.

### Changes in Internal Control over Financial Reporting

Our principal executive officer and principal financial officer have indicated that, upon evaluation, there were no changes in our internal control over financial reporting or other factors during the period covered by this report that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting

## PART II OTHER INFORMATION

### ITEM 1. LEGAL PROCEEDINGS

Torchlight Energy Resources, Inc. and its subsidiary Torchlight Energy, Inc. has pending in the 429th judicial district court in Collin County, Texas a lawsuit against Husky Ventures, Inc., Charles V. Long, Silverstar of Nevada, Inc., Gastar Exploration Inc., J. Russell Porter, Michael A. Gerlich, and Jerry R. Schuyler that was originally filed in May

2016 (previous defendants April Glidewell, Maximus Exploration, LLC, Atwood Acquisitions, LLC and John M. Selser, Sr have been non-suited without prejudice to re-filing the claims). In the lawsuit, we allege, among other things, that the defendants acted improperly in connection with multiple transactions, and that the defendants misrepresented and omitted material information to us with respect to these transactions. The lawsuit seeks damages arising from 15 different causes of action, including without limitation, violations of the Texas Securities Act, fraud, negligent misrepresentation, breach of fiduciary duty, breach of contract, unjust enrichment and tortious interference. The lawsuit also seeks a complete accounting as to how our investment funds were used, including all transfers between and among the defendants. We are seeking the full amount of our damages on \$20,000,000 invested. At this time we believe our damages to be in excess of \$1,000,000, but the precise amount will be determined in the litigation.

## ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

During the three months ended September 30, 2016, the Company issued a total of 150,000 shares of common stock as compensation for consulting services.

During the three months ended September 30, 2016, the Company issued a total of 251,456 shares of common stock in connection with oil and gas lease related costs, including without limitation 115,000 shares to Green Hill Minerals, LLC (Green Hill Minerals is owned by sons of Gregory McCabe, our director since July 2016).



ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS - continued

During the three months ended September 30, 2016, the Company issued a total of 425,000 warrants in connection with oil and gas lease related costs to Green Hill Minerals, LLC (Green Hill Minerals is owned by sons of Gregory McCabe, our director since July 2016). The warrants have an exercise price of \$.70 per share and expire in February 2020.

During the three months ended September 30, 2016, the Company issued 250,000 shares of common stock in exercise of warrants at \$.50 per share in connection with the termination of a consulting agreement.

All of the above sales of securities were sold under the exemption from registration provided by Section 4(a)(2) of the Securities Act of 1933 and the rules and regulations promulgated thereunder. The issuances of securities did not involve a “public offering” based upon the following factors: (i) the issuances of securities were isolated private transactions; (ii) a limited number of securities were issued to a limited number of purchasers; (iii) there were no public solicitations; (iv) the investment intent of the purchasers; and (v) the restriction on transferability of the securities issued.

ITEM 6. EXHIBITS

Exhibit No.	Description
2.1	Share Exchange Agreement dated November 23, 2010. (Incorporated by reference from Form 8-K filed with the SEC on November 24, 2010.) *
3.1	Articles of Incorporation. (Incorporated by reference from Form S-1 filed with the SEC on May 2, 2008.) *
3.2	Certificate of Amendment to Articles of Incorporation dated December 10, 2014. (Incorporated by reference from Form 10-Q filed with the SEC on May 15, 2015.) *
3.3	Certificate of Amendment to Articles of Incorporation dated September 15, 2015. (Incorporated by reference from Form 10-Q filed with the SEC on November 12, 2015.) *
3.4	Amended and Restated Bylaws (Incorporated by reference from Form 8-K filed with the SEC on October 26, 2016.) *
4.1	Certificate of Designation for Series A Convertible Preferred Stock (Incorporated by reference from Form 8-K filed with the SEC on June 9, 2015.) *
4.2	Certificate of Designation for Series B Convertible Preferred Stock (Incorporated by reference from Form 8-K filed with the SEC on September 30, 2015.) *
4.3	Certificate of Designation for Series C Convertible Preferred Stock (Incorporated by reference from Form 8-K filed with the SEC on July 11, 2016.) *
10.1	Agreement to Participate in Oil and Gas Development Joint Venture between Bayshore Operating Corporation, LLC and Torchlight Energy, Inc. (Incorporated by reference from Form 8-K filed with the SEC on November 24, 2010) *
10.2	

Edgar Filing: TORCHLIGHT ENERGY RESOURCES INC - Form 10-Q

Purchase and Sale Agreement between Torchlight Energy Inc. and Xtreme Oil and Gas Inc..effective April 1, 2013. (Incorporated by reference from Form 10-Q filed with the SEC on May 15, 2013)\*

- 10.3 Development Agreement between Ring Energy, Inc. and Torchlight Energy Resources, Inc. (Incorporated by reference from Form 8-K filed with the SEC on October 22, 2013.) \*
- 10.4 Coulter Limited Partnership Agreement dated January 10, 2012 (Incorporated by reference from Form 10-Q filed with the SEC on August 14, 2014.) \*
- 10.5 Promissory Note with Boeckman Well LLC dated May 1, 2013 and amendments thereto (Incorporated by reference from Form 10-Q filed with the SEC on August 14, 2014.) \*
- 10.6 Securities Purchase Agreement (form of), January 2014 (Incorporated by reference from Form 10-Q filed with the SEC on August 14, 2014.) \*
- 10.7 Registration Rights Agreement (form of), January 2014 (Incorporated by reference from Form 10-Q filed with the SEC on August 14, 2014.) \*
- 10.8 Purchase Agreement with Hudspeth Oil Corporation, McCabe Petroleum Corporation and Greg McCabe dated August 7, 2014 (Incorporated by reference from Form 10-Q/A filed with the SEC on October 21, 2014.) \*





ITEM 6. EXHIBITS - continued

- 10.9 Purchase and Sale Agreement between Torchlight Energy, Inc. and Zenith Petroleum Corporation (Incorporated by reference from Form 8-K filed with the SEC on June 10, 2014) \*
- 10.10 Securities Purchase Agreement with Castleton Commodities Opportunities Master Fund, L.P. (Incorporated by reference from Form 8-K filed with the SEC on August 20, 2014) \*
- 10.11 Purchase Agreement with Hudspeth Oil Corporation, McCabe Petroleum Corporation and Greg McCabe dated August 7, 2014 (Incorporated by reference from Form 10-Q/A filed with the SEC on October 21, 2014) \*
- 10.12 12% Series B Unsecured Convertible Promissory Note (form of) (Incorporated by reference from Form 10-Q filed with the SEC on August 14, 2015.) \*
- 10.13 Securities Purchase Agreement (for Series A Convertible Preferred Stock) (Incorporated by reference from Form 10-Q filed with the SEC on August 14, 2015.) \*
- 10.14 Employment Agreement (with John A. Brda) (Incorporated by reference from Form 8-K filed with the SEC on June 16, 2015.) \*
- 10.15 Employment Agreement (with Willard G. McAndrew) (Incorporated by reference from Form 8-K filed with the SEC on June 16, 2015.) \*
- 10.16 Employment Agreement (with Roger Wurtele) (Incorporated by reference from Form 8-K filed with the SEC on June 16, 2015.) \*
- 10.17 Loan documentation and warrants with Eunis L. Shockey (Incorporated by reference from Form 10-Q filed with the SEC on August 14, 2015.) \*
- 10.18 Farmout Agreement between Hudspeth Oil Corporation, Founders Oil & Gas, LLC and certain other parties (Incorporated by reference from Form 8-K filed with the SEC on September 29, 2015) \*
- 10.19 Securities Purchase Agreement and Amendment to Securities Purchase Agreement (for Series B Convertible Preferred Stock) (Incorporated by reference from Form 10-Q filed with the SEC on November 12, 2015) \*
- 10.20 Purchase and Sale Agreement with Husky Ventures, Inc. (Incorporated by reference from Form 8-K filed with the SEC on November 12, 2015) \*
- 10.21 Purchase Agreement with McCabe Petroleum Corporation for acquisition of “Hazel Project” (Incorporated by reference from Form 10-Q filed with the SEC on August 15, 2016)\*
- 10.22 Resignation and Settlement Agreement with Willard G. McAndrew
- 31.1 Certification of principal executive officer required by Rule 13a – 14(1) or Rule 15d – 14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of principal financial officer required by Rule 13a – 14(1) or Rule 15d – 14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

32.1 Certification of principal executive officer and principal financial officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 and Section 1350 of 18 U.S.C. 63.

101.INS XBRL Instance Document  
101.SCH XBRL Taxonomy Extension Schema  
101.CAL XBRL Taxonomy Extension Calculation Linkbase  
101.DEF XBRL Taxonomy Extension Definitions Linkbase  
101.LAB XBRL Taxonomy Extension Label Linkbase

\* Incorporated by reference from our previous filings with the SEC

23



SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Torchlight Energy Resources, Inc.

Date: November 10, 2016 /s/ John A. Brda  
By: John A. Brda  
Chief Executive Officer

Date: November 10, 2016 /s/ Roger Wurtele  
By: Roger Wurtele  
Chief Financial Officer and Principal Accounting Officer