EVOLUTION PETROLEUM CORP
Form 10-Q
February 08, 2016
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

ý QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended December 31, 2015

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from to

Commission File Number 001-32942

EVOLUTION PETROLEUM CORPORATION
(Exact name of registrant as specified in its charter)

Nevada (State or other jurisdiction of incorporation or organization)	41-1781991 (IRS Employer Identification No.)

2500 CityWest Blvd., Suite 1300, Houston, Texas 77042
(Address of principal executive offices and zip code)

(713) 935-0122
(Registrant's telephone number, including area code)

Not Applicable
(Former name, former address and former fiscal year if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes: ý No: o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of 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: ý No: o

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

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act.). Yes: o No: ý

The number of shares outstanding of the registrant’s common stock, par value $0.001, as of February 2, 2016, was 32,881,445.

EVOLUTION PETROLEUM CORPORATION AND SUBSIDIARIES

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PART I — FINANCIAL INFORMATION
ITEM 1. CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

Evolution Petroleum Corporation and Subsidiaries
Consolidated Condensed Balance Sheets
(Unaudited)

	December 31, 2015	June 30, 2015
Assets		
Current assets		
Cash and cash equivalents	$16,325,013	$20,118,757
Receivables	2,557,731	3,122,473
Deferred tax asset	—	82,414
Derivative assets, net	1,323,749	—
Prepaid expenses and other current assets	396,018	369,404
Total current assets	20,602,511	23,693,048
Oil and natural gas property and equipment, net (full-cost method of accounting)	49,049,250	45,186,886
Other property and equipment, net	38,279	276,756
Total property and equipment	49,087,529	45,463,642
Other assets	225,355	726,037
Total assets	$69,915,395	$69,882,727
Liabilities and Stockholders' Equity		
Current liabilities		
Accounts payable	$4,902,135	$8,173,878
Accrued liabilities and other	1,262,275	855,373
Derivative liabilities, net	—	109,974
Deferred income taxes	367,661	—
State and federal income taxes payable	342,930	190,032
Total current liabilities	6,875,001	9,329,257
Long term liabilities		
Deferred income taxes	10,244,897	11,242,551
Asset retirement obligations	692,976	715,767
Deferred rent	—	18,575
Total liabilities	17,812,874	21,306,150
Commitments and contingencies (Note 16)		
Stockholders' equity		
Preferred stock, par value $0.001; 5,000,000 shares authorized:8.5% Series A Cumulative Preferred Stock, 1,000,000 shares designated, 317,319 shares issued and outstanding at December 31, 2015 and June 30, 2015 with a liquidation preference of $7,932,975 ($25.00 per share)	317	317
Common stock; par value $0.001; 100,000,000 shares authorized: issued and outstanding 32,881,445 shares and 32,845,205 as of December 31, 2015 and June 30, 2015, respectively	32,881	32,845
Additional paid-in capital	40,063,167	36,847,289
Retained earnings	12,006,156	11,696,126
Total stockholders' equity	52,102,521	48,576,577
Total liabilities and stockholders' equity	$69,915,395	$69,882,727

See accompanying notes to consolidated condensed financial statements.

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Evolution Petroleum Corporation and Subsidiaries
Consolidated Condensed Statements of Operations
(Unaudited)

	Three Months Ended December 31,		Six Months Ended December 31,	
	2015	2014	2015	2014
Revenues				
Delhi field	$6,558,215	$7,644,831	$13,854,601	$11,513,433
Artificial lift technology	64,712	63,236	147,732	179,092
Other properties	—	—	—	20,369
Total revenues	6,622,927	7,708,067	14,002,333	11,712,894
Operating costs				
Production costs - Delhi field	2,226,141	2,817,866	4,784,028	2,817,866
Production costs - artificial lift technology	53,731	191,553	113,245	388,913
Production costs - other properties	—	9,390	1,046	97,412
Depreciation, depletion and amortization	1,471,571	917,757	2,689,844	1,287,107
Accretion of discount on asset retirement obligations	11,517	8,137	22,860	12,773
General and administrative expenses *	2,057,521	1,606,501	3,742,366	3,111,094
Restructuring charges**	1,257,433	(5,431)	1,257,433	(5,431)
Total operating costs	7,077,914	5,545,773	12,610,822	7,709,734
Income (loss) from operations	(454,987)	2,162,294	1,391,511	4,003,160
Other				
Gain on settled derivative instruments, net	1,298,201	—	2,164,628	—
Gain on unsettled derivative instruments, net	361,761	—	1,433,723	—
Delhi field insurance recovery related to pre-reversion event	—	—	1,074,957	—
Interest income	5,853	7,662	11,665	20,425
Interest (expense)	(18,666)	(12,159)	(37,126)	(30,619)
Income before income taxes	1,192,162	2,157,797	6,039,358	3,992,966
Income tax provision	368,889	917,879	2,123,858	1,624,038
Net income attributable to the Company	823,273	1,239,918	3,915,500	2,368,928
Dividends on preferred stock	168,576	168,576	337,151	337,151
Net income available to common stockholders	$654,697	$1,071,342	$3,578,349	$2,031,777
Earnings per common share				
Basic	$0.02	$0.03	$0.11	$0.06
Diluted	$0.02	$0.03	$0.11	$0.06
Weighted average number of common shares				
Basic	32,741,166	32,825,631	32,729,705	32,754,016
Diluted	32,802,440	32,947,280	32,789,461	32,884,754

* General and administrative expenses for the three months ended December 31, 2015 and 2014 included non-cash stock-based compensation expense of $212,724 and $245,020, respectively. For the corresponding six month periods, non-cash stock-based compensation expense was $430,839 and $488,357, respectively.

** Restructuring charges include $569,228 of non-cash impairment charges and $59,339 of non-cash stock-based compensation for the three months and six months ended December 31, 2015.

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Evolution Petroleum Corporation and Subsidiaries
Consolidated Condensed Statements of Cash Flows
(Unaudited)

	Six Months Ended December 31, 2015	2014
Cash flows from operating activities		
Net income attributable to the Company	$3,915,500	$2,368,928
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation, depletion and amortization	2,714,162	1,311,425
Impairments included in restructuring charge	569,228	—
Stock-based compensation	430,839	488,357
Stock-based compensation included in restructuring charge	59,339	—
Accretion of discount on asset retirement obligations	22,860	12,773
Settlements of asset retirement obligations	—	(220,522)
Deferred income taxes	(547,579)	656,589
Deferred rent	—	(8,574)
(Gain) on derivative instruments, net	(3,598,351)	—
Write-off of deferred loan costs	50,414	—
Changes in operating assets and liabilities:		
Receivables from oil and natural gas sales	1,176,758	(1,454,866)
Receivables other	(9,367)	(12,492)
Prepaid expenses and other current assets	(119,515)	69,697
Accounts payable and accrued expenses	(310,054)	1,384,201
Income taxes payable	152,898	45,392
Net cash provided by operating activities	4,507,132	4,640,908
Cash flows from investing activities		
Derivative settlements received	1,561,979	—
Proceeds from asset sales	—	389,166
Capital expenditures for oil and natural gas properties	(8,650,217)	(1,136)
Capital expenditures for other property and equipment	—	(311,075)
Other assets	(161,345)	(84,341)
Net cash used in investing activities	(7,249,583)	(7,386)
Cash flows from financing activities		
Cash dividends to preferred stockholders	(337,151)	(337,151)
Cash dividends to common stockholders	(3,268,319)	(6,565,350)
Acquisition of treasury stock	(1,354,743)	(58,660)
Tax benefits related to stock-based compensation	3,910,163	921,581
Other	(1,243)	(11,292)
Net cash used in financing activities	(1,051,293)	(6,050,872)
Net decrease in cash and cash equivalents	(3,793,744)	(1,417,350)
Cash and cash equivalents, beginning of period	20,118,757	23,940,514
Cash and cash equivalents, end of period	$16,325,013	$22,523,164

Supplemental disclosures of cash flow information:	Six Months Ended December 31, 2015	2014
Income taxes paid	$440,000	$100,000

Louisiana carryback income tax refund and related interest received	$1,556,999	$—
Non-cash transactions:		
Change in accounts payable used to acquire property and equipment	(2,442,183)	1,410,420
Deferred loan costs charged to oil and gas property costs	108,472	—
Oil and natural gas property costs incurred through recognition of asset retirement obligations	—	562,482
Settlement of accrued treasury stock purchases	(170,283)	—
Royalty rights acquired through non-monetary exchange of patent and trademark assets	108,512	—

See accompanying notes to consolidated condensed financial statements.

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Evolution Petroleum Corporation and Subsidiaries
Consolidated Condensed Statement of Changes in Stockholders' Equity
For the Six Months Ended December 31, 2015
(Unaudited)

	Preferred		Common Stock		Additional Paid-in Capital	Retained Earnings	Treasury Stock	Total Stockholders' Equity
	Shares	Par Value	Shares	Par Value				
Balance at June 30, 2015	317,319	$317	32,845,205	$32,845	$36,847,289	$11,696,126	$—	$48,576,577
Issuance of restricted common stock	—	—	272,098	272	(239)	—	—	33
Forfeitures of restricted stock	—	—	(31,467)	(31)	31	—	—	—
Acquisition of treasury stock	—	—	(204,391)	—	—	—	(1,184,460)	(1,184,460)
Retirements of treasury stock	—	—	—	(205)	(1,184,255)	—	1,184,460	—
Stock-based compensation	—	—	—	—	490,178	—	—	490,178
Tax benefits related to stock-based compensation	—	—	—	—	3,910,163	—	—	3,910,163
Net income attributable to the Company	—	—	—	—	—	3,915,500	—	3,915,500
Common stock cash dividends	—	—	—	—	—	(3,268,319)	—	(3,268,319)
Preferred stock cash dividends	—	—	—	—	—	(337,151)	—	(337,151)
Balance at December 31, 2015	317,319	$317	32,881,445	$32,881	$40,063,167	$12,006,156	$—	$52,102,521

See accompanying notes to consolidated condensed financial statements.

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Evolution Petroleum Corporation And Consolidated Subsidiaries
Notes to Unaudited Consolidated Condensed Financial Statements

Note 1 — Organization and Basis of Preparation

Nature of Operations. Evolution Petroleum Corporation ("EPM") and its subsidiaries (the "Company", "we", "our" or "us"), is an independent petroleum company headquartered in Houston, Texas and incorporated under the laws of the State of Nevada. We are engaged primarily in the development of oil and gas reserves within known oil and gas resources for our shareholders and customers utilizing conventional and proprietary technology.

Interim Financial Statements. The accompanying unaudited consolidated condensed financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) for interim financial information and with the appropriate rules and regulations of the Securities and Exchange Commission (“SEC”). Accordingly, certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States have been condensed or omitted pursuant to such rules and regulations. All adjustments (consisting of normal recurring accruals) which are, in the opinion of management, necessary for a fair presentation of the financial position and results of operations for the interim periods presented have been included. The interim financial information and notes hereto should be read in conjunction with the Company’s 2015 Annual Report on Form 10-K for the fiscal year ended June 30, 2015, as filed with the SEC. The results of operations for interim periods are not necessarily indicative of results to be expected for a full fiscal year.

Principles of Consolidation and Reporting. Our consolidated financial statements include the accounts of EPM and its wholly-owned subsidiaries. All significant intercompany transactions have been eliminated in consolidation. The consolidated financial statements for the previous year include certain reclassifications that were made to conform to the current presentation. Such reclassifications have no impact on previously reported net income or stockholders' equity.

Use of Estimates. The preparation of financial statements in conformity with GAAP requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities at the dates of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Significant estimates include reserve quantities and estimated future cash flows associated with proved reserves, which significantly impact depletion expense and potential impairments of oil and natural gas properties, income taxes and the valuation of deferred tax assets, stock-based compensation and commitments and contingencies. We analyze our estimates based on historical experience and various other assumptions that we believe to be reasonable. While we believe that our estimates and assumptions used in preparation of the consolidated financial statements are appropriate, actual results could differ from those estimates.

New Accounting Pronouncement. In November 2015, the FASB issued ASU No. 2015-17, “Balance Sheet Classification of Deferred Taxes” as part of their simplification initiatives. The update requires that deferred tax liabilities and assets be classified as noncurrent in a classified statement of financial position. The update is effective for public company annual reporting periods beginning after December 15, 2016, and may be adopted prospectively or retrospectively with early adoption is permitted. At present, the Company does not believe that adoption of this update will have a material impact on our results of operations, financial position or cash flows.

Note 2 — Restructuring Charge

Separation of GARP Artificial Lift Technology Operations

During the quarter ended December 31, 2015, we conducted a strategic review of our GARP® artificial lift technology operations and consummated a plan to separate and transfer these operations to a new entity controlled by the inventor of the technology, our Senior Vice President of Operations, and certain former employees of the Company. We invested $108,750 in common and preferred stock of the new entity, Well Lift Inc. ("WLI"). We own 17.5% of WLI and our former employees own the balance of the common stock. Our preferred stock is convertible at our option into common stock which would result in our ownership of 42.5% of WLI, based on the current capital structure of WLI. The company has no contractual exposure to losses of WLI, nor does it have any obligation or agreement to provide additional funding or support to WLI if it is needed. In connection with this transaction, three employees of the Company were terminated. We accrued a restructuring charge based on agreements with the employees covering salary and benefit continuation and an acceleration of vesting of equity awards in exchange for release from liabilities and other provisions including agreements not to compete. Our estimate of accounting charges related to the personnel restructuring as of December 31, 2015 is as follows:

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Evolution Petroleum Corporation And Consolidated Subsidiaries
Notes to Unaudited Consolidated Condensed Financial Statements

Type of Cost	December 31, 2015
Salary expense	$530,387
Payroll taxes and benefits expense	98,479
Stock compensation expense	59,339
Personnel restructuring charge	$688,205

Other Restructuring Impairments

Also in connection with the separation of GARP®, the Company and WLI entered into an agreement under which we transferred our technology assets, including our patents and trademarks, to WLI in exchange for a perpetual royalty of 5% on all future gross revenues associated with the GARP® technology. We reduced the carrying value of these exchanged technology assets to our estimate of their expected discounted net present value, which was $108,512. This estimate was based on the recent financial results from our artificial lift technology operations and the current depressed state of the oil and gas industry and the potential upside cases were assigned relatively low probabilities for accounting purposes. This resulted in an impairment charge of $469,395. In addition, we transferred certain inventory and minor fixed assets to WLI which had no further use in our operations and were deemed to have negligible market or salvage value. This resulted in impairments of $92,901 to equipment inventory and $6,932 to fixed assets, respectively. These impairments total $569,228 and are included in restructuring charges for the three months ended December 31, 2015.

Note 3 — Receivables

As of December 31, 2015 and June 30, 2015 our receivables consisted of the following:

	December 31, 2015	June 30, 2015
Receivables from oil and gas sales	$1,945,397	$3,122,155
Receivable from settled derivatives	602,649	—
Other	9,685	318
Total receivables	$2,557,731	$3,122,473

Note 4 — Prepaid Expenses and Other Current Assets

As of December 31, 2015 and June 30, 2015 our prepaid expenses and other current assets consisted of the following:

	December 31, 2015	June 30, 2015
Prepaid insurance	$133,927	$178,994
Equipment inventory (a)	—	81,538
Retainers and deposits	26,978	26,978
Prepaid federal and state income taxes	204,694	22,542
Other prepaid expenses	30,419	59,352
Prepaid expenses and other current assets	$396,018	$369,404

(a) As discussed in Note 2, our equipment inventory was determined to have no future value in use for our operations and was charged to restructuring costs as part of the separation of our GARP® artificial lift technology operations.

Evolution Petroleum Corporation And Consolidated Subsidiaries
Notes to Unaudited Consolidated Condensed Financial Statements

Note 5 — Property and Equipment

As of December 31, 2015 and June 30, 2015 our oil and natural gas properties and other property and equipment consisted of the following:

	December 31, 2015	June 30, 2015
Oil and natural gas properties		
Property costs subject to amortization	$64,024,239	$57,718,653
Less: Accumulated depreciation, depletion, and amortization	(14,974,989)	(12,531,767)
Unproved properties not subject to amortization	—	—
Oil and natural gas properties, net	$49,049,250	$45,186,886
Other property and equipment		
Other equipment, at cost	$337,245	$607,674
Less: Accumulated depreciation	(298,966)	(330,918)
Other equipment, net	$38,279	$276,756

During the six months ended December 31, 2015 the Company incurred capital expenditures of $6.3 million for the Delhi field, including approximately $4.4 million for the NGL plant project which is currently in progress. We have incurred approximately $9.4 million on a cumulative basis for the NGL plant out of a total authorized commitment of $24.6 million.

During the three months ended December 31, 2015, we recorded a charge of $210,392 to expense the remaining capitalized costs of certain artificial lift equipment installed in the wells of a third-party customer. We continue to own this equipment and contract rights, but do not expect to realize any significant future value from this investment at current prices.

Note 6 — Other Assets

As of December 31, 2015 and June 30, 2015 other assets consisted of the following:

	December 31, 2015