PRIMEENERGY CORP
Form 10-Q
November 17, 2017
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the Quarterly Period Ended September 30, 2017

Or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the Transition Period From ________ to ________

Commission File Number 0-7406

PrimeEnergy Corporation

(Exact name of registrant as specified in its charter)

Delaware	**84-0637348**
xx(State or other jurisdiction of	**(I.R.S. employer**
incorporation or organization)	**Identification No.)**

9821 Katy Freeway, Houston, Texas 77024

(Address of principal executive offices)

(713) 735-0000

(Registrant s telephone number, including area code)

(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 filings required 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, smaller reporting company, or an emerging growth company. See the definitions of large accelerated filer, accelerated filer, smaller reporting company, and emerging growth company in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer	Accelerated Filer
Non-Accelerated Filer	Smaller Reporting Company
	Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

The number of shares outstanding of each class of the Registrant s Common Stock as of November 7, 2017 was: Common Stock, $0.10 par value 2,181,681 shares.

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PART I FINANCIAL INFORMATION

Item 1. FINANCIAL STATEMENTS -

PRIMEENERGY CORPORATION

CONDENSED CONSOLIDATED BALANCE SHEETS Unaudited

(Thousands of dollars, except per share amounts)

	September 30, 2017	December 31, 2016
ASSETS		
Current Assets		
Cash and cash equivalents	$ 9,920	$ 6,568
Restricted cash and cash equivalents	4,193	3,543
Accounts receivable, net	10,322	7,400
Other current assets	1,086	572
Total Current Assets	25,521	18,083
Property and Equipment, at cost		
Oil and gas properties (successful efforts method), net	200,405	187,490
Field and office equipment, net	7,507	8,878
Total Property and Equipment, Net	207,912	196,368
Other Assets	183	203
Total Assets	$ 233,616	$ 214,654
LIABILITIES AND EQUITY		
Current Liabilities		
Accounts payable	$ 13,302	$ 11,965
Accrued liabilities	16,955	8,184
Current portion of long-term debt	2,905	2,949
Current portion of asset retirement obligations	2,006	1,563
Derivative liability short-term	292	2,547
Due to related parties	31	
Total Current Liabilities	35,491	27,208
Long-Term Bank Debt	50,840	66,316
Asset Retirement Obligations	15,711	15,943
Derivative Liability Long-Term	329	1,092
Deferred Income Taxes	47,925	37,500
Other Long-Term Obligations	616	715
Total Liabilities	150,912	148,774

Commitments and Contingencies		
Equity		
Common stock, $.10 par value; Authorized: 4,000,000 shares, issued: 3,836,397 shares	383	383
Paid-in capital	8,440	8,313
Retained earnings	116,970	96,322
Treasury stock, at cost; 1,654,101 shares and 1,552,894 shares	(51,473)	(46,473)
Total Stockholders Equity PrimeEnergy	74,320	58,545
Non-controlling interest	8,384	7,335
Total Equity	82,704	65,880
Total Liabilities and Equity	$ 233,616	$ 214,654

The accompanying Notes are an integral part of these Condensed Consolidated Financial Statements

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PRIMEENERGY CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS Unaudited

(Thousands of dollars, except per share amounts)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	**2016**	**2017**	**2016**
Revenues				
Oil and gas sales	$ 12,604	$ 11,557	$ 39,045	$ 27,395
Realized gain (loss) on derivative instruments, net	156		(49)	
Field service income	4,109	3,694	12,176	11,628
Administrative overhead fees	1,530	1,600	4,758	4,990
Unrealized (loss) gain on derivative instruments, net	(1,262)	(354)	3,092	(354)
Other income	47	2	169	59
Total Revenues	17,184	16,499	59,191	43,718
Costs and Expenses				
Lease operating expense	6,762	6,285	21,058	21,758
Field service expense	3,126	2,662	9,152	9,582
Depreciation, depletion, amortization and accretion on discounted liabilities	7,812	7,308	23,821	18,889
General and administrative expense	2,523	2,405	6,878	6,685
Total Costs and Expenses	20,223	18,660	60,909	56,914
Gain on Sale and Exchange of Assets	359	10,546	42,078	26,869
(Loss) Income from Operations	(2,680)	8,385	40,360	13,673
Less: Interest expense	594	1,002	1,659	2,809
(Loss) Income Before Provision (Benefit) for Income Taxes	(3,274)	7,383	38,701	10,864
(Benefit) Provision for Income Taxes	(1,384)	2,667	12,407	3,036
Net (Loss) Income	(1,890)	4,716	26,294	7,828
Less: Net Income (Loss) Attributable to Non-Controlling Interests	122	(208)	5,646	2,239
(Loss) Income Attributable to PrimeEnergy	$ (2,012)	$ 4,924	$ 20,648	$ 5,589
Basic (Loss) Income Per Common Share	$ (1.22)	$ 2.15	$ 9.29	$ 2.44
Diluted (Loss) Income Per Common Share	$ (1.22)	$ 1.62	$ 6.94	$ 1.83

The accompanying Notes are an integral part of these Condensed Consolidated Financial Statements

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PRIMEENERGY CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME Unaudited

Nine Months Ended September 30, 2017 and 2016

(Thousands of dollars)

	2017	2016
Net Income	$ 26,294	$ 7,828
Other Comprehensive Income, net of taxes:		
Changes in fair value of hedge positions, net of taxes of $0 and $(2), respectively		5
Total other comprehensive income		5
Comprehensive Income	26,294	7,833
Less: Comprehensive Income Attributable to Non-Controlling Interest	(5,646)	(2,239)
Comprehensive Income Attributable to PrimeEnergy	$ 20,648	$ 5,594

The accompanying Notes are an integral part of these Condensed Consolidated Financial Statements

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PRIMEENERGY CORPORATION

CONDENSED CONSOLIDATED STATEMENT OF EQUITY Unaudited

Nine Months Ended September 30, 2017

(Thousands of dollars)

	Common Stock Shares	Common Stock Amount	Additional Paid in Capital	Retained Earnings	Treasury Stock	Total Stockholders Equity PrimeEnergy	Non-Controlling Interest	Total Equity
Balance at December 31, 2016	3,836,397	$ 383	$ 8,313	$ 96,322	$ (46,473)	$ 58,545	$ 7,335	$ 65,880
Repurchase 101,207 shares of common stock					(5,000)	(5,000)		(5,000)
Net income				20,648		20,648	5,646	26,294
Repurchase of non-controlling interests			127			127	(187)	(60)
Distribution of non-controlling interests							(4,410)	(4,410)
Balance at September 30, 2017	3,836,397	$ 383	$ 8,440	$ 116,970	$ (51,473)	$ 74,320	$ 8,384	$ 82,704

The accompanying Notes are an integral part of these Condensed Consolidated Financial Statements

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PRIMEENERGY CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS Unaudited

Nine Months Ended September 30, 2017 and 2016

(Thousands of dollars)

	2017	2016
Cash Flows from Operating Activities:		
Net income	$ 26,294	$ 7,828
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation, depletion, amortization and accretion on discounted liabilities	23,821	18,889
Gain on sale and exchange of assets	(42,078)	(26,869)
Unrealized (gain) loss on derivative instruments, net	(3,092)	354
Provision for deferred income taxes	10,425	1,648
Changes in assets and liabilities:		
(Increase) decrease in accounts receivable	(2,922)	2,009
(Increase) in other current assets and restricted cash	(1,164)	(612)
Increase (decrease) in accounts payable	1,337	(2,497)
Increase in accrued liabilities	8,771	4,188
Increase in due to related parties	31	22
Net Cash Provided by Operating Activities	21,423	4,960
Cash Flows from Investing Activities:		
Capital expenditures, including exploration expense	(40,057)	(11,701)
Proceeds from sale of property and equipment	46,977	28,238
Net Cash Provided by (Used in) Investing Activities	6,920	16,537
Cash Flows from Financing Activities:		
Purchase of stock for treasury	(5,000)	(509)
Purchase of non-controlling interests	(60)	(187)
Proceeds from long-term bank debt and other long-term obligations	52,000	9,000
Repayment of long-term bank debt and other long-term obligations	(67,521)	(33,311)
Distributions to non-controlling interests	(4,410)	(843)
Net Cash Used in Financing Activities	(24,991)	(25,850)
Net Increase (Decrease) in Cash and Cash Equivalents	3,352	(4,353)
Cash and Cash Equivalents at the Beginning of the Period	6,568	9,750
Cash and Cash Equivalents at the End of the Period	$ 9,920	$ 5,397
Supplemental Disclosures:		

Income taxes paid	$ 2,588	$ 45
Interest paid	$ 1,762	$ 2,798

The accompanying Notes are an integral part of these Condensed Consolidated Financial

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PRIMEENERGY CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2017

(Unaudited)

(1) Basis of Presentation:

The accompanying condensed consolidated financial statements of PrimeEnergy Corporation (PEC or the Company) have not been audited by independent public accountants. Pursuant to applicable Securities and Exchange Commission (SEC) rules and regulations, the accompanying interim financial statements do not include all disclosures presented in annual financial statements and the reader should refer to the Company s Form 10-K for the year ended December 31, 2016. In the opinion of management, the accompanying interim condensed consolidated financial statements contain all material adjustments, consisting only of normal recurring adjustments, necessary for a fair presentation of the Company s condensed consolidated balance sheets as of September 30, 2017 and December 31, 2016, the condensed consolidated results of operations for the three and nine months ended September 30, 2017 and 2016, and the condensed consolidated results of cash flows and equity for the nine months ended September 30, 2017. Certain amounts presented in prior period financial statements have been reclassified for consistency with current period presentation. The results for interim periods are not necessarily indicative of annual results. For purposes of disclosure in the condensed consolidated financial statements, subsequent events have been evaluated through the date the statements were issued.

Recently Issued Accounting Pronouncements:

The FASB issued ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)*. This ASU supersedes the *Revenue recognition* requirements in Topic 605, Revenue Recognition and industry-specific guidance in Subtopic 932-605. *Extractivies Oil and Gas Revenue Recognition.* This ASU provides guidance concerning the recognition and measurement of revenue from contracts with customers. Its objective is to increase the usefulness of information in the financial statements regarding the nature, timing and uncertainty of revenues. The effective date for ASU 2014-09 was delayed through the issuance of ASU 2015-14, *Revenue from Contracts with Customers* Deferral of the *Effective Date,* to annual and interim periods beginning in 2018 and is required to be adopted using either the retrospective or cumulative effect (modified retrospective) transition method, with early adoption permitted in 2017. The Company is evaluating the impact this ASU will have on its consolidated financial statements and related disclosures and does not plan on early adopting.

The FASB issued ASU 2016-02, *Leases (Topic 842).* This ASU requires lessee recognition on the balance sheet of a right-of-use asset and a lease liability, initially measured at the present value of the lease payments. It further requires recognition in the income statement of a single lease cost, calculated so that the cost of the lease is allocated over the lease term on a generally straight-line basis. Finally, it requires classification of all cash payments within operating activities in the statement of cash flows. It is effective for fiscal years commencing after December 15, 2018 and early adoption is permitted. This ASU will not have a material impact on the Company s financial statements and related disclosures.

In August 2016, the FASB issued Accounting Standards Update (ASU) 2016-15, Statement of Cash Flows (Topic 230). ASU 2016-15 seeks to reduce the existing diversity in practice in how certain cash receipts and cash payments are presented and classified in the statement of cash flows. This update is effective for fiscal years beginning after

December 15, 2017, including interim periods within those fiscal years, with early adoption permitted. The Company is currently evaluating the provisions of ASU 2016-15 and assessing the impact, if any, it may have on its statement of consolidated cash flows.

In January 2017, the FASB issued ASU No. 2017-03, Accounting Changes and Error Corrections (Topic 250) and Investments Equity Method and Joint Venture (Topic 323), which states that registrants should consider additional qualitative disclosures if the impact of an issued but not yet adopted ASU is unknown or cannot be reasonably estimated and to include a description of the effect of the accounting policies that the registrant expects to apply, if determined. Transition guidance in certain issued but not yet adopted ASUs, including Leases and Revenue Recognition, was also updated to reflect this amendment. This guidance is effective immediately. The adoption of this guidance had no effect on the Company s financial statements.

(2) Acquisitions and Dispositions:

Historically the Company has repurchased the interests of the partners and trust unit holders in the oil and gas limited partnerships (the Partnerships) and the asset and business income trusts (the Trusts) managed by the Company as general partner and as managing trustee, respectively. The Company purchased such interests in amounts totaling $60,000 and $187,000 for the nine months ended September 30, 2017 and 2016, respectively.

During the nine months ended September 30, 2017, The Company sold or farmed out interests in certain non-core undeveloped oil and natural gas properties through a number of separate individually negotiated transactions in exchange for cash and a royalty or working interest in West Texas, New Mexico and Oklahoma. Proceeds under these agreements were $47 million.

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During the nine months of 2017, the Company acquired approximately 118 net mineral acres for $596,000 adjacent to existing Company acreage in order to facilitate the drilling of future horizontal wells.

(3) Restricted Cash and Cash Equivalents:

Restricted cash and cash equivalents include $4.19 million and $3.54 million at September 30, 2017 and December 31, 2016, respectively, of cash primarily pertaining to oil and gas revenue payments. There were corresponding accounts payable recorded at September 30, 2017 and December 31, 2016 for these liabilities. Both the restricted cash and the accounts payable are classified as current on the accompanying condensed consolidated balance sheets.

(4) Additional Balance Sheet Information:

Certain balance sheet amounts are comprised of the following:

(Thousands of dollars)	**September 30, 2017**	**December 31, 2016**
Accounts Receivable:		
Joint interest billing	$ 2,886	$ 2,345
Trade receivables	1,354	1,070
Oil and gas sales	6,087	4,078
Other	207	204
	10,534	7,697
Less: Allowance for doubtful accounts	(212)	(297)
Total	$ 10,322	$ 7,400
Accounts Payable:		
Trade	$ 5,273	$ 3,967
Royalty and other owners	7,174	6,501
Prepaid drilling deposits	67	83
Other	788	1,414
Total	$ 13,302	$ 11,965
Accrued Liabilities:		
Compensation and related expenses	$ 2,887	$ 2,295
Property costs	12,133	3,317
Income Tax	1,366	1,988
Other	569	584
Total	$ 16,955	$ 8,184

(5) Property and Equipment:

Property and equipment at September 30, 2017 and December 31, 2016 consisted of the following:

(Thousands of dollars)	**September 30, 2017**	**December 31, 2016**
Proved oil and gas properties, at cost	$ 452,400	$ 417,821
Less: Accumulated depletion and depreciation	(251,995)	(230,331)
Oil and Gas Properties, Net	$ 200,405	$ 187,490
Field and office equipment	$ 26,586	$ 26,902
Less: Accumulated depreciation	(19,079)	(18,024)
Field and Office Equipment, Net	$ 7,507	$ 8,878
Total Property and Equipment, Net	$ 207,912	$ 196,368

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6) Long-Term Debt:

Bank Debt:

Effective July 30, 2010 the Company entered into a Second Amended and Restated Credit Agreement between Compass Bank as agent and a syndicated group of lenders (Credit Agreement). The Credit Agreement had a revolving line of credit and letter of credit facility of up to $250 million with a final maturity date of July 30, 2017. The credit facility was secured by substantially all of the Company s oil and gas properties. The credit facility was subject to a borrowing base determined by the lenders taking into consideration the estimated value of PEC s oil and gas properties in accordance with the lenders customary practices for oil and gas loans.

On February 15, 2017, the Company and its lenders entered into a Third Amended and Restated Credit Agreement (the 2017 Credit Agreement) with a maturity date of February 15, 2021. The Second Amended and Restated Credit Agreement and subsequent amendments were amended and restated by the 2017 Credit Agreement. Pursuant to the terms and conditions of the 2017 Credit Agreement, the Company has a revolving line of credit and letter of credit facility of up to $300 million subject to a borrowing base that is determined semi-annually by the lenders based upon the Company s financial statements and the estimated value of the Company s oil and gas properties, in accordance with the Lenders customary practices for oil and gas loans. The credit facility is secured by substantially all of the Company s oil and gas properties. As of September 30, 2017, the Company s borrowing base was $67 million. The 2017 Credit Agreement includes terms and covenants that require the Company to maintain a minimum current ratio, total indebtedness to EBITDAX (earnings before depreciation, depletion, amortization, taxes, interest expense and exploration costs) ratio and interest coverage ratio, as defined, and restrictions are placed on the payment of dividends, the amount of treasury stock the Company may purchase, commodity hedge agreements, and loans and investments in its consolidated subsidiaries and limited partnerships.

At September 30, 2017, the Company had a total of $49.8 million of borrowings outstanding under its revolving credit facility at a weighted-average interest rate of 4.67% and $17.2 million available for future borrowings. The combined weighted average interest rate paid on outstanding bank borrowings subject to base rate and LIBO interest was 4.98% for the nine months ended September 30, 2017 as compared to 3.83% for the nine months ended September 30, 2016. The Company s borrowings under this credit facility approximates fair value because the interest rates are variable and reflective of market rates.

The Company entered into interest rate hedge agreements to help manage interest rate exposure. These contracts include interest rate swaps. Interest rate swap transactions generally involve the exchange of fixed and floating rate interest payment obligations without the exchange of the underlying principal amounts. In July 2012, the Company entered into interest swap agreements for a period of two years, which commenced in January 2014, related to $75 million of the Company s bank debt resulting in a LIBO fixed rate of 0.563% and terminated in January 2016. The Company recorded interest expense and paid $7,000 related to the settlement of interest rate swaps for the nine months ended September 30, 2016.

Equipment Loans:

On July 31, 2013, the Company entered into a $10.0 million Loan and Security Agreement with JP Morgan Chase Bank (Equipment Loan). The Equipment Loan is secured by a portion of the Company s field service equipment, carries an interest rate of 3.95% per annum, requires monthly payments (principal and interest) of $184,000, and has a final maturity date of July 31, 2018. As of September 30, 2017, the Company had a total of $1.80 million outstanding on this Equipment Loan.

On July 29, 2014, the Company entered into additional equipment financing facilities (Additional Equipment Loans) totaling $6.0 million with JP Morgan Chase Bank. In August 2014, the Company drew down $4.8 million of this facility that is secured by field service equipment, carries an interest rate of 3.40% per annum, requires monthly payments (principal and interest) of $87,800, and has a final maturity date of July 31, 2019. The remaining $1.2 million under the Additional Equipment Loans was available for interim draws to finance the acquisition of any future field service equipment. In December 2014, the Company made an interim draw of an additional $0.5 million on this facility that is secured by recently purchased field service equipment. Interim draws on this facility carried a floating interest rate, payable monthly at the LIBO published rate plus 2.50% and on June 26, 2015 converted into a fixed term loan, with a rate of 3.50% and requiring monthly payments (principal and interest) of $8,700 with a final maturity date of June 26, 2020. As of September 30, 2017, the Company had a total of $2.14 million outstanding on the Additional Equipment Loans.

The Company determined these loans are Level 3 liabilities in the fair-value hierarchy and estimated their fair value as $3,941 million and $6,958 million at September 30, 2017 and 2016, respectively, using a discounted cash flow model.

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(7) Other Long-Term Obligations and Commitments:

Operating Leases:

The Company has non-cancelable operating leases, primarily for rental of office space, that have a term of more than one year. The future minimum lease payments for the rest of fiscal 2017 and thereafter for the operating leases are as follows:

(Thousands of dollars)		**Operating Leases**
2017		141
2018		525
Total minimum payments	$	666

Rent expense for office space for the nine months ended September 30, 2017 and 2016 was $509,000 and $677,000, respectively.

Asset Retirement Obligation:

A reconciliation of the liability for plugging and abandonment costs for the nine months ended September 30, 2017 is as follows:

(Thousands of dollars)		
Asset retirement obligation	December 31, 2016	$ 17,505
Liabilities incurred		45
Liabilities settled		(409)
Accretion expense		576
Asset retirement obligation	September 30, 2017	$ 17,717

The Company s liability is determined using significant assumptions, including current estimates of plugging and abandonment costs, annual inflation of these costs, the productive life of wells and a risk-adjusted interest rate. Changes in any of these assumptions can result in significant revisions to the estimated asset retirement obligation. Revisions to the asset retirement obligation are recorded with an offsetting change to producing properties, resulting in prospective changes to depreciation, depletion and amortization expense and accretion of discount. Because of the subjectivity of assumptions and the relatively long life of most of the Company s wells, the costs to ultimately retire the wells may vary significantly from previous estimates.

(8) Contingent Liabilities:

The Company, as managing general partner of the affiliated Partnerships, is responsible for all Partnership activities, including the drilling of development wells and the production and sale of oil and gas from productive wells. The Company also provides the administration, accounting and tax preparation work for the Partnerships, and is liable for all debts and liabilities of the affiliated Partnerships, to the extent that the assets of a given limited Partnership are not sufficient to satisfy its obligations. At September 30, 2017, the affiliated Partnerships have established cash reserves in excess of their debts and liabilities and the Company believes these reserves will be sufficient to satisfy Partnership obligations.

The Company is subject to environmental laws and regulations. Management believes that future expenses, before recoveries from third parties, if any, will not have a material effect on the Company s financial condition. This opinion is based on expenses incurred to date for remediation and compliance with laws and regulations, which have not been material to the Company s results of operations.

From time to time, the Company is party to certain legal actions arising in the ordinary course of business. While the outcome of these events cannot be predicted with certainty, management does not expect these matters to have a materially adverse effect on the financial position or results of operations of the Company.

(9) Stock Options and Other Compensation:

In May 1989, non-statutory stock options were granted by the Company to four key executive officers for the purchase of shares of common stock. At September 30, 2017 and 2016, remaining options held by two key executive officers on 767,500 shares were outstanding and exercisable at prices ranging from $1.00 to $1.25. According to their terms, the options have no expiration date.

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(10) Related Party Transactions:

The Company, as managing general partner or managing trustee, makes an annual offer to repurchase the interests of the partners and trust unit holders in certain of the Partnerships or Trusts. The Company purchased such interests in amounts totaling $60,000 and $187,000 for the nine months ended September 30, 2017 and 2016, respectively.

Receivables from related parties consist of reimbursable general and administrative costs, lease operating expenses and reimbursement for property development and related costs. These receivables are due from joint venture partners, which may include members of the Company s Board of Directors.

Payables owed to related parties primarily represent receipts collected by the Company as agent for the joint venture partners, which may include members of the Company s Board of Directors, for oil and gas sales net of expenses.

(11). Financial Instruments

Fair Value Measurements:

Authoritative guidance on fair value measurements defines fair value, establishes a framework for measuring fair value and stipulates the related disclosure requirements. The Company follows a three-level hierarchy, prioritizing and defining the types of inputs used to measure fair value. The fair values of the Company s interest rate swaps, natural gas and crude oil price collars and swaps are designated as Level 3. The following fair value hierarchy table presents information about the Company s assets and liabilities measured at fair value on a recurring basis at September 30, 2017 and December 31, 2016:

September 30, 2017	**Quoted Prices in Active Markets For Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**	**Balance at September 30, 2017**
(Thousands of dollars)				
Assets				
Commodity derivative contracts	$	$	$ 131	$ 131
Total assets	$	$	$ 131	$ 131
Liabilities				
Commodity derivative contracts	$	$	$ (621)	$ (621)
Total liabilities	$	$	$ (621)	$ (621)

December 31, 2016	**Quoted Prices in Active Markets For Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**	**Balance at December 31, 2016**

(Thousands of dollars)				
Assets				
Commodity derivative contracts	$	$	$ 57	$ 57
Total assets	$	$	$ 57	$ 57
Liabilities				
Commodity derivative contract	$	$	$ (3,639)	$ (3,639)
Total liabilities	$	$	$ (3,639)	$ (3,639)

The derivative contracts were measured based on quotes from the Company s counterparties. Such quotes have been derived using valuation models that consider various inputs including current market and contractual prices for the underlying instruments, quoted forward prices for natural gas and crude oil, volatility factors and interest rates, such as a LIBOR curve for a similar length of time as the derivative contract term as applicable. These estimates are verified using comparable NYMEX futures contracts or are compared to multiple quotes obtained from counterparties for reasonableness.

The significant unobservable inputs for Level 3 derivative contracts include basis differentials and volatility factors. An increase (decrease) in these unobservable inputs would result in an increase (decrease) in fair value, respectively. The Company does not have access to the specific assumptions used in its counterparties valuation models. Consequently, additional disclosures regarding significant Level 3 unobservable inputs were not provided.

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The following table sets forth a reconciliation of changes in the fair value of financial assets and liabilities classified as Level 3 in the fair value hierarchy for the six months ended September 30, 2017.

(Thousands of dollars)	
Net Liabilities December 31, 2016	$ (3,582)
Total realized and unrealized (gains) losses:	
Included in earnings (a)	3043
Purchases, sales, issuances and settlements	49
Net Liabilities September 30, 2017	$ (490)

a) Derivative instruments are reported in revenues as realized gain/loss and on a separately reported line item captioned unrealized gain/loss on derivative instruments, and interest rate swap instruments are reported as an increase or reduction to interest expense.

Derivative Instruments:

The Company is exposed to commodity price and interest rate risk, and management considers periodically the Company s exposure to cash flow variability resulting from the commodity price changes and interest rate fluctuations. Futures, swaps and options are used to manage the Company s exposure to commodity price risk inherent in the Company s oil and gas production operations. The Company does not apply hedge accounting to any of its commodity based derivatives. Both realized and unrealized gains and losses associated with commodity derivative instruments are recognized in earnings.

Interest rate swap derivatives are treated as cash-flow hedges and are used to fix our floating interest rates on existing debt. Settlements of the swaps, which began in January 2014 and concluded in January 2016, was recognized within interest expense. There were no remaining interest rate swaps as of September 30, 2017 and December 31, 2016.The value of interest rate swaps if applicable, would be recorded in accumulated other comprehensive loss, net of tax.

The following table sets forth the effect of derivative instruments on the consolidated balance sheets at September 30, 2017 and December 31, 2016:

		Fair Value	
(Thousands of dollars)	**Balance Sheet Location**	**September 30, 2017**	**December 31, 2016**
Asset Derivatives:			
Derivatives not designated as cash-flow hedging instruments:			
Crude oil commodity contracts	Other Current Assets	$ 12	$
Natural gas commodity contracts	Other Current Assets	94	
Crude oil commodity contracts	Other Assets	19	
Natural gas commodity contracts	Other Assets	6	57

Total		$ 131	$ 57
Liability Derivatives:			
Derivatives not designated as cash-flow hedging instruments:			
Crude oil commodity contracts	Derivative liability short-term	(88)	(1,065)
Natural gas commodity contracts	Derivative liability short-term	(204)	(1,482)
Natural gas commodity contracts	Derivative liability long-term	(254)	(463)
Crude oil commodity contracts	Derivative liability long-term	(75)	(629)
Total		$ (621)	$ (3,639)
Total derivative instruments		$ (490)	$ (3,582)

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The following table sets forth the effect of derivative instruments on the consolidated statements of operations for the nine month periods ended September 30, 2017 and 2016:

(Thousands of dollars)	**Location of gain/loss recognized in income**	**Amount of gain/loss recognized in income 2017**	**2016**
Derivative designated as cash-flow hedge instruments:			
Interest rate swap contracts	Interest expense	$	$ (7)
Derivatives not designated as cash-flow hedge instruments:			
Natural gas commodity contracts	Unrealized (loss) gain on derivative instruments, net	1,709	
Crude oil commodity contracts	Unrealized (loss) gain on derivative instruments, net	1,383	
Natural gas commodity contracts	Realized gain (loss) on derivative instruments, net	(130)	
Crude oil commodity contracts	Realized gain (loss) on derivative instruments, net	81	