

US ENERGY CORP

FORM 10-Q (Quarterly Report)

Filed 08/14/17 for the Period Ending 06/30/17

Address	4643 S. ULSTER STREET SUITE 970 DENVER, CO 80237
Telephone	303 993 3200
CIK	0000101594
Symbol	USEG
SIC Code	1311 - Crude Petroleum and Natural Gas
Industry	Mining Support Services & Equipment
Sector	Basic Materials
Fiscal Year	12/31

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

FORM 10-Q

(Mark One)

Quarterly report pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934

For the Quarterly Period Ended June 30, 2017

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 000-6814



U.S. ENERGY CORP.

(Exact Name of Registrant as Specified in its Charter)

Wyoming

(State or other jurisdiction of incorporation or organization)

83-0205516

(I.R.S. Employer Identification No.)

4643 S. Ulster Street, Suite 970, Denver, CO
(Address of principal executive offices)

80237
(Zip Code)

Registrant's telephone number, including area code:

(303) 993-3200

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 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 the definitions of "large accelerated filer," "accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer
Emerging growth company

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

The registrant had 6,134,506 shares of its \$0.01 par value common stock outstanding as of August 14, 2017.

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Part I. FINANCIAL INFORMATION

Item 1. Financial Statements

**U.S. ENERGY CORP. AND SUBSIDIARIES
UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS**

(In Thousands, Except Share and Per Share Amounts)

	<u>June 30, 2017</u>	<u>December 31, 2016</u>
ASSETS		
Current assets:		
Cash and equivalents	\$ 1,987	\$ 2,518
Oil and gas sales receivable	641	562
Discontinued operations - assets of mining segment	114	114
Assets available for sale	653	653
Marketable securities	622	946
Oil price risk derivatives	311	—
Other current assets	233	96
Total current assets	<u>4,561</u>	<u>4,889</u>
Oil and gas properties under full cost method:		
Unevaluated properties and exploratory wells in progress	4,664	4,664
Evaluated properties	87,919	87,834
Less accumulated depreciation, depletion and amortization	(83,094)	(82,640)
Net oil and gas properties	<u>9,489</u>	<u>9,858</u>
Other assets:		
Property and equipment, net	1,650	1,864
Other assets	108	156
Total other assets	<u>1,758</u>	<u>2,020</u>
Total assets	<u>\$ 15,808</u>	<u>\$ 16,767</u>
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable and accrued liabilities:		
Payable to major operator	\$ 2,667	\$ 2,710
Contingent ownership interests	1,518	1,430
Other	748	743
Accrued compensation and benefits	63	49
Current portion of long-term debt	—	6,000
Total current liabilities	<u>4,996</u>	<u>10,932</u>
Noncurrent liabilities:		
Revolving credit facility	6,000	—
Asset retirement obligations	1,061	1,045
Warrant liability	510	1,030
Other liabilities	—	2
Total noncurrent liabilities	<u>7,571</u>	<u>2,077</u>
Commitments and contingencies (Note 7)		
Shareholders' equity:		
Preferred stock, par value \$0.01 per share. Authorized 100,000 shares, 50,000 shares of series A Convertible Preferred Stock outstanding as of June 30, 2017 and December 31, 2016; liquidation preference of \$2,375 as of June 30, 2017.	1	1
Common stock, \$0.01 par value; unlimited shares authorized; 6,134,506 and 5,834,568 shares issued and outstanding, respectively	61	61
Additional paid-in capital	127,787	127,576
Accumulated deficit	(124,229)	(123,825)
Other comprehensive loss	(379)	(55)

Total shareholders' equity	<u>3,241</u>	<u>3,758</u>
Total liabilities and shareholders' equity	<u>\$ 15,808</u>	<u>\$ 16,767</u>

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

U.S. ENERGY CORP. AND SUBSIDIARIES
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND
COMPREHENSIVE LOSS

(In Thousands, Except Share and Per Share Amounts)

	Three Months Ended June 30:		Six Months Ended June 30:	
	2017	2016	2017	2016
Revenue:				
Oil	\$ 1,591	\$ 1,677	\$ 2,830	\$ 2,541
Natural gas and liquids	401	319	909	521
Total revenue	1,992	1,996	3,739	3,062
Operating expenses:				
Oil and gas operations:				
Production costs	803	1,434	1,856	2,464
Depreciation, depletion and amortization	202	864	473	1,646
Impairment of oil and gas properties	—	2,611	—	9,568
General and administrative:				
Compensation and benefits, including director and contract employees	178	172	354	311
Stock-based compensation	106	34	212	68
Professional services	571	541	1,350	768
Insurance, rent and other	136	16	237	183
Total operating expenses	1,996	5,672	4,482	15,008
Operating loss	(4)	(3,676)	(743)	(11,946)
Other income (expense):				
Realized gain (loss) on oil price risk derivatives	100	380	100	1,262
Unrealized gain (loss) on oil price risk derivatives	311	(887)	311	(1,460)
Gain on sale of assets	1	100	1	100
Rental and other income (loss)	(131)	(48)	(347)	(79)
Warrant fair value adjustment	180	—	520	—
Interest expense	(121)	(75)	(246)	(247)
Total other income (expense)	340	(530)	339	(424)
Income (loss) from continuing operations	336	(4,206)	(404)	(12,370)
Discontinued operations				
Discontinued operations	—	(10)	—	(2,448)
Loss from discontinued operations	—	(10)	—	(2,448)
Net income (loss)	336	(4,216)	(404)	(14,818)
Change in fair value of marketable equity securities	(238)	927	(324)	927
Comprehensive profit (loss)	\$ 98	\$ (3,289)	\$ (728)	\$ (13,891)
Profit (loss) from continuing operations applicable to common shareholders:				
Profit (loss) from continuing operations	\$ 98	\$ (4,206)	\$ (728)	\$ (12,370)
Accrued dividends related to Series A Convertible Preferred Stock	(71)	(62)	(140)	(96)
Profit (loss) from continuing operations applicable to common shareholders	\$ 27	\$ (4,268)	\$ (868)	\$ (12,466)
Profit (loss) per share-Basic:				
Continuing operations	\$ 0.05	\$ (0.90)	\$ (0.09)	\$ (2.63)

Discontinued operations	—	—	—	(0.52)
Total	\$ 0.05	\$ (0.90)	\$ (0.09)	\$ (3.15)
Diluted:				
Continuing operations	\$ 0.05	\$ (0.90)	\$ (0.09)	\$ (2.63)
Discontinued operations	—	—	—	(0.52)
Total	<u>\$ 0.05</u>	<u>\$ (0.90)</u>	<u>\$ (0.09)</u>	<u>\$ (3.15)</u>
Weighted average shares outstanding:				
Basic	5,834,568	4,705,000	5,834,568	4,705,000
Diluted:	<u>6,626,344</u>	<u>4,705,000</u>	<u>5,834,568</u>	<u>4,705,000</u>

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

Please note that 2016 “Loss per share- basic & diluted” may differ from results reported on the Company’s previous quarterly reports on Form 10-Q due to fractional shares associated with the Company’s 6 for 1 stock split in June 2016.

U.S. ENERGY CORP. AND SUBSIDIARIES
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE SIX MONTHS ENDED JUNE 30, 2017 AND 2016

(In Thousands)

	<u>2017</u>	<u>2016</u>
Cash flows from operating activities:		
Net loss	\$ (404)	\$ (14,818)
Loss from discontinued operations	—	2,448
Loss from continuing operations	(404)	(12,370)
Adjustments to reconcile loss from continuing operations to net cash used in operating activities:		
Depreciation and depletion	674	1,718
Debt amortization	27	—
Impairment of oil and gas properties	—	9,568
Change in fair value of oil price risk derivative	(311)	1,460
Stock-based compensation and services	212	68
Warrant fair value adjustment	(520)	—
Other	(8)	52
Changes in operating assets and liabilities:		
Decrease (increase) in:		
Oil and gas sales receivable	(79)	309
Other assets	(138)	(160)
Increase (decrease) in:		
Accounts payable and accrued liabilities	—	(948)
Accrued compensation and benefits	14	(1,131)
Net cash used in operating activities	(533)	(1,434)
Cash flows from investing activities:		
Capital expenditures	(22)	(86)
Proceeds from asset sale	24	—
Net cash provided by investing activities:	2	(86)
Cash flows from financing activities:		
Proceeds from issuance of preferred stock	—	1
Payments for debt issuance costs	—	(24)
Cash payment for fractional shares in reverse stock split	—	(3)
Net cash used in financing activities	—	(26)
Discontinued operations:		
Net cash used in discontinued operations	—	(448)
Net decrease in cash and equivalents	(531)	(1,994)
Cash and equivalents, beginning of period	2,518	3,354
Cash and equivalents, end of period	<u>\$ 1,987</u>	<u>\$ 1,360</u>
Non-cash investing and financing activities:		
Issuance of preferred stock in disposition of mining segment	—	\$ 1,999
Elimination of asset retirement obligations in disposition of mining segment	—	204
Unrealized gain on marketable equity securities	—	927
Net additions to oil and gas properties through asset retirement obligations	—	1

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

U.S. ENERGY CORP. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Dollars in Thousands, Except Per Share Amounts)

1. ORGANIZATION, OPERATIONS AND SIGNIFICANT ACCOUNTING POLICIES

Organization and Operations

U.S. Energy Corp. (collectively with its subsidiaries referred to as the “Company” or “U.S. Energy”) was incorporated in the State of Wyoming on January 26, 1966. The Company’s principal business activities are focused on the acquisition, exploration and development of oil and gas properties in the United States.

Basis of Presentation.

The accompanying unaudited condensed consolidated financial statements are presented in accordance with U.S. generally accepted accounting principles (“GAAP”) and have been prepared by the Company pursuant to the rules and regulations of the Securities and Exchange Commission (the “SEC”) regarding interim financial reporting. Accordingly, certain information and footnote disclosures required by GAAP for complete financial statements have been condensed or omitted in accordance with such rules and regulations. In the opinion of management, all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation of the consolidated financial statements have been included.

We have substantial debt obligations and our ongoing capital and operating expenditures will exceed the revenue we expect to receive from our oil and natural gas operations in the near future. If we are unable to raise substantial additional funding, refinance existing indebtedness or consummate significant asset sales on a timely basis and/or on acceptable terms, we may be required to significantly curtail our business and operations. The consolidated financial statements included in this report on Form 10-Q have been prepared on a going concern basis of accounting, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. The consolidated financial statements do not reflect any adjustments that might be necessary should we be unable to continue as a going concern. Our ability to continue as a going concern is subject to, among other factors, our ability to monetize assets, our ability to obtain financing or refinance existing indebtedness, our ability to continue our cost cutting efforts, oil and gas commodity prices, our ability to recognize, acquire and develop strategic interests and prospects, the speed and cost with which we can develop our prospects and the ability to adapt our business by integrating specific operations associated with operating companies. There can be no assurance that we will be able to obtain additional funding on a timely basis and on satisfactory terms, or at all. In addition, no assurance can be given that any such funding, if obtained, will be adequate to meet our capital needs and support our growth. If additional funding cannot be obtained on a timely basis and on satisfactory terms, then our operations would be materially negatively impacted and we may be unable to continue as a going concern. If we become unable to continue as a going concern, we may find it necessary to file a voluntary petition for reorganization under the Bankruptcy Code in order to provide us additional time to identify an appropriate solution to our financial situation and implement a plan of reorganization aimed at improving our capital structure.

For further information, please refer to the consolidated financial statements and footnotes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2016 filed on April 17, 2017. Our financial condition as of June 30, 2017, and operating results for the six months ended June 30, 2017 are not necessarily indicative of the financial condition and results of operations that may be expected for any future interim period or for the year ending December 31, 2017.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Significant estimates include oil and gas reserves that are used in the calculation of depreciation, depletion, amortization and impairment of the carrying value of evaluated oil and gas properties; production and commodity price estimates used to record accrued oil and gas sales receivable; valuation of commodity derivative instruments; fair value of outstanding warrants; and the cost of future asset retirement obligations. The Company evaluates its estimates on an on-going basis and bases its estimates on historical experience and on various other assumptions the Company believes to be reasonable. Due to inherent uncertainties, including the future prices of oil and gas, these estimates could change in the near term and such changes could be material.

Principles of Consolidation

The accompanying financial statements include the accounts of the Company and its wholly-owned subsidiary Energy One LLC (“Energy One”). All inter-company balances and transactions have been eliminated in consolidation. Certain prior period amounts have been reclassified to conform to the current period presentation of the accompanying financial statements.

Comprehensive Income (Loss)

Comprehensive income (loss) is used to refer to net income (loss) plus other comprehensive income (loss). Other comprehensive income (loss) is comprised of revenues, expenses, gains, and losses that under GAAP are reported as separate components of shareholders' equity instead of net income (loss).

Significant Account Policies

There have been no material changes to the Company's critical accounting policies and estimates from those disclosed in the 2016 Annual Report.

Recent Accounting Pronouncements

Revenue recognition. In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update No. 2014-09, *Revenue from Contracts with Customers* ("ASU 2014-09"). The objective of ASU 2014-09 is greater consistency and comparability across industries by using a five-step model to recognize revenue from customer contracts. ASU 2014-09 also contains some new disclosure requirements under GAAP. In August 2015, the FASB issued Accounting Standards Update No. 2015-14, *Deferral of the Effective Date* ("ASU 2015-14"). ASU 2015-14 defers the effective date of the new revenue standard by one year, making it effective for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period. In 2016, the FASB issued additional accounting standards updates to clarify the implementation guidance of ASU 2014-09. The Company is currently evaluating the effect that adopting this guidance will have on its financial position, cash flows and results of operations.

Financial instruments. In January 2016, the FASB issued Accounting Standards Update No. 2016-01, *Recognition and Measurement of Financial Assets and Financial Liabilities* ("ASU 2016-01"), which requires that most equity instruments be measured at fair value with subsequent changes in fair value recognized in net income. ASU 2016-01 also impacts financial liabilities under the fair value option and the presentation and disclosure requirements for financial instruments. ASU 2016-01 does not apply to equity method investments or investments in consolidated subsidiaries. ASU 2016-01 is effective for fiscal years beginning after December 15, 2017, including interim periods within those years. The Company is currently evaluating the effect that adopting this guidance will have on its financial position, cash flows and results of operations.

Leases. In February 2016, the FASB issued Accounting Standards Update No. 2016-02, *Leases* ("ASU 2016-02"), which requires a lessee to recognize lease payment obligations and a corresponding right-of-use asset to be measured at fair value on the balance sheet. ASU 2016-02 also requires certain qualitative and quantitative disclosures about the amount, timing and uncertainty of cash flows arising from leases. ASU 2016-02 is effective for fiscal years beginning after December 15, 2018, including interim periods within those years. The Company is currently evaluating the effect that adopting this guidance will have on its financial position, cash flows and results of operations.

Statement of cash flows. In August 2016, the FASB issued Accounting Standards Update No. 2016-15, *Statement of Cash Flows* ("ASU 2016-15"), which is intended to reduce diversity in practice in how certain transactions are classified in the statement of cash flows. ASU 2016-15 is effective for fiscal years beginning after December 15, 2017, including interim periods within those years. The adoption of this guidance will not impact the Company's financial position or results of operations, but could result in presentation changes on the Company's statement of cash flows.

Business combinations. In January 2017, the FASB issued Accounting Standards Update No. 2017-01, *Clarifying the Definition of a Business* (“ASU 2017-01”), which provides guidance to assist entities with evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. ASU 2017-01 requires entities to use a screen test to determine when an integrated set of assets and activities is not a business or if the integrated set of assets and activities needs to be further evaluated against the framework. ASU 2017-01 is effective for fiscal years beginning after December 15, 2017, including interim periods within those years. The Company is currently evaluating the effect that adopting this guidance will have on its financial position, cash flows and results of operations.

Stock-based compensation. In May 2017, the FASB issued Accounting Standards Update No. 2017-09, *Scope of Modification Accounting* (“ASU 2017-09”), which provides guidance about which changes to the terms or conditions of a share-based payment award require an entity to apply modification accounting. The adoption of ASU 2017-09 will become effective for annual periods beginning after December 15, 2017, and the Company is currently evaluating the impact that it will have on its financial position, cash flows and results of operations.

2. LIQUIDITY & GOING CONCERN

As of June 30, 2017, the Company has a working capital deficit of \$0.4 million and an accumulated deficit of \$124.2 million. Additionally, the Company incurred a net profit of \$0.3 million and a net loss of \$0.4 million for the three and six months ended June 30, 2017, respectively.

On May 2, 2017, the Amended and Restated Credit Agreement, dated July 30, 2010, between U.S. Energy Corp.’s wholly-owned subsidiary, Energy One and Wells Fargo Bank N.A. was sold, assigned and transferred to APEG Energy II, L.P. (“APEG”) (the “Credit Agreement”). APEG purchased and assumed all of Wells Fargo’s rights and obligations as the lender to Energy One under the credit facility. Concurrently, U.S. Energy Corp., Energy One and APEG entered into a Limited Forbearance Agreement dated May 2, 2017. On June 28, 2017, U.S. Energy Corp., Energy One and APEG entered into a Fifth Amendment to the Credit Agreement providing for, among other things, an extension of the maturity date to July 19, 2019, new financial coverage ratio covenants and a limited release and waiver with respect to any historical Company non-compliance with any and all financial covenants by the Company. As of June 30, 2017, the Company was in compliance with all financial covenants and fully conforming with all requirements under its credit agreement. Accordingly, the entire balance of \$6.0 million has been classified as a long-term liability.

As of June 30, 2017, the Company had cash and equivalents of \$2.0 million. Management believes overhead and mining expense eliminations have poised the Company to survive the continued low commodity price environment. However, there can be no assurance that the Company will be able to complete future financings, dispositions or acquisitions on acceptable terms or at all. The significantly lower oil price environment has substantially decreased our cash flows from operating activities. Sustained low oil prices could significantly reduce or eliminate our planned capital expenditures. If production is not replaced through the acquisition or drilling of new wells our production levels will lower due to the natural decline of production from existing wells.

Our strategy is to continue to (1) maintain adequate liquidity and selectively participate in new drilling and completion activities, subject to economic and industry conditions, (2) pursue acquisition and disposition opportunities as available liquidity permits and (3) evaluate various avenues to strengthen our balance sheet and improve our liquidity position. We expect to fund any near-term capital requirements and working capital needs from current cash on hand. Our activity could be further curtailed if our cash flows decline from expected levels. Because production from existing oil and natural gas wells declines over time, further reductions of capital expenditures used to drill and complete new oil and natural gas wells would likely result in lower levels of oil and natural gas production in the future.

3. OIL PRICE RISK DERIVATIVES

The Company's wholly-owned subsidiary Energy One has historically entered into crude oil derivative contracts ("economic hedges"). The derivative contracts are priced based on West Texas Intermediate ("WTI") quoted prices for crude oil. The Company is a guarantor of Energy One's obligations under the economic hedges. The objective of utilizing the economic hedges is to reduce the effect of price changes on a portion of the Company's future oil production, achieve more predictable cash flows in an environment of volatile oil and gas prices and to manage the Company's exposure to commodity price risk. The use of these derivative instruments limits the downside risk of adverse price movements. However, there is a risk that such use may limit the Company's ability to benefit from favorable price movements. Energy One may, from time to time, add incremental derivatives to hedge additional production, restructure existing derivative contracts or enter into new transactions to modify the terms of current contracts in order to realize the current value of its existing positions. The Company does not engage in speculative derivative activities or derivative trading activities, nor does it use derivatives with leveraged features. Presented below is a summary of outstanding crude oil swaps as of June 30, 2017.

	<u>Begin</u>	<u>End</u>	<u>Quantity (bbls/d)</u>	<u>Price</u>
Crude oil price swaps	<u>5/1/17</u>	<u>12/31/17</u>	<u>300</u>	<u>\$ 52.40</u>

Unrealized gains and losses resulting from derivatives are recorded at fair value in the consolidated balance sheet. Changes in fair value are included in the "change in unrealized gain (loss) on oil price risk derivatives" in the consolidated statements of operations. For the six months ended June 30, 2017 and 2016, the Company's unrealized gains (losses) from derivatives amounted to \$0.3 and \$(1.5) million, respectively. Derivative contract settlements are included in the "realized gain (loss) on oil price risk derivatives" in the consolidated statement of operations. For the six months ended June 30, 2017 and 2016, the Company's realized gains (losses) from derivatives amounted to \$0.1 and \$1.3 million, respectively.

Please refer to Note 13 entitled "Subsequent Events" for more information.

4. CEILING TEST FOR OIL AND GAS PROPERTIES

The reserves used in the Company's full cost ceiling test incorporate assumptions regarding pricing and discount rates in the determination of present value. In the calculation of the ceiling test as of June 30, 2017, the Company used a price of \$42.56 per barrel for oil and \$2.94 per MMBtu for natural gas (as further adjusted for property specific gravity, quality, local markets and distance from markets) to compute the future cash flows of the Company's producing properties. These prices compare to \$42.75 per barrel for oil and \$2.48 per MMBtu for natural gas used in the calculation of the Ceiling Test as of December 31, 2016. The Company used a discount factor of 10%.

For the six months ended June 30, 2017 and 2016, ceiling test impairment charges for the Company's oil and gas properties amounted to \$0 and \$9.6 million, respectively.

5. DISCONTINUED OPERATIONS AND PREFERRED STOCK ISSUANCE

Disposition of Mining Segment

In February 2006, the Company reacquired the Mt. Emmons molybdenum mining properties (the "Property"). In February 2016, the Company's Board of Directors decided to dispose of the Property rather than continuing the Company's long-term development strategy whereby the Company entered into the following agreements:

- A. The Company entered into an Acquisition Agreement (the "Acquisition Agreement") with Mt. Emmons Mining Company, a subsidiary of Freeport-McMoRan Inc. ("MEM"), whereby MEM acquired the Property. The Company did not receive any cash consideration for the disposition; the sole consideration for the transfer was that MEM assumed the Company's obligations to operate the Water Treatment Plant ("WTP") and to pay the future mine holding costs for portions of the Property that it desires to retain.

Under U.S. GAAP, the disposal of a segment is reported as discontinued operations in the Company's financial statements. Presented below are the assets and liabilities associated with the Company's mining segment as of June 30, 2017 and December 31, 2016:

	<u>2017</u>	<u>2016</u>
Assets retained by the Company:		
Performance bonds	\$ 114	\$ 114
Total assets of discontinued operations	<u>\$ 114</u>	<u>\$ 114</u>

- B. Concurrent with entry into the Acquisition Agreement and as additional consideration for MEM to accept transfer of the Property, the Company entered into a Series A Convertible Preferred Stock Purchase Agreement (the "Series A Purchase Agreement") with MEM, whereby the Company issued 50,000 shares of newly designated Series A Convertible Preferred Stock (the "Preferred Stock") to MEM in exchange for (i) MEM accepting the transfer of the Property and replacing the Company as the permittee and operator of the WTP, and (ii) the payment of approximately \$1 to the Company. The Series A Purchase Agreement contains customary representations and warranties on the part of the Company. As contemplated by the Acquisition Agreement and the Series A Purchase Agreement and as approved by the Company's Board of Directors, the Company filed with the Secretary of State of the State of Wyoming Articles of Amendment containing a Certificate of Designations with respect to the Preferred Stock (the "Certificate of Designations"). Pursuant to the Certificate of Designations, the Company designated 50,000 shares of its authorized preferred stock as Series A Convertible Preferred Stock. The Preferred Stock accrues dividends at a rate of 12.25% per annum of the Adjusted Liquidation Preference (as defined below); such dividends are not payable in cash but are accrued and compounded quarterly in arrears on the first business day of the succeeding calendar quarter. At issuance, the aggregate fair value of the Preferred Stock was \$2,000 based on the initial liquidation preference of \$40 per share. The "Adjusted Liquidation Preference" is initially \$40 per share of Preferred Stock, with increases each quarter by the accrued quarterly dividend. The Preferred Stock is senior to other classes or series of shares of the Company with respect to dividend rights and rights upon liquidation. No dividend or distribution will be declared or paid on junior stock, including the Company's common stock, (1) unless approved by the holders of Preferred Stock and (2) unless and until a like dividend has been declared and paid on the Preferred Stock on an as-converted basis.

At the option of the holder, each share of Preferred Stock was initially convertible into approximately 13.33 shares of the Company's \$0.01 par value common stock (the "Conversion Rate") for an aggregate of 666,667 shares of common stock. The Conversion Rate is subject to anti-dilution adjustments for stock splits, stock dividends, certain reorganization events, and to price-based anti-dilution protections if the Company subsequently issues shares for less than 90% of fair value on the date of issuance. Each share of Preferred Stock will be convertible into a number of shares of common stock equal to the ratio of the initial conversion value to the conversion value as adjusted for accumulated dividends multiplied by the Conversion Rate. In no event will the aggregate number of shares of common stock issued upon conversion be greater than approximately 793,000 shares. The Preferred Stock will generally not vote with the Company's common stock on an as-converted basis on matters put before the Company's shareholders. The holders of the Preferred Stock have the right to approve specified matters as set forth in the Certificate of Designations and have the right to require the Company to repurchase the Preferred Stock in connection with a change of control. However, the Company's Board of Directors has the ability to prevent any change of control that could trigger a redemption obligation related to the Preferred Stock.

During the first quarter of 2016, the Company recorded the fair value of the Preferred Stock based on the initial liquidation preference of \$2,000. Since the cash consideration paid by MEM for the Preferred Stock was a nominal amount, the Company recorded a charge to operations of approximately \$2,000 associated with the issuance.

- C. Concurrent with entry into the Acquisition Agreement and the Series A Purchase Agreement, the Company and MEM entered into an Investor Rights Agreement, which provides MEM rights to certain information and Board observer rights. MEM has agreed that it, along with its affiliates, will not acquire more than 16.86% of the Company's issued and outstanding shares of Common Stock. In addition, MEM has the right to demand registration of the shares of Common Stock issuable upon conversion of the Preferred Stock under the Securities Act of 1933, as amended.

Combined Results of Operations for Discontinued Operations

The results of operations of the discontinued mining operations are presented separately in the accompanying financial statements. Presented below are the components for the six months ended June 30, 2017 and 2016:

	<u>2017</u>	<u>2016</u>
Issuance of preferred stock to induce disposition	\$ —	\$ (1,999)
Operating expenses of mining segment:		
Water treatment plant	—	(256)
Mine property holding costs	—	(117)
Professional fees	—	(76)
Total results for discontinued operations	<u>\$ —</u>	<u>\$ (2,448)</u>

6. DEBT

Energy One, a wholly-owned subsidiary the Company, has a credit facility with APEG Energy II, L.P. ("APEG"). As of June 30, 2017 and 2016, outstanding borrowings under the credit facility amounted to \$6.0 million. U.S. Energy Corp., Energy One and APEG entered into a Limited Forbearance Agreement dated May 2, 2017. On June 28, 2017, U.S. Energy Corp., Energy One and APEG entered into a Fifth Amendment to the credit facility providing for, among other things, an extension of the maturity date to July 19, 2019, new financial coverage ratio covenants and a waiver with respect to any historical Company non-compliance with any and all financial covenants. As of June 30, 2017 and 2016, the borrowing base was \$6.0 million. Borrowings under the credit facility are secured by Energy One's oil and gas producing properties and substantially all of the Company's cash and equivalents. Each borrowing under the agreement has a term of six months, but can be continued at the Company's election through July 2019 if the Company remains in compliance with the covenants under the credit facility. The weighted average interest rate on this debt is 7.23% as of June 30, 2017. The interest rate on the credit facility is currently fixed at 8.75%.

Energy One is required to comply with customary affirmative covenants and with certain negative covenants. The principal negative financial covenants do not permit (as the following terms are defined in the Fifth Amendment) (i) PDP Coverage Ratio to be less than 1.2 to 1; and (ii) the current ratio to be less than 1.0 to 1.0. As of June 30, 2017, the Company is in compliance with all credit facility covenants. Additionally, the Credit Agreement prohibits or limits Energy One's ability to incur additional debt, pay cash dividends and other restricted payments, sell assets, enter into transactions with affiliates, and to merge or consolidate with another company. The Company is a guarantor of Energy One's obligations under the Credit Agreement.

7. COMMITMENTS AND CONTINGENCIES

From time to time, the Company is party to certain legal actions and claims 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 Company's financial position or results of operations. Following is updated information related to currently pending legal matters:

North Dakota Properties. On June 8, 2011, Brigham Oil & Gas, L.P. ("Brigham"), as the operator of the Williston 25-36 #1H Well, filed an action in the State of North Dakota, County of Williams, in District Court, Northwest Judicial District, Case No. 53-11-CV-00495 to interplead to the court with respect to the undistributed suspended royalty funds from this well to protect itself from potential litigation. Brigham became aware of an apparent dispute with respect to ownership of the mineral interest between the ordinary high water mark and the ordinary low water mark of the Missouri River. Brigham suspended payment of certain royalty proceeds of production related to the minerals in and under this property pending resolution of the apparent dispute. Brigham was subsequently sold to Statoil ASA ("Statoil") who assumed Brigham's rights and obligations under this case. The Company owns a working interest, not royalty interest, in this well and no funds have been withheld.

On January 28, 2013, the District Court Northwest Judicial District issued an Order for Partial Summary Judgment holding that the State of North Dakota as part of its title to the beds of navigable waterways owns the minerals in the area between the ordinary high and low watermarks on these waterways, and that this public title excludes ownership and any proprietary interest by riparian landowners. This issue has been appealed to the North Dakota Supreme Court. The Company's legal position is aligned with Brigham, who will continue to provide legal counsel in this case for the benefit of all working interest owners.

The Company is also a party to litigation that seeks to reform certain assignments of mineral interests it acquired from Brigham. This matter involves the depth below the surface to which the assignments were effective. The plaintiff is seeking to reform the agreement such that the Company's assignment would be revised to be 12 feet closer to the surface. This dispute affects one of the Company's producing wells. The matter was settled on July 7, 2017 with the court ruling in favor of Brigham and therefore U.S. Energy will retain all interests in all subject leases.

Texas Quiet Title Action – Willerson Lease. In September 2013, the Company acquired from Chesapeake a 15% working interest in approximately 4,244 gross mineral acres referred to as the Willerson lease. In January 2014, Willerson inquired if their lease had terminated due to the failure to achieve production in paying quantities pursuant to the terms of the lease. The Company along with Crimson and Liberty filed a declaratory judgment action in the District Court of Dimmit County in May 2014 seeking a determination from the court that the lease remains valid and in effect. The lessors counterclaimed for breach of contract, trespass, and related causes of action. In January 2016, the lessors filed a third-party petition alleging breach of contract, trespass, and related causes of action against Chesapeake and EXCO Operating Company, LP. The matter has settled in 2017 with the Company's portion of such settlement being \$75,000 plus related legal fees of \$165,000 as reflected in the Company's financial statements under "Professional fees, insurance and other" as of June 30, 2017.

Arbitration of Employment Claim. A former employee has claimed that the Company owes up to \$1.8 million under an Executive Severance and Non-Compete agreement (the "Agreement") due to a change of control and termination of employment without cause. The Agreement requires that any disputes be submitted to binding arbitration and a request for arbitration was submitted by the parties in March 2016. This matter was settled in May 2017 for \$175,000 plus non-essential equipment of \$15,000 as reflected in the Company's financial statements under "Rental and other income/(loss)" as of June 30, 2017.

Contingent Ownership Interests. As of June 30, 2017, the Company had recognized a contingent liability associated with uncertain ownership interests of \$1.5 million. This liability arises when the calculations of respective joint ownership interests by operators differs from the Company's calculations. These differences relate to a variety of matters, including allocation of non-consent interests, complex payout calculations for individual and group wells and the timing of reversionary interests. Accordingly, these matters are subject to legal interpretation and the related obligations are presented as a contingent liability in the accompanying condensed consolidated balance sheet as of June 30, 2017. While the Company has classified this entire amount as a current liability, most of these issues are expected to be resolved through arbitration, mediation or litigation. Due to the complexity of the issues involved, there can be no assurance that the outcome of these contingencies will be resolved within the next twelve months.

Anfield Gain Contingency. In 2007, the Company sold all of its uranium assets for cash and stock of the purchaser, Uranium One Inc. (“Uranium One”). The assets sold included a uranium mill in Utah and unpatented uranium claims in Wyoming, Colorado, Arizona and Utah. Pursuant to the asset purchase agreement, the Company was entitled to additional consideration from Uranium One up to \$40,000 based on, among other things, the performance of the mill, and achievement of commercial production and royalties, however no additional consideration has been received from Uranium One. In August 2014, the Company entered into an agreement with Anfield Resources Inc. (“Anfield”) whereby if Anfield was successful in acquiring the property from Uranium One, Anfield would be released from the future payment obligations stemming from the 2007 sale to Uranium One. On September 1, 2015, Anfield acquired the property from Uranium One and is now obligated to provide the following consideration to the Company:

- Issuance of \$2,500 in Anfield common shares to the Company. The Anfield shares are to be held in escrow and released in tranches over a 36-month period. Pursuant to the agreement, if any of the share issuances result in the Company holding in excess of 20% of the then issued and outstanding shares of Anfield (the “Threshold”), such shares in excess of the Threshold would not be issued at that time, but deferred to the next scheduled share issuance. If, upon the final scheduled share issuance the number of shares to be issued exceeds the Threshold, the value in excess of the Threshold is payable to the Company in cash,
- \$2,500 payable in cash upon 18 months of continuous commercial production, and
- \$2,500 payable in cash upon 36 months of continuous commercial production.

The first tranche of common shares resulted in the issuance of 7,436,505 shares of Anfield with a market value of \$750,000 and such shares were delivered to the Company in September 2015. The second tranche of shares resulted in the issuance of 3,937,652 additional shares of Anfield with a market value of \$750,000, and such shares were delivered to the Company in September 2016. Since the trading volume in Anfield shares has increased, beginning primarily in the quarter ended June 30, 2016, the Company determined a mark-to-market technique would be the most appropriate method to determine the fair value for Anfield shares. The primary factor in using a mark-to-market valuation in determining the fair value of Anfield shares is justified because of the Company’s belief that due to the increased liquidity in the stock, using current market prices for Anfield shares reflects the most accurate fair value calculation. At June 30, 2017, we determined the fair value of the Anfield shares to be approximately \$0.6 million. The timing of any future receipt of cash from Anfield is not determinable and there can be no assurance that any cash will ever be received from Anfield or that the shares received from Anfield will ever be liquidated for cash.

8. SHAREHOLDERS’ EQUITY

Preferred Stock

The Company’s articles of incorporation authorize the issuance of up to 100,000 shares of preferred stock, \$0.01 par value. Shares of preferred stock may be issued with such dividend, liquidation, voting and conversion features as may be determined by the Board of Directors without shareholder approval. As discussed in Note 5, in February 2016 the Board of Directors approved the designation of 50,000 shares of Series A Convertible Preferred Stock in connection with the disposition of the Company’s mining segment.

Warrants

On December 21, 2016, the Company completed a registered direct offering of 1.0 million shares of common stock at a net price of \$1.50 per share. Concurrently, the investors received warrants to purchase 1.0 million shares of Common Stock of the Company at an exercise price of \$2.05 per share, subject to adjustment, for a period of five years from closing. The total net proceeds received by the Company was approximately \$1.32 million. The fair value of the warrants upon issuance was \$1.24 million, with the remaining \$0.08 million being attributed to common stock. The warrants contain a dilutive issuance and other liability provisions which cause the warrants to be accounted for as a liability. Such warrant instruments are initially recorded as a liability and are accounted for at fair value with changes in fair value reported in earnings.

Stock Options

For the six months ended June 30, 2017 and 2016, total stock-based compensation expense related to stock options was \$36,000 and \$43,000 respectively. As of June 30, 2017, there was \$44,000 of unrecognized expense related to unvested stock options, which will be recognized as stock-based compensation expense through January 2018. For the six months ended June 30, 2017, no stock options were granted, exercised, forfeited or expired. Presented below is information about stock options outstanding and exercisable as of June 30, 2017 and December 31, 2016:

	June 30, 2017		December 31, 2016	
	Shares	Price ⁽¹⁾	Shares	Price ⁽¹⁾
Stock options outstanding	390,525	\$ 20.64	390,525	\$ 20.64
Stock options exercisable	381,640	\$ 20.79	376,084	\$ 20.97

(1) Represents the weighted average price.

The following table summarizes information for stock options outstanding and exercisable at June 30, 2017:

Number of Shares	Options Outstanding				Remaining Contractual Term (years)	Options Exercisable	
	Exercise Price Range		Weighted Average	Number of Shares		Weighted Average Exercise Price	
	Low	High					
56,786	\$ 9.00	\$ 9.00	\$ 9.00	7.5	51,231	\$ 9.00	
49,504	12.48	12.48	12.48	6.0	49,504	12.48	
98,396	13.92	17.10	15.01	2.3	98,396	15.01	
185,839	22.62	30.24	29.35	0.6	182,509	29.48	
390,525	\$ 9.00	\$ 30.24	\$ 20.64	2.7	381,640	\$ 20.97	

As of June 30, 2017, no shares are available for future grants under the Company's stock option plans. Based upon the closing price for the Company's common stock of \$0.68 per share on June 30, 2017, there was no intrinsic value related to stock options outstanding as of June 30, 2017.

Restricted Stock Grants

In January 2015, the Board of Directors granted 340,711 shares of restricted stock under the 2012 Equity Plan to four officers of the Company. These shares originally vested annually over a period of three years. However, during 2015 vesting was accelerated for three of the four officers in connection with severance agreements for an aggregate of 240,711 shares. The remaining 100,000 shares vested for 33,333 shares in both January 2016 and January 2017 and the remaining shares will vest for 33,334 shares in January 2018. The fair market value of the 340,711 shares on the date of grant was approximately \$511,000. On September 23, 2016, the Board of Directors granted restricted stock to each member of the Board for 58,500 shares per Board member for an aggregate grant of 351,000 shares. The vesting of the directors' restricted grants was accelerated in May 2017 in connection with the resignations of members of the Company's Board of Directors. The closing price of the Company's common stock on the grant date was \$1.74, which is expected to result in an aggregate compensation charge of \$611,000. For the six months ended June 30, 2017 and 2016, total stock-based compensation expense related to restricted stock grants was \$176,000 and \$25,000 respectively. As of June 30, 2017, there was \$402,000 of unrecognized expense related to unvested restricted stock grants, which will be recognized as stock-based compensation expense through January 2018.

9. INCOME TAXES

For Federal income tax purposes, as of December 31, 2016 the Company had net operating loss and percentage depletion carryovers of approximately \$74.7 million and \$2.5 million, respectively. The net operating loss carryovers may be carried back two years and forward twenty years from the year the net operating loss was generated. The net operating losses may be used to offset future taxable income and expire in varying amounts through 2035. In addition, the Company has alternative minimum tax credit carry-forwards of approximately \$0.7 million which are available to offset future federal income taxes over an indefinite period. The Company has established a valuation allowance for all deferred tax assets including the net operating loss and alternative minimum tax credit carryforwards discussed above since the “more likely than not” realization criterion was not met as of June 30, 2017 and 2016. Accordingly, the Company did not recognize an income tax benefit for the six months ended June 30, 2017 and 2016. Furthermore, the Company projects a net loss for the fiscal year ended December 31, 2017.

The Company recognizes, measures, and discloses uncertain tax positions whereby tax positions must meet a “more-likely-than-not” threshold to be recognized. As of June 30, 2017, gross unrecognized tax benefits are immaterial and there was no change in such benefits during the three months ended June, 2017. The Company does not expect significant increase or decrease to the uncertain tax positions within the next twelve months.

10. EARNINGS (LOSS) PER SHARE

Basic earnings (loss) per share is computed based on the weighted average number of common shares outstanding. The calculation of diluted earnings (loss) per share includes the potential dilutive impact of unvested restricted stock awards and contingently issuable shares during the periods presented, unless their effect is anti-dilutive. For the three and six months ended June 30, 2017 and 2016, common stock equivalents excluded from the calculation of weighted average shares because they were antidilutive are as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017s	2016
Stock options	390,525	390,525 ⁽¹⁾	390,525	390,525 ⁽¹⁾
Unvested shares of restricted common stock	356,555	11,111	356,555	11,141
Outstanding warrants	1,000,000	—	1,000,000	—
Total	1,747,080	401,636	1,747,080	401,666

⁽¹⁾ Includes weighted average number of shares for options and shares of restricted stock issued during the period

11. SIGNIFICANT CONCENTRATIONS

The Company has exposure to credit risk in the event of nonpayment by the joint interest operators of the Company’s oil and gas properties. Approximately 27% of the Company’s proved developed oil and gas reserve quantities are associated with wells that are operated by a single operator (the “Major Operator”). As of June 30, 2017 and December 31, 2016, the Company had a liability to the Major Operator of \$2,667,000 and \$2,710,000 respectively, for accrued operating expenses and overpayments of net revenues when the Major Operator failed to recognize that the Company’s ownership interest reverted after payout was achieved for certain wells during 2014 and 2015. Beginning in the second quarter of 2015, the Major Operator began withholding the Company’s net revenues from all wells that it operates for the Company and management expects the Major Operator will continue to withhold the Company’s net revenues until this liability is paid in full. Based on the oil and gas prices and costs used in the Company’s reserve report as of June 30, 2017, this liability is not expected to be fully settled until the first quarter of 2020, but under higher pricing scenarios the Company expects the liability will be repaid from future production. Accordingly, the aggregate balances are presented as current liabilities in the accompanying consolidated balance sheets.

12. FAIR VALUE MEASUREMENTS

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. In determining fair value, the Company uses various methods including market, income and cost approaches. Based on these approaches, the Company often utilizes certain assumptions that market participants would use in pricing the asset or liability, including assumptions about risk and the risks inherent in the inputs to the valuation technique. These inputs can be readily observable, market corroborated, or generally unobservable inputs. The Company utilizes valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs. Based on the observability of the inputs used in the valuation techniques the Company is required to provide the following information according to the fair value hierarchy. The fair value hierarchy ranks the quality and reliability of the information used to determine fair values. Financial assets and liabilities carried at fair value will be classified and disclosed in one of the following three categories:

Level 1 - Quoted prices for identical assets and liabilities traded in active exchange markets, such as the New York Stock Exchange.

Level 2 - Observable inputs other than Level 1 including quoted prices for similar assets or liabilities, quoted prices in less active markets, or other observable inputs that can be corroborated by observable market data. Level 2 also includes derivative contracts whose value is determined using a pricing model with observable market inputs or can be derived principally from or corroborated by observable market data.

Level 3 - Unobservable inputs supported by little or no market activity for financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation; also includes observable inputs for nonbinding single dealer quotes not corroborated by observable market data.

The Company has processes and controls in place to attempt to ensure that fair value is reasonably estimated. The Company performs due diligence procedures over third-party pricing service providers in order to support their use in the valuation process. Where market information is not available to support internal valuations, independent reviews of the valuations are performed and any material exposures are evaluated through a management review process.

While the Company believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different estimate of fair value at the reporting date. The following is a description of the valuation methodologies used for complex financial instruments measured at fair value:

Marketable Equity Securities Valuation Methodologies

The fair value of available for sale securities is based on quoted market prices obtained from independent pricing services. Accordingly, the Company has classified these instruments as Level 1.

Warrant Valuation Methodologies

The warrants contain a dilutive issuance and other liability provisions which cause the warrants to be accounted for as a liability. Such warrant instruments are initially recorded and valued as a level 3 liability and are accounted for at fair value with changes in fair value reported in earnings.

The Company estimated the value of the warrants issued with the Securities Purchase Agreement on December 31, 2016 to be \$1,030,000, or \$1.03 per warrant, using the Monte Carlo model with the following assumptions: a term expiring June 21, 2022, exercise price of \$2.05, stock price of \$1.28, average volatility rate of 90%, and a risk-free interest rate of 2.01%. The Company re-measured the warrants as of June 30, 2017, using the same Monte Carlo model, using the following assumptions: a term expiring June 21, 2022, exercise price of \$2.05, stock price of \$0.68, average volatility rate of 88%, and a risk-free interest rate of 1.89%. As of June 30, 2017, the fair value of the warrants was \$510,000, or \$0.51 per warrant, and was recorded as a liability on the accompanying consolidated balance sheets. An increase in any of the variables would cause an increase in the fair value of the warrants. Likewise, a decrease in any variable would cause a decrease in the value of the warrants.

Other Financial Instruments

The carrying amount of cash and equivalents, oil and gas sales receivable, other current assets, accounts payable and accrued expenses approximate fair value because of the short-term nature of those instruments. The recorded amounts for the Senior Secured Revolving Credit Facility discussed in Note 6 approximates the fair market value due to the variable nature of the interest rates, and the fact that market interest rates have remained substantially the same since the latest amendment to the credit facility.

Recurring Fair Value Measurements

Recurring measurements of the fair value of assets and liabilities as of June 30, 2017 and December 31, 2016 are as follows:

	June 30, 2017				December 31, 2016			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
Marketable equity securities:								
Sutter Gold Mining Company	\$ 11	\$ —	\$ —	\$ 11	\$ 16	\$ —	\$ —	\$ 16
Anfield Resources, Inc.	611	—	—	611	930	—	—	930
Crude oil price risk derivatives		311	—	311	—	—	—	—
Total	\$ 622	\$ 311	\$ —	\$ 933	\$ 946	\$ —	\$ —	\$ 946
Outstanding warrant liability	\$ —	\$ —	\$ 510	\$ 510	\$ —	\$ —	\$ 1,030	\$ 1,030

The following table presents a reconciliation of changes in assets and liabilities measured at fair value on a recurring basis for the period ended June 30, 2017 and the year ended December 31, 2016.

	Assets			Liabilities	
	Marketable Securities and Derivatives			Warrants (Level 3)	Net
	Sutter (Level 1)	Anfield (Level 1)	Derivatives (Level 2)		
Fair value, December 31, 2016	\$ 16	\$ 930	\$ —	1,030	\$ 1,976
Total net losses included in:					
Other comprehensive loss		(5)	(319)	—	(324)
Fair value adjustments included in net loss:					
Net unrealized gain on warrant fair value adjustment	—	—	—	(520)	(520)
Crude oil price risk derivatives	—	—	311	—	311
Fair value, June 30, 2017	<u>\$ 11</u>	<u>\$ 611</u>	<u>311</u>	<u>510</u>	<u>\$ 1,443</u>

13. SUBSEQUENT EVENTS

On July 26, 2017, for the period beginning January 1, 2018 through December 31, 2018, the Company entered into NYMEX natural gas swap contracts for 500 mcf per day at \$3.01 per mcf.

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

Forward Looking Statements

This Form 10-Q contains "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). All statements other than statements of historical facts included in and incorporated by reference into this Form 10-Q are forward-looking statements. When used in this Form 10-Q, the words "will", "expect", "anticipate", "intend", "plan", "believe", "seek", "estimate" and similar expressions are intended to identify forward-looking statements, although not all forward-looking statements contain these identifying words. Forward-looking statements in this Form 10-Q include statements regarding our expected future revenue, income, production, liquidity, cash flows, reclamation and other liabilities, expenses and capital projects, future capital expenditures and future transactions. Because these forward-looking statements involve risks and uncertainties, actual results could differ materially from those expressed or implied by these forward-looking statements due to a variety of factors, including those associated with our ability to find oil and natural gas reserves that are economically recoverable, the volatility of oil, NGL and natural gas prices, declines in the values of our properties that have resulted in and may in the future result in additional ceiling test write downs, our ability to replace reserves and sustain production, our estimate of the sufficiency of our existing capital sources, our ability to raise additional capital to fund cash requirements for our participation in oil and gas properties and for future acquisitions, the uncertainties involved in estimating quantities of proved oil and natural gas reserves, in prospect development and property acquisitions or dispositions and in projecting future rates of production or future reserves, the timing of development expenditures and drilling of wells, hurricanes and other natural disasters and the operating hazards attendant to the oil and gas and minerals businesses. In particular, careful consideration should be given to cautionary statements made in the "Risk Factors" section of our 2015 Annual Report on Form 10-K and other quarterly reports on Form 10-Q filed with the SEC, all of which are incorporated herein by reference. The Company undertakes no duty to update or revise any forward-looking statements.

General Overview

We are an independent energy company focused on the lease acquisition and development of oil and gas producing properties in the continental United States. Our business is currently focused in South Texas and the Williston Basin in North Dakota. However, we do not intend to limit our focus to these geographic areas. We continue to focus on increasing production, reserves, revenues and cash flow from operations while managing our level of debt.

We currently explore for and produce oil and gas through a non-operator business model; however, we may operate oil and gas properties for our own account and may expand our holdings or operations into other areas. As a non-operator, we rely on our operating partners to propose, permit and manage wells. Before a well is drilled, the operator is required to provide all oil and gas interest owners in the designated well the opportunity to participate in the drilling costs and revenues of the well on a pro-rata basis. After the well is completed, our operating partners also transport, market and account for all production. As discussed in Item 1. Business, our long-term strategic focus is to develop operational capabilities through the pursuit of opportunities to acquire operated properties and/or operatorship of existing properties.

Recent Developments

On July 26, 2017, for the period beginning January 1, 2018 through December 31, 2018, the Company entered into NYMEX natural gas swap contracts for 500 mcf per day at \$3.01 per mcf.

Critical Accounting Policies and Estimates

The preparation of our consolidated financial statements in conformity with generally accepted accounting principles in the United States (“GAAP”) requires us to make assumptions and estimates that affect the reported amounts of assets, liabilities, revenues and expenses, as well as the disclosure of contingent assets and liabilities at the date of our financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results may differ from these estimates under different assumptions or conditions. A summary of our significant accounting policies is detailed in *Note 1 – Organization, Operations and Significant Accounting Policies* in Item 8 of our 2016 Annual Report on Form 10-K filed with the SEC on April 17, 2017.

Recently Issued Accounting Standards

Please refer to the section entitled *Recent Accounting Pronouncements* under *Note 1 – Organization, Operations and Significant Accounting Policies* in the Notes to the Financial Statements included in Item 1 of this report for additional information on recently issued accounting standards and our plans for adoption of those standards.

Results of Operations

Comparison of our Statements of Operations for the Three Months Ended June 30, 2017 and 2016

During the three months ended June 30, 2017, we recorded a net profit of \$0.3 million as compared to a net loss of \$4.2 million for the three months ended June 30, 2016. In the following sections we discuss our revenue, operating expenses, non-operating income, and discontinued operations for the three months ended June 30, 2017 compared to the three months ended June 30, 2016.

Revenue. Presented below is a comparison of our oil and gas sales, production quantities and average sales prices for the three months ended June 30, 2017 and 2016 (dollars in thousands, except average sales prices):

	<u>2017</u>	<u>2016</u>	<u>Change</u>	
			<u>Amount</u>	<u>Percent</u>
Revenue:				
Oil	\$ 1,591	\$ 1,677	\$ (86)	-5%
Gas	<u>401</u>	<u>319</u>	<u>82</u>	<u>26%</u>
Total	<u>\$ 1,992</u>	<u>\$ 1,996</u>	<u>\$ (4)</u>	<u>0%</u>
Production quantities:				
Oil (Bbls)	36,004	43,032	(7,028)	-16%
Gas (Mcf)	134,187	167,897	(33,710)	-20%
BOE	58,369	71,015	(12,646)	-18%
Average sales prices:				
Oil (Bbls)	\$ 44.19	\$ 38.97	\$ 5.22	13%
Gas (Mcf)	2.99	1.90	1.09	57%
BOE	34.13	28.11	6.02	21%

The decrease in our oil sales of \$0.1 million for the three months ended June 30, 2017 as compared to the three months ended June 30, 2016 was primarily the result of a 16% decrease in oil production during the three months ended June 30, 2017. The 13% increase in the average oil price realized partially offset the reduction in our oil production quantity during the three months ended June 30, 2017. The increase in our gas sales of \$0.1 million for the three months June 30, 2017 as compared to the three months ended June 30, 2016 was driven by a 57% increase in the average gas price realized which offset a 20% decrease in our gas production during the three months ended June 30, 2017. The increase in our net realized oil price is reflective of the partial recovery in global commodity prices during the first half of 2017. During the last year, the differential between West Texas Intermediate (“WTI”) quoted prices for crude oil and the prices we realize for sales in the Williston Basin was approximately \$6.00 per barrel lower. We expect this differential to continue (with the amount of the differential varying over time) and that our oil sales revenue will be affected by lower realized prices from this region.

For the three months ended June 30, 2017, we produced 58,369 BOE, or an average of 641 BOE per day, as compared to 71,015 BOE or 780 BOE per day during the comparable period in 2016. This 18% reduction was attributable to several factors, including (i) the normal decline in production for wells in the area of our properties, (ii) the Company did not add significant reserves from drilling or acquisition over the past year, and (iii) the low commodity price environment incentivizes operators to scale back production until prices recover.

Oil and Gas Production Costs . Presented below is a comparison of the Company's oil and gas production costs for the three months ended June 30, 2017 and 2016 (dollars in thousands):

	2017	2016	Change	
			Amount	Percent
Production taxes and other expenses	\$ 267	\$ 271	\$ (4)	-1%
Lease operating expenses	536	1,163	(627)	-54%
Total	<u>\$ 803</u>	<u>\$ 1,434</u>	<u>\$ (631)</u>	-44%

For the three months ended June 30, 2017, production taxes and other expenses slightly decreased compared to the comparable period in 2016. The consistency in production taxes resulted from similar revenues from oil and gas sales. For the three months ended June 30, 2017, lease operating expense decreased by \$0.6 million which was primarily due to the implementation of cost reduction strategies by the operators of our wells. During 2017, we expect cost reduction implementation programs to continue during the prolonged global commodity price downturn.

Depreciation, depletion and amortization. Our DD&A rate for the three months ended June 30, 2017 was \$3.33 per BOE compared to \$12.17 per BOE for the three months ended June 30, 2016. Our DD&A rate can fluctuate as a result of changes in drilling and completion costs, impairments, divestitures, changes in the mix of our production, the underlying proved reserve volumes and estimated costs to drill and complete proved undeveloped reserves. The primary factor that resulted in a reduction in our DD&A rate for the three months ended June 30, 2017 was \$9.6 million of aggregate quarterly impairment charges that resulted from our quarterly Full Cost Ceiling limitations during 2016. During each of the quarters ended March 31, 2016 and June 30, 2016, we recognized impairment charges which reduced the net capitalized costs subject to future DD&A calculations. Accordingly, our DD&A rate per BOE decreased as we reduced the net capitalized costs by the quarterly impairment charges discussed below.

Impairment of oil and gas properties. During the three months ended June 30, 2017 and 2016, we recorded impairment charges related to our oil and gas properties of \$0.0 million and \$2.6 million, respectively, because the net capitalized costs were in excess of the Full Cost Ceiling limitation. These quarterly impairment charges were primarily due to the deepening declines in the price of oil beginning in 2015 and continuing through 2016. Presented below are the weighted average prices (before applying the impact of basis differentials between the benchmark prices and the actual prices realized for our wells) used to prepare our reserve estimates and to calculate our Full Cost Ceiling limitations for each of the last five calendar quarters, along with the impairment charges recognized during each of those quarters (dollars in thousands, except average prices):

	Average Price ⁽¹⁾		Impairment Charge
	Oil (Bbl)	Gas (MMbtu)	
Second quarter of 2016	43.12	2.24	2,611
Third quarter of 2016	41.68	2.28	—
Fourth quarter of 2016	42.75	2.48	—
First quarter of 2017	47.61	2.73	—
Second quarter of 2017	48.95	3.01	—

(1) Represents the trailing 12-month average for benchmark oil and gas prices ending in the last month of the calendar quarter shown.

Our quarterly reserve reports are prepared based on a trailing 12-month average for benchmark oil and gas prices.

General and Administrative Expenses. Presented below is a comparison of our general and administrative expenses for the three months ended June 30, 2017 and 2016 (dollars in thousands):

	2017	2016	Change	
			Amount	Percent
Compensation and benefits, including directors	\$ 178	\$ 172	\$ 6	3%
Stock-based compensation	106	34	72	212%
Professional fees	571	541	30	6%
Insurance, rent and other	136	16	120	750%
Total	\$ 991	\$ 763	\$ 228	30%

General and administrative expenses increased by \$0.2 million for the three months ended June 30, 2017 compared to the three months ended June 30, 2016. This increase was primarily attributable to (i) an increase of \$0.1 million in insurance fees associated with the Company's operations, and (ii) an increase in stock-based compensation which primarily resulted from the amortization of restricted stock grants issued in September 2016.

Non-Operating Income (Expense). Presented below is a comparison of our non-operating income (expense) for the three months ended June 30, 2017 and 2016 (dollars in thousands):

	2017	2016	Change	
			Amount	Percent
Realized gain on oil price risk derivatives	\$ 100	\$ 380	\$ (280)	-73%
Unrealized gain (loss) on oil price risk derivatives	311	(887)	1,198	135%
Rental and other income (expense), net	(131)	(48)	(83)	173%
Warrant revaluation gain	180	—	180	NA
Interest expense	(121)	(75)	(46)	61%
Gain on sale of assets	1	100	(99)	-99%
Total other income (expense)	\$ 340	\$ (530)	\$ 870	164%

During the three months ending June 30, 2017, the Company had a realized gain on oil price risk derivatives of \$0.1 million compared to a gain of \$0.4 million for the comparable period in 2016. The Company had an unrealized gain on oil price risk derivatives of \$0.3 million for the six months ended June 30, 2017 compared to a loss of \$0.9 million for the comparable period for 2016. Unrealized gains or losses result from changes in the fair value of the derivatives as commodity prices increase or decrease. Unrealized losses are also recognized in the month when derivative contracts are settled in cash through the recognition of a realized gain. Similarly, unrealized gains are also recognized in the month when derivative contracts are settled in cash through the recognition of a realized loss.

During the three months ending June 30, 2017, the Company realized an expense of \$0.1 million on rental and other income (expense), an increase of \$0.1 million over the comparable period in 2016. The increased expense was primarily due to an increase in office rental expenses of \$0.1 million incurred during the quarter ending June 30, 2017.

During the three months ending June 30, 2017, we realized a non-cash gain on the revaluation of our outstanding warrants of \$0.2 million. Our warrant liability is accounted for using the mark-to-market accounting method whereby gains and losses from changes in the fair value of derivative instruments are recognized immediately into earnings. No warrants were outstanding for the period ending June 30, 2016. We will continue to revalue our outstanding warrants on a quarterly basis.

Interest expense increased by \$0.05 million during the three months ended June 30, 2017 compared to the comparable period in 2016. The average interest rate increased to 7.23% for the three months ended June 30, 2017 in comparison to 2.95% for the three months ended June 30, 2016.

Discontinued Operations. In February 2016 the Company completed the disposition of our mining segment to Mt. Emmons Mining Company (“MEM”), including the Keystone Mine, the WTP and other related properties. A significant objective for completing the disposition was to improve future profitability through the elimination of the obligations to operate the WTP and mine holding costs, which are expected to result in estimated annual cash savings of \$3.0 million. During the three months ended June 30, 2017 and 2016, we incurred operating expenses associated with the discontinued mining segment of \$0 and \$0.1 million, respectively.

In order to induce MEM to assume the Company’s obligations to operate the WTP we issued additional consideration in the form of 50,000 shares of Series A Convertible Preferred Stock. For the three months ended March 31, 2016, we recorded the fair value of the Preferred Stock based on the initial liquidation preference of \$2.0 million. Since the cash consideration paid by MEM for the Preferred Stock was \$500, we recorded a charge to discontinued operations of approximately \$2.0 million associated with the issuance. There were no charges associated with discontinued operations for the period ended June 30, 2017.

Comparison of our Statements of Operations for the Six Months Ended June 30, 2017 and 2016

During the six months ended June 30, 2017, we recorded a net loss of \$0.4 million as compared to a net loss of \$14.8 million for the six months ended June 30, 2016. Our loss from continuing operations was \$0.4 million for six months ended June 30, 2017 compared to \$12.3 million for the six months ended June 30, 2016. In the following sections we discuss our revenue, operating expenses, non-operating income, and discontinued operations for the six months ended June 30, 2017 compared to the six months ended June 30, 2016.

Revenue. Presented below is a comparison of our oil and gas sales, production quantities and average sales prices for the six months ended June 30, 2017 and 2016 (dollars in thousands, except average sales prices):

	2017	2016	Change	
			Amount	Percent
Revenue:				
Oil	\$ 2,830	\$ 2,541	\$ 289	11%
Gas	909	521	388	74%
Total	<u>\$ 3,739</u>	<u>\$ 3,062</u>	<u>\$ 677</u>	22%
Production quantities:				
Oil (Bbls)	65,040	82,680	(17,640)	-21%
Gas (Mcf)	259,282	233,776	25,506	11%
BOE	108,253	121,643	(13,390)	-11%
Average sales prices:				
Oil (Bbls)	\$ 43.51	\$ 30.73	\$ 12.78	42%
Gas (Mcf)	3.51	2.23	1.28	57%
BOE	34.54	25.17	9.37	37%

The increase in our oil sales of \$0.3 million for the six months ended June 30, 2017 as compared to the six months ended June 30, 2016 was primarily the result of a 42% increase in the average oil price realized during the six months ended June 30, 2017. The increase in the average oil price realized offset a 21% reduction in our oil production quantity during the six months ended June 30, 2017. The increase in our gas sales of \$0.4 million for the six months ended June 30, 2017 as compared to the six months ended June 30, 2016 was driven by a 57% increase in the average gas price realized during the six months ended June 30, 2017 combined with a 11% increase in our gas production quantity for the same period. The increase in our net realized commodity prices is reflective of the partial recovery in global commodity prices during the first half of 2017. During the last year, the differential between West Texas Intermediate (“WTI”) quoted prices for crude oil and the prices we realize for sales in the Williston Basin was approximately \$6.00 per barrel lower. We expect this differential to continue (with the amount of the differential varying over time) and that our oil sales revenue will be affected by lower realized prices from this region.

For the six months ended June 30, 2017, we produced 108,253 BOE, or an average of 598 BOE per day, as compared to 121,643 BOE or 667 BOE per day during the comparable period in 2016. This 11% reduction was attributable to several factors, including (i) the normal decline in production for wells in the area of our properties, (ii) the Company did not add significant reserves from drilling or acquisition over the past year, and (iii) the low price environment incentivizes operators to scale back production until prices recover.

Oil and Gas Production Costs. Presented below is a comparison of our oil and gas production costs for the six months ended June 30, 2017 and 2016 (dollars in thousands):

	<u>2017</u>	<u>2016</u>	<u>Change</u>	
			<u>Amount</u>	<u>Percent</u>
Production taxes and other expenses	\$ 620	\$ 480	\$ 140	29%
Lease operating expenses	1,236	1,984	(748)	-37%
Total	<u>\$ 1,856</u>	<u>\$ 2,464</u>	<u>\$ (608)</u>	<u>-25%</u>

For the six months ended June 30, 2017, production taxes and other expenses increased by \$0.1 million compared to the comparable period in 2016. Substantially all of this increase in production taxes resulted from increased oil and gas sales. For the six months ended June 30, 2017, lease operating expense decreased by \$0.7 million which was primarily due to the implementation of cost reduction strategies by the operators of our wells. During 2017, we expect cost reduction implementation programs to continue during the prolonged global commodity price downturn.

Depreciation, depletion and amortization. Our DD&A rate for the six months ended June 30, 2017 was \$4.21 per BOE compared to \$13.53 per BOE for the six months ended June 30, 2016. Our DD&A rate can fluctuate as a result of changes in drilling and completion costs, impairments, divestitures, changes in the mix of our production, the underlying proved reserve volumes and estimated costs to drill and complete proved undeveloped reserves. The primary factor that resulted in a reduction in our DD&A rate for the six months ended June 30, 2017 was \$9.6 million of aggregate quarterly impairment charges that resulted from our quarterly Full Cost Ceiling limitations during 2016. During each of the quarters ended March 31, 2016 and June 30, 2016, we recognized impairment charges which reduced the net capitalized costs subject to future DD&A calculations. Accordingly, our DD&A rate per BOE decreased as we reduced the net capitalized costs by the quarterly impairment charges discussed below.

Impairment of oil and gas properties. During the six months ended June 30, 2017 and 2016, we recorded impairment charges related to our oil and gas properties of \$0.0 million and \$9.6 million, respectively, because the net capitalized costs were in excess of the Full Cost Ceiling limitation. These quarterly impairment charges were primarily due to the deepening declines in the price of oil beginning in 2015 and continuing through 2016. Presented below are the weighted average prices (before applying the impact of basis differentials between the benchmark prices and the actual prices realized for our wells) used to prepare our reserve estimates and to calculate our Full Cost Ceiling limitations for each of the last five calendar quarters, along with the impairment charges recognized during each of those quarters (dollars in thousands, except average prices):

General and Administrative Expenses. Presented below is a comparison of our general and administrative expenses for the six months ended June 30, 2017 and 2016 (dollars in thousands):

	<u>2017</u>	<u>2016</u>	<u>Change</u>	
			<u>Amount</u>	<u>Percent</u>
Compensation and benefits, including directors	\$ 354	\$ 311	\$ 43	14%
Stock-based compensation	212	68	144	212%
Professional fees	1,350	768	582	76%
Insurance, rent and other	237	183	54	30%
Total	<u>\$ 2,153</u>	<u>\$ 1,330</u>	<u>\$ 823</u>	<u>62%</u>

General and administrative expenses increased by \$0.8 million for the six months ended June 30, 2017 compared to the six months ended June 30, 2016. This increase was primarily attributable to (i) an increase of \$0.6 million in professional fees as we replaced some of the services previously performed by employees with consultants combined with a legal settlement on the Willerson lease (See Note 7 Commitments and Contingencies), and (ii) an increase in stock-based compensation which primarily resulted from the amortization of restricted stock grants issued in September 2016.

Non-Operating Income (Expense). Presented below is a comparison of our non-operating income (expense) for the six months ended June 30, 2017 and 2016 (dollars in thousands):

	2017	2016	Change	
			Amount	Percent
Realized gain on oil price risk derivatives	\$ 100	\$ 1,262	\$ (1,162)	-92%
Unrealized gain (loss) on oil price risk derivatives	311	(1,460)	1,771	121%
Rental and other income (expense), net	(347)	(79)	(268)	339%
Warrant revaluation gain	520	—	520	NA
Interest expense	(246)	(247)	1	0%
Gain on sale of assets	1	100	(99)	-99%
Total other income (expense)	<u>\$ 339</u>	<u>\$ (424)</u>	<u>\$ 763</u>	<u>180%</u>

During the six months ending June 30, 2017, the Company had a realized gain on oil price risk derivatives of \$0.1 million and of \$1.3 million for the comparable period in 2016. We have an unrealized gain on oil price risk derivatives of \$0.3 million for the six months ended June 30, 2017 compared to a loss of \$1.5 million for the comparable period for 2016. Unrealized gains or losses result from changes in the fair value of the derivatives as commodity prices increase or decrease. Unrealized losses are also recognized in the month when derivative contracts are settled in cash through the recognition of a realized gain. Similarly, unrealized gains are also recognized in the month when derivative contracts are settled in cash through the recognition of a realized loss.

During the six months ending June 30, 2017, the Company realized an expense of \$0.3 million on rental and other income (expense), an increase of \$0.3 million over the comparable period in 2016. The increased expense was primarily due to an increase in office rental expenses of \$0.1 million combined with a \$0.2 million settlement associated with a former employee claim. Please refer to Note 7 entitled “Commitment and Contingencies” for more information.

During the six months ending June 30, 2017, we realized a non-cash gain on the revaluation of our outstanding warrants of \$0.5 million. Our warrant liability is accounted for using the mark-to-market accounting method whereby gains and losses from changes in the fair value of derivative instruments are recognized immediately into earnings. No warrants were outstanding for the six month period ending June 30, 2016. We will continue to revalue our outstanding warrants on a quarterly basis.

Interest expense decreased by a non-material amount during the six months ended June 30, 2017 compared to the comparable period in 2016. The decrease was attributable to the one-time amortization of a debt issuance cost that was recognized in the six month period ended June 30, 2016. The one-time amortization cost was offset by an increase in the average interest rate to 7.23% for the six months ended June 30, 2017.

Discontinued Operations. In February 2016 we completed the disposition of our mining segment to Mt. Emmons Mining Company (“MEM”), including the Keystone Mine, the WTP and other related properties. A significant objective for completing the disposition was to improve future profitability through the elimination of the obligations to operate the WTP and mine holding costs, which are expected to result in estimated annual cash savings of \$3.0 million. During the six months ended June 30, 2017 and 2016, we incurred operating expenses associated with the discontinued mining segment of \$0 and \$0.4 million, respectively.

In order to induce MEM to assume the Company's obligations to operate the WTP we issued additional consideration in the form of 50,000 shares of Series A Convertible Preferred Stock. For the three months ended March 31, 2016, we recorded the fair value of the Preferred Stock based on the initial liquidation preference of \$2.0 million. Since the cash consideration paid by MEM for the Preferred Stock was \$500, we recorded a charge to discontinued operations of approximately \$2.0 million associated with the issuance. There were no charges associated with discontinued operations for the six month period ended June 30, 2017.

Non-GAAP Financial Measures- Adjusted EBITDAX

Adjusted EBITDAX represents income (loss) from continuing operations as further modified to eliminate impairments, depreciation, depletion and amortization, stock-based compensation expense, loss on investments and other non-operating income or expense, income taxes, unrealized derivative gains and losses, interest expense, exploration expense, and other items set forth in the table below. Adjusted EBITDAX excludes certain items that we believe affect the comparability of operating results and can exclude items that are generally one-time in nature or whose timing and/or amount cannot be reasonably estimated.

Adjusted EBITDAX is a non-GAAP measure that is presented because we believe it provides useful additional information to investors and analysts as a performance measure. In addition, adjusted EBITDAX is widely used by professional research analysts and others in the valuation, comparison, and investment recommendations of companies in the oil and gas exploration and production industry, and many investors use the published research of industry research analysts in making investment decisions. Adjusted EBITDAX should not be considered in isolation or as a substitute for net income (loss), income (loss) from operations, net cash provided by operating activities, or profitability or liquidity measures prepared under GAAP. Because adjusted EBITDAX excludes some, but not all items that affect net income (loss) and may vary among companies, the adjusted EBITDAX amounts presented may not be comparable to similar metrics of other companies.

The following table provides reconciliations of income (loss) from continuing operations to adjusted EBITDAX for the three and six months ended June 30, 2017 and 2016:

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2017	2016	2017	2016
Income (loss) from continuing operations (GAAP)	\$ 336	\$ (4,206)	\$ (404)	\$ (12,370)
Impairment of oil and gas properties	—	2,611	—	9,568
Depreciation, depletion and amortization:				
Oil and gas operations	202	864	473	1,646
Other		36		72
Unrealized (gain) loss on oil price risk derivatives	(311)	887	(311)	1,460
Stock-based compensation	106	34	212	68
Gain on sale of assets	(1)	(100)	(1)	100
Rental and other income (expense), net	131	48	347	79
Warrant Fair Value Adjustment (gain) loss	(180)		(520)	
Interest expense	121	69	246	247
Adjusted EBITDAX (Non-GAAP)	\$ 404	\$ 243	\$ 42	\$ 870

Liquidity and Capital Resources

The following table sets forth certain measures of our liquidity as of June 30, 2017 and December 31, 2016:

	<u>2017</u>	<u>2016</u>	<u>Change</u>
Cash and equivalents	\$ 1,987	\$ 2,518	\$ (531)
Working capital deficit ⁽¹⁾	(435)	(6,043)	5,608
Total assets	15,800	16,767	(967)
Outstanding debt under Credit Facility	6,000	6,000	—
Borrowing base under Credit Facility	6,000	6,000	—
Total shareholders' equity	3,241	3,758	(517)
Select Ratios			
Current ratio ⁽²⁾	0.91 to 1.00	0.45 to 1.00	
Debt to equity ratio ⁽³⁾	1.86 to 1.00	1.59 to 1.00	

(1) Working capital deficit is computed by subtracting total current liabilities from total current assets.

(2) The current ratio is computed by dividing total current assets by total current liabilities.

(3) The debt to equity ratio is computed by dividing total debt by total shareholders' equity.

As of June 30, 2017, we have a working capital deficit of \$0.4 million compared to a working capital deficit of \$6.0 million as of December 31, 2016, an increase of \$5.6 million. This increase was primarily attributable to a reclassification of the Company's Credit Facility as a long term liability. The reclassification offset a reduction in cash by \$0.5 million, primarily driven by an increase in professional service fees and an accrual for the settlement of the Employee Arbitration (See Note 7 Commitments and Contingencies).

On May 2, 2017, the Amended and Restated Credit Agreement, dated July 30, 2010 between U.S. Energy Corp.'s wholly-owned subsidiary, Energy One and Wells Fargo Bank N.A. was sold, assigned and transferred to APEG Energy II, L.P. ("APEG") (the "Credit Agreement"). APEG purchased and assumed all of Wells Fargo's rights and obligations as the lender to Energy One under the Credit Agreement. Concurrently, U.S. Energy Corp., Energy One and APEG entered into a Limited Forbearance Agreement dated May 2, 2017. On June 28, 2017, U.S. Energy Corp., Energy One and APEG entered into a Fifth Amendment to the Credit Agreement providing for, among other things, an extension of the maturity date to July 19, 2019, new financial coverage ratio covenants and a limited release and waiver with respect to any historical Company non-compliance with any and all financial covenants. The Company is currently forecasted to remain in compliance with all covenants throughout the life of the credit facility and believes the multi-year extension to the maturity date will provide the parties sufficient time to work towards a long-term solution that enables the Company to execute its operational strategy and ensure value for existing shareholders. As of June 30, 2017, the Company was in compliance with all financial covenants and fully conforming with all requirements under its credit agreement. Accordingly, the entire balance of \$6.0 million has been classified as a long-term liability.

During 2015 and 2014, we received significant overpayments due to an operator's failure to timely recognize the payout implications of our joint operating agreements. During the second quarter of 2015, the operator corrected its records and has elected to begin withholding the net revenues from all of our wells that it operates to recover these overpayments. As of June 30, 2017, the balance of the overpayment was approximately \$2.7 million. Based on the oil and gas prices and costs used in the Company's reserve report as of June 30, 2017, this liability is not expected to be fully settled until the first quarter of 2020, but under higher pricing scenarios we expect the entire liability will be repaid sooner. The aggregate balances are presented as current liabilities in our consolidated balance sheets.

We believe certain operators have failed to allocate our share of non-consent ownership interests which results in contingent liabilities to the extent we have not been billed for our proportionate share of such interests, and contingent assets to the extent that we have not received our share of the net revenues. We record net contingent liabilities for the obligations that we believe are probable which amounted to \$1.5 million as of June 30, 2017. The ultimate resolution of these uncertainties about our working interests and net revenue interests can extend over a long period of time and the Company cannot provide any assurance that these matters will be resolved within the next year.

As of June 30, 2017, we had cash and equivalents of \$2.0 million, and we expect to maintain cash balances in this range for some time. We also expect potential investors and lenders will find our singular industry focus, combined with attractive producing properties and a low-cost overhead structure to be an attractive vehicle to partner with the Company during this continued industry downturn and low commodity price environment. Additionally, our long-term strategy is to acquire additional oil and gas properties at attractive prices. However, there can be no assurance that we will be able to complete future transactions on acceptable terms or at all.

If we have unanticipated needs for financing in 2017, alternatives that we will consider if necessary include selling or joint venturing an interest in some of our oil and gas assets, selling our real estate assets in Wyoming, selling our marketable equity securities, issuing shares of our common stock for cash or as consideration for acquisitions, and other alternatives, as we determine how to best fund our capital programs and meet our financial obligations. Our capital expenditure plan and our ability to obtain sufficient funding to make anticipated capital expenditures and satisfy our financial obligations are subject to numerous risks and uncertainties, including those discussed in *Risk Factors* in our 2016 Annual Report on Form 10-K filed on April 17, 2017.

Cash Flows

The following table summarizes our cash flows for the six months ended June 30, 2017 and 2016 (in thousands):

	<u>2017</u>		<u>2016</u>		<u>Change</u>
Net cash provided by (used in):					
Operating activities	\$ (533)	\$	(1,434)	\$	901
Investing activities	2		(86)		88
Financing activities	—		(26)		26
Discontinued operations	—		(448)		448

Operating Activities. Cash used in operating activities for the six months ended June 30, 2017 was \$0.5 million as compared to cash used by operated activities \$1.4 million for the comparable period in 2016, an improvement of \$0.9 million. The improvement is primarily attributed to one time severance agreements with previous employees being paid in the period ended June 30, 2016.

Investing Activities. Cash used in investing activities for the six months ended June 30, 2017 was \$2,000 as compared to cash used in investing activities of \$0.1 million for the comparable period in 2016. The primary use of cash in our investing activities for 2017 was for capital workovers for our oil and gas drilling activities.

Financing Activities. For the six months ended June 30, 2017, we had no cash flow from financing compared to June 30, 2016 of a nominal amount received for the issuance of Series A Convertible Preferred Stock.

Discontinued Operations. We had no cash used for discontinued operations for the six months ended of June 30, 2017. Cash used in discontinued operations was \$0.4 million for the six months ended June 30, 2016.

Off-balance Sheet Arrangements

As part of our ongoing business, we have not participated in transactions that generate relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities (“SPEs”), which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes.

We evaluate our transactions to determine if any variable interest entities exist. If it is determined that we are the primary beneficiary of a variable interest entity, that entity will be consolidated in our consolidated financial statements. We have not been involved in any unconsolidated SPE transactions during the periods covered by this report.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

As a smaller reporting company, we are not required to provide the information under this Item.

Item 4. Controls and Procedures**Evaluation of Disclosure Controls and Procedures**

Based on an evaluation of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act), as of the end of our quarter ended June 30, 2017, our Chief Executive Officer and Principal Financial Officer determined that our controls were not adequate due to a vacancy in certain accounting and finance consulting positions that the Company has historically utilized to implement the Company's review of key controls in a timely manner. A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the Company's annual or interim financial statements will not be prevented or detected on a timely basis. Accordingly, based on this material weakness, our Chief Executive Officer and Principal Financial Officer concluded that our disclosure controls and procedures were not effective as of the end of the period covered by this Quarterly Report on Form 10-Q, June 30, 2017 as it relates to the timely implementation of the Company's review of key controls.

The Company has addressed this weakness by filling the consulting vacancy with professionals with experience in implementing a full review of key controls on an ongoing basis.

Changes in Internal Control over Financial Reporting

During the fiscal quarter ended June 30, 2017, there have been no changes in our internal control over financial reporting 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

Except as set forth above in Note 7 to the Financial Statements, there have been no material changes from the legal proceedings as previously disclosed in Item 3 of our 2016 Annual Report on Form 10-K.

Item 1A. Risk Factors.

As a smaller reporting company, we are not required to provide the information under this Item.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

Not applicable.

Item 3. Defaults Upon Senior Securities.

Not applicable.

Item 4. Mine Safety Disclosures.

Not applicable.

Item 5. Other Information.

Not applicable.

Item 6. Exhibits

10.1*	Fifth Amendment to Credit Agreement with APEG ENERGY II L.P.
31.1*	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes – Oxley Act of 2002
31.2*	Certification of principal financial officer pursuant to Section 302 of the Sarbanes – Oxley Act of 2002
32.1*†	Certification under Rule 13a-14(b) of Chief Executive Officer and principal financial officer
101.INS	XBRL Instance Document
101.SCH	XBRL Schema Document
101.CAL	XBRL Calculation Linkbase Document
101.DEF	XBRL Definition Linkbase Document
101.LAB	XBRL Label Linkbase Document
101.PRE	XBRL Presentation Linkbase Document

* Filed herewith.

Δ Exhibit constitutes a management contract or compensatory plan or agreement.

† In accordance with SEC Release 33-8238, Exhibit 32.1 is being furnished and not filed.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

U.S. ENERGY CORP. (Registrant)

Date: August 14, 2017

By: /s/ David A. Veltri
DAVID A. VELTRI, Chief Executive Officer

Date: August 14, 2017

By: /s/ Ryan L. Smith
RYAN L. SMITH, Chief Financial Officer

FIFTH AMENDMENT

to

CREDIT AGREEMENT

among

ENERGY ONE LLC ,
as Borrower,

THE GUARANTOR PARTY HERETO,

APEG ENERGY II, L.P. ,
as Administrative Agent and Sole Lender,

FIFTH AMENDMENT TO CREDIT AGREEMENT

This FIFTH AMENDMENT TO CREDIT AGREEMENT (this “Fifth Amendment”) dated as of June 28, 2017, is among ENERGY ONE LLC, a limited liability company duly formed and existing under the laws of the State of Wyoming (the “Borrower”); the undersigned Guarantor (the “Guarantor”) and collectively with the Borrower, the “Obligors”); and APEG ENERGY II L.P. , as administrative agent for the Lender (in such capacity, together with its successors, the “Administrative Agent”).

Recitals

- A. The Borrower, the Administrative Agent and the Lender are parties to that certain Credit Agreement dated as of July 30, 2010 (as amended by the First Amendment to Credit Agreement dated April 10, 2012, the Second Amendment to Credit Agreement dated July 23, 2013, the Third Amendment to Credit Agreement dated as of July 16, 2015, and the Fourth Amendment to Credit Agreement dated as of August 11, 2016, the “Credit Agreement”), pursuant to which the Lender has made certain credit available to and on behalf of the Borrower.
- B. The Borrower and the Guarantor are parties to that certain Guarantee and Pledge Agreement, dated as of July 30, 2010, made by the Borrower and each of the other Obligors party thereto in favor of the Administrative Agent (the “Guarantee and Pledge Agreement”).
- C. The Borrower, the Administrative Agent and the Lenders have agreed to amend certain provisions of the Credit Agreement as more fully set forth herein.
- D. NOW, THEREFORE, in consideration of the premises and the mutual covenants herein contained, for good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the parties hereto agree as follows:

Section 1. Defined Terms. Each capitalized term which is defined in the Credit Agreement, but which is not defined in this Fifth Amendment, shall have the meaning ascribed such term in the Credit Agreement. Unless otherwise indicated, all section and schedule references in this Fifth Amendment refer to sections or schedules of the Credit Agreement.

Section 2. Amendments to Credit Agreement.

2.1 Amendments to Section 1.02.

- (a) The following definitions are hereby amended and restated in its entirety to read as follows:

“Agreement” means this Credit Agreement, as amended by the First Amendment, the Second Amendment, the Third Amendment, the Fourth Amendment and the Fifth Amendment, as the same may from time to time be further amended, modified, supplemented or restated.

“Maturity Date” means July 30, 2019.

- (b) The following definitions are hereby added where alphabetically appropriate to read as follows:

“Fifth Amendment” means that certain Fifth Amendment to Credit Agreement, dated as of June 20, 2017, among the Borrower, the Guarantor, the Administrative Agent and the Lender party thereto.

“Fifth Amendment Effective Date” has the meaning ascribed to such term in the Fifth Amendment.

“PDP Coverage Ratio” means, as of any date of determination, the ratio of (a) the Borrower’s and the Guarantors’ Total PDP PV-10 as of such date to (b) Net Senior Secured Debt as of such date.

“Proved Reserves” means “Proved Reserves” as defined in the Definitions for Oil and Gas Reserves (in this paragraph, the “Definitions”) promulgated by the Society of Petroleum Engineers (or any generally recognized successor) as in effect at the time in question. “Proved Developed Producing Reserves” or “PDP” means Proved Reserves which are categorized as both “Developed” and “Producing” in the Definitions, “Proved Developed Nonproducing Reserves” means Proved Reserves which are categorized as both “Developed” and “Nonproducing” in the Definitions, “Proved Developed Reserves” means the sum of Proved Developed Producing Reserves and Proved Developed Nonproducing Reserves, and “Proved Undeveloped Reserves” means Proved Reserves which are categorized as “Undeveloped” in the Definitions.

“Total PDP PV-10” means, for any Person or group of Persons, the present value of estimated future revenues less severance and ad valorem taxes, operating, gathering, transportation and marketing expenses and capital expenditures from the production of Proved Developed Producing Reserves on such Person’s or such group’s Oil and Gas Properties as set forth in the most recent Reserve Report delivered pursuant hereto, calculated in accordance with the SEC guidelines and using the Five-Year Strip Price without giving effect to non-property related expenses such as general and administrative expenses, debt service, future income tax expense and depreciation, depletion and amortization, and discounted using an annual discount rate of 10% all as reasonably acceptable to the Administrative Agent. Total PDP PV-10 shall be adjusted to give effect to any Secured Swap Agreements then in effect discounted at 10%. The Total PDP PV-10 shall be calculated on a pro forma basis, giving effect to (a) acquisitions and dispositions of Oil and Gas Properties consummated by the Borrower and the Subsidiaries (provided that in the case of any acquisition, the Administrative Agent shall have received a Reserve Report, in form and substance reasonably satisfactory to it, evaluating the Proved Developed Producing Reserves subject thereto); (b) the Liquidation of any Swap Agreements to which the Borrower or any Subsidiary is a party, in each case, occurring since the date of the Reserve Report most recently delivered pursuant to Section 8.12; and (c) the Proved Developed Producing Reserves attributable to production from any completed and fully paid wells that have commenced and flowed into sales during the 60 day period after the measurement date, subject to such Proved Developed Producing Reserve assessment being prepared by an Approved Petroleum Engineer.

2.2 Amendment to Section 9.01. Section 9.01 is hereby amended and restated in its entirety to read as follows:

- (a) PDP Coverage Ratio. The Borrower will not permit, as of the last day of any fiscal quarter ending on or after June 30, 2017, the PDP Coverage Ratio to be less than 1.2 to 1.0.
- (b) Current Ratio. The Borrower will not permit, as of the last day of any fiscal quarter ending on or after June 30, 2017, its ratio of (i) consolidated current assets (including the unused amount of the total Commitments, but excluding non-cash assets under the equivalent of FAS 133 under GAAP) to (ii) consolidated current liabilities (excluding non-cash obligations under the equivalent of FAS 133 under GAAP and amounts outstanding under this Agreement) to be less than 1.0 to 1.0. The outstanding amounts under the categories titled “Payable to Major Operator” and “Contingent ownership interests” on the Guarantor’s financial statements shall not be included in any covenant calculation.

Section 3. Amendment to Section 3.02. Section 3.02 is hereby amended and restated in its entirety to read as follows:

- (a) Interest Rate. Commencing on the Effective Date, Borrower shall pay to Administrative Agent, for the benefit of the Lender on a pro rata basis accrued interest on the outstanding principal balance of the Loans on the last Business Day of each calendar month. Commencing on the Effective Date, interest shall accrue and be payable on the outstanding principal balance of the Loans at a rate per annum equal to 875 basis points (8.75%), but in no event to exceed the Highest Lawful Rate.
- (b) Interest Rate Computations. All interest hereunder shall be computed on the basis of a year of 360 days, unless such computation would exceed the Highest Lawful Rate, in which case interest shall be computed on the basis of a year of 365 days (or 366 days in a leap year).

Section 4. Conditions Precedent. This Fifth Amendment shall become effective on the date (such date, the “Fifth Amendment Effective Date”) when each of the following conditions is satisfied:

4.1 The Administrative Agent shall have received from the Lender and the Borrower counterparts (in such number as may be requested by the Administrative Agent) of this Fifth Amendment signed on behalf of such Persons.

The Administrative Agent is hereby authorized and directed to declare this Fifth Amendment to be effective (and the Fifth Amendment Effective Date shall occur) when it has received documents confirming or certifying, to the satisfaction of the Administrative Agent, compliance with the conditions set forth in this Section 4. Such declaration shall be final, conclusive and binding upon all parties to the Credit Agreement for all purposes.

Section 5. Limited Waivers

The Borrower has requested that the Lenders waive, and the Lenders do hereby provide a waiver of non-compliance, for the Borrower’s failure to comply with any and all financial covenants for all historical quarterly financial reporting periods through March 31, 2017.

Except as expressly waived herein, all covenants, obligations and agreements of the Borrower and each Guarantor contained in the Credit Agreement and the other Loan Documents shall remain in full force and effect in accordance with their terms. Without limitation of the foregoing, the foregoing waivers are hereby granted to the extent and only to the extent specifically stated herein and for no other purpose and shall not be deemed to (a) be a consent or agreement to, or waiver or modification of, or amendment to, any other term or condition of the Credit Agreement, any other Loan Document or any of the documents referred to therein, (b) except as expressly set forth herein, prejudice any right or rights which the Administrative Agent or the Lenders may now have or may have in the future under or in connection with the Credit Agreement, any other Loan Document or any of the documents referred to therein, or (c) constitute any course of dealing or other basis for altering any obligation of the Borrower or any Guarantor or any right, privilege or remedy of the Administrative Agent or the Lenders under the Credit Agreement, the other Loan Documents, or any other contract or instrument. Granting the waivers set forth herein does not and should not be construed to be an assurance or promise that consents or waivers will be granted in the future, whether for the matters herein stated or on other unrelated matters.

Section 6. Miscellaneous.

6.1 Confirmation. The provisions of the Credit Agreement, as amended by this Fifth Amendment, shall remain in full force and effect following the Fifth Amendment Effective Date.

6.2 Ratification and Affirmation; Representations and Warranties. Each Obligor hereby: (a) acknowledges the terms of this Fifth Amendment; (b) ratifies and affirms its obligations under, and acknowledges its continued liability under, each Loan Document and agrees that each Loan Document remains in full force and effect as expressly amended hereby; (c) agrees that from and after the Fifth Amendment Effective Date each reference to the Credit Agreement in the other Loan Documents shall be deemed to be a reference to the Credit Agreement, as amended by this Fifth Amendment; and (d) represents and warrants to the Lender that as of the date hereof, after giving effect to the terms of this Fifth Amendment: (i) all of the representations and warranties contained in each Loan Document are true and correct, except to the extent any such representations and warranties are expressly limited to an earlier date, in which case, such representations and warranties shall continue to be true and correct as of such specified earlier date, (ii) no Default or Event of Default has occurred and is continuing and (iii) no event, development or circumstance has occurred or shall then exist that has resulted in, or could reasonably be expected to have, a Material Adverse Effect.

6.3 Counterparts. This Fifth Amendment may be executed by one or more of the parties hereto in any number of separate counterparts, and all of such counterparts taken together shall be deemed to constitute one and the same instrument. Delivery of an executed counterpart of a signature page of this Fifth Amendment by telecopy, facsimile or email transmission shall be effective as delivery of a manually executed counterpart of this Fifth Amendment.

6.4 No Oral Agreement. This Fifth Amendment, the Credit Agreement, the Guaranty and Pledge Agreement and the other Loan Documents executed in connection herewith and therewith represent the final agreement between the parties and may not be contradicted by evidence of prior, contemporaneous, or oral agreements of the parties. There are no oral agreements between the parties.

6.5 GOVERNING LAW. THIS FIFTH AMENDMENT SHALL BE GOVERNED BY, AND CONSTRUED IN ACCORDANCE WITH, THE LAWS OF THE STATE OF TEXAS.

6.6 Payment of Expenses. In accordance with Section 12.03, the Borrower agrees to pay or reimburse the Administrative Agent for all of its reasonable out-of-pocket costs and reasonable expenses incurred in connection with this Fifth Amendment, any other documents prepared in connection herewith and the transactions contemplated hereby, including, without limitation, the reasonable fees and disbursements of counsel to the Administrative Agent.

6.7 Severability. Any provision of this Fifth Amendment which is prohibited or unenforceable in any jurisdiction shall, as to such jurisdiction, be ineffective to the extent of such prohibition or unenforceability without invalidating the remaining provisions hereof, and any such prohibition or unenforceability in any jurisdiction shall not invalidate or render unenforceable such provision in any other jurisdiction.

6.8 Successors and Assigns. This Fifth Amendment shall be binding upon and inure to the benefit of the parties hereto and their respective successors and assigns.

6.9 Loan Document. This Fifth Amendment is a "Loan Document" as defined and described in the Credit Agreement, and all of the terms and provisions of the Credit Agreement relating to Loan Documents shall apply hereto.

6.10 **RELEASE**. FOR GOOD AND VALUABLE CONSIDERATION, THE RECEIPT AND SUFFICIENCY OF WHICH ARE HEREBY ACKNOWLEDGED, EACH OBLIGOR HEREBY, FOR ITSELF AND ITS SUCCESSORS AND ASSIGNS, FULLY AND WITHOUT RESERVE, RELEASES AND FOREVER DISCHARGES EACH LENDER, THE ARRANGER, THE ISSUING BANK, AND EACH OF THEIR RESPECTIVE SUCCESSORS AND ASSIGNS, OFFICERS, DIRECTORS, EMPLOYEES, REPRESENTATIVES, TRUSTEES, ATTORNEYS, AGENTS, ADVISORS (INCLUDING ATTORNEYS, ACCOUNTANTS AND EXPERTS) AND AFFILIATES (COLLECTIVELY THE “ **RELEASED PARTIES** ” AND INDIVIDUALLY A “ **RELEASED PARTY** ”) FROM ANY AND ALL ACTIONS, CLAIMS, DEMANDS, CAUSES OF ACTION, JUDGMENTS, EXECUTIONS, SUITS, DEBTS, LIABILITIES, COSTS, DAMAGES, EXPENSES OR OTHER OBLIGATIONS OF ANY KIND AND NATURE WHATSOEVER, KNOWN OR UNKNOWN, DIRECT AND/OR INDIRECT, AT LAW OR IN EQUITY, WHETHER NOW EXISTING OR HEREAFTER ASSERTED (INCLUDING, WITHOUT LIMITATION, ANY OFFSETS, REDUCTIONS, REBATEMENT, CLAIMS OF USURY OR CLAIMS WITH RESPECT TO THE NEGLIGENCE OF ANY RELEASED PARTY), FOR OR BECAUSE OF ANY MATTERS OR THINGS OCCURRING, EXISTING OR ACTIONS DONE, OMITTED TO BE DONE, OR SUFFERED TO BE DONE BY ANY OF THE RELEASED PARTIES, IN EACH CASE, ON OR PRIOR TO THE FIFTH AMENDMENT EFFECTIVE DATE AND ARE IN ANY WAY DIRECTLY OR INDIRECTLY ARISING OUT OF OR IN ANY WAY CONNECTED TO ANY OF THIS FIFTH AMENDMENT, THE CREDIT AGREEMENT, ANY OTHER LOAN DOCUMENT OR ANY OF THE TRANSACTIONS CONTEMPLATED HEREBY OR THEREBY (COLLECTIVELY, THE “ **RELEASED MATTERS** ”). EACH OBLIGOR, BY EXECUTION HEREOF, HEREBY ACKNOWLEDGES AND AGREES THAT THE AGREEMENTS IN THIS SECTION 6.10 ARE INTENDED TO COVER AND BE IN FULL SATISFACTION FOR ALL OR ANY ALLEGED INJURIES OR DAMAGES ARISING IN CONNECTION WITH THE RELEASED MATTERS .

[Signature Pages Follow]

IN WITNESS WHEREOF, the parties hereto have caused this Fifth Amendment to be duly executed effective as of the Fifth Amendment Effective Date.

BORROWER:

ENERGY ONE LLC

By: /s/ David Veltri
Name: David Veltri
Title: Chief Executive Officer

GUARANTOR:

U.S. ENERGY CORP.

By: /s/ David Veltri
Name: David Veltri
Title: Chief Executive Officer

ADMINISTRATIVE AGENT:

APEG ENERGY II GP, LLC
a Texas limited liability company

as Administrative Agent and a Lender

By: /s/ Patrick Duke
Name: Patrick Duke
Title: Manager

By: /s/ Paul Haarman
Name: Paul Haarman
Title: Manager

**CERTIFICATION PURSUANT TO
RULES 13a-14(a) AND 15d-14(a) UNDER THE SECURITIES EXCHANGE ACT OF 1934,
AS ADOPTED PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, David A. Veltri, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of U.S. Energy Corp.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant, as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 14, 2017

By: /s/ David A. Veltri

David A. Veltri

Chairman, Chief Executive Officer and President

**CERTIFICATION PURSUANT TO
RULES 13a-14(a) AND 15d-14(a) UNDER THE SECURITIES EXCHANGE ACT OF 1934,
AS ADOPTED PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Ryan L. Smith, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of U.S. Energy Corp.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant, as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 14, 2017

By: /s/ Ryan L. Smith
Ryan L. Smith
Chief Financial Officer

**CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350, AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report on Form 10-Q of U.S. Energy Corp. (the "Company") for the period ending June 30, 2017 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, to my knowledge, that:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: August 14, 2017

By: /s/ David A. Veltri

David A. Veltri

Chairman, Chief Executive Officer and President
