TRANS ENERGY INC
Form 10-Q
June 12, 2014
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended March 31, 2014

OR

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

For the transition period from __________ to __________

Commission File Number 0-23530

TRANS ENERGY, INC.

(Exact name of registrant as specified in its charter)

Nevada	**93-0997412**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

210 Second Street, P.O. Box 393, St. Marys, West Virginia 26170

(Address of principal executive offices)

Registrant s telephone number, including area code: (304) 684-7053

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 past 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 x 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 x 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 ¨	Accelerated filer ¨
Non-accelerated filer ¨ (Do not check if smaller reporting company)	Smaller reporting company x

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

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date.

Class	Outstanding as of June 12, 2014
Common Stock, $0.001 par value	**13,619,309**

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements

TRANS ENERGY, INC. AND SUBSIDIARIES

Condensed Consolidated Balance Sheets

Unaudited

	March 31, 2014 Unaudited	December 31, 2013 Audited
ASSETS		
CURRENT ASSETS		
Cash	$ 1,846,903	$ 2,727,832
Accounts receivable, trade	7,663,815	4,460,535
Accounts receivable, related parties	18,500	18,500
Advance royalties	12,032	16,937
Prepaid expenses	1,068,386	1,065,061
Deferred financing costs, net of amortization of $1,513,302 and $1,308,817, respectively	752,529	817,938
Total current assets	11,362,165	9,106,803
OIL AND GAS PROPERTIES, USING SUCCESSFUL EFFORTS ACCOUNTING		
Proved properties	81,059,386	77,961,183
Unproved properties	16,092,722	15,092,783
Pipelines	1,397,440	1,397,440
Accumulated depreciation, depletion and amortization	(16,563,032)	(14,473,069)
Oil and gas properties, net	81,986,516	79,978,337
PROPERTY AND EQUIPMENT, net of accumulated depreciation of $339,466 and $317,704, respectively	565,455	587,218
OTHER ASSETS		
Deferred financing costs		139,076
Other assets	304,376	303,887
Total other assets	304,376	442,963
TOTAL ASSETS	$ 94,218,512	$ 90,115,321

See notes to unaudited condensed consolidated financial statements.

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TRANS ENERGY, INC. AND SUBSIDIARIES

Condensed Consolidated Balance Sheets (continued)

Unaudited

	March 31, 2014 Unaudited	December 31, 2013 Audited
LIABILITIES AND STOCKHOLDERS EQUITY		
CURRENT LIABILITIES		
Accounts payable, trade	$ 379,074	$ 632,795
Accounts payable due to drilling operator	6,584,668	2,698,302
Accounts payable, related party	1,500	1,500
Accrued expenses	5,099,185	5,302,816
Revenue payable	164,570	127,106
Commodity derivative liability	431,423	58,176
Notes payable current	15,063	14,897
Notes payable, related party		205,314
Total current liabilities	12,675,483	9,040,906
LONG-TERM LIABILITIES		
Notes payable, net	90,833,888	89,204,102
Asset retirement obligations	53,812	41,440
Commodity derivative liability		67,597
Total long-term liabilities	90,887,700	89,313,139
Total liabilities	103,563,183	98,354,045
COMMITMENTS AND CONTINGENCIES		
STOCKHOLDERS EQUITY		
Preferred stock; 10,000,000 shares authorized at $0.001 par value; -0- shares issued and outstanding		
Common stock; 500,000,000 shares authorized at $0.001 par value; 13,621,309 and 13,457,978 shares issued, respectively, and 13,619,309 and 13,455,978 shares outstanding, respectively	13,621	13,458
Additional paid-in capital	42,978,416	42,556,292
Treasury stock, at cost, 2,000 shares	(1,950)	(1,950)
Accumulated deficit	(52,334,758)	(50,806,524)
Total stockholders equity (deficit)	(9,344,671)	(8,238,724)
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	$ 94,218,512	$ 90,115,321

See notes to unaudited condensed consolidated financial statements.

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TRANS ENERGY, INC. AND SUBSIDIARIES

Condensed Consolidated Statements of Operations (Unaudited)

	For the Three Months Ended March 31, 2014	2013
OPERATING REVENUES		
Oil and gas sales	$ 9,716,422	$ 3,573,883
Gas transportation, gathering, and processing	54,789	35,443
Other income	5,131	
Total operating revenues	9,776,342	3,609,326
OPERATING COSTS AND EXPENSES		
Production costs	3,255,950	2,319,640
Depreciation, depletion, amortization and accretion	2,111,726	639,449
Selling, general and administrative	1,447,819	1,560,338
Total operating costs and expenses	6,815,495	4,519,427
Gain (loss) on sale of assets	207,396	(8,787)
INCOME (LOSS) FROM OPERATIONS	3,168,243	(918,888)
OTHER INCOME (EXPENSES)		
Interest income	908	4,821
Interest expense	(4,131,193)	(1,902,746)
Gain on warrant derivatives		124,316
Loss on commodity derivative	(566,192)	(639)
Total other income (expenses)	(4,696,477)	(1,774,248)
NET LOSS BEFORE INCOME TAXES	(1,528,234)	(2,693,136)
INCOME TAX		
NET LOSS	$ (1,528,234)	$ (2,693,136)
NET LOSS PER SHARE BASIC AND DILUTED	$ (.11)	$ (.20)
WEIGHTED AVERAGE SHARES BASIC AND DILUTED	13,516,199	13,236,228

See notes to unaudited condensed consolidated financial statements.

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TRANS ENERGY, INC. AND SUBSIDIARIES

Condensed Consolidated Statements of Cash Flows

(Unaudited)

	For the Three Months Ended March 31, 2014	2013
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	$ (1,528,234)	$ (2,693,136)
Adjustments to reconcile net loss to net cash used by operating activities:		
Depreciation, depletion, amortization and accretion	2,111,726	639,449
Amortization of financing costs and debt discount	1,305,651	427,604
Share-based compensation	198,541	310,062
(Gain) loss on sale of assets	(207,396)	8,787
Interest and legal expense added to principal	534,571	
Unrealized gain on warrant derivative		(124,316)
Unrealized loss on commodity derivative assets	305,650	
Realized loss on commodity derivative assets	260,542	639
Changes in operating assets and liabilities:		
Accounts receivable, trade	(3,203,280)	851,418
Accounts receivable due from operator, net	269,558	
Prepaid expenses and other current assets	1,580	(420,182)
Other assets	(489)	(481)
Accounts payable and accrued expenses	747,804	(183,663)
Revenue payable	37,464	59,943
Net cash provided (used) by operating activities	833,688	(1,123,876)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Proceeds from sale of assets	259,543	2,618,025
Expenditures for oil and gas properties	(1,986,807)	(1,377,891)
Expenditures for property and equipment		(5,251)
Net cash (used) provided by investing activities	(1,727,264)	1,234,883
CASH FLOWS FROM FINANCING ACTIVITIES:		
Financing costs paid		(110,365)
Payments on notes payable	(211,099)	(5,571)
Proceeds from notes payable		25,000,000
Stock options exercised	223,746	
Net cash provided by financing activities	12,647	24,884,064
NET CHANGE IN CASH	(880,929)	24,995,071

CASH, BEGINNING OF PERIOD	2,727,832	1,009,084
CASH, END OF PERIOD	$ 1,846,903	$ 26,004,155
SUPPLEMENTAL DISCLOSURES FOR CASH FLOW INFORMATION:		
CASH PAID FOR:		
Interest	$ 2,409,018	$ 1,638,040
Income taxes		
Non-cash investing and financing activities:		
Accrued expenditures for oil and gas properties	$ 3,509,412	$ 1,211,010
Increase in asset retirement obligation	$ 12,372	$ 27,000

See notes to unaudited condensed consolidated financial statements.

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TRANS ENERGY, INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (Unaudited)

NOTE 1 BASIS OF FINANCIAL STATEMENT PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES

The accompanying unaudited interim condensed consolidated financial statements have been prepared by Trans Energy, Inc., (Trans Energy, we, our, us, or the Company), in accordance with accounting principles generally accepted in the United State of America (GAAP) for interim financial information and with the instructions to Form 10-Q and Rule 8-03 of Regulation S-X. Accordingly, they do not include certain information and footnote disclosures normally included in a full set of financial statements prepared in accordance with GAAP. The information furnished in the interim condensed consolidated financial statements includes normal recurring adjustments and reflects all adjustments, which, in the opinion of management, are necessary for a fair presentation of such financial statements. Although management believes the disclosures and information presented are adequate to make the information not misleading, these interim consolidated financial statements should be read in conjunction with our most recent audited consolidated financial statements and notes thereto included in our December 31, 2013 Annual Report on Form 10-K. Operating results for the three months ended March 31, 2014 are not necessarily indicative of the results that may be expected for the year ending December 31, 2014.

Significant Accounting Policies

The accounting policies followed by the Company are set forth in Note 1 to the Company s consolidated financial statements in the 2013 Form 10-K, and are supplemented by the notes to the unaudited condensed consolidated financial statements in this report.

Nature of Operations and Organization

We are an independent energy company engaged in the acquisition, exploration, development, exploitation and production of oil and natural gas. Our operations are presently focused in the State of West Virginia.

Principles of Consolidation

The unaudited consolidated financial statements include Trans Energy and our wholly-owned subsidiaries, Prima Oil Company, Inc. (Prima), Ritchie County Gathering Systems, Inc., Tyler Construction Company, Inc., American Shale Development, Inc. (American Shale or ASD), and Tyler Energy, Inc., and interests with joint venture partners, which are accounted for under the proportional consolidation method. All significant inter-company balances and transactions have been eliminated in consolidation.

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 and 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. Actual results could differ from those estimates. Our financial statements are based on a number of significant estimates, including oil and gas reserve quantities which are the basis for the calculation of depreciation, depletion, amortization, and impairment of oil and gas properties, timing and costs associated with our asset retirement obligations, estimates of fair value of derivative instruments and estimates used in stock-based compensation calculations. Reserve estimates are by their nature inherently imprecise.

Financing Costs

In October 2013 we reached a settlement with Oppenheimer & Co., Inc. (Opco) which related to the amount of the fee which was earned by Opco acting as our investment banker in assisting the Company in obtaining funding (Tranche A) with Chambers Energy Capital (Chambers). We recorded $401,625 in financing fees related to the settlement. The Opco financing fees are being amortized over the same period as the Tranche A loan. In addition, when we obtained new financing in February 2013 and April 2012, we incurred $122,230 in fees during 2013 and $1,741,976 in 2012. These fees were recorded as financing costs and are being amortized over the life of the loan using the straight-line method, which approximates the effective interest method. Amortization of financing costs for the three months ended March 31, 2014 and 2013 were $204,484 and $162,901, respectively. Our policy is to recognize twelve months of deferred financing costs as a current asset and the remaining balance of deferred financing costs as other assets in the condensed consolidated balance sheets.

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Property and Equipment

Property and equipment are recorded at cost. Depreciation on vehicles, machinery and equipment is computed using the straight-line method over expected useful lives of five to ten years. Additions are capitalized and maintenance and repairs are charged to expense as incurred.

Oil and Gas Properties

Trans Energy uses the successful efforts method of accounting for oil and gas producing activities. Under the successful efforts method, costs to acquire mineral interests in oil and gas properties, to drill and equip exploratory wells that find proved reserves, and to drill and equip development wells and asset retirement costs are capitalized. Costs to drill exploratory wells that do not find proved reserves, geological and geophysical costs, and costs of carrying and retaining unproved properties are expensed as incurred.

Unproved oil and gas properties that are individually significant are periodically assessed for impairment of value, and a loss is recognized at the time of impairment by providing an impairment allowance. Other unproved properties are amortized based on Trans Energy s experience of successful drilling and average holding period. Capitalized costs of producing oil and gas properties, after considering estimated dismantlement and abandonment costs and estimated salvage values, are depreciated and depleted by the unit-of-production method. Depreciation on pipelines and related equipment, including compressors, is computed using the straight-line method over the expected useful lives of ten to twenty-five years.

On the sale or retirement of a proved property, the cost and related accumulated depreciation, depletion, and amortization are eliminated from the property accounts, and the resultant gain or loss is recognized.

On the sale of an entire interest in an unproved property for cash or cash equivalent, gain or loss on the sale is recognized, taking into consideration the amount of any recorded impairment if the property had been assessed individually.

If a partial interest in an unproved property is sold, the amount received is treated as a reduction of the cost of the interest retained.

Impairments

Generally accepted accounting principles require that long- lived assets (including oil and gas properties) and certain identifiable intangibles be reviewed for impairment whenever events or changes in circumstances indicated that the carrying amount of an asset may not be recoverable. The Company, at least annually, reviews its proved oil and gas properties for impairment by comparing the carrying value of its properties to the properties undiscounted estimated future net cash flows. Estimates of future oil and gas prices, operating costs, and production are utilized in determining undiscounted future net cash flows. The estimated future production of oil and gas reserves is based upon the Company s independent reserve engineer s estimate of proved reserves, which includes assumptions regarding field decline rates and future prices and costs. For properties where the carrying value exceeds undiscounted future net cash flows, the Company recognizes as impairment the difference between the carrying value and fair market value of the properties.

In January 2013, the Company sold certain shallow wells for approximately $11.5 million. We determined that the sales price negotiated with the independent buyer represented the fair market value of those properties as of December 31, 2012. Accordingly, the Company recorded an impairment of approximately $10.1 million in 2012 so that the carrying value of those properties as of December 31, 2012 were equal to the subsequent sales price.

No impairments were recorded through March 31, 2014 or 2013.

Derivatives

We may enter into derivative commodity contracts at times to manage or reduce commodity price risk related to our production. Derivatives and embedded derivatives, if applicable, are measured at fair value and recognized in the consolidated balance sheets as assets or liabilities. Derivatives are classified in the consolidated balance sheets as current or non-current based on whether net-cash settlement is expected to be required within 12 months of the balance sheet date. These commodity contracts are not designated as cash flow hedges, so changes in the fair value are recognized immediately in other income (expense) in the consolidated statement of operations. The pricing models used for valuation often incorporate significant estimates and assumptions, which may impact the level of precision in the financial statements.

We have determined that the warrant previously issued for equity of one of our wholly-own subsidiaries was a derivative liability prior to being settled in December 2013.

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Notes Payable

We record notes payable at fair value and recognize interest expense for accrued interest payable under the terms of the agreements. Principal and interest payments due within one year are classified as current, whereas principal and interest payments for periods beyond one year are classified as long term.

Asset Retirement Obligations

We record the fair value of a liability for an asset retirement obligation in the period in which it is incurred if a reasonable estimate of fair value can be made. These obligations include dismantlement, plugging and abandonment of oil and gas wells and associated pipelines and equipment. The associated asset retirement costs are capitalized as part of the carrying amount of the long-lived asset. The liability is accreted to its then present value each period, and the capitalized cost is depleted over the estimated useful life of the related asset which has been determined to be 40 years for Marcellus Shale wells.

The following is a description of the changes to our asset retirement obligations for the three months ended March 31:

	2014	2013
Asset retirement obligations at beginning of period	$ 41,440	$ 416,322
Liabilities incurred during the period	11,372	
Accretion expense	1,000	920
Liabilities held for sale		(388,005)
Asset retirement obligations at end of period	$ 53,812	$ 29,237

At March 31, 2014 and December 31, 2013, our current portion of the asset retirement obligation was $0. In addition, asset retirement obligations related to the shallow wells sold in 2013 was reported as a liability of $388,005 at December 31, 2012.

Income Taxes

At March 31, 2014, the Company had net operating loss carry forwards (NOLs) for future years of approximately $54.0 million. These NOLs will expire at various dates through 2033. There is no current tax provision for the three months ended March 31, 2014 due to a net operating loss for the period. No tax benefit has been recorded in the consolidated financial statements for the remaining NOLs or Alternative Minimum Tax (AMT) credit since the potential tax benefit is offset by a valuation allowance of the same amount. Utilization of the NOLs could be limited if there is a substantial change in ownership of the Company and is contingent on future earnings.

We have provided a valuation allowance equal to 100% of the total net deferred asset in recognition of the uncertainty regarding the ultimate amount of the net deferred tax asset that will be realized.

The Company has no material unrecognized tax benefits. No tax penalties or interest expense were accrued as of March 31, 2014 or December 31, 2013 or paid during the periods then ended. We file tax returns in the United States and states in which we have operations and are subject to taxation. Tax years subsequent to 2009 remain open to examination by U.S. federal and state tax jurisdictions, however prior year net operating losses remain open for examination.

Revenue and Cost Recognition

We recognize gas revenues upon delivery of the gas to the customers pipeline from our pipelines when recorded as received by the customer s meter. We recognize oil revenues when pumped and metered by the customer. We use the sales method to account for sales and imbalances of natural gas. Under this method, revenues are recognized based on actual volumes sold to purchasers. The volumes sold may differ from the volumes to which we are entitled based on our interest in the properties. These differences create imbalances which are recognized as a liability only when the imbalance exceeds the estimate of remaining reserves. We had no material imbalances as of March 31, 2014 and December 31, 2013. Costs associated with production are expensed in the period incurred.

Revenue payable represents cash received but not yet distributed to third parties.

Transportation revenue is recognized when earned and we have a contractual right to receive payment.

On January 1, 2013, the Company adopted new authoritative accounting guidance issued by the Financial Accounting Standards Board (FASB), which enhanced disclosures by requiring an entity to disclose information about netting arrangements, including rights of offset, to

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enable users of its financial statements to understand the effect of those arrangements on its financial position and provided clarification as to the specific instruments that should be considered in these disclosures. These pronouncements were issued to facilitate comparison between financial statements prepared on the basis of GAAP and International Financial Reporting Standards. These disclosures are effective for annual and interim reporting periods beginning on or after January 1, 2013, and are to be applied retrospectively for all comparative periods presented. See Note 07 - Derivative and Hedging Financial Instruments for tabular presentation of the Company s gross and net derivative positions.

Share-Based Compensation

Trans Energy estimates the fair value of each stock option award at the grant date by using the Black-Scholes option pricing model. The model employs various assumptions, based on management s best estimates at the time of the grant, which impact the fair value calculated and ultimately, the expense that is recognized over the life of the award. We have utilized historical data and analyzed current information to reasonably support these assumptions. The fair value of restricted stock awards is determined based on the fair market value of our common stock on the date of the grant.

We recognize share-based compensation expense on a straight-line basis over the requisite service period for the entire award. As a result of stock and option transactions, we recorded total share-based compensation of $198,541 and $310,062 for the three months ended March 31, 2