PRIMEENERGY CORP
Form 10-Q
July 31, 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 June 30, 2014

Or

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

For the Transition Period From to __________ to __________

Commission File Number 0-7406

PrimeEnergy Corporation

(Exact name of registrant as specified in its charter)

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

9821 Katy Freeway, Houston, Texas 77024

(Address of principal executive offices)

(713) 735-0000

(Registrant s telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filings required for the past 90 days. Yes 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

The number of shares outstanding of each class of the Registrant s Common Stock as of July 25, 2014 was: Common Stock, $0.10 par value 2,357,601 shares.

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PrimeEnergy Corporation

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PART I FINANCIAL INFORMATION

Item 1. FINANCIAL STATEMENTS

PRIMEENERGY CORPORATION

CONDENSED CONSOLIDATED BALANCE SHEETS Unaudited

(Thousands of dollars, except per share amounts)

	June 30, 2014	December 31, 2013
ASSETS		
Current Assets		
Cash and cash equivalents	$ 10,317	$ 9,526
Restricted cash and cash equivalents	3,565	2,065
Accounts receivable, net	15,859	17,693
Other current assets	2,891	3,391
Total Current Assets	32,632	32,675
Property and Equipment, at cost		
Oil and gas properties (successful efforts method), net	204,611	195,023
Field and office equipment, net	13,039	13,402
Total Property and Equipment, Net	217,650	208,425
Other Assets	941	1,822
Total Assets	$ 251,223	$ 242,922
LIABILITIES AND EQUITY		
Current Liabilities		
Accounts payable	$ 16,875	$ 16,249
Accrued liabilities	12,125	6,832
Current portion of long-term debt	1,907	1,870
Current portion of asset retirement and other long-term obligations	3,303	3,310
Derivative liability short-term	5,548	2,194
Due to related parties	65	23
Total Current Liabilities	39,823	30,478
Long-Term Bank Debt	109,310	120,023
Asset Retirement Obligations	7,329	7,227
Derivative Liability Long-Term	1,504	94
Deferred Income Taxes	34,186	31,962

Total Liabilities	192,152	189,784
Commitments and Contingencies		
Equity		
Common stock, $.10 par value; Authorized: 4,000,000 shares, issued: 3,836,397 shares	383	383
Paid-in capital	7,097	6,803
Retained earnings	84,658	78,616
Accumulated other comprehensive loss, net	(155)	(123)
Treasury stock, at cost; 1,472,455 shares and 1,447,613 shares	(41,542)	(40,251)
Total Stockholders Equity PrimeEnergy	50,441	45,428
Non-controlling interest	8,630	7,710
Total Equity	59,071	53,138
Total Liabilities and Equity	$ 251,223	$ 242,922

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

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PRIMEENERGY CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS Unaudited

(Thousands of dollars, except per share amounts)

	Three Months Ended June 30, 2014	Three Months Ended June 30, 2013	Six Months Ended June 30, 2014	Six Months Ended June 30, 2013
Revenues				
Oil and gas sales	$ 26,063	$ 24,135	$ 50,264	$ 45,494
Realized gain (loss) on derivative instruments, net	(1,726)	(166)	(2,723)	74
Field service income	6,586	6,245	13,358	11,576
Administrative overhead fees	2,390	2,540	4,674	4,657
Unrealized gain (loss) on derivative instruments, net	(4,017)	4,480	(5,999)	2,397
Other income	33	46	140	52
Total Revenues	29,329	37,280	59,714	64,250
Costs and Expenses				
Lease operating expense	10,230	10,996	22,136	20,979
Field service expense	5,044	5,168	10,571	9,703
Depreciation, depletion, amortization and accretion on discounted liabilities	5,606	6,269	10,959	11,152
General and administrative expense	3,084	4,348	7,530	8,388
Exploration costs				1
Total Costs and Expenses	23,964	26,781	51,196	50,223
Gain on Sale and Exchange of Assets	842	699	4,015	1,759
Income from Operations	6,207	11,198	12,533	15,786
Other Income and Expenses				
Less: Interest expense	1,040	1,085	2,119	2,158
Add: Interest income				2
Income Before Provision for Income Taxes	5,167	10,113	10,414	13,630
Provision for Income Taxes	1,436	3,555	2,914	4,708
Net Income	3,731	6,558	7,500	8,922
Less: Net Income Attributable to Non-Controlling Interests	498	464	1,458	570
Net Income Attributable to PrimeEnergy	$ 3,233	$ 6,094	$ 6,042	$ 8,352
Basic Income Per Common Share	$ 1.37	$ 2.51	$ 2.55	$ 3.39
Diluted Income Per Common Share	$ 1.04	$ 1.92	$ 1.93	$ 2.61

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

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PRIMEENERGY CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME Unaudited

Six Months Ended June 30, 2014 and 2013

(Thousands of dollars)

	2014	2013
Net Income	$ 7,500	$ 8,922
Other Comprehensive Income (Loss), net of taxes:		
Changes in fair value of hedge positions, net of taxes of $(18) and $114, respectively	(32)	203
Total other comprehensive income (loss)	(32)	203
Comprehensive Income	7,468	9,125
Less: Comprehensive Income Attributable to Non-Controlling Interest	1,458	570
Comprehensive Income Attributable to PrimeEnergy	$ 6,010	$ 8,555

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

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PRIMEENERGY CORPORATION

CONDENSED CONSOLIDATED STATEMENT OF EQUITY Unaudited

Six Months Ended June 30, 2014

(Thousands of dollars)

	Common Stock		Additional Paid in Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Treasury Stock	Total Stockholders Equity PrimeEnergy	Non-Controlling Interest	Total Equity
	Shares	Amount							
Balance at December 31, 2013	3,836,397	$ 383	$ 6,803	$ 78,616	$ (123)	$ (40,251)	$ 45,428	$ 7,710	$ 53,138
Repurchase 24,842 shares of common stock						(1,291)	(1,291)		(1,291)
Net income				6,042			6,042	1,458	7,500
Other comprehensive loss, net of taxes					(32)		(32)		(32)
Repurchase of non-controlling interests			294				294	(503)	(209)
Distributions to non-controlling interests								(35)	(35)
Balance at June 30, 2014	3,836,397	$ 383	$ 7,097	$ 84,658	$ (155)	$ (41,542)	$ 50,441	$ 8,630	$ 59,071

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

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PRIMEENERGY CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS Unaudited

Six Months Ended June 30, 2014 and 2013

(Thousands of dollars)

	2014	**2013**
Cash Flows from Operating Activities:		
Net income	$ 7,500	$ 8,922
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation, depletion, amortization and accretion on discounted liabilities	10,959	11,152
Gain on sale of properties	(4,015)	(1,759)
Unrealized (gain) loss on derivative instruments, net	5,999	(2,397)
Provision for deferred income taxes	2,239	4,374
Changes in assets and liabilities:		
(Increase) decrease in accounts receivable	1,834	(4,707)
Decrease in other assets	63	93
Decrease in accounts payable	(874)	(1,091)
Increase in accrued liabilities	5,293	2,239
Increase in due to related parties	78	49
Net Cash Provided by Operating Activities	29,076	16,875
Cash Flows from Investing Activities:		
Capital expenditures, including exploration expense	(20,742)	(14,815)
Proceeds from sale of property and equipment	4,668	2,147
Net Cash Used in Investing Activities	(16,074)	(12,668)
Cash Flows from Financing Activities:		
Purchase of stock for treasury	(1,291)	(2,734)
Purchase of non-controlling interests	(209)	(7)
Proceeds from long-term bank debt and other long-term obligations	30,750	27,250
Repayment of long-term bank debt and other long-term obligations	(41,426)	(28,000)
Distribution to non-controlling interests	(35)	(39)
Net Cash Used in Financing Activities	(12,211)	(3,530)
Net Increase in Cash and Cash Equivalents	791	677
Cash and Cash Equivalents at the Beginning of the Period	9,526	8,602
Cash and Cash Equivalents at the End of the Period	$ 10,317	$ 9,279
Supplemental Disclosures:		

Income taxes paid (refunded)	$ 356	$ (94)
Interest paid	$ 2,183	$ 2,147

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

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PRIMEENERGY CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2014

(Unaudited)

(1) Basis of Presentation:

The accompanying condensed consolidated financial statements of PrimeEnergy Corporation (PEC or the Company) have not been audited by independent public accountants. Pursuant to applicable Securities and Exchange Commission (SEC) rules and regulations, the accompanying interim financial statements do not include all disclosures presented in annual financial statements and the reader should refer to the Company s Form 10-K for the year ended December 31, 2013. In the opinion of management, the accompanying interim condensed consolidated financial statements contain all material adjustments, consisting only of normal recurring adjustments, necessary for a fair presentation of the Company s condensed consolidated balance sheets as of June 30, 2014 and December 31, 2013, the condensed consolidated results of operations for the three and six months ended June 30, 2014 and 2013, and the condensed consolidated results of cash flows and equity for the six months ended June 30, 2014 and 2013. Certain amounts presented in prior period financial statements have been reclassified for consistency with current period presentation. The results for interim periods are not necessarily indicative of annual results. For purposes of disclosure in the condensed consolidated financial statements, subsequent events have been evaluated through the date the statements were issued.

Recently Issued Accounting Pronouncements-:

In July 2013, the FASB issued ASU 2013-11, Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists. ASU 2013-11 provided guidance on the presentation of an unrecognized tax benefit when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists. This guidance requires entities to present unrecognized tax benefits as a decrease in a net operating loss, similar tax loss, or tax credit carryforward if certain criteria are met. The guidance will eliminate the diversity in practice in the presentation of unrecognized tax benefits but will not alter the way in which entities assess deferred tax assets for realizability. ASU No. 2013-11 is effective for annual and interim reporting periods beginning after December 15, 2013. The requirements of ASU 2013-11 did not have a material impact on the Company s condensed consolidated financial position, results of operations or cash flows.

(2) Acquisitions and Dispositions:

Historically the Company has repurchased the interests of the partners and trust unit holders in the eighteen oil and gas limited partnerships (the Partnerships) and the two asset and business income trusts (the Trusts) managed by the Company as general partner and as managing trustee, respectively. The Company purchased such interests in amounts totaling $209,000 and $7,000 for the six months ended June 30, 2014 and 2013, respectively.

(3) Restricted Cash and Cash Equivalents:

Restricted cash and cash equivalents include $3.51 million and $2.01 million at June 30, 2014 and December 31, 2013, respectively, of cash primarily pertaining to oil and gas revenue payments. There were corresponding accounts payable recorded at June 30, 2014 and December 31, 2013 for these liabilities. Both the restricted cash and the accounts payable are classified as current on the accompanying condensed consolidated balance sheets.

(4) Additional Balance Sheet Information:

Certain balance sheet amounts are comprised of the following:

(Thousands of dollars)	**June 30, 2014**	**December 31, 2013**
Accounts Receivable:		
Joint interest billing	$ 2,515	$ 6,287
Trade receivables	1,911	2,014
Oil and gas sales	11,554	9,604
Other	213	122
	16,193	18,027
Less: Allowance for doubtful accounts	(334)	(334)
Total	$ 15,859	$ 17,693

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(Thousands of dollars)	**June 30, 2014**	**December 31, 2013**
Accounts Payable:		
Trade	$ 1,301	$ 1,596
Royalty and other owners	9,930	7,391
Partner advances	3,150	3,378
Prepaid drilling deposits	330	978
Other	2,164	2,906
Total	$ 16,875	$ 16,249
Accrued Liabilities:		
Compensation and related expenses	$ 5,741	$ 3,062
Property costs	5,323	3,119
Income tax	584	268
Other	477	383
Total	$ 12,125	$ 6,832

(5) Property and Equipment:

Property and equipment at June 30, 2014 and December 31, 2013 consisted of the following:

(Thousands of dollars)	**June 30, 2014**	**December 31, 2013**
Proved oil and gas properties, at cost	$ 383,048	$ 364,123
Less: Accumulated depletion and depreciation	(178,437)	(169,100)
Oil and Gas Properties, Net	$ 204,611	$ 195,023
Field and office equipment	$ 26,689	$ 26,653
Less: Accumulated depreciation	(13,650)	(13,251)
Field and Office Equipment, Net	$ 13,039	$ 13,402
Total Property and Equipment, Net	$ 217,650	$ 208,425

(6) Long-Term Bank Debt:

Bank Debt*:*

Effective July 30, 2010 the Company entered into a Second Amended and Restated Credit Agreement between Compass Bank as agent and a syndicated group of lenders (Credit Agreement). The Credit Agreement has a revolving line of credit and letter of credit facility of up to $250 million with a final maturity date of July 30, 2017. The credit facility is secured by substantially all of the Company s oil and gas properties. The credit facility is subject to a borrowing base determined by the lenders taking into consideration the estimated value of PEC s oil and gas properties in accordance with the lenders customary practices for oil and gas loans. This process involves reviewing PEC s estimated proved reserves and their valuation. The borrowing base is redetermined semi-annually, and the available borrowing amount could be increased or decreased as a result of such redetermination. In addition, PEC and the lenders each have at their discretion the right to request the borrowing base be redetermined with a maximum of one such request each year. A revision to PEC s reserves may prompt such a request on the part of the lenders, which could possibly result in a reduction in the borrowing base and availability under the credit facility. At any time if the sum of the outstanding borrowings and letter of credit exposures exceed the applicable portion of the borrowing base, PEC would be required to repay the excess amount within a prescribed period.

At June 30, 2014, the credit facility borrowing base was $160.0 million with no required monthly reduction amount. The borrowings made within the credit facility may be placed in a base rate loan or LIBO rate loan. The Company s borrowing rates in the credit facility provide for base rate loans at the prime rate (3.25% at June 30, 2014) plus applicable margin utilization rates that range from 1.50% to 2.00%, and LIBO rate loans at LIBO published rates plus applicable utilization rates (2.50% to 3.00% at June 30, 2014). At June 30, 2014, the Company had in place one base rate loan and one LIBO rate loan with effective rates of 4.75% and 2.65%, respectively.

At June 30, 2014, the Company had a total of $102.8 million of borrowings outstanding under its revolving credit facility at a weighted-average interest rate of 3.59% and $57.2 million available for future borrowings. The combined weighted average interest rate paid on outstanding bank borrowings subject to base rate and LIBO interest was 3.53% for the six months ended June 30, 2014 as compared to 3.57% for the six months ended June 30, 2013.

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On July 31, 2013, the Company entered into a $10.0 million Loan and Security Agreement with JP Morgan Chase Bank (Equipment Loan). The Equipment Loan is secured by a portion of the Company s field service equipment, carries an interest rate of 3.95% per annum, requires monthly payments (principal and interest) of $184,000, and has a final maturity date of July 31, 2018. As of June 30, 2014, the Company had a total of $8.5 million outstanding on the Equipment Loan.

The Company entered into interest rate hedge agreements to help manage interest rate exposure. These contracts include interest rate swaps. Interest rate swap transactions generally involve the exchange of fixed and floating rate interest payment obligations without the exchange of the underlying principal amounts. In July 2012, the Company entered into interest swap agreements for a period of two years, which commenced in January 2014, related to $75 million of the Company s bank debt resulting in a LIBO fixed rate of 0.563%. For the six months ended June 30, 2014, the Company recorded interest expense and paid $132,000 related to the settlement of interest rate swaps.

(7) Other Long-Term Obligations and Commitments:

Operating Leases:

The Company has several non-cancelable operating leases, primarily for rental of office space, that have a term of more than one year. The future minimum lease payments for the rest of fiscal 2014 and thereafter for the operating leases are as follows:

(Thousands of dollars)	**Operating Leases**
2014	$ 376
2015	651
2016	545
2017	46
Total minimum payments	$ 1,618

Rent expense for office space for the six months ended June 30, 2014 and 2013 was $369,000 and $376,000, respectively.

Asset Retirement Obligation:

A reconciliation of the liability for plugging and abandonment costs for the six months ended June 30, 2014 is as follows:

(Thousands of dollars)	
Asset retirement obligation December 31, 2013	$ 10,537
Liabilities incurred	155
Liabilities settled	(240)
Accretion expense	180
Revisions in estimated liabilities	

Asset retirement obligation	June 30, 2014	$ 10,632

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

(8) Contingent Liabilities:

The Company, as managing general partner of the affiliated Partnerships, is responsible for all Partnership activities, including the drilling of development wells and the production and sale of oil and gas from productive wells. The Company also provides the administration, accounting and tax preparation work for the Partnerships, and is liable for all debts and liabilities of the affiliated Partnerships, to the extent that the assets of a given limited Partnership are not sufficient to satisfy its obligations. As of June 30, 2014, the affiliated Partnerships have established cash reserves in excess of their debts and liabilities and the Company believes these reserves will be sufficient to satisfy Partnership obligations.

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

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

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(9) Stock Options and Other Compensation:

In May 1989, non-statutory stock options were granted by the Company to four key executive officers for the purchase of shares of common stock. At June 30, 2014 and 2013, remaining options held by two key executive officers on 767,500 shares were outstanding and exercisable at prices ranging from $1.00 to $1.25. According to their terms, the options have no expiration date.

(10) Related Party Transactions:

The Company, as managing general partner or managing trustee, makes an annual offer to repurchase the interests of the partners and trust unit holders in certain of the Partnerships or Trusts. The Company purchased such interests in amounts totaling $209,000 and $7,000 for the six months ended June 30, 2014 and 2013, respectively.

Treasury stock purchases in any reported period may include shares from a related party, which may include members of the Company s Board of Directors.

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

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

(11) Financial Instruments:

Fair Value Measurements:

Authoritative guidance on fair value measurements defines fair value, establishes a framework for measuring fair value and stipulates the related disclosure requirements. The Company follows a three-level hierarchy, prioritizing and defining the types of inputs used to measure fair value. The fair values of the Company s interest rate swaps, natural gas and crude oil price collars and swaps are designated as Level 3. The following fair value hierarchy table presents information about the Company s assets and liabilities measured at fair value on a recurring basis as of June 30, 2014 and December 31, 2013:

June 30, 2014 *(Thousands of dollars)*	**Quoted Prices in Active Markets For Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**	**Balance as of June 30, 2014**
Assets				
Commodity derivative contracts	$	$	$ 95	$ 95
Interest rate derivative contracts			42	42
Total assets	$	$	$ 137	$ 137
Liabilities				

Commodity derivative contracts	$	$	$ (6,767)	$ (6,767)
Interest rate derivative contracts			(285)	(285)
Total liabilities	$	$	$ (7,052)	$ (7,052)

December 31, 2013 *(Thousands of dollars)*	**Quoted Prices in Active Markets For Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**	**Balance as of December 31, 2013**
Assets				
Commodity derivative contracts	$	$	$ 1,337	$ 1,337
Interest rate derivative contracts			86	86
Total assets	$	$	$ 1,423	$ 1,423
Liabilities				
Commodity derivative contracts	$	$	$ (2,010)	$ (2,010)
Interest rate derivative contracts			(278)	(278)
Total liabilities	$	$	$ (2,288)	$ (2,288)

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

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

The following table sets forth a reconciliation of changes in the fair value of financial assets and liabilities classified as Level 3 in the fair value hierarchy for the six months ended June 30, 2014.

(Thousands of dollars)	
Net liabilities December 31, 2013	$ (865)
Total realized and unrealized gains / losses:	
Included in earnings (a)	(8,854)
Included in other comprehensive loss	(50)
Purchases, sales, issuances and settlements	2,854
Net liabilities June 30, 2014	$ (6,915)

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

Derivative Instruments:

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

Interest rate swap derivatives are treated as cash-flow hedges and are used to fix or float interest rates on existing debt. The value of these interest rate swaps at June 30, 2014 and December 31, 2013 is located in accumulated other comprehensive loss, net of tax. Settlement of the swaps, which began in January 2014, is recorded within interest expense.

The following table sets forth the effect of derivative instruments on the condensed consolidated balance sheets at June 30, 2014 and December 31, 2013:

		Fair Value	
(Thousands of dollars)	**Balance Sheet Location**	**June 30, 2014**	**December 31, 2013**
Asset Derivatives:			

Derivatives designated as cash-flow hedging instruments:			
Interest rate swap contracts	Other assets	$ 42	$ 86
Derivatives not designated as cash-flow hedging instruments:			
Crude oil commodity contracts	Other current assets		307
Natural gas commodity contracts	Other current assets	45	50
Crude oil commodity contracts	Other assets	13	980
Natural gas commodity contracts	Other assets	37	
Total		$ 137	$ 1,423
Liability Derivatives:			
Derivatives designated as cash-flow hedging instruments:			
Interest rate swap contracts	Derivative liability short-term	$ (268)	$ (209)
Interest rate swap contracts	Derivative liability long-term	(17)	(69)
Derivatives not designated as cash-flow hedging instruments:			
Crude oil commodity contracts	Derivative liability short-term	(4,640)	(1,667)
Natural gas commodity contracts	Derivative liability short-term	(640)	(318)
Crude oil commodity contracts	Derivative liability long-term	(1,460)	(25)
Natural gas commodity contracts	Derivative liability long-term	(27)	
Total		$ (7,052)	$ (2,288)
Total derivative instruments		$ (6,915)	$ (865)

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The following table sets forth the effect of derivative instruments on the condensed consolidated statement of operations for the six-month periods ended June 30, 2014 and 2013:

(Thousands of dollars)	**Location of gain/loss recognized in income**	**Amount of gain/loss recognized in income 2014**	**2013**
Derivative designated as cash-flow hedge instruments:			
Interest rate swap contracts	Interest expense	$ (132)	$
Derivatives not designated as cash-flow hedge instruments			
Natural gas commodity contracts	Unrealized loss on derivative instruments, net	(316)	(437)
Crude oil commodity contracts	Unrealized gain (loss) on derivative instruments, net	(5,683)	2,834
Natural gas commodity contracts (a)	Realized gain (loss) on derivative instruments, net	(596)	331
Crude oil commodity contracts	Realized loss on derivative instruments, net	(2,127)	(257)
		$ (8,854)	$ 2,471

(a) In January 2014, the Company unwound and monetized natural gas swaps with original settlement dates from January 2015 through December 2015 for net proceeds of $276,000. The $276,000 gain associated with this early settlement transaction is included in realized gain on derivative instruments for the six months ended June 30, 2014.

(12) Earnings Per Share:

Basic earnings per share are computed by dividing earnings available to common stockholders by the weighted average number of common shares outstanding during the period. Diluted earnings per share reflect per share amounts that would have resulted if dilutive potential common stock had been converted to common stock in gain periods. The following reconciles amounts reported in the financial statements:

	Six Months Ended June 30,					
	2014			**2013**		
	Net Income (In 000 s)	**Weighted Average Number of Shares Outstanding**	**Per Share Amount**	**Net Income** (In 000 s)	**Weighted Average Number of Shares Outstanding**	**Per Share Amount**

Basic	$ 6,042	2,373,109	$	2.55	$ 8,352	2,465,740	$	3.39
Effect of dilutive securities:								
Options		752,628				739,322		
Diluted	$ 6,042	3,125,737	$	1.93	$ 8,352	3,205,062	$	2.61

Three Months Ended June 30, 2014