

TORCHLIGHT ENERGY RESOURCES INC
Form 10-Q
August 14, 2014

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

FORM 10-Q
(Mark One)

Quarterly report under Section 13 or 15(d) of the Securities Exchange Act of 1934
For the Quarter Ended June 30, 2014.

Transition report under Section 13 or 15(d) of the Securities Exchange Act of 1934 (No fee required)
For the transition period from _____ to _____.

Commission file number: 001-36247

TORCHLIGHT ENERGY RESOURCES, INC.

(Name of registrant in its charter)

Nevada
(State or Other Jurisdiction of Incorporation or
Organization)

74-3237581
(I.R.S. Employer Identification No.)

5700 West Plano Pkwy, Suite 3600
Plano, Texas 75093

5700 West Plano Pkwy, Suite 3600
(Address of Principal Executive Offices)

(214) 432-8002

(Issuer's Telephone Number, Including Area Code)

Securities registered pursuant to Section 12(b) of the Exchange Act:

Common Stock (\$0.001 Par Value)

(Title of Each Class)

NASDAQ

(Name of each exchange on which registered)

Securities registered pursuant to Section 12(g) of the Exchange Act:

None

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 x No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act. (Check one):

| | | | |
|-------------------------|-----------------------|---------------------------|----------------------------------|
| Large accelerated filer | <input type="radio"/> | Accelerated filer | <input type="radio"/> |
| Non-accelerated filer | <input type="radio"/> | Smaller reporting company | <input checked="" type="radio"/> |

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

As of August 14, 2014, there were 20,411,639 shares of the registrant’s common stock outstanding (the only class of voting common stock).

FORM 10-Q

TABLE OF CONTENTS

| | | |
|---------------------------------------|---|-----------|
| Note About Forward-Looking Statements | | 3 |
| PART I | FINANCIAL INFORMATION | 4 |
| Item 1. | Consolidated Financial Statements | 4 |
| | Consolidated Balance Sheets (Unaudited) | 4 |
| | Consolidated Statements of Operations (Unaudited) | 5 |
| | Consolidated Statements of Cash Flows (Unaudited) | 6 |
| | Notes to Consolidated Financial Statements (Unaudited) | 7 |
| Item 2. | Management's Discussion and Analysis of Financial Condition and Results of Operations | 14 |
| Item 3. | Quantitative and Qualitative Disclosures About Market Risk | 19 |
| Item 4. | Controls and Procedures | 19 |
| PART II | OTHER INFORMATION | 20 |
| Item 1. | Legal Proceedings | 20 |
| Item 2. | Unregistered Sales of Equity Securities and Use of Proceeds | 20 |
| Item 6. | Exhibits | 21 |
| | Signatures | 22 |

NOTE ABOUT FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These statements include, among other things, statements regarding plans, objectives, goals, strategies, future events or performance and underlying assumptions and other statements, which are other than statements of historical facts. Forward-looking statements may appear throughout this report, including without limitation, Item 2 “Management’s Discussion and Analysis of Financial Condition and Results of Operations.” Forward-looking statements generally can be identified by words such as “anticipates,” “believes,” “estimates,” “expects,” “intends,” “plans,” “predicts,” “projects,” “will be,” “will continue,” “will likely result,” and similar expressions. Forward-looking statements are based on current expectations and assumptions that are subject to risks and uncertainties, which could cause our actual results to differ materially from those reflected in the forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those discussed in this report and in our Annual Report on Form 10-K for the year ended December 31, 2013, and in particular, the risks discussed in our Form 10-K under the caption “Risk Factors” in Item 1A therein, and those discussed in other documents we file with the Securities and Exchange Commission (“SEC”). Important factors that in our view could cause material adverse effects on our financial condition and results of operations include, but are not limited to, risks associated with the company's ability to obtain additional capital in the future to fund planned expansion, the demand for oil and natural gas, general economic factors, competition in the industry and other factors that may cause actual results to be materially different from those described herein as anticipated, believed, estimated or expected. We undertake no obligation to revise or publicly release the results of any revision to any forward-looking statements, except as required by law. Given these risks and uncertainties, readers are cautioned not to place undue reliance on such forward-looking statements.

As used herein, the “Company,” “we,” “our,” and similar terms include Torchlight Energy Resources, Inc. and its subsidiaries, unless the context indicates otherwise.

PART I FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

TORCHLIGHT ENERGY RESOURCES, INC.
CONSOLIDATED CONDENSED BALANCE SHEETS

| | June 30, 2014 (Unaudited) | December 31, 2013 (Audited) |
|--|---------------------------------|-----------------------------------|
| ASSETS | | |
| Current assets: | | |
| Cash | \$ 1,053,571 | \$ 1,811,713 |
| Accounts receivable | 330,976 | 429,699 |
| Production revenue receivable | 777,989 | - |
| Note receivable | 294,318 | - |
| Prepayments - development costs | 824,383 | 9,144 |
| Prepaid expenses | 39,000 | - |
| Total current assets | 3,320,237 | 2,250,556 |
| Investment in oil and gas properties, net | 26,316,900 | 13,038,751 |
| Office Equipment | 61,706 | 11,604 |
| Debt issuance costs, net | 625,980 | 920,947 |
| Goodwill | 447,084 | 447,084 |
| Other Assets | 74,894 | 74,379 |
| TOTAL ASSETS | \$ 30,846,801 | \$ 16,743,321 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Accounts payable | \$ 3,479,071 | \$ 985,123 |
| Accrued liabilities | 240,000 | - |
| Related party payables | 90,000 | 90,000 |
| Convertible promissory notes, net of discount of \$2,355,084 at June 30, 2014 | 5,952,513 | - |
| Notes payable within one year | 674,690 | 753,904 |
| Due to working interest owners | 528,438 | 580,484 |
| Interest payable | 277,084 | 309,498 |
| Total current liabilities | 11,241,796 | 2,719,009 |
| Convertible promissory notes, net of discount of \$587,010 at June 30, 2014 and \$5,500,462 at December 31, 2013 | 2,610,490 | 4,802,711 |
| Asset retirement obligation | 25,975 | 24,382 |
| Commitments and contingencies | - | - |
| Stockholders' equity: | 20,440 | 16,142 |

Edgar Filing: TORCHLIGHT ENERGY RESOURCES INC - Form 10-Q

Common stock, par value \$0.001 per share; 75,000,000 shares authorized;

20,440,210 issued and outstanding at June 30, 2014

16,141,765 issued and outstanding at December 31, 2013

| | | |
|---|----------------------|----------------------|
| Additional paid-in capital | 35,776,392 | 21,978,616 |
| Warrants outstanding | 7,505,270 | 3,043,420 |
| Accumulated deficit | (26,333,562) | (15,840,959) |
| Total stockholders' equity | 16,968,540 | 9,197,219 |
| TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY | \$ 30,846,801 | \$ 16,743,321 |

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

TORCHLIGHT ENERGY
RESOURCES, INC.
CONSOLIDATED STATEMENTS
OF OPERATIONS

| | THREE MONTHS ENDED June 30, 2014 (Unaudited) | THREE MONTHS ENDED June 30, 2013 (Unaudited) | SIX MONTHS ENDED June 30, 2014 (Unaudited) | SIX MONTHS ENDED June 30, 2013 (Unaudited) |
|---|--|--|---|---|
| Revenue | | | | |
| Oil and gas sales | \$ 1,630,035 | \$ 160,882 | \$ 2,273,005 | \$ 390,086 |
| SWD and royalties | 9,799 | 9,304 | 48,964 | 9,304 |
| Cost of revenue | (397,184) | (93,021) | (576,235) | (161,021) |
| Gross income | 1,242,650 | 77,165 | 1,745,734 | 238,369 |
| Operating expenses: | | | | |
| General and administrative expense | 1,318,179 | 1,581,102 | 7,139,247 | 2,114,651 |
| Depreciation, depletion and amortization | 628,372 | 237,737 | 962,703 | 354,584 |
| Total operating expenses | 1,946,551 | 1,818,839 | 8,101,950 | 2,469,235 |
| Other income (expense) | | | | |
| Interest income | 6 | 40 | 56 | 40 |
| Interest and accretion expense | (2,226,957) | (566,458) | (4,136,444) | (735,459) |
| Total other income (expense) | (2,226,951) | (566,418) | (4,136,388) | (735,419) |
| Net loss before taxes | (2,930,852) | (2,308,092) | (10,492,604) | (2,966,285) |
| Provision for income taxes | - | - | - | - |
| Net (loss) | \$ (2,930,852) | \$ (2,308,092) | \$ (10,492,604) | \$ (2,966,285) |
| Loss per share: | | | | |
| Basic and Diluted | \$ (0.17) | \$ (0.168) | \$ (0.68) | \$ (0.22) |
| Weighted average shares outstanding: | | | | |
| Basic and Diluted | 15,334,868 | 13,758,277 | 17,184,891 | 13,614,318 |

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

TORCHLIGHT ENERGY RESOURCES, INC.
CONSOLIDATED STATEMENTS OF CASH FLOW (Unaudited)

| | SIX MONTHS ENDING June 30, 2014 | SIX MONTHS ENDING June 30, 2013 |
|--|---------------------------------------|---------------------------------------|
| Cash Flows From Operating Activities | | |
| Net (loss) | \$ (10,492,604) | \$ (2,966,285) |
| Adjustments to reconcile net loss to net cash from operations: | | |
| Stock based compensation | 4,753,686 | 1,352,005 |
| Accretion of convertible note discounts | 3,158,850 | 574,895 |
| Depreciation, depletion and amortization | 962,703 | 354,584 |
| Change in: | | |
| Accounts receivable | 85,677 | (37,156) |
| Note receivable | (294,318) | - |
| Production revenue receivable | (777,989) | - |
| Prepayment of development costs | (824,383) | - |
| Prepaid expenses | (29,856) | (28,228) |
| Debt issuance costs amortization | 373,732 | (601,101) |
| Other assets | (515) | - |
| Accounts payable and accrued liabilities | 2,408,948 | (166,439) |
| Related party payable | - | 19,852 |
| Due to working interest owners | (52,046) | - |
| Asset retirement obligation | 1,593 | - |
| Interest payable | (22,900) | 107,587 |
| Net cash used in operating activities | (749,422) | (1,390,286) |
| Cash Flows From Investing Activities | | |
| Investment in oil and gas properties | (10,789,519) | (3,879,519) |
| Acquisition of office equipment | (53,960) | - |
| Net cash used in investing activities | (10,843,479) | (3,879,519) |
| Cash Flows From Financing Activities | | |
| Proceeds from sale of common stock | 7,220,291 | - |
| Proceeds from issuance of convertible notes | 3,197,500 | - |
| Proceeds from warrant exercise | 379,982 | - |
| Proceeds from promissory notes | 36,986 | 6,041,800 |
| Repayment of promissory notes | - | (51,000) |
| Net cash provided by financing activities | 10,834,759 | 5,990,800 |
| Net increase (decrease) in cash | (758,142) | 720,995 |
| Cash - beginning of period | 1,811,713 | 63,252 |
| Cash - end of period | \$ 1,053,571 | \$ 784,247 |
| Supplemental disclosure of cash flow information: | | |
| Non cash transactions: | | |
| Cash paid for interest | \$ 601,384 | \$ 26,665 |
| Common stock issued for services | \$ 168,577 | \$ - |
| Warrants issued in connection with promissory notes | \$ 405,016 | \$ 914,449 |

Edgar Filing: TORCHLIGHT ENERGY RESOURCES INC - Form 10-Q

| | | |
|---|--------------|--------------|
| Warrants issued for services | \$ 4,663,865 | \$ - |
| Beneficial conversion feature on promissory notes | \$ 195,466 | \$ 1,827,100 |
| Liabilities assumed-purchase of properties | \$ - | \$ 1,809,572 |
| Sale of properties for note receivable | \$ - | \$ 990,000 |
| Common stock issued for mineral interests | \$ 3,225,629 | \$ - |
| Capitalized interest cost | \$ - | \$ 32,335 |
| Common stock issued in conversion of promissory notes | \$ 1,995,575 | \$ - |
| Common stock issued in warrant exercises | \$ 380,000 | \$ - |
| Asset retirement obligation | \$ - | \$ - |

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

1. NATURE OF BUSINESS

Torchlight Energy Resources, Inc. was incorporated in October 2007 under the laws of the State of Nevada as Pole Perfect Studios, Inc. (“PPS”). From its incorporation to November 2010, the company was primarily engaged in business start-up activities.

On November 23, 2010, we entered into and closed a Share Exchange Agreement (the “Exchange Agreement”) between the major shareholders of PPS and the shareholders of Torchlight Energy, Inc. (“TEI”). At closing, the TEI shareholders transferred all of their shares of TEI common stock to us in exchange for an aggregate of 9,444,500 newly issued shares of our common stock. This transaction was recorded as a reverse acquisition for accounting purposes where TEI is the accounting acquirer. The assets and liabilities of PPS were recorded at fair value of \$0. The Company recorded \$447,084 of goodwill which represents the estimated fair value of the consideration exchanged. Also at closing of the Exchange Agreement, certain of the former PPS shareholders transferred to us an aggregate of 14,400,000 shares of our common stock for cancellation in exchange for aggregate consideration of \$270,000. Upon closing of these transactions, we had 12,251,420 shares of common stock issued and outstanding. The 9,444,500 shares issued to the TEI Stockholders at closing represented 77.1% of our voting securities after completion of the Exchange Agreement.

As a result of the transactions effected by the Exchange Agreement, at closing (i) TEI became our wholly-owned subsidiary, (ii) we abandoned all of our previous business plans within the health and fitness industries and (iii) the business of TEI became our sole business. TEI is an energy company, incorporated under the laws of the State of Nevada in June 2010. It is engaged in the acquisition, exploration, exploitation and/or development of oil and natural gas properties in the United States.

On December 10, 2010, we effected a 4-for-1 forward split of our shares of common stock outstanding. All owners of record at the close of business on December 10, 2010 (record date) received three additional shares for every one share they owned. All share amounts reflected throughout this report take into account the 4-for-1 forward split.

Effective February 8, 2011, we changed our name to “Torchlight Energy Resources, Inc.” In connection with the name change, our ticker symbol changed from “PPFT” to “TRCH.”

The Company is engaged in the acquisition, exploration, development and production of oil and gas properties within the United States. The Company’s success will depend in large part on its ability to obtain and develop profitable oil and gas interests.

2. GOING CONCERN

These consolidated financial statements have been prepared in accordance with generally accepted accounting principles applicable to a going concern, which assumes that the Company will be able to meet its obligations and continue its operations for its next fiscal year.

At June 30, 2014, the Company has negative working capital of \$7,921,559, had not yet achieved profitable operations, had accumulated losses of \$26,333,562 since its inception and expects to incur further losses in the development of its business, which casts substantial doubt about the Company’s ability to generate future profitable operations and/or to obtain the necessary financing to meet its obligations and repay its liabilities arising from normal business operations when they come due. Management’s plan to address the Company’s ability to continue as a going concern includes: (1) obtaining debt or equity funding from private placement or institutional sources; (2) obtaining

loans from financial institutions, where possible, or (3) participating in joint venture transactions with third parties. Although management believes that it will be able to obtain the necessary funding to allow the Company to remain a going concern through the methods discussed above, there can be no assurances that such methods will prove successful. The accompanying consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

3. SIGNIFICANT ACCOUNTING POLICIES

The Company maintains its accounts on the accrual method of accounting in accordance with accounting principles generally accepted in the United States of America. These interim period unaudited financial statements should be read in conjunction with the audited financial statements and footnotes which are included as part of the Company's Form 10-K for the year ended December 31, 2013. Accounting principles followed and the methods of applying those principles, which materially affect the determination of financial position, results of operations and cash flows are summarized below:

Use of estimates – The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and certain assumptions that affect the amounts reported in these consolidated financial statements and accompanying notes. Actual results could differ from these estimates.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

3. SIGNIFICANT ACCOUNTING POLICIES - continued

Basis of presentation—The financial statements are presented on a consolidated basis and include all of the accounts of Torchlight Energy Resources Inc. and its wholly owned subsidiary, Torchlight Energy, Inc. All significant intercompany balances and transactions have been eliminated.

Risks and uncertainties – The Company’s operations are subject to significant risks and uncertainties, including financial, operational, technological and other risks associated with operating an emerging business, including the potential risk of business failure.

Concentration of risks – The Company’s cash is placed with a highly rated financial institution, and the Company periodically reviews the credit worthiness of the financial institutions with which it does business. At times the Company’s cash balances are in excess of amounts guaranteed by the Federal Deposit Insurance Corporation.

Fair value of financial instruments – Financial instruments consist of cash, accounts receivable, notes receivable, accounts payable, notes payable to related party and convertible promissory notes. The estimated fair values of cash, accounts receivable, notes receivable, accounts payable and notes to related party approximate the carrying amount due to the relatively short maturity of these instruments. The carrying amounts of notes receivable and convertible promissory notes approximate their fair value giving affect for the term of the note and the effective interest rates.

For assets and liabilities that require re-measurement to fair value the Company categorizes them in a three-level fair value hierarchy as follows:

- Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities.
- Level 2 inputs are quoted prices for similar assets and liabilities in active markets or inputs that are observable for the asset or liability, either directly or indirectly through market corroboration.
- Level 3 inputs are unobservable inputs based on management’s own assumptions used to measure assets and liabilities at fair value.

A financial asset or liability’s classification within the hierarchy is determined based on the lowest level input that is significant to the fair value measurement.

Accounts receivable – Accounts receivable consist of uncollateralized oil and natural gas revenues due under normal trade terms, as well as amounts due from working interest owners of oil and gas properties for their share of expenses paid on their behalf by the Company. Management reviews receivables periodically and reduces the carrying amount by a valuation allowance that reflects management’s best estimate of the amount that may not be collectible. As of June 30, 2014 and December 31, 2013 no valuation allowance was considered necessary.

Investment in oil and gas properties – The Company uses the full cost method of accounting for exploration and development activities as defined by the Securities and Exchange Commission (“SEC”). Under this method of accounting, the costs of unsuccessful, as well as successful, exploration and development activities are capitalized as properties and equipment. This includes any internal costs that are directly related to property acquisition, exploration and development activities but does not include any costs related to production, general corporate overhead or similar activities. Gain or loss on the sale or other disposition of oil and gas properties is not recognized, unless the gain or loss would significantly alter the relationship between capitalized costs and proved reserves.

Oil and gas properties include costs that are excluded from costs being depleted or amortized. Oil and natural gas property costs excluded represent investments in unevaluated properties and include non-producing leasehold, geological and geophysical costs associated with leasehold or drilling interests and exploration drilling costs. The Company allocates a portion of its acquisition costs to unevaluated properties based on relative value. Costs are transferred to the full cost pool as the properties are evaluated over the life of the reservoir.

Capitalized interest - The Company capitalizes interest on unevaluated properties during the periods in which they are excluded from costs being depleted or amortized. During the six months ended June 30, 2014, the Company capitalized \$13,190 of interest on unevaluated properties.

Depreciation, depletion and amortization –The depreciable base for oil and natural gas properties includes the sum of all capitalized costs net of accumulated depreciation, depletion and amortization (“DD&A”), estimated future development costs and asset retirement costs not included in oil and natural gas properties, less costs excluded from amortization. The depreciable base of oil and natural gas properties is amortized on a unit-of-production method.

Ceiling test – Future production volumes from oil and gas properties are a significant factor in determining the full cost ceiling limitation of capitalized costs. Under the full cost method of accounting, the Company is required to periodically perform a “ceiling test” that determines a limit on the book value of oil and gas properties. If the net capitalized cost of proved oil and gas properties, net of related deferred income taxes, plus the cost of unproved oil and gas properties, exceeds the present value of estimated future net cash flows discounted at 10 percent, net of related tax affects, plus the cost of unproved oil and gas properties, the excess is charged to expense and reflected as additional accumulated DD&A. The ceiling test calculation uses a commodity price assumption which is based on the weighted arithmetic average of the price on the first day of each month for each month within the prior 12 month period and excludes future cash outflows related to estimated abandonment costs. The Company did not recognize impairment on its oil and gas properties during the quarter ended June 30, 2014, nor any prior period. Due to the volatility of commodity prices, should oil and natural gas prices decline in the future, it is possible that a write-down could occur.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

3. SIGNIFICANT ACCOUNTING POLICIES - continued

Proved reserves are estimated quantities of crude oil, natural gas, and natural gas liquids, which geological and engineering data demonstrate with reasonable certainty to be recoverable from known reservoirs under existing economic and operating conditions. The independent engineering estimates include only those amounts considered to be proved reserves and do not include additional amounts which may result from new discoveries in the future, or from application of secondary and tertiary recovery processes where facilities are not in place or for which transportation and/or marketing contracts are not in place. Estimated reserves to be developed through secondary or tertiary recovery processes are classified as unevaluated properties.

The determination of oil and gas reserves is a subjective process, and the accuracy of any reserve estimate depends on the quality of available data and the application of engineering and geological interpretation and judgment. Estimates of economically recoverable reserves and future net cash flows depend on a number of variable factors and assumptions that are difficult to predict and may vary considerably from actual results. In particular, reserve estimates for wells with limited or no production history are less reliable than those based on actual production. Subsequent re-evaluation of reserves and cost estimates related to future development of proved oil and gas reserves could result in significant revisions to proved reserves. Other issues, such as changes in regulatory requirements, technological advances and other factors which are difficult to predict could also affect estimates of proved reserves in the future.

Gains and losses on the sale of oil and gas properties are not generally reflected in income. Sales of less than 100% of the Company's interest in the oil and gas property are treated as a reduction of the capital cost of the field, with no gain or loss recognized, as long as doing so does not significantly affect the unit-of-production depletion rate. Costs of retired equipment, net of salvage value, are usually charged to accumulated depreciation.

Goodwill - Goodwill represents the excess of the purchase price over the fair value of the net identifiable tangible and intangible assets of acquired companies. Goodwill is not amortized; instead, it is tested for impairment annually or more frequently if indicators of impairment exist.

Goodwill was \$447,084 as of June 30, 2014 and December 31, 2013, and was acquired on November 23, 2010 in connection with the Company's reverse acquisition (Note 1).

Asset retirement obligations – Accounting principles require that the fair value of a liability for an asset's retirement obligation ("ARO") be recorded in the period in which it is incurred if a reasonable estimate of fair value can be made, and that the corresponding cost be capitalized as part of the carrying amount of the related long-lived asset. The liability is accreted to its then-present value each subsequent period, and the capitalized cost is depleted over the useful life of the related asset. Abandonment cost incurred is recorded as a reduction to the ARO liability.

Inherent in the fair value calculation of an ARO are numerous assumptions and judgments including the ultimate settlement amounts, inflation factors, credit adjusted discount rates, timing of settlement, and changes in the legal, regulatory, environmental and political environments. To the extent future revisions to these assumptions impact the fair value of the existing ARO liability, a corresponding adjustment is made to the oil and gas property balance. Settlements greater than or less than amounts accrued as ARO are recorded as a gain or loss upon settlement.

Asset retirement obligation activity is disclosed in Note 10.

Share-based compensation– Compensation cost for equity awards is based on the fair value of the equity instrument on the date of grant and is recognized over the period during which an employee is required to provide service in

exchange for the award. Compensation cost for liability awards is based on the fair value of the vested award at the end of each period.

Revenue recognition – The Company recognizes oil and gas revenues based on production date. When production is sold at a fixed or determinable price, persuasive evidence of an arrangement exists, delivery has occurred and title has transferred, and collectability is reasonably assured any revenue adjustments for volume variances are recognized.

Basic and diluted earnings (loss) per share - Basic earnings (loss) per common share is computed by dividing net income (loss) available to common shareholders by the weighted average number of common shares outstanding during the period. Diluted earnings (loss) per common share is computed in the same way as basic earnings (loss) per common share except that the denominator is increased to include the number of additional common shares that would be outstanding if all potential common shares had been issued and if the additional common shares were dilutive. The Company has not included potentially dilutive securities in the calculation of loss per share for any periods presented as the effects would be anti-dilutive.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

3. SIGNIFICANT ACCOUNTING POLICIES - continued

Environmental laws and regulations – The Company is subject to extensive federal, state and local environmental laws and regulations. Environmental expenditures are expensed or capitalized depending on their future economic benefit. The Company believes that it is in compliance with existing laws and regulations.

Recent accounting pronouncements – In May 2011, the FASB issued updated accounting guidance related to fair value measurements and disclosures. This guidance includes amendments that clarify the application of existing fair value measurement requirements, in addition to other amendments that change principles or requirements for measuring fair value and for disclosing information about fair value measurements. This guidance is effective for annual periods beginning after December 15, 2011. The adoption of this guidance did not have a material effect on the Company's consolidated financial statements.

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2014-09 that introduces a new five-step revenue recognition model in which an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. This ASU also requires disclosures sufficient to enable users to understand the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers, including qualitative and quantitative disclosures about contracts with customers, significant judgments and changes in judgments, and assets recognized from the costs to obtain or fulfill a contract. This standard is effective for fiscal years beginning after December 15, 2016, including interim periods within that reporting period. The Company is currently evaluating the new guidance to determine the impact it will have on its consolidated financial statements.

In September 2011, the FASB issued guidance that amends and simplifies the rules related to testing goodwill for impairment. The revised guidance allows an entity to first assess qualitative factors to determine whether the existence of events or circumstances leads to a determination whether it is more likely than not that the fair value of reporting unit is less than its carrying amount. The results of this assessment will determine whether it is necessary to perform the currently required two-step impairment test. Under this update, an entity also has the option to bypass the qualitative assessment for any reporting unit in any period and proceed directly to performing the two-step goodwill impairment test. This guidance is effective for annual periods beginning after December 15, 2011. The adoption of this guidance did not have a material effect on the Company's consolidated financial statements.

Other recently issued or adopted accounting pronouncements are not expected to have, or did not have, a material impact on the Company's financial position or results from operations.

Subsequent events – The Company evaluated subsequent events through August 14, 2014 the date of issuance of the financial statements. Subsequent events are disclosed in Note 11.

4. RELATED PARTY PAYABLES

As of June 30, 2014 related party payables consisted of accrued and unpaid compensation to two of our executive officers totaling \$90,000.

5. COMMITMENTS AND CONTINGENCIES

The Company is subject to contingencies as a result of environmental laws and regulations. Present and future environmental laws and regulations applicable to the Company's operations could require substantial capital expenditures or could adversely affect its operations in other ways that cannot be predicted at this time. As of June 30, 2014 and December 31, 2013, no amounts had been recorded because no specific liability has been identified that is reasonably probable of requiring the Company to fund any future material amounts.

6. STOCKHOLDERS' EQUITY

The Company's Articles of Incorporation do not authorize the Board of Directors to issue any shares of preferred stock. As of June 30, 2014 there were no issued and outstanding shares of preferred stock and there were no agreements or understandings for the issuance of preferred stock.

During the quarter ended June 30, 2014, the Company issued 447,155 shares of Common Stock for cash of \$1,650,000.

During the quarter ended June 30, 2014, the Company issued 50,180 shares of Common Stock as compensation for services valued at \$161,202.

During the quarter ended June 30, 2014, the Company issued 100,000 shares of Common Stock for exercise of warrants.

During the quarter ended June 30, 2014 the Company issued 579,285 shares of Common Stock in conversions of convertible note principal of \$1,013,750 and 5,437 shares for interest of \$9,514 on convertible notes.

During the quarter ended June 30, 2014, the Company issued 912,845 shares of Common Stock for mineral interests valued at \$3,225,629.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

6. STOCKHOLDERS' EQUITY - continued

A summary of warrants and stock options outstanding as of June 30, 2014 by exercise price and year of expiration is presented below:

| Exercise Price | Expiration Date in | | 2016 | 2017 | 2018 | 2019 | Total |
|----------------|--------------------|---------|-----------|---------|-----------|---------|-----------|
| | 2014 | 2015 | | | | | |
| \$ 1.75 | 80,000 | 855,000 | 1,135,714 | - | - | | 2,070,714 |
| \$ 2.00 | - | - | 1,035,271 | 126,000 | 1,696,380 | | 2,857,651 |
| \$ 2.09 | | | | | 2,800,000 | | 2,800,000 |
| \$ 2.50 | 225,000 | 50,000 | 100,000 | - | - | | 375,000 |
| \$ 2.75 | | | 250,000 | | | | 250,000 |
| \$ 2.82 | | | | | 38,174 | | 38,174 |
| \$ 3.00 | | | 100,000 | | | | 100,000 |
| \$ 5.00 | - | - | 25,000 | 20,000 | | | 45,000 |
| \$ 6.00 | | | | | 577,501 | 142,111 | 719,612 |
| | 305,000 | 905,000 | 2,645,985 | 146,000 | 5,112,055 | 142,111 | 9,256,151 |

At June 30, 2014 the Company had reserved 9,256,151 shares for future exercise of warrants.

Warrants issued in relation to the promissory notes issued (see note 9) were valued using the Black-Scholes Option Pricing Model. The assumptions used in calculating the fair value of the warrants issued are as follows:

| | |
|--|-------------|
| Risk-free interest rate | 0.78% |
| Expected volatility of 191% - common stock | 247% |
| Dividend yield | 0.00% |
| Discount due to lack of 20% to marketability | 30% |
| Expected life of warrant | 3 - 5 years |

7. INVESTMENT IN OIL AND GAS PROPERTIES

The following table presents the investment in oil and gas properties of the Company as of June 30, 2014 and December 31, 2013:

| | 6/30/2014 | 12/31/2013 |
|---|---------------|---------------|
| Evaluated costs subject to amortization | \$ 20,490,274 | \$ 9,484,014 |
| Unevaluated costs | 7,989,540 | 4,758,806 |
| Total capitalized costs | 28,479,814 | 14,242,820 |
| Less accumulated depreciation, depletion and amortization | (2,162,914) | (1,204,069) |
| Net capitalized costs | \$ 26,316,900 | \$ 13,038,751 |

Unevaluated costs as of June 30, 2014 include \$656,647 associated with the Company's interest in the Coulter #1 well. The Coulter #1 well is undergoing production and test operations with the goal of removing sufficient water from the wellbore to allow production of natural gas. Other unevaluated costs are related to accumulated mineral lease costs.

In April 2013, we entered into an agreement to acquire certain assets of Xtreme Oil & Gas, Inc. of Plano, Texas ("Xtreme"). Included in that agreement were the Smokey Hills Prospect in McPherson County, Kansas, the Cimarron Area Hunton Project in Logan County, Oklahoma, and an interest in a salt water disposal facility in Seminole, Oklahoma. Total consideration for all the properties was \$1.6 million.

During the second quarter, 2014 the Company acquired additional interest in Hunton properties in exchange for 902,845 shares of common stock valued at \$3,193,029. This acquisition increased the percentage ownership in leased acreage and working interests in various Hunton wells.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

8. INCOME TAXES

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss carry forwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. A valuation allowance is established to reduce deferred tax assets if it is more likely than not that the related tax benefits will not be realized. The Company has placed a 100% valuation allowance against the net deferred tax asset because future realization of these assets is not assured.

Authoritative guidance for uncertainty in income taxes requires that the Company recognize the financial statement benefit of a tax position only after determining that the relevant tax authority would more likely than not sustain the position following an examination. Management has reviewed the Company's tax positions and determined there were no uncertain tax positions requiring recognition in the consolidated financial statements. The Company's tax returns remain subject to federal and state tax examinations for all tax years since inception as none of the statutes have expired. Generally, the applicable statutes of limitation are three to four years from their respective filings.

Estimated interest and penalties related to potential underpayment on any unrecognized tax benefits are classified as a component of tax expense in the statement of operation. The Company has not recorded any interest or penalties associated with unrecognized tax benefits for any periods covered by these financial statements.

As of December 31, 2013 the Company had federal net operating loss carry forwards of approximately \$12.6 million available to offset future taxable income, and has incurred additional taxable losses during 2014. These loss carry forwards will expire in various years through 2032, if not previously utilized. Utilization of these net operating loss carry forwards is dependent, in part, on generating sufficient taxable income prior to the expiration of such loss carry forwards. In addition, the Company's ability to utilize its net operating loss carry forwards may be substantially limited or eliminated pursuant to Internal Revenue Code Section 382.

9. PROMISSORY NOTES

On December 18, 2012, the Company exchanged \$412,500 of outstanding convertible promissory notes for new 12% Series A Secured Convertible Promissory Notes ("12% Notes") described below. The 12% Notes were issued as part of a larger offering with senior liens on the Company's oil and gas properties. In order to induce the holders of the previously outstanding convertible promissory notes to exchange such promissory notes and to relinquish their priority liens on the Company's oil and gas properties in favor of all 12% Convertible Promissory Note holders, the Company agreed to grant the note holders a total of 235,714 four year warrants to purchase common stock at \$1.75 per share, valued at \$240,428, and 235,714 four year warrants to purchase common stock at \$2.00 per share, valued at \$233,357. The total of these warrants, \$473,785, is reflected as debt issuance costs on the balance sheet, as these costs relate to the larger offering of 12% Convertible Promissory Notes.

On December 18, 2012, the Company issued \$690,000 of 12% Notes to new investors. The 12% Notes are due and payable on March 31, 2015 and provide for conversion into common stock at a price of \$1.75 per share and include the issuance of 8,000 warrants for each \$70,000 of principal amount purchased. The warrants carry a five year term and have an exercise price of \$2.00 per share. They were valued at \$137,340, which is reflected as a discount on the 12% Notes, to be amortized over the life of the debt under the effective interest method. Since the conversion price on

the 12% Notes was below the market price of the Company's common stock on the date of issuance, this constitutes a beneficial conversion feature. The amount is calculated as the difference between the market price of the common stock on the date of closing and the effective conversion price as adjusted by the discount for the warrants issued. The amount of the beneficial conversion feature was \$390,600, and is also reflected as a discount on the 12% Notes. The fair value of the 12% Notes is determined utilizing Level 2 measurements in the fair value hierarchy.

During the year ended December 31, 2013, the Company issued an additional \$10,895,773 in principal value of 12% Notes. Such notes carry the same terms as described above. In connection therewith, the Company also issued a total of 1,308,082 five-year warrants to purchase common stock at an exercise price of \$2.00 per share. The value of the warrant shares was \$1,917,158 and the amount recorded for the beneficial conversion feature was \$5,770,654. These amounts were recorded as a discount on the 12% Notes. In addition, the Company engaged a placement agent to source investors for the majority of these additional notes. This placement agent was paid a fee of 10% of the principal amount of the notes plus a non-accountable expense reimbursement of up to 2% of the principal raised by the agent. The placement agent also received 552,057 warrants to purchase common shares at \$2.00 per share for a period of three years, valued at \$614,163. All the amounts paid to the placement agent have been included in debt issuance costs and will be amortized into interest expense over the life of the 12% Notes.

The 12% Notes described above have a first priority lien on all of the assets of the Company.

During the quarter ended June 30, 2014, the Company issued an additional \$3,197,500 in principal value of 12% Series B Convertible Unsecured Promissory Notes. The 12% Notes are due and payable on June 30, 2017 and provide for conversion into common stock at a price of \$4.50 per share and include the issuance of one warrant for each \$22.50 of principal amount purchased. The Company issued a total of 142,111 of these five-year warrants to purchase common stock at an exercise price of \$6.00 per share. The value of the warrant shares was \$405,016 and the amount recorded for the beneficial conversion feature was \$195,466. These amounts were recorded as a discount on the 12% Notes.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

10. ASSET RETIREMENT OBLIGATIONS

The following is a reconciliation of the asset retirement obligation liability through June 30, 2014:

| | |
|---|-----------|
| Asset retirement obligation – January 1, 2012 | \$ 11,369 |
| Adjustment to estimated liability | 693 |
| Accretion expense | 552 |
| Asset retirement obligation – December 31, 2012 | \$ 12,614 |
| Estimated liabilities recorded | 10,407 |
| Accretion Expense | 1,361 |
| Asset retirement obligation – December 31, 2013 | \$ 24,382 |
| Accretion Expense | 534 |
| Asset retirement obligation – March 31, 2014 | \$ 24,916 |
| Accretion Expense | 1,059 |
| Asset retirement obligation – June 30, 2014 | \$ 25,975 |

11. SUBSEQUENT EVENTS

On August 7, 2014, we entered into a Purchase Agreement with Hudspeth Oil Corporation (“Hudspeth”), McCabe Petroleum Corporation (“MPC”) and Greg McCabe. Mr. McCabe is the sole owner of both Hudspeth and MPC. Under the terms and conditions of the Purchase Agreement, at closing, we will purchase 100% of the capital stock of Hudspeth which will hold certain oil and gas assets, including a 100% working interest in 172,000 mostly contiguous acres in the Orogrande Basin in West Texas. This acreage is in the primary term under five-year leases that carry additional five-year extension provisions. As consideration, at closing we will issue 868,750 shares of our common stock to Mr. McCabe and pay a total of \$100,000 in geologic origination fees to third parties. Additionally, Mr. McCabe will have an optional 10% working interest back-in after payout and a reversionary interest if drilling obligations are not met, all under the terms and conditions of a participation and development agreement. Closing of the transactions contemplated by the Purchase Agreement is to take place on or before September 23, 2014.

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

Basis of Presentation of Financial Information

On November 23, 2010, the Share Exchange Agreement (the "Exchange Agreement" or "Transaction") between Pole Perfect Studios, Inc. ("PPS") and Torchlight Energy, Inc. ("TEI") was entered into and closed, through which the former shareholders of TEI became shareholders of PPS. At closing, PPS abandoned its previous business. Consequently, as a result of the Transaction, the business of TEI became our sole business.

Summary of Key Results

Overview

We are engaged in the acquisition, exploration, exploitation and/or development of oil and natural gas properties in the United States.

The following discussion of our financial condition and results of operations should be read in conjunction with our audited financial statements included herewith for the year ended December 31, 2013. This discussion should not be construed to imply that the results discussed herein will necessarily continue into the future, or that any conclusion reached herein will necessarily be indicative of actual operating results in the future. Such discussion represents only the best present assessment by our management.

We had no active operations prior to the inception of TEI on June 25, 2010 and had limited revenues prior to the year ended December 31, 2012.

Current Projects

We currently have interests in five oil and gas projects, the Marcelina Creek Field Development in Wilson County, Texas, the Coulter Field in Waller County, Texas, the Smokey Hills Prospect in McPherson County, Kansas, the Ring Energy Joint Venture in Southwest Kansas and the Hunton play in partnership with Husky Ventures in Central Oklahoma.

Marcelina Creek Field Development.

On July 6, 2010, TEI entered into a participation agreement with Bayshore Operating Corporation, LLC ("Bayshore"), which is currently the holder of an oil, gas and mineral lease covering approximately 1,045 acres in Wilson County, Texas, known as the Marcelina Creek Field Development. The Participation Agreement provides for the drilling of four wells. Three of the obligation wells have been drilled. The first three wells include a horizontal re-entry well known as the Johnson-1-H, a vertical well known as the Johnson #4, and a lateral well known as the Johnson #2-H. These three wells are presently producing a total of approximately 150 BOPD. The remaining well is to be a vertical development well at a location to be determined within the existing lease. The company has 1,045 acres in the Project, all held by production.

The Marcelina Creek Field Development is located over the Austin Chalk, Buda and Eagle Ford Formations, which formations are well known and established producers in central Texas. Their production is controlled by vertical fracturing of the rock with high productivity in wells which encounter the greatest amount of fractures. With the advent of horizontal drilling technology, numerous opportunities exist in areas and fields that were only drilled

vertically.

Coulter Field

In January 2012, we entered into a farm-in agreement, titled the “Coulter Limited Partnership Agreement” (the “Coulter Agreement”), with La Sal Energy, LLC (“La Sal”). La Sal owns a 100% working interest and a 75% net revenue interest in approximately 940 acres of oil, gas and mineral leases in Waller County, Texas, on which the well known as “John Coulter #1-R” is located. This well is adjacent to the Katy Field, located on its northwestern up dip edge, which produces primarily from the Wilcox Sparks formation.

Pursuant to the Coulter Agreement, we acquired a 34% working interest and a 25.5% net revenue interest from La Sal’s interest in the John Coulter #1-R for the purchase price of \$350,000, which was to be applied to 100% of the costs of a fracture stimulation treatment on the well. Under the agreement, we had options to purchase additional working interests up to a total of 45%. We exercised the first option and purchased an additional 6% for \$50,000, bringing our working interest to 40% and our net revenue interest to 30%. Our option to purchase an additional 5% working interest can be exercised by the payment of \$50,000 within 30 days of first commercial production from the well. If commercial production is established, the net revenue split will be 80% to us and 20% to La Sal until net revenue totals \$437,500, after which the net revenue will be split according to the interests in the well. Expenses above the initial \$350,000 will be split according to the working interests in the well. Our total investment in the project, including fracture stimulation, subsequent testing, and purchase of additional interests and capitalized interest, amounted to \$656,647 as of June 30, 2014.

The Coulter #1-R was a replacement well drilled by La Sal for the Coulter #1 which had mechanical problems caused by split casing. In February 2012 the well was fracture stimulated. The results were encouraging and the well appears to be capable of commercial gas production. However, the well is still recovering fluid and has not yet been hooked up to a nearby pipeline for production. The source of the fluid has not been conclusively determined. It may be recovery of drilling and/or fracture stimulation fluid or may be entering the wellbore from one or more downhole formations or an adjacent wellbore in the field. We are continuing to flow fluid from the well and the well is periodically shut-in for pressure build up tests. We have cemented off the split casing in the Coulter #1 well and are conducting tests to determine productivity. We have begun discussions with the gas gatherer in the area and are working on completing the gas contract and the well. Limited activity has occurred in the first quarter as we continue to explore our options for this property.

Smokey Hills Prospect, McPherson County, Kansas

In April 2013, we entered into an agreement to acquire certain assets of Xtreme Oil & Gas, Inc. of Plano, Texas (“Xtreme”). Included in that agreement were the Smokey Hills Prospect in McPherson County, Kansas, the Cimarron Area Hunton Project in Logan County, Oklahoma, and an interest in a salt water disposal facility in Seminole, Oklahoma. Total consideration for all the properties was \$1.6 million.

The Smokey Hills acquisition included approximately 16,000 gross acres and a well, the Hoffman 1-H within the greater Lindsborg Field area. Our working interest is nearly 18%. Wells had been drilled vertically in the 1960’s to present at depths of less than 4,000 feet looking for production from Mississippian carbonated fractured reservoirs. The Hoffman well was drilled laterally 4,200 feet and fracking had not been completed at the time of our acquisition of the project. Core analysis and logs indicated good porosity at 14 to 22%. Following our acquisition, the well was hydraulically fractured, but the results were disappointing. We presently are evaluating our next efforts to monetize the investment of nearly \$940,000. Allocated costs are high due to the large acreage position. We are in process of drilling the first well in a ten well program as of June 30, 2014 to evaluate producing the formation in a traditional vertical method. Of the 800 wells of interest in the area, all were produced vertically and in economic quantities.

The results of the ten well program will drive the continuing development of the Smokey Hills acreage. Based on the economic success of the first ten wells and the geological analysis of the acreage, a drilling program will continue at an initial planned pace of four wells each month which will hold 640 additional acres per month. The leases are beyond their primary term and in their two year extension period. The leases are scheduled to expire over the period from third quarter, 2014 through third quarter, 2015. As continued drilling generates economic success we plan to increase the pace of drilling sufficient to develop 100% of the acreage prior to expiration of any of the acreage undeveloped as of December 31, 2013.

Since development did not continue due to the need for analysis after the Hoffman well experience, the acreage position declined from approximately 16,000 acres at acquisition to approximately 11,752 at December 31, 2013.

The Ring Energy Joint Venture, Southwest Kansas

In October 2013, we entered into a Joint Venture agreement with Ring Energy. The agreement called for us to provide for \$6.2 million in drilling capital to, in effect, match Ring Energy’s expenditures for leasing. In exchange for this commitment, we would receive a 50% interest in each well bore drilled and the acreage unit it held, until we had spent \$6.2 million. At such time, we would then receive a 50% Working Interest in the entire lease block consisting of 17,000 +/- acres. We were to provide \$3.1 million in advance of the program commencing, which would cover approximately 5 wells to be drilled and completed. Once the initial five wells are completed, we and Ring would evaluate the program and the drilling activity and determine if another five wells are to be drilled. Should we continue with the program, we would then deposit another \$3.1 million with Ring for drilling and completion of the next five

wells.

We made the initial \$3.1 million deposit and the first five well drilling program is currently underway. Well locations have been selected and drilling operations have commenced in March, 2014. As of June 30, 2014 we are currently in well five of the first five well program.

Hunton Play, Central Oklahoma

The Xtreme transaction also included the acquisition of three Hunton wells, the Hancock, Robinson and Lenhart. The Hancock and Robinson are producing wells but have small working interests of 1% and .25 of 1%, respectively.

The Lenhart well is a 62% working interest and was being prepared for a fracture stimulation when it was previously damaged, prior to our acquisition, by the service contractor. The well bore at the Hunton level has an irretrievable pipe in the hole and cannot be used to produce from the Hunton. Although Xtreme won the litigation against the contractor, he failed to pay for the replacement of the well bore, and Xtreme was responsible for costs primarily to Baker-Hughes for work done on the well. We took responsibility for those charges and negotiated a settlement of approximately \$600,000.

Subsequent to the above, we have identified a shallow sandstone that could potentially be productive. As previously planned, we tested this formation, and although there were hydrocarbons present, they were thought not to be in sufficient quantities to be economic. However, prior to plugging the well, we had a crew check the well one last time and we found that the well had significant pressure build up indicating a possibility of economic hydrocarbons. We are currently in initial restart of production of the well to determine future economic feasibility.

During the second quarter of 2013, Torchlight entered into an agreement with Husky Ventures to participate in the drilling of wells to the Hunton Formation in central Oklahoma. We continue to expand this relationship with Husky Ventures on a monthly basis as we expand our lease acreage in the contracted Areas of Mutual Interest (AMI's).

When Torchlight executed the agreement Husky had already drilled and completed 18 successful wells in the Hunton. We estimated that Husky had spent, or caused to be spent, \$125 million dollars in what we considered a Research and Development project. The results of Husky's initial program lead them to develop certain drilling and completions techniques of which we could participate in and take advantage of.

The terms in our agreement with Husky are that we pay our proportionate costs of leases and operating expenses based on our working interest. However, for the drilling costs, the AFE, we carry Husky for 15% based on our working interest participation. This is to compensate Husky for the initial program mentioned above and, additionally, the project coordination of the geological, leasing, legal and title opinions, survey and permitting, all drilling, frac design, completion and equipping, day to day operations, and accounting and filing all required monthly and annual reporting to all governmental agencies .

Torchlight believes this is an equitable agreement in that we have the benefit of the initial programs results while participating with a proven operator in areas that continue to provide us with outstanding results in a safe investment environment.

Specifically, we were able to negotiate a 15% working interest in approximately 3,700 acres in the Cimarron Area of Logan County in May 2013. Leasing continued monthly which resulted in our acreage increasing to 5,061 by December 31, 2013. Within a week the Boeckman #1-H well was spud and was subsequently completed and fracture stimulated in July. At June 30, 2014, the Boeckman well continues to produce at a rate of 68 barrels of oil per day and 424 thousand cubic feet of gas per day. We acquired a working interest in the Boeckman #1-H well and subsequently sold part of our ownership in the Boeckman well for \$990,000. The purchaser executed a promissory note dated May 1, 2013 for the purchase. We have collected the balance in full. We agreed to a preferential payout to the purchaser equal to 50% of his acquired interest. The agreement was amended in the first quarter of 2014 to include our agreement to advance funds under a note receivable from the purchaser to be repaid from the purchaser's revenue preference subsequent to October, 2014. Revenue payable to the investor based on revenue to June 30, 2014 has been accrued in the accompanying financial statements.

In the third quarter of 2013, we acquired from a third party for stock, a 15.3% working interest in 5011+/- acres in the Chisolm Trail AMI with Husky Ventures Inc. as the operator. Leasing also continued monthly in this AMI increasing our acreage to 8,665 as of December 31, 2013. Our acreage position at June 30, 2014 totals 12,554 acres. This acquisition will allow us to participate in 60+ gross wells in the coming two years. This acquisition along with the previous acreage position in the Cimarron Trail will give us 80+ drilling locations in the two AMI's. It is our intention to continue to increase this position through continuing leasing and forced pooling.

In the fourth quarter of 2013 we entered into our 3rd Area of Mutual Interest (AMI) with Husky Ventures, the Viking Prospect. This AMI covers four townships in size. We acquired a 25% interest in 3,945 acres in the Viking. Leasing is continuing monthly so that we had an interest in 4,326 acres as of June 30, 2014. In second quarter, 2014 Husky spud the first two wells in the AMI.

In January of 2014, we again elected to continue to expand in the Hunton Play with Husky Ventures. We again contracted for a 25% Working Interest in an AMI consisting of eight townships in South Central Oklahoma. There is an active leasing program in this AMI as well. Our acreage position at June 30, 2014 totals 5,938 acres. We expect to spud our first well in this AMI in July, 2014.

Lastly, in February of 2014, we picked up a 10% Working Interest in a well in the Prairie Grove AMI that is currently drilling. We picked up this interest from a non-consenting third party who elected not to participate in the well.

As of June 30, 2014, we are actively producing, drilling, fracking, or flowing back in twenty-one wells across all of our AMI's with Husky Ventures.

During the second quarter, 2014 the Company acquired additional interest in Hunton properties in exchange for 902,845 shares of common stock valued at \$3,193,029. This acquisition increased the percentage ownership in leased acreage and working interests in various Hunton wells.

Salt Water Disposal Facility

As part of the Xtreme transaction we also acquired a 22.5% net royalty on a salt water disposal facility in Seminole, Oklahoma. No value was placed on the facility due to operational uncertainty. The facility which was newly commissioned in January 2013 is a state of the art disposal facility which can handle 20,000 barrels of produced and injected fluids per day. Oil and gas wells produce large quantities of saltwater that must be trucked and disposed of at a cost to the producer. During the second quarter, 2014 disposal at the facility averaged 1,583 barrels per day. With increasing activity in the area, we anticipate volume increasing in the future. In addition to the royalty, we have a small working interest in the Project and the right to a working interest of 37.5% when the original investors in the facility receive payout of their investment.

Historical Results for the six months ended June 30, 2014 and 2013:

Revenues and Cost of Revenues

For the six months ended June 30, 2014, we had production revenue of \$2,321,969 compared to \$399,390 for 2013. Refer to the table of production and revenue included below for quarterly changes in revenue. Our cost of revenue, consisting of lease operating expenses and production taxes, was \$576,235, and \$161,021 for the six months ended June 30, 2014 and 2013, respectively.

| Property | Quarter | Oil Production {BBLs} | Gas Production {MCF} | Oil Revenue | Gas Revenue | Total Revenue |
|------------------------|--------------|-----------------------------|----------------------------|--------------|-------------|---------------|
| Marcelina | Q1 - 2013 | 2,255 | 0 | \$ 229,204 | \$ - | \$ 229,204 |
| Oklahoma | Q1 - 2013 | 0 | 0 | \$ - | \$ - | \$ - |
| Total Q1 | | 2,255 | 0 | \$ 229,204 | \$ - | \$ 229,204 |
| Marcelina | Q2 - 2013 | 1,673 | 0 | \$ 160,823 | \$ - | \$ 160,823 |
| Oklahoma | Q2 - 2013 | 0 | 0 | \$ - | \$ - | \$ - |
| Total Q2 | | 1,673 | 0 | \$ 160,823 | \$ - | \$ 160,823 |
| Marcelina | Q3 - 2013 | 3,896 | 0 | \$ 387,872 | \$ - | \$ 387,872 |
| Oklahoma | Q3 - 2013 | 316 | 1,321 | \$ 7,064 | \$ - | \$ 7,064 |
| Total Q3 | | 4,212 | 1,321 | \$ 394,936 | \$ - | \$ 394,936 |
| Marcelina | Q4 - 2013 | 4,626 | 0 | \$ 401,956 | \$ - | \$ 401,956 |
| Oklahoma | Q4 - 2013 | 519 | 2,220 | \$ 47,793 | \$ 9,286 | \$ 57,079 |
| Total Q4 | | 5,145 | 2,220 | \$ 449,749 | \$ 9,286 | \$ 459,035 |
| Year ended 12/31/13 | | 13,285 | 3,541 | \$ 1,234,712 | \$ 9,286 | \$ 1,243,998 |
| Marcelina | Q1 - 2014 | 3,888 | 0 | \$ 360,074 | \$ - | \$ 360,074 |

Edgar Filing: TORCHLIGHT ENERGY RESOURCES INC - Form 10-Q

| | | | | | | |
|---------------|--------------|--------|--------|--------------|------------|--------------|
| Oklahoma | Q1 - 2014 | 2,326 | 7,366 | \$ 233,686 | \$ 49,210 | \$ 282,896 |
| Total Q1-2014 | | 6,214 | 7,366 | \$ 593,760 | \$ 49,210 | \$ 642,970 |
| Marcelina | Q2 - 2014 | 4,546 | 0 | 368,937 | - | 368,937 |
| Oklahoma | Q2 - 2014 | 9,660 | 33,584 | \$ 899,709 | \$ 189,073 | 1,088,782 |
| Kansas | Q2 - 2014 | 2,059 | 0 | \$ 172,316 | \$ - | 172,316 |
| Total Q2-2014 | | 16,265 | 33,584 | \$ 1,440,962 | \$ 189,073 | \$ 1,630,035 |

We recorded depreciation, depletion and amortization expense of \$958,845 for the six months ended June 30, 2014.

General and Administrative Expenses

Our general and administrative expenses for the six months ended June 30, 2014 and 2013 were \$7,139,247 and \$2,114,651, respectively. Our general and administrative expenses consisted of noncash stock and warrant compensation expense \$4,754,000, employee compensation expense \$746,000, capital funding costs \$260,000, investor relations costs \$516,000, accounting, auditing, and professional fees \$289,000, and consulting fees and other general corporate expenses \$574,247. The increases in general and administrative expenses for the six months ended June 30, 2014 compared to 2013 are detailed as follows:

| | | |
|---|---|-------------|
| - | Increase in non cash stock and warrant compensation | \$3,700,000 |
| - | Increase in capital funding costs | 108,000 |
| - | Increase in investor relations costs | 126,000 |
| - | Increase in legal and auditing expense | 134,000 |
| - | Increase in salaries and expenses (staff increased from two to seven employees) | 746,000 |
| - | Increase in general corporate expenses | 210,596 |
| | Total increase in general and administrative expenses | \$5,024,596 |

Historical Results for the Three Months Ended June 30, 2014 and 2013:

Revenues and Cost of Revenues

For the three months ended June 30, 2014, we had revenue of \$1,639,834 compared to \$170,186 of revenue for the three months ended June 30, 2013. Our cost of revenue, consisting of lease operating expenses and production taxes, was \$397,184 and \$93,021 for the three months ended June 30, 2014 and 2013, respectively.

We recorded depreciation, depletion and amortization expense of \$628,372 for the three months ended June 30, 2014.

General and Administrative Expenses

Our general and administrative expenses for the three months ended June 30, 2014 and 2013 were \$1,318,179 and \$1,581,102, respectively. Our general and administrative expenses consisted of noncash stock and warrant compensation expense \$360,300, employee compensation expense \$378,600, capital funding costs \$88,500, investor relations costs \$177,000, accounting, auditing, and professional fees \$255,400, and consulting fees and other general corporate expenses \$58,379. The increases (decreases) in general and administrative expenses for the three months ended June 30, 2014 compared to 2013 are detailed as follows:

| | | |
|---|---|--------------|
| - | Decrease in noncash stock and warrant compensation | \$(860,700) |
| - | Increase in capital funding costs | 50,100 |
| - | Increase in investor relations costs | 86,500 |
| - | Increase in legal and auditing expense | 27,600 |
| - | Increase in salaries and expenses (staff increased from two to seven employees) | 243,600 |

| | | |
|---|--|--------------|
| - | General corporate expenses | 189,977 |
| | | |
| | Total increase (decrease) in general and administrative expenses | \$(262,923) |

Liquidity and Capital Resources

As June 30, 2014, we had negative working capital of \$7,921,559, current assets of \$3,320,237 consisting of cash, accounts receivable, notes receivable, and prepaid costs and expenses and total assets of \$30,846,801 consisting of current assets, investments in oil and gas properties and goodwill. As of June 30, 2014, we had current liabilities of \$11,241,796, consisting of, accounts payable (principally for development costs), payables to related parties, notes payable and accrued interest. The remaining balance of convertible notes payable (which mature on March 15, 2015) has been reclassified from long term liabilities to current liabilities as of March 31, 2014 which accounts for \$5,952,513 of negative working capital at June 30, 2014. Stockholders' equity was \$16,968,540.

Cash flow used in operating activities for the six months ended June 30, 2014 was \$749,422 compared to \$1,390,286 for the six months ended June 30, 2013. Cash flow used in operating activities can be primarily attributed to net losses from operations of \$10,492,604, which consists primarily of \$7,139,247 of general and administrative expenses, \$4,753,686 of which is non-cash stock based compensation, depreciation, depletion, and amortization of \$962,703, and accretion of convertible note discounts of \$3,158,850.

Cash flow used in operating activities for the six months ended June 30, 2013 can be primarily attributed to net losses from operations of \$2,966,285, which consists primarily of \$2,114,651 of general and administrative expenses, \$1,352,005 of which is non-cash stock based compensation, depreciation, depletion, and amortization of \$354,584, and accretion of convertible note discounts of \$574,895.

We expect to continue to use cash flow in operating activities until such time as we achieve sufficient commercial oil and gas production to cover all of our cash costs.

Cash flow used in investing activities for six months ended June 30, 2014 was \$10,843,479 compared to \$3,879,519 for the six months ended June 30, 2013. Cash flow used in investing activities consists primarily of oil and gas investments in Oklahoma and Kansas properties acquired during the six months ended June 30, 2014.

Cash flow provided by financing activities for the six months ended June 30, 2014 was \$10,834,759 as compared to \$5,990,800 for the six months ended June 30, 2013. Cash flow provided by financing activities consists primarily of proceeds from issuance of convertible notes payable, common stock issues and warrant exercises.

We expect to continue to have cash flow provided by financing activities as we seek new rounds of financing and continue to develop our oil and gas investments.

Our current assets are insufficient to meet our current obligations or to satisfy our cash needs over the next twelve months and as such we will require additional debt or equity financing. Subsequent to June 30, 2014, we received net proceeds of approximately \$425,000 from the offering of convertible notes payable, but these proceeds will not be sufficient to fund all of our proposed drilling operations and operating needs during 2014. We will seek additional financing to meet our drilling plans and needs. We face obstacles in continuing to attract new financing due to our history and current record of net losses and working capital deficits. Therefore, despite our efforts we can provide no assurance that we will be able to obtain the financing required to meet our stated objectives or even to continue as a going concern.

We do not expect to pay cash dividends in the foreseeable future.

Commitments and Contingencies

We are subject to contingencies as a result of environmental laws and regulations. Present and future environmental laws and regulations applicable to our operations could require substantial capital expenditures or could adversely affect our operations in other ways that cannot be predicted at this time. As of June 30, 2014 and June 30, 2013, no amounts have been recorded because no specific liability has been identified that is reasonably probable of requiring us to fund any future material amounts.

We currently have interests in five oil and gas projects, the Marcelina Creek Field Development in Wilson County, Texas, the Coulter Field in Waller County, Texas, projects in Logan and Kingfisher counties, Oklahoma and projects in McPherson and Gray and Finney counties in Kansas. See the description under "Current Projects" above under "Overview" for more information and disclosure regarding commitments and contingencies relating to these projects.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Not Applicable.

ITEM 4. CONTROLS AND PROCEDURES

Disclosure of Controls and Procedures

Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we evaluated the effectiveness of the design and operation of our disclosure controls and

procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act, as of June 30, 2014. Based on this evaluation, our principal executive officer and our principal financial officer concluded that, as of the end of the period covered by this report, our disclosure controls and procedures were effective and adequately designed to ensure that the information required to be disclosed by us in the reports we submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the applicable rules and forms and that such information was accumulated and communicated to our principal executive officer and principal financial officer, in a manner that allowed for timely decisions regarding disclosure.

Changes in Internal Control over Financial Reporting

During the second quarter, 2014 the Company instituted the conversion of its accounting systems to WolfePak, a well respected Oil and Gas Enterprise Accounting System. An additional staff person was added to the accounting department which expands the segregation of duties thereby improving internal control over asset handling and accounting functions.

Our principal executive officer and principal financial officer have indicated that, upon evaluation, there were no other changes in our internal control over financial reporting or other factors during the period covered by this report 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

On February 16, 2012, we filed a lawsuit against Hockley Energy, Inc. and Frank O. Snorheim in the District Court of Harris County, Texas in connection with farmout agreements we entered into with Hockley Energy in November 2011 for the Marcelina Creek prospect and the East Stockdale prospect. We allege that Hockley Energy did not perform its obligations under the agreements, which obligations included providing the agreed upon funding, and we seek damages against both Hockley and Mr. Snorheim (who is a shareholder of Hockley Energy) for breach of contract, fraudulent inducement and promissory estoppel. Each defendant has answered our original petition with a general denial, and we have filed a motion for default judgment. A trial date is set for the two weeks following September 22, 2014, but we have refiled for summary judgment, which will be heard before the trial date. If the motion is granted, it will dispose of the case in Torchlight's favor without a trial. We have also had discussions with the defendants regarding resolving this matter out of court, but we have not reached an agreement to date.

On April 1, 2014, a former member of our Board of Directors, Greg Williams, filed a lawsuit in the 122nd District Court of Galveston County, Texas against us in connection with Mr. Williams' sale of 300,000 shares of our common stock to certain third parties in April 2013. The suit names as defendants the third parties, Torchlight Energy Resources, Inc., Torchlight Energy, Inc., our Chief Executive Officer, Thomas Lapinski, and our President, John Brda. Mr. Williams alleges that Messrs. Brda and Lapinski made misrepresentations to him in connection with the sale, and accordingly they, Torchlight and the third parties are liable to him. The suit seeks rescission of the sale and/or damages. We believe the suit is without merit and intend to vigorously defend ourselves. A mediation is scheduled for September 25, 2014.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

During the quarter ended June 30, 2014, we issued 50,180 shares of common stock to consultants as compensation for services. The securities were issued under the exemption from registration provided by Section 4(a) (2) of the Securities Act of 1933 and the rules and regulations promulgated thereunder. The issuance of securities did not involve a "public offering" based upon the following factors: (i) the issuance of securities was an isolated private transaction; (ii) a limited number of securities were issued to a limited number of purchasers; (iii) there were no public solicitations; (iv) the investment intent of the purchasers; and (v) the restriction on transferability of the securities issued.

During the quarter ended June 30, 2014, investors exercised warrant agreements to purchase a total of 100,000 shares of common stock at a price of \$2.00 per share. The securities were issued under the exemption from registration provided by Section 4(a)(2) of the Securities Act of 1933 and the rules and regulations promulgated thereunder. The issuances of securities did not involve a "public offering" based upon the following factors: (i) each issuance of securities was an isolated private transaction; (ii) a limited number of securities were issued to a limited number of purchasers; (iii) there were no public solicitations; (iv) each purchaser previously represented that it was an "accredited investor"; (v) the investment intent of each purchaser; and (vi) the restriction on transferability of the securities issued.

In May and June of 2014, we sold 12% Series B Unsecured Convertible Promissory Notes to investors, which notes have an aggregate principal amount of \$3,197,500. The notes are due and payable on June 30, 2017 and have a conversion price of \$4.50 per share. We also issued these investors a total of 142,111 of five-year warrants exercisable at \$6.00 per share. We received total consideration of \$3,197,500. The securities were issued under the exemption from registration provided by Section 4(a)(2) of the Securities Act of 1933 and the rules and regulations

promulgated thereunder. The issuances of securities did not involve a “public offering” based upon the following factors: (i) the issuances of securities were an isolated private transaction; (ii) a limited number of securities were issued to a limited number of purchasers; (iii) there were no public solicitations; (iv) each purchaser represented that it was an “accredited investor”; (v) the investment intent of each purchaser; and (vi) the restriction on transferability of the securities issued.

In April 2014, we granted 60,000 stock options to purchase shares of common stock at an exercise price of \$5.05 per share to an employee of a subsidiary of ours, as consideration for services rendered. 20,000 of the options vested immediately, 20,000 of the options will vest on February 1, 2015 and the remaining 20,000 options will vest on February 1, 2016. All of the options will expire on April 1, 2017. The securities were issued under the exemption from registration provided by Section 4(a)(2) of the Securities Act of 1933 and the rules and regulations promulgated thereunder. The issuance of securities did not involve a “public offering” based upon the following factors: (i) the issuance of securities was an isolated private transaction; (ii) a limited number of securities were issued to a single purchaser; (iii) there were no public solicitations; (iv) the investment intent of the purchaser; and (v) the restriction on transferability of the securities issued.

ITEM 6. EXHIBITS

| Exhibit No. | Description |
|-------------|---|
| 2.1 | Share Exchange Agreement dated November 23, 2010. (Incorporated by reference from Form 8-K filed with the SEC on November 24, 2010.) * |
| 3.1 | Articles of Incorporation. (Incorporated by reference from Form S-1 filed with the SEC on May 2, 2008.) * |
| 3.2 | Amended and Restated Bylaws (Incorporated by reference from Form 8-K filed with the SEC on January 12, 2011.) * |
| 10.1 | Agreement to Participate in Oil and Gas Development Joint Venture between Bayshore Operating Corporation, LLC and Torchlight Energy, Inc. (Incorporated by reference from Form 8-K filed with the SEC on November 24, 2010) * |
| 10.2 | Purchase and Sale Agreement between Torchlight Energy, Inc. and Xtreme Oil and Gas, Inc. effective April 1, 2013. (Incorporated by reference from Form 10-Q filed with the SEC on May 15, 2013.) * |
| 10.3 | Employment Agreement with Thomas Lapinski (Incorporated by reference from Form 8-K filed with the SEC on October 15, 2013.) * |
| 10.4 | Employment Agreement with John A. Brda (Incorporated by reference from Form 8-K filed with the SEC on October 15, 2013.) * |
| 10.5 | Amendment to Employment Agreement with John A. Brda (Incorporated by reference from Form 10-K filed with the SEC on June 30, 2014.) * |
| 10.6 | Employment Agreement with Roger Wurtele (Incorporated by reference from Form 8-K filed with the SEC on October 15, 2013.) * |
| 10.7 | Amendment to Employment Agreement with Roger Wurtele (Incorporated by reference from Form 10-K filed with the SEC on June 30, 2014.) * |
| 10.8 | Employment Agreement with Willard McAndrew III (Incorporated by reference from Form 8-K filed with the SEC on October 15, 2013.) * |
| 10.9 | Amendment to Employment Agreement with Willard McAndrew III (Incorporated by reference from Form 8-K filed with the SEC on October 15, 2013.) * |
| 10.10 | Second Amendment to Employment Agreement with Willard McAndrew III (Incorporated by reference from Form 10-K filed with the SEC on June 30, 2014.) * |
| 10.11 | Development Agreement between Ring Energy, Inc. and Torchlight Energy Resources, Inc. (Incorporated by reference from Form 8-K filed with the SEC on October 22, 2013.) * |

- 10.12 Coulter Limited Partnership Agreement dated January 10, 2012
- 10.13 Promissory Note with Boeckman Well LLC dated May 1, 2013 and amendments thereto
- 10.14 12% Series A Secured Convertible Promissory Note (form of)
- 10.15 Securities Purchase Agreement (form of), January 2014
- 10.16 Registration Rights Agreement (form of), January 2014

- 31.1 Certification of principal executive officer required by Rule 13a – 14(1) or Rule 15d – 14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

- 31.2 Certification of principal financial officer required by Rule 13a – 14(1) or Rule 15d – 14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

- 32.1 Certification of principal executive officer and principal financial officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 and Section 1350 of 18 U.S.C. 63.

- 101.INS XBRL Instance Document
- 101.SCH XBRL Taxonomy Extension Schema
- 101.CAL XBRL Taxonomy Extension Calculation Linkbase
- 101.DEF XBRL Taxonomy Extension Definitions Linkbase
- 101.LAB XBRL Taxonomy Extension Label Linkbase
- 101.PRE XBRL Taxonomy Extension Presentation Linkbase

* Incorporated by reference from our previous filings with the SEC

SIGNATURES

Pursuant to the requirements 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.

Torchlight Energy Resources, Inc.

Date: August 14, 2014

/s/ Thomas Lapinski
By: Thomas Lapinski
Chief Executive Officer

Date: August 14, 2014

/s/ Roger Wurtele
By: Roger Wurtele
Chief Financial Officer and Principal
Accounting Officer