CONTANGO OIL & GAS CO
Form 10-Q
November 03, 2016

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2016

OR

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

For the transition period from to

Commission file number 001-16317

CONTANGO OIL & GAS COMPANY

(Exact name of registrant as specified in its charter)

DELAWARE	95-4079863
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)
717 TEXAS AVENUE, SUITE 2900	77002

HOUSTON, TEXAS
(Address of principal executive offices) (Zip Code)

(713) 236-7400

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

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

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

Large accelerated filer	Accelerated filer
Non-accelerated filer	Smaller reporting company

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

The total number of shares of common stock, par value $0.04 per share, outstanding as of November 2, 2016 was 25,262,152.

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CONTANGO OIL & GAS COMPANY AND SUBSIDIARIES

QUARTERLY REPORT ON FORM 10-Q

FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2016

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All references in this Quarterly Report on Form 10-Q to the "Company", "Contango", "we", "us" or "our" are to Contango Oil Gas Company and its subsidiaries.

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Item 1. Consolidated Financial Statements

CONTANGO OIL & GAS COMPANY AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(in thousands, except shares)

	September 30, 2016 (unaudited)	December 31, 2015
CURRENT ASSETS:		
Cash and cash equivalents	$ —	$ —
Accounts receivable, net	10,629	20,504
Prepaid expenses	1,510	1,228
Inventory	540	540
Total current assets	12,679	22,272
PROPERTY, PLANT AND EQUIPMENT:		
Natural gas and oil properties, successful efforts method of accounting:		
Proved properties	1,194,990	1,187,707
Unproved properties	32,283	16,439
Other property and equipment	1,081	1,081
Accumulated depreciation, depletion and amortization	(874,827)	(826,022)
Total property, plant and equipment, net	353,527	379,205
OTHER NON-CURRENT ASSETS:		
Investments in affiliates	16,024	14,222
Other	1,430	1,057
Total other non-current assets	17,454	15,279
TOTAL ASSETS	$ 383,660	$ 416,756
CURRENT LIABILITIES:		
Accounts payable and accrued liabilities	$ 39,908	$ 36,358
Current derivative liability	2,133	—
Current asset retirement obligations	4,430	4,603
Total current liabilities	46,471	40,961
NON-CURRENT LIABILITIES:		
Long-term debt	62,463	115,446
Long-term derivative liability	267	—
Asset retirement obligations	23,004	22,506
Total non-current liabilities	85,734	137,952
Total liabilities	132,205	178,913
COMMITMENTS AND CONTINGENCIES (NOTE 12)		
SHAREHOLDERS' EQUITY:		
Common stock, $0.04 par value, 50 million shares authorized, 30,280,418 shares issued and 24,995,692 shares outstanding at September 30, 2016, 24,636,936	1,200	974

shares issued and 19,381,146 shares outstanding at December 31, 2015		
Additional paid-in capital	294,325	239,524
Treasury shares at cost (5,284,726 shares at September 30, 2016 and 5,255,790 shares at December 31, 2015)	(127,990)	(127,760)
Retained earnings	83,920	125,105
Total shareholders' equity	251,455	237,843
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$ 383,660	$ 416,756

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

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CONTANGO OIL & GAS COMPANY AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share amounts)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(unaudited)		(unaudited)	
REVENUES:				
Oil and condensate sales	$ 4,946	$ 9,500	$ 17,164	$ 35,882
Natural gas sales	12,011	16,020	31,283	48,130
Natural gas liquids sales	2,619	3,515	8,073	11,004
Total revenues	19,576	29,035	56,520	95,016
EXPENSES:				
Operating expenses	8,158	9,036	22,782	29,919
Exploration expenses	444	407	1,088	11,814
Depreciation, depletion and amortization	15,166	38,386	49,586	112,271
Impairment and abandonment of oil and gas properties	1,165	235,150	4,268	237,667
General and administrative expenses	7,486	7,504	18,772	22,683
Total expenses	32,419	290,483	96,496	414,354
OTHER INCOME (EXPENSE):				
Gain (loss) from investment in affiliates, net of income taxes	467	(375)	1,802	(562)
Interest expense	(989)	(785)	(3,045)	(2,315)
Gain on derivatives, net	913	2,011	736	2,001
Other income (expense)	18	4,288	(292)	5,278
Total other income (expense)	409	5,139	(799)	4,402
NET LOSS BEFORE INCOME TAXES	(12,434)	(256,309)	(40,775)	(314,936)
Income tax benefit (provision)	(51)	70,624	(410)	91,159
NET LOSS	$ (12,485)	$ (185,685)	$ (41,185)	$ (223,777)
NET LOSS PER SHARE:				
Basic	$ (0.55)	$ (9.79)	$ (2.02)	$ (11.81)
Diluted	$ (0.55)	$ (9.79)	$ (2.02)	$ (11.81)
WEIGHTED AVERAGE COMMON SHARES OUTSTANDING:				
Basic	22,881	18,966	20,370	18,948
Diluted	22,881	18,966	20,370	18,948

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

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CONTANGO OIL & GAS COMPANY AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

	Nine Months Ended September 30, 2016	2015
	(unaudited)	
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	$ (41,185)	$ (223,777)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation, depletion and amortization	49,586	112,271
Impairment of natural gas and oil properties	4,137	237,656
Exploration expenses (recovery)	(2)	6,826
Deferred income taxes	—	(92,328)
Loss (gain) on sale of assets	(11)	231
Loss (gain) from investment in affiliates	(1,802)	865
Stock-based compensation	4,315	5,008
Unrealized loss (gain) on derivative instruments	2,400	(999)
Changes in operating assets and liabilities:		
Decrease in accounts receivable and other receivables	7,026	3,581
Increase in prepaid expenses	(282)	(5,198)
Decrease in accounts payable and advances from joint owners	(5,621)	(25,373)
Increase (decrease) in other accrued liabilities	2,384	(1,494)
Decrease in income taxes receivable, net	2,668	748
Other	(17)	1,233
Net cash provided by operating activities	$ 23,596	$ 19,250
CASH FLOWS FROM INVESTING ACTIVITIES:		
Natural gas and oil exploration and development expenditures	$ (19,849)	$ (70,389)
Sale of furniture & equipment	$ 11	$ —
Net cash used in investing activities	$ (19,838)	$ (70,389)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Borrowings under credit facility	$ 118,310	$ 284,378
Repayments under credit facility	(171,293)	(233,168)
Net proceeds from equity offering	50,451	—
Purchase of treasury stock	(230)	(71)
Debt issuance costs	(996)	—
Net cash provided by (used in) financing activities	$ (3,758)	$ 51,139
NET CHANGE IN CASH AND CASH EQUIVALENTS	$ —	$ —
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	—	—
CASH AND CASH EQUIVALENTS, END OF PERIOD	$ —	$ —

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

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CONTANGO OIL & GAS COMPANY AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY

(in thousands, except number of shares)

	Common Stock Shares (unaudited)	Amount	Additional Paid-in Capital	Treasury Stock	Retained Earnings	Total Shareholders' Equity
Balance at December 31, 2015	19,381,146	$ 974	$ 239,524	$ (127,760)	$ 125,105	$ 237,843
Equity offering	5,360,000	214	50,237	—	—	50,451
Treasury shares at cost	(28,936)	—	—	(230)	—	(230)
Restricted shares activity	283,482	12	(11)	—	—	1
Stock-based compensation	—	—	4,575	—	—	4,575
Net loss	—	—	—	—	(41,185)	(41,185)
Balance at September 30, 2016	24,995,692	$ 1,200	$ 294,325	$ (127,990)	$ 83,920	$ 251,455

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

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CONTANGO OIL & GAS COMPANY AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. Organization and Business

Contango Oil & Gas Company (collectively with its subsidiaries, “Contango” or the “Company”) is a Houston, Texas based, independent oil and natural gas company. The Company’s business is to maximize production and cash flow from its onshore and offshore properties in the shallow waters of the Gulf of Mexico and to use that cash flow to explore, develop, exploit, produce and acquire crude oil and natural gas properties in the onshore Texas and Rocky Mountain regions of the United States.

The following table lists the Company’s primary producing areas as of September 30, 2016:

Location	Formation
Gulf of Mexico	Offshore Louisiana - water depths less than 300 feet
Madison and Grimes counties, Texas	Woodbine (Upper Lewisville)
Zavala and Dimmit counties, Texas	Buda / Austin Chalk
Weston County, Wyoming	Muddy Sandstone
Texas Gulf Coast	Conventional formations
Sublette County, Wyoming	Jonah Field (1)

(1) Through a 37% equity investment in Exaro Energy III LLC (“Exaro”). Production associated with this investment is not included in the Company’s reported production results for the three and nine months ended September 30, 2016.

Since October 2013, upon the merger with Crimson Exploration Inc., the Company has focused its drilling efforts on liquids-rich horizontal resource plays, such as the Woodbine in Southeast Texas, the Eagle Ford and Buda in South Texas, and the Muddy Sandstone in Wyoming. In addition, the Company has (i) operated producing properties in the Haynesville Shale, Mid Bossier and James Lime formations in East Texas and (ii) operated producing properties in the Denver Julesburg Basin (“DJ Basin”) in Weld and Adams counties in Colorado, which the Company believes may also be prospective in the Niobrara Shale oil play. In July 2016, the Company purchased one-half of the seller’s interest in approximately 12,100 gross undeveloped acres (approximately 5,000 net acres) in the Southern Delaware Basin of Texas for up to $25 million. The Company commenced drilling of its first well on this recently acquired acreage in October 2016.

During the three months ended September 30, 2016, we completed an underwritten public offering of 5,360,000 shares of our common stock for net proceeds of approximately $50.5 million. See Note 3 - "Acquisition and Underwritten Public Offering” for additional information.

Due to the current challenging commodity price environment, the Company has been focusing its 2016 capital program on: (i) the preservation of its healthy financial position; (ii) identification of opportunities for cost efficiencies in all areas of its operations; and (iii) maintaining core leases and continuing to identify new resource potential opportunities internally and, where appropriate, through acquisition. The Company will continuously monitor the commodity price environment, and, if warranted, make adjustments to its strategy as the year progresses. As noted previously, the Company recently began drilling its first well in the newly acquired Southern Delaware Basin acreage.

2. Summary of Significant Accounting Policies

The accounting policies followed by the Company are set forth in the notes to the Company’s audited consolidated financial statements included in its Annual Report on Form 10-K for the year ended December 31, 2015 (the “2015 Form 10-K”) filed with the Securities and Exchange Commission (“SEC”). Please refer to the notes to the financial statements included in the 2015 Form 10-K for additional details of the Company’s financial condition, results of operations and cash flows. No material items included in those notes have changed except as a result of normal transactions in the interim or as disclosed within this report.

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Basis of Presentation

The accompanying unaudited consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America ("GAAP") for interim financial information, pursuant to the rules and regulations of the SEC, including instructions to Quarterly Reports on Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all the information and footnotes required by GAAP for complete annual financial statements. In the opinion of management, all adjustments considered necessary for a fair statement of the unaudited consolidated financial statements have been included. All such adjustments are of a normal recurring nature. The consolidated financial statements should be read in conjunction with the 2015 Form 10-K. The consolidated results of operations for the nine months ended September 30, 2016 are not necessarily indicative of the results that may be expected for the year ending December 31, 2016.

The Company's consolidated financial statements include the accounts of Contango Oil & Gas Company and its subsidiaries, after elimination of all material intercompany balances and transactions. All wholly-owned subsidiaries are consolidated. Republic Exploration LLC ("REX"), a partially-owned oil and gas exploration and development affiliate which is not controlled by the Company, was proportionately consolidated prior to its dissolution as of December 31, 2015. The investment in Exaro by our wholly-owned subsidiary, Contaro Company ("Contaro") is accounted for using the equity method of accounting, and therefore, the Company does not include its share of individual operating results, reserves or production in those reported for the Company's consolidated results.

Impairment of Long-Lived Assets

Pursuant to GAAP, when circumstances indicate that proved properties may be impaired, the Company compares expected undiscounted future cash flows on a field by field basis to the unamortized capitalized cost of the asset. If the estimated future undiscounted cash flows based on the Company's estimate of future reserves, natural gas and oil prices, operating costs and production levels from oil and natural gas reserves, are lower than the unamortized capitalized cost, then the capitalized cost is reduced to fair value. The factors used to determine fair value include, but are not limited to, estimates of proved and probable reserves, future commodity prices, the timing of future production and capital expenditures and a discount rate commensurate with the risk reflective of the lives remaining for the respective oil and gas properties. Additionally, the Company may use appropriate market data to determine fair value. The Company recognized no impairment of proved properties for the three months ended September 30, 2016 and approximately $0.7 million for impairment of proved properties for the nine months ended September 30, 2016. Substantially all of the non-cash impairment charge in the nine months ended September 30, 2016 was directly related to the decline in commodity prices and the resulting impact on estimated future net cash flows from associated reserves. The Company recognized $225.6 million impairment of proved properties for the three months ended September 30, 2015 and $227.6 million impairment of proved properties for the nine months ended September 30, 2015 also due to the decline in commodity prices and the resulting impact on estimated future net cash flows from associated reserves.

Unproved properties are reviewed quarterly to determine if there has been impairment of the carrying value, with any such impairment charged to expense in the period. The Company recognized impairment expense of approximately $1.1 million and approximately $3.4 million for the three and nine months ended September 30, 2016, respectively, related to partial impairment of unproved lease costs in non-core areas. The Company recognized impairment expense of approximately $9.5 million and $10.1 million for the three and nine months ended September 30, 2015, respectively, related to impairment and partial impairment of certain unproved properties and onshore prospects due primarily to the sustained low commodity price environment and expiring leases.

Net Loss Per Common Share

Basic net loss per common share is computed by dividing the net loss attributable to common stock by the weighted average number of common shares outstanding for the period. Diluted net loss per common share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock. Potential dilutive securities, including unexercised stock options and unvested restricted stock, have not been considered when their effect would be antidilutive. For the three and nine months ended September 30, 2016, 114,804 stock options and 437,355 restricted shares were excluded from dilutive shares due to the loss for the period. For the three and nine months ended September 30, 2015, 127,613 stock options and 423,820 restricted shares were excluded from dilutive shares due to the loss for the period.

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Subsidiary Guarantees

Contango Oil & Gas Company, as the parent company (the “Parent Company”), has filed a registration statement on Form S-3 with the SEC to register, among other securities, debt securities that the Parent Company may issue from time to time. Any such debt securities would likely be guaranteed on a full and unconditional basis by each of the Company’s current subsidiaries and any future subsidiaries specified in any future prospectus supplement (each a “Subsidiary Guarantor”). Each of the Subsidiary Guarantors is wholly-owned by the Parent Company, either directly or indirectly. The Parent Company has no assets or operations independent of the Subsidiary Guarantors, and there are no significant restrictions upon the ability of the Subsidiary Guarantors to distribute funds to the Parent Company. The Parent Company has one wholly-owned subsidiary that is inactive and not a Subsidiary Guarantor. Finally, the Parent Company’s wholly-owned subsidiaries do not have restricted assets that exceed 25% of net assets as of the most recent fiscal year end that may not be transferred to the Parent Company in the form of loans, advances or cash dividends by such subsidiary without the consent of a third party.

Recent Accounting Pronouncements

In August 2016, the Financial Accounting Standards Board (the “FASB”) issued Accounting Standards Update No. 2016-15: Statement of Cash Flows (Topic 230), Classification of Certain Cash Receipts and Cash Payments. The main objective of this update is to reduce the diversity in practice in how certain cash receipts and cash payments are presented and classified in the statement of cash flows under Topic 230, Statement of Cash Flows, and other Topics. This Update addresses eight specific cash flow issues with the objective of reducing the existing diversity in practice. The eight cash flow updates relate to the following issues: 1) debt prepayment or debt extinguishment costs; 2) settlement of zero-coupon debt instruments or other debt instruments with coupon interest rates that are insignificant in relation to the effective interest rate of the borrowing; 3) contingent consideration payments made after a business combination; 4) proceeds from the settlement of insurance claims; 5) proceeds from the settlement of corporate-owned life insurance policies, including bank-owned life insurance policies; 6) distributions received from equity method investees; 7) beneficial interest in securitization transactions; and 8) separately identifiable cash flows and application of the predominance principle. The amendments in this update are effective for public business entities for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. The Company will continue to assess the impact this may have on its statement of cash flows.

In May 2016, the FASB issued Accounting Standards Update No. 2016-12: Revenue from Contracts with Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients (ASU 2016-12). The core principle of the guidance in Topic 606 is that 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. The amendments of ASU 2016-12 do not change that core principle. Rather, the amendments affect only the following narrow aspects of Topic 606: assessing the collectability criterion and accounting for contracts that do not meet the criteria for step 1, presentation of sales tax and other similar taxes collected from customers, noncash consideration, contract modifications at transition, completed contracts at transition, and technical correction. For public entities, ASU 2016-12 is effective for annual reporting periods after December 31, 2017. The provisions of this accounting update are not expected to have a material impact on the Company's financial position or results of operations.

In March 2016, the FASB issued Accounting Standards Update No. 2016-09: Compensation – Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting (ASU 2016-09). ASU 2016 09 is part of an initiative to reduce complexity in accounting standards. The areas of simplification in ASU 2016 09 involve several aspects of accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. For public entities, ASU 2016-09 is effective for financial statements issued for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years; early application is permitted. The provisions of this accounting update are not expected to have a material impact on the Company's financial position, results of operations or cash flows.

In February 2016, the FASB issued Accounting Standards Update No. 2016-02: Leases (Topic 842) (ASU 2016-02). The main objective of ASU 2016-02 is to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. The main difference between previous GAAP and Topic 842 is the recognition of lease assets and lease

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liabilities by lessees for those leases classified as operating leases. ASU 2016-02 requires lessees to recognize assets and liabilities arising from leases on the balance sheet. ASU 2016-02 further defines a lease as a contract that conveys the right to control the use of identified property, plant, or equipment for a period of time in exchange for consideration. Control over the use of the identified asset means that the customer has both (1) the right to obtain substantially all of the economic benefit from the use of the asset and (2) the right to direct the use of the asset. ASU 2016-02 requires disclosures by lessees and lessors to meet the objective of enabling users of financial statements to assess the amount, timing, and uncertainty of cash flows arising from leases. In transition, lessees and lessors are required to recognize and measure leases at the beginning of the earliest period presented using a modified retrospective approach. For public entities, ASU 2016-02 is effective for financial statements issued for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years; early application is permitted. The Company will continue to assess the impact this may have on its financial position, results of operations, and cash flows.

In January 2016, the FASB issued Accounting Standards Update No. 2016-01: Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities (ASU 2016-01). The main objective of ASU 2016-01 is enhancing the reporting model for financial instruments to provide users of financial statements with more decision-useful information. The amendments in ASU 2016-01 make targeted improvements to GAAP by: (i) requiring equity investments (except those accounted for under the equity method of accounting or those that result in consolidation of the investee) be measured at fair value with changes in fair value recognized in net income; (ii) simplifying the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment; (iii) exempting all non-public business entities from disclosing fair value information for financial instruments measured at amortized cost; (iv) eliminating requirement for public business entities to disclose the methods and significant assumptions used to estimate the fair value for financial instruments measured at amortized cost on the balance sheet: (v) requiring public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes; (vi) requiring separate presentation in other comprehensive income the portion of the total change in fair value of a liability resulting from a change in the instrument- specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments; (vii) requiring separate presentation of financial assets and financial liabilities by measurement category and form of financial asset; and (viii) clarifying that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale securities in combination with the entity’s other deferred tax assets. For public entities, ASU 2016-01 is effective for financial statements issued for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years; early application is permitted. The provisions of this accounting update are not expected to have a material impact on the Company’s financial position or results of operations.

Further, management is closely monitoring the joint standard-setting efforts of the FASB and the International Accounting Standards Board. There are a large number of pending accounting standards that are being targeted for completion in 2016 and beyond. Because these pending standards have not yet been finalized, management is not able to determine the potential future impact that these standards will have, if any, on the Company's financial position, results of operations, or cash flows.

3. Acquisition and Underwritten Public Offering

In July 2016, the Company purchased one-half of the seller's interest in approximately 12,100 gross undeveloped acres (approximately 5,000 net acres) in the Southern Delaware Basin of Texas (the "Acquisition") for up to $25 million. The purchase price was comprised of $10 million in cash paid on July 26, 2016, and $10 million in carried well costs expected to be paid over the next 14 months. Certain additional payments contingent upon success could increase total consideration to $25 million.

During the three months ended September 30, 2016, the Company completed an underwritten public offering of 5,360,000 shares of its common stock for net proceeds of approximately $50.5 million. Proceeds from the offering were used to fund the portion of the purchase price paid at closing of the Acquisition and are expected to be used to fund drilling costs associated with the initial exploration and development of the acquired acreage. Pending such use, the Company used the proceeds of the offering to repay amounts outstanding under its revolving credit facility.

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4. Fair Value Measurements

Pursuant to Accounting Standards Codification 820, Fair Value Measurements and Disclosures (ASC 820), the Company's determination of fair value incorporates not only the credit standing of the counterparties involved in transactions with the Company resulting in receivables on the Company's consolidated balance sheets, but also the impact of the Company's nonperformance risk on its own liabilities. ASC 820 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (exit price). ASC 820 establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy assigns the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). Level 2 measurements are inputs that are observable for assets or liabilities, either directly or indirectly, other than quoted prices included within Level 1. The Company utilizes market data or assumptions that market participants would use in pricing the asset or liability, including assumptions about risk and the risks inherent in the inputs to the valuation technique. These inputs can be readily observable, market corroborated, or generally unobservable. The Company classifies fair value balances based on the observability of those inputs.

The following table sets forth, by level within the fair value hierarchy, the Company’s financial assets and liabilities that were accounted for at fair value as of September 30, 2016. As required by ASC 820, a financial instrument's level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement. The Company's assessment of the significance of a particular input to the fair value measurement requires judgment and may affect the valuation of fair value assets and liabilities and their placement within the fair value hierarchy levels. There have been no transfers between Level 1, Level 2 or Level 3.

Fair value information for financial assets and liabilities was as follows as of September 30, 2016 (in thousands):

	Total	Fair Value Measurements Using		
	Carrying Value	Level 1	Level 2	Level 3
Derivatives				
Commodity price contracts - assets	$ —	$ —	$ —	$ —
Commodity price contracts - liabilities	$ 2,400	$ —	$ 2,400	$ —

Derivatives listed above are recorded in “Current and long-term derivative liability” on the Company’s consolidated balance sheet and include swaps and costless collars that are carried at fair value. The Company records the net change in the fair value of these positions in "Gain on derivatives, net" in the Company's consolidated statements of operations. The Company is able to value the assets and liabilities based on observable market data for similar instruments, which resulted in the Company reporting its derivatives as Level 2. This observable data includes the forward curves for commodity prices based on quoted markets prices and implied volatility factors related to changes in the forward curves. As of December 31, 2015, there were no outstanding commodity price contracts. See Note 5 - "Derivative Instruments" for additional discussion of derivatives.

As of September 30, 2016, the Company's derivative contracts were with certain members of its bank group which are major financial institutions with investment grade credit ratings which are believed to have minimal credit risk. As such, the Company is exposed to credit risk to the extent of nonperformance by the counterparties in the derivative contracts discussed above; however, the Company does not anticipate such nonperformance.

Estimates of the fair value of financial instruments are made in accordance with the requirements of ASC 825, Financial Instruments. The estimated fair value amounts are determined at discrete points in time based on relevant market information. These estimates involve uncertainties and cannot be determined with precision. The estimated fair value of cash, accounts receivable and accounts payable approximates their carrying value due to their short-term nature. The estimated fair value of the Company's credit facility with the Royal Bank of Canada and other lenders (the “RBC Credit Facility”) approximates carrying value because the facility interest rate approximates current market rates and is reset at least every six months. See Note 9 - "Long-Term Debt" for further information.

Impairments

Contango tests proved oil and natural gas properties for impairment when events and circumstances indicate a decline in the recoverability of the carrying value of such properties, such as a downward revision of the reserve

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estimates or lower commodity prices. The Company estimates the undiscounted future cash flows expected in connection with the oil and gas properties on a field by field basis and compares such future cash flows to the unamortized capitalized costs of the properties. If the estimated future undiscounted cash flows are lower than the unamortized capitalized cost, the capitalized cost is reduced to its fair value. The factors used to determine fair value include, but are not limited to, estimates of proved and probable reserves, future commodity prices, the timing of future production and capital expenditures and a discount rate commensurate with the risk reflective of the lives remaining for the respective oil and gas properties. Additionally, the Company may use appropriate market data to determine fair value. Because these significant fair value inputs are typically not observable, impairments of long-lived assets are classified as a Level 3 fair value measure.

Asset Retirement Obligations

The initial measurement of asset retirement obligations at fair value is calculated using discounted cash flow techniques and based on internal estimates of future retirement costs associated with oil and gas properties. The factors used to determine fair value include, but are not limited to, estimated future plugging and abandonment costs and expected lives of the related reserves.

5. Derivative Instruments

The Company is exposed to certain risks relating to its ongoing business operations, such as commodity price risk. Derivative contracts are typically utilized to hedge the Company's exposure to price fluctuations and reduce the variability in the Company's cash flows associated with anticipated sales of future oil and natural gas production. The Company typically hedges a substantial, but varying, portion of anticipated oil and natural gas production for future periods. The Company believes that these derivative arrangements, although not free of risk, allow it to achieve a more predictable cash flow and to reduce exposure to commodity price fluctuations. However, derivative arrangements limit the benefit of increases in the prices of crude oil, natural gas and natural gas liquids sales. Moreover, because its derivative arrangements apply only to a portion of its production, the Company’s strategy provides only partial protection against declines in commodity prices. Such arrangements may expose the Company to risk of financial loss in certain circumstances. The Company continuously reevaluates its hedging programs in light of changes in production, market conditions and commodity price forecasts.

As of September 30, 2016, the Company’s natural gas derivative positions consisted of “swaps” and “costless collars”. Swaps are designed so that the Company receives or makes payments based on a differential between fixed and variable prices for crude oil and natural gas. A costless collar consists of a purchased put option and a sold call option, which establishes a minimum and maximum price, respectively, that the Company will receive for the volumes under the contract.

It is the Company's policy to enter into derivative contracts only with counterparties that are creditworthy institutions deemed by management as competent and competitive market makers. The Company does not post collateral, nor is exposed to potential margin calls, under any of these contracts as they are secured under the RBC Credit Facility. See Note 9 - "Long-Term Debt" for further information regarding the RBC Credit Facility.

The Company has elected not to designate any of its derivative contracts for hedge accounting. Accordingly, derivatives are carried at fair value on the consolidated balance sheets as assets or liabilities, with the changes in the fair value included in the consolidated statements of operations for the period in which the change occurs. The Company records the net change in the mark-to-market valuation of these derivative contracts, as well as all payments and receipts on settled derivative contracts, in "Gain on derivatives, net" on the consolidated statements of operations.

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The following derivative instruments were in place at September 30, 2016 (fair value in thousands):

Commodity	Period	Derivative	Volume/Month	Price/Unit (1)	Fair Value
Natural Gas	Oct 2016	Swap	250,000 MMBtu	$ 2.53	(105)
Natural Gas	Nov 2016 - Dec 2016	Swap	1,300,000 MMBtu	$ 2.53	(1,270)
Natural Gas	Jan 2017 - Jul 2017	Collar	400,000 MMBtu	$ 2.65 - 3.00	(689)
Natural Gas	Aug 2017 - Oct 2017	Collar	200,000 MMBtu	$ 2.65 - 3.00	(106)
Natural Gas	Nov 2017 - Dec 2017	Collar	400,000 MMBtu	$ 2.65 - 3.00	(230)
		Total net fair value of derivative instruments			$ (2,400)

(1) Commodity price derivatives based on Henry Hub NYMEX natural gas prices.

The following summarizes the fair value of commodity derivatives outstanding on a gross and net basis as of September 30, 2016 (in thousands):

	Gross	Netting (1)	Total
Assets	$ —	$ —	$ —
Liabilities	$ (2,400)	$ —	$ (2,400)

(1) Represents counterparty netting under agreements governing such derivatives.

As of December 31, 2015, the Company did not have any outstanding derivative positions.

The following table summarizes the effect of derivative contracts on the consolidated statements of operations for the three and nine months ended September 30, 2016 and 2015 (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Crude oil contracts	$ —	$ 1,002	$ —	$ 1,002

Natural gas contracts	(619)	—	3,136	—
Realized gain (loss)	$ (619)	$ 1,002	$ 3,136	$ 1,002
Crude oil contracts	$ —	$ 1,009	$ —	$ 999
Natural gas contracts	1,532	—	(2,400)	—
Unrealized gain (loss)	$ 1,532	$ 1,009	$ (2,400)	$ 999
Gain on derivatives, net	$ 913	$ 2,011	$ 736	$ 2,001

6. Stock-Based Compensation

During the nine months ended September 30, 2016, the Company had a stock-based compensation program in effect which allows for stock options and/or restricted stock to be awarded to officers, directors, consultants and employees. This program includes (i) the Company's Amended and Restated 2009 Incentive Compensation Plan (the “2009 Plan”); and (ii) the Crimson 2005 Stock Incentive Plan (the “2005 Plan” or "Crimson Plan"), which expired on February 25, 2015.

Effective September 1, 2015, all employees and board members entered into a salary replacement program (the “Salary Replacement Program”). The Salary Replacement Program reduced all office employees’ base salary by 10% and all board of director retainer and committee chairman fees by 10% and replaced the portion of the salary/fees being reduced with immediately vested common stock in a number of shares commensurate with the salary/fees reduction amount. These shares were to be issued immediately after the year for which the salary was reduced. The Company discontinued this policy effective September 1, 2016 and the compensation accrued as of that date was paid to employees and directors in cash.

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Stock Options

Under the fair value method of accounting for stock options, cash flows from the exercise of stock options resulting from tax benefits in excess of recognized cumulative compensation cost (excess tax benefits) are classified as financing cash flows. For the nine months ended September 30, 2016 and 2015, there was no excess tax benefit recognized.

Compensation expense related to stock option grants are recognized over the stock option's vesting period based on the fair value at the date the options are granted. The fair value of each option is estimated as of the date of grant using the Black-Scholes options-pricing model. No stock options were granted during the nine months ended September 30, 2016 or 2015.

During the nine months ended September 30, 2016, no stock options were exercised and 1,657 stock options were forfeited. During the nine months ended September 30, 2015, no stock options were exercised and stock options for 2,321 shares of common stock were forfeited.

Restricted Stock

During the nine months ended September 30, 2016, the Company granted 40,876 shares of restricted common stock under the 2009 Plan for salaries replaced pursuant to the Salary Replacement Program for 2015. Of these, 38,943 shares were granted to employees, and 1,933 shares were granted to directors. Additionally, the Company granted 197,306 shares of restricted common stock to employees as part of their overall compensation package, which vest over four years, and 49,460 shares of restricted common stock to directors pursuant to the Company's director compensation plan, which vest after one year. The weighted average fair value of the restricted shares granted during the nine months ended September 30, 2016, was $11.60 with a total fair value of approximately $3.3 million after adjustment for an estimated weighted average forfeiture rate of 3.5%. During the nine months ended September 30, 2016, 4,160 restricted shares were forfeited by former employees. The aggregate intrinsic value of restricted shares forfeited during the nine months ended September 30, 2016 was approximately $130 thousand. No shares of restricted common stock were granted or forfeited during the three months ended September 30, 2016. Approximately 0.6 million shares remain available for grant under the 2009 Plan as of September 30, 2016.

During the nine months ended September 30, 2015, the Company granted 270,091 shares of restricted common stock under the 2009 Plan. Of these, 242,887 shares were granted to employees as part of their overall compensation package, which vest over four years, and 27,204 shares were granted to directors pursuant to the Company's director compensation plan, which vest after one year. Additionally, the Company issued the final 7,030 shares of restricted stock under the 2005 Plan to employees as part of their compensation package, which vest over four years. The weighted average fair value of the restricted shares granted during the nine months ended September 30, 2015, was

$22.02 with a total fair value of approximately $6.1 million after adjustment for an estimated weighted average forfeiture rate of 4.9%. During the nine months ended September 30, 2015, 4,735 restricted shares were forfeited by former employees. The aggregate intrinsic value of restricted shares forfeited during the nine months ended September 30, 2015 was approximately $147 thousand. No shares of restricted common stock were granted and 216 restricted shares were forfeited by former employees during the three months ended September 30, 2015.

The Company recognized approximately $4.3 million and $5.0 million in stock compensation expense during the nine months ended September 30, 2016 and 2015, respectively, for restricted shares granted to its officers, employees and directors. As of September 30, 2016, an additional $5.9 million of compensation expense remained to be recognized over the remaining weighted-average vesting period of 2.4 years.

In October 2016, two members of the Company's management team had employment agreements that expired and were not renewed, resulting in the immediate vesting of 25,928 shares of unvested stock.

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7. Other Financial Information

The following table provides additional detail for accounts receivable, prepaid expenses and other, and accounts payable and accrued liabilities which are presented on the consolidated balance sheets (in thousands):

	September 30, 2016		December 31, 2015	
Accounts receivable:				
Trade receivable	$	5,876	$	7,530
Alta Resources		1,993		1,993
Joint interest billing		3,120		7,366
Income taxes receivable		—		2,868
Other receivables		322		1,448
Allowance for doubtful accounts		(682)		(701)
Total accounts receivable	$	10,629	$	20,504
Prepaid expenses:				
Prepaid insurance	$	800	$	900
Other prepaids		710		328
Total prepaid expenses	$	1,510	$	1,228
Accounts payable and accrued liabilities:				
Royalties and revenue payable	$	17,299	$	17,906