

MEXCO ENERGY CORP
Form 10-Q
February 14, 2011

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 December 31, 2010

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 No. 0-6994

MEXCO ENERGY CORPORATION
(Exact name of registrant as specified in its charter)

Colorado
(State or other jurisdiction of
incorporation or organization)

84-0627918
(IRS Employer
Identification Number)

214 West Texas Avenue, Suite 1101
Midland, Texas
(Address of principal executive offices)

79701
(Zip code)

(432) 682-1119
(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 and (2) has been subject to such filing requirements for the past 90 days. YES NO

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 229.405 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 as defined in Rule 12b-2 of the Exchange Act.

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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 number of shares outstanding of the registrant's common stock, par value \$.50 per share, as of February 14, 2011 was 1,959,949.

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MEXCO ENERGY CORPORATION

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Mexco Energy Corporation and Subsidiaries
CONSOLIDATED BALANCE SHEETS

| | December 31, 2010 (Unaudited) | March 31, 2010 |
|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------|-------------------|
| ASSETS | | |
| Current assets | | |
| Cash and cash equivalents | \$ 165,573 | \$ 160,439 |
| Accounts receivable: | | |
| Oil and gas sales | 408,326 | 538,444 |
| Trade | 33,542 | 63,455 |
| Related parties | - | 55 |
| Prepaid costs and expenses | 83,688 | 17,161 |
| Total current assets | 691,129 | 779,554 |
| | | |
| Property and equipment, at cost | | |
| Oil and gas properties, using the full cost method | 29,643,465 | 27,353,016 |
| Other | 78,520 | 76,161 |
| | 29,721,985 | 27,429,177 |
| | | |
| Less accumulated depreciation, depletion and amortization | 14,942,407 | 14,179,156 |
| Property and equipment, net | 14,779,578 | 13,250,021 |
| | \$ 15,470,707 | \$ 14,029,575 |
| | | |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current liabilities | | |
| Accounts payable and accrued expenses | \$ 181,204 | \$ 301,160 |
| | | |
| Long-term debt | 1,950,000 | 700,000 |
| Asset retirement obligations | 508,286 | 486,305 |
| Deferred income tax liabilities | 888,158 | 902,757 |
| | | |
| Commitments and contingencies | | |
| | | |
| Stockholders' equity | | |
| Preferred stock - \$1.00 par value; 10,000,000 shares authorized; none outstanding | - | - |
| Common stock - \$0.50 par value; 40,000,000 shares authorized; 2,010,116 and 2,003,866 shares issued; 1,950,949 and 1,919,866 shares outstanding as of December 31, 2010 and March 31, 2010, respectively | 1,005,058 | 1,001,933 |
| Additional paid-in capital | 5,981,814 | 5,907,899 |
| Retained earnings | 5,258,852 | 5,156,138 |
| Treasury stock, at cost (59,167 and 84,000 shares as of December 31, 2010 and March 31, 2010, respectively) | (302,665) | (426,617) |
| Total stockholders' equity | 11,943,059 | 11,639,353 |

\$15,470,707 \$14,029,575

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

Mexco Energy Corporation and Subsidiaries
CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

| | Three Months Ended | | Nine Months Ended | |
|---------------------------------------------|--------------------|-----------|-------------------|-------------|
| | December 31 | | December 31 | |
| | 2010 | 2009 | 2010 | 2009 |
| Operating revenue: | | | | |
| Oil and gas | \$752,778 | \$857,035 | \$2,368,778 | \$2,248,789 |
| Other | 3,798 | 8,134 | 12,830 | 20,851 |
| Total operating revenues | 756,576 | 865,169 | 2,381,608 | 2,269,640 |
| Operating expenses: | | | | |
| Production | 200,785 | 269,154 | 822,150 | 779,379 |
| Accretion of asset retirement obligation | 8,489 | 7,963 | 25,463 | 23,570 |
| Depreciation, depletion, and amortization | 244,065 | 252,940 | 763,251 | 791,474 |
| General and administrative | 235,137 | 198,527 | 682,820 | 628,941 |
| Total operating expenses | 688,476 | 728,584 | 2,293,684 | 2,223,364 |
| Operating profit | 68,100 | 136,585 | 87,924 | 46,276 |
| Other income (expenses): | | | | |
| Interest income | 10 | 100 | 36 | 328 |
| Interest expense | (15,151) | (8,516) | (25,347) | (26,877) |
| Net other expense | (15,141) | (8,416) | (25,311) | (26,549) |
| Earnings before provision for income taxes | 52,959 | 128,169 | 62,613 | 19,727 |
| Income tax expense (benefit): | | | | |
| Current | (59,500) | 21,988 | (25,502) | 21,988 |
| Deferred | 85,561 | (60,964) | (14,599) | (259,753) |
| | 26,061 | (38,976) | (40,101) | (237,765) |
| Net income | \$26,898 | \$167,145 | \$102,714 | \$257,492 |
| Earnings per common share: | | | | |
| Basic | \$0.01 | \$0.09 | \$0.05 | \$0.14 |
| Diluted | \$0.01 | \$0.09 | \$0.05 | \$0.13 |
| Weighted average common shares outstanding: | | | | |
| Basic | 1,947,370 | 1,891,866 | 1,934,953 | 1,884,598 |
| Diluted | 1,961,041 | 1,946,076 | 1,951,316 | 1,946,362 |

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

Mexco Energy Corporation and Subsidiaries
CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY
(Unaudited)

| | Common Stock Par Value | Treasury Stock | Additional Paid-In Capital | Retained Earnings | Total Stockholders' Equity |
|------------------------------------------------------|------------------------------|-------------------|----------------------------------|----------------------|----------------------------------|
| Balance at March 31, 2010 | \$ 1,001,933 | \$(426,617) | \$ 5,907,899 | \$ 5,156,138 | \$ 11,639,353 |
| Net income | - | - | - | 5,776 | 5,776 |
| Issuance of stock through options exercised | 1,250 | - | 9,625 | - | 10,875 |
| Stock based compensation | - | - | 3,668 | - | 3,668 |
| Balance at June 30, 2010 | \$ 1,003,183 | \$(426,617) | \$ 5,921,192 | \$ 5,161,914 | \$ 11,659,672 |
| Net Income | - | - | - | 70,040 | 70,040 |
| Issuance of stock for properties | - | 136,277 | 28,479 | - | 164,756 |
| Excess tax benefits from stock-based compensation | - | - | 33,998 | - | 33,998 |
| Stock based compensation | - | - | 13,754 | - | 13,754 |
| Balance at September 30, 2010 | \$ 1,003,183 | \$(290,340) | \$ 5,997,423 | \$ 5,231,954 | \$ 11,942,220 |
| Net income | - | - | - | 26,898 | 26,898 |
| Purchase of stock | - | (12,325) | - | - | (12,325) |
| Issuance of stock through options exercised | 1,875 | - | 14,437 | - | 16,312 |
| Excess tax benefit from stock-based compensation | - | - | (59,500) | - | (59,500) |
| Stock based compensation | - | - | 29,454 | - | 29,454 |
| Balance at December 31, 2010 | \$ 1,005,058 | \$(302,665) | \$ 5,981,814 | \$ 5,258,852 | \$ 11,943,059 |

SHARE ACTIVITY

Common stock shares, issued:

| | |
|---------------------------|-----------|
| Balance at March 31, 2010 | 2,003,866 |
| Issued | 2,500 |
| Balance at June 30, 2010 | 2,006,366 |
| Issued | - |
| Balance at Sept. 30, 2010 | 2,006,366 |
| Issued | 3,750 |
| Balance at Dec. 31, 2010 | 2,010,116 |

Common stock shares, held in treasury:

| | |
|---------------------------|-----------|
| Balance at March 31, 2010 | (84,000) |
| Acquisitions | - |
| Balance at June 30, 2010 | (84,000) |
| Exchange for property | 26,833 |
| Balance at Sept. 30, 2010 | (57,167) |
| Acquisitions | (2,000) |
| Balance at Dec. 31, 2010 | (59,167) |

Common stock shares, outstanding

at December 31, 2010

1,950,949

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

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Mexco Energy Corporation and Subsidiaries
 CONSOLIDATED STATEMENTS OF CASH FLOWS
 For the Nine Months Ended December 31,
 (Unaudited)

| | 2010 | 2009 | |
|-----------------------------------------------------------------------------------|------------|------------|---|
| Cash flows from operating activities: | | | |
| Net income | \$ 102,714 | \$ 257,492 | |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | |
| Deferred income tax expense (benefit) | (14,599 | (259,753 |) |
| Excess tax expense (benefit) from share based payment arrangement | 25,502 | (21,988 |) |
| Stock-based compensation | 46,876 | 21,645 | |
| Depreciation, depletion and amortization | 763,251 | 791,474 | |
| Accretion of asset retirement obligations | 25,463 | 23,570 | |
| Other | (17,860 | (5,849 |) |
| Changes in assets and liabilities: | | | |
| Decrease (increase) in accounts receivable | 170,936 | (16,875 |) |
| (Increase) decrease in prepaid expenses | (66,527 |) 4,196 | |
| (Decrease) increase in income taxes payable | (25,502 |) 21,988 | |
| Decrease in accounts payable and accrued expenses | (97,478 |) (49,843 |) |
| Net cash provided by operating activities | 912,776 | 766,057 | |
| Cash flows from investing activities: | | | |
| Additions to oil and gas properties | (1,668,296 |) (621,870 |) |
| Acquisition of business | (478,000 |) - | |
| Additions to other property and equipment | (2,359 |) (8,371 |) |
| Proceeds from sale of oil and gas properties and equipment | 1,653 | 103,674 | |
| Net cash used in investing activities | (2,147,002 |) (526,567 |) |
| Cash flows from financing activities: | | | |
| Proceeds from exercise of stock options | 27,187 | 92,792 | |
| Acquisition of treasury stock | (12,325 |) - | |
| Reduction of long-term debt | (645,000 |) (485,000 |) |
| Proceeds from long-term debt | 1,895,000 | 75,000 | |
| Excess tax (expense) benefit from share based payment arrangement | (25,502 |) 21,988 | |
| Net cash provided by (used in) financing activities | 1,239,360 | (295,220 |) |
| Net increase (decrease) in cash and cash equivalents | 5,134 | (55,730 |) |
| Cash and cash equivalents at beginning of period | 160,439 | 223,583 | |
| Cash and cash equivalents at end of period | \$ 165,573 | \$ 167,853 | |
| Supplemental disclosure of cash flow information: | | | |
| Cash paid for interest | \$ 22,896 | \$ 27,789 | |
| Income taxes paid | \$ - | \$ - | |

Non-cash investing and financing activities:

| | | |
|------------------------------------------------------------------------------------------------------------|-----------|----------|
| Asset retirement obligations | \$8,064 | \$11,689 |
| Issuance of common stock in exchange for oil and gas properties | \$164,756 | \$- |
| Acquisition of Southwest Texas Disposal Corporation resulting in the assumption of liabilities as follows: | | |
| Fair value of assets | \$487,868 | - |
| Cash paid | (478,000) | - |
| Liabilities assumed | \$9,868 | - |

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

MEXCO ENERGY CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. Nature of Operations

Mexco Energy Corporation (a Colorado corporation) and its wholly owned subsidiaries, Forman Energy Corporation (a New York corporation) and Southwest Texas Disposal Corporation (a Texas corporation) (collectively, the “Company”) are engaged in the exploration, development and production of natural gas, crude oil, condensate and natural gas liquids (“NGLs”). Most of the Company’s oil and gas interests are centered in West Texas; however, the Company owns producing properties and undeveloped acreage in twelve states. Although most of the Company’s oil and gas interests are operated by others, the Company operates several properties in which it owns an interest.

On September 30, 2010, Mexco Energy Corporation acquired all of the issued and outstanding stock of Southwest Texas Disposal Corporation, a Texas corporation which owns royalties producing primarily natural gas.

2. Summary of Significant Accounting Policies

Principles of Consolidation. The consolidated financial statements include the accounts of Mexco Energy Corporation and its wholly owned subsidiaries. All significant intercompany balances and transactions associated with the consolidated operations have been eliminated.

Estimates and Assumptions. In preparing financial statements in conformity with accounting principles generally accepted in the United States of America, management is required to make informed judgments, estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the financial statements and affect the reported amounts of revenues and expenses during the reporting period. In addition, significant estimates are used in determining year end proved oil and gas reserves. Although management believes its estimates and assumptions are reasonable, actual results may differ materially from those estimates. The estimate of the Company’s oil and natural gas reserves, which is the used to compute depreciation, depletion, amortization and impairment of oil and gas properties, is the most significant of the estimates and assumptions that affect these reported results.

Interim Financial Statements. In the opinion of management, the accompanying unaudited consolidated financial statements contain all adjustments (consisting only of normal recurring accruals) necessary to present fairly the financial position of the Company as of December 31, 2010, and the results of its operations and cash flows for the interim periods ended December 31, 2010 and 2009. The results of operations for the periods presented are not necessarily indicative of the results to be expected for a full year. The accounting policies followed by the Company are set forth in more detail in Note 2 of the “Notes to Consolidated Financial Statements” in the Company’s annual report on Form 10-K filed with the Securities and Exchange Commission (“SEC”). Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted in this Form 10-Q pursuant to the rules and regulations of the SEC. However, the disclosures herein are adequate to make the information presented not misleading. It is suggested that these financial statements be read in conjunction with the financial statements and notes thereto included in the Form 10-K.

Recent Accounting Pronouncements. In January 2010, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2010-06, Fair Value Measurements and Disclosures (Topic 820). ASU No. 2010-06 amends Accounting Standards Codification (“ASC”) Topic 820 with new guidance and clarifications for improving disclosures about fair value measurements. This guidance requires enhanced disclosures regarding transfers of assets and liabilities between Level 1 (quoted prices in active market for identical assets or liabilities) and

Level 2 (significant other observable inputs) of the fair value measurement hierarchy, including the reasons and the timing of the transfers. Additionally, the guidance requires a roll forward of activities on purchases, sales, issuance, and settlements of the assets and liabilities measured using significant unobservable inputs (Level 3 fair value measurements). ASU No. 2010-06 became effective for the Company beginning January 1, 2010, except for the disclosure on the roll forward activities for Level 3 fair value measurements, which will become effective for the Company with the reporting period beginning April 1, 2011. Other than requiring additional disclosures, adoption of this new guidance did not have any effect on the financial statements.

In December 2010, the FASB issued ASU No. 2010-29, Business Combinations (Topic 805): Disclosure of Supplementary Pro Forma Information for Business Combinations. ASU No. 2010-29 amends ASC Topic 805 and reflects the decision reached in Emerging Issues Task Force (“EITF”) Issue No. 10-G. The amendments in this ASU specify that if a public entity presents comparative financial statements, the entity should disclose revenue and earnings of the combined entity as though the business combination(s) that occurred during the current year had occurred as of the beginning of the comparable prior annual reporting period only. The amendments also expand the supplemental pro forma disclosures to include a description of the nature and amount of material, nonrecurring pro forma adjustments directly attributable to the business combination included in the reported pro forma revenue and earnings. ASU No. 2010-29 becomes effective prospectively for the Company with the reporting period beginning April 1, 2011. The Company does not anticipate that adoption of this new guidance will have a material impact on its financial statements.

There were various other accounting standards and interpretations issued in 2010, all of which have been determined to be not applicable or significant by management and once adopted are not expected to have a material impact on the Company’s financial position, operations or cash flows.

Gas Balancing. Gas imbalances are accounted for under the sales method whereby revenues are recognized based on production sold. A liability is recorded when our excess takes of natural gas volumes exceeds our estimated remaining recoverable reserves (over produced). No receivables are recorded for those wells where the Company has taken less than its ownership share of gas production (under produced). The Company does not have any significant gas imbalances.

3. Business Combinations and Property Acquisitions

On September 30, 2010, the Company purchased all of the outstanding stock of Southwest Texas Disposal Corporation (“STDC”), a Texas corporation which owns primarily royalties producing primarily natural gas, expanding the Company’s royalty revenues. The cash purchase price of \$478,000 was funded from our \$4.9 million credit facility.

The purchase price was allocated to the assets acquired and liabilities assumed at estimated fair values as follows:

| | | |
|--------------------------------------|-----------|---|
| Proved oil and gas properties | \$477,018 | |
| Accounts receivable | 10,850 | |
| Total assets acquired | 487,868 | |
| Accounts payable | (7,850 |) |
| Asset retirement obligations assumed | (2,018 |) |
| Net purchase price | \$478,000 | |

The Company has not disclosed the pro forma information for this acquisition because the revenue and expenses for this acquisition are immaterial to our interim consolidated financial statements.

In August 2010, the Company purchased overriding royalty interests averaging .28% in 5,120 gross acres covering eight sections in the Haynesville trend area of DeSoto Parish, Louisiana, for an approximate purchase price of \$1.65 million, prior to closing adjustments. The Company paid \$1.46 million in cash and the remainder was paid as 26,833 shares of its common stock issued from treasury shares.

4. Asset Retirement Obligations

The Company's asset retirement obligations ("ARO") relate to the plugging of wells, the removal of facilities and equipment, and site restoration on oil and gas properties. The fair value of a liability for an ARO is recorded in the period in which it is incurred, discounted to its present value using the credit adjusted risk-free interest rate, and a corresponding amount capitalized by increasing the carrying amount of the related long-lived asset. The liability is accreted each period, and the capitalized cost is depreciated over the useful life of the related asset.

The following table provides a rollforward of the asset retirement obligations for the first nine months of fiscal 2011:

| | | |
|-------------------------------------------------------------------------|-----------|---|
| Carrying amount of asset retirement obligations as of April 1, 2010 | \$536,305 | |
| Liabilities incurred | 8,064 | |
| Liabilities settled | (11,546 |) |
| Accretion expense | 25,463 | |
| Carrying amount of asset retirement obligations as of December 31, 2010 | 558,286 | |
| Less: Current portion | 50,000 | |
| Non-Current asset retirement obligation | \$508,286 | |

The ARO is included on the consolidated balance sheets with the current portion being included in the accounts payable and other accrued expenses.

5. Stock-based Compensation

The Company uses the Binomial option pricing model to estimate the fair value of stock based compensation expenses at grant date. This expense is recognized as compensation expense in our financial statements over the vesting period. We recognize the fair value of stock based compensation awards as wages in the Consolidated Statements of Operations based on a graded-vesting schedule over the vesting period.

The Company recognized compensation expense of \$29,454 and \$5,749 in general and administrative expense in the Consolidated Statements of Operations for the three months ended December 31, 2010 and 2009, respectively. Compensation expense recognized for the nine months ended December 31, 2010 and 2009 was \$46,876 and \$21,645, respectively. The total cost related to non-vested awards not yet recognized at December 31, 2010 totals approximately \$180,000 which is expected to be recognized over a weighted average of 3.4 years.

The fair value of each stock option is estimated on the date of grant using the Binomial valuation model. Expected volatilities are based on historical volatility of the Company's stock over the expected term of 84 months and other factors. We use historical data to estimate option exercise and employee termination within the valuation model. The expected term of options granted is derived from the output of the option valuation model and represents the period of time that options granted are expected to be outstanding. The risk-free rate for periods within the contractual life of the option is based on the U.S. Treasury yield curve in effect at the time of grant. As the Company has never declared dividends, no dividend yield is used in the calculation. Actual value realized, if any, is dependent on the future performance of the Company's common stock and overall stock market conditions. There is no assurance the value realized by an optionee will be at or near the value estimated by the Binomial model.

During the nine months ended December 31, 2010, stock options covering 42,500 shares were granted. There were no stock options granted during the nine months ended December 31, 2009. Included in the following table is a summary of the grant-date fair value of stock options granted and the related assumptions used in the Binomial models for stock options granted during the nine months ended December 31, 2010. All such amounts represent the weighted average amounts.

| | |
|--------------------------|--------|
| Grant-date fair value | \$5.15 |
| Volatility factor | 82.83% |
| Dividend yield | - |
| Risk-free interest rate | 2.07% |
| Expected term (in years) | 7 |

During the nine months ended December 31, 2010, stock options covering 6,250 shares were exercised with a total intrinsic value of \$24,340. The Company received proceeds of \$27,187 from these exercises. During the nine months ended December 31, 2009, stock options covering 13,250 shares were exercised with a total intrinsic value of \$55,661. The Company received proceeds of \$92,792 from these exercises.

No forfeiture rate is assumed for stock options granted to directors or employees due to the forfeiture rate history for these types of awards. During the nine months ended December 31, 2010, 7,500 unvested stock options were forfeited due to the termination of a consulting agreement with a consultant. There were no stock options forfeited or expired during the nine months ended December 31, 2009.

The following table is a summary of stock option activity for the nine months ended December 31, 2010:

| | Number of Shares | Weighted Average Exercise Price Per Share | Weighted Aggregate Average Remaining Contract Life in Years | Intrinsic Value |
|----------------------------------|---------------------|----------------------------------------------------|----------------------------------------------------------------------------|-----------------|
| Outstanding at March 31, 2010 | 107,500 | \$5.94 | 2.51 | \$237,088 |
| Granted | 42,500 | 6.24 | | |
| Exercised | (6,250) | 4.35 | | |
| Forfeited or Expired | (7,500) | 5.65 | | |
| Outstanding at December 31, 2010 | 136,250 | \$6.12 | 4.23 | \$207,788 |
| Vested at December 31, 2010 | 90,000 | \$6.15 | 1.76 | \$135,313 |
| Exercisable at December 31, 2010 | 90,000 | \$6.15 | 1.76 | \$135,313 |

Outstanding options at December 31, 2010 expire between January 2011 and September 2020 and have exercise prices ranging from \$4.00 to \$8.24.

6. Fair Value of Financial Instruments

Fair value as defined by authoritative literature is the price that would be received to sell an asset or paid to transfer a liability (exit price) in an orderly transaction between market participants at the measurement date. Fair value measurements are classified and disclosed in one of the following categories:

Level 1 – Quoted prices in active markets for identical assets and liabilities.

Level 2 – Quoted prices in active markets for similar assets and liabilities, quoted prices for identical or similar instruments in markets that are not active and model-derived valuations whose inputs are observable or whose significant value drivers are observable.

Level 3 – Significant inputs to the valuation model are unobservable.

Financial assets and liabilities are classified based on the lowest level of input that is significant to the fair value measurement. In accordance with the reporting requirements of FASB ASC Topic 825, Financial Instruments, the Company calculates the fair value of its assets and liabilities which qualify as financial instruments.

The initial measurement of asset retirement obligations' fair value is calculated using discounted cash flow techniques and is based on internal estimates of future retirement costs associated with oil and gas properties. Given the unobservable nature of the inputs, including plugging costs and reserve lives, the initial measurement of the ARO liability is deemed to use Level 3 inputs. See the Company's note on AROs for further discussion. AROs incurred during the nine months ended December 31, 2010 were approximately \$8,000.

The carrying amount reported in the accompanying consolidated balance sheets for cash and cash equivalents, accounts receivable and accounts payable and accrued expenses approximates fair value because of the immediate or short-term maturity of these financial instruments. The carrying amount reported in the accompanying consolidated balance sheets for long term debt approximates fair value because the actual interest rates do not significantly differ from current rates offered for instruments with similar characteristics.

7. Credit Facility

Effective October 22, 2010, Company has a revolving credit agreement with Bank of America, N.A. (the "Agreement"), which provides for a credit facility of \$4,900,000 with no monthly commitment reductions and a borrowing base evaluated annually set at \$4,900,000. Amounts borrowed under the Agreement are collateralized by the common stock of one of the Company's wholly owned subsidiaries and substantially all of the Company's oil and gas properties. Availability of this line of credit at December 31, 2010 was \$2,950,000. No principal payments are anticipated to be required through November 30, 2012.

The Agreement was renewed four times with the fourth amendment on October 22, 2010, which revised the maturity date to November 30, 2012. Under the original and renewed agreements, interest on the facility accrues at an annual rate equal to the British Bankers Association London Interbank Offered Rate ("BBA LIBOR") daily floating rate, plus 2.50 percentage points, which was 2.76% on December 31, 2010. Interest on the outstanding amount under the Agreement is payable monthly. In addition, the Company will pay an unused commitment fee in an amount equal to ½ of 1 percent (.5%) times the daily average of the unadvanced amount of the commitment. The unused commitment fee is payable quarterly in arrears on the last day of each calendar quarter.

The Agreement contains customary covenants for credit facilities of this type including limitations on disposition of assets, mergers and reorganizations. The Company is also obligated to meet certain financial covenants under the Agreement. The Company is in compliance with all covenants as of December 31, 2010. In addition, this Agreement prohibits the Company from paying cash dividends on its common stock.

As of December 31, 2010, a letter of credit for \$50,000, in lieu of a plugging bond with the Texas Railroad Commission covering the properties the Company operates is also outstanding under the facility. This letter of credit is renewed annually.

The balance outstanding on the line of credit was \$1,950,000 as of December 31, 2010 and \$1,700,000 as of February 14, 2011.

8. Income Taxes

The Company recognizes deferred tax assets and liabilities for future tax consequences of temporary differences between the carrying amounts of assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates applicable to the years in which those differences are expected to be settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in net income in the period that includes the enactment date. For the three and nine months ended December 31, 2010, there was a current income tax benefit of \$59,500 and \$25,502, respectively. For the three months ended December 31, 2010, deferred income tax expense was \$85,561. For the nine months ended December 31, 2010, there was a deferred income tax benefit of \$14,599. The Company's effective tax rate differs from the federal statutory tax rate due to the completion of the 2009 tax return which included an increase in current depletion expense and a decrease in the statutory depletion carryforward. Current income tax expense was \$21,988 for the three and nine months ending December 31, 2009. For the three and nine months ended December 2009, there was a deferred income tax benefit of \$60,964 and \$259,753, respectively.

As of December 31, 2010, the Company has a statutory depletion carryforward of approximately \$3,871,000, which does not expire. At December 31, 2010, there was a net operating loss carryforward for regular income tax reporting purposes of approximately \$1,965,000, which will begin expiring in 2021. The Company's ability to use some of the net operating loss carryforward and certain other tax attributes to reduce current and future U.S. federal taxable income is subject to limitations under the Internal Revenue Code.

Any interest and penalties related to uncertain tax positions are recorded as interest expense and general and administrative expense, respectively. As of December 31, 2010, the Company has unrecognized tax benefits of approximately \$441,000. As of December 31, 2009, the amount of unrecognized tax benefits was approximately \$451,000.

9. Related Party Transactions

Related party transactions for the Company relate to shared office expenditures in addition to administrative and operating expenses paid on behalf of the majority stockholder. The total billed to the stockholder for the nine months ended December 31, 2010 and 2009 was \$104,089 and \$41,033, respectively. These amounts include reimbursements of \$99,402 and \$36,917, respectively.

10. Income Per Common Share

Basic net income per share is computed by dividing net income by the weighted average number of common shares outstanding during the period. Diluted net income per share assumes the exercise of all stock options having exercise prices less than the average market price of the common stock during the period using the treasury stock method and is computed by dividing net income by the weighted average number of common shares and dilutive potential common shares (stock options) outstanding during the period. In periods where losses are reported, the weighted-average number of common shares outstanding excludes potential common shares, because their inclusion would be anti-dilutive.

The following is a reconciliation of the number of shares used in the calculation of basic income per share and diluted income per share for the three and nine month periods ended December 31, 2010 and 2009:

| | Three Months Ended December 31 | | Nine Months Ended December 31 | |
|----------------------------------------------------------|-----------------------------------|-----------|----------------------------------|-----------|
| | 2010 | 2009 | 2010 | 2009 |
| Net income | \$26,898 | \$167,145 | \$102,714 | \$257,492 |
| Shares outstanding: | | | | |
| Weighted avg. common shares outstanding – basic | 1,947,370 | 1,891,866 | 1,934,953 | 1,884,598 |
| Effect of the assumed exercise of dilutive stock options | 13,671 | 54,210 | 16,363 | 61,764 |
| Weighted avg. common shares outstanding – dilutive | 1,961,041 | 1,946,076 | 1,951,316 | 1,946,362 |
| Earnings per common share: | | | | |
| Basic | \$0.01 | \$0.09 | \$0.05 | \$0.14 |
| Diluted | \$0.01 | \$0.09 | \$0.05 | \$0.13 |

For the three and nine months ended December 31, 2010, 61,250 options were excluded from the diluted net income per share calculations because the options are anti-dilutive. Anti-dilutive stock options have a weighted average exercise price of \$6.86 at December 31, 2010. For the three and nine month periods ended December 31, 2009, no potential common shares relating to stock options were excluded in the computation of diluted net income per share.

11. Subsequent Events

The Company completed a review and analysis of all events that occurred after the balance sheet date to determine if any such events must be reported and has determined that there are no subsequent events to be disclosed.

Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations

Unless the context otherwise requires, references to the “Company”, “Mexco”, “we”, “us” or “our” mean Mexco Energy Corporation and its consolidated subsidiary.

Cautionary Statements Regarding Forward-Looking Statements. Management’s Discussion and Analysis of Financial Condition and Results of Operations (“MD&A”) contains “forward-looking statements” within the meaning of Section 27A of the Securities Act of 1933, as amended (the “Securities Act”), and Section 21E of the Securities Exchange Act of

1934, as amended (the “Exchange Act”). Forward-looking statements include statements regarding our plans, beliefs or current expectations and may be signified by the words “could”, “should”, “expect”, “project”, “estimate”, “believe”, “anticipate”, “intend”, “budget”, “plan”, “forecast”, “predict” and other similar expressions. Forward-looking statements appear throughout this Form 10-Q with respect to, among other things: profitability; planned capital expenditures; estimates of oil and gas production; future project dates; estimates of future oil and gas prices; estimates of oil and gas reserves; our future financial condition or results of operations; and our business strategy and other plans and objectives for future operations. Forward-looking statements involve known and unknown risks and uncertainties that could cause actual results to differ materially from those contained in any forward-looking statement.

While we have made assumptions that we believe are reasonable, the assumptions that support our forward-looking statements are based upon information that is currently available and is subject to change. All forward-looking statements in the Form 10-Q are qualified in their entirety by the cautionary statement contained in this section. We do not undertake to update, revise or correct any of the forward-looking information. It is suggested that these financial statements be read in conjunction with the financial statements and notes thereto included in the Form 10-K.

Liquidity and Capital Resources. Historically, we have funded our operations, acquisitions, exploration and development expenditures from cash generated by operating activities, bank borrowings and issuance of common stock. Our primary financial resource is our base of oil and gas reserves. We pledge our producing oil and gas properties to secure our revolving line of credit. The Company does not have any delivery commitments to provide a fixed and determinable quantity of its oil and gas under any existing contract or agreement.

Our long term strategy is on increasing profit margins while concentrating on obtaining reserves with low cost operations by acquiring and developing primarily gas properties and secondarily oil properties with potential for long-lived production. We focus our efforts on the acquisition of royalties in areas with significant development potential.

For the first nine months of fiscal 2011, cash flow from operations was \$912,776, a 19% increase when compared to the corresponding period of fiscal 2010. Cash of \$1,668,296 was used for additions to oil and gas properties, \$478,000 was used for the acquisition of a subsidiary, cash of \$27,187 was provided by the exercise of stock options and net proceeds from long term debt was \$1,250,000. The net cash increase of \$5,134 can be primarily attributed to an increase in cash receipts from accounts receivable partially offset by an increase in cash payments to vendors.

During the nine months ended December 31, 2010, we repurchased 2,000 shares for the treasury at an aggregate cost of \$12,325.

During the first nine months of fiscal 2011, we participated in 5 wells in the Dodd Federal Unit operated by Concho Resources, Inc. (formerly Marbob Energy Corporation). This unit, located in Eddy County, New Mexico currently contains approximately 110 wells and is expected to contain approximately 140 wells when completely drilled. For the fiscal year ending March 31, 2010, we participated in the drilling of 7 producing wells in this unit. Our working interest in this unit is .185% (.14% net revenue interest).

In August 2010, we purchased overriding royalty interests averaging .28% in 5,120 gross acres covering eight sections in the Haynesville trend area of DeSoto Parish, Louisiana, for an approximate purchase price of \$1.65 million, prior to closing adjustments. The Company paid \$1.46 million in cash and the remainder was paid as 26,833 shares of its common stock issued from treasury shares. This acreage currently contains five (5) horizontal wells producing from the Haynesville Shale formation and operated by Petrohawk Operating Company which will operate six of the eight sections. The two remaining sections will be operated by Chesapeake Energy. This acreage contains an additional 59 potential drill sites in the Haynesville. Other wells drilled in the Haynesville area show the presence of at least two (2) other potential producing zones, the Bossier and Cotton Valley, which are held by production and available for development should conditions warrant. Hundreds of Haynesville, hundreds of Cotton Valley and several dozen Bossier Shale wells are currently producing in the Haynesville trend area. Any development of these royalties will be free to the Company of expenses for drilling and operations. The Haynesville area has been estimated to become the largest gas resource in the United States and the fourth largest in the world subject to realization of technical estimates, according to World Oil in its June 2010 edition. World Oil recognizes DeSoto Parish as one of the top six (6) parishes of Louisiana where the most productive Haynesville wells are located.

On September 30, 2010, we purchased all of the outstanding stock of Southwest Texas Disposal Corporation, a Texas corporation which owns royalties producing primarily natural gas and free of drilling, development and operating

expenses. The cash purchase price of \$478,000 was funded from our \$4.9 million credit facility. These royalties cover over 200 properties located in 60 counties and parishes in Oklahoma, Texas, Louisiana, New Mexico, Mississippi and Alabama.

We are participating in other projects and are reviewing projects in which we may participate. The cost of such projects would be funded, to the extent possible, from existing cash balances and cash flow from operations. The remainder may be funded through borrowings on the credit facility and, if appropriate, sales of common stock of the Company.

At December 31, 2010, we had working capital of approximately \$509,925 compared to working capital of \$478,394 at March 31, 2010, an increase of \$31,531. This was mainly as a result of a decrease in accounts payable and accrued expenses and an increase in prepaid costs and expenses partially offset by a decrease in accounts receivable.

Crude oil and natural gas prices have fluctuated significantly in recent years. The effect of declining product prices on our business is significant. Lower product prices reduce our cash flow from operations and diminish the present value of our oil and gas reserves. Lower product prices also offer us less incentive to assume the drilling risks that are inherent in our business. The volatility of the energy markets makes it extremely difficult to predict future oil and natural gas price movements with any certainty. For example in the last twelve months, the West Texas Intermediate (“WTI”) posted price for crude oil has ranged from a low of \$66.88 per bbl in May 2010 to a high of \$92.21 per bbl in December 2010. The Henry Hub Spot Market Price (“Henry Hub”) for natural gas has ranged from a low of \$3.18 per MMBtu in October 2010 to a high of \$7.51 per MMBtu in January 2010. On December 30, 2010 the WTI posted price for crude oil was \$89.84 per bbl and the Henry Hub spot price for natural gas was \$4.23 per MMBtu. Management is of the opinion that cash flow from operations and funds available from financing will be sufficient to provide adequate liquidity for the next fiscal year.

Contractual Obligations. We have no off-balance sheet debt or unrecorded obligations and have not guaranteed the debt of any other party. The following table summarizes our future payments we are obligated to make based on agreements in place as of December 31, 2010:

| | Total | Payments Due In (1): | | |
|-----------------------------|-------------|----------------------|-------------|---------|
| | | less than 1 year | 1-3 years | 3 years |
| Contractual obligations: | | | | |
| Secured bank line of credit | \$1,950,000 | \$— | \$1,950,000 | \$— |

(1) Does not include estimated interest of \$54,000 less than 1 year and \$162,000 1-3 years.

These amounts represent the balances outstanding under the bank line of credit. These repayments assume that interest will be paid on a monthly basis and that no additional funds will be drawn.

Results of Operations – Three Months Ended December 31, 2010 and 2009. Net income was \$26,898 for the quarter ended December 31, 2010, as compared to net income of \$167,145 for the quarter ended December 31, 2009.

Oil and gas sales. Revenue from oil and gas sales was \$752,778 for the third quarter of fiscal 2011, a 12% decrease from \$857,035 for the same period of fiscal 2010. This resulted from a decrease in oil and gas production and gas price partially offset by an increase in oil price. The following table sets forth our oil and gas revenues, production quantities and average prices received during the three months ended December 31.

| | 2010 | 2009 | % Difference | |
|-------------------------|-----------|-----------|--------------|----|
| Oil: | | | | |
| Revenue | \$334,141 | \$324,245 | 3.1 | % |
| Volume (bbls) | 4,169 | 4,519 | (7.7 | %) |
| Average Price (per bbl) | \$80.15 | \$71.76 | 11.7 | % |

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| | | | | |
|-------------------------|-----------|-----------|-------|----|
| Gas: | | | | |
| Revenue | \$418,637 | \$532,790 | (21.4 | %) |
| Volume (mcf) | 115,911 | 136,073 | (14.8 | %) |
| Average Price (per mcf) | \$3.61 | \$3.92 | (7.9 | %) |

Production and exploration. Production costs were \$200,785 for the third quarter of fiscal 2011, a 25% decrease from \$269,154 for the same period of fiscal 2010. This was primarily the result of a decrease in repairs on operated wells in the El Cinco field.

Depreciation, depletion and amortization. Depreciation, depletion and amortization expense was \$244,065 for the third quarter of fiscal 2011, a 4% decrease from \$252,940 for the same period of fiscal 2010, primarily due to a decrease in oil and gas production and an increase in reserves due to current year purchases.

General and administrative expenses. General and administrative expenses were \$235,137 for the third quarter of fiscal 2011, an 18% increase from \$198,527 for the same period of fiscal 2010. This was primarily due to an increase in stock option compensation expense.

Interest expense. Interest expense was \$15,151 for the third quarter of fiscal 2011, a 78% increase from \$8,516 for the same period of fiscal 2010, due to an increase in borrowings.

Income taxes. There was an income tax expense \$26,061 for the quarter ended December 31, 2010 compared to an income tax benefit of \$38,976 for the quarter ended December 31, 2009. The Company's effective tax rate differs from the federal statutory tax rate due to the completion of the 2009 tax return which included an increase in current depletion expense and a decrease in the statutory depletion carryforward.

Results of Operations – Nine Months Ended December 31, 2010 and 2009. Net income was \$102,714 for the nine months ended December 31, 2010, as compared to net income of \$257,492 for the nine months ended December 31, 2009.

Oil and gas sales. Revenue from oil and gas sales was \$2,368,778 for the nine months ended December 31, 2010, a 5% increase from \$2,248,789 for the same period of fiscal 2010. This resulted from an increase in oil and gas prices partially offset by a decrease in oil and gas production. The following table sets forth our oil and gas revenues, production quantities and average prices received during the nine months ended December 31.

| | 2010 | 2009 | % Difference | |
|-------------------------|-------------|-------------|--------------|----|
| Oil: | | | | |
| Revenue | \$987,257 | \$839,184 | 17.6 | % |
| Volume (bbls) | 13,154 | 13,229 | (0.6 | %) |
| Average Price (per bbl) | \$75.05 | \$63.44 | 18.3 | % |
| Gas: | | | | |
| Revenue | \$1,381,521 | \$1,409,604 | (2.0 | %) |
| Volume (mcf) | 351,855 | 422,343 | (16.7 | %) |
| Average Price (per mcf) | \$3.93 | \$3.34 | 17.7 | % |

Production and exploration. Production costs were \$822,150 for the nine months ended December 31, 2010, a 5% increase from \$779,379 for the nine months ended December 31, 2009. This was primarily the result of an unsuccessful workover on one of our operated wells in Hutchinson County, Texas in which we own 100% working interest.

Depreciation, depletion and amortization. Depreciation, depletion and amortization expense was \$763,251 for the nine months ended December 31, 2010, a 4% decrease from \$791,474 for the nine months ended December 31, 2009 primarily due to a decrease in oil and gas production and an increase in reserves due to current year purchases.

General and administrative expenses. General and administrative expenses were \$682,820 for the nine months ended December 31, 2010, a 9% increase from \$628,941 for the nine months ended December 31, 2009. This was due to an increase in stock option compensation expense and engineering services.

Interest expense. Interest expense was \$25,347 for the nine months ended December 31, 2010, a 6% decrease from \$26,877 for the nine months ended December 31, 2009 due to a decrease in borrowings.

Income taxes. There was an income tax benefit of \$40,101 for the nine months ended December 31, 2010 compared to \$237,765 for the nine months ended December 31, 2009. The Company's effective tax rate differs from the federal statutory tax rate due to the completion of the 2009 tax return which included an increase in current depletion expense and a decrease in the statutory depletion carryforward.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

The primary sources of market risk for us include fluctuations in commodity prices and interest rates. All of our financial instruments are for purposes other than trading. At December 31, 2010, we had not entered into any hedge arrangements, commodity swap agreements, commodity futures, options or other similar agreements relating to crude oil and natural gas.

Interest Rate Risk. At December 31, 2010, we had an outstanding loan balance of \$1,950,000 under our \$4.9 million revolving credit agreement, which bears interest at an annual rate equal to the BBA LIBOR daily floating rate, plus 2.50 percentage points. If the interest rate on our bank debt increases or decreases by one percentage point, our annual pretax income would change by \$19,500 based on the outstanding balance at December 31, 2010.

Credit Risk. Credit risk is the risk of loss as a result of nonperformance by other parties of their contractual obligations. Our primary credit risk is related to oil and gas production sold to various purchasers and the receivables are generally not collateralized. At December 31, 2010, our largest credit risk associated with any single purchaser was \$69,584. We are also exposed to credit risk in the event of nonperformance from any of our working interest partners. At December 31, 2010, our largest credit risk associated with any working interest partner was \$2,480. We have not experienced any significant credit losses.

Energy Price Risk. Our most significant market risk is the pricing for natural gas and crude oil. Our financial condition, results of operations, and capital resources are highly dependent upon the prevailing market prices of, and demand for, oil and natural gas. Prices for oil and natural gas fluctuate widely. We cannot predict future oil and natural gas prices with any certainty. Historically, the markets for oil and gas have been volatile, and they are likely to continue to be volatile. Factors that can cause price fluctuations include the level of global demand for petroleum products, foreign supply of oil and gas, the establishment of and compliance with production quotas by oil-exporting countries, weather conditions, the price and availability of alternative fuels and overall political and economic conditions in oil producing countries. Declines in oil and natural gas prices will materially adversely affect our financial condition, liquidity, ability to obtain financing and operating results. Changes in oil and gas prices impact both estimated future net revenue and the estimated quantity of proved reserves. Any reduction in reserves, including reductions due to price fluctuations, can reduce the borrowing base under our revolving credit facility and adversely affect the amount of cash flow available for capital expenditures and our ability to obtain additional capital for our exploration and development activities. In addition, a noncash write-down of our oil and gas properties could be required under full cost accounting rules if prices declined significantly, even if it is only for a short period of time. Lower prices may also reduce the amount of crude oil and natural gas that can be produced economically. Thus, we may experience material increases or decreases in reserve quantities solely as a result of price changes and not as a result of drilling or well performance.

Similarly, any improvements in oil and gas prices can have a favorable impact on our financial condition, results of operations and capital resources. Oil and natural gas prices do not necessarily fluctuate in direct relationship to each other. Our financial results are more sensitive to movements in natural gas prices than oil prices because most of our production and reserves are natural gas. If the average oil price had increased or decreased by one dollar per barrel for the first nine months of fiscal 2011, our net income would have changed by \$13,154. If the average gas price had increased or decreased by one dollar per mcf for the first nine months of fiscal 2011, our net income would have changed by \$351,855.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures. We maintain disclosure controls and procedures to ensure that the information we must disclose in our filings with the SEC is recorded, processed, summarized and reported on a timely

basis. At the end of the period covered by this report, our principal executive officer and principal financial officer reviewed and evaluated the effectiveness of our disclosure controls and procedures, as defined in Exchange Act Rules 13a-15(e) and 15d-15(e). Based on such evaluation, such officers concluded that, as of December 31, 2010, our disclosure controls and procedures were effective to ensure that information we are required to disclose in the reports that we file or submit under the Exchange Act is disclosed within the time periods specified in the SEC's rules and forms and are effective to ensure that information required to be disclosed by us is accumulated and communicated to them to allow timely decisions regarding required disclosure.

Changes in Internal Control over Financial Reporting. No changes in the Company's internal control over financial reporting occurred during the quarter ended December 31, 2010 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

We may, from time to time, be involved in litigation and claims arising out of our operations in the normal course of business. We are not aware of any legal or governmental proceedings against us, or contemplated to be brought against us, under various environmental protection statutes or other regulations to which we are subject.

Item 1A. Risk Factors

There have been no material changes to the information previously disclosed in Item 1A. “Risk Factors” in our 2010 Annual Report on Form 10-K.

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

None.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Removed and Reserved

Item 5. Other Information

None.

Item 6. Exhibits

31.1 Certification of the Chief Executive Officer of Mexco Energy Corporation

31.2 Certification of the Chief Financial Officer of Mexco Energy Corporation

32.1 Certification of the Chief Executive Officer and Chief Financial Officer of Mexco Energy Corporation pursuant to 18 U.S.C. §1350

SIGNATURES

Pursuant to the requirements of the Securities and Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

MEXCO ENERGY CORPORATION
(Registrant)

Dated: February 14, 2011

/s/ Nicholas C. Taylor
Nicholas C. Taylor
President

Dated: February 14, 2011

/s/ Tamala L. McComic
Tamala L. McComic
Executive Vice President, Treasurer and Assistant
Secretary

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