

TORCHLIGHT ENERGY RESOURCES INC
Form 10-Q
August 08, 2017

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

FORM 10-Q

(Mark One)

Quarterly report under Section 13 or 15(d) of the Securities Exchange Act of 1934
For the Quarter Ended June 30, 2017

Transition report under Section 13 or 15(d) of the Securities Exchange Act of 1934
For the transition period from _____ to _____.

Commission file number: 001-36247

TORCHLIGHT ENERGY RESOURCES, INC.

(Name of registrant in its charter)

Nevada 74-3237581
(State or Other Jurisdiction of Incorporation or Organization) (I.R.S. Employer Identification No.)

5700 West Plano Pkwy, Suite 3600
Plano, Texas 75093

(Address of Principal Executive Offices)

(214) 432-8002

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. Large accelerated filer Accelerated filer

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

Non-accelerated filer Smaller reporting company Emerging growth company

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

As of August 7, 2017, there were 60,211,935 shares of the registrant's common stock outstanding (the only class of voting common stock).

FORM 10-Q

TABLE OF CONTENTS

Note About Forward-Looking Statements	3
PART I FINANCIAL INFORMATION	4
Item 1. Consolidated Financial Statements	4
Consolidated Balance Sheets (Unaudited)	4
Consolidated Statements of Operations (Unaudited)	5
Consolidated Statements of Cash Flows (Unaudited)	6
Notes to Consolidated Financial Statements (Unaudited)	7
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations	15
Item 3. Quantitative and Qualitative Disclosures About Market Risk	20
Item 4. Controls and Procedures	20
PART II OTHER INFORMATION	21
Item 1. Legal Proceedings	21
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds	21
Item 6. Exhibits	22
Signatures	23

NOTE ABOUT FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These statements include, among other things, statements regarding plans, objectives, goals, strategies, future events or performance and underlying assumptions and other statements, which are other than statements of historical facts. Forward-looking statements may appear throughout this report, including without limitation, Item 2 “Management’s Discussion and Analysis of Financial Condition and Results of Operations.” Forward-looking statements generally can be identified by words such as “anticipates,” “believes,” “estimates,” “expects,” “intends,” “plans,” “predicts,” “projects,” “will be,” “will continue,” “will likely result,” and similar expressions. These forward-looking statements are based on current expectations and assumptions that are subject to risks and uncertainties, which could cause our actual results to differ materially from those reflected in the forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those discussed in this report and in our Annual Report on Form 10-K for the year ended December 31, 2016 and in particular, the risks discussed in our Form 10-K under the caption “Risk Factors” in Item 1A therein, and those discussed in other documents we file with the Securities and Exchange Commission (“SEC”). Important factors that in our view could cause material adverse effects on our financial condition and results of operations include, but are not limited to, risks associated with the company's ability to obtain additional capital in the future to fund planned expansion, the demand for oil and natural gas, general economic factors, competition in the industry and other factors that may cause actual results to be materially different from those described herein as anticipated, believed, estimated or expected. We undertake no obligation to revise or publicly release the results of any revision to any forward-looking statements, except as required by law. Given these risks and uncertainties, readers are cautioned not to place undue reliance on such forward-looking statements.

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

PART I FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

TORCHLIGHT ENERGY RESOURCES, INC.

CONSOLIDATED BALANCE SHEETS (Unaudited)

	June 30,	December 31,
	2017	2016
ASSETS		
Current assets:		
Cash	\$1,465,647	\$1,769,499
Accounts receivable	600,631	603,446
Production revenue receivable	13,725	7,325
Prepayments - development costs	1,747,856	583,347
Prepaid expenses	71,695	26,829
Total current assets	3,899,554	2,990,446
Oil and gas properties, net	15,608,309	9,392,288
Office equipment, net	21,535	29,848
Other assets	6,362	21,066
TOTAL ASSETS	\$19,535,760	\$12,433,648
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$242,443	\$422,684
Funds received pending settlement	520,400	520,400
Accrued payroll	605,176	565,176
Related party payables	45,000	237,044
Convertible promissory notes, (Series B) net of discount of \$91,379 at December 31, 2016	-	3,478,121
Due to working interest owners	54,320	54,320
Interest payable	53,026	6,049

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

Total current liabilities	1,520,365	5,283,794
Unsecured promissory notes, net of discount and financing costs of \$966,342 at June 30, 2017	7,097,955	-
Asset retirement obligation	7,133	7,051
Total liabilities	8,625,453	5,290,845
Commitments and contingencies	-	-
Stockholders' equity:		
Preferred stock, par value \$.001, 10,000,000 shares authorized; -0- issued and outstanding at June 30, 2017 and December 31, 2016	-	-
Common stock, par value \$0.001 per share; 100,000,000 shares authorized; 60,186,935 issued and outstanding at June 30, 2017		
55,096,503 issued and outstanding at December 31, 2016	60,190	55,100
Additional paid-in capital	95,548,915	89,675,488
Accumulated deficit	(84,698,798)	(82,587,785)
Total stockholders' equity	10,910,307	7,142,803
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$19,535,760	\$12,433,648

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

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

	Three Months	Three Months	Six Months	Six Months
	Ended	Ended	Ended	Ended
	June 30, 2017	June 30, 2016	June 30, 2017	June 30, 2016
Revenue				
Oil and gas sales	\$13,303	\$105,220	26,252	303,513
SWD and royalties	-	-	-	-
Cost of revenue	(11,976)	(139,116)	(16,133)	(245,300)
Gross profit	1,327	(33,896)	10,119	58,213
Operating expenses:				
General and administrative expense	949,040	3,796,418	1,942,445	4,747,704
Depreciation, depletion and amortization	25,918	100,082	50,435	722,054
Impairment expense	-	57,912	-	57,912
Loss on sale	-	146,138	-	146,138
Total operating expenses	974,958	4,100,550	1,992,880	5,673,808
Other (income) expense				
Interest income	(182)	-	(294)	-
Interest and accretion expense	81,281	(47,481)	128,547	(169,858)
Total other (income) expense	81,099	(47,481)	128,253	(169,858)
Net loss before taxes	(1,054,730)	(4,181,927)	(2,111,014)	(5,785,453)
Provision for income taxes	-	-	-	-
Net loss	\$(1,054,730)	\$(4,181,927)	\$(2,111,014)	\$(5,785,453)
Loss per share:				
Basic and Diluted	\$(0.02)	\$(0.11)	\$(0.04)	\$(0.17)
Weighted average shares outstanding:				
Basic and Diluted	59,597,753	38,159,174	58,473,923	36,220,417

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

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

	Six Months	Six Months
	Ended	Ended
	June 30, 2017	June 30, 2016
Cash Flows From Operating Activities		
Net loss	\$(2,111,014)	\$(5,785,453)
Adjustments to reconcile net loss to net cash from operations:		
Stock based compensation	716,719	3,214,690
Accretion of convertible note discounts	119,845	95,979
Depreciation, depletion and amortization	50,435	722,054
Impairment expense	-	57,912
Loss on sale of assets	-	146,138
Change in:		
Accounts receivable	2,815	79,686
Production revenue receivable	(6,400)	190,500
Prepayment of development costs	(1,164,509)	(150,362)
Prepaid expenses	(44,866)	38,776
Other assets	11,999	28,720
Accounts payable and accrued liabilities	(90,241)	635,368
Due to working interest owners	-	113,113
Interest payable	54,866	(15,174)
Net cash from operating activities	(2,460,351)	(628,053)
Cash Flows From Investing Activities		
Investment in oil and gas properties	(2,655,199)	(1,882,458)
Proceeds from sale of leases	-	1,572,000
Net cash from investing activities	(2,655,199)	(310,458)
Cash Flows From Financing Activities		
Preferred dividends paid in cash	-	(224,260)
Proceeds from warrant exercise	29,250	406,541
Proceeds from promissory notes	7,291,948	661,270
Repayment of promissory notes	(2,509,500)	(613,629)
Net cash from financing activities	4,811,698	229,922
Net change in cash	(303,852)	(708,589)
Cash - beginning of period	1,769,499	1,026,600

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

Cash - end of period	\$1,465,647	\$318,011
Supplemental disclosure of cash flow information: (Non Cash Items)		
Common stock issued for services	\$542,254	\$410,474
Common stock issued for lease interests	\$373,431	\$1,484,166
Common stock issued in warrant exercise	\$29,250	\$397,471
Common stock issued in conversion of preferred stock	\$-	\$9,700,000
Common stock issued in conversion of promissory note	\$1,007,890	\$-
Mineral interests received in warrant exercise	\$3,229,431	\$-
Warrants issued in connection with promissory notes	\$-	\$80,750
Warrants issued for mineral interests	\$-	\$1,409,761
Cash paid for interest	\$332,273	\$266,259

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

1. NATURE OF BUSINESS

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

On November 23, 2010, we entered into and closed a Share Exchange Agreement (the “Exchange Agreement”) between the major shareholders of PPS and the shareholders of Torchlight Energy, Inc. (“TEI”). As a result of the transactions effected by the Exchange Agreement, at closing TEI became our wholly-owned subsidiary, and the business of TEI became our sole business. TEI was incorporated under the laws of the State of Nevada in June, 2010. We are engaged in the acquisition, exploitation and/or development of oil and natural gas properties in the United States. We operate our business through our subsidiaries Torchlight Energy Inc., Torchlight Energy Operating, LLC, Hudspeth Oil Corporation, and Torchlight Hazel, LLC.

2. GOING CONCERN

At June 30, 2017, the Company had not yet achieved profitable operations. We had a net loss of \$2,111,014 for the six months ended June 30, 2017 and had accumulated losses of \$84,698,798 since our inception. The Company had working capital as of June 30, 2017 of \$2,379,189. We expect to incur further losses in the development of our business. These conditions raise substantial doubt about the Company’s ability to continue as a going concern.

The Company’s ability to continue as a going concern is dependent on its ability to generate future profitable operations and/or to obtain the necessary financing to meet its projected development costs and repay its liabilities arising from normal business operations when they come due. Management’s plan to address the Company’s ability to continue as a going concern includes: (1) obtaining debt or equity funding from private placement or institutional sources; (2) obtain loans from financial institutions, where possible, or (3) participating in joint venture transactions with third parties. Although management believes that it will be able to obtain the necessary funding to allow the Company to remain a going concern through the methods discussed above, there can be no assurances that such methods will prove successful.

These consolidated financial statements have been prepared assuming that the Company will continue as a going concern and therefore, the financial statements do not include any adjustments to reflect the possible future effects on the recoverability and classification of assets or the amount and classifications of liabilities that may result from the outcome of this uncertainty.

3. SIGNIFICANT ACCOUNTING POLICIES

The Company maintains its accounts on the accrual method of accounting in accordance with accounting principles generally accepted in the United States of America. Accounting principles followed and the methods of applying those principles, which materially affect the determination of financial position, results of operations and cash flows are summarized below:

Basis of presentation— The accompanying interim financial statements are unaudited and have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (“SEC”) regarding interim financial reporting. Certain disclosures have been condensed or omitted from these financial statements. Accordingly, they do not include all of the information and notes required by accounting principles generally accepted in the United States of America (“GAAP”) for complete consolidated financial statements, and should be read in conjunction with the audited

consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2016. The financial statements are presented on a consolidated basis and include all of the accounts of Torchlight Energy Resources Inc. and its wholly owned subsidiaries, Torchlight Energy, Inc., Torchlight Energy Operating, LLC, Hudspeth Oil Corporation, and Torchlight Hazel, LLC. All intercompany transactions have been eliminated in consolidation. Certain reclassifications have been made to the prior year's consolidated financial statements and related footnotes to conform them to the current year presentation. In the opinion of the Company's management, the accompanying unaudited condensed consolidated financial statements include all adjustments, consisting of normal recurring adjustments, necessary to fairly present the financial position as of, and the results of operations for, all periods presented. In preparing the accompanying condensed consolidated financial statements, management has made certain estimates and assumptions that affect reported amounts in the condensed consolidated financial statements and disclosures of contingencies. Actual results may differ from those estimates. The results for interim periods are not necessarily indicative of annual results.

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

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

3. SIGNIFICANT ACCOUNTING POLICIES - continued

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

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

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

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

Accounts receivable – Accounts receivable consist of uncollateralized oil and natural gas revenues due under normal trade terms, as well as amounts due from working interest owners of oil and gas properties for their share of expenses paid on their behalf by the Company. Management reviews receivables periodically and reduces the carrying amount by a valuation allowance that reflects management's best estimate of the amount that may not be collectible. As of June 30, 2017 and December 31, 2016, no valuation allowance was considered necessary.

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

Oil and gas properties include costs that are excluded from costs being depleted or amortized. Oil and natural gas property costs excluded represent investments in unevaluated properties and include non-producing leasehold, geological, and geophysical costs associated with leasehold or drilling interests and exploration drilling costs. The Company allocates a portion of its acquisition costs to unevaluated properties based on relative value. Costs are transferred to the full cost pool as the properties are evaluated over the life of the reservoir. Unevaluated properties are reviewed for impairment at least quarterly and are determined through an evaluation considering, among other factors, seismic data, requirements to relinquish acreage, drilling results, remaining time in the commitment period, remaining capital plan, and political, economic, and market conditions.

Gains and losses on the sale of oil and gas properties are not generally reflected in income unless the gain or loss would significantly alter the relationship between capitalized costs and proved reserves. Sales of less than 100% of the

Company's interest in the oil and gas property are treated as a reduction of the capital cost of the field, with no gain or loss recognized, as long as doing so does not significantly affect the unit-of-production depletion rate. Costs of retired equipment, net of salvage value, are usually charged to accumulated depreciation.

Capitalized interest – The Company capitalizes interest on unevaluated properties during the periods in which they are excluded from costs being depleted or amortized. During six months ended June 30, 2017 and 2016, the Company capitalized \$408,627 and \$157,581, respectively, of interest on unevaluated properties.

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

Ceiling test – Future production volumes from oil and gas properties are a significant factor in determining the full cost ceiling limitation of capitalized costs. Under the full cost method of accounting, the Company is required to periodically perform a “ceiling test” that determines a limit on the book value of oil and gas properties. If the net capitalized cost of proved oil and gas properties, net of related deferred income taxes, plus the cost of unproved oil and gas properties, exceeds the present value of estimated future net cash flows discounted at 10 percent, net of related tax affects, plus the cost of unproved oil and gas properties, the excess is charged to expense and reflected as additional accumulated DD&A. The ceiling test calculation uses a commodity price assumption which is based on the unweighted arithmetic average of the price on the first day of each month for each month within the prior 12 month period and excludes future cash outflows related to estimated abandonment costs.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

3. SIGNIFICANT ACCOUNTING POLICIES - continued

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

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

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

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

Authoritative guidance for uncertainty in income taxes requires that the Company recognize the financial statement benefit of a tax position only after determining that the relevant tax authority would more likely than not sustain the position following an examination. Management has reviewed the Company’s tax positions and determined there were no uncertain tax positions requiring recognition in the consolidated financial statements. Company tax returns remain subject to Federal and State tax examinations. Generally, the applicable statutes of limitation are three to four years from their respective filings.

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

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

The Company also issues equity awards to non-employees. The fair value of these option awards is estimated when the award recipient completes the contracted professional services. The Company recognizes expense for the estimated total value of the awards during the period from their issuance until performance completion, at which time the estimated expense is adjusted to the final value of the award as measured at performance completion.

The Company values warrant and option awards using the Black-Scholes option pricing model.

Revenue recognition – The Company recognizes oil and gas revenues when production is sold at a fixed or determinable price, persuasive evidence of an arrangement exists, delivery has occurred and title has transferred, and collectability is reasonably assured.

Basic and diluted earnings (loss) per share – Basic earnings (loss) per common share is computed by dividing net income (loss) available to common shareholders by the weighted average number of common shares outstanding during the period. Diluted earnings (loss) per common share is computed in the same way as basic earnings (loss) per common share except that the denominator is increased to include the number of additional common shares that would be outstanding if all potential common shares had been issued and if the additional common shares were dilutive. The calculation of diluted earnings per share excludes 20,561,231 shares issuable upon the exercise of outstanding warrants and options because their effect would be anti-dilutive.

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

3. SIGNIFICANT ACCOUNTING POLICIES - continued

Recent accounting pronouncements –

In May 2014, the FASB issued ASU 2014-09, Revenue From Contracts With Customers that introduces a new five-step revenue recognition model in which an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. This ASU also requires disclosures sufficient to enable users to understand the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers, including qualitative and quantitative disclosures about contracts with customers, significant judgments and changes in judgments, and assets recognized from the costs to obtain or fulfill a contract. This standard is effective for fiscal years beginning after December 15, 2017, including interim periods within that reporting period. The Company is currently evaluating the new guidance to determine the impact it will have on its consolidated financial statements.

In February 2016, the FASB, issued ASU, 2016-02, Leases. The ASU requires companies to recognize on the balance sheet the assets and liabilities for the rights and obligations created by leased assets. ASU 2016-02 will be effective for the Company in the first quarter of 2019, with early adoption permitted. The Company is currently evaluating the impact that the adoption of ASU 2016-02 will have on the Company's consolidated financial statements and related disclosures.

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

Subsequent events – The Company evaluated subsequent events through August 7, 2017, the date of issuance of the financial statements. Subsequent events, if any, are disclosed in Note 11.

4. OIL & GAS PROPERTIES

The following table presents the capitalized costs for oil & gas properties of the Company as of June 30, 2017 and December 31, 2016:

	2017	2016
Evaluated costs subject to amortization	\$2,721,503	\$1,470,939
Unevaluated costs	18,386,503	13,376,742
Total capitalized costs	21,108,006	14,847,681
Less accumulated depreciation, depletion and amortization	(5,499,697)	(5,455,393)
Total oil and gas properties	\$15,608,309	\$9,392,288

Unevaluated costs as of June 30, 2017 include cumulative costs on developing projects including the Orogrande and Hazel Projects in West Texas and adjusted costs of nonproducing leases in Oklahoma.

On January 30, 2017, we and our wholly-owned subsidiary, Torchlight Acquisition Corporation, a Texas corporation (“TAC”), entered into and closed an Agreement and Plan of Reorganization and Plan of Merger with Line Drive Energy, LLC, a Texas limited liability company (“Line Drive”), under which agreements TAC merged with and into Line Drive and the separate existence of TAC ceased, with Line Drive being the surviving organization and becoming our wholly-owned subsidiary. Line Drive, which was wholly-owned by Gregory McCabe, our Chairman, owned certain assets and securities, including approximately 40.66% of 12,000 gross acres in the Hazel Project and 521,739 warrants to purchase our common stock (which warrants had been assigned by Mr. McCabe to Line Drive). Under the merger transaction, our shares of common stock of TAC converted into a membership interest of Line Drive, the membership interest in Line Drive held by Mr. McCabe immediately prior to the transaction ceased to exist, and we issued Mr. McCabe 3,301,739 restricted shares of common stock as consideration therefor. Immediately after closing, the 521,739 warrants held by Line Drive were cancelled, which warrants had an exercise price of \$1.40 per share and an expiration date of June 9, 2020. A Certificate of Merger for the merger transaction was filed with the Secretary of State of Texas on January 31, 2017. Subsequent to the closing the name of Line Drive Energy, LLC was changed to Torchlight Hazel, LLC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

4. OIL & GAS PROPERTIES - continued

Also on January 30, 2017, our wholly-owned subsidiary, Torchlight Energy, Inc., a Nevada corporation (“TEI”), entered into and closed a Purchase and Sale Agreement with Wolfbone Investments, LLC, a Texas limited liability company (“Wolfbone”) which is wholly-owned by Gregory McCabe. Under the agreement, TEI acquired certain of Wolfbone’s Hazel Project assets, including its interest in the Flying B Ranch #1 well and the 40 acre unit surrounding the well, for consideration of \$415,000, and additionally, Wolfbone caused to be cancelled a total of 2,780,000 warrants to purchase our common stock, including 1,500,000 warrants held by McCabe Petroleum Corporation, an entity owned by Mr. McCabe, and 1,280,000 warrants held by Green Hill Minerals, an entity owned by Mr. McCabe’s son, which warrant cancellations were effected through certain Warrant Cancellation Agreements. The 1,500,000 warrants held by McCabe Petroleum Corporation had an exercise price of \$1.00 per share and an expiration date of April 4, 2021. The warrants held by Green Hill Minerals included 100,000 warrants with an exercise price of \$1.73 and an expiration date of September 30, 2018 and 1,180,000 warrants with an exercise price of \$0.70 and an expiration date of February 15, 2020.

Since Mr. McCabe held the controlling interest in both Line Drive and Wolfbone Investments, LLC, the transactions were combined for accounting purposes. The working interest in the Hazel Project was the only asset held by Line Drive. The warrant cancellation was treated in the aggregate as an exercise of the warrants with the transfer of the working interests as the consideration. The Company recorded the transactions as an increase in its investment in the Hazel project working interests of \$3,644,431 which is equal to the exercise price of the warrants plus the cash paid to Wolfbone.

Upon the closing of the above transactions, the Company’s working interest in the Hazel project increased by 40.66% to a total ownership of 74%.

Effective June 1, 2017, the Company acquired an additional 6% working interest from unrelated working interest owners in exchange for 268,656 shares of common stock, increasing its interest in the Hazel project to 80%.

5. RELATED PARTY PAYABLES

As of June 30, 2017, related party payables consisted of accrued and unpaid compensation to one of our executive officers totaling \$45,000.

During the three months ended June 30, 2017, the Company issued 58,026 stock options in payment of accounts payable to two directors for 2016 director fees.

During the three months ended June 30, 2017, the Company issued a total of 237,001 shares of common stock in payment of amounts due to a director for 2016 director fees and compensation for serving on the Litigation Committee of the Board of Directors. All of the shares are presently unvested and are subject to vesting at specified future events. The value of the award has been fully recognized in expense according to its terms.

6. COMMITMENTS AND CONTINGENCIES

Legal Proceeding

Torchlight Energy Resources, Inc. and its subsidiary Torchlight Energy, Inc. has pending in the 429th judicial district court in Collin County, Texas a lawsuit against Husky Ventures, Inc., Charles V. Long, Silverstar of Nevada, Inc.,

Gastar Exploration Inc., J. Russell Porter, Michael A. Gerlich, and Jerry R. Schuyler that was originally filed in May 2016 (previous defendants April Glidewell, Maximus Exploration, LLC, Atwood Acquisitions, LLC and John M. Selser, Sr have been non-suited without prejudice to re-filing the claims). In the lawsuit, we allege, among other things, that the defendants acted improperly in connection with multiple transactions, and that the defendants misrepresented and omitted material information to us with respect to these transactions. The lawsuit seeks damages arising from 15 different causes of action, including without limitation, violations of the Texas Securities Act, fraud, negligent misrepresentation, breach of fiduciary duty, breach of contract, unjust enrichment and tortious interference. The lawsuit also seeks a complete accounting as to how our investment funds were used, including all transfers between and among the defendants. We are seeking the full amount of our damages on \$20,000,000 invested. At this time we believe our damages to be in excess of \$1,000,000, but the precise amount will be determined in the litigation.

On April 13, 2017, Husky Ventures, Inc. filed in the above lawsuit a counterclaim against Torchlight Energy Resources, Inc. and its subsidiary Torchlight Energy, Inc., and a third-party petition against John Brda, the Chief Executive Officer of Torchlight Energy Resources, Inc., and Willard McAndrew III, a former officer of Torchlight Energy Resources, Inc. (“Husky Counterclaim”). The Husky Counterclaim asserts breach of contract against Torchlight Energy Resources, Inc. and its subsidiary Torchlight Energy, Inc. and asserts a claim for tortious interference with Husky’s contractual relationship with Torchlight and a claim for conspiracy to tortiously interfere with unspecified Husky business and contractual relationships against Torchlight Energy Resources, Inc. and its subsidiary Torchlight Energy, Inc., John Brda and Willard McAndrew III. We believe the Husky Counterclaim is without merit and intend to vigorously defend against it.

On May 22, 2017, the Court granted Gastar Exploration, Inc., J. Russell Porter, Michael A. Gerlich, and Jerry R. Schuyler’s (“Gastar Defendants”) motion for summary judgment dismissing all of Torchlight’s claims against the Gastar Defendants with prejudice. The only claim remaining related to the Gastar Defendants is a counterclaim against Torchlight by Gastar Exploration, Inc. for Torchlight’s alleged breach of a release that Gastar Exploration, Inc. claims occurred because Torchlight filed this lawsuit against the Gastar Defendants. Torchlight alleges in its lawsuit that this release is unenforceable against all the Defendants including but not limited to Gastar Defendants.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

6. COMMITMENTS AND CONTINGENCIES - continued

Environmental matters

We are subject to contingencies as a result of environmental laws and regulations. Present and future environmental laws and regulations applicable to our operations could require substantial capital expenditures or could adversely affect our operations in other ways that cannot be predicted at this time. As of June 30, 2017 and December 31, 2016, no amounts have been recorded because no specific liability has been identified that is reasonably probable of requiring us to fund any future material amounts.

7. STOCKHOLDERS' EQUITY

Effective June 1, 2017 we issued 268,656 shares of common stock to certain working interest owners in exchange for an aggregate 6% working interest in the Hazel Project.

During the three months ended June 30, 2017 the Company issued 1,007,890 shares of common stock in connection with the conversion of a previously outstanding 12% Series B Unsecured Convertible Promissory Note.

During the three months ended June 30, 2017 the Company issued 441,575 shares of common stock for services including 237,001 shares to a director which are subject to vesting at specified future events. The value of the director award has been fully recognized in expense according to its terms.

During the three months ended June 30, 2017 the Company issued 29,250 shares of common stock in warrant exercises.

During the three months ended June 30, 2017, the Company recognized \$42,312 of expense related to 200,000 warrants issued for services in the first quarter, 2017.

A summary of warrants outstanding as of June 30, 2017 by exercise price and year of expiration is presented below:

Exercise Expiration Date in

Price	2017	2018	2019	2020	2021	Total
\$0.50	-	528,099	-	-	-	528,099
\$0.70	-	-	-	420,000	-	420,000
\$0.77	-	-	100,000	-	-	100,000
\$1.00	150,000	-	25,116	-	-	175,116
\$1.03	-	-	-	-	120,000	120,000
\$1.08	-	-	37,500	-	-	37,500
\$1.40	-	-	-	1,121,736	-	1,121,736
\$1.64	-	-	-	-	200,000	200,000

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

\$1.73	-	100,000	-	-	-	100,000
\$1.80	-	-	-	1,250,000	-	1,250,000
\$2.00	126,000	1,906,249	-	-	-	2,032,249
\$2.03	-	2,000,000	-	-	-	2,000,000
\$2.09	-	2,800,000	-	-	-	2,800,000
\$2.23	-	-	-	832,512	-	832,512
\$2.29	-	120,000	-	-	-	120,000
\$2.50	-	-	35,211	-	-	35,211
\$2.82	-	38,174	-	-	-	38,174
\$3.50	-	-	15,000	-	-	15,000
\$4.50	-	-	700,000	-	-	700,000
\$5.00	75,000	-	-	-	-	75,000
\$6.00	-	523,123	22,580	-	-	545,703
\$7.00	-	-	700,000	-	-	700,000
	351,000	8,015,645	1,635,407	3,624,248	320,000	13,946,300

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

7. STOCKHOLDERS' EQUITY - continued

During the three months ended June 30, 2017, the Company recognized \$287,250 of expense related to previously issued employee stock options and issued 58,026 options in payment of a \$54,544 account payable to directors for 2016 director fees.

A summary of stock options outstanding as of June 30, 2017 by exercise price and year of expiration is presented below:

Exercise Price	Expiration Date in					
	2017	2018	2019	2020	2021	Total
\$0.97	-	-	-	-	259,742	259,742
\$1.57	-	-	-	5,997,163	-	5,997,163
\$1.63	-	-	-	-	58,026	58,026
\$1.79	-	-	-	300,000	-	300,000
	-	-	-	6,297,163	317,768	6,614,931

At June 30, 2017 the Company had reserved 20,561,231 shares for future exercise of warrants and options.

Warrants and options issued were valued using the Black Scholes Option Pricing Model. The assumptions used in calculating the fair value of the warrants issued were as follows:

2017

Risk-free interest rate	1.47% - 1.94%
Expected volatility of common stock	106.5% - 116.5%
Dividend yield	0.00%
Discount due to lack of marketability	20%
Expected life of warrant	4 years - 5 years

2016

Risk-free interest rate	0.78%-1.47%
Expected volatility of common stock	101% - 189%
Dividend yield	0.00%
Discount due to lack of marketability	20-30%
Expected life of warrant	3 years - 5 years

8. INCOME TAXES

The Company estimates its annual effective income tax rate in recording its quarterly provision for income taxes in the various jurisdictions in which it operates. Statutory tax rate changes and other significant or unusual items are recognized as discrete items in the quarter in which they occur. The Company recorded no income tax expense for the six months ended June 30, 2017 because the Company expects to incur a tax loss in the current year. Similarly, no income tax expense was recognized for the six months ended June 30, 2016 for this same reason.

The Company had a net deferred tax asset related to federal net operating loss carryforwards totaling \$49,319,054 and \$47,850,266 at June 30, 2017 and December 31, 2016, respectively. The federal net operating loss carryforward will begin to expire in 2032. Realization of the deferred tax asset is dependent, in part, on generating sufficient taxable income prior to expiration of the loss carryforwards. The Company has placed a 100% valuation allowance against the net deferred tax asset because future realization of these assets is not assured.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

9. PROMISSORY NOTES

On April 10, 2017, we sold to investors in a private transaction two 12% unsecured promissory notes with a total of \$8,000,000 in principal amount. Interest only is due and payable on the notes each month at the rate of 12% per annum, with a balloon payment of the outstanding principal due and payable at maturity on April 10, 2020. The holders of the notes will also receive annual payments of common stock at the rate of 2.5% of principal amount outstanding, based on a volume-weighted average price. Both notes were sold at an original issue discount of 94.25% and accordingly, we received total proceeds of \$7,540,000 from the investors. We are using the proceeds for working capital and general corporate purposes, which includes, without limitation, drilling capital, lease acquisition capital and repayment of prior debt.

These 12% promissory notes allow for early redemption, provided that if we redeem before April 10, 2018, we must pay the holders all unpaid interest and common stock payments on the portion of the notes redeemed that would have been earned through April 10, 2018. The notes also contain certain covenants under which we have agreed that, except for financing arrangements with established commercial banking or financial institutions and other debts and liabilities incurred in the normal course of business, we will not issue any other notes or debt offerings which have a maturity date prior to the payment in full of the 12% notes, unless consented to by the holders.

The effective interest rate is 16.15%.

On April 24, 2017 we used \$2,509,500 of the proceeds from this financing to redeem and repay a portion of the outstanding 12% Series B Convertible Unsecured Promissory Notes. Separately, \$1,000,000 of the principal amount of the Series B Notes plus accrued interest was converted into 1,007,890 shares of common stock and \$60,000 was rolled into the new debt financing.

10. ASSET RETIREMENT OBLIGATIONS

The following is a reconciliation of the asset retirement obligation liability through June 30, 2017:

Asset retirement obligation – December 31, 2015	\$29,083
Accretion Expense	41
Removal of ARO for wells sold	(22,073)
Asset retirement obligation – December 31, 2016	\$7,051
Accretion Expense	41
Asset retirement obligation – March 31, 2017	\$7,092
Accretion Expense	41
Asset retirement obligation – June 30, 2017	\$7,133

11. SUBSEQUENT EVENTS

None

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

Overview

We are engaged in the acquisition, exploration, exploitation, and/or development of oil and natural gas properties in the United States. We operate our business through our subsidiaries Torchlight Energy Inc., Torchlight Energy Operating, LLC, Hudspeth Oil Corporation, and Torchlight Hazel, LLC.

The core strategy of the Company is pursuing the ongoing development of its assets in the Permian basin consisting of the Orogrande and the Hazel Projects. These West Texas properties demonstrate significant potential and future production capabilities based upon the analysis of scientific data already gathered in the day by day development activity. Therefore, the Board has determined to focus its efforts and capital on these two projects to maximize shareholder value for the long run.

The following discussion of our financial condition and results of operations should be read in conjunction with our unaudited financial statements included herewith and our audited financial statements included with our Form 10-K for the year ended December 31, 2016. This discussion should not be construed to imply that the results discussed herein will necessarily continue into the future, or that any conclusion reached herein will necessarily be indicative of actual operating results in the future. Such discussion represents only the best present assessment by our management.

Current Projects

As of June 30, 2017 the Company had interests in three oil and gas projects: the Orogrande Project in Hudspeth County, Texas, the Hazel Project in Sterling, Tom Green, and Irion Counties, Texas, and the Hunton wells in partnership with Husky Ventures in Central Oklahoma.

Orogrande Project, West Texas

On August 7, 2014, we entered into a Purchase Agreement with Hudspeth Oil Corporation (“Hudspeth”), McCabe Petroleum Corporation (“MPC”), and Greg McCabe. Mr. McCabe was the sole owner of both Hudspeth and MPC. Under the terms and conditions of the Purchase Agreement, at closing, we purchased 100% of the capital stock of Hudspeth which holds certain oil and gas assets, including a 100% working interest in 172,000 mostly contiguous acres in the Orogrande Basin in West Texas. This acreage is in the primary term under five-year leases that carry additional five-year extension provisions. As consideration, at closing we issued 868,750 shares of our common stock to Mr. McCabe and paid a total of \$100,000 in geologic origination fees to third parties. Additionally, Mr. McCabe has, at his option, a 10% working interest back-in after payout and a reversionary interest if drilling obligations are not met, all under the terms and conditions of a participation and development agreement. All drilling obligations through June 30, 2017 have been met

On September 23, 2015, our subsidiary, Hudspeth Oil Corporation (“HOC”), entered into a Farmout Agreement by and between HOC, Pandora Energy, LP (“Pandora”), Founders Oil & Gas, LLC (“Founders”), McCabe Petroleum Corporation and Greg McCabe (McCabe Petroleum Corporation and Greg McCabe are parties to the Farmout Agreement for limited purposes) for the entire Orogrande Project in Hudspeth County, Texas. The Farmout Agreement provides for Founders to earn from HOC and Pandora (collectively, the “Farmor”) an undivided 50% of the leasehold interest in the Orogrande Project by Founder’s spending a minimum of \$45 million on actual drilling operations on the Orogrande Project in the following two years.

Under a joint operating agreement (on A.A.P.L. Form 610 – 1989 Model Form Operating Agreement with COPAS 2005 Accounting Procedures) (“JOA”) also entered into on September 23, 2015, Founders is designated as operator of the leases.

The Rich A-11 well that was drilled by Torchlight in second quarter, 2015 was evaluated and numerous scientific tests were performed to provide key data for the field development thesis. Future utility of this well may be conversion to a salt water disposal well in the course of further development of the Orogrande acreage.

The second test well, the University Founders B-19 #1, was spudded on April 24, 2016 and drilled in second quarter, 2016. The well successfully pumped down completion fluid in the third quarter of 2016 and indications of hydrocarbons were seen at the surface on this second Orogrande Project test well. Future utility of this well may be conversion to a salt water disposal well in the course of further development of the Orogrande acreage.

On March 22, 2017, the Company, along with Founders, their operating partner, signed a Drilling and Development Unit (DDU) Agreement with University Lands on its Orogrande Basin Project. The agreement has an effective date of January 1, 2017 and required a payment from both Torchlight and Founders of \$335,323 as part of the extension fee. Torchlight's portion of the fee was paid by Founders in April 2017 and will be deducted from the required spud fee payable to Torchlight at commencement of the next well drilled.

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

The DDU agreement allows for all 192 existing leases covering the 133,000 net acres leased from University Lands to be combined into one lease for development purposes. The time to drill on the unit is extended through April of 2023 on the first extension. The agreement also grants exclusive right to continue through April of 2028 if compliance with the agreement is met and extension fee associated with the additional time paid. The Company's drilling obligations begin with one well in the first year, and increase to five wells per year by year 2023. The drilling obligation set is a minimum requirement and may be exceeded if acceleration is desired. The DDU agreement replaces all prior agreements and will govern future drilling obligations on the lease.

Torchlight Energy and Founders have elected to move forward on planning the next phase of drilling in the Orogrande Project. The project operator planned to permit two new wells in 2017. The new wells would be drilled vertically for test purposes and would have sufficient casing size to support lateral entry into any pay zone(s) encountered once the well is tested vertically. Torchlight and the project operator would then run a battery of tests on each well to gain information for future development of the field. The scheduled spud date for the next well is August 25, 2017.

Hazel Project in the Midland Basin in West Texas

Effective April 1, 2016, Torchlight Energy Inc. acquired from McCabe Petroleum Corporation, a 66.66% working interest in approximately 12,000 acres in the Midland Basin in exchange for 1,500,000 warrants to purchase our common stock with an exercise price of \$1.00 for five years and a back-in after payout of a 25% working interest to the seller.

Initial development of the first well on the property, the Flying B Ranch #1, began July 10, 2016 and development continued through September 30, 2016. This well is classified as a test well in the development pursuit of the Hazel Project.

In October, 2016, the holders of the Company's Series C Preferred shares (which were issued in July, 2016) elected to convert into a 33.33% Working Interest in the Company's Hazel Project, reducing Torchlight's ownership from 66.66% to a 33.33% Working Interest.

On December 27, 2016, drilling activities commenced on its next Midland Basin, Hazel Project well, the Flying B Ranch #2. The well is a vertical test similar to the Company's first Hazel Project well, the Flying B Ranch #1. Recompletion in an alternative geological formation is scheduled for this well.

Following the closing of the new debt financing in April, 2017, the Company disclosed its intent to drill a horizontal well in the Project in June, 2017 in compliance with the continuous drilling obligation. The well, the Flying B Ranch #3, was spudded on June 10, 2017. At the date of this filing the Flying B Ranch #3 has been drilled, cased, and is scheduled for stimulation.

Acquisition of Additional Interests in Hazel Project

On January 30, 2017, we and our wholly-owned subsidiary, Torchlight Acquisition Corporation, a Texas corporation ("TAC"), entered into and closed an Agreement and Plan of Reorganization and Plan of Merger with Line Drive Energy, LLC, a Texas limited liability company ("Line Drive"), under which agreements TAC merged with and into Line Drive and the separate existence of TAC ceased, with Line Drive being the surviving organization and becoming our wholly-owned subsidiary. Line Drive, which was wholly-owned by Gregory McCabe, our Chairman, owned certain assets and securities, including approximately 40.66% of 12,000 gross acres in the Hazel Project and 521,739 warrants

to purchase our common stock (which warrants had been assigned by Mr. McCabe to Line Drive). Under the merger transaction, our shares of common stock of TAC converted into a membership interest of Line Drive, the membership interest in Line Drive held by Mr. McCabe immediately prior to the transaction ceased to exist, and we issued Mr. McCabe 3,301,739 restricted shares of common stock as consideration therefor. Immediately after closing, the 521,739 warrants held by Line Drive were cancelled, which warrants had an exercise price of \$1.40 per share and an expiration date of June 9, 2020. A Certificate of Merger for the merger transaction was filed with the Secretary of State of Texas on January 31, 2017. Subsequent to the closing the name of Line Drive Energy, LLC was changed to Torchlight Hazel, LLC.

Also on January 30, 2017, our wholly-owned subsidiary, Torchlight Energy, Inc., a Nevada corporation (“TEI”), entered into and closed a Purchase and Sale Agreement with Wolfbone Investments, LLC, a Texas limited liability company (“Wolfbone”) which is wholly-owned by Gregory McCabe. Under the agreement, TEI acquired certain of Wolfbone’s Hazel Project assets, including its interest in the Flying B Ranch #1 well and the 40 acre unit surrounding the well, for consideration of \$415,000, and additionally, Wolfbone caused to be cancelled a total of 2,780,000 warrants to purchase our common stock, including 1,500,000 warrants held by McCabe Petroleum Corporation, an entity owned by Mr. McCabe, and 1,280,000 warrants held by Green Hill Minerals, an entity owned by Mr. McCabe’s son, which warrant cancellations were effected through certain Warrant Cancellation Agreements. The 1,500,000 warrants held by McCabe Petroleum Corporation had an exercise price of \$1.00 per share and an expiration date of April 4, 2021. The warrants held by Green Hill Minerals included 100,000 warrants with an exercise price of \$1.73 and an expiration date of September 30, 2018 and 1,180,000 warrants with an exercise price of \$0.70 and an expiration date of February 15, 2020.

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

Since Mr. McCabe held the controlling interest in both Line Drive and Wolfbone Investments, LLC, the transactions were combined for accounting purposes. The working interest in the Hazel Project was the only asset held by Line Drive. The warrant cancellation was treated in the aggregate as an exercise of the warrants with the transfer of the working interests as the consideration. The Company recorded the transactions as an increase in its investment in the Hazel project working interests of \$3,644,431 which is equal to the exercise price of the warrants plus the cash paid to Wolfbone.

Upon the closing of the transactions, the Company's working interest in the Hazel project increased by 40.66% to a total ownership of 74%.

Effective June 1, 2017, the Company acquired an additional 6% working interest from unrelated working interest owners in exchange for 268,656 shares of common stock, increasing its working interest in the Hazel project to 80%.

Hunton Play, Central Oklahoma

As of June 30, 2017, we were actively producing from one well in the Viking AMI, and one well in Prairie Grove. The Company also holds undeveloped acreage in the Rosedale and Thunderbird AMI's.

Legal Proceeding

As previously disclosed, in May, 2016, Torchlight Energy Resources, Inc. and its subsidiary Torchlight Energy, Inc. filed a lawsuit in the 429th judicial district court in Collin County, Texas against Husky Ventures, Inc., Charles V. Long, April Glidewell, Silverstar of Nevada, Inc., Maximus Exploration, LLC, Atwood Acquisitions, LLC, Gastar Exploration Inc., J. Russell Porter, Michael A. Gerlich, Jerry R. Schuyler, and John M. Selser, Sr. Reference is made to the subsection titled "Legal Proceeding" under Note 6, "Commitments and Contingencies" of the Notes to Consolidated Financial Statements included in Part I, Item 1 of this Quarterly Report on Form 10-Q, which is incorporated herein by reference.

Viking AMI

In the fourth quarter of 2013 we entered into an Area of Mutual Interest (AMI) with Husky Ventures, the Viking Prospect. We acquired a 25% interest in 3,945 acres and subsequently acquired an additional 5% in May, 2014. We had an interest in 8,800 total acres as of June 30, 2017. (Net undeveloped acres = 2,600) Husky drilled the first two wells in the AMI in second quarter, 2014. Our net cumulative investment through June 30, 2017 in undeveloped acres in the Viking AMI was \$1,387,928. In addition the company has incurred \$133,468 as its share of costs related to the early stages of the construction of a gas pipeline which was to serve the Viking AMI.

Prairie Grove – Judy Well

In February of 2014, we acquired a 10% Working Interest in a well in the Prairie Grove AMI from a non-consenting third party who elected not to participate in the well.

Rosedale AMI

In January of 2014 we contracted for a 25% Working Interest in approximately 5,000 acres in the Rosedale AMI consisting of eight townships in South Central Oklahoma. We subsequently acquired an additional 5% in May, 2014.

The Company had an interest in 11,600 total acres as of June 30, 2017 (Net undeveloped acres = 3,500). Our cumulative investment through June 30, 2017 in the Rosedale AMI was \$2,833,829.

Thunderbird AMI

In July of 2014, we contracted for a 25% Working Interest in the Thunderbird AMI. The total acres in which the Company has an interest at June 30, 2017 totals 4,300 acres (Net undeveloped acres = 1,100) Our cumulative investment through June 30, 2017 in the Thunderbird AMI was \$949,530.

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

Historical Results for the six months ended June 30, 2017 and 2016:

Revenues and Cost of Revenues

For the six months ended June 30, 2017, we had production revenue of \$26,252 compared to \$303,513 for the six months ended June 30, 2016. Refer to the table of production and revenue included below for quarterly changes in revenue. Our cost of revenue, consisting of lease operating expenses and production taxes, was \$16,133, and \$245,300 for the six months ended June 30, 2017 and 2016, respectively.

Property	Quarter	Oil Production {BBLs}	Gas Production {MCF}	Oil Revenue	Gas Revenue	Total Revenue
Marcelina (TX)	Q1 - 2016	3,000	0	\$92,546	\$-	\$92,546
Oklahoma	Q1 - 2016	2,026	21,148	54,289	38,624	92,913
Kansas	Q1 - 2016	312	0	8,854	-	8,854
Total Q1-2016		5,338	21,148	\$155,689	\$38,624	\$194,313
Marcelina (TX)	Q2 - 2016	917	0	\$38,812	\$-	\$38,812
Oklahoma	Q2 - 2016	675	9,689	30,411	11,142	41,553
Kansas	Q2 - 2016	731	0	24,855	-	24,855
Total Q2-2016		2,323	9,689	\$94,078	\$11,142	\$105,220
Marcelina (TX)	Q3 - 2016	464	0	\$20,189	\$-	\$20,189
Oklahoma	Q3 - 2016	180	2,830	7,925	6,170	14,095
Kansas	Q3 - 2016	0	0	-	-	-
Total Q3-2016		644	2,830	\$28,114	\$6,170	\$34,284
Marcelina (TX)	Q4 - 2016	0	0	\$-	\$-	\$-
Oklahoma	Q4 - 2016	184	2,845	8,024	8,569	16,593
Kansas	Q4 - 2016	0	0	-	-	-
Total Q4-2016		184	2,845	\$8,024	\$8,569	\$16,593
Oklahoma	Q1 - 2017	101	2,303	\$5,346	\$7,604	\$12,950
Hazel (TX)	Q1 - 2017	0	0	-	-	-

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

Total						
Q1-2017		101	2,303	\$5,346	\$7,604	\$12,950
Oklahoma	Q2 - 2017	140	2,332	6,594	6,709	13,303
Hazel (TX)	Q2 - 2017	0	0	-	-	-
Total		140	2,332	\$6,594	\$6,709	\$13,303
Q2-2017						

We recorded depreciation, depletion, and amortization expense of \$50,435 for the six months ended June 30, 2017 compared to \$722,054 for the six months ended June 30, 2016.

The decline in revenue, cost of revenue and depreciation, depletion, and amortization expense is attributable to the divestiture of oil and gas producing properties beginning in the fourth quarter, 2015 and continuing through December 31, 2016.

General and Administrative Expenses

Our general and administrative expenses for the six months ended June 30, 2017 and 2016 were \$1,942,445 and \$4,747,704, respectively, a decrease of \$2,805,259. Our general and administrative expenses consisted of consulting and compensation expense, substantially all of which was non-cash or deferred, accounting and administrative costs, professional consulting fees, and other general corporate expenses. The change in general and administrative expenses for the six months ended June 30, 2017 compared to 2016 is detailed as follows:

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

Increase(decrease) in non cash stock and warrant compensation	\$(2,497,970)
Increase(decrease) in consulting expense	\$(158,092)
Increase(decrease) in professional fees	\$(34,613)
Increase(decrease) in investor relations	\$870
Increase(decrease) in travel expense	\$(19,645)
Increase(decrease) in salaries and compensation	\$(247,562)
Increase(decrease) in legal fees	\$136,512
Increase(decrease) in insurance	\$(6,361)
Increase(decrease) in general corporate expenses	\$(18,387)
Increase(decrease) in audit fees	\$39,989
Total (Decrease) in General and Administrative Expenses	\$(2,805,259)

Historical Results for the three months ended June 30, 2017 and 2016:

Revenues and Cost of Revenues

For the three months ended June 30, 2017, we had production revenue of \$13,303 compared to \$105,220 for the three months ended June 30, 2016. Refer to the table of production and revenue included above for quarterly changes in revenue. Our cost of revenue, consisting of lease operating expenses and production taxes, was \$11,976 and \$139,116 for the three months ended June 30, 2017 and 2016, respectively.

We recorded depreciation, depletion, and amortization expense of \$25,918 for the three months ended June 30, 2017 compared to \$100,082 for the three months ended June 30, 2016.

The decline in revenue, cost of revenue and depreciation, depletion, and amortization expense is attributable to the divestiture of oil and gas producing properties beginning in the fourth quarter, 2015 and continuing through December 31, 2016.

General and Administrative Expenses

Our general and administrative expenses for the three months ended June 30, 2017 and 2016 were \$949,040 and \$3,796,418, respectively, a decrease of \$2,847,378. Our general and administrative expenses consisted of consulting and compensation expense, substantially all of which was non-cash or deferred, accounting and administrative costs, professional consulting fees, and other general corporate expenses. The change in general and administrative expenses for the three months ended June 30, 2017 compared to 2016 is detailed as follows:

Increase(decrease) in non cash stock and warrant compensation	\$(2,727,205)
Increase(decrease) in consulting expense	\$(36,842)
Increase(decrease) in professional fees	\$(25,522)
Increase(decrease) in investor relations	\$4,094
Increase(decrease) in travel expense	\$(11,001)
Increase(decrease) in salaries and compensation	\$(113,371)
Increase(decrease) in legal fees	\$74,603
Increase(decrease) in insurance	\$(10,221)
Increase(decrease) in general corporate expenses	\$(21,748)

Increase(decrease) in audit fees	\$19,835
Total (Decrease) in General and Administrative Expenses	\$(2,847,378)

Liquidity and Capital Resources

At June 30, 2017, we had working capital of \$2,379,189 and total assets of \$19,535,760. Stockholders' equity was \$10,910,307.

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

Cash flow (used) in operating activities for the six months ended June 30, 2017 was \$(2,460,351) compared to \$(628,053) for the six months ended June 30, 2016, a decrease of \$1,832,298. Cash flow (used) in operating activities for the six months ended June 30, 2017 can be primarily attributed to net loss from operations of \$2,111,014. Cash flow (used) by operating activities for the six months ended June 30, 2016 can be primarily attributed to net loss from operations of \$5,785,453. Reference the Consolidated Statement of Cash Flow for additional detail of the components that comprise the net use of cash in operations. We expect to continue to use cash flow in operating activities until such time as we achieve sufficient commercial oil and gas production to cover all of our cash costs.

Cash flow used in investing activities for the six months ended June 30, 2017 was \$2,655,199 compared to \$310,458 for the six months ended June 30, 2016. Cash flow used in investing activities consists primarily of investment in oil and gas properties in Texas during the six months ended June 30, 2017. Investment in oil and gas properties during the six months ended June 30, 2016 was \$1,882,458 which was partially offset by the proceeds from sale of leases in 2016 of \$1,572,000.

Cash flow provided by financing activities for the six months ended June 30, 2017 was \$4,811,698 as compared to \$229,922 for the six months ended June 30, 2016. Cash flow provided by financing activities consists primarily of proceeds from promissory notes and warrant exercises. We expect to continue to have cash flow provided by financing activities as we seek new rounds of financing and continue to develop our oil and gas investments.

We will require additional debt or equity financing to meet our plans and needs. We face obstacles in continuing to attract new financing due to industry conditions and our history and current record of net losses and working capital deficits. Despite our efforts, we can provide no assurance that we will be able to obtain the financing required to meet our stated objectives or even to continue as a going concern.

We do not expect to pay cash dividends on our common stock in the foreseeable future.

Commitments and Contingencies

Leases

The Company has a non-cancelable lease for its office premises that expires on November 30, 2019 and which requires the payment of base lease amounts and executory costs such as taxes, maintenance and insurance. Rental expense for the lease was \$39,912 for the six months ended June 30, 2017 and \$81,595 for the year ended December 31, 2016.

Approximate future minimum rental commitments under the office premises lease are:

For the Year Ending

June 30,	Amount
2018	\$93,720
2019	93,720
To 2019 Expiration	45,999

\$233,439

Environmental matters

We are subject to contingencies as a result of environmental laws and regulations. Present and future environmental laws and regulations applicable to our operations could require substantial capital expenditures or could adversely affect our operations in other ways that cannot be predicted at this time. As of June 30, 2017 and December 31, 2016, no amounts have been recorded because no specific liability has been identified that is reasonably probable of requiring us to fund any future material amounts.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Not Applicable.

ITEM 4. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

Under the supervision and with the participation of our management, including our Chief Executive Officer (principal executive officer) and Chief Financial Officer (principal financial officer), we evaluated the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act, as of June 30, 2017. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective to ensure that the information required to be disclosed by us in the reports we submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the applicable rules and forms and that such information was accumulated and communicated to our Chief Executive Officer and Chief Financial Officer, in a manner that allowed for timely decisions regarding disclosure.

ITEM 4. CONTROLS AND PROCEDURES - continued

Changes in Internal Control over Financial Reporting

As described in our Form 10-K for the year ended December 31, 2016 filed on March 31, 2017, management concluded that we did not maintain effective internal control over financial reporting as of December 31, 2016. Specifically, management identified material weaknesses over the accounting for stock options issued to employees and nonemployees and stock warrants issued for services, property and financings. Beginning in the three months ended March 31, 2017 and continuing through the three months ended June 30, 2017, we implemented a remediation process (see below) to address these material weaknesses. We believe this remediation process constitutes changes in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) of the Exchange Act) that occurred during the three months ended June 30, 2017 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Remediation Process

Following the identification of the material weaknesses described above, and with the oversight of the Audit Committee, we commenced a process to remediate the underlying causes of those material weaknesses, enhance the control environment and strengthen our internal control over financial reporting. Those steps included review and implementation of equity compensation controls, policies and plan documentation to ensure those terms are accounted for and require timely review by our Chief Financial Officer, or an appropriate designee, of all compensation arrangements for proper accounting treatment, with prior approval required for any revision to or deviation from any pre-defined equity compensation plans. We believe these actions have effectively enhanced our internal control over financial reporting to remediate and cure the underlying causes of the material weaknesses identified above.

PART II OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

For a description of our material pending legal proceedings, please refer to the subsection titled “Legal Proceeding” under Note 6, “Commitments and Contingencies,” of the Notes to Consolidated Financial Statements included in Part I, Item 1 of this Quarterly Report on Form 10-Q, which is incorporated herein by reference.

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

During the three months ended June 30, 2017, we issued a total of 237,001 shares of common stock in payment of amounts due to a director for 2016 director fees and compensation for serving on the Litigation Committee of the Board of Directors. All of the shares are presently unvested and are subject to vesting at specified future events.

In May 2017, we issued 204,574 shares of common stock for consulting services.

Effective June 1, 2017, we issued 268,656 shares of common stock to certain working interest owners in exchange for their 6% working interest in the Hazel Project.

During the three months ended June 30, 2017, we issued 29,250 shares of common stock in warrant exercises.

All of the above sales of securities were sold under the exemption from registration provided by Section 4(a)(2) of the Securities Act of 1933 and the rules and regulations promulgated thereunder. The issuances of securities did not

involve a “public offering” based upon the following factors: (i) the issuances of securities were isolated private transactions; (ii) a limited number of securities were issued to a limited number of purchasers; (iii) there were no public solicitations; (iv) the investment intent of the purchasers; and (v) the restriction on transferability of the securities issued.

ITEM 6. EXHIBITS

Exhibit No.	Description
2.1	Share Exchange Agreement dated November 23, 2010. (Incorporated by reference from Form 8-K filed with the SEC on November 24, 2010.) *
3.1	Articles of Incorporation. (Incorporated by reference from Form S-1 filed with the SEC on May 2, 2008.) *
3.2	Certificate of Amendment to Articles of Incorporation dated December 10, 2014. (Incorporated by reference from Form 10-Q filed with the SEC on May 15, 2015.) *
3.3	Certificate of Amendment to Articles of Incorporation dated September 15, 2015. (Incorporated by reference from Form 10-Q filed with the SEC on November 12, 2015.) *
3.4	Amended and Restated Bylaws (Incorporated by reference from Form 8-K filed with the SEC on October 26, 2016.) *
4.1	Certificate of Designation for Series A Convertible Preferred Stock (Incorporated by reference from Form 8-K filed with the SEC on June 9, 2015.) *
4.2	Certificate of Designation for Series B Convertible Preferred Stock (Incorporated by reference from Form 8-K filed with the SEC on September 30, 2015.) *
4.3	Certificate of Designation for Series C Convertible Preferred Stock (Incorporated by reference from Form 8-K filed with the SEC on July 11, 2016.) *
10.1	12% Series B Unsecured Convertible Promissory Note (form of) (Incorporated by reference from Form 10-Q filed with the SEC on August 14, 2015.) *
10.2	Securities Purchase Agreement (for Series A Convertible Preferred Stock) (Incorporated by reference from Form 10-Q filed with the SEC on August 14, 2015.) *
10.3	Employment Agreement (with John A. Brda) (Incorporated by reference from Form 8-K filed with the SEC on June 16, 2015.) *
10.4	Employment Agreement (with Roger Wurtele) (Incorporated by reference from Form 8-K filed with the SEC on June 16, 2015.) *
10.5	Loan documentation and warrants with Eunis L. Shockey (Incorporated by reference from Form 10-Q filed with the SEC on August 14, 2015.) *
10.6	Farmout Agreement between Hudspeth Oil Corporation, Founders Oil & Gas, LLC and certain other parties (Incorporated by reference from Form 8-K filed with the SEC on September 29, 2015) *
10.7	Securities Purchase Agreement and Amendment to Securities Purchase Agreement (for Series B Convertible Preferred Stock) (Incorporated by reference from Form 10-Q filed with the SEC on November 12, 2015) *

- 10.8 Purchase and Sale Agreement with Husky Ventures, Inc. (Incorporated by reference from Form 8-K filed with the SEC on November 12, 2015) *
- 10.10 Purchase Agreement with McCabe Petroleum Corporation for acquisition of “Hazel Project” (Incorporated by reference from Form 10-Q filed with the SEC on August 15, 2016) *
- 10.11 Resignation and Settlement Agreement with Willard G. McAndrew (Incorporated by reference from Form 10-Q filed with the SEC on November 10, 2016) *
- 10.12 Agreement and Plan of Reorganization and Plan of Merger with Line Drive Energy, LLC (Incorporated by reference from Form 10-K filed with the SEC on June 30, 2017) *
- 10.13 Purchase and Sale Agreement with Wolfbone Investments, LLC (Incorporated by reference from Form 10-K filed with the SEC on June 30, 2017) *
- 10.14 12% 2020 Senior Unsecured Promissory Note (form of) (Incorporated by reference from Form 10-Q filed with the SEC on May 12, 2017) *

ITEM 6. EXHIBITS - continued

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

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

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

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

* Incorporated by reference from our previous filings with the SEC

SIGNATURES

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

Torchlight Energy Resources, Inc.

Date: August 8, 2017 /s/ John A. Brda
By: John A. Brda
Chief Executive Officer

Date: August 8, 2017 /s/ Roger Wurtele
By: Roger Wurtele
Chief Financial Officer and Principal Accounting Officer