

TORCHLIGHT ENERGY RESOURCES INC

Form 10-Q

November 10, 2016

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 September 30, 2016

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

(State or Other Jurisdiction of Incorporation or Organization)

74-3237581

(I.R.S. Employer Identification No.)

5700 West Plano Pkwy, Suite 3600

Plano, Texas 75093

(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 or a smaller reporting company. See definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.:

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

As of November 10, 2016, there were 50,336,762 shares of the registrant's common stock outstanding (the only class of voting common stock).

FORM 10-Q

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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, 2015 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 CONDENSED BALANCE SHEETS (Unaudited)

	September 30,	December 31,
	2016	2015
ASSETS		
Current assets:		
Cash	\$218,470	\$1,026,600
Accounts receivable	655,618	741,653
Production revenue receivable	5,213	199,317
Note receivable	-	613
Prepayments - development costs	1,000,000	-
Prepaid expenses	-	38,776
Total current assets	1,879,301	2,006,959
Investment in oil and gas properties, net	9,550,419	7,057,671
Office equipment, net	31,206	43,110
Debt issuance costs, net	4,092	8,224
Other assets	18,362	72,082
TOTAL ASSETS	\$11,483,380	\$9,188,046
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$557,444	\$1,114,409
Funds received pending settlement	520,400	-
Accrued liabilities	840,114	628,876
Related party payables	81,112	130,000
Convertible promissory notes, (Series B) net of discount of \$138,267 at September 30, 2016	3,431,233	-
Notes payable within one year - related party	134,375	205,000
Notes payable within one year	-	129,741
Due to working interest owners	66,845	103,364
Interest payable	-	173,710
Total current liabilities	5,631,523	2,485,100

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Convertible promissory notes, (Series B) net of discount of \$277,911 at December 31, 2015	-	3,291,589
Asset retirement obligation	1,711	29,083
Commitments and contingencies	-	-
Stockholders' equity:		
Preferred stock, par value \$.001, 10,000,000 shares authorized; 10,000 issued and outstanding at September 30, 2016 134,000 issued and outstanding at December 31, 2015	10	134
Common stock, par value \$.001 per share; 100,000,000 shares authorized; 50,336,762 issued and outstanding at September 30, 2016 33,166,344 issued and outstanding at December 31, 2015	50,340	33,168
Additional paid-in capital	66,544,240	61,921,450
Warrants outstanding	20,819,937	16,330,961
Accumulated deficit	(81,564,381)	(74,903,439)
Total stockholders' equity	5,850,146	3,382,274
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$11,483,380	\$9,188,046

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

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

	THREE MONTHS ENDED September 30, 2016	THREE MONTHS ENDED September 30, 2015	NINE MONTHS ENDED September 30, 2016	NINE MONTHS ENDED September 30, 2015
Revenue				
Oil and gas sales	\$34,284	\$400,030	\$337,798	\$1,442,857
SWD and royalties	-	415	-	57,485
Cost of revenue	(49,908)	(159,082)	(295,208)	(669,626)
Gross income	(15,624)	241,363	42,590	830,717
Operating expenses:				
General and administrative expense	787,228	3,359,679	5,534,933	12,255,704
Depreciation, depletion and amortization	18,005	203,348	740,059	902,153
Impairment expense	-	-	57,912	22,438,114
Loss on sale	-	-	146,138	-
Total operating expenses	805,233	3,563,027	6,479,042	35,595,971
Other income (expense)				
Other income	30	-	30	962
Interest and accretion expense	(54,662)	(60,958)	(224,520)	(1,692,067)
Total other income (expense)	(54,632)	(60,958)	(224,490)	(1,691,105)
Net loss before taxes	(875,489)	(3,382,622)	(6,660,942)	(36,456,359)

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Provision for income taxes	-	-	-	-
Net (loss)	\$(875,489)	\$(3,382,622)	\$(6,660,942)	\$(36,456,359)
Loss per share:				
Basic and Diluted	\$(0.03)	\$(0.16)	\$(0.40)	\$(2.23)
Weighted average shares outstanding:				
Basic and Diluted	28,427,672	21,533,966	16,551,858	16,349,023

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

TORCHLIGHT ENERGY RESOURCES, INC.

CONSOLIDATED STATEMENTS OF CASH FLOW (Unaudited)

	NINE MONTHS	NINE MONTHS
	ENDED	ENDED
	September 30, 2016	September 30, 2015
Cash Flows From Operating Activities		
Net (loss)	\$(6,660,942)	\$(36,456,359)
Adjustments to reconcile net loss to net cash from operation		
Stock based compensation	3,410,731	9,382,259
Accretion of convertible note discounts	142,867	1,228,161
Loss on sale of assets	146,138	-
Impairment expense	57,912	22,438,114
Depreciation, depletion and amortization	740,059	902,153
Change in:		
Accounts receivable	86,036	48,975
Note receivable	613	8,594
Production revenue receivable	194,104	(91,461)
Prepayment of development costs	(1,000,000)	10,602
Debt issuance costs	4,132	-
Prepaid expenses	38,776	29,634
Other assets	53,721	(59,999)
Accounts payable and accrued liabilities	(290,229)	1,198,036
Due to working interest owners	(36,519)	(36,092)
Funds received pending settlement	520,400	
Asset retirement obligation	(27,372)	1,593
Interest payable	(176,933)	467,550
Capitalized interest	(106,388)	(577,576)
Net cash provided by (used) in operating activities	(2,902,894)	(1,505,816)
Cash Flows From Investing Activities		
Investment in oil and gas properties	(1,544,220)	(4,369,187)
Acquisition of office equipment	-	(1,191)
Proceeds from Sale of Leases	1,572,000	1,951,918
Net cash used in investing activities	27,780	(2,418,460)
Cash Flows From Financing Activities		
Proceeds from short term advance	150,000	-
Repayment of short term advance	(150,000)	
Proceeds from sale of common stock	-	1,300,000

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Proceeds from sale of preferred stock	1,000,000	13,500,000
Preferred dividends paid in cash	(320,724)	-
Proceeds from warrant exercise	1,486,942	-
Proceeds from promissory notes	514,395	412,000
Repayment of convertible notes	-	(8,859,011)
Repayment of promissory notes	(613,629)	(716,893)
Net cash provided by financing activities	2,066,984	5,636,096
Net increase (decrease) in cash	(808,130)	1,711,820
Cash - beginning of period	1,026,600	179,787
Cash - end of period	\$218,470	\$1,891,607
Supplemental disclosure of cash flow information: (Non Cash Items)		
Common stock issued for services	\$587,473	\$783,668
Common stock issued for mineral interests	\$1,816,096	\$-
Warrants issued for services	\$2,716,125	\$1,080,000
Common stock issued in conversion of preferred stock	\$13,399,991	\$-
Common stock issued in conversion of promissory notes	\$-	\$150,000
Warrants issued in connection with promissory notes	\$80,750	\$439,800
Common stock issued in warrant exercises	\$1,557,004	\$-
Warrants issued for mineral interests	\$1,630,761	\$-
Cash paid for interest	\$536,410	\$1,108,059

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

1. NATURE OF BUSINESS

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

On November 23, 2010, we entered into and closed a Share Exchange Agreement (the “Exchange Agreement”) between the major shareholders of PPS and the shareholders of Torchlight Energy, Inc. (“TEI”). 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. In addition to TEI, we also operate our business through our wholly-owned subsidiaries Torchlight Energy Operating, LLC, a Texas limited liability company, and Hudspeth Oil Corporation, a Texas corporation.

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

2. GOING CONCERN

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

At September 30, 2016, the Company had not yet achieved profitable operations. We had a net loss of \$6,660,942 for the nine months ended September 30, 2016 and had accumulated losses of \$81,564,381 since our inception to September 30, 2016, and expect to incur further losses in the development of our business. Working Capital as of September 30, 2016 was negative \$3,752,222. Negative working capital is exacerbated by the inclusion in current liabilities of the \$3,431,233 outstanding balance of subordinated convertible notes which have a maturity date of June 30, 2017 and are therefore included in current liabilities as of September 30, 2016.

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 obligations and repay its liabilities arising from normal business operations when they come due. Management’s plan to address the Company’s ability to continue as a going concern includes: (1) obtaining debt or equity funding from private placement or institutional sources; (2) obtain loans from financial institutions, where possible; (3) participating in joint venture transactions with third parties; or (4) sale of assets. Although management believes that it will be able to obtain the necessary funding to allow the Company to remain a going concern through the methods discussed above, there can be no assurances that such methods will prove successful. The accompanying consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

3. SIGNIFICANT ACCOUNTING POLICIES

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

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

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

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

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

Fair value of financial instruments – Financial instruments consist of cash, accounts receivable, accounts payable, notes payable to related party, and convertible promissory notes. 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 the convertible promissory notes approximate their fair value giving affect for the term of the note and the effective interest rates.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

3. SIGNIFICANT ACCOUNTING POLICIES - continued

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 September 30, 2016 and December 31, 2015 no valuation allowance was considered necessary.

As of December 31, 2015, the Company had a \$419,839 account receivable from Husky Ventures for the estimated balance of the sale proceeds from the sale of the Chisholm Trail properties in fourth quarter, 2015. The Chisholm Trail properties were sold to Husky Ventures who then included them with the Husky interests in Chisholm Trail and then entered into a sale agreement with Gastar Exploration Inc. for the combined Torchlight and Husky interests. Receipt of the balance of the sale proceeds was subject to final determination of mineral lease classification and was to occur by February 28, 2016.

On June 14, 2016, after the lawsuit that is described in Part II Item 1. "Legal Proceedings" regarding the Hunton Play, the Company received and subsequently deposited a check from Husky Ventures in the amount of \$520,400. Husky Ventures designated that the check was in full satisfaction of its obligations under the transaction in which the Company sold the Chisholm Trail properties as described above. The Company does not believe the check is in full satisfaction of Husky Ventures's obligations, including but not limited to that Husky Ventures has provided insufficient information for the Company regarding this transaction. The Company is currently pursuing claims against Husky Ventures, and others, related to this transaction and intends to continue to pursue those claims as described further in Part II Item 1. "Legal Proceedings" regarding the Hunton Play.

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

Oil and gas properties include costs that are excluded from costs being depleted or amortized. Oil and natural gas property costs excluded represent investments in unevaluated properties and include non-producing leasehold, geological, and geophysical costs associated with leasehold or drilling interests and exploration drilling costs. The

Company allocates a portion of its acquisition costs to unevaluated properties based on relative value. Costs are transferred to the full cost pool as the properties are evaluated over the life of the reservoir.

As of June 30, 2016 the Company performed an assessment of evaluated and unevaluated costs in the cost pool to conform the cumulative value of the Full Cost Pool to the combined amount of Reserve Value of evaluated, producing properties (as determined by independent analysis at December 31, 2015), plus the lesser of cumulative historical cost or estimated realizable value of unevaluated leases and projects expected to commence production in future operating periods. The results of the assessment was an additional charge to Impairment Expense of \$57,912 on June 30, 2016. No further adjustments were required at September 30, 2016.

Capitalized interest – The Company capitalizes interest on unevaluated properties during the periods in which they are excluded from costs being depleted or amortized. During the periods ended September 30, 2016 and September 30, 2015, the Company capitalized \$106,388 (net of full cost pool adjustments) and \$577,576, 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.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

3. SIGNIFICANT ACCOUNTING POLICIES - continued

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. The Company recognized impairment of \$22,438,114 on its oil and gas properties during the three months ended June 30, 2015 and an additional impairment at December 31, 2015 of \$3,236,009 for a total impairment adjustment for 2015 of \$25,674,123. Impairment in the amount of \$57,912 was recognized at June 30, 2016 as a result of the Company’s assessment. . No further adjustments were required at September 30, 2016. Due to the volatility of commodity prices, should oil and natural gas prices decline in the future, it is possible that a write-down could occur. Proved reserves are estimated quantities of crude oil, natural gas, and natural gas liquids, which geological and engineering data demonstrate with reasonable certainty to be recoverable from known reservoirs under existing economic and operating conditions. The independent engineering estimates include only those amounts considered to be proved reserves and do not include additional amounts which may result from new discoveries in the future, or from application of secondary and tertiary recovery processes where facilities are not in place or for which transportation and/or marketing contracts are not in place. Estimated reserves to be developed through secondary or tertiary recovery processes are classified as unevaluated properties.

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

Gains and losses on the sale of oil and gas properties are not generally reflected in income 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.

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

Inherent in the fair value calculation of an ARO are numerous assumptions and judgments including the ultimate settlement amounts, inflation factors, credit adjusted discount rates, timing of settlement, and changes in the legal,

regulatory, environmental, and political environments. To the extent future revisions to these assumptions impact the fair value of the existing ARO liability, a corresponding adjustment is made to the oil and gas property balance. Settlements greater than or less than amounts accrued as ARO are recorded as a gain or loss upon settlement.

Asset retirement obligation activity is disclosed in Note 10.

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

Revenue recognition – The Company recognizes oil and gas revenues 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 Company has not included potentially dilutive securities in the calculation of loss per share for any periods presented as the effects would be anti-dilutive.