

MEXCO ENERGY CORP  
Form 10-Q  
August 14, 2008

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

FORM 10-Q

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

For the quarterly period ended June 30, 2008

OR

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

For the transition period from        to

Commission File No. 0-6994

**MEXCO ENERGY CORPORATION**

*(Exact name of registrant as specified in its charter)*

Colorado  
*(State or other jurisdiction of  
incorporation or organization)*

84-0627918  
*(IRS Employer  
Identification Number)*

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

79701  
*(Zip code)*

(432) 682-1119  
*(Registrant's telephone number, including area code)*

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

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

Large Accelerated Filer       Accelerated Filer   
Non-Accelerated Filer       Smaller reporting company   
*(Do not check if a smaller reporting  
company)*

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

The number of shares outstanding of the registrant's common stock, \$0.50 par value, as of August 12, 2008 was  
1,874,866.

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**Mexco Energy Corporation and Subsidiaries**  
**CONSOLIDATED BALANCE SHEETS**

|   | June 30,<br>2008<br>(Unaudited) | March 31,<br>2008 |
|---|---------------------------------|-------------------|
| <b>ASSETS</b>   |                                 |                   |
| Current assets  |                                 |                   |
| Cash and cash equivalents   | \$ 220,713                      | \$ 303,617        |
| Accounts receivable:  |                                 |                   |
| Oil and gas sales   | 1,271,406                       | 758,459           |
| Trade   | 255,286                         | 102,403           |
| Related parties   | 1,834                           | 12,659            |
| Prepaid costs and expenses  | 48,846                          | 22,062            |
| Total current assets  | 1,798,085                       | 1,199,200         |
| Investment in GazTex, LLC   | -                               | 20,509            |
| Property and equipment, at cost   |                                 |                   |
| Oil and gas properties, using the full cost method  | 24,578,655                      | 23,941,483        |
| Other   | 61,362                          | 61,362            |
|   | 24,640,017                      | 24,002,845        |
| Less accumulated depreciation, depletion and amortization   | 12,258,740                      | 12,019,895        |
| Property and equipment, net   | 12,381,277                      | 11,982,950        |
|   | \$ 14,179,362                   | \$ 13,202,659     |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>   |                                 |                   |
| Current liabilities   |                                 |                   |
| Accounts payable and accrued expenses   | \$ 416,254                      | \$ 571,526        |
| Long-term debt  | 2,275,000                       | 2,600,000         |
| Asset retirement obligation   | 381,901                         | 374,789           |
| Deferred income tax liability   | 1,227,413                       | 1,196,280         |
| Stockholders' equity  |                                 |                   |
| Preferred stock - \$1.00 par value; 10,000,000 shares authorized; none outstanding  | -                               | -                 |
| Common stock - \$0.50 par value; 40,000,000 shares authorized; 1,948,866 and 1,841,366 shares issued; 1,864,866 and 1,757,366 shares outstanding as of June 30, 2008 and March 31, 2008, respectively | 974,433                         | 920,683           |
| Additional paid-in capital  | 5,207,460                       | 4,381,269         |
| Retained earnings   | 4,123,518                       | 3,584,729         |
| Treasury stock, at cost (84,000 shares)   | (426,617)                       | (426,617)         |
| Total stockholders' equity  | 9,878,794                       | 8,460,064         |
|   | \$ 14,179,362                   | \$ 13,202,659     |

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



**Mexco Energy Corporation and Subsidiaries**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**  
For the Three Months Ended June 30,  
(Unaudited)

|  | 2008              | 2007             |
|--|-------------------|------------------|
| <b>Operating revenues:</b>                         |                   |                  |
| Oil and gas  | \$ 1,672,587      | \$ 850,144       |
| Other  | 6,733             | 173              |
| <b>Total operating revenues</b>                    | <b>1,679,320</b>  | <b>850,317</b>   |
| <b>Operating expenses:</b>                         |                   |                  |
| Production   | 334,988           | 333,050          |
| Accretion of asset retirement obligation           | 6,938             | 6,611            |
| Depreciation, depletion and amortization           | 238,844           | 172,884          |
| General and administrative                         | 281,661           | 269,624          |
| <b>Total operating expenses</b>                    | <b>862,431</b>    | <b>782,169</b>   |
| <b>Income from operations</b>                      | <b>816,889</b>    | <b>68,148</b>    |
| <b>Other income (expense):</b>                     |                   |                  |
| Interest income                                    | 336               | 338              |
| Interest expense                                   | (33,735)          | (15,348)         |
| <b>Net other expense</b>                           | <b>(33,399)</b>   | <b>(15,010)</b>  |
| <b>Income before income taxes</b>                  | <b>783,490</b>    | <b>53,138</b>    |
| <b>Income tax expense:</b>                         |                   |                  |
| Current  | 213,568           | -                |
| Deferred   | 31,133            | 18,332           |
|  | 244,701           | 18,332           |
| <b>Net income</b>                                  | <b>\$ 538,789</b> | <b>\$ 34,806</b> |
| <b>Earnings per common share:</b>                  |                   |                  |
| Basic  | \$ 0.31           | \$ 0.02          |
| Diluted  | \$ 0.29           | \$ 0.02          |
| <b>Weighted average common shares outstanding:</b> |                   |                  |
| Basic  | 1,762,190         | 1,776,809        |
| Diluted  | 1,869,075         | 1,789,234        |

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

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

|   | Common Stock<br>Par Value | Treasury<br>Stock | Additional<br>Paid-In<br>Capital | Retained<br>Earnings | Total<br>Stockholders'<br>Equity |
|---|---------------------------|-------------------|----------------------------------|----------------------|----------------------------------|
| Balance at March 31, 2008                         | \$ 920,683                | \$ (426,617)      | \$ 4,381,269                     | \$ 3,584,729         | \$ 8,460,064                     |
| Net income  | -                         | -                 | -                                | 538,789              | 538,789                          |
| Issuance of stock through options exercised       | 53,750                    | -                 | 593,178                          | -                    | 646,928                          |
| Excess tax benefits from stock based compensation |                           |                   | 213,568                          |                      | 213,568                          |
| Stock based compensation                          | -                         | -                 | 19,445                           | -                    | 19,445                           |
| Balance at June 30, 2008                          | \$ 974,433                | \$ (426,617)      | \$ 5,207,460                     | \$ 4,123,518         | \$ 9,878,794                     |

#### SHARE ACTIVITY

##### Common stock shares, issued:

|                           |           |
|---------------------------|-----------|
| Balance at March 31, 2008 | 1,841,366 |
| Issued                    | 107,500   |
| Balance at June 30, 2008  | 1,948,866 |

##### Common stock shares, held in treasury:

|                           |          |
|---------------------------|----------|
| Balance at March 31, 2008 | (84,000) |
| Acquisitions              | -        |
| Balance at June 30, 2008  | (84,000) |

##### Common stock shares, outstanding at June 30, 2008

1,864,866

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

**Mexco Energy Corporation and Subsidiaries**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
For the Three Months Ended June 30,  
(Unaudited)

|  | 2008               | 2007              |
|--|--------------------|-------------------|
| <b>Cash flows from operating activities:</b>   |                    |                   |
| Net income   | \$ 538,789         | \$ 34,806         |
| <b>Adjustments to reconcile net income to net cash provided by operating activities:</b> |                    |                   |
| Increase in deferred tax liabilities   | 31,133             | 18,332            |
| Excess tax benefit from share based payment arrangement                                  | (213,568)          | -                 |
| Stock-based compensation   | 19,445             | 33,387            |
| Depreciation, depletion and amortization   | 238,844            | 172,884           |
| Accretion of asset retirement obligations  | 6,938              | 6,611             |
| <b>Changes in assets and liabilities:</b>  |                    |                   |
| Increase in accounts receivable  | (655,004)          | (79,388)          |
| (Increase) decrease in prepaid expenses  | (26,785)           | 25,409            |
| Increase in income taxes payable   | 213,568            | -                 |
| Increase (decrease) in accounts payable and accrued expenses                             | 232,841            | (17,085)          |
| <b>Net cash provided by operating activities</b>   | <b>386,201</b>     | <b>194,956</b>    |
| <b>Cash flows from investing activities:</b>   |                    |                   |
| Additions to oil and gas properties  | (1,023,675)        | (311,820)         |
| Proceeds from Investment in GazTex, LLC  | 18,700             | -                 |
| Proceeds from sale of oil and gas properties and equipment                               | 374                | 507               |
| <b>Net cash used in investing activities</b>   | <b>(1,004,601)</b> | <b>(311,313)</b>  |
| <b>Cash flows from financing activities:</b>   |                    |                   |
| Acquisition of treasury stock  | -                  | (24,247)          |
| Proceeds from exercise of stock options  | 646,928            | -                 |
| Reduction of long-term debt  | (700,000)          | (50,000)          |
| Proceeds from long-term debt   | 375,000            | 225,000           |
| Excess tax benefit from share based payment arrangement                                  | 213,568            | -                 |
| <b>Net cash provided by financing activities</b>   | <b>535,496</b>     | <b>150,753</b>    |
| <b>Net (decrease) increase in cash and cash equivalents</b>                              | <b>(82,904)</b>    | <b>34,396</b>     |
| <b>Cash and cash equivalents at beginning of period</b>                                  | <b>303,617</b>     | <b>72,537</b>     |
| <b>Cash and cash equivalents at end of period</b>  | <b>\$ 220,713</b>  | <b>\$ 106,933</b> |
| <b>Supplemental disclosure of cash flow information:</b>                                 |                    |                   |
| Cash paid for interest   | \$ 35,243          | \$ 22,736         |
| <b>Non-cash investing and financing activities:</b>                                      |                    |                   |
| Asset retirement obligations   | \$ 433             | \$ 8,088          |



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

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

## 1. Nature of Operations

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

In the opinion of management, the accompanying unaudited consolidated financial statements contain all adjustments (consisting only of normal recurring accruals) necessary to present fairly the financial position of the Company as of June 30, 2008, and the results of its operations and cash flows for the interim periods ended June 30, 2008 and 2007. The results of operations for the periods presented are not necessarily indicative of the results to be expected for a full year. The accounting policies followed by the Company are set forth in more detail in Note A of the “Notes to Consolidated Financial Statements” in the Company’s annual report on Form 10-K filed with the Securities and Exchange Commission (“SEC”). Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted in this Form 10-Q pursuant to the rules and regulations of the Securities and Exchange Commission. However, the disclosures herein are adequate to make the information presented not misleading. It is suggested that these financial statements be read in conjunction with the financial statements and notes thereto included in the Form 10-K.

## 2. Summary of Significant Accounting Policies

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

**Estimates and Assumptions.** In preparing financial statements in conformity with accounting principles generally accepted in the United States of America, management is required to make informed judgments and estimates that affect the reported amounts of assets and liabilities as of the date of the financial statements and affect the reported amounts of revenues and expenses during the reporting period. Although management believes its estimates and assumptions are reasonable, actual results may differ materially from those estimates. Significant estimates affecting these financial statements include the estimated quantities of proved oil and gas reserves, the related present value of estimated future net cash flows and the future development, dismantlement and abandonment costs.

**Stock-based Compensation.** The Company recognized compensation expense of \$19,445 and \$33,387 in general and administrative expense in the Consolidated Statements of Operations for the three months ended June 30, 2008 and 2007, respectively.

The following table is a summary of activity of stock options for the three months ended June 30, 2008:

| Number of<br>Shares | Weighted Average<br>Exercise Price<br>Per Share | Weighted Aggregate<br>Average Remaining<br>Contract Life in Years | Intrinsic<br>Value |
|---------------------|---|---|--------------------|
| 290,000             | \$ 6.06   | 3.30  | \$ (535,750)       |

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|                               |         |    |      |      |              |
|-------------------------------|---------|----|------|------|--------------|
| Outstanding at March 31, 2008 |         |    |      |      |              |
| Granted                       | -       |    | -    |      |              |
| Exercised                     | 107,500 |    | 6.02 |      |              |
| Forfeited or Expired          | 20,000  |    | 7.75 |      |              |
| Outstanding at June 30, 2008  | 162,500 | \$ | 5.88 | 3.78 | \$ 5,571,278 |
| Vested at June 30, 2008       | 107,500 | \$ | 5.69 | 3.73 | \$ 3,705,553 |
| Exercisable at June 30, 2008  | 107,500 | \$ | 5.69 | 3.73 | \$ 3,705,553 |

There were no stock options granted during the quarters ended June 30, 2008 and 2007.

During the three months ended June 30, 2008, employees and directors exercised a total of 107,500 options at exercise prices between \$4.00 and \$8.24 per share. The Company received proceeds of \$646,928 from these exercises. The total intrinsic value of the exercised options was \$3,901,840. No tax deduction is recorded when options are awarded. Of these exercised options, 44,500 shares resulted in a disqualifying disposition and a tax benefit for the company of \$213,568 for the three months ended June 30, 2008. The Company issued new shares of common stock to settle these option exercises.

No forfeiture rate is assumed for stock options granted to directors or employees due to the forfeiture rate history for these types of awards. On April 2, 2008, 20,000 stock options expired because they were not exercised prior to the end of their ten-year term.

Outstanding options at June 30, 2008 expire between September 2009 and July 2014 and have exercise prices ranging from \$4.00 to \$8.24.

The total cost related to non-vested awards not yet recognized at June 30, 2008 totals approximately \$72,967 which is expected to be recognized over a weighted average of 2.41 years.

**Asset Retirement Obligations.** The Company's asset retirement obligations relate to the plugging of wells, the removal of facilities and equipment, and site restoration on oil and gas properties. SFAS No. 143 requires the fair value of a liability for an asset retirement obligation to be recorded in the period in which it is incurred with a corresponding increase in the carrying amount of the related long-lived asset.

The following table provides a rollforward of the asset retirement obligations for the first three months of fiscal 2009:

|   |            |
|---|------------|
| Carrying amount of asset retirement obligations as of April 1, 2008 | \$ 424,789 |
| Liabilities incurred  | 433        |
| Liabilities settled   | (259)      |
| Accretion expense   | 6,938      |
| Carrying amount of asset retirement obligations as of June 30, 2008 | 439,901    |
| Less: Current portion   | 50,000     |
| Non-Current asset retirement obligation                             | \$ 381,901 |

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

**Income Per Common Share.** Basic net income per share is computed by dividing net income by the weighted average number of common shares outstanding during the period. Diluted net income per share is computed by dividing net income by the weighted average number of common shares and dilutive potential common shares (stock options) outstanding during the period. The following is a reconciliation of the number of shares used in the calculation of basic income per share and diluted income per share for the three month periods ended June 30, 2008 and 2007.

|  | 2008      | 2007      |
|--|-----------|-----------|
| Weighted average common shares outstanding – basic       | 1,762,190 | 1,776,809 |
| Effect of the assumed exercise of dilutive stock options | 106,885   | 12,425    |
| Weighted average common shares outstanding – dilutive    | 1,869,075 | 1,789,234 |

|                            |    |      |         |
|----------------------------|----|------|---------|
| Earnings per common share: |    |      |         |
| Basic                      | \$ | 0.31 | \$ 0.02 |
| Diluted                    | \$ | 0.29 | \$ 0.02 |

For the quarter ended June 30, 2008, no potential common shares relating to stock options were excluded in the computation of diluted net income per share. For the quarter ended June 30, 2007, 184,000 stock options were excluded in the computation of diluted net income per share because the options were anti-dilutive. The June 30, 2007 anti-dilutive stock options had a weighted average exercise price of \$7.08.

**Income Taxes.** The Company recognizes deferred tax assets and liabilities for future tax consequences of temporary differences between the carrying amounts of assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates applicable to the years in which those differences are expected to be settled. The effect on deferred tax assets and liabilities of a change in tax rates under SFAS No. 109 is recognized in net income in the period that includes the enactment date. For the three months ended June 30, 2008, current income tax is \$213,568 and deferred income tax is \$31,133, resulting in an effective tax rate of 31%. The deferred income tax for the three months ended June 30, 2007 was \$18,332, an effective tax rate of 34%. There was no current income tax for the three months ended June 30, 2007.

Under FIN No. 48, any interest and penalties related to uncertain tax positions are recorded as interest expense and general and administrative expense, respectively. For the quarter ended June 30, 2008, the amount of unrecognized tax benefits was \$754,000. For the quarter ended June 30, 2007, there were no unrecognized tax benefits.

**Investment in GazTex, LLC.** The Company's long-term asset consisted of an investment in GazTex, LLC, a Russian company owned 50% by OBTX, LLC, accounted for by the equity method. OBTX, LLC is a Delaware limited liability company in which from January 16, 2007, Mexco owned 100% of the interest. In May 2008, we dissolved GazTex, LLC and received our initial cash investment less related fees and expenses for a net amount of \$18,700.

**Long Term Liabilities.** Long term liabilities consist of a revolving credit agreement with Bank of America, N.A. ("Bank"), which provides for a credit facility of \$5,000,000 with no monthly commitment reductions. The borrowing base is evaluated annually, on or about September 1. Amounts borrowed under this agreement are collateralized by the common stock of one of the Company's wholly owned subsidiaries and all of the Company's oil and gas properties. On September 26, 2007, the borrowing base was redetermined and set at \$4,225,000 bearing interest at prime rate per annum with a maturity date of October 31, 2009. Two letters of credit for \$50,000 each, in lieu of a plugging bond covering the properties we operate, are outstanding under the facility, one with the Texas Railroad commission and one with the State of New Mexico. Interest under this agreement is payable monthly at prime rate (5.0% and 8.25% at June 30, 2008 and 2007, respectively). The balance outstanding on the line of credit as of June 30, 2008 was \$2,275,000.

**Recent Accounting Pronouncements.** Effective April 1, 2008, the Company implemented Financial Accounting Standards Board ("FASB") Statement of Financial Accounting Standards No. 157, *Fair Value Measurements* ("SFAS 157"), which defines fair value, establishes a framework for its measurement and expands disclosures about fair value measurements. Mexco elected to implement this Statement with the one-year deferral permitted by FASB Staff Position ("FSP") 157-2 for nonfinancial assets and nonfinancial liabilities measured at fair value, except those that are recognized or disclosed on a recurring basis (at least annually). The deferral applies to nonfinancial assets and liabilities measured at fair value in a business combination; impaired properties, plants and equipment; intangible assets and goodwill; and initial recognition of asset retirement obligations and restructuring costs for which the Company uses fair value. Management does not expect any significant impact to the consolidated financial statements when SFAS 157 for these assets and liabilities is implemented.

## **Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

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

**Cautionary Statements Regarding Forward-Looking Statements.** Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") contains "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933 (the "Securities Act"), and Section 21E of the Securities Exchange Act of 1934 (the "Exchange Act"). Forward-looking statements include statements regarding our plans, beliefs or current expectations and may be signified by the words "could", "should", "expect", "project", "estimate", "believe", "anticipate", "budget", "plan", "forecast", "predict" and other words and phrases of similar meaning. Forward-looking statements appear throughout this Form 10-Q with respect to, among other things: profitability, planned capital expenditures; estimates of oil and gas production; future project dates; estimates of future oil and gas prices; estimates of oil and gas reserves; our future financial condition or results of operations; and our business strategy and other plans and objectives for future operations. Forward-looking statements involve known and unknown risks and uncertainties that could cause actual results to differ materially from those contained in any forward-looking statement. While we have made assumptions that we believe are reasonable, the assumptions that support our forward-looking statements are based upon information that is currently available and is subject to change. All forward-looking statements in the Form 10-Q are qualified in their entirety by the cautionary statement contained in this section. We do not undertake to update,

revise or correct any of the forward-looking information.

**Liquidity and Capital Resources.** Historically, we have funded our operations, acquisitions, exploration and development expenditures from cash generated by operating activities, bank borrowings and issuance of common stock. Our primary financial resource is our base of oil and gas reserves. We pledge our producing oil and gas properties to secure our revolving line of credit.

Our long term strategy is on increasing profit margins while concentrating on obtaining reserves with low cost operations by acquiring and developing primarily gas properties and secondarily oil properties with potential for long-lived production.

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For the first three months of fiscal 2009, cash flow from operations was \$386,201 compared to \$194,956 for the first three months of fiscal 2008. This increase was primarily due to an increase in net income. Cash of \$1,023,675 was used for additions to oil and gas properties and \$325,000 for net reduction in long term debt. Cash of \$646,928 was received from exercises of stock options. Accordingly, net cash decreased \$82,904.

During fiscal 2008, we participated in an exploratory well in San Patricio County, Texas. This well has been completed and began producing natural gas as well as oil in April 2008. Costs incurred for this project are approximately \$178,000.

We are in the process of acquiring mineral, royalty and surface interests in several counties, mainly in Texas. Purchases incurred related to this project through June 2008 are approximately \$34,000.

During the third quarter of fiscal 2008, we acted as operator and drilled an exploratory well in Loving County, Texas. This well has been completed and based on a four point test by an independent testing firm, was calculated to produce at an absolute open flow rate of 12,773,000 cubic feet of natural gas per day. During this test which lasted four hours, the well actually produced 1,366,000 cubic feet of natural gas, 26 barrels of 63 gravity condensate and 12 barrels of water on chokes ranging from 11/64 to 15/64 inches. Previously the well had been shut in for a period in excess of 72 hours. The rates at which this will be produced and sold have not yet been determined and may be substantially different from these potential tests, based on regulatory and engineering considerations as well as performance of the well over longer periods of time. We are in the process of acquiring a right-of-way and preparing to build a pipeline to enable production and sales of natural gas from this well. Our share of the costs incurred for this project through July 31, 2008 is approximately \$408,000.

On December 31, 2007, we purchased 122 mineral acres amounting to approximately 21.45% royalty interest in Tarrant County, Texas for \$1,850,000. At the time of purchase, this property contained one producing well in the Newark East (Barnett Shale) Field. Two additional wells have been completed and all three wells are now producing natural gas into a sales pipeline. One additional well is planned for a portion of this acreage.

During the fourth quarter of fiscal 2008, we drilled a gas well in Reeves County, Texas. This well has been completed and began producing in April 2008. Our working interest in this well is 32.5% before payout and 24.375% after payout (respectively, net revenue interests of 23.875% and 17.9063%).

On June 6, 2008 we purchased mineral and royalty interests contained in an aggregate of 522 acres with royalties varying from .126% to .385% in 6 producing natural gas wells and 5 proven undeveloped well locations in the Newark East (Barnett-Shale) Field of Tarrant County, Texas for approximately \$429,000. There are an additional 6 potential drill sites on this acreage.

We continue to focus our efforts on the acquisition of royalties in areas with significant development potential.

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

At June 30, 2008, we had working capital of approximately \$1,381,831 compared to working capital of \$627,674 at March 31, 2008, an increase of \$754,157. This was mainly as a result of an increase in account receivables related to oil and gas sales and a decrease in accounts payable.

Crude oil and natural gas prices have fluctuated significantly in recent years as well as in recent months. Fluctuations in price have a significant impact on our financial condition and liquidity. However, management is of the opinion that cash flow from operations and funds available from financing will be sufficient to provide adequate liquidity for



the current fiscal year.

We have a revolving credit agreement with Bank of America, N.A. (“Bank”), which provides for a credit facility of \$5,000,000, subject to a borrowing base determination. On September 26, 2007, the borrowing base was redetermined and increased to \$4,225,000 with no monthly commitment reductions. The borrowing base is evaluated annually, on or about September 1. Amounts borrowed under this agreement are collateralized by the common stock of one of our wholly owned subsidiaries and all of our oil and gas properties. Two letters of credit for \$50,000 each, in lieu of a plugging bond covering the properties we operate, are outstanding under the facility, one with the Texas Railroad commission and one with the State of New Mexico. Interest under this agreement is payable monthly at prime rate (5.0% and 8.25% at June 30, 2008 and 2007, respectively). This agreement generally restricts our ability to transfer assets or control of the Company, incur debt, extend credit, change the nature of our business, substantially change management personnel or pay cash dividends. The balance outstanding under this agreement as of June 30, 2008 was \$2,275,000 and \$1,500,000 as of August 8, 2008.

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**Results of Operations – Three Months Ended June 30, 2008 Compared to Three Months Ended June 30, 2007.**

Net income increased from \$34,806 for the quarter ended June 30, 2007 to \$538,789 for the quarter ended June 30, 2008; an increase of \$503,983 as a result of an increase in operating revenues partially offset by an increase in depreciation, depletion and amortization and interest expense.

*Oil and gas sales.* Revenue from oil and gas sales increased from \$850,144 for the first quarter of fiscal 2008 to \$1,672,587 for the same period of fiscal 2009. This increase of 97% or \$822,443 resulted from an increase in oil and gas prices and gas production offset partially by a decrease in oil production. Revenues from oil and gas royalty interests accounted for approximately 37% of our total revenues for the first quarter of fiscal 2009 compared to 24% for the first quarter of fiscal 2008. Average gas prices increased from \$6.74 per mcf for the first quarter of fiscal 2008 to \$9.70 per mcf for the same period of fiscal 2009. Average oil prices increased from \$59.32 per bbl for the first quarter of fiscal 2008 to \$118.57 for the same period of fiscal 2009. Oil and gas production quantities were 4,392 barrels (“bbls”) and 87,539 thousand cubic feet (“mcf”) for the first quarter of fiscal 2008 and 4,107 bbls and 122,286 mcf for the same period of fiscal 2009, a decrease of 6% in oil production and an increase of 40% in gas production.

*Production and exploration.* Production costs increased \$1,938 or .6% from \$333,050 for the first quarter of fiscal 2008 to \$334,988 for the same period of fiscal 2009. This was the result of an increase in production taxes due to the increase in oil and gas sales partially offset by a decrease in lease operating expenses.

*Depreciation, depletion and amortization.* Depreciation, depletion and amortization expense increased 38%, from \$172,884 for the first quarter of fiscal 2008 to \$238,844 for the same period of fiscal 2009 primarily due to an increase to the full cost pool amortization base and an increase in gas production partially offset by an increase in oil and gas reserves.

*General and administrative expenses.* General and administrative expenses increased 4% from \$269,624 for the first quarter of fiscal 2008 to \$281,661 for the same period of fiscal 2009. This was due to an increase in engineering fees.

*Interest expense.* Interest expense increased 120% from \$15,348 for the first quarter of fiscal 2008 to \$33,735 for the same period of fiscal 2009, due to an increase in borrowings partially offset by a decrease in interest rates.

**Item 3. Quantitative and Qualitative Disclosures About Market Risk**

The primary sources of market risk for us include fluctuations in commodity prices and interest rate fluctuations. At June 30, 2008, we had not entered into any hedge arrangements, commodity swap agreements, commodity futures, options or other similar agreements relating to crude oil and natural gas.

**Interest Rate Risk.** At June 30, 2008, we had an outstanding loan balance of \$2,275,000 under our \$5.0 million revolving credit agreement, which bears interest at the prime rate, which varies from time to time. If the interest rate on our bank debt increases or decreases by one percentage point our annual pretax income would change by \$22,750, based on the outstanding balance at June 30, 2008.

**Credit Risk.** Credit risk is the risk of loss as a result of nonperformance by other parties of their contractual obligations. Our primary credit risk is related to oil and gas production sold to various purchasers and the receivables are generally not collateralized. At June 30, 2008, our largest credit risk associated with any single purchaser was \$385,716. We are also exposed to credit risk in the event of nonperformance from any of our working interest partners. At June 30, 2008, our largest credit risk associated with any working interest partner was \$39,808. We have not experienced any significant credit losses.

**Volatility of Oil and Gas Prices.** Our revenues, operating results and future rate of growth are highly dependent upon the prevailing market prices of, and demand for, oil and natural gas. Prices for oil and natural gas fluctuate widely. We

cannot predict future oil and natural gas prices with any certainty. Historically, the markets for oil and gas have been volatile, and they are likely to continue to be volatile. Factors that can cause price fluctuations include the level of global demand for petroleum products, foreign supply of oil and gas, the establishment of and compliance with production quotas by oil-exporting countries, weather conditions, the price and availability of alternative fuels and overall political and economic conditions in oil producing countries.

Changes in oil and gas prices impact both estimated future net revenue and the estimated quantity of proved reserves. Any reduction in reserves, including reductions due to price fluctuations, can reduce the borrowing base under our revolving credit facility and adversely affect the amount of cash flow available for capital expenditures and our ability to obtain additional capital for our exploration and development activities. In addition, we may have ceiling test writedowns when prices decline. Lower prices may also reduce the amount of crude oil and natural gas that can be produced economically. Thus, we may experience material increases or decreases in reserve quantities solely as a result of price changes and not as a result of drilling or well performance.

Similarly, any improvements in oil and gas prices can have a favorable impact on our financial condition, results of operations and capital resources. Oil and natural gas prices do not necessarily fluctuate in direct relationship to each other. Our financial results are more sensitive to movements in natural gas prices than oil prices because most of our production and reserves are natural gas. If the average oil price had increased or decreased by one dollar per barrel for the quarter ended June 30, 2008, our pretax income would have changed by \$4,107. If the average gas price had increased or decreased by one dollar per mcf for the quarter ended June 30, 2008, our pretax income would have changed by \$122,286.

#### **Item 4. Controls and Procedures**

We maintain disclosure controls and procedures to ensure that the information we must disclose in our filings with the SEC is recorded, processed, summarized and reported on a timely basis. At the end of the period covered by this report, our principal executive officer and principal financial officer have reviewed and evaluated the effectiveness of our disclosure controls and procedures, as defined in Exchange Act Rules 13a-15(e) and 15d-15(e). Based on such evaluation, such officers have concluded that, as of June 30, 2008, our disclosure controls and procedures were effective in timely alerting them to material information relating to us (and our consolidated subsidiaries) required to be included in our periodic SEC filings.

No changes in the Company's internal control over financial reporting occurred during the quarter ended June 30, 2008 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## **PART II – OTHER INFORMATION**

### **Item 1. Legal Proceedings**

We may, from time to time, be involved in litigation and claims arising out of our operations in the normal course of business. We are currently a party to a lawsuit that is being filed against the drilling company of a well in which we have a working interest of approximately 6.5%. We are not aware of any legal or governmental proceedings against us, or contemplated to be brought against us, under various environmental protection statutes or other regulations to which we are subject.

### **Item 1A. Risk Factors**

There have been no material changes to the information previously disclosed in Item 1A. "Risk Factors" in our 2008 Annual Report on Form 10-K.

### **Item 2. Unregistered Sales of Equity Securities and Use of Proceeds** None.

### **Item 3. Defaults Upon Senior Securities** None.

### **Item 4. Submission of Matters to a Vote of Security Holders** None.

### **Item 5. Other Information** None.

### **Item 6. Exhibits**

Exhibits

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

**SIGNATURES**

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

MEXCO ENERGY CORPORATION  
(Registrant)

Dated: August 12, 2008 /s/ Nicholas C. Taylor  
Nicholas C. Taylor  
President

Dated: August 12, 2008 /s/ Tamala L. McComic  
Tamala L. McComic  
Vice President, Treasurer and Assistant Secretary

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