GeoMet, Inc.
Form 10-Q
May 15, 2013
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended March 31, 2013

OR

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

For the transition period from to

Commission File Number 001-32960

GeoMet, Inc.

(Exact name of registrant as specified in its charter)

Delaware	**76-0662382**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)

909 Fannin, Suite 1850

Houston, Texas 77010

(713) 659-3855

(Address of principal executive offices and telephone number, including area code)

N/A

(Former name, former address and former fiscal year, if changed since last report)

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. x Yes o 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). x Yes o No

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

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

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

As of May 1, 2013, 40,689,486 shares and 5,471,610 shares, respectively, of the registrant s common stock and preferred stock, par value $0.001 per share, were outstanding.

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Part I. FINANCIAL INFORMATION

Item 1. Financial Statements

GEOMET, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS (UNAUDITED)

	March 31, 2013	December 31, 2012
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 7,382,319	$ 7,234,225
Accounts receivable, net of allowance of $14,744 and $17,634 at March 31, 2013 and December 31, 2012, respectively	4,514,157	6,248,819
Inventory	269,569	262,885
Derivative asset natural gas contracts		3,929,767
Other current assets	1,233,779	1,437,819
Total current assets	13,399,824	19,113,515
Gas properties utilizing the full cost method of accounting:		
Proved gas properties	539,151,397	539,077,119
Other property and equipment	3,663,310	3,749,621
Total property and equipment	542,814,707	542,826,740
Less accumulated depreciation, depletion, amortization and impairment of gas properties	(469,153,061)	(467,702,053)
Property and equipment net	73,661,646	75,124,687
Other noncurrent assets:		
Deferred income taxes		1,125,804
Other	795,773	962,451
Total other noncurrent assets	795,773	2,088,255
TOTAL ASSETS	$ 87,857,243	$ 96,326,457
LIABILITIES, MEZZANINE AND STOCKHOLDERS DEFICIT		
Current Liabilities:		
Accounts payable	$ 3,247,634	$ 5,728,879
Royalties payable	3,537,344	3,830,904
Accrued liabilities	3,501,872	1,793,946
Deferred income taxes		1,125,804
Derivative liability natural gas contracts	5,543,501	919,572
Asset retirement obligations	43,851	73,706
Current portion of long-term debt	5,800,000	10,300,000
Total current liabilities	21,674,202	23,772,811
Long-term debt	129,000,000	129,000,000
Asset retirement obligations	13,542,331	13,235,318
Derivative liability natural gas contracts	1,717,523	1,636,348
Other long-term accrued liabilities	136,120	143,682
TOTAL LIABILITIES	166,070,176	167,788,159
Commitments and contingencies (Note 16)		
Mezzanine equity:		
Series A Convertible Redeemable Preferred Stock net of offering costs of $1,660,435; redemption amount $53,058,650; $.001 par value; 7,401,832 shares authorized,	36,345,424	35,851,887

5,305,865 shares were issued and outstanding at March 31, 2013 and December 31, 2012				
Stockholders Deficit:				
Preferred stock, $0.001 par value 2,598,168 shares authorized, none issued				
Common stock, $0.001 par value authorized 125,000,000 shares; 40,689,486 and 40,690,077 issued and outstanding at March 31, 2013 and December 31, 2012, respectively		40,689		40,690
Treasury stock 10,432 shares at March 31, 2013 and December 31, 2012		(94,424)		(94,424)
Paid-in capital		193,522,720		195,033,585
Accumulated other comprehensive loss		(31,725)		(53,020)
Retained deficit		(307,812,410)		(302,057,496)
Less notes receivable		(183,207)		(182,924)
Total stockholders deficit		(114,558,357)		(107,313,589)
TOTAL LIABILITIES, MEZZANINE AND STOCKHOLDERS DEFICIT	$	87,857,243	$	96,326,457

See accompanying Notes to Audited Consolidated Financial Statements (Unaudited).

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GEOMET, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)

FOR THE THREE MONTHS ENDED MARCH 31,

		2013		**2012**
Revenues:				
Gas sales	$	10,879,264	$	10,143,174
Other		44,956		75,765
Total revenues		10,924,220		10,218,939
Expenses:				
Lease operating expense		4,469,239		4,441,434
Compression and transportation expense		1,838,636		2,239,488
Production taxes		550,546		469,649
Depreciation, depletion and amortization		1,506,366		3,630,469
Impairment of gas properties				15,779,441
General and administrative		998,233		1,302,025
Restructuring costs		70,188		
Losses (gains) on natural gas derivatives		5,535,119		(10,017,080)
Total operating expenses		14,968,327		17,845,426
Operating loss		(4,044,107)		(7,626,487)
Other income (expense):				
Interest income		420		3,702
Interest expense		(1,676,329)		(1,275,844)
Other		(28,648)		(4,352)
Total other income (expense):		(1,704,557)		(1,276,494)
Loss before income taxes from continuing operations		(5,748,664)		(8,902,981)
Income tax expense		6,250		44,024,450
Loss from continuing operations		(5,754,914)		(52,927,431)
Discontinued operations				(20,573)
Net loss	$	(5,754,914)	$	(52,948,004)
Accretion of discount on Series A Convertible Redeemable Preferred Stock		(493,537)		(462,016)
Paid-in-kind dividends on Series A Convertible Redeemable Preferred Stock		(1,075,685)		(1,240,720)
Cash dividends paid on Series A Convertible Redeemable Preferred Stock		(633)		(645)
Net loss available to common stockholders	$	(7,324,769)	$	(54,651,385)
Net loss per common share basic:				
Net loss per common share from continuing operations	$	(0.18)	$	(1.37)
Net loss per common share from discontinued operations	$		$	
Net loss per common share basic	$	(0.18)	$	(1.37)
Net loss per common share diluted:				
Net loss per common share from continuing operations	$	(0.18)	$	(1.37)
Net loss per common share from discontinued operations	$		$	
Net loss per common share diluted	$	(0.18)	$	(1.37)
Weighted average number of common shares:				
Basic		40,456,773		39,748,005
Diluted		40,456,773		39,748,005

See accompanying Notes to Audited Consolidated Financial Statements (Unaudited).

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GEOMET, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS (UNAUDITED)

FOR THE THREE MONTHS ENDED MARCH 31,

	2013	2012
Net loss	$ (5,754,914)	$ (52,948,004)
Other comprehensive income (loss), net of related taxes:		
Foreign currency translation adjustment	1,232	(7,451)
Unrealized gain on available for sale securities	20,063	
Comprehensive loss	$ (5,733,619)	$ (52,955,455)

See accompanying Notes to Audited Consolidated Financial Statements (Unaudited).

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GEOMET, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

FOR THE YEARS ENDED DECEMBER 31,

	Three Months Ended March 31,	
	2013	**2012**
Cash flows provided by operating activities:		
Net loss	$ (5,754,914)	$ (52,948,004)
Adjustments to reconcile net loss to net cash flows provided by operating activities:		
Depreciation, depletion and amortization	1,506,366	3,629,341
Impairment of gas properties		15,779,441
Amortization of debt issuance costs	225,870	161,606
Deferred income tax		44,018,200
Unrealized losses (gains) from the change in market value of open derivative contracts	8,634,871	(5,224,211)
Stock-based compensation	58,724	114,756
Loss on sale of other assets	27,616	5,200
Accretion expense	317,013	196,210
Changes in operating assets and liabilities:		
Accounts receivable	1,734,662	50,145
Other current assets	163,260	56,512
Accounts payable	(2,682,655)	543,641
Other accrued liabilities	584,823	142,019
Net cash provided by operating activities	4,815,636	6,524,856
Cash flows (used in) provided by investing activities:		
Capital expenditures	(172,466)	(292,316)
Return of original basis through the settlement of natural gas derivative contracts		2,544,230
Proceeds from sale of other assets	9,375	3,500
Other assets		10,049
Net cash (used in) provided by investing activities	(163,091)	2,265,463
Cash flows used in financing activities:		
Proceeds from borrowings under Credit Agreement		7,400,000
Repayment of borrowings under Credit Agreement	(4,500,000)	(15,800,000)
Deferred financing costs	(3,801)	(32,843)
Payments on other debt		(22,166)
Dividends paid	(633)	(645)
Treasury stock	(17)	(1,862)
Net cash used in financing activities	(4,504,451)	(8,457,516)
Effect of exchange rate changes on cash		507
Increase in cash and cash equivalents	148,094	333,310
Cash and cash equivalents at beginning of period	7,234,225	457,865
Cash and cash equivalents at end of period	$ 7,382,319	$ 791,175
Supplemental disclosure of cash flow information:		
Cash paid during the period for:		

Interest expense	$	1,664,956	$	1,369,617
Income taxes	$	6,250	$	6,250
Significant noncash investing and financing activities:				
Accrued capital expenditures	$	357,856	$	840,226

See accompanying Notes to Consolidated Financial Statements (Unaudited)

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GEOMET, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

Note 1 Organization and Our Business

GeoMet, Inc. (GeoMet, Company, we, or our) (formerly GeoMet Resources, Inc.) was incorporated under the laws of the state of Delaware on November 9, 2000. We are primarily engaged in the exploration for and development and production of natural gas from coal seams (coalbed methane or CBM). All of our production is CBM, which is a dry natural gas containing no hydrocarbon liquids. We were originally founded as a consulting company to the coalbed methane industry in 1985 and have been active as an operator, developer and producer of coalbed methane properties since 1993. Our principal operations and producing properties are located in the Cahaba and Black Warrior Basins in Alabama and the central Appalachian Basin in Virginia and West Virginia. We also own additional coalbed methane and oil and gas development rights, principally in Alabama, Virginia, and West Virginia.

Note 2 Sale of Coalbed Methane Properties in Alabama

On May 3, 2013, the Company entered into a purchase and sale agreement (PSA) to sell its coalbed methane properties in Alabama to Saga Resource Partners LLC, for a purchase price of $63.2 million, subject to customary purchase price adjustments. The effective date of this transaction is April 1, 2013, and it is expected to close on or before June 14, 2013, subject to the exercise of preferential rights and customary closing conditions. GeoMet plans to use the cash proceeds from this asset divestiture, net of purchase price adjustments and other transaction related expenditures, to repay borrowings under its Credit Agreement. We have estimated no material income tax impact on the gain resulting from the sale due to offsetting operating losses.

In connection with the PSA to sell the coalbed methane properties in Alabama, on May 1, 2013, the Company and the lenders under its Fifth Amended and Restated Credit Agreement executed the Fifth Amendment to such agreement (Amendment), which became effective as of May 1, 2013 and provides the necessary consents to sell the coalbed methane properties in Alabama. The Amendment requires repayment of a minimum of $52 million of borrowings which will result in the elimination of the non-conforming tranche B portion of total outstanding borrowings. Following the expected use of net proceeds for repayment of indebtedness, GeoMet s borrowing base will be the lesser of $83 million or actual outstanding borrowings at such time.

GeoMet s average net interest in the coalbed methane properties in Alabama being sold produced approximately 9,700 Mcf of natural gas per day during the month of March 2013, or approximately 29% of GeoMet s total production for this time period. As of March 31, 2013 and based on Securities and Exchange Commission guidelines, GeoMet s net proved reserves attributable to the coalbed methane properties in Alabama being sold were estimated to be approximately 43 Bcf, all classified as proved developed reserves.

Note 3 Going Concern and Management s Plans

The accompanying consolidated financial statements (unaudited) have been prepared in conformity with accounting principles generally accepted in the United States which contemplate continuation of the Company as a going concern. In 2012, the amounts outstanding under the Company s Fifth Amended and Restated Credit Agreement (Credit Agreement) exceeded the borrowing base as determined by the lenders under the Credit Agreement. In August 2012, the Company amended the Credit Agreement to provide for a conforming tranche limited to the borrowing base, and a non-conforming tranche in the amount outstanding in excess of the borrowing base. The Company is required to dedicate substantially all of its free cash flow to repayment of the non-conforming tranche. The Credit Agreement matures on April 1, 2014, and no assurances can be made that the Company will be able to refinance, repay or further extend the maturity date of the Credit Agreement. The borrowing base deficiency also adversely impacted the Company s working capital by reclassifying the next twelve months required payments from Long-term debt to Current Liabilities in the Consolidated Balance Sheets (Unaudited) as of March 31, 2013. In addition, as of March 31, 2013, the Company had a working capital deficit of $8.3 million, a retained deficit of $307.8 million and stockholders deficit of $114.6 million. Depressed natural gas prices in 2012 resulted in significant property impairments and full valuation of our deferred tax assets during 2012. On April 2, 2013, all the indebtedness under the Company s Credit Agreement was reclassified to current liabilities. These and other factors raise substantial doubt about the Company s ability to continue as a going concern.

Management s current business plan is primarily focused on eliminating the borrowing base deficiency, maintaining compliance with the Credit Agreement, as amended, maintaining production levels and controlling costs. In addition, management recently executed a purchase and sale agreement for all of the Company s coalbed methane properties in Alabama described above in Footnote 2 Sale of Coalbed Methane Properties in Alabama that were being marketed for sale by an asset divestiture firm. Management will continue to evaluate the viability of additional asset sales or strategic corporate transactions. There can be no assurance that the Company will be able to sell properties (including under the existing PSA), to effect a strategic transaction, or realize adequate proceeds from the sale of properties to eliminate the deficiency under, or to refinance, the Credit Agreement.

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The ability of the Company to continue as a going concern is dependent upon its ability to generate sufficient cash flows and sales proceeds or other sources of capital sufficient to repay or refinance its indebtedness, continue its operations and fund its long-term capital needs. The accompanying consolidated financial statements do not include any adjustments that might be necessary if the Company is unable to continue as a going concern.

Note 4 Recent Accounting Pronouncements

In February 2013, the Financial Accounting Standards Board (FASB), issued Accounting Standards Update (ASU), No. 2013-04, Liabilities (Topic 405): Obligations Resulting from Joint and Several Liability Arrangements for Which the Total Amount of the Obligation is Fixed at the Reporting Date. ASU 2013-04 provides guidance for the recognition, measurement, and disclosure of obligations resulting from joint and several liability arrangements for which the total amount of the obligation is fixed at the reporting date, except for obligations addressed within existing guidance. The update is effective for interim and annual periods beginning after December 15, 2013 and is required to be applied retrospectively to all prior periods presented for those obligations that existed upon adoption of ASU 2013-04. We are presently assessing the potential impact of ASU 2013-04.

In February 2013, the FASB issued Accounting Standards Update (ASU) No. 2013-02, Comprehensive Income (Topic 220): Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income, to improve the transparency of reporting reclassifications out of accumulated other comprehensive income. The update requires an entity to report the effect of significant reclassifications out of accumulated other comprehensive income on the respective line items in net income if the amount being reclassified is required under accounting principles generally accepted in the United States (GAAP) to be reclassified in its entirety to net income. For other amounts that are not required under GAAP to be reclassified in their entirety to net income in the same reporting period, an entity is required to cross-reference other disclosures required under GAAP that provide additional detail about those amounts. The amendments are effective prospectively for reporting periods beginning after December 15, 2012 The Company has adopted and applied the provisions of ASU 2012-02 which did not impact its operating results, financial position or cash flows.

In January 2013, the FASB issued ASU No. 2013-01, Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities. The amendments in this update clarify that the scope of ASU 2011-11 applies to derivatives accounted for in accordance with ASC 815, Derivatives and Hedging, including bifurcated embedded derivatives, repurchase agreements and reverse repurchase agreements, and securities borrowing and securities lending transactions that are either offset in accordance with ASC 210-20-45 or ASC 815-10-45 or subject to an enforceable master netting arrangement or similar agreement. The amendments are effective during interim and annual periods beginning on or after January 1, 2013. The Company has adopted and applied the provisions of ASU 2013-01. As the Company currently presents unrealized gains (losses) on commodity derivatives on a gross basis on our Consolidated Balance Sheets (Unaudited), no material impact was noted.

In July 2012, the FASB issued ASU 2012-02, which amends the guidance in ASC 350-30 on testing indefinite-lived intangible assets, other than goodwill, for impairment. The FASB issued the ASU in response to feedback on ASU 2011-08, which amended the goodwill impairment testing requirements by allowing an entity to perform a qualitative impairment assessment before proceeding to the two- step impairment test. Similarly, under ASU 2012-02, an entity testing an indefinite-lived intangible asset for impairment has the option of performing a qualitative assessment before calculating the fair value of the asset. Although ASU 2012-02 revises the examples of events and circumstances that an entity should consider in interim periods, it does not revise the requirements to test indefinite-lived intangible assets (1) annually for impairment and (2) between annual tests if there is a change in events or circumstances. ASU 2012-02 is effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012. The Company has adopted and applied the provisions of ASU 2012-02 which did not impact its operating results, financial position or cash flows.

Note 5 Discontinued Operations

On June 20, 2012, we disposed of Hudson s Hope Gas, Ltd., a subsidiary which held our Canadian gas properties, in exchange for two million shares of Canada Energy Partners, Inc. (CEP Shares) which we are restricted from selling before June 20, 2013. We recognized a loss on the disposition in the amount of $0.7 million, which was made up of a $1.3 million loss related to the currency translation adjustment, offset by $0.3 million in asset retirement obligations conveyed to the buyer and the proceeds consisting of the $0.3 million in estimated fair value of the CEP shares received. The loss on this disposition has been included in Discontinued operations, net of tax, in the Consolidated Statements of Operations (Unaudited). Additionally, all historical operating results related to the disposed company have been removed from Operating (loss) income and included in Discontinued operations, net of tax, in the Consolidated Statements of Operations (Unaudited) for the periods presented.

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As a result of the disposition, we are classifying these activities as a discontinued operation for all the periods presented. Results for activities reported as discontinued operations for the three months ended March 31, 2013 and 2012 were as follows:

		2013		2012
Revenues	$		$	
Operating expenses				20,549
Operating loss				(20,549)
Loss on sale of Hudson s Hope Gas, Ltd.				
Other expense				(24)
Income tax expense				
Net income (loss)	$		$	(20,573)

Note 6 Net Loss Per Common Share

Net Loss Per Share of Common Stock Net loss per common share basic is calculated by dividing Net loss available to common stockholders by the weighted average number of shares of common stock outstanding during the period. Net loss per common share diluted assumes the conversion of all potentially dilutive securities and is calculated by dividing Net loss available to common stockholders by the sum of the weighted average number of shares of common stock outstanding plus potentially dilutive securities. Net loss per common share diluted considers the impact of potentially dilutive securities except in periods in which there is a loss because the inclusion of the potential shares of common stock would have an anti-dilutive effect. A reconciliation of the numerator and denominator for the three months ended March 31, 2013 and 2012 is as follows:

		2013		2012
Net loss available to common stockholders	$	(7,324,769)	$	(54,651,385)
Net loss per common share basic:				
Net loss per common share from continuing operations	$	(0.18)	$	(1.37)
Net loss per common share from discontinued operations	$		$	
Net loss per common share basic	$	(0.18)	$	(1.37)
Net loss per common share diluted:				
Net loss per common share from continuing operations	$	(0.18)	$	(1.37)
Net loss per common share from discontinued operations	$		$	
Net loss per common share diluted	$	(0.18)	$	(1.37)
Weighted average number of common shares:				
Basic		40,456,773		39,748,005
Diluted		40,456,773		39,748,005

Net loss per common share diluted for the three months ended March 31, 2013 excluded the effect of outstanding exercisable options to purchase 2,365,466 shares, 233,099 weighted average restricted shares outstanding, and 5,305,865 shares of Series A Convertible Redeemable Preferred Stock (40,814,346 in dilutive shares, as converted, which assumes conversion on the first day of the period) because we reported a Net loss

available to common stockholders which caused the options and restricted shares to be anti-dilutive. Additionally, in computing the dilutive effect of convertible securities, Net loss available to common stockholders is also adjusted to add back any convertible preferred dividends and accretion unless the preferred shares are anti-dilutive. As such, there was no add back to Net loss available to common stockholders for the three months ended March 31, 2013 for Accretion of and dividends paid for Series A Convertible Redeemable Preferred Stock of $493,537 and $1,076,318, respectively, in computing Net loss per common share diluted as the preferred shares were anti-dilutive.

Net loss per common share diluted for the three months ended March 31, 2012 excluded the effect of outstanding exercisable options to purchase 1,384,398 shares, 262,896 weighted average restricted shares outstanding, and 4,549,537 shares of Series A Convertible Redeemable Preferred Stock (34,996,440 in dilutive shares, as converted, which assumes conversion on the first day of the period) because we reported a Net loss available to common stockholders which caused the options and restricted shares to be anti-dilutive. Additionally, in computing the dilutive effect of convertible securities, Net loss available to common stockholders is also

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adjusted to add back any convertible preferred dividends and accretion unless the preferred shares are anti-dilutive. As such, there was no add back to Net loss available to common stockholders for the three months ended March 31, 2012 for Accretion of and dividends paid for Series A Convertible Redeemable Preferred Stock of $462,016 and $1,241,365, respectively, in computing Net loss per common share diluted as the preferred shares were anti-dilutive.

Note 7 Gas Properties

The method of accounting for oil and gas producing activities determines which costs are capitalized and how these costs are ultimately matched with revenues and expenses. We use the full cost method of accounting for our gas properties. Under this method, all direct costs and certain indirect costs associated with the acquisition, exploration, and development of our gas properties are capitalized.

Gas properties are depleted using the units-of-production method. The depletion expense is significantly affected by the unamortized historical and future development costs and the estimated proved gas reserves.

Estimation of proved gas reserves involves professional judgment and use of factors that cannot be precisely determined. Subsequent proved reserve estimates materially different from those reported would change the depletion expense recognized during future reporting periods. No gains or losses are recognized upon the sale or disposition of gas properties unless the sale or disposition represents a significant quantity of gas reserves, which would have a significant impact on the depreciation, depletion and amortization rate.

Under full cost accounting rules, total capitalized costs are limited to a ceiling equal to the present value of estimated future net revenues, discounted at 10% per annum, plus cost of properties not being amortized plus the lower of cost or fair value of unevaluated properties less income tax effects (the ceiling limitation). We perform a quarterly ceiling test to evaluate whether the net book value of our full cost pool exceeds the ceiling limitation. If capitalized costs (net of accumulated depreciation, depletion and amortization) less related deferred taxes are greater than the discounted future net revenues or ceiling limitation, a write-down or impairment of the full cost pool is required. A write-down of the carrying value of the full cost pool is a non-cash charge that reduces earnings and stockholders equity in the period of occurrence and typically results in lower depreciation, depletion and amortization expense in future periods. Once incurred, a write-down is not reversible at a later date.

The ceiling test is calculated using the unweighted arithmetic average of the natural gas price on the first day of each month within the twelve-month period prior to the end of the reporting period, unless prices are defined by contractual arrangements, excluding escalations based on future conditions. In addition, the future cash outflows associated with settling asset retirement obligations were not included in the computation of the discounted present value of future net revenues for the purposes of the ceiling test calculation.

For the twelve months ended March 31, 2013, the unweighted arithmetic average of the Henry Hub spot market price on the first day of each month was $2.97 per Mcf, resulting in a natural gas price of $3.03 per Mcf when adjusted for regional price differentials. Based on the ceiling test performed utilizing the aforementioned prices, no write-down of the carrying value of our U.S. full cost pool was required at March 31, 2013.

For the twelve months ended March 31, 2012, the unweighted arithmetic average of the Henry Hub spot market price on the first day of each month was $3.75 per Mcf, resulting in a natural gas price of $3.90 per Mcf when adjusted for regional price differentials. Based on the ceiling test performed utilizing the aforementioned prices, we recorded a $15.8 million write-down of the carrying value of our U.S. full cost pool at March 31, 2012.

Note 8 Asset Retirement Obligations

We record an asset retirement obligation (ARO) in the Consolidated Balance Sheets (Unaudited) and capitalize the asset retirement costs in gas properties in the period in which the retirement obligation is incurred. The amount of the ARO and the costs capitalized are equal to the estimated future costs to satisfy the obligation using current prices that are escalated by an assumed inflation factor up to the estimated settlement date, which is then discounted back to the date the abandonment obligation was incurred using an assumed cost of funds for GeoMet. Once the ARO is recorded, it is then accreted to its estimated future value using the same assumed cost of funds. Periodically, we update the cost assumptions resulting from market changes and revise the liability recorded accordingly.

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The following table details the changes to our asset retirement liability for the three months ended March 31, 2013:

Current portion of liability at January 1, 2013	$	73,706
Add: Long-term asset retirement liability at January 1, 2013		13,235,318
Asset retirement liability at January 1, 2013		13,309,024
Settlements		(39,855)
Accretion		317,013
Asset retirement liability at March 31, 2013		13,586,182
Less: Current portion of liability		(43,851)
Long-term asset retirement liability	$	13,542,331

Note 9 Derivative Instruments and Hedging Activities

The energy markets have historically been volatile, and there can be no assurance that future natural gas prices will not be subject to wide fluctuations. In an effort to reduce the effects of the volatility of the price of natural gas on our operations, management has adopted a policy of hedging natural gas prices primarily using derivative instruments in the form of three-way collars, traditional collars and swaps. While the use of these hedging arrangements limits the downside risk of adverse price movements, it also limits future gains from favorable movements. Our price risk management policy strictly prohibits the use of derivatives for speculative positions.

We enter into hedging transactions, generally for forward periods up to two years or more, which increase the probability of achieving our targeted level of cash flows. Our Credit Agreement limits amounts of future natural gas production that we may hedge. At March 31, 2013, we do not have the ability to enter into additional natural gas hedges because we do not have the credit capacity with our existing natural gas hedge counterparties.

Swaps exchange floating price risk in the future for a fixed price at the time of the hedge. Costless collars set both a maximum ceiling (a sold ceiling) and a minimum floor (a bought floor) future price. We have accounted for these transactions using the mark-to-market accounting method. Generally, we incur accounting losses on derivatives during periods where prices are rising and gains during periods where prices are falling which may cause significant fluctuations in our Consolidated Balance Sheets (Unaudited) and Consolidated Statements of Operations (Unaudited).

Commodity Price Risk and Related Hedging Activities

At March 31, 2013, we had the following natural gas collar positions:

Period

	Volume (MMBtu)		Sold Ceiling		Bought Floor		Fair Value
January 2014 through December 2015	3,650,000	$	4.30	$	3.60	$	(904,032)
January 2014 through December 2015	3,650,000	$	4.20	$	3.50		(1,141,532)