

ENTHEOS TECHNOLOGIES INC  
Form 10-Q  
May 21, 2010

**United States**

**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

**FORM 10-Q**

(Mark One)

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

**For the quarterly period ended March 31, 2010**

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

**ENTHEOS TECHNOLOGIES, INC.**

(Exact name of registrant as specified in its charter)

**Nevada**  
(State or other jurisdiction of incorporation)

**98-0170247**  
(I.R.S. Employer Identification No.)

**888 3rd Street SW, Suite 1000, Calgary, Alberta,**  
**Canada**  
(Address of principal executive offices)

**T2P 5C5**  
(Zip Code)

403-444-6418

(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  Not Applicable

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 | <input type="checkbox"/> | Accelerated filer         | <input type="checkbox"/> |
| Non-accelerated filer   | <input type="checkbox"/> | Smaller reporting company | <input type="checkbox"/> |

Indicate by check mark whether the registrant is a shell company (as defined in 12b-2 of the Exchange Act)

Yes  No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: 63,075,122 shares of Common Stock, par value \$0.00001, were outstanding on May 14, 2010.

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**PART I FINANCIAL INFORMATION****Item 1. Financial Statements (Unaudited)**

**ENTHEOS TECHNOLOGIES, INC.**  
**BALANCE SHEETS**  
**March 31, 2010 and December 31, 2009**

|  | <b>(unaudited)</b><br><b>March 31,</b><br><b>2010</b> | <b>December 31,</b><br><b>2009</b> |
|--|---|------------------------------------|
| <b>ASSETS</b>  |   |                                    |
| <b>Current assets</b>  |   |                                    |
| Cash and cash equivalents  | \$ 2,324,894  | \$ 2,409,770                       |
| Accounts receivable  | 7,639   | 8,759                              |
| Total current assets   | 2,332,533   | 2,418,529                          |
| Oil and gas properties at cost (Note 4)                            |   |                                    |
| Proven properties  | 431,309   | 424,191                            |
| Unproven properties  | 101,682   | 101,682                            |
| Accumulated depreciation, depletion, amortization and impairment   | (448,088)   | (429,338)                          |
| Oil and gas properties, net  | 84,903  | 96,535                             |
| <b>Total assets</b>  | <b>\$ 2,417,436</b>                                   | <b>\$ 2,515,064</b>                |
| <b>LIABILITIES</b>   |   |                                    |
| <b>Current liabilities</b>   |   |                                    |
| Accounts payable and accrued liabilities                           | \$ 35,534   | \$ 30,468                          |
| Accounts payable - related parties                                 | -   | 5,172                              |
| Asset retirement obligation  | 10,000  | 10,000                             |
| Warrant liability (Note 5)   | 3,291,344   | 1,368,420                          |
| Total current liabilities  | 3,336,878   | 1,414,060                          |
| <b>Long-term liabilities</b>                                       |   |                                    |
| Asset retirement obligation, less current portion                  | 40,628  | 40,000                             |
| Total liabilities  | 3,377,506   | 1,454,060                          |
| <b>STOCKHOLDERS' EQUITY (DEFICIT) (Note 5)</b>                     |   |                                    |
| Preferred stock: \$0.0001 par value: Authorized: 10,000,000 shares |   |                                    |
| Issued and outstanding: nil  | -   | -                                  |
| Common stock: \$0.00001 par value; Authorized: 200,000,000 shares  |   |                                    |
| Issued and outstanding: 63,075,122 shares (2009: 63,075,122)       | 631   | 631                                |

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|   |                     |                     |
|---|---------------------|---------------------|
| Additional paid-in capital                                  | 5,505,369           | 5,498,374           |
| Accumulated deficit   | (6,466,070)         | (4,438,001)         |
| <b>Total stockholders' equity (deficit)</b>                 | <b>(960,070)</b>    | <b>1,061,004</b>    |
| <b>Total liabilities and stockholders' equity (deficit)</b> | <b>\$ 2,417,436</b> | <b>\$ 2,515,064</b> |

(The accompanying notes are an integral part of these financial statements)

**ENTHEOS TECHNOLOGIES, INC.**  
**STATEMENTS OF OPERATIONS**  
**For the three months ended March 31, 2010 and 2009**  
(Unaudited)

|  | <b>March 31,<br/>2010</b> | <b>March 31,<br/>2009</b> |
|--|---------------------------|---------------------------|
| <b>Revenue</b>   |                           |                           |
| Oil and gas sales  | \$ 11,735                 | \$ 14,784                 |
| <b>Expenses</b>  |                           |                           |
| Lease operating expenses                                     | 6,697                     | 14,703                    |
| General and administrative expenses                          | 91,433                    | 79,569                    |
| Impairment and depreciation                                  | 18,750                    | 46,840                    |
| Total operating expenses                                     | 116,880                   | 141,112                   |
| <b>Operating Loss</b>  | (105,145)                 | (126,328)                 |
| <b>Other income (expense)</b>                                |                           |                           |
| Change in fair value of warrant liability                    | (1,922,924)               | 234,517                   |
|  | (1,922,924)               | 234,517                   |
| <b>Net income (loss) attributable to common stockholders</b> | \$ (2,028,069)            | \$ 108,189                |
| <b>Income (loss) per common share - basic and diluted</b>    | \$ (0.03)                 | \$ 0.00                   |
| <b>Weighted average number of shares - basic and diluted</b> | 63,075,122                | 63,075,122                |

(The accompanying notes are an integral part of these financial statements)

**ENTHEOS TECHNOLOGIES, INC.**  
**STATEMENTS OF STOCKHOLDERS' EQUITY (DEFICIT)**  
**For the three months ended March 31, 2010 and year ended December 31, 2009**  
(Unaudited)

|   | <u>Common Stock</u> |        | Additional      | Accumulated        | Total                          |
|---|---------------------|--------|-----------------|--------------------|--------------------------------|
|   | Shares              | Amount | paid-in capital | earnings (deficit) | Stockholders' Equity (Deficit) |
| Balance, December 31, 2008                          | 63,075,122          | \$ 631 | \$ 7,107,622    | \$ (4,083,037)     | \$ 3,025,216                   |
| Cumulative effect of change in accounting principle | -                   | -      | (1,653,362)     | (1,624,513)        | (3,277,875)                    |
| Stock-based compensation expense                    | -                   | -      | 44,114          | -                  | 44,114                         |
| Net income, year ended December 31, 2009            | -                   | -      | -               | 1,269,549          | 1,269,549                      |
| Balance, December 31, 2009                          | 63,075,122          | 631    | 5,498,374       | (4,438,001)        | 1,061,004                      |
| Stock-based compensation expense                    | -                   | -      | 6,995           | -                  | 6,995                          |
| Net loss, three months ended March 31, 2010         | -                   | -      | -               | (2,028,069)        | (2,028,069)                    |
| Balance, March 31, 2010                             | 63,075,122          | \$ 631 | \$ 5,505,369    | \$ (6,466,070)     | \$ (960,070)                   |

(The accompanying notes are an integral part of these financial statements)

**ENTHEOS TECHNOLOGIES, INC.**  
**STATEMENTS OF CASH FLOWS**  
**For the three months ended March 31, 2010 and 2009**  
(Unaudited)

|   | <b>March 31,<br/>2010</b> | <b>March 31,<br/>2009</b> |
|---|---------------------------|---------------------------|
| <b>Cash flows from operating activities</b>   |                           |                           |
| Net income (loss)   | \$ (2,028,069)            | \$ 108,189                |
| Adjustments to reconcile net income (loss) to net cash flows from operating activities: |                           |                           |
| Impairment and depreciation   | 18,750                    | 46,840                    |
| Stock-based compensation  | 6,995                     | 13,137                    |
| Accretion of asset retirement obligation  | 628                       | -                         |
| Change in fair value of warrant liability   | 1,922,924                 | (234,517)                 |
| Changes in operating assets and liabilities:  |                           |                           |
| Accounts receivable   | 1,120                     | 4,252                     |
| Prepaid expenses  | -                         | 720                       |
| Accounts payable and accrued liabilities, including related party payables              | (106)                     | 2,645                     |
| Net cash flows from operating activities  | (77,758)                  | (58,734)                  |
| <b>Cash flows from investing activities</b>   |                           |                           |
| Acquisition of oil and gas properties   | (7,118)                   | (10,994)                  |
| Net cash flows from investing activities  | (7,118)                   | (10,994)                  |
| <b>Decrease in cash and cash equivalents</b>  | (84,876)                  | (69,728)                  |
| <b>Cash and cash equivalents, beginning of period</b>                                   | 2,409,770                 | 2,734,591                 |
| <b>Cash and cash equivalents, end of period</b>   | \$ 2,324,894              | \$ 2,664,863              |
| <b>Supplemental disclosure of cash flow information:</b>                                |                           |                           |
| Interest paid in cash   | \$ -                      | \$ -                      |
| Income tax paid in cash   | \$ -                      | \$ -                      |

(The accompanying notes are an integral part of these financial statements)



**ENTHEOS TECHNOLOGIES, INC.**

**NOTES TO FINANCIAL STATEMENTS**

**FOR THE THREE MONTHS ENDED MARCH 31, 2010**

**(Unaudited)**

**Note 1. Organization and Nature of Operations**

Entheos Technologies, Inc. (the Company, we, us, and our) is a small independent oil and gas production company with a focus on participation in producing oil and gas wells and the re-development/recompletion of oil and gas wells. We pursue oil and gas prospects in partnership with oil and gas companies with exploration, development and production expertise. Currently, our interests consist of non-operating, minority working interests. The Company's prospect areas consist of land in La Salle County, Lee County, Fayette County and Frio County, Texas. Currently four of the five wells in which the Company has minority working interests are producing. The Company does not operate any of the wells in which it has an interest.

Incorporated under the laws of the State of Nevada, the Company has an authorized capital of 200,000,000 shares of \$0.00001 par value common stock, of which 63,075,122 shares are outstanding and 10,000,000 shares of \$0.0001 par value preferred stock, of which none are outstanding.

The Company has recently incurred net operating losses and operating cash flow deficits. It may continue to incur losses from operations and operating cash flow deficits in the future. Management believes that the Company's cash and cash equivalent balances, anticipated cash flows from operations and other external sources of credit will be sufficient to meet its cash requirements through December 2011 if not further. The future of the Company after December 2011 will depend in large part on its ability to successfully generate cash flows from operations and raise capital from external sources to fund operations.

**Note 2. Significant Accounting Policies**

The accompanying unaudited financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Form

10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. In the opinion of management, all adjustments (which are of a normal recurring nature) considered necessary for a fair presentation of the financial statements have been included. Operating results for the quarter ended March 31, 2010 are not necessarily indicative of the results that may be expected for the year ended December 31, 2010 or any other interim period. For further information, refer to the financial statements and notes thereto included in our 2009 Annual Report on Form 10-K for the year ended December 31, 2009 filed with the Securities and Exchange Commission.

#### *References to Authoritative Accounting Literature*

In June 2009, the Financial Accounting Standards Board ("FASB") issued the Accounting Standards Codification ("ASC") as the single source of authoritative accounting principles generally accepted in the United States of America ( U.S. GAAP ) recognized by the FASB to be applied by non-governmental entities in preparation of financial statements in conformity with U.S. GAAP, except for additional authoritative rules and interpretative releases issued by the SEC. While the adoption of the ASC changes how we reference accounting standards, the adoption did not have an impact on our financial statements.

#### *Principles of Consolidation*

The Company accounts for its undivided interest in oil and gas properties using the proportionate consolidation method, whereby its share of assets, liabilities, revenues and expenses are included in its financial statements.

#### *Accounting 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 assumptions that affect the reported amounts of assets and liabilities and the reported amounts of revenues and expenses during the reporting period. Management's judgments and estimates in these

areas are based on information available from both internal and external sources, including engineers, geologists, consultants and historical experience in similar matters. The more significant reporting areas impacted by management's judgments and estimates are warrant derivative liabilities; accruals related to oil and gas sales and expenses; estimates used in the impairment of oil and gas properties; and the estimated future timing and cost of asset retirement obligations.

Actual results could differ from the estimates as additional information becomes known. The carrying values of oil and gas properties are particularly susceptible to change in the near term. Changes in the future estimated oil and gas reserves or the estimated future cash flows attributable to the reserves that are utilized for impairment analysis could have a significant impact on the future results of operations.

#### *Full Cost Method of Accounting for Oil and Gas Properties*

The Company has elected to utilize the full cost method of accounting for its oil and gas activities. In accordance with the full cost method of accounting, all costs associated with acquisition, exploration, and development of oil and gas reserves, including directly related overhead costs and related asset retirement costs, are capitalized.

All capitalized costs of oil and gas properties, including the estimated future costs to develop proved reserves, are amortized on the unit-of-production method using estimates of proved reserves once proved reserves are determined to exist. The Company has not yet obtained reserve reports. Management is assessing production data to determine the feasibility of obtaining reserves studies. At March 31, 2010, there were no capitalized costs subject to amortization.

Oil and gas properties without estimated proved reserves are not amortized until proved reserves associated with the properties can be determined or until impairment occurs. The cost of these properties is assessed quarterly, on a property-by-property basis, to determine whether the properties are recorded at the lower of cost or fair market value. In determining whether such costs should be impaired, the Company evaluates historical experience, current drilling results, lease expiration dates, current oil and gas industry conditions, international economic conditions, capital availability, and available geological and geophysical information.

Sales of oil and gas properties are accounted for as adjustments of capitalized costs with no gain or loss recognized, unless such adjustments would significantly alter the relationship between capitalized costs and proved reserves of oil and gas, in which case the gain or loss is recognized in income. The Company has not sold any oil and gas properties.

#### *Full Cost Ceiling Test*

At the end of each quarterly reporting period, the unamortized costs of oil and gas properties are subject to a ceiling test which basically limits capitalized costs to the sum of the estimated future net revenues from proved reserves, discounted at 10% per annum to present value, based on current economic and operating conditions, adjusted for related income tax effects.

#### *Oil and Gas Revenues*

The Company recognizes oil and gas revenues when oil and gas production is sold to a purchaser at a fixed or determinable price, when delivery has occurred and title has transferred, and if collectability of the revenue is probable. Delivery occurs and title is transferred when production has been delivered to a purchaser's pipeline or truck. As a result of the numerous requirements necessary to gather information from purchasers or various measurement locations, calculate volumes produced, perform field and wellhead allocations, distribute and disburse funds to various working interest partners and royalty owners, the collection of revenues from oil and gas production may take up to 45 days following the month of production. Therefore, the Company may make accruals for revenues and accounts receivable based on estimates of its share of production. Since the settlement process may take 30 to 60 days following the month of actual production, its financial results may include estimates of production and revenues for the related time period. The Company will record any differences between the actual amounts ultimately received and the original estimates in the period they become finalized.

#### *Asset Retirement Obligation*

The Company accounts for its future asset retirement obligations by recording the fair value of the liability during the period in which it was incurred. The associated asset retirement costs are capitalized as part of the carrying amount of the long-lived asset. The increase in carrying value of a property associated with the capitalization of an asset retirement obligation is included in proven oil and gas properties in the balance sheets. The Company's asset retirement obligation consists of costs

related to the plugging of wells, removal of facilities and equipment and site restoration on its oil and gas properties. The asset retirement obligation is allocated to operating expense using a systematic and rational method considering the estimated remaining life of the well.

### *Fair Value*

We measure fair value as the price that would be received to sell an asset or paid to transfer a liability (an exit price) in an orderly transaction between market participants at the reporting date. We utilize a three-tier hierarchy, which prioritizes the inputs used in the valuation methodologies in measuring fair value:

Level 1. Valuations based on quoted prices in active markets for identical assets or liabilities that an entity has the ability to access. We have no assets or liabilities valued with Level 1 inputs.

Level 2. Valuations based on quoted prices for similar assets or liabilities, quoted prices for identical assets or liabilities in markets that are not active, or other inputs that are observable or can be corroborated by observable data for substantially the full term of the assets or liabilities. We have no assets or liabilities valued with Level 2 inputs.

Level 3. Valuations based on inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Liabilities valued with Level 3 inputs are described in Note 5. Stockholders' Equity and Note 4. Oil and Gas Properties.

### *Warrant Liability Derivative*

We evaluate financial instruments for freestanding or embedded derivatives. The warrant liability derivative is recorded at fair value with changes in value recognized as other income (expense) in the statements of operations in the period of change.

### *Stock-Based Compensation*

We measure all stock-based compensation awards at fair value on the date of grant and recognize such expense in our financial statements over the requisite service period for awards expected to vest. The Company uses the

Black-Scholes pricing model to determine the fair value of stock-based compensation awards on the date of grant. The Black-Scholes pricing model requires management to make assumptions regarding the option lives, expected volatility, and risk free interest rates. See Note 6. Stock Options for additional information on the Company's stock-based compensation plans.

#### *Earnings (Loss) Per Share*

The computation of basic net income (loss) per common share is based on the weighted average number of shares that were outstanding during the period. The computation of diluted net income (loss) per common share is based on the weighted average number of shares used in the basic net income (loss) per share calculation plus the number of common shares that would be issued assuming the exercise of all potentially dilutive common shares outstanding using the treasury stock method for shares subject to stock options and warrants. See Note 3. Earnings (Loss) Per Share for further discussion.

#### *Related Party Transactions*

A related party is generally defined as (i) any person who holds 10% or more of the Company's securities and their immediate families, (ii) the Company's management, (iii) someone who directly or indirectly controls, is controlled by or is under common control with the Company, or (iv) anyone who can significantly influence the financial and operating decisions of the Company. A transaction is considered to be a related party transaction when there is a transfer of resources or obligations between related parties. (See Note 7. Related Party Transactions).

#### *Recent and Adopted Accounting Pronouncements*

We review new accounting standards as issued. Although some of these accounting standards issued or effective after the end of our previous fiscal year may be applicable to us, we expect that none of the new standards will have a significant impact on our financial statements.

**Note 3. Earnings (Loss) Per Share (EPS)**

Dilutive common stock equivalents include 13,050,000 and 13,100,000 warrants and stock options that are not included in the computation of diluted loss per share because to do so would be anti-dilutive for the three-month periods ended March 31, 2010 and 2009, respectively. All share and per share information are adjusted retroactively to reflect stock splits and changes in par value, when applicable.

Following is the computation of basic and diluted net loss per share for the three month periods ended March 31, 2010 and 2009:

|  | <b>2010</b>    | <b>2009</b> |
|--|----------------|-------------|
| Numerator - net income (loss)                                      | \$ (2,028,069) | \$ 108,189  |
| Denominator - weighted average number of common shares outstanding | 63,075,122     | 63,075,122  |
| Basic and diluted income (loss) per common share                   | \$ (0.03)      | \$ 0.00     |

**Note 4. Oil and Gas Properties**

As of March 31, 2010, the Company owned non-operating, working interests in five wells in one geographic area as follows:

|                                    | <b>Acquisition<br/>Date</b> | <b>Interest<br/>Working</b> | <b>Interest<br/>Net Revenue</b> | <b>Month<br/>Production<br/>Started</b> | <b>Acreage</b> | <b>Formation</b> |
|------------------------------------|-----------------------------|-----------------------------|---------------------------------|---|----------------|------------------|
| <b><i>Proven Properties:</i></b>   |                             |                             |                                 |   |                |                  |
| Cooke #6                           | 9/1/2008                    | 21.75%                      | 16.3125%                        | Dec-07                                  | 40             | Escondido        |
| Onnie Ray #1                       | 9/12/2008                   | 20.00%                      | 15.00%                          | Oct-08                                  | 80             | Austin Chalk     |
| Stahl #1                           | 9/12/2008                   | 20.00%                      | 15.00%                          | Oct-08                                  | 20             | Austin Chalk     |
| Pearce #1                          | 10/31/2008                  | 20.00%                      | 15.00%                          | Dec-08                                  | 360            | Austin Chalk     |
| <b><i>Unproven Properties:</i></b> |                             |                             |                                 |   |                |                  |

|          |           |        |        |   |     |              |
|----------|-----------|--------|--------|---|-----|--------------|
| Haile #1 | 9/12/2008 | 20.00% | 15.00% | - | 100 | Austin Chalk |
|----------|-----------|--------|--------|---|-----|--------------|

Costs incurred for oil and gas property properties are summarized as follows as of March 31, 2010:

|  | <b>Proven</b> | <b>Unproven</b> | <b>Total</b> |
|--|---------------|-----------------|--------------|
| Acquisition costs  | \$ 218,528    | \$ 16,071       | \$ 234,599   |
| Exploration costs  | 31,069        | 85,611          | 116,680      |
| Development costs  | 181,712       | -               | 181,712      |
|  | 431,309       | 101,682         | 532,991      |
| Accumulated depreciation, depletion, amortization and impairment | (356,991)     | (91,097)        | (448,088)    |
| Oil and gas properties, net                                      | \$ 74,318     | \$ 10,585       | \$ 84,903    |

The Company amortizes all capitalized costs of oil and gas properties on the unit-of-production method using proved reserves. The Company has not obtained reserve studies with estimated proved reserves. Management is assessing production data to determine the feasibility of obtaining reserves studies. Therefore for the three month periods ended March 31, 2010 and 2009, there were no capitalized costs subject to amortization.

Unproven properties costs as of March 31, 2010 are associated with a development oil well which was completed in August 2009 and did not produce. Management has considered the well impaired to the extent of anticipated salvage value of the equipment.



Properties which are not being amortized are assessed quarterly, on a property-by-property basis, to determine whether they are recorded at the lower of cost or fair market value. As a result of this analysis and lack of proved reserves, the Company recorded an impairment loss of \$0 and \$46,840 for the three month periods ended March 31, 2010 and 2009, respectively. No impairment was recognized for the three month period ended March 31, 2010 as the net carrying value approximates fair value. The impairment is similar to amortization and therefore is not added to the cost of properties being amortized. Depreciation amounted to \$18,750 and \$nil for the three month periods ended March 31, 2010 and 2009, respectively.

#### Asset Retirement Obligation

The following table summarizes the activity for the Company's asset retirement obligations for the three month periods ended March 31, 2010 and 2009:

|   |    | <b>2010</b> |    | <b>2009</b> |
|---|----|-------------|----|-------------|
| Asset retirement obligations, beginning of period     | \$ | 50,000      | \$ | -           |
| Accretion expense                                     |    | 628         |    | -           |
| Liabilities incurred                                  |    | -           |    | -           |
| Change in estimated obligations                       |    | -           |    | -           |
| Asset retirement obligations, end of period           |    | 50,628      |    | -           |
| Less: current portion                                 |    | (10,000)    |    | -           |
| Long-term asset retirement obligations, end of period | \$ | 40,628      | \$ | -           |

The carrying value of asset retirement obligations were measured using Level 3 inputs, as defined in the fair value hierarchy.

#### **Note 5. Stockholders' Equity**

On July 28, 2008, the Company completed a self-directed private placement of 6,450,000 units at a price of \$0.50 per unit or \$3,225,000 in the aggregate. Each unit consists of one share of the Company's common stock, one Series A stock purchase warrant (Series A warrant) to purchase one share of common stock at \$0.60 per share for a period of 18 months from the date of issuance and one Series B stock purchase warrant (Series B warrant) to purchase one share of common stock at \$0.75 per share for a period of 24 months from the date of issuance (refer to the Warrants section below for a discussion of the extension of the expiration date of the warrants).

In connection with the private placement, the Company issued an aggregate of 50,000 units in payment of legal fees in the amount of \$25,000. These units were otherwise issued on the same terms and conditions as the units sold in the private placement.

Pursuant to the Subscription Agreement and the Registration Rights Agreement relating to the private placement, the Company and the investor parties made other covenants and representations and warranties regarding matters that are customarily included in financings of this nature. In the event that during the period when the warrants are outstanding, if the Company issues common stock or common stock equivalents at a price per share which is less than the warrant exercise price, \$0.60 per share for Series A warrants and \$0.75 per share for Series B warrants, then the exercise price for the warrants shall be reduced to equal the share price of the new issuance and the number of warrant shares issuable shall be increased such that the aggregate exercise price payable shall be equal to the aggregate exercise price prior to such adjustment according to the Securities Purchase Agreement (the "Dilutive Issuance").

### Warrants

Each of the Company's warrants outstanding entitles the holder to purchase one share of the Company's common stock for each warrant share held. No warrants were exercised during the three month periods ended March 31, 2010 and 2009.

On December 14, 2009, the Company extended the expiration date of the 6,450,000 Series A warrants from January 28, 2010 to July 28, 2010 and extended the expiration date of the 6,450,000 Series B warrants from July 28, 2010 to January 28, 2011. The exercise price of the warrants remains unchanged at \$0.60 and \$0.75 for the Series A and Series B warrants, respectively.

On January 27, 2010, the Company extended the expiration date of 6,450,000 Series A warrants again from July 28, 2010 to January 28, 2011 and extended the expiration date of the 6,450,000 Series B warrants again from January 28, 2011 to July 28, 2011. The exercise price of the warrants remains unchanged at \$0.60 per share and \$0.75 per share for the Series A and Series B warrants, respectively.

The potential of a Dilutive Issuance to the warrants' exercise price and number of underlying shares of common stock may result in a settlement amount that does not equal the difference between the fair value of a fixed number of the Company's common stock and a fixed exercise price. Accordingly, the warrants are not considered indexed to the Company's own stock and, therefore, are accounted for as a derivative pursuant to ASC 815-40 *Contracts in an Entity's Own Equity* which became effective January 1, 2009. Upon the adoption of this guidance, the Company recognized a one-time decrease to opening accumulated deficit of \$1,624,513.

As of March 31, 2010, the Company has not sold any shares of common stock or common stock equivalents that would result in an adjustment to the exercise price or number of shares of common stock underlying the warrants outstanding. Additionally, the Company does not intend to sell any shares of common stock or common stock equivalents at a price that is below the exercise price of the warrants, prior to their expiration dates, which would result in an adjustment to the exercise price or number of shares of common stock underlying the warrants. Since the Company determined that the future probability of a Dilutive Issuance is deemed unlikely, it did not have a material impact on the fair value estimate of the warrant liability at March 31, 2010 as it relates to the Series A or Series B Warrants.

At March 31, 2010, the Company valued the warrant liability using a Black-Scholes model (Level 3 inputs) containing the following assumptions:

|  | <b>Series A Warrants</b> | <b>Series B Warrants</b> |
|--|--------------------------|--------------------------|
| Warrants outstanding and exercisable at March 31, 2010 | 6,450,000                | 6,450,000                |
| Exercise price   | \$0.60                   | \$0.75                   |
| Black-Scholes option pricing model assumptions:        |                          |                          |
| Risk-free interest rate                                | 0.325%                   | 0.41%                    |
| Expected term  | 0.83 years               | 1.33 years               |
| Expected volatility                                    | 29.45%                   | 78.62%                   |
| Dividend per share                                     | \$0                      | \$0                      |
| Expiration date  | January 28, 2011         | July 28, 2011            |

The following table is a roll forward of the fair value of the warrant liability related to the common stock warrants using the Black-Scholes assumptions as of March 31, 2010 (Level 3 inputs):

|                                 | <b>Series A Warrants</b> | <b>Series B Warrants</b> | <b>Total</b> |
|---------------------------------|--------------------------|--------------------------|--------------|
| Balance as of December 31, 2009 | \$ 309,215               | \$ 1,059,205             | \$ 1,368,420 |
| Change in fair value            | 1,062,779                | 860,145                  | 1,922,924    |
| Balance as of March 31, 2010    | \$ 1,371,994             | \$ 1,919,350             | \$ 3,291,344 |

As a result of adjusting the warrant liability to fair value, we recorded a non-cash loss of \$1,062,779 and a non-cash loss of \$860,145 relating to the Series A and Series B Warrants, respectively, for the three month period ended March 31, 2010.

A total of 12,900,000 shares of the Company's common stock have been reserved for issuance upon exercise of Series A and Series B warrants outstanding as of March 31, 2010.

#### **Note 6. Stock Options**

The Company has an active stock option plan that provides shares available for option grants to employees, directors and others. A total of 120,000,000 shares of the Company's common stock have been reserved for award under the stock option plan, of which 119,850,000 were available for future issuance as of March 31, 2010. Options granted under the Company's option plan generally vest over five years or as otherwise determined by the Board of Directors, have exercise prices equal to the fair market value of the common stock on the date of grant, and expire no later than ten years after the date of grant.

During the three month periods ended March 31, 2010 and 2009, the Company did not grant any stock options awards.

During the three month periods ended March 31, 2010 and 2009, stock-based compensation expense of \$6,995 and \$13,137 was recognized as general and administrative expenses. As of March 31, 2010, the Company had \$44,073 of total unrecognized compensation cost related to unvested stock options, which is expected to be recognized over a weighted average period of approximately 3.45 years.

The Company does not repurchase shares to fulfill the requirements of options that are exercised. Further, the Company issues new shares when options are exercised.

#### **Note 7. Related Party Transactions**

*Executive Management:* For both three month periods ended March 31, 2010 and 2009, the Company incurred \$7,500 in fees paid to Derek Cooper the President, Chief Executive Officer and Chief Financial Officer of the Company. In addition, the Company recorded \$2,332 and \$4,148 as stock compensation expense related to options granted to Derek Cooper (refer to Note 6. Stock Options ) for the three month periods ended March 31, 2010 and 2009, respectively.

*Director Fees:* For the three month periods ended March 31, 2010 and 2009, the Company incurred nil and \$6,435, respectively, in board fees for non-employee directors of the Company. In addition, the Company recorded \$4,663 and \$8,989 as stock compensation expense related to options granted to non-employee directors (refer to Note 6. Stock Options ) for the three months ended March 31, 2010 and 2009, respectively.

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

### **Forward-Looking Statements**

*Except for the historical information presented in this document, the matters discussed in this Form 10-Q for the three months ended March 31, 2010, and specifically in the items entitled "Management's Discussion and Analysis of Financial Condition and Results of Operations," or otherwise incorporated by reference into this document, contain "forward-looking statements" (as such term is defined in the Private Securities Litigation Reform Act of 1995). These statements are identified by the use of forward-looking terminology such as "believes," "plans," "intend," "scheduled," "potential," "continue," "estimates," "hopes," "goal," "objective," "expects," "may," "will," "should," or "anticipates" or the negative thereof or other variations thereon or comparable terminology, or by discussions of strategy that involve risks and uncertainties.*

*The safe harbor provisions of Section 21E of the Securities Exchange Act of 1934, as amended, and Section 27A of the Securities Act of 1933, as amended, apply to forward-looking statements made by the Company. The reader is cautioned that no statements contained in this Form 10-Q should be construed as a guarantee or assurance of future performance or results. These forward-looking statements involve risks and uncertainties, including those identified within this Form 10-Q. The actual results that the Company achieves may differ materially from any forward-looking statements due to such risks and uncertainties. These forward-looking statements are based on current expectations, and the Company assumes no obligation to update this information. Readers are urged to carefully review and consider the various disclosures made by the Company in this Form 10-Q and in the Company's other reports filed with the Securities and Exchange Commission that attempt to advise interested parties of the risks and factors that may affect the Company's business.*

### **Overview**

Incorporated under the laws of the State of Nevada, the Company has an authorized capital of 200,000,000 shares of \$0.00001 par value common stock, of which 63,075,122 shares are outstanding and 10,000,000 shares of \$0.0001 par value preferred stock, of which none are outstanding.

Our principal executive offices are located at 888 3<sup>rd</sup> Street SW, Suite 1000, Calgary Alberta, Canada T2P 5C5. Our telephone number is (403) 444-6418.

**Description of Business**

We are a small independent energy company engaged in the acquisition and development of crude oil and natural gas interests in the United States. We pursue oil and gas prospects in partnership with oil and gas companies with exploration, development and production expertise. We currently have interests in producing properties in La Salle County, Fayette County, Lee County and Frio County, Texas.

The leases for these properties are maintained and operated by our partners Leexus Oil LLC and Bayshore Exploration LLC; there are no obligations to further explore or develop lands in the lease areas to maintain the leases. The operators of the leases are not affiliated with the Company or any of its directors or major shareholders. We are not aware of any relationships or affiliations between or among any of our leasehold partners and the lease operators.

**Oil and Gas Properties**

The following table sets forth a summary of our current oil and gas interests:

|                                    | <b>Acquisition<br/>Date</b> | <b>Interest<br/>Working</b> | <b>Net Revenue</b> | <b>Month<br/>Production<br/>Started</b> | <b>Acreage</b> | <b>Formation</b> |
|------------------------------------|-----------------------------|-----------------------------|--------------------|---|----------------|------------------|
| <b><i>Proven Properties:</i></b>   |                             |                             |                    |   |                |                  |
| Cooke #6                           | 9/1/2008                    | 21.75%                      | 16.3125%           | Dec-07                                  | 40             | Escondido        |
| Onnie Ray #1                       | 9/12/2008                   | 20.00%                      | 15.00%             | Oct-08                                  | 80             | Austin Chalk     |
| Stahl #1                           | 9/12/2008                   | 20.00%                      | 15.00%             | Oct-08                                  | 20             | Austin Chalk     |
| Pearce #1                          | 10/31/2008                  | 20.00%                      | 15.00%             | Dec-08                                  | 360            | Austin Chalk     |
| <b><i>Unproven Properties:</i></b> |                             |                             |                    |   |                |                  |
| Haile #1                           | 9/12/2008                   | 20.00%                      | 15.00%             | -                                       | 100            | Austin Chalk     |

We utilize the full cost method of accounting for our oil and gas activities. In accordance with the full cost method of accounting, all costs associated with acquisition, exploration, and development of oil and gas reserves, including directly related overhead costs and related asset retirement costs, are capitalized. Net capitalized costs associated with oil and gas properties as of March 31, 2010 and December 31, 2009 are summarized as follows:

|          |  | <b>Cost Incurred for Oil &amp; Gas Properties</b> |             |                  |                 |
|----------|--|---|-------------|------------------|-----------------|
|          |  | <b>December 31,</b>                               |             | <b>\$ Change</b> | <b>% Change</b> |
|          |  | <b>March 31, 2010</b>                             | <b>2009</b> |                  |                 |
| Proven   |  |   |             |                  |                 |
|          | Acquisition costs  | \$ 218,528  | \$ 218,528  | \$ -             | 0%              |
|          | Exploration costs  | 31,069  | 25,260      | 5,809            | 23%             |
|          | Development costs  | 181,712   | 180,403     | 1,309            | 1%              |
|          |  | 431,309   | 424,191     | 7,118            | 2%              |
| Unproven |  |   |             |                  |                 |
|          | Acquisition costs  | 16,071  | 16,071      | -                | 0%              |
|          | Exploration costs  | 85,611  | 85,611      | -                | 0%              |
|          |  | 101,682   | 101,682     | -                | 0%              |
|          | Accumulated depreciation, depletion<br>amortization and impairment | (448,088)   | (429,338)   | (18,750)         | 4%              |
|          | Oil and gas properties, net  | \$ 84,903   | \$ 96,535   | \$ (11,632)      | (12%)           |

Capital expenditures totaled \$7,118 for the three month period ended March 31, 2010 in order to correct a tubing puncture in the Onnie Ray #1 well. An authorization for expenditure was submitted to us by the well operator in January 2010 and the workover was completed in March 2010. Production of the well increased upon completion of the workover. The benefit of this workover is anticipated to be seen in our second quarter results once the well has been online for a full fiscal quarter. Accumulated depreciation, depletion, amortization and impairment increased by \$18,750 and was determined using a systematic and rational method.



There was no impairment of oil and gas properties for the three month period ended March 31, 2010 as we believe that the net carrying value of our properties approximates fair market value.

At the time of acquisition, the unproven property, Haile #1, was being recompleted to a zone that was previously productive. Once the recompletion efforts were final and the well did not support production, an exploratory drilling program was started in early 2009 to complete a new unproven upper zone. The new upper zone completion also resulted in no oil or gas production and the well was shut-in during August 2009. In accordance with our accounting policies, we assessed this well, at December 31, 2009, to determine whether the well was recorded at the lower of cost or fair market value. Upon completion of our assessment, we impaired the well to the extent of anticipated

salvage value of the equipment and recorded an asset retirement obligation to accrue for estimated closure costs.

## **Critical Accounting Policies**

### *Accounting 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 assumptions that affect the reported amounts of assets and liabilities and the reported amounts of revenues and expenses during the reporting period. Management's judgments and estimates in these areas are based on information available from both internal and external sources, including engineers, geologists, consultants and historical experience in similar matters. The more significant reporting areas impacted by management's judgments and estimates are warrant derivative liabilities; accruals related to oil and gas sales and expenses; estimates used in the impairment of oil and gas properties; and the estimated future timing and cost of asset retirement obligations.

Actual results could differ from the estimates as additional information becomes known. The carrying values of oil and gas properties are particularly susceptible to change in the near term. Changes in the future estimated oil and gas reserves or the estimated future cash flows attributable to the reserves that are utilized for impairment analysis could have a significant impact on the future results of operations.

### *References to Authoritative Accounting Literature*

In June 2009, the Financial Accounting Standards Board ("FASB") issued the Accounting Standards Codification ("ASC") as the single source of authoritative accounting principles generally accepted in the United States of America ("U.S. GAAP") recognized by the FASB to be applied by non-governmental entities in preparation of financial statements in conformity with U.S. GAAP, except for additional authoritative rules and interpretative releases issued by the SEC. While the adoption of the ASC changes how we reference accounting standards, the adoption did not have an impact on our financial statements.

### *Full Cost Method of Accounting for Oil and Gas Properties*

We have elected to utilize the full cost method of accounting for our oil and gas activities. In accordance with the full cost method of accounting, all costs associated with acquisition, exploration, and development of oil and gas reserves,

including directly related overhead costs and related asset retirement costs, are capitalized.

All capitalized costs of oil and gas properties, including the estimated future costs to develop proved reserves, are amortized on the unit-of-production method using estimates of proved reserves once proved reserves are determined to exist. We have not yet obtained reserve reports because of our recent acquisition of our oil and gas properties and because these properties recently began producing. Management is assessing geographic and production data to determine the need for reserves studies. At March 31, 2010, there were no capitalized costs subject to amortization.

Oil and gas properties without estimated proved reserves are not amortized until proved reserves associated with the properties can be determined or until impairment occurs. The cost of these properties is assessed quarterly, on a property-by-property basis, to determine whether the properties are recorded at the lower of cost or fair market value. In determining whether such costs should be impaired, we evaluate historical experience, current drilling results, lease expiration dates, current oil and gas industry conditions, international economic conditions, capital availability, and available geological and geophysical information. As a result of this analysis and lack of proved reserves, we recorded an impairment loss of nil and \$46,840 for the three month periods ended March 31, 2010 and 2009, respectively. The impairment is similar to amortization and therefore is not added to the costs of properties being amortized.

Sales of oil and gas properties are accounted for as adjustments of capitalized costs with no gain or loss recognized, unless such adjustments would significantly alter the relationship between capitalized costs and proved reserves of oil and gas, in which case the gain or loss is recognized in income. We have not sold any oil and gas properties.

#### *Full Cost Ceiling Test*

At the end of each quarterly reporting period, the unamortized costs of oil and gas properties are subject to a ceiling test which limits capitalized costs to the sum of the estimated future net revenues from proved reserves, discounted at 10% per annum to present value, based on current economic and operating conditions, adjusted for related income tax effects.

### *Oil and Gas Revenues*

We recognize oil and gas revenues when oil and gas production is sold to a purchaser at a fixed or determinable price, when delivery has occurred and title has transferred, and if collectability of the revenue is probable. Delivery occurs and title is transferred when production has been delivered to a purchaser's pipeline or truck. As a result of the numerous requirements necessary to gather information from purchasers or various measurement locations, calculate volumes produced, perform field and wellhead allocations, distribute and disburse funds to various working interest partners and royalty owners, the collection of revenues from oil and gas production may take up to 45 days following the month of production. Therefore, we may make accruals for revenues and accounts receivable based on estimates of our share of production. Since the settlement process may take 30 to 60 days following the month of actual production, our financial results may include estimates of production and revenues for the related time period. We will record any differences between the actual amounts ultimately received and the original estimates in the period they become finalized.

### *Asset Retirement Obligation*

We account for our future asset retirement obligations by recording the fair value of the liability during the period in which it was incurred. The associated asset retirement costs are capitalized as part of the carrying amount of the long-lived asset. The increase in carrying value of a property associated with the capitalization of an asset retirement cost is included in proved oil and gas properties in the balance sheets. Our asset retirement obligation consists of costs related to the plugging of wells, removal of facilities and equipment and site restoration on our oil and gas properties and gathering assets. The asset retirement obligation is allocated to operating expense using a systematic and rational method considering the estimated remaining life of the well.

### *Fair Value*

We measure fair value as the price that would be received to sell an asset or paid to transfer a liability (an exit price) in an orderly transaction between market participants at the reporting date. We utilize a three-tier hierarchy, which prioritizes the inputs used in the valuation methodologies in measuring fair value:

Level 1. Valuations based on quoted prices in active markets for identical assets or liabilities that an entity has the ability to access. We have no assets or liabilities valued with Level 1 inputs.

Level 2. Valuations based on quoted prices for similar assets or liabilities, quoted prices for identical assets or liabilities in markets that are not active, or other inputs that are observable or can be corroborated by observable data

for substantially the full term of the assets or liabilities. We have no assets or liabilities valued with Level 2 inputs.

Level 3. Valuations based on inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Liabilities valued with Level 3 inputs are described in Note 5. Stockholders' Equity and Note 4. Oil and Gas Properties in the Notes to Financial Statements.

#### *Recent and Adopted Accounting Pronouncements*

We review new accounting standards as issued. Although some of these accounting standards issued or effective after the end of our previous fiscal year may be applicable to us, we expect that none of the new standards will have a significant impact on our financial statements.

#### **Variables and Trends**

We have very limited history with respect to our acquisition and development of oil and gas properties. In the event we are able to obtain the necessary financing to move forward with our growth plans, we expect our expenses to increase significantly as we grow our business. Accordingly, the comparison of the financial data for the periods presented may not be a meaningful indicator of our future performance and must be considered in light of these circumstances.

## GLOSSARY OF CERTAIN OIL AND GAS TERMS

The following is a description of the meanings of some of the natural gas and oil industry terms used in this filing:

**Bbl** means a barrel or barrels of oil.

**BOE** means barrels of oil equivalent.

**Btu** means British thermal unit, which means the quantity of heat required to raise the temperature of one pound of water by one degree Fahrenheit.

**Completion** means the installation of permanent equipment for the production of natural gas or oil.

**Condensate** means hydrocarbons naturally occurring in the gaseous phase in a reservoir that condense to become a liquid at the surface due to the change in pressure and temperature.

**Crude** means unrefined liquid petroleum.

**Gross acres** or **gross wells** refer to the total acres or wells, as the case may be, in which a working interest is owned.

**Mcf** means thousand cubic feet of natural gas. The Company has assumed that 1Mcf = 1 MMBtu for our calculations.

**MMBtu** means one million Btus.

**Operator** refers to the individual or company responsible for the exploration, development and production of an oil or gas well or lease.

**Proved developed oil and gas reserves** refers to reserves that can be expected to be recovered through existing wells with existing equipment and operating methods. Additional oil and gas expected to be obtained through the application of fluid injection or other improved recovery techniques for supplementing the natural forces and mechanisms of primary recovery should be included as proved developed reserves only after testing by a pilot project or after the operation of an installed program has confirmed through production responses that increased recovery will be achieved.

**Proved oil and gas reserves** means the estimated quantities of crude oil, natural gas and natural gas liquids which geological and engineering data demonstrate with reasonable certainty to be recoverable in future years from known reservoirs under existing economic and operating conditions, i.e., prices and costs as of the date the estimate is made. Reservoirs are considered proved if economic producibility is supported by either actual production or conclusive formation test. The area of a reservoir considered proved includes (a) that portion delineated by drilling and defined by gas-oil and/or oil-water contacts, if any, and (b) the immediately adjoining portions not yet drilled, but which can be reasonably judged as economically productive on the basis of available geological and engineering data. In the absence of information on fluid contacts, the lowest known structural occurrence of hydrocarbons controls the lower proved limit of the reservoir. Reserves which can be produced economically through application of improved recovery techniques (such as fluid injection) are included in the proved classification when successful testing by a pilot project, or the operation of an installed program in the reservoir, provides support for the engineering analysis on which the project or program was based. Estimates of proved reserves do not include the following: (a) oil that may become available from known reservoirs but is classified separately as indicated additional reserves ; (b) crude oil, natural gas and natural gas liquids, the recovery of which is subject to reasonable doubt because of uncertainty as to geology, reservoir characteristics or economic factors; (c) crude oil, natural gas and natural gas liquids that may occur in undrilled prospects; and (d) crude oil, natural gas and natural gas liquids that may be recovered from oil shales, coal, gilsonite and other such sources.

**Proven properties** refers to properties containing proved reserves.

**Proved undeveloped reserves** refers to reserves that are expected to be recovered from new wells on undrilled

acreage or from existing wells where a relatively major expenditure is required for recompletion. Reserves on undrilled acreage are limited to those drilling units offsetting productive units that are reasonably certain of production when drilled. Proved reserves for other undrilled units can be claimed only where it can be demonstrated with certainty that there is continuity of production from the existing productive formation. Proved undeveloped reserves may not include estimates attributable to any acreage for which an application of fluid injection or other improved recovery technique is contemplated, unless such techniques have been proved effective by actual tests in the area and in the same reservoir.

**Recompletion** means, after the initial completion of the well, the actions and techniques of re-entering the well and redoing or repairing the original completion in order to restore the well's productivity.

**Shut-in** means a well which is capable of producing but is not presently producing.

**Unproven properties** refers to properties containing no proved reserves.

**Working interest** refers to the operating interest that gives the owner the right to drill, produce and conduct operating activities on the property and receive a share of production.

**Workover** means operations on a producing well to restore or increase production.



**Results of Operations for the Three Month Periods Ended March 31, 2010 and 2009**

|   | March 31, 2010 | March 31, 2009 | change         | % change |
|---|----------------|----------------|----------------|----------|
| <b>Production:</b>                        |                |                |                |          |
| Oil (Bbls)                                | 124.0          | 302.7          | (178.7)        | (59%)    |
| Gas (Mcf)                                 | 337.4          | 780.2          | (442.8)        | (57%)    |
| Total production (BOE)                    | 180.2          | 432.8          | (252.6)        | (58%)    |
| Average daily production (BOE)            | 2.0            | 4.8            | (2.8)          | (58%)    |
| % oil of production                       | 69%            | 70%            | (1.0)          | (1%)     |
| <b>Average sales price:</b>               |                |                |                |          |
| Oil (per Bbl)                             | \$ 72.09       | \$ 36.60       | \$ 35.49       | 97%      |
| Gas (per Mcf)                             | \$ 8.29        | \$ 4.77        | \$ 3.52        | 74%      |
| Total (per BOE)                           | \$ 65.13       | \$ 34.16       | \$ 30.97       | 91%      |
| <b>Oil and gas revenues:</b>              |                |                |                |          |
| Oil revenue                               | \$ 8,936       | \$ 11,080      | \$ (2,144)     | (19%)    |
| Gas revenue                               | \$ 2,799       | \$ 3,704       | \$ (905)       | (24%)    |
| Total                                     | \$ 11,735      | \$ 14,784      | \$ (3,049)     | (21%)    |
| Lease operating expenses                  | \$ 6,697       | \$ 14,703      | \$ (8,006)     | (54%)    |
| <b>Additional per BOE data:</b>           |                |                |                |          |
| Sales price                               | \$ 65.13       | \$ 34.16       | \$ 30.97       | 91%      |
| Lease operating expenses                  | \$ 37.17       | \$ 33.97       | \$ 3.20        | 9%       |
| Operating Margin per BOE                  | \$ 27.96       | \$ 0.19        | \$ 27.77       | 146%     |
| Impairment and DDA                        | \$ 18,750      | \$ 46,840      | \$ (28,090)    | (60%)    |
| <b>General and administrative:</b>        |                |                |                |          |
| Management fees                           | \$ 14,495      | \$ 27,072      | \$ (12,577)    | (46%)    |
| Accounting & legal                        | \$ 58,051      | \$ 48,402      | \$ 9,649       | 20%      |
| Office, investor relations and travel     | \$ 18,887      | \$ 4,095       | \$ 14,792      | 361%     |
| Total                                     | \$ 91,433      | \$ 79,569      | \$ 11,864      | 15%      |
| Change in fair value of warrant liability | \$ (1,922,924) | \$ 234,517     | \$ (2,157,441) | (920%)   |

**Oil and Gas Revenues**

Total oil and gas revenues decreased 21% from \$14,784 to \$11,735 comparatively for the three month periods ended March 31, 2009 to 2010 due to a decline in production from the natural decline in the reservoirs and from lost production due to maintenance and rework. Average daily production on an equivalent basis for the three-month period ended March 31, 2010 was 2.0 BOE compared to 4.8 BOE for the same period in 2009 which represents a decrease of 58%. The decline is due to our largest oil well, Pearce #1, experiencing a drop in production rate and due to down time from a workover and gas line maintenance on Onnie Ray #1. Oil remains the majority of our revenue mix at 69% and 70% for the three-month period ended March 31, 2010 and 2009, respectively.

Oil production for the three month period ended March 31, 2010 was 124.0 barrels and generated revenue of \$8,936 for an average price per barrel of \$72.09. Oil production for the three month period ended March 31, 2009 was 302.7 barrels and generated revenue of \$11,080 for an average price per barrel of \$36.60. The 59% decrease in production was offset by the 97% increase in price per barrel.

Gas production for the three month period ended March 31, 2010 was 337.4 Mcf and generated revenue of \$2,799 for an average price of \$8.29 per Mcf. Gas production for the three month period ended March 31, 2009 was 780.2 Mcf and generated revenue of \$3,704 for an average price per of \$4.77 per Mcf. The decrease in production is due to a scheduled workover on Onnie Ray #1 as well as an unscheduled repair to a gas line. The 58% decrease in production was offset by the 74% increase in price per Mcf.

Although production rates have declined, the workover on the Onnie Ray well has been successful and should help offset declining production. In addition to optimizing the current well production rates management is actively looking to add to our production base.

### **Lease Operating Expenses**

Lease operating expenses for the three month period ended March 31, 2010 decreased 54% to \$6,697 from \$14,703 for the same period in 2009. This decrease is attributable to increased operator efficiency as well as reduced maintenance costs. Lease operating expenses on an equivalent production basis increased 3.20 per BOE to 37.17 from 33.97 or 9% due to lower production volumes.

### **Impairment and DDA**

The impairment of oil and gas properties decreased to \$0 from \$46,840 comparatively for the three month periods ended March 31, 2010 and 2009, respectively. We believe that our net book value approximates fair market value. Depreciation amounted to \$18,750 for the three months ended March 31, 2010.

### **Management Fees**

Management fees decreased for the three month periods ended March 31, 2010 to \$14,495 from \$27,072 representing a \$12,577 decrease or 46%. The decrease is comprised of a decrease of \$6,435 in director's fees and a decrease of \$6,142 in stock-based compensation expense.

Although we compensate our non-employee directors, in December 2008, Mr. Hudson, a non-employee director, agreed to waive payment of his monthly fees commencing January 1, 2009, and Mr. Sidhu, a non-employee director, agreed to waive payment of his fees commencing November 1, 2009. However, each director continues to be entitled to be reimbursed for reasonable and necessary expenses incurred on our behalf.

Stock-based compensation expense has decreased as the amortization of the vesting is weighted more heavily in the early years of the option grants.

### **Accounting and Legal Fees**

Accounting and legal expenses increased for the three month periods ended March 31, 2010 and 2009 to \$58,051 from \$48,402, respectively, representing an increase of 20%. The \$9,649 increase is comprised of an increase in auditor and tax preparation fees of \$9,453, an increase in outsourced accounting fees of \$6,089 and a decrease in legal fees of \$5,893.

### **Office, Investor Relations and Travel**

Office, investor relations and travel expenses increased to \$18,887 from \$4,095 for the three month period ended March 31, 2010 compared to the same period in 2009 representing an increase of \$14,792 or 361% increase. This increase is due to an increase in filing fees of \$6,093 due to our S-1 filed in February 2010, an increase in travel expenses of \$4,797 due to site visits to the oil wells, an increase in investor relations expense of \$1,500 due to hiring an investor relations consultant in April 2009, and an increase in office expense of \$2,402 due to additional activity this fiscal quarter compared to the prior year's quarter.

### **Change in Fair Value of Warrant Liability**

During 2009, we began to account for the Series A and the Series B Warrants as derivatives. We determined that our Series A and Series B warrants contained a Dilutive Issuance provision. As a result, we reclassified a total of

12,900,000 warrants from equity to a noncurrent warrant liability and recorded a cumulative effect of change in accounting principle that reduced our accumulated deficit as of January 1, 2009 by \$1,624,513.

We measure the fair value of the warrant liability in accordance with *ASC 820 Fair Value Measurement and Disclosure* which emphasizes that fair value is a market-based measurement, not an entity-specific measurement. Therefore, a fair value measurement should be determined based on the assumptions that market participants would use in pricing the asset or liability. As a basis for considering market participant assumptions in fair value measurements, ASC 820 establishes a fair value hierarchy that distinguishes between market participant assumptions based on market data obtained from sources independent of the reporting entity (observable inputs that are classified within Levels 1 and 2 of the hierarchy) and the reporting entity's own assumptions about market participant assumptions (unobservable inputs classified within Level 3 of the hierarchy). At the end of each reporting period, we revalue the warrant liability using a Black-Scholes model (Level 3 inputs). As a result of adjusting the warrant liability to fair value, we recorded a non-cash loss of \$1,062,799 and \$860,145 (total loss of

\$1,922,944) relating to the Series A and Series B Warrants, respectively, for the three month period ended March 31, 2010.

### **Liquidity and Capital Resources**

We had cash and cash equivalents of \$2,324,894 and \$2,409,770 as of March 31, 2010 and December 31, 2009, respectively. We have financed our operations from cash on hand for the three month period ended March 31, 2010.

Net cash flows used in operating activities was (\$77,758) for the three month period ended March 31, 2010 compared to net cash used in operating activities of (\$58,734) for the three month period ended March 31, 2009. Cash used for operating activities increased due to an increase in accounting, office and travel expenses over 2009.

Cash used in investing activities was (\$7,118) for the three month period ended March 31, 2010, compared to cash used in investing activities of (\$10,994) for the three-month period ended March 31, 2009. The cash used during both three month periods represents additions to capitalized costs of oil and gas properties.

We had no cash used or generated in financing activities for the three month periods ended March 31, 2010 and 2009.

The accompanying financial statements have been prepared assuming we will continue as a going concern. We have incurred cumulative losses of \$6,466,070 through March 31, 2010. Additionally, we have expended a significant amount of cash to acquire working interests in oil and gas properties and operating as a public entity. We expect to continue to incur losses from business operations in the future. Management believes that our cash and cash equivalent balances, anticipated cash flows from operations and other external sources of credit will be sufficient to meet our cash requirements through December 2011 if not longer. Our prospects after December 2011 will depend in large part on our ability to successfully raise capital from external sources to pay for planned expenditures and to fund operations.

Due to the "start up" nature of our business, we expect to incur losses as we expand. We expect to raise additional funds through private or public equity investment in order to expand the range and scope of our business operations. We will seek access to private or public equity but there is no assurance that such additional funds will be available for us to finance our operations on acceptable terms, if at all.

At this time, we have no agreements or understandings with any third party regarding any financings.

Moreover, the trading price of our shares of common stock and a downturn in the United States stock and debt markets could make it more difficult to obtain financing through the issuance of equity or debt securities. Even if we are able to raise the funds required, it is possible that we could incur unexpected costs and expenses, or experience unexpected cash requirements that would force us to seek alternative financing. Further, if we issue additional equity or debt securities, stockholders may experience additional dilution or the new equity securities may have rights, preferences or privileges senior to those of existing holders of our shares of common stock. If additional financing is not available or is not available on acceptable terms, we will have to curtail our operations.

### **Related Party Transactions**

*Executive Management:* For the three month periods ended March 31, 2010 and 2009, we incurred \$7,500 and \$7,500, respectively, in fees paid to Derek Cooper the President, Chief Executive Officer and Chief Financial Officer of the Company. In addition, we recorded \$2,332 and \$4,148 as stock compensation expense related to options granted to Derek Cooper (refer to Note 6. Stock Options in the Notes to Financial Statements) for the three month periods ended March 31, 2010 and 2009, respectively.

*Director Fees:* For the three month periods ended March 31, 2010 and 2009, we incurred nil and \$6,435, respectively, in board fees for non-employee directors of the Company. In addition, we recorded \$4,663 and \$8,989 as stock compensation expense related to options granted to non-employee directors (refer to Note 6. Stock Options in the Notes to Financial Statements) for the three months ended March 31, 2010 and 2009, respectively.

### **Off Balance Sheet Arrangements**

The Company has no off-balance sheet arrangements.

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

Our exposure to market risk is confined to our cash equivalents and short-term investments. We invest in high-quality financial instruments; primarily money market funds, federal agency notes, and US Treasury obligations, with the effective duration of the portfolio within one year which we believe are subject to limited credit risk. We currently do not hedge interest rate exposure. Due to the short-term nature of our investments, we do not believe that we have any material exposure to interest rate risk arising from our investments.

**Item 4T. Controls and Procedures**

**(a) Evaluation of Disclosure Controls and Procedures**

Under the supervision and with the participation of the Company's management, including its Chief Executive Officer and Chief Financial Officer, the Company conducted an evaluation of the effectiveness of the design and operation of its disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934 (the Exchange Act), as of the end of the period covered by this quarterly report. Based on this evaluation, the Company's Chief Executive Officer and Chief Financial Officer concluded as of March 31, 2010 that the Company's disclosure controls and procedures were effective such that the information required to be disclosed in the Company's United States Securities and Exchange Commission (the SEC) reports is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms, and is accumulated and communicated to the Company's management, including its Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

**(b) Changes in Internal Control over Financial Reporting**

There were no changes in the Company's internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that occurred during the period covered by this report that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

**PART II OTHER INFORMATION**

Item 1. Legal Proceedings

None

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

**Exhibit Index**



| Exhibit No. | Description of Exhibit  |
|-------------|---|
| 3.1         | Articles of incorporation (exhibit 3.1). S-8 filing dated October 3, 2003.  |
| 3.2         | Bylaws (exhibit 3.2). S-8 filing dated October 3, 2003.   |
| 10.1        | Subscription Agreement (exhibit 10.1), Series A Warrant Agreement (exhibit 10.2), Series B Warrant Agreement (exhibit 10.2), Registration Rights Agreement (exhibit 10.4) for 6,450,000 unit private placement on July 28, 2008. 8-K filing dated August 1, 2008. |
| 10.2        | Participation Agreement dated September 9, 2008 with respect to the Stahl #1 Well located Fayette County, Texas. 8-K filing dated October 24, 2008.   |
| 10.3        | Participation Agreement dated September 9, 2008 with respect to the Onnie Ray #1 Well located Lee County, Texas. 8-K filing dated October 24, 2008.   |
| 10.4        | Participation Agreement dated September 9, 2008 with respect to the Haile #1 Well located Frio County, Texas. 8-K filing dated October 24, 2008.  |
| 10.5        | 2001 Incentive Stock Option Plan (exhibit 99.1). S-8 filing dated October 3, 2003.  |
| 14.1        | Code of Ethics. 10-K filing dated April 14, 2009.   |
| 31.1*       | Certification of the Chief Executive Officer pursuant to Rule 13a-14(a).*   |
| 32.1*       | Certification by the Chief Executive Officer pursuant to 18 U.S.C. 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.*  |

\*Filed here within.

**SIGNATURES**

Pursuant to the requirements of Sections 13 or 15 (d) 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 on this 21<sup>st</sup> day of May, 2010.

Entheos Technologies, Inc.  
(Registrant)

Date  
May 21, 2010

Signature  
/s/ Derek Cooper  
Derek Cooper

Title  
President, CEO, CFO and Director