

NORTHERN OIL & GAS, INC.  
Form 10-K/A  
March 18, 2011

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

**FORM 10-K/A**

(AMENDMENT NO. 3)

(Mark One)

- ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
For the fiscal year ended December 31, 2009  
Or
- TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.  
For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File No. - 001-33999

**NORTHERN OIL AND GAS, INC.**

*(Exact Name of Registrant as Specified in Its Charter)*

**Nevada**

*(State or Other Jurisdiction of Incorporation or Organization)*

**95-3848122**

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

**315 Manitoba Avenue Suite 200, Wayzata, Minnesota 55391**

*(Address of Principal Executive Offices) (Zip Code)*

**952-476-9800**

*(Registrant's Telephone Number, Including Area Code)*

Securities registered pursuant to Section 12(b) of the Act:

| <b>Title of Each Class</b>      | <b>Name of Each Exchange On Which Registered</b> |
|---------------------------------|--|
| Common Stock, \$0.001 par value | NYSE Amex Equities Market                        |

Securities registered pursuant to Section 12(g) of the Act:

**None**

*(Title of Class)*

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act. Yes  No

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

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(or for such shorter period that the registrant was required to submit and post such files. Yes  No

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Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

|                         |                       |                           |                                  |
|-------------------------|-----------------------|---------------------------|----------------------------------|
| Large Accelerated Filer | <input type="radio"/> | Accelerated Filer         | <input checked="" type="radio"/> |
| Non-Accelerated Filer   | <input type="radio"/> | Smaller Reporting Company | <input type="radio"/>            |

*(Do not check if a smaller reporting company)*

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

State the aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold, or the average bid and asked price of such common equity, as of the last business day of the registrant's most recently completed second fiscal quarter.

The aggregate market value of the registrant's voting and non-voting common equity held by non-affiliates of the registrant on the last business day of the registrant's most recently completed second fiscal quarter (based on the closing sale price as reported by the NYSE Amex Equities Market) was approximately \$192,730,733.

Indicate the number of shares outstanding of each of the registrant's classes of common stock, as of the latest practicable date.

As of March 1, 2010, the registrant had 43,911,044 shares of common stock issued and outstanding.

### **DOCUMENTS INCORPORATED BY REFERENCE**

No documents are incorporated herein by reference.

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NORTHERN OIL AND GAS, INC.

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## EXPLANATORY NOTE

Northern Oil and Gas, Inc. is filing this Amendment No. 3 to its Annual Report on Form 10-K for the year ended December 31, 2009 filed with the Securities and Exchange Commission (the SEC) on March 8, 2010, as amended by Amendment No. 1 filed on April 30, 2010 and Amendment No. 2 filed on November 5, 2010. Our Annual Report on Form 10-K and Amendments No. 1 and No. 2 to that Annual Report are collectively referred to herein as the Original Filings. This Amendment No. 3 to Form 10-K does not contain any new or revised disclosures that were not previously provided in the Original Filings, but simply sets forth the complete text of each applicable item as amended.

Except where specifically indicated, this Amendment No. 3 to Form 10-K does not reflect events occurring after the filing of the Original Filings or modify or update those disclosures affected by subsequent events. Consequently, all other information is unchanged and reflects the disclosures made at the time of the filing of the Original Filings. Except as expressly set forth in this Form 10-K/A, the Original Filings have not been amended, updated or otherwise modified.

### PART III

#### Item 8. Financial Statements and Supplementary Data

Our Financial Statements required by this item are included on the pages immediately following the Index to Financial Statements appearing on page F-1.

### PART III

#### Item 15. Exhibits and Financial Statement Schedules

(a) Documents filed as Part of this Reports:

1. *Financial Statements*

See Index to Financial Statements on page F-1.

2. *Financial Statement Schedules*

All schedules are omitted because they are either not applicable or required information is shown in the financial statements or notes thereto.

(b) Exhibits:

Unless otherwise indicated, all documents incorporated by reference into this report are filed with the SEC pursuant to the Securities and Exchange Act of 1934, as amended, under file number 001-33999.

| Exhibit No. | Description  | Reference   |
|-------------|--|---|
| 3.1         | Composite Articles of Incorporation of Northern Oil and Gas, Inc.  | Incorporated by reference to Exhibit 3.1 to our company's Annual Report on Form 10-K/A (Amendment No. 3) filed with the SEC on June 24, 2009              |
| 3.2         | Amended and Restated Bylaws of Northern Oil and Gas, Inc.  | Incorporated by reference to Exhibit 99.2 to the Registrant's Current Report on Form 8-K filed with the SEC on December 6, 2007 (File No. 000-30955)      |
| 4.1         | Specimen Stock Certificate of Northern Oil and Gas, Inc.   | Incorporated by reference to Exhibit 2.2 to the Registration Statement on Form SB-2 filed with the SEC on June 11, 2007, as amended (File No. 333-143648) |
| 10.1        | Form of Warrant  | Incorporated by reference to Exhibit 10.2 to the current report on Form 8-K filed with the SEC on September 14, 2007 (File No. 000-30955)                 |
| 10.2*       | Amended and Restated Employment Agreement by and between Northern Oil and Gas, Inc. and Michael L. Reger, dated January 30, 2009   | Incorporated by reference to Exhibit 10.2 to the Registrant's Current Report on Form 8-K filed with the SEC on February 2, 2009 (File No. 000-30955)      |
| 10.3*       | Amended and Restated Employment Agreement by and between Northern Oil and Gas, Inc. and Ryan R. Gilbertson, dated January 30, 2009 | Incorporated by reference to Exhibit 10.3 to the Registrant's Current Report on Form 8-K filed with the SEC on February 2, 2009 (File No. 000-30955)      |

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| <b>Exhibit No.</b> | <b>Description</b>  | <b>Reference</b>   |
|--------------------|---|--|
| 10.4               | Irrevocable Proxy Provided by Joseph A. Geraci II, Kimerlie Geraci, Lantern Advisers, LLC, Isles Capital, LLC and Mill City Ventures, LP, dated February 21, 2008   | Incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed with the SEC on March 19, 2008 (File No. 000-30955)                 |
| 10.5               | Agreement by and between Northern Oil and Gas, Inc. and Deephaven MCF Acquisition LLC dated April 14, 2008  | Incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed with the SEC on April 16, 2008 (File No. 000-30955)                 |
| 10.6               | Second Amendment to Agreement by and between Northern Oil and Gas, Inc. and Deephaven MCF Acquisition LLC dated April 14, 2008  | Incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed with the SEC on September 29, 2008 (File No. 000-30955)             |
| 10.7               | Registration Rights Agreement By and Among Northern Oil and Gas, Inc. and Deephaven MCF Acquisition LLC dated April 14, 2008  | Incorporated by reference to Exhibit 10.2 to the Registrant's Current Report on Form 8-K filed with the SEC on April 16, 2008 (File No. 000-30955)                 |
| 10.8               | Lease Purchase Agreement By and Between Northern Oil and Gas, Inc. and Woodstone Resources, L.L.C.  | Incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed with the SEC on June 17, 2008 (File No. 000-30955)                  |
| 10.9               | Northern Oil and Gas, Inc. 2009 Equity Compensation Plan  | Incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed with the SEC on February 2, 2009 (File No. 000-30955)               |
| 10.10              | Credit Agreement dated as of February 27, 2009 among Northern Oil and Gas, Inc., as Borrower, CIT Capital USA Inc., as Administrative Agent, and The Lenders Party Hereto                                 | Incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed with the SEC on March 2, 2009 (File No. 000-30955)                  |
| 10.11              | Form of Note Under that Certain Credit Agreement dated as of February 27, 2009 among Northern Oil and Gas, Inc., as Borrower, CIT Capital USA Inc., as Administrative Agent, and The Lenders Party Hereto | Incorporated by reference to Exhibit 10.2 to the Registrant's Current Report on Form 8-K filed with the SEC on March 2, 2009 (File No. 000-30955)                  |
| 10.12              | Guaranty and Collateral Agreement dated as of February 27, 2009 made by Northern Oil and Gas, Inc. in favor of CIT Capital USA Inc., as Administrative Agent  | Incorporated by reference to Exhibit 10.3 to the Registrant's Current Report on Form 8-K filed with the SEC on March 2, 2009 (File No. 000-30955)                  |
| 10.13              | Guaranty and Collateral Agreement dated as of February 27, 2009 made by Northern Oil and Gas, Inc. in favor of CIT Capital USA Inc., as Administrative Agent  | Incorporated by reference to Exhibit 10.4 to the Registrant's Current Report on Form 8-K filed with the SEC on March 2, 2009 (File No. 000-30955)                  |
| 10.14              | Warrant to Purchase Shares of Northern Oil and Gas, Inc. Common Stock Issued to CIT Group/Equity Investments, Inc. on February 27, 2009   | Incorporated by reference to Exhibit 10.5 to the Registrant's Current Report on Form 8-K filed with the SEC on March 2, 2009 (File No. 000-30955)                  |
| 10.15*             | Northern Oil and Gas, Inc. 2009 Equity Incentive Plan   | Incorporated by reference to Exhibit 10.1 to the Registrant's Current Registration Statement on Form S-8 filed with the SEC on July 16, 2009 (File No. 333-160602) |
| 10.16              | Exploration and Development Agreement dated effective as of April 1, 2009 by and between Slawson Exploration Company, Inc. and Northern Oil and Gas, Inc.   | Incorporated by reference to Exhibit 2.1 to the Registrant's Current Report on Form 8-K filed with the SEC on May 29, 2009   |
| 10.17              | First Amendment to Credit Agreement dated as of May 22, 2009 among Northern Oil and Gas, Inc., CIT Capital USA Inc., and the Lenders party thereto  | Incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed with the SEC on May 29, 2009  |
| 10.18*             | Form of Promissory Note issued to Michael L. Reger and Ryan R. Gilbertson   | Incorporated by reference to Exhibit 10.18 to the Registrant's Annual Report on Form 10-K filed with the SEC on March 3, 2010.                                     |
| 10.19*             | Form of Restricted Stock Agreement issued under the Northern Oil and Gas, Inc. 2009 Equity Incentive Plan   | Incorporated by reference to Exhibit 10.19 to the Registrant's Annual Report on Form 10-K filed with the SEC on March 3, 2010.                                     |
| 18.1               | Letter from Mantyla McReynolds, LLC Regarding Change in Accounting Principles   | Incorporated by reference to Exhibit 18.1 to the Registrant's Current Report on Form 10-Q filed with the SEC on October 27, 2009                                   |
| 23.1               | Consent of Independent Registered Public Accounting Firm Mantyla McReynolds LLC   | Filed herewith   |

23.2

Consent of Ryder Scott Company, LP

Filed herewith

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| <b>Exhibit No.</b> | <b>Description</b>   | <b>Reference</b>  |
|--------------------|--|---|
| 31.1               | Certification of the Chief Executive Officer pursuant to Rule 13a-14(a) or 15d-14(a) under the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 | Filed herewith  |
| 31.2               | Certification of the Chief Financial Officer pursuant to Rule 13a-14(a) or 15d-14(a) under the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 | Filed herewith  |
| 32.1               | Certification of the Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002                    | Filed herewith  |
| 99.1               | Report of Ryder Scott Company, LP.   | Incorporated by reference to Exhibit 99.1 to the Registrant's Annual Report on Form 10-K filed with the SEC on March 3, 2010. |



**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

**NORTHERN OIL AND GAS, INC.**

Date: March 18, 2011

By: /s/ Michael L. Reger  
Michael L. Reger  
Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacity and on the dates indicated:

| <b>Signature</b>                         | <b>Title</b>  | <b>Date</b>    |
|--|---|----------------|
| /s/ Michael L. Reger<br>Michael L. Reger | Chief Executive Officer and Director  | March 18, 2011 |
| /s/ Chad D. Winter<br>Chad D. Winter     | Chief Financial Officer, Principal Financial Officer and Principal Accounting Officer | March 18, 2011 |
| *<br>Ryan R. Gilbertson                  | Director  | March 18, 2011 |
| *<br>Loren J. O Toole                    | Director  | March 18, 2011 |
| *<br>Carter Stewart                      | Director  | March 18, 2011 |
| *<br>Jack King                           | Director  | March 18, 2011 |
| *<br>Robert Grabb                        | Director  | March 18, 2011 |
| *<br>Lisa Bromiley Meier                 | Director  | March 18, 2011 |

\* Michael L. Reger, by signing his name hereto, does hereby sign this document on behalf of the above-named directors of the Registrant pursuant to powers of attorney duly executed by such persons.

By: /s/ Michael L. Reger  
Michael L. Reger  
Attorney-in-Fact

NORTHERN OIL AND GAS, INC.

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Board of Directors and Stockholders  
Northern Oil and Gas, Inc.:

We have audited the accompanying balance sheets of Northern Oil and Gas, Inc. (the Company) as of December 31, 2009 and 2008, and the related statements of operations, stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2009. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2009 and 2008, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2009 in conformity with accounting principles generally accepted in the United States of America.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company's internal control over financial reporting as of December 31, 2009, based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated March 8, 2010 expressed an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

As discussed in Note 2 to the financial statements, the Company has elected to change its method of accounting for accrued drilling costs in 2009.

Mantyla McReynolds LLC  
Salt Lake City, Utah  
March 8, 2010

**NORTHERN OIL AND GAS, INC.**  
**BALANCE SHEETS**  
**DECEMBER 31, 2009 AND 2008**

|  | <b>Year Ended December 31,</b> |                           |
|--|--------------------------------|---------------------------|
|  | <b>2009</b>                    | <b>2008<br/>Adjusted*</b> |
| <b>ASSETS</b>  |                                |                           |
| <b>CURRENT ASSETS</b>  |                                |                           |
| Cash and Cash Equivalents  | \$ 6,233,372                   | \$ 780,716                |
| Trade Receivables  | 7,025,011                      | 2,028,941                 |
| Other Receivables  | -                              | 874,453                   |
| Prepaid Drilling Costs   | 1,454,034                      | 4,549                     |
| Prepaid Expenses   | 143,606                        | 71,554                    |
| Other Current Assets   | 201,314                        | -                         |
| Short - Term Investments   | 24,903,476                     | -                         |
| Deferred Tax Asset   | 2,057,000                      | 1,390,000                 |
| <b>Total Current Assets</b>  | <b>42,017,813</b>              | <b>5,150,213</b>          |
| <b>PROPERTY AND EQUIPMENT</b>  |                                |                           |
| Oil and Natural Gas Properties, Full Cost Method (including unevaluated cost of \$53,862,529 at 12/31/09 and \$35,990,267 at 12/31/2008) | 96,801,626                     | 47,260,838                |
| Other Property and Equipment   | 439,656                        | 408,400                   |
| <b>Total Property and Equipment</b>  | <b>97,241,282</b>              | <b>47,669,238</b>         |
| Less - Accumulated Depreciation and Depletion  | 5,091,198                      | 748,421                   |
| <b>Total Property and Equipment, Net</b>   | <b>92,150,084</b>              | <b>46,920,817</b>         |
| <b>LONG - TERM INVESTMENTS</b>   | <b>-</b>                       | <b>2,416,369</b>          |
| <b>DEBT ISSUANCE COSTS</b>   | <b>1,427,071</b>               | <b>-</b>                  |
| <b>DEFERRED TAX ASSET</b>  | <b>-</b>                       | <b>33,000</b>             |
| <b>Total Assets</b>  | <b>\$ 135,594,968</b>          | <b>\$ 54,520,399</b>      |
| <b>LIABILITIES AND STOCKHOLDERS EQUITY</b>   |                                |                           |
| <b>CURRENT LIABILITIES</b>   |                                |                           |
| Accounts Payable   | \$ 6,419,534                   | \$ 1,934,810              |
| Line of Credit   | 834,492                        | 1,650,720                 |
| Accrued Expenses   | 316,977                        | 1,270,075                 |
| Derivative Liability   | 1,320,679                      | -                         |
| Other Liabilities  | 18,574                         | 18,574                    |
| <b>Total Current Liabilities</b>   | <b>8,910,256</b>               | <b>4,874,179</b>          |
| <b>LONG-TERM LIABILITIES</b>   |                                |                           |
| Revolving Line of Credit   | -                              | -                         |
| Derivative Liability   | 1,459,374                      | -                         |
| Subordinated Notes   | 500,000                        | -                         |
| Other Noncurrent Liabilities   | 243,888                        | 117,157                   |
| <b>Total Long-Term Liabilities</b>   | <b>2,203,262</b>               | <b>117,157</b>            |
| <b>DEFERRED TAX LIABILITY</b>  | <b>922,000</b>                 | <b>-</b>                  |
| <b>Total Liabilities</b>   | <b>12,035,518</b>              | <b>4,991,336</b>          |
| <b>STOCKHOLDERS EQUITY</b>   |                                |                           |
| Common Stock, Par Value \$.001; 100,000,000 Authorized, 43,911,044 Outstanding (2008 34,120,103 Shares Outstanding)                      | 43,912                         | 34,121                    |
| Additional Paid-In Capital   | 124,884,266                    | 51,692,776                |

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|   |             |             |
|---|-------------|-------------|
| Retained Earnings (Accumulated Deficit)       | 841,892     | (1,957,060) |
| Accumulated Other Comprehensive Income (Loss) | (2,210,620) | (240,774)   |
| Total Stockholders Equity                     | 123,559,450 | 49,529,063  |

Total Liabilities and Stockholders Equity \$ 135,594,968 \$ 54,520,399

\* See Note 2

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

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**NORTHERN OIL AND GAS, INC.**  
**STATEMENTS OF OPERATIONS**  
**FOR THE YEARS ENDED DECEMBER 31, 2009, 2008, AND 2007**

|   | Year Ended December 31, |                    |                |
|---|-------------------------|--------------------|----------------|
|   | 2009                    | 2008<br>Adjusted * | 2007           |
| <b>REVENUES</b>                                       |                         |                    |                |
| Oil and Gas Sales                                     | \$ 15,171,824           | \$ 3,542,994       | \$ -           |
| Gain (Loss) on Settled Derivatives                    | (624,541)               | 778,885            | -              |
| Mark-to-Market of Derivative Instruments              | (363,414)               |                    | -              |
| Other Revenue   | 37,630                  | -                  | -              |
|   | 14,221,499              | 4,321,879          | -              |
| <b>OPERATING EXPENSES</b>                             |                         |                    |                |
| Production Expenses                                   | 754,976                 | 70,954             | -              |
| Production Taxes                                      | 1,300,373               | 203,182            | -              |
| General and Administrative Expense                    | 2,452,823               | 1,985,914          | 1,754,826      |
| Share Based Compensation                              | 1,233,507               | 105,375            | 2,754,917      |
| Depletion of Oil and Gas Properties                   | 4,250,983               | 677,915            | -              |
| Depreciation and Amortization                         | 91,794                  | 67,060             | 3,446          |
| Accretion of Discount on Asset Retirement Obligations | 8,082                   | 1,030              | -              |
| Total Expenses  | 10,092,538              | 3,111,430          | 4,513,189      |
| <b>INCOME (LOSS) FROM OPERATIONS</b>                  | 4,128,961               | 1,210,449          | (4,513,189)    |
| <b>OTHER INCOME</b>                                   | 135,991                 | 383,891            | 207,896        |
| <b>INCOME (LOSS) BEFORE INCOME TAXES</b>              | 4,264,952               | 1,594,340          | (4,305,293)    |
| <b>INCOME TAX PROVISION (BENEFIT)</b>                 | 1,466,000               | (830,000)          | -              |
| <b>NET INCOME (LOSS)</b>                              | \$ 2,798,952            | \$ 2,424,340       | \$ (4,305,293) |
| Net Income (Loss) Per Common Share - Basic            | \$ 0.08                 | \$ 0.08            | \$ (0.18)      |
| Net Income (Loss) Per Common Share - Diluted          | \$ 0.08                 | \$ 0.07            | \$ (0.18)      |
| Weighted Average Shares Outstanding - Basic           | 36,705,267              | 31,920,747         | 23,667,119     |
| Weighted Average Shares Outstanding - Diluted         | 36,877,070              | 32,653,552         | 23,667,119     |

\*See Note 2

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

**NORTHERN OIL AND GAS, INC.**  
**STATEMENT OF STOCKHOLDERS EQUITY (DEFICIT)**  
**FOR THE YEARS ENDED DECEMBER 31, 2009, 2008, AND 2007**

|   | Common Stock<br>Shares | Common Stock<br>Amount | Additional<br>Paid-In<br>Capital | Stock<br>Subscriptions<br>Receivable | Accumulated<br>Other<br>Comprehensive<br>Income<br>(Loss) | Retained<br>Earnings<br>(Accumulated<br>Deficit) | Total<br>Stockholders<br>Equity<br>(Deficit) |
|---|------------------------|------------------------|----------------------------------|--------------------------------------|---|--|--|
| <b>Balance December 31, 2006</b>  | 18,000,000             | \$ 1,800               | \$ 38,575                        | \$ (1,400)                           | \$ -  | \$ (76,107)                                      | \$ (37,132)                                  |
| Payment on Stock Subscriptions<br>Receivable  | -                      | -                      | -                                | 1,400                                | -   | -  | 1,400  |
| Sale of 2,501,573 Common Shares<br>for \$1.05 Per Share   | 2,501,573              | 250                    | 2,626,402                        | -                                    | -   | -  | 2,626,652                                    |
| Private Placement Costs   | -                      | -                      | (9,933)                          | -                                    | -   | -  | (9,933)                                      |
| Issued 400,000 Common Shares to<br>Montana Oil and Gas, Inc. for<br>Leasehold Interest  | 400,000                | 40                     | 419,960                          | -                                    | -   | -  | 420,000                                      |
| Issued 271,440 Shares to Southfork<br>Exploration, LLC for Leasehold<br>Interest  | 271,440                | 27                     | 284,985                          | -                                    | -   | -  | 285,012                                      |
| <b>Balance Immediately Prior to<br/>Reverse Acquisition with Kentex</b>   | 21,173,013             | 2,117                  | 3,359,989                        | -                                    | -   | (76,107)   | 3,285,999                                    |
| Reverse Acquisition with Kentex:<br>Recapitalization of NOG with<br>Kentex Common Stock Issued in the<br>Acquisition (Par Value Changed to<br>\$.001 Per Share) | -                      | 19,056                 | (19,056)                         | -                                    | -   | -  | -  |
| Acquisition of Kentex   | 1,491,110              | 1,491                  | (1,491)                          | -                                    | -   | -  | -  |
| Legal Fees  | -                      | -                      | (25,000)                         | -                                    | -   | -  | (25,000)                                     |
| Introduction Fee  | -                      | -                      | (12,500)                         | -                                    | -   | -  | (12,500)                                     |
| Payment to Kentex Stockholders  | -                      | -                      | (377,500)                        | -                                    | -   | -  | (377,500)                                    |
| Other Professional Fees   | -                      | -                      | (36,062)                         | -                                    | -   | -  | (36,062)                                     |
| <b>Totals of Reverse Acquisition</b>  | 1,491,110              | 20,547                 | (471,609)                        | -                                    | -   | -  | (451,062)                                    |
| <b>Balance Immediately After<br/>Reverse Acquisition with Kentex</b>  | 22,664,123             | 22,664                 | 2,888,380                        | -                                    | -   | (76,107)   | 2,834,937                                    |
| Issued 173,500 Shares for Consulting<br>Fees (Value between \$4.75 and<br>\$5.18 per Common Share)  | 173,500                | 174                    | 855,556                          | -                                    | -   | -  | 855,730                                      |
| Compensation Related Stock Option<br>Grants   | -                      | -                      | 2,366,417                        | -                                    | -   | -  | 2,366,417                                    |
| Sale of 4,545,455 Common Shares<br>for \$3.30 Per Share(unit placement)   | 4,545,455              | 4,545                  | 14,995,457                       | -                                    | -   | -  | 15,000,002                                   |
| Private Placement Costs net of<br>Warrants Granted to Agent   | -                      | -                      | (1,191,000)                      | -                                    | -   | -  | (1,191,000)                                  |
| Issued 390,000 Common Shares for<br>Leasehold Interest  | 390,000                | 390                    | 1,957,410                        | -                                    | -   | -  | 1,957,800                                    |
| Issued 75,000 Shares as<br>Compensation   | 75,000                 | 75                     | 388,425                          | -                                    | -   | -  | 388,500                                      |

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|   |            |           |               |      |             |                |               |
|---|------------|-----------|---------------|------|-------------|----------------|---------------|
| Repurchase of 152,156 Common Shares   | (152,156)  | (152)     | (1,049,724)   | -    | -           | -              | (1,049,876)   |
| Issued Pursuant to Exercise of Options  | 1,000,000  | 1,000     | 1,049,000     | -    | -           | -              | 1,050,000     |
| Net Income (Loss)   | -          | -         | -             | -    | -           | (4,305,293)    | (4,305,293)   |
| <b>Balance December 31, 2007</b>  | 28,695,922 | \$ 28,696 | \$ 22,259,921 | \$ - | \$ -        | (4,381,400)    | \$ 17,907,217 |
| Issued 7,500 Common Shares for services   | 7,500      | 8         | 49,867        | -    | -           | -              | 49,875        |
| Issued 318,495 Common Shares for Leasehold Interest (Value between \$2.30 and \$11.98 per Common Share) | 318,495    | 319       | 2,084,053     | -    | -           | -              | 2,084,372     |
| Issued 20,000 Common Shares of Restricted Stock for employee services                                   | 20,000     | 20        | (20)          | -    | -           | -              | -             |
| Listing Fee Paid to American Stock Exchange   | -          | -         | (65,000)      | -    | -           | -              | (65,000)      |
| Issued Pursuant to Exercise of Options  | 260,000    | 260       | 933,540       | -    | -           | -              | 933,800       |
| Issued Pursuant to Exercise of Warrants   | 4,818,186  | 4,818     | 25,977,244    | -    | -           | -              | 25,982,062    |
| Warrant Exercise Costs  | -          | -         | (77,204)      | -    | -           | -              | (77,204)      |
| Stock Grant Compensation  | -          | -         | 105,375       | -    | -           | -              | 105,375       |
| Unrealized Losses on Auction Rate Securities  | -          | -         | -             | -    | (240,774)   | -              | (240,774)     |
| Income Tax Benefit from Options Exercised   | -          | -         | 425,000       | -    | -           | -              | 425,000       |
| Net Income - As Adjusted  | -          | -         | -             | -    | -           | 2,424,340      | 2,424,340     |
| <b>Balance December 31, 2008</b>  | 34,120,103 | \$ 34,121 | \$ 51,692,776 | \$ - | (240,774)   | \$ (1,957,060) | \$ 49,529,063 |
| Warrants Issued Included for Debt Issuance Costs  | -          | -         | 221,153       | -    | -           | -              | 221,153       |
| Stock Grant Compensation  | -          | -         | 366,690       | -    | -           | -              | 366,690       |
| Net Change in Cash Flow Hedge Derivatives   | -          | -         | -             | -    | (1,483,639) | -              | (1,483,639)   |
| Unrealized Gain on Short-Term Investments   | -          | -         | -             | -    | (486,207)   | -              | (486,207)     |
| Issued 180,000 shares as Debt Insurance Costs   | 180,000    | 180       | 475,020       | -    | -           | -              | 475,200       |
| Issued 283,670 Shares as Compensation/Director Fees (Value between \$2.84 and \$9.70 per Common Share)  | 283,670    | 284       | 2,092,695     | -    | -           | -              | 2,092,979     |
| Sale of 2,250,000 Common Shares for \$6.00 Per Share  | 2,250,000  | 2,250     | 13,497,750    | -    | -           | -              | 13,500,000    |
| Sale of 6,500,000 Common Shares for \$9.12 Per Share  | 6,500,000  | 6,500     | 59,273,500    | -    | -           | -              | 59,280,000    |



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|   |            |           |                |   |                |            |                |
|---|------------|-----------|----------------|---|----------------|------------|----------------|
| Issued 128,097 Common Shares for Leasehold Interest (Value between \$4.25 and \$11.46 per Common Share) | 128,097    | 128       | 1,115,610      | - | -              | -          | 1,115,738      |
| Repurchase of 2,084 Common Shares   | (2,084)    | (2)       | (20,213)       | - | -              | -          | (20,215)       |
| Costs of Capital Raise  | -          | -         | (3,785,264)    | - | -              | -          | (3,785,264)    |
| Issued 361,330 Common Shares of Restricted Stock  | 361,330    | 361       | (361)          | - | -              | -          | -              |
| Repurchase of 52,061 Common Shares  | (52,061)   | (52)      | (517,948)      | - | -              | -          | (518,000)      |
| Issued Pursuant to Exercise of Options  | 100,000    | 100       | 517,900        | - | -              | -          | 518,000        |
| Share Adjustment Related to Kentex Transaction  | 41,989     | 42        | (42)           | - | -              | -          | -              |
| Income Tax Provision for Share Based Compensation   | -          | -         | (45,000)       | - | -              | -          | (45,000)       |
| Net Income  | -          | -         | -              | - | -              | 2,798,952  | 2,798,952      |
| <b>Balance - December 31, 2009</b>  | 43,911,044 | \$ 43,912 | \$ 124,884,266 | - | \$ (2,210,620) | \$ 841,892 | \$ 123,559,450 |

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

**NORTHERN OIL AND GAS, INC.**  
**STATEMENTS OF CASH FLOWS**  
**FOR THE YEARS ENDED DECEMBER 31, 2009, 2008, AND 2007**

|   | Year Ended December 31, |                    |                |
|---|-------------------------|--------------------|----------------|
|   | 2009                    | 2008<br>Adjusted * | 2007           |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES</b>   |                         |                    |                |
| Net Income (Loss)   | \$ 2,798,952            | \$ 2,424,340       | \$ (4,305,293) |
| Adjustments to Reconcile Net Income (Loss) to Net Cash Provided by (Used for) Operating Activities: |                         |                    |                |
| Depletion of Oil and Gas Properties   | 4,250,983               | 677,915            | -              |
| Depreciation and Amortization   | 91,794                  | 67,060             | 3,446          |
| Amortization of Debt Issuance Costs   | 459,343                 |                    |                |
| Accretion of Discount on Asset Retirement Obligations   | 8,082                   | 1,030              | -              |
| Income Tax Provision (Benefit)  | 1,466,000               | (830,000)          | -              |
| Issuance of Stock for Consulting Fees   | -                       | 49,875             | 855,730        |
| Loss on Sale of Available for Sale Securities   | -                       | 381                | -              |
| Market Value adjustment of Derivative Instruments   | 363,414                 | (95,148)           | -              |
| Lease Incentives Received   | -                       | 91,320             |                |
| Amortization of Deferred Rent   | (18,573)                | (17,026)           | -              |
| Share - Based Compensation Expense  | 1,213,292               | 105,375            | 2,754,917      |
| Changes in Working Capital and Other Items:   |                         |                    |                |
| Increase in Trade Receivables   | (4,996,070)             | (2,028,941)        | -              |
| Increase (Decrease) in Other Receivables  | 874,453                 | (874,453)          | -              |
| Increase in Prepaid Expenses  | (72,052)                | (45,874)           | (24,556)       |
| Increase in Other Current Assets  | (158,334)               | -                  | -              |
| Increase in Accounts Payable  | 4,484,724               | 1,821,556          | 113,254        |
| Increase (Decrease) in Accrued Expenses   | (953,098)               | 1,159,082          | 110,993        |
| Net Cash Provided By (Used For) Operating Activities  | 9,812,910               | 2,506,492          | (491,509)      |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES</b>   |                         |                    |                |
| Purchases of Office Equipment and Furniture   | (31,256)                | (363,631)          | (44,769)       |
| Decrease (Increase) in Prepaid Drilling Costs   | (1,449,485)             | 359,741            | (364,290)      |
| Proceeds from Sale of Oil and Gas Properties  | -                       | 468,609            | -              |
| Purchase of Available for Sale Securities   | (24,106,294)            | (3,800,524)        | -              |
| Proceeds from Sale of Available for Sale Securities   | 800,000                 | 975,000            | -              |
| Increase in Oil and Gas Properties  | (47,061,666)            | (37,997,157)       | (4,669,699)    |
| Net Cash Used For Investing Activities  | (71,848,701)            | (40,357,962)       | (5,078,758)    |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES</b>   |                         |                    |                |
| Increase in Margin Loan   | -                       | 1,650,720          | -              |
| Payments on Line of Credit  | (816,228)               | -                  | -              |
| Advances on Revolving Credit Facility   | 29,750,000              | -                  | -              |
| Repayments on Revolving Credit Facility   | (29,750,000)            | -                  | -              |
| Repayments of Convertible Notes Payable (Related Party)   | -                       | -                  | (165,000)      |
| Cash Paid for Listing Fee   | -                       | (65,000)           | -              |
| Proceeds from Derivatives   | -                       | 95,148             | -              |
| Increase in Subordinated Notes, net   | 500,000                 | -                  |                |
| Debt Issuance Costs Paid  | (1,190,061)             | -                  | -              |
| Proceeds from the Issuance of Common Stock - Net of Issuance Costs                                  | 68,994,736              | 25,904,858         | 14,997,992     |
| Proceeds from Exercise of Stock Options   | -                       | 933,800            | -              |
| Net Cash Provided by Financing Activities   | 67,488,447              | 28,519,526         | 14,832,992     |
| <b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>   | 5,452,656               | (9,331,944)        | 9,262,725      |
| <b>CASH AND CASH EQUIVALENTS BEGINNING OF PERIOD</b>  | 780,716                 | 10,112,660         | 849,935        |
| <b>CASH AND CASH EQUIVALENTS END OF PERIOD</b>  | \$ 6,233,372            | \$ 780,716         | \$ 10,112,660  |

**Supplemental Disclosure of Cash Flow Information**

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|  |            |      |      |
|--|------------|------|------|
| Cash Paid During the Period for Interest     | \$ 624,717 | \$ - | \$ - |
| Cash Paid During the Period for Income Taxes | \$ -       | \$ - | \$ - |

Non-Cash Financing and Investing Activities:

|   |              |              |              |
|---|--------------|--------------|--------------|
| Purchase of Oil and Gas Properties through Issuance of Common Stock | \$ 1,115,738 | \$ 2,084,372 | \$ 2,662,812 |
| Payment of Consulting Fees through Issuance of Common Stock         | \$ -         | \$ 49,875    | \$ 855,730   |
| Payment of Compensation through Issuance of Common Stock            | \$ 1,213,292 | \$ -         | \$ 388,500   |
| Capitalized Asset Retirement Obligations                            | \$ 137,222   | \$ 60,407    | \$ -         |
| Cashless Exercise of Stock Options                                  | \$ 518,000   | \$ -         | \$ 1,050,000 |
| Fair Value of Warrants Issued for Debt Issuance Costs               | \$ 221,153   | \$ -         | \$ -         |
| Payment of Debt Issuance Costs through Issuance of Common Stock     | \$ 475,200   | \$ -         | \$ -         |

\* See Note 2

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

**NORTHERN OIL AND GAS, INC.**  
**NOTES TO FINANCIAL STATEMENTS**  
**DECEMBER 31, 2009**

**NOTE 1 ORGANIZATION AND NATURE OF BUSINESS**

Northern Oil and Gas, Inc. (the Company, we, us, our and words of similar import) is a growth-oriented independent energy company engaged in the acquisition, exploration, exploitation and development of oil and natural gas properties. Prior to March 20, 2007, our name was Kentex Petroleum, Inc. The Company took its present form on March 20, 2007, when Kentex completed a so-called short-form merger with its wholly-owned subsidiary, Northern Oil and Gas, Inc. ( NOG ), a Nevada corporation engaged in the Company's current business, in which NOG merged into Kentex and Kentex was the surviving entity. The Company's common stock trades on the American Stock Exchange under the symbol NOG .

The Company will continue to focus on projects in the oil and gas industry primarily based in the Rocky Mountains and specifically the Williston Basin Bakken Shale formation. The Company has begun to develop its substantial leasehold in the Bakken play and will continue to do so as well as target additional opportunities in emerging plays utilizing its first mover leasing advantage. The Company participates on a heads up basis in the drilling of wells on our leasehold. The Company owns working interest in wells, and does not lease land to operators. To this point we have participated only in wells operated by others but have a substantial inventory of high working interest locations that we have begun to develop. We believe the advantage gained by participating as a non-operating partner in approximately 179 gross oil wells completed as of December 31, 2009 has given us valuable data on completions and will help our operating partners control well costs and enhance results as we continue to develop our higher working interest sections in 2010 and beyond.

The Company participates on a heads up basis proportionate to its working interest in a declared drilling unit. Although to this point we have participated with interests ranging from approximately 1% to 61%, we expect to participate in incrementally higher working interest drilling units. Our current North Dakota and Montana acreage position in the growing Williston Basin Bakken and Three Forks Play exposes us to approximately 162 net wells based on 640 acre spacing units and 255 net wells based on 320 acre spacing units. With 320-acre spacing units we have the ability to drill approximately 578 net wells, including 255 net wells targeting the Bakken formation, 255 net wells targeting the Three Forks formation and 68 net wells targeting the Red River formation.

Our land acquisition and field operations, along with various other services, are primarily outsourced through the use of consultants and drilling partners. The Company will continue to retain independent contractors to assist in operating and managing the prospects as well as to carry out the principal and necessary functions incidental to the oil and gas business. With the additional acquisition of oil and natural gas properties, the Company intends to continue to use both in-house employees and outside consultants to develop and exploit its leasehold interests.

As an independent oil and gas producer, the Company's revenue, profitability and future rate of growth are substantially dependent on prevailing prices of natural gas and oil. Historically, the energy markets have been very volatile and it is likely that oil and gas prices will continue to be subject to wide fluctuations in the future. A substantial or extended decline in natural gas and oil prices could have a material adverse effect on the Company's financial position, results of operations, cash flows and access to capital, and on the quantities of natural gas and oil reserves that can be economically produced.

**NOTE 2 SIGNIFICANT ACCOUNTING POLICIES**

These financial statements have been prepared in accordance with generally accepted accounting principles in the United States of America ( GAAP ).

Cash and Cash Equivalents

The Company considers highly liquid investments with insignificant interest rate risk and original maturities to the Company of three months or less to be cash equivalents. Cash equivalents consist primarily of interest-bearing bank accounts and money market funds. Our cash positions represent assets held in checking and money market accounts. These assets are generally available to us on a daily or weekly basis and are highly liquid in nature. Due to the balances being greater than \$250,000, we do not have FDIC coverage on the entire amount of bank deposits. The company believes this risk is minimal. In addition, we are subject to Security Investor Protection Corporation (SIPC) protection on a vast majority of our financial assets.

### Short-Term Investments

All marketable debt and equity securities and United States Treasuries that are included in short-term investments are considered available-for-sale and are carried at fair value. The short-term investments are considered current assets due their maturity term or the company's ability and intent to use them to fund current operations. The unrealized gains and losses related to these securities are included in accumulated other comprehensive income (loss). When securities are sold, their cost is determined based on the first-in first-out method. The realized gains and losses related to these securities are included in other income in the statements of operations.

### Other Property and Equipment

Property and equipment that are not oil and gas properties are recorded at cost and depreciated using the straight-line method over their estimated useful lives of three to five years. Expenditures for replacements, renewals, and betterments are capitalized. Maintenance and repairs are charged to operations as incurred. Long-lived assets, other than oil and gas properties, are evaluated for impairment to determine if current circumstances and market conditions indicate the carrying amount may not be recoverable. We have not recognized any impairment losses on non oil and gas long-lived assets. Depreciation expense was \$91,794, \$67,070, and \$3,446 for the years ended December 31, 2009, 2008, and 2007.

### Debt Issuance Costs

In February 2009, the Company entered into a revolving credit facility with CIT Capital USA, Inc. (CIT) (See Note 9). The Company incurred costs related to this facility that were capitalized on the Balance Sheet as Debt Issuance Costs. Included in the Debt Issuance Costs are direct costs paid to third parties for broker fees and legal fees, 180,000 shares of restricted common stock paid as additional compensation for broker fees, and the fair value of 300,000 warrants issued to CIT. The fair value of the warrants was calculated using the Black-Scholes valuation model based on factors present at the time of closing. CIT can exercise these warrants at any time until the warrants expire in February 2012. The exercise price of the warrants is \$5.00 per warrant. The total amount capitalized for Debt Issuance Costs is \$1,670,000. The capitalized costs are being amortized for three years over the term of the facility using the effective interest method. In May 2009, the Company amended the revolving credit facility with CIT to allow for additional borrowings. The Company incurred \$216,414 of direct costs related to this amendment. The capitalized costs will be amortized over the remaining term of the facility using the effective interest method. The amortization of debt issuance costs for the year ended December 31, 2009 was \$459,343.

### Asset Retirement Obligations

The Company records the fair value of a liability for an asset retirement obligation in the period in which the asset is acquired and a corresponding increase in the carrying amount of the related long-lived asset. The liability is accreted to its present value each period, and the capitalized cost is depreciated over the useful life of the related asset. If the liability is settled for an amount other than the recorded amount, a gain or loss is recognized.

### Revenue Recognition and Gas Balancing

We recognize oil and gas revenues from our interests in producing wells when production is delivered to, and title has transferred to, the purchaser and to the extent the selling price is reasonably determinable. We use the sales method of accounting for gas balancing of gas production and would recognize a liability if the existing proven reserves were not adequate to cover the current imbalance situation. As of December 31, 2009 and 2008, our gas production was in balance, i.e., our cumulative portion of gas production taken and sold from wells in which we have an interest equaled our entitled interest in gas production from those wells.

### Stock-Based Compensation

The Company has accounted for stock-based compensation under the provisions of FASB Accounting Standards Codification (ASC) 718-10-55 (*Prior authoritative literature: FASB Statement 123(R), Share-Based Payment*). This statement requires us to record an expense associated with the fair value of stock-based compensation. We use the Black-Scholes option valuation model to calculate stock based compensation at the date of grant. Option pricing models require the input of highly subjective assumptions, including the expected price volatility. Changes in these assumptions can materially affect the fair value estimate.

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### Income Taxes

The Company accounts for income taxes under FASB ASC 740-10-30 (*Prior authoritative literature*, FASB Statement 109, *Accounting for Income Taxes*). Deferred income tax assets and liabilities are determined based upon differences between the financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse. Accounting standards requires the consideration of a valuation allowance for deferred tax assets if it is more likely than not that some component or all of the benefits of deferred tax assets will not be realized.

### Stock Issuance

The Company records the stock-based compensation awards issued to non-employees and other external entities for goods and services at either the fair market value of the goods received or services rendered on the instruments issued in exchange for such services, whichever is more readily determinable, using the measurement date guidelines enumerated in FASB ASC 505-50-30 (*Prior authoritative literature*, EITF 96-18, *Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring or in Conjunction with Selling, Goods, or Services*).

### Net Income (Loss) Per Common Share

Net Income (Loss) per common share is based on the Net Income (Loss) divided by weighted average number of common shares outstanding.

Diluted earnings per share are computed using weighted average number of common shares plus dilutive common share equivalents outstanding during the period using the treasury stock method. As the Company has a loss for the period ended December 31, 2007 the potentially dilutive shares were anti-dilutive and were thus not added into the earnings per share calculation.

### Full Cost Method

The Company follows the full cost method of accounting for oil and gas operations whereby all costs related to the exploration and development of oil and gas properties are initially capitalized into a single cost center ( full cost pool ). Such costs include land acquisition costs, geological and geophysical expenses, carrying charges on non-producing properties, costs of drilling directly related to acquisition, and exploration activities. Internal costs that are capitalized are directly attributable to acquisition, exploration and development activities and do not include costs related to the production, general corporate overhead or similar activities. Costs associated with production and general corporate activities are expensed in the period incurred. Capitalized costs are summarized as follows for the years ended December 31, 2009, 2008, and 2007:

|  | Year Ended December 31, |              |      |
|--|-------------------------|--------------|------|
|  | 2009                    | 2008         | 2007 |
| Capitalized Certain Payroll and Other Internal Costs | \$ 2,616,262            | \$ 1,374,071 | \$   |
| Capitalized Interest Costs                           | 624,717                 |              |      |
| Total  | \$ 3,240,979            | \$ 1,374,071 | \$   |

As of December 31, 2009 we controlled acreage in Sheridan County, Montana with primary targets including the Red River and Mission Canyon. We controlled acreage in North Dakota, primarily in Mountrail County, targeting the Bakken Shale and Three Forks/Sanish as well as acreage in Yates County, New York that is prospective for Marcellus Shale and Trenton-Black River natural gas production. See Note 5 for explanation of activities on these properties.

Proceeds from property sales will generally be credited to the full cost pool, with no gain or loss recognized, unless such a sale would significantly alter the relationship between capitalized costs and the proved reserves attributable to these costs. A significant alteration would typically involve a sale of 25% or more of the proved reserves related to a single full cost pool. In the year ended December 31, 2008, the Company sold acreage for \$468,609. The proceeds for these sales were applied to reduce the capitalized costs of oil and gas properties. There were no property sales for the year ended December 31, 2009.

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Capitalized costs associated with impaired properties and capitalized cost related to properties having proved reserves, plus the estimated future development costs, asset retirement costs under FASB ASC 410-20-25 (*Prior authoritative literature*; FASB Statement 143, *Accounting for Asset Retirement Obligations*) are depleted and amortized on the unit-of-production method based on the estimated gross proved reserves as determined by independent petroleum engineers. The costs of unproved properties are withheld from the depletion base until such time as they are either developed or abandoned. When proved reserves are assigned or the property is considered to be impaired, the cost of the property or the amount of the impairment is added to costs subject to depletion calculations.

Capitalized costs of oil and gas properties (net of related deferred income taxes) may not exceed an amount equal to the present value, discounted at 10% per annum, of the estimated future net cash flows from proved oil and gas reserves plus the cost of unevaluated properties (adjusted for related income tax effects). Should capitalized costs exceed this ceiling, impairment is recognized. The present value of estimated future net cash flows is computed by applying 12-month average price of oil and natural gas to estimated future production of proved oil and gas reserves as of period-end, less estimated future expenditures to be incurred in developing and producing the proved reserves and assuming continuation of existing economic conditions. Such present value of proved reserves future net cash flows excludes future cash outflows associated with settling asset retirement obligations that have been accrued on the Balance Sheet. Should this comparison indicate an excess carrying value, the excess is charged to earnings as an impairment expense. To this point the Company has not realized any impairment of its properties due to our low basis in the acreage and productivity and economics of our producing wells.

### Use of Estimates

The preparation of financial statements under generally accepted accounting principles ( GAAP ) in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. The most significant estimates relate to proved oil and natural gas reserve volumes, future development costs, estimates relating to certain oil and natural gas revenues and expenses, fair value of derivative instruments, fair value of certain investments, and deferred income taxes. Actual results may differ from those estimates.

### Reclassifications

Certain reclassifications have been made to prior years reported amounts in order to conform with the current year presentation. These reclassifications did not impact our net income, stockholders equity or cash flows.

### Derivative Instruments and Price Risk Management

The Company uses derivative instruments from time to time to manage market risks resulting from fluctuations in the prices of oil and natural gas. The Company may periodically enter into derivative contracts, including price swaps, caps and floors, which require payments to (or receipts from) counterparties based on the differential between a fixed price and a variable price for a fixed quantity of oil or natural gas without the exchange of underlying volumes. The notional amounts of these financial instruments are based on expected production from existing wells. The Company has, and may continue to use exchange traded futures contracts and option contracts to hedge the delivery price of oil at a future date. At the inception of a derivative contract, the Company historically designated the derivative as a cash flow hedge. For all derivatives designated as cash flow hedges, the Company formally documented the relationship between the derivative contract and the hedged items, as well as the risk management objective for entering into the derivative contract. To be designated as a cash flow hedge transaction, the relationship between the derivative and the hedged items must be highly effective in achieving the offset of changes in cash flows attributable to the risk both at the inception of the derivative and on an ongoing basis. The Company historically measured hedge effectiveness on a quarterly basis and hedge accounting would be discontinued prospectively if it determined that the derivative is no longer effective in offsetting changes in the cash flows of the hedged item. Gains and losses deferred in accumulated other comprehensive income related to cash flow hedge derivatives that become ineffective remain unchanged until the related production is delivered. If the Company determines that it is probable that a hedged forecasted transaction will not occur, deferred gains or losses on the derivative are recognized in earnings immediately. See Note 15 for a description of the derivative contracts which the Company executed during 2009.

Derivatives, historically, are recorded on the balance sheet at fair value and changes in the fair value of derivatives are recorded each period in current earnings or other comprehensive income, depending on whether a derivative is designated as part of a hedge transaction and, if it is, depending on the type of hedge transaction. The Company s derivatives historically consist primarily of cash flow hedge transactions in which the Company is hedging the variability of cash flows related to a forecasted transaction. Period to period changes in the fair value of derivative instruments designated as cash flow hedges were reported in other comprehensive income and reclassified to earnings in the periods in which the contracts are settled. The ineffective portion of the cash flow hedges was reflected in current period earnings as gain or loss from derivative. Gains and losses on derivative instruments that did not qualify for hedge accounting were included in income or loss from derivatives in the period in which they occur. The resulting cash flows from derivatives are reported as cash flows from operating activities.

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On November 1, 2009, due to the volatility of price differentials in the Williston Basin, the Company de-designated all derivatives that were previously classified as cash flow hedges and in addition, the Company has elected not to designate any subsequent derivative contracts as accounting hedges under FASB ASC 815-20-25 (Prior authoritative literature: FASB Statement 133, *Accounting for Derivative Instruments and Hedging Activities*). As such, all derivative positions are carried at their fair value on the balance sheet and are marked-to-market at the end of each period. Any realized and unrealized gains or losses are recorded as gain (loss) on derivatives net, as an increase or decrease in revenues on the Statement of Operations rather than as a component of other comprehensive income (loss) or other Income (expense).

### Impairment

FASB ASC 360-10-35-21 (Prior authoritative literature, FASB Statement 144, *Accounting for the Impairment and Disposal of Long-Lived Assets*), requires that long-lived assets to be held and used be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Oil and gas properties accounted for using the full cost method of accounting (which we use) are excluded from this requirement but continue to be subject to the full cost method's impairment rules. There was no impairment identified at December 31, 2009, 2008, and 2007.

### Change in Accounting Principle Related to Drilling Costs

In 2009, the Company changed its method of accounting for drilling costs from the accrual of drilling costs at the time drilling commenced for a well to recording the costs when amounts are invoiced by operators. Recording drilling costs when the amounts are invoiced by operators is deemed preferable as it better represents the Company's actual drilling costs. The recording of drilling costs in this method also is consistent with other companies in the oil and gas industry. Generally accepted accounting principles require that the impact of the change in accounting be applied retrospectively to all periods presented. As a result, all prior period financial statements have been adjusted to give effect to the cumulative impact of this change.



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The following Table shows the effects on the Company's Balance Sheet:

|  | Year Ended December 31, 2008 |                |                  |
|--|------------------------------|----------------|------------------|
|  | As Reported                  | Adjusted       | Effect of Change |
| Deferred Tax Asset - Current             | \$ 1,433,000                 | \$ 1,390,000   | \$ (43,000)      |
| Oil and Gas Properties, Full Cost Method | 55,680,567                   | 47,260,838     | (8,419,729)      |
| Accumulated Depreciation and Depletion   | 856,010                      | 748,421        | (107,589)        |
| Accrued Drilling Costs                   | 8,419,729                    | -              | (8,419,729)      |
| Accumulated Deficit                      | \$ (2,021,649)               | \$ (1,957,060) | \$ 64,589        |

The following Table shows the effect on the Company's Statement of Operations:

|                                | Year Ended December 31, 2008 |              |                  |
|--------------------------------|------------------------------|--------------|------------------|
|                                | As Reported                  | Adjusted     | Effect of Change |
| Depletion Expense              | \$ 785,504                   | \$ 677,915   | \$ (107,589)     |
| Income Tax Provision (Benefit) | (873,000)                    | (830,000)    | 43,000           |
| Net Income                     | \$ 2,359,751                 | \$ 2,424,340 | \$ 64,589        |
| Earnings Per Share - Basic     | \$ 0.07                      | \$ 0.08      | \$ 0.01          |
| Earnings Per Share - Diluted   | \$ 0.07                      | \$ 0.07      | \$ -             |

The following Table shows the effect on the Company's Statement of Cash Flows:

|                                     | Year Ended December 31, 2008 |              |                  |
|-------------------------------------|------------------------------|--------------|------------------|
|                                     | As Reported                  | Adjusted     | Effect of Change |
| Net Income                          | \$ 2,359,751                 | \$ 2,424,340 | \$ 64,589        |
| Depletion of Oil and Gas Properties | 785,504                      | 677,915      | (107,589)        |
| Income Tax Benefit                  | (873,000)                    | (830,000)    | 43,000           |
| Increase in Accrued Drilling Costs  | 8,419,729                    | -            | (8,419,729)      |
| Increase in Oil and Gas Properties  | (46,416,886)                 | (37,997,157) | 8,419,729        |

There was no effect on the Company's Statement of Operations or Statement of Cash Flows for the year ended December 31, 2007. The Company did not commence production on its wells until 2008 and reported no Accrued Drilling Costs as of December 31, 2007.

New Accounting Pronouncements

In March 2008, the FSAB issued FASB ASC 815-10-15 (*Prior authoritative literature*, FASB Statement 161, *Disclosures About Derivative Instruments and Hedging Activities*). FASB ASC 815-10-15 is intended to improve financial reporting about derivative instruments and hedging activities by requiring enhanced disclosures to enable investors to better understand their effects on an entity's financial position, financial performance, and cash flows. FASB ASC 815-10-15 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged. Pursuant to the transition provisions of the Statement, the Company adopted FASB ASC 815-10-15 on January 1, 2009. The required disclosures are presented in Note 15 on a prospective basis. This Statement does not impact the financial results as it is disclosure-only in nature.

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In April 2009, the FASB issued FASB ASC 270-10-05 (*Prior authoritative literature: APB 28-1, Interim Disclosures About Fair Value of Financial Instruments*). FASB ASC 270-10-05 amends FASB ASC 825-10-50 (*Prior authoritative literature: FASB Statement 107, Disclosures About Fair Value of Financial Instruments*) to require an entity to provide disclosures about fair value of financial instruments in interim financial information. FASB ASC 270-10-05 is to be applied prospectively and is effective for interim and annual periods ending after June 15, 2009 with early adoption permitted for periods ending after March 15, 2009. The required disclosures are presented in Note 13 on a prospective basis.

In February 2008, the FASB issued FASB ASC 820-10-65-1 (*Prior authoritative literature: FSP FAS 157-2/Statement 157, Effective Date of FASB Statement No. 157.*) FASB ASC 820-10-65-1 delayed the effective date for all nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). The adoption of the provisions of FASB ASC 820-10-65-1 related to nonfinancial assets and nonfinancial liabilities on January 1, 2009 did not have a material impact on the Financial Statements. See Note 13 for FASB ASC 820-10-65-1 disclosures.

In April 2009, the FASB issued FASB ASC 820-10-65-4 (*Prior authoritative literature: FASB Statement 157-4, Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly*). FASB ASC 820-10-65-4 provides additional guidance in estimating fair value, when the volume and level of transaction activity for an asset or liability have significantly decreased in relation to normal market activity for the asset or liability. FASB ASC 820-10-65-4 also provides additional guidance on circumstances that may indicate a transaction is not orderly. FASB ASC 820-10-65-4 is effective for interim periods ending after June 15, 2009, and the Company has adopted its provisions during second quarter 2009. FASB ASC 820-10-65-4 did not have a significant impact on the Company's financial position, results of operations, cash flows, or disclosures.

In April 2009, the FASB issued FASB ASC 320-10-65 (*Prior authoritative literature: FSP FAS 115-2/124-2, Recognition and Presentation of Other-Than-Temporary Impairments*). The guidance applies to investments in debt securities for which other-than-temporary impairments may be recorded. If an entity's management asserts that it does not have the intent to sell a debt security and it is more likely than not that it will not have to sell the security before recovery of its cost basis, then an entity may separate other-than-temporary impairments into two components: 1) the amount related to credit losses (recorded in earnings), and 2) all other amounts (recorded in other comprehensive income). This ASC is to be applied prospectively and is effective for interim and annual periods ending after June 15, 2009 with early adoption permitted for periods ending after March 15, 2009. The adoption of the provisions of this ASC in the second quarter 2009 did not have a material impact on the Financial Statements.

In June 2009, the FASB issued FASB ASC 860-10-05 (*Prior authoritative literature: FASB Statement 166, Accounting for Transfers of Financial Assets*). FASB ASC 860-10-05 is effective for fiscal years beginning after November 15, 2009. The Company is currently assessing the impact of FASB ASC 860-10-05 on its financial position and results of operations.

In June 2009, the FASB issued FASB ASC 810-10-25 (*Prior authoritative literature: FASB Statement 167-Amendment to FIN 46(R), Consolidation of Variable Entities*). FASB ASC 810-10-25 eliminates the quantitative approach previously required for determining the primary beneficiary of a variable interest entity and requires a qualitative analysis to determine whether an enterprise's variable interest gives it a controlling financial interest in a variable interest entity. FASB ASC 810-10-25 contains certain guidance for determining whether an entity is a variable interest entity. This statement also requires ongoing reassessments of whether an enterprise is the primary beneficiary of a variable interest entity. FASB ASC 810-10-25 will be effective as of the beginning of the Company's 2010 fiscal year. The Company is currently evaluating the impact of the adoption of FASB ASC 810-10-25.

In June 2009, the FASB issued FASB ASC 105-10-65 (*Prior authoritative literature: FASB Statement 168, The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles*). Under FASB ASC 105-10-65, the FASB Accounting Standards Codification (the Codification) becomes the exclusive source of authoritative U.S. generally accepted accounting principles (U.S. GAAP) recognized by the FASB to be applied by nongovernmental entities. Rules and interpretive releases of the Securities and Exchange Commission (SEC) under authority of federal securities laws are also sources of authoritative GAAP for SEC registrants. The Codification will supersede all then-existing non-SEC accounting and reporting standards, with the exception of certain non-SEC accounting literature which will become nonauthoritative. FASB ASC 105-10-65 is effective for the Company's 2009 third fiscal quarter. The adoption of FASB ASC 105-10-65 did not have a material impact on the Company's Financial Statements. All references to U.S. GAAP provided in the notes to the Financial Statements have been updated to conform to the Codification.

In October 2009, the FASB issued ASU No. 200-13, Revenue Recognition—Multiple Deliverable Revenue Arrangements (ASU 2009-13). ASU 2009-13 updates the existing multiple-element revenue arrangements guidance currently included in FASB ASC 605-25. The revised guidance provides for two significant changes to the existing multiple-element revenue arrangements guidance. The first change relates to the determination of when the individual deliverables included in a multiple-element arrangement may be treated as separate units of accounting. This change will result in the requirement to separate more deliverables within an arrangement, ultimately leading to less revenue deferral. The second change modifies the manner in which the transaction consideration is allocated across the separately identified deliverables. Together, these changes will result in earlier recognition of revenue and related costs for multiple-element arrangements than under previous guidance. This guidance expands the disclosures required for multiple-element revenue arrangements. Effective for interim and annual reporting periods beginning after December 15, 2009. The Company is currently evaluating the potential impact, if any, of this guidance on its financial

statements.

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**NOTE 3 SHORT-TERM INVESTMENTS**

All marketable debt and equity securities and United States Treasuries that are included in short-term investments are considered available-for-sale and are carried at fair value. The short-term investments are considered current assets due their maturity term or the company's ability and intent to use them to fund current operations. The unrealized gains and losses related to these securities are included in accumulated other comprehensive income (loss). When securities are sold, their cost is determined based on the first-in first-out method. The realized gains and losses related to these securities are included in other income in the statements of operations.

The following is a summary of our short-term investments as of December 31, 2009:

|                              | <b>Cost at<br/>December 31,<br/>2009</b> | <b>Unrealized<br/>(Loss)</b> | <b>Fair<br/>Market<br/>Value at<br/>December 31,<br/>2009</b> |
|------------------------------|--|------------------------------|---|
| Auction Rate Municipal Bonds | \$ 1,750,000                             | \$ (198,105)                 | \$ 1,551,895  |
| Auction Rate Preferred Stock | 275,143                                  | (8,682)                      | 266,461   |
| United States Treasuries     | 24,063,314                               | (978,194)                    | 23,085,120  |
| Total Short-Term Investments | \$ 26,088,457                            | \$ (1,184,981)               | \$ 24,903,476   |

For the year ended December 31, 2009 there were no realized gains or losses recognized on the sale of investments. In November 2008 we received, in a settlement agreement from UBS AG (UBS), rights which allow us to put back the auction rate securities at par value to UBS starting in June 2010. We expect to liquidate these investments at par no later than June 2010, in the meantime they continue to pay interest at various rates. Under the settlement agreement with UBS, we also have the ability to borrow up to 75% of the loan-to-market value of eligible auction rate securities on a no-net cost basis. As of December 31, 2009, we have borrowed \$834,492 under this agreement, with an additional \$684,258 of borrowings available under the agreement.

The Company reviews these investments on a quarterly basis to determine if it is probable that the Company will realize some portion of the unrealized loss in accordance with FASB ASC 320-10-35 (*Prior authoritative literature*, FASB Statement 115, 115-1, and 124-1, *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments*). In determining if the difference between cost and estimated fair value of the short-term investments was deemed either temporary or other-than-temporary impairment, the Company evaluated each type of short-term investment using a set of criteria including decline in value, duration of the decline, period until anticipated recovery, nature of investment, probability of recovery, financial condition and near-term prospects of the issuer, the Company's intent and ability to retain the investment, attributes of the decline in value, status with rating agencies, status of principal and interest payments and any other issues related to the underlying securities. The Company determined the decline in the fair values in all of the short-term investments were temporary as of December 31, 2009 and 2008, primarily based on estimated cash flows of the investments, the settlement agreement entered into with UBS, and the Company's ability and intent to hold the investments until settlement.

**NOTE 4 PROPERTY AND EQUIPMENT**

Property and equipment at December 31, 2009 and 2008, consisted of the following:

|  | <b>Year Ended December 31,</b> |                          |
|--|--------------------------------|--------------------------|
|  | <b>2009</b>                    | <b>2008<br/>Adjusted</b> |
| Oil and Gas Properties, Full Cost Method                         |                                |                          |
| Unevaluated Costs, Not Subject to Amortization or Ceiling Test   | \$ 53,862,529                  | \$ 35,990,267            |
| Evaluated Costs  | 42,939,097                     | 11,270,571               |
|  | 96,801,626                     | 47,260,838               |
| Office Equipment, Furniture, Leasehold Improvements and Software | 439,656                        | 408,400                  |
|  | 97,241,282                     | 47,669,238               |
| Less: Accumulated Depreciation, Depletion and Amortization       |                                |                          |
| Property and Equipment   | 5,091,198                      | 748,421                  |
| Total  | \$ 92,150,084                  | \$ 46,920,817            |

The following table shows depreciation, depletion, and amortization expense by type of asset:

|   | <b>Year Ended December 31,</b> |                          |
|---|--------------------------------|--------------------------|
|   | <b>2009</b>                    | <b>2008<br/>Adjusted</b> |
| Depletion of Costs for Evaluated Oil and Gas Properties   | \$ 4,250,983                   | \$ 677,915               |
| Depreciation of Office Equipment, Furniture, and Software | 91,794                         | 67,060                   |
| Total Depreciation, Depletion, and Amortization Expense   | \$ 4,342,777                   | \$ 744,975               |

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**NOTE 5 OIL AND GAS PROPERTIES**

Acquisitions

*Montana Acquisitions*

In February 2007, the Company acquired leasehold interests in approximately 22,000 net mineral acres in Sheridan County, Montana. The Company paid a combination of cash and stock as consideration for such acquisition, including the issuance of an aggregate of 400,000 restricted shares of its common stock.

At various points in 2009, we acquired leasehold interests in approximately 6,100 net mineral acres in development areas located in Roosevelt, Richland and Sheridan Counties, Montana, in which we are targeting the Bakken Shale.

On November 13, 2009, we entered into a Letter of Intent with Slawson pursuant to which we agreed to acquire a twenty percent (20%) working interest ownership in the exploration and development of Slawson's Big Sky Project in Richland County, Montana for which Slawson controls leasehold interest in 13,401 gross acres and 11,586 net acres. For each well we elect to participate, we will pay a participation interest share of all costs to drill, equip, complete, test and plug such well(s) on an at cost basis.

*North Dakota Acquisitions*

At various points in late 2007 and throughout 2008, the Company acquired leasehold interests in approximately 21,498 net mineral acres of land via bulk purchases in the core development area of Mountrail County, North Dakota. The Company paid a combination of cash and stock as consideration for such acquisitions, including the issuance of an aggregate of 633,027 restricted shares of its common stock. In addition to these major acquisitions the Company completed a series of small transactions pursuant to which it purchased leasehold interests in approximately 8,000 net mineral acres in Mountrail County.

On June 11, 2008, the Company entered into a purchase agreement pursuant to which it ultimately acquired leasehold interests in approximately 23,210 net mineral acres primarily in Dunn County, North Dakota. The Company also completed various additional acquisitions of oil and gas leasehold interests through numerous small transactions with several parties in fiscal years 2007 and 2008.

At various points in 2007 and 2008, the Company purchased leasehold interests in approximately 10,000 net mineral acres in and around Burke and Divide Counties of North Dakota for cash consideration.

In May 2009, the Company entered into an exploration and development agreement with Slawson Exploration Company, Inc. (Slawson) pursuant to which the Company acquired certain North Dakota Bakken assets from Windsor Bakken LLC as part of a syndicate led by privately owned Slawson. Pursuant to the agreement, the Company purchased a five percent (5.0%) interest of the undeveloped acreage, including approximately 60,000 net acres. The Company also acquired an additional nine percent (9%) interest in the existing well bores purchased from Windsor Bakken LLC, providing the Company an aggregate fourteen percent (14%) interest in the existing 59 gross Bakken and Three Forks well bores in North Dakota including approximately 1,200 barrels of oil production per day. In the transaction, the Company purchased approximately 300,000 barrels of proven producing reserves as well as approximately 3,000 net undeveloped acres. The Company paid a total cost of \$7,300,000 for the initial acquisition of acreage and well bore interests.

On November 3, 2009, along with Slawson Exploration we acquired 24 high working interest sections comprising approximately 12,000 net acres located in western McKenzie and Williams Counties of North Dakota. We acquired a 50% interest in these properties and will participate in drilling on a heads-up basis. These properties are proximal to several recent high-rate producing wells. We paid approximately \$1,100 per net acre acquired in this acquisition and expect to begin drilling these properties in early 2011.

On November 17, 2009, we entered into an Exploration and Development Agreement with Area of Mutual Interest with Slawson pursuant to which we agreed to participate with a fifty percent (50%) working interest ownership, which equates to a thirty percent (30%) participation interest in the exploration and development of Slawson's Anvil Project in Roosevelt and Sheridan Counties, Montana and Williams County, North Dakota. In the transaction, we acquired an interest in 12,500 net acres in leases at \$750 per net acre for a thirty percent (30%) interest and an aggregate sum of \$2,812,500. We agreed to participate in all costs to drill, equip, complete, test and plug the well and to pay costs for the well on an at cost basis. We have the option to elect to participate or not participate as to each well drilled in the applicable project area. For each well in which we elect to participate, we will pay a participation interest share of all costs to drill, equip, complete, test and plug such wells on an at cost basis.



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In addition to acquiring acreage through large block acquisitions, we have organically acquired approximately 4,000 net mineral acres in all of our key prospect areas in the form of both effective leases and top-leases. In this organic acquisition program we have spent an average of approximately \$730 per net acre acquired.

The Company has also completed other miscellaneous non-material acquisitions in North Dakota, and utilized a combination of stock and cash consideration for some of the acquisitions.

### *New York Acquisition*

In September 2007, the Company acquired leasehold interests in approximately 10,000 net mineral acres in the Appalachia Basin of New York. The Company paid a combination of cash and stock as consideration for such acquisition, including the issuance of an aggregate of 275,000 restricted shares of its common stock.

Certain of the foregoing acquisitions were purchased using the services of, or purchased from, parties considered to be related to the Company or the Company's Chief Executive Officer, Michael L. Reger. See Note 7. All transactions involving related parties were approved by the Company's Board of Directors or Audit Committee.

### **NOTE 6 PREFERRED AND COMMON STOCK**

The Company has neither authorized nor issued any shares of preferred stock.

On May 3, 2007, the Company issued 100,000 shares of common stock to Insight Capital Consultants Corporation pursuant to a consulting agreement with them. The stock issued was valued at \$475,000 and expensed to general and administrative expense. The shares were valued based on the market price of the Company's stock on the date of issuance.

In September 2007, the Company completed a private placement of 4,545,455 shares of common stock to accredited investors at a subscription price of \$3.30 per share for total gross proceeds of \$15,000,002. In addition to common stock, investors purchasing shares in the private placement received a warrant to purchase common stock. For each share of common stock purchased in this transaction, the purchaser received the right to purchase one-half share of the Company's common stock at a price of \$5.00 per share for a period of 18 months from the date of closing and the right to purchase one-half share of the Company's common stock at a price of \$6.00 for a period of 48 months from the date of closing. The placement agents received consideration in cash and warrants of \$1,191,000 which were netted against the proceeds of the offering through Additional Paid-In Capital. The total number of shares that are issuable upon exercise of warrants, including the placement agent's warrant is 4,818,183. All warrants issued as part of this private placement were exercised in 2008.

In November 2007, the Company issued 73,500 shares of common stock to various consultants pursuant to consulting agreements. The company also issued 75,000 shares of common stock to an employee pursuant to a written employment agreement. These 148,500 shares were valued at \$769,230, the market value of the shares of common stock on the date of issuance, and expensed as general and administrative expenses. The shares were valued at the calculated fair value of the Company's stock on the date of the issuance.

In December 2007, the Chief Executive Officer and Chief Financial Officer each exercised 500,000 stock options granted to them in 2006.

In 2008 optionees exercised 260,000 stock options granted in 2006 and 2007, resulting in cash proceeds to the Company of \$933,800. A tax benefit of \$425,000 related to fully vested stock option awards exercised was recorded as an increase to additional paid-in capital.

In February 2009, the Company agreed to issue 92,000 shares of Common Stock to three employees of the company as compensation for their services. The employees were fully vested in the shares on the date of the grant. The fair value of the stock to be issued was \$261,280 or \$2.84 per share, the market value of a share of common stock on the date the stock was obligated to be issued. The entire amount of this stock award was expensed in the year ended December 31, 2009.



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On February 27, 2009, the Company closed on a revolving credit facility with CIT Capital USA, Inc. (CIT). As part of obtaining this credit facility agreement the Company entered into an engagement with Cynergy Advisors, LLC (Cynergy). As part of the compensation for the work performed on obtaining the financing, Cynergy received 180,000 shares of restricted Common Stock of the Company. The fair value of the restricted stock was \$475,200 or \$2.64 per share, the market value of a share of Common Stock on the date the financing closed. The fair value of this stock was capitalized as Debt Issuance Costs and is being amortized for three years over the term of the financing.

On April 3, 2009 the Company acquired leasehold interests in North Dakota. The total consideration paid for this acreage was 49,092 shares of restricted common stock. The fair value of the restricted stock was \$224,879, or \$4.58 per share, the market value of a share of Common Stock on the date the leasehold interests were acquired.

In June 2009, the Company completed a registered direct offering of 2,250,000 shares of common stock at a price of \$6.00 per share for total gross proceeds of \$13,500,000. The Company incurred costs of \$813,237 related to this offering. These costs were netted against the proceeds of the offering through Additional Paid-In Capital.

On October 26, 2009, we deposited 41,989 shares of common stock in a specially-designated shareholder account that had been previously-created to hold shares of our common stock represented by certificates that appear in our stock transfer records but were known to have been cancelled and their underlying shares transferred between July of 1987 and August of 1999. An aggregate of 58,268 shares of our common stock are held in the specially-designated shareholder account, which, following a substantial review of all available historical stock transfer records, we concluded represents the maximum number of shares of our common stock that could potentially be released to shareholders who may be able to establish a valid claim to such shares due to previously unrecognized issues with our stock transfer records. These shares are considered issued and outstanding and are included in the total number of shares outstanding disclosed on the cover page of this report.

On November 4, 2009 the Company completed a registered direct offering of 6,500,000 shares of common stock at a price of \$9.12 per share for total gross proceeds of \$59,280,000. The Company incurred costs of \$2,972,027 related to the offering. These costs were netted against the proceeds of the offering through Additional Paid-in Capital.

In November and December 2009, the issued 79,005 shares of common stock related to the purchase of leasehold interests in North Dakota. The fair value of the stock was \$890,859, the market value of the Common Stock on the date the leasehold interests were acquired.

In November 2009, the Company issued 50,000 shares of Common Stock to two employees of the company as compensation for their services. The employees were fully vested in the shares on the date of the grant. The fair value of the stock issued was \$457,500 or \$9.15 per share, the market value of a share of common stock on the date the stock was issued. The entire amount of this stock award was expensed in the year ended December 31, 2009.

In December 2009, the Company issued 100,000 shares of Common Stock to two executives of the company as compensation for their services. The executives were fully vested in the shares on the date of the grant. The fair value of the stock issued was \$970,000 or \$9.70 per share, the market value of a share of common stock on the date the stock was issued. The entire amount of this stock award was expensed in the year ended December 31, 2009.

In December 2009, the Company issued 41,670 shares of Common Stock to the Company's outside Directors as compensation for their services. The Directors were fully vested in the shares on the date of the grant. The fair value of the stock issued was \$404,199 or \$9.70 per share, the market value of a share of common stock on the date the stock was issued. The entire amount of this stock award was expensed in the year ended December 31, 2009.

In December 2009, a Director of the Company exercised 100,000 stock options granted to him in 2007. The exercise of these options was completed through a cashless exercise whereas the company repurchased 52,061 of common shares to issue the common shares related to this option exercise.

### Restricted Stock Awards

During the years ended December 31, 2009 and 2008, The Company issued 361,330 and 20,000, respectively, restricted shares of common stock as compensation to officers, employees, and directors of the Company. The restricted shares vest over various terms with all restricted shares vesting no later than December 31, 2011. As of December 31, 2009, there was approximately \$2.9 million of total unrecognized compensation expense related to unvested restricted stock. This compensation expense will be recognized over the remaining vesting period of the grants. The Company has assumed a zero percent forfeiture rate for restricted stock.

*Unevaluated Properties*

The Company's unproved properties not being amortized are comprised of approximately 105,542 net acres of undeveloped leasehold interests that could result in over 165 net potential drilling locations based on one well per 640 acre spacing unit. The Company believes that the majority of our unproved costs will become subject to depletion within the next five years by proving up reserves relating to the acreage through exploration and development activities, by impairing the acreage that will expire before we can explore or develop it further or by determining that further exploration and development activity will not occur.

Excluded costs for unevaluated properties are accumulated by year. Costs are reflected in the full cost pool as the drilling costs are incurred or as costs are evaluated and deemed impaired. The Company anticipates these excluded costs will be included in the depletion computation over the next five years. The Company is unable to predict the future impact on depletion rates. The following is a summary of capitalized costs excluded from depletion at December 31, 2009 by year incurred.

|                              | Year Ended December 31, |               |              |
|------------------------------|-------------------------|---------------|--------------|
|                              | 2009                    | 2008          | 2007         |
| Property Acquisition Costs   | \$ 17,478,196           | \$ 29,080,499 | \$ 5,147,236 |
| Developmental Drilling Costs | 394,066                 | 1,762,532     | -            |
| Total                        | \$ 17,872,262           | \$ 30,843,031 | \$ 5,147,236 |

The Company had 1.55 net wells drilling and completing as of December 31, 2009. All properties that have not yet commenced production are considered unevaluated properties and, thus, the costs associated with such properties are not subject to depletion. Once production commences for a well, all associated acreage and drilling costs are subject to depletion.

The following table reflects the outstanding restricted stock awards and activity related thereto for the years ended December 31:

|  | Year Ended<br>December 31, 2009 |                               | Year Ended<br>December 31, 2008 |                               |
|--|---------------------------------|-------------------------------|---------------------------------|-------------------------------|
|  | Number of<br>Shares             | Weighted-<br>Average<br>Price | Number of<br>Shares             | Weighted-<br>Average<br>Price |
| Restricted Stock Awards:                                   |                                 |                               |                                 |                               |
| Restricted Shares Outstanding at the Beginning of the Year | 20,000                          | \$ 7.03                       | -                               | \$ -                          |
| Shares Granted   | 361,330                         | \$ 8.49                       | 20,000                          | \$ 7.03                       |
| Lapse of Restrictions                                      | (56,000)                        | \$ 4.91                       | -                               | \$ -                          |
| Restricted Shares Outstanding at the End of the Year       | 325,330                         | \$ 9.01                       | 20,000                          | \$ 7.03                       |

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**NOTE 7 RELATED PARTY TRANSACTIONS**

The Company has purchased leasehold interests from South Fork Exploration, LLC (SFE). In 2009, the company paid a total of \$501,603 related to a previously executed leasehold agreement. SFE's president is J.R. Reger, the brother of the Company's CEO, Michael Reger. J.R. Reger is also a shareholder in the Company.

The Company has also purchased leasehold interests from Montana Oil Properties (MOP) for total consideration of approximately \$62,234 in 2009. MOP is controlled by Mr. Tom Ryan and Mr. Steven Reger, both are relatives of the Company's CEO, Michael Reger.

The Company has also purchased leasehold interests from Gallatin Resources, LLC for total consideration of approximately \$22,223 in 2009, Carter Stewart, one of the Company's directors, owns a 25% interest in Gallatin Resources, LLC.

All transactions involving related parties were approved by the Company's Board of Directors or Audit Committee.

**NOTE 8 STOCK OPTIONS/STOCK-BASED COMPENSATION AND WARRANTS**

The Company's Board of Directors approved a stock option plan in October 2006 (2006 Stock Option Plan) to provide incentives to employees, directors, officers, and consultants and under which 2,000,000 shares of common stock have been reserved for issuance. The options can be either incentive stock options or non-statutory stock options and are valued at the fair market value of the stock on the date of grant. The exercise price of incentive stock options may not be less than 100% of the fair market value of the stock subject to the option on the date of the grant and, in some cases, may not be less than 110% of such fair market value. The exercise price of non-statutory options may not be less than 100% of the fair market value of the stock on the date of grant.

On November 1, 2007 the Board of Directors granted 560,000 of options under this 2006 Stock Option Plan. The Company granted 500,000 options in aggregate, to members of the board and 60,000 options to one employee pursuant to an employment agreement. These options were granted at a price of \$5.18 per share and the optionees were fully vested on the grant date. 260,000 options granted in 2007 have been exercised as of December 31, 2009.

The Company accounts for stock-based compensation under the provisions of FASB ASC 718-10-55 (*Prior authoritative literature: FASB Statement 123(R), Share-Based Payment*). This statement requires us to record an expense associated with the fair value of stock-based compensation. We use the Black-Scholes option valuation model to calculate stock-based compensation at the date of grant. Option pricing models require the input of highly subjective assumptions, including the expected price volatility. Changes in these assumptions can materially affect the fair value estimate. The total fair value of the options are recognized as compensation over the vesting period. There have been no stock options granted in 2009 and 2008 under the 2006 Stock Option Plan, and all exercises of options during 2009 and 2008 related to 2007 grants.

*Options Granted November 1, 2007*

On November 1, 2007, the Board of Directors granted 560,000 options to board members and one employee. The total fair value of the options was recognized as compensation in 2007 as the optionees were immediately vested. In computing the expected volatility, we used the combined historical volatility of the Company's common stock for a one-month period and the blended historical volatility for two of our peer companies over a period of four years and eleven months. In computing the exercise price we used the average closing/last trade price of the Company's common stock for the five highest volume trading days during the 30-day trading period ending on the last trading day preceding the date of the grants.

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The following assumptions were used for the Black-Scholes model:

|   |                         |
|---|-------------------------|
|   | <b>November 1, 2007</b> |
| Risk free rates                             | 4.36%                   |
| Dividend yield                              | 0%                      |
| Expected volatility                         | 56%                     |
| Weighted average expected stock option life | 5 Years                 |

The fair market value at the date of grant for stock options granted using the formula relied upon for calculating the exercise price is as follows:

|  |              |
|--|--------------|
| Weighted average fair value per share                | \$ 2.72      |
| Total options granted                                | 560,000      |
| Total weighted average fair value of options granted | \$ 1,524,992 |

The following table presents the impact on our statement of operations of stock-based compensation expense related to options granted for the years ended December 31, 2009, 2008, and 2007:

|  | <b>Year Ended December 31,</b> |             |              |
|--|--------------------------------|-------------|--------------|
|  | <b>2009</b>                    | <b>2008</b> | <b>2007</b>  |
| Expenses   | \$ -                           | \$ -        | \$ 2,366,417 |
| Option Stock-Based Compensation Expense Before Taxes | -                              | -           | 2,366,417    |
| Income Tax Benefit                                   | -                              | -           | -            |
| Option Stock-Based Compensation Expense After Taxes  | \$ -                           | \$ -        | \$ 2,366,417 |

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Changes in stock options for the years ended December 31, 2009, 2008, and 2007 were as follows:

|  | Number<br>of<br>Shares | Weighted<br>Average<br>Exercise<br>Price | Remaining<br>Contractual<br>Term<br>(in Years) | Intrinsic<br>Value |
|--|------------------------|--|--|--------------------|
| <b>2007:</b>   |                        |  |  |                    |
| Beginning Balance  | 1,100,000              | \$ -                                     | -  | -                  |
| Granted  | 560,000                | 5.18                                     | -  | -                  |
| Exercised  | 1,000,000              | 1.05                                     | -  | -                  |
| Outstanding at December 31                                 | 660,000                | 4.55                                     | 9.7  | 1,581,200          |
| Exercisable  | 660,000                | 4.55                                     | 9.7  | 1,581,200          |
| Ending Vested  | 660,000                | 4.55                                     |  | 1,581,200          |
| Weighted Average Fair Value of Options Granted During Year |                        | \$ 2.72                                  |  |                    |
| <b>2008:</b>   |                        |  |  |                    |
| Beginning Balance  | 660,000                | \$ -                                     | -  | -                  |
| Granted  | -                      | -  | -  | -                  |
| Exercised  | 260,000                | 3.59                                     | -  | -                  |
| Outstanding at December 31                                 | 400,000                | 5.18                                     | 8.8  | -                  |
| Exercisable  | 400,000                | 5.18                                     | 8.8  | -                  |
| Ending Vested  | 400,000                | 5.18                                     | 8.8  | -                  |
| Weighted Average Fair Value of Options Granted During Year |                        | \$ -                                     |  |                    |
| <b>2009:</b>   |                        |  |  |                    |
| Beginning Balance  | 400,000                | \$ -                                     | -  | -                  |
| Granted  | -                      | -  | -  | -                  |
| Exercised  | 100,000                | 5.18                                     | -  | -                  |
| Outstanding at December 31                                 | 300,000                | 5.18                                     | 7.8  | 1,998,000          |
| Exercisable  | 300,000                | 5.18                                     | 7.8  | 1,998,000          |
| Ending Vested  | 300,000                | 5.18                                     | 7.8  | 1,998,000          |
| Weighted Average Fair Value of Options Granted During Year |                        | \$ -                                     |  |                    |
| Currently Outstanding Options                              |                        |  |  |                    |

No options were forfeited or expired during the years ended December 31, 2009, 2008, and 2007.

The company recorded compensation expense related to these options of \$2,366,417 for the year ended December 31, 2007. There is no further compensation expense that will be recognized in future years, relating to all options that have been granted as of December 31, 2009, since the entire fair value compensation has been recognized based on the vesting period of the options during 2006 and 2007.

There were no unvested options at December 31, 2009, 2008, and 2007.

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Warrants Granted February 2009

On February 27, 2009, in conjunction with the closing of the revolving credit facility (see Note 9), the company issued CIT Capital USA, Inc. (CIT) warrants to purchase a total of 300,000 shares of common stock exercisable at \$5.00 per share. The total fair value of the warrants was calculated using the Black-Scholes valuation model based on factors present at the time the warrants were issued. The fair value of the warrants is included in Debt Issuance Costs and are being amortized for three years over the term of the facility using the effective interest method. CIT can exercise the warrants at any time until the warrants expire in February 2012.

The following assumptions were used for the Black-Scholes model:

|  | February 27, 2009 |
|--|-------------------|
| Risk free rates                        | 1%                |
| Dividend yield                         | 0%                |
| Expected volatility                    | 96.43%            |
| Weighted average expected warrant life | 1.5 Years         |

The fair market value at the date of issuance for the warrants issued using the formula relied upon for calculating the fair value of warrants is as follows:

|  |            |
|--|------------|
| Weighted average fair value per share                | \$ .74     |
| Total options granted                                | 300,000    |
| Total weighted average fair value of options granted | \$ 221,153 |

In January 2009, the Company's Board of Directors adopted the 2009 Equity Incentive Plan, pursuant to which we may issue up to 3,000,000 shares of our common stock either upon exercise of stock options granted under such plan or through restricted stock awards under such plan. As of December 31, 2009, we had issued 642,916 shares of common stock pursuant to our 2009 Equity Incentive Plan (See Note 6).

The table below reflects the status of warrants outstanding at December 31, 2009:

| Issue Date        | Common<br>Shares | Exercise<br>Price | Expiration<br>Date |
|-------------------|------------------|-------------------|--------------------|
| February 27, 2009 | 300,000          | \$ 5.00           | February 27, 2012  |

At December 31, 2009 the per-share weighted average exercise price of outstanding warrants was \$5.00 per share, and the weighted average remaining contractual life was 2.2 years. None of the warrants issued in 2009 were exercised and all of the warrants are exercisable at December 31, 2009.

**NOTE 9 REVOLVING CREDIT FACILITY**

In February 2009, the Company completed the closing of a revolving credit facility with CIT Capital USA Inc. ( CIT ) that will provide up to a maximum principal amount of \$25 million of working capital for exploration and production operations (the Facility ). The borrowing base of funds available under the Facility will be redetermined semi-annually based upon the net present value, discounted at 10% per annum, of the future net revenues expected to accrue from its interests in proved reserves estimated to be produced from its oil and gas properties. \$11 million of financing was initially available under the Facility. In May 2009 CIT agreed to increase the current amount available under the Facility to \$16 million in conjunction with the acquisition of certain assets of Windsor Bakken, LLC (see Note 5). An additional \$9 million of financing could become available upon subsequent borrowing base redeterminations. The Facility terminates on February 27, 2012, with all outstanding borrowings due at that time. The Company had no borrowings under the facility at December 31, 2009.

The Company has the option to designate the reference rate of interest for each specific borrowing under the Facility as amounts are advanced. Borrowings based upon the London interbank offering rate (LIBOR) will be outstanding for a period of one, three or six months (as designated by us) and bear interest at a rate equal to 5.50% over the one-month, three-month or six-month LIBOR rate to be no less than 2.50%. Any borrowings not designated as being based upon LIBOR will have no specified term and generally will bear interest at a rate equal to 4.50% over the greater of (a) the current three-month LIBOR rate plus 1.0% or (b) the current prime rate as published by JP Morgan Chase Bank, N.A. The Company has the option to designate either pricing mechanism. Payments are due under the Facility in arrears, in the case of a loan based on LIBOR on the last day of the specified loan period and in the case of all other loans on the last day of each March, June, September and December. All outstanding principal is due and payable upon termination of the Facility.

The applicable interest rate increases under the Facility and the lenders may accelerate payments under the Facility, or call all obligations due under certain circumstances, upon an event of default. The Facility references various events constituting a default on the Facility, including, but not limited to, failure to pay interest on any loan under the Facility, any material violation of any representation or warranty under the Credit Agreement in connection with the Facility, failure to observe or perform certain covenants, conditions or agreements under the Facility, a change in control of the Company, default under any other material indebtedness the Company might have, bankruptcy and similar proceedings and failure to pay disbursements from lines of credit issued under the Facility. The Company was not in default on the Facility as of December 31, 2009, and is not expected to be in default in the future.

The Facility required that the Company enter into swap agreements with Macquarie Bank Limited ( Macquarie ) for each month of the thirty-six (36) month period following the date on which each such swap agreement is executed, the notional volumes for which (when aggregated with other commodity swap agreements and additional fixed-price physical off-take contracts then in effect other than basis differential swaps on volumes already hedged pursuant to other swap agreements), as of the date such swap agreement is executed, is not less than 50% of, nor exceeds 80% of, the reasonably anticipated projected production from the Company's proved developed producing reserves. The hedged production is estimated to be equal to approximately 20% of 2009 total production and less than 10% of production volumes in 2010-12. See Note 15 for additional disclosure concerning these swap agreements.

All of the Company's obligations under the Facility and the swap agreements with Macquarie are secured by a first priority security interest in any and all assets of the Company pursuant to the terms of a Guaranty and Collateral Agreement and perfected by a mortgage, notice of pledge and security and similar documents.

**NOTE 10 ASSET RETIREMENT OBLIGATION**

The Company has asset retirement obligations associated with the future plugging and abandonment of proved properties and related facilities. Under the provisions of FASB ASC 410-20-25 ( *Prior authoritative literature*: FASB Statement 143, *Accounting for Asset Retirement Obligations* ), the fair value of a liability for an asset retirement obligation is recorded in the period in which it is incurred and a corresponding increase in the carrying amount of the related long lived asset. The liability is accreted to its present value each period, and the capitalized cost is depreciated over the useful life of the related asset. If the liability is settled for an amount other than the recorded amount, a gain or loss is recognized. The Company has no assets that are legally restricted for purposes of settling asset retirement obligations.

The following table summarizes the company's asset retirement obligation transactions recorded in accordance with the provisions of FASB ASC 410-20-25 during the year ended December 31, 2009 and 2008.

|   | Year Ended December 31, |        |
|---|-------------------------|--------|
|   | 2009                    | 2008   |
| Beginning Asset Retirement Obligation                   | \$ 61,437               | \$ -0- |
| Liabilities Incurred for New Wells Placed in Production | 137,222                 | 60,407 |
| Accretion of Discount on Asset Retirement Obligations   | 8,082                   | 1,030  |
| Ending Asset Retirement Obligation                      | \$ 206,741              | 61,437 |

**NOTE 11 INCOME TAXES**

The Company utilizes the asset and liability approach to measuring deferred tax assets and liabilities based on temporary differences existing at each balance sheet date using currently enacted tax rates in accordance with FASB ASC 740-10-30 (*Prior authoritative literature: FASB Statement 109, Accounting for Income Taxes*). Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment.

The income tax expense (benefit) for the year ended December 31, 2009, 2008, and 2007 consists of the following:

|                       | 2009         | 2008<br>Adjusted | 2007 |
|-----------------------|--------------|------------------|------|
| Current Income Taxes  | \$ -         | \$ -             | \$ - |
| Deferred Income Taxes |              |                  |      |
| Federal               | 1,215,000    | (680,000)        | -    |
| State                 | 251,000      | (150,000)        | -    |
| Total Expense         | \$ 1,466,000 | \$ (830,000)     | \$ - |

The following is a reconciliation of the reported amount of income tax expense (benefit) for the years ended December 31, 2009, 2008, and 2007 to the amount of income tax expenses that would result from applying the statutory rate to pretax income.

Reconciliation of reported amount of income tax expense:

|   | 2009         | 2008<br>Adjusted | 2007           |
|---|--------------|------------------|----------------|
| Income (Loss) Before Tau8xes and NOL                | \$ 4,264,952 | \$ 1,594,340     | \$ (4,305,293) |
| Federal Statutory Rate                              | X 34%        | x 34%            | x 34%          |
| Taxes (Benefit) Computed at Federal Statutory Rates | 1,450,000    | 540,000          | (1,460,000)    |
| State Taxes (Benefit), Net of Federal Taxes         | 295,000      | 110,000          | -              |
| Effects of:   |              |                  |                |
| Other   | (279,000)    | (7,659)          | (12,341)       |
| Change in Valuation                                 | -            | (1,472,341)      | 1,472,341      |
| Reported Provision                                  | \$ 1,466,000 | \$ (830,000)     | \$ -           |

At December 31, 2009, 2008 and 2007, the Company has a net operating loss carryforward for Federal income tax purposes of \$18,494,000, \$9,348,000 and \$1,950,000, respectively, which expires in varying amounts during the tax years 2027, 2028 and 2029.



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The components of the Company's deferred tax asset were as follows:

|   | Year Ended December 31, |                     |
|---|-------------------------|---------------------|
|   | 2009                    | 2008<br>Adjusted    |
| <b>Deferred Tax Assets</b>                  |                         |                     |
| <b>Current:</b>                             |                         |                     |
| Share Based Compensation (Options)          | \$ 774,000              | \$ 774,000          |
| Share Based Compensation (Restricted Stock) | (91,000)                | -                   |
| Unrealized Investment Losses                | 1,231,000               | 168,000             |
| Accrued Payroll                             | 288,000                 | 520,000             |
| Other                                       | (145,000)               | (72,000)            |
| <b>Current</b>                              | <b>2,057,000</b>        | <b>1,390,000</b>    |
| <b>Non-Current:</b>                         |                         |                     |
| Net Operating Loss Carryforwards (NOLs)     | 7,583,000               | 3,588,000           |
| Fixed Assets                                | (2,646,000)             | (931,000)           |
| Dry Well Write Off                          | (36,000)                | (36,000)            |
| Unrealized Investment Losses                | 395,000                 |                     |
| Depletion                                   | 1,562,000               | 214,000             |
| Intangible Drilling Costs                   | (7,955,000)             | (2,962,000)         |
| Sale of Land Lease Rights                   | 117,000                 | 117,000             |
| Other                                       | 58,000                  | 43,000              |
| <b>Non-Current</b>                          | <b>(922,000)</b>        | <b>33,000</b>       |
| <b>Total Deferred Tax Assets</b>            | <b>1,135,000</b>        | <b>1,423,000</b>    |
| Less: Valuation Allowance                   | -                       | -                   |
| <b>Net Deferred Tax Asset</b>               | <b>\$ 1,135,000</b>     | <b>\$ 1,423,000</b> |

In June 2006, FASB issued FASB ASC 740-10-05-6 (*Prior authoritative literature: FASB Statement 48, Accounting for Uncertainty in Income Taxes*). We adopted FASB ASC 740-10-05-6 on January 1, 2007. Under FASB ASC 740-10-05-6, tax benefits are recognized only for tax positions that are more likely than not to be sustained upon examination by tax authorities. The amount recognized is measured as the largest amount of benefit that is greater than 50 percent likely to be realized upon ultimate settlement. Unrecognized tax benefits are tax benefits claimed in our tax returns that do not meet these recognition and measurement standards.

Upon the adoption of FASB ASC 740-10-05-6, we had no liabilities for unrecognized tax benefits and, as such, the adoption had no impact on our financial statements, and we have recorded no additional interest or penalties. The adoption of FASB ASC 740-10-05-6 did not impact our effective tax rates.

Our policy is to recognize potential interest and penalties accrued related to unrecognized tax benefits within income tax expense. For the year ended December 31, 2009, we did not recognize any interest or penalties in our Statement of Operations, nor did we have any interest or penalties accrued in our Balance Sheet at December 31, 2009 relating to unrecognized benefits.

The tax years 2008, 2007 and 2006 remain open to examination for federal income tax purposes and by the other major taxing jurisdictions to which we are subject.

**NOTE 12 OPERATING LEASES**

Vehicles

The Company leases vehicles under noncancelable operating leases. Total rent expense under the agreements was approximately \$52,000, \$31,000 and \$22,000 for the years ended December 31, 2009, 2008, and 2007, respectively.

Minimum future lease payments under these vehicle leases are as follows:

|              | <b>Year Ending<br/>December 31,</b> | <b>Amount</b>    |
|--------------|-------------------------------------|------------------|
|              | 2010                                | \$ 41,372        |
|              | 2011                                | 19,744           |
| <b>Total</b> |                                     | <b>\$ 61,116</b> |

Building

Effective February 2008, the Company entered into an operating lease agreement to lease 3,044 square feet of office space. The lease requires initial gross monthly lease payments of \$11,415. The monthly payments increase by 4% on each anniversary date. The lease expires in December 2012. Total rent expense under the agreement was approximately \$142,000 and \$114,000 for the years ended December 31, 2009 and 2008, respectively.

The Company has prepaid \$34,245, the last three months rent. Minimum future lease payments under the building lease are as follows:

|              | <b>Year Ending<br/>December 31,</b> | <b>Amount</b>     |
|--------------|-------------------------------------|-------------------|
|              | 2010                                | \$ 148,151        |
|              | 2011                                | 154,087           |
|              | 2012                                | 160,236           |
| <b>Total</b> |                                     | <b>\$ 462,474</b> |

The Company received \$91,320 of landlord incentives under the lease agreement. The Company has recorded a deferred rent liability for this amount that is being amortized over the term of the lease.

Prior to this lease the Company was paying \$1,250 on a month-to-month lease.

**NOTE 13 FAIR VALUE**

FASB ASC 820-10-55 (*Prior authoritative literature: FASB Statement 157, Fair Value Measurements*) defines fair value, establishes a framework for measuring fair value under generally accepted accounting principles and enhances disclosures about fair value measurements. Fair value is defined under FASB ASC 820-10-55 as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. Valuation techniques used to measure fair value under FASB ASC 820-10-55 must maximize the use of observable inputs and minimize the use of unobservable inputs. The standard describes a fair value hierarchy based on three levels of inputs, of which the first two are considered observable and the last unobservable, that may be used to measure fair value which are the following:

Level 1 - Quoted prices in active markets for identical assets or liabilities.

Level 2 - Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 - Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

The following schedule summarizes the valuation of financial instruments measured at fair value on a recurring basis in the balance sheet as of December 31, 2009 and 2008.

| <b>Fair Value Measurements at December<br/>31, 2009 Using</b> |   |  |  |
|---|---|--|--|
|   | <b>Quoted<br/>Prices In<br/>Active<br/>Markets<br/>for<br/>Identical<br/>Assets<br/>(Level 1)</b> | <b>Significant<br/>Other<br/>Observable<br/>Inputs<br/>(Level 2)</b> | <b>Significant<br/>Unobservable<br/>Inputs<br/>(Level 3)</b> |
| Current Derivative Liabilities                                | \$ -  | \$ (1,320,679)   | \$ -   |
| Non-Current Derivative Liabilities                            | -   | (1,459,374)  | -  |
| Short-Term Investments (See Note 3)                           | 23,085,120  | -  | 1,818,356  |
| Total   | \$ 23,085,120   | \$ (2,780,053)   | \$ 1,818,356   |

| <b>Fair Value Measurements at December<br/>31, 2008 Using</b> |   |  |  |
|---|---|--|--|
|   | <b>Quoted<br/>Prices In<br/>Active<br/>Markets<br/>for<br/>Identical<br/>Assets<br/>(Level 1)</b> | <b>Significant<br/>Other<br/>Observable<br/>Inputs<br/>(Level 2)</b> | <b>Significant<br/>Unobservable<br/>Inputs<br/>(Level 3)</b> |
| Long-Term Investments (See Note 3)                            | \$ -  | \$ -   | \$ 2,416,369   |
| Total   | \$ -  | \$ -   | \$ 2,416,369   |

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Level 1 assets consist of US Treasury Notes, the fair value of these treasuries is based on quoted market prices.

Level 2 liabilities consist of derivative liabilities (see Note 15). Under FASB ASC 820-10-55 (*Prior authoritative literature: FASB Statement 157, Fair Value Measurements*), the fair value of the Company's derivative financial instruments is determined based on the Company's valuation models that utilize market corroborated inputs. The fair value of all derivative contracts is reflected on the balance sheet. The current liability amounts represent the fair values expected to be included in the results of operations for the subsequent year.

Level 3 assets consist of municipal bonds and floating rate preferred stock (see Note 3) with an auction reset feature (auction rate securities or ARS). The underlying assets for the municipal bonds are student loans which are substantially backed by the federal government. Auction-rate securities are long-term floating rate bonds or floating rate perpetual preferred stock tied to short-term interest rates. After the initial issuance of the securities, the interest rate on the securities is reset periodically, at intervals established at the time of issuance (primarily every twenty-eight days), based on market demand for a reset period. Auction-rate securities are bought and sold in the marketplace through a competitive bidding process often referred to as a Dutch auction. If there is insufficient interest in the securities at the time of an auction, the auction may not be completed and the rates may be reset to predetermined penalty or maximum rates based on mathematical formulas in accordance with each security's prospectus.

In February 2008, auctions began to fail for these securities and each auction since then has failed. Consequently, the investments are not currently liquid. In the event the Company needed to access these funds, they are not expected to be accessible until one of the following occurs: a successful auction occurs, the issuer redeems the issue, a buyer is found outside of the auction process or the underlying securities mature. In October 2008, the Company received an offer (the Offer) from UBS AG (UBS), one of its investment providers, to sell at par value auction-rate securities originally purchased from UBS (\$2,025,143) at anytime during a two-year period beginning June 30, 2010. The Offer was non-transferable and expired on November 14, 2008. On October 28, 2008 the Company elected to participate in the Offer. The Company has classified auction rate securities as short-term assets on our balance sheet. In addition to the Offer, UBS is providing no net cost loans up to 75% of the loan-to-market value of eligible auction rate securities until June 30, 2010.

Typically, the fair value of ARS investments approximates par value due to the frequent resets through the auction process. While the Company continues to earn interest on its ARS investments at the contractual rate, these investments are not currently trading and therefore do not have a readily determinable market value. Accordingly, the estimated fair value of the ARS no longer approximates par value. At December 31, 2009, the Company valued the ARS investments based on Level 3 inputs. The Company utilized a discounted cash flow approach to arrive at this valuation. The assumptions used in preparing the discounted cash flow model include estimates of, based on data available as of December 31, 2009, interest rates, timing and amount of cash flows, credit and liquidity premiums, and expected holding periods of the ARS. These assumptions are volatile and subject to change as the underlying sources of these assumptions and market conditions change. Based on this Level 3 valuation, the Company valued the ARS investments at \$1,818,356, which represents a decline in value of \$206,787 from par.

Although there is uncertainty with regard to the short-term liquidity of these securities, the Company continues to believe that the carrying value represents the fair value of these marketable securities because of the overall quality of the underlying investments and the anticipated future market for such investments. In addition, the Company has the intent and ability to hold these securities until the earlier of: the market for auction rate securities stabilizes, the issuer refinances the underlying security, a buyer is found outside of the auction process at acceptable terms, the underlying securities have matured or the Company accepts the investment manager's offer to redeem the securities.

Based on the CIT financing, the expected positive operating cash flows, and the Company's ability to obtain no net cost loans up to 75% of the loan-to-market value, as determined by UBS, on eligible auction rate securities, the Company does not anticipate the current inability to liquidate the auction rate securities to adversely affect the Company's ability to conduct its business.

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The following table provides a reconciliation of the beginning and ending balances for the assets measured at fair value using significant unobservable inputs (Level 3):

|   | <b>Fair Value Measurements at Reporting Date Using Significant Unobservable Inputs (Level 3)</b> |           |
|---|--|-----------|
|   | <b>Level 3 Financial Assets</b>  |           |
| Balance at January 1, 2008                                    | \$   | -         |
| Purchases   |  | 3,800,524 |
| Sales/Maturities  |  | (975,000) |
| Realized Loss on Sales/Maturities                             |  | (381)     |
| Unrealized Loss Included in Other Comprehensive Income (Loss) |  | (408,774) |
| Balance at December 31, 2008                                  | \$   | 2,416,369 |
| Sales   |  | (800,000) |
| Unrealized Gain Included in Other Comprehensive Income (Loss) |  | 201,987   |
| Balance at December 31, 2009                                  | \$   | 1,818,356 |

The Company's assessment of the significance of a particular input to the fair value measurement requires judgment and may effect the valuation of the nonfinancial assets and liabilities and their placement in the fair value hierarchy levels. The fair value of the Company's asset retirement obligations are determined using discounted cash flow methodologies based on inputs that are not readily available in public markets. The fair value of the asset retirement obligations is reflected on the balance sheet as follows.

|                               |    | <b>Fair Value Measurements at December 31, 2009 Using</b> |   |  |  |
|-------------------------------|----|---|---|--|--|
|                               |    | <b>December 31, 2009</b>                                  | <b>Quoted Prices In Active Markets for Identical Assets (Level 1)</b> | <b>Significant Other Observable Inputs (Level 2)</b> | <b>Significant Unobservable Inputs (Level 3)</b> |
| <b>Description</b>            |    |   |   |  |  |
| Other Non-current Liabilities | \$ | (206,741)   | \$ -  | \$ -   | \$ (206,741)                                     |
| Total                         | \$ | (206,741)   | \$ -  | \$ -   | \$ (206,741)                                     |

|                               |    | <b>Fair Value Measurements at December 31, 2008 Using</b> |   |  |  |
|-------------------------------|----|---|---|--|--|
|                               |    | <b>December 31, 2008</b>                                  | <b>Quoted Prices In Active Markets for Identical Assets (Level 1)</b> | <b>Significant Other Observable Inputs (Level 2)</b> | <b>Significant Unobservable Inputs (Level 3)</b> |
| <b>Description</b>            |    |   |   |  |  |
| Other Non-current Liabilities | \$ | (61,437)  | \$ -  | \$ -   | \$ (61,437)                                      |
| Total                         | \$ | (61,437)  | \$ -  | \$ -   | \$ (61,437)                                      |

See Note 10 for a rollforward of the Asset Retirement Obligation.

**NOTE 14 FINANCIAL INSTRUMENTS**

The Company's non-derivative financial instruments include cash and cash equivalents, accounts receivable, accounts payable and line of credit. The carrying amount of cash and cash equivalents, accounts receivable, accounts payable, and line of credit approximate fair value because of their immediate or short-term maturities.

The Company's accounts receivable relate to oil and natural gas sold to various industry companies. Credit terms, typical of industry standards, are of a short-term nature and the Company does not require collateral. The Company's accounts receivable at December 31, 2009 and 2008 do not represent significant credit risks as they are dispersed across many counterparties.

**NOTE 15 DERIVATIVE INSTRUMENTS AND PRICE RISK MANAGEMENT**

The Company utilizes commodity swap contracts to (i) reduce the effects of volatility in price changes on the oil commodities it produces and sells, (ii) reduce commodity price risk and (iii) provide a base level of cash flow in order to assure it can execute at least a portion of its capital spending.

Crude Oil Derivative Contracts Cash-flow Hedges

Historically, all derivative positions that qualified for hedge accounting were designated on the date the Company entered into the contract as a hedge against the variability in cash flows associated with the forecasted sale of future oil production. The cash flow hedges were valued at the end of each period and adjustments to the fair value of the contract prior to settlement were recorded on the statement of stockholders' equity as other comprehensive income. Upon settlement, the gain (loss) on the cash flow hedge was recorded as an increase or decrease in revenue on the statement of operations. The company reports average oil and gas prices and revenues including the net results of hedging activities.

On November 1, 2009, due to the volatility of price differentials in the Williston Basin, the Company de-designated all derivatives that were previously classified as cash flow hedges and, in addition, the Company has elected not to designate any subsequent derivative contracts as cash flow hedges under FASB ASC 815-20-25 (*Prior authoritative literature: FASB Statement 133, Accounting for Derivative Instruments and Hedging Activities*). Beginning on November 1, 2009, all derivative positions are carried at their fair value on the balance sheet and are marked-to-market at the end of each period. Any realized and unrealized gains or losses are recorded as gain (loss) on derivatives, net, as an increase or decrease in revenue on the statement of operations rather than as a component of other comprehensive income or as other income (expense).

The net mark-to-market loss on the Company's remaining swaps that qualified for cash flow hedge accounting at the date the decision was made to discontinue hedge accounting totals \$2,416,639 as of December 31, 2009. The amount is in accumulated other comprehensive income in stockholders' equity and will be amortized into revenues as the original forecasted hedged oil production occurs in 2010 and 2011.

The Company realized a hedging loss of \$624,541 and a hedging gain of \$778,885 for the years ended December 31, 2009 and 2008, respectively.

The following table reflects open commodity derivative contracts as of December 31, 2009, the associated volumes and the corresponding weighted average NYMEX reference price.

| Settlement Period   | Oil (Barrels) | Fixed Price | Weighted Avg NYMEX Reference Price |
|---------------------|---------------|-------------|------------------------------------|
| <b>Oil Swaps</b>    |               |             |                                    |
| 01/01/10 - 02/29/12 | 63,000        | 51.25       | 83.99                              |
| 01/01/10 - 12/31/11 | 36,000        | 66.15       | 84.20                              |
| 01/01/10 - 12/31/11 | 132,000       | 82.60       | 83.68                              |
| 01/01/10 - 12/31/11 | 54,000        | 84.25       | 83.56                              |

At December 31, 2009, the Company had derivative financial instruments under FASB ASC 815-20-25 recorded on the consolidated balance sheet as set forth below:

| Type of Contract                                     | Balance Sheet Location        | Estimated Fair Value |
|--|-------------------------------|----------------------|
| <b>Derivatives Designated as Hedging Instruments</b> |                               |                      |
| Derivative Liabilities:                              |                               |                      |
| Oil Contracts  | Other Current Liabilities     | \$ 1,320,679         |
| Oil Contracts  | Other Non-Current Liabilities | 1,459,374            |
| Total Derivative Liabilities:                        |                               | \$ 2,780,053         |

**NOTE 16 EARNINGS PER SHARE**

The following is a reconciliation of the numerator and denominator used to calculate basic earnings per share and diluted earnings per share for the years ended December 31, 2009, 2008, and 2007:

|                            | 2009         |            |           | 2008                |            |           | 2007           |            |           |
|----------------------------|--------------|------------|-----------|---------------------|------------|-----------|----------------|------------|-----------|
|                            | Net Income   | Shares     | Per Share | Net Income Adjusted | Shares     | Per Share | Net Loss       | Shares     | Per Share |
| Basic EPS                  | \$ 2,798,952 | 36,705,267 | \$ 0.08   | \$ 2,424,340        | 31,920,747 | \$ 0.08   | \$ (4,305,293) | 23,667,119 | \$ (0.18) |
| Dilutive effect of options | -            | 171,803    | -         | -                   | 732,805    | -         | -              | -          | -         |
| Diluted EPS                | \$ 2,798,952 | 36,877,070 | \$ 0.08   | \$ 2,424,340        | 32,653,552 | \$ 0.07   | \$ (4,305,293) | 23,667,119 | \$ (0.18) |

For the years ended December 31, 2009 and 2008, options and warrants to purchase 21,678 and 7,476 shares of common stock were not considered in calculating diluted earnings per share because the exercise prices were greater than the average market price of common shares during the year and, therefore, the effect would be anti-dilutive.

As of December 31, 2007, there were 600,000 potentially dilutive shares from stock options that became exercisable during 2007. In addition, there were 4,818,183 warrants that were issued and outstanding. These warrants were exercisable and represented potentially dilutive shares. As the Company had a loss for the year ended December 31, 2007 the potentially dilutive share were anti-dilutive and were not added into the earnings per share calculation.

**NOTE 17 COMPREHENSIVE INCOME**

The Company follows the provisions of FASB ASC 220-10-55 (*Prior authoritative literature: FASB Statement 130, Reporting Comprehensive Income*) which establishes standards for reporting comprehensive income. In addition to net income, comprehensive income includes all changes in equity during a period, except those resulting from investments and distributions to stockholders of the Company.

For the periods indicated, comprehensive income (loss) consisted of the following:

|   | <b>2009</b>  | <b>Year Ended<br/>December 31,<br/>2008<br/>Adjusted</b> | <b>2007</b>    |
|---|--------------|--|----------------|
| Net Income (Loss)   | \$ 2,798,952 | \$ 2,424,340   | \$ (4,305,293) |
| Unrealized losses on Short-term Investments (net of tax of \$290,000 and \$168,000 at December 31, 2009 and 2008) | (486,207)    | (240,774)  | -              |
| Net unrealized losses on hedges (Net of tax of \$933,000 at December 31, 2009)                                    | (1,483,639)  | -  | -              |
| Other Comprehensive income (loss) net   | \$ 829,106   | \$ 2,183,566   | \$ (4,305,293) |

**NOTE 18 EMPLOYEE BENEFIT PLANS**

In 2009, the Company adopted a defined contribution 401(k) plan for substantially all of its employees. The plan provides for Company matching of employee contributions to the plan, at the Company's discretion. During 2009, the Company provided a match contribution equal to 100% of an eligible employee's deferral contribution, up to 6% of the employee's earnings up to \$16,500. The Company contributed approximately \$66,400 to the 401(k) plan for the year ended December 31, 2009.

**NOTE 19 SUBSEQUENT EVENTS**

In February 2010, the Company entered into a commodity swap contract. The oil swap contract is for 11,900 barrels of oil per month for the months of March 2010 through December 2010 and 4,583 barrels of oil per month in 2011. The price on the contract is fixed at \$80.90 per barrel.



**SUPPLEMENTAL OIL AND GAS INFORMATION**  
(UNAUDITED)

**Oil and Natural Gas Exploration and Production Activities**

Oil and gas sales reflect the market prices of net production sold or transferred with appropriate adjustments for royalties, net profits interest, and other contractual provisions. Production expenses include lifting costs incurred to operate and maintain productive wells and related equipment including such costs as operating labor, repairs and maintenance, materials, supplies and fuel consumed. Production taxes include production and severance taxes. Depletion of oil and gas properties relates to capitalized costs incurred in acquisition, exploration, and development activities. Results of operations do not include interest expense and general corporate amounts. The results of operations for the company's oil and gas production activities are provided in the company's related statements of operations.

**Costs Incurred and Capitalized Costs**

The costs incurred in oil and gas acquisition, exploration and development activities follow:

|                               | Year Ended December 31, |               |              |
|-------------------------------|-------------------------|---------------|--------------|
|                               | 2009                    | 2008          | 2007         |
| Costs Incurred for the Year:  |                         |               |              |
| Proved Property Acquisition   | \$ 30,800,883           | \$ 30,508,139 | \$ 3,231,694 |
| Unproved Property Acquisition | -                       | -             | 4,169,773    |
| Development                   | 18,739,905              | 9,165,188     | 186,044      |
| Total                         | \$ 49,540,788           | \$ 39,673,327 | \$ 7,587,511 |

Excluded costs for unevaluated properties are accumulated by year. Costs are reflected in the full cost pool as the drilling costs are incurred or as costs are evaluated and deemed impaired. The Company anticipates these excluded costs will be included in the depletion computation over the next five years. The Company is unable to predict the future impact on depletion rates. The following is a summary of capitalized costs excluded from depletion at December 31, 2009 by year incurred.

|                      | Year Ended December 31, |               |              |
|----------------------|-------------------------|---------------|--------------|
|                      | 2009                    | 2008          | 2007         |
| Property Acquisition | \$ 17,478,196           | \$ 29,080,499 | \$ 5,147,236 |
| Drilling             | 394,066                 | 1,762,532     | -            |
| Total                | \$ 17,872,262           | \$ 30,843,031 | \$ 5,147,236 |

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**Oil and Natural Gas Reserves and Related Financial Data**

Information with respect to the Company's oil and gas producing activities is presented in the following tables. Reserve quantities, as well as certain information regarding future production and discounted cash flows, were determined by Ryder Scott Company, independent petroleum consultants based on information provided by the company.

***Oil and Natural Gas Reserve Data***

The following tables present the Company's independent petroleum consultants' estimates of its proved oil and gas reserves. The Company emphasizes that reserves are approximations and are expected to change as additional information becomes available. Reservoir engineering is a subjective process of estimating underground accumulations of oil and gas that cannot be measured in an exact way, and the accuracy of any reserve estimate is a function of the quality of available data and of engineering and geological interpretation and judgment.

|  | <b>Natural<br/>Gas<br/>(MCF)</b> | <b>Oil<br/>(BLS)</b> |
|--|----------------------------------|----------------------|
| Proved Developed and Undeveloped Reserves at December 31, 2007 | -                                | -                    |
| Extensions, Discoveries and Other Additions                    | 220,420                          | 778,545              |
| Production   | (3,969)                          | (50,880)             |
| Proved Developed and Undeveloped Reserves at December 31, 2008 | 216,451                          | 727,665              |
| Revisions of Previous Estimates                                | (27,820)                         | (93,819)             |
| Extensions, Discoveries and Other Additions                    | 1,619,597                        | 5,456,261            |
| Production   | (47,305)                         | (274,528)            |
| Proved Developed and Undeveloped Reserves at December 31, 2009 | 1,760,923                        | 5,815,579            |
| Proved Developed Reserves at December 31, 2008                 | 216,451                          | 727,665              |
| Proved Developed Reserves at December 31, 2009                 | 727,237                          | 2,247,718            |

Proved reserves are estimated quantities of oil and gas, which geological and engineering data indicate with reasonable certainty to be recoverable in future years from known reservoirs under existing economic and operating conditions. Proved developed reserves are proved reserves that can be expected to be recovered through existing wells with existing equipment and operating methods. Proved undeveloped reserves are included for reserves for which there is a high degree of confidence in their recoverability and they are scheduled to be drilled within the next five years.

***Standardized Measure of Discounted Future Net Cash Inflows and Changes Therein***

The following table presents a standardized measure of discounted future net cash flows relating to proved oil and gas reserves and the changes in standardized measure of discounted future net cash flows relating proved oil and gas were prepared in accordance with the provisions of ASC 932-235-555 (formerly SFAS 69). Future cash inflows were computed by applying average prices of oil and gas for the last 12 months as of December 31, 2009 and current prices as of December 31, 2008 to estimated future production. Future production and development costs were computed by estimating the expenditures to be incurred in developing and producing the proved oil and gas reserves at the end of the year, based on year-end costs and assuming continuation of existing economic conditions. Future income tax expenses were calculated by applying appropriate year-end tax rates to future pretax cash flows relating to proved oil and gas reserves, less the tax basis of properties involved and tax credits and loss carryforwards relating to oil and gas producing activities. Future net cash flows are discounted at the rate of 10% annually to derive the standardized measure of discounted future cash flows. Actual future cash inflows may vary considerably, and the standardized measure does not necessarily represent the fair value of the Company's oil and gas reserves.

|  | <b>Year Ended December 31,</b> |               |
|--|--------------------------------|---------------|
|  | <b>2009</b>                    | <b>2008</b>   |
| Future Cash Inflows                                      | \$ 315,142,688                 | \$ 29,342,354 |
| Future Production Costs                                  | (105,982,773)                  | (8,719,621)   |
| Future Development Costs                                 | (54,011,133)                   | (1,321,948)   |
| Future Income Tax Expense                                | (43,761,765)                   | -             |
| Future Net Cash Inflows                                  | 111,387,017                    | 19,300,785    |
| 10% Annual Discount for Estimated Timing of Cash Flows   | (43,580,456)                   | (7,514,731)   |
| Standardized Measure of Discounted Future Net Cash Flows | \$ 67,806,561                  | \$ 11,786,054 |

The twelve month average prices for the year ended December 31, 2009 and year-end spot prices at December 31, 2008 were adjusted to reflect applicable transportation and quality differentials on a well-by-well basis to arrive at realized sales prices used to estimate the Company's reserves. The prices for the Company's reserve estimates were as follows:

|                                | <b>Natural<br/>Gas<br/>MCF</b> | <b>Oil<br/>Bbl</b> |
|--------------------------------|--------------------------------|--------------------|
| December 31, 2008 (Spot Price) | \$ 5.80                        | \$ 38.60           |
| December 31, 2009 (Average)    | \$ 3.93                        | \$ 53.00           |

Changes in the future net cash inflows discounted at 10% per annum follow:

|  | <b>Year Ended December 31,</b> |               |
|--|--------------------------------|---------------|
|  | <b>2009</b>                    | <b>2008</b>   |
| Beginning of Period  | \$ 11,786,054                  | \$ -          |
| Sales of Oil and Natural Gas Produced, Net of Production Costs   | (13,116,475)                   | (3,268,858)   |
| Extensions and Discoveries                                       | 74,946,755                     | 19,967,182    |
| Previously Estimated Development Cost Incurred During the Period | 1,321,948                      | -             |
| Net Change of Prices and Production Costs                        | 4,352,381                      | (3,660,754)   |
| Change in Future Development Costs                               | -                              | (1,251,516)   |
| Revisions of Quantity and Timing Estimates                       | (1,650,626)                    | -             |
| Accretion of Discount  | 1,178,605                      | -             |
| Change in Income Taxes   | (20,005,322)                   | -             |
| Purchase of Reserves in Place                                    | 9,579,951                      | -             |
| Other  | (586,710)                      | -             |
| End of Period  | \$ 67,806,561                  | \$ 11,786,054 |

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QUARTERLY RESULTS OF OPERATIONS (UNAUDITED)

Quarterly data for the years ended December 31, 2009, 2008, and 2007 is as follows:

|  | March 31,<br>Adjusted** | June 30,<br>Adjusted** | Quarter Ended<br>September 30,<br>Adjusted** | December 31, |
|--|-------------------------|------------------------|--|--------------|
| 2009:  |                         |                        |  |              |
| Revenue                                      | \$ 658,268              | \$ 2,275,084           | \$ 4,855,972                                 | \$ 6,432,175 |
| Expenses                                     | 1,047,614               | 1,437,445              | 2,530,315                                    | 5,077,164    |
| Income (Loss) from Operations                | (389,346)               | 837,639                | 2,325,657                                    | 1,355,011    |
| Other Income (Expense)                       | (43,527)                | (139,243)              | 321,589                                      | (2,828)      |
| Income Tax Provision (Benefit)               | (174,000)               | 280,000                | 1,059,000                                    | 301,000      |
| Net Income (Loss)                            | (258,873)               | 418,396                | 1,588,246                                    | 1,051,183    |
| Net Income (Loss) Per Common Share - Basic   | (0.01)                  | 0.01                   | 0.04   | 0.03         |
| Net Income (Loss) Per Common Share - Diluted | (0.01)                  | 0.01                   | 0.04   | 0.03         |

|  | March 31,<br>Adjusted** | June 30,<br>Adjusted** | Quarter Ended<br>September 30,<br>Adjusted** | December 31,<br>Adjusted** |
|--|-------------------------|------------------------|--|----------------------------|
| 2008:  |                         |                        |  |                            |
| Revenue  | \$ 287,029              | \$ 764,528             | \$ 1,362,655                                 | \$ 1,907,667               |
| Expenses   | 570,575                 | 548,849                | 600,213                                      | 1,391,793                  |
| Income (Loss) from Operations                          | (283,546)               | 215,679                | 762,442                                      | 515,874                    |
| Other Income   | 96,269                  | 95,424                 | 155,121                                      | 37,077                     |
| Income Tax Provision (Benefit)                         | -                       | -                      | -  | (830,000)                  |
| Net Income (Loss)                                      | (187,277)               | 311,103                | 917,563                                      | 1,382,951                  |
| Net Income (Loss) Per Common Share - Basic and Diluted | (0.01)                  | 0.01                   | 0.03   | 0.03                       |

|   | March 31, | June 30,    | Quarter Ended<br>September 30, | December 31, |
|---|-----------|-------------|--------------------------------|--------------|
| 2007:   |           |             |                                |              |
| Revenue                                       | \$ -      | \$ -        | \$ -                           | \$ -         |
| Expenses                                      | 297,719   | 894,720 *   | 309,487                        | 3,011,263    |
| Loss from Operations                          | (297,719) | (894,720) * | (309,487)                      | (3,011,263)  |
| Other Income                                  | 10,133    | 13,660      | 42,189                         | 141,914      |
| Income Tax Expense                            | -         | -           | -                              | -            |
| Net Loss                                      | (287,586) | (881,060) * | (267,298)                      | (2,869,349)  |
| Net Loss Per Common Share - Basic and Diluted | (0.01)    | (0.04) *    | (0.01)                         | (0.10)       |

\* The second quarter 2007 financial statements were adjusted, from what was reported, as the company rescinded stock it had previously issued to Ibis Consulting Group, LLC.

\*\* In 2009, the company changed its method of accounting for drilling costs. As required by generally accepted accounting principles the impact of the change in accounting has been applied retrospectively to all periods presented.