Siberian Energy Group Inc.
Form 10-Q
August 16, 2010

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

FORM 10-Q

(Mark One)

[X] QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2010

[ ] TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT

For the transition period from ____________ to ______________

Commission file number: 000-53766

SIBERIAN ENERGY GROUP INC.
(Exact name of registrant as specified in its charter)

NEVADA	52-2207080
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

275 Madison Ave, 6th Floor, New York, NY 10016
(Address of principal executive offices)

(212) 828-3011
(Registrant's telephone number)

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 x No [ ]

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes [ ] No [ ]

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

Large accelerated filer [ ]	Accelerated filer [ ]
Non-accelerated filer [ ]	Smaller reporting company x

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

As of August 16, 2010, the issuer had 18,705,585 shares of common stock, $0.001 par value per share outstanding, which number does not include 140,000 shares which the registrant has agreed to issue to its President, Helen Teplitskaia for services rendered during the months of July 2009 through August 2010, which shares have not been issued to date and have not been included in the total number of outstanding shares disclosed throughout this report.

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders
Siberian Energy Group Inc.

We have reviewed the accompanying condensed consolidated balance sheet of Siberian Energy Group Inc. (a development stage company) as of June 30, 2010, and the related condensed consolidated statements of operations for the three and six months ended June 30, 2010 and 2009, and the cumulative period of development stage activity (January 1, 2003 through June 30, 2010), and the condensed consolidated statements of stockholders' equity and cash flows for the six months ended June 30, 2010 and 2009, and the cumulative period of development stage activity (January 1, 2003 through June 30, 2010). These financial statements are the responsibility of the Company's management.

We conducted our review in accordance with standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures to financial data and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the auditing standards of the Public Company Accounting Oversight Board, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to the accompanying interim financial statements referred to above for them to be in conformity with accounting principles generally accepted in the United States of America.

We have previously audited, in accordance with auditing standards of the Public Company Accounting Oversight Board, the consolidated balance sheet as of December 31, 2009, and the related consolidated statements of operations, stockholders' equity, and cash flows for the year then ended (not presented herein); and in our report dated April 9, 2010, we included an explanatory paragraph describing conditions that raised substantial doubt about the Company's ability to continue as a going concern. In our opinion, the information set forth in the accompanying condensed consolidated balance sheet as of December 31, 2009 is fairly stated, in all material respects, in relation to the balance sheet from which it has been derived.

Lumsden & McCormick, LLP
Buffalo, New York
August 9, 2010

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SIBERIAN ENERGY GROUP INC. (A Development Stage Company)

Condensed Consolidated Balance Sheets	(Unaudited) June 30, 2010	December 31, 2009
Assets		
Current assets:		
Cash	$ 505	$ 751
Prepaid expenses and other	586	569
	1,091	1,320
Investment in ZNG, Ltd., at equity	-	-
Investment in KNG, at equity	-	-
Oil and gas properties, unproved	-	-
Property and equipment, net	959	1,267
	$ 2,050	$ 2,587
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable:		
Related party - stockholders	$ 539,931	$ 523,906
Related party - Baltic Petroleum, interest at 14%	72,148	68,848
Others	719,661	606,831
Accrued payroll	1,319,607	1,152,054
	2,651,347	2,351,639
Stockholders' equity:		
Common stock - authorized 100,000,000 shares, $.001 par value,		
18,705,550 issued and outstanding	18,706	18,706
Additional paid-in capital	13,161,691	13,161,691
Accumulated deficit		
Pre-development stage	(449,785)	(449,785)
Development stage	(15,365,819)	(15,072,720)
Accumulated other comprehensive income (loss)	(14,090)	(6,944)
	(2,649,297)	(2,349,052)
	$ 2,050	$ 2,587

See accompanying notes.

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SIBERIAN ENERGY GROUP INC. (A Development Stage Company)

Condensed Consolidated Statements of Operations

	For the three months ended June 30, 2010	For the three months ended June 30, 2009	For the six months ended June 30, 2010	For the six months ended June 30, 2009	For the cumulative period of Development Stage Activity- January 1, 2003 through June 30, 2010
Revenues and other income:					
Management fees from joint venture	$ -	$ -	$ -	$ -	$ 1,135,000
Gain from entrance into joint venture	-	-	-	-	364,479
Other	-	-	-	-	6,382
Total revenues and other income	-	-	-	-	1,505,861
Expenses:					
Salaries	82,700	102,926	164,500	183,526	3,970,358
Professional and consulting fees	58,393	61,009	118,544	114,360	5,212,485
Rent and occupancy	-	-	-	-	237,226
Depreciation and amortization	167	152	335	299	105,193
Finance charges and interest	1,661	1,701	3,420	3,699	122,524
Marketing and other	3,284	16,438	6,300	23,993	2,070,877
Total expenses	146,205	182,226	293,099	325,877	11,718,663
Loss from disposition of loan receivable - affliate	-	-	-	-	29,500
Loss from sale of investment	-	-	-	-	669,570
Loss on deemed disposition of oil and gas properties, unproved	-	-	-	-	3,928,000
Impairment charge on investment	-	-	-	-	525,947

Loss before income taxes	146,205	182,226	293,099	325,877	15,395,819
Provision for income taxes (benefit)	-	-	-	-	-
Net loss (development stage)	$ 146,205	$ 182,226	$ 293,099	$ 325,877	$ 15,395,819
Basic and diluted loss per common share	$ (0.01)	$ (0.01)	$ (0.02)	$ (0.02)	$ (1.19)
Weighted average number of basic and diluted common shares outstanding	18,705,550	18,652,803	18,705,550	18,649,176	12,952,538

See accompanying notes.

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SIBERIAN ENERGY GROUP INC. (A Development Stage Company)

Condensed Consolidated Statements of Stockholders' Equity

For the cumulative period of Development Stage Activity - January 1, 2003 through June 30, 2010

	Common Stock Number of Shares	Par Value	Additional Paid-In Capital	Accumulated Deficit	Accumulated Other Comprehensive Income (Loss)	Total	Comprehensive Loss
Balance, January 1, 2003 (pre-development stage)	4,902,886	$ 4,903	$ 430,195	$ (449,785)	$ -	$ (14,687)	
Loss for the year - 2003	-	-	-	(422,516)	-	(422,516)	$ (422,516)
Shares issued in acquisition (ZNG)	1,000,000	1,000	(1,000)	-	-	-	
Balance, December 31, 2003	5,902,886	$ 5,903	$ 429,195	$ (872,301)	$ -	$ (437,203)	
Loss for the year - 2004	-	-	-	(833,567)	-	(833,567)	
Foreign currency translation adjustment	-	-	-	-	(53,120)	(53,120)	$ (886,687)
Shares issued in acquisition (ZNG)	3,450,000	3,450	746,550	-	-	750,000	
Shares issued for professional services	50,000	50	9,950	-	-	10,000	
Other	-	-	34,426	-	-	34,426	
Balance, December 31, 2004	9,402,886	$ 9,403	$ 1,220,121	$ (1,705,868)	$ (53,120)	$ (529,464)	
Loss for the year - 2005	-	-	-	(1,153,686)	-	(1,153,686)	

Foreign currency translation adjustment	-	-	-	-	50,614	50,614	$ (1,103,072)
Shares issued for professional services	385,000	385	197,829	-	-	198,214	
Shares issued for accrued salaries	1,700,000	1,700	301,871	-	-	303,571	
Warrants granted for professional services	-	-	310,000	-	-	310,000	
Balance, December 31, 2005	11,487,886	$ 11,488	$ 2,029,821	$ (2,859,554)	$ (2,506)	$ (820,751)	
Loss for the year - 2006	-	-	-	(4,072,788)	-	(4,072,788)	
Foreign currency translation adjustment	-	-	-	-	(1,939)	(1,939)	$ (4,074,727)
Shares issued for employee stock option plan and warrants	195,000	195	45,305	-	-	45,500	
Shares issued for geological data	1,900,000	1,900	3,323,100	-	-	3,325,000	
Shares issued for professional services	1,139,499	1,140	2,120,320	-	-	2,121,460	
Warrants granted for professional services	-	-	1,201,960	-	-	1,201,960	
Shares cancelled	(609,424)	(610)	610	-	-	-	
Balance, December 31, 2006	14,112,961	$ 14,113	$ 8,721,116	$ (6,932,342)	$ (4,445)	$ 1,798,442	

See accompanying notes

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SIBERIAN ENERGY GROUP INC. (A Development Stage Company)

Consolidated Statements of Stockholders' Equity

For the cumulative period of Development Stage Activity - January 1, 2003 through June 30, 2010

	Common Stock Number of Shares	Par Value	Additional Paid-In Capital	Accumulated Deficit	Accumulated Other Comprehensive Income (Loss)	Total	Comprehensive Loss
	14,112,961	$ 14,113	$ 8,721,116	$ (6,932,342)	$ (4,445)	$ 1,798,442	
Loss for the year - 2007	-	-	-	(2,060,487)	-	(2,060,487)	
Foreign currency translation adjustment	-	-	-	-	(9,804)	(9,804)	$ (2,070,291)
Shares issued for employee stock option plan and warrants	566,935	567	(567)	-	-	-	
Shares issued for geological data	200,000	200	349,800	-	-	350,000	
Shares issued for accrued salaries	788,000	788	1,444,618	-	-	1,445,406	
Shares issued for licenses	2,000,000	2,000	1,318,000	-	-	1,320,000	
Shares issued for professional services	715,134	715	1,070,395	-	-	1,071,110	
Warrants granted for professional services	-	-	150,394	-	-	150,394	
	18,383,030	$ 18,383	$ 13,053,756	$ (8,992,829)	$ (14,249)	$ 4,065,061	

Balance, December 31, 2007							
Loss for the year - 2008	-	-	-	(5,863,560)	-	(5,863,560)	
Foreign currency translation adjustment	-	-	-	-	27,019	27,019	$ (5,836,541)
Shares issued for professional services and accrued salaries	155,000	155	41,595	-	-	41,750	
Warrants granted for professional services	-	-	6,303	-	-	6,303	
Shares issued for loan repayment and related interest	107,520	108	10,645	-	-	10,753	
Balance, December 31, 2008	18,645,550	$ 18,646	$ 13,112,299	$ (14,856,389)	$ 12,770	$ (1,712,674)	
Loss for the year - 2009	-	-	-	(666,116)	-	(666,116)	
Foreign currency translation adjustment	-	-	-	-	(19,714)	(19,714)	$ (685,830)
Shares issued for accrued salaries	60,000	60	3,540	-	-	3,600	
Options vested to employees and directors	-	-	45,852	-	-	45,852	
Balance, December 31, 2009	18,705,550	$ 18,706	$ 13,161,691	$ (15,522,505)	$ (6,944)	$ (2,349,052)	

Loss for six months - 2010	-	-	-	(293,099)	-	(293,099)	
Foreign currency translation adjustment	-	-	-	-	(7,146)	(7,146)	$ (300,245)
Balance, June 30, 2010	18,705,550	$ 18,706	$ 13,161,691	$ (15,815,604)	$ (14,090)	$ (2,649,297)	
See accompanying notes.							

SIBERIAN ENERGY GROUP INC. (A Development Stage Company)

Condensed Consolidated Statements of Cash Flows

For the six months ended June 30,	2010	2009	For the cumulative period of Development Stage Activity- January 1, 2003 through June 30, 2010
Operating activities:			
Net loss (development stage)	$ (293,099)	$ (325,877)	$ (15,365,819)
Depreciation and amortization	335	299	105,193
Common stock and warrants issued			
for professional services and salaries and geological data	-	26,526	7,231,933
Gain from entrance into joint venture	-	-	(364,479)
Loss on disposition of office furniture	-	-	1,029
Loss on sale of investment, including deconsolidation of subsidiary	-	-	823,692
Loss on deemed disposition of oil and gas properties, unproved	-	-	3,928,000
Impairment charge on investment	-	-	525,947
Changes in other current assets and			
current liabilities:			
Management fee receivable	-	-	110,000
Prepaid expenses and other assets	(17)	(15)	(263,978)
Accounts payable and accrued expenses	299,708	305,406	4,291,125
Net operating activities	6,927	6,339	1,022,643
Investing activities:			
Expenditures for licenses and related	-	-	(528,961)
Expenditures for oil and gas properties	-	-	(770,750)
Expenditures for property and equipment	-	-	(6,244)
Proceeds of disposition of office furniture	-	-	107
Loan to affiliate	-	-	(29,500)
Cash received in acquisition	-	-	6
Cash received from entrance into joint venture	-	-	175,000
Net investing activities	-	-	(1,160,342)
Financing activities:			
Net proceeds from demand loans	-	-	72,500
Common stock issued for employee stock option plan	-	-	45,500
Additional paid-in capital	-	-	34,426
Net financing activities	-	-	152,426
Effect of exchange rates on cash	(7,173)	(6,319)	(14,222)
Net change in cash	(246)	20	505

Cash - beginning		751		739		-
Cash - ending	$	505	$	759	$	505

See accompanying notes.

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SIBERIAN ENERGY GROUP INC. (A Development Stage Company)

Notes to Condensed Consolidated Financial Statements

1. Basis of Presentation:

The accompanying unaudited consolidated financial statements of Siberian Energy Group Inc. (the Company) include the accounts of the Company and its 100% owned subsidiaries. These financial statements have been prepared pursuant to the rules of the Securities and Exchange Commission (SEC) interim reporting, and do not include all of the information and note disclosures required by generally accepted accounting principles. These consolidated financial statements and notes herein are unaudited, but in the opinion of management, include all the adjustments (consisting of only normal recurring adjustments) necessary for a fair presentation of the Company's financial positions, results of operations, and cash flows for the periods presented. Accounting policies used in fiscal 2010 are consistent with those used in the cumulative period of Development Stage Activity – January 1, 2003 through December 31, 2009. These financial statements should be read in conjunction with the Company's audited consolidated financial statements and notes thereto. Interim operating results are not necessarily indicative of operating results for any future interim period or the full year.

2. The Company and Description of Business:

Kondaneftegaz

The Company, through its subsidiary Kondaneftegaz, LLC (KNG), has been engaged in the business of exploiting and developing certain oil and gas and other petroleum products licenses issued for a period of five years by Russia's subsurface management authorities in October 2007. The two licensed areas lie in the Karabashsky zone in the Khanty-Mansiysk Autonomous area of the Russian Federation. KNG has its principal place of business in the city of Khanty-Mansiysk, Russia. KNG has prepared and coordinated with Russian authorities the Program of exploration works on the Karabashski 61 and Karabashski 67 license areas. KNG is evaluating the possibility of using prior seismic data in the current exploration program.

KNG was acquired together with the vast collection of geological information data (oil and gas properties, unproved) on the Karabashski zone of Khanty-Mansiysk Autonomous district of the Tuymen region of the Russian Federation through the issuance of shares and warrants as follows:

Restricted common shares issued for oil and gas properties, unproved in 2006	1,900,000
Restricted common shares issued in connection with license acquisition by KNG in 2007	2,000,000
Restricted common shares issued in 2006	200,000
Total restricted common shares issued	4,100,000

Stock warrants issued in 2006

for purchase option	250,000

As a result of the purchase, a calculated acquisition value of $3,928,000 was assigned to the oil and gas properties, unproved that considered the approximate market value of the stock issued ($1.75) on the transaction date including $3,675,000 assigned to 2,100,000 shares issued in 2006 and $253,000 assigned to 250,000 stock warrants issued. A value of $1,320,000 was assigned to the acquisition of licenses by KNG based on the market value of the 2,000,000 shares on the date of issue.

On September 30, 2008 the Company sold a 51% interest in KNG to a Russian oil and gas company, and a 5% interest to two Russian individuals for $223. This Russian company has committed to lead the exploration works on the licensed areas by accepting the operator's role and agreeing to provide funding for KNG's activities. Simultaneously with the sale of 56% of KNG, the Company made available all geological data to the operator to be used in the program of geological studies in the region. Since no consideration was received and the Company has no intent to further utilize this geological data, a loss on the deemed disposition of these unproven oil and gas properties of $3,928,000 has been recorded. Operations of KNG prior to September 30, 2008 are included in the consolidated accounts of the Company in the accompanying financial statements. Effective September 30, 2008, the Company's 44% investment in KNG is recorded on the equity method of accounting. At September 30, 2008, KNG's assets were $13,572 and liabilities were $135,740. Since 56% of the Company was sold for a nominal amount, a non-cash impairment charge of $525,947 has been recorded to reduce the carrying value of the 44% investment in KNG to zero.

Zauralneftegaz

Zauralneftegaz Ltd. (ZNG, Ltd.) is the Company's 50% owned joint venture with Baltic Petroleum Limited, UK created in 2005, which operates through its Russian subsidiary Zaural Neftegaz (ZNG). ZNG has been involved in oil and gas research activities in the Kurgan region of the Russian Federation. During 2003 through 2008 it has completed seismic studies and drilling program in the Kurgan region, after which date Kurgan operations were put on hold until further economical advisability is confirmed. The Company believes ZNG, Ltd. has created value through the geological results of the two exploratory wells and other data gathered in the area and ZNG, Ltd. is considering its options with regard to realizing this value by either a farm out or a direct sale of geophysical and seismic data to a third party operating in the area.

Activities of ZNG for the period March 2003 through October 2005 are included in the consolidated accounts of the Company in the accompanying financial statements. Effective October 14, 2005, the Company's investment in Joint Venture has been recorded on the equity method of accounting. Since the cumulative losses of the Joint Venture exceed the Company's investment, the investment asset is carried at zero value as of and through June 30, 2010.

Both equity investments are recorded at zero on the accompanying balance sheets. Although management is hopeful, the Company is uncertain when and if any income will be realized from these investments. On a moving forward basis, the Company anticipates further business expansion. It is constantly evaluating new mineral resource assets, both explored and unexplored, as part of its growth strategy.

The Company was incorporated in the State of Nevada on August 13, 1997, and previously provided comprehensive outpatient rehabilitation services to patients suffering from work, sports and accident related injuries. All activities related to the Company's previous business ventures were essentially discontinued prior to January 1, 2000. Predecessor names of the Company since its inception include Trans Energy Group, Inc., King Incorporated and Advanced Rehab Technology Corporation.

3. Income Taxes:

At June 30, 2010, the Company effectively has U.S. tax net operating loss carryforwards totaling approximately $14,084,000. These carryforwards may be used to offset future taxable income, and expire in varying amounts through 2030. No tax benefit has been reported in the financial statements, however, because the Company believes there is at least a 50% chance that the carryforwards will expire unused. Accordingly, the $2,817,000 estimated cumulative tax benefit of the loss carryforwards have been offset by a valuation allowance of the same amount.

4. Loss Per Common Share:

Basic and diluted loss per common share is computed using the weighted average number of common shares outstanding during the period. Shares issuable for common stock options and warrants may have had a dilutive effect on earnings per share had the Company generated income during the periods through June 30, 2010.

5. Going Concern:

These financial statements have been prepared assuming the Company will continue as a going concern, however, since inception of its current endeavor in 2003, it has not earned substantial revenues and is considered to be in the development stage, which raises substantial doubt about its ability to continue as a going concern.

Management is of the opinion that its current and proposed oil and gas ventures will successfully generate allocable profits to the Company in the near term.

For the cumulative period ended June 30, 2010, the Company has obtained cash financing from organizing stockholders and employees in the form of loans, advances, and deferred salaries. However, there can be no certainty as to availability of continued financing in the future. Failure to obtain sufficient financing may require the Company to reduce its operating activities. A failure to continue as a going concern would then require stated amounts of assets and liabilities to be reflected on a liquidation basis which could differ form the going concern basis.

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS

CERTAIN STATEMENTS IN THIS QUARTERLY REPORT ON FORM 10-Q (THIS "FORM 10-Q"), CONSTITUTE "FORWARD LOOKING STATEMENTS" WITHIN THE MEANING OF SECTION 27A OF THE SECURITIES ACT OF 1934, AS AMENDED, AND THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995 (COLLECTIVELY, THE "REFORM ACT"). CERTAIN, BUT NOT NECESSARILY ALL, OF SUCH FORWARD-LOOKING STATEMENTS CAN BE IDENTIFIED BY THE USE OF FORWARD-LOOKING TERMINOLOGY SUCH AS "BELIEVES", "EXPECTS", "MAY", "SHOULD", OR "ANTICIPATES", OR THE NEGATIVE THEREOF OR OTHER VARIATIONS THEREON OR COMPARABLE TERMINOLOGY, OR BY DISCUSSIONS OF STRATEGY THAT INVOLVE RISKS AND UNCERTAINTIES. SUCH FORWARD-LOOKING STATEMENTS INVOLVE KNOWN AND UNKNOWN RISKS, UNCERTAINTIES AND OTHER FACTORS WHICH MAY CAUSE THE ACTUAL RESULTS, PERFORMANCE OR ACHIEVEMENTS OF SIBERIAN ENERGY GROUP INC. ("THE COMPANY", "WE", "US" OR "OUR") TO BE MATERIALLY DIFFERENT FROM ANY FUTURE RESULTS, PERFORMANCE OR ACHIEVEMENTS EXPRESSED OR IMPLIED BY SUCH FORWARD-LOOKING STATEMENTS. REFERENCES IN THIS FORM 10-Q, UNLESS ANOTHER DATE IS STATED, ARE TO JUNE 30, 2010.

Investors should also take note of the fact that some of the more technical terms relating to the Company's operations as described below are explained in greater detail under exhibit 99.1, incorporated by reference hereto.

BUSINESS DEVELOPMENT:

Siberian Energy Group Inc. was formed as a Nevada corporation on August 13, 1997, as Advanced Rehab Technology Corporation. Subsequently, on March 9, 2001, the Company changed its name to Talking Cards, Inc.; on February 12, 2002, the Company changed its name to Oysterking Incorporated; on December 3, 2002, the Company changed its name to 17388 Corporation Inc., at which point the controlling interest of the Company was sold and a new board of directors was appointed; on May 5, 2003, the Company changed its name to Trans Energy Group Inc.; and on December 3, 2003, the Company changed its name to Siberian Energy Group Inc.

On September 17, 1999, the Company affected a 1-for-30 reverse stock split. A subsequent 3-for-1 forward split was consummated on October 2, 2000 and a further 1:2 reverse stock split was affected on May 2, 2005 (collectively the “Stock Splits”). All share amounts subsequently listed are retroactively adjusted to reflect these stock splits unless otherwise provided.

In the spring of 2003, a majority of the Company's shares were purchased by new shareholders who stepped into the management of the Company and defined its new business direction as an oil and gas exploration company.

On May 9, 2003, the Company entered into an Acquisition Agreement (the "Acquisition Agreement") by and among the Company, Zaural Neftegaz, a Russian corporation ("ZNG"), the shareholders of ZNG and Oleg Zhuravlev, President of ZNG, and a former Director of the Company. Pursuant to the Acquisition Agreement, the Company acquired a 51% interest in ZNG by issuing to ZNG 2,000,000 shares of the Company's common stock. In June 2004, the Company purchased the remaining 49% of ZNG in exchange for 6,900,000 shares of the Company's common stock, making ZNG a wholly-owned subsidiary of the Company. The Company had no affiliation with ZNG prior to the acquisition in May 2003.

Currently, the operating activities of ZNG are carried out through the Joint Venture Shareholders' Agreement ("Joint Venture") entered into on October 14, 2005 with Baltic Petroleum (E&P) Limited ("BP" or "Baltic") and Zauralneftegaz Limited, the joint venture company ("ZNG, Ltd."), as contemplated by the Option Agreement, as amended (the "Option"). The Company closed the Joint Venture and transferred 100% of the outstanding stock of ZNG to ZNG, Ltd. in connection with the terms and conditions of the Joint Venture. As a result of such transfer, the

Company holds 50% of the outstanding stock of ZNG, Ltd., which holds 100% of the outstanding stock of the Company's former wholly-owned subsidiary, ZNG. ZNG, Ltd. operates through ZNG and is engaged in the exploration and development of, production and sale of, oil and gas assets in the Western Siberian region of the Russian Federation and the former Soviet Union.

On December 13, 2006, we entered into an Interest Purchase Agreement (the "Purchase Agreement") with Key Brokerage LLC ("Key Brokerage"), pursuant to which we purchased 100% of the stock of Kondaneftegaz LLC ("KNG"), a Russian limited liability company, which was created in 2004 for the purpose of oil and gas exploration in the Khanty-Mansiysk district of Western Siberia, Russia. In addition to acquiring 100% of the stock of KNG, we received the geological information package on the Karabashski zone of Khanty-Mansiysk Autonomous district (Tuymen region of Russian Federation) ("Geological Data").

On or about September 30, 2008, we entered into an Agreement of Purchase and Sale with Limited Liability Company Neftebitum, a Russian limited liability company, and two Russian individuals, pursuant to which we sold fifty-six percent (56%) of the ownership interest of KNG, as described in greater detail below.

All dollar amounts used throughout this Report are in United States dollars, unless otherwise stated. All amounts in Canadian dollars used throughout this Report are preceded by CDN, for example CDN $500, is referring to $500 Canadian dollars.

BUSINESS OPERATIONS:

We are a development stage company which is seeking opportunities for investment in and/or acquisition of small to medium companies in Russia, specifically in the oil and gas industry.

We currently hold investments in ZNG, Ltd. and KNG. Both companies are operating in the Western Siberia region of Russia and are involved in oil and gas exploration, provided however, as described below, ZNG, Ltd. has advised us that it will no longer undertake any further exploration activities in Western Siberia.

Moving forward the Company plans to focus on those assets that involve less exploration risk and is also actively seeking and negotiating the acquisition of production or close-to-production assets in Russia and countries of the former Soviet Union; however, the Company has not entered into any definitive agreements to date, and there can be no assurance that any such agreements will be entered into on favorable terms, if at all.

Description of KNG

KNG was created in 2004 for the purpose of oil and gas exploration in the Khanty-Mansiysk district of Western Siberia, Russia. In October 2007, KNG was awarded two oil and gas exploration licenses in Khanty-Mansiysk region in Western Siberia, Russia for the Karabashsky-61 and Karabashsky-67 blocks located in the Khanty-Mansiysk Autonomous Region, Russian Federation. The license areas together cover 166,000 acres and are situated in the territory of the Urals oil and gas bearing area. KNG also has eight more outstanding applications for exploration licenses filed with the Russian authorities, which auctions have not occurred to date.

The right to use the subsurface resources of the Karabashski-61 and Karabashki-67 Fields is granted for the term of validity of the license (five (5) years), from the date of its state registration (October 22, 2007), subject to the completion of certain exploration activities on the license blocks. The term of use of the subsurface resources can be extended to finish exploration and estimation of deposit or for liquidation work, if the terms of usage of the subsurface resources are not breached.

KNG has prepared and coordinated with the Russian authorities an exploration works program on the Karabashski-61 and Karabashski-67 license areas to stay in compliance with the license agreements' requirements described below in further detail:

- o to begin 2D seismic works during the 2009-2010 fieldwork season and to perform not less than 176.26 linear kilometers of seismic profiles on Karabashky-61 and 158 linear kilometers on Karabashky-67 (minimal density of the profile not less than 1 linear kilometer per 1 square kilometer of license area), and

- o no later than 2011, to start drilling an exploratory well and to complete not less than 2 exploratory wells by April 1, 2012.

As of June 30, 2010 KNG has re-interpreted the existing seismic data from prior studies and updated its program of seismic works. 2D seismic studies are currently planned to start in the fourth quarter of 2010.

On or about September 30, 2008, we entered into an Agreement of Purchase and Sale with Limited Liability Company Neftebitum, a Russian limited liability company ("Neftebitum"), Sergey V. Prokopiev, an individual and Russian citizen, and Oleg G. Shelepov, an individual and Russian citizen (collectively, the "Purchasers" and the "Sale Agreement"). The Company's Board of Directors approved and ratified the Company's entry into the Sale Agreement and the transactions contemplated therein on or about October 30, 2008. Pursuant to the Sale Agreement, the Company agreed to sell to the Purchasers an aggregate of fifty-six percent (56%) of the registered capital of KNG for aggregate consideration of 5,600 Russian Rubles (approximately $223). Neftebitum agreed to purchase a 51% interest for total consideration of 5,100 Russian Rubles (approximately $203) and Mr. Prokopiev and Mr. Shelepov agreed to each purchase a 2.5% interest for consideration of 250 Russian Rubles each (approximately $10).

Pursuant to the Sale Agreement, the Sellers are obligated to maintain KNG's main priority of performing geological studies and exploring for hydrocarbon deposits in the Karabashsky-61 and Karabashsky-67 blocks (the "Blocks"). Further, the Purchasers are obligated to provide financing, by way of direct financing or third-party loans, in the amounts necessary to comply with the licensing agreements for the Blocks. The Company's and the Purchasers' relationship is to be regulated by the Operating Agreement (as described below), which was entered into in connection with the Sale Agreement. Lastly, the Sale Agreement provides that in connection with Neftebitum obtaining a majority interest in KNG, it is obligated to be a guarantor and accept joint responsibility with KNG for repayment of any financing the Purchasers obtain for KNG.

On or about November 5, 2008, and in connection with their entry into the Sale Agreement, Neftebitum, the Company and KNG entered into an Operating Agreement that defines the rights and responsibilities of the parties (the "Operating Agreement"). Pursuant to the Operating Agreement, Neftebitum is designated the exclusive Operator of KNG and all of its current and future mineral claims and has the right to appoint all members of KNG's management. As Operator, Neftebitum has exclusive control of all technical, management, operational and associated matters involving KNG and the Blocks and any potential hydrocarbon exploration and production licenses (the "Operations"). Neftebitum must manage and conduct the Operations by itself, its agents, independent contractors and/or servants in general accordance with standard oil and gas field practices. Neftebitum must use all reasonable endeavors to:

- · Prepare annual programs and budgets pursuant to the Operating Agreement and the licensing agreements for the Blocks;

- · Begin 2D seismic works on the Blocks during the 2009-2010 fieldwork season and perform not less than 176.26 linear kilometers of seismic profiles on the Karabashky-61 Block and not less than 158 linear kilometers of seismic works on the Karabashky-67 Block;

- Start drilling an exploratory well no later than 2011, and complete no less than 2 exploratory wells by April 1, 2012;

- Provide adequate financing to carry out KNG's planned activities; and

- Supervise implementation of all programs and budgets and provide written progress reports on a quarterly basis relating to KNG's activities and programs.

Further, as Operator, Neftebitum may enter into and negotiate contracts on behalf of KNG and the Company and represent KNG or the Company in all dealings with governmental and regulatory bodies. Neftebitum must guarantee any financial obligations entered into on KNG's behalf. Neftebitum may be reimbursed for expenses incurred in its role as Operator, and if KNG has inadequate resources to reimburse such expenses, these unreimbursed expenses may be accounted for at the time of the distribution of profits from KNG's operations, if any. Neftebitum, however, will not charge Operator's management fees in connection with its role as Operator. Additionally, the Company made available to the Operator all of the geological data, to be used in the program of geological studies in the region and will not charge fees for the use of geological data it provides. Neftebitum must also use its best efforts to maintain insurance for the Company. Lastly, Neftebitum's responsibilities as Operator under the Operating Agreement may not be assigned or transferred.

As of the date of this filing, Neftebitum has raised approximately $155,000 through the sale of debt to pay for the first stage of the seismic project and the government fees for the subsoil use.

As of June 30, 2010, the Company owned a 44% interest in KNG. Effective September 30, 2008, the Company's 44% investment in KNG is recorded on the equity method of accounting. The operations of KNG prior to September 30, 2008 are included in the consolidated accounts of the Company in the accompanying financial statements.

After careful consideration of the current financial position of KNG, the Company has applied an impairment charge to the value of investment in KNG which resulted in carrying it at zero value.

Description of ZNG

ZNG has been involved in the oil and gas research activities in the Kurgan region of the Russian Federation. During 2003-2008 it has completed seismic studies and a drilling program in the Kurgan region of Siberia, Russia. The Company believes ZNG, Ltd. has created value through the geological results of the two exploratory wells and other data gathered in the area and ZNG, Ltd. is considering its options with regard to realizing this value in connection with a potential direct sale of geophysical and seismic data to a third party operating in the area.

Between 2003 and 2007, ZNG carried out extensive seismic and gas seismotomographic studies on its 4 licensed blocks acquired in 2003 through a government tender (which have since expired): the Privolny, Mokrousovsky, West-Suersky and Orlovo-Pashkovsky blocks, and drilled 2 exploratory wells on the Privolny and Mokrousovsky blocks. Based on the interpretation of seismic and seismotomographic surveys and analysis of samples from the wells, ZNG prepared a comprehensive analysis of geological resources of the Kurgan region. Both the Privolny-1 and Mokrousovsky-1 studies confirmed the presence of hydrocarbons and contributed greatly to the understanding of geological resources in the region. However, a substantial amount of further exploration studies and work is required before a conclusion on the future potential of the blocks can be drawn. Upon the expiration of the license terms of these blocks in March 2008, ZNG kept the preferential right to re-apply for the licenses.

The Company's investment in the Joint Venture is recorded on the equity method of accounting. Since cumulative losses of Joint Venture exceed the Company's investment, the investment asset is carried at zero value as of and through June 30, 2010.

As of the date of this filing, Baltic has advised us that Baltic and as a result, ZNG, has withdrawn from any further exploration activities in the Kurgan region and that they will not expend any further resources on such activities moving forward. Baltic has however advised us that they believe they may be able to sell ZNG's previously prepared seismic and geological studies and data in the future, assuming other exploration companies in the area desire to purchase such information, of which there is no assurance.

Joint Venture

The operations of the Joint Venture were funded via loans provided to ZNG, Ltd. and ZNG by Caspian Finance Limited ("Caspian"), a financing company wholly-owned by Baltic. Loans are guaranteed by ZNG, Ltd.'s holdings in ZNG. As of June 30, 2010, the total funding provided to ZNG, Ltd. and ZNG by Baltic was equal to approximately $23.5 million plus accrued interest of approximately $5 million. The loans are not dilutive to the Company's ownership in ZNG.

Recent Events:

In April 2010, and effective as of January 1, 2010, the Company entered into extensions to the Employment Agreements of David Zaikin, its Chairman and Chief Executive Officer and Elena Pochapski, its Director and Chief Financial Officer, which Employment Agreements as extended expired on June 30, 2010. Mr. Zaikin's Employment Agreement extension set his annual compensation at $180,000 and Ms. Pochapski's Employment Agreement extension set her annual compensation at $75,000. The Company anticipates entering into agreements further extending the Employment Agreements of Mr. Zaikin and Ms. Pochapski subsequent to the date of this filing, which agreements and the terms and conditions thereof have not been finalized to date.

PLAN OF OPERATIONS FOR THE NEXT TWELVE MONTHS

In coordination with Neftebitum, the Company plans to focus on the exploration activities of KNG in the Khanty-Mansiysk region of Russia, to satisfy the requirements of the licensing agreements and to conduct preparatory work for the seismic surveys on these areas, funding permitting (which funding is the responsibility of Neftebitum), of which there can be no assurance.

Moving forward, we anticipate targeting other potential long term investments in Russia and countries in the former Soviet Union, separate from our involvement in the Joint Venture and KNG, funding permitting, of which there can be no assurance. Additionally, the Company currently plans to change its business focus from targeting early stage exploration projects to acquiring assets in producing fields, funding permitting, of which there can be no assurance, in order to decrease its exploration risks.

Currently we are evaluating different business opportunities in the oil and gas industry, including advanced development stage and revenue-producing enterprises and are in preliminary discussions with a potential partner which owns several oil and gas producing properties in Western Siberia; however, as no definitive agreement has been reached, we can provide no assurances that the discussions will result in any definitive understandings or partnerships, and it is likely that any agreement would be conditioned on us raising substantial additional funding, which we can provide no assurances will be available on favorable terms, if at all.

Historically, we have obtained cash financing from organizing stockholders in the form of loans and advances. Additionally, during the fourth quarter of 2005, we restructured much of our debt through the issuance of shares of our common stock to our creditors and obtained waiver letters, postponing certain of our liabilities until such time as we have generated sufficient profits to pay such debts. These waiver letters related to the payment of certain trade debts as well as shareholder loans and accrued salaries.

In connection with the Joint Venture, the Company previously received monthly management fees, which varied from $25,000 to $85,000 per month. Due to the "transition period" of the Joint Venture's exploration activities and subsequent decision of Baltic not to pursue further exploration activities through ZNG, no management fees have been paid since October 2007, and the Joint Venture will not pay any management fees in the future. As the Company will not receive any management fees moving forward, the Company believes that its organizing stockholders will continue to provide financing for the Company, of which there can be no assurance.

In the past, we have obtained cash financing from organizing stockholders in the form of loans and advances, as a result, amounts totaling $539,931 and $523,906 were payable to the stockholders as of June 30, 2010 and December 31, 2009, respectively. However, there can be no certainty as to the availability of continued financing in the future. Failure to obtain sufficient financing may require us to reduce our operating activities. A failure to continue as a going concern would then require stated amounts of assets and liabilities to be reflected on a liquidation basis which could differ from the going concern basis.

COMPARISON OF OPERATING RESULTS