

VALERO ENERGY CORP/TX

Form 10-Q

May 09, 2007

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**
Washington, D.C. 20549
FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2007

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 number 1-13175

VALERO ENERGY CORPORATION
(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

74-1828067
(I.R.S. Employer
Identification No.)

One Valero Way
San Antonio, Texas
(Address of principal executive offices)
78249
(Zip Code)

(210) 345-2000
(Registrant's telephone number, including area code)

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

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

Yes No

The number of shares of the registrant's only class of common stock, \$0.01 par value, outstanding as of April 30, 2007 was 548,990,535.

**VALERO ENERGY CORPORATION AND SUBSIDIARIES
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VALERO ENERGY CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(Millions of Dollars, Except Par Value)

	March 31, 2007 (Unaudited)	December 31, 2006
ASSETS		
Current assets:		
Cash and temporary cash investments	\$ 1,696	\$ 1,590
Restricted cash	31	31
Receivables, net	4,173	4,389
Inventories	4,835	4,430
Income taxes receivable	-	32
Deferred income taxes	147	143
Prepaid expenses and other	113	145
 Total current assets	 10,995	 10,760
 Property, plant and equipment, at cost	 24,793	 24,377
Accumulated depreciation	(3,499)	(3,279)
 Property, plant and equipment, net	 21,294	 21,098
 Intangible assets, net	 293	 303
Goodwill	4,209	4,211
Deferred charges and other assets, net	1,396	1,381
 Total assets	 \$38,187	 \$ 37,753
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Current portion of long-term debt and capital lease obligations	\$ 297	\$ 476
Accounts payable	6,970	6,864
Accrued expenses	465	510
Taxes other than income taxes	577	586
Income taxes payable	434	23
Deferred income taxes	291	363
 Total current liabilities	 9,034	 8,822
 Long-term debt and capital lease obligations, less current portion	 4,649	 4,657

Deferred income taxes	4,048	4,047
Other long-term liabilities	1,726	1,622
Commitments and contingencies (Note 14)		
Stockholders' equity:		
Common stock, \$0.01 par value; 1,200,000,000 shares authorized; 627,501,593 and 627,501,593 shares issued	6	6
Additional paid-in capital	7,543	7,779
Treasury stock, at cost; 35,461,598 and 23,738,162 common shares	(2,074)	(1,396)
Retained earnings	13,022	11,951
Accumulated other comprehensive income	233	265
Total stockholders' equity	18,730	18,605
Total liabilities and stockholders' equity	\$38,187	\$37,753

See Condensed Notes to Consolidated Financial Statements.

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VALERO ENERGY CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
(Millions of Dollars, Except per Share Amounts)
(Unaudited)

	Three Months Ended March	
	31,	
	2007	2006
Operating revenues (1)	\$ 19,698	\$ 20,927
Costs and expenses:		
Cost of sales	16,308	18,085
Refining operating expenses	975	926
Retail selling expenses	171	172
General and administrative expenses	145	151
Depreciation and amortization expense	334	260
Total costs and expenses	17,933	19,594
Operating income	1,765	1,333
Equity in earnings of NuStar Energy L.P.	-	12
Other income, net	5	-
Interest and debt expense:		
Incurred	(90)	(96)
Capitalized	31	37
Income before income tax expense	1,711	1,286
Income tax expense	567	437
Net income	1,144	849
Preferred stock dividends	-	1
Net income applicable to common stock	\$ 1,144	\$ 848
Earnings per common share	\$ 1.91	\$ 1.37
Weighted-average common shares outstanding (in millions)	599	619
Earnings per common share - assuming dilution	\$ 1.86	\$ 1.32
Weighted-average common equivalent shares outstanding (in millions)	615	644
Dividends per common share	\$ 0.12	\$ 0.06

Supplemental information:

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(1) Includes excise taxes on sales by our U.S. retail system	\$ 196	\$ 194
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See Condensed Notes to Consolidated Financial Statements.

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VALERO ENERGY CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Millions of Dollars)
(Unaudited)

	Three Months Ended March	
	31,	
	2007	2006
Cash flows from operating activities:		
Net income	\$ 1,144	\$ 849
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization expense	334	260
Stock-based compensation expense	30	23
Deferred income tax expense	44	120
Changes in current assets and current liabilities	338	537
Changes in deferred charges and credits and other, net	(4)	(49)
Net cash provided by operating activities	1,886	1,740
 Cash flows from investing activities:		
Capital expenditures	(551)	(775)
Deferred turnaround and catalyst costs	(129)	(199)
Contingent payments in connection with acquisitions	(50)	(50)
Other investing activities, net	7	11
Net cash used in investing activities	(723)	(1,013)
 Cash flows from financing activities:		
Long-term note repayments	(183)	(220)
Bank credit agreements:		
Borrowings	-	280
Repayments	-	(280)
Purchase of treasury stock	(904)	(590)
Issuance of common stock in connection with employee benefit plans	37	32
Benefit from tax deduction in excess of recognized stock-based compensation cost	63	89
Common and preferred stock dividends	(73)	(38)
Net cash used in financing activities	(1,060)	(727)
Effect of foreign exchange rate changes on cash	3	-
Net increase in cash and temporary cash investments	106	-
Cash and temporary cash investments at beginning of period	1,590	436
Cash and temporary cash investments at end of period	\$ 1,696	\$ 436

See Condensed Notes to Consolidated Financial Statements.

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VALERO ENERGY CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Millions of Dollars)
(Unaudited)

	Three Months Ended March	
	31,	
	2007	2006
Net income	\$ 1,144	\$ 849
Other comprehensive income (loss):		
Foreign currency translation adjustment	20	(8)
Pension and other postretirement benefits net loss reclassified into income, net of income tax benefit of \$1 and \$-	1	-
Net loss on derivative instruments designated and qualifying as cash flow hedges:		
Net gain (loss) arising during the period, net of income tax (expense) benefit of \$23 and \$(1)	(42)	2
Net gain reclassified into income, net of income tax expense of \$6 and \$3	(11)	(6)
Net loss on cash flow hedges	(53)	(4)
Other comprehensive loss	(32)	(12)
Comprehensive income	\$ 1,112	\$ 837

See Condensed Notes to Consolidated Financial Statements.

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**VALERO ENERGY CORPORATION AND SUBSIDIARIES
CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

1. BASIS OF PRESENTATION, PRINCIPLES OF CONSOLIDATION AND SIGNIFICANT ACCOUNTING POLICIES

As used in this report, the terms Valero, we, us, or our may refer to Valero Energy Corporation, one or more of our consolidated subsidiaries, or all of them taken as a whole.

These unaudited consolidated financial statements include the accounts of Valero and subsidiaries in which Valero has a controlling interest. Intercompany balances and transactions have been eliminated in consolidation. Investments in significant non-controlled entities are accounted for using the equity method of accounting.

These unaudited consolidated financial statements have been prepared in accordance with United States generally accepted accounting principles (GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X of the Securities Exchange Act of 1934. Accordingly, they do not include all of the information and notes required by GAAP for complete consolidated financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation have been included. All such adjustments are of a normal recurring nature unless disclosed otherwise. Financial information for the three months ended March 31, 2007 and 2006 included in these Condensed Notes to Consolidated Financial Statements is derived from our unaudited consolidated financial statements. Operating results for the three months ended March 31, 2007 are not necessarily indicative of the results that may be expected for the year ending December 31, 2007.

The consolidated balance sheet as of December 31, 2006 has been derived from the audited financial statements as of that date. For further information, refer to the consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2006.

On December 22, 2006, we sold our remaining ownership interest in NuStar GP Holdings, LLC (formerly Valero GP Holdings, LLC), which indirectly owns the general partner interest, the incentive distribution rights, and a 21.4% limited partner interest in NuStar Energy L.P. (formerly Valero L.P.). As a result, the statement of income reflects no equity in earnings of NuStar Energy L.P. subsequent to December 21, 2006.

Reclassifications

Certain previously reported amounts have been reclassified to conform to the 2007 presentation, including reflecting in our consolidated statement of cash flows for 2006 gross borrowings and repayments under our uncommitted bank credit facilities and presenting those amounts, along with borrowings and repayments under our committed bank credit facilities, separate from borrowings and repayments related to our long-term notes. The reclassifications also affected amounts previously reported in our consolidated statement of income in 2006 for operating revenues, cost of sales, and retail selling expenses. Commencing January 1, 2007, third-party processing costs associated with certain credit card transactions processed on behalf of our distributors and dealers are being netted against fees received from distributors and dealers to better reflect the nature of the credit card transactions. These reclassified income statement amounts were as follows (in millions):

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VALERO ENERGY CORPORATION AND SUBSIDIARIES
CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	Three Months Ended March 31, 2006		
	Previously		Currently
	Reported	Increase (Decrease)	Reported
Operating revenues	\$20,941	\$ (14)	\$20,927
Cost of sales	18,082	3	18,085
Retail selling expenses	189	(17)	172

2. ACCOUNTING PRONOUNCEMENTS***FASB Statement No. 155***

In February 2006, the Financial Accounting Standards Board (FASB) issued Statement No. 155, Accounting for Certain Hybrid Financial Instruments, which amends Statement No. 133, Accounting for Derivative Instruments and Hedging Activities, and Statement No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities. This statement improves the financial reporting of certain hybrid financial instruments and simplifies the accounting for these instruments. In particular, Statement No. 155 (i) permits fair value remeasurement for any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation, (ii) clarifies which interest-only and principal-only strips are not subject to the requirements of Statement No. 133, (iii) establishes a requirement to evaluate interests in securitized financial assets to identify interests that are freestanding derivatives or that are hybrid financial instruments that contain an embedded derivative requiring bifurcation, (iv) clarifies that concentrations of credit risk in the form of subordination are not embedded derivatives, and (v) amends Statement No. 140 to eliminate the prohibition on a qualifying special-purpose entity from holding a derivative financial instrument that pertains to a beneficial interest other than another derivative financial instrument. The adoption of Statement No. 155 on January 1, 2007 has not affected our financial position or results of operations.

FASB Statement No. 156

In March 2006, the FASB issued Statement No. 156, Accounting for Servicing of Financial Assets, which amends Statement No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities. Statement No. 156 requires the initial recognition at fair value of a servicing asset or servicing liability when an obligation to service a financial asset is undertaken by entering into a servicing contract. The adoption of Statement No. 156 on January 1, 2007 has not affected our financial position or results of operations.

FASB Interpretation No. 48

In June 2006, the FASB issued Interpretation No. 48, Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109 (FIN 48). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB Statement No. 109, Accounting for Income Taxes, by prescribing a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. If a tax position is more likely than not to be sustained upon examination, then an enterprise is required to recognize in its financial statements the largest amount of benefit that is greater than 50% likely of being realized upon ultimate settlement. The adoption of FIN 48 on January 1, 2007 did not materially affect our financial position or results of operations.

We have elected to classify any interest expense related to the underpayment of income taxes in income tax expense in our consolidated statement of income. Any penalties related to the underpayment of

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**VALERO ENERGY CORPORATION AND SUBSIDIARIES
CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

income taxes are recorded in the corresponding expense category in our consolidated statement of income.

EITF Issue No. 06-3

In June 2006, the FASB ratified its consensus on EITF Issue No. 06-3, How Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (That Is, Gross versus Net Presentation) (EITF No. 06-3). The scope of EITF No. 06-3 includes any tax assessed by a governmental authority that is imposed concurrent with or subsequent to a revenue-producing transaction between a seller and a customer. For taxes within the scope of this issue that are significant in amount, the consensus requires the following disclosures: (i) the accounting policy elected for these taxes and (ii) the amount of the taxes reflected gross in the income statement on an interim and annual basis for all periods presented. The disclosure of those taxes can be done on an aggregate basis. We adopted the consensus on January 1, 2007. We present excise taxes on sales by our U.S. retail system on a gross basis with supplemental information regarding the amount of such taxes included in revenues provided in a footnote on the face of the income statement. All other excise taxes are presented on a net basis in the income statement.

FASB Statement No. 157

In September 2006, the FASB issued Statement No. 157, Fair Value Measurements. Statement No. 157 defines fair value, establishes a framework for measuring fair value under GAAP, and expands disclosures about fair value measures. Statement No. 157 is effective for fiscal years beginning after November 15, 2007, with early adoption encouraged. The provisions of Statement No. 157 are to be applied on a prospective basis, with the exception of certain financial instruments for which retrospective application is required. The adoption of Statement No. 157 is not expected to materially affect our financial position or results of operations.

FASB Statement No. 159

In February 2007, the FASB issued Statement No. 159, The Fair Value Option for Financial Assets and Financial Liabilities. Statement No. 159 permits entities to choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. Statement No. 159 is effective for fiscal years beginning after November 15, 2007, with early adoption permitted provided the entity also elects to apply the provisions of Statement No. 157. We do not expect the adoption of Statement No. 159 to have any impact on our financial position or results of operations.

3. DISPOSITION OF LIMA REFINERY

On May 2, 2007, we entered into an agreement to sell our refinery in Lima, Ohio to Husky Refining Company, a wholly owned subsidiary of Husky Energy Inc. The sales price is \$1.9 billion, plus an amount equal to net working capital as of the closing date of the sale, which is expected to occur by the end of the second quarter of 2007. Net proceeds from the sale exceed the carrying amount of the net assets being sold. The sale is subject to the receipt of required regulatory approvals.

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VALERO ENERGY CORPORATION AND SUBSIDIARIES
CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

4. INVENTORIES

Inventories consisted of the following (in millions):

	March 31, 2007	December 31, 2006
Refinery feedstocks	\$2,466	\$ 1,981
Refined products and blendstocks	2,115	2,197
Convenience store merchandise	83	85
Materials and supplies	171	167
Inventories	\$4,835	\$ 4,430

As of March 31, 2007 and December 31, 2006, the replacement cost (market value) of LIFO inventories exceeded their LIFO carrying amounts by approximately \$4.4 billion and \$2.9 billion, respectively.

5. INVESTMENT IN AND TRANSACTIONS WITH NUSTAR ENERGY L.P.

Our ownership interest in NuStar Energy L.P. as of March 31, 2006 was 23.4%, which was composed of a 2% general partner interest, incentive distribution rights, and a 21.4% limited partner interest represented by 627,339 common units and 9,599,322 subordinated units. NuStar GP Holdings, LLC completed public offerings in July and December 2006 through which we sold all of our ownership interest in NuStar GP Holdings, LLC. As a result, we no longer owned any interest in NuStar Energy L.P. as of December 31, 2006. Financial information reported by NuStar Energy L.P. for the three months ended March 31, 2006 is summarized below (in millions):

	Three Months Ended March 31, 2006
Revenues	\$ 274
Operating income	56
Net income	39

Related-Party Transactions

Through December 31, 2006, we provided NuStar Energy L.P. with certain corporate functions for an annual fee as prescribed by a services agreement. Effective January 1, 2007, the services agreement was amended to provide for limited services. The amended services agreement provides for a termination date of December 31, 2010, unless we terminate the agreement earlier, in which case we are required to pay a termination fee of \$13 million. In April, we notified NuStar Energy L.P. of our decision to terminate the services agreement. Accordingly, the \$13 million termination fee is expected to be paid during the second quarter of 2007.

The following table summarizes the results of transactions with NuStar Energy L.P. for the three months ended March 31, 2006 (in millions):

Fees and expenses charged by us to NuStar Energy L.P.	\$ 26
Fees and expenses charged to us by NuStar Energy L.P.	61

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**VALERO ENERGY CORPORATION AND SUBSIDIARIES
CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

6. DEBT

On February 1, 2007, we redeemed our 9.25% senior notes for \$183 million, or 104.625% of stated value. These notes had a carrying amount of \$187 million on the date of redemption, resulting in a gain of \$4 million that was included in other income, net in the consolidated statement of income.

During the three months ended March 31, 2007, we had no borrowings under our revolving credit facilities or our short-term uncommitted bank credit facilities.

In April 2007, we made a scheduled debt repayment of \$230 million related to our 6.125% notes. Also in April 2007, to fund the accelerated share repurchase program discussed in Note 7, we borrowed \$3 billion under a 364-day term credit agreement with a financial institution. The term loan bears interest at LIBOR plus a margin, or an alternate base rate as defined under the agreement. The interest rate is subject to adjustment based upon the credit ratings assigned to our long-term debt. The amount borrowed can be prepaid at any time, and proceeds from any long-term financing during the term of this agreement, with certain exceptions, must be used to reduce the amount borrowed under the 364-day term credit agreement.

7. STOCKHOLDERS' EQUITY

Treasury Stock

During the three months ended March 31, 2007 and 2006, we purchased 15.6 million and 10.7 million shares of our common stock at a cost of \$904 million and \$590 million, respectively, in connection with the administration of our employee benefit plans and the \$2 billion common stock purchase program authorized by our board of directors. During the three months ended March 31, 2007, we issued 3.8 million shares from treasury at an average cost of \$58.63 per share, and for the three months ended March 31, 2006, we issued 7.0 million shares from treasury at an average cost of \$52.24 per share, for our employee benefit plans.

During April 2007, we purchased an additional 4.2 million shares at a cost of approximately \$275 million, excluding the effect of the accelerated share repurchase program discussed below.

Accelerated Share Repurchase Program

On April 25, 2007, our board of directors approved an amendment to our \$2 billion common stock purchase program to increase the authorized purchases under the program to \$6 billion. In conjunction with the increase in our common stock purchase program, we entered into an agreement with a financial institution to purchase \$3 billion of our shares under an accelerated share repurchase program, and in late April, approximately 42 million shares were purchased under this agreement. The purchase of these shares was funded with a short-term bridge loan, which we expect to replace with longer-term financing. At the expiration of the accelerated share repurchase program, which is expected to occur in the third quarter of 2007, the cost of the shares purchased under this accelerated share repurchase program will be adjusted, with the final purchase cost based on a discount to the average trading price of our common stock, weighted by the daily volume of shares traded, during the program period. Any adjustment to the cost can be paid in cash or stock, at our option.

Common Stock Dividends

On April 26, 2007, our board of directors declared a regular quarterly cash dividend of \$0.12 per common share payable on June 13, 2007 to holders of record at the close of business on May 16, 2007.

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VALERO ENERGY CORPORATION AND SUBSIDIARIES
CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

8. EARNINGS PER COMMON SHARE

Earnings per common share amounts were computed as follows (dollars and shares in millions, except per share amounts):

	Three Months Ended March	
	2007	31, 2006
Earnings per Common Share:		
Net income	\$ 1,144	\$ 849
Preferred stock dividends	-	1
Net income applicable to common stock	\$ 1,144	\$ 848
Weighted-average common shares outstanding	599	619
Earnings per common share	\$ 1.91	\$ 1.37
Earnings per Common Share - Assuming Dilution:		
Net income applicable to common equivalent shares	\$ 1,144	\$ 849
Weighted-average common shares outstanding	599	619
Effect of dilutive securities:		
Stock options	15	19
Performance awards and other benefit plans	1	1
Mandatory convertible preferred stock	-	5
Weighted-average common equivalent shares outstanding	615	644
Earnings per common share - assuming dilution	\$ 1.86	\$ 1.32

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VALERO ENERGY CORPORATION AND SUBSIDIARIES
CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

9. STATEMENTS OF CASH FLOWS

In order to determine net cash provided by operating activities, net income is adjusted by, among other things, changes in current assets and current liabilities as follows (in millions):

	Three Months Ended March	
	31,	
	2007	2006
Decrease (increase) in current assets:		
Receivables, net	\$ 221	\$ 450
Inventories	(402)	(342)
Income taxes receivable	32	62
Prepaid expenses and other	32	(11)
Increase (decrease) in current liabilities:		
Accounts payable	115	606
Accrued expenses	(75)	(140)
Taxes other than income taxes	(7)	(104)
Income taxes payable	422	16
Changes in current assets and current liabilities	\$ 338	\$ 537

The above changes in current assets and current liabilities differ from changes between amounts reflected in the applicable consolidated balance sheets for the respective periods for the following reasons:

the amounts shown above exclude changes in cash and temporary cash investments, deferred income taxes, and current portion of long-term debt and capital lease obligations, as well as the effect of certain noncash investing and financing activities discussed below;

previously accrued capital expenditures, deferred turnaround and catalyst costs, and contingent earn-out payments are reflected in investing activities in the consolidated statements of cash flows; and

certain differences between consolidated balance sheet changes and consolidated statement of cash flow changes reflected above result from translating foreign currency denominated amounts at different exchange rates.

Noncash financing activities for the three months ended March 31, 2007 included the accrual of \$137 million of common stock purchases in the open market for which settlement and payment occurred in April 2007. There were no significant noncash investing activities for the three months ended March 31, 2007.

Noncash financing activities for the three months ended March 31, 2006 included the conversion of 713,035 shares of preferred stock into 1,413,233 shares of our common stock. There were no significant noncash investing activities for the three months ended March 31, 2006.

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VALERO ENERGY CORPORATION AND SUBSIDIARIES
CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Cash flows related to interest and income taxes were as follows (in millions):

	Three Months Ended March	
	31,	
	2007	2006
Interest paid (net of amount capitalized)	\$ 13	\$ 15
Income taxes paid (net of tax refunds received)	5	151

10. PRICE RISK MANAGEMENT ACTIVITIES

The net gain (loss) recognized in income representing the amount of hedge ineffectiveness was as follows (in millions):

Prior to closing, all of the assets and operations related to the SDA Mill were transferred to a newly incorporated entity, Minerales Vane 2 S.A. de C.V. (“Minerales Vane 2”). Effective November 30, 2017, the Company’s newly incorporated wholly-owned subsidiary, Magellan Acquisition Corporation (“MAC”), acquired 100% of the issued and outstanding shares of Minerales Vane 2.

The total purchase price for the SDA Mill was determined to be \$1,476,025 which consisted of \$850,000 cash, a \$50,000 promissory note, the \$50,000 non-refundable option payment, the \$100,000 paid for the option-to-purchase extension, and 14,200,834 shares of common stock (the “Shares”) with a fair value of \$426,025. The note was non-interest bearing and was paid in full April 12, 2018. This note was grouped with Notes Payable Related Party due to Rose’s share ownership in the Company. The Shares will be held in escrow for a period of 12 months and the Company has the option to repurchase the Shares from Rose for the sum of \$500,000 in the first six months and \$550,000 in months 7 to 12.

On April 12, 2018, the Company satisfied its note payable in the amount of \$50,000 in favor of Rose Petroleum, plc in respect of the purchase of the SDA Mill, as required under terms of the Stock Purchase Agreement.

Subsequent to the purchase of the SDA Mill, the Company and Rose Petroleum executed an IVA Agreement which implemented the provisions of the Stock Purchase Agreement with respect to the payment of the IVA Tax assessed by the Mexican taxing authorities on the sale and purchase of the IVA Mill. Under the terms of the IVA Agreement, Rose Petroleum advanced the IVA tax, in Mexican Pesos, for the payment of the IVA tax, approximately \$260,000. The Company has agreed that all future tax credits or refunds that it receives from the Mexican taxing authority will be paid over to Rose until such time as Rose has recouped the advance, in full. Mr. Carson executed a Guaranty of the Company's obligations under the IVA Agreement effective March 8, 2018.

In March 2018, the Company and Rose Petroleum, plc satisfied their respective obligations for payment of Mexican VAT on purchase of the SDA Mill, as required under terms of the Stock Purchase Agreement.

Pro forma results of operations for the nine months ended 2017 as though the Company had acquired the SDA Mill on the first day of the fiscal year of 2017 are set forth below:

	September 30, 2017 Pro Forma
Net Sales	\$234,856
Operating Expenses	2,238,594
Net Loss	\$(2,003,738)

Note 5 – Interim Toll Milling Agreement

On November 7, 2017 the Company and Rose executed an Interim Milling Agreement (the “Agreement”), with an effective date of November 1, 2017, whereby, pending closing of the SDA Mill acquisition, Rose shall cause its subsidiary, Minerales Vane S.A. de C.V., a Mexico corporation (“Vane”), to reopen the SDA Mill and recommence operations on a toll milling basis for a third-party. Under the Agreement, the Company is required to provide the working capital to fund the operations and is entitled to all the positive cash flow after covering the related expenses.

The Agreement was completed and terminated during November 2017. The Company has an outstanding receivable from Rose of \$-0- as of September 30, 2018 and \$27,147 as of December 31, 2017, respectively.

Note 6 - Fair Value of Financial Instruments

Financial assets and liabilities recorded at fair value in our consolidated balance sheets are categorized based upon a fair value hierarchy established by GAAP, which prioritizes the inputs used to measure fair value into the following levels:

Level 1— Quoted market prices in active markets for identical assets or liabilities at the measurement date.

Level 2— Quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets and liabilities in markets that are not active; or other inputs that are observable and can be corroborated by observable market data.

Level 3— Inputs reflecting management’s best estimates and assumptions of what market participants would use in pricing assets or liabilities at the measurement date. The inputs are unobservable in the market and significant to the valuation of the instruments.

A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement.

Financial assets and liabilities measured at fair value on a recurring basis are summarized below:

	Fair Value at September 30, 2018	Fair Value Measurement at September 30, 2018		
		Level 1	Level 2	Level 3
		Investment in Rio Silver equities	\$ 85,213	\$85,213

	Fair Value at December 31, 2017	Fair Value Measurement at December 31, 2017		
		Level 1	Level 2	Level 3
Investment in Rio Silver equities	\$ 109,532	\$ 109,532	\$ -	\$-

The carrying values for cash and cash equivalents, prepaid assets, accounts payable and accrued liabilities, related party line of credit and notes payable approximate their fair value due to their short-term maturities.

Note 7 – Line of Credit – Related Party

Effective December 31, 2012, we entered into a line of credit arrangement with John D. Gibbs, a significant investor, to facilitate timely cash flows for the Company’s operations. The line of credit originally provided for a maximum balance of \$250,000, accrued interest at 6% annually, and matured on December 31, 2014.

On December 31, 2013 we amended our credit agreement with Mr. Gibbs to increase the borrowing limit under the line of credit to \$750,000. All other terms of the credit agreement, including the interest rate and maturity date remained unchanged.

On December 31, 2014, we again amended the credit agreement to increase the borrowing limit to \$900,000 and extend the maturity date to December 31, 2015. As part of the 2014 amendment and the subsequent appointment of Dr. Pierce Carson as the President, CEO and Director of G+W effective June 1, 2015, we had pledged all of our 85% equity interest in G+W, which owns the Silver District properties, as security for all amounts outstanding under the credit agreement. In July 2016, we completed a share exchange with Dr. Carson to reacquire the 15% interest in G+W, and therefore at September 30, 2017 our entire 100% interest in G+W remains pledged as security for outstanding amounts under this credit agreement.

On December 31, 2015 we again amended the credit agreement to increase the borrowing limit to \$1,000,000 and extended the maturity date to December 31, 2016. Finally, on March 31, 2017 with an effective date of December 31, 2016 we again amended the credit agreement to extend the maturity date to December 31, 2018. All other terms of the agreement were unchanged. At September 30, 2018 the Company has \$167,500 available under the credit line.

No draws were made during the nine months ended September 30, 2018. During the same period Mr. Gibbs converted \$100,000 of the outstanding balance on the line of credit into 5,000,000 shares of common stock at \$0.02 per share. The outstanding balance under the line of credit was \$832,500 and \$932,500 at September 30, 2018 and December 31, 2017, respectively. In addition, a total of \$253,285 and \$213,657 of interest has been accrued on this obligation and is included in Accrued interest - related parties on the accompanying consolidated balance sheets at September 30, 2018 and December 31, 2017, respectively.

Note 8 – Notes Payable – Related Parties

In August 2011, we entered into an unsecured loan from John Power, the Company's Director, evidenced by a \$20,000 promissory note. The promissory note bears interest at 6% per annum and is payable on demand with thirty days' notice from the lender. During 2014, the Company made payments totaling \$5,000 to pay down the principal balance of the note. Effective December 31, 2017, the interest rate on the note increased to 12% per annum. At both September 30, 2018 and December 31, 2017, the note balance was \$15,000. At September 30, 2018 and December 31, 2017, interest totaling \$1,346 and \$1,576, respectively, was accrued on this note payable and is included in Accrued interest – related parties on the accompanying consolidated balance sheets.

In January 2014, we entered into an additional unsecured loan from Mr. Power, evidenced by a \$50,000 promissory note. The promissory note bears interest at 6.75% per annum and is payable on demand with thirty days' notice from the lender. Effective December 31, 2017, the interest rate on the note increased to 12% per annum. At September 30, 2018 and December 31, 2017, interest totaling \$4,488 and \$6,249, respectively, was accrued on this note payable and is included in Accrued interest – related parties on the accompanying consolidated balance sheets. At both September 30, 2018 and December 31, 2017, the note balance was \$50,000.

On May 31, 2017 we entered into three short-term notes with Mr. Gibbs, Dr. Carson and Mr. Power in the principal amounts of \$100,000, \$25,000 and \$25,000, respectively. The notes bear interest at 6% and matured on November 15, 2017. A total of \$3,760 and \$4,512 of interest is accrued on these notes as of September 30, 2018 and December 31, 2017, respectively. The note balances were subsequently rolled into the Series 2017 Notes.

On June 30, 2017 we entered into an additional secured loan for advances from Mr. Power and evidenced by a \$125,000 promissory note. The promissory note bears interest at 6% per annum and matured on December 31, 2017 and is currently in default. Effective December 31, 2017, the interest rate on the note increased to 12% per annum.

The note is collateralized by our investment in Rio Silver shares and warrants. At both September 30, 2018 and December 31, 2017, the note balance was \$125,000. A total of \$11,219 and \$3,781 of interest is accrued on these notes as of September 30, 2018 and December 31, 2017, respectively and is included in Accrued interest – related parties on the accompanying consolidated balance sheets.

On November 30, 2017 we entered into a series of secured promissory notes (“Series 2017 Notes”) with both related and unrelated parties in the aggregate amount of \$1,155,000, including financing fees of \$105,000 recorded as a discount to the notes.

Net proceeds on the issuance after reducing for the transfers previously listed total \$900,000. The notes are secured by a stock pledge agreement covering 100% of the outstanding common stock of Magellan Acquisition Corporation, bear interest at 10% and mature on December 31, 2018.

The total of portion of the Series 2017 Notes from related parties totaled \$1,045,000, including financing fees of \$95,000 recorded as discount to the notes. Mr. Gibbs, Dr. Carson, and Mr. Power transferred \$100,000, \$25,000, and \$25,000, respectively, from the May 31, 2017 short term related party notes into the Series 2017 Notes. As of September 30, 2018 the balance on the Series 2017 Notes from related parties, net of unamortized discount of \$22,071, is \$1,022,929 with accrued interest of \$87,036. As of December 31, 2017, the balance on the Series 2017 Notes from related parties, net of unamortized discount of \$87,563, is \$957,437 with accrued interest of \$8,875.

During the nine months ended September 30, 2018 \$65,492 of debt discount related to the above notes was amortized to interest expense.

Note 9 – Notes payable

As discussed in Note 8 – Notes Payable – Related Parties, on November 30, 2017 we entered into a series of secured promissory notes (“Series 2017 Notes”) with both related and unrelated parties in the aggregate amount of \$1,155,000, including financing fees of \$105,000 recorded as a discount to the notes.

The total of portion of the Series 2017 Notes from non-related parties totaled \$110,000, including financing fees of \$10,000 recorded as discount to the notes. As of September 30, 2018 the balance on the notes from non-related parties, net of unamortized discount of \$2,323, is \$107,677 with accrued interest of \$9,161. As of December 31, 2017, the balance on the notes from non-related parties, net of unamortized discount of \$9,217 is \$100,783 with accrued interest of \$934.

During the nine months ended September 30, 2018 \$6,894 of debt discount related to the above notes was amortized to interest expense.

Note 10 – Convertible Note Payable

On November 1, 2017, the Company sold a 10% Convertible Promissory Note (“Auctus Note”) in a principal amount of \$170,000. After deducting the investor’s discount and legal fees, net proceeds to the Company were \$153,650. The Note matures on November 1, 2018 and can be converted into the Company’s common stock after 180 days from the date the Note is issued. In early May 2018 when the note became convertible at a variable price the conversion feature was valued and recorded as a derivative liability. The conversion option continued to qualify for derivative treatment until the note was amended on June 8, 2018 (see below) and a minimum conversion price was added to the instrument. The derivative was initially valued at \$176,860 which was allocated \$170,000 as a debt discount and \$6,860 as a loss on derivative liability. The debt discount was fully amortized and the derivative liability was adjusted to \$0 as June 8, 2018 when the debt was amended. The result was \$170,000 of amortization of debt discount included in interest expense and \$176,860 of gain on change in derivative liability.

Effective June 8, 2018 the Company and Auctus Fund, LLC (“Auctus”) signed an Amendment No. 1 to the Convertible Promissory Note (the “Auctus Note”) dated November 1, 2017 (the “Auctus Amendment”). Under the terms of the Auctus Amendment, the principal outstanding balance of the Auctus Note has been increased from \$170,000, to \$212,500. Also, Auctus agreed to forbear from exercising rights arising from certain Events of Default (as defined in the Note) unless a new Event of Default occurs or the Company fails to become current in its required SEC filings by June 30, 2018. Auctus also agreed not to exercise its conversion privileges under the Auctus Note at prices below \$0.02 per share until September 30, 2018. The Company evaluated this conversion feature and determined that it did not qualify for derivative accounting. It was then determined that no beneficial conversion feature existed at the time of debt issuance. The Company recorded the change in the debt instrument as an extinguishment and recorded the increase in principal balance of \$42,500 as a loss on extinguishment of debt. On August 16, 2018 the Auctus Note was again amended to decrease the minimum conversion price to \$0.018. The amendment was not considered to be a substantial modification. The Company re-evaluated the conversion feature and determined that no beneficial conversion feature existed at the time of the amendment.

During the nine months ended September 30, 2018, 6,000,000 shares were related to the conversion of \$91,070 of notes and \$19,330 of interest and fees. As of September 30, 2018, \$121,430 remains outstanding on the Auctus Notes.

On November 2, 2017, the Company sold a 10% Convertible Promissory Note (“EMA Note”) in principal amount of \$125,000. After deducting the investor’s discount and legal fees, net proceeds to the Company were \$113,500. The Note originally matured on November 2, 2018 but was amended to be November 2, 2019 and can be converted into the Company’s common stock after 180 days from the date the Note is issued. In early May 2018 when the note became convertible at a variable price the conversion feature was valued and recorded as a derivative liability. The conversion option continued to qualify for derivative treatment until the note was amended on June 8, 2018 (see below) and a minimum conversion price was added to the instrument. The derivative was initially valued at \$225,711 which was allocated \$125,000 as a debt discount and \$100,711 as a loss on derivative liability. The debt discount was fully amortized and the derivative liability was adjusted to \$0 as June 8, 2018 when the debt was amended. The result was \$125,000 of amortization of debt discount included in interest expense and \$225,711 of gain on change in derivative liability.

Effective June 8, 2018 the Company and EMA Financial, LLC (“EMA”) signed an Amendment No. 1 to the Convertible Promissory Note (the “EMA Note”) dated November 2, 2017 (the “EMA Amendment”). Under the terms of the EMA Amendment, the principal outstanding balance of the EMA Note has been increased from \$125,000, to \$156,250. Also, EMA agreed to forbear from exercising rights arising from certain Events of Default (as defined in the Note) unless a new Event of Default occurs or the Company fails to become current in its required SEC filings by June 30, 2018. EMA also agreed not to exercise its conversion privileges under the EMA Note at prices below \$0.02 per share until September 30, 2018. The Company evaluated this conversion feature and determined that it did not qualify for derivative accounting. It was then determined that no beneficial conversion feature existed at the time of debt issuance. The Company recorded the change in the debt instrument as an extinguishment and recorded the increase in principal balance of \$31,250 as a loss on extinguishment of debt. On August 16, 2018 the EMA Note was again amended to decrease the minimum conversion price to \$0.018. The amendment was not considered to be a substantial modification. The Company re-evaluated the conversion feature and determined that no beneficial conversion feature

existed at the time of the amendment.

The Company evaluated other convertible instruments and determined that the outstanding common stock warrants were required to be treated as a derivative during the period from May 1, 2018 through June 8, 2018 as a result of the variable conversion feature on the above notes. As a result an initial derivative liability of \$62,569 was recorded and reclassified out of equity and a final derivative liability of \$70,650 was reclassified back into equity at the point the common stock warrants no longer qualified as a derivative. The impact was the recording of a loss on derivative liability of \$8,081.

During the nine months ended September 30, 2018, 1,600,000 shares were related to the conversion of \$26,550 of notes and \$2,250 of interest and fees. As of September 30, 2018, \$129,700 remains outstanding on the EMA Notes.

On July 26, 2018, the Company sold a 10% Convertible Promissory Note to Power Up Lending Group Ltd. (“July Power Up Note”) in a principal amount of \$63,000. After deducting the investor’s discount and legal fees, net proceeds to the Company were \$60,000. The Note matures on July 26, 2019 and can be converted into the Company’s common stock after 180 days from the date the Note is issued.

On August 20, 2018, the Company sold a 10% Convertible Promissory Note to Power Up Lending Group Ltd. (“August Power Up Note”) in a principal amount of \$38,000. After deducting the investor’s discount and legal fees, net proceeds to the Company were \$35,000. The Note matures on August 20, 2019 and can be converted into the Company’s common stock after 180 days from the date the Note is issued.

As of September 30, 2018, the balance on the convertible notes, net of unamortized discount of \$5,121, is \$347,010 with accrued interest of \$13,902. As of December 31, 2017, the balance on the notes, net of unamortized discount of \$23,303 is \$271,697 with accrued interest of \$4,815. During the three and nine months ended September 30, 2018, \$879 and \$24,183 of debt discount related to the above notes, respectively, was amortized to interest expense.

Note 11 – Stockholders’ Deficit

Sales of common stock and warrants:

During the nine months ended September 30, 2018, the Company raised \$340,000 through the sale of 17,000,000 common stock and warrants (“Units”) at a price of \$0.02 per Unit, each Unit consisting of one share of common stock and one warrant to purchase one additional share of common stock at an exercise price of \$0.02 per share. The expiration date of the warrants varies from August 31, 2018 to December 31, 2018. Of this raise \$330,000 was purchased by directors or significant shareholders. A price protection feature of the offering provides that if at December 31, 2018, the Company has issued common stock at a price less than \$0.02 per share, then the number of Units issuable to each investor shall be increased so as to reduce the Unit price to the lower price. The allocation of relative fair values of the equity instruments at the dates of the sale transactions was as follows: common stock at 63% and the warrants at 37%.

During the nine months ended September 30, 2018, the Company received net proceeds of \$120,000 from the exercise of 6,000,000 warrants at \$0.02 per share.

During the nine months ended September 30, 2018, Convertible Note holders converted \$21,580 of accrued interest and fees and \$117,620 of principal into 7,600,000 shares of common stock in accordance with the note agreements.

During the nine months ended September 30, 2018, the Company issued 1,013,035 shares of common stock as part of the acquisition of a data package related to the El Dorado project. The shares were valued at \$18,235 and recorded as an asset.

Effective July 24, 2018, the Company and W. Pierce Carson, President, executed an Agreement to Convert Debt, pursuant to which Carson agreed to convert \$90,000 in accrued but unpaid executive compensation for the fiscal quarters ended December 31, 2017, March 31, 2018 and June 30, 2018 and a cash advance of \$8,100 made to the Company into an aggregate of 4,905,000 shares of Common Stock, valued at \$0.02 per share.

Effective July 24, 2018, the Company and W. Pierce Carson executed a Restricted Stock Award Agreement pursuant to which the Company granted to Carson a restricted stock award consisting of 4,000,000 shares of Common Stock, valued at \$0.02 per share. 1,000,000 of the shares will vest upon the Company completing a milestone, and the remaining 3,000,000 shares are subject to ratable vesting over an 18-month period. During the nine months ended September 30, 2018 the Company recognized an expense of \$26,667 related to this issuance.

Stock Options and the 2017 Equity Incentive Plan:

Under the 2017 Equity Incentive Plan, the Company is authorized to grant rights to acquire up to a maximum of 10,000,000 shares of common stock. The 2017 Plan provides for the grant of (1) both incentive and nonstatutory stock options, (2) stock bonuses, (3) rights to purchase restricted stock and (4) stock appreciation rights.

During the year ended December 31, 2017, the Company granted ten-year options to purchase 3,600,000 shares of common stock at an option exercise price of \$0.04 per share, the closing price on the date of grant. As of September 30, 2018 the Company had 6,400,000 shares available for future grant.

Stock option activity within the 2017 Equity Incentive Plan and warrant activity outside the plan, for the nine-months ended September 30, 2018 is as follows:

	Stock Options		Stock Warrants	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Outstanding at December 31, 2017	3,600,000	\$0.04	1,850,000	\$0.10
Granted	—	—	17,000,000	\$0.02
Cancelled	—	—	—	—
Expired	—	—	(6,500,000)	\$0.02
Exercised	—	—	(6,000,000)	\$0.02
Outstanding at September 30, 2018	3,600,000	\$0.04	6,350,000	\$0.04
Exercisable at September 30, 2018	3,600,000	\$0.04	6,350,000	\$0.04

As of September 30, 2018 the outstanding stock options have a weighted average remaining term of 9.08 years and no intrinsic value, and the outstanding stock warrants have a weighted average remaining term of 0.25 years and no intrinsic value.

Note 12 - Commitments and Contingencies

Mining Claims

As part of our acquisition of the Silver District properties from Columbus Exploration, we assumed the Red Cloud lease whose initial term expires in August 2026. The lease requires annual advance minimum royalty payments of \$10,000 through the term of the lease due on the annual anniversary of the agreement. The lease is also subject to a 2% net production royalty to be paid to the lessor from the sale of precious metals extracted from the leased property.

In order to maintain the BLM lode and mill site claims, annual payments are required before the end of August of each year. Payments are also due annually on two patented claims we leased in July 2015 and on our Arizona State Minerals Exploration Permit. As of September 30, 2018, all of these claims and leases are in good standing except for the two patented claims leased in 2015.

Leases

As part of our acquisition of MV2 in Mexico, we assumed the following leases payable in local currency as follows:

- a) Ejido S.D.A, 10 year lease, 6 hectares, executed January 2016, expires December 2025. Annual payments 25,000 MX pesos. Renewable for 10 years.

- b) Silverio Medina Ozuna, 3 year lease, 1 hectare, executed May 2017, expires April 2020. Annual payments 15,000 MX pesos. Renewable for 3 year periods.

- c) Silverio Medina Ozuna, 10 year lease, 2 hectares, executed May 2010, expires April 2020. Payment \$100,000 MX pesos paid in advance at lease execution. Renewable for 10 years.

The minimum future payments due on these leases are as follows for the next five years and thereafter and have been translated to US dollars using an exchange rate at September 30, 2018 of 18.72 MX pesos to US dollars:

Payment Due Date	Minimum Due (\$)
2019	2,137
2020	1,336
2021	1,336
2022 and thereafter	9,349

Other contractual arrangements

On November 1, 2016 the Company executed a Finder’s Agreement (“Agreement”), with a third party consultant to introduce the Company to potential investors beginning with its November 2016 private placement offering. The term of the Agreement is six months, or until the Company informs the consultant it has located investors to purchase the securities. The consultant is to be compensated for the services by cash payments totaling \$30,000, payable at or before the termination of the Agreement. As of September 30, 2018, the Company paid approximately \$23,500 in total to the consultant pursuant to the Agreement, including \$12,500 paid during year ended December 31, 2017 and \$11,000 during the year ended December 31, 2016.

On October 24, 2016, the Company entered into an agreement with Rio Silver, discussed in Note 3 – Mining Option Agreement, requiring the Company to spend \$2,000,000 in exploration costs over the three-year period commencing with the execution of the Agreement. Effective December 31, 2017, the Company agreed with Rio Silver to terminate the option agreement, thereby terminating the requirement for exploration cost expenditures and the Company’s option to earn an interest in the Niñobamba Silver/Gold Project.

Note 13 – Executive Employment Agreement

On June 1, 2016 we executed an employment agreement with Dr. Carson in which he assumed the positions of President and Chief Executive Officer of Magellan Gold Corporation. The agreement also provided that Dr. Carson be appointed a Director of Magellan Gold Corporation, and effective June 30, 2016, Dr. Carson was appointed a Director of Magellan. The term of the agreement covered the period from June 1, 2016 to May 31, 2017 and is subject to annual renewal. The agreement has subsequently been renewed each year and is currently effective from June 1, 2018 to May 31, 2019, with all terms of the original agreement remaining unchanged.

During the term of the agreement, Magellan agreed to pay Dr. Carson a base salary in equal semi-monthly installments less required withholding and other applicable taxes. Dr. Carson's salary was set at \$6,667 per month during the three-month period from June 1, 2016 through August 31, 2016, and thereafter at \$10,000 per month. Until such time as Magellan is properly funded, Magellan may defer and accrue salary owed. If not properly funded before the end of the term, Magellan may at its option issue shares of Magellan common stock as settlement of the accrued salary liability.

Dr. Carson shall have the right to voluntarily terminate his employment with Magellan during the term. To effect such voluntary termination, Dr. Carson shall provide Magellan at least 60 days advanced written notice of such termination. Upon termination, Dr. Carson shall be paid his base salary through the date of termination, including any amount that may have been deferred and accrued.

At September 30, 2018 a total of \$30,000 and \$11,110 of salary and associated payroll tax obligations, respectively, is accrued in connection with the agreement and included in accrued liabilities on the accompanying consolidated balance sheets.

At December 31, 2017 a total of \$30,000 and \$2,796 of salary and associated payroll tax obligations, respectively, is accrued in connection with the agreement and included in accrued liabilities on the accompanying consolidated balance sheets.

Note 14- Related Party Transactions

Conflicts of Interests

Athena Silver Corporation (“Athena”) is a company under common control. Mr. Power is also a director and CEO of Athena. Mr. Gibbs is a significant investor in both Magellan and Athena. Magellan and Athena are both exploration stage companies involved in the business of acquisition and exploration of mineral resources.

Silver Saddle Resources, LLC is also a company under common control. Mr. Power and Mr. Gibbs are significant investors and managing members of Silver Saddle. Magellan and Silver Saddle are both exploration stage companies involved in the business of acquisition and exploration of mineral resources.

The existence of common ownership and common management could result in significantly different operating results or financial position from those that could have resulted had Magellan, Athena and Silver Saddle been autonomous.

Management Fees

The Company previously maintained a month-to-month management agreement with Mr. Power requiring a monthly payment, in advance, of \$2,500 as consideration for his services as CFO to Magellan. Effective August 31, 2017, Mr.

Power resigned as CFO and Secretary of the Company and was replaced by Michael P. Martinez on September 18, 2017 to serve as CFO, Secretary and Treasurer. Mr. Power continues to serve as a member of the Board of Directors.

Management fees to Mr. Power for the three months ended September 30, 2018 and 2017, are \$-0- and \$7,500, respectively. Management fees to Mr. Power for the nine months ended September 30, 2018 and 2017, are \$-0- and \$15,000, respectively. These fees are included in general and administrative expenses in our statement of operations.

At September 30, 2018 and December 31, 2017, \$27,500 of the fees had not been paid and are included in accrued liabilities on the accompanying consolidated balance sheets.

Accrued Interest - Related Parties

Accrued interest due to related parties is included in our consolidated balance sheets as follows:

	September 30, 2018	December 31, 2017
Accrued interest payable - Mr. Gibbs	\$ 299,811	\$ 221,103
Accrued interest payable - Mr. Power	58,281	16,562
Accrued interest payable - Dr. Carson	3,042	986
	\$ 361,134	\$ 238,651

During the nine months ended September 30, 2018, we paid a total of \$12,357 to Mr. Power representing unpaid accrued interest on notes payable. During the year ended December 31, 2017, we paid a total of \$382 to Mr. Power representing unpaid accrued interest on notes payable.

Advances Payable – Related Party

We borrowed and repaid non-interest bearing advances from/to related parties as follows:

	Nine Months Ended September 30, 2018	
	Advances	Repayments/Conversion
Mr. Power	\$ 116,185	\$ 71,037
Mr. Carson	–	8,100
Totals	\$ 116,185	\$ 79,137

	Year Ended December 31, 2017	
	Advances	Repayments
Mr. Power	\$ 26,050	\$ 26,050
Mr. Carson	8,100	–
Totals	\$ 34,150	\$ 26,050

At September 30, 2018 and December 31, 2017 a total of \$45,148 and \$8,100 of short-term advances from related parties were outstanding and are included in advances payable, related party on the accompanying consolidated balance sheets.

In addition to the above, during the year ended December 31, 2017, Mr. Power loaned the Company \$25,000 in a short term note that was subsequently transferred into the Series 2017 Notes.

Note 15 – Subsequent Events

Subsequent to September 30, 2018, the Auctus Note holders converted \$2,814 of accrued interest and fees and \$45,234 of principal into 4,200,000 shares of common stock in accordance with the note agreements. On October 31, 2018, the Company repaid in full the remaining balance of the Auctus note with a payment of \$86,217.

In October 2018, the Company sold \$205,000 of Series 2018A 10% Unsecured Convertible Notes. The purchase price of the Note is equal to the principal amount of the Note. The Notes are convertible into shares of Common Stock at a

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conversion price of \$0.02 during the life of the Note. The Notes will accrue interest at the rate of 10% per annum, payable quarterly in arrears. The Notes mature twelve (12) months from the Date of Issue. Maturity Date can be extended at the option of the Company for an additional one (1) year. Within thirty (30) days following the closing of the Offering, the Company has agreed to prepare and file a Registration Statement on Form S-1 registering the resale of the shares of Common Stock issuable upon conversion of the Notes. Funds from this financing was used to repay in full the EMA Note.

In October 2018 the Company sold \$160,700 of Series 2018 36% Unsecured Promissory Notes (“Notes”) (“Bridge Note Offering”). The purchase price of the Note is equal to the principal amount of the Note. The Maturity Date of the Notes is December 31, 2018.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

We use the terms "Magellan," "we," "our," and "us" to refer to Magellan Gold Corporation.

The following discussion and analysis provides information that management believes is relevant for an assessment and understanding of our results of operations and financial condition. This information should be read in conjunction with our audited financial statements, which are included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2017, and our interim unaudited financial statements and notes thereto included with this report in Part I, Item 1.

Forward-Looking Statements

Some of the information presented in this Form 10-Q constitutes "forward-looking statements". These forward-looking statements include, but are not limited to, statements that include terms such as "may," "will," "intend," "anticipate," "estimate," "expect," "continue," "believe," "plan," or the like, as well as all statements that are not historical facts. Forward-looking statements are inherently subject to risks and uncertainties that could cause actual results to differ materially from current expectations. Although we believe our expectations are based on reasonable assumptions within the bounds of our knowledge of our business and operations, there can be no assurance that actual results will not differ materially from expectations.

All forward-looking statements speak only as of the date on which they are made. We undertake no obligation to update such statements to reflect events that occur or circumstances that exist after the date on which they are made.

Overview

We were incorporated on September 28, 2010, in Nevada. Our principal business is the acquisition and exploration of mineral resources. We have not presently determined whether the properties to which we have mineral rights contain mineral reserves that are economically recoverable.

We have only had limited operations to date and we rely upon the sale of our securities and borrowings from officers, directors and other significant investors to fund our operations, as we have not generated any revenue.

In August 2012, we entered into an option agreement and subsequently purchased the “Silver District” project consisting of 85 unpatented lode mining claims, 4 patented lode claims, a Arizona State Exploration Permit of 154.66 acres and 23 unpatented mill site claims, totaling over 2,000 acres in La Paz County, Arizona. Since our acquisition, we have increased our land position in the Silver District by staking two unpatented lode mining claims, leased two additional patented claims and have increased our Arizona State Exploration Permit to 334.85 acres.

On September 30, 2014, we formed and organized a new wholly-owned subsidiary, Gulf + Western Industries, Inc., a Nevada corporation (“Gulf+Western” or “G+W”), to own our Silver District mining interests. On October 1, 2014 we completed the transfer of those assets from Magellan to G+W. At the time of the transfer, Magellan owned all the outstanding common stock of G+W. Effective December 31, 2014, Magellan pledged all its ownership interest in G+W to Mr. John D. Gibbs, a significant shareholder in the Company, as security for outstanding amounts under a line of credit agreement between Magellan and Mr. Gibbs. As of September 30, 2018, the total amount owed under the credit agreement was \$1,085,785, which includes \$832,500 of principal and \$253,285 of accrued interest.

On June 1, 2015, we transferred 15% of our ownership interest in G+W to Dr. Pierce Carson in exchange for one year of service as President, Chief Executive Officer and Director of G+W. As a result of the transaction, Magellan’s ownership interest in G+W was reduced to 85%. The transaction was valued at \$50,000 representing deferred compensation for the one-year period June 2015, through May 2016. On June 1, 2016 Magellan entered into a one-year employment agreement with Dr. Carson in which he assumed the positions of President and Chief Executive Officer of Magellan. As a result, Mr. John Power resigned his positions as President and Chief Executive Officer concurrent with the execution of Dr. Carson’s employment agreement. Mr. Power has retained the positions of Chief Financial Officer and Director of Magellan. Dr. Carson was appointed a Director of Magellan effective June 30, 2016.

In July 2016, the Company completed a share exchange with Dr. Carson in which Dr. Carson surrendered his 15% interest in G+W in exchange for 8,623,957 shares of Magellan Gold Corporation. As a result of this transaction, G+W became a wholly owned subsidiary of Magellan Gold Corporation.

On October 24, 2016, the Company entered into a Mining Option Agreement (“Agreement”) between and among Rio Silver Inc., a Canadian company (“Rio Silver”), Minera Rio Plata S.A.C., a Peruvian company and subsidiary of Rio Silver (“Minera”), and Magellan Gold Peru S.A.C., a Peruvian company and wholly owned subsidiary of the Company (“Magellan Peru”) pursuant to which Rio Silver through Minera, granted to the Company the sole and exclusive option to acquire an undivided 50% interest in and to property located in central Peru. . Effective December 31, 2017, the Company agreed with Rio Silver to terminate the option agreement, thereby terminating the Company’s option to earn an interest in the Niñobamba Silver/Gold Project. The Company retained its ownership of Rio Silver stock and warrants, which have been pledged to secure a \$125,000 loan from John Power.

On November 30, 2017, the Company purchased from Rose Petroleum plc (“Rose”) a mineral processing mill operation located in the state of Navarit, Mexico (the “SDA Mill”) as well as its associated assets, licenses and agreements. Magellan paid a \$50,000 option payment, and an additional \$100,000 option-to-purchase extension. The \$100,000 option extension payment was applied against the cash portion of the purchase price.

The purchase price for the SDA Mill consisted of \$850,000 cash, a \$50,000 promissory note, the \$50,000 non-refundable option payment, the \$100,000 for the option-to-purchase payment, and 14,200,834 shares of common stock (the “Shares”) with a fair value of \$426,025 at the closing date. The note is non-interest bearing and was due on March 10, 2018 and paid in April 2018. The Shares will be held in escrow for a period of 12 months and the Company has the option to repurchase the Shares from Rose for the sum of \$500,000 in the first six months and \$550,000 in months 7 to 12.

Prior to closing, all of the assets and operations related to the SDA Mill were transferred to a newly incorporated entity, Minerales Vane 2 S.A. de C.V. (“Minerales Vane 2”). Effective November 30, 2017, the Company’s newly incorporated wholly-owned subsidiary, Magellan Acquisition Corporation (“MAC”), acquired 100% of the issued and outstanding shares of Minerales Vane 2.

On October 17, 2017, the Company amended the agreement to include the acquisition of Minerales Vane Operaciones (“MVO”) (the entity that provides labor to the Mill) for \$2,500. In January 2018 the Company paid the purchase price and obtained legal control of MVO. MVO is the sister entity which was organized for the purpose of employing all personnel of the SDA mill. The acquisition of MVO will not result in the acquisition of any additional assets or liabilities.

The Company entered into an agreement giving it the right to acquire the El Dorado Gold-Silver Property, a 50 hectare mining concession located near the village of Las Minitas, which lies 50 kilometers south of Magellan's SDA Flotation Plant at Acaponeta, Nayarit State. Magellan intends to advance El Dorado towards production as a matter of priority. The Company has initiated permitting and is in the process of selecting an underground mining contractor. The project has excellent road and rail infrastructure, and the Company plans to truck the ore from El Dorado to the SDA Plant for processing. El Dorado is situated within a district of epithermal vein systems from which historic mining produced high grades.

Commencement of mining will depend on a number of preconditions, the most important of which include obtaining environmental and blasting permits, selecting and mobilizing a mining contractor and procuring financing. An access and land use agreement with the local ejido already is in place. Once development begins, ore will be accessible with a minimal amount of underground development. Ore will be sourced initially from the shallow, upper portions of the mineralized veins.

Drilling on the El Dorado vein system was conducted by a TSX.V-listed company in 2010-2011 and comprised 28 diamond core holes totaling 4,950 meters. Two veins appear to offer particular promise for mining, namely the Hundido and Intermedia veins. These veins lie adjacent to and along strike from the old Hundido Mine, which from 1900-1927 produced an estimated 50,000 tonnes of high-grade gold-silver ore. The veins are steeply-dipping, highly silicified structures cutting volcanic rocks. Polygonal resource calculations for the two veins, based on intersections in 10 core holes and after applying a 25% tonnage deduction for dilution and recovery factors, yielded respectively 89,000 tonnes grading 7.01 g/t gold equivalent (Au+Ag) over a true width of 2.3 meters (Hundido Vein); and 91,000 tonnes grading 15.17 g/t gold equivalent (Au+Ag) over a true width of 8.3 meters (Intermedia Vein). These resources are non-NI43-101 compliant. The mineralization extends from near surface to a drilled depth of 150 meters and is open at greater depth.

The El Dorado vein system can be traced on the surface for a distance greater than three kilometers and exhibits structural complexity with numerous conjugate vein splits both in the hangingwall and footwall. This complex structure hosts multiple mineralized zones including high-grade veins potentially minable underground, and lower-grade open-pittable stockwork zones that are observed to extend over tens of meters in width in both the hangingwall and footwall of the El Dorado vein system.

Magellan has concluded an agreement with Ingenieros Mineros, S.A. de C.V., the owner of the El Dorado mining concession giving the Company the right to acquire the concession by making staged six-monthly option payments over two years towards an end purchase price of \$800,000 (plus 16% IVA). No royalties are payable. Magellan has the right to begin production during the term of the agreement. The Company has made the initial option payment of \$50,000 (plus 16% IVA). In addition, Magellan has agreed with a TSX.V-listed company to purchase a comprehensive El Dorado data package including diamond drill core and technical information for a price of \$120,000, payable in cash and Magellan common stock.

Our primary focus with the acquisition of the SDA Mill in Mexico is to transform Magellan into a production company, to continue to advance our Arizona silver project towards resource definition and eventual development, and possibly to acquire additional mineral rights and conduct additional exploration, development and permitting activities. Our mineral lease payments, permitting applications and exploration and development efforts will require additional capital. We rely upon the sale of our securities as well as advances and loans from executive management and significant shareholders to fund our operations as we have not generated any significant revenue.

Results of Operations for the three months Ended September 30, 2018 and 2017

	Three months ended September 30,	
	2018	2017
Revenues, net	\$2,418	\$—
Operating costs and expenses:		
Cost of Sales	121,014	—
Exploration costs	10,000	10,872
General and administrative expenses	243,359	194,356
Total operating costs and expenses	374,373	205,228
Operating loss	(371,955)	(205,228)
Other income (expense):		
Interest expense	(83,490)	(19,356)

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Foreign currency exchange gain	2,819	–
Unrealized gain (loss) on available-for-sale securities	1,557	–
Loss on change in derivative liability	–	(1,900)
Net loss	\$(451,069)	(226,484)

Revenues

During the three months ended September 30, 2018 our total revenues were \$2,418 as compared to \$-0- during the same period in 2017. Revenues were generated from the sale of tailings left from operations prior to our acquisition of the SDA Mill.

Operating expenses

During the three months ended September 30, 2018, our total operating cost and expenses were \$374,373 as compared to \$205,228 during the three months ended September 30, 2017.

During the three months ended September 30, 2018 our total cost of sales were \$121,014 as compared to \$-0- during the same period in 2017. Cost of sales were comprised primarily of labor and benefits, equipment depreciation, utilities and supplies of running the SDA Mill.

During the three months ended September 30, 2018 we incurred \$10,000 of exploration costs as compared to \$10,872 during the same period in 2017. Exploration costs for the three months ended September 30, 2018 comprised of \$10,000 for advance royalty payments associated with our Silver District claims. Exploration costs for the three months ended September 30, 2017 comprised of \$10,872 for our lease payments and maintenance expenses associated with our Silver District claims.

General and administrative expenses for the three months ended September 30, 2018 total \$243,359 as compared to \$194,356 for the three months ended September 30, 2017. The \$49,003 increase is primarily associated with increases in accounting and audit fees, officer compensation, investor relations, travel expenses and other administrative costs.

These were were offset primarily by a decrease in other costs, including expenses associated with our acquisition efforts of the SDA Mill, and management fees. For the three months ended September 30, 2018, administrative expenses were comprised of accounting and auditing fees of \$38,772, legal fees of \$26,290, officer compensation of \$68,427, investor relations fees of \$49,300, and other costs, including administrative, travel, office, facility rents, and other expenses totaling \$60,570.

On June 1, 2016 we executed an employment agreement with Dr. Carson in which he assumed the positions of President and Chief Executive Officer of Magellan Gold Corporation. The term of the agreement covered the period from June 1, 2016 to May 31, 2017, subject to annual renewal. The agreement has subsequently been renewed each year and is currently effective from June 1, 2018 to May 31, 2019, with all terms of the original agreement remaining unchanged. A total of \$32,760 representing Dr. Carson's base salary and applicable payroll taxes was expensed and is included in general and administrative expenses for both three month periods ended September 30, 2018 and 2017, respectively.

For the three months ended September 30, 2017, general and administrative expenses were comprised of accounting and auditing fees of \$20,658, legal fees of \$25,010, officer compensation and payroll taxes of \$68,427, management fees of \$5,000, investor relations fees of \$17,758, other costs, including administrative expenses, travel, office and facility rents, and other expenses associated with our acquisition efforts of the SDA Mill totaling \$88,037.

Interest expense for the three months ended September 30, 2018 and 2017 totaled \$83,490 and \$19,356, respectively. Interest expense for the current period is attributable primarily to our amortization of debt discount, related party line of credit, related party notes payable, notes payable, and convertible notes.

Results of Operations for the nine months Ended September 30, 2018 and 2017

	Nine months ended September 30,	
	2018	2017
Revenues, net	\$125,247	\$-
Operating costs and expenses:		
Cost of Sales	436,241	-
Exploration costs	20,035	53,733
General and administrative expenses	668,689	480,871
Total operating costs and expenses	1,124,965	534,604
Operating loss	(999,718)	(534,604)
Other income (expense):		
Interest expense	(561,440)	(50,349)
Foreign currency exchange gain	3,162	-
Loss on change in derivative liability	(73,250)	-
Unrealized gain (loss) on available-for-sale securities	(24,319	-
Gain (loss) on change in derivative liability	286,919	(657,776)
Net loss	\$(1,368,646)	\$(1,242,729)

Revenues

During the nine months ended September 30, 2018 our total revenues were \$125,247 as compared to \$-0- during the same period in 2017. Revenues were generated from the sale of tailings left from operations prior to our acquisition of the SDA Mill.

Operating expenses

During the nine months ended September 30, 2018, our total operating costs and expenses were \$1,124,965 as compared to \$534,604 during the nine months ended September 30, 2017.

During the nine months ended September 30, 2018 our total cost of sales were \$436,241 as compared to \$-0- during the same period in 2017. Cost of sales were comprised primarily of labor and benefits, equipment depreciation, utilities and supplies.

During the nine months ended September 30, 2018 we incurred \$20,035 of exploration costs as compared to \$53,733 in 2017. Exploration costs for the nine months ended September 30, 2018 are comprised of \$10,035 for professional geologic fees and \$10,000 of advance royalty payments, both associated with our Silver District claims.

Exploration costs for the nine months ended September 30, 2017 are comprised of \$24,188 for our consulting geologist, geochemical, lease payments and maintenance expenses associated with our Silver District claims and \$29,545 in various mining related expenses associated with our mining efforts in Peru.

General and administrative expenses for the nine months ended September 30, 2018 total \$668,689 as compared to \$480,871 for the nine months ended September 30, 2017. For the nine months ended September 30, 2018, administrative expenses were comprised of accounting and auditing fees of \$139,655, legal fees of \$59,934, officer compensation and payroll taxes of \$155,982, investor relations of \$155,881, and other expenses, including administrative, travel, office and facility rents, and other costs associated with our acquisition efforts of the SDA Mill, totaling \$157,237.

For the nine months ended September 30, 2017, general and administrative expenses primarily comprised of accounting and auditing fees of \$60,128, legal fees of \$68,901, officer compensation of \$98,387, management fees to Mr. Power of \$20,000, investor relations fees of \$89,095, and other expenses, including administrative, travel, office and facility rents, and other costs associated with our acquisition efforts of the SDA Mill, totaling \$144,409.

On June 1, 2016 we executed an employment agreement with Dr. Carson in which he assumed the positions of President and Chief Executive Officer of Magellan Gold Corporation. The term of the agreement covered the period from June 1, 2016 to May 31, 2017, subject to annual renewal. The agreement has subsequently been renewed each year and is currently effective from June 1, 2018 to May 31, 2019, with all terms of the original agreement remaining unchanged. A total of \$98,315 representing Dr. Carson's base salary and applicable payroll taxes was expensed and is included in general and administrative expenses for both nine month periods ended September 30, 2018 and 2017, respectively.

Interest expense for the nine months ended September 30, 2018 and 2017 totaled \$561,440 and \$50,349, respectively. Interest expense for the current period is attributable primarily to our amortization of debt discount, related party line of credit, related party notes payable, notes payable, and convertible notes.

Liquidity and Capital Resources

Our unaudited consolidated financial statements have been prepared on a going concern basis, which assumes that we will be able to meet our obligations and continue our operations during the next fiscal year. Asset realization values may be significantly different from carrying values as shown in our consolidated financial statements and do not give effect to adjustments that would be necessary to the carrying values of assets and liabilities should we be unable to continue as a going concern. At September 30, 2018, we had not yet generated any revenues or achieved profitable operations and we have accumulated losses of \$5,404,215. We expect to incur further losses in the development of our business, all of which raises substantial doubt about our ability to continue as a going concern. Our ability to continue as a going concern depends on our ability to generate future profits and/or to obtain the necessary financing to meet our obligations arising from normal business operations when they come due.

We have amended our credit agreement with Mr. Gibbs, a related party, on multiple occasions with the most recent amendment extending the maturity date for the line of credit to December 31, 2018. The current borrowing limit on the credit line is \$1,000,000 with a borrowing availability of \$167,500 remaining.

During the nine months ended September 30, 2018, we sold 17,000,000 units consisting of common stock and warrants and realized net proceeds of \$340,000. Additionally, 6,000,000 warrants were exercised during the same period and net proceeds of \$120,000 were realized. Proceeds from these transactions were generally used to fund working capital.

Additionally through various transactions with related parties during the year ended December 31, 2017, the Company realized approximately \$1,075,000 which is primarily reflected in a series of promissory notes ("Series 2017 Notes"). The proceeds were generally used to fund the purchase of the SDA Mill in Mexico. The Series 2017 Notes are secured by a pledge of all the outstanding shares of Magellan Acquisition Corporation, a wholly-owned subsidiary that owns the SDA Mill through Minerales Vane 2.

We anticipate that additional funding will be in the form of additional loans from officers, directors or significant shareholders, or equity financing from the sale of our common stock but cannot assure that any future financings will occur.

Cash Flows

A summary of our cash provided by and used in operating, investing and financing activities is as follows:

	Nine Months Ended September 30,	
	2018	2017
Net cash used in operating activities	\$(418,196)	\$(300,999)
Net cash used in investing activities	(66,273)	(208,297)
Net cash provided by financing activities	550,148	511,100
Effect of foreign currency exchange	(63,986)	(862)
Net increase in cash and cash equivalents	1,693	942
Cash and cash equivalents beginning of period	421	485
Cash and cash equivalents end of period	\$2,114	\$1,427

At September 30, 2018, we had \$2,114 in cash and a \$3,389,923 working capital deficit. This compares to cash of \$421 and a working capital deficit of \$2,827,255 at December 31, 2017.

Net cash used in operating activities during the nine months ended September 30, 2018 was \$418,196 and was mainly comprised of our \$1,368,646 net loss during the period, adjusted by a non-cash charges of \$392,069 for accretion of discounts on notes payable, \$119,167 for amortization of certain service contracts, \$286,919 as a loss on change in derivative liability, 26,667 as a stock compensation and depreciation expense of \$91,703. In addition, it reflects a decrease in Due from Rose Petroleum of \$27,147, an increase in prepaid expenses and other assets totaling \$38,752, as well as increases in accounts payable and accrued expenses totaling \$155,627.

Net cash used in operating activities during the nine months ended September 30, 2017 was \$300,999 and was mainly comprised of our \$1,242,729 net loss during the period, adjusted by a non-cash charge of \$43,428 representing the amortization of certain service contracts, and the loss on a increase in our derivative liability of \$657,776, and a \$7,862 loss on an impairment of an investment. In addition, it reflects an increase in prepaid expenses and other assets totaling \$20,199, as well as increases in accounts payable and accrued expenses totaling \$202,899, and increases in accrued interest totaling \$49,964 representing accrued interest on our related party line of credit and related party and other notes payable.

During the nine months ended September 30, 2018, our net cash used in investing activities was \$66,273 which was due to the purchase of plant, property and equipment, as well as an installment payment for acquisition of the El Dorado gold-silver property.

During the nine months ended September 30, 2017, our net cash used in investing activities was \$208,297. During the period we completed the second of two private placement unit financings in Rio Silver Inc. (“Rio Silver”), associated with our mining option agreement with Rio Silver. The private placement resulted in the Company obtaining an additional 1,250,000 units at a price of Cdn\$0.06, which included one share of Rio Silver common stock and one warrant to purchase one share of Rio Silver common stock for Cdn\$0.06 which expire on July 19, 2018. This warrant was subsequently extended for an additional period of 18 months. The cost of the units in the second private placement totaled USD \$58,297. In addition we paid \$150,000 towards the purchase of the SDA Mill.

During the nine months ended September 30, 2018, net cash provided by financing activities was \$550,148 comprised of the sale of stock and warrants, related party advances, the exercise of warrants and paydown on the note payable to Rose Petroleum. Funds were raised in conjunction with a private placement of equity securities in which we sold a total of 17,000,000 units priced at \$0.02 per unit, resulting in total proceeds of \$340,000. Each unit was comprised of one share of common stock, and one warrant entitling the holder to purchase one share of common stock at a price of \$0.02 per share in cash, and have varying expiration dates from August 31, 2018 to December 31, 2018. Related party advances from John Power contributed a net amount of \$45,148 in proceeds during the period while payments on the note payable to Rose Petroleum used \$50,000. Finally, the exercise of 6,000,000 warrants at \$0.02 per share during the period generated proceeds of \$120,000.

During the nine months ended September 30, 2017, net cash provided by financing activities was \$511,100. During the period, Mr. Power, an executive and director, advanced the Company a total of \$78,050 of which \$25,050 was repaid. Also during the period, Dr. Carson, an executive and director, advanced the Company \$8,100 with no repayments. In addition, during the nine months ended September 30, 2017 we completed a private placement of equity securities with two investors in which we sold a total of 1,250,000 units priced at \$0.10 per unit, resulting in total proceeds of \$125,000. Each unit was comprised of one share of common stock, and one warrant entitling the holder to purchase one share of common stock at a price of \$0.10 per share in cash, and expire December 30, 2017. In addition on August 3, 2017, a warrant holder exercised 500,000 warrants resulting in net proceeds of \$50,000.

During the nine months ended September 30, 2017 we issued a total of \$275,000 of related party promissory notes. On May 31, 2017 we executed three short-term notes with Mr. Gibbs, significant shareholder, and our two executive officers, Dr. Carson and Mr. Power in the principal amounts of \$100,000, \$25,000 and \$25,000, respectively. The notes bear interest at 6% and mature on November 15, 2017. In addition, on June 30, 2017 we entered into an additional secured loan for advances from Mr. Power and evidenced by a \$125,000 promissory note. The promissory note bears interest at 6% per annum and matures on December 31, 2017. The note is collateralized by our investment in Rio Silver shares and warrants.

Off Balance Sheet Arrangements

We do not have and have never had any off-balance sheet arrangements.

Summary of Significant Accounting Policies

Basis of Presentation and Principles of Consolidation

Our consolidated financial statements include our accounts and the accounts of our 100% owned subsidiaries, Gulf + Western Industries, Inc., Magellan Acquisition Corporation, Minerales Vane 2, S.A. de C.V., and Minerales Vane Operaciones, S.A de C.V.. All intercompany transactions and balances have been eliminated. Our consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (“U.S. GAAP”).

Use of Estimates

The preparation of financial statements in conformity with U.S. GAAP requires us to make estimates, assumptions and judgments that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the financial statements and the reported amounts of expenses during the period presented.

We make our estimate of the ultimate outcome for these items based on historical trends and other information available when the financial statements are prepared. Changes in estimates are recognized in accordance with the accounting rules for the estimate, which is typically in the period when new information becomes available. We believe that our significant estimates, assumptions and judgments are reasonable, based upon information available at the time they were made. Actual results could differ from these estimates, making it possible that a change in these estimates could occur in the near term.

Foreign Currency Translations

The Company maintains its accounting records in US Dollars. Our operating subsidiaries, Minerales Vane 2, S.A. de C.V., and Minerales Vane Operaciones, S.A de C.V., report in Mexican Pesos which is the functional currency for both entities. The subsidiaries' transactions are recorded in their respective functional currencies and are reported to the Company in Mexican Pesos. For reporting, the Company translates the subsidiaries' transactions and accounts to US Dollars at exchange rates approximating those ruling at the transaction dates. Exchange gains and losses are recorded in the statements of income and comprehensive income. Assets and liabilities of the Company and its subsidiaries are translated into the U.S. dollars at exchange rates at the balance sheet date, equity accounts are translated at historical exchange rate and revenues and expenses are translated by using the average exchange rates. Translation adjustments are reported as a separate component of other comprehensive income in the consolidated statements of operations and comprehensive loss.

Fair Value of Financial Instruments

We value our financial assets and liabilities using fair value measurements. Our financial instruments primarily consist of cash and cash equivalents, accounts payable, accrued liabilities, amounts due to related parties and notes payable to related parties. Fair value is based on the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The carrying amount of cash and cash equivalents, accounts payable, accrued liabilities, notes payable to related parties and other amounts due to related parties approximates fair value because of the short-term nature of these financial instruments.

Concentrations of Credit Risk

Our financial instruments which potentially subject us to credit risk are our cash and cash equivalents. We maintain our cash and cash equivalents at reputable financial institutions and currently, we are not exposed to significant credit risk.

Cash and Cash Equivalents

We consider all amounts on deposit with financial institutions and highly liquid investments with an original maturity of three months or less to be cash equivalents at the date of purchase.

Mineral Rights

We have determined that our mineral rights meet the definition of mineral rights, as defined by accounting standards, and are tangible assets. As a result, our direct costs to acquire or lease mineral rights are initially capitalized as tangible assets. Mineral rights include costs associated with: leasing or acquiring patented and unpatented mining claims; leasing mining rights including lease signature bonuses, lease rental payments and advance minimum royalty payments; and options to purchase or lease mineral properties.

If we establish proven and probable reserves for a mineral property and establish that the mineral property can be economically developed, mineral rights will be amortized over the estimated useful life of the property following the commencement of commercial production or expensed if it is determined that the mineral property has no future economic value or if the property is sold or abandoned. For mineral rights in which proven and probable reserves have not yet been established, we assess the carrying values for impairment at the end of each reporting period and whenever events or changes in circumstances indicate that the carrying value may not be recoverable.

The net carrying value of our mineral rights represents the fair value at the time the mineral rights were acquired less accumulated depletion and any abandonment or impairment losses. Proven and probable reserves have not been established for mineral rights as of September 30, 2018. At September 30, 2018 mineral rights totaling \$373,713 were net of \$117,857 of impairment and abandonment charges. No impairment charges were recognized for either of the nine months ended September 30, 2018 or 2017.

Impairment of Long-lived Assets and Mining Rights

We continually monitor events and changes in circumstances that could indicate that our carrying amounts of long-lived assets, including mineral rights, may not be recoverable. When such events or changes in circumstances occur, we assess the recoverability of long-lived assets by determining whether the carrying value of such assets will be recovered through their undiscounted expected future cash flow. If the future undiscounted cash flow is less than the carrying amount of these assets, we recognize an impairment loss based on the excess of the carrying amount over the fair value of the assets.

Notes Payable – Related Parties

Notes payable to related parties are classified as current liabilities as the note holders either have the ability to control the repayment dates of the notes or the notes are due within twelve months of the balance sheet date.

Exploration Costs

Mineral exploration costs are expensed as incurred. When it has been determined that it is economically feasible to extract minerals and the permitting process has been initiated, exploration costs incurred to further delineate and develop the property are considered pre-commercial production costs and will be capitalized and included as mine development costs in our balance sheets.

Income Taxes

We recognize deferred tax assets and liabilities for temporary differences between the tax basis of assets and liabilities and the amounts at which they are carried in the financial statements and the effect of net operating losses based upon the enacted tax rates in effect for the year in which the differences are expected to reverse. A valuation allowance is established when necessary to reduce deferred tax assets to the amount expected to be realized. At September 30, 2018, the Company had no uncertain tax positions.

Net Loss per Common Share

We compute basic net loss per common share by dividing our net loss attributable to common shareholders by our weighted-average number of common shares outstanding during the period. Computation of diluted net loss per common share adds the weighted-average number of potential common shares outstanding to the weighted-average common shares outstanding, as calculated for basic net loss per share, except for instances in which there is a net loss.

For the three and nine months ended September 30, 2018 and 2017, potential common shares associated with convertible notes payable and outstanding warrants to purchase common stock have been omitted from the net loss per common share computation as they are anti-dilutive due to the net loss for these periods.

Stock-based Compensation

The Company determines the fair value of stock option awards granted to employees in accordance with FASB ASC Topic 718 – 10 and to non-employees in accordance with FASB ASC Topic 505 – 50. Compensation cost is measured at the grant date based on the value of the award and is recognized over the service period, which is usually the vesting period.

New Accounting Standards

From time to time, the Financial Accounting Standards Board (“FASB”) or other standards setting bodies issue new accounting pronouncements. Updates to the FASB Accounting Standards Codification are communicated through issuance of an Accounting Standards Update. Unless otherwise discussed, we believe that the impact of recently issued guidance, whether adopted or to be adopted in the future, is not expected to have a material impact on our financial statements upon adoption.

In February 2016, the Financial Accounting Standards Board issued ASU No. 2016-02, "Leases: Topic 842 (ASU 2016-02)", to supersede nearly all existing lease guidance under GAAP. The guidance would require lessees to recognize most leases on their balance sheets as lease liabilities with corresponding right-of-use assets. ASU 2016-02 is effective for the Company in the first quarter of our fiscal year ending December 31, 2019 using a modified retrospective approach with the option to elect certain practical expedients. The Company is currently evaluating the impact of its pending adoption of ASU 2016-02 on its consolidated financial statements.

Recently Adopted Accounting Standards

In January 2016, the FASB issued ASU No. 2016-01, “Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities,” which addresses the recognition, measurement, presentation and disclosure of financial assets and liabilities. This ASU primarily affects the accounting for equity investments, financial liabilities under the fair value option and the presentation and disclosure requirements for financial instruments. In addition, this ASU clarifies the valuation allowance assessment when recognizing deferred tax assets resulting from unrealized losses on available-for-sale debt securities. This standard became effective on January 1, 2018. At the adoption of this standard the Company reclassified \$8,518 from Accumulated Other Comprehensive Loss to Accumulated Deficit which represented the cumulative impact of the new standard.

Accounting Standards Update No. 2014-09—Revenue from Contracts with Customers (Topic 606). On May 28, 2014, the FASB issued guidance that requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. This ASU was further amended by ASU No. 2015-14, No. 2016-08, No. 2016-10, No. 2016-12 and No. 2016-20. The guidance provides a five-step approach to be applied to all contracts with customers and also requires expanded disclosures about revenue recognition. The Company has performed an assessment of the revised guidance and the impacts on the Company's Consolidated Financial Statements and disclosures and has determined that the adoption of this guidance did not have an impact. The Company adopted the new guidance effective January 1, 2018 using the modified retrospective approach.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Not applicable.

ITEM 4. CONTROLS AND PROCEDURES

Conclusion Regarding the Effectiveness of Disclosure Controls and Procedures:

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our Exchange Act reports is recorded, processed, summarized and reported within the time periods specified in the

Securities and Exchange Commission's ("SEC") rules and forms, and that such information is accumulated and communicated to management, including W. Pierce Carson, our President, and Michael P. Martinez, our Principal Accounting Officer, as appropriate, to allow timely decisions regarding required disclosure. Management necessarily applied its judgment in assessing the costs and benefits of such controls and procedures, which, by their nature, can provide only reasonable assurance regarding management's control objectives.

Our management, with the participation of our CEO, evaluated the effectiveness of the design and operation of our disclosure controls and procedures as of the end of the period covered by this report. Based upon this evaluation, our CEO concluded that our disclosure controls and procedures were not effective as of such date as a result of material weaknesses in our internal control over financial reporting due to lack of segregation of duties, a limited corporate governance structure, and lack of a formal review process that includes multiple levels of review as discussed in Item 9A of our Form 10-K for the fiscal year ended December 31, 2017.

While we strive to segregate duties as much as practicable, there is an insufficient volume of transactions at this point in time to justify additional full time staff. We believe that this is typical in many exploration stage companies. We may not be able to fully remediate the material weakness until we commence mining operations at which time we would expect to hire more staff. We will continue to monitor and assess the costs and benefits of additional staffing.

Changes in Internal Control Over Financial Reporting:

There were no changes in our internal control over financial reporting that occurred during the last fiscal quarter covered by this report that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

None.

ITEM 1A. RISK FACTORS

There have been no material changes from the risk factors disclosed in Item 1A. to Part I. of our Annual Report on Form 10-K for the year ended December 31, 2017.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

All sales of unregistered securities were reported on Form 8-K during the period.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. MINE SAFETY DISCLOSURES

None.

ITEM 5. OTHER INFORMATION

None.

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ITEM 6. EXHIBITS

Exhibit Number	Exhibit Description
31.1	* <u>Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002</u>
31.2	* <u>Certification of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002</u>
32	* <u>Certification of the President, Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002</u>
101.INS	*XBRL Instance Document
101.SCH	*XBRL Taxonomy Extension Schema Document
101.CAL	*XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	*XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	*XBRL Taxonomy Extension Label Linkbase Document
101.PRE	*XBRL Taxonomy Extension Presentation Linkbase Document

* Filed or furnished herewith.

SIGNATURE

Pursuant to the requirements 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.

Dated: November 19, 2018

MAGELLAN GOLD CORPORATION

By: /s/ W. Pierce Carson

W. Pierce Carson

President, Chief Executive Officer

(Principal Executive Officer)

By: /s/ Michael P. Martinez

Michael P. Martinez

Chief Financial Officer

(Principal Accounting Officer)

