

VERDISYS INC
Form SB-2/A
August 27, 2004

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

PRE-EFFECTIVE AMENDMENT NO. 1

FORM SB-2

REGISTRATION STATEMENT UNDER THE SECURITIES ACT OF 1933

VERDISYS, INC.

(Name of small business issuer in its charter)

California

State of incorporation

1382

Primary Standard Industrial
Classification Code Number
22-37755993

IRS Employer Identification No.

14550 Torrey Chase Boulevard, Suite 330
Houston, Texas 77014-1022
(281) 453-2888

Principal Executive Offices and Principal Place of Business

John O'Keefe, Chief Financial Officer
14550 Torrey Chase Boulevard, Suite 330
Houston, Texas 77014-1022
(281) 453-2888

Name, address, and telephone number of agent for service

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. []

If this Form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. []

If this Form is a post-effective amendment filed pursuant to Rule 462(d) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. []

If delivery of the prospectus is expected to be made pursuant to Rule 434 check the following box. []

If any of the securities being registered on this form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933, check the following box. [X]

The registrant hereby amends this registration statement on such date or dates as may be necessary to delay its effective date until the registrant shall file a further amendment which specifically states that this registration statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933 or until the registration statement shall become effective on such date as the Commission, acting pursuant to said Section 8(a), may determine.

Approximate date of proposed sale to the public: **As soon as practical following the effective date of registration.**

**VERDISYS, INC.
14550 TORREY CHASE BOULEVARD, SUITE 330
HOUSTON, TEXAS 77014-1022**

3,337,502 SHARES

COMMON STOCK

We are registering up to 3,337,502 shares of our common stock for sale by certain shareholders of our company identified in this Prospectus. These shareholders are referred to throughout this Prospectus as "selling stockholders." Of the 3,337,502 shares of our common stock subject to this Prospectus, 2,881,899 shares of our common stock are currently issued and outstanding; 177,835 shares of our common stock are issuable upon exercise of certain warrants, and a maximum of 277,778 shares of common stock are issuable contingent upon the occurrence of certain triggering events contained in a prior financing agreement with Gryphon Master Fund, L.P.

The selling stockholders who wish to sell their shares of our common stock may offer and sell their shares on a continuous or delayed basis in the future. These sales may be conducted at fixed prices, market prices or at negotiated prices, and the selling stockholders may engage a broker or dealer to sell their shares. We will not receive any proceeds from these sales, but we will receive proceeds from the exercise of any warrants. For additional information on possible methods of sale, you should see "Plan of Distribution" on page 18.

The securities being registered trade on the Pink Sheets under the symbol "VDYS.PK".

The date of this Offering Prospectus is: August __, 2004

NEITHER THE SECURITIES AND EXCHANGE COMMISSION NOR ANY STATE SECURITIES COMMISSION HAS APPROVED OR DISAPPROVED OF THESE SECURITIES OR PASSED UPON THE ADEQUACY OR ACCURACY OF THE PROSPECTUS. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.

THE INFORMATION IN THIS PROSPECTUS MAY NOT BE COMPLETE AND IS SUBJECT TO CHANGE. SELLING SECURITY HOLDERS MAY NOT SELL THESE SECURITIES UNTIL THE REGISTRATION STATEMENT, OF WHICH THIS PROSPECTUS IS A PART, FILED WITH THE SECURITIES AND EXCHANGE COMMISSION IS EFFECTIVE. THIS PROSPECTUS IS NOT AN OFFER TO SELL THESE SECURITIES AND IS NOT SOLICITING AN OFFER TO BUY THESE SECURITIES IN ANY STATE WHERE THE OFFER OR SALE IS NOT PERMITTED.

INVESTMENT IN SMALL BUSINESSES INVOLVES A HIGH DEGREE OF RISK, AND INVESTORS SHOULD NOT INVEST ANY FUNDS IN VERDISYS, INC. UNLESS THEY CAN AFFORD TO LOSE THEIR ENTIRE INVESTMENT.

SEE RISK FACTORS, BEGINNING ON PAGE 6.

VERDISYS, INC.

TABLE OF CONTENTS

SUMMARY INFORMATION AND RISK FACTORS	4
<i>Summary Information</i>	4
<hr/>	
<i>Risk factors</i>	6
<hr/>	
USE OF PROCEEDS	15
SELLING SECURITY HOLDERS	15
PLAN OF DISTRIBUTION	18
LEGAL PROCEEDINGS	19
DIRECTORS, EXECUTIVE OFFICERS AND CONTROL PERSONS	21
SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT	23
DESCRIPTION OF SECURITIES	24
INTEREST OF NAMED EXPERTS AND COUNSEL	26
DISCLOSURE OF COMMISSION POSITION ON INDEMNIFICATION FOR SECURITIES ACT LIABILITIES	26
DESCRIPTION OF BUSINESS	26
<i>Business Development</i>	26
<hr/>	
<i>Business Segments</i>	27
<hr/>	
<i>Industry</i>	28
<hr/>	
<i>Lateral Drilling Services</i>	29
<hr/>	
<i>Major Customers</i>	33
<hr/>	
<i>Customer Acceptance</i>	33
<hr/>	
<i>Market</i>	33
<hr/>	
<i>Competition</i>	34
<hr/>	
<i>Satellite Services</i>	35
<hr/>	
<i>Major Customers</i>	37
<hr/>	
<i>Market</i>	37
<hr/>	
<i>Competition</i>	37
<hr/>	
<i>Patents</i>	37
<hr/>	
<i>Governmental Regulation</i>	38
<hr/>	
<i>Employees</i>	38
<hr/>	
MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION	39

DESCRIPTION OF PROPERTY	45
CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS	46
MARKET FOR COMMON EQUITY AND RELATED STOCKHOLDER MATTERS	48
CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE	52
FINANCIAL STATEMENTS	54
OTHER EXPENSES OF ISSUANCE AND DISTRIBUTION	83
RECENT SALES OF UNREGISTERED SECURITIES	83
EXHIBITS	86
UNDERTAKINGS	88
SIGNATURES	91

- III -

VERDISYS, INC.

Summary Information and Risk Factors

Summary Information

PROSPECTUS SUMMARY

You should read the following summary together with the more detailed information regarding us and the securities being offered for sale by means of this Prospectus and our financial statements and notes to those statements appearing elsewhere in this Prospectus. This summary highlights material information contained elsewhere in this Prospectus.

General

Our mission is to substantially improve the economics of existing and evolving oil and gas operations through the application of selected technologies. We currently operate in the oil and gas service industry in two distinct business segments. Our primary segment is providing a service that enhances the recovery of oil and gas from new and existing wells. This service is performed by our specially fabricated mobile drilling rigs equipped to utilize a proprietary lateral drilling system known as Verdisys Lateral Drilling Services, or VLDS. With VLDS, we can drill multiple lateral holes for a distance of 300 feet horizontally, in selected formations, from an existing well bore down to a depth of 5800 feet. We can provide our services in a few days at approximately one-fourth the cost of conventional methods. We believe the combination of low front-end costs and the effectiveness and speed of the process should make VLDS highly attractive to oil and gas companies. We believe that there exists a substantial potential market in North America for the application of the VDLs technology.

Our secondary business segment is providing satellite services to oil and gas producers, allowing them to remotely monitor and control well head and pipeline and drilling operations. Using satellite, wireless fidelity 802.11 networks [Wi-Fi], and other wireless technology, we provide oil and gas producers the ability to dispense with a manual structure and move to a real-time, automated, state of the art energy management program. With our services, production levels can be optimized to respond to current market conditions and commitments. Our satellite service competes on the basis of its low cost, speed and broadband capability and our technical expertise in the use of multi-frequencies.

Corporate History

In September 2000, we were incorporated initially as Rocker & Spike Entertainment, Inc, a California corporation. Until December 31, 2000, operations consisted of organizational matters and the search for an operating company with which to perform a merger or acquisition. Effective January 1, 2001, we purchased the assets and web domain of Accident Reconstruction Communications Network from its sole proprietor. Following the acquisition, we changed our name from Rocker & Spike Entertainment, Inc. to Reconstruction Data Group, Inc. At that time, we provided research, communication and marketing exposure to the accident reconstruction industry through our website and seminars.

In April 2003, we entered into a merger agreement with Verdisys, Inc. (Verdisys). Verdisys was initially incorporated as TheAgZone Inc. in 1999 as a California corporation. Its purpose was to provide e-Commerce satellite services to agribusiness. They changed their name to Verdisys in 2001, and in 2003, with the acquisition of exclusive rights to a proprietary lateral drilling process throughout most of the U.S. and Canada, they changed their market focus to concentrate on services to the oil and gas industry.

The merger agreement with Verdisys called for us to be the surviving company. In connection with the merger, our name changed to Verdisys, our articles of incorporation and bylaws remained in effect, the officers and directors of Verdisys became our officers and directors, each share of Verdisys common stock was converted into one share of our common stock, and our accident reconstruction assets were sold. Additionally, Verdisys historical financial statements replaced ours. As a result of the merger, we now provide specialty services to oil and gas production companies located in Oklahoma, Texas and Louisiana, and we have exclusive rights to the lateral drilling process throughout most of the U.S. and Canada.

- 4 -

VERDISYS, INC.

Summary of the Offering

Shares outstanding before the offering	31,373,777 ⁽¹⁾
Shares offered by selling stockholders	2,881,899 shares of our common stock
Shares issuable upon exercise of warrants offered by selling stockholders	
177,835 shares of our common stock	
Shares issuable contingent to triggering events contained in a prior financing agreement with Gryphon Master Fund, L.P	
277,778 shares of our common stock	
Shares outstanding after the offering	31,892,390

Use of proceeds

We will not receive any of the proceeds from the sale of our common stock offered by the selling stockholders. However, we may receive an aggregate of \$604,006 upon the exercise of all of the warrants held by the selling stockholders if such warrants are exercised for cash. Such funds, if any, will be used for working capital and general corporate purposes.

Risk factors

The shares offered hereby involve a high degree of risk. You should carefully consider the information set forth in the Risk Factors section of this Prospectus as well as other information set forth in this Prospectus, including our financial statements and related notes.

Plan of distribution

The offering of our shares of common stock is being made by stockholders of our company who may wish to sell their shares. Sales of our common stock may be made by the selling stockholders in the open market or in privately negotiated transactions and at market prices, fixed prices or negotiated prices.

Pink Sheets Trading Symbol VDIS.PK

⁽¹⁾ As of August 19, 2004

VERDISYS, INC.Risk factors

Investing in our common stock is highly speculative and risky. You should be able to bear a complete loss of your investment. You should carefully consider the following risks and the other information in this Prospectus before investing in the shares. If any of the following risks and uncertainties develops into actual events, the business, financial condition and operating results could be materially adversely affected, and you could lose your entire investment. The risks and uncertainties described below are not the only ones which we face; there may be additional risks and uncertainties not presently known to us or those we currently believe are immaterial which could also have a negative impact on our business, financial condition, and operating results.

This Prospectus contains forward-looking statements that involve risks and uncertainties. Actual results could differ materially from those discussed in the forward-looking statements as a result of certain factors, including the risk factors described below. The following risk factors should be considered carefully in addition to the other information contained in this Prospectus before purchasing the shares offered hereby.

GENERAL RISKS RELATING TO OUR COMPANY**1. We have a limited operating history, which makes it difficult to evaluate our business performance.**

We have been in existence for a few years, but we have been conducting drilling operations using the proprietary lateral drilling technology only since June 2003 and satellite services to the oil and gas industry only since June 2002. Because we have a limited operating history, there is little historical financial data upon which an investor may evaluate our business performance. Our revenue and income potential are unproven. An investor must consider the risks, uncertainties, expenses and difficulties frequently encountered by companies in their early stages of development, particularly companies with limited capital in a rapidly evolving market. These risks and difficulties include our ability to develop our infrastructure, reliability in the milling process in our lateral drilling technology, attract and maintain a base of customers, provide customer support, personnel, and facilities to support our business, and respond effectively to competitive and technological developments. Our business strategy may not be successful or may not successfully address any of these risks or difficulties. While we believe our business model will permit us to generate substantial revenues, there is no guarantee that the revenues will be realized. Failure to realize the revenue may have a material adverse effect on our financial condition.

2. Verdisys, Inc. is an investment risk because business and marketing strategies planned are not proven.

We have no established basis to assure investors that business or marketing strategies will be successful. We are highly dependent upon the acquisition of subscribers for our satellite division; selection of, and productivity from, appropriate oil and gas wells; as well as the effective application of technologies and services within operations. Our business model and marketing strategies anticipate such application and productivity, yet are unproven by a significant history of business operations. Failure to prove that our business model and strategies work through continued operations may have a material adverse effect on our business and financial condition.

3. We may require additional capital in the future, which may not be available to us.

We may need to raise additional funds through public or private debt or equity financing or other various means. Adequate funds may not be available when needed or may not be available on favorable terms. If we raise additional funds by issuing equity securities, dilution to existing stockholders will result, and such equity may have rights, preferences and privileges senior to those of our common stock. If we raise additional funds by issuing debt securities, we may be required to agree to covenants that may restrict our ability to expend or raise capital in the future. If funding is insufficient at any time in the future, we may be unable to fund acquisitions, take advantage of business opportunities or respond to competitive pressures. Failure to raise additional capital in the future may have a material adverse effect on our financial condition.

4. Our auditors have expressed doubt as to our ability to continue as a going concern

As noted in the Independent Auditors Report (See Financial Note 2) due to the continued substantial operating losses that the Company has incurred raises substantial doubt as to the Company's ability to continue as a going

- 6 -

VERDISYS, INC.

concern. The Company is in an early stage of development and is rapidly depleting its cash resources, therefore it has determined that it will need to raise additional financing in the short term to continue in operation and fund future growth. The Company incurred liquidated damages claimed by an investor of \$400,000 related to the timing of providing registration rights for the private financing that it arranged in November 2003. If we are unable to raise additional financing to satisfy obligations this would have a material adverse effect on the Company.

The Company currently plans to raise additional financing. The use of stock for currency in financing or making acquisitions may be heavily curtailed while the Company is under SEC investigation. (See Financial Note 16) If we are unable to arrange new financing or generate sufficient revenue from new business arrangements, the Company will be unable to continue in its current form and will be forced to restructure or seek creditor protection.

5. We experienced operating losses in 2002 and 2003, and this trend may continue.

We suffered net losses of \$3,128,782 for the year ended December 31, 2002 and \$7,356,045 for the year ended December 31, 2003, respectively, and for \$3,365,826 the six months ended June 30, 2004, and \$2,917,470 for the six months ended June 30, 2003, respectively, largely because our revenues were inadequate to compensate for increased operating and overhead costs. The volatility underlying the early stage nature of our business and our industry prevents us from accurately predicting future operating conditions and results, and we could continue to have losses. It is uncertain when, if ever, the company will have significant operating income or cash flow from operations sufficient to sustain operations. If cash needs exceed available resources, there can be no assurances that additional capital will be available through public or private equity or debt financings. Sustained losses will continue to have a material adverse effect on our business.

6. Significant amounts of our outstanding common shares are restricted from immediate resale but may be available for resale into the market in the near future, possibly causing the market price of our common stock to drop significantly.

As of August 19, 2004, Verdisys, Inc. had 31,373,777 shares of common stock issued, outstanding and held by approximately 782 shareholders of record. The shares we are registering in this offering and shares issuable upon exercise of the warrants may be resold in the public market immediately, resulting in an additional 3,337,502 common shares available for resale in the public market; increasing the amount of common shares for resale by approximately 130%.

As restrictions on resale for these shares being registered and the remaining outstanding shares end, the market price could drop significantly if the holders of these restricted shares sell them or are perceived by the market as intending to sell them in an excessive amount relative to the market demand for our shares. An excessive sale of our shares may result in a material adverse effect on the price of our common stock, and our ability to raise capital.

7. One principal stockholder can influence the corporate and management policies of our company.

After giving effect to this offering, Berg McAfee Companies, and its affiliates, will effectively control approximately 30% of the outstanding common stock on a pro forma basis. Therefore, Berg McAfee Companies, and its affiliates, may have the ability to substantially influence all decisions made by us. Additionally, Berg McAfee Companies, and its affiliates, control could have a negative impact on any future takeover attempts or other acquisition transactions. Furthermore, certain types of equity offerings require stockholder approval depending on the exchange on which shares of a company's common stock is traded. In the event we are required

to obtain stockholder approval of a financing, Berg McAfee Companies, and its affiliates, ownership could block such a financing. The control by one principal stockholder results in less control by our board of directors, management and the remaining stockholders. Please read [Certain Relationships and Related Transactions.]

8. We may sustain losses resulting from our extension of credit to non-paying customers.

We have, prior to February 2004, conducted much of our drilling activities for related parties, and we did not require collateral in support of our account receivables. This resulted, on occasion, in an impediment to us obtaining full payment for accounts receivable. Although we are implementing procedures to combat this credit risk, there can be no assurance that our efforts will be successful. Failure to guard against credit risk may have a material adverse effect on our financial condition.

- 7 -

VERDISYS, INC.

9. Securities and Exchange Investigation Inquiries may continue to draw on our limited financial resources and continue to negatively impact our ability to raise additional capital.

Verdisys has received notice that the Securities and Exchange Commission has initiated a formal investigation into its reporting practices and public statements about the Company in 2003.

The SEC has requested substantiation and documentary evidence from the Company concerning the performance of certain lateral drilling services by subcontractors in the period from May 2003 to September 2003, supervision of such services by the Company's executive management at the time, revenue recognition related to the performance of such services, the third quarter 2003 earnings restatement, public statements concerning the services performed, and related matters. The SEC has also requested information and documentary evidence related to the Verdisys's acquisition of certain assets of QuikView, Inc., a related party company, in June, 2003. In its letters to Verdisys requesting documents, the SEC stated that the staff's inquiry should not be construed as an indication that any violations of securities laws have occurred or as an adverse reflection on any persons, company or security.

Since December 2003, the Company has taken several steps to address issues related to the SEC's inquiries, including the termination and replacement of the previous Chief Executive Officer and Chief Operating Officer. Two directors have resigned from the Company's board and the Company has appointed a new CFO. Internal controls have been strengthened overall, particularly with respect to the public release of Company information and the recognition of revenue. The Company has also initiated an internal investigation of the matters of concern to the SEC. Consequently, the Company restated its second and third quarter financial statements and has decided to defer all revenue related to the aforementioned period until such time that it can substantiate whether or not the services were performed.

Verdisys is cooperating fully with the SEC, including the provision of numerous documents and voluntary testimony by our current executives. Verdisys is not aware of any pending or threatened enforcement or other actions that might be initiated by the SEC. Although the Company is working to bring the matter to a prompt conclusion, it cannot make any assurance that the investigation will be resolved positively or that it will not have negative effects on the Company's limited resources or its ability to raise capital and use its stock as acquisition currency during the period of the investigation.

Although the Company is working to bring the matter to a prompt conclusion, it cannot make any assurance that the investigation will be resolved positively or that it will not have negative effects on the Company's limited resources.

10. We have initiated a declaratory judgment action. If the court does not rule favorably it may lead to damages we would be required to pay related to the agreement.

Verdisys initiated a lawsuit against Edge Capital that requests a declaratory judgment that a purported agreement between Verdisys and Edge is not enforceable. It was filed in Montgomery County, Texas in February 2004. The lawsuit arises from Edge's contention that one of Verdisys's ex-officers committed the company to

purchase certain alleged oil and gas properties from Edge. Edge filed a counterclaim against Verdisys and asserts claims against new parties including persons related to Edge's financing source and current and former officers and directors of Verdisys. Edge seeks to enforce the agreement Verdisys challenges, and alleges several causes of action including claims for fraud, breach of contract, negligence, and conspiracy. If Edge prevails, it may obtain significant damages that may have a material adverse effect on Verdisys's financial condition.

11. We have incurred a default judgment for an amount in excess of fifteen million dollars. If this judgment is upheld, these damages would have a material adverse effect on Verdisys's financial condition.

Verdisys was informed that a default judgment was entered against it in a lawsuit brought by Scooter's Convenience, Inc. dba LSS Satellite in Hockley County, Texas. The trial court judge granted Verdisys's motion for new trial and vacated the default judgment. In the underlying lawsuit, LSS Satellite has alleged breach of contract, violations of the Texas Deceptive Trade Practices Act and other claims. Verdisys has meritorious and complete defenses to the claims asserted in the lawsuit and intends to vigorously defend itself. If LSS Satellite prevails or if Verdisys is unable to settle the dispute on favorable terms, LSS Satellite it may obtain significant damages that may have a material adverse effect on Verdisys's financial condition.

- 8 -

VERDISYS, INC.

12. We are subject to certain additional lawsuits. If these lawsuits are successful and substantial damages are awarded, these damages would have a material adverse effect on Verdisys's financial condition.

We are a defendant in a consolidated lawsuit filed in the Southern District of Texas which seek class action status on behalf of all persons or entities that purchased common stock of the Company. The named defendants include the Company, the Company's former Chief Financial Officer and the Company's former Chief Executive Officer. The complaints alleges that the defendants violated Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder by making false and misleading statements concerning our reported financial results during the period, primarily relating to revenue recognition. See "Legal Proceedings".

In connection with its financing in October 2003, the Company agreed to provide certain registration rights to the investors. As part of the registration rights agreement with the investors, the Company agreed to register the shares on or before March 2004. In the event that the Company failed to comply with the required deadlines, the Company could be subject to certain liquidated damages. The investors have made a claim against the Company for the maximum liquidated damages in an amount of \$400,000 and have claimed actual damages in excess of \$6.2 million. In July 2004, Gryphon filed a lawsuit in state district court in Dallas, Texas, alleging, among other claims, breach of contract and securities fraud. Verdisys has filed an answer to the lawsuit and intends to vigorously defend itself. If Gryphon prevails, it may obtain significant damages that may have a material adverse effect on the Company.

In July, 2004 Verdisys was informed that a former Chief Executive Officer of Verdisys filed a lawsuit against Verdisys for breach of contract and wrongful discharge. These claims seek relief in excess of \$500,000 related to an alleged employment agreement and also seeks damages related to an excess of 4,000,000 stock options claimed due pursuant to the alleged agreement. The company has only recently received notice of these claims. The lawsuit was filed in state court in San Diego, California. Verdisys intends to vigorously defend itself.

An adverse outcome in any of the above litigation would have a material adverse effective on our financial condition and result of operations.

Please see the section "Legal Proceedings".

13. Our common stock is currently traded over the counter on the Pink Sheets and is considered a penny stock resulting in potential illiquidity and high volatility in the market price of our common stock.

The market price of our common stock is likely to be highly volatile as is the stock market in general as well as the capital stock of most small cap companies. Our common stock currently trades over the counter on the Pink Sheets, where stocks typically suffer from lower liquidity. This may lead to depressed trading prices, greater price volatility and difficulty in buying or selling shares in large quantities. Currently, there is a limited trading market for our common stock, and we cannot predict when, if ever, a fully developed public market for the common stock will occur.

14.

Because the Company's common stock is considered a "penny stock," certain rules may impede the development of increased trading activity and could affect the liquidity for stockholders.

Penny stocks generally are equity securities with a price of less than \$5.00 per share other than securities registered on certain national securities exchanges or quoted on the Nasdaq stock market, subject to certain exceptions for companies which exceed certain minimum tangible net worth requirements.

Our common stock is subject to the SEC's "penny stock rules". The rules impose additional sales practice requirements on broker-dealers who sell penny stock securities to persons other than established customers and accredited investors. For transactions covered by these rules, the broker-dealer must make a special suitability determination for the purchase of penny stock securities and have received the purchaser's written consent to the transaction prior to the purchase. Additionally, for any transaction involving a penny stock, unless exempt, the "penny stock rules" require the delivery, prior to the transaction, of a disclosure schedule relating to the penny stock market. The broker-dealer also must disclose the commissions payable to both the broker-dealer and the registered representative and current quotations for the securities. And, monthly statements must be sent disclosing recent price information on the limited market in penny stocks. These rules may restrict the ability of broker-dealers to sell our securities and may have the effect of reducing the level of trading activity of our common stock in the secondary market. In addition, the penny-stock rules could have an adverse effect on our ability to raise capital in the future from offerings of our common stock.

- 9 -

VERDISYS, INC.

On January 12, 2004, the SEC proposed amendments to the penny stock rules to ensure that investors continue to receive the protections of those rules. The SEC also is proposing that broker-dealers be required to enhance their disclosure schedule to investors who purchase penny stocks, and that those investors have an explicit "cooling-off period" to rescind the transaction. These amendments could place further constraints on broker-dealers' ability to sell our securities.

15. Our operations are subject to inherent risks that are beyond our control, and these risks may not be fully covered under our insurance policies.

Our operations are subject to hazards inherent in the oil and gas industry, such as accidents, blowouts, explosions, craterings, fires and oil spills. These conditions can cause:

personal injury or loss of life;
damage to or destruction of property, equipment and the environment; and suspension of operations.

In addition, claims for loss of oil and gas production and damage to formations can occur in the well service industry. Litigation arising from a catastrophic occurrence at a location where our equipment and services are being used may result in us being named as a defendant in lawsuits asserting large claims.

We maintain insurance coverage that we believe to be customary in the industry against these hazards. However, we may not be able to maintain adequate insurance in the future at rates we consider reasonable. In addition, our insurance is subject to coverage limits and some policies exclude coverage for damages resulting from environmental contamination. The occurrence of a significant event or adverse claim in excess of the insurance coverage that we maintain or that is not covered by insurance could have a materially adverse effect on our financial condition and results of operations.

16. We are subject to various operational and performance risks related to projects that we undertake and services that we provide.

We are subject to various operational and performance risks related to projects that we undertake and services that we provide. These risks include:

changes in the price or the availability of commodities that we use;
non-performance, default or bankruptcy of key suppliers or subcontractors;
cost over-runs and operating cost inflation resulting from fixed-price projects; and
failure by one or more parties to a complex business arrangement for technically demanding projects.

Failure to guard against operational and performance risks may have a material adverse effect on our financial condition.

17. Our markets may be adversely affected by oil and gas industry conditions that are beyond our control.

Oil and gas industry conditions are influenced by numerous factors over which we have no control, such as the supply of and demand for oil and gas, domestic and worldwide economic conditions, political instability in oil producing countries and merger and divestiture activity among oil and gas producers. Those conditions could adversely impact the level of drilling and workover activity by some of our customers. This reduction in activity may cause a decline in the demand for our services or adversely affect the price of our services. We cannot accurately predict either the future level of demand for our services or future conditions of the well service industry. A decline in the demand for our services may have a material adverse effect on our business.

18. Our success depends on key members of our management, the loss of whom could disrupt our business operations.

We depend to a large extent on the services of some of our executive officers and directors. The loss of the services of either John O'Keefe, or David Adams could disrupt our operations. We have entered into employment agreements with several of our key executives that contain non-compete provisions. Notwithstanding these agreements, we may not be able to retain our executive officers and may not be able to enforce the non-compete

- 10 -

VERDISYS, INC.

provisions in the employment agreements. Failure to retain key members of our management may have a material adverse effect on our business.

RISKS RELATED TO OUR LATERAL DRILLING BUSINESS

1. We are highly dependent on a small number of customers, two of whom are related parties. The loss of any of these customers would have an adverse effect on our revenue.

One customer accounted for 38% and 87% of total revenues in 2003 and 2002, respectively. Related parties accounted for 52% of total revenue.

In the past a relatively limited number of customers has accounted for a substantial portion of our revenue. In the second half of 2003, 53% of our revenue was derived from services provided to three customers. Of those three customers, two may be considered related parties. In the same period, 52% of our revenue was derived from services provided to the two related parties. In addition, Edge, our only non-related customer in that period, has refused to pay for wells drilled in the second half of 2003, resulting in a total of \$1,993,000 being reversed or deferred. We are attempting to resolve such matter on an expedited basis; however, no assurance is given that such funds will be recovered from such customer in the near future or at all.

We expect that sales of our services to a limited number of customers will continue to account for a high percentage of our revenue for the near term. There can be no assurance that our current customers will continue to place orders with us or that we will be able to obtain orders from new customers. The loss of any customer or any reduction in orders by such customers, including reductions due to market or competitive conditions in the industry or the inability to collect monies owed to us by certain customers may have a material adverse effect on our business.

2. We may not be able to protect our lateral drilling technology which could result in competition with service providers utilizing an infringing technology.

The license agreement allocates responsibility in maintaining the status of the patents underlying the technology we license with the US Patent and Trademark Office to the licensor. Although the licensor has performed this obligation in the past, there can be no assurance that the licensor will have the ability to continue to maintain the patents. In the event Verdisys, Inc. had to assume these responsibilities additional pressure on our financial resources would result. An inability to continue operations under the exclusivity granted by the licensing agreement may have a material adverse effect on our business.

3. Our customers may not realize the expected benefits from our lateral drilling technology, which may impair market acceptance of our lateral drilling services.

Our lateral drilling business is heavily dependent upon our clients achieving enhanced production, or lower costs, from certain types of existing oil and gas wells. Many of the wells for which the lateral drilling technology is used or suspected of being useful have been abandoned for some time due to low production volumes or other reasons. In some cases, we have experienced difficulty in having the enhanced production reach the market due to the gathering field pipeline system's disrepair resulting from the age of the fields and the reliability of the milling process. There can be no assurance that our lateral drilling technology will achieve enhanced production from every well drilled, or that, if enhanced production is achieved initially, it will continue for the duration necessary to achieve payout or that it will reach the market on a timely basis. The failure to achieve projected enhancements could result in making the application of the technology uneconomic for our clients. Please see the section "Verdisys Lateral Drilling Service" for an explanation as to how we have added additional screening tools and criteria to attempt to improve the likelihood of achieving an economic benefit for our clients. Failure to achieve an economic benefit for our clients in the provision of this service may have a material adverse effect on our business.

4. We may be unable to accurately identify oil and gas wells on which our lateral drilling technology will enhance oil and gas recovery, which may impair the market acceptance of our lateral drilling services.

Our lateral drilling business is heavily dependent on our ability to correctly identify with our clients, the appropriate oil and gas wells that will produce the enhanced revenues or lower costs. Certain subsurface conditions are not conducive to the use of our high pressure lateral drilling technology, and certain wells may have been severely

- 11 -

VERDISYS, INC.

depleted or otherwise negatively impacted in some manner by the operator. While we have added an evaluation screening technique and other new technology and improvements relating to analysis of depleted fields, the failure to identify the correct types of oil and gas wells could result in not realizing the expected economic returns which could initially have a material adverse effect on our business, financial condition and operating results.

5. Competition within the well service industry may adversely affect our ability to market our services.

The well service industry is highly competitive and includes several large companies, such as Halliburton, Baker Hughes, Schlumberger and other independent drilling companies that possess substantially greater financial and other resources than we do. These greater resources could allow those competitors to compete more effectively

than we can. Additionally, the number of rigs available continues to exceed demand, resulting in active price competition. Moreover, many contracts are awarded on a bid basis, which further increases competition based on price. Failure to successfully compete within our industry may have a material adverse effect on our business.

6. We may be subject to environmental requirements which may increase our costs or liabilities related to our lateral drilling operations.

Given the manner in which we currently operate our business, we are not regulated to the extent that an oil and gas company is with respect to environmental laws, rules and regulations in the U.S. and other countries, including those covering hazardous materials, because we generally do not own the properties we service. However, environmental requirements generally are becoming increasingly strict. In the future, we may be held liable for certain failures relating to environmental regulations. Sanctions for failure to comply with these requirements, many of which may be applied retroactively, may include:

administrative, civil and criminal penalties;

revocation of permits; and

corrective action orders, including orders to investigate and/or clean up contamination.

Liability for damages arising as a result of environmental laws could be substantial and could have a material adverse effect on our results of operations. The liabilities incurred as a result of complying with environmental requirements or failure on our part to comply with applicable environmental requirements may have a material adverse effect on our financial condition. There can be no assurance that governmental laws will not broaden in scope in the future to cover the types of services that we currently provide. Failure to comply with environmental laws could have a material negative impact on our financial condition.

7. Changes in environmental laws may decrease demand for our services.

Changes in environmental laws may negatively impact demand for our services. Activity by oil and gas exploration and production companies may decline if, for example, the Environmental Protection Agency promulgates more stringent environmental regulations such as land use policies. If oil and gas exploration and production activities decline, this could have a material adverse effect on our operating results.

RISKS RELATED TO OUR SATELLITE BUSINESS

1. We are highly dependent upon a few key providers who furnish satellite networking components, hardware, and technological services.

Our satellite business is heavily dependent on agreements with Spacenet, ViaSat and other equipment and service providers. These strategic relationships provide key network technology, satellite data transport, hardware and software. Failure of Spacenet, ViaSat or other key relationships to meet our expectations or termination of a relationship with one of our key providers may have a material adverse effect on our business.

- 12 -

VERDISYS, INC.

2. We depend upon our vendors and their affiliates to provide services that we require to operate the network we use to provide services to our customers.

We are not and do not plan to become a licensee of the Federal Communications Commission (‘‘FCC’’) and do not hold any authorization to operate satellite communications facilities. We depend upon licenses held by Spacenet and ViaSat and their subsidiaries for our satellite communications. If the licenses held by Spacenet and ViaSat are limited or revoked, if the FCC limits the number of its customer premises earth stations or if Spacenet or ViaSat fails to operate the earth stations providing service to us and our subscribers in a satisfactory manner, our operating results may be materially adversely affected.

3. We rely on third-party independent contractors to install our customer premises equipment at new subscribers’ businesses and homes.

We have agreements with Keypoint, RS&I and Metron North America to provide installation services to our customers. We do not control the hiring, training, certification and monitoring of the employees of our third-party independent contractors. If growth of our new subscriber base outpaces growth of our installer base or if the installers fail to provide the quality of service that our customers expect, our operating results may be materially adversely affected.

4. The service we provide is entirely dependent on the functionality of satellites on which we lease transponders and on our computer and communications hardware and software.

Our ability to provide service is entirely dependent on the functionality of satellites on which we lease transponders. These satellites may experience failure, loss, damage or destruction from a variety of causes, including war, anti-satellite devices and collision with space debris. If this occurs, we are likely to suffer:

permanent loss of service;

temporary gaps in service availability; or decreased quality of service.

Such a failure in the service we provide may have a material adverse effect on our business, financial condition and operating results.

The ability to provide timely information and services depends also on the efficient and uninterrupted operation of our computer and communications hardware and software systems. These systems and operations are vulnerable to damage or interruption from human error, natural disasters, telecommunication failures, break-ins, sabotage, computer viruses, intentional acts of vandalism and similar events. We are in the process of designing and plan to implement a disaster recovery plan. Despite precautions, there is always the danger that human error or sabotage could substantially disrupt the system. Any such failure may have a material adverse effect on our business.

5. We may be unable to attract or retain subscribers.

If we are unable to attract or retain subscribers, our telecommunications business will be harmed. Our success depends upon our ability to rapidly grow our subscriber base. Several factors may negatively impact this ability, including:

- loss of our existing sales employees, resulting in our lack of access to potential subscribers;
- failure to establish and maintain the Verdisys brand through advertising and marketing, or erosion of our brand due to misjudgments in service offerings;
- failure to develop or acquire technology for additional value added services that appeals to the evolving preferences of our subscribers;

failure to meet our expected minimum sales commitments to Spacenet and ViaSat; and

failure to provide the minimum transmission speeds and quality of service our customers expect.

VERDISYS, INC.

costs but such subsidy may not be possible. Failure to attract or retain subscribers may have a material adverse effect on our business.

6. We may fail to manage any potential growth or expansion, negatively impacting our quality of service or overcapacity impacting profitability.

If we fail to manage our potential rapid growth and expansion effectively or expand and allocate our resources efficiently, we may not be able to retain or grow our subscriber base. If our assumptions regarding the usage patterns of our subscribers are wrong or if our subscribers' usage patterns change, we will have either too little or too much satellite capacity, both of which could harm our business.

If we achieve the substantial subscriber growth that we anticipate, we will need to procure additional satellite capacity. If we are unable to procure this capacity, we may be unable to provide service to our subscribers or the quality of service we provide may not meet their expectations. Failure to manage any potential growth may have a material adverse effect on our business.

7. Our current services may become obsolete due to the highly competitive and continued advancement of the satellite industry. Larger service providers may provide services reduced pricing.

Intense competition in the Internet services market and inherent limitations in existing satellite technology may negatively affect the number of our subscribers. Competition in the market for consumer Internet access services is intense, and we expect the level of competition to intensify in the future. We compete with providers of various high-speed communications technologies for local access connections such as cable modem and DSL. We also may face competition from traditional telephone companies, competitive local exchange carriers and wireless communication companies. As our competitors expand their operations to offer high speed Internet services, we may no longer be the only high-speed service available in certain markets. We also expect additional competitors with satellite-based networks to begin operations soon. In particular, some satellite companies have announced that in the future they may offer high-speed Internet service at the same price or at a lower price than we currently intend to offer and are offering our services. Many of our current and potential competitors have longer operating histories, greater brand name recognition, larger subscriber bases and substantially greater financial, technical, marketing and other resources than we have. Therefore, they may be able to respond more quickly than we can respond to new or changing opportunities, technologies, standards or subscriber requirements. Any such competition may have a material adverse effect on our business.

8. We may be mistaken in our belief as to future growth of the satellite broadband market.

While we believe that the trend toward satellite broadband information services in the energy market will continue to develop, our future success is highly dependent on increased use of these services within the sector. The number of satellite broadband users willing to pay for online services and information may not continue to increase. A failure in the market for satellite broadband services to develop as expected may have a material adverse effect on our business.

9. We may be subject to significant liability for our products.

If our products contain defects, we may be subject to significant liability claims from subscribers and other users of our products and incur significant unexpected expenses or lost revenues. Our telecommunications products are complex and may contain undetected errors or failures. If this happens, we may experience delay in or loss of market acceptance and sales, products returns, diversion of research and development resources, injury to our reputation or increased service and warranty costs. We also have exposure to significant liability claims from our customers because our products are designed to provide critical communications services. Although we attempt to limit such exposure through product liability insurance and through contractual limitations in our customer agreements, such precautions may not cover all potential claims resulting from a defect in one or more of our products. Failure of our products to perform satisfactorily may have a material adverse effect on our operating results.

- 14 -

VERDISYS, INC.

Use of Proceeds

We will not receive any of the proceeds from the sale of our common stock offered by the selling stockholders. However, we may receive an aggregate of \$604,006 upon the exercise of all of the warrants held by the selling stockholders if such warrants are exercised for cash. Such funds, if any, will be used for working capital and general corporate purposes. Verdisys, Inc. is registering these 3,337,502 common stock shares on behalf of the selling security holders and shall bear all costs associated with the registration of these issued and outstanding shares.

Selling Security Holders

Edgar Filing: VERDISYS INC - Form SB-2/A

This Prospectus covers a total of 3,337,502 shares of our common stock to be sold by the selling stockholders, including:

2,881,899 shares of our common stock issued and outstanding; and
177,835 shares of common stock issuable upon exercise of outstanding warrants.

A maximum of 277,778 shares of common stock are issuable contingent upon the occurrence of triggering events contained in a prior financing agreement with Gryphon Master Fund, L.P. If in the ten months subsequent to the agreement, the 30 day average closing price of Verdisys common stock drops below \$6 per share, such drops could result in the issuance of a maximum of 277,778 additional shares of common stock for no additional compensation. If this occurs, a total of 1,111,111 common shares will have been issued for an average price of \$4.50 per share.

After the registration statement of which this prospectus is a part becomes effective and subject to applicable rules and restrictions of the Securities Act of 1933, security holders may from time to time sell the shares on the Pink Sheets, or any other securities exchange or automated quotation system on which the common stock may be listed or traded, in negotiated transactions or otherwise, at the prices then prevailing or related to the then current market price or at negotiated prices. Verdisys shall neither be involved in determination of the price nor shall receive any proceeds from the sale of any shares sold by selling security holders. Shares being registered were issued to the selling stockholders in connection with transactions exempt from the registration requirements of the Securities Act of 1933, as amended.

The common shares of Verdisys, Inc. are currently listed on the Pink Sheets under the symbol "VDYS.PK".

The following table lists:

all of the stockholders and amount of shares to be registered under this Offering;
the number of shares of our common stock (including those shares of our common stock underlying warrants) covered by this Offering; and
the amount of shares of our common stock owned by each such selling stockholder as of March 31, 2004 assuming that each such stockholder would sell all of his or her shares of our common stock that this offering registers.

- 15 -

VERDISYS, INC.

Name of Registering Stockholder	Shares of Common Stock Registered in this Offering	Shares of Common Stock Issuable Upon Exercise of Warrants	Total	Shares of Common Stock Owned After the Offering ⁽¹⁾
Marcus Abundis	6,250	0	6,250	0
Michael L. and Sharon Bowman	7,500	0	7,500	0
John Burke	8,000	0	8,000	0
James Todd Burkdall	12,500	0	12,500	0
Vivian JeNeal Carter	6,667	0	6,667	0
Joseph Childrey	25,000	0	25,000	0
Cohen Specialists LLC	25,000	0	25,000	0
Robert E and Rosalie T Dettle Living Trust	12,500	0	12,500	0
Jerome Dreyfus	6,250	0	6,250	0
R.V. Edwards, Jr.	15,000	0	15,000	0
David Eskandari	6,250	0	6,250	0
Michael A. Frangopoulos	15,000	0	15,000	0
Donald W. Greve	5,333	0	5,333	0
Nick Gorenc	46,000	0	46,000	0
Scott R. Griffith	6,667	30,945	37,612	0
Gryphon Master Fund, L.P.(3)	1,411,111	0	1,411,111	0

Edgar Filing: VERDISYS INC - Form SB-2/A

Kenneth A. Ikemiya	53,333	0	53,333	319,992
Multi Ag Media	112,000	0	112,000	0
Matthew R. Iwasaka	30,000	0	30,000	300,000
Jericho Investments, LLC	25,000	0	25,000	0
Howard Kaplan	17,500	0	17,500	0
Vivianis Kaplanis	8,000	0	8,000	0
Venkata Kollipara	25,000	0	25,000	0
Maria Koutoures FOB IRA	25,000	0	25,000	0
Carl Landers(2)	125,000	0	125,000	800,000
Gary B. Laughlin	13,333	0	13,333	0
London Family Trust	273,333	30,945	304,278	0
Mahi-Niki Loumidis	7,500	0	7,500	0
Louis Lyras	7,000	0	7,000	0
George Shirahama Maggay	12,500	0	12,500	0
Harry Markus, Jr.	13,333	0	13,333	6,800
Peter A. Massaniso	80,000	0	80,000	0
Henry H. and Margaret O'Neill Mauz	20,000	0	20,000	50,000
Steve McIntee	12,500	0	12,500	0

- 16 -

VERDISYS, INC.

<u>Name of Registering Stockholder</u>	<u>Shares of Common Stock Registered in this Offering</u>	<u>Shares of Common Stock Issuable Upon Exercise of Warrants</u>	<u>Total</u>	<u>Shares of Common Stock Owned After the Offering⁽¹⁾</u>
Robert E. McMillan	10,000	0	10,000	0
David D. McNabb	7,000	0	7,000	4,000
Ronald Minor	100,000	0	100,000	100,000
Nancy Mondesitt	20,000	0	20,000	0
Montana Grain Growers Association	0	85,000	85,000	0
Gregg Mullery	12,500	0	12,500	0
David Newton	10,000	0	10,000	0
Robert Pastor	13,333	0	13,333	0
PNP Petroleum Inc.	20,000	0	20,000	0
Ponte Vedra Partners, Ltd.	110,000	0	110,000	0
Prima Capital Group, Inc.	39,400	0	39,400	0
Elizabeth A. Reed	18,750	0	18,750	0
John Rogers	26,667	0	26,667	0
Peter Skafte	5,000	0	5,000	0
Jesse B. Shelmire	6,667	30,945	37,612	0
Jay D. Smith	12,500	0	12,500	0
Pepper Snyder	204,166	0	204,166	100,000
George M. and Lisa K. Spanish	26,667	0	26,667	0
Take Care Family Limited Partnership	6,667	0	6,667	10,000
Ernest Telford	25,000	0	25,000	0
Joseph Zito	10,000	0	10,000	0
Totals	3,159,667	177,835	3,337,502	1,690,792

- (1) All of the selling stockholders listed in the table shall hold less than 1% of the outstanding shares of our common stock after this offering (assuming the sale of all of the shares of our common stock covered by this prospectus) with the exception of Kenneth A. Ikemiya and Carl Landers.
- (2) Mr. Carl Landers was a Director of the Company from October 2003 to March 2004. Otherwise none of the named security holders have held any position, office, or material relationship within the past three years with Verdisys, Inc. or any predecessor or affiliates.

- (3) This includes 277,778 common shares which may be issued contingent upon the occurrence of certain triggering events contained in a prior financing agreement with Gryphon Master Fund, L.P.

All amounts shown represent shares of common stock of Verdisys, Inc.

With respect to the above selling stockholders which are entities, to the Company's knowledge the natural persons that have ultimate beneficial ownership of such entities are as follows: Cohen Specialists LLC □ Perry Peregoy; Gryphon Master Fund, L.P. □ Bucky Lyon, III; Jericho Investments, LLC □ Perry Peregoy; London Family Trust □ Robert London; Montana Grain Growers Association □ Richard Owen; PNP Petroleum Inc. □ Phil Zaccaria; Ponte Vedra Partners, Ltd. □ Peter Massaniso; Prima Capital Group, Inc. □ Elias Argyropolous; and Take Care Family Limited Partnership □ George Wilson. None of the persons are directors, officers, or employees of Verdisys.

- 17 -

VERDISYS, INC.

Plan of Distribution

PLAN OF DISTRIBUTION

We are registering the shares of common stock on behalf of the selling stockholders. The shares of common stock may be sold in one or more transactions at fixed prices, at prevailing market prices at the time of sale, at prices related to the prevailing market prices, at varying prices determined at the time of sale, or at negotiated prices. These sales may be effected at various times in one or more of the following transactions, or in other kinds of transaction:

transactions on any national securities exchange or U. S. inter-dealer system of a registered national securities association on which the common stock may be listed or quoted at the time of sale;

in the over-the-counter market;

in private transactions and transactions otherwise than on these exchanges or systems or in the over-the-counter market;

in connection with short sales of the shares;

by pledge to secure or in payment of debt and other obligations;

through the writing of options, whether the options are listed on an options exchange or otherwise;

in connection with the writing of non-traded call options, in hedge transactions and in settlement of other transactions in standardized or over-the-counter options; or

through a combination of any of the above transactions.

The selling stockholder and its successors, including its transferees, pledges or donees or their successors, may sell the common stock directly to the purchaser or through underwriters, broker-dealers or agents, who may receive compensation in the form of discounts, concessions or commissions from the selling stockholder or the purchaser. These discounts, concessions or commissions as to any particular underwriter, broker-dealer or agent may be in excess of those customary in the types of transactions involved.

In addition, any securities covered by this Prospectus which qualify for sale pursuant to Rule 144 of the Securities Act may be sold under Rule 144 rather than pursuant to this Prospectus.

We entered into a registration rights agreement for the benefit of the selling stockholders to register our common stock under applicable federal and state securities laws. We have agreed to bear certain expenses in connection with the registration of the shares subject to this Prospectus, but we will not receive any of the proceeds from the sale of the shares of common stock subject to this Prospectus by the selling stockholders except for payment of the exercise price in the event that the warrants are exercised. The registration rights agreement provides for cross-indemnification of the selling stockholders and us and our respective directors, officers and controlling persons against specific liabilities in connection with the offer and sale of the common stock, including liabilities under the Securities Act.

VERDISYS, INC.**Legal Proceedings***Breach of Promissory Note / Breach of Security Agreement*

In August 2002, Verdisys settled a lawsuit filed against it by Peter Verbica in late 2001 in Santa Clara County Superior Court for breach of promissory note and breach of security agreement, by agreeing to pay \$228,494. Verdisys agreed to pay \$15,000 on October 1, 2002 and \$5,000 per month from November 2002 through August 2004. Verdisys settled the debt in 2003 by paying \$180,000 cash and issuing 200,000 shares of common stock for a cashless exercise of 20,000 warrants at \$.10 per share.

Lawsuits Involving Edge Capital Group, Inc.

Verdisys initiated a lawsuit against Edge Capital that requests a declaratory judgment that a purported agreement between Verdisys and Edge is not enforceable. It was filed in Montgomery County, Texas in February 2004. The lawsuit arises from Edge's contention that one of Verdisys's ex-officers committed the company to purchase certain alleged oil and gas properties from Edge. Edge filed a counterclaim against Verdisys and asserts claims against Dan Williams (Verdisys's former President and CEO), Eric McAfee (Verdisys's former Vice Chairman), Ron Robinson, Frederick Ruiz, Joseph Penbera, James Woodward, John Block, and Andrew Wilson. Edge has also made claims against Solarcom, L.L.C., DeLage Landen Financial Services, Inc., Andrew Wilson, and Allen Voight. Edge seeks to enforce the agreement Verdisys challenges, and alleges several causes of action including claims for fraud, breach of contract, negligence, and conspiracy. If Edge prevails, it may obtain significant damages that may have a material adverse effect on Verdisys's financial condition.

Edge and one of its apparent owners, Frazier Ltd., initiated a lawsuit in Summin County, Ohio against Solarcom, L.L.C., DeLage Landen Financial Services, Inc., Verdisys, Inc., and Firstmerit Bank, N.A. that sought an injunction against the draw against a letter of credit pledged as collateral for a credit advanced to Edge. Edge asserted that its transaction with Verdisys was the product of fraud and that its creditor, DeLage Landen as assignee from Solarcom, should not be allowed to draw against Edge's letter of credit from Firstmerit. The Ohio state court denied Edge's request for a temporary injunction. Verdisys is uncertain whether Edge will prosecute its claims against Verdisys in the Montgomery County, Texas action, which was filed first, or the Ohio action. The pleadings in the Ohio action do not include any claim for damages from Verdisys and Verdisys is unable to determine whether an adverse judgment would have a material adverse effect on Verdisys's financial condition.

Class Action Lawsuits

Verdisys has learned that it is a defendant in a consolidated lawsuit brought by former shareholders in March 2004 in the U.S. District Court for the Southern District of Texas, and which seeks class action status. The lawsuit alleges that Verdisys and its former CEO, Dan Williams, and the Company's former CFO, Andrew Wilson, violated Sections 10(b) and 20(a) of the Securities Exchange Act of 1934, and Rule 10b-5 promulgated thereunder. The lawsuit alleges that defendants made materially misstatements about Verdisys's financial results. More specifically, the Complaints allege that defendants failed to disclose and indicate: (1) that Verdisys had materially overstated its net income and earnings per share; (2) that defendants prematurely recognized revenue from contracts between Verdisys, Edge Capital and Energy 2000 in violation of GAAP and its own revenue recognition policy; (3) that Verdisys lacked adequate internal controls and was therefore unable to ascertain the true financial condition of the company; and (4) that as a result of recognizing revenue prematurely, Verdisys's financial results were inflated at all relevant times. Verdisys continues to evaluate its defense to these allegations, as well as the potential impact that an adverse judgment would have on it.

Securities and Exchange Commission Investigation Inquiries

Verdisys received notice in January, 2004 that the Securities and Exchange Commission has initiated a formal investigation into its reporting practices and public statements about the Company in 2003.

The SEC has requested substantiation and documentary evidence from the Company concerning the performance of certain lateral drilling services by subcontractors in the period from May, 2003 to September 2003, supervision of such services by the Company's executive management at the time, revenue recognition related to the performance

- 19 -

VERDISYS, INC.

of such services, the third quarter 2003 earnings restatement, public statements concerning the services performed, and related matters. The SEC has also requested information and documentary evidence related to the Verdisys's acquisition of certain assets of QuikView, Inc., a related party company, in June, 2003. In its letters to Verdisys requesting documents, the SEC stated that the staff's inquiry should not be construed as an indication that any violations of securities laws have occurred or as an adverse reflection on any persons, company or security.

Since December 2003, the Company has taken several steps to address issues related to the SEC's inquiries, including the termination and replacement of the previous Chief Executive Officer and Chief Operating Officer and the reassignment of its Chief Financial Officer. Two directors have resigned from the Company's board and the Company has appointed a new CFO. Internal controls have been strengthened overall, particularly with respect to the public release of Company information and the recognition of revenue. The Company has also initiated an internal investigation of the matters of concern to the SEC. Consequently, the Company restated its second and third quarter financial statements from fiscal year 2003 and deferred all revenue related to the aforementioned period until such time that it can substantiate whether or not the services were performed.

Verdisys is cooperating fully with the SEC, including the provision of numerous documents and voluntary testimony by our current executives. Verdisys is not aware of any pending or threatened enforcement or other actions that might be initiated by the SEC. Although the Company is working to bring the matter to a prompt conclusion, it cannot make any assurance that the investigation will be resolved positively or that it will not have negative effects on the Company's limited resources or its ability to raise capital and use its stock as acquisition currency during the period of the investigation.

Default Judgment

Verdisys was informed that a default judgment was entered against us in a lawsuit brought by Scooter's Convenience, Inc. dba LSS Satellite in May, 2004 in Hockley County, Texas. Verdisys filed a motion for new trial which was granted by the trial court, which also vacated the default judgment. In the underlying lawsuit, LSS Satellite has alleged breach of contract, violations of the Texas Deceptive Trade Practices Act, and other claims against Verdisys. Verdisys believes it has meritorious and complete defenses to the claims asserted in the lawsuit and intends to vigorously defend itself. If LSS Satellite prevails or if Verdisys is unable to settle the lawsuit on favorable terms, LSS Satellite may obtain significant damages that may have a material adverse effect on Verdisys's financial condition.

Claims by Investor

In connection with its financing in October 2003 with Gryphon Master Fund, L.P, Verdisys agreed to register the shares issued to Gryphon on or before March 2004 or be subject to certain liquidated damages. Gryphon has made a claim against Verdisys for the maximum liquidated damages in an amount of \$400,000. It has also c