

Siberian Energy Group Inc.
Form 10QSB
August 14, 2007

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

FORM 10-QSB

(Mark One)

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

For the quarterly period ended June 30, 2007

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

For the transition period from _____ to _____

Commission file number 333-118902

SIBERIAN ENERGY GROUP INC.

(Exact name of small business issuer as specified in its charter)

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

275 Madison Ave, 6th Floor, New York, NY 10016

(Address of principal executive offices)

(212) 828-3011

(Registrant's telephone number)

Check whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 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

As of August 1, 2007, 16,218,065 shares of Common Stock of the issuer were outstanding ("Common Stock").

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

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Traditional Small Business Disclosure Format (Check One): Yes [] No [].

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

**SIBERIAN ENERGY GROUP INC.
(A Development Stage Company)**

**CONDENSED CONSOLIDATED
FINANCIAL STATEMENTS**

June 30, 2007

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders
Siberian Energy Group Inc.

We have reviewed the accompanying condensed consolidated balance sheet of Siberian Energy Group Inc. (a development stage company) as of June 30, 2007, and the related condensed consolidated statements of operations, stockholders' equity, and cash flows for the six months ended June 30, 2007 and 2006, and the cumulative period of development stage activity (January 1, 2003 through June 30, 2007). These financial statements are the responsibility of the Company's management.

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

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

We have previously audited, in accordance with auditing standards of the Public Company Accounting Oversight Board, the consolidated balance sheet as of December 31, 2006, and the related consolidated statements of operations, stockholders' equity and cash flows for the year then ended (not presented herein); and in our report dated March 28, 2007, we included an explanatory paragraph describing conditions that raised substantial doubt about the Company's ability to continue as a going concern. In our opinion, the information set forth in the accompanying condensed consolidated balance sheet as of December 31, 2006 is fairly stated, in all material respects, in relation to the balance sheet from which it has been derived.

Lumsden & McCormick, LLP
Buffalo, New York
August 1, 2007

SIBERIAN ENERGY GROUP INC. (A Development Stage Company)

Condensed Consolidated Balance Sheets

	(Unaudited) June 30, 2007	December 31, 2006
Assets		
Current assets:		
Cash	\$ 2,791	\$ 1,435
Management fee receivable	85,000	110,000
Prepaid expenses and other	112,100	5,272
	199,891	116,707
Investment in joint venture	-	-
Oil and gas properties, unproved	2,700,000	2,700,000
Property and equipment, net	3,953	2,565
	\$ 2,903,844	\$ 2,819,272
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable:		
Related party - stockholders	\$ 365,814	\$ 362,166
Related party - Baltic Petroleum, interest at 14%	53,628	50,615
Others	532,348	459,561
Accrued payroll	698,784	1,011,788
	1,650,574	1,884,130
Stockholders' equity:		
Common stock - authorized 100,000,000 shares, \$.001 par value, 15,708,030 and 14,112,961 issued and outstanding	15,708	14,113
Additional paid-in capital	8,053,318	6,593,829
Accumulated deficit		
Pre-development stage	(449,785)	(449,785)
Development stage	(6,355,701)	(5,218,570)
Accumulated other comprehensive income (loss)	(10,270)	(4,445)
	1,253,270	935,142
	\$ 2,903,844	\$ 2,819,272

See accompanying notes.

SIBERIAN ENERGY GROUP INC. (A Development Stage Company)

Condensed Consolidated Statements of Operations

	For the three months ended		For the six months ended		For the cumulative period of Development Stage Activity- January 1, 2003 through June 30, 2007
	June 30, 2007	June 30, 2006	June 30, 2007	June 30, 2006	June 30, 2007
Revenues and other income:					
Management fees from joint venture	\$ 195,000	\$ 75,000	\$ 360,000	\$ 150,000	\$ 795,000
Gain from entrance into joint venture	-	-	-	-	364,479
Other	-	-	-	-	6,382
Total revenues and other income	195,000	75,000	360,000	150,000	1,165,861
Expenses:					
Salaries	384,426	35,251	468,069	68,562	2,346,136
Professional and consulting fees	461,866	1,433,429	664,254	1,589,145	3,313,900
Rent and occupancy	10,184	10,009	22,569	19,746	198,812
Depreciation and amortization	133	81	215	167	102,932
Finance charges and interest	1,515	2,416	3,014	6,264	61,390
Marketing and other	164,914	161,727	339,010	353,218	1,498,392
Total expenses	1,023,038	1,642,913	1,497,131	2,037,102	7,521,562
Loss before income taxes	828,038	1,567,913	1,137,131	1,887,102	6,355,701
Provision for income taxes (benefit)	-	-	-	-	-
Net loss (development stage)	\$ 828,038	\$ 1,567,913	\$ 1,137,131	\$ 1,887,102	\$ 6,355,701

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Basic and diluted loss per common share	\$	(0.05)	\$	(0.14)	\$	(0.08)	\$	(0.16)	\$	(0.67)
Weighted average number of basic and diluted common shares outstanding		15,173,503		11,453,792		14,905,185		11,487,319		9,405,277

*See accompanying
notes.*

SIBERIAN ENERGY GROUP INC. (A Development Stage Company)

Condensed Consolidated Statements of Stockholders' Equity

For the cumulative period of Development Stage Activity - January 1, 2003 through June 30, 2007

	Common Stock		Additional Paid-In Capital
	Number of Shares	Par Value	
Balance, January 1, 2003 (pre-development stage)	4,902,886	\$ 4,903	\$ 430,195
Loss for the year - 2003	-	-	-
Shares issued in acquisition (ZNG)	1,000,000	1,000	(1,000)
Balance, December 31, 2003	5,902,886	\$ 5,903	\$ 429,195
Loss for the year - 2004	-	-	-
Foreign currency translation adjustment	-	-	-
Shares issued in acquisition (ZNG)	3,450,000	3,450	746,550
Shares issued for professional services	50,000	50	9,950
Other	-	-	34,426
Balance, December 31, 2004	9,402,886	\$ 9,403	\$ 1,220,121
Loss for the year - 2005	-	-	-
Foreign currency translation adjustment	-	-	-
Shares issued for professional services	385,000	385	138,365
Shares issued for accrued salaries	1,700,000	1,700	210,800
Warrants granted for professional services	-	-	217,000
Balance, December 31, 2005	11,487,886	\$ 11,488	\$ 1,786,286
Loss for the year - 2006	-	-	-
Foreign currency translation adjustment	-	-	-
Shares issued for employee stock option plan and warrants	195,000	195	45,305

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Shares issued for geological data	1,900,000	1,900	2,235,100
Shares issued for professional services	1,139,499	1,140	1,685,351
Warrants granted for professional services	-	-	841,177
Shares cancelled	(609,424)	(610)	610
Balance, December 31, 2006	14,112,961	\$ 14,113	\$ 6,593,829
Loss for six months - 2007			
Foreign currency translation adjustment			
Shares issued for employee stock option plan and warrants	566,935	567	67,447
Shares issued for geological data	200,000	200	285,800
Shares issued for accrued salaries	465,000	465	669,135
Shares issued for professional services	363,134	363	437,107
Balance, June 30, 2007	15,708,030	\$ 15,708	\$ 8,053,318

See accompanying notes.

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Accumulated Deficit	Accumulated Other Comprehensive Income (Loss)	Total	Comprehensive Loss
\$ (449,785)	\$ -	\$ (14,687)	
(422,516)	-	(422,516)	\$ (422,516)
-	-	-	
\$ (872,301)	-	\$ 437,203)	
(833,567)	-	(833,567)	
-	(53,120)	(53,120)	\$ (886,687)
-	-	750,000	
-	-	10,000	
-	-	34,426	
\$ (1,705,868)	\$ (53,120)	\$ 529,464)	
(882,151)		(882,151)	
-	50,614	50,614	\$ (831,537)
-	-	138,750	
-	-	212,500	
-	-	217,000	
\$ (2,588,019)	\$ (2,506)	\$ (792,751)	
(3,080,336)	-	(3,080,336)	
-	(1,939)	(1,939)	\$ (3,082,275)
-	-	45,500	
-	-	2,237,000	
-	-	1,686,491	

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	-	-	841,177		
	-	-	-		
\$	(5,668,355)	\$	(4,445)	\$	935,142
	(1,137,131)		(1,137,131)		
		(5,825)	(5,825)	\$	(1,142,956)
			68,014		
			286,000		
			669,600		
			437,470		
\$	(6,805,486)	\$	(10,270)	\$	1,253,270

SIBERIAN ENERGY GROUP INC. (A Development Stage Company)

Condensed Consolidated Statements of Cash Flows

			For the cumulative period of Development Stage Activity- January 1, 2003 through June 30, 2007
For the six months ended June 30,	2007	2006	
Cash flows from operating activities:			
Net loss (development stage)	\$ (1,137,131)	\$(1,887,102)	\$ (6,355,701)
Depreciation and amortization	215	167	102,932
Common stock and warrants issued	1,461,084	1,039,980	4,327,502
Gain from entrance into joint venture	-	-	(364,479)
Changes in other current assets and current liabilities:			
Prepaid expenses and other assets	(81,828)	25,000	(350,492)
Accounts payable and accrued expenses	(233,556)	845,999	3,641,412
Net cash flows from operating activities	8,784	24,044	1,001,174
Cash flows from investing activities:			
Expenditures for licenses and related	-	-	(528,961)
Expenditures for oil and gas properties	-	-	(770,750)
Expenditures for property and equipment	(1,603)	-	(5,834)
Cash received in acquisition	-	-	6
Cash received from entrance into joint venture	-	-	175,000
Net cash flows for investing activities	(1,603)	-	(1,130,539)
Cash flows from financing activities:			
Net proceeds from demand loan	-	-	62,500
Common stock issued for employee stock option plan	-	14,000	45,500
Additional paid-in capital	-	-	34,426
Net cash flows from financing activities	-	14,000	142,426
Effect of exchange rates on cash	(5,825)	(3,314)	(1,000)
Net increase in cash	1,356	34,730	2,791
Cash - beginning	1,435	11,551	-
Cash - ending	\$ 2,791	\$ 46,281	\$ 2,791

See accompanying notes.

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SIBERIAN ENERGY GROUP INC. (A Development Stage Company)

Notes to Condensed Consolidated Financial Statements

1. Basis of Presentation:

The accompanying unaudited consolidated financial statements of Siberian Energy Group Inc. (the Company) include the accounts of the Company and its 100% owned subsidiaries. These financial statements have been prepared pursuant to the rules of the Securities and Exchange Commission (SEC) interim reporting, and do not include all of the information and note disclosures required by generally accepted accounting principles. These consolidated financial statements and notes herein are unaudited, but in the opinion of management, include all the adjustments (consisting of only normal recurring adjustments) necessary for a fair presentation of the Company's financial positions, results of operations, and cash flows for the periods presented. Accounting policies used in fiscal 2007 are consistent with those used in the cumulative period of Development Stage Activity – January 1, 2003 through June 30, 2007. These financial statements should be read in conjunction with the Company's audited consolidated financial statements and notes thereto. Interim operating results are not necessarily indicative of operating results for any future interim period or the full year.

2. The Company and Description of Business:

Through October 14, 2005, the Company operated through its wholly owned subsidiary, Zaural Neftegaz (ZNG). ZNG is engaged in the business of exploiting and developing certain oil and gas and other petroleum products licenses issued by the Russia's Kurgan Provincial Government for the Eastern part of Kurgan Province. ZNG has its principal place of business in Kurgan City, Kurgan Province, Russia, and is the sole and exclusive owner of the exploration licenses.

On October 14, 2005, the Company entered into a joint venture agreement with a third party, Baltic Petroleum Limited (Baltic). The Company transferred 100% of its ownership interest in ZNG to the Joint Venture Zauralneftgaz Limited, UK (ZL) and transferred 50% of the Joint Venture interest to Baltic for \$175,000 and the agreement by Baltic to provide future funding to the Joint Venture as detailed in a Joint Venture Shareholders' Agreement. ZL is currently preparing to drill its second well based on the recommendations from the analysis of the first Privolny-1 well and continues geological exploration works throughout the territory of its seven licenses covering in total 1 million acres. These operations are funded via loans provided to ZL and ZNG by a financing company wholly owned by Baltic. Loans are guaranteed by ZL's holdings in ZNG. As of June 30, 2007 the total amounts provided through such loans to ZL and ZNG were equal to \$17.2 million plus accrued interest of approximately \$1.9 million.

In connection with the current program of seismic studies and drilling of the first four wells in the ZNG's license blocks, additional funds were raised by Baltic's parent through a placement of shares. On June 18, 2007 ZNG entered into a new loan agreement for \$7.4 million, and it is anticipated that ZL will enter into an additional loan agreement for approximately \$5.3 million covering drilling and geological works through the end of 2007. The loans will not be dilutive to the Company's ownership in ZNG. In connection with the funding provided by Baltic, ZNG entered into a gross override royalty agreement with Baltic.

Additional details surrounding the Company's involvement in the Joint Venture follow:

-

During the arrangement, the Company will receive a monthly management fee of \$25,000 from ZNG (\$55,000 effective November 2006);

- Profits from the Joint Venture are allocated 50% to the Company only after all financing of ZNG are settled with Baltic and Baltic's financing subsidiaries;
- Although the Company and Baltic each own 50% of the Joint Venture's shares and each appoint 50% of the Directors to the Joint Venture, Baltic always has an additional casting vote on Board of Director related issues;
 - The Company has essentially no liability to guarantee the debts of the Joint Venture;
- The Company recognized a settlement gain of \$364,479 as a result of the initial joint venture transaction. This resulted primarily to adjust the Company's negative investment to zero as of the agreement date. All activity of ZNG before the agreement date is otherwise included in these financial statements.

Effective October 14, 2005, the Company's investment in Joint Venture is recorded on the equity method of accounting. Since cumulative losses of Joint Venture exceed the Company's investment, the investment asset is carried at zero value as of June 30, 2007 and December 31, 2006. Activities of ZNG prior to October 14, 2005 are otherwise included in the consolidated accounts of the Company in the accompanying financial statements.

As part of a planned separate oil and gas venture, on December 31, 2006, the Company acquired oil and gas related geological information on the Karabashki zone of Khanty-Mansiysk Autonomous district (Tuymen region of the Russian Federation) from Key Brokerage, LLC, a Delaware limited liability company, for 1,900,000 shares of restricted common stock. In conjunction with this asset purchase, the Company was also assigned ownership of Kondaneftegaz, LLC (Konda), a Russian limited liability company wholly-owned by Key Brokerage, LLC.

As a result of the purchase, the Company assigned an acquisition value of \$2,700,000 to the geological data assets based on both the approximate share value of the Company's stock issued at the purchase date and the assets' estimated value as determined by an independent appraisal prior to the acquisition. Since Konda had essentially no assets or liabilities at the purchase date, had no previous operating history, and was transferred only to facilitate the Company's potential future operations in Russia, no value was otherwise assigned to it at acquisition.

In 2007, the Company plans to participate in two or three auctions for development and production licenses for the parcels belonging to the existing oil deposits of Khanty-Mansiysk district.

On a moving forward basis, the Company anticipates further business expansion. It is constantly evaluating new mineral resource assets, both explored and unexplored, as part of its growth strategy.

The Company was incorporated in the State of Nevada on August 13, 1997, and previously provided comprehensive outpatient rehabilitation services to patients suffering from work, sports and accident related injuries. All activities related to the Company's previous business ventures were essentially discontinued prior to January 1, 2000. Predecessor names of the Company since its inception include Trans Energy Group Inc., 17388 Corporation Inc., Talking Cards Inc., Oyster King Incorporated and Advanced Rehab Technology Corporation.

3. Income Taxes:

At June 30, 2007, the Company has estimated U.S. tax net operating loss carryforwards totaling approximately \$5,075,000. These carryforwards may be used to offset future taxable income, and expire in varying amounts through 2027. No tax benefit has been reported in the financial statements since the Company believes there is at least a 50% chance that the carryforwards will expire unused. Accordingly, the \$1,015,000 estimated cumulative tax benefit of the loss carryforward has been offset by a valuation allowance of the same amount.

4. Loss Per Common Share:

Basic and diluted loss per common share is computed using the weighted average number of common shares outstanding during the period. Shares issuable for common stock options may have had a dilutive effect on earnings per share had the Company generated income during the periods through June 30, 2007.

5. Going Concern:

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

Management is of the opinion that the Joint Venture arrangement established in 2005 will successfully generate allocable profits to the Company in the near term.

For the cumulative period ended June 30, 2007, the Company has obtained cash financing from organizing stockholders and employees in the form of loans, advances, and deferred salaries. However, there can be no certainty as to availability of continued financing in the future. Failure to obtain sufficient financing may require the Company to reduce its operating activities. A failure to continue as a going concern would then require stated amounts of assets and liabilities be reflected on a liquidation basis which could differ from the going concern basis.

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION

CERTAIN STATEMENTS IN THIS QUARTERLY REPORT ON FORM 10-QSB (THIS "FORM 10-QSB"), CONSTITUTE "FORWARD LOOKING STATEMENTS" WITHIN THE MEANING OF SECTION 27A OF THE SECURITIES ACT OF 1934, AS AMENDED, AND THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995 (COLLECTIVELY, THE "REFORM ACT"). CERTAIN, BUT NOT NECESSARILY ALL, OF SUCH FORWARD-LOOKING STATEMENTS CAN BE IDENTIFIED BY THE USE OF FORWARD-LOOKING TERMINOLOGY SUCH AS "BELIEVES", "EXPECTS", "MAY", "SHOULD", OR "ANTICIPATES", OR THE NEGATIVE THEREOF OR OTHER VARIATIONS THEREON OR COMPARABLE TERMINOLOGY, OR BY DISCUSSIONS OF STRATEGY THAT INVOLVE RISKS AND UNCERTAINTIES. SUCH FORWARD-LOOKING STATEMENTS INVOLVE KNOWN AND UNKNOWN RISKS, UNCERTAINTIES AND OTHER FACTORS WHICH MAY CAUSE THE ACTUAL RESULTS, PERFORMANCE OR ACHIEVEMENTS OF SIBERIAN ENERGY GROUP INC. ("SIBERIAN", THE "COMPANY", "WE", "US" OR "OUR") TO BE MATERIALLY DIFFERENT FROM ANY FUTURE RESULTS, PERFORMANCE OR ACHIEVEMENTS EXPRESSED OR IMPLIED BY SUCH FORWARD-LOOKING STATEMENTS. REFERENCES IN THIS FORM 10-QSB, UNLESS ANOTHER DATE IS STATED, ARE TO JUNE 30, 2007.

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

BUSINESS DEVELOPMENT:

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

On September 17, 1999, the Company effected a 1-for-30 reverse stock split. A subsequent 3-for-1 forward split was consummated on October 2, 2000. All share amounts subsequently listed are retroactively adjusted to reflect these stock splits unless otherwise provided. All activities related to the Company's business were discontinued prior to January 1, 2000 and the Company began looking for opportunities to acquire an operating business.

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

On May 9, 2003, the Company entered into an Acquisition Agreement (the "Acquisition Agreement") by and among the Company, Zaural Neftegaz, a Russian corporation ("ZNG"), the shareholders of ZNG and Oleg Zhuravlev, President of ZNG. Pursuant to the Acquisition Agreement, the Company acquired a 51% interest in ZNG by issuing to ZNG 2,000,000 shares of the Company's common stock. In June 2004, the Company purchased the remaining 49% of ZNG in exchange for 6,900,000 shares of the Company's common stock, making ZNG a wholly owned subsidiary of the Company. ZNG holds seven (7) oil and gas licenses for the rights to prospect, explore, drill and remove oil and gas (the "Exploration Rights") in the eastern parts of Kurgan Province in Russia. The Company had no affiliation with ZNG prior to the acquisition in May 2003.

On May 2, 2005, the Company affected a 1:2 reverse stock split and all share amounts listed throughout this report on Form 10-QSB reflect such split unless otherwise stated.

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

BUSINESS OPERATIONS:

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

Until October 14, 2005, the Company's operations were conducted solely through its then wholly owned subsidiary, Zaural Neftegaz ("ZNG") a development stage oil and gas exploration company located in the Western Siberian Region of Russia. However, on October 14, 2005, the Company entered into a Joint Venture agreement, whereby the Company transferred 100% of the ownership of ZNG to a newly formed Joint Venture company, Zauralneftegaz Limited, a company organized under the laws of the United Kingdom ("ZNG, Ltd."), of which the Company owns 50% pursuant to the Joint Venture agreement entered into on October 14, 2005 (as described in greater detail below under "Joint Venture"). From October 14, 2005 to December 13, 2006, the Company had no oil and gas operations except through its ownership of 50% of ZNG, Ltd. On December 13, 2006, the Company entered into an Interest Purchase Agreement with Key Brokerage, whereby the Company purchased 100% of the issued and outstanding common stock of Kondaneftegaz, LLC ("KNG"), a Russian limited liability company, which was created in 2004 for the purpose of oil and gas exploration in the Khanty-Mansiysk district of Western Siberia, Russia. KNG has previously applied for 10 exploration and production licenses for parcels located within the existing oil deposits of the Khanty-Mansiysk district, in Russia, four of which are expected to be auctioned off during the third or fourth quarters of 2007.

Moving forward the Company plans to focus on the exploration and potential development of any licenses acquired by KNG through government auctions in fiscal 2007 and working with its partner in the Joint Venture, Baltic Petroleum (E&P) Limited ("BP" or "Baltic"), to continue the oil and gas exploration activities through their co-ownership of the Joint Venture and ZNG.

Description of KNG

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

From 2005 through 2007 KNG applied for a total of 15 exploration and production licenses in the Khanty-Mansiysk district of Russia. We believe that through auctions and/or tenders, KNG may obtain licenses to four of the licensed areas during the third or fourth quarters of 2007; however, the remaining other auction/tender dates are currently undetermined.

The Purchase Agreement consummated the transactions contemplated by the Option Agreement (the "Key Brokerage Option"), which we entered into with Key Brokerage in September 2006. In consideration for agreeing to the Key Brokerage Option, we granted Key Brokerage 250,000 warrants to purchase shares of our common stock at an exercise price of \$2.20 per share, exercisable for up to two (2) years from the date of the Key Brokerage Option (the "Key Brokerage Warrants") in September 2006.

In connection with the purchase of KNG, we received certain geological information, including well logs, surveys and structural maps regarding the Karabashsky zone of the Khanty-Mansiysk district, which an independent appraisal valued at approximately \$2,700,000.

In consideration for the transfer of 100% of the stock of KNG, we issued Key Brokerage an aggregate of 1,900,000 restricted shares of our common stock valued at approximately \$2,700,000, which value approximated the value of geological information relevant to the license blocks applied for by KNG.

Description of ZNG

ZNG was created to explore and develop new hydrocarbon fields and oil and gas properties in the Kurgan region of Southwest Siberia, Russia. ZNG has compiled data in the Eastern part of the Kurgan region by analyzing prior geological, geophysical and lithographic exploration works in the region, data, maps, and reports from 12 test wells drilled between 1979-1986, profile sections, correlation schemes, and geographic maps of the region. ZNG has also obtained core samples from parametric wells drilled in prior years on the licensed areas and adjacent territories in the Eastern part of Kurgan region during the initial search for oil and gas in the region, and performed analysis of the data provided by the samples.

In March 2003, ZNG acquired four 5-year exploration licenses through a government tender, which licenses expire in March 2008, and which licenses are for concessions covering a total territory of 643,000 acres. Upon expiration of the licenses, ZNG will have, subject to the signing of the Subsoil Legislation, preferential right to apply for the full production license for the term of 25 years.

The Mokrousovsky license is the largest of the four licenses, encompassing a total of 240,000 acres, followed by the West Suersky, which covers 230,000 acres, the Privolny, which covers 123,000 acres, and the Orlovo-Pashkovsky license, which covers 50,000 acres.

In June 2006, through participation in governmental auctions, ZNG successfully obtained three more oil and gas licenses in the Kurgan region of Siberia, Russia: the Yuzhno-Voskresensky, Petuhovsky and Lebyazhevsky parcels. The new licenses are for the period of 25 years and allow both exploration and production on the licensed areas. The total cost paid at the auctions for the three new licenses by ZNG was approximately \$425,000. The acquisition of the three new licenses increased the total area covered by the licenses held by ZNG from 643,000 acres to over 1 million acres. All seven licensed areas are located in the Eastern part of Kurgan region, have well-developed infrastructure, including close proximity to the major oil pipeline, and have available existing prior geological data.

ZNG also has outstanding applications for two more parcels in the same area - Zapadno-Petukhovsky and Orlovo-Pashkovsky-2. The anticipated auction dates for these licenses are currently unknown and there can be no assurance that ZNG will be awarded the licenses to the parcels at auction.

As of June 2007, ZNG had performed the following research and exploration works on its licensed areas:

- Obtained core samples from parametric wells drilled in prior years on the licensed areas and adjacent territories in the Eastern part of Kurgan region during the initial search for oil and gas in the region, and performed analysis of the data provided by the samples;
-

Completed a 2D seismic survey on the West-Suersky block (approximately 320 linear kilometers), the Privolny block (approximately 140 linear kilometers), and the Mokrousovsky block (approximately 340 linear kilometers) using Bazneftgeophysica;

- Performed gravimetric surveys on the West-Suersky block;

- Completed approximately 2,106 linear kilometers of gas seismotomographic and geochemical surveys performed by Exotrad on the Privolny, Mokrousovsky, West-Suersky, Orlovo- Pashkovsky, South-Voskresensky, Petukhovsky and Lebyazhevsky blocks. Gas seismotomography is an advanced technique of combining active gas geochemistry, passive seismic and electromagnetic methods. The surveys were performed by Exotrad, a world leader in this field. Exotrad has used this technology in more than 260 projects as well as “Caspian Pipeline Consortium”; “Sakhalin-2”; and “Blue Stream” in diverse locations across Asia, Eastern Europe and the Americas;
- Scientific and technical analysis was performed by the team of geologists, which included experts from Exploration Consultants Limited ("ECL"), a leading international oil and gas consulting firm (part of RPS Group);
- Based on the results of the gas seismotomographic surveys and high definition 2D seismic survey shot over the geochemical anomalies found in the Privolny and Mokrousovsky blocks, ZNG's Board of Directors decided to drill up to four exploration wells. At least two of these wells are proposed to be drilled in northern locations in the Privolny block (one of which has previously been drilled, the Privolny-1 Well) and the other two wells are proposed to be drilled on the Mokrousovsky block; and
- Preliminary Drilling Results of the first well drilled on the Privolny block, the Privolny-1 Well, have been obtained to substantiate the interpretation of seismic data obtained in 2006, together with other geophysical and geochemical work conducted over the last two years. ZNG believes that the Privolny-1 Well will help provide an improved analysis which will allow it to create a work program including the drilling of at least two more exploration wells.

Following detailed data collection, survey and seismic testing, ZNG will proceed with development of the most promising licenses first, which will allow it to concentrate its resources on the most prospective areas. Based on research performed to date the areas of most interest are the Privolny and Mokrousovsky blocks. The West Suersky and Orlovo-Pashkovsky-1 blocks currently have the least potential in the assessment of ZNG and ZNG has decided not to proceed with its commitments in respect to those licenses. The Yuzhno-Voskresensky, Petuhovsky and Lebyazhevsky parcels will require further exploration before the decision on their potential can be reached.

The following survey and exploration activities have taken place on the first two blocks designated by ZNG for exploration, the Privolny and the Mokrousovsky blocks to date:

Privolny Block

- Based on the results of the gas seismotomographic surveys and high definition 2D seismic survey shot over the geochemical anomalies found in the Privolny and Mokrousovsky blocks, two drilling prospects were identified in the northern part of the Privolny block;

- A drilling of the first prospect located in the Privolny block was performed. The “Privolny-1” well is intended to provide physical data to enable the seismic survey to be correlated to the geology of the block and to better determine the subsurface structures which are present in the block;
- A drilling depth of 2402.5 meters has been reached to date on the Privolny-1 well, and sufficient data has been gathered to enable a tie in to the adjoining Mokrousovsky license block; and
- The core samples from the Privolny-1 well were obtained in the Middle Carboniferous-Moscovian and Upper and Middle Devonian sections, including lean source rocks lying within the oil maturation window. The cores and electric logs obtained from the Privolny-1 well will be analyzed and the results will determine whether the well is to be further deepened to prospective geological horizons. As such, further drilling on the Privolny-1 well has been temporarily put on hold, pending further analysis of the data.

Mokrousovsky Block

ZNG has completed an interim Seismic Interpretation and received a Mapping Report created by RPS Energy ("RPS"), relating to the 2D seismic studies conducted on the Mokrousovsky block to date. The Mokrousovsky block is the second licensed area surveyed using conventional 2D seismic surveys, over which 339 kilometers ("km") of seismic surveys have been shot. The following results have been obtained through those surveys:

- One structural prospect was identified in the south west of the Mokrousovsky license area. The structure has a maximum area of approximately 72 square km, of which approximately 52 square km lie within the licensed area. The surface geochemical anomaly discovered in the area lies over the north eastern flank of the structure within the license area;
- A drilling location has been recommended by RPS for the prospect, based on the strong structure and geochemical coincidence, which drilling has not begun to date; and
- ZNG believes that the data gathered by drilling of the Privolny-1 well will enable it to determine the location for its second well, the Mokrousovsky-1, with a greater degree of confidence, of which there can be no assurance. As of the date of this filing, ZNG has signed the contract for drilling of the Mokrousovsky-1 well. Actual drilling is expected to begin in late September or early October 2007, of which there can be no assurance.

Joint Venture

Operating activities of ZNG described above are carried out through the Joint Venture Shareholders' Agreement ("Joint Venture") entered into on October 14, 2005 with Baltic Petroleum (E&P) Limited ("BP" or "Baltic") and Zauralneftegaz Limited, the joint venture company ("ZNG, Ltd."), as contemplated by the Option Agreement, as amended (the "Option"). The Company closed the Joint Venture and transferred 100% of the outstanding stock of ZNG to ZNG, Ltd. in connection with the terms and conditions of the Joint Venture. As a result of such transfer, the Company holds 50% of the outstanding stock of ZNG, Ltd., which holds 100% of the outstanding stock of the Company's former wholly owned subsidiary, ZNG. ZNG, Ltd., will, operate through ZNG and be engaged in the exploration and development of, production and sale of, oil and gas assets in the Western Siberian region of the Russian Federation and the former Soviet Union and as a result of such transfer, the Company no longer has any separate oil and gas exploration activities in Kurgan, Russia, other than through its ownership of ZNG, Ltd.

The operations of the Joint Venture are funded via loans provided to ZNG, Ltd. and ZNG by Caspian Finance Limited ("Caspian"), a financing company wholly owned by Baltic. Loans are guaranteed by ZNG, Ltd.'s holdings in ZNG. As of June 30, 2007 the total funding provided to ZL and ZNG by Baltic was equal to \$17.2 million plus accrued interest of approximately \$1.9 million.

To date, Caspian has provided ZNG various loans from 2005 through 2007, as described below:

- On November 9, 2005, ZNG entered into a New Loan with Caspian (the "New Loan"). Under the loan agreement, Caspian agreed to provide a loan of up to \$6,874,325 representing the assumed commitment under a prior loan equal to \$1,739,658, of which ZNG had received \$1,110,624 as of November 9, 2005, and a new commitment of up to \$5,134,667, to be used for operations in the Kurgan

region in 2005 and through the first half of 2006. The New Loan is available to ZNG until the sixth anniversary of the date of the New Loan, or November 9, 2011 (the "Term");

- On January 16, 2007 ZNG and Caspian entered into a Deed of Variation of the Loan Agreement, whereby, inter alia, the Lender agreed to make available to ZNG an additional loan facility of US\$2,000,000;
- On April 23, 2007, ZNG and Caspian further entered into a Deed of Variation of the Loan Agreement whereby, inter alia, the Lender agreed to make available to ZNG an additional loan facility of US\$300,000; and
- On June 18, 2007, ZNG and Caspian entered into another Deed of Variation to the Loan Agreement, whereby Caspian agreed to make available to ZNG an additional loan facility of US\$7,359,190 (the "June 2007 Deed of Variation").

The total outstanding balance of the New Loan provided up to June 30, 2007, is \$10,107,000, including \$8,992,000 principal and \$1,115,000 of interest accrued as of June 30, 2007.

Funding to ZNG, Ltd. is provided by Caspian on the same terms as to ZNG, through the mechanism of intercompany billing within Baltic and certain companies affiliated with Baltic. As of June 30, 2007, the total loan to ZNG, Ltd. from Caspian comprised \$7,956,000 including \$7,128,000 of principal and accrued interest of \$828,000. In addition, ZNG, Ltd. owes \$1,135,000 directly to Baltic for unpaid management fees and accrued interest through June 30, 2007.

The total budget for the current program of seismic studies and drilling of the first four wells on ZNG's licenses which the Board has proposed to undertake on ZNG's licensed blocks in 2007, is approximately US \$14,998,000, or approximately \$8 million British pounds. These funds were raised by Baltic's parent company through a placement of shares. Of the total budgeted amount of \$14,998,000, the sum of \$9,659,000 is being provided through the ZNG loans described earlier and the sum of \$5,339,000 is committed to be provided to ZNG, Ltd. The loans will not be dilutive to the Company's ownership in ZNG. In connection with the funding provided by Baltic, ZNG entered into a gross override royalty agreement with Baltic, as described below under "Deed of Agreement," and "Gross Override Royalty Agreement."

Terms of loans to ZL and ZNG:

Interest on any amounts loaned under the New Loan bears interest at the following rates, calculated and compounded on a daily basis, 14% per annum during the first two years of the Term, 13% per annum during the third year of the Term; and 12% thereafter until the end of the Term.

Additionally, under the terms of the June 2007 Deed of Variation, interest on the loans made by Baltic to ZNG is payable on:

- a) the earlier of (i) the date on which ZNG's monthly turnover as shown by its monthly management accounts exceeds US \$200,000 and (ii) the fifth anniversary of the Deed of Variation dated June 18, 2007; and
- b) thereafter, on a monthly basis on the final day of each calendar month using all available turnover, provided that in the event the interest due thereafter exceeds the monthly turnover of ZNG then all of the turnover except for the direct budgeted operating expenses of ZNG and management fees agreed to be paid to Siberian Energy Group Inc. under the Joint Venture Agreement will be allocated prior to the payment of such interest and any interest not able to be paid will accrue and be payable as soon as the level of turnover (less the fees payable to us) permits (collectively the "Interest Payments").

In the event that ZNG does not make the Interest Payments when due, interest on the unpaid amounts shall be payable from the due date to the date paid at the rate of 6% per annum, calculated and accrued on a daily basis. The New Loan is unsecured by ZNG, but Caspian reserved the right to request security over all or some of the assets and/or undertaking of ZNG at any time prior to any drawdown of the New Loan, or while any money is outstanding under the New Loan.

Pursuant to the New Loan, ZNG is responsible for satisfying all requirements of Russian Federation law and regulations in connection with each advance made under the New Loan, and ZNG shall indemnify Caspian for any loss or damage it may suffer as a result of the New Loan.

On November 9, 2005, ZNG, Ltd. and Caspian entered into a Debenture, whereby ZNG, Ltd. granted Caspian a security interest in substantially all of its assets, including its 100% ownership of ZNG, to secure the repayment of the New Loan Agreement. Pursuant to the Debenture, ZNG, Ltd. granted Caspian a continuing security interest for the payment, performance and discharge of all of the liabilities owing to Caspian by ZNG, Ltd., in the following assets, both present and future, from time to time to the extent owned by ZNG, Ltd., or to the extent in which it has an interest.

Additionally, on November 9, 2005, ZNG, Ltd. and Caspian entered into an "Agreement for the Pledge of the Participatory Interest in OOO Zauralneftegaz" (the "Pledge Agreement"). Pursuant to the Pledge Agreement, ZNG, Ltd., pledged its 100% ownership interest in ZNG to Caspian, which included any proceeds, dividends, distributions or income deriving from ZNG and any compensation, whether monetary or in-kind, deriving from ZNG, received due to the liquidation or reorganization of ZNG. The Pledge Agreement shall remain in effect until all amounts owed to Caspian by ZNG, Ltd. are repaid. Pursuant to the Pledge Agreement, ZNG, Ltd., agreed to hold all dividends, interest and other income deriving from and by it for the account of Caspian, and agreed to pay such dividends, interest and other income to Caspian upon Caspian's request.

If ZNG, Ltd. fails to pay the amounts owed to Caspian pursuant to the Pledge Agreement, Caspian can sell the 100% interest in ZNG at public auction, in one or several sales, with an opening bid price of seventy-five percent (75%) of the value set forth for the value of ZNG in the Pledge Agreement (\$7,705,079) at the first public auction and fifty percent (50%) of the value set forth in the Pledge Agreement at the second public auction. If the opening bid for ZNG is not met at either the first or second public auction, Caspian shall have the right to retain ZNG, with its value equal to 90% of the value set at the second auction, and set-off its claims secured by ZNG, Ltd. by such value. If ZNG is sold at public auction, any and all proceeds from such sale received by Caspian shall be applied towards the discharge of the amounts owed by ZNG, Ltd. to Caspian.

Deed of Agreement

On July 26, 2006, we entered into a Deed of Agreement with Baltic Petroleum (E&P) Limited ("BP" or "Baltic") and ZNG. Pursuant to the Deed of Agreement, BP agreed to allow the drawdown by ZNG, within 10 days of the date of the Deed of Agreement, of certain funds from Caspian under the New Loan, including:

- o \$185,000 to be paid to Business Standard, which was owed to Business Standard from ZNG in consideration for Business Standard assisting ZNG with the process of the granting of the three oil and gas licenses awarded to ZNG in June 2006;
- o \$170,000 to be paid to Mr. Victor Repin (a significant shareholder of the Company) and Sergey Potapov (a Director of the Company) in final settlement of amounts due to them by ZNG; and

- o \$44,000 to ZNG's landlord in full settlement of all sums due in connection with the rent on ZNG's offices in Kurgan, Russia.

Gross Overriding Royalty Agreement

In December 2006, ZNG entered into a Gross Overriding Royalty Agreement (the "Royalty Agreement") with Baltic, which was contemplated by the Deed of Agreement dated July 26, 2006, described above and entered into in connection with the addition to the New Loan, described above. The Royalty Agreement provided that ZNG would grant Baltic a gross overriding royalty interest equal to 3% of ZNG's interest in any and all of the hydrocarbons found in, produced, marketed and/or extracted from ZNG's licensed blocks (the "Royalty"). Pursuant to the Royalty Agreement, the Royalty shall be paid free and clear of any expenses associated with the exploration and/or production of any hydrocarbons discovered on the licensed blocks. The Royalty will apply until ZNG has received an aggregate of \$20,000,000 from the gross sales of any hydrocarbon production produced or occurring on any wells owned or operated by ZNG. The Royalty Agreement also provides that Baltic may at any time, upon not less than one (1) week prior notice, take the Royalty in oil and/or gas production, instead of in cash. ZNG also granted Baltic a security interest on any and all of its future hydrocarbon production to secure the payment of the Royalty.

Agreement With Alternative Energy Finance, Ltd.

We previously agreed to issue Alternative Energy Finance Ltd. ("AEF"), of which Tim Peara is the Managing Director as well as a Director of the Company, certain warrants in connection with Mr. Peara introducing the parties who formed the joint venture. Pursuant to an agreement between AEF and the Company, AEF will receive compensation based on the total investment made by Baltic Petroleum Ltd. in the Joint Venture. This compensation included a commission of approximately \$18,024 (1% of Baltic's first \$1,802,441 investment in the Joint Venture) and 50,068 options to purchase shares of our common stock at \$0.63 per share which were granted to Mr. Peara on March 6, 2006 and a commission of \$6,673 (1% of Baltic's \$667,313 investment in the Joint Venture in the first quarter of 2006), and 17,561 options to purchase shares of our common stock at \$0.67 per share for the first quarter of 2006, which were granted to Mr. Peara on March 31, 2006, which options contain a cashless exercise provision.

On June 30, 2006, in connection with our agreement with AEF, we agreed to grant AEF a warrant to purchase 20,412 shares of our common stock at an exercise price of \$2.02, which warrants contained a cashless exercise feature. The warrants expire three years from the grant date. We were also obligated to pay AEF \$23,562 during the quarter ended June 30, 2006 (equal to 1% of Baltic's \$2,356,153 investment in the Joint Venture in the second quarter 2006).

On September 30, 2006, in connection with our agreement with AEF, we agreed to grant AEF a warrant to purchase 20,952 shares of our common stock at an exercise price of \$1.53 per share, which warrants contained a cashless exercise feature. The warrants expire three years from the grant date. We were also obligated to pay AEF \$18,303 during the quarter ended September 30, 2006 (equal to 1% of Baltic's \$1,830,292 investment in the Joint Venture in the third quarter of 2006).

On December 31, 2006, in connection with our agreement with AEF, we agreed to grant AEF a warrant to purchase 38,648 shares of our common stock at an exercise price of \$1.44 per share, which warrants contained a cashless feature. The warrants expire three years from the grant date. We were also obligated to pay AEF \$31,794 during the three months ended December 31, 2006 (equal to 1% of Baltic's approximately \$3,197,400 investment in the Joint Venture in the fourth quarter of 2006).

On March 13, 2007, Mr. Peara personally, and on behalf of AEF agreed to accept 58,134 shares of our restricted common stock in consideration for the forgiveness of \$45,626 owed personally to Mr. Peara in Directors fees and accrued expenses and \$47,969 owed to AEF in connection with our agreement with AEF, which shares have been issued to date and which debt has been forgiven by Mr. Peara and AEF.

On March 31, 2007, in connection with our agreement with AEF, we agreed to grant AEF a warrant to purchase 48,925 shares of our common stock at an exercise price of \$1.10 per share, which warrants contained a cashless

feature. The warrants expire three years from the grant date. We were also obligated to pay AEF approximately \$30,695 during the three months ended March 31, 2007 (equal to 1% of Baltic's approximately \$3,069,482 investment in the Joint Venture in the first quarter of 2007); which amount has not been paid to date.

On June 30, 2007, in connection with our agreement with AEF, we agreed to grant AEF a warrant to purchase 55,233 shares of our common stock at an exercise price of \$1.14 per share, which warrants contained a cashless feature. The warrants expire three years from the grant date. We were also obliged to pay AEF approximately \$35,938.00 during the three months ended June 30, 2007 (equal to 1% of Baltic's approximately \$ 3,593,848 investment in the Joint Venture in the second quarter of 2007); which amount has not been paid to date.

Recent Officer and Director Transactions:

On January 25, 2007, we approved an annual salary of \$180,000 (plus a performance based bonus to be determined by the Board of Directors at the end of the 2007 fiscal year) for our Chief Executive Officer and Director, David Zaikin for the 2007 fiscal year. On January 31, 2007, Mr. Zaikin notified us that effective February 1, 2007, he was withdrawing his previous request to not accrue any salary until we had sufficient funds to pay such salary, and instead requested that we pay him his 2007 salary if funds were available for such payments and/or that we accrue such salary until we have sufficient funds to repay him any accrued amounts. In February 2007, our Board of Directors approved the issuance of 350,000 shares of our restricted common stock to Mr. Zaikin, in consideration for compensation for the year ended December 31, 2006, which compensation was granted by our Board of Directors in its sole discretion, even though Mr. Zaikin had previously agreed not to be paid or accrue any salary for fiscal 2006. In July 2007, we issued an aggregate of 190,000 restricted shares of common stock to Mr. Zaikin, and certain of his assigns, in consideration for services rendered during the first two quarters of 2007.

In June 2007, we issued 70,000 shares of restricted common stock to our President, Helen Teplitskaia, of which 50,000 shares was a sign-on bonus in connection with her agreeing to be an officer of the Company in May 2007, and 20,000 shares were part of her compensation package with the Company, whereby she is to be paid 10,000 shares per month for her service to the Company, which shares were issued for services rendered in May and June 2007.

In July 2007, Mr. Zaikin agreed to transfer 40,000 shares of the Company's restricted common stock which he held to the Toronto Jewish Russian Academy Ohr Menahem (the "TJRA"). The shares were transferred to the TJRA as a charitable donation from Mr. Zaikin personally.

Uptick Capital Agreement

On January 31, 2007, we entered into an agreement with Uptick Capital Ltd. ("Uptick"), whereby Uptick agreed to assist us in developing market links and strategic initiatives as well as financing introductions for us as requested from time to time. The initial agreement was for a period of three (3) months, but was extended for two months, and has since been terminated. We agreed to issue Uptick 10,000 shares of our restricted common stock for each month that the agreement with Uptick is in place. We also agreed to indemnify Uptick for certain costs and damages in connection with its performance of its duties under the Uptick agreement, as described in greater detail in the agreement.

Global Consulting Group Agreement

With an effective date of April 10, 2007, we entered into an agreement with The Global Consulting Group ("Global"), whereby Global agreed to perform investor relations and medial communications services for us for the period of one (1) year, which agreement is automatically renewable for additional one (1) year periods if not terminated prior as described below. Pursuant to the Global agreement, we agreed to pay Global \$12,000 per month during the term of the agreement (subject to 3% yearly increases, if such agreement is not terminated prior to the one (1) year anniversary of the agreement), and pay Global one time bonuses of \$5,000 upon the achievement of any of the following goals: our

common stock being listed on the AMEX; a valuation of our common stock of at least \$40 million for more than 30 days; and/or any feature story in a top tier media outlet (The Wall Street Journal, The New York Times or similar publication). We also agreed to pay Global's reasonable out of pocket expenses, subject to prior approval for any expense over \$300 and to indemnify Global against any losses they may incur as a result of the Global agreement up to a maximum of \$10,000.

The Global agreement can be terminated by either party after six (6) months upon thirty (30) days prior written notice, and can be terminated immediately at any time due to a material breach of the agreement by either party, which breach is not cured within 15 days of notice thereof from the non-breaching party, and/or if any party becomes bankrupt or ceases to carry on business.

Exercise of Stock Options

On May 1, 2007 at 9:00 a.m., Tim Peara, our Director, exercised 50,000 of the options he held to purchase restricted shares of our common stock at an exercise price of \$0.30 per share, which options would have expired on May 1, 2007 at 5:00 p.m. if not previously exercised by Mr. Peara. Mr. Peara used the cashless exercise provision of the options and received 41,935 shares of our common stock in connection with the exercise of the options, based on the fair market value of the common stock on the date he exercised of \$1.86.

In June 2007, Mr. Viktor Repin exercised 700,000 of the options he held to purchase 112,500 shares of our restricted common stock at an exercise price of \$1.00 per share and 137,000 shares at an exercise price of \$1.05 per share. Mr. Repin used the cashless exercise provision of the options and received 250,000 shares of our common stock in the name of his nominee in connection with the exercise of the options, based on the fair market value of the common stock on the date he exercised of \$1.60.

In June 2007, LLC Business Standard exercised 800,000 of the options it held to purchase shares of our restricted common stock at an exercise price of \$1.05 per share. Business Standard used the cashless exercise provision of the options and received 275,000 shares of our common stock for it and its nominees in connection with the exercise of the options, based on the fair market value of the common stock on the date he exercised of \$1.60.

Amendment to Employment Agreement with Elena Pochapski

On or about April 2, 2007, with an effective date of April 1, 2007, we entered into "Amendment 2 to the Employment Agreement Dated August 1, 2003" with Elena Pochapski, our Chief Financial Officer and Director, which amended the terms of the first amendment to Ms. Pochapski's Employment Agreement, in September 2005, to provide that Ms. Pochapski's annual salary shall thereafter be \$75,000 per year.

Appointment of New Officer and Director

Effective May 1, 2007, Helen Teplitskaia was appointed as the Company's President and as a Director of the Company.

Helen Teplitskaia is Executive Vice President and Head of Eurasia Practice at Imnex International, Inc. She also serves as President of the American-Russian Chamber of Commerce & Industry, President of the American-Eurasian Chamber of Commerce, Director of the International Energy Advisory Council and Adjunct Associate Professor of International Business and Markets - Global Initiatives in Management at Northwestern University Kellogg School of Management.

Throughout her career, Ms. Teplitskaia has successfully assisted a variety of government agencies and private sector companies, including the United States Agency for International Development, US State Department, Ministry of Foreign Affairs of the Republic of Uzbekistan, AT&T, Baker & McKenzie, Case New Holland, Gazprom, Gillette, HeidelbergCement, Ingersoll-Rand, Maytag, Motorola, Pepsi-Cola and Morgan Stanley with start-up operations in markets, direct investment, mergers and acquisitions, joint ventures and licensing, marketing research, political interfacing and media relations.

Helen Teplitskaia received her BA/MIS from the St. Petersburg University of Culture and MBA degree from Northwestern University Kellogg School of Management.

Subsequent to her appointment as President of the Company, we agreed to provide Ms. Teplitskaia a compensation package consisting of 10,000 shares per month for her service to the Company and a sign-on bonus of 50,000 shares of common stock.

Critical Accounting Policies and Estimates

Our discussion and analysis of our financial condition and results of operations is based upon our unaudited financial statements, which have been prepared in accordance with accounting principals generally accepted in the United States. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of any contingent assets and liabilities. On an on-going basis, we evaluate our estimates. We base our estimates on various assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

We believe the following critical accounting policy affects our more significant judgments and estimates used in the preparation of our financial statements:

Going Concern

The Company's financial statements have been prepared assuming that the Company will continue as a going concern; however, since inception of its current endeavors in 2003, the Company has not earned any revenues from production of hydrocarbons and is considered to be in the development stage, which raises substantial doubt about its ability to continue as a going concern. The Company is of the opinion that sufficient financing will be obtained from external sources to provide the Company with the ability to continue the process of development to achieve commercial production and sales of products. Since inception, the Company has obtained cash financing from organizing stockholders and employees in the form of loans, advances and deferred salaries, as well as through debt financing and more recently has received \$85,000 per month in management fees from its Joint Venture. There can be no certainty as to availability of continued financing in the future. Failure to obtain sufficient financing may require the Company

to reduce its operating activities. A failure to continue as a going concern would require stated amounts of assets and liabilities to be reflected on a liquidation basis which could differ from the going concern basis.

PLAN OF OPERATIONS FOR THE NEXT TWELVE MONTHS

As a result of the Joint Venture, the Company will work with its partner in the Joint Venture, Baltic Petroleum (E&P) Limited ("BP" or "Baltic") to continue the oil and gas exploration activities through their co-ownership of the Joint Venture, ZNG, Ltd., which in turn owns ZNG. The Company believes that ZNG has adopted an aggressive but sensible work program. In connection with the Joint Venture, BP will supply ZNG with both the technical and financial support that is required to fulfill the work program. If circumstances permit and ZNG is awarded additional blocks in the Kurgan Region, we believe that BP will be able to ensure that adequate funding is available to support the Work Programs on these blocks.

The Company also plans to put a large part of its resources into KNG, and the licenses which KNG has applied for. If KNG is granted any or all of the 10 licenses it applied for in November 2005 and May 2006, or the 5 additional licenses which it submitted applications for during the first quarter of 2007, the Company anticipates conducting oil and gas exploration surveys and studies on those licenses.

Moving forward, we anticipate targeting other potential long term investments in Russia, separate from our involvement in the Joint Venture and KNG. Currently we are evaluating different business opportunities in the oil and gas industry, including both development stage and revenue-producing enterprises. As of the filing of this report on Form 10-QSB, the Company is researching certain other projects which involve the potential purchase of oil and gas interests in Western Siberia, Russia; however no formal agreements or understandings have been entered into as of the filing date of this report, other than the purchase of KNG as described above.

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

In connection with the Joint Venture (described under "Joint Venture Agreement," above), the Company received \$25,000 per month in management fees in connection with the Joint Venture from the date the Joint Venture was entered into until November 2006, at which time the management fees were increased to \$55,000 per month until June 2007 when they increased again to \$85,000. The Company, however, can make no assurance that \$85,000 per month will be adequate to pay its upcoming expenses and liabilities, in which case the Company plans that its organizing stockholders will continue to provide financing for the Company, of which there can be no assurance.

In the past, we have obtained cash financing from organizing stockholders in the form of loans and advances, as a result, amounts totaling \$365,814 and \$421,343 were payable to the stockholders as of June 30, 2007 and June 30, 2006, respectively. However, there can be no certainty as to the availability of continued financing in the future. Failure to obtain sufficient financing may require us to reduce our operating activities. A failure to continue as a going concern would then require stated amounts of assets and liabilities to be reflected on a liquidation basis which could differ from the going concern basis.

COMPARISON OF OPERATING RESULTS

RESULTS OF OPERATIONS FOR THE THREE MONTHS ENDED JUNE 30, 2007, COMPARED TO THE THREE MONTHS ENDED JUNE 30, 2006

We had revenues and other income of \$195,000 for the three months ended June 30, 2007, which was primarily due to \$55,000 of monthly management fees received from ZNG, Ltd for the months of April and May 2007 and monthly management fees of \$85,000 for the month of June 2007. We had \$75,000 of revenue and other income for the three months ended June 30, 2006, due solely to \$75,000 of management fees received. In November 2006, the management fees we received pursuant to our Joint Venture increased from \$25,000 per month to \$55,000 per month and in June 2007 the monthly management fees increased again to \$85,000 per month. Revenues increased \$120,000 or 160% for the three months ended June 30, 2007, compared to the three months ended June 30, 2006, which increase was due to the increases in management fees received in connection with the Joint Venture.

We have not generated any revenues to date through the sale of oil and/or gas.

We had total expenses of \$1,023,038 for the three months ended June 30, 2007, compared to total expenses for the three months ended June 30, 2006, of \$1,642,913, which represented a decrease in total expenses from the prior period of \$619,875 or 37.7%.

The main reason for the decrease in total expenses for the three months ended June 30, 2007, compared to the three months ended June 30, 2006, was a \$971,563 decrease in professional and consulting fees, to \$461,866 for the three months ended June 30, 2007, compared to \$1,433,429 for the three months ended June 30, 2006, which decrease is largely attributable to 600,000 shares of common stock issued to a consulting firm Business Standard, which had a value of \$1,113,000 in connection with the acquisition of three additional licenses by ZNG in June 2006 and to \$276,000 of stock options granted to certain of our consultants during the three months ended June 30, 2006,, which were not represented during the three months ended June 30, 2007; which was offset by a \$349,175 increase in salaries to \$384,426 for the three months ended June 30, 2007, compared to \$35,251 for the three months ended June 30, 2006, mainly attributable to the salary of David Zaikin, who previously agreed during the 2006 fiscal year, including the three months ended June 30, 2006, to not accrue salary, but who since decided as of January 30, 2007, to once again accrue salary from the Company, the 190,000 shares of common stock issued to Mr. Zaikin during the three months ended June 30, 2007, in consideration for services rendered and to the salary of our new President Helen Teplitskaia, which was paid through the issuance of shares of common stock during the three months ended June 30, 2007, as described below, which expenses were not present during the three months ended June 30, 2006.

The \$384,426 of salaries for the three months ended June 30, 2007, included \$22,358 which was attributable to the our Chief Financial Officer, Elena Pochapski, of which \$6,104 was accrued; \$45,000 attributable to the salary of our Chief Executive Officer, David Zaikin, of which such \$45,000 amount was accrued and \$216,600 value of the 190,000 shares issued to David Zaikin (as described below under “Unregistered Sales of Equity Securities”); \$79,800 attributable to the salary of our President Helen Teplitskaia, which was paid through the issuance of 70,000 shares (described below under “Unregistered Sales of Equity Securities”) and certain other amounts which were paid to various other officers, Directors, employees and consultants.

We had a net loss of \$828,038 for the three months ended June 30, 2007, compared to a net loss of \$1,567,913 for the three months ended June 30, 2006, a decrease in net loss of \$739,875 or 47.2% from the prior period. The decrease in net loss was mainly attributable to the \$120,000 or 160% increase in management fees and by the \$619,875 or 39.5% decrease in total expenses, namely the increase in salaries offset by the decrease in professional and consulting fees, for the three months ended June 30, 2007, compared to the three months ended June 30, 2006.

RESULTS OF OPERATIONS FOR THE SIX MONTHS ENDED JUNE 30, 2007, COMPARED TO THE SIX MONTHS ENDED JUNE 30, 2006

We had revenues and other income of \$360,000 for the six months ended June 30, 2007, which was primarily due to \$55,000 of monthly management fees received from ZNG, Ltd for the months of April and May 2007 and monthly management fees of \$85,000 for the month of June 2007. We had \$150,000 of revenue and other income for the six months ended June 30, 2006, due solely to \$150,000 of management fees received. In November 2006, the management fees we received pursuant to our Joint Venture increased from \$25,000 per month to \$55,000 per month and in June 2007, the management fees increased again to \$85,000 per month. Revenues increased \$210,000 or 140% for the six months ended June 30, 2007, compared to the six months ended June 30, 2006, which increase was due solely to the increases in monthly management fees we receive in connection with the Joint Venture

We have not generated any revenues to date through the sale of oil and/or gas.

We had total expenses of \$1,497,131 for the six months ended June 30, 2007, compared to total expenses for the six months ended June 30, 2006, of \$2,037,102, which represented a decrease in total expenses from the prior period of \$539,971 or 26.5%.

The main reason for the decrease in total expenses for the six months ended June 30, 2007, compared to the six months ended June 30, 2006, was a \$924,891 decrease in professional and consulting fees, to \$664,254 for the six months ended June 30, 2007, compared to \$1,589,145 for the six months ended June 30, 2006, which decrease is largely attributable to 600,000 shares of common stock issued to a consulting firm Business Standard, which had a value of \$1,113,000 in connection with the acquisition of three additional licenses by ZNG in June 2006 and to \$276,000 value of stock options granted to certain of our consultants during the six months ended June 30, 2006, which were not represented during the six months ended June 30, 2007, partially offset by increased fees of Business Standard, accrued on a monthly basis starting in January 2007. The decrease in professional and consulting fees was offset by a \$399,507 increase in salaries to \$468,069 for the six months ended June 30, 2007, compared to \$68,562 for the six months ended June 30, 2006, mainly attributable to the salary of David Zaikin, who previously agreed during the 2006 fiscal year, including the six months ended June 30, 2006, to not accrue salary, but who since decided as of January 30, 2007, to once again accrue salary from the Company, and the 190,000 shares of common stock issued to Mr. Zaikin during the three months ended June 30, 2007, in consideration for services rendered and to the salary of our new President Helen Teplitskaia, which was paid through the issuance of shares of common stock during the six months ended June 30, 2007, as described below, which expenses were not present during the six months ended June 30, 2006.

The \$468,069 of salaries for the six months ended June 30, 2007, included \$40,418 which was attributable to the our Chief Financial Officer, Elena Pochapski, of which \$6,104 was accrued; \$90,000 attributable to the salary of our Chief Executive Officer, David Zaikin, of which such \$90,000 amount was accrued and \$216,600 value of the 190,000 shares issued to David Zaikin (as described below under "Unregistered Sales of Equity Securities"); \$79,800 attributable to the salary of our President Helen Teplitskaia, which was paid through the issuance of 70,000 shares (described below under "Unregistered Sales of Equity Securities"); and certain other amounts which were paid to various other officers, Directors, employees and consultants.

We had a net loss of \$1,137,131 for the six months ended June 30, 2007, compared to a net loss of \$1,887,102 for the six months ended June 30, 2006, a decrease in net loss of \$749,971 or 39.7% from the prior period. The decrease in net loss was mainly attributable to the \$210,000 or 140% increase in management fees and by the \$539,971 or 26.5% decrease in total expenses, namely the decrease in professional and consulting fees, described above, offset by the increase in salaries for the six months ended June 30, 2007, compared to the six months ended June 30, 2006.

LIQUIDITY AND CAPITAL RESOURCES

We had current assets of \$199,891 as of June 30, 2007, which included cash of \$2,791; management fee receivable of \$85,000, which represented amounts owed to us by ZNG, Ltd. in management fees, which amount has been paid to date; and prepaid expenses and other of \$112,100.

We had total assets of \$2,903,844 as of June 30, 2007, which included current assets of \$199,891 and non-current assets of \$2,703,953. Non-current assets included \$2,700,000 of oil and gas properties, unproved, representing geological studies and data, which we received in connection with the purchase of KNG and \$3,953 of property and equipment, net.

We had total liabilities of \$1,650,574 as of June 30, 2007, which were solely current liabilities and which included \$365,814 of accounts payable to related party stockholders in connection with those shareholders paying certain of our expenses from the period between January 1, 2003 to June 30, 2007; \$53,628 of accounts payable to Baltic in connection with a \$29,000 loan advanced to the Company from Baltic and certain other expenses owed to Baltic; \$532,348 of accounts payable to others for advisory and professional services rendered; and \$698,784 of accrued payroll, which included \$419,100 payable to our Chief Executive Officer, David Zaikin of which \$216,600 was paid to Mr. Zaikin in July 2007, through the issuance of 190,000 shares (described below under "Unregistered Sales of Equity Securities"), \$90,000 relating to Mr. Zaikin's salary for the six months ended June 30, 2007, which amount has been accrued, and \$112,500 which was owed to Mr. Zaikin for services rendered prior to September 2005, at which time he agreed to stop accruing salary until January 2007, when he provided us notice of his intent to once again begin accruing salary until such time as we have sufficient funds to pay such accrued salary, \$90,811 payable to our Chief Financial Officer, Elena Pochapski, and \$69,242 of accrued salary payable to our former Chief Executive Officer, Shakeel Adam.

We had negative working capital of \$1,450,683 and a total pre development and development stage accumulated deficit of \$6,805,486 as of June 30, 2007.

Because our cumulative losses associated with the operations of ZNG exceeded our investment as of the date of the Joint Venture, ZNG is carried on our balance sheet at \$-0- as of June 30, 2007. Our investment in ZNG will exceed \$-0- at such time as ZNG has cumulative earnings sufficient to repay all loans to Baltic as provided in the Joint Venture, if ever.

We had \$8,784 of net cash flows for operating activities for the six months ended June 30, 2007, which resulted from payment of current liabilities through the issuance of common stock, particularly common stock and warrants worth \$1,461,084 were issued for professional services and salaries offset by a \$233,556 increase in accounts payable and accrued expenses, and \$1,137,131 of net loss.

Pursuant to the Deed of Agreement, whereby Baltic agreed to loan ZNG approximately \$12,000,000 to be used on seismic studies, the budget for the current program of seismic studies and drilling of the first four wells on ZNG's licenses in 2007 was adopted by ZL's Board. This budget amounted to US \$14,998,000, or approximately \$8 million British pounds. These funds were raised by Baltic's parent company through a placement of shares. Of the total budgeted amount of \$14,998,000, the sum of \$9,659,000 is being provided through the ZNG loans described earlier and the sum of \$5,339,000 is committed to be provided to ZNG, Ltd. The loans will not be dilutive to the Company's ownership in ZNG.

As of June 30, 2007, ZNG had received \$10,107,000 pursuant to the New Loan, which amount includes \$1,110,624 assumed by ZNG in connection with a previous loan made to ZNG. Total interest accrued as of June 30, 2007 was \$1,115,000, including accrued interest on the previous loan. The total funding provided to ZNG, Ltd. and ZNG by Baltic as of June 30, 2007 was equal to \$17.2 million plus accrued interest of approximately \$1.9 million.

Under the Joint Venture, we currently receive \$85,000 per month as a management fee from ZNG, Ltd. In addition to the monthly management fee, ZNG Ltd. agreed to lend \$78,000 to us to pay for legal and consulting services in connection with establishing the Joint Venture. We received \$29,000 of this amount in November 2005; and will receive the additional \$49,000 if all five of the new licenses are awarded to ZNG, of which three have been awarded to date, and ZNG submits a letter from the relevant license authority of the Ministry of Natural Resources of the Russian Federation confirming such awards, of which there can be no assurance.

Since our transfer of ZNG to the Joint Venture, our only oil and gas operations separate from our ownership of 50% of ZNG, Ltd. has been through KNG, and we hope to be awarded oil and gas exploration licenses in connection with KNG during 2007. Moving forward, we believe that in the long run a number of trends will favorably affect our liquidity. These trends include the steady trend of economic growth in Russia in the recent years which is improving the liquidity of our potential customers, and may favorably impact our debt management and the increasing overall credit rating in Russia, which we hope will lead to increased foreign investment in Russian companies and which will benefit us as well.

We are taking steps in an attempt to raise equity capital and/or to borrow additional funds. There can be no assurance that any new capital will be available to us or that adequate funds for our operations, whether from our financial markets, or other arrangements will be available when needed or on terms satisfactory to us, if at all. We have no commitments from officers, directors or affiliates to provide funding. Our failure to obtain adequate financing may require us to delay, curtail or scale back some or all of our operations. Additionally, any additional financing may involve dilution to our then-existing shareholders.

RISK FACTORS

Our securities are highly speculative and should only be purchased by persons who can afford to lose their entire investment in our Company. If any of the following risks actually occur, our business and financial results could be negatively affected to a significant extent. The Company's business is subject to many risk factors, including the following:

RISK OF CONTINUING OUR BUSINESS PLAN WITHOUT ADDITIONAL FINANCING.

We depend to a great degree on the ability to attract external financing in order to conduct future exploratory and development activities. The Company believes it can satisfy its cash requirements during the next twelve months through funding provided by existing stockholders and with amounts received from the Joint Venture (described above), including \$85,000 a month which the Company is to receive from ZNG, Ltd., pursuant to the Joint Venture. Additionally, ZNG has received approximately \$1,110,624 from BP pursuant to a prior loan and another \$8,996,376 pursuant to the New Loan, which had a total outstanding balance, including the assumed balance of the prior loan and accrued and unpaid interest on the prior loan and the New Loan as of June 30, 2007, of \$10,107,000, which has been spent on various purposes, including paying consultants for services performed in connection with surveys previously performed on the licensed area. As the Joint Venture is now responsible for the funding of the operations of ZNG, we believe our expenditures in connection with ZNG will decrease in the upcoming periods. If we are unable to raise the additional funds required for the planned activities of the Joint Venture and for additional activities, separate from the Joint Venture, our Company may be forced to abandon its current business plan. If you invest in our Company and we are unable to raise the required funds, your investment could become worthless.

WE WILL NEED SUBSTANTIAL FINANCING AND SUBSTANTIAL TIME BEFORE WE ANTICIPATE GENERATING REVENUES THROUGH OUR OWNERSHIP OF ZNG, LTD., IF ANY.

The Company does not expect to generate any revenues through the operations of ZNG, other than the \$85,000 a month that it will receive from ZNG, Ltd., of which there can be no assurance. Therefore, investors should keep in mind that even if ZNG is able to raise the substantial amounts of additional financing it requires for its operations, it could still be years before ZNG generates any revenue, if ever. Even if generated such revenues will likely not be great enough to sustain ZNG. If no revenues are generated and hydrocarbon reserves are not located, we may be forced to abandon or curtail our current business plan. If ZNG, which is 100% owned by the Company 50/50 joint venture ownership of ZNG, Ltd., were forced to abandon its business plan, the Company could be forced to abandon or curtail its business plan as well, which could cause the value of the Company's common stock to become worthless.

WE WILL NEED SUBSTANTIAL FINANCING AND SUBSTANTIAL TIME BEFORE WE ANTICIPATE GENERATING REVENUES THROUGH KNG, IF ANY.

The Company anticipates the need for approximately \$15,000,000 prior to KNG's expected generation of any revenues. Currently the Company has not raised any of this financing and the Company can make no assurances that this financing will ever be raised. The Company also does not expect to generate any revenues through the operations of KNG, until such financing can be raised, of which there can be no assurance. Therefore, investors should keep in mind that even if KNG is able to raise the substantial amounts of additional financing it requires for its operations, it could still be years before KNG generates any revenue, if ever. If KNG does not raise the \$15,000,000 which it anticipates needing to generate revenues, which, even if generated, will likely not be great enough to sustain KNG if no revenues are generated and hydrocarbon reserves are not discovered, KNG may be forced to abandon its business plan, and the Company could be forced to abandon or curtail its business plan as well, which could cause the value of the Company's common stock to become worthless.

OUR AUDITORS HAVE EXPRESSED SUBSTANTIAL DOUBT AS TO WHETHER OUR COMPANY CAN CONTINUE AS A GOING CONCERN.

Our Company is in its early development stage, as planned principal activities have not begun. We have generated only minimal revenues since inception and have incurred substantial losses including a net loss of \$3,080,336 for the year ended December 31, 2006, a net loss of \$1,137,131 for the six months ended June 30, 2007 and a total accumulated deficit of \$6,805,486 as of June 30, 2007. These factors among others indicate that the Company may be unable to continue as a going concern, particularly in the event that it cannot generate sufficient cash flow to conduct its operations and/or obtain additional sources of capital and financing.

WE LACK AN OPERATING HISTORY WHICH YOU CAN USE TO EVALUATE US, MAKING ANY INVESTMENT IN OUR COMPANY RISKY.

Our Company lacks a long standing operating history which investors can use to evaluate our Company's previous earnings. Therefore, an investment in our Company is risky because we have no business history and it is hard to predict what the outcome of our business operations will be in the future.

WE MAY CONTINUE TO BE UNPROFITABLE AND MAY NOT GENERATE PROFITS TO CONTINUE OUR BUSINESS PLAN.

As a development stage company, we have no revenues or profits to date and our net cumulative deficit attributable to our development stage as of June 30, 2007, was \$6,355,701, and our total cumulative deficit was \$6,805,486 which included \$449,785 of pre-development stage deficit. We had \$698,784 in accrued and unpaid salaries and a working capital deficit of \$1,450,683 as of June 30, 2007. The Company is currently being funded by existing shareholders and the \$85,000 monthly payments, which the Company receives from the Joint Venture in connection with management fees, but there can be no assurance this amount will be sufficient to continue our planned operations or that we will have enough money to repay our outstanding debts. There is a risk that ZNG will never begin production and our Company will never generate any revenues through our ownership of ZNG, Ltd. There is also a risk that KNG will not be awarded the licenses for which it has applied. If throughout ZNG's oil exploration (and KNG's, assuming it is awarded the licenses for which it has applied, of which there can be no assurance), no viable wells are found, and consequently, we generate only minimal revenues through ZNG, Ltd. (and/or through KNG), we will likely be forced to curtail or abandon our business plan. If this happens, you could lose your investment in our Company. If we are unable to generate profits, we will be forced to rely on external financing, of which there is no guarantee, to continue with our business plan.

WE HAVE A POOR FINANCIAL POSITION AND IF WE DO NOT GENERATE REVENUES, WE MAY BE FORCED TO ABANDON OUR BUSINESS PLAN.

Our Company currently has a poor financial position. We have generated only minimal revenues to date, and we have not discovered any hydrocarbon reserves or begun production on any wells. There is a risk that we will not find enough, or even any, viable wells which we require to generate enough profits for your investment in our Company to appreciate. If we never generate any revenues, our Company may be forced to curtail or abandon its business plan and your shares may become worthless.

OUR BUSINESS IS SPECULATIVE AND RISKY AND IF ZNG OR KNG DOES NOT FIND HYDROCARBON RESERVES, WE MAY BE FORCED TO CURTAIL OUR BUSINESS PLAN.

There is a risk that ZNG and KNG, assuming it is awarded the licenses for which it has applied, of which there can be no assurance, will not find any hydrocarbon reserves and the cost of exploration will become too high for ZNG, Ltd. to continue ZNG's business plan and/or us to continue KNG's business plan. As our only current operations are through our 50% ownership of ZNG, Ltd. which in turn owns 100% of ZNG, and through KNG, if ZNG, ZNG, Ltd. or KNG were to cease operations, your investment in our Company could become devalued or could become worthless.

OUR INDUSTRY IS COMPETITIVE AND AS SUCH, COMPETITIVE PRESSURES COULD PREVENT US FROM OBTAINING PROFITS.

The main factor determining success in the oil exploration and extraction industry is finding viable wells. If our Company, through ZNG, Ltd., KNG or other joint ventures we may enter into in the future, are unable to find producing wells and our competition is, it is likely that our Company will be driven out of business. Additionally, our industry is subject to significant capital requirements and as such, larger companies such as LUKoil, BP-TNK, Surgutneftegaz and Sibneft may have an advantage should they compete with us for exploration licenses, because they may have resources substantially greater than ours. Investors should take into account the above factors and understand that if we are unable to raise additional capital or generate the profits, the Company may be forced to liquidate its assets and an investment in our Company could become worthless.

OUR GROWTH WILL PLACE SIGNIFICANT STRAINS ON OUR RESOURCES.

The Company's growth is expected to place a significant strain on the Company's managerial, operational and financial resources. Furthermore, as the Company receives contracts, the Company will be required to manage multiple relationships with various customers and other third parties. These requirements will be exacerbated in the event of further growth of the Company or in the number of its contracts. There can be no assurance that the Company's systems, procedures or controls will be adequate to support the Company's operations or that the Company will be able to achieve the rapid execution necessary to succeed and implement its business plan. The Company's future operating results will also depend on its ability to add additional personnel commensurate with the growth of its business. If the Company is unable to manage growth effectively, the Company's business, results of operations and financial condition will be adversely affected.

WE RELY ON KEY PERSONNEL AND IF THEY LEAVE OUR COMPANY OUR BUSINESS PLAN COULD BE ADVERSELY AFFECTED.

We rely on the Company's Chief Executive Officer and Chief Financial Officer, David Zaikin and Elena Pochapski, for the success of our Company, both of whom are employed under contracts. Their experience and input create the foundation for our business and they are responsible for the directorship and control over the Company's development activities. The Company does not hold "key man" insurance on either member of management. Moving forward, should they be lost for any reason, the Company will incur costs associated with recruiting replacement personnel and any potential delays in operations. If we are unable to replace Mr. Zaikin and/or Ms. Pochapski, the Company may be forced to scale back or curtail its business plan. As a result of this, any securities you hold in our Company could become devalued.

ZNG'S OR KNG'S PROJECTIONS, ESTIMATES AND STATISTICAL ANALYSIS MAY BE INACCURATE OR SUBSTANTIALLY WRONG, WHICH MAY PREVENT ZNG AND/OR KNG FROM EXECUTING THEIR BUSINESS PLANS.

Projections on future revenues as well as costs and required capital expenditures are based on estimates. Business statistical analysis is used in projection of drilling success ratios, average production costs, world oil price fluctuations and their correspondence to Russian domestic market. If ZNG's or KNG's projections or estimates are wrong or our statistical analysis faulty, ZNG's or KNG's revenues may be adversely affected which could prevent ZNG and/or KNG from executing their business strategy. As an investor, if this happens your securities in our Company could be adversely affected and you could lose your investment in our Company due to the fact that our only current oil and gas operations are through our 50% ownership of ZNG, Ltd., which in turn owns 100% of ZNG and through KNG, which has applied for, but not been awarded any licenses to date.

THERE IS UNCERTAINTY AS TO OUR ABILITY TO ENFORCE CIVIL LIABILITIES BOTH IN AND OUTSIDE OF THE UNITED STATES DUE TO THE FACT THAT OUR OFFICERS, DIRECTORS AND ASSETS ARE NOT LOCATED IN THE UNITED STATES.

Our officers and Directors, our properties and licenses, and the majority of our assets are located in countries other than the United States, including Canada and Russia. As a result, it may be difficult for shareholders to effect service of process within the United States on our officer and Director. In addition, investors may have difficulty enforcing judgments based upon the civil liability provisions of the securities laws of the United States or any state thereof, both in and outside of the United States.

WE FACE RISKS ASSOCIATED WITH THE FACT THAT THE MAJORITY OF OUR OPERATIONS THROUGH OUR JOINT VENTURE ARE CONDUCTED IN RUSSIA, AND THE LICENSES OWNED THROUGH OUR JOINT VENTURE ARE IN RUSSIA.

Zauralneftegaz, Ltd. which we own 50% of through our Joint Venture holds licenses to certain oil and gas properties in the Kurgan Region of Russia. As a result, we are subject to various risks associated with doing business in Russia relating to Russia's economic and political environment. As is typical of an emerging market, Russia does not possess a well-developed business, legal and regulatory infrastructure that would generally exist in a more mature free market economy and, in recent years, Russia has undergone substantial political, economic and social change. Furthermore, in recent years the Russian government has unilaterally annexed certain oil and gas properties and companies for the government, and there can be no assurance that if commercially exploitable oil and gas reserves are found on our properties, that such properties will not be annexed or otherwise claimed by the Russian government. Our failure to manage the risks associated with doing business in Russia could have a material adverse effect upon our results of operations.

IF WE ARE LATE IN FILING OUR QUARTERLY OR ANNUAL REPORTS WITH THE SEC, WE MAY BE DE-LISTED FROM THE OVER-THE-COUNTER BULLETIN BOARD.

Under Over-The-Counter Bulletin Board ("OTCBB") rules relating to the timely filing of periodic reports with the SEC, any OTCBB issuer who fails to file a periodic report (Form 10-QSB's or 10-KSB's) by the due date of such report (not withstanding any extension granted to the issuer by the filing of a Form 12b-25), three (3) times during any twenty-four (24) month period are de-listed from the OTCBB. Such removed issuer would not be re-eligible to be listed on the OTCBB for a period of one-year, during which time any subsequent late filing would reset the one-year period of de-listing. Therefore, if we are late in filing a periodic report three times in any twenty-four (24) month period and are de-listed from the OTCBB, our securities may become worthless and we may be forced to curtail or abandon our business plan.

IN THE FUTURE, WE WILL INCUR SIGNIFICANT INCREASED COSTS AS A RESULT OF OPERATING AS A FULLY REPORTING COMPANY AND OUR MANAGEMENT WILL BE REQUIRED TO DEVOTE SUBSTANTIAL TIME TO NEW COMPLIANCE INITIATIVES.

Moving forward, we anticipate incurring significant legal, accounting and other expenses in connection with our status as a fully reporting public company. The Sarbanes-Oxley Act of 2002 (the "Sarbanes-Oxley Act") and new rules subsequently implemented by the SEC have imposed various new requirements on public companies, including requiring changes in corporate governance practices. As such, our management and other personnel will need to devote a substantial amount of time to these new compliance initiatives. Moreover, these rules and regulations will increase our legal and financial compliance costs and will make some activities more time-consuming and costly. For example, we expect these new rules and regulations to make it more difficult and more expensive for us to obtain director and officer liability insurance, and we may be required to incur substantial costs to maintain the same or

similar coverage. In addition, the Sarbanes-Oxley Act requires, among other things, that we maintain effective internal controls for financial reporting and disclosure of controls and procedures. In particular, commencing in fiscal 2008, we must perform system and process evaluation and testing of our internal controls over financial reporting to allow management and our independent registered public accounting firm to report on the effectiveness of our internal controls over financial reporting, as required by Section 404 of the Sarbanes-Oxley Act. Our testing, or the subsequent testing by our independent registered public accounting firm, may reveal deficiencies in our internal controls over financial reporting that are deemed to be material weaknesses. Our compliance with Section 404 will require that we incur substantial accounting expense and expend significant management efforts. We currently do not have an internal audit group, and we will need to hire additional accounting and financial staff with appropriate public company experience and technical accounting knowledge. Moreover, if we are not able to comply with the requirements of Section 404 in a timely manner, or if we or our independent registered public accounting firm identifies deficiencies in our internal controls over financial reporting that are deemed to be material weaknesses, the market price of our stock could decline, and we could be subject to sanctions or investigations by the SEC or other regulatory authorities, which would require additional financial and management resources.

AS THERE IS CURRENTLY ONLY A LIMITED MARKET FOR OUR COMMON STOCK, THE MARKET FOR OUR COMMON STOCK MAY CONTINUE TO BE ILLIQUID, SPORADIC AND VOLATILE.

There is currently only a limited market for our common stock, and as such, we anticipate that such market will be illiquid, sporadic and subject to wide fluctuations in response to several factors moving forward, including, but not limited to:

- (1) actual or anticipated variations in our results of operations;
- (2) our ability or inability to generate new revenues;
- (3) the number of shares in our public float;
- (4) increased competition;
- (5) the political atmosphere in Russia; and
- (6) conditions and trends in the oil, gas, and energy industries in general.

Furthermore, because our common stock is traded on the NASD Over The Counter Bulletin Board, our stock price may be impacted by factors that are unrelated or disproportionate to our operating performance. These market fluctuations, as well as general economic, political and market conditions, such as recessions, interest rates or international currency fluctuations may adversely affect the market price of our common stock. Additionally, at present, we have a limited number of shares in our public float, and as a result, there could be extreme fluctuations in the price of our common stock. Further, due to the limited volume of our shares which trade and our limited public float, we believe that our stock prices (bid, ask and closing prices) are entirely arbitrary, are not related to the actual value of the Company, and do not reflect the actual value of our common stock (and in fact reflect a value that is much higher than the actual value of our common stock). Shareholders and potential investors in our common stock should exercise caution before making an investment in the Company, and should not rely on the publicly quoted or traded stock prices in determining our common stock value, but should instead determine value of our common stock based on the information contained in the Company's public reports, industry information, and those business valuation methods commonly used to value private companies.

INVESTORS MAY FACE SIGNIFICANT RESTRICTIONS ON THE RESALE OF OUR COMMON STOCK DUE TO FEDERAL REGULATIONS OF PENNY STOCKS.

Our common stock will be subject to the requirements of Rule 15(g)9, promulgated under the Securities Exchange Act as long as the price of our common stock is below \$4.00 per share. Under such rule, broker-dealers who recommend low-priced securities to persons other than established customers and accredited investors must satisfy special sales practice requirements, including a requirement that they make an individualized written suitability determination for the purchaser and receive the purchaser's consent prior to the transaction. The Securities Enforcement Remedies and Penny Stock Reform Act of 1990, also requires additional disclosure in connection with any trades involving a stock defined as a penny stock. Generally, the Commission defines a penny stock as any equity security not traded on an exchange or quoted on NASDAQ that has a market price of less than \$4.00 per share. The required penny stock disclosures include the delivery, prior to any transaction, of a disclosure schedule explaining the penny stock market and the risks associated with it. Such requirements could severely limit the market liquidity of the securities and the ability of purchasers to sell their securities in the secondary market.

In addition, various state securities laws impose restrictions on transferring "penny stocks" and as a result, investors in the common stock may have their ability to sell their shares of the common stock impaired.

ITEM 3. CONTROLS AND PROCEDURES

(a) Evaluation of disclosure controls and procedures. Our Chief Executive Officer and Principal Financial Officer, after evaluating the effectiveness of our "disclosure controls and procedures" (as defined in the Securities Exchange Act of 1934 Rules 13a-15(e) and 15d-15(e)) as of the end of the period covered by this Quarterly Report on Form 10-QSB (the "Evaluation Date"), have concluded that as of the Evaluation Date, our disclosure controls and procedures are effective to provide reasonable assurance that information we are required to disclose in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Principal Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

(b) Changes in internal control over financial reporting. There were no changes in our internal control over financial reporting during our most recent fiscal quarter that materially affected, or were reasonably likely to materially affect, our internal control over financial reporting.

PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

In January 2007, we learned that certain of our former officers, Directors and shareholders, had attempted to transfer shares of our common stock, which those individuals had agreed to cancel in connection with the purchase of a majority of the Company's outstanding shares from those individuals by our current officers, Directors and majority shareholders in April 2003. In February 2007, we filed for a Temporary Restraining Order and Motion for Preliminary Injunction against those individuals in the District Court of Clark County, Nevada.

On February 20, 2007, our Temporary Restraining Order and Motion for Preliminary Injunction was heard by the District Court of Clark County, Nevada, and we were granted an indefinite injunction without a hearing by the court. As such, those individuals who previously attempted to transfer and sell the shares which they held will be prevented from transferring or selling such shares until they can show good cause with the court why such indefinite injunction should be lifted.

From time to time, we may become party to other litigation or other legal proceedings that we consider to be a part of the ordinary course of our business. We are not currently involved in legal proceedings that could reasonably be expected to have a material adverse effect on our business, prospects, financial condition or results of operations, other than the proceeding described above. We may become involved in material legal proceedings in the future.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES

In April 2007, we issued 35,000 restricted shares of common stock to Uptick Capital in connection with the agreement with Uptick Capital entered into in January 2007 (as described above) for services rendered during the months of February, March, April and half of May 2007. We claim an exemption from registration afforded by Section 4(2) of the Securities