

Siberian Energy Group Inc.
Form 10-K
April 15, 2011

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

FORM 10-K

(Mark One)

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

For the fiscal year ended December 31, 2010

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

For the transition period from _____ to _____

Commission file number: 000-53766

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)

330 Madison Ave, 6th Floor, New York, New York 10017
(Address of principal executive offices)

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

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

Securities registered under Section 12(b) of the Exchange Act:

NONE

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Securities registered under Section 12(g) of the Exchange Act:

Common Stock, \$0.001 par value
(Title of Class)

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

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

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

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

Indicated by check mark if disclosure of delinquent filers in response to Item 405 of Regulation S-K is not contained in this form, and no disclosure will be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Large accelerated filer Accelerated filer
Non-accelerated filer Smaller reporting company
(Do not check if a smaller reporting company)

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

The issuer's revenues for the most recent fiscal year ended December 31, 2010 were \$0.

The aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the closing value of the Registrant's common stock on June 29, 2010 (the nearest closing date prior to, as there was no closing price of the Registrant's common stock on June 30, 2010), was approximately \$1,222,620.

As of April 8, 2011, the issuer had 667,659 shares of common stock, \$0.001 par value per share outstanding, which number does not include 429 shares which the registrant has agreed to issue to its President, Helen Teplitskaia for services rendered during the months of January through March 2011, which shares have not been issued to date and have not been included in the total number of outstanding shares disclosed throughout this report.

Documents Incorporated by Reference: NONE

Transitional Small Business Disclosure Format: Yes No

SIBERIAN ENERGY GROUP INC.
FORM 10-K
YEAR ENDED DECEMBER 31, 2010
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PART I

ITEM 1. BUSINESS

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

CERTAIN STATEMENTS IN THIS ANNUAL REPORT ON FORM 10-K (THIS "FORM 10-K"), INCLUDING STATEMENTS UNDER "ITEM 1. BUSINESS," AND "ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS", 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. AND KONDANEFTEGAZ, LLC, A RUSSIAN LIMITED LIABILITY, THE REGISTRANT'S 44% OWNED SUBSIDIARY, AND ZAURALNEFTEGAZ LIMITED, A COMPANY ORGANIZED UNDER THE LAWS OF THE COUNTRY OF ENGLAND, WHICH THE REGISTRANT OWNS 50% OF (COLLECTIVELY "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-K, UNLESS ANOTHER DATE IS STATED, ARE TO DECEMBER 31, 2010.

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

BUSINESS DEVELOPMENT:

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

On September 17, 1999, the Company affected a 1-for-30 reverse stock split. A subsequent 3-for-1 forward split was consummated on October 2, 2000 and a further 1:2 reverse stock split was affected on May 2, 2005. As described below, effective March 15, 2011, the Company affected a 1:70 reverse stock split with the shares held by remaining shareholders rounded up to a minimum of 100 shares on a per shareholder basis (collectively the "Stock Splits"). All share amounts, trading prices, and option and warrant exercise prices, subsequently listed are retroactively adjusted to reflect these Stock Splits unless otherwise provided.

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

On May 9, 2003, the Company entered into an Acquisition Agreement (the "Acquisition Agreement") by and among the Company, Zaural Neftegaz, a Russian corporation ("ZNG"), the shareholders of ZNG and Oleg Zhuravlev, President of ZNG, and a former Director of the Company. Pursuant to the Acquisition Agreement, the Company

acquired a 51% interest in ZNG by issuing to ZNG 28,571 shares of the Company's common stock. In June 2004, the Company purchased the remaining 49% of ZNG in exchange for 98,571 shares of the Company's common stock, making ZNG a wholly-owned subsidiary of the Company. The Company had no affiliation with ZNG prior to the acquisition in May 2003.

The activities of ZNG were carried out through the Joint Venture Shareholders' Agreement ("Joint Venture") entered into on October 14, 2005 with Baltic Petroleum (E&P) Limited ("BP" or "Baltic") and Zauralneftegaz Limited, the joint venture company ("ZNG, Ltd."), as contemplated by the Option Agreement, as amended (the "Option"). The Company closed the Joint Venture and transferred 100% of the outstanding stock of ZNG to ZNG, Ltd. in connection with the terms and conditions of the Joint Venture. As a result of such transfer, the Company holds 50% of the outstanding stock of ZNG, Ltd., which holds 100% of the outstanding stock of the Company's former wholly-owned subsidiary, ZNG. ZNG, Ltd. operates through ZNG and is engaged in the exploration and development of, production and sale of, oil and gas assets in the Western Siberian region of the Russian Federation and the former Soviet Union.

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

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

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

BUSINESS OPERATIONS:

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

We currently hold investments in ZNG, Ltd. and KNG. Both companies are involved in oil and gas exploration in the Western Siberia region of Russia; provided however, as described below, ZNG, Ltd. has advised us that it will no longer undertake any further exploration activities in Western Siberia and we have recently been advised that KNG has determined not to undertake any further exploration activities. As a result, we are currently seeking out additional oil and gas acquisition opportunities in Russia at this time and do not anticipate ZNG, Ltd. or KNG generating any revenues moving forward.

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

Description of KNG

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

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

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

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

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

KNG previously prepared and coordinated with the Russian authorities an exploration works program on the Karabashski-61 and Karabashski-67 license areas. Certain preliminary exploration activities were performed on the licensed areas over the past several years; however, KNG recently determined to cease exploration activities on the licensed areas at this time. As such, we do not anticipate KNG generating any revenues moving forward. The Company is currently evaluating spinning off its investment in KNG and focusing its attention on the acquisition of assets in producing fields, funding permitting, as described in further detail under “Plan of Operations For The Next Twelve Months.”

As of December 31, 2010, the Company owned a 44% interest in KNG. Effective September 30, 2008, the Company’s 44% investment in KNG is recorded on the equity method of accounting. The operations of KNG prior to September 30, 2008 are included in the consolidated accounts of the Company in the accompanying financial statements.

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

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Description of ZNG

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

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

The Company's investment in the Joint Venture is recorded on the equity method of accounting. Since cumulative losses of Joint Venture exceed the Company's investment, the investment asset is carried at zero value as of and through December 31, 2010.

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

Joint Venture

The operations of the Joint Venture were funded via loans provided to ZNG, Ltd. and ZNG by Caspian Finance Limited ("Caspian"), a financing company wholly-owned by Baltic. Loans are guaranteed by ZNG, Ltd.'s holdings in ZNG. As of December 31, 2010, the total funding provided to ZNG, Ltd. and ZNG by Baltic was equal to approximately \$23.5 million plus accrued interest of approximately \$5 million. The loans are not dilutive to the Company's ownership in ZNG.

Recent Events:

In August 2010, and effective as of July 1, 2010, the Company entered into extensions to the Employment Agreements of David Zaikin, its Chairman and Chief Executive Officer and Elena Pochapski, its Director and Chief Financial Officer, which Employment Agreements were extended until December 31, 2010. Mr. Zaikin's Employment Agreement extension set his annual compensation at \$180,000 and Ms. Pochapski's Employment Agreement extension set her annual compensation at \$75,000.

In October 2010, the Company entered into Debt Conversion Agreements with nine (9) creditors of the Company (the majority of which were shareholders and related parties of the Company), pursuant to which such creditors agreed to convert an aggregate of \$2,554,460 of debt owed to such creditors by the Company and accrued and unpaid interest thereon, which debt represented loans previously provided by the creditors to the Company, accrued and unpaid salary and other debts owed to the creditors by the Company, into 331,748 shares of restricted common stock of the Company (representing approximately 55% of the Company's then outstanding shares, at the rate of one share for each

\$7.70 of debt converted (the “Conversion”). The Conversion price of \$7.70 per share was calculated based on the average market price of the Company’s common stock for the six months prior to September 30, 2010.

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Included in the creditors who agreed to the Conversions were Alternative Energy Finance (which is an entity controlled by Timothy Pearsa, a Director of the Company), which converted \$158,924 of debt owed to it by the Company into 20,640 shares of restricted common stock (representing approximately 3.4% of the Company's then outstanding common stock); Timothy Pearsa, who converted \$147,537 of debt owed to him by the Company into 19,161 shares of restricted common stock (representing approximately 3.2% of the Company's then outstanding common stock); Elena Pochapski, the Company's Chief Financial Officer and Director, who converted \$298,832 owed to her by the Company into 38,809 shares of restricted common stock (representing approximately 6.5% of the Company's then outstanding common stock); and David Zaikin, the Company's Chief Executive Officer and Director, who converted \$1,153,228 of debt owed to him by the Company into 149,770 shares of restricted common stock (representing approximately 24.9% of the Company's then outstanding common stock). Additionally, Business Standard, a consultant of the Company, converted \$607,975 of debt owed to it by the Company into 78,958 shares of common stock (representing 13.2% of the Company's then outstanding common stock).

A form of the Debt Conversion Agreements is incorporated by reference as Exhibit 10.44 herewith.

On February 28, 2011, the Company held an Annual Meeting of Stockholders (the "Meeting"). The Meeting was announced and disclosed pursuant to the Schedule 14C Information Statement Filing, filed with the Securities and Exchange Commission on January 14, 2011, notice of which was mailed to shareholders of the Company on or around January 17, 2011. Present at the Meeting was David Zaikin, the Company's Chief Executive Officer and Director. Certain of the Company's officers, Directors and affiliates, including Elena Pochapski, our Chief Financial Officer and Director; Timothy Pearsa, our Director; Helen Teplitskaia, our President and Director; and Business Standard, a significant shareholder of the Company (the "Majority Shareholders"), provided Mr. Zaikin voting proxies to vote the shares of common stock which they held as of January 7, 2011, the record date of the Meeting (the "Record Date"). As of the Record Date, Mr. Zaikin, both personally and as a result of the voting proxies obtained from the Majority Shareholders had the right to vote an aggregate of 346,310 shares of our common stock or 57.5% of our outstanding common stock as of the Record Date.

At the Meeting, Mr. Zaikin, voting all of the shares described above, approved the Proposals (as defined below), which included the filing of a Certificate of Amendment to our Articles of Incorporation with the Secretary of State of Nevada (the "Amendment") to affect a 1:70 reverse stock split of our outstanding common stock and to re-authorize 100,000,000 shares of common stock, \$0.001 par value per share and 10,000,000 shares of preferred stock, \$0.001 par value per share; provided that no shareholder following the reverse split will hold less than 100 shares of common stock and any fractional shares left after the reverse split will be rounded up to the nearest whole share on a per shareholder basis (the "Rounding").

The Amendment was filed with and became effective with the Secretary of State of Nevada on March 4, 2011; provided however that the reverse split did not become effective with the Financial Industry Regulatory Authority ("FINRA") until March 15, 2011. As a result of the filing of the Amendment and the reverse split, the Company had approximately 667,659 post- reverse split shares of common stock issued and outstanding (after taking into account the Rounding) and 100,000,000 shares of common stock, \$0.001 par value per share and 10,000,000 shares of preferred stock, \$0.001 par value per share, authorized.

Additionally, as a result of the above, the Company's symbol on the OTC Pinks (the Company was automatically delisted from the Over-The-Counter Bulletin Board (the "OTCBB") on February 22, 2011, due to the failure of a market maker to quote the Company's common stock on the OTCBB for the time period required under FINRA rules and regulations and re-quoted on the OTCBB on March 22, 2011) changed to "SIBND", effective March 15, 2011, which symbol will change back to "SIBN" after twenty business days.

At the Meeting, Mr. Zaikin voted 346,310 shares of our common stock or 57.5% of our outstanding common stock (which included shares held by the Majority Shareholders, who provided voting proxies to Mr. Zaikin to vote such shares held by the Majority Shareholders at the Meeting) in favor of and to approve the following items (the "Proposals"), which were approved, confirmed and ratified at the Meeting (no votes were cast against or withheld in connection with the Proposals to come before the Meeting, and no broker non-votes were cast at the Meeting):

1. To re-elect David Zaikin, Elena Pochapski, Helen Teplitskaia and Timothy Pears as Directors of the Company;
2. To authorize and approve the Amendment and reverse split;
3. To approve and ratify the Company's 2010 Stock Incentive Plan (described in greater detail below); and
4. To ratify the appointment of Lumsden & McCormick, LLP, as the Company's independent auditors for the fiscal years ending December 31, 2011 and 2010.

Estimate of Amount of Time Spent On Research and Development

An initial business plan was developed over the course of three months in 2003. During that time period, market research was conducted. Research and development activities on the licensed blocks in the Kurgan Region were directly borne by the Company up to the time the Joint Venture was closed in October 2005. Research activities include gravimetric, seismic works and seismotomography studies on the previously licensed areas. Costs incurred by ZNG and ZNG Ltd. in connection with these studies as of December 31, 2010 totaled approximately \$18 million.

Employees

Siberian Energy Group Inc. currently employs three (3) employees in management. KNG, which we own a 44% interest in, has two (2) part-time employees. Zauralneftegaz ("ZNG"), which is 50% owned by the Company through its joint venture ZNG, Ltd., currently employs two (2) part-time employees.

Critical Accounting Policies and Estimates

The Company prepares its consolidated financial statements 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 its operations. 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 financing previously received of \$25,000 to \$85,000 per month in management fees from its Joint Venture, which management fees the Company has not received since October 2007, and which the Company does not believe will ever resume. 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.

Competition

Competition among Russian oil producers occurs in two distinct tiers. The first tier includes large corporations such as Surgutneftegaz, LUKoil, Sibneft, Tatneft, Slaveft, YUKOS, TNK, Bashneft, Rosneft and Sidanco which together control more than 90% of the Russian oil and gas market. These companies operate large-scale fields and are primarily oriented towards exportation. The second tier, so called junior players, includes a large number of smaller companies that operate small and medium sized oil and gas fields. These companies enjoy a limited but stable range of customers within Russia's domestic market, and their customers include the larger companies which purchase this product for export. Like other junior players, the Company believes it has potential to succeed, assuming it can locate and obtain rights to additional producing properties or exploration projects, given the continued high demand for oil both domestically and internationally.

Another type of competition which the Company may face in the future is competition in the process of acquisition of new licenses. The Company expects that competitive pressures will further increase if hydrocarbon reservoirs are found in the Kurgan province and/or Khanty-Mansiysk district of Western Siberia, Russia.

Dependence on One or A Few Major Customers

The nature of the oil industry is not based on individual customers. Crude and refined products are sold to local and international brokers as well as to refineries. The Company does not currently and can provide no assurances that it will ever produce crude or refined products.

Patents, Trademarks and Licenses

KNG currently holds two five-year oil and gas exploration licenses, awarded in October 2007; provided that KNG has recently decided not to move forward with the exploration of such licenses.

Need For Government Approval

Federal and local government approval will not be required for conversion of any exploration licenses to production licenses and/or for extension of licenses beyond their initial term. However, the Company will need to receive approval for additional exploration licenses it may choose to acquire in the future and additional approval will be required if the Company is to deliver future crude or refined products on the national pipeline system. These approvals can only be guaranteed once the Company has proved reserves.

Additionally, under certain Russian federal laws the Company does not require the approval of state and/or federal agencies for conversion of exploration licenses to production licenses and extension of production licenses beyond their initial term as they automatically convert to 25 year production licenses upon the discovery of oil and gas, of which the Company provides no assurance.

Costs and Effects of Compliance with Environmental Laws

According to the laws and regulations of the Russian Federation, organizations are permitted to carry out seismic and other development activities on licensed fields, provided the companies conform to ecological standards. Accordingly, ZNG and KNG have previously encountered two costs associated with environmental law compliance: costs associated with obtaining licenses and costs associated with obtaining permission from the Russian Ministry of Natural Resources (the "Ministry"). ZNG's costs have totaled approximately \$186,900, which includes \$2,000 relating to the ecological review by the Ministry and \$184,900 in legal costs and fees to obtain the Company's licenses (which the Company and its partners have determined not to proceed in the exploration of).

The Company will face additional costs to comply with environmental laws, which may be significant. In addition, the Ministry imposes certain environmental obligations on the Company, such as clean-up procedures.

ITEM 1A. 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, estimated at approximately \$300,000, through funding provided by existing stockholders. As of December 31, 2010, the total funding provided to ZNG, Ltd. and ZNG by Baltic was equal to \$23.5 million plus accrued interest of approximately \$5 million, which has been spent on various purposes, including seismic and gas seismotomography surveys, drilling of two exploratory wells, and paying consultants for services performed in connection with surveys performed on the previously licensed area. Our partner in ZNG, Baltic and our partner in KNG, Neftebitum, have informed us that they do not plan to move forward with any further exploration activities through ZNG or KNG, respectively. If you invest in our Company and we are unable to raise the required funds, your investment could become worthless.

SHAREHOLDERS MAY BE DILUTED SIGNIFICANTLY THROUGH OUR EFFORTS TO PAY CONSULTANTS, OBTAIN FINANCING, SATISFY OBLIGATIONS AND/OR COMPLETE ACQUISITIONS THROUGH THE ISSUANCE OF ADDITIONAL SHARES OF OUR COMMON STOCK OR OTHER SECURITIES.

We have no committed source of financing. Wherever possible, our Board of Directors will attempt to use non-cash consideration to satisfy obligations and pay consultants. In many instances, we believe that the non-cash consideration will consist of restricted shares of our common stock or other securities. These transactions may result in significant additional shares of common stock of the Company being issued in consideration for services rendered, loans made, or to satisfy outstanding amounts owed or accrued to various parties, similar to the Conversion, described above. Additionally, moving forward, we may attempt to conduct acquisitions of other entities or assets using our common stock or other securities as payment for such acquisitions. Our Board of Directors has authority, without action or vote of the shareholders, to issue all or part of the authorized but unissued shares of common stock and preferred stock with various preferences and other rights. These actions may, similar to the Conversions, result in substantial dilution of the ownership interests of existing shareholders, cause the value of the Company's common stock to decline in value, and dilute the book value of the Company's common stock.

WE WILL NEED TO RAISE SUBSTANTIAL FINANCING, WHICH MAY CAUSE SUBSTANTIAL DILUTION TO EXISTING SHAREHOLDERS, TO ACQUIRE RIGHTS TO ADDITIONAL ASSETS AND WILL REQUIRE SUBSTANTIAL TIME AND FINANCING BEFORE WE ANTICIPATE GENERATING REVENUES THROUGH OUR FUTURE OPERATIONS, IF ANY.

Assuming the Company can locate and obtain rights to additional exploration assets, licenses or other rights to production or potential future production, the Company will need to raise substantial additional funds to complete the acquisition of any such assets. Assuming such assets can be acquired, of which there can be no assurance, and which acquisition(s) may cause substantial dilution to our existing shareholders, the Company anticipates the need for approximately \$15,000,000 in funding for exploration and other expenses prior to the expected generation of any revenues, of which there can be no assurance. Therefore, investors should keep in mind that even if the Company is able to locate suitable investment opportunities and assets, raise the substantial funding necessary to acquire such assets, is able to raise the substantial amounts of additional financing that the Company will require for its future exploration operations, it could still be years before the Company generates any revenue, if ever. If the Company is unable to locate or obtain rights to additional exploration or production assets, the Company does not raise the funding required to complete future exploration activities, no commercial amounts of hydrocarbons are discovered or the Company is unable to extract such hydrocarbons, the Company 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 substantially decline or 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 \$666,116 for the year ended December 31, 2009 a net loss of \$579,251 for the year ended December 31, 2010, and had total cash on hand of \$467 and a total accumulated deficit of \$16,101,756 as of December 31, 2010. 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 had limited revenues and no profits to date and our net cumulative deficit attributable to our development stage as of December 31, 2010, was \$15,651,971, and our total cumulative deficit was \$16,101,756 which included \$449,785 of pre-development stage deficit. We had a working capital deficit of \$359,063 as of December 31, 2010. The Company is currently being funded by existing shareholders, 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. ZNG has previously determined to cease further exploration activities and KNG recently determined to cease exploration activities as well. As such, we are currently seeking out additional oil and gas exploration and production assets in Russia. If we are unable to locate, or obtain rights to any future oil and gas exploration and production assets in the future, or if through such future oil exploration activities, if any, no viable wells are found, and consequently, we are unable to generate any revenues, 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.

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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 in the future 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 WE DO NOT FIND HYDROCARBON RESERVES, WE MAY BE FORCED TO CURTAIL OUR BUSINESS PLAN.

There is a risk that we will not find any hydrocarbon reserves and the cost of acquiring assets or exploration activities will become too high for us to continue our business plan. If we 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 or 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 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 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, who are not currently employed under Employment Agreements, as such prior agreements expired on December 31, 2010. 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, or if Mr. Zaikin or Ms. Pochapski are unable to spend a sufficient amount of time on Company matters, 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.

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OUR FUTURE PROJECTIONS, ESTIMATES AND STATISTICAL ANALYSIS MAY BE INACCURATE OR SUBSTANTIALLY WRONG, WHICH MAY PREVENT US FROM EXECUTING OUR 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 our projections or estimates are wrong or our statistical analysis faulty, our future revenues, if any, may be adversely affected which could prevent us from executing our 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.

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 officers and Directors. 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 HOLDINGS ARE CONDUCTED IN RUSSIA, AND THE LICENSES OWNED THROUGH OUR HOLDINGS AND THAT WE HOPE TO ACQUIRE IN THE FUTURE ARE IN RUSSIA.

Zauralneftegaz, Ltd. which we own 50% of through our Joint Venture, and KNG, which we own 44% of, hold certain licenses and rights to reapply for licenses to certain oil and gas properties in the Kurgan Region of Russia. Additionally, moving forward, we hope to seek out and acquire additional licenses in Siberia, 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.

NEVADA LAW AND OUR ARTICLES OF INCORPORATION AUTHORIZE US TO ISSUE SHARES OF STOCK, WHICH SHARES MAY CAUSE SUBSTANTIAL DILUTION TO OUR EXISTING SHAREHOLDERS.

We have authorized capital stock consisting of 100,000,000 shares of common stock, \$0.001 par value per share and 10,000,000 shares of preferred stock, \$0.001 par value per share. As of the date of this filing, we had 667,659 shares of common stock issued and outstanding and – 0 – shares of preferred stock issued and outstanding. As a result, our Board of Directors has the ability to issue a large number of additional shares of common stock without shareholder approval, which if issued could cause substantial dilution to our then shareholders. Additionally, shares of preferred stock may be issued by our Board of Directors without shareholder approval with voting powers, and such preferences and relative, participating, optional or other special rights and powers as determined by our Board of Directors, which may be greater than the shares of common stock currently outstanding. As a result, shares of preferred stock may be issued by our Board of Directors which cause the holders to have super majority voting power over our shares, provide the holders of the preferred stock the right to convert the shares of preferred stock they hold into shares of our common stock, which may cause substantial dilution to our then common stock shareholders and/or have other rights

and preferences greater than those of our common stock shareholders. Investors should keep in mind that the Board of Directors has the authority to issue additional shares of common stock and preferred stock, which could cause substantial dilution to our existing shareholders. Additionally, the dilutive effect of any preferred stock, which we may issue may be exacerbated given the fact that such preferred stock may have super majority voting rights and/or other rights or preferences which could provide the preferred shareholders with voting control over us subsequent to this filing and/or give those holders the power to prevent or cause a change in control. As a result, the issuance of shares of common stock and/or preferred stock may cause the value of our securities to decrease and/or become worthless.

IF WE ARE LATE IN FILING OUR QUARTERLY OR ANNUAL REPORTS WITH THE SECURITIES AND EXCHANGE COMMISSION OR A MARKET MAKER FAILS TO QUOTE OUR COMMON STOCK ON THE OVER-THE-COUNTER BULLETIN BOARD FOR A PERIOD OF MORE THAN FOUR DAYS, WE MAY BE DE-LISTED FROM THE OVER-THE-COUNTER BULLETIN BOARD.

Pursuant to Over-The-Counter Bulletin Board ("OTCBB") rules relating to the timely filing of periodic reports with the Securities and Exchange Commission ("SEC"), any OTCBB issuer which fails to file a periodic report (Form 10-Q or 10-K) by the due date of such report (not withstanding any extension granted to the issuer by the filing of a Form 12b-25), three times during any 24 month period is automatically 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. Additionally, if a market maker fails to quote our common stock on the OTCBB for a period of more than four consecutive days, we will be automatically delisted from the OTCBB (similar as to how we were automatically delisted from the OTCBB in February 2011, which forced us to take actions to requote our common stock on the OTCBB in March 2011). If we are late in our filings three times in any 24 month and are de-listed from the OTCBB period or are automatically delisted for failure of a market maker to quote our stock our securities may become worthless and we may be forced to curtail or abandon our business plan.

WE INCUR SIGNIFICANT COSTS AS A RESULT OF OPERATING AS A FULLY REPORTING COMPANY IN CONNECTION WITH SECTION 404 OF THE SARBANES OXLEY ACT, AND OUR MANAGEMENT IS REQUIRED TO DEVOTE SUBSTANTIAL TIME TO NEW COMPLIANCE INITIATIVES.

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. 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. Our testing 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 may 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 identify 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.