SARATOGA RESOURCES INC /TX
Form 8-K/A
August 21, 2008

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 8-K/A

(Amendment No. 1)

CURRENT REPORT

Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

Date of Report (Date of earliest event reported): **July 14, 2008**

SARATOGA RESOURCES, INC.

(Exact name of Registrant as specified in its charter)

Texas	**0-27563**	**76-0314489**
(State or other jurisdiction of incorporation or organization)	*(Commission File No.)*	*(IRS Employer Identification No.)*

2304 Hancock Drive, Suite 5

Austin, Texas 78756

(Address of Principal Executive Offices)(Zip Code)

Registrant s Telephone Number, including area code: **(512) 478-5717**

N/A

(Former name, former address and former fiscal year, if changed since last report)

Check the appropriate box below if the Form 8-K filing is intended to simultaneously satisfy the filing obligation of the registrant under any of the following provisions (see General Instruction A.2.):

Written communications pursuant to Rule 425 under the Securities Act (17 CFR 230.425)

Soliciting material pursuant to Rule 14a-12 under the Exchange Act (17 CFR 240.14a-12)

Pre-commencement communications pursuant to Rule 14d-2(b) under the Exchange Act (17 CFR 240.14d-2(b))

Pre-commencement communications pursuant to Rule 13e-4(c) under the Exchange Act (17 CFR 240.13e-4(c))

Explanatory Note

Saratoga Resources, Inc. is filing this Amendment to its Form 8-K, dated July 14, 2008 (the Original Form 8-K), as filed with the U.S. Securities and Exchange Commission (SEC) on July 18, 2008. This Amendment is being filed (1) to include financial statements of Harvest Oil &Gas, LLC and The Harvest Group, LLC for the quarter ended March 31, 2007, which were inadvertently omitted from the Original Form 8-K, (2) to correct footing errors reflected in the financial statements of Saratoga for the quarter ended March 31, 2008 and included in the pro forma financial statements (the Pro Formas) filed with the Original Form 8-K, (3) to correct the classification, within the Pro Formas, of $12.5 million of borrowings under Saratoga s revolving credit facility originally shown in the Pro Formas as current liabilities and corrected to show those borrowings as non-current liabilities, and (4) to revise the Management s Discussion and Analysis of Financial Condition and Results of Operations appearing in Exhibit 99.1 to reflect the foregoing revisions.

This Form 8-K/A continues to speak as of the date of the Original Form 8-K and no attempt has been made to modify or update disclosures in the Original Form 8-K except as noted above. This Form 8-K/A does not reflect events occurring after the filing of the Original Form 8-K or modify or update any related disclosures, and information not affected by this amendment is unchanged and reflects the disclosure made at the time of the filing of the Original Form 8-K with the SEC. In particular, any forward-looking statements included in this Form 8-K/A represent management s view as of the filing date of the Original Form 8-K.

Forward-Looking Statements

This Current Report on Form 8-K/A contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. This Current Report on Form 8-K/A includes statements regarding our plans, goals, strategies, intent, beliefs or current expectations. These statements are expressed in good faith and based upon a reasonable basis when made, but there can be no assurance that these expectations will be achieved or accomplished. These forward looking statements can be identified by the use of terms and phrases such as believe, plan, intend, anticipate, target, estimate, expec like, and/or future-tense or conditional constructions (will, may, could, should, etc.). Items contemplating, or maki assumptions about, actual or potential future sales, market size, collaborations, and trends or operating results also constitute such forward-looking statements.

Although forward-looking statements in this report reflect the good faith judgment of management, forward-looking statements are inherently subject to known and unknown risks, business, economic and other risks and uncertainties that may cause actual results to be materially different from those discussed in these forward-looking statements. Readers are urged not to place undue reliance on these forward-looking statements, which speak only as of the date of the Original Form 8-K. We assume no obligation to update any forward-looking statements in order to reflect any event or circumstance that may arise after the date of the Original Form 8-K, other than as may be required by applicable law or regulation. Readers are urged to carefully review and consider the various disclosures made by us in our reports filed with the SEC which attempt to advise interested parties of the risks and factors that may affect our business, financial condition, results of operation and cash flows. If one or more of these risks or uncertainties materialize, or if the underlying assumptions prove incorrect, our actual results may vary materially from those expected or projected.

The use of the terms we , us , our or similar words below, refer to Saratoga Resources, Inc. and its subsidiaries.

Item 1.01.

Entry into a Material Definitive Agreement.

Amendment to Harvest Purchase and Sale Agreements

On July 14, 2008, we entered into (1) a Fourth Amendment to Purchase and Sale Agreement (the Harvest Oil PSA Amendment) with Harvest Oil & Gas, LLC (Harvest Oil) and Barry Ray Salsbury, Salsbury Foundation, Brian Carl Albrecht and Shell Sibley, the owners of Harvest Oil, and (2) a Fourth Amendment to Purchase and Sale Agreement (the Harvest Group PSA Amendment) with The Harvest Group, LLC (Harvest Group , and together with Harvest Oil, the Harvest Companies) and Barry Ray Salsbury, Salsbury Foundation, Brian Carl Albrecht, Shell Sibley, Willie Willard Powell and Carolyn Monica Greer, the owners of Harvest Group.

Each of the Harvest Oil PSA Amendment and the Harvest Group PSA Amendment reinstates the original Purchase and Sale Agreements between us and Harvest Oil and Harvest Group (the original Purchase and Sale Agreements being referred to, respectively, as the Original Harvest Oil PSA and the Original Harvest Group PSA and, as amended, the Amended Harvest Oil PSA and the Amended Harvest Group PSA and, collectively, the Harvest PSAs) and extends the closing date under the Harvest PSAs to July 14, 2008.

The Harvest Oil PSA Amendment provides for an amended purchase price of Harvest Oil consisting of (1) $84,546,400 in cash and (2) 3,920,000 shares of our common stock.

The Harvest Group PSA Amendment provides for an amended purchase price of Harvest Group consisting of (1) $21,136,600 in cash and (2) 980,000 shares of our common stock.

The foregoing is qualified in its entirety by reference to the Harvest Oil PSA Amendment and the Harvest Group PSA Amendment filed as Exhibits 10.1 and 10.2 to the Original Form 8-K.

Wayzata Credit Agreement

In conjunction with the acquisition of Harvest Oil and Harvest Group, as described in Item 2.01 below, on July 14, 2008, we entered into a Credit Agreement (the Wayzata Credit Agreement) with Wayzata Investment Partners LLC (Wayzata) pursuant to which Wayzata, or other lenders (together, the Wayzata Lenders), agreed to provide loans to us in an amount up to, and did loan to us, $97,500,000 to be used to fund the acquisition of the Harvest Companies.

Pursuant to the terms of the Wayzata Credit Agreement, we granted to the Wayzata Lenders a second lien on substantially all of our assets, and each of our subsidiaries, including the Harvest Companies, agreed to guaranty all amounts owing under the Wayzata Credit Agreement.

Loans made under the Wayzata Credit Agreement bear interest at 20% per annum and are due and payable in monthly installments of interest only with the principal being due and payable in full on July 14, 2011.

Pursuant to the terms of the Wayzata Credit Agreement, we issued to the Wayzata Lenders a warrant to purchase 805,515 shares of our common stock exercisable for a period of five years at a price of $0.01 per share.

The Wayzata Credit Agreement includes normal covenants and credit conditions and is subject to the terms of an Intercreditor Agreement with us and Macquarie Bank Limited.

The foregoing is qualified in its entirety by reference to the Wayzata Credit Agreement and the form of warrant filed as Exhibits 10.3 and 10.5 to the Original Form 8-K.

Macquarie Credit Agreement

In conjunction with the acquisition of Harvest Oil and Harvest Group, on July 14, 2008, we entered into a Credit Agreement (the Revolving Credit Agreement) with Macquarie Bank Limited (Macquarie) pursuant to which we assumed and restated the existing Macquarie credit facilities of the Harvest Companies and Macquarie, or other lenders (together, the Revolving Credit Lenders), agreed to provide a revolving credit loan facility in an amount up to $25,000,000. Simultaneous with execution of the Revolving Credit Agreement, we borrowed $12,528,878 under the revolving credit facilities to pay amounts due with respect to the acquisition of the Harvest Companies and related transaction costs. Additionally, letters of credit of the Harvest Companies, totaling $11.5 million, remained outstanding following the acquisition and reduce available borrowing under the revolving credit facility.

Pursuant to the terms of the Revolving Credit Agreement, we granted to the Macquarie Lenders a first lien on substantially all of our assets, and each of our subsidiaries, including the Harvest Companies, agreed to guaranty all amounts owing under the Revolving Credit Agreement.

Loans made under the Revolving Credit Agreement are subject to borrowing base requirements and bear interest at varying rates based on percentage usage of the borrowing base and margins ranging from 2.25% to 2.75% over the applicable LIBO Rate, as defined in the Revolving Credit Agreement, and 0.75% to 1.25% over the applicable prime rate. Interest on the revolving credit facility is due monthly with respect to prime rate based loans and at the end of each applicable interest period with respect to Eurodollar loans. Loans under the Revolving Credit Agreement mature on April 1, 2011.

Pursuant to the terms of the Revolving Credit Agreement, we will pay certain administrative fees, letter of credit fees and other fees and expenses in connection with maintenance and advances under the Revolving Credit Agreement.

The Revolving Credit Agreement includes normal covenants and credit conditions and is subject to the terms of the Intercreditor Agreement with us and the Wayzata Lenders.

The foregoing is qualified in its entirety by reference to the Revolving Credit Agreement filed as Exhibit 10.4 to the Original Form 8-K.

Renewal and Extension of Shareholder Loan and Accrued Salaries of Officers

In conjunction with the acquisition of the Harvest Companies and the related financing, at closing, the Company repaid $100,000 of advances from Thomas Cooke, the Company s Chairman, Chief Executive Officer and principal shareholder. The balance owing to Mr. Cooke, totaling $463,412, plus accrued salary in the amount of $157,500, was renewed and extended pursuant to a Subordinated Promissory Note, providing for payment of equal monthly installments of $17,247.55, including interest at 10% per annum, over three years.

Accrued salary in the amount of $157,500 owed to Andy Clifford, the Company s President was renewed and extended pursuant to a Subordinated Promissory Note providing for payment of equal monthly installments of $4,375, including interest at 10%, over three years.

The foregoing is qualified in its entirety by reference to the Subordinated Promissory Notes filed as Exhibits 10.6 and 10.7 to the Original Form 8-K.

Item 2.01.

Completion of Acquisition or Disposition of Assets.

On July 14, 2008, we acquired (the Harvest Acquisitions) all of the equity interests in Harvest Oil and Harvest Group pursuant to the terms of the Harvest PSAs.

The Harvest Companies are independent oil and natural gas companies engaged in the production, development, and exploitation of natural gas and crude oil properties, together covering an estimated 33,000 gross acres (30,000 net) across 11 fields in the state waters of Louisiana. In connection with the Harvest Acquisitions, we entered into employment agreements with, or otherwise retained the services of, the management and certain key employees of the Harvest Companies.

As consideration for the membership interests in the Harvest Companies, we paid to the former members of the Harvest Companies a combined purchase price of $105,683,000 in cash and issued 4.9 million shares of our common stock. The cash portion of the purchase price included $33,650,818 and $30,000,000 paid by the Harvest Companies to pay a note payable to Macquarie and to obtain a release of a net profits interest and an overriding royalty interest in the properties of the Harvest Companies held by Macquarie and its affiliates, respectively, which amounts we paid directly to Macquarie on behalf of the Harvest Companies at closing. Of the 4.9 million shares of common stock issued in the acquisitions, 3.3 million shares were issued directly to Macquarie pursuant to an agreement between Macquairie and the members of the Harvest Companies relating to the release of the net profits interest and overriding royalty interest held by Macquarie. Prior to the Harvest Acquisitions, there existed no material relationship between the Harvest Companies and us or any of our affiliates, or any of our directors or officers, or any associates of our directors or officers.

The cash portion of the purchase price payable in connection with the Harvest Acquisitions was paid from borrowings under the Wayzata Credit Agreement and the Revolving Credit Agreement.

Because of the materiality of the Harvest Acquisitions, we have included in Exhibit 99.1 to this Current Report, the information that would be required if we were filing a general form for registration of securities on Form 10 as a smaller reporting company.

Item 2.03.

Creation of a Direct Financial Obligation or an Obligation under an Off-Balance Sheet Arrangement of a Registrant

See Wayzata Credit Agreement and Macquarie Credit Agreement under Item 1.01 above.

Item 3.02.

Unregistered Sale of Equity Securities

In connection with the Harvest Acquisition described in Item 2.01 above, we issued (i) 4,900,000 shares of common stock to 6 persons as partial consideration for the acquisition of the Harvest Companies, (ii) a warrant to purchase 805,515 shares of common stock at $0.01 per share for five years as partial consideration under the Wayzata Credit Agreement, and (iii) 1,040,000 shares of stock to 9 key employees of the Harvest Companies as an inducement for ongoing services.

The foregoing securities were issued to a limited number of investors without general solicitation pursuant to the exemption set forth in Section 4(2) of the Securities Act of 1933.

Item 5.02.

Departure of Directors or Certain Officers; Election of Directors; Appointment of Certain Officers; Compensatory Arrangements of Certain Officers

In connection with the Harvest Acquisition, on July 14, 2008, the Company appointed Barry Salsbury as President of the Company s principal operating subsidiaries, Harvest Oil & Gas LLC and The Harvest Group, LLC.

Mr. Salsbury co-founded and, since 2004, served as President of the Harvest Companies.

The Company entered into an employment agreement and restricted stock agreement with Mr. Salsbury. Under the terms of Mr. Salsbury s employment agreement, Mr. Salsbury will serve as President of the Harvest Companies for a term of three years and will receive a base salary of $165,000 per year plus participation in the Company s executive benefit programs. Under the terms of a restricted stock agreement, Mr. Salsbury was issued 500,000 shares of common stock, of which 200,000 shares are subject to forfeiture in the event that Mr. Salsbury is not continuing in his service as President of the Harvest Companies on January 14, 2009 and 200,000 shares are subject to forfeiture in the event that Mr. Salsbury is not continuing in his service as President of the Harvest Companies on July 14, 2009.

Item 9.01.

Financial Statements and Exhibits.

(a) Financial Statements of Business Acquired.

(b) Pro Forma Financial Information.

(d) Exhibits

Exhibit No.	Description
10.1	Fourth Amendment to Purchase and Sale Agreement, dated July 11, 2008, between Saratoga Resources, Inc., Harvest Oil & Gas, LLC, Barry Ray Salsbury, Brian Carl Albrecht and Shell Sibley[(1)]
10.2	Fourth Amendment to Purchase and Sale Agreement, dated July 11, 2008, between Saratoga Resources, Inc., The Harvest Group, LLC, Barry Ray Salsbury, Brian Carl Albrecht, Shell Sibley, Willie Willard Powell and Carolyn Monica Greer[(1)]
10.3	Credit Agreement, dated July 14, 2008, between Saratoga Resources, Inc. and Wayzata Investment Partners, LLC[(1)]
10.4	Amended and Restated Credit Agreement, dated July 14, 2008, between Saratoga Resources, Inc. and Macquarie Bank Limited[(1)]
10.5	Wayzata Investment Partners LLC Warrant, dated July 14, 2008[(1)]
10.6	Subordinated Promissory Note, dated July 14, 2008, payable to Thomas F. Cooke[(1)]
10.7	Subordinated Promissory Note, dated July 14, 2008[(1)]
10.8	Employment Agreement, dated July 14, 2008 between Saratoga Resources, Inc. and Barry Salsbury[(1)]
99.1	Form 10 Information reflecting Harvest Acquisition

---

(1)

Incorporated by reference to the registrant s Form 8-K, dated July 14, 2008, filed with the SEC on July 18, 2008.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned hereunto duly authorized.

SARATOGA RESOURCES, INC.

By: /s/ Thomas Cooke
Thomas Cooke
Chief Executive Officer

Date: August 21, 2008

THE HARVEST GROUP, LLC
BALANCE SHEET

March 31, 2008

ASSETS

CURRENT ASSETS	
Cash	$ 6,302,916
Sales and Marketing Receivables	7,277,256
Joint Interest and Other Receivables	1,804,180
Prepaid Expenses	222,688
Due from Affiliates	501,415
Other Assets	625,000
Total Current Assets	16,733,455
PROPERTY AND EQUIPMENT, at Cost	
Successful Efforts Used for Oil and Gas Properties:	
Oil and Gas Property and Equipment - Proved	13,189,335
Furniture, Fixtures, Equipment and Other	145,458
	13,334,793
Less: Accumulated Depreciation, Depletion and Amortization	(4,910,189)
Total Property and Equipment, Net	8,424,604
OTHER ASSETS	
Restricted Cash	945,604
Total Other Assets	945,604

Total Assets	$ 26,103,663

See accompanying notes to financial statements.

LIABILITIES AND MEMBERS' CAPITAL

CURRENT LIABILITIES	
Accounts Payable	$ 4,702,134
Accrued Expenses Payable	1,009,187
Note Payable, Net of Debt Discount ($186,783 in 2008)	512,681
Hedging Liability	110,820
Total Current Liabilities	6,334,822
LONG-TERM LIABILITIES	
Hedging Liability	1,861,654
Asset Retirement Obligations	7,022,017
Total Long-Term Liabilities	8,883,671
Total Liabilities	15,218,493
MEMBERS' CAPITAL	
Members' Distributions	(2,769,864)
Retained Earnings	13,655,034
Total Members' Capital	10,885,170
Total Liabilities and Members' Capital	$ 26,103,663

See and accompanying notes to financial statements.

THE HARVEST GROUP, LLC
STATEMENT OF OPERATIONS

For the Three Months Ended March 31, 2008 and 2007

	Three Months Ended March 31, 2008	Three Months Ended March 31, 2007
REVENUE		
Oil and Gas Revenue, Net of Royalties	$ 10,255,709	$ 5,255,729
Derivative Expense/(Income)	(657,611)	2,009,949
Other Income	285,474	-
Total Revenue	9,883,572	7,265,678
COSTS AND EXPENSES		
Lease Operating Expenses	5,129,816	3,109,240
Workover Expenses	-	321,198
Depreciation, Depletion and Amortization	605,469	742,706
Plug and Abandonment Provision	180,583	43,802
Other Selling, General and Administrative Expenses	546,224	19,561
Total Cost and Expenses	6,462,092	4,236,506
Operating Income	3,421,480	3,029,172
OTHER INCOME (EXPENSE)		
Interest Income	17,378	-
Interest Expense	(17,406)	(290,831)
Total Other Expense	(28)	(290,831)
NET INCOME	$ 3,421,452	$ 2,738,341

See accompanying notes to financial statements.

THE HARVEST GROUP, LLC
STATEMENT OF CHANGES IN MEMBERS' CAPITAL

For the Three Months Ended March 31, 2008

	Members' Distributions	Retained Earnings	Total
BALANCE - December 31, 2007	$ (2,266,407)	$ 10,233,582	$ 7,967,175
Members' Distribution	(503,457)	-	(503,457)
Net Income	-	3,421,452	3,421,452
BALANCE - March 31, 2008	$ (2,769,864)	$ 13,655,034	$ 10,885,170

See accompanying notes to financial statements.

THE HARVEST GROUP, LLC
STATEMENT OF CASH FLOWS

For the Three Months Ended March 31, 2008 and 2007

	Three Months Ended March 31, 2008	2007
CASH FLOWS FROM OPERATING ACTIVITIES		
Net Income	$ 3,421,452	$ 2,738,341
Adjustments to Reconcile Net Income to Net Cash		
Provided by Operating Activities:		
Depreciation, Depletion and Amortization	605,469	742,706
Amortization of Debt Discount	8,361	-
Accretion of Plug and Abandonment Liability	180,583	43,802
(Gain) Loss on Derivative Instruments	657,611	(2,009,949)
Decrease (Increase) in Receivables	(1,072,690)	1,189,596
Decrease in Prepaid Expenses and Other Assets	147,340	50,585
(Increase) in Due from Affiliates	(803,640)	-
Increase in Accounts Payable and Accrued Expenses	2,107,478	437,120
Net Cash Provided by Operating Activities	5,251,964	3,192,201
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of Oil and Gas Property and Equipment	(316,657)	(1,357,402)
Purchases of Furniture, Fixtures, Equipment and Other	(15,000)	-
Increase in Restricted Cash	-	(411,544)
Purchase of Commodity Derivative Instruments	-	108,265
Net Settlement of Derivative Instruments	(539,705)	-
Net Cash Used in Investing Activities	(871,362)	(1,660,681)
CASH FLOWS FROM FINANCING ACTIVITIES		
Due to Related Parties	-	617,957

Payments on Long-term Debt		-		(490,427)
Members' Distributions		(503,457)		-
Net Cash Used in Financing Activities		(503,457)		127,529
NET INCREASE IN CASH AND CASH EQUIVALENTS		3,877,145		1,659,049
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD		2,425,771		585,934
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$	6,302,916	$	2,244,983
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION				
Cash Paid During the Period for Interest	$	5,051	$	86,507

See accompanying notes to financial statements.

THE HARVEST GROUP, LLC

NOTES TO FINANCIAL STATEMENTS

NOTE A

ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES

THE HARVEST GROUP, LLC (the Company), is an independent oil and gas company engaged in the acquisition, development and exploration of oil and natural gas. The Company s principal areas of operation are in the Gulf of Mexico. The Company was formed as a limited liability company on June 10, 2004, and began operations in September 2006.

USE OF ESTIMATES

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term include the determination of depreciation, depletion and amortization, plugging and abandonment liabilities, and the valuation of oil and gas property.

REVENUE RECOGNITION

The Company recognizes oil and gas revenue from its interests in producing wells as the oil and gas is sold. Revenue from the purchase, transportation, and sale of natural gas is recognized upon completion of the sale and when transported volumes are delivered. The Company recognizes revenue related to gas balancing agreements based on the entitlement method. The Company s net imbalance position at March 31, 2008, was immaterial.

HEDGING AGREEMENTS

The Company manages the potential impact of changes in the price of oil and natural gas by entering into derivatives commodity instruments (hedges), but does not use them for speculative purposes.

The Company accounts for hedging agreements in accordance with SFAS No. 133, as amended, *Accounting for Derivative Instruments and Hedging Activities.* SFAS No. 133 requires the Company to recognize all derivative instruments on the balance sheet as either an asset or liability, measured at fair value, and requires that changes in a derivative s fair value be realized currently in earnings, unless hedge accounting criteria are met. If the derivative is a qualifying hedge, depending on the nature of the hedge, changes in the fair value will either be offset against the change in fair value of the hedged assets, liabilities, or firm commitments through earnings, or recognized in other comprehensive income until the hedged item is recognized in earnings. The ineffective portion of a derivative s change in fair value will be immediately recognized in earnings.

CONCENTRATION OF CREDIT RISK

The Company s accounts receivable relate primarily to the sale of natural gas and crude oil. Credit terms, typical of industry standards, are of a short-term nature and generally do not require collateral.

THE HARVEST GROUP, LLC

NOTES TO FINANCIAL STATEMENTS

NOTE A

ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES (Continued)

CONCENTRATION OF CREDIT RISK (Continued)

During the three months ended March 31, 2008, the Company sold 100% of its products to one customer. At March 31, 2008, amounts due from that customer totaled $7,277,256.

Periodically during the three months ended March 31, 2008, the Company maintained cash balances in a financial institution in excess of federally insured limits.

CASH AND CASH EQUIVALENTS

For the purpose of the Statement of Cash Flows, the Company considers all highly liquid investments with a maturity of three months or less to be cash equivalents.

ACCOUNTS RECEIVABLE

Receivables are carried at original invoice amount. Uncollectible accounts receivable are charged directly against earnings when they are determined to be uncollectible. Use of this method does not result in a material difference from the valuation method required by generally accepted accounting principles.

PROPERTY AND EQUIPMENT

The successful efforts method is used for accounting for oil and gas exploration and production operations. Lease acquisition, tangible and intangible drilling costs are capitalized when incurred. If the drilling venture is successful, these costs are amortized over the estimated recoverable proved reserves. Costs of unsuccessful exploratory drilling ventures are charged to expense.

The Company capitalizes interest on expenditures for significant exploration and development projects while activities are in progress to bring the assets to their intended use. There was no interest capitalized for the three months ended March 31, 2008.

Depreciation, depletion, and amortization (DD&A) is computed on the units-of-production method separately on each individual property. DD&A expense includes the accrual of future plugging and abandonment costs. The Company accounts for future plugging and abandonment costs in accordance with SFAS No. 143, *Accounting for Asset Retirement Obligations.* SFAS No. 143 requires legal obligations associated with the retirement of long-lived assets (i.e., future plugging and abandonment costs) to be recognized at their fair value at the time the obligations are incurred. Upon initial recognition of the liability, that cost should be capitalized as part of the related long-lived asset and allocated to expense over the useful life of the asset. The estimate of future plugging and abandonment costs is highly subjective. Management s current estimate of the Company s share of such future costs is approximately $14,453,000 as of March 31, 2008. The DD&A expense per equivalent MCF of production for the three months ended March 31, 2008 was $.55.

THE HARVEST GROUP, LLC

NOTES TO FINANCIAL STATEMENTS

NOTE A

ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES (Continued)

PROPERTY AND EQUIPMENT(Continued)

Furniture, fixtures, equipment, and other are depreciated using the straight-line method over the estimated useful lives of the assets.

LONG-LIVED ASSETS

The Company evaluates the recoverability of its long-lived assets in accordance with SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, which superseded SFAS No. 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of.* Impairment losses are based on the difference between fair value, which was calculated using the discounted future cash flows of the related properties, and the net book value of those properties. The discounted future cash flows are derived from reserve estimates of independent petroleum engineers. There were no impairment losses recognized during the three months ended March 31, 2008.

INCOME TAXES

The Company is treated as a partnership for income tax purposes and, as such, each member is taxed separately on their distributive share of the Company s income whether or not that income is actually distributed.

NOTE B

NOTES PAYABLE AND LONG-TERM DEBT

At March 31, 2008, the Company s long-term debt included borrowings under a Credit Agreement dated September 29, 2006, and amended December 15, 2006, in an amount up to $25,000,000. The balance outstanding as of March 31, 2008, was $699,464. The Credit Agreement is scheduled to mature September 29, 2008. The loan requires monthly interest payments that are accrued on the principal balance at prime plus 4%, which, at March 31, 2008, was 9.25%. Principal reductions will result if the lender s sweep of the Company s net operating cash flows exceeds interest and fees payable to the lender. The loan is collateralized by all of the real and personal property of the Company, and the membership interests.

The Company is subject to certain restrictive financial covenants under the credit facility, including an interest coverage ratio of at least 2.5 to 1.0, a current ratio of at least 1.0 to 1.0, and an adjusted present value ratio of not less than 1.75 to 1.0 as of December 31, 2006, and 2.0 to 1.0 thereafter, all as defined in the Credit Agreement. The credit facility also includes customary restrictions with respect to liens, indebtedness, loans and investments, material changes in the Company s business, asset sales or leases or transfers of assets, restricted payments, such as distributions and dividends, mergers or consolidations, transactions with affiliates and rate management transactions. At December 31, 2007, the Company was in compliance with the covenants.

THE HARVEST GROUP, LLC

NOTES TO FINANCIAL STATEMENTS

NOTE B

NOTES PAYABLE AND LONG-TERM DEBT (Continued)

As part of the loan agreement, the Company conveyed to the lender a 4% overriding royalty interest (ORRI) in all of its oil and gas properties, commencing on September 29, 2006. As a result, $3,425,374, the fair value, was allocated to the property conveyance, thereby reducing capitalized costs and recording a debt discount. The debt discount is being amortized over the life of the loan. Included in interest expense for the three months ended March 31, 2008, was $8,361, related to the amortization of the debt discount.

NOTE C

HEDGING AGREEMENTS

The Company entered into hedging agreements to reduce the impact of changes in the prices of oil and natural gas. Under SFAS No. 133, as amended, the nature of a derivative instrument must be evaluated to determine if it qualifies for hedge accounting treatment. Instruments qualifying for hedge accounting treatment are recorded as an asset or liability measured at fair value and subsequent changes in fair value are recognized in equity through other comprehensive income, to the extent the hedge is effective. The cash settlements of cash flow hedges are recorded into revenue. Instruments not qualifying for hedge accounting treatment are recorded in the balance sheet and changes in fair value are recognized in earnings as derivative expense (income). During the three month period ended March 31, 2008, the Company recognized net derivative expense of $591,041 in the Statement of Operations, as the result of hedges settled during the period and $66,570 as the result of market fluctuations.

The Company s hedges are specifically referenced to the NYMEX index prices received for its designated production. The effectiveness of hedges is evaluated at the time the contracts are entered into, as well as periodically over the lives of the contracts, by analyzing the correlation between NYMEX index prices and the posted prices received from the designated production. Through this analysis, the Company is able to determine if a high correlation exists between the prices received for its designated production and the NYMEX prices at which the hedges will be settled. At March 31, 2008, the Company s hedging contracts were considered effective cash flow hedges.

Estimating the fair value of hedging derivatives requires complex calculations incorporating estimates of future prices, discount rates and price movements. As a result, the Company obtains the fair value of its commodity derivatives from the counterparties to those contracts. Because the counterparties are market makers, they are able to provide a literal market value, or what they would be willing to settle such contracts for as of the given date.

THE HARVEST GROUP, LLC

NOTES TO FINANCIAL STATEMENTS

NOTE C

HEDGING AGREEMENTS (Continued)

As of March 31, 2008, the Company had the following oil and gas hedge contracts accounted for as cash flow hedges, still in place:

Production Period	Instrument Type	Volume		Price
Crude Oil:				
2008	Swap	51,592	Bbls	$60.00
2009	Swap	40,989	Bbls	$60.00
2008	Call	49,601	Bbls	$75.00
2009	Call	40,989	Bbls	$75.00
2008	Put	24,801	Bbls	$60.00
2009	Put	20,495	Bbls	$60.00
Natural Gas:				
2008	Swap	115,437	Mmbtu	$7.00
2009	Swap	59,437	Mmbtu	$7.00
2008	Put	70,094	Mmbtu	