ReoStar Energy CORP
Form 10-K
June 29, 2010
Table of Contents

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

FORM 10-K

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

For the fiscal year ended March 31, 2010

Commission file number 000-26139

REOSTAR ENERGY CORPORATION
(Name of small business issuer in its charter)

Nevada (State or other jurisdiction of incorporation or organization)	20-8428738 (IRS Employer Identification Number)
3880 Hulen St., Ste 500, Fort Worth, TX (Address of principal executive offices)	76107 (Zip Code)

Issuer's telephone number: 817-989-7367

Securities registered under Section 12(b) of the Exchange Act:
None

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

Common Stock, $.001 par value
(Title of class)

Check whether the issuer is not required to file reports pursuant to Section 13 or 15(d) of the Exchange Act. o

Check whether the issuer (1) 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 x No o

Check if there is no disclosure of delinquent filers in response to Item 405 of Regulation S-B contained in this form, and no disclosure will be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K o

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

Revenue for the fiscal year ended March 31, 2010 is $3,533,722 and the aggregate market value of the voting stock held by non-affiliates of the registrant based on the closing bid price of such stock as of March 31, 2010 amounted to $2,307,592.

The number of shares outstanding of the registrant's common stock as of March 31, 2010 was 80,743,912 shares.

Table of Contents

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the proxy statement for the registrant's 2010 annual meeting of shareholders to be filed with the SEC within 120 days after the end of the fiscal year ended March 31, 2010 are incorporated by reference in Part III of this Form 10-K.

Transitional Small Business Disclosure Format (check one): Yes o No x

REOSTAR ENERGY CORPORATION
FORM 10-K ANNUAL REPORT
FISCAL YEAR ENDED MARCH 31, 2010
TABLE OF CONTENTS

Table of Contents

Disclosures Regarding Forward-Looking Statements

Certain information included in this report, other materials filed or to be filed with the Securities and Exchange Commission (the "SEC"), as well as information included in oral statements or other written statements made or to be made by us contain or incorporate by reference certain statements (other than statements of historical fact) that constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. When used herein, the words "budget," "budgeted," "assumes," "should," "goal," "anticipates," "expects," "believes," "seeks," "plans," "estimates," "intends," "projects" or "targets" and similar expressions that convey the uncertainty of future events or outcomes are intended to identify forward-looking statements. Where any forward-looking statement includes a statement of the assumptions or bases underlying such forward-looking statement, we caution that while we believe these assumptions or bases to be reasonable and to be made in good faith, assumed facts or bases almost always vary from actual results and the difference between assumed facts or bases and the actual results could be material, depending on the circumstances. It is important to note that our actual results could differ materially from those projected by such forward-looking statements. Although we believe that the expectations reflected in such forward-looking statements are reasonable and such forward-looking statements are based upon the best data available at the date this report is filed with the SEC, we cannot assure you that such expectations will prove correct. Factors that could cause our results to differ materially from the results discussed in such forward-looking statements include, but are not limited to, the following: the factors described in Item 1A of this report under the heading "Risk Factors," production variance from expectations, volatility of oil and gas prices, hedging results, the need to develop and replace reserves, the substantial capital expenditures required to fund operations, exploration risks, environmental risks, uncertainties about estimates of reserves, competition, litigation, government regulation, political risks, our ability to implement our business strategy, costs and results of drilling new projects, mechanical and other inherent risks associated with oil and gas production, weather, availability of drilling equipment and changes in interest rates. All such forward-looking statements in this document are expressly qualified in their entirety by the cautionary statements in this paragraph, we do not undertake, and specifically disclaim any obligation, to update or revise such statements to reflect new circumstances or unanticipated events as they occur, and we urge readers to review and consider disclosures we make in this and other reports that discuss factors germane to our business, including our reports on Forms 10-K, 10-Q, and 8-K subsequently filed from time to time with the SEC.

PART I

ITEM 1. BUSINESS

General

We are engaged in the exploration, development and acquisition of oil and gas properties, primarily located in the state of Texas. We seek to increase oil and gas reserves and production through internally generated drilling projects on currently owned assets, coupled with complementary acquisitions.

At year-end 2010, we owned approximately 9,000 acres of leasehold, which includes 5,000 acres of exploratory and developmental prospects as well as 4,000 acres of enhanced oil recovery prospects. We have built a multi-year inventory of drilling projects and drilling locations and currently have enough acreage to sustain several years of drilling.

ReoStar was incorporated in Nevada on November 29, 2004 under the name Goldrange Resources, Inc. In February of 2007 we changed our name to ReoStar Energy Corporation.

Our corporate offices are located at 3880 Hulen Street, Suite 500, Fort Worth, Texas 76107. Our telephone number is (817) 989-7367.

Table of Contents

Business Strategy

Our objective is to build shareholder value by establishing and consistently growing our production and reserves with a strong emphasis on cost control and risk mitigation. Our strategy is (1) to control operations of all our leases through our affiliated operating companies, (2) to acquire and develop leasehold in key regional resource development plays while utilizing existing infrastructure and engaging in long-term drilling and development programs, and (3) to acquire leasehold in mature fields and implement enhanced oil recovery programs.

Significant Accomplishments in Fiscal Year 2010

Leasehold Acquisition and Development:

Barnett Shale. Our main area of interest in the Barnett Shale play is located in the "oil window" of the Barnett in southwest Cooke County, Texas.

We completed, and began production in the two wells that were in process as of March 31, 2009.

Corsicana Enhanced Oil Recovery ("EOR") Project. We entered into negotiations to test a new chemical foam technology that appears to have similar sweep efficiencies as surfactant polymer but at a reduced operational cost. We expect to deploy the technology in the wells originally drilled for our Phase II of the surfactant polymer project.

Corsicana deeper zone exploration. We successfully drilled and completed two deeper exploratory wells in the Pecan Gap zone in the Corsicana acreage and expect to continue drilling Pecan Gap on our acreage in Corsicana.

Corsicana technology survey. The Company is currently testing a new technology in the Corsicana field involving the detection and recording of helium atoms through sub-surface sensors that are being placed throughout our leasehold. This technology could assist the Company in its mapping of the Pecan Gap reservoir could substantially affect the results of subsequent drilling into that zone.

Concentrate in Core Operating Areas. We currently focus in one region: the Southern Mid-continent region of the United States (which includes the Barnett Shale of North Central Texas and our Corsicana EOR prospect in East Central Texas). Concentrating our drilling and producing activities in these core areas allows us to develop the regional expertise needed to interpret specific geological and operating trends and develop economies of scale. Operating developmental projects (such as our Barnett Shale prospects) and Enhanced Oil Recovery prospects in the same core area allow us to achieve reserve growth, balance our portfolio between oil and natural gas, and minimize some of the operational risks inherent in our industry, while leveraging the benefits of the existing infrastructure.

During the fiscal year, our wholly owned subsidiary, ReoStar Operating, Inc., assumed operations in our Corsicana field.

Manage Our Risk Exposure. We continue to sell a portion of the working interests in the development wells we drill, which allows us to spread the risk by drilling more wells for the same capital expenditure budget.

Plans for fiscal year 2011

Barnett Shale

In December 2008, we suspended our Barnett Shale development due to depressed natural gas prices. We do not expect to renew the development program during this fiscal year. However, we expect to resume the development program during the next fiscal year.

Table of Contents

Corsicana

We have completed our analysis of the results of Phase I of our surfactant polymer flood. We have concluded that the results of the program warrant execution of Phase II. However, during the course of our evaluation, potential new technology with similar sweep efficiencies was evaluated. Based upon the data, we believe the new technology could be employed at a substantial cost savings when compared with a surfactant polymer flood. We have entered into negotiations with the company that owns the technology and expect to begin implementation of a pilot program to test the technology in the second quarter of the fiscal year.

We are also testing a new technology in the Corsicana field involving the detection and recording of helium atoms through the drilling of one-meter holes in 300 plotted locations throughout our leasehold. The technology is owned by one of our largest shareholders and has been successful in its application in foreign oil fields. This technology is able to detect and map helium atoms in the soil, which are always present in hydrocarbon molecules. This technology could assist the Company in its mapping of the Pecan Gap reservoir in leasehold and could substantially affect the results of subsequent drilling in that zone. This Company is not being charged for the direct costs associated with the implementation of the helium technology.

Production, Revenues and Price History

The following table sets forth information regarding oil and gas production, and revenues for ReoStar Energy.

Years Ending	March 31, 2010	March 31, 2009	March 31, 2008
Production			
Oil (Bbl)	23,949	45,105	33,602
Gas (Mcf)	404,131	479,180	351,538
Revenues			
Crude Oil	$ 1,613,235	$ 4,034,376	$ 2,704,468
Gas	1,406,275	2,523,693	2,197,604
Total	3,019,510	6,558,069	4,902,072
Average Sale Price per Bbl	67.36	89.44	$ $80.49
Average Sale Price per MCF	3.48	5.27	$ 6.25
Lease Operating Costs (per BOE)	20.13	20.79	$ 23.05
Severance Taxes (per BOE)	1.71	3.00	$ 3.13
Average Sale Price (per BOE)	33.07	52.48	$ 53.17
Average Sale Price (per MCFE)	5.51	8.75	$ 8.86

(a) Natural Gas was converted to BOE at the rate of 1 barrel equals 6 MCF.

Competition

We encounter substantial competition in developing and acquiring oil and gas properties, securing and retaining personnel, conducting drilling and field operations and marketing production. Competitors in exploration, development, acquisitions and production include the major oil companies as well as numerous independent oil companies, individual proprietors and others. Although our sizable acreage position and core-area concentration provide some competitive advantages, many competitors have financial and other resources substantially exceeding ours. Therefore, competitors may be able to pay more for desirable leases and to evaluate, bid for and purchase a greater number of properties or prospects than our financial or personnel resources allow. Our ability to replace and expand our reserve base depends on our ability to attract and retain quality personnel and our ability to identify and acquire suitable producing properties and prospects for future drilling.

Table of Contents

Employees

As of April 1, 2010, ReoStar Energy Corporation and our subsidiaries had 13 full-time and 4 part-time employees.

All of ReoStar's full-time employees are eligible to receive equity awards approved by the Compensation Committee of the Board of Directors. No employees are covered by a labor union or other collective bargaining arrangement. We believe that the relationship with our employees is excellent. We regularly utilize independent consultants and contractors to perform various professional services, particularly in the areas of drilling, completion, field and on-site production operation services, mainly through our affiliated operator, Rife Energy Operating, Inc.

Available Information

We maintain an internet website under the name "www.reostarenergy.com." Information contained on or connected to our website is not incorporated by reference into this Form 10-K and should not be considered part of this report or any other filing that we make with the SEC. Our Code of Ethics is available on our website and available to any stockholder who provides a written request to Investor Relations at 3880 Hulen Street, Suite 500, Fort Worth, Texas 76107.

We file annual reports on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K, proxy statements and other documents with the SEC under the Securities Exchange Act of 1934. The public may read and copy any materials that we file with the SEC at the SEC's Public Reference Room at 100 F Street, N.E., Washington DC 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. Also, the SEC maintains an internet website that contains reports, proxy and information statements, and other information regarding issuers, including REOSTAR, that file electronically with the SEC. The public can obtain any document we file with the SEC at "www.sec.gov."

Marketing and Customers

We market nearly all of our oil and gas production from the properties we operate for both our interest and that of the other working interest owners and royalty owners. All of our gas produced from the Barnett Shale is sold pursuant to a gas contract with Copano Field Services/North Texas LLC. The contract expires May 31, 2017 and provides for two stages of gathering fees. For all wells in production through December 31, 2010, a gathering fee of $0.55 per MMBTU is assessed against our revenue. Thereafter, for all wells in production as of December 31, 2010, no gathering fee will be assessed. Currently, none of our gas is sold under long-term fixed price contracts. Our Barnett oil is currently sold to Parnon Gathering, Inc. under a month to month contract until such time as either party cancels by providing thirty (30) days advance written notice to the other party of intent to cancel. The contract pays Platts plus minus $1.00 based on Plains - North Texas Sweet posted price.

Oil and gas purchasers are selected on the basis of price, credit quality and service. For a summary of purchasers of our oil and gas production that accounted for 10% or more of consolidated revenue, see Note 13 to our financial statements. Because alternative purchasers of oil and gas are usually readily available, we believe that the loss of any of these purchasers would not have a material adverse effect on us.

During the fiscal year, we implemented a comprehensive commodity price hedging program. The Company entered into a swap contract for 2,000 barrels of oil per month from August through December 2009. The contract locked in the price of oil at $70.40 per barrel. The Company entered into a swap contract for 20,000 MMBTU of natural gas per month from August through December 2009. The contract locked in the price of natural gas at $4.205 per MMBTU. The Company entered into a swap contract for 20,000 MMBTU of natural gas per month from January 2010 through June 2010. The contract locks in the price of natural gas at $5.54 per MMBTU.

During the fiscal year ended March 31, 2010, the Company entered into put and call contracts, which collar 2,000 barrels of oil per month during calendar 2010. The floor is $65 per barrel and the ceiling is $85 per barrel. The Company also entered into put and call contracts which collar 20,000 MMBTU of natural gas per month from July 2010 through December 2010. The floor is $5.50 per MMBTU and the ceiling is $6.50 per MMBTU.

Proximity to local markets, availability of competitive fuels and overall supply and demand are factors affecting the prices for which our production can be sold. Market volatility due to international political developments, overall energy supply and demand, fluctuating weather conditions, economic growth rates and other factors in the United States and worldwide has had, and will continue to have, a significant effect on energy prices.

Table of Contents

For additional information, see "Risk Factors".

Governmental Regulation

Federal, state and local laws and regulations substantially affect our operations. In particular, oil and gas production and related operations are, or have been, subject to price controls, taxes and numerous other laws and regulations. All of the jurisdictions in which we own or operate producing crude oil and natural gas properties have statutory provisions regulating the exploration for and production of crude oil and natural gas, including provisions related to permits for the drilling of wells, bonding requirements in order to drill or operate wells, the location of wells, the method of drilling and casing wells, the surface use and restoration of properties upon which wells are drilled, and the abandonment of wells. Our operations are also subject to various conservation laws and regulations. These include the regulation of the size of drilling and spacing units or proration units, the number of wells which may be drilled in an area, and the unitization or pooling of crude oil and natural gas wells, generally prohibit the venting or flaring of natural gas, and impose certain requirements regarding the ratability or fair apportionment of production from fields and individuals wells.

In August 2005, Congress enacted the Energy Policy Act of 2005 ("EPAct 2005"). Among other matters, the EPAct 2005 amends the Natural Gas Act ("NGA"), to make it unlawful for "any entity", including otherwise non-jurisdictional producers such as ReoStar, to use any deceptive or manipulative device or contrivance in connection with the purchase or sale of natural gas or the purchase or sale of transportation services subject to regulation by the Federal Energy Regulatory Commission ("FERC"), in contravention of rules prescribed by the FERC. On January 20, 2006, the FERC issued rules implementing this provision. The rules make it unlawful in connection with the purchase or sale of natural gas subject to the jurisdiction of FERC, or the purchase or sale of transportation services subject to the jurisdiction of FERC, for any entity, directly or indirectly, to use or employ any device, scheme or artifice to defraud; to make any untrue statement of material fact or omit to make any such statement necessary to make the statements made not misleading; or to engage in any act or practice that operates as a fraud or deceit upon any person. EPAct 2005 also gives the FERC authority to impose civil penalties for violations of the NGA up to $1,000,000 per day per violation. The new anti-manipulation rule does not apply to activities that relate only to intrastate or other non-jurisdictional sale or gathering, but does apply to activities or otherwise non-jurisdictional entities to the extent the activities are conducted "in connection with" gas sales, purchases or transportation subject to FERC jurisdiction. It therefore reflects a significant expansion of FERC's enforcement authority. ReoStar does not anticipate it will be affected any differently than other producers of natural gas.

Failure to comply with applicable laws and regulations can result in substantial penalties. The regulatory burden on the industry increases the cost of doing business and affects profitability. Although we believe we are in substantial compliance with all applicable laws and regulations, such laws and regulations are frequently amended or reinterpreted. Therefore, we are unable to predict the future costs or impact of compliance. Congress, the states, the FERC, and the courts regularly consider additional proposals and proceedings that affect the oil and gas industry. We cannot predict when or whether any such proposals may become effective.

Environmental Matters

Our operations are subject to stringent federal, state and local laws governing the discharge of materials into the environment or otherwise relating to environmental protection. Numerous governmental departments such as the Environmental Protection Agency ("EPA") issue regulations to implement and enforce such laws, which are often difficult and costly to comply with and which carry substantial civil and criminal penalties for failure to comply. These laws and regulations may require the acquisition of a permit before drilling commences, restrict the types, quantities and concentrations of various substances that can be released into the environment in connection with drilling, production and transporting through pipelines, limit or prohibit drilling activities on certain lands lying within wilderness, wetlands, frontier and other protected areas, require some form of remedial action to prevent pollution from former operations such as plugging abandoned wells, and impose substantial liabilities for pollution resulting from operations. In addition, these laws, rules and regulations may restrict the rate of production. The regulatory burden on the oil and gas industry increases the cost of doing business, affecting growth and profitability. Changes in environmental laws and regulations occur frequently, and changes that result in more stringent and costly waste handling, disposal or clean-up requirements could adversely affect our operations and financial position, as well as the industry in general. We believe we are in substantial compliance with current applicable environmental laws and regulations. Although we have not experienced any material adverse effect from compliance with environmental requirements, there is no assurance that this will continue. We did not have any material capital or other non-recurring expenditures in connection with complying with environmental laws or environmental remediation matters during fiscal year ended 2010, nor do we anticipate that such expenditures will be material in fiscal year ended 2011.

Table of Contents

The Comprehensive Environmental Response, Compensation and Liability Act ("CERCLA"), known as the "Superfund" law, imposes liability, without regard to fault or the legality of the original conduct, on certain classes of persons who are considered to be responsible for the release of a "hazardous substance" into the environment. These persons include owners or operators of the disposal site or sites where the release occurred and companies that disposed of or arranged for the disposal of the hazardous substances at the site where the release occurred. Under CERCLA, such persons may be subject to joint and several liabilities for the costs of cleaning up the hazardous substances that have been released into the environment, for damages to natural resources and for the costs of certain health studies. Furthermore, although petroleum, including crude oil and natural gas, is not a "hazardous substance" under CERCLA, at least two courts have ruled that certain wastes associated with the production of crude oil may be classified as "hazardous substances" under CERCLA and that such wastes may therefore give rise to liability under CERCLA. Beyond CERCLA, state laws regulate the disposal of oil and gas wastes, and periodically new state legislative initiatives are proposed that could have a significant impact on us. In addition, it is not uncommon for neighboring landowners and other third parties to file claims for personal injury and property damages allegedly caused by the release of hazardous substances or other pollutants into the environment pursuant to environmental statutes, common law or both.

The Federal Water Pollution Control Act ("FWPCA") imposes restrictions and strict controls regarding the discharge of produced waters and other oil and gas wastes into waters of the United States. Permits must be obtained to discharge pollutants into state and federal waters. The FWPCA and analogous state laws provide for civil, criminal and administrative penalties for any unauthorized discharges of oil and other hazardous substances in reportable quantities and may impose substantial potential liability for the costs of removal, remediation and damages. State water discharge regulations and Federal National Pollutant Discharge Elimination System permits applicable to the oil and gas industry generally prohibit the discharge of produced water, sand and some other substances into coastal waters. The cost to comply with zero discharges mandated under federal and state law has not had a material adverse impact on our financial condition and results of operations.

Some oil and gas exploration and production facilities are required to obtain permits for their storm water discharges. Costs may be incurred in connection with treatment of wastewater or developing and implementing storm water pollution prevention plans. The Resource Conservation and Recovery Act ("RCRA") as amended, generally does not regulate most wastes generated by the exploration and production of oil and gas. RCRA specifically excludes from the definition of hazardous waste "drilling fluids, produced waters, and other wastes associated with the exploration, development, or production of crude oil, natural gas or geothermal energy." However, these wastes may be regulated by the EPA or state agencies as non-hazardous solid waste. Moreover, ordinary industrial wastes, such as paint wastes, waste solvents, laboratory wastes and waste compressor oils, can be regulated as hazardous wastes. Although the costs of managing wastes classified as hazardous waste may be significant, we do not expect to experience more burdensome costs than similarly situated companies.

The Oil Pollution Act ("OPA") requires owners and operators of facilities that could be the source of an oil spill into "waters of the United States" (a term defined to include rivers, creeks, wetlands and coastal waters) to adopt and implement plans and procedures to prevent any spill of oil into any waters of the United States. OPA also requires affected facility owners and operators to demonstrate that they have sufficient financial resources to pay for the costs of cleaning up an oil spill and compensating any parties damaged by an oil spill. Substantial civil and criminal fines and penalties can be imposed for violations of OPA and other environmental statutes.

Stricter standards in environmental legislation may be imposed on the oil and gas industry in the future. For instance, legislation has been proposed in Congress from time-to-time that would alter the RCRA exemption by reclassifying certain oil and gas exploration and production wastes as "hazardous wastes" and make the waste subject to more stringent handling, disposal and clean-up restrictions. If such legislation were enacted, it could have a significant impact on our operating costs, as well as the industry in general. Compliance with environmental requirements generally could have a material adverse effect on our capital expenditures, earnings or competitive position. Although we have not experienced any material adverse effect from compliance with environmental requirements, no assurance may be given that this will continue.

Table of Contents

ITEM 1A. RISK FACTORS

An investment in our common stock is speculative and involves a high degree of risk and uncertainty. You should carefully consider the risks described below, together with the other information contained in our reports filed with the SEC, including the consolidated financial statements and notes thereto of our company, before deciding to invest in our common stock. The risks described below are not the only ones facing our company. Additional risks not presently known to us or that we presently consider immaterial may also adversely affect our company. If any of the following risks occur, our business, financial condition and results of operations and the value of our common stock could be materially and adversely affected.

The Company received a qualified going concern opinion in the report from its auditors.

In their report dated June 29, 2010, the Company's auditors indicated there was substantial doubt about the Company's ability to continue as a going concern without additional fund-raising. Accordingly, unless we raise additional working capital, project financing and/or revenues grow to support our business plan we may be unable to remain in business

Volatility of oil and natural gas prices significantly affects our cash flow and capital resources and could hamper our ability to produce oil and gas economically.

Oil and natural gas prices are volatile, and a decline in prices would adversely affect our profitability and financial condition. The oil and natural gas industry is typically cyclical, and prices for oil and natural gas have been highly volatile. Historically, the industry has experienced severe downturns characterized by oversupply and/or weak demand. In recent years, higher oil and natural gas prices have contributed to increased earnings industry wide. However, long-term supply and demand for oil and natural gas is uncertain and subject to a myriad of factors such as:

- the domestic and foreign supply of oil and gas;
- the price and availability of alternative fuels;
- weather conditions;
- the level of consumer demand;
- the price of foreign imports;
- world-wide economic conditions;
- political conditions in oil and gas producing regions; and
- domestic and foreign governmental regulations.

Decreases in oil and natural gas prices from current levels could adversely affect our revenues, net income, cash flow and economically recoverable proved reserves. Significant price decreases could have a material adverse effect on our operations and limit our ability to fund capital expenditures. Without the ability to fund capital expenditures, we would be unable to replace reserves and production.

High operating costs are inherent in enhanced oil recovery projects and could impair our ability to produce oil and gas economically.

The Company has initiated a surfactant polymer flood, which is classified as an enhanced oil recovery project. The cost of the surfactants and polymers, the cost of preparing the mixture for injection, the cost of injection, the cost of monitoring the quality of the injected solution, and the cost of monitoring the results all contribute to operating expenses which are significantly higher than operating expenses incurred using primary and secondary recovery techniques. Additionally, the response time, response rate, and overall recovery rate of a surfactant polymer flood are uncertain, which could materially impact the operating cost per unit produced.

Due to the higher operating costs (which for the fiscal year ended March 31, 2008 averaged more than $30.00 per BOE), a significant decline in commodity prices could magnify the negative impact on net income, cash flow and proved reserves.

Table of Contents

Hedging transactions may limit our potential gains and involve other risks.

To manage our exposure to price risk, we may, from time to time, enter into hedging arrangements, utilizing commodity derivatives with respect to a significant portion of our future production. The goal of hedging is to lock in prices so as to limit volatility and increase the predictability of cash flow. These transactions may limit potential gains if oil and natural gas prices rise above the price established by the hedge. In addition, hedging transactions may cause risk of financial loss in certain circumstances.

Information concerning our reserves and future net reserve estimates is uncertain.

There are numerous uncertainties inherent in estimating quantities of proved oil and natural gas reserves and their values, including many factors beyond our control. Estimates of proved reserves are by their nature uncertain. Although we believe these estimates are reasonable, actual production, revenues and costs to develop will likely vary from estimates, and these variances could be material.

The accuracy of any reserve estimate is a function of the quality of available data; engineering and geological interpretation and judgment; assumptions used regarding quantities of oil and natural gas in place; recovery rates; and future commodity pricing.

Actual prices, production, development expenditures, operating expenses and quantities of recoverable oil and natural gas reserves will vary from those assumed in our estimates, and such variances may be material. Any variance in the assumptions could materially affect the estimated quantity and value of the reserves.

If oil and natural gas prices decrease or exploration efforts are unsuccessful, we may be required to take write-downs of our oil and natural gas properties.

This could occur when oil and natural gas prices are low, if we have downward adjustments to our estimated proved reserves, increases in our estimates of operating or development costs, deterioration in our exploration results, unsatisfactory results in our enhanced oil recovery projects, or mechanical problems with wells where the cost to re-drill or repair does not justify the expenditures required.

Accounting rules require that the carrying value of oil and natural gas properties be periodically reviewed for possible impairment. "Impairment" is recognized when the book value of a proven property is greater than the expected undiscounted future net cash flows from that property and on acreage when conditions indicate the carrying value is not recoverable. We may be required to write down the carrying value of a property based on oil and natural gas prices at the time of the impairment review, as well as a continuing evaluation of drilling results, production data, economics and other factors. While an impairment charge reflects our long-term ability to recover an investment, it does not impact cash or cash flow from operating activities, but it does reduce our reported earnings and negatively impacts our leverage ratios.

Our business is subject to operating hazards and environmental regulations that could result in substantial losses or liabilities.

Oil and natural gas operations are subject to many risks, including well blowouts, mechanical failures, explosions, uncontrollable flows of oil, natural gas or well fluids, fires, formations with abnormal pressures, pipeline ruptures or spills, pollution, releases of toxic natural gas and other environmental hazards and risks. If any of these hazards occur, we could sustain substantial losses as a result of:

- injury or loss of life;
- severe damage to or destruction of property, natural resources, and equipment;
- pollution or other environmental damage;
- clean-up responsibilities;
- regulatory investigations and penalties; or
- suspension of operations.

Table of Contents

As we drill to deeper horizons and in more geologically complex areas, we could experience a greater increase in operating and financial risks due to inherent higher reservoir pressures and unknown down-hole risk exposures. As we continue to drill deeper, the number of rigs capable of drilling to such depths will be fewer and we may experience greater competition from other operators.

Our operations are subject to numerous and increasingly strict federal, state and local laws, regulations and enforcement policies relating to the environment. We may incur significant costs and liabilities in complying with existing or future environmental laws, regulations and enforcement policies and may incur costs arising out of property damage or injuries to employees and other persons. These costs may result from our current and former operations and even may be caused by previous owners of property we own or lease. Any past, present or future failure by us to completely comply with environmental laws, regulations and enforcement policies could cause us to incur substantial fines, sanctions or liabilities from cleanup costs or other damages. Incurrence of those costs or damages could reduce or eliminate funds available for exploration, development or acquisitions or cause us to incur losses.

In accordance with our operating agreements, the operator maintains insurance against some, but not all, of these potential risks and losses. We may elect not to obtain insurance if we believe that the cost of available insurance is excessive relative to the risks presented. We do not maintain business interruption insurance.

In addition, pollution and environmental risks generally are not fully insurable. If a significant accident or other event occurs that is not fully covered by insurance, it could have a material adverse affect on our financial condition and results of operations.

We are subject to financing and interest rate exposure risks.

Our business and operating results can be harmed by factors such as the availability, terms of and cost of capital, increases in interest rates or a reduction in credit rating. These changes could cause our cost of doing business to increase, which limit our ability to pursue acquisition opportunities and place us at a competitive disadvantage.

Many of our current and potential competitors have greater resources than ours, and we may not be able to successfully compete in acquiring, exploring and developing new properties.

We face competition in every aspect of our business, including, but not limited to, acquiring reserves and leases, obtaining goods, services and employees needed to operate and manage our business and marketing oil and natural gas. Competitors include multinational oil companies, independent production companies and individual producers and operators. Many of our competitors have greater financial and other resources than we do.

The demand for field services and their ability to meet that demand may limit our ability to drill and produce our oil and natural gas properties.

Due to current industry demands, well service providers and related equipment and personnel are in short supply. This will result in escalating prices, the possibility of poor services coupled with potential damage to down-hole reservoirs and personnel injuries. Such pressures will likely increase the actual cost of services, extend the time to secure such services and add costs for damages due to accidents sustained from the over use of equipment and inexperienced personnel.

The oil and natural gas industry is subject to extensive regulation.

The oil and natural gas industry is subject to various types of regulations in the United States by local, state and federal agencies. Legislation affecting the industry is under constant review for amendment or expansion, frequently increasing our regulatory burden. Numerous departments and agencies, both state and federal, are authorized by statute to issue rules and regulations binding on participants in the oil and natural gas industry. Compliance with such rules and regulations often increases our cost of doing business and, in turn, decreases our profitability.

Table of Contents

Acquisitions are subject to the risks and uncertainties of evaluating reserves and potential liabilities and may be disruptive and difficult to integrate into our business.

We could be subject to significant liabilities related to acquisitions. It generally is not feasible to review in detail every individual property included in an acquisition. Ordinarily, a review is focused on higher valued properties. However, even a detailed review of all properties and records may not reveal existing or potential problems in all of the properties, nor will it permit us to become sufficiently familiar with the properties to assess fully their deficiencies and capabilities. We do not always inspect every well we acquire, and environmental problems, such as groundwater contamination, are not necessarily observable even when an inspection is performed.

In addition, there is intense competition for acquisition opportunities in our industry. Competition for acquisitions may increase the cost of, or cause us to refrain from, completing acquisitions. Our acquisition strategy is dependent upon, among other things, our ability to obtain debt and equity financing and, in some cases, regulatory approvals. Our ability to pursue our acquisition strategy may be hindered if we are not able to obtain financing on terms acceptable to regulatory approvals or us.

Acquisitions often pose integration risks and difficulties. In connection with future acquisitions, the process of integrating acquired operations into our existing operations may result in unforeseen operating difficulties and may require significant management attention and financial resources that would otherwise be available for the ongoing development or expansion of existing operations. Future acquisitions could result in our incurring additional debt, contingent liabilities, expenses and diversion of resources, all of which could have a material adverse effect on our financial condition and operating results.

Our success depends on key members of our management and our ability to attract and retain experienced technical and other professional personnel.

Our success is highly dependent on our management personnel. The loss of one or more of these individuals could have a material adverse effect on our business. Furthermore, competition for experienced technical and other professional personnel is intense. If we cannot retain our current personnel or attract additional experienced personnel, our ability to compete could be adversely affected.

Our future success depends on our ability to replace reserves that we produce.

Because the rate of production from oil and natural gas properties generally declines as reserves are depleted, our future success depends upon our ability to economically find or acquire and produce additional oil and natural gas reserves. Except to the extent that we acquire additional properties containing proved reserves, conduct successful exploration and development activities or, through engineering studies, identify additional behind-pipe zones or secondary recovery reserves, our proved reserves will decline as reserves are produced. Future oil and natural gas production, therefore, is highly dependent upon our level of success in acquiring or finding additional reserves that are economically recoverable. We cannot assure you that we will be able to find or acquire and develop additional reserves at an acceptable cost.

New technologies may cause our current exploration and drilling methods to become obsolete.

The oil and natural gas industry is subject to rapid and significant advancements in technology, including the introduction of new products and services using new technologies. As competitors use or develop new technologies, we may be placed at a competitive disadvantage, and competitive pressures may force us to implement new technologies at a substantial cost. In addition, competitors may have greater financial, technical and personnel resources that allow them to enjoy technological advantages and may in the future allow them to implement new technologies before we can. One or more of the technologies that we currently use or that we may implement in the future may become obsolete. We cannot be certain that we will be able to implement technologies on a timely basis or at a cost that is acceptable to us. If we are not able to maintain technological advancements consistent with industry standards, our operations and financial condition may be adversely affected.

Table of Contents

Our business depends on oil and natural gas transportation facilities, most of which are owned by others.

The marketability of our oil and natural gas production depends in part on the availability, proximity and capacity of pipeline systems owned by third parties. The unavailability of or lack of available capacity on these systems and facilities could result in the shut-in of producing wells or the delay or discontinuance of development plans for properties. Although we have some contractual control over the transportation of our product, material changes in these business relationships could materially affect our operations. We generally do not purchase firm transportation on third party facilities and therefore, our production transportation can be interrupted by those having firm arrangements.

Federal and state regulation of oil and natural gas production and transportation, tax and energy policies, changes in supply and demand, pipeline pressures, damage to or destruction of pipelines and general economic conditions could adversely affect our ability to produce, gather and transport oil and natural gas.

The disruption of third-party facilities due to maintenance and/or weather could negatively impact our ability to market and deliver our products. We have no control over when or if such facilities are restored or what prices will be charged. A total shut-in of production could materially affect us due to a lack of cash flow, and if a substantial portion of the production is hedged at lower than market prices, those financial hedges would have to be paid from borrowings absent sufficient cash flow.

Indebtedness could limit our ability to successfully operate our business.

If we decide to pursue additional acquisitions, our capital expenditures will increase both to complete such acquisitions and to explore and develop any newly acquired properties. Our existing operations will also require ongoing capital expenditures. We may choose to increase debt in order to finance any of these potential capital expenditure requirements. The degree to which we are leveraged could have other important consequences, including the following:

- we may be required to dedicate a substantial portion of our cash flows from operations to the payment of our indebtedness, reducing the funds available for our operations;
- a portion of our borrowings are at variable rates of interest, making us vulnerable to increases in interest rates;
- we may be more highly leveraged than some of our competitors, which could place us at a competitive disadvantage;
- our degree of leverage may make us more vulnerable to a downturn in our business or the general economy;
- the terms of our credit arrangements could contain numerous financial and other restrictive covenants;
- our debt level could limit our flexibility in planning for, or reacting to, changes in our business and the industry in which we operate; and
- we may have difficulties borrowing money in the future.

Any failure to meet our debt obligations could harm our business, financial condition and results of operations.

If our cash flow and capital resources are insufficient to fund our current or future debt obligations, we may be forced to sell assets, seek additional equity or restructure our debt. In addition, any failure to make scheduled payments of interest and principal on our outstanding indebtedness would likely result in a reduction of our credit rating, which could harm our ability to incur additional indebtedness on acceptable terms. Our cash flow and capital resources may be insufficient for payment of interest on and principal of our debt in the future and any such alternative measures may be unsuccessful or may not permit us to meet scheduled debt service obligations, which could cause us to default on our obligations and impair our liquidity.

Table of Contents

The current global financial crisis may adversely affect our business, operating results and financial condition.

The global financial markets are in turmoil, and the economies of the United States and many other countries have recently been in recession, which may be severe and prolonged and have been characterized by high unemployment, limited availability of credit and capital, increased rates of default and bankruptcy and decreased consumer and business spending. These developments could negatively affect our business, operating results and financial condition in a number of ways. For example, this recession has had an unprecedented negative impact on the global credit and capital markets, resulting in financing terms that are less attractive to borrowers, and in many cases, the unavailability of certain types of debt or capital financing. If this crisis continues or worsens, and if we are required to obtain financing in the near term to meet our working capital or other business needs, we may not be able obtain that financing. Further, even if we are able to obtain the financing we need, it may be on terms that are not favorable to us, with increased financing costs and restrictive covenants.

We exist in a litigious environment.

Any constituent could bring suit or allege a violation of an existing contract. This action could delay when operations can actually commence or could cause a halt to production until the courts resolve such alleged violations. Not only could we incur significant legal and support expenses in defending our rights, planned operations could be delayed which would impact our future operations and financial condition. Such legal disputes could also distract management and other personnel from their primary responsibilities.

Common stockholders will be diluted if additional shares are issued.

We may incur debt that provides for a conversion to equity. Additionally, we may issue stock as consideration for additional property acquisitions. If we issue additional shares of our common stock in the future, it may have a dilutive effect on our current outstanding stockholders.

Dividend limitations.

Our ability to pay dividends may be limited by covenants imposed under future debt arrangements.

Our financial statements are complex.

Due to accounting rules, our financial statements continue to be complex, particularly with reference to hedging, asset retirement obligations, equity awards, and deferred taxes. We expect such complexity to continue and possibly increase.

Our stock price may be volatile and you may not be able to resell shares of our common stock at or above the price you paid.

The price of our common stock fluctuates significantly, which may result in losses for investors. To date our stock has been lightly traded, with the average daily volume being quite low. The low trading volume may prevent you from liquidating your position in our stock quickly. Additionally, the low trading volume may contribute significantly to price volatility. We expect our stock to be subject to fluctuations as a result of a variety of factors, including factors beyond our control. These include:

- changes in oil and natural gas prices;
- variations in quarterly drilling, re-completions, acquisitions and operating results;
- changes in financial estimates by securities analysts;
- changes in market valuations of comparable companies;
- additions or departures of key personnel; or
- future sales of our stock.

Table of Contents

We may fail to meet expectations of our stockholders or of securities analysts at some time in the future, and our stock price could decline as a result. Furthermore, the ability to access capital has been somewhat impaired due to the financial downturn, which could impact the Company's ability to do the same.

ITEM 1B. UNRESOLVED STAFF COMMENTS

Not applicable

ITEM 2. PROPERTIES

The information below summarizes certain data for our core operating areas for the year ended March 31, 2010. Segment reporting is not applicable to us as we have a single company-wide management team that administers all properties as a whole rather than by discrete operating segments. We track only basic operational data by area. We do not maintain complete separate financial statement information by area. We measure financial performance as a single enterprise and not on an area-by-area basis.

We conduct drilling, production and field operations in the Barnett Shale of North Central Texas, and the Corsicana field of East Central Texas.

Barnett Shale

The Barnett Shale is a non-conventional natural gas resource play located in North Texas. It underlies approximately 5,000 square miles and at least 17 counties. Our leases lie in the north western portion of the Barnett Shale, an area known as the "oil window," due to its production of both oil and gas.

We have drilled and own interests in 71 completed wells, all of which are operated by Rife Energy Operating, Inc., a non-publicly traded affiliated company owned by a shareholder who controls more than 25% of our outstanding stock. Our average working interest is 47%, and our average net revenue interest is 36%. We have approximately 5,215 acres under lease, the majority of which is not classified as proven. During the fiscal year ended March 31, 2010, our Barnett Shale production consisted of 404,131 MCF of natural gas and 23,949 barrels of oil, or approximately 91,300 BOE (547,825 MCFE).

Proved developed producing reserves consisted of 1,920 MMCF of natural gas and 58 M barrels of oil, or, 378 MBOE (2,267 MMCFE). Proved developed non-producing reserves consisted of 33 MMCF of natural gas and 8 M barrels of oil, or, 13 MBOE (81 MMCFE). Total proved developed reserves at March 31, 2010 were 392 MBOE (2,348 MMCFE). Total proven, undeveloped reserves consisted of 16,820 MMCF natural gas and 643 M barrels of oil, or, 3,446 MBOE (20,680 MMCFE).

At March 31, 2010, we had a Barnett Shale drilling inventory of 50 proven drilling locations and more than 100 probable drilling locations.

Corsicana Field

We own interests in 77 producing well bores and 199 inactive wells. During the fiscal year, we transitioned operation of all of our properties in Corsicana from a non-publicly traded affiliate to a ReoStar Operating, Inc. Our average working interest is 95%, and our average net revenue interest is 76%. During the fiscal year ended March 31, 2010, our oil production in the Corsicana field totaled 10,300 barrels of oil.

The Nacatoch reservoir is fairly shallow with depths of less than 1,000 feet. While this field has been producing for more than one hundred years, several engineering studies have estimated that more than 80% of the original reserves still remain in place or approximately 100 MMBO.

We are evaluating optional EOR techniques including the use of chemicals (micellar flood), steam, and fire floods.

There are many alternative reservoirs between 1000 and 7000 feet, which are being evaluated for optimal exploitation. The company feels that there are tremendous opportunities in the multiple zones within this range and it plans on attempting to produce from each one.

Table of Contents

During the fiscal year ended March 31, 2010, the Company drilled three Pecan Gap test wells. Two of the wells were successfully completed. The Company has identified 7 additional proven undeveloped drilling locations in the Pecan Gap formation and plans to beginning drilling these wells in the fourth quarter of the fiscal year. If these wells are successful, the Company expects to begin an extensive drilling program, and may drill up to 200 more Pecan Gap wells. The Pecan Gap formation lies at about 1,800 feet, and the wells cost approximately $130,000 to drill and complete. The Company has secured co-financing for these wells from an industry partners who have purchased working interests in the first three wells and expects to sell up to 50% of any additional Pecan Gap wells we drill.

We are also testing a new technology in the Corsicana field involving the detection and recording of helium atoms through the drilling of one-meter holes in 300 plotted locations throughout our leasehold. The technology is owned by one of our largest shareholders and has been successful in its application in foreign oil fields. This technology is able to detect and map helium atoms in the soil, which are always present in hydrocarbon molecules. This technology could assist the Company in its mapping of the Pecan Gap reservoir in leasehold and could substantially affect the results of subsequent drilling in that zone. This Company is not being charged for the direct costs associated with the implementation of the helium technology.

As of March 31, 2010, total proved developed reserves were 32 MBOE and proved undeveloped reserves totaled 40 MBOE.

East Texas Properties

During the fiscal year ended March 31, 2010, the Company divested of its East Texas assets.

Proven Reserves

Proven oil and gas reserves are defined as the estimated quantities of crude oil, condensate, natural gas liquids and natural gas that geological and engineering data demonstrate with reasonable certainty are recoverable from known reservoirs under existing economic and operating conditions, i.e., prices and costs as of the date the estimate is made. Prices include consideration of changes in existing prices provided only by contractual arrangements, but not on escalations based upon future conditions.

See financial statement footnote number 17, "Supplemental Info on Oil and Gas Exploration, Development, and Production Activities" for the disclosures required by FASB ASC 932 and more detailed information regarding our proven reserves.

At year-end 2010, the independent petroleum-consulting firm of Forrest Garb and Associates, Inc. reviewed our reserves. These engineers were selected for their geographic expertise and their history in engineering enhanced oil recovery prospects similar to our Corsicana properties. At March 31, 2010, these consultants reviewed 100% of our proved reserves.

All estimates of oil and gas reserves are subject to uncertainty. The following table sets forth the estimated proven reserves in barrel of oil equivalents and the benchmark prices used in projecting them (in thousands except prices):

Estimated Proved Reserves	*Barnett Shale*	*Corsicana Field*	*Total*
Proved Developed (MBOE)	392	32	424
Proved Undeveloped (MBOE)	3,446	40	3,486
Total Proven Reserves at March 31, 2010	3,838	72	3,910
Benchmark Pricing			
Natural Gas per mmbtu	$3.99		
Crude Oil per barrel	$70.03		

There are numerous uncertainties inherent in estimating reserves and related information and different reservoir engineers often arrive at different estimates for the same properties. No estimates of our reserves have been filed with or included in reports to another federal authority or agency.

Table of Contents

Wells are classified as crude oil or natural gas according to their predominant production stream.

The day-to-day operations of oil and gas properties are the responsibility of the operator designated under pooling or operating agreements. The operator supervises production, maintains production records, employs or contracts for field personnel and performs other functions. An operator receives reimbursement for direct expenses incurred in the performance of its duties as well as monthly per-well producing and drilling overhead reimbursement at rates customarily charged by unaffiliated third parties. The charges customarily vary with the depth and location of the well being operated. The operator of our Barnett Shale properties is affiliated with ReoStar and is owned by shareholders who own more than 25% of our issued and outstanding common stock.

Undeveloped Acreage Expirations

A significant amount of our Barnett Shale acreage is not yet held by production. However, due to our planned drilling schedules and lease renewal provisions, we do not anticipate significant leasehold expirations during the next two years.

Our Corsicana properties are held by production.

Title to Properties

We believe that we have satisfactory title to all of our producing properties in accordance with generally accepted industry standards. As is customary in the industry, in the case of undeveloped properties, often minimal investigation of record title is made at the time of lease acquisition. Investigations are made prior to the consummation of an acquisition of producing properties and before commencement of drilling operations on undeveloped properties. Individual properties may be subject to burdens that we believe do not materially interfere with the use or affect the value of the properties. Burdens on properties may include:

- customary royalty interests;
- liens incident to operating agreements and for current taxes;
- obligations or duties under applicable laws;
- development obligations under oil and gas leases; or
- burdens such as net profit interests.

Our headquarters are located at 3880 Hulen St, Suite 500, Fort Worth, Texas. We lease approximately 12,000 square feet of office space under a lease and sublease approximately one- half of the space to our affiliated operating entity, which contributes to the costs of leasing and maintenance of the leasehold, pro-rata to their respective usage. The lease expires on January 31, 2011. We pay rent at a rate of $1.26 per square foot, per month. Our administrative and office facilities are suitable for their respective uses.

ITEM 3. LEGAL PROCEEDINGS

On September 15, 2008, a royalty owner in the Corsicana polymer pilot, representing approximately one-third of the mineral ownership, filed an amendment to a suit originally filed in 2007. The amendment was filed to include the Company as a defendant. The suit, filed in the 13th Judicial District Court in Navarro County, Texas, alleges the lease has expired because no oil was produced from January 2005 through September 2005. The plaintiff has asked the court to declare the lease to be void; demands payment for any oil produced and sold subsequent to the time the lease expired; demands that all equipment and salvage located on the lease be given by court order to the plaintiff; and asks that any plugging liability be adjudged to be the responsibility of the Company.

The other royalty owners representing the remaining two-thirds mineral ownership have ratified the lease.

Table of Contents

In October 2008, the court issued an order requiring the Company and plaintiff to attend mediation to settle the matter. The Company and plaintiff attended mediation in Corsicana, Texas, but were unable to resolve the matter during mediation. In March, the plaintiff filed a motion for summary judgment, which the court has denied. The Company is evaluating which actions are the most appropriate for the Company to take in respect of this matter, and we intend to continue to defend this matter vigorously or otherwise resolve this matter in a manner that we believe will not have a material adverse effect on our business, financial condition and results of operations.

If the plaintiff should prevail in the lawsuit, the amount of the loss contingency cannot be reasonable estimated; therefore no expense for this contingency has been recorded on the accompanying financial statements.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

There were no matters submitted to a vote of our security holders during the fourth quarter of 2010.

PART II

ITEM 5. MARKET FOR COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Market Information

Our common stock is currently quoted for trading on Over-the-Counter Bulletin Board (OTCBB) maintained by the Financial Industry Regulatory Authority (FINRA) under the symbol "REOS". There was no active market or any trading volume with respect to the shares of our common stock in the periods prior to the quarter ended December 31, 2006.

The following table sets forth the high and low closing sale price of our common stock, as reported by the National Association of Securities Dealers Composite for each quarter during the past two fiscal years.

Fiscal 2009	High	Low
30-Jun-09	$0.51	$0.06
30-Sep-09	$0.50	$0.10
31-Dec-09	$0.49	$0.11
31-Mar-10	$0.39	$0.08

Fiscal 2009	High	Low
30-Jun-08	$0.95	$0.20
30-Sep-08	$0.74	$0.20
31-Dec-08	$0.50	$0.10
31-Mar-09	$0.30	$0.05

Holders of Record

On March 31, 2010, there were approximately 90 holders of record of our common stock.

Dividends

We have not paid any cash dividends on our Common Stock, and do not anticipate paying cash dividends on our Common Stock in the next year. We anticipate that any income generated in the foreseeable future will be retained for the development and expansion of our business. Future dividend policy is subject to the discretion of the Board of Directors and will depend upon a number of factors, including future earnings, debt service, debt covenants, capital requirements, business conditions, the financial condition of the Company and other factors that the Board of Directors may deem relevant.

Table of Contents

ITEM 6. SELECTED FINANCIAL DATA

Not applicable.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion is intended to assist you in understanding our business and results of operations together with our present financial condition. This section should be read in conjunction with the financial statements and the accompanying notes included elsewhere in this annual report on Form 10-K.

Statements in our discussion may be forward-looking. These forward-looking statements involve risks and uncertainties. We caution that a number of factors could cause future production, revenues and expenses to differ materially from our expectations. See "Disclosures Regarding Forward-Looking statements" at the beginning of this Annual Report and "Risk Factors" in Item 1A for additional discussion of some of these factors and risks.

Overview of Our Business

We are an independent natural gas and oil company engaged in the acquisition, development, and exploration of oil and gas properties, primarily in Texas. Our objective is to build a balanced portfolio consisting of oil and gas producing properties and reserves in both resource (developmental) and enhanced oil recovery (redevelopment) plays. We will expand reserves through internally generated drilling projects coupled with complementary acquisitions.

Our revenues, profitability and future growth depend substantially on prevailing prices for oil and gas and on our ability to find, develop and acquire oil and gas reserves that are economically recoverable. Our profitability depends upon our ability to control operations of our oil and gas assets.

We have a single company-wide management team that administers all properties as a whole rather than by independent operating segments. We track only basic operational data by area and we do not maintain complete separate financial statement information by area. We measure financial performance as a single enterprise and not on an area-by-area basis.

Successful Efforts Method of Accounting

We account for our exploration and development activities utilizing the successful efforts method of accounting. Under this method, costs of productive exploratory wells, development dry holes and productive wells and undeveloped leases are capitalized. Oil and natural gas lease acquisition costs are also capitalized. Exploration costs, including personnel costs, certain geological and geophysical expenses and delay rentals for oil and natural gas leases, are charged to expense as incurred. Exploratory drilling costs are initially capitalized, but charged to expense if and when the well is determined not to have found reserves in commercial quantities. The sale of a partial interest in a proved property is accounted for as a cost recovery and no gain or loss is recognized as long as this treatment does not significantly affect the unit-of-production amortization rate. A gain or loss is recognized for all other sales of producing properties.

The application of the successful efforts method of accounting requires managerial judgment to determine the proper classification of wells designated as developmental or exploratory which will ultimately determine the proper accounting treatment of the costs incurred. The results from a drilling operation can take considerable time to analyze and the determination that commercial reserves have been discovered requires both judgment and industry experience. Wells may be completed that are assumed to be productive and actually deliver oil and natural gas in quantities insufficient to be economic, which may result in the abandonment of the wells at a later date. The evaluation of oil and natural gas leasehold acquisition costs requires managerial judgment to estimate the fair value of these costs with reference to drilling activity in a given area.

Table of Contents

The successful efforts method of accounting can have a significant impact on the operational results reported when we enter a new exploratory area in hopes of finding an oil and natural gas field that will be the focus of future developmental drilling activity. The initial exploratory wells may be unsuccessful and will be expensed. Seismic costs can be substantial which will result in additional exploration expenses when incurred.

Industry Environment

We operate entirely within the United States, a mature region for the exploration and production of oil and gas. As a mature region, the size and frequency of new discoveries is declining, while finding and development costs are increasing.

We believe that there remain certain areas in the southern Mid-continent region which are under-explored or have not been fully explored and developed with the benefit of newly available exploration, production and reserve enhancement technology. Examples of such technology include advanced 3-D seismic processing, hydraulic reservoir fracture stimulation, advances in well logging and analysis, and enhanced oil recovery practices.

Another characteristic of a mature region is the historical exit of larger independent producers and major oil companies from such regions. These companies, searching for larger new discoveries, have ventured increasingly overseas and offshore, de-emphasizing their onshore United States assets. This movement out of mature basins by larger companies has provided acquisition opportunities for companies that are capable of quickly analyzing opportunities, well positioned financially to quickly close an acquisition, and have the technical expertise to generate additional value from these assets.

In other situations, larger independent producers and major integrated oil companies have allowed smaller companies the opportunity to explore and develop reserves on their undeveloped acreage through joint ventures and farm-in arrangements.

We believe the acquisition market for natural gas properties has become extremely competitive as producers vie for additional production and expanded drilling opportunities. During the last fiscal year, leasehold acquisition values reached historic highs. While these prices have moderated with the decline in natural gas commodity prices, we expect these values to increase in the near future. As natural gas demand rebounds, we expect drilling and service costs pressures to increase, resulting in higher finding and development costs. In addition, we expect lease-operating expenses to continue to rise as producers are forced to make operational enhancements to maintain production in aging fields.

Crude oil and natural gas are commodities that are traded on regulated markets. The price that we receive for the crude oil and natural gas we produce is largely a function of market supply and demand. Demand for natural gas in the United States has increased dramatically over the last ten years. Demand is impacted by general economic conditions, estimates of gas in storage, weather and other seasonal conditions, including hurricanes and tropical storms. Demand for crude oil has also increased over the last ten years while the increase in supply has not increased proportionately resulting in a tight market. Market conditions involving over or under supply of crude oil and natural gas can result in substantial price volatility. Historically, commodity prices have been volatile and we saw extreme volatility during the last fiscal year. We expect the volatility to continue in the future. A substantial or extended decline in oil and gas prices or poor drilling results could have a material adverse effect on our financial position, results of operations, cash flows, quantities of oil and gas reserves that may be economically produced and our ability to access capital markets.

We derive our revenues from the sale of crude oil and natural gas that is produced from our properties. Revenues are a function of the volume produced and the prevailing market price at the time of sale. The price of oil and natural gas is the primary factor affecting our revenues.

Principal Components of Our Cost Structure

Direct Operating Expenses. These are day-to-day costs incurred to bring hydrocarbons out of the ground and to the market together with the daily costs incurred to maintain our producing properties. Such costs also include work-over repairs to our oil and gas properties not covered by insurance. To minimize and help control our costs, we acquired a work-over drilling rig and a swab rig in June of 2007. During fiscal year ended March 31, 2009 we completed refurbishment of a shallow well oil drilling rig which will be used to drill our Corsicana Nacatoch and Pecan Gap wells.

Table of Contents

Production and Ad Valorem Taxes. These costs are primarily paid based on a percentage of market prices or at fixed rates established by federal, state or local taxing authorities.

Exploration Expense. The costs include geological and geophysical costs, seismic costs, delay rentals and the costs of unsuccessful wells or dry holes. While our current asset mix requires a minimum of geological and geophysical costs and seismic costs, it is possible this component of our cost structure could sharply increase depending upon future property acquisitions.

Plugging Costs. The Corsicana field is over one hundred years old and has hundreds of abandoned well bores scattered throughout the properties. In order to properly execute our enhanced oil recovery projects, we need to plug these abandoned, worn out well bores. Since the wells are fairly shallow, we are able to cement in the entire well bore at a cost of less than $1,500 per well.

General and Administrative Expenses. Overhead, including payroll and benefits for our corporate staff, costs of maintaining our headquarters, costs of finding our working interest partners, costs of managing our production and development operations, audit and other professional fees and legal compliance are included in general and administrative expense. General and administrative expense includes stock-based compensation expense (non-cash) associated with the adoption of FASB ASC 718, amortization of restricted stock grants as part of employee compensation.

Interest. We increased our levels of debt during fiscal year 2010, and in the future, we may finance a larger portion of our working capital requirements and acquisitions with borrowings under a credit facility or with longer-term public traded debt securities. As a result, interest expense could become a much more prevalent component of our cost structure.

Depreciation, Depletion and Amortization. As a successful efforts company, we capitalize all costs associated with our acquisition and all successful development and exploration efforts, and apportion these costs to each unit of production through depreciation, depletion and amortization expense. This also includes the systematic, monthly depreciation of our oilfield equipment assets.

Changes in Estimates. Changes in estimates of proved reserves significantly impact the depletion expense we record each year. When proved reserves increase, our depletion rate decreases, resulting in a lower depletion expense and high