ARETE INDUSTRIES INC
Form 10-Q
May 20, 2013
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# UNITED STATES

# SECURITIES AND EXCHANGE COMMISSION

**WASHINGTON, D.C. 20549**

# FORM 10-Q

x **Quarterly Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.**
**For the quarterly period ended March 31, 2013**

**Or**

¨ **Transition Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.**
**For the transition period from _________ to _________**

**Commission File Number 33-16820-D**

# ARÊTE INDUSTRIES, INC.

**(Exact name of registrant as specified in its charter)**

| | |
|---|---|
| **Colorado** | **84-1508638** |
| **(State or Other Jurisdiction of** | **(I.R.S. Employer** |
| **Incorporation or Organization)** | **Identification No.)** |
| **7260 Osceola Street, Westminster, Colorado** | **80030** |
| **(Address of Principal Executive Offices)** | **(Zip Code)** |

**303-427-8688**

**(Registrant s Telephone Number, Including Area Code)**

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

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

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

| | | | |
|---|---|---|---|
| Large accelerated filer | ¨ | Accelerated filer | ¨ |
| Non-accelerated filer | ¨ | Smaller reporting company | x |

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

As of May 15, 2013, the Registrant had 7,979,801 shares of common stock issued and outstanding.

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**Part 1 FINANCIAL INFORMATION**

**Item 1 - Financial Statements**

## ARÊTE INDUSTRIES, INC. AND SUBSIDIARIES

### UNAUDITED CONSOLIDATED BALANCE SHEETS

### December 31, 2012 and March 31, 2013

| ASSETS | 2012 | 2013 |
|---|---|---|
| **Current Assets:** | | |
| Cash and equivalents | $ 6,921 | $ 3,948 |
| Receivable from DNR Oil & Gas, Inc.: | | |
| Oil and gas sales, net of production costs | 87,989 | 183,280 |
| Other | 61,243 | 72,721 |
| Prepaid expenses and other | 61,034 | 31,365 |
| Total Current Assets | 217,187 | 291,314 |
| **Property and Equipment:** | | |
| Oil and gas properties, at cost, successful efforts method: | | |
| Proved properties | 9,389,245 | 9,568,861 |
| Unevaluated properties | 314,336 | 314,336 |
| Natural gas gathering system | 442,195 | 442,195 |
| Furniture and equipment | 22,522 | 22,522 |
| Total property and equipment | 10,168,298 | 10,347,914 |
| Less accumulated depreciation, depletion and amortization | (1,499,284) | (1,666,932) |
| Net Property and Equipment | 8,669,014 | 8,680,982 |
| **TOTAL ASSETS** | $ 8,886,201 | $ 8,972,296 |

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**ARÊTE INDUSTRIES, INC. AND SUBSIDIARIES**

**UNAUDITED CONSOLIDATED BALANCE SHEETS**

**December 31, 2012 and March 31, 2013**

| LIABILITIES AND STOCKHOLDERS EQUITY | 2012 | 2013 |
|---|---|---|
| **Current Liabilities:** | | |
| Accounts payable: | | |
| Payable to DNR Oil & Gas, Inc.: | | |
| Oil and gas property acquisition costs | $ 250,000 | $ 250,000 |
| Gas gathering operating costs | 436,403 | 436,403 |
| Operator fees and other | 159,748 | 313,529 |
| Unrelated parties | 92,943 | 99,080 |
| Preferred stock dividends payable | | |
| Notes and advances payable: | | |
| Directors and affiliates | 508,991 | 548,423 |
| Unrelated parties | 250,000 | 250,000 |
| Accrued interest expense | 48,359 | 67,105 |
| Director fees payable in common stock | 33,615 | 34,065 |
| Accrued consulting services payable in common stock | 42,000 | 60,750 |
| Current portion of asset retirement obligations | 78,140 | 79,380 |
| Other accrued costs and expenses | 255,740 | 180,252 |
| Total Current Liabilities | 2,155,939 | 2,318,987 |
| **Long-Term Liabilities:** | | |
| Contingent acquisition costs payable to DNR Oil & Gas, Inc. | 250,000 | 250,000 |
| Asset retirement obligations, net of current portion | 569,128 | 584,182 |
| Total Long-Term Liabilities | 819,128 | 834,182 |
| Total Liabilities | 2,975,067 | 3,153,169 |
| **Commitments and Contingencies (Notes 3, 4, 10 and 13)** | | |
| **Stockholders Equity:** | | |
| Convertible Class A preferred stock; $10,000 face value per share, authorized 1,000,000 shares: | | |
| Series 1; authorized 30,000 shares, issued and outstanding 522.5 shares in 2012 and 2013, liquidation preference of $5,420,938 in 2012 and $5,616,875 in 2013 | 4,987,326 | 4,987,326 |
| Series 2; authorized 2,500 shares, no shares issued and outstanding in 2012 and 2013 | | |
| Common stock, no par value; authorized 499,000,000 shares, issued and outstanding 7,979,801 in 2012 and 7,979,801 in 2013 | 17,151,097 | 17,151,097 |
| Accumulated deficit | (16,227,289) | (16,319,296) |
| Total Stockholders Equity | 5,911,134 | 5,819,127 |
| **TOTAL LIABILITIES AND STOCKHOLDERS EQUITY** | $ 8,886,201 | $ 8,972,296 |

The Accompanying Notes are an Integral Part of These Financial Statements.

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**ARÊTE INDUSTRIES, INC. AND SUBSIDIARIES**

**UNAUDITED CONSOLIDATED STATEMENTS OF OPERATIONS**

**Quarters Ended March 31, 2012 and 2013**

| | 2012 | 2013 |
|---|---|---|
| **Revenues:** | | |
| Oil and natural gas sales | $ 554,035 | $ 457,725 |
| Sale of oil and natural gas properties | 533,048 | 949 |
| Gas gathering income | | |
| Total revenues | 1,087,083 | 458,674 |
| **Operating Expenses:** | | |
| Oil and gas producing activities: | | |
| Lease operating expenses | 283,709 | 187,807 |
| Production taxes | 44,196 | 35,837 |
| Depreciation, depletion, amortization and accretion | 131,107 | 172,602 |
| Gas gathering: | | |
| Operating expenses | 3,660 | 3,543 |
| Depreciation | 11,055 | 11,055 |
| General and administrative expenses: | | |
| Director fees | 30,000 | 450 |
| Investor relations | 45,804 | 30,897 |
| Legal, auditing and professional services | 49,080 | 30,590 |
| Consulting and executive services: | | |
| Related parties | 110,750 | 30,750 |
| Unrelated parties | 71,445 | |
| Other administrative expenses | 13,546 | 21,370 |
| Depreciation | 143 | 285 |
| Total operating expenses | 794,495 | 525,186 |
| Operating loss | 292,588 | (66,512) |
| **Other income (expense):** | | |
| Gain on extinguishment of debt | | |
| Interest income | 155 | 1 |
| Interest expense | (17,845) | (25,496) |
| Income (loss) before income taxes | 274,898 | (92,007) |
| **Income tax benefit (expense)** | | |
| **Net income (loss)** | $ 274,898 | $ (92,007) |
| **Net Income (Loss) Applicable to Common Stockholders:** | | |
| Net income (loss) | $ 274,898 | $ (92,007) |
| Accrued preferred stock dividends | (195,875) | (195,875) |
| Net income (loss) applicable to common stockholders | $ 79,023 | $ (287,882) |
| **Earnings (Loss) Per Share Applicable to Common Stockholders:** | | |

| | | | | |
|---|---|---|---|---|
| Basic | $ | 0.01 | $ | (0.04) |
| Diluted | $ | 0.01 | $ | (0.04) |
| **Weighted Average Number of Common Shares Outstanding:** | | | | |
| Basic | | 7,764,000 | | 7,980,000 |
| Diluted | | 7,764,000 | | 7,980,000 |

The Accompanying Notes are an Integral Part of These Financial Statements.

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**ARÊTE INDUSTRIES, INC. AND SUBSIDIARIES**

**UNAUDITED CONSOLIDATED STATEMENT OF STOCKHOLDERS EQUITY**

**Quarter Ended March 31, 2013**

| | Class A Preferred Stock | | Common Stock | | Accumulated | |
|---|---|---|---|---|---|---|
| | Shares | Amount | Shares | Amount | Deficit | Total |
| Balances, December 31, 2012 | 522.5 | $ 4,987,326 | 7,979,801 | $ 17,151,097 | $ (16,227,289) | $ 5,911,134 |
| Net loss | | | | | (92,007) | (92,007) |
| Balances, March 31, 2013 | 522.5 | $ 4,987,326 | 7,979,801 | $ 17,151,097 | $ (16,319,296) | $ 5,819,127 |

The Accompanying Notes are an Integral Part of These Financial Statements.

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**ARÊTE INDUSTRIES, INC. AND SUBSIDIARIES**

**UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS**

**Quarters Ended March 31, 2012 and 2013**

| | 2012 | 2013 |
|---|---|---|
| **Cash Flows from Operating Activities:** | | |
| Net income (loss) | $ 274,898 | $ (92,007) |
| Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities: | | |
| Depreciation, depletion and amortization | 140,239 | 167,648 |
| Accretion of discount on asset retirement obligations | 2,066 | 16,294 |
| Gain on sale of oil and gas properties | (533,048) | (949) |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | 24 | (106,769) |
| Prepaid expenses and other | 38,655 | 29,669 |
| Accounts payable | (22,054) | 159,917 |
| Accrued costs and expenses | 177,675 | (37,540) |
| Net cash provided by (used in) operating activities | 78,455 | 136,263 |
| **Cash Flows from Investing Activities:** | | |
| Capital expenditures for property and equipment | (617,270) | (179,616) |
| Proceeds from sale of oil and gas properties | 1,108,709 | 949 |
| Contingent consideration paid to DNR under sharing arrangement | (282,704) | |
| Net cash provided by (used in) investing activities | 208,735 | (178,667) |
| **Cash Flows from Financing Activities:** | | |
| Proceeds from notes and advance payable | 375,000 | 40,000 |
| Principal payments on notes payable | (250,000) | (569) |
| Net cash provided by (used in) financing activities | 125,000 | 39,431 |
| Net increase (decrease) in cash and equivalents | 412,190 | (2,973) |
| **Cash and equivalents, beginning of period** | 219,566 | 6,921 |
| **Cash and equivalents, end of period** | $ 631,756 | $ 3,948 |
| **Supplemental Disclosure of Cash Flow Information:** | | |
| Cash paid for interest | $ 20,000 | $ 6,750 |
| Cash paid for income taxes | $ | $ |
| **Supplemental Disclosure of Non-cash Investing and Financing Activities:** | | |
| Preferred stock dividends declared | $ 391,875 | $ 391,875 |
| Asset retirement obligations assumed upon sale of oil and gas properties | $ 16,411 | $ |

The Accompanying Notes are an Integral Part of These Financial Statements.

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**ARÊTE INDUSTRIES, INC. AND SUBSIDIARIES**

**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

**March 31, 2013**

**1. Organization and Nature of Operations**

Arête Industries, Inc. ( Arête or the Company ), is a Colorado corporation that was incorporated on July 21, 1987. The Company owns 100% of Arete Energy, Inc. which is an inactive subsidiary which has no assets, liabilities or operations. Arête has operated a natural gas gathering system in Wyoming since 2006 and on July 29, 2011 the Company purchased oil & natural gas properties in Colorado, Montana, Kansas, and Wyoming.

The Company seeks to focus on acquiring interests in traditional oil and gas ventures, and seek properties that offer profit potential from overlooked and by-passed reserves of oil and natural gas, which may include shut-in wells, in-field development, stripper wells, re-completion and re-working projects. In addition, the Company s strategy includes purchase and sale of acreage prospective for oil and natural gas and seeking to obtain cash flow from the sale and farm out of such prospects.

**2. Summary of Significant Accounting Policies**

**Basis of presentation**

The accompanying unaudited consolidated financial statements have been prepared by the Company. In the opinion of management, the accompanying unaudited financial statements contain all adjustments (consisting of only normal recurring accruals) necessary for a fair presentation of the financial position as of December 31, 2012 and March 31, 2013, and the results of operations, changes in stockholders equity, and cash flows for the quarters ended March 31, 2012 and 2013. Operating results for the interim periods presented are not necessarily indicative of the results that may be expected for a full year. The Company s 2012 Annual Report on Form 10-K includes certain definitions and a summary of significant accounting policies and should be read in conjunction with this Form 10-Q. Except as disclosed herein, there have been no material changes to the information disclosed in the notes to the consolidated financial statements included in the Company s 2012 Annual Report on Form 10-K.

**Use of Estimates**

Preparation of the Company s financial statements in accordance with GAAP requires management to make various assumptions, judgments and estimates that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities as of the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Changes in these assumptions, judgments and estimates will occur as a result of the passage of time and the occurrence of future events and, accordingly, actual results could differ from amounts initially established.

The most significant areas requiring the use of assumptions, judgments and estimates relate to the volumes of natural gas and oil reserves used in calculating depreciation, depletion and amortization ( DD&A ), the amount of expected future cash flows used in determining possible impairments of oil and gas properties and the amount of future capital costs used in these calculations. Assumptions, judgments and estimates also are required in determining future asset retirement obligations, impairments of undeveloped properties, and in valuing stock-based payment awards.

The only component of comprehensive income that is applicable to the Company is net income (loss). Accordingly, a separate statement of comprehensive income (loss) is not included in these financial statements.

**Principles of Consolidation**

The consolidated financial statements of the Company include the accounts of Arête and its inactive subsidiary, Arete Energy, Inc. All intercompany accounts and transactions have been eliminated in consolidation.

**Reclassifications**

The Company has condensed certain line items within the current period financial statements, and certain prior period balances were reclassified to conform to the current year presentation. Reclassifications did not have any impact on the Company s previously reported working capital, results of operations or cash flows.

**Earnings per share**

Basic net income (loss) per share of common stock is calculated by dividing net income (loss) attributable to common stockholders by the weighted average number of common shares outstanding during each period. Diluted net

**ARÊTE INDUSTRIES, INC. AND SUBSIDIARIES**

**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

**March 31, 2013**

income (loss) attributable to common stockholders is calculated by dividing net income (loss) attributable to common stockholders by the weighted average number of common shares outstanding and other dilutive securities. The only potentially dilutive securities for the diluted earnings per share calculations consist of Series 1 preferred stock that is convertible into common stock at an exchange price of $3.30 per common share. As of March 31, 2013, the convertible preferred stock had an aggregate liquidation preference of $5,616,875 and was convertible to 1,698,182 shares of common stock. These shares were excluded from the earnings per share calculation because it was anti-dilutive to assume conversion at the beginning of the quarter, which would have eliminated preferred dividends from the earnings per share calculation.

**New Accounting Pronouncements**

In May 2011, the Financial Accounting Standards Board ( FASB ) issued new fair value measurement authoritative accounting guidance clarifying the application of fair value measurement and disclosure requirements and changes particular principles or requirements for measuring fair value. This authoritative accounting guidance is effective for interim and annual periods beginning after December 15, 2011. Based on the Company s current operations and structure, the adoption of this standard did not have an impact on the Company s 2012 financial statements.

In June 2011, the FASB issued new authoritative accounting guidance that states an entity that reports items of other comprehensive income has the option to present the components of net income and comprehensive income in either one continuous financial statement, or two consecutive financial statements, including reclassification adjustments. In December 2011, the FASB issued new authoritative accounting guidance which effectively deferred the requirement to present the reclassification adjustments on the face of the financial statements. This authoritative accounting guidance is effective for interim and annual periods beginning after December 15, 2011. Based on the Company s current operations and structure, the adoption of this standard did not have an impact on the Company s 2012 financial statements.

Other accounting standards that have been issued or proposed by the FASB, or other standards-setting bodies, that do not require adoption until a future date are not expected to have a material impact on the Company s financial statements upon adoption.

**3. Disposition of Oil and Gas Properties**

In February 2012, the Company sold to an unaffiliated party a working interest in a well and related lease in Niobrara County, Wyoming for gross proceeds of approximately $1,109,000. After payment of additional consideration pursuant to the formula discussed under (b) in the acquisition table above, the Company realized net proceeds of $826,000. The purchaser assumed the asset retirement obligations estimated at approximately $16,000 and after deducting the net book value of the property, the Company recognized a gain on sale of $533,048. The Company retained a 2.575% overriding royalty interest in this property. This sale comprised approximately 1.6% of the Company s barrels of oil equivalent ( BOE ) of oil and gas reserve quantities, and approximately 2.2% of the Company s discounted future net revenues prior to the sale. The Company determined that this sale did not qualify for discontinued operations reporting. Except for the sale of the Separate Interests discussed above, all gains and losses recognized from oil and gas property sales are included in other operating revenues in the consolidated statements of operations.

**4. Income taxes**

The book to tax temporary differences resulting in deferred tax assets and liabilities are primarily net operating loss carry forwards of approximately $8.4 million which expire in 2018 through 2032. A 100% valuation allowance has been established against the deferred tax assets, as utilization of the loss carry forwards and realization of other deferred tax assets cannot be reasonably assured. For the quarter ended March 31, 2013, the Company did not recognize any income tax benefit due to the valuation allowance.

**5. Stock transactions and preferred stock dividends**

During the quarter ended March 31, 2013, the Company did not issue any common stock for compensation or services. The Board of Directors has not declared the semi-annual dividend payable to preferred shareholders of record as of March 31, 2013. Under most circumstances, the

Company is required to either pay preferred dividends in cash in the aggregate amount of $391,875 or in shares of common stock of equivalent value. The Board of Directors declared the preferred dividend of $391,875 on April 26, 2013 and paid in cash on April 28, 2013. (See note 10)

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**ARÊTE INDUSTRIES, INC. AND SUBSIDIARIES**

**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

**March 31, 2013**

**6. Contracts Payable**

The Company entered into a consulting contract for financing, structure, and investor services on March 2, 2010 for 800,000 shares of Common Stock valued at $500,000. The contract was for a period of three years and the fair value of the services were amortized ratably over the service period. Accordingly, the Company recognized a charge to investor relations expense of $41,667 and $27,778 for the quarters ended March 31, 2012 and 2013, respectively.

**7. Notes and advances payable**

Notes payable consist of the following as of December 31, 2012 and March 31, 2013:

| | 2012 | 2013 |
|---|---|---|
| Officers, directors and affiliates: | | |
| Notes and advances payable, interest at 8.0%, due on demand | $ 12,882 | $ 52,314 |
| Notes and advances payable, interest at 9.7%, due on demand | 85,000 | 85,000 |
| Note payable, interest at 12.0%, due March 2013 | 150,000 | 150,000 |
| Collateralized note payable (see below) | 261,109 | 261,109 |
| Total officers, directors and affiliates | 508,991 | 548,423 |
| Unrelated parties: | | |
| Notes payable, interest at 12.0%, due March 2013 | 250,000 | 250,000 |
| Total unrelated parties | 250,000 | 250,000 |
| Total notes and advance payable | $ 758,991 | $ 798,423 |

On September 29, 2012, the Company borrowed $425,000 from an affiliate of a stockholder and director under a note agreement that provides for interest at the stated annual rate of 12% (and an effective annual rate of 17.8%) with unpaid principal and interest due on March 29, 2013. The outstanding principal balance as of March 31, 2013 was $261,109. The Company also agreed to assign 75% of its operating income from its oil and gas operations and any lease or well sale or any other asset sales to the note holder to secure the debt.

All of the notes payable shown above are unsecured. Accrued interest on notes and advances payable amounted to $48,359 as of December 31, 2012 and $67,105 as of March 31, 2013.

**8. Asset retirement obligations (ARO)**

A reconciliation of the Company s asset retirement obligations for the quarter ended March 31, 2013, is as follows:

| | |
|---|---|
| Balance, December 31, 2012 | $ 647,268 |
| Liabilities incurred | |
| Accretion expense | 16,294 |

Revisions to estimate

| | |
|---|---|
| Balance, March 31, 2013 | 663,562 |
| Less current asset retirement obligations | (79,380) |
| Long-term asset retirement obligations | $ 584,182 |

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**ARÊTE INDUSTRIES, INC. AND SUBSIDIARIES**

**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

**March 31, 2013**

**9. Related Party Cost Reductions**

In connection with the property acquisition agreement entered into in the third quarter of 2011, the Company executed an operating agreement whereby DNR provides services to operate all of the properties acquired by the Company for a monthly fee of $23,000. The operating agreement expired on March 31, 2012 and renews on a month to month basis. Based on operator costs for the properties prior to the Company s acquisition, approximately $8,000 per month is included in lease operating expenses and $15,000 per month is included in related party consulting fees in the accompanying Consolidated Statements of Operations for the first quarter of 2012. Effective July 1, 2012, the monthly operator fee was reduced to $18,000 per month, of which $8,000 per month is included in lease operating expense and the remaining $10,000 per month is included in related party consulting fees.

Effective July 1, 2012 the Company reduced the amount paid for director fees and other related party consulting arrangements. Presented below is a comparison of the impact of related party cost reductions for the first quarter of 2012 compared to the first quarter of 2013:

| | Quarter Ended: | | |
|---|---|---|---|
| | 03/31/12 | 3/31/13 | Reduction |
| Fees payable in cash: | | | |
| Operator fees | $ 69,000 | $ 54,000 | $ 15,000 |
| Consulting fees | 15,000 | | 15,000 |
| Fees payable in shares of common stock: | | | |
| Director fees | 30,000 | 450 | 29,550 |
| Consulting fees | 45,000 | | 45,000 |
| | $ 159,000 | $ 54,450 | $ 104,550 |

If these cost reductions had not been implemented for the first quarter of 2013, the Company s net loss applicable to common stockholders would have increased from $287,882 to $392,432, and net loss per share applicable to common stockholders would have increased from $0.04 to $0.05.

**10. Subsequent events**

On April 26, 2013 the Board of Directors declared the 15% dividend on the Series A-1 preferred stock which was paid in cash on April 29, 2013. The Company made arrangements to borrow $1,000,000 from Apex Financial Services Corp, a Colorado corporation (Apex), the principal sum of $1,000,000, with interest accruing at an annual rate of 7.5%, with principal and interest due on May 31, 2014. The Registrant also agreed to assign 75% of its operating income from its oil and gas operations and any lease or well sale or any other assets sales to the Apex to secure the debt. The Apex is 100% owned by the CEO, director, and shareholder of the Company, Nicholas L. Scheidt. The Company borrowed the full amount of principal on the Note, and also paid a loan fee of $10,000 on the Note. In the event of default on the Note and failure to cure the default in ten days, Apex may accelerate payment and the annual interest rate on the Note will accrue at 18%. Default includes failure to pay the Note when due or if the Company borrows any other monies or offers security in the Registrant or in the collateral securing the Note prior to the Note being paid in full. The Company used the proceeds to pay the preferred dividend, the accounts payable from operations currently due, and accrued interest on the outstanding notes payable. The Company had two promissory notes in the amount of $400,000 and the Company has negotiated an extension on both notes for two years to expire March 31, 2015.

During the first quarter 2013 the Company participated in drilling a well in Kansas in which they have a 20% working interest and have $133,407 of costs as of March 31, 2013. The costs are carried as part of proved properties on the balance sheet as a well in progress. The Company does not have detailed information as to the results of the well as of May 15, 2013.

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**Item 2 - Management s Discussion and Analysis of Financial Condition and Results of Operations**

***Forward-looking information***

This report contains certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Exchange Act of 1934, as amended, that are based on management s exercise of business judgment as well as assumptions made by, and information currently available to, management. When used in this document, the words may , will , anticipate , believe , estimate expect , intend , and words of similar import, are intended to identify any forward-looking statements. You should not place undue reliance on these forward-looking statements. These statements reflect our current view of future events and are subject to certain risks and uncertainties as noted below. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, our actual results could differ materially from those anticipated in these forward-looking statements. Although we believe that our expectations are based on reasonable assumptions, we can give no assurance that our expectations will materialize.

Management s Discussion and Analysis of Financial Condition and Results of Operations should be read together with our audited financial statements and related notes included in our Annual Report on Form 10-K and the financial statements and footnotes included in this Quarterly Report on Form 10-Q. This Quarterly Report on Form 10-Q, including the following discussion, contains trend analysis and other forward-looking statements within the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Any statements in this Quarterly Report on Form 10-Q that are not statements of historical facts are forward-looking statements. These forward-looking statements made herein are based on our current expectations, involve a number of risks and uncertainties and should not be considered as guarantees of future performance. The factors that could cause actual results to differ materially include without limitation:

capital requirements and uncertainty of obtaining additional funding on terms acceptable to us;

unsuccessful drilling and completion activities and the possibility of resulting write-downs;

price volatility of oil and natural gas prices, and the effect that lower prices may have on our earnings and stockholders equity;

a decline in oil or natural gas production or oil or natural gas prices, and the impact of general economic conditions on the demand for oil and natural gas and the availability of capital;

geographical concentration of our operations;

increases in the cost of drilling, completion and gas gathering or other costs of production and operations;

our ability to successfully drill wells that produce oil or natural gas in commercially viable quantities;

adverse variations from estimates of reserves, production, production prices and expenditure requirements, and our inability to replace our reserves through acquisition, exploration and development activities;

our current level of indebtedness and the effect of any increase in our level of indebtedness;

limited control over non-operated properties;

reliance on limited number of customers;

title defects to our properties and inability to retain our leases;

our ability to retain key members of our senior management and key consulting resources;

federal, state and regulations and laws;

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- impact of environmental, health and safety, and other governmental regulations, and of current or pending legislation;
- federal and state legislation and regulatory initiatives relating to hydraulic fracturing;
- risks in connection with evaluating potential acquisitions, integration of significant acquisitions, and difficulty managing our growth and the related demands on our resources;
- developments in the global economy;
- financing and interest rate exposure;
- effects of competition;
- effect of seasonal factors;
- lack of availability of drilling rigs, equipment, supplies, insurance, personnel and oil field services; and
- further sales or issuances of common stock.

Finally, our future results will depend upon various other risks and uncertainties, including, but not limited to, those detailed in the section entitled Risk Factors included in our Annual Report on Form 10-K. All forward-looking statements attributable to us or persons acting on our behalf are expressly qualified in their entirety by the cautionary statements in this section and elsewhere in this report. Other than as required under securities laws, we do not assume a duty to update these forward-looking statements, whether as a result of new information, subsequent events or circumstances, changes in expectations or otherwise

***General Overview***

It is our desire to provide an understanding of the Company s past performance, its financial condition and its prospects for the future. Accordingly, we will discuss and provide our analysis of the following:

- Critical accounting policies;
- Results of operations;
- Liquidity and capital resources;
- Contractual obligations
- New accounting pronouncements.

In the third quarter of 2011, we completed an acquisition of producing oil and natural gas properties in Montana, Wyoming, Colorado and Kansas. These properties include several proved undeveloped and probable drilling opportunities. We believe our primary challenge over the next few months is to obtain additional financing to exploit existing drilling opportunities and to possibly acquire additional properties. We have sold some of our properties while retaining overriding royalty interests for future upside upon further development of the properties. In addition, we are in the process of reviewing several opportunities for the purchase of production and undeveloped oil and gas leases for future development. In order to purchase properties or begin substantive drilling activities we must obtain additional financing, which cannot be assured. We rely heavily on the skills of our board members in the fields of business development, capital acquisition, corporate visibility, oil and gas development, geology and operations.

*Critical Accounting Policies*

The following discussion and analysis of the results of operations and financial condition are based on the our consolidated financial statements that have been prepared in accordance with accounting principles generally accepted in the United States of America. Our significant accounting policies are more fully described in Note 2 of the Notes to Consolidated Financial Statements included in our Annual Report on Form 10-K, as supplemented by the Unaudited Notes to Consolidated Financial Statements included herein. However, certain accounting policies and estimates are particularly important to the understanding of our financial position and results of operations and require the application of significant judgment by our management or can be materially affected by changes from period to period in economic factors or conditions that are outside of our control. As a result, they are subject to uncertainty. In applying these policies, our management uses its judgment to determine the appropriate assumptions to be used in the determination of certain estimates. Those estimates are based on our historical experience, our future business plans and projected financial results, the terms of existing contracts, our observance of trends in the oil and gas industry, information provided by our customers and information available from other outside sources, as appropriate. Actual results may differ from these estimates. We believe the following critical accounting policies affect our most significant judgments and estimates used in the preparation of our consolidated financial statements.

**Revenue Recognition**

We record revenue from the sale of natural gas, natural gas liquids ( NGL ) and crude oil when delivery to the purchaser has occurred and title has transferred. We use the sales method to account for gas imbalances. Under this method, revenue is recorded on the basis of gas actually sold by us. In addition, we will record revenue for our share of gas sold by other owners that cannot be volumetrically balanced in the future due to insufficient remaining reserves. We also reduce revenue for other owners gas sold by us that cannot be volumetrically balanced in the future due to insufficient remaining reserves. Our remaining over and under-produced gas balancing positions are considered in our proved oil and gas reserves. Gas imbalances at March 31, 2013 were not material.

**Property and equipment**

In January 2010, the Financial Accounting Standards Board ( FASB ) issued authoritative oil and gas reserve estimation and disclosure guidance that was effective for the Company beginning in 2010. This guidance was issued to align the accounting oil and gas reserve estimation and disclosure requirements with the requirements in the SEC final rule, Modernization of Oil and Gas Reporting , which was also effective in 2010.

Our oil and gas exploration and production activities are accounted for using the successful efforts method. Under this method, all property acquisition costs and costs of exploratory and development wells are capitalized when incurred, pending determination of whether the well has found proved reserves. If an exploratory well does not find proved reserves, the costs of drilling the well are charged to expense and included within cash flows from investing activities in the consolidated statements of cash flows. The costs of development wells are capitalized whether productive or nonproductive. Oil and gas lease acquisition costs are also capitalized.

Other exploration costs, including certain geological and geophysical expenses and delay rentals for oil and gas leases, are charged to expense as incurred. 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 DD&A rate. A gain or loss is recognized for all other sales of proved properties and is classified in other operating revenues. Maintenance and repairs are charged to expense, and renewals and betterments are capitalized to the appropriate property and equipment accounts.

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Unevaluated oil and gas property costs are transferred to proved oil and gas properties if the properties are subsequently determined to be productive. Proceeds from sales of partial interests in unproved leases are accounted for as a recovery of cost without recognizing any gain until all costs are recovered. Unevaluated oil and gas properties are assessed periodically for impairment on a property-by-property basis based on remaining lease terms, drilling results, reservoir performance, commodity price outlooks or future plans to develop acreage.

We review our proved oil and gas properties and our gas gathering system for impairment whenever events and circumstances indicate that a decline in the recoverability of their carrying value may have occurred. We estimate the expected undiscounted future cash flows of assets evaluated for impairment and compare such undiscounted future cash flows to the carrying amount of the respective asset to determine if the carrying amount is recoverable. If the carrying amount exceeds the estimated undiscounted future cash flows, we will adjust the carrying amount of the asset to fair value. The factors used to determine fair value include, but are not limited to, recent sales prices of comparable properties, the present value of estimated future cash flows, net of estimated operating and development costs using estimates of reserves, future commodity pricing, future production estimates, anticipated capital expenditures and various discount rates commensurate with the risk and current market conditions associated with realizing the expected cash flows projected.

The provision for DD&A of oil and gas properties is calculated on a field-by-field basis using the unit-of-production method. Natural gas is converted to barrel of oil equivalents ( BOE ) at the rate of six Mcf of natural gas to one barrel of oil. Estimated future dismantlement, restoration and abandonment costs, which are net of estimated salvage values, are taken into consideration.

**Asset Retirement Obligations**

The estimated fair value of the future costs associated with dismantlement, abandonment and restoration of oil and gas properties is recorded generally upon acquisition or completion of a well. The net estimated costs are discounted to present values using a credit-adjusted, risk-free rate over the estimated economic life of the oil and gas properties. Such costs are capitalized as part of the related asset. The asset is depleted on the units-of-production method on a field-by-field basis. The associated liability is classified in current and long-term liabilities in the consolidated balance sheets. The liability is periodically adjusted to reflect (1) new liabilities incurred, (2) liabilities settled during the period, (3) accretion expense and (4) revisions to estimated future cash flow requirements. The accretion expense is recorded as a component of depreciation, depletion and amortization expense in the consolidated statements of operations.

**Stock-based Compensation**

We have not granted any stock options or warrants during the quarters ended March 31, 2012 and 2013, and no options or warrants were outstanding at any time during 2012 and 2013. We issued shares of common stock for services performed by officers, directors and unrelated parties during 2012 and 2013 and we expect to issue shares for services in the future. We recorded these transactions based on the value of the services or the value of the common stock, whichever was more readily determinable.

***Results of Operations for the Quarters Ended March 31, 2012 and 2013***

To date, inflation has not had a material impact on our operations. Presented below is a discussion of our results of operations for the Quarters Ended March 31, 2012 and 2013.

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**Oil and Gas Producing Activities**

During the third quarter of 2011, we entered into a purchase and sale agreement which resulted in our acquisition of producing oil and gas properties in Wyoming, Colorado, Kansas and Montana. Presented below is a summary of our oil and gas operations for the quarters ended March 31, 2012 and 2013:

| | 2012 | 2013 |
|---|---|---|
| Oil Sales | $ 450,630 | $ 359,794 |
| Natural Gas Sales | 103,405 | 97,931 |
| Total Revenue | 554,035 | 457,725 |
| Production Taxes | (44,196) | (35,837) |
| Lease Operating Expense | (283,709) | (187,807) |
| Depreciation, depletion, amortization and accretion | (131,107) | (172,602) |
| Net | $ 95,023 | $ 61,478 |
| Net barrels of oil sold | 5,044 | 4,389 |
| Net mcf of gas sold | 22,830 | 20,620 |
| Average price for oil (per Bbl) | $ 89.34 | $ 81.98 |
| Average price for gas (per Mcf) | $ 4.53 | $ 4.74 |
| Lease operating expense per BOE | $ 32.06 | $ 23.99 |
| DD&A per BOE | $ 14.82 | $ 22.06 |

Our oil sales are primarily attributable to our properties in Kansas and Wyoming. The average oil price for the first quarter of 2013 was $81.98 per barrel but ranged from a low of $78.10 for March and a high of $85.82 for February. The average oil price for the first quarter of 2012 was $89.34 per barrel but ranged from a low of $88.24 for January to a high of $91.08 for February. The oil revenue for the first quarter 2013 was down due to factors: 1) the average price of oil sold was lower by $7.36 per barrel sold, 2) the numbers of barrels in January was down by an estimated 650 barrels based on bad weather not allowing for the oil to be picked up in Kansas. The wells were shut in for about 10 days as the tanks were full. The oil was picked up late January and production was restarted. The average natural gas prices, including proceeds from sales of natural gas liquids, amounted to $4.74 per Mcf for the first quarter of 2013 but ranged from a low of $4.34 per Mcf for February to a high of $4.82 per Mcf for January. Our average natural gas prices, including proceeds from sales of natural gas liquids, amounted to $4.53 per Mcf for the first quarter of 2012 but ranged from a low of $4.25 per Mcf for February to a high of $4.80 per Mcf for January.

Production taxes were approximately 8% of our oil and gas sales for the first quarters of 2013 and 2012. Lease operating expense averaged $23.99 per Barrel of Oil Equivalent ( BOE ), whereby six Mcf of gas are equal to one barrel of oil, for the first quarter of 2013. Lease operating expense averaged $32.06 per Barrel of Oil Equivalent ( BOE ) for the same period 2012. Many of the wells included in our acquisition have been producing for a decade or longer and the cost of workovers and normal maintenance are charged to expense in the period the costs are incurred. For the first quarter of 2013, we incurred approximately $71,000 for workovers, well service units and repairs which accounted for approximately $9.06 per BOE of our lease operating expenses that was capitalized based on increased production the wells. For the first quarter of 2012, we incurred approximately $87,000 for workovers, well service units and repairs which accounted for approximately $9.83 per BOE that were capitalized (see further discussion below).

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Under successful efforts accounting, DD&A expense is separately computed for each producing field based on geologic and reservoir delineation. The capital expenditures for proved properties for each field compared to the proved reserves corresponding to each producing field determine a weighted average DD&A rate for current production. Future DD&A rates will be adjusted to reflect future capital expenditures and proved reserve changes in specific areas.

During the first quarter of 2012, we sold one of our properties with a 100% working interest in a producing oil and gas well, which resulted in gross proceeds of approximately $1,109,000. This property was sold to an unrelated purchaser and pursuant to our amended property purchase agreement entered into during the third quarter of 2011, we were required to pay the related party sellers approximately $283,000 of the proceeds due to their contingent interest and, as a result our net proceeds were $826,000. After deducting the net book value of the property of $309,000, plus the asset retirement obligation assumed by the unrelated purchaser of $16,000, we recognized a gain of approximately $533,000. We expect to periodically evaluate our portfolio of properties and sell additional properties if we believe a sale can be completed on terms that provide attractive returns.

**Gas Gathering Activities**

We have owned and operated a natural gas gathering system (pipeline and compressor station) for coal bed methane properties in the Powder River Basin of Wyoming since 2006. We had no revenues for the first quarters of 2013 and 2012, due to low natural gas prices which resulted in all wells in the field being shut-in since June 2011.

Presented below is a summary of operating costs for the quarters ended March 31, 2012 and 2013:

| | 2012 | 2013 |
|---|---|---|
| Related party- cost of production | $ | $ |
| Unrelated parties: | | |
| Compressor rental | | |
| Pumper costs | | |
| Transportation | | |
| Property taxes | 1,392 | 1,275 |
| Land rent, utilities, repairs and other | 2,268 | 2,268 |
| Total unrelated party costs | 3,660 | 3,543 |
| Total | $ 3,660 | $ 3,543 |

Depreciation expense related to the gas gathering system was $11,055 for the first quarter of both 2012 and 2013.

In July 2011, we acquired the entire field of coal bed methane wells as part of our $11 million acquisition. While these wells are not economic at current prices being received for natural gas related to the production capability from the existing geologic formation, we have geologic and engineering data that suggest gas reserves exist on these properties by drilling new wells and/or recompleting the existing wells to several new geologic formations. We expect to further evaluate these properties and, if warranted, execute our development plans within the next three years is seeking to exploit the value of the properties and the gas gathering system. As of March 31, 2013, the capitalized cost of the coal bed methane leases is $248,295 and the net capitalized cost of the gas gathering system is $178,252. As of March 31, 2012, the capitalized cost of the coal bed methane leases is $314,336 and the net capitalized cost of the gas gathering system is $222,471.

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**General and Administrative**

Presented below is a summary of general and administrative expenses for the quarters ended March 31, 2012 and 2013:

| | 2012 | 2013 | Change |
|---|---|---|---|
| Director fees | $ 30,000 | $ 450 | $ (29,550) |
| Investor relations | 45,804 | 30,897 | (14,907) |
| Legal, auditing and transfer agent | 49,080 | 30,590 | (18,490) |
| Accounting, financial reporting and rent- related party | 35,750 | 750 | (35,000) |
| Consulting fees: | | | |
| Related parties | 75,000 | 30,000 | (45,000) |
| Unrelated parties | 71,445 | | (71,445) |
| Other administrative expense | 13,546 | 21,370 | 7,824 |
| Depreciation | 143 | 285 | 142 |
| Total general and administrative expenses | $ 320,768 | $ 114,342 | $ (206,426) |

General and administrative expenses decreased by $206,426 in 2013 compared to 2012, primarily due to an effort by management to cut costs. The management has provided accounting services and all needed administrative services for compliance with regulatory agencies and no cost to the Company. In addition, we had no acquisition costs or due diligence costs for the quarter 2013.

The monthly charge of $10,000 under an agreement with DNR, whereby executive level expertise is provided for our existing and prospective oil and properties. The total monthly charge under the operating agreement is $18,000, of which $8,000 is allocated to lease operating expense. DNR is an affiliate of Charles B. Davis, an executive officer and director of the Company.

**Income (loss) from operations**

Income from operations for the first quarter of 2012 was $292,588 compared to a loss of $66,512 for the first quarter of 2013. The decrease in income was primarily due to the 2012 gain on sale of oil and gas properties of $533,000 in 2012, as well as the items discussed above relating to the oil and natural gas operations, gas gathering activities, and general and administrative expenses.

**Interest Expense**

Interest expense increased from $25,496 in the first quarter of 2013 to $17,845 in the first quarter of 2012, an increase of $7,651. This increase was primarily due to an increase in borrowing in March and September 2012.

***Liquidity and Capital Resources***

We had a working capital deficit as of March 31, 2013 of $2,027,673, compared to a working capital deficit of $1,938,752 at December 31, 2012. The $90,000 increase in our working capital deficit resulted from an advance from the CFO of $40,000, accrued interest payable $19,000, amounts due to DNR for operating and the cost of the drilling of the Kansas well of $154,000. These were off-set by the reduction of other accrued expenses that were paid of $75,000 and an increase in our current assets of $74,000 during the three month period ending March 31, 2013.

We generated positive operating cash flow of $136,263 for the first quarter of 2013 compared to operating cash flow of approximately $78,455 for the first quarter of 2012. The net increase in operating cash flow of $57,808 was due to a number of different factors both positive and negative. We had decrease of our income by $366,905 with a net loss of $92,007 in the first quarter of 2012 compared to net income of $274,898 in the first quarter of 2012, We had an increase in depreciation, depletion, amortization and accretion of $41,637, and changes in working capital of an increase in cash flow of $45,377. The aggregate impact of amounts that improved our operating cash flow in the first quarter of 2012 compared to the first quarter of 2012 totaled $589,907, and this amount was partially offset by a $532,099 net of gains attributable to investing activities.

For the first quarter of 2013, we used $179,616 of cash flows related to investing activities for capital expenditures. For the first quarter of 2012, we generated net proceeds of approximately $826,000 from the sale of a 100% working interest in an oil and gas property. We realized a gain of approximately $533,000 on the sale of this property. The proceeds from the sale of oil and gas properties were partially offset by capital expenditures of $617,000, of which approximately $598,000 was acquisition costs paid to a related party for the group of properties that we acquired in the third quarter of 2011.

For the first quarter of 2013, we had net borrowings of approximately $40,000. These funds were needed to fund current bills and were provided by the CFO. For the first quarter of 2012, our financing activities generated net cash proceeds of $125,000 as we borrowed $375,000 and repaid borrowings of $250,000. The borrowings of $375,000 during the first quarter of 2012 provide for interest at 12.0% and a due date in March 2013.

Effective April 26, 2013, our board of directors declared a semi-annual cash dividend due on our Series A-1 convertible preferred stock. The dividend was payable to preferred holders of record on April 1, 2013 and is not reflected as a payable on our balance sheet as of March 31, 2013. The payment of this dividend will be reflected as a financing activity on our cash flow statement for the second quarter of 2013.

During the first quarter 2013 we participated in drilling a well in Kansas in which we have a 20% working interest and have $133,407 of costs as of March 31, 2013. The costs are carried as part of proved properties on the balance sheet as a well in progress. We do not have detailed information regarding the results of the well as of May 15, 2013. We have the entire cost paid as of April 29, 2013.

As of March 31, 2013, we had cash and equivalents of approximately $4,000 and approximately $250,000 in receivables due from oil and natural gas operations in the next 60 days. Based on the current prices received from the sale of our oil and natural gas, the cash flows may not be adequate to cover all of our operating, general, administrative and interest costs. We have a commitment for a $1,000,000 loan that we closed on April 29, 2013 and will be due May 31, 2014. We have negotiated an extension on its two promissory notes that are unsecured to be extended to March 31, 2015 with a new interest rate of 7.5%. We also expect to evaluate acquisitions that are consistent with our business objective of acquiring interests in traditional oil and gas ventures, and seeking properties that offer profit potential from overlooked and by-passed reserves of oil and natural gas.

In order to execute our plan to acquire additional interests in oil and gas properties that meet our objectives, we need additional financing. From the time we acquired our existing properties in the third quarter of 2011, we have sold our interests in some of those properties, which resulted in aggregate net proceeds from two sales of $5,927,000, which was used to repay acquisition indebtedness. We intend to only sell properties that can be liquidated for an attractive premium and there can be no assurance that we will continue to generate any proceeds from the sale of our properties.

We are currently in preliminary discussions with lenders that have expressed an interest in providing a line of credit that would be secured by our oil and gas properties. There is no assurance that we will be successful in attracting a lender or that the amount of any financing will be sufficient to execute our business plan for 2013. In addition we are in negotiations with Preferred A-1 shareholders to restructure in an effort to improve our cash flow and balance sheet. There is no assurance that any or all of the Preferred A-1 shareholders will approve a transaction that management will present.

If oil and gas prices decrease materially from current levels and additional debt or equity funding is unavailable on acceptable terms, or at all, our strategy would include some or all of the following: (i) defer development drilling on our existing properties, (ii) forego additional oil and gas property acquisitions, (iii) shut-in any marginal or uneconomic wells, (iv) attempt to negotiate the issuance of common stock in exchange for services, and (v) review and implement other opportunities to reduce general, administrative and operating expenses.

***Contractual Obligations and Commercial Commitments***

As of March 31, 2013, we have future minimum lease payments of approximately $7,000. This amount is payable during the years ending March 31, 2014, 2015, 2016, 2017 and after 2017 in the amounts of $1,000, $1,000, $1,000, $1,000, and $2,000, respectively.

***Off-Balance Sheet Arrangements***

In connection with the related party acquisition of oil and gas properties in the third quarter of 2011, we acquired interests in certain geologic zones of the properties. The Colorado and Kansas properties provide for additional consideration that is payable to the related party sellers if proved producing reserves are increased relating to these properties through drilling or recompletion activities over a period of ten years after the closing date. First to the extent that oil reserves increase, the sellers are entitled to additional consideration of $250,000 for each increase of 20,000 net barrels. Second, to the extent that oil and gas prices increase, the sellers are entitled to additional consideration as the targeted price thresholds are exceeded for periods of 61 days. The increase in purchase price for the Kansas and Colorado properties is limited to a maximum of $5 million.

The acquired properties that are located in Wyoming and Montana provide a similar formula as used for the Colorado and Kansas properties that could result in an obligation for additional purchase consideration to the extent that we perform future drilling or recompletion activities in formations that were not producing as of the September 29, 2011 closing date. Furthermore, if we sell properties where reserves have been proved up through drilling or recompletion, the sellers have retained an interest of 70% in the net sales proceeds (after we receive a recovery of 125% of the original purchase allocation in the amended and restated purchase agreement). The increase in purchase price for all properties (Colorado, Kansas, Wyoming and Montana) is limited to a maximum of $25 million.

Due to consideration retained by the related party sellers from sales of properties through the first quarter of 2012, and $250,000 of consideration payable in December 2012 due to a sustained increase in oil prices over $90 per barrel, the maximum future consideration has been reduced by approximately $5.0 million to $20.0 million as of March 31, 2012.

*New Accounting Pronouncements*

In May 2011, the FASB issued new fair value measurement authoritative accounting guidance clarifying the application of fair value measurement and disclosure requirements and changes particular principles or requirements for measuring fair value. This authoritative accounting guidance is effective for interim and annual periods beginning after December 15, 2011. Based on the Company s current operations and structure, the adoption of this standard did not have an impact on the Company s 2012 financial statements.

In June 2011, the FASB issued new authoritative accounting guidance that states an entity that reports items of other comprehensive income has the option to present the components of net income and comprehensive income in either one continuous financial statement, or two consecutive financial statements, including reclassification adjustments. In December 2011, the FASB issued new authoritative accounting guidance which effectively deferred the requirement to present the reclassification adjustments on the face of the financial statements. This authoritative accounting guidance is effective for interim and annual periods beginning after December 15, 2011. Based on the Company s current operations and structure, the adoption of this standard did not have an impact on the Company s 2012 financial statements.

Other accounting standards that have been issued or proposed by the FASB, or other standards-setting bodies, that do not require adoption until a future date are not expected to have a material impact on the financial statements upon adoption.

**Item 3 - Quantitative and Qualitative Disclosures about Market Risk**

The Company is a Smaller Reporting Company as defined by Rule 229.10 (f)(1) and is not required to provide or disclose the information required by this item.

**Item 4 - Controls and Procedures**

As of March 31, 2013, our Chief Executive Officer and Chief Financial Officer (the Certifying Officers ) conducted evaluations of our disclosure controls and procedures. As defined under Sections 13a-15(e) and 15d-15(e) of the Exchange Act, the term disclosure controls and procedures means controls and other procedures of an issuer that are designed to ensure that information required to be disclosed by the issuer in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC s rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by an issuer in the reports that it files or submits under the Exchange Act is accumulated and communicated to the issuer s management, including the Certifying Officers, to allow timely decisions regarding required disclosure. Based on this evaluation, the Certifying Officers have concluded that our disclosure controls and procedures were not effective to ensure that material information is recorded, processed, summarized and reported by our management on a timely basis in order to comply with our disclosure obligations under the Exchange Act and the rules and regulations promulgated thereunder. As discussed in our Annual Report on Form 10-K/A for the year ended December 31, 2012, the ineffectiveness of our disclosure controls and procedures is due primarily to (i) our Board of Directors does not currently have any independent members that qualify as an audit committee financial expert, (ii) we have not developed and effectively communicated our accounting policies and procedures, and (iii) our controls over financial statement disclosures were determined to be ineffective.

Further, there were no changes in our internal control over financial reporting during the third fiscal quarter that has materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## PART II - OTHER INFORMATION

**Item 1 - Legal Proceedings.**

From time to time, the Company is a party to routine litigation and proceedings that are considered part of the ordinary course of its business. The Company is not aware of any material current, pending, or threatened litigation.

**Item 1A - Risk Factors.**

There have been no material changes to the risk factors set forth in our Annual Report on Form 10-K for the year ended December 31, 2012, as filed with the SEC on April 19, 2013. The risk factors in our Annual Report on Form 10-K for the year ended December 31, 2012, in addition to the other information set forth in this quarterly report, could materially affect our business, financial condition or results of operations. Additional risks and uncertainties not currently known to us or that we deem to be immaterial could also materially adversely affect our business, financial condition or results of operations.

**Item 2 - Unregistered Sales of Equity Securities and Use of Proceeds.**

None

**Ite m 3 - Defaults upon Senior Securities.**

None

**Item 4 - Mine Safety Disclosures.**

Not Applicable

**Item 5 - Other Information.**

None

**Ite m 6 - Exhibits**

The following documents are filed as exhibits to this report on Form 10-Q or incorporated by reference herein.

| | |
|---|---|
| 31.1 | Certification of the Principal Executive Officer pursuant to §302 of the Sarbanes-Oxley Act of 2002. |
| 31.2 | Certification of the Principal Financial Officer pursuant to §302 of the Sarbanes-Oxley Act of 2002. |
| 32.1 | Certification of the Principal Executive Officer pursuant to 18 U.S.C. Section 1350. |
| 32.2 | Certification of the Principal Financial Officer pursuant to 18 U.S.C. Section 1350. |
| 101 | The following materials are filed herewith: (i) XBRL Instance, (ii) XBRL Taxonomy Extension Schema, (iii) XBRL Taxonomy Extension Calculation, (iv) XBRL Taxonomy Extension Labels, (v) XBRL Taxonomy Extension Presentation, and (vi) XBRL Taxonomy Extension Definition. In accordance with Rule 406T of Regulation S-T, the information in these exhibits is furnished and deemed not filed or a part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, is deemed not filed for purposes of section 18 of the Exchange Act of 1934, and otherwise is not subject to liability under these sections and shall not be incorporated by reference into any registration statement or other document filed under the Securities Act of 1933, as amended, except as expressly set forth by the specific reference in such filing. |

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**ARÊTE INDUSTRIES, INC.**

**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 thereunto duly authorized.

By: /s/ Nicholas L. Scheidt, CEO
Nicholas L. Scheidt, Principal Executive Officer
Dated: May 20, 2013

By: /s/ Donald W. Prosser, CFO
Donald W. Prosser, Principal Financial and Accounting Officer
Dated: May 20, 2013