

Edgar Filing: TETON PETROLEUM CO - Form 10-Q

TETON PETROLEUM CO  
Form 10-Q  
August 16, 2004

U.S. SECURITIES AND EXCHANGE COMMISSION  
Washington, D. C. 20549

FORM 10-Q

(Mark One)

☒ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15 OF THE SECURITIES EXCHANGE  
ACT OF 1934

For the Quarterly Period Ended June 30, 2004

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number: 001-31679

TETON PETROLEUM COMPANY

(Exact Name of Registrant as Specified in its Charter)

Delaware

84-1482290

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(State or Other Jurisdiction of  
Incorporation or Organization)

(I.R.S. Employer  
Identification No.)

(303)-542-1878

(Registrant's Telephone Number including area code)

1600 Broadway, Suite 2400  
Denver, Colorado 80202-4921  
(Address of Principal Executive Office)

Check whether the registrant (1) filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes ☒ No ☐  
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Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-3 of the Exchange Act).

Yes ☐ No ☒  
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APPLICABLE ONLY TO ISSUERS INVOLVED IN BANKRUPTCY PROCEEDINGS DURING THE PRECEDING FIVE YEARS:

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Sections 12, 13 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court.

Yes ☐ No ☐

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APPLICABLE ONLY TO CORPORATE ISSUERS

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

As of August 12, 2004, 9,121,806 shares of the issuer's common stock were outstanding.

## TETON PETROLEUM COMPANY

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TETON PETROLEUM COMPANY

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## PART I. FINANCIAL INFORMATION

### Consolidated Balance Sheets

|                                                                                                                                                                                                                                                                                                   | June 30,<br>2004<br>(Unaudited) | December 31,<br>2003<br>(Audited) |
|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------------|-----------------------------------|
|                                                                                                                                                                                                                                                                                                   | -----                           | -----                             |
| Assets                                                                                                                                                                                                                                                                                            |                                 |                                   |
| Current assets                                                                                                                                                                                                                                                                                    |                                 |                                   |
| Cash .....                                                                                                                                                                                                                                                                                        | \$ 8,577,869                    | \$ 7,588,439                      |
| Proportionate share of Goloil accounts receivable .....                                                                                                                                                                                                                                           | 10,971                          | 15,739                            |
| Proportionate share of Goloil VAT and other accounts<br>receivable .....                                                                                                                                                                                                                          | 1,765,612                       | 1,078,369                         |
| Proportionate share of Goloil inventory .....                                                                                                                                                                                                                                                     | 529,556                         | 448,812                           |
| Prepaid expenses and other assets .....                                                                                                                                                                                                                                                           | 157,705                         | 95,693                            |
|                                                                                                                                                                                                                                                                                                   | -----                           | -----                             |
| Total current assets .....                                                                                                                                                                                                                                                                        | 11,041,713                      | 9,227,052                         |
|                                                                                                                                                                                                                                                                                                   | -----                           | -----                             |
| Non-current assets                                                                                                                                                                                                                                                                                |                                 |                                   |
| Oil and gas properties, net (successful efforts) .....                                                                                                                                                                                                                                            | 7,375,761                       | 9,339,786                         |
| Cogeneration plant construction in progress .....                                                                                                                                                                                                                                                 | 1,725,301                       | 1,700,696                         |
| Fixed assets, net .....                                                                                                                                                                                                                                                                           | 522,280                         | 450,841                           |
|                                                                                                                                                                                                                                                                                                   | -----                           | -----                             |
| Total non-current assets .....                                                                                                                                                                                                                                                                    | 9,623,342                       | 11,491,323                        |
|                                                                                                                                                                                                                                                                                                   | -----                           | -----                             |
| Total assets .....                                                                                                                                                                                                                                                                                | \$ 20,665,055                   | \$ 20,718,375                     |
|                                                                                                                                                                                                                                                                                                   | =====                           | =====                             |
| Liabilities and Stockholders' Equity                                                                                                                                                                                                                                                              |                                 |                                   |
| Current liabilities                                                                                                                                                                                                                                                                               |                                 |                                   |
| Accounts payable and accrued liabilities .....                                                                                                                                                                                                                                                    | \$ 439,218                      | \$ 376,429                        |
| Proportionate share of Goloil accounts payable and<br>accrued liabilities .....                                                                                                                                                                                                                   | 3,274,658                       | 2,590,901                         |
| Current portion of proportionate share of notes payable<br>owed to affiliate (Note 2) .....                                                                                                                                                                                                       | 10,677,787                      | 7,419,409                         |
|                                                                                                                                                                                                                                                                                                   | -----                           | -----                             |
| Total current liabilities .....                                                                                                                                                                                                                                                                   | 14,391,663                      | 10,386,739                        |
|                                                                                                                                                                                                                                                                                                   | -----                           | -----                             |
| Non-current liabilities                                                                                                                                                                                                                                                                           |                                 |                                   |
| Asset retirement obligation.....                                                                                                                                                                                                                                                                  | 131,000                         | 126,500                           |
|                                                                                                                                                                                                                                                                                                   | -----                           | -----                             |
| Total non-current liabilities .....                                                                                                                                                                                                                                                               | 131,000                         | 126,500                           |
|                                                                                                                                                                                                                                                                                                   | -----                           | -----                             |
| Total liabilities .....                                                                                                                                                                                                                                                                           | 14,522,663                      | 10,513,239                        |
|                                                                                                                                                                                                                                                                                                   | -----                           | -----                             |
| Commitments and contingencies                                                                                                                                                                                                                                                                     |                                 |                                   |
| Stockholders' equity                                                                                                                                                                                                                                                                              |                                 |                                   |
| Series A convertible preferred stock, \$.001 par value,<br>25,000,000 shares authorized, 281,460 and 618,231 issued<br>and outstanding at June 30, 2004 and December 31, 2003.<br>Liquidation preference at June 30, 2004 and<br>December 31, 2003 of \$1,249,838 and \$2,689,305, respectively.. | 281                             | 618                               |

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|                                                                                                                                                                                           |               |               |
|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------|---------------|
| Common stock, \$0.001 par value, 250,000,000 shares<br>authorized, 9,114,663 and 8,584,068 shares issued and<br>outstanding at June 30, 2004 and December 31, 2003,<br>respectively ..... | 9,115         | 8,584         |
| Additional paid-in capital .....                                                                                                                                                          | 37,677,175    | 37,073,366    |
| Unamortized preferred stock dividends.....                                                                                                                                                | --            | (118,610)     |
| Accumulated deficit .....                                                                                                                                                                 | (32,160,079)  | (27,657,578)  |
| Foreign currency translation adjustment .....                                                                                                                                             | 615,900       | 898,756       |
|                                                                                                                                                                                           | -----         | -----         |
| Total stockholders' equity .....                                                                                                                                                          | 6,142,392     | 10,205,136    |
|                                                                                                                                                                                           | -----         | -----         |
| Total liabilities and stockholders' equity .....                                                                                                                                          | \$ 20,665,055 | \$ 20,718,375 |
|                                                                                                                                                                                           | =====         | =====         |

See notes to unaudited consolidated financial statements

### TETON PETROLEUM COMPANY

#### Unaudited Consolidated Statements of Operations and Comprehensive Loss

|                                                    | For the Three Months Ended<br>June 30, |              |
|----------------------------------------------------|----------------------------------------|--------------|
|                                                    | 2004                                   | 2003         |
|                                                    | -----                                  | -----        |
| Sales .....                                        | \$ 3,589,638                           | \$ 2,978,554 |
| Cost of sales and expenses                         |                                        |              |
| Oil and gas production .....                       | 708,996                                | 513,011      |
| Transportation and marketing .....                 | --                                     | 320,234      |
| Taxes other than income taxes .....                | 2,312,750                              | 1,250,134    |
| Export duties.....                                 | --                                     | 598,970      |
| Exploration .....                                  | 172,988                                | 103,665      |
| General and administrative - Goloil .....          | 195,643                                | 167,928      |
| General and administrative - Teton Petroleum ..... | 1,726,816                              | 981,023      |
| Depreciation, depletion and amortization .....     | 341,645                                | 423,860      |
|                                                    | -----                                  | -----        |
| Total cost of sales and expenses .....             | 5,458,838                              | 4,358,825    |
|                                                    | -----                                  | -----        |
| Loss from operations .....                         | (1,869,200)                            | (1,380,271)  |
|                                                    | -----                                  | -----        |
| Other income (expense)                             |                                        |              |
| Other income .....                                 | 16,325                                 | 291          |
| Interest expense .....                             | (110,685)                              | (49,684)     |
|                                                    | -----                                  | -----        |
| Total other income (expense) .....                 | (94,360)                               | (49,393)     |
|                                                    | -----                                  | -----        |
| Net loss before taxes .....                        | (1,963,560)                            | (1,429,664)  |
|                                                    | -----                                  | -----        |
| Foreign income tax .....                           | (16,829)                               | (17,576)     |

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|                                                                                        |                |                |
|----------------------------------------------------------------------------------------|----------------|----------------|
| Net loss .....                                                                         | (1,980,389)    | (1,447,240)    |
| Imputed preferred stock dividends for inducements<br>and beneficial conversion charges | --             | --             |
| Preferred stock dividends .....                                                        | (25,487)       | --             |
| Net loss applicable to common stock .....                                              | (2,005,876)    | (1,447,240)    |
| Other comprehensive (loss) income, net of tax                                          |                |                |
| Effect of exchange rates .....                                                         | 2,300          | 369,500        |
|                                                                                        | -----          | -----          |
| Other comprehensive (loss) income .....                                                | 2,300          | 369,500        |
|                                                                                        | -----          | -----          |
| Comprehensive loss .....                                                               | \$ (2,003,576) | \$ (1,077,740) |
|                                                                                        | =====          | =====          |
| Basic and diluted weighted average common shares outstanding                           | 9,112,009      | 6,674,988      |
|                                                                                        | =====          | =====          |
| Basic and diluted (loss) income per common share .....                                 | \$ (.22)       | \$ (.22)       |
|                                                                                        | =====          | =====          |

See notes to unaudited consolidated financial statements.

## TETON PETROLEUM COMPANY

### Unaudited Consolidated Statements of Operations and Comprehensive Loss

|                                                    | For the Six Months Ended<br>June 30, |              |
|----------------------------------------------------|--------------------------------------|--------------|
|                                                    | 2004                                 | 2003         |
|                                                    | -----                                | -----        |
| Sales .....                                        | \$ 6,552,138                         | \$ 6,387,272 |
| Cost of sales and expenses                         |                                      |              |
| Oil and gas production .....                       | 1,331,273                            | 839,316      |
| Transportation and marketing .....                 | --                                   | 601,199      |
| Taxes other than income taxes .....                | 4,286,025                            | 2,677,706    |
| Export duties.....                                 | --                                   | 1,158,210    |
| Exploration .....                                  | 327,764                              | 196,813      |
| General and administrative - Goloil .....          | 379,729                              | 387,485      |
| General and administrative - Teton Petroleum ..... | 3,829,454                            | 1,753,922    |
| Depreciation, depletion and amortization .....     | 751,315                              | 756,598      |
|                                                    | -----                                | -----        |
| Total cost of sales and expenses .....             | 10,905,560                           | 8,371,249    |
|                                                    | -----                                | -----        |
| Loss from operations .....                         | (4,353,422)                          | (1,983,977)  |
|                                                    | -----                                | -----        |
| Other income (expense)                             |                                      |              |

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|                                                                                        |                |                |
|----------------------------------------------------------------------------------------|----------------|----------------|
| Other income .....                                                                     | 33,965         | 1,869          |
| Interest expense .....                                                                 | (166,216)      | (123,799)      |
|                                                                                        | -----          | -----          |
| Total other income (expense) .....                                                     | (132,251)      | (121,930)      |
|                                                                                        | -----          | -----          |
| Net loss before taxes .....                                                            | (4,485,673)    | (2,105,907)    |
|                                                                                        | -----          | -----          |
| Foreign income tax .....                                                               | (16,829)       | (122,418)      |
| Net loss .....                                                                         | (4,502,502)    | (2,228,325)    |
| Imputed preferred stock dividends for inducements<br>and beneficial conversion charges | (521,482)      | --             |
| Preferred stock dividends.....                                                         | (56,975)       | --             |
| Net loss applicable to common stock .....                                              | (5,080,959)    | (2,228,325)    |
| Other comprehensive (loss) income, net of tax                                          |                |                |
| Effect of exchange rates .....                                                         | (282,856)      | 455,500        |
|                                                                                        | -----          | -----          |
| Other comprehensive (loss) income .....                                                | (282,856)      | 455,500        |
|                                                                                        | -----          | -----          |
| Comprehensive loss .....                                                               | \$ (5,363,815) | \$ (1,772,825) |
|                                                                                        | =====          | =====          |
| Basic and diluted weighted average common shares outstanding                           | 8,927,699      | 6,518,278      |
|                                                                                        | =====          | =====          |
| Basic and diluted (loss) income per common share .....                                 | \$ (.57)       | \$ (.34)       |
|                                                                                        | =====          | =====          |

See notes to unaudited consolidated financial statements.

## TETON PETROLEUM COMPANY

### Unaudited Consolidated Statements of Cash Flows

|                                                                                        | For the Six Months Ended<br>June 30, |                |
|----------------------------------------------------------------------------------------|--------------------------------------|----------------|
|                                                                                        | 2004                                 | 2003           |
|                                                                                        | -----                                | -----          |
| Cash flows from operating activities                                                   |                                      |                |
| Net loss .....                                                                         | \$ (4,502,502)                       | \$ (2,228,325) |
|                                                                                        | -----                                | -----          |
| Adjustments to reconcile net (loss) income to net<br>cash used in operating activities |                                      |                |
| Depreciation, depletion, and amortization .....                                        | 751,315                              | 756,598        |
| Stock and warrants issued for services and interest ..                                 | 150,594                              | 97,901         |
| Amortization of note payable discount.....                                             | --                                   | 347            |

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|                                                                                   |              |             |
|-----------------------------------------------------------------------------------|--------------|-------------|
| Changes in assets and liabilities                                                 |              |             |
| Accounts receivable .....                                                         | (682,475)    | (638,806)   |
| Prepaid expenses and other assets .....                                           | (62,012)     | (32,426)    |
| Inventory .....                                                                   | (80,744)     | (141,300)   |
| Accounts payable and accrued liabilities .....                                    | 1,317,601    | (625,326)   |
|                                                                                   | -----        | -----       |
|                                                                                   | 1,394,279    | (583,012)   |
|                                                                                   | -----        | -----       |
| Net cash (used in) operating activities .....                                     | (3,108,223)  | (2,811,337) |
|                                                                                   | -----        | -----       |
| Cash flows from investing activities                                              |              |             |
| Repayment of loans from Goloil.....                                               | 3,658,252    | --          |
| Oil and gas properties and equipment expenditures .....                           | (3,004,632)  | (2,889,820) |
|                                                                                   | -----        | -----       |
| Net cash provided by (used in) investing activities..                             | 653,620      | (2,889,820) |
|                                                                                   | -----        | -----       |
| Cash flows from financing activities                                              |              |             |
| Net (repayments) proceeds from advances under notes payable from affiliate.....   | 3,258,378    | 1,399,028   |
| Proceeds from stock subscriptions.....                                            | --           | 1,939,610   |
| Proceeds from issuance of stock, net of issue costs of \$50,000 and \$98,100..... | 499,999      | 1,091,900   |
| Proceeds from notes payable.....                                                  | --           | 478,750     |
| Payment of dividends.....                                                         | (31,488)     | --          |
|                                                                                   | -----        | -----       |
| Net cash provided by financing activities .....                                   | 3,726,889    | 4,909,288   |
|                                                                                   | -----        | -----       |
| Effect of exchange rates .....                                                    | (282,856)    | 455,500     |
|                                                                                   | -----        | -----       |
| Net increase (decrease) in cash .....                                             | 989,430      | (336,369)   |
| Cash - beginning of year .....                                                    | 7,588,439    | 712,013     |
|                                                                                   | -----        | -----       |
| Cash - end of period .....                                                        | \$ 8,577,869 | \$ 375,644  |
|                                                                                   | =====        | =====       |

### Supplemental disclosure of non-cash activity:

During the six months ended June 30, 2004, the Company had the following transactions:

100,000 warrants were issued to a consultant for services valued at \$102,094.

13,750 shares of common stock were issued for the settlement of accrued liabilities at December 31, 2003 valued at \$58,700.

The Company issued (i) 1,306,669 non-qualified options to officers and directors valued at \$3,243,406; and (ii) 108,331 incentive stock options valued at \$268,899 with no expense being recorded for accounting purposes.

The Company issued 5,000 shares of common stock for services valued at \$20,000.

The Company has (i) issued warrants valued at \$48,697 to consultants; (ii) issued 5,626 share of common stock valued at \$23,329 to consultants; and (iii) issued 5,955 shares of common stock valued at \$28,500 for services

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rendered by the outside directors.

Approximately \$1,317,000 of capital expenditures for oil and gas properties were included in accounts payable at June 30, 2004 and approximately \$1,786,000 of capital expenditures were in accounts payable at December 31, 2003 for a decrease during the six months ended June 30, 2004 of \$469,000.

Conversion of 463,207 shares of preferred stock, plus dividends of 37,057 shares converted into 500,264 shares of common stock.

We issued 50,000 warrants valued at \$22,863 in settlement of accrued liabilities at December 31, 2003.

We accrued dividends to preferred stockholders of \$25,487 at June 30, 2004.

Supplemental disclosure of non-cash activity:

During the six months ended June 30, 2003, the Company had the following transactions:

7,408 shares of stock were issued to a consultant for services valued at \$20,000 provided in 2001 and accrued in accounts payable.

73,422 shares of stock and 66,667 warrants exercisable at \$6.00 were issued to a consultant for services provided in 2002 valued at \$200,000 and accrued in accounts payable.

3,700 warrants issued with debt and valued at \$10,592 were initially recorded as a discount on the note payable. At June 30, 2003, \$347 of the discount had been amortized and recorded as financing costs.

87,500 warrants issued with debt and valued at \$69,072 were initially recorded as a discount on the debentures. At June 30, 2003, none of the discount had been amortized and recorded as financing costs.

Approximately \$1,818,000 of capital expenditures for oil and gas properties was included in accounts payable at June 30, 2003.

See notes to unaudited consolidated financial statements.

### **Notes to Unaudited Consolidated Financial Statements**

#### **Note 1 - Basis of Presentation and Significant Accounting Policies**

The June 30, 2004 financial statements are unaudited and reflect all adjustments (consisting only of normal recurring adjustments), which are, in the opinion of management, necessary for a fair presentation of the financial position and operating results for the interim periods. The unaudited financial statements as of June 30, 2004, as is customary in the oil and gas industry, reflect a pro-rata consolidation of the Company's 50% interest in ZAO Goloil, a Russian closed joint-stock company. However, see note 5 regarding the sale of Goloil. The unaudited financial statements contained herein should be read in conjunction with the financial statements and notes thereto contained in the Company's financial statements for the year ended December 31, 2003, as reported in the Company's Form 10-KSB/A. The results of operations for the period ended June 30, 2004 are not necessarily indicative of the results for the entire fiscal year.

Certain amounts for June 30, 2003 have been adjusted to include adjustments to exploration expenses and depreciation, depletion and amortization made during



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the fourth quarter of 2003.

### Foreign Currency Exchange Rates

The conversion of the functional currency of Goloil (a Russian Company) in rubles to the reporting currency of U.S. dollars is based upon the exchange rates in effect. The exchange rates in effect at June 30, 2004 and 2003 were 29.03 and 30.38 rubles to the U.S. dollar, respectively. The average rates in effect during the six months ended June 30, 2004 and 2003 were 28.76 and 30.89 rubles to the U.S. dollar, respectively.

### Earnings Per Share

At the March 19, 2003 shareholders' meeting, the Company's shareholders approved a reverse 1 for 12 stock split. All share amounts and earnings per share have been adjusted to reflect the split.

All potential dilutive securities have an antidilutive effect on earnings (loss) per share and accordingly, basic and dilutive weighted average shares are the same.

### Note 2 - Proportionate Share of Liabilities

The proportionate share of accounts payable and accrued liabilities of \$3,274,658 at June 30, 2004, are obligations of Goloil and not the Company nor have they been guaranteed by the Company.

The Company's 50% pro-rata share of notes payable advances made which are advances to Goloil by an affiliate are also obligations of Goloil at June 30, 2004 and not the Company nor have they been guaranteed by the Company. However, see note 5 regarding the sale of Goloil.

The Company's pro-rata share of Goloil notes payable owed to an affiliate totaled \$10,677,787 at June 30, 2004. The proceeds were used to pay certain operating expenses and capital expenditures of Goloil. These notes provide for interest rates of 8%, with quarterly interest payments, maturing through December 2004. These notes are secured by substantially all Goloil assets. The notes payable will be repaid from cash flow from ZAO Goloil as available, or extended to future periods. However, see note 5 regarding the sale of Goloil.

### Note 3 - Stockholder's Equity

#### Private Placements of Common Stock

During the six months ended June 30, 2004, 30,331 common shares valued at \$130,529 were issued for (i) the settlement of accrued liabilities of \$82,029; and (ii) services provided by consultants of \$20,000 and (iii) services provided by the advisory board of \$28,500.

50,000 warrants were issued to settle a liability at December 31, 2003 valued at \$46,967. We also issued 100,000 warrants to a consultant valued at \$102,094 for services.

#### Private Placements of Series A Convertible Preferred Stock

During the six-month period ending June 30, 2004 the Company received the following proceeds from the issuance of privately placed preferred stock at a price of \$4.35 per share.

Proceeds of \$499,999 (net of cash costs of \$50,000) from the issuance of 126,436 shares of 8% convertible preferred stock.

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The preferred stock carries an 8% dividend, payable quarterly commencing January 1, 2004 and is convertible into common stock at a price of \$4.35 per share. The preferred stock is entitled to vote on all matters presented to the Company's common stockholders, with the number of votes being equal to the number of underlying common shares. The preferred stock also contains a liquidation preference of \$4.35 per share plus accrued unpaid dividends. The preferred stock can be redeemed by the Company after one year for \$4.35 per share upon proper notice of redemption being provided by the Company.

In connection with the private placements of the Company's preferred stock, certain sales were entered into when the underlying price of the common stock to which the preferred shares are convertible into, exceeded the \$4.35 stated conversion rate. As a result of the underlying shares being in-the-money, the Company was required to compute a beneficial conversion charge, which is calculated as the difference between the conversion price of \$4.35 and the closing stock price on the effective date each offering, multiplied by the total of the related common shares to be issued upon conversion of the preferred stock. These charges are reflected as a dividend to the preferred shareholders and are recognized over the period in which the preferred stock first becomes convertible. For the Tranche 1 shares the charge was immediately recognized as the shares were immediately convertible into common. For Tranche 2, the shares could not be converted until completion of a shareholder vote, which occurred on January 27, 2004, approving the issuance of additional common shares. The calculated beneficial conversion feature on Tranche 2 was therefore amortized from the effective date of each issuance through January 27, 2004. This resulted in total beneficial conversion charges of \$1,182,452, of which \$1,063,842 was recorded during the fourth quarter of 2003, and \$118,610 was amortized and recorded as preferred dividends in January 2004.

In order to induce convertible preferred shareholders to convert to common shares, the Company agreed to issue dividends of 8% for a full year, totaling \$140,815, payable in common shares, and agreed to issue, 402,990 warrants, valued at \$262,057, resulting in a total inducement charge of \$402,872 to be recognized as a preferred dividend in the first quarter for those investors which accepted the inducement offer. As a result, shareholders converted 463,207 of 8% convertible preferred shares to common stock at a price of \$4.35 per share during the first quarter of 2004. The warrants issued were valued using the Black-Scholes option pricing model using the following assumptions: volatility of 55.2%, a risk-free rate of 1.59%, zero dividend payments, and a life of two years.

### **Note 4 - Stock Options**

At the annual meeting on March 19, 2003, the Company's shareholders approved an employee stock option plan and authorized 2,083,333 shares of Common Stock for issuance thereunder. Under the plan, incentive and non-qualified options may be granted.

During the first quarter of 2004, the Company issued 1,306,669 non-qualified options to employees, officers and directors valued at \$3,243,406 using the Black-Scholes option-pricing model with the following assumptions: volatility of 55.2%, a risk-free rate of 4%, zero dividend payments, and a life of ten years. The Company also issued 108,331 incentive options to employees, officers and directors valued at \$268,899 using the Black-Scholes option-pricing model under the same assumptions described above.

At the annual meeting on July 16, 2004 the Company's shareholders approved a stock compensation plan for non-employees. The maximum number of shares of Common Stock with respect to which awards can be granted is 1,000,000 shares. As of August 12, 2004 no grants have been authorized.

The Company has adopted the disclosure-only provisions of Statement of Financial

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Accounting Standards No. 123, "Accounting for Stock-Based Compensation." Accordingly, no compensation cost has been recognized for stock options issued to employees, officers and directors under the stock option plan. Had compensation cost for the Company's options issued to employees, officers and directors been determined based on the fair value at the grant date for awards consistent with the provisions of SFAS No. 123, as amended by SFAS No. 148, the Company's net loss and basic loss per common share would have been changed to the pro forma amounts indicated below:

|                                                 | For the Six Months Ended<br>June 30, |                |
|-------------------------------------------------|--------------------------------------|----------------|
|                                                 | 2004                                 | 2003           |
| Net loss - as reported                          | \$ (5,080,959)                       | \$ (2,228,325) |
| Add fair value of employee compensation expense | (3,512,305)                          | (4,571,026)    |
| Net loss per common share - pro forma           | \$ (8,593,264)                       | \$ (6,799,351) |
| Basic loss per common share - as reported       | \$ (0.57)                            | \$ (0.34)      |
| Basic loss per common share - pro forma         | \$ (0.96)                            | \$ (1.04)      |

|                                                 | For the Three Months Ended<br>June 30, |                |
|-------------------------------------------------|----------------------------------------|----------------|
|                                                 | 2004                                   | 2003           |
| Net loss - as reported                          | \$ (2,005,876)                         | \$ (1,447,240) |
| Add fair value of employee compensation expense | --                                     | \$ (4,571,026) |
| Net loss per common share - pro forma           | \$ (2,005,876)                         | \$ (6,018,266) |
| Basic loss per common share - as reported       | \$ (0.22)                              | \$ (0.22)      |
| Basic loss per common share - pro forma         | \$ (0.22)                              | \$ (0.90)      |

### **Note 5-Proposed Sale of Goloil Shares**

On August 3, 2004 the Company finalized its sale of Goloil to RussNeft, an Open Joint-Stock Company organized under the laws of the Russian Federation. Pursuant to the terms of the Sale and Purchase Agreement (the "Agreement"), RussNeft paid \$8,960,000 for all of the Company's shares of Goloil. In connection with the Agreement, the Company entered into a separate agreement with Goloil for repayment of all of the outstanding advances owed to the Company. At the date the parties reached agreement in April, the Company had advances totaling \$6,040,000, of which \$3,658,000 had been received as of June 30, 2004. During August 2004 the Company paid the remaining amounts owed for an investment banking fee totaling \$750,000 in connection with the Agreement and estimates its expenses, incurred after June 30, 2004 in connection with the negotiation of the Agreement to be \$135,000.

The Company had recorded the advances as investments in Goloil and accordingly such amounts have been included in the carrying value of oil and gas properties.

The effective date of the transaction will be July 1, 2004 and accordingly, the

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Company will record a gain of approximately \$13,000,000 during the third quarter.

The following unaudited pro forma condensed balance sheet gives effect to the sale of Goloil shares assuming the sale of Goloil shares occurred on June 30, 2004:

|                                               |               |
|-----------------------------------------------|---------------|
| Current assets                                | \$ 19,012,000 |
| Non-current assets                            | 30,000        |
|                                               | -----         |
| Total assets                                  | \$ 19,042,000 |
|                                               | =====         |
| Current liabilities                           | \$ 439,000    |
| Stockholders' equity                          | 18,603,000    |
|                                               | -----         |
| Total liabilities and<br>stockholders' equity | \$ 19,042,000 |
|                                               | =====         |

The condensed pro forma balance sheet reflects the historical balance sheet included in this Form 10-Q adjusted for the following:

- The proceeds of \$8,960,000 from the sale of Goloil shares plus the remaining \$2,382,000 advances to be received, subsequent to June 30, 2004, less estimated expenses of \$885,000 and alternative minimum taxes of \$181,000.
- Elimination of Goloil's assets and liabilities, which have been historically consolidated on a pro rata basis.
- Recording a gain from the disposition of a discontinued operation, net of tax, of approximately \$13,000,000.

Assuming the sale occurred on June 30, 2004 Teton would have had, on a pro forma basis, an estimated net loss from continuing operations applicable to common shares for the six months ended June 30, 2004 of \$4,380,000 and as a result of the sale, net income of approximately \$7,995,000. On a pro forma basis, the loss per share from continuing operations would be \$.49 per common share and net income per common share would be \$.90.

### Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

#### FORWARD LOOKING STATEMENTS

With the exception of historical matters, the matters discussed herein are forward looking statements that involve risks and uncertainties. Forward looking statements include, but are not limited to, statements concerning anticipated trends in revenues, and may include words or phrases such as "will likely result," "are expected to," "will continue," "is anticipated," "estimate," "projected," "intends to," or similar expressions, which are intended to identify "forward looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. Our actual results could differ materially from the results discussed in such forward-looking statements. There is absolutely no assurance that we will achieve the results expressed or implied in forward-looking statements. Among other factors discussed elsewhere in this Report, our ability to successfully implement our strategy to acquire additional oil and gas properties and our ability to successfully manage and operate any oil and gas properties acquired by us will affect our future results.

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### Management Discussion & Analysis

#### Overview

Teton Petroleum Company is an independent oil and gas exploration and production company whose primary focus, until July 1, 2004 was the Russian Federation and former Commonwealth of Independent States ("CIS"). However, see "Sale of Goloil Interest" below. The Company, through its wholly owned subsidiary, Goltech, owned a 35.30% equity interest in Goloil. RussNeft owned, until the sale, the remaining 64.70% of Goloil through two subsidiaries, McGrady and InvestPetrol. McGrady held 35.29% and InvestPetrol held 29.41% of the equity interests in Goloil. However, until Goltech and McGrady received the return of 100% of their capital investment in Goloil, they were each entitled to a 50% net profit in Goloil. Goloil is managed by a seven-person management board on which we had two representatives. Pursuant to the existing agreements among Goloil's shareholders, Goltech and McGrady shared equally in capital expenditures, gross revenues, costs and expenses, until they received 100% return of their investments in Goloil. Limited Liability Company Energosoyuz-A ("EUA"), a wholly owned subsidiary of RussNeft, is the lessor of certain oil field facilities to Goloil pursuant to a Lease Agreement No. EST 160/000630 (the "EUA Lease Agreement") among EUA as lessor and Goloil as lessee dated as June 2000. EUA was also the recipient of a production payment ("Production Payment") consisting of 50% of Goloil's production (or at EUA's option, cash in lieu of such production). Since October 2003 through the effective date of the sale EUA took cash instead of oil under the Production Payment in the amount of approximately \$650,000 per month. In addition, Goloil has been selling its oil at a fixed price of 2,400 rubles per ton or \$11.50 per barrel and starting May 2004, 2,700 rubles per ton or \$12.74 per barrel. It is possible that a significant portion of such sales have been made to or through one or more affiliates of RussNeft.

RussNeft, which was founded in the fall of 2002, is one of Russia's largest independent oil producers. In September 2003, RussNeft acquired a 64.70% equity interest in Goloil in a private transaction in which it purchased all of the ownership interests in McGrady and InvestPetrol, the other shareholders of Goloil. At that time, RussNeft also acquired EUA, the lessor of various wells and facilities to Goloil under the EUA Lease Agreement. In acquiring such interests, RussNeft became entitled to appoint a majority of the management board of Goloil and acceded to EUA's interest in the Production Payment.

Goloil holds a twenty-five year renewable license to produce oil and gas in a portion of Western Siberia. The license was issued by the Russian Federation and expires in 2022, but may be extended if Goloil complies with certain specified conditions and undertakes additional operations at the end of the term of the license. The Goloil license encompasses 187 square kilometers (78 square miles) in the south central portion of the west Siberian basin. The license area is located approximately 50 miles north of Nizhnevartovsk in western Siberia. Three oil producing fields are located within the license area: Golevaya, Eguryak, and South Eguryak.

Financial highlights from the quarter ended June 30, 2004 include the following:

- o Teton's share of production from Goloil increased by 8.4% to 178,022 barrels year over year in the second quarter.
- o Second quarter production revenues increased year over year by 20.5% to \$3,589,638 primarily as a consequence of the higher oil prices.
- o Teton's net loss applicable to shareholders for the second quarter widened from \$1,447,240 to \$2,005,876 from the same period in 2003.

During 2004 Teton's activities have been focused in three areas:

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- 1) Discussions with its partner RussNeft over the management of its Goloil subsidiary;
- 2) Negotiating and finalizing the sale of Goloil to RussNeft; and
- 3) Evaluating potential acquisitions of other producing oil properties in Russia, the CIS and the United States.

### **Sale of Goloil Interest to RussNeft**

In September 2003, RussNeft, a newly formed Russian independent oil producer acquired the 64.70% of Goloil shares held by McGrady and InvestPetrol and assumed responsibility for operating Goloil's Eguryak License.

Commencing October 1 2003, RussNeft began selling Goloil's production to an entity believed by the Company to be an affiliate of RussNeft for a fixed price of 2,400 rubles per ton (\$11.50 per barrel), a price substantially below the blended market price Goloil formerly received selling its production into the export, near abroad and domestic markets and significantly below current market prices. As a consequence, the Company estimates its revenues after taxes for the quarter were reduced by approximately \$1.44 million in fourth quarter of 2003 and by \$2.02 million in the first quarter of 2004 from what it would have received under its previous arrangements. Moreover, since this pricing arrangement prevailed through the end of the fourth quarter and beyond, the Company had to significantly reduce the present value of its reserves effective January 1, 2004, as detailed in its Form 10-KSB/A for the year ended December 31, 2003.

Efforts to resolve these and other issues with RussNeft culminated in a series of meetings in Russia starting in November 2003 between Company executives and representatives of RussNeft, which failed to yield an acceptable resolution. Shortly thereafter, the Company and RussNeft began to discuss the terms of an exit via a sale of the Company's interest in Goloil to RussNeft.

The sale of the Company's interest in Goloil, pending shareholder approval, was announced on April 12, 2004 and on May 12, 2004 the Company provided additional detail concerning the sale, including, among other things, the sales price, in a press release. The purchase price for our 35.30% interest in Goloil is \$8,960,229 in cash. Goloil also repaid advances made by the Company to Goloil totaling \$6,039,771, of which \$3,569,051 of the principal and \$131,452 of the accrued interest had been repaid as of June 30, 2004. The advances were made to Goloil by the Company to finance our 50% share of Goloil's capital expenditures and currently bear interest at the rate of 8% per annum. The gross proceeds of the two transactions to the Company total \$15,000,000. The Company shareholders approved the sale at our annual meeting held July 16, 2004, and the sale closed during August 2004. See note 5 to financial statements, which include pro forma information assuming the sale had occurred as of June 30, 2004.

### **2004 Operational and Financial Objectives - Update**

As described in the Company's 2003 10-KSB/A, the Company's original plans called for it to focus its efforts in two areas: 1) the continued development of the Goloil License and 2) the acquisition, development and exploitation of similar projects in Russia, FSU and North America. With the sale of Goloil, the first objective is no longer operative and the second objective will become paramount. In addition, as the Company no longer has an operating asset, the Company will be significantly reducing its general and administrative costs.

The Company has been actively seeking to make acquisitions of producing properties in Russia, FSU and North America, where the Company itself will have the opportunity to jointly or fully operate the property. Specifically the Company has determined to target properties with existing production in the

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range of 4,000 to 6,000 barrels of oil per day with upside potential from developmental drilling and other exploitation opportunities. Among the financial criteria for such acquisitions is that they generate positive cash flow and be accretive to the Company earnings in a reasonable period of time. To date, the Company has evaluated 300 projects, rejected 291 projects, submitted 4 offers (2 of which are outstanding), with 5 projects remaining open, pending further review.

The Company's plans to pursue such acquisitions means that it will incur due diligence and legal expenses, that will be reflected in its general and administrative expenses. The company is now devoting significant internal resources to evaluating acquisitions while also utilizing the services of outside technical, legal and accounting consultants.

### Results of Operations

The table below summarizes some of the most important components of our revenues, operating costs and net loss. Please note that since Teton has been absorbing 50% of the cost of producing the oil paid under the Goloil production payment (included in the cost amounts), the Company's per barrel production costs are effectively doubled.

#### Operating Highlights for the Quarter ended June 30

(in U.S. Dollars, unless otherwise noted)

|                                                   | 2004        | 2003        | Change    | % Change |
|---------------------------------------------------|-------------|-------------|-----------|----------|
| Sales, Barrels                                    | 178,022     | 164,273     | 13,749    | 8.4%     |
| Average Daily Sales, Barrels                      | 1,956       | 1,805       | 151       | 8.4%     |
| Average Selling Price, \$/barrel                  | 20.16       | 18.13       | 2.03      | 11.2%    |
| Revenues                                          | 3,589,638   | 2,978,554   | 611,084   | 20.5%    |
| Costs of Sales and Expenses,<br>excl. DD&A        |             |             |           |          |
| Production Costs                                  | 708,996     | 513,011     | 195,985   | 38.2%    |
| Transportation & Marketing                        | -           | 320,234     | (320,234) | -100%    |
| Taxes other than Income taxes                     | 2,312,750   | 1,250,134   | 1,062,616 | 85%      |
| Exploration cost (Geology &<br>Geophysics)        | 172,988     | 103,665     | 69,323    | -66.9%   |
| Export Duties                                     | -           | 598,970     | (598,970) | -100.0%  |
|                                                   | 3,194,734   | 2,786,014   | 408,720   | 14.7%    |
| Results from Goloil Operations,<br>before DD&A    | 394,904     | 192,540     | 202,364   | -        |
| Less General & Administrative<br>Expense, Goloil  | 195,643     | 167,928     | 27,715    | 16.5%    |
|                                                   | 199,261     | 24,612      | 174,649   | -        |
| Depreciation, Depletion &<br>Amortization, Goloil | 341,645     | 423,860     | (82,215)  | -19.4%   |
| Operating Income (Loss), Goloil                   | (142,384)   | (399,248)   | 256,864   | -        |
| General & Administrative Expense,<br>Teton        | 1,726,816   | 981,023     | 745,793   | 76%      |
| Operating Loss, Teton                             | (1,869,200) | (1,380,271) | (488,929) | -        |

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### Costs and Expenses during the Quarter ended June 30 (in U.S. \$ per barrel)

|                               | 2004  | 2003  | Change | % Change |
|-------------------------------|-------|-------|--------|----------|
| Controllable Costs            |       |       |        |          |
| Production Costs              | 3.72  | 3.12  | .60    | 19.2%    |
| G&A - Goloil                  | 1.10  | 1.45  | (0.35) | -24.1%   |
| G&A - Teton                   | 12.58 | 5.11  | 7.47   | 146.2%   |
|                               | ----- | ----- | -----  | -----    |
|                               | 17.40 | 9.68  | 7.72   | 79.8%    |
| Non-Controllable Costs        |       |       |        |          |
| Transportation & Marketing    | -     | 1.95  | (1.95) | -100.0%  |
| Taxes other than Income Taxes | 11.80 | 9.44  | 2.36   | 25.1%    |
| Export Duties                 | -     | 3.65  | (3.65) | -100.0%  |
|                               | ----- | ----- | -----  | -----    |
|                               | 11.80 | 15.04 | (3.24) | -21.5%   |

During the second quarter, the Company's net loss, applicable to common stock, widened from \$1,447,240 in the second quarter of 2003 to \$2,005,876 or \$558,636 after taking into account preferred dividends of \$25,487 in 2004. On a per share basis, the Company's loss remained \$0.22. The increased loss was largely due to an increase in the Company's domestic general and administrative ("G&A") expenses from \$981,023 to \$1,726,816.

The Company's share of Goloil revenues increased year over year from \$2,978,554 to \$3,589,638 in the second quarter. The increase reflected a 11.2% increase in average selling price from \$18.13 to \$20.16 per barrel and a 8.4% increase in production volume from 164,273 to 178,022 barrels. Please note that the \$650,000 paid for the production payment, which is recorded as a reduction of revenues, is less than one half of the Company's production at the set price. However, sales quantities above assume that 50% of the volumes have been paid out for the production payment. Accordingly, the average selling price received is greater than the \$12.74 per barrel discussed previously. Production costs increased by \$195,985, or 38.2%, while taxes other than income taxes increased by \$1,062,616 or 85%. The increase in production costs was tied to increased workover activity and higher diesel fuel expenditures. Taxes other than income taxes include the Russian Minerals Extraction Tax and Value Added Tax (VAT) and represent significant expenses for all Russian oil producers. The Mineral Extraction Tax is a tax on revenues tied to the price of Urals blend crude, a benchmark for exports. Goloil no longer incurs export tariffs or transportation charges under the marketing arrangement now in place; all sales take place at the wellhead. Teton's share of Goloil's depreciation, depletion, and amortization expenses decreased by \$82,215.

Second quarter domestic G&A expense at the Company increased from \$981,023 to \$1,726,816 year over year, an increase of 76.0%. The key factors contributing to this increase were an increase in compensation costs of \$266,550, as well as increases in advertising and public relations expenses of \$51,677, legal and accounting expenses of \$279,121 and public company compliance expenses of \$192,606. In addition to the increase in compensation relating to additional staffing to meet Company goals and objectives, many of the other increases in G&A expenses were the result of its due diligence and financing costs incurred in connection with preliminary negotiations to acquire and develop new oil and gas properties in Russia.

### Operating Highlights for the Six months ended June 30 (in U.S. Dollars, unless otherwise noted)

| 2004 | 2003 | Change | % Change |
|------|------|--------|----------|
|------|------|--------|----------|



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|                                                |             |             |             |         |
|------------------------------------------------|-------------|-------------|-------------|---------|
| Sales, Barrels                                 | 345,183     | 315,577     | 29,606      | 9.4%    |
| Average Daily Sales, Barrels                   | 3,793       | 3,468       | 325         | 9.4%    |
| Average Selling Price, \$/barrel               | 18.98       | 20.24       | (1.26)      | -6.2%   |
| Revenues                                       | 6,552,138   | 6,387,272   | 164,866     | 2.6%    |
| Costs of Sales and Expenses, excl. DD&A        |             |             |             |         |
| Production Costs                               | 1,331,273   | 839,316     | 491,957     | 58.6%   |
| Transportation & Marketing                     | -           | 601,199     | (601,199)   | -100.0% |
| Taxes other than Income taxes                  | 4,286,025   | 2,677,706   | 1,608,319   | 60.1%   |
| Exploration cost                               | 327,764     | 196,813     | 130,951     |         |
| Export Duties                                  | -           | 1,158,210   | (1,158,210) | -100.0% |
|                                                | -----       | -----       | -----       |         |
|                                                | 5,945,062   | 5,473,244   | 471,818     | 8.6%    |
| Results from Goloil Operations, before DD&A    | 607,076     | 914,028     | (306,952)   | -       |
| Less General & Administrative Expense, Goloil  | 379,729     | 387,485     | 7,756       | -2.0%   |
|                                                | -----       | -----       | -----       |         |
|                                                | 227,347     | 526,543     | (299,196)   | -       |
| Depreciation, Depletion & Amortization, Goloil | 751,315     | 756,598     | (5,283)     | -.6%    |
| Operating Loss, Goloil                         | (523,968)   | (230,055)   | (293,913)   | -       |
| General & Administrative Expense, Teton        | 3,829,454   | 1,753,922   | 2,075,532   | 118.3%  |
| Operating Loss, Teton                          |             |             |             |         |
|                                                | (4,353,422) | (1,983,977) | (2,369,445) | -       |

### Costs and Expenses during the Six months ended June 30 (in U.S. \$ per barrel)

|                               | 2004  | 2003  | Change | % Change |
|-------------------------------|-------|-------|--------|----------|
| Controllable Costs            |       |       |        |          |
| Production Costs              | 3.86  | 2.66  | 1.20   | 45.1%    |
| G&A - Goloil                  | 1.10  | 1.23  | (0.13) | -10.6%   |
| G&A - Teton                   | 11.09 | 5.57  | 5.52   | 99.1%    |
|                               | ----- | ----- | -----  | -----    |
|                               | 16.05 | 9.46  | 6.59   | 69.7%    |
| Non-Controllable Costs        |       |       |        |          |
| Transportation & Marketing    | -     | 1.91  | (1.91) | -100.0%  |
| Taxes other than Income Taxes | 12.42 | 8.49  | 3.93   | 46.3%    |
| Export Duties                 | -     | 3.67  | (3.67) | 100.0%   |
|                               | ----- | ----- | -----  | -----    |
|                               | 12.42 | 14.07 | (1.65) | -11.7%   |

During the six months ended June 30, 2004, the Company's net loss, applicable to common stock, widened from \$2,228,325 in 2003 to \$4,502,502 or \$2,274,177. On a per share basis, the Company's loss widened from \$0.34 per share to \$0.57. The increased loss was largely due to an increase in the Company's domestic general and administrative ("G&A") expenses from \$1,753,922 to \$3,829,454 in addition to an increased loss from Goloil activities.

The Company's share of Goloil revenues increased year over year from \$6,387,272 to \$6,552,138 during the six-month period. The increase reflected a 6.2%

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decrease in average selling price from \$20.24 to \$18.98 per barrel and a 9.9% increase in production volume from 316,957 to 348,404 barrels. Production costs increased by \$491,957, or 58.6%, while taxes other than income taxes increased by \$1,608,320 or 60.1%. The increase in production costs was tied to increased workover activity and higher diesel fuel expenditures. Taxes other than income taxes include the Russian Minerals Extraction Tax and Value Added Tax (VAT) and represent significant expenses for all Russian oil producers. The Mineral Extraction Tax is a tax on revenues tied to the price of Urals blend crude, a benchmark for exports. Goloil no longer incurs export tariffs or transportation charges under the marketing arrangement now in place; all sales take place at the wellhead. the Company's share of Goloil's depreciation, depletion, and amortization expenses decreased by \$5,283.

Six months domestic G&A expense at the Company increased from \$1,753,922 to \$3,829,454 year over year, an increase of 118.3%. The key factors contributing to this increase were an increase in compensation costs of \$742,775 including addition of management and the increase in compensation relating to additional staffing to meet Company goals and objectives, many of the other increases in G&A expenses were the result of the Company's due diligence and financing costs incurred in connection with preliminary negotiations to acquire and develop new oil and gas properties in Russia.

### **Liquidity and Capital Resources**

The Company had a cash balance of \$8,577,869 on June 30, 2004 and a working capital deficit of \$3,349,950. Excluding the pro rata consolidation of Goloil's working capital deficit, Teton has a working capital surplus of \$8,147,458.

As of August 12, 2004 the Company has approximately \$18 million in cash, due to the closing of the sale of Goloil. In addition, its \$10.7 million share of Goloil's net liabilities will be extinguished leaving it with a working capital position essentially equal to its cash.

The Company expects that it will invest in its acquisition program, the cash from the sale of Goloil combined with an estimated \$10 to \$20 million in additional financing. The additional \$10 to \$20 million will be a combination of debt and equity.

### **Sources and Uses of Funds**

Historically, Teton's primary source of liquidity has been cash provided by equity offerings. Such offerings will continue to play an important role in financing Teton's business. On July 16, 2004 the shareholders approved the issuance of common stock, which could result in an increase in outstanding shares of common stock of 20% or more. In addition, the Company is working to establish a borrowing facility with one or more international banks, most likely in the form of a revolving line of credit that will be used primarily for the acquisition of producing properties and for developmental drilling and other capital expenditures.

### **Cash Flows and Capital Expenditures**

Cash used in operating activities for the six months ended June 30, 2004 was \$3,108,223 compared to \$2,811,337 for the six months ended June 30, 2003. As described above the Company's net loss increased to \$4,502,502 from \$2,228,325 at June 30, 2003. This was partially offset by an increase in Goloil's accounts payable for the second quarter.

During 2004, the Company received the reimbursement of advances totaling \$3,658,252 pursuant to its agreement with RussNeft.

During 2004, the Company received \$499,999 from the sale of preferred stock. The

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increase in proceeds from advances from notes payable to affiliates represents amounts advanced by RussNeft to Goloil. As discussed above, such advances will be eliminated now that the sale of Goloil has been completed.

### **Income Taxes, Net Operating Losses and Tax Credits**

Currently, Goloil pays a profits tax in Russia equal to 24% of net profits as defined by Russian income tax law. As discussed in our 10-KSB the taxation system in Russia is evolving as the central government transforms itself from a command to a market-oriented economy. Based on current tax law and the U.S. Russian Income Tax Treaty the profits tax paid to Russia will be a creditable tax when determining the Company's U.S. income taxes payable, if any. At June 30, 2004 the Company has a U.S. net operating loss tax carry forward of approximately \$24,000,000, utilization of which is limited under IRC section 382.

While the Company expects to realize a profit of approximately \$13.0 million from the sale of Goloil, Teton's tax advisors anticipate that it will incur only a relatively small Alternative Minimum Tax liability of approximately \$180,000. Based on the remaining net operating loss, the Company is unlikely to pay U.S. income taxes in the near to medium term future.

### **Subsequent Events**

On August 3, 2004 the Company closed and completed the sale of its interest in Goloil pursuant to the terms discussed above.

At the annual meeting on July 16, 2004 the Company's shareholders approved a stock compensation plan for non-employees. The maximum number of shares of Common Stock with respect to which awards can be granted is 1,000,000 shares. As of August 12, 2004 no grants have been authorized.

### **Critical Accounting Policies**

In the ordinary course of business, we have made a number of estimates and assumptions relating to the reporting of results of operations and financial condition in the preparation of our financial statements in conformity with accounting principles generally accepted in the United States. Actual results could differ significantly from those estimates under different assumptions and conditions. We believe that the following discussion addresses our most critical accounting policies, which are those that are most important to the portrayal of our financial condition and results of operations and require our most difficult, subjective, and complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain.

**Reserve Estimates:** The information regarding the Company's share of oil and gas reserves, the changes thereto and the resulting net cash flows are all dependent upon assumptions used in preparing the Company's annual reserve study. A qualified independent petroleum engineer, in accordance with standards of applicable regulatory agencies and the Securities and Exchange Commission definitions, prepares the Company's reserve study. Estimates of economically recoverable oil and natural gas reserves and future net cash flows necessarily depend upon a number of variable factors and assumptions, such as historical production from the area compared with production from other producing areas, the assumed effects of regulations by governmental agencies and assumptions governing future oil and natural gas prices, the exchange rate between the Russian ruble and the U.S. dollar, future operating costs, severance, ad valorem, export, excise and other taxes, development costs and workover and remedial costs, all of which may, in fact, vary considerably from actual results. For these reasons, estimates of the economically recoverable quantities of oil and natural gas attributable to any particular group of properties, classifications of such reserves based on risk of recovery, and estimates of the

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future net cash flows expected there from may vary substantially. Any significant variance in the assumptions could materially affect the estimated quantity and value of the reserves, which could affect the carrying value of the Company's oil and gas properties and the rate of depletion of the oil and gas properties. Management believes that the current assumptions used in preparation of the reserve study are reasonable. The Company's revised downward its estimate of oil and gas reserves by 4.4 million barrels in the fourth quarter of 2003 primarily due to the reclassification of certain waterflood reserves and reserves associated with undrilled locations to probable. Only reserves associated with two wells planned and budgeted for 2004 have been classified as proved undeveloped. The Company's estimated proved reserves at December 31, 2003 and 2002 were prepared by independent petroleum engineering consultants Gustavson and Associates.

**Property, Equipment and Depreciation:** The Company follows the successful efforts method of accounting for oil and gas properties. As of June 30, 2004 all of the Company's oil and gas assets are held in one cost center located in Siberia, Russia. As the Company makes additional acquisitions it will have additional cost centers. Under the successful efforts method of accounting the costs of development wells are capitalized, but exploratory wells are capitalized only if they are successful. The Company plans to increase its oil and gas reserves by acquisition and the development of reserves in place. Accordingly, acquisition and drilling costs on successful wells will be capitalized. Capitalized costs will be depleted and depreciated using the units of production method based on estimated proved oil reserves as determined by independent engineers, currently Gustavson and Associates. If the estimates of oil and gas reserves are changed materially then the amount of depreciation and depletion recorded by the Company could increase or decrease materially. In addition the carrying costs of the oil and gas properties are subject to the requirements of SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." The Company is required to impair the net book value for a cost center when such net book value is greater than the estimated future cash flows for such cost center.

**Pro Rata Consolidation:** The Company currently pro rata consolidates its 50% interest in Goloil, because, as of June 30, 2004, Management believes that to be the most meaningful presentation. When the Company completes the proposed sale of its interest in Goloil then the assets and liabilities of Goloil will be eliminated in recording the gain on sale. See the note 5 to the financial statements.

**Production Payment:** During June 2000 the Company entered into a Master Agreement that requires, among other things, a seven-year production payment to Energosoyuz equal to 50% of the oil produced from new and existing Goloil wells in exchange for wells and facilities constructed by Energosoyuz. Because the production payment was for a specified amount of production and not for a fixed and determinable dollar amount, the Company did not record such transaction as a loan. Currently, Goloil is paying Energosoyuz a flat amount of 19,000,000 rubles per month (U.S. \$650,000), which, at current prices, is less than 50% of the oil produced. Had the Company not been successful in its efforts to sell Goloil to RussNeft, we would have continued our interest in Goloil reserves, which would have continued to be subject to a production payment through June 2007.

**Asset Retirement Obligation:** During the fourth quarter of 2003 the Company applied the provisions of SFAS 143 "Accounting for Asset Retirement Obligations" and recorded the estimated December 31, 2003 liability for the retirement of its Russian oil and gas assets along with a corresponding increase in the carrying value of the related oil and gas properties. The liability was estimated based on the estimated, discounted future cost to plug the oil and gas wells existing at December 31, 2003 plus the costs of clean up based on the Company's current understanding of the standards that will be applied at the time of retirement. The Company recorded an increase in the asset retirement obligation during the interim periods of 2004 solely due to the accretion of the discount.

**ITEM 3 QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

Market risk is the exposure to loss resulting from changes in interest rates, foreign currency exchange rates, commodity prices and equity prices. To the extent we borrow or finance our activities we will be exposed to interest rate risk, which is sensitive to many factors, including governmental monetary and tax policies, domestic and international economic and political considerations and other factors that are beyond the Company's control.

The Company is exposed to interest rate risk primarily through any borrowing activities it may undertake. The extent of this risk is not quantifiable or predictable because of the variability of future interest rates and the Company's future financing requirements.

The Company has no current borrowings other than its pro rata share of Goloil's borrowings, which no longer exist at August 12, 2004.

The Company has not and does not plan to, enter into any derivative financial instruments for trading or speculative purposes.

Prior to August 12, 2004, the Company conducted business primarily in Russia. Therefore, changes in the value of Russia's currency affect the Company's financial position and cash flows when translated into U.S. Dollars. The Company has generally accepted the exposure to exchange rate movements relative to its investment in foreign operations.

**ITEM 4. CONTROLS AND PROCEDURES**

As of June 30, 2004, an evaluation was performed by our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures. Based on that evaluation, Our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were not completely effective as of June 30, 2004.

In connection with the audit of the year ended December 31, 2003, there were no "reportable events" except that the Company's auditors reported to the Company's Audit Committee that the auditors' considered two matters involving internal controls and their operation to be material weaknesses. Specifically, in connection with its audit of the consolidated financial statements of the Company and its subsidiary for the year ended December 31, 2003, the auditors reported that a material weakness existed related to the lack of formalized policies and procedures to permit timely recording and processing of financial information to permit the timely preparation of financial statements and recommended implementation of formal policies and procedures and significantly enhancing the accounting staff. Since December 31, 2003 the Company is addressing this concern and has hired additional accounting staff and restructured certain accounting and reporting responsibilities and is in the process of preparing formal procedures to permit timely recording and processing of financial information. The second matter related to oversight of its Russian subsidiary and reporting of its financial results on a timely basis which impact and represents substantially all of the Company's operating results. As discussed above, the Company completed the sale of its Russian subsidiary in August 2004. The Company is also in preliminary negotiations with respect to potential acquisitions. The Company intends to pursue acquisitions where the Company will jointly or fully operate which will allow the Company to put in place those procedures and controls necessary to ensure proper and timely reporting of financial results.

**PART II. OTHER INFORMATION**

**ITEM 1. LEGAL PROCEEDINGS**

Not applicable.

**ITEM 2. CHANGES IN SECURITIES, USE OF PROCEEDS AND ISSUER PURCHASES OF EQUITY SECURITIES**

The securities described below represent our securities sold by us for the period starting April 1, 2004 and ending June 30, 2004 that were not registered under the Securities Act of 1933, as amended, all of which were issued by us pursuant to exemptions under the Securities Act. Underwriters were involved in none of these transactions.

**PRIVATE PLACEMENTS OF STOCK FOR CASH**

On June 30, 2004 the Company issued 11,494 shares of Series A Convertible Preferred Stock in exchange for \$50,000. The \$50,000 had been received during the first quarter of 2004 and was recorded as a current liability at the time of receipt. The Preferred Stock is convertible into Common Stock on a 1-for-1 basis. Dividends accrue quarterly on the Preferred Stock at the annual rate of 8%. The Company has certain rights to redeem the Preferred Stock and the stock automatically converts into Common Stock upon the happening of certain specified events.

The offer and sale of the Preferred Stock was made in reliance on the exemptions under Rule 506 of Regulation D and Section 4(2) of the Securities Act. No advertising or general solicitation was employed in offering the securities. The offer and sale were made to an accredited investor and transfer of the stock was restricted in accordance with the requirements of the Securities Act of 1933.

**SALES OF DEBT AND WARRANTS FOR CASH**

None.

**OPTION GRANTS**

None.

**ISSUANCES OF STOCK FOR SERVICES OR IN SATISFACTION OF OBLIGATIONS**

On April 6, 2004, Teton issued 1,250 shares of Common Stock to a consultant in exchange for investor relations services valued at \$5,000. This offer and sale was deemed to be exempt under Section 4(2) of the Securities Act. No advertising or general solicitation was employed in offering the securities. The investor due to the investor's relationship with the Company had access to information concerning the Company. Transfer of the Common Stock was restricted in accordance with the requirements of the Securities Act of 1933.

On April 16, 2004 Teton issued a total of 5,955 shares of Common Stock valued at \$28,500 to three of its directors for service on its Board of Directors. These offers and sales were made in reliance on the exemption under Section 4(2) of the Securities Act. No advertising or general solicitation was employed in offering the securities. As directors, the investors had access to information concerning the Company. The offers and sales were made to accredited investors and transfer of the Common Stock was restricted in accordance with the requirements of the Securities Act of 1933.

During the second quarter, Teton issued 5,626 shares of Common Stock to consultants in exchange for investor relation services valued at \$23,329. This

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offer and sale was deemed to be exempt under Section 4(2) of the Securities Act. No advertising or general solicitation was employed in offering the securities. The consultants due to their relationship with the Company had access to information concerning the Company. Transfer of the Common Stock was restricted in accordance with the requirements of the Securities Act of 1933.

### ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not Applicable.

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

None.

### ITEM 5. OTHER INFORMATION

None.

### ITEM 6. EXHIBITS AND REPORTS ON 8-K:

#### Exhibits

31.1 Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

31.2 Certification of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

32.1 Certification of the Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

32.2 Certification of the Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

Reports on Form 8-K: None

### SIGNATURES

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

Date: August 16, 2004

By: /s/ Karl F. Arleth

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Karl F. Arleth,  
President and CEO

Date: August 16, 2004

By: /s/ Patrick A. Quinn

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Patrick A. Quinn,  
CFO