

TIDELANDS OIL & GAS CORP/WA
Form 10-K
April 17, 2007

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D. C. 20549**

FORM 10-K

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

**For the year ended December 31, 2006
Commission File Number 0-29613**

TIDELANDS OIL & GAS CORPORATION
(Name of small business issuer in its charter)

<u>Nevada</u>	<u>66-0549380</u>
(State or other jurisdiction of incorporation or organization)	(I. R. S. Employer Identification No.)

1862 West Bitters Rd., San Antonio, TX 78248
(Address of principal executive office)

(210) 764-8642
(Issuer's Telephone Number)

Securities Registered Pursuant of Section 12(b) of the Act: **None**

Securities Registered Pursuant of Section 12(g) of the Act:
Common Stock, \$0.001 Par Value

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

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) Yes o No
☒ x

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definitions of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one): Large accelerated filer ☐, Accelerated filer ☐, Non-accelerated filer ☒

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

The aggregate market value of the issuer's common stock held by non-affiliates was \$49,433,203 based on the closing sales price as reported by the NASD OTC Electronic Bulletin Board on June 30, 2006. The sum excludes the shares held by officers, directors, and stockholders whose ownership exceeded 10% of the outstanding shares, as such persons may be deemed affiliates of the Company. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

As of March 31, 2007, there were 105,104,494 shares of the issuer's common stock outstanding.

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PART I

CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

This 2006 Annual Report on Form 10-K, including the sections entitled "Risk Factors," "Management's Discussion and Analysis Financial Condition and Results of Operation" and "Business," contains "forward-looking statements" that include information relating to future events, future financial performance, strategies, expectations, competitive environment, regulation and availability of resources. These forward-looking statements include, without limitation, statements regarding: projections, predictions, expectations, estimates or forecasts for our business, financial and operating results and future economic performance; statements of management's goals and objectives; and other similar expressions concerning matters that are not historical facts. Words such as "may," "will," "should," "could," "would," "predicts," "potential," "continue," "expects," "anticipates," "future," "intends," "plans," "believes" and "estimates," and similar expressions, as well as statements in future tense, identify forward-looking statements.

Forward-looking statements should not be read as a guarantee of future performance or results, and will not necessarily be accurate indications of the times at, or by which, that performance or those results will be achieved. Forward-looking statements are based on information available at the time they are made and/or management's good faith belief as of that time with respect to future events, and are subject to risks and uncertainties that could cause actual performance or results to differ materially from those expressed in or suggested by the forward-looking statements. Important factors that could cause these differences include, but are not limited to:

- our failure to implement our business plan within the time period we originally planned to accomplish; and
- other factors discussed under the headings "Risk Factors," "Management's Discussion and Analysis of Financial Condition and Results of Operation" and "Business."

Forward-looking statements speak only as of the date they are made. You should not put undue reliance on any forward-looking statements. We assume no obligation to update forward-looking statements to reflect actual results, changes in assumptions or changes in other factors affecting forward-looking information, except to the extent required by applicable securities laws. If we do update one or more forward-looking statements, no inference should be drawn that we will make additional updates with respect to those or other forward-looking statements.

All references to "we," "our," "us" and the "Company" in this Annual Report on Form 10-K refer to Tidelands Oil & Gas Corporation and its subsidiaries.

ITEM 1. BUSINESS

Tidelands Oil & Gas Corporation, formerly known as C2 Technologies, Inc., was incorporated under the laws of the State of Nevada on February 25, 1997. C2 Technologies, Inc. changed its name to Tidelands Oil & Gas Corporation on November 19, 1998. On April 17, 2006, we filed an amendment to our articles of incorporation increasing our authorized common stock capital from One Hundred Million (100,000,000) shares to Two Hundred Fifty Million (250,000,000) shares. We have eleven subsidiaries that we directly and indirectly own as follows: (1) Rio Bravo Energy LLC, (2) Arrecefe Management LLC, (3) Marea Associates, L.P., (4) Terranova Energia, S. de R.L. de C.V., (5) Esperanza Energy LLC and (6) Sonterra Energy Corporation. We also own a 97% limited partnership interest in (7) Reef Ventures, L.P. Arrecefe Management LLC owns a 1% general partner interest in Reef Ventures, L.P. Rio Bravo Energy, LLC owns 100% of the member interest in (8) Sonora Pipeline LLC. Reef Ventures, L.P. owns 100% of the member interest in (9) Reef International LLC and (10) Reef Marketing LLC. In February 2006, we formed subsidiary number (11) Tidelands Exploration & Production Corporation.

Our products and services are primarily focused on development and operation of transportation, processing, distribution and storage of natural gas and natural gas liquids in the northeastern states of Mexico (Coahuila, Nuevo Leon and Tamaulipas) and the States of Texas and California.

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Reef Ventures International Pipeline

The assets of this business consist of two different pipelines: (1) an 8 mile twelve inch diameter natural gas pipeline with metering and dehydration facilities and (2) a two mile segment of six inch diameter pipeline to be used in a future LPG project. The twelve inch pipeline connects and receives natural gas from a third party pipeline for transmission to the border between Texas and Coahuila, Mexico. The pipeline is buried underneath the Rio Grande River with its termination at the delivery point in Piedras Negras, Coahuila owned by CONAGAS (the local distribution company). Reef Ventures, L.P. derives its revenues from transportation fees charged to CONAGAS for delivery of natural gas. The LPG project will require the future construction of receiving terminal facilities in Texas, boring and installation of additional six inch diameter pipeline under the Rio Grande River and approximately one mile of additional pipeline in Mexico with an unloading terminal and storage facilities at its termination point.

Esperanza Energy, LLC

Esperanza Energy, LLC ("Esperanza") was formed as a wholly-owned subsidiary of the Company in March 2006 to evaluate the feasibility of developing an offshore, deep-water liquefied natural gas (LNG) receiving and regasification terminal near Long Beach, California. Esperanza would utilize TORP Technology's HiLoad LNG Regas unit that attaches to an LNG tanker, directly vaporizes the LNG as it is offloaded and injects the regasified natural gas into an undersea pipeline for transportation of the natural gas to onshore metering stations and transmission pipelines to supply nearby gas markets. The TORP HiLoad LNG Regas unit eliminates the need for extensive above-ground storage tanks or large marine structures required for berthing and processing of the LNG. Esperanza has conducted its feasibility study for this project with the assistance of best-in-class LNG, environmental, pipeline and legal advisors and has concluded that the project is technically, environmentally and commercially feasible. Esperanza plans to develop the necessary information in 2007 to file applications with California state and U.S. Federal agencies for appropriate permits to construct, own and operate the LNG facilities.

Terranova Energia, S. de R.L. de C.V and the Burgos Hub Project

In December 2003, we entered into a Memorandum of Understanding (MOU) with PEMEX to design, build and operate an underground natural gas storage facility in the vicinity of Reynosa, Tamaulipas, Mexico, in the Burgos Basin area and eventually at other regions in Mexico.

We completed the initial study of the Burgos facility and expect to receive permits in 2007 to construct, own and operate the storage facility and the interconnecting pipelines from the Comision Reguladora de Energia (the Mexican regulatory branch of the Secretary of Energy). The capital budget for the first two phases of this project exceeds \$700 Million Dollars and may be funded through issuance of additional equity of the Company, the addition of joint venture partners and/or debt financing. Marea Associates, L.P. was formed to own the majority interest in Terranova Energia, S. de R.L. de C.V., a Mexican company which will conduct all business dealings in Mexico on behalf of Tidelands. Rio Bravo Energy LLC, an existing wholly owned subsidiary owns the general partner interest in Marea Associates, L.P. and a minority interest in Terranova Energia, S. de R.L. de C.V.

On June 5, 2006, Tidelands Oil & Gas Corporation subsidiary, Terranova Energia, S. de R.L. de C.V. was awarded a Permit (#G/183/TRA 2006) by the Comision Reguladora de Energia de Mexico (CRE) to begin construction of the Terranova Occidente and Oriente pipeline portions of its Burgos Hub Project.

The Permit is for the Occidente and Oriente Sections of the Terranova pipelines. The Occidente section will feature a 30-inch diameter pipeline, spanning approximately 323 kilometers in total length. One segment will run from the Brasil storage field to Nuevo Progreso, Mexico, where it will connect with the Sonora Pipeline LLC Progreso International Pipeline, a proposed international pipeline crossing into South Texas from Mexico extending to the

Donna Station, which will provide the opportunity for interconnects into Texas natural gas pipelines owned by TETCO, TGPL and Texas Gas Services. The permitted pipeline will also include a section that will stretch from the Brasil storage field to Station 19 and up to Arguelles where another proposed international pipeline crossing into South Texas is planned (Sonora Pipeline, LLC's Mission International Pipeline) with opportunities to interconnect with Houston Pipeline, Calpine and Kinder Morgan. A 36-inch diameter pipeline spanning some 149 kilometers will characterize the Oriente Section of the Terranova pipelines. It will run from the proposed offshore LNG Regasification Terminal to Norte Puerto Mezquital and proceed to the Brazil storage field. Both Terranova pipelines are designed to flow natural gas bi-directionally between Texas and Mexico at a rate of approximately 1.0 BCFD (billion cubic feet per day).

In the second quarter of 2007, Terranova expects to file an application with the CRE to amend its existing Mexican pipeline permit to allow for the construction of an additional segment of pipeline which will extend from Station 19 (located to the southwest of Reynosa, Tamaulipas) to Monterrey, Nuevo Leon. This filing is being pursued in response to commercial interest from industrial customers and potential service opportunity for the power generation facilities proposed by the Comision Federal de Electricidad (CFE) in northeast Mexico. Discussion with staff at the regulatory body, CRE, indicates a timeline for action on the amended permit by the fourth quarter of 2007.

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Terranova submitted the storage permit to the CRE on August 5, 2005 and it was accepted for full review on October 14, 2005. Several unique questions are presented by the filing of this permit due to the proposed location and the lack of previous storage permit applications having been considered by the CRE. The CRE, with cooperation from Terranova, is conducting discussions with PEMEX, the energy ministry of the United Mexican States (SENER) and the Mexican Petroleum Institute (MPI) to determine the mechanism for the grant of use rights for the depleted reservoir as a natural gas storage facility and the proper legal vesting of such rights with the holder of the CRE permit to construct own and operate a gas storage facility. Terranova expects that these issues and a decision regarding the Company's storage permit application will be resolved by the CRE Commissioners in the third quarter of 2007.

The Company continues to present the pipeline and storage segments of the Burgos Hub project to commercial audiences in efforts to solicit their interest and participation in the project at various levels. There have been numerous meetings with staff of the Comision Federal de Electricidad (CFE) with respect to its planned natural gas usage in northeast Mexico and the Monterrey industrial consumers of natural gas with a view toward clarifying their need and usage of the proposed project facilities. Efforts continue to secure precedent agreements for capacity reservation of the project facilities. Preliminary evaluation of demand for storage capacity reservation based upon direct discussion with the various customers is estimated at 40 Bcf for the market area influenced by the project. Similarly, discussions are continuing with interested parties in the U.S. and Mexico regarding the execution of a joint development agreement between Terranova and their firms for the funding, development and ownership of the Project.

Sonora Pipeline, LLC and the Burgos Hub Project

In connection with the Mexican storage and pipeline project mentioned above, Sonora Pipeline, LLC is the applicant before the Federal Energy Regulatory Commission for two proposed U.S. pipelines that will transport gas bidirectionally to/from the United States to Mexico at two different international crossing points along the Rio Grande River in South Texas - the Progreso International Pipeline and the Mission International Pipeline. The Progreso pipeline segment will be approximately 8.7 miles long and will comprise the eastern leg of the U.S. pipelines, which will interconnect with the Tennessee Gas Pipeline transmission lines at the Donna Station and will ultimately deliver natural gas to the proposed Brasil Storage facility approximately 17 miles south of the U.S./Mexico border at Progreso, Texas. The proposed Mission International Pipeline segment was re-designed in the first quarter of 2006 due to a routing conflict with a fiber optic line. It will be approximately 20.2 miles long and will commence at the existing HPL Valero-Gilmore gas plant in Hidalgo County, Texas, and will extend southward to the Arguelles crossing of the Rio Grande River into Mexico near the city of Mission, Texas. Both U.S. pipelines will connect with the pipelines being developed by Tidelands' subsidiary in Mexico, Terranova Energia, S. de R.L. de C.V. On January 31, 2007, Sonora Pipeline, LLC ("Sonora") filed application with FERC for a certificate of public convenience and necessity to construct and operate these natural gas pipeline facilities and to transport natural gas in interstate commerce for others including an application for a presidential permit at each pipeline segment's crossing point from the U.S. into Mexico. Simultaneously, Sonora filed its Applicant Prepared Draft Environmental Assessment for review by the FERC. Sonora continues to respond to FERC inquiries and analysis with respect to these applications and has asked the FERC to grant the authorizations requested in the applications by July 1, 2007. The current catalog of FERC correspondence for Sonora's activities is located at www.ferc.gov under Docket No. PF07-74 et sequence.

Rio Bravo Energy, LLC and Sonora Pipeline, LLC

Rio Bravo Energy, LLC was formed on August 10, 1998 to operate the Chittim Gas Processing Plant which was purchased in 1999 and was processing natural gas primarily from Conoco Oil's Sacatosa Field. The Sacatosa Field was primarily an oilfield which produced high BTU casinghead gas from which gas processing operations would yield valuable hydrocarbon components such as propane, butane and natural gasolines. As the field depleted, lower volumes of casinghead gas were being delivered by Conoco, and other gas producers could not be contracted with for processing of additional replacement volumes of gas. Therefore, in October 2002, the plant was temporarily shut

down due to the declining economics associated with low volume operation of the plant. During 2002 through the fourth quarter of 2005, management planned to reopen the plant when adequate volumes of gas from third party producers were obtained to make plant operations economically attractive. However, we have been unsuccessful in locating a locally available and adequate supply of high BTU natural gas and have elected to dispose of the gas plant assets. Accordingly, our financial statements for 2005 reflect an impairment charge with respect to the carrying value of these assets. Rio Bravo Energy, LLC continues to serve as the parent company for Sonora Pipeline, LLC, as the one percent general partner of Marea Associates, L.P. and owns a less than one percent minority interest in Terranova Energia, S. de R.L. de C.V.

Sonora Pipeline, LLC was formed in January 1998 to operate the Sonora pipeline network which has the capability of delivering adequate volumes of natural gas for economic operation of the Chittim Gas Processing Plant. The pipeline network consists of approximately 80 miles of gas pipeline. This pipeline network was acquired in conjunction with the Chittim Gas Processing Plant acquisition and, when operational, could generate revenue from transportation fees to be charged to third party gas producers shipping natural gas to the gas plant owned by Rio Bravo Energy, LLC. As noted above, management has evaluated the carrying value of these assets and has recorded an impairment charge in our 2005 financial statements with respect to pipeline network in addition to the gas plant. These assets will also be sold at a later date.

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Sonterra Energy Corporation Business

The assets of our Sonterra Energy Corporation ("Sonterra") subsidiary consist of propane distribution systems, including gas mains, yard lines, meters and storage tanks, serving the following residential subdivisions in the Austin, Texas area. The subdivisions include:

1. Arbolago
2. Austin's Colony
3. Avonlea
4. Casalona/Riverbend
5. Cordillera Ranch
6. Costa Bella
7. The Hollows at Northshore
8. Hills of Lakeway
9. Jacarandas
10. Lake Pointe
11. La Ventana
12. Lakewinds Estates
13. Rob Roy Rim
14. Senna Hills
15. Sterling Acres
16. The Point
17. The Preserve at Barton Creek

These subdivisions contain approximately 2,250 lots which can be supplied with gas service from Sonterra. Currently 1,155 of these lots are metered for use. There are approximately 1,095 unmetered future lots within the above subdivisions where propane service can be connected. As new homes are constructed on these lots our customer base will grow. Construction activities continue in the existing subdivisions where expansion phases of development will result in the addition of approximately 170 customers in 2007. Sonterra's participation in the launch of new subdivisions is also occurring, as exemplified by the signing of a construction contract with the developers of Las Brisas at Ensenada Shores (located on Canyon Lake), where 75 new lots with propane service have been completed for sale to new customers. This subdivision's second phase of development is expected to add another 175 lots. Construction continues on Section 205 of the Cordillera Ranch subdivision which added 50 more residential customers in the fourth quarter of 2006. Sonterra has expanded into additional markets as evidenced by the signing of a construction contract to build a central propane system for a multi-use retail center in Lago Vista, Texas. The system will serve five to ten large commercial customers including two restaurants.

Sonterra is the exclusive seller of propane in these subdivisions and is not considered a rate-regulated utility. The Texas Railroad Commission regulates all aspects of the production, transportation and processing of petroleum products, including propane, in the State of Texas. Sonterra purchases propane products from a number of distributors in Austin, Texas. Seasonality and weather conditions have a significant impact on the demand for propane for heating purposes. All of our propane customers rely heavily on propane as a heating fuel. The volume of propane sold is at its highest during the six-month peak heating season of October through March, during which approximately two-thirds of our annual retail propane volume is sold.

Table of Contents**Tidelands Exploration & Production Corporation**

On July 9, 2006, Tidelands Exploration & Production Corporation acquired a 50% interest in a 26-mile natural gas pipeline located in Medina, Atascosa and Bexar Counties in the state of Texas. In addition, the Company also acquired an undivided 50% working interest in two leases with 5 recompleted natural gas wells on approximately 1,000 acres with at least 10 additional natural gas wells for re-entry. These leases are located in Atascosa and Medina counties. The Company has elected not to participate in this venture on an ongoing basis and expects to resell these properties in 2007.

Segment Reporting for Reef Ventures, LP and Sonterra Energy Corporation:

The following table is a summary of the results of operations and other financial information by major segment:

2006	Propane Sales and Related Services	Pipeline Transportation Fees	All Other and Corporate	Total
Revenue	\$ 1,921,763	\$ 285,098	\$ 15,737	\$ 2,222,598
Depreciation	\$ 126,844	\$ 305,313	\$ 34,084	\$ 466,241
Interest	\$ 1,629	\$ -	\$ 3,404,149	\$ 3,405,778
Operating Income (Loss)	\$ (263,535)	\$ (93,524)	\$ (11,582,775)	\$ (11,939,834)
Total Assets	\$ 5,284,938	\$ 5,702,978	\$ 4,198,723	\$ 15,186,639

2005	Propane Sales and Related Services	Pipeline Transportation Fees	All Other and Corporate	Total
Revenue	\$ 1,630,246	\$ 231,077	\$ --	\$ 1,861,323
Depreciation	\$ 116,853	\$ 305,313	\$ 63,315	\$ 485,481
Interest	\$ 2,514	\$ --	\$ 608,849	\$ 611,363
Operating Income (Loss)	\$ (380,900)	\$ (164,523)	\$ (12,765,170)	\$ (13,310,593)
Total Assets	\$ 2,997,001	\$ 5,621,536	\$ 4,870,312	\$ 13,488,849

2004	Propane Sales and Related Services	Natural Gas Sales and Pipeline Transportation Fees	All Other and Corporate	Total
Revenue	\$ 438,611	\$ 1,400,227	\$ --	\$ 1,838,838
Depreciation	\$ 20,158	\$ 178,099	\$ 46,632	\$ 244,889
Interest	\$ 300	\$ --	\$ 300,266	\$ 300,566
Operating Income (Loss)	\$ 98,229	\$ (141,502)	\$ (29,699,024)	\$ (29,742,297)

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Total Assets	\$	2,775,281	\$	5,881,774	\$	13,765,611	\$	22,422,666
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Note: Reef Ventures and Sonterra commenced operations in 2004.

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Competition

Reef Ventures, L.P. Eagle Pass Pipeline Crossing

Our Eagle Pass international pipeline crossing competes with a pipeline owned by West Texas Gas, Inc. which is located two miles north of Eagle Pass. We believe that the West Texas Gas crossing will be able to compete with us but due to a very limited transmission capability, that organization cannot supply the total demand of the market area. Further efforts to increase revenues from the system by increasing transportation fees are currently being undertaken.

Sonterra Energy Corporation Propane Distribution

Our propane distribution business is not subject to competition within the residential subdivisions served because we are the sole propane supplier. The residential subdivisions are subject to a propane supply covenant granting us the exclusive supply of propane for each subdivision. In the future, we will compete in the bidding process for new propane distribution systems as new residential subdivisions are developed. We may also be able to acquire additional existing propane distribution systems from competitors.

In addition, we compete with other established businesses that market similar products. Many of these companies have greater capital, marketing and other resources than we do. There can be no assurance that these or other companies will not develop new or enhanced products that have greater market acceptance than any that may be marketed by us.

Employees

Tidelands has six full-time employees including our corporate officers. Our Sonterra Energy subsidiary, which operates the Austin propane gas distribution company, has eight full-time employees.

ITEM 1A. RISK FACTORS

In addition to the other information presented in this report, the following should be considered carefully in evaluating our business or purchasing shares of our common stock. Investing in our common stock involves a high degree of risk. This report contains various forward looking statements that involve risk and uncertainties. Our actual results may differ materially from the results discussed in the forward looking statements. Factors that might cause such a difference include, but are not limited to, those discussed below and elsewhere in this report.

OPERATING LOSSES

We have had significant losses ever since starting business and we expect to continue losing money for some time. To date, we have incurred significant losses. For the year ended December 31, 2006, we lost \$11,836,925 and for the year ended December 31, 2005, we lost \$7,662,904. These losses were caused primarily by:

- s Financing costs in connection with acquisitions made in prior years and the issuance of convertible debentures;
- s Limited volumes of gas transported through the international pipeline crossing;
- s Pre-development and operating expenses associated with the development of additional pipeline and storage projects in Mexico;
- s Idle assets not producing revenue, such as the gas plant and associated pipeline;

- s Default interest penalties regarding a convertible debenture financing;
- s Increased employee related salaries, stock-based compensation and related costs.

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WE MAY NOT HAVE ENOUGH FUNDING TO COMPLETE OUR BUSINESS PLAN OR CONTINUE OPERATIONS.

We will need additional financing to fully implement our business plan. We cannot give any assurance that this additional financing could be obtained of attractive terms or at all. Lack of funding could force us to curtail substantially or cease our operations.

The financial statements included in this report have been prepared on the basis that we will continue as a going concern, which assumes the realization of assets and the satisfaction of liabilities in the normal course of business. We have incurred significant accumulated losses as of December 31, 2006. We do not expect to generate sufficient revenue to meet our cash requirements for the next twelve months. We will need to raise additional capital to continue meeting operational expenses. Our independent auditors have added an explanatory paragraph to their report of our financial statements for the year ended December 31, 2006 stating that our net losses, lack of revenues and dependence on our ability to raise additional capital to continue our existence, raise substantial doubt about our ability to continue as a going concern. If we are not successful in raising sufficient additional capital, we may we may not be able to continue as a going concern, our stockholders may lose their entire investment in us.

LIMITED OPERATING HISTORY

We have a limited operating history and our financial health will be subject to all the risks inherent in the establishment of a new business enterprise. The likelihood of success of our Company must be considered in the light of the problems, expenses, difficulties, complications, and delays frequently encountered in connection with the startup and growth of a new business, and the competitive environment in which we will operate. Our success is dependent upon the successful financing and development of our business plan. No assurance of success is offered. Unanticipated problems, expenses, and delays are frequently encountered in establishing a new business and marketing and developing products. These include, but are not limited to, competition, the need to develop customers and market expertise, market conditions, sales, marketing and governmental regulation. The failure of the Company to meet any of these conditions would have a materially adverse effect upon the Company and may force the Company to reduce or curtail operations. No assurance can be given that the Company can or will ever operate profitably.

RELIANCE ON MANAGEMENT

We recently appointed James B. Smith as our President and Chief Executive Officer. Mr. Smith also continues to serve as Chief Financial Officer. Assuming the roles of both Chief Executive Officer and Chief Financial Officer could place undue burden on Mr. Smith's time and resources. In addition, the Company faces risks associated with the transition of management from our prior Chief Executive Officer to Mr. Smith. The Company depends substantially upon the efforts and abilities of Mr. Smith and the loss of Mr. Smith's services could have a serious adverse effect on our business, operations, revenues or prospects. We do not currently maintain any key man life insurance on Mr. Smith.

TRADING IN OUR COMMON STOCK ON THE OTC BULLETIN BOARD MAY BE LIMITED.

Our common stock trades on the OTC Bulletin Board. The OTC Bulletin Board is not an exchange. Trading of securities on the OTC Bulletin Board is often more sporadic than the trading of securities listed on an exchange or Nasdaq. You may have difficulty reselling any of our common stock shares.

THERE HAS BEEN A VOLATILE PUBLIC MARKET FOR OUR COMMON STOCK AND THE PRICE OF OUR STOCK MAY BE SUBJECT TO FLUCTUATIONS.

We cannot assure you that a liquid transparent trading market for our common stock will develop or be sustained. You may not be able to resell your shares at or above the price you paid for them. The market price of our common stock is likely to be volatile and could be subject to fluctuations in response to factors such as the following, most of which are beyond our control:

- s operating results that vary from the expectations of securities analysts and investors;
- s changes in expectations as to our future financial performance, including financial estimates by securities analysts and investors;
- s the operations, regulatory, market and other risks discussed in this section;
- s announcements by us or our competitors of significant contracts, acquisitions, strategic partnerships, joint ventures or capital commitments;
- s announcements by third parties of significant claims or proceedings against us; and
- s future sales of our common stock.

In addition, the market for our stock has from time to time experienced extreme price and volume fluctuations. These broad market fluctuations may adversely affect the market price of our common stock.

OUR COMMON STOCK IS SUBJECT TO PENNY STOCK REGULATION.

Our common stock is subject to regulations of the Securities and Exchange Commission relating to the market for penny stocks. The Securities Enforcement and Penny Stock Reform Act of 1990 (the "Reform Act") also requires additional disclosure in connection with any trades involving a stock defined as a "penny stock" (generally, according to recent regulations adopted by the Commission, any equity security that has a market price of less than \$5.00 per share, subject to certain exceptions), including the delivery, prior to any penny stock transaction, of a disclosure schedule explaining the penny stock market and the risks associated therewith. These regulations generally require broker-dealers who sell penny stocks to persons other than established customers and accredited investors to deliver a disclosure schedule explaining the penny stock market and the risks associated with that market. These regulations also impose various sales practice requirements on broker-dealers. The regulations that apply to penny stocks may severely affect the market liquidity for our securities and that could limit your ability to sell your securities in the secondary market.

RISKS RELATING TO LOW-PRICE STOCKS

Because our stock is quoted on the NASD OTC Electronic Bulletin Board and subject to the Penny Stock Regulations, an investor may find it difficult to dispose of, or to obtain accurate quotations as to the market value of, our Company's securities. The regulations governing low-priced or penny stocks could limit the ability of broker-dealers to sell the Company's securities and thus the ability of holders of our common stock to sell their securities in the secondary market.

FUTURE CAPITAL NEEDS COULD RESULT IN DILUTION TO STOCKHOLDERS; ADDITIONAL FINANCING COULD BE UNAVAILABLE OR HAVE UNFAVORABLE TERMS.

Our future capital requirements will depend on many factors, including cash flow from operations, progress in our gas operations, competing market developments, and our ability to market our proposed products successfully. Our working capital is presently insufficient to fund the Company's activities. It will be necessary to raise additional funds through equity or debt financings. Any equity financings could result in dilution to our then-existing stockholders. Sources of debt financing may result in higher interest expense. Any financing, if available, may be on terms unfavorable to the Company. If adequate funds are not obtained, the Company may be required to reduce or curtail operations.

SUBSTANTIAL CAPITAL REQUIREMENTS

We may make substantial capital expenditures for the development, acquisition and production of natural gas pipeline, processing systems and, or storage facilities. If revenues or the Company's equity financing decrease as a result of lower natural gas prices or operating difficulties, the Company may have limited ability to expend the capital necessary to undertake or complete proposed plans and opportunities. There can be no assurance that additional debt or equity financing or cash generated by operations will be available to meet these requirements.

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WE CAN GIVE NO ASSURANCE REGARDING THE AMOUNTS OF CASH THAT WE WILL GENERATE.

The actual amounts of cash we generate will depend upon numerous factors relating to our business which may be beyond our control, including:

- s the demand for natural gas;
- s profitability of operations;
- s required principal and interest payments on any debt we may incur;
- s the cost of acquisitions;
- s our issuance of equity securities;
- s fluctuations in working capital;
- s capital expenditures;
- s continued development of gas transportation network systems;
- s prevailing economic conditions; and
- s government regulations.

WE DO NOT EXPECT TO PAY DIVIDENDS FOR SOME TIME, IF AT ALL.

No cash dividends have been paid on the Common Stock. We expect that any income received from operations will be devoted to our future operations and growth. We do not expect to pay cash dividends in the near future. Payment of dividends would depend upon our profitability at the time, cash available for those dividends, and other factors.

COMPETITION

We will be competing with other established businesses that market similar products. Many of these companies have greater capital, marketing and other resources than we do. There can be no assurance that these or other companies will not develop new or enhanced products that have greater market acceptance than any that may be marketed by us. There can be no assurance that we will successfully differentiate ourselves from our competitors or that the market will consider our products to be superior or to be more appealing than those of our competitors. Market entry by any significant competitor may have an adverse effect on our sales and profitability.

WE OPERATE IN HIGHLY COMPETITIVE MARKETS IN COMPETITION WITH A NUMBER OF DIFFERENT COMPANIES.

We face strong competition in our geographic areas of operations. Our competitors include major integrated oil companies, interstate and intrastate pipelines. We compete with integrated companies that have greater access to raw natural gas supply and are less susceptible to fluctuations in price or volume, and some of our competitors that have greater financial resources may have an advantage in competing for acquisitions or other new business opportunities.

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GROWING OUR BUSINESS BY CONSTRUCTING NEW PIPELINES AND PROCESSING FACILITIES SUBJECTS US TO CONSTRUCTION RISKS AND RISKS THAT RAW NATURAL GAS SUPPLIES WILL NOT BE AVAILABLE UPON COMPLETION OF THE FACILITIES.

One of the ways we intend to grow our business is through the construction of additions to our existing gathering systems, modification of our existing gas processing plant and construction of new processing facilities. The construction of gathering and processing facilities requires the expenditure of significant amounts of capital, which may exceed our expectations. Generally, we may have only limited raw natural gas supplies committed to these facilities prior to their construction. Moreover, we may construct facilities to capture anticipated future growth in production in a region in which anticipated production growth does not materialize. As a result, there is the risk that new facilities may not be able to attract enough raw natural gas to achieve our expected investment return, which could adversely affect our results of operations and financial condition.

A SIGNIFICANT COMPONENT OF OUR GROWTH STRATEGY WILL BE ACQUISITIONS AND WE MAY NOT BE ABLE TO COMPLETE FUTURE ACQUISITIONS SUCCESSFULLY.

Our business strategy will emphasize growth through strategic acquisitions, but we cannot assure you that we will be able to identify attractive or willing acquisition candidates or that we will be able to acquire these candidates on economically acceptable terms. Competition for acquisition opportunities in our industry exists and may increase. Any increase in the level of competition for acquisitions may increase the cost of, or cause us to refrain from, completing acquisitions.

Our strategy of acquisitions is dependent upon, among other things, our ability to obtain debt and equity financing and possible regulatory approvals. Our ability to pursue our growth strategy may be hindered if we are not able to obtain financing or regulatory approvals, including those under federal and state antitrust laws. Our ability to grow through acquisitions and manage such growth will require us to invest in operational, financial and management information systems and to attract, retain, motivate and effectively manage our employees. The inability to manage the integration of acquisitions effectively could have a material adverse effect on our financial condition, results of operations and business. Pursuit of our acquisition strategy may cause our financial position and results of operations to fluctuate significantly from period to period.

IF WE ARE UNABLE TO MAKE ACQUISITIONS ON ECONOMICALLY AND OPERATIONALLY ACCEPTABLE TERMS, OUR FUTURE FINANCIAL PERFORMANCE MAY BE LIMITED.

There can be no assurance that:

- s we will identify attractive acquisition candidates in the future;
- s we will be able to acquire assets on economically acceptable terms;
- s any acquisitions will not be dilutive to earnings and operating surplus; or
- s any debt incurred to finance an acquisition will not affect our ability to make distributions to you.

If we are unable to make acquisitions on economically and operationally acceptable terms, our future financial performance will be limited to the performance of our present gas gathering network.

Our acquisition strategy involves many risks, including:

- s difficulties inherent in the integration of operations and systems;
- s the diversion of management's attention from other business concerns; and
- s the potential loss of key employees of acquired businesses.

In addition, future acquisitions may involve significant expenditures. Depending upon the nature, size and timing of future acquisitions, we may be required to secure financing. We cannot assure you that additional financing will be available to us on acceptable terms.

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OUR BUSINESS IS DEPENDENT UPON PRICES AND MARKET DEMAND FOR NATURAL GAS AND PROPANE, WHICH ARE BEYOND OUR CONTROL AND HAVE BEEN EXTREMELY VOLATILE.

We are subject to significant risks due to fluctuations in commodity prices, primarily with respect to the prices of gas that we may own as a result of our processing and distribution activities.

The markets and prices for residue gas depend upon factors beyond our control. These factors include demand for oil, and natural gas, which fluctuate with changes in market and economic conditions and other factors, including:

- s the impact of weather on the demand for oil and natural gas;
- s the level of domestic oil and natural gas production;
- s the availability of imported oil and natural gas;
- s the availability of local, intrastate and interstate transportation systems;
- s the availability and marketing of competitive fuels;
- s the impact of energy conservation efforts; and
- s the extent of governmental regulation and taxation.

WE GENERALLY DO NOT OWN THE LAND ON WHICH OUR PIPELINES ARE CONSTRUCTED AND WE ARE SUBJECT TO THE POSSIBILITY OF INCREASED COSTS FOR THE LOSS OF LAND USE.

We generally do not own the land on which our pipelines are constructed. Instead, we obtain the right to construct and operate the pipelines on other people's land for a period of time. If we were to lose these rights, our business could be affected negatively.

RISKS RELATED TO THE RETAIL PROPANE AND ASSOCIATED BUSINESSES

s Decreases in the demand for propane because of warmer weather may adversely affect our financial condition and results of operations.

s Weather conditions have a significant impact on the demand for propane for heating purposes. All of our propane customers rely heavily on propane as a heating fuel. The volume of propane sold is at its highest during the six-month peak heating season of October through March and is directly affected by the severity of the winter weather. We estimate that approximately two-thirds of our annual retail propane volume will be sold during these months. Actual weather conditions can vary substantially from quarter to quarter and year to year, significantly affecting our financial performance. Furthermore, warmer than normal temperatures in our service area can significantly decrease the total volume of propane we sell. Consequently, our operating results may vary significantly due to actual changes in temperature. Weather conditions in any quarter or year may have a material adverse effect on our operations.

s Sudden and sharp propane price increases that cannot be passed on to customers may adversely affect our profits, income, and cash flow.

s Energy efficiency and technology may reduce the demand for propane and our revenues.

s The national trend toward increased conservation and technological advances, including installation of improved insulation and the development of more efficient furnaces and other heating devices, has adversely affected the demand for propane by retail customers. Future conservation and efficiency measures or technological advances in heating, conservation, energy generation, or other devices might reduce demand for propane and our revenues.

s The propane business is highly regulated. New or stricter environmental, health, or safety regulations may increase our operating costs and reduce our net income.

s The propane business is subject to a wide range of federal, state, and local environmental, transportation, health and safety laws and regulations governing the storage, distribution, and transportation of propane. We may have increased costs in the future due to new or stricter safety, health, transportation, and environmental regulations or liabilities resulting from non-compliance with operating or other regulatory permits. The increase in any such costs may reduce our net income.

s We will be subject to all operating hazards and risks normally associated with handling, storing, transporting, and delivering combustible liquids such as propane for use by consumers. As a result, we may be a defendant in various legal proceedings and litigation arising in the ordinary course of business. Our insurance may not be adequate to protect us from all material expenses related to potential future claims for personal injury and property damage or that insurance will be available in the future at economical prices. In addition, the occurrence of a serious accident, whether or not we are involved, may have an adverse effect on the public's desire to use our products.

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GOVERNMENT REGULATION AND ENVIRONMENTAL MATTERS

Our business is regulated by certain local, state and federal laws and regulations relating to the exploration for, and the development, production, marketing, pricing, transportation and storage of, natural gas and oil. We are also subject to extensive and changing environmental and safety laws and regulations governing plugging and abandonment, the discharge of materials into the environment or otherwise relating to environmental protection. In addition, we are subject to changing and extensive tax laws, and the effect of newly enacted tax laws cannot be predicted. The implementation of new, or the modification of existing, laws or regulations, including regulations which may be promulgated under the Oil Pollution Act of 1990, could have a material adverse effect on the Company.

FEDERAL, STATE OR LOCAL REGULATORY MEASURES COULD ADVERSELY AFFECT OUR BUSINESS.

While the Federal Energy Regulatory Commission, or FERC, does not directly regulate the major portions of our operations, federal regulation, directly or indirectly, influences certain aspects of our business and the market for our products. As a raw natural gas gatherer and not an operator of interstate transmission pipelines, we generally are exempt from FERC regulation under the Natural Gas Act of 1938, but FERC regulation still significantly affects our business. In recent years, FERC has pursued pro-competition policies in its regulation of interstate natural gas pipelines. However, we cannot assure you that FERC will continue this approach as it considers proposals by pipelines to allow negotiated rates not limited by rate ceilings, pipeline rate case proposals and revisions to rules and policies that may affect rights of access to natural gas transportation capacity.

While state public utility commissions do not regulate our business, state and local regulations do affect our business. We are subject to ratable take and common purchaser statutes in the states where we operate. Ratable take statutes generally require gatherers to take, without undue discrimination, natural gas production that may be tendered to the gatherer for handling. Similarly, common purchaser statutes generally require gatherers to purchase without undue discrimination as to source of supply or producer. These statutes are designed to prohibit discrimination in favor of one producer over another producer or one source of supply over another source of supply. These statutes also have the effect of restricting our right as an owner of gathering facilities to decide with whom we contract to purchase or transport natural gas. Federal law leaves any economic regulation of raw natural gas gathering to the states, and some of the states in which we operate have adopted complaint-based or other limited economic regulation of raw natural gas gathering activities. States in which we operate that have adopted some form of complaint-based regulation, like Oklahoma, Kansas and Texas, generally allow natural gas producers and shippers to file complaints with state regulators in an effort to resolve grievances relating to natural gas gathering access and rate discrimination. The states in which we conduct operations administer federal pipeline safety standards under the Pipeline Safety Act of 1968, and the "rural gathering exemption" under that statute that our gathering facilities currently enjoy may be restricted in the future. The "rural gathering exemption" under the Natural Gas Pipeline Safety Act of 1968 presently exempts substantial portions of our gathering facilities from jurisdiction under that statute, including those portions located outside of cities, towns, or any area designated as residential or commercial, such as a subdivision or shopping center.

GOVERNMENTAL REGULATION OF OUR PIPELINES COULD INCREASE OUR OPERATING COSTS.

Currently our operations involving the gathering of natural gas from wells are exempt from regulation under the Natural Gas Act. Section 1(b) of the Natural Gas Act provides that the provisions of the Act shall not apply to facilities used for the production or gathering of natural gas. Our physical dimensions and operations support the conclusion that our facilities perform primarily a gathering function. We should not, therefore, be subject to Natural Gas Act regulation. There, however, can be no assurance that this will remain the case. The Federal Energy Regulatory Commission's oversight of entities subject to the Natural Gas Act includes the regulation of rates, entry and exit of service, acquisition, construction and abandonment of transmission facilities, and accounting for regulatory

purposes. The implementation of new laws or policies that would subject us to regulation by the Federal Energy Regulatory Commission under the Natural Gas Act could have a material adverse effect on our financial condition and operations. Similarly, changes in the method or circumstances of operation, or in the configuration of facilities, could result in changes in our regulatory status. In addition, we are subject to federal and state safety laws that dictate the type of pipeline, quality of pipe protection, depth, methods of welding and other construction-related standards.

Our gas gathering operations are subject to regulation at the state level, which increases the costs of operating our pipeline facilities. Matters subject to regulation include rates, service and safety. We have been granted an exemption from regulation as a public utility in Texas. Presently, our rates are not regulated in Texas. Changes in state regulations, or our status under these regulations due to configuration changes in our operating facilities, that subject us to further regulation could have a material adverse effect on our financial condition. Litigation or governmental regulation relating to environmental protection and operational safety may result in substantial costs and liabilities.

OUR BUSINESS INVOLVES HAZARDOUS SUBSTANCES AND MAY BE ADVERSELY AFFECTED BY ENVIRONMENTAL REGULATION.

Many of the operations and activities of our gathering systems, plants and other facilities are subject to significant federal, state and local environmental laws and regulations. These include, for example, laws and regulations that impose obligations related to air emissions and discharge of wastes from our facilities and the cleanup of hazardous substances that may have been released at properties currently or previously owned or operated by us or locations to which we have sent wastes for disposal. Various governmental authorities have the power to enforce compliance with these regulations and the permits issued under them, and violators are subject to administrative, civil and criminal penalties, including civil fines, injunctions or both. Liability may be incurred without regard to fault for the remediation of contaminated areas. Private parties, including the owners of properties through which our gathering systems pass, may also have the right to pursue legal actions to enforce compliance as well as to seek damages for non-compliance with environmental laws and regulations or for personal injury or property damage.

There is inherent risk of the incurrence of environmental costs and liabilities in our business due to our handling of natural gas and other petroleum products, air emissions related to our operations, historical industry operations, waste disposal practices and the prior use of natural gas flow meters containing mercury. In addition, the possibility exists that stricter laws, regulations or enforcement policies could significantly increase our compliance costs and the cost of any remediation that may become necessary. We cannot assure you that we will not incur material environmental costs and liabilities. Furthermore, we cannot assure you that our insurance will provide sufficient coverage in the event an environmental claim is made against us.

Our business may be adversely affected by increased costs due to stricter pollution control requirements or liabilities resulting from non-compliance with required operating or other regulatory permits. New environmental regulations might adversely affect our products and activities, including processing, storage and transportation, as well as waste management and air emissions. Federal and state agencies also could impose additional safety requirements, any of which could affect our profitability.

RISK OF ADDITIONAL COSTS AND LIABILITIES RELATED TO ENVIRONMENTAL AND SAFETY REGULATIONS AND CLAIMS

Our pipeline operations are subject to various federal, state and local environmental, safety, health and other laws, which can increase the cost of planning, designing, installing and operating such facilities. There can be no assurance that costs and liabilities relating to compliance will not be incurred in the future. Moreover, it is possible that other developments, such as increasingly strict environmental and safety laws, regulations and enforcement policies thereunder, and claims for damages to property or persons resulting from our operations, could result in additional costs to and liabilities for us.

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SOVEREIGN RISK

We are focusing on the development of infrastructure projects through our Mexican entity, Terranova Energia S. de R.L. de C.V., in the nation of the United Mexican States (Mexico). The risk of indirect or regulatory actions by local, state or federal authorities in Mexico which may inhibit, delay, hinder or block projects under development in Mexico is very high given the history of operations conducted by past businesses other than the Company in Mexico. There is a substantial risk that a set of actions taken by commission or omission by the various actors in the public, private, nongovernmental and/or social sectors could negatively impact a project or investment in Mexico. The legal system employed in Mexico is dramatically different in its structure and method of operation compared to the common law foundation present in the United States of America. The level of legal protection afforded investors by the North American Free Trade Agreement has not materially improved from a foreign investor's viewpoint.

There can be no assurance that a commercially viable project will be completed due to the above factors which could result in commercial competitors trying to circumvent the market system through the exploitation of undocumented, extra-official channels of influence that constitute unfair competition. Federal, state and local authorities are not well coordinated in their legal protections and improper influence and competition may arise from any level of government to disrupt or destroy the commercial viability of investments by foreign investors. While the Company has taken precautions to limit its investments to prudent levels, there is a continuing risk of adverse activities arising from the above sources that could impair or result in the entire loss of investment in otherwise commercially viable projects initiated by the Company in Mexico.

PIPELINE SYSTEM OPERATIONS ARE SUBJECT TO OPERATIONAL HAZARDS AND UNFORESEEN INTERRUPTIONS.

The operations of our pipeline systems are subject to hazards and unforeseen interruptions, including natural disasters, adverse weather, accidents or other events, beyond our control. A casualty occurrence might result in injury and extensive property or environmental damage. Although we intend to maintain customary insurance coverages for gathering systems of similar capacity, we can offer no assurance that these coverages will be sufficient for any casualty loss we may incur.

OPERATING RISKS OF NATURAL GAS OPERATIONS

The natural gas business involves certain operating hazards. The availability of a ready market for our natural gas products also depends on the proximity of reserves to, and the capacity of, natural gas gathering systems, pipelines and trucking or terminal facilities. As a result, substantial liabilities to third parties or governmental entities may be incurred, the payment of which could reduce or eliminate the funds available for exploration, development or acquisitions or result in the loss of our properties. In accordance with customary industry practices, we maintain insurance against some, but not all, of such risks and losses. We do not carry business interruption insurance. The occurrence of such an event not fully covered by insurance could have a material adverse effect on our financial condition and results of operations.

OUR BUSINESS INVOLVES MANY HAZARDS AND OPERATIONAL RISKS, SOME OF WHICH MAY NOT BE COVERED BY INSURANCE.

Our operations are subject to the many hazards inherent in the gathering, compressing, treating and processing of raw natural gas and NGLs and storage of residue gas, including ruptures, leaks and fires. These risks could result in substantial losses due to personal injury and/or loss of life, severe damage to and destruction of property and equipment and pollution or other environmental damage and may result in curtailment or suspension of our related operations. We are not fully insured against all risks incident to our business. If a significant accident or event occurs

that is not fully insured, it could adversely affect our operations and financial condition.

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INSURANCE

Companies engaged in the petroleum products distribution and storage business may be sued for substantial damages in the event of an actual or alleged accident or environmental contamination. We maintain \$2,000,000 of liability insurance. There can be no assurance that we will be able to continue to maintain liability insurance at a reasonable cost in the future, or that a potential liability will not exceed the coverage limits. Nor can there be any assurance that the amount of insurance carried by us will enable us to satisfy any claims for which we might be held liable resulting from the conduct of our business operations.

ITEM 1B. UNRESOLVED STAFF COMMENTS

Not Applicable to Non-Accelerated Filers.

ITEM 2. DESCRIPTION OF PROPERTIES

Reef Ventures, L.P. owns and operates the international natural gas pipeline and related facilities located in Maverick County, Texas and Coahuila, Mexico. Tidelands owns a 97% limited partnership interest and a 1% general partner interest (through Arrecefe Management, LLC) in this entity. We acquired these interests from Impact International, LLC. Impact financed our purchase of this system and, as of December 31, 2006, we owe Impact \$4,785,003.

Rio Bravo Energy, LLC owns and operates the Chittim Gas Processing Plant which is located in Maverick County, Texas. The plant is currently shut down. The gas plant has the capability to fractionate natural gas into commercial grade propane and butane. In the near future, we expect to sell these assets.

Sonora Pipeline, LLC owns the Sonora Pipeline network in Maverick, Dimmitt and Zavala Counties, Texas, consisting of approximately 80 miles of pipeline. No significant encumbrances exist with respect to the assets of this subsidiary. The pipeline is currently inactive and could be used to transport natural gas from third party producers to supply feedstock for the Chittim Gas Processing Plant owned by Rio Bravo Energy, LLC. In the near future, we expect to sell these assets. Sonora Pipeline, LLC also plans to construct, own and operate approximately 29 miles of natural gas pipelines in Hidalgo County, Texas which will interconnect at the U.S.-Mexico border with the pipeline and storage assets to be constructed, owned and operated by Terranova Energia, S. de R.L. de C.V, another subsidiary of Tidelands Oil & Gas Corporation.

Sonterra Energy Corporation operates propane distribution systems providing propane to 17 residential subdivisions in Central Texas. Sonterra is currently constructing a propane distribution system for approximately 350 residential units in Cordillera Ranch, a rural subdivision located in Kendall County, Texas.

Tidelands Exploration & Production Corporation owns a 50% interest in a 26 mile natural gas pipeline located in Medina, Atascosa and Bexar Counties, Texas and also owns a 50% interest in two leases with 5 recompleted natural gas wells in Atascosa and Medina Counties, Texas. These assets are held for sale at present with active negotiations underway.

We lease our San Antonio executive office. We renewed this lease on February 1, 2006 for a term until December 31, 2007, with a current monthly lease payment of \$3,400. Sonterra Energy Corporation entered into a sublease agreement for its offices in an adjacent building. On February 1, 2006, Sonterra Energy Corporation entered into a direct lease with the building owner at a rent of \$3,300 per month for a term ending December 31, 2007. Sonterra leased a field office and storage yard in Dripping Springs, Texas on May 15, 2006, for a five-year term at an annual rent rate of \$8,100.

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ITEM 3. LEGAL PROCEEDINGS

Matter No. 1:

On January 6, 2003, we were served as a third party defendant in a lawsuit titled Northern Natural Gas Company vs. Betty Lou Sheerin vs. Tidelands Oil & Gas Corporation, ZG Gathering, Ltd. and Ken Lay, in the 150th Judicial District Court, Bexar County, Texas, Cause Number 2002-C1-16421. The lawsuit was initiated by Northern Natural Gas ("Northern") when it sued Betty Lou Sheerin ("Sheerin") for her failure to make payments on a note she executed payable to Northern in the original principal amount of \$1,950,000. Northern's suit was filed on November 13, 2002. Sheerin answered Northern's lawsuit on January 6, 2003. Sheerin's answer generally denied Northern's claims and raised the affirmative defenses of fraudulent inducement by Northern, estoppel, waiver and the further claim that the note does not comport with the legal requirements of a negotiable instrument. Sheerin seeks a judicial ruling that Northern be denied any recovery on the note. Sheerin's answer included a counterclaim against Northern, ZG Gathering, and Ken Lay generally alleging, among other things, that Northern, ZG Gathering, Ltd. and Ken Lay, fraudulently induced her execution of the note. Northern has filed a general denial of Sheerin's counterclaims. Sheerin's answer included a third party cross claim against Tidelands Oil and Gas Corporation ("Tidelands"). She alleges that Tidelands entered into an agreement to purchase the Zavala Gathering System from ZG Gathering Ltd. and that, as a part of the agreement, Tidelands agreed to satisfy all of the obligations due and owing to Northern, thereby relieving Sheerin of all obligations she had to Northern on the \$1,950,000 promissory note in question. Tidelands and Sheerin agreed to delay the Tidelands' answer date in order to allow time for mediation of the case. Tidelands participated in mediation on March 11, 2003. The case was not settled at that time. Tidelands answered the Sheerin suit on March 26, 2003. Tidelands' answer denies all of Sheerin's allegations.

On May 24 and June 16, 2004 respectively, Betty Lou Sheerin filed her first and second amended original answer, affirmative defenses, special exceptions and second amended original counterclaim, second amended original third party cross-actions and requests for disclosure. In these amended pleadings, she sued Michael Ward, Royis Ward, James B. Smith, Carl Hessel and Ahmed Karim in their individual capacities. Her claims against these individuals are for fraud, breach of contract, breach of the Uniform Commercial Code, breach of duty of good faith and fair dealing and conversion. Sheerin has now non-suited her claims against Michael Ward, Royis Ward, and James B. Smith.

In September 2002, as a pre-closing deposit to the purchase of the Zavala Gathering System, the Company executed a \$300,000 promissory note to Betty L. Sheerin, a partner of ZG Gathering, Ltd. In addition, the Company issued 1,000,000 shares of its common stock to various partners of ZG Gathering, Ltd. On December 3, 2003, Sheerin filed a separate lawsuit against Tidelands in the 150th District Court of Bexar County, Texas on this promissory note seeking a judgment against Tidelands for the principle amount of the note, plus interest. On December 29th, 2003, Tidelands answered this lawsuit denying liability on the note. On April 1, 2004, Tidelands filed a plea in abatement asking the court to dismiss or abate Sheerin's lawsuit on the \$300,000 promissory note as it was related to and its outcome was dependent on the outcome of the Sheerin third party cross action against Tidelands in Cause Number 2002-C1-16421. The Company believes that the promissory note and shares of common stock should be cancelled based upon the outcome of the litigation described above. Accordingly, our financial statements reflect this belief.

On September 15, 2004 and again on October 15, 2004 respectively, Sheerin amended her pleadings to include a third and fourth amended third party cross action against Tidelands adding a claim for the \$300,000 promissory note. In these amended pleadings, Sheerin also deleted her claims against Carl Hessel and Ahmed Karim ("Company Directors"). After adding the claim on the \$300,000 promissory note to the third party claims of Sheerin against Tidelands in Cause No. 2002-C1-16421, Sheerin dismissed Cause Number 2002-C1-16421.

Tidelands won a partial summary judgment against Sheerin as to all of her tort claims pled against Tidelands, save and except only her claim for conversion of 500,000 shares of Tidelands stock.

Sheerin seeks damages against Tidelands for indemnity for any sums found to be due from her to Northern, unspecified amounts of actual damages, statutory damages, unspecified amounts of exemplary damages, attorneys fees, costs of suit, and prejudgment and post judgment interest.

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On August 5, 2005, Northern filed its Fourth Amended Original Petition which, for the first time, named Tidelands as a defendant to Northern. Northern seeks to impose liability on Tidelands for \$1,950,000 promissory note signed by McDay Energy Partners, Ltd. (the predecessor to ZG Gathering, Ltd.) and Sheerin and the \$1,700,000 promissory note signed by McDay only. Northern contends that Tidelands is alternatively liable to Northern for payment of both such promissory notes totaling \$3,709,914 plus interest because Northern is a third party beneficiary under a December 3, 2001 purchase and sale agreement between ZG Gathering, Ltd., and Tidelands claiming that in such agreement Tidelands agreed to assume and satisfy all indebtedness due and owing Northern by Sheerin and ZG Gathering, Ltd. Northern also claims that it is entitled to foreclosure of a lien on the gas gathering system and pipeline that was the subject of the promissory notes in question. Tidelands won a summary judgment motion it filed against Northern and the court has now dismissed Northern's claims against Tidelands.

On November 28, 2005, ZG Gathering, Ltd. and ZG Pipeline Management ("ZG") filed its answer to Northern's Fifth Amended Petition, its counter-claim against Northern, and its answer and cross claim against Tidelands. ZG contends that the promissory notes given by ZG and Sheerin to Northern were procured by Northern's fraudulent misrepresentations and it claims unspecified amounts of damages against Northern. ZG's cross action against Tidelands claims Tidelands entered into an agreement to purchase the Zavala Gathering System from ZG and that, as part of that agreement, Tidelands agreed to satisfy the \$3,700,914 Northern indebtedness of ZG, and to defend, indemnify, and hold ZG and Sheerin harmless from such indebtedness, to pay off a Sheerin loan of \$300,000, and to issue 1 million shares of Tidelands stock, of which 500,000 was to be free trading shares. ZG claims that Tidelands breached this agreement by failing to satisfy the Northern indebtedness, failing to defend and indemnify it from such debt, failing to pay off the \$300,000 note, failing to issue the free trading shares in Tidelands, and by placing a stop transfer order on the restricted stock that was issued by Tidelands. ZG seeks specific performance of the agreement, recovery of an unspecified amount of damages, and its attorney's fees.

On March 6, 2006, the Court granted Tidelands' motion for summary judgment against NNG and dismissed NNG's suit against Tidelands. On March 16, 2006, the Court denied Tidelands' motion for summary judgment against Sheerin on Tidelands' affirmative defense of mutual mistake. On July 19, 2006, the Court denied ZG's motion for summary judgment to strike Tidelands' affirmative defense of mutual mistake.

Trial is scheduled to begin May 7, 2007, unless a settlement is completed. A settlement agreement which is conditioned on funding and which involves Tidelands' sale of certain assets has been signed by all but one of the litigation parties. Based on negotiations, the Company has reserved \$2,250,000 as an estimated litigation settlement and that amount has been included in this report.

Matter No. 2:

Cause No. GM 501625, Senna Hills, Ltd., Plaintiff, vs. Sonterra Energy Corp., Defendant, was filed in the 53rd Judicial District of Travis County, Texas and Cause No. GN 501626, HBH Development Co., LLC, Plaintiff, vs. Sonterra Energy Corp., Defendant, was filed in the 98th Judicial District Court of Travis County, Texas. The above matters were each filed against Sonterra in May 2005 and involve the same claims arising from the same propane service agreement. In each case, the plaintiff initially brought claims against Sonterra arising from Sonterra's failure, as an assignee of the agreement, to pay easement use fees to the plaintiff. Sonterra obtained summary judgment as to the plaintiffs' respective breach of contract and failure of assignment claims arising from the failure to pay easement use fees. The cases were not, however, fully dismissed because the plaintiffs added new causes of action for failure to pay easement use fees, claims for unpaid developer bonus, reformation of the agreements to require payment of easement use fees and alleged failure of assignment. These separate lawsuits have since been consolidated into one suit for purposes of pretrial and trial. The May 2007 trial date has been continued and will likely be reset in September 2007.

Matter No. 3:

Cause No. GN 500948, Goodson Builders, Ltd., Plaintiff, vs. Jim Blackwell, BNC Engineering, Et. Al, Defendants, was filed April 7, 2005, in the 345th District Court of Travis County, Texas. This case involves a claim that Defendant Toll Brothers Property, LP (“Toll Brothers”) sold Plaintiff Goodson Builder, Ltd. (“Plaintiff” or “Goodson”) property without disclosing a propane easement. Plaintiff sued Sonterra Energy Corp. (“Sonterra”) for trespassing through the use of the easement. Goodson’s primary claim is against the seller for fraud and non-disclosure. Toll Brothers has responded with a claim for sanctions because the claim is frivolous. Toll Brothers offers a witness who is Plaintiff’s former employee and took pictures of the propane tank prior to the Plaintiff’s purchase. Goodson seeks damages in the hundreds of thousands of dollars. Insurance would not cover these damages.

The case is pending summary judgment. The Company is contesting the case vigorously; however, the Company is willing to settle if the Plaintiff is willing to drop the claim.

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

No matters were brought to a vote of the security holders during the quarter ended December 31, 2006.

Table of Contents**PART II****ITEM 5. MARKET FOR COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER****PURCHASES OF EQUITY SECURITIES****Market For Common Equity And Related Stockholder Matters**

Our common stock is traded on the OTC Electronic Bulletin Board. The following table sets forth the high and low bid prices of our common stock for each quarter for the years 2006 and 2005. The quotations set forth below reflect inter-dealer prices, without retail mark-up, mark-down or commission and may not represent actual transactions.

Common Stock

Our common stock trades Over-the-Counter (OTC) on the OTC Bulletin Board under the symbol TIDE. The table below sets forth the high and low bid information for the past two years. These quotations reflect inter-dealer prices, without retail mark-up, mark-down or commission and may not represent actual transactions. These quarterly trade and quote data provided by NASDAQ OTC Bulletin Board.

Bid Information

Fiscal Quarter Ended

	High	Low
December 31, 2006	0.57	0.26
September 30, 2006	0.84	0.51
June 30, 2006	1.18	0.51
March 31, 2006	1.18	0.78
December 31, 2005	1.01	0.76
September 30, 2005	1.39	0.80
June 30, 2005	1.77	0.95
March 31, 2005	2.59	1.74

As of December 31, 2006, we had an aggregate of 95 stockholders of record as reported by our transfer agent, Signature Stock Transfer Co., Inc. Certain shares are held in the "street" names of securities broker dealers and we estimate the number of stockholders which may be represented by such securities broker dealer accounts may exceed 5,000.

Table of Contents**Dividends and Dividend Policy**

There are no restrictions imposed on the Company that limit its ability to declare or pay dividends on its common stock, except as limited by state corporation law. During the year ended December 31, 2006, no cash or stock dividends were declared or paid and none are expected to be paid in the foreseeable future.

We expect to continue to retain all earnings generated by our future operations for the development and growth of our business. The Board of Directors will determine whether or not to pay dividends in the future in light of our earnings, financial condition, capital requirements and other factors.

Recent Sales of Unregistered Securities

We made the following issuances of unregistered (restricted) securities during the fourth quarter of the fiscal year ended on December 31, 2006:

On November 27, 2006, the Company issued 40,000 shares of its restricted common stock valued at \$16,000 to an employee of the Company.

No commissions were paid in connection with any of these sales. We did not employ any form of general solicitation or advertising in connection with the offer and sale of the securities described below. Except as otherwise noted above, the offer and sale of the securities listed below were made in reliance on the exemption from registration provided by Section 4(2) of the Securities Act and/or Regulation D promulgated by the Securities and Exchange Commission as transactions by an issuer not involving any public offering.

PERFORMANCE GRAPH

The following graph compares total stockholder returns for Tideland Oil and Gas Corporation's common stock for the past five years to two indices: the Russell Microcap Index and the Nasdaq Combined Industrial Index. All of the cumulative total returns are computed assuming the value of the investment in Tideland's common stock and each index as \$100.00 on December 31, 2001, and the reinvestment of all dividends (to date, the Company has not declared any dividends). The comparisons shown on the graph below are based on historical data and are not intended to be indicative of future performance of Tideland's common stock.

Company/Index	INDEXED RETURNS					
	Years Ending December 31					
	Base Period 12/31/01	2002	2003	2004	2005	2006
TIDELANDS OIL AND GAS CORP.	100	22.00	151.36	92.33	56.41	17.41
RUSSELL MICROCAP INDEX	100	88.10	121.58	144.05	161.65	183.26
NASDAQ COMBINED INDUSTRIAL INDEX	100	76.04	114.41	130.69	134.51	149.49

The Stock Performance Graph shall not be deemed incorporated by reference into any filing made by the Company under the Securities Act of 1933 or the Securities Exchange Act of 1934, notwithstanding any general statement contained in any such filing incorporating this Annual Report on Form 10-K by reference, except to the extent the Company incorporates the Graph by specific reference.

Table of Contents**ITEM 6. SELECTED FINANCIAL DATA****SELECTED CONSOLIDATED FINANCIAL INFORMATION**

The following tables present our selected consolidated financial information as of the end of the periods indicated. The selected consolidated financial information for, and as of the end of, each of the twelve months ended December 31, 2006, December 31, 2005, December 31, 2004, December 31, 2003, and December 31, 2002, are from our audited consolidated financial statements.

The selected consolidated financial information is not necessarily indicative of the results that may be expected for any future period. The selected consolidated financial information should be read in conjunction with "Management's Discussion and Analysis" and the historical and consolidated financial statements and notes incorporated by reference in this prospectus.

(Dollars in thousands, except share and per share data)

Operating Data:	2006	2005	2004	2003	2002
Revenue	\$ 2,223	\$ 1,861	\$ 1,884	\$ 179	\$ 710
Operating Expenses	14,163	15,172	31,626	3,061	4,454
Operating Income (Loss)	(11,940)	(13,311)	(29,742)	(2,882)	(3,744)
Other Income (Expense), Net	103	5,648	15,440	1,534	(316)
Net Income (Loss)	\$ (11,837)	\$ (7,663)	\$ (14,302)	\$ (1,348)	\$ (4,060)

Statement of Cash Flows Data:

Cash Provided (Used) by Operating Activities	\$ (4,821)	\$ (2,784)	\$ (3,108)	\$ 441	\$ (423)
Cash Provided (Used) by Investing Activities	\$ (2,793)	\$ (1,836)	\$ (9,629)	\$ 366	\$ (354)
Cash Provided (Used) by Financing Activities	\$ 6,868	\$ 275	\$ 17,302	\$ (106)	\$ 573

Balance Sheet Data:

Total Assets	\$ 15,187	\$ 13,489	\$ 22,423	\$ 1,624	\$ 1,379
Long-Term Debt	\$ 8,934	\$ 4,272	\$ 11,732	\$ -	\$ -
Total Stockholders' Equity	\$ 2,153	\$ 7,767	\$ 4,949	\$ 485	\$ (2,536)

Table of Contents**SELECTED CONSOLIDATED QUARTERLY FINANCIAL INFORMATION**

The information below is from unaudited consolidated financial statements.

Year Ended December 31, 2006	March 31	June 30	September 30	December 31
Revenues	\$ 802	\$ 407	\$ 369	\$ 645
Cost of Goods Sold	377	206	177	414
Gross Margin	425	201	192	231
Operating Expenses	2,155	2,190	4,017	2,377
Other Income (Expense), Net	34	28	48	(7)
Net earnings (loss)	\$ (1,696)	\$ (1,961)	\$ (3,777)	\$ (2,153)
Basic (loss) per share	\$ (0.02)	\$ (0.03)	\$ (0.05)	\$ (0.03)
Diluted (loss) per share	\$ (0.02)	\$ (0.03)	\$ (0.05)	\$ (0.03)

Year Ended December 31, 2005	March 31	June 30	September 30	December 31
Revenues	\$ 628	\$ 341	\$ 248	\$ 644
Cost of Goods Sold	285	130	220	368
Gross Margin	343	211	28	276
Operating Expenses	6,947	3,825	1,580	1,817
Other Income (Expense), Net	(2,862)	8,096	324	90
Net earnings (loss)	\$ (9,466)	\$ 4,482	\$ (1,228)	\$ (1,451)
Basic income (loss) per share	\$ (0.15)	\$ 0.08	\$ (0.02)	\$ (0.11)
Diluted income (loss) per share	\$ (0.15)	\$ 0.08	\$ (0.02)	\$ (0.11)

Year Ended December 31, 2004	March 31	June 30	September 30	December 31
Revenues	\$ 0	\$ 508	\$ 825	\$ 551
Cost of Goods Sold	0	498	802	209
Gross Margin	0	10	23	342
Operating Expenses	1,538	4,209	3,545	20,825
Other Income (Expense), Net	4	15,397	6	33
Net earnings (loss)	\$ (1,534)	\$ 11,198	\$ (3,516)	\$ (20,450)
Basic income (loss) per share	\$ (0.03)	\$ 0.18	\$ (0.02)	\$ (0.34)
Diluted income (loss) per share	\$ (0.03)	\$ 0.18	\$ (0.02)	\$ (0.34)

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

Business Overview

Our products and services are primarily focused on development and operation of transportation, processing, distribution and storage projects of natural gas and natural gas liquids in the northeastern states of Mexico (Coahuila, Nuevo Leon and Tamaulipas) and the states of Texas and California in the United States of America.

We derive our revenue from transportation fees from delivery of natural gas to Conagas, the local distribution company in Piedras Negras, Coahuila, through the pipeline owned by Reef Ventures, L.P. and the sale of propane gas to residential customers through the assets owned by Sonterra Energy Corporation. Sonterra also designs and constructs residential propane delivery systems for new residential developments in Central Texas. We derive revenue from this activity in two ways, the first being from construction revenue for yard lines and meter sets installed to a homeowner's lot, and the second being the sale of LPG gas to customers in the residential subdivisions. Sonterra Energy Corporation has recently begun performing construction services for third party utility companies in order to more efficiently utilize its existing competencies and assets.

With respect to our pipeline system owned by Reef Ventures, L.P., management has evaluated an expansion of the pipeline in Coahuila to serve new markets along the state highway No. 57 corridor to Monclova, Coahuila. We currently expect that Reef Ventures, L.P. will not be participating in the construction of additional pipelines in Mexico to reach these new markets. The required pipeline will be constructed by end users or an intermediate purchaser of the natural gas. If constructed, Reef Ventures, L.P. is expecting to simply continue to transport the additional volumes of natural gas required for these markets through its existing facilities which would be interconnected in Mexico to the new pipeline that is required to reach these potential markets. Management believes the timeline for the initiation of construction for such pipeline project in Mexico is likely to be a 2009 event with completion in 2010. The increased volume for the Reef Ventures pipeline from such an event could approximate 5 million cubic feet per day. The current baseload for the Conagas system in Piedras Negras is approximately 5.5 million cubic feet per day of which Reef Ventures LP transports 1/3 to 1/2 of the total volume. The expected end users for increased market demand in the Piedras Negras, Coahuila area would be a cardboard packaging and bottling operation for a proposed beer brewing facility. In December 2006, Grupo Modelo announced its intention to build the first phase of a new brewery in the year 2010. In addition to these potential developments, management believes that increasing volumes of natural gas can be transported in its existing facilities. In 2005, which was the final year of a two-year contractual nomination scheme, the Reef Ventures pipeline was carrying only half the actual baseload volume (and none of the swing volume) was being transported to CONAGAS in Piedras Negras. In 2006, management did not successfully increase the volumes transported on the natural gas line. We believe that if given adequate supplies, the Reef Ventures pipeline can transport all of the current base load and the swing requirements of CONAGAS which would result in a doubling of volumes and revenues for the pipeline. However the current dependence on volume increases in order to achieve the necessary rate of return on this investment has been unsuccessful. Accordingly, management has sought to increase revenues by imposing a minimum demand charge for the reservation of capacity on the pipeline. Negotiations are currently underway to achieve that objective. In the event these negotiations are unsuccessful, a sale of all or part of the Reef Ventures, LP pipeline will be considered in order to retire the current indebtedness of \$4,785,003 currently owed to Impact International, LLC. This debt matures at the end of May 2008 and is currently increasing each quarter due to negative amortization as a result of the poor revenue return from the current transportation fee arrangements.

Sonterra Energy Corporation, a wholly-owned subsidiary of Tidelands, entered into the residential propane distribution business on November 1, 2004 with its acquisition of 850 existing customers located in 15 subdivisions in the vicinity of Austin, Texas. At December 31, 2006, Sonterra had increased its number of meter hookups to 1,155 and is expecting a 15% rate of increase in the number of new meter hookups in 2007. There are approximately 1,095

unmetered future lots within the above subdivisions where propane service can be connected. As new homes are constructed on these lots our customer base will grow. Construction activities continue in the existing subdivisions where expansion phases of development will result in the addition of approximately 170 customers in 2007. Sonterra's participation in the launch of new subdivisions is also occurring, as exemplified by the signing of a construction contract with the developers of Las Brisas at Ensenada Shores (located on Canyon Lake), where 75 new lots with propane service have been completed for sale to new customers. This subdivision's second phase of development is expected to add another 175 lots. Construction continues on Section 205 of the Cordillera Ranch subdivision, which added 50 more residential customers in the fourth quarter of 2006. Sonterra has expanded into additional markets as evidenced by the signing of a construction contract to build a central propane system for a multi-use retail center in Lago Vista, Texas. The system will serve five to ten large commercial customers including two restaurants.

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Sonora Pipeline, LLC, will own and operate the U.S. (Texas) pipeline segments to be constructed in connection with the Burgos Hub pipeline, LNG regasification terminal and gas storage projects which will interconnect to the U.S. via two international pipeline crossings in Hidalgo County, Texas. Management has filed applications for a certificate of public convenience and necessity and two presidential permits for cross-border pipeline construction into Mexico with the Federal Energy Regulatory Commission. If the permits are granted and the pipelines are completed and fully operational, these international pipeline crossings near Mission and Progreso, Texas would result in the delivery of natural gas into the state of Tamaulipas and the pipelines owned by our Mexican subsidiary, Terranova Energia S. de R.L. de C.V.

The Company is focusing on the development of the Burgos Hub projects through its Mexican entity, Terranova Energia S. de R.L. de C.V., in Mexico. Terranova Energia is focused on project development and implementation of a natural gas storage and transportation infrastructure to support the integration of Northeastern Mexico and South Texas and the related economic growth of the border regions.

Tidelands and Terranova Energia have hired project development advisors in the United States and Mexico. The Terranova Energia advisors include Project Consulting Services, Inc., and Ritch Mueller, SC, Abogados. The Tidelands/Sonora advisors include Netherland Sewell & Associates, Mayer Brown Rowe & Maw, LLP, BNC Engineering, LLC, HSBC Securities, USA, Inc. and Ross, Marsh & Foster.

The Terranova Energia project was developed to serve the needs of CFE, the Mexican federal electricity commission, to manage swing and seasonal spread in its procurement and dispatch of natural gas to its combined cycle power plants in Northern Mexico. The region's forecasted growth will require additional natural gas for power generation in the region. The same need to manage swing and seasonal spread is present for the industrial users of natural gas in Northern Mexico, in particular, the industrial users located in the Monterrey, Nuevo Leon area.

Our various projects in South Texas and Northeast Mexico are collectively called the Burgos Hub Project. Our medium term goals, subject to a variety of factors, including, but not limited to, regulatory permitting, engineering design, financing, construction and operating agreements, are focused on the Brasil storage field and Terranova Occidente pipeline.

The pipelines proposed are (A) the Occidente Section comprised of: (1) a pipeline from the Brasil Storage field to Nuevo Progreso with a proposed international pipeline crossing into the U.S., (2) a pipeline from Brasil storage to Station 19 up to Arguelles which is another proposed international pipeline crossing into U.S. and (3) a pipeline from Pemex's Station 19 south of Reynosa which will extend southward to the Monterey Nuevo Leon area; and (B) the Oriente Section from the offshore regasification station to Norte Puerto Mezquital proceeding to the Brazil storage field. The Occidente Section will include approximately 323 kilometers of pipeline and the Oriente Section will contain approximately 149 kilometers of pipeline. Our long term goal includes the construction of the offshore LNG regasification station.

The proposed international pipeline crossings into South Texas will interconnect with other pipelines at the Donna Station and the Valero Gilmore Plant. At the Donna Station, our potential interconnects into Texas pipelines are with TETCO, TGPL and Texas Gas Services. At the Arguelles crossing and the Valero Gilmore Plant, our potential interconnects are with HPL, Calpine and Kinder Morgan. The Terranova pipeline capacity is estimated at 1.0 BCFD (billion cubic feet per day).

The Terranova pipelines have been designed for 30 and 36 inch diameter with bi-directional flow. The pipeline from the proposed LNG regasification terminal to the Brasil field is anticipated to be a 36 inch diameter pipeline and from the Brasil field to Monterey and international crossings are anticipated to be 30 inch diameter pipelines.

On June 5, 2006, Tidelands Oil & Gas Corporation subsidiary, Terranova Energia, S. de R.L. de C.V. was awarded a Permit (#G/183/TRA 2006) by the Comision Reguladora de Energia de Mexico (CRE) to begin construction of the Terranova Occidente and Oriente pipeline portions of its Burgos Hub Project. In the second quarter of 2007, Terranova expects to file an application with the CRE to amend its existing Mexican pipeline permit to allow for the construction of an additional segment of pipeline which will extend from Station 19 to Monterrey, Nuevo Leon. This filing is being pursued in response to commercial interest from industrial customers and potential service opportunity for the power generation facilities proposed by the Comision Federal de Electricidad (CFE) in northeast Mexico. Discussion with staff at the regulatory body, CRE, indicates a timeline for approval of the amended permit by the fourth quarter of 2007.

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The proposed underground natural gas storage facility will be located in the depleted reservoir at the B1 Horizon-Brasil Field and include above ground facilities. Our design proposal for the use of this depleted reservoir as a storage facility was prepared by Netherland Sewell. Netherland Sewell, after geological and mechanical modeling, reported the reservoir at the B1 horizon as suitable for natural gas storage. The design capacity of the storage field contemplates incremental increases in capacity over three seasons. The first season capacity is 25 BCF (billion cubic feet), second season capacity is 40 BCF and third season onward is 50 BCF. The design proposes that natural gas be injected into the reservoir at 350 MMCFD (million cubic feet per day) at pressures from 2,400 psi up to 3,200 psi. Extraction flows of natural gas will be kept at 500 MMCFD to maintain structural integrity of the reservoir. The storage facility plans call for 22 injection and extraction wells. The above ground facilities will include compression stations.

Additionally, we submitted the storage permit to the CRE on August 5, 2005 and it was accepted for full review on October 14, 2005. Several unique questions are presented by the filing of this permit due to the proposed location and the lack of previous storage permit applications having been considered by the CRE. The CRE, with cooperation from Terranova, is conducting discussions with PEMEX, the energy ministry of the United Mexican States (SENER) and the Mexican Petroleum Institute (MPI) to determine the mechanism for the grant of use rights for the depleted reservoir as a natural gas storage facility and the proper legal vesting of such rights with the holder of the CRE permit to construct own and operate a gas storage facility. Terranova expects that these issues regarding the Company's storage permit application will be resolved by the CRE Commissioners in the fourth quarter of 2007.

The proposed Offshore LNG Regasification Station will be based on technology developed by the Norwegian company TORP Technology. It utilizes an unmanned floating station called a HiLoad. It has a peak capacity of 1.4 BCFD (billion cubic feet per day). This technology permits any LNG carrier vessel to connect and carry out regasification operations without any vessel modifications. The LNG station will be located no less than 40 nautical miles from the coast at a depth of 450 feet. A support station with a power generation system and central control will be located on-shore. A buoy will support the mooring of the LNG carrier vessels. Electrical power cables, control umbilicals and pipelines will connect the HiLoad to the on-shore support station. We expect this phase of the project to be developed as the last phase of the project given the tightness of LNG supply in the Atlantic Basin for the next four years. A further influence on the timing and implementation of this phase of the project will be the degree of progress made in actual construction of permitted LNG receiving terminals in the Corpus Christi, Texas area.

There are significant challenges for the natural gas supply to the power generation industry in Northeastern Mexico. Presently, there are three LNG regasification projects permitted or under construction in Mexico at Altamira, Rosarito and Manzanillo. Additionally, there are new electrical generation plants and associated pipelines under construction. The CFE has forecasted natural gas demand growth in the region from 2004 through year 2013. The CFE forecasts gas demand will increase from 1.7 BCFD in 2004 to 4.2 BCFD in 2013. We believe that natural gas storage facilities in northern Mexico will provide a reliable, flexible gas supplies while creating conditions for competitive natural gas pricing.

With the assistance of our financial advisory firm, we have determined that financing of the project should be possible under a commercial structure acceptable to debt providers that would involve long-term capacity reservation agreements with creditworthy counterparties for each constituent element of the project. Another essential factor that is critical for the project's ability to raise debt financing is the ability of Terranova to attract equity capital from strategic and/or financial investors in the amounts which are likely to be required by debt providers. Our financial advisory firm continues to assist us in making presentations of the project to the potential strategic and financial equity investors. We have received positive feedback from several such parties and active negotiations are continuing under confidentiality agreements with several firms, including energy enterprises headquartered in Mexico. On this basis, we could conclude that the project, in its currently envisioned configuration, could attract considerable equity capital from the potential investors. Investor appetite will depend on our ability to obtain an acceptable commercial

structure, relevant permits and other regulatory approvals and the fulfillment of other conditions standard for non-recourse project financing. We believe that in 2007 the Company will bring to completion our efforts to obtain the required major permit approvals and the co-investment in the project of industry partners. Given the timeline necessary to obtain debt financing, execute an EPC contract, and the actual construction time for the first phase of the project (the pipeline from South Texas to Monterrey, Nuevo Leon), we are projecting the first operating cash flows from our Burgos Hub Project to be received in the year 2010.

Esperanza Energy, LLC ("Esperanza") was formed as a wholly-owned subsidiary of the Company in March 2006 to evaluate the feasibility of developing an offshore, deep-water liquefied natural gas (LNG) receiving and regasification terminal near Long Beach, California. Esperanza would utilize TORP Technology's HiLoad LNG Regas unit that attaches to an LNG tanker, directly vaporizes the LNG as it is offloaded and injects the regasified natural gas into an undersea pipeline for transportation of the natural gas to onshore metering stations and transmission pipelines to supply nearby gas markets. The TORP HiLoad LNG Regas unit eliminates the need for extensive above-ground storage tanks or large marine structures required for berthing and processing of the LNG. Esperanza has conducted its feasibility study for this project with the assistance of best-in-class LNG, environmental, pipeline and legal advisors and has concluded that the project is technically, environmentally and commercially feasible. Esperanza will develop the necessary information in 2007 to file applications with California state and U.S. Federal agencies for appropriate permits to construct, own and operate the LNG facilities.

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The expected timeline for development of the Port Esperanza project is influenced by the preparation of the application in a form sufficient to be “deemed complete” by the Maritime Administration and Coast Guard which are the principal Federal agencies with permit jurisdiction for LNG terminal development in the offshore United States of America waters. After an application is deemed complete, the process of obtaining the approvals is often longer than the statutory time period of approximately one year due to “time out” or suspension of the running of the clock on the application process due to issues raised during the review of the permit application. California state and local agency approvals can also impact the permit approval process beyond the normal time expectations. The focus of the Port Esperanza project team has been to design a project that has anticipated and mitigated these risks during its design phase. We have assembled best-in-class team members with previous offshore LNG terminal development experience with a view of profiting from their experience in dealing with the various issues raised in the development of an LNG receiving facility in California. Nevertheless, in view of the relative shortage of LNG supply in the Pacific Basin through the year 2011, we anticipate that the first operational cash flows from the Port Esperanza project would occur in the year 2012. The projected capital expenditures for the project are significant and depending on the final configuration may cost as much as \$1 billion USD with the cost of the permitting process for the USCG/MARAD permit estimated in excess of \$20 million USD. It is expected that a major portion of the initial development cost and the required equity in the project will be obtained from co-venturers. Active discussions are underway with several potential partners who would invest in the project. An announcement concerning partners is expected by the end of the second quarter 2007, to be followed by the initiation of the process of developing the application for the USCG/MARAD permit which is estimated to require a six month timeline prior to submission of the application.

Given the large capital outlays required for development of the Burgos Hub Project and Port Esperanza, it is likely that the Company will be diluted with respect to the project level cash flows by virtue of the sale of interests in the projects to third party partners. Similarly, the Company as an integrated enterprise continues to experience negative cash flows and will require sequential rounds of deficit fundings which will likely result in further dilution to the Company shareholders. The Board of Directors is considering all options for dealing with these issues including the merger or acquisition of profitable and complementary business operations with a view towards eliminating Company operating deficits and efficient utilization of tax loss carryforwards.

Results of Operations

YEAR ENDED DECEMBER 31, 2006 COMPARED WITH YEAR ENDED DECEMBER 31, 2005

REVENUES: The Company reported revenues of \$2,222,598 for the twelve months ended December 31, 2006, as compared with revenues from continuing operations of \$1,861,323 for the twelve months ended December 31, 2005. The increase was divided between each revenue stream: Reef Ventures, LP, increased income from gas transportation fees from \$231,077 for the twelve months ended December 31, 2005, to \$285,098 for the twelve months ended December 31, 2006, an increase of \$54,021; Sonterra Energy Corporation increased propane gas sales to \$1,740,870 for the twelve months ended December 31, 2006, from \$1,494,679 for the twelve months ended December 31, 2005, an increase of \$246,191 due mainly to an increase in total customers served and product prices. Construction service revenues for Sonterra Energy Corporation increased to \$180,693 for the twelve months ended December 31, 2006 compared to \$135,567 for the twelve months ended December 31, 2005, an increase of \$45,126. Tidelands Exploration & Production Corporation had \$15,737 of natural gas revenues for its first quarter of operations.

TOTAL COSTS AND EXPENSES: Total costs and expenses from continuing operations decreased from \$15,171,916 for the twelve months ended December 31, 2005, to \$14,162,432 for the twelve months ended December 31, 2006. The most significant decreases occurred in Sales, General and Administrative and Impairment Losses, which decreases more than offset increased interest expense due to default costs incurred with a private placement of convertible debt (See Note 16 of Audited Financial Statements) whereas a reserve for litigation of \$2,250,000 was

recorded which reduced the decrease of expenses to \$1,009,484.

COST OF SALES: Total Cost of Sales increased from \$1,003,386 for the twelve months ended December 31, 2005, to \$1,173,561 for the twelve months ended December 31, 2006, an increase of \$170,175, of which \$164,216 was attributable to Sonterra Energy Corporation. This increase resulted from increased cost and volume of propane sold and, to a lesser extent, increased construction services.

OPERATING EXPENSES: Operating expenses from continuing operations which are expenses related to the operation of Company assets in an active business segment increased from \$202,766 for the twelve months ended December 31, 2005, to \$420,200 for the twelve months ended December 31, 2006, an increase of \$217,434; \$165,215 of this increase was from the operating expenses incurred by Sonterra Energy Corporation due to increased revenues. Depreciation expense decreased from \$485,481 for the twelve months ended December 31, 2005, to \$466,241 for the twelve months ended December 31, 2006, reflecting a decrease in depreciable assets for the respective periods due to impairment of certain long-lived assets in 2005.

INTEREST EXPENSE: Interest expense increased from \$611,363 for the twelve months ended December 31, 2005, to \$3,405,778 for the twelve months ended December 31, 2006, primarily as a result of three factors: (a) interest penalties in the amount of \$1,696,982 in connection with the payment of stock to the various investors upon the defaults described in Notes 16 of the Audited Financial Statements, (b) liquidated damage payments in the amount of \$478,155 paid in cash to the various investors as described in Note 16 of the Financial Statements, and (c) interest paid in connection with the convertible debenture financing as described in Note 16 of the Audited Financial Statements, in the amount of \$763,499 during the twelve-month period ended December 31, 2006. No income or expense for Beneficial Conversion Feature Interest was recorded for the twelve months ended December 31, 2006, as compared to income of \$756,339 for the twelve months ended December 31, 2005, due to a reversal of previously charged Beneficial Conversion Feature Interest. The market price for the Company's common stock at the relevant measurement dates during the twelve months ended December 31, 2006, was less than the conversion price for the e="vertical-align:bottom;background-color:#cceeef;padding-left:2px;padding-top:2px;padding-bottom:2px;">9,232

Denominator effect of dilutive securities

Stock options and restricted stock units

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—

—

Warrant

—

—

—

—

Diluted potential common shares

—

—

—

—

Weighted average shares outstanding – diluted
9,404

9,241

9,335

9,232

Net loss per share – diluted

\$
(0.25
)

\$
(0.27
)

\$
(0.91
)

\$
(1.18
)

Stock options, warrant and restricted stock units to acquire common shares excluded from the computation of diluted weighted-average common shares as their effect is anti-dilutive were as follows (in thousands):

	Three Months Ended September 30, 2017		Nine Months Ended September 30, 2016	
Stock options	1,540	1,312	1,544	1,418
Warrant	314	—	314	—
Restricted stock units	150	120	135	81
Total anti-dilutive	2,004	1,432	1,993	1,499

(8) Investment in Software Company

As of September 30, 2017 and December 31, 2016, the Company held an investment totaling \$3.1 million in convertible preferred stock of BriefCam, Ltd. ("BriefCam"), a privately-held Israeli company that develops video synopsis technology to augment security and surveillance systems to facilitate review of surveillance video. The investment is included in other non-current assets. Because Qumu's ownership interest is less than 20% and it has no other rights or privileges that enable it to exercise significant influence over the operating and financial policies of BriefCam, Qumu accounts for this equity investment using the cost method. Equity securities accounted for under the cost method are reviewed quarterly for changes in circumstances or the occurrence of events that suggest the Company's investment may not be fully recoverable. If an unrealized loss for the investment is considered to be other-than-temporary, the loss will be recognized in the consolidated statements of operations in the period the determination is made. Qumu monitors BriefCam's results of operations, business plan and capital raising activities and is not aware of any events or circumstances that would indicate a decline in the fair value below the

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carrying value of its investment. Qumu has determined that estimating the fair value of BriefCam on a periodic basis is impracticable due to the infrequency of transactions in BriefCam's equity and the cost of obtaining an independent valuation appears excessive considering the materiality of the investment.

(9) Recently Issued Accounting Standards

In January 2017, the FASB issued ASU 2017-04, Intangibles – Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment. The purpose of the amendment is to simplify how an entity is required to test goodwill for impairment by eliminating Step 2 from the goodwill impairment test. Step 2 measures a goodwill impairment loss by comparing the implied fair value of a reporting unit's goodwill with the carrying amount of that goodwill. This standard is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. The Company is currently evaluating the impact of adopting this standard, which could be material to its consolidated financial statements.

In March 2016, the FASB issued ASU 2016-09, Compensation - Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting, which simplifies the income tax consequences, accounting for forfeitures and classification on the statements of consolidated cash flows. This standard is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2016, with early adoption permitted. The Company adopted ASU 2016-09 effective January 1, 2017 and elected to account for forfeitures of share-based payment awards as they occur. The adoption did not have a material impact to the consolidated financial statements and related disclosures.

In February 2016, the FASB issued ASU 2016-02, Leases, which will supersede the existing lease guidance and will require all leases with a term greater than 12 months to be recognized in the statements of financial position and eliminate current real estate-specific lease guidance, while maintaining substantially similar classification criteria for distinguishing between finance leases and operating leases. This standard is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018, with early adoption permitted. The Company is currently evaluating the impact on its consolidated financial statements of adopting this standard, which will require right-of-use assets and lease liabilities be recorded in the consolidated balance sheet for operating leases.

In January 2016, the FASB issued ASU 2016-01, Financial Instruments - Overall, which requires entities to measure equity instruments at fair value and recognize any changes in fair value in net income (loss). Entities may estimate the fair value of certain equity securities that do not have readily determinable fair value or may choose a practical expedient. If the practical expedient is elected, these investments would be recorded at cost, less any impairment, plus or minus changes resulting from observable price changes in orderly transactions for the identical or a similar investment of the same issuer. The guidance also updates certain presentation and disclosure requirements. This standard is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2017. The Company is currently evaluating the impact of adopting this standard, which could be material to its consolidated financial statements.

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers, which requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. The ASU will replace most existing revenue recognition guidance in U.S. GAAP when it becomes effective. In July 2015, the FASB voted to amend ASU 2014-09 by approving a one-year deferral of the effective date as well as providing the option to early adopt the standard on the original effective date. The FASB has issued several additional ASUs since this time that add additional clarification. The new standard is effective for the Company on January 1, 2018.

The new revenue standard may be applied using either of the following transition methods: a full retrospective approach reflecting the application of the standard in each prior reporting period with the option to elect certain practical expedients, or a modified retrospective approach with the cumulative effect of initially adopting the standard recognized at the date of adoption (which includes additional footnote disclosures). The Company will adopt the standard in the first quarter of 2018 using the modified retrospective method. The cumulative catch-up adjustment that would be recorded through stockholders' equity on January 1, 2018 is still being quantified. The Company will continue evaluating the impact of the standard on its contract portfolio through the date of adoption.

Currently, the Company has a project team and is in the process of reviewing its historical contracts to quantify the impact that the adoption of the standard will have on specific performance obligations. The Company is also continuing to evaluate the impact of the standard on its recognition of costs related to obtaining customer contracts (namely, sales commissions). While the Company continues to assess all potential impacts of this new standard, it currently believes the most significant impacts relate to the timing of revenue recognition of subscription, or term-based, software license arrangements. Specifically, under the new standard:

Software revenue associated with non-cancellable subscription, or term-based, software license arrangements will generally be recognized upon delivery of the license. Historically, these arrangements have been material, and the Company currently recognizes this revenue ratably over the term of the software license; and

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• The Company expects that the accounting for software revenue derived from perpetual-based licensing arrangements and associated services revenues will not be materially impacted.

The Company is in the process of implementing and testing enhanced revenue accounting and reporting functionality within its enterprise resource planning ("ERP") system and expects such functionality to be available for use upon adoption. The implementation of this ERP functionality and new accounting processes resulting from the adoption of the standard will change the Company's internal controls over revenue recognition, contract acquisition costs and financial reporting. The Company is designing and implementing these controls in anticipation adopting the new standard January 1, 2018.

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

The following discussion and analysis of our financial condition and results of operations should be read together with the section titled "Financial Information" and our audited financial statements and related notes which are included in our most recent Annual Report on Form 10-K. Our actual results could differ materially from those anticipated in the forward-looking statements included in this discussion as a result of certain factors, including, but not limited to, those discussed in "Risk Factors" included our most recent Annual Report on Form 10-K.

Overview

Qumu Corporation ("Qumu" or the "Company") provides the software applications businesses use to create, manage, secure, deliver and measure the success of their videos. The Company's innovative solutions release the power in video to engage and empower employees, partners and clients, allowing organizations around the world to realize the greatest possible value from video they create and publish. Whatever the audience size, viewer device or network configuration, the Company's solutions are how business does video.

The Company generates revenue through the sale of enterprise video content management software solutions, hardware, maintenance and support, and professional and other services. Software sales may take the form of a perpetual software license, a term software license or a cloud-hosted software as a service (SaaS). Software licenses and appliances revenue includes sales of perpetual software licenses and hardware. Service revenue includes term software licenses, SaaS, maintenance and support, and professional and other services.

For the nine months ended September 30, 2017 and 2016, the Company generated revenues of \$20.9 million and \$22.4 million, respectively. For the years ended December 31, 2016, 2015 and 2014, the Company generated revenues of \$31.7 million, \$34.5 million and \$26.5 million, respectively.

Critical Accounting Policies

The discussion of the Company's financial condition and results of operations is based upon its financial statements, which are prepared in accordance with accounting principles generally accepted in the United States of America, or GAAP. The preparation of the Company's financial statements requires management to make estimates, judgments and assumptions that affect the reported amounts of assets, liabilities, revenues, costs and expenses and related disclosures. On an ongoing basis, management evaluates its estimates and assumptions. Management bases its estimates of the carrying value of certain assets and liabilities on historical experience and on various other assumptions that management believes to be reasonable. The Company's actual results may differ from these estimates under different assumptions or conditions.

Management utilizes its technical knowledge, cumulative business experience, judgment and other factors in the selection and application of the Company's accounting policies. The accounting policies considered by management to be the most critical to the presentation of the condensed consolidated financial statements because they require the most difficult, subjective and complex judgments include revenue recognition, impairment of long-lived assets and goodwill, investment in nonconsolidated company, derivative liability for outstanding warrant, stock-based compensation, royalties for third party technology, and deferred tax asset valuation allowances. These accounting policies are discussed in Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations" of the Company's Annual Report on Form 10-K for the year ended December 31, 2016.

Management made no significant changes to the Company's critical accounting policies during the nine months ended September 30, 2017.

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Results of Operations

The percentage relationships to revenues of certain income and expense items for the three and nine months ended September 30, 2017 and 2016, and the percentage changes in these income and expense items relative to prior year periods, are contained in the following table:

	Three Months Ended September 30,			Nine Months Ended September 30,		
	Percentage of Revenues		Percent Increase (Decrease)	Percentage of Revenues		Percent Increase (Decrease)
	2017	2016	2016 to 2017	2017	2016	2016 to 2017
Revenues	100.0 %	100.0 %	7 %	100.0 %	100.0 %	(6) %
Cost of revenues	(38.4)	(40.2)	2	(37.2)	(43.1)	(19)
Gross profit	61.6	59.8	10	62.8	56.9	3
Operating expenses:						
Research and development	23.4	27.9	(11)	27.1	30.2	(16)
Sales and marketing	33.1	34.2	3	35.7	40.0	(16)
General and administrative	27.5	29.7	(1)	31.3	32.8	(11)
Amortization of purchased intangibles	3.0	3.1	2	3.2	3.0	—
Total operating expenses	87.0	94.9	(2)	97.3	106.0	(14)
Operating loss	(25.4)	(35.1)	(23)	(34.5)	(49.1)	(34)
Other expense, net	(6.5)	(0.4)	n/m	(6.7)	(0.3)	n/m
Loss before income taxes	(31.9)	(35.5)	(4)	(41.2)	(49.4)	(22)
Income tax benefit	(1.4)	(0.5)	182	(0.7)	(0.6)	5
Net loss	(30.5)%	(35.0)%	(7)%	(40.5)%	(48.8)%	(22)%

n/m = not meaningful

Revenues

The Company generates revenue through the sale of enterprise video content management software solutions, appliances, maintenance and support, and professional and other services. Software sales may take the form of a perpetual software license, a term software license or a cloud-hosted software as a service (SaaS). Software licenses and appliances revenue includes sales of perpetual software licenses and hardware. Service revenue includes term software licenses, SaaS, maintenance and support, and professional and other services.

The table below describes Qumu's revenues by product category (dollars in thousands):

	Three Months Ended September 30,				Nine Months Ended September 30,			
			Increase (Decrease)	Percent Increase (Decrease)			Increase (Decrease)	Percent Increase (Decrease)
	2017	2016	2016 to 2017	2016 to 2017	2017	2016	2016 to 2017	2016 to 2017
Software licenses and appliances	\$1,822	\$1,154	\$ 668	58 %	\$3,971	\$3,952	\$ 19	— %
Service								
Subscription, maintenance and support	5,113	4,986	127	3	15,061	15,223	(162)	(1)
Professional services and other	638	970	(332)	(34)	1,906	3,186	(1,280)	(40)
Total service	5,751	5,956	(205)	(3)	16,967	18,409	(1,442)	(8)
Total revenues	\$7,573	\$7,110	\$ 463	7 %	\$20,938	\$22,361	\$ (1,423)	(6)%

Revenues can vary period to period based on the type and size of contract the Company enters into with each customer. Contracts for perpetual software licenses, which are included in software licenses and appliances revenues,

generally result in revenue recognized closer to the contract commitment date, while contracts for term software licenses and SaaS, which are included in service revenues, result in most of the revenue being recognized over the period of the contract.

The increases in software licenses and appliances revenues in the three and nine months ended September 30, 2017 compared to the same periods in 2016 were driven by increases in perpetual software license and appliance sales.

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The increase in subscription, maintenance and support revenues in the three months ended September 30, 2017 compared to the corresponding 2016 period primary resulted from increased subscription sales during prior twelve months. The decrease in subscription, maintenance and support revenues in the nine months ended September 30, 2017 compared to the corresponding 2016 period was primary due to the inclusion of approximately \$700,000 of revenue in the 2016 period relating to customer acceptance and contract buyouts.

Professional services revenues, which generally move directionally with changes in perpetual license sales, decreased in the three and nine months ended September 30, 2017 compared to the corresponding 2016 periods due primarily to a decrease in the value of perpetual software and appliance sales entered into during the immediately preceding quarters as well as the timing of delivery of professional services. Additionally, the decreases in professional services revenues in the three and nine months ended September 30, 2017 compared to the corresponding 2016 periods aligned with fewer professional services personnel and with an increase in sales of third-party extensions, which require less professional services, over the same periods.

Future consolidated revenues will be dependent upon many factors, including the rate of adoption of the Company's software solutions in its targeted markets and whether arrangements with customers are structured as a perpetual software license, a term software license or a SaaS, which impacts the timing of revenue recognition. Other factors that will influence future consolidated revenues include the timing of customer orders, the product and service mix of customer orders, the impact of changes in economic conditions and the impact of foreign currency exchange rate fluctuations.

Cost of Revenues and Gross Profit

A comparison of gross profit and gross margin by revenue category is as follows (dollars in thousands):

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2017	2016	Increase (Decrease) 2016 to 2017	Percent Increase (Decrease) 2016 to 2017	2017	2016	Increase (Decrease) 2016 to 2017	Percent Increase (Decrease) 2016 to 2017
Gross profit:								
Software licenses and appliances	\$ 906	\$ 591	\$ 315	53 %	\$ 2,193	\$ 2,020	\$ 173	9 %
Service	3,756	3,662	94	3	10,964	10,712	252	2
Total gross profit	\$ 4,662	\$ 4,253	\$ 409	10 %	\$ 13,157	\$ 12,732	\$ 425	3 %
Gross margin:								
Software licenses and appliances	49.7 %	51.2 %	(1.5)%		55.2 %	51.1 %	4.1 %	
Service	65.3 %	61.5 %	3.8 %		64.6 %	58.2 %	6.4 %	
Total gross margin	61.6 %	59.8 %	1.8 %		62.8 %	56.9 %	5.9 %	

Gross margins include \$302,000 and \$308,000 for the three months ended September 30, 2017 and 2016, respectively, and \$893,000 and \$953,000 for the nine months ended September 30, 2017 and 2016, respectively, for the amortization of intangible assets acquired as a result of the acquisition of Qumu, Inc. in the fourth quarter of 2011 and Kulu Valley in the fourth quarter of 2014. Cost of revenues for the full year 2017 is expected to include approximately \$1.2 million of amortization expense for purchased intangibles. The Company had 22 and 28 service personnel at September 30, 2017 and 2016, respectively.

The 1.8% and 5.9% improvement in total gross margin in the three and nine months ended September 30, 2017, respectively, compared to the corresponding 2016 periods, resulted from improvements in service gross margin for the three months ended September 30, 2017 and improvements in both software licenses and appliance gross margin and service gross margin for the nine months ended September 30, 2017. The 1.5% decrease in software licenses and appliance gross margin in the three months ended September 30, 2017 was due primarily to the increase in sales of third-party extensions which carry lower margins. The 4.1% improvement in software licenses and appliance gross

margin in the nine months ended September 30, 2017 was due primarily to a product mix which included less lower-margin hardware revenue. The 3.8% and 6.4% improvement in service gross margin in the three and nine months ended September 30, 2017, respectively, was primarily driven by a reduction in headcount. The Company incurred no severance expense for either of the three-month periods ended September 30, 2017 and 2016, and incurred \$4,000 and \$116,000 of severance expense for the nine months ended September 30, 2017 and 2016, respectively. Future gross profit margins will fluctuate quarter to quarter and will be impacted by the rate of growth and mix of the Company's product and service offerings and foreign currency exchange rate fluctuations.

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Operating Expenses

The following is a summary of operating expenses (dollars in thousands):

	Three Months Ended September 30,				Nine Months Ended September 30,			
			Increase (Decrease)	Percent Increase (Decrease)			Increase (Decrease)	Percent Increase (Decrease)
	2017	2016	2016 to 2017	2016 to 2017	2017	2016	2016 to 2017	2016 to 2017
Operating expenses:								
Research and development	\$1,769	\$1,986	\$ (217)	(11)%	\$5,676	\$6,746	\$ (1,070)	(16)%
Sales and marketing	2,509	2,435	74	3	7,484	8,945	(1,461)	(16)
General and administrative	2,083	2,109	(26)	(1)	6,552	7,344	(792)	(11)
Amortization of purchased intangibles	226	221	5	2	675	674	1	—
Total operating expenses	\$6,587	\$6,751	\$ (164)	(2)%	\$20,387	\$23,709	\$ (3,322)	(14)%

Operating expenses for the three and nine months ended September 30, 2017 compared to the corresponding 2016 periods reflected continued improvement in the Company's operational efficiency. The Company had 98 and 124 personnel in operating activities at September 30, 2017 and 2016, respectively. The Company incurred severance expense relating to cost reduction initiatives of \$4,000 and \$128,000 for the three months ended September 30, 2017 and 2016, respectively, and \$123,000 and \$447,000 for the nine months ended September 30, 2017 and 2016, respectively.

Research and development

Research and development expenses were as follows (dollars in thousands):

	Three Months Ended September 30,				Nine Months Ended September 30,			
			Increase (Decrease)	Percent Increase (Decrease)			Increase (Decrease)	Percent Increase (Decrease)
	2017	2016	2016 to 2017	2016 to 2017	2017	2016	2016 to 2017	2016 to 2017
Compensation and employee-related	\$1,311	\$1,512	\$ (201)	(13)%	\$4,297	\$4,804	\$ (507)	(11)%
Overhead and other expenses	249	271	(22)	(8)	813	981	(168)	(17)
Outside services and consulting	154	103	51	50	345	645	(300)	(47)
Depreciation and amortization	32	51	(19)	(37)	106	165	(59)	(36)
Equity-based compensation	23	49	(26)	(53)	115	151	(36)	(24)
Total research and development expenses	\$1,769	\$1,986	\$ (217)	(11)%	\$5,676	\$6,746	\$ (1,070)	(16)%

Total research and development expenses as a percent of revenues were 23% and 28% for the three months ended September 30, 2017 and 2016, respectively, and 27% and 30% for the nine months ended September 30, 2017 and 2016, respectively. The Company had 40 and 63 research and development personnel at September 30, 2017 and 2016, respectively, which reflects a planned personnel reduction at the Company's software development and testing facility in Hyderabad, India in the nine months ended September 30, 2017.

The decreases in expenses were driven primarily by lower employee costs, due to fewer research and development personnel, and continued improvement in the Company's operational efficiency in the three and nine months ended September 30, 2017 compared to the corresponding 2016 periods, as well as by decreased utilization of outside service providers and consultants and in the nine months ended September 30, 2017 compared to the corresponding 2016 period.

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Sales and marketing

Sales and marketing expenses were as follows (dollars in thousands):

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2017	2016	Increase (Decrease) 2016 to 2017	Percent Increase (Decrease) 2016 to 2017	2017	2016	Increase (Decrease) 2016 to 2017	Percent Increase (Decrease) 2016 to 2017
Compensation and employee-related	\$1,959	\$1,869	\$ 90	5 %	\$5,818	\$7,100	\$ (1,282)	(18)%
Overhead and other expenses	260	264	(4)	(2)	788	924	(136)	(15)
Outside services and consulting	212	285	(73)	(26)	660	675	(15)	(2)
Depreciation and amortization	14	32	(18)	(56)	48	98	(50)	(51)
Equity-based compensation	64	(15)	79	(527)	170	148	22	15
Total sales and marketing expenses	\$2,509	\$2,435	\$ 74	3 %	\$7,484	\$8,945	\$ (1,461)	(16)%

Total sales and marketing expenses as a percent of revenues were 33% and 34% for the three months ended September 30, 2017 and 2016, respectively, and 36% and 40% for the nine months ended September 30, 2017 and 2016, respectively. The Company had 37 and 36 sales and marketing personnel at September 30, 2017 and 2016, respectively.

The increase in the expenses in the three months ended September 30, 2017 compared to the corresponding 2016 period was primarily due to higher employee costs resulting from sales and marketing personnel changes, including an increase in headcount, and higher commission expense, partially offset by a decrease in severance expense.

The decrease in expenses in the nine months ended September 30, 2017 compared to the corresponding 2016 period was primarily driven by lower employee costs due to a decrease in the average number of sales and marketing personnel during the 2017 period. The Company incurred no sales and marketing severance expense for the three months ended September 30, 2017 and \$128,000 for the corresponding 2016 period, and \$101,000 and \$356,000 for the nine months ended September 30, 2017 and 2016, respectively.

General and administrative

General and administrative expenses were as follows (dollars in thousands):

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2017	2016	Increase (Decrease) 2016 to 2017	Percent Increase (Decrease) 2016 to 2017	2017	2016	Increase (Decrease) 2016 to 2017	Percent Increase (Decrease) 2016 to 2017
Compensation and employee-related	\$842	\$884	\$ (42)	(5)%	\$2,711	\$2,993	\$ (282)	(9)%
Overhead and other expenses	321	359	(38)	(11)	898	1,145	(247)	(22)
Outside services and consulting	516	426	90	21	1,605	1,927	(322)	(17)
Depreciation and amortization	181	188	(7)	(4)	562	570	(8)	(1)
Equity-based compensation	223	252	(29)	(12)	776	709	67	9
Total general and administrative expenses	\$2,083	\$2,109	\$ (26)	(1)%	\$6,552	\$7,344	\$ (792)	(11)%

Total general and administrative expenses as a percent of revenues were 28% and 30% for the three months ended September 30, 2017 and 2016, respectively, and 31% and 33% for the nine months ended September 30, 2017 and 2016, respectively. The Company had 21 and 25 general and administrative personnel at September 30, 2017 and 2016, respectively.

The decreases in expenses compared to the corresponding 2016 periods were driven primarily by continued improvement in the Company's operational efficiency, as well as by lower employee costs due to fewer general and administrative personnel in the three and nine months ended September 30, 2017, and by decreased utilization of

outside service providers and consultants in the nine months ended September 30, 2017.

Amortization of Purchased Intangibles

Operating expenses include \$226,000 and \$221,000 for the three months ended September 30, 2017 and 2016, respectively, and \$675,000 and \$674,000 for the nine months ended September 30, 2017 and 2016, respectively, for the amortization of

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intangible assets acquired as part of the Company's acquisition of Qumu, Inc. in October 2011 and Kulu Valley in October 2014. Operating expenses for the full year 2017 are expected to include approximately \$0.9 million of amortization expense associated with purchased intangibles, exclusive of the portion classified in cost of revenue.

Other Income (Expense), Net

The Company recognized interest expense on its term loan and capital leases of \$343,000 and \$994,000 for the three and nine months ended September 30, 2017 and interest expense on its capital leases of \$13,000 and \$40,000 for the three and nine months ended September 30, 2016.

During the three and nine months ended September 30, 2017, the Company recorded non-cash income of \$15,000 and a non-cash loss of \$52,000, respectively, from the change in fair value of the warrant liability. The decrease in fair value of the warrant liability during the three months ended September 30, 2017 was primarily driven by decreased volatility in the Company's stock price, and the increase in fair value of the warrant liability during the nine months ended September 30, 2017 was primarily driven by an increase in the Company's stock price.

Other expense, net, included net losses on foreign currency transactions of \$166,000 and \$2,000 for the three months ended September 30, 2017 and 2016, respectively, and \$342,000 and \$13,000 for the nine months ended September 30, 2017 and 2016, respectively. See "Liquidity and Capital Resources" below for a discussion of changes in cash levels.

Income Taxes

The provision for income taxes represents federal, state, and foreign income taxes or income tax benefit on income or loss. Net income tax benefit amounted to \$110,000 and \$39,000 for the three months ended September 30, 2017 and 2016, respectively, and \$139,000 and \$133,000 for the nine months ended September 30, 2017 and 2016, respectively. The income tax benefit for the three and nine months ended September 30, 2017 and 2016 is primarily attributable to United Kingdom operations, which include refundable research credits.

Liquidity and Capital Resources

The following table sets forth certain relevant measures of the Company's liquidity and capital resources (in thousands):

	September 30, December 31,	
	2017	2016
Cash and cash equivalents	\$ 7,738	\$ 10,364
Working capital	\$ 485	\$ 5,215
Financing obligations	\$ 297	\$ 678
Term loan	6,856	6,617
Financing obligations and term loan	\$ 7,153	\$ 7,295

The Company has continued to experience recurring operating losses and negative cash flows from operating activities. The ability of the Company to continue as a going concern is dependent upon the Company maintaining compliance with its term loan covenants. If an event of default occurs due to the Company not maintaining compliance with its covenants, the lender may accelerate the repayment of outstanding principal, which could negatively impact the Company's ability to fund its working capital requirements, capital expenditures and general corporate expenses. Subsequent to the quarter ended September 30, 2017, the Company was unable to project, with reasonable certainty, future compliance with certain covenants related to minimum cash and eligible accounts receivable requirements. As a result, on November 6, 2017, the Company amended its credit agreement to significantly reduce the impact of a provision which disallowed from the computation of eligible accounts receivable certain amounts and to decrease the minimum ratio of eligible accounts receivable and cash to outstanding obligations. The amendment also included changes to other covenants, a summary of which is included in Note 3, "Commitments and Contingencies," of the accompanying condensed consolidated financial statements. The Company is projecting future compliance with the amended covenants under its current operating plan.

The Company expects it will be able to maintain current operations and anticipated capital expenditure requirements for at least the next 12 months through its cash reserves as well as any cash flows that may be generated from current operations. If the Company is unable to meet its revenue growth expectations, it is positioned to further reduce costs to mitigate the impact on its cash reserves for at least the next 12 months. Additionally, the Company continues to

manage its working capital to maintain compliance with its debt covenants. At September 30, 2017, the Company had aggregate working capital of \$0.5 million, compared to working capital of \$5.2 million at December 31, 2016. Working capital includes current deferred revenue of \$9.4 million and \$9.0 million at September 30, 2017 and December 31, 2016, respectively. The primary contributors to the change in working capital were the decrease in cash and cash equivalents by \$2.6 million and the decreased sales volume during the three

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months ended September 30, 2017 compared to the three months ended December 31, 2016, which negatively impacted accounts receivable by \$1.1 million.

Financing obligations consist of capital leases related to the acquisition of computer and network equipment and furniture and other financing obligations. The term loan consists of a three-year note having a face value of \$8.0 million and requiring a payment of \$3.0 million (which is inclusive of a 10% prepayment fee) on May 7, 2018, with the remaining principal balance scheduled to mature on October 21, 2019. The term loan requires payment of interest monthly at the prime rate plus 6.0%. As of September 30, 2017, interest was payable at 10.25%.

The Company's primary source of cash from operating activities has been cash collections from sales of products and services to customers. The Company expects cash inflows from operating activities to be affected by increases or decreases in sales and timing of collections. The Company's primary use of cash for operating activities has been for personnel costs, payment of royalties associated with third-party software licenses and purchases of equipment to fulfill customer orders. The Company expects cash flows from operating activities to be affected by fluctuations in revenues, personnel costs and the amount and timing of royalty payments and equipment purchases as the Company continues to support the growth of the business. The amount of cash and cash equivalents held by the Company's international subsidiaries that is not available to fund domestic operations unless repatriated was \$726,000 as of September 30, 2017. During the nine months ended September 30, 2017, the Company repatriated a net \$1.7 million from its international subsidiaries. The repatriation of cash and cash equivalents held by the Company's international subsidiaries would not result in an adverse tax impact on cash due to the Company's net operating loss position with respect to income taxes.

Summary of Cash Flows. A summary of cash flows is as follows (in thousands):

	Nine Months Ended September 30, 2017 2016	
Cash flows provided by (used in):		
Operating activities	\$(2,186)	\$(8,105)
Investing activities	(22)	6,198
Financing activities	(519)	(404)
Effect of exchange rate changes on cash	101	(120)
Net change in cash and cash equivalents	\$(2,626)	\$(2,431)
Net change in marketable securities	\$—	\$(6,249)

Operating activities

Net cash used in operating activities was \$2.2 million for the nine months ended September 30, 2017 compared to \$8.1 million for the corresponding 2016 period. The operating cash flows for the 2017 period was favorably impacted by changes in receivables. The change in operating cash flows period over period was favorably impacted by the decrease in the net loss and the changes in deferred revenue, prepaid expenses and other assets, accounts payable and other accrued liabilities, and accrued compensation, partially offset by the change in receivables.

Investing activities

Net cash used in investing activities totaled \$22,000 for the nine months ended September 30, 2017 compared to net cash provided by investing activities of \$6.2 million in the corresponding 2016 period. The \$6.2 million cash provided by investing activities in 2016 resulted from maturities of marketable securities of \$6.3 million, partially offset by purchases of property and equipment of \$52,000.

Financing activities

Financing activities used net cash of \$519,000 for the nine months ended September 30, 2017 and \$404,000 in the comparable 2016 period. Primarily impacting the current period use of cash were principal payments on capital leases and other financing obligations of \$383,000 and the payment of a term loan amendment fee of \$125,000 classified as debt issuance costs.

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In October 2010, the Company's Board of Directors approved a common stock repurchase program of up to 3,500,000 shares. Shares may be purchased at prevailing market prices in the open market or in private transactions, subject to market conditions, share price, trading volume and other factors. The repurchase program has been funded to date using cash on hand and may be discontinued at any time. The Company did not repurchase any shares of its common stock under the repurchase program during the nine months ended September 30, 2017 and 2016. As of September 30, 2017, the Company had 778,365 shares available for repurchase under the authorizations. While the current authorization remains in effect, the Company expects its primary use of cash will be to fund operations in support of the Company's goals for revenue growth and operating margin improvement. Under the credit agreement, the Company is prohibited from repurchasing or redeeming its stock, subject to certain exceptions relating to the exercise or vesting of equity awards.

The Company did not declare or pay any dividends during the nine months ended September 30, 2017 and 2016. Under the credit agreement, the Company is prohibited from declaring or paying any dividends.

Cautionary Note Regarding Forward-Looking Statements

This report contains forward-looking statements that involve risks and uncertainties. For this purpose, any statements contained in this report that are not statements of historical fact may be deemed to be forward-looking statements. Without limiting the foregoing, words such as "may," "will," "expect," "believe," "anticipate," "estimate" or "continue" or comparable terminology are intended to identify forward-looking statements. These statements by their nature involve substantial risks and uncertainties. The Company's actual results could differ significantly from those discussed in the forward-looking statements.

Factors that could cause or contribute to such differences include, but are not limited to, the following, as well as other factors not now identified: our dependence upon growth in the markets for video content and software to manage video content; our ability to compete effectively by improving existing products and introducing new products that achieve market acceptance; if we do not generate sufficient cash flow to fund our operations, our need for additional capital, which may not be available in the amount or at the time we need it or on acceptable terms, if at all; our limited operating history with our video content software management business, which may make evaluating our business and prospects difficult; the intense competition we face in all areas of our business, which may result in price reductions, lower gross profits and loss of market share; we encounter long sales cycles with our Qumu enterprise video solutions, which could adversely affect our operating results in a given period; adverse economic conditions, particularly those affecting our customers have harmed and may continue to harm our business; our sales will decline, and our business will be materially harmed, if our sales and marketing efforts are not effective; competition for highly skilled personnel is intense and if we fail to attract and retain talented employees, we may fail to compete effectively; our enterprise video content management software products must be successfully integrated into our customers' information technology environments and workflows and changes to these environments, workflows or unforeseen combinations of technologies may harm our customers' experience in using our software products; the growth and functionality of our enterprise video content management software products depend upon the solution's effective operation with mobile operating systems and computer networks; any failure of major elements of our products could lead to significant disruptions in the ability to serve customers, which could damage our reputation, reduce our revenues or otherwise harm our business; if we lose access to third-party licenses, our software product development and production may be delayed or we may incur additional expense to modify our products or products in development; if the limited amount of open source software that is incorporated into our products were to become unavailable or if we violate the terms of open source licenses, it could adversely affect sales of our products, which could disrupt our business and harm our financial results; we sell a significant portion of our products internationally, which exposes us to risks associated with international operations; if our domestic or international intellectual property rights are not adequately protected, others may offer products similar to ours or independently develop the same or similar technologies or otherwise obtain access to our technology and trade secrets which could depress our product selling prices and gross profit or result in loss of market share; changes in laws and regulations related to the internet or changes in the internet infrastructure itself may diminish the demand for our products, and could have a negative impact on our business; expanding laws, regulations and customer requirements relating to data security and privacy may adversely affect

sales of our products and result in increased compliance costs; a failure to maintain adequate internal control over financial reporting in accordance with Section 404 of the Sarbanes-Oxley Act of 2002 or to prevent or detect material misstatements in our annual or interim financial statements in the future could result in inaccurate financial reporting, or could otherwise harm our business; we may face circumstances in the future that could result in impairment charges, including, but not limited to, significant goodwill impairment charges; we may experience significant quarterly and annual fluctuations in our results of operations due to a number of factors and these fluctuations may negatively impact the market price of our common stock; the limited liquidity for our common stock could affect your ability to sell your shares at a satisfactory price; provisions of Minnesota law, our bylaws and other agreements may deter a change of control of our company and may have a possible negative effect on our stock price; and compliance with changing regulation of corporate governance and public disclosure may result in additional expenses and will constitute a larger percentage of our annual revenue than prior to the sale of the disc publishing business. These forward-looking statements are made as of the date of this report and the Company assumes no

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obligation to update such forward-looking statements, or to update the reasons why actual results could differ materially from those anticipated in such forward-looking statements.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Foreign Currency Translation. As of September 30, 2017, the Company is exposed to market risk primarily from foreign exchange rate fluctuations of the British Pound Sterling, Japanese Yen and Singapore Dollar to the U.S. Dollar as the financial position and operating results of the Company's foreign subsidiaries are translated into U.S. dollars for consolidation. Resulting translation adjustments are recorded as a separate component of stockholders' equity.

Interest Rates. The Company's term loan requires payment of interest monthly at the prime rate plus 6% and changes in interest rates would impact the Company's monthly interest payment and cash reserves. A 100-basis point increase in the prime rate would increase our annual pre-tax interest expense by approximately \$80,000.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

The Company's Chief Executive Officer, Vern Hanzlik, and the Company's Interim Chief Financial Officer, Dave Ristow, have evaluated the Company's disclosure controls and procedures as of September 30, 2017. Based upon such evaluation, they have concluded that these disclosure controls and procedures are effective. The Company's Chief Executive Officer and Interim Chief Financial Officer used the definition of "disclosure controls and procedures" as set forth in Rule 13a-15(e) under the Exchange Act in making their conclusion as to the effectiveness of such controls and procedures.

Changes in Internal Control Over Financial Reporting

No changes in internal controls over financial reporting have occurred during the quarter ended September 30, 2017 that have materially affected, or are reasonable likely to materially affect, the Company's internal control over financial reporting.

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PART II — OTHER INFORMATION

Item 1. Legal Proceedings

Not Applicable.

Item 1A. Risk Factors

Not Applicable.

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

Issuer Purchases of Equity Securities

In October 2010, the Company's Board of Directors approved a common stock repurchase program of up to 3,500,000 shares of the Company's common stock. Shares may be purchased at prevailing market prices in the open market or in private transactions, subject to market conditions, share price, trading volume and other factors. The repurchase program may be discontinued at any time. The repurchase program has been funded to date using cash on hand.

During the three months ended September 30, 2017, no repurchases were made under the repurchase program. While the current authorization remains in effect, the Company expects its primary use of cash will be to fund operations in support of the Company's goals for revenue growth and operating margin improvement.

In addition to shares that may be purchased under the Board authorization, the Company purchases shares of common stock held by employees who wish to tender owned shares to satisfy the exercise price or tax withholding on stock option exercises or vesting of restricted awards. No share repurchase activity associated with the satisfaction of employee tax withholding requirements on the vesting of restricted stock awards occurred for the three months ended September 30, 2017. Under the credit agreement, the Company is prohibited from repurchasing or redeeming its stock, subject to certain exceptions relating to the exercise or vesting of equity awards.

Information on the Company's repurchases of its common stock during each month of the quarter ended September 30, 2017 is as follows:

Monthly Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as part of Publicly Announced Plans or Programs	Maximum Number of Shares that may yet be Purchased under the Plans or Programs (at end of period)
July 2017	—	\$—	—	778,365
August 2017	—	\$—	—	778,365
September 2017	—	\$—	—	778,365

Item 3. Defaults Upon Senior Securities

Not Applicable.

Item 4. Mine Safety Disclosures

Not Applicable.

Item 5. Other Information

None.

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Item 6. Exhibits

(a) The following exhibits are included herein:

31.1 Certificate of Chief Executive Officer pursuant to Rules 13a-14(a) and 15d-14(a) of the Exchange Act.

31.2 Certificate of Interim Chief Financial Officer pursuant to Rules 13a-14(a) and 15d-14(a) of the Exchange Act.

32. Certifications pursuant to 18 U.S.C. §1350.

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SIGNATURES

In accordance with the Exchange Act, the registrant has duly caused this report to be signed on its behalf by the undersigned thereto duly authorized.

QUMU CORPORATION

Registrant

Date: November 13, 2017 By: /s/ Vern Hanzlik

Vern Hanzlik

President and Chief Executive Officer

(Principal Executive Officer)

Date: November 13, 2017 By: /s/ Dave Ristow

Dave Ristow

Interim Chief Financial Officer

(Principal Financial Officer)

(Principal Accounting Officer)