HMN FINANCIAL INC
Form 10-K
March 04, 2011

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
Form 10-K

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

For the fiscal year ended December 31, 2010

OR

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from __________ to __________.

Commission file number: 0-24100.

HMN FINANCIAL, INC.

(Exact Name of Registrant as Specified in its Charter)

Delaware	**41-1777397**
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)

1016 Civic Center Drive Northwest, PO Box 6057	**55901**
Rochester, Minnesota	(Zip Code)
(Address of Principal Executive Offices)	

(507) 535-1200

Registrant s Telephone Number, Including Area Code

Securities Registered Pursuant to Section 12(b) of the Act: Common Stock, par value $.01 per share(Title of each class)

Securities Registered Pursuant to Section 12(g) of the Act: None

Name of each exchange on which registered: Nasdaq Global Market

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 þ

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. YES o NO þ

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).YES o NOo

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not 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 to this Form 10-K. o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of large accelerated filer , accelerated filer and smaller reporting

company in Rule 12b-2 of the Exchange Act.

Large accelerated filer o	Accelerated filer o	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company þ

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

As of June 30, 2010, the aggregate market value of the registrant s common stock held by non-affiliates of the registrant was $12.9 million based on the closing stock price of $4.58 on such date as reported on the Nasdaq Global Market.

As of February 18, 2011, the number of outstanding shares of common stock of the registrant was 4,388,399.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant s annual report to stockholders for the year ended December 31, 2010, are incorporated by reference in Parts I, II and IV of this Form 10-K. Portions of the registrant s definitive proxy statement to be filed with the Securities and Exchange Commission pursuant to Regulation 14A not later than 120 days after the close of the registrant s fiscal year ended December 31, 2010 are incorporated by reference in Part III of this Form 10-K.

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Forward-Looking Statements

The information presented or incorporated by reference in this Annual Report on Form 10-K under the headings Item 1. Business and Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations contains forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934. These statements are often identified by such forward-looking terminology as expect, intent, look, believe, anticip estimate, project, seek, may, will, would, could, should, trend, target, and goal or similar state such terms and include, but are not limited to those relating to the adequacy and amount of available liquidity and capital resources to the Bank, the Company s liquidity and capital requirements, changes in the size of the Bank s loan portfolio, the recovery of the valuation allowance on deferred tax assets, the amount and mix of the Bank s non-performing assets and the adequacy of the allowance there for, future losses on non-performing assets, the amount of interest-earning assets, the amount and mix of brokered and other deposits (including the Company s ability to renew brokered deposits), the availability of alternate funding sources, the payment of dividends, the future outlook for the Company, and the Company s and the Bank s compliance with regulatory standards generally (including the Bank s status as well-capitalized), and supervisory agreements, individual capital requirements or other supervisory directives or requirements to which the Company or the Bank are expressly subject, specifically. A number of factors could cause actual results to differ materially from the Company s assumptions and expectations. These include but are not limited to the adequacy and marketability of real estate securing loans to borrowers, possible legislative and regulatory changes, including changes in the degree and manner of regulatory supervision, the ability of the Company and the Bank to establish and adhere to plans and policies relating to, among other things, capital, business, non-performing assets, loan modifications, documentation of loan loss allowance and concentrations of credit that are satisfactory to the OTS in accordance with the terms of the Company and Bank supervisory agreements and to otherwise manage the operations of the Company and the Bank to ensure compliance with other requirements set forth in the supervisory agreements; the ability of the Company and the Bank to obtain required consents from the OTS under the supervisory agreements or other directives; adverse economic, business and competitive developments such as shrinking interest margins, reduced collateral values, deposit outflows and reduced demand for financial services and loan products; changes in accounting policies and guidelines, or monetary and fiscal policies of the federal government or tax laws; international economic developments; changes in credit or other risks posed by the Company s loan and investment portfolios; technological, computer-related or operational difficulties; adverse changes in securities markets; results of litigation; collateral advance rates and policies of the FHLB; costs associated with alternate funding sources; or other significant uncertainties. Additional factors that may cause actual results to differ from the Company s assumptions and expectations include those set forth in this Form 10-K. All forward-looking statements are qualified by, and should be considered in conjunction with, such cautionary statements. For additional discussion of the risks and uncertainties applicable to the Company, see the Risk Factors section of this Form 10-K.

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PART I

ITEM 1. BUSINESS

General

HMN Financial, Inc. (HMN or the Company) is a stock savings bank holding company that owns 100% of Home Federal Savings Bank (the Bank). The Bank has a community banking philosophy and operates retail banking and loan production facilities in Minnesota and Iowa. The Bank has one wholly owned subsidiary, Osterud Insurance Agency, Inc. (OIA) which offers financial planning products and services. HMN has another wholly owned subsidiary, Security Finance Corporation (SFC) which acts as an intermediary for the Bank in completing certain real estate transactions. The Company was incorporated in Delaware in 1994.

As a community-oriented financial institution, the Company seeks to serve the financial needs of communities in its market area. The Company s business involves attracting deposits from the general public and businesses and using such deposits to originate or purchase one-to-four family residential, commercial real estate, and multi-family mortgage loans as well as consumer, construction, and commercial business loans. The Company also invests in mortgage-backed and related securities, U.S. government agency obligations and other permissible investments. The executive offices of the Company are located at 1016 Civic Center Drive Northwest, Rochester, Minnesota 55901. Its telephone number at that address is (507) 535-1200. The Company s website is located at www.hmnf.com. Information contained on the Company s website is expressly not incorporated by reference into this Form 10-K.

Market Area

The Company serves the southern Minnesota counties of Fillmore, Freeborn, Houston, Mower, Olmsted and Winona and portions of Steele, Dodge, Goodhue and Wabasha through its corporate office located in Rochester, Minnesota and its ten branch offices located in Albert Lea, Austin, La Crescent, Rochester, Spring Valley and Winona, Minnesota. The portion of the Company s southern Minnesota market area consisting of Rochester and the contiguous communities is composed of primarily urban and suburban communities, while the balance of the Company s southern Minnesota market area consists primarily of rural areas and small towns. Primary industries in the Company s southern Minnesota market area include manufacturing, agriculture, health care, wholesale and retail trade, service industries and education. Major employers include the Mayo Clinic, Hormel Foods (a food processing company), and IBM. The Company s market area is also the home of Winona State University, Rochester Community and Technical College, University of Minnesota Rochester, Winona State University Rochester Center and Austin s Riverland Community College.

The Company serves Dakota County, in the southern portion of the Minneapolis and St. Paul metropolitan area, from its office located in Eagan, Minnesota. Major employers in this market area include Delta Airlines, Cenex Harvest States (cooperative), Flint Hills Resources LP (oil refinery), Unisys Corp (computer software) and West Group, a Thomson Reuters business (legal research).

The Company serves the Iowa counties of Marshall and Tama through its branch offices located in Marshalltown and Toledo, Iowa. Major employers in the area are Swift & Company (pork processors), Fisher Controls International (valve and regulator manufacturing), Lennox Industries (furnace and air conditioner manufacturing), Iowa Veterans Home (hospital care), Marshall Community School District (education), Marshall Medical & Surgical Center (hospital care) and Meskwaki Casino (gaming operations).

Based upon information obtained from the U.S. Census Bureau for 2009 (the last year for which information is available), the population of the six primary counties in the Bank s southern Minnesota market area was estimated as follows: Fillmore 20,838; Freeborn 31,002; Houston 19,244; Mower 38,215; Olmsted 143,962; and Winona 49,436. For these same six counties, the median household income from the U.S. Census Bureau for 2008 (the last year for which information is available) ranged from $45,155 to $66,993. The population of Dakota County was 396,500 and the median household income was $71,988. With respect to Iowa, the population of Marshall County was 39,259 and the population of Tama County was 17,377. The median household income of these two counties ranged from $44,615 to $47,298.

The Company also serves a diverse high net worth customer base primarily in the seven county metropolitan area of Minneapolis and St. Paul from its private banking office, located in Edina, Minnesota. The Company serves a

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similar group of individuals and businesses in Olmsted County from its private banking office located in Rochester, Minnesota.

Lending Activities

General. Historically, the Company has originated 15 and 30 year fixed rate mortgage loans secured by one-to-four family residences for its loan portfolio. Over the past 10 years, the Company has focused on managing interest rate risk and increasing interest income by increasing its investment in shorter term and generally higher yielding commercial real estate, commercial business and construction loans, while reducing its investment in longer term one-to-four family real estate loans. The Company continues to originate 15 and 30 year fixed rate mortgage loans and some shorter term fixed rate loans. The shorter term fixed and adjustable rate loans are placed into portfolio, while the majority of the 15 and 30 year fixed rate mortgage loans are sold in the secondary mortgage market. Mortgage interest rates were at historical lows in 2010 and very few 15 and 30 year loans were placed into portfolio as most were sold into the secondary market in order to manage the Company s interest rate risk position. The Company also offers an array of consumer loan products that include both open and closed end home equity loans. Home equity lines of credit have adjustable interest rates based upon the prime rate, as published in the Wall Street Journal, plus a margin. Refer to Notes 4 and 5 of the Notes to Consolidated Financial Statements in the Annual Report for more information on the loan portfolio (incorporated by reference in Item 8 of Part II of this Form 10-K).

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The following table shows the composition of the Company s loan portfolio by fixed and adjustable rate loans as of December 31:

	2010		2009		2008		2007		2006	
(Dollars in thousands)	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
Fixed rate Loans										
Real estate:										
One-to-four family:										
GEM	$ 4,221	0.60%	$ 7,590	0.92%	$ 8,962	0.97%	$ 11,854	1.34%	$ 13,335	1.70%
Other	65,203	9.20	70,104	8.50	79,728	8.62	80,663	9.14	62,184	7.92
Total one-to-four family	69,424	9.80	77,694	9.42	88,690	9.59	92,517	10.48	75,519	9.62
Multi-family	23,079	3.26	11,455	1.39	4,703	0.50	5,952	0.68	6,238	0.80
Commercial	110,267	15.56	103,036	12.49	91,835	9.93	69,276	7.84	100,562	12.80
Construction or development	5,743	0.81	11,148	1.35	29,344	3.17	16,519	1.87	6,640	0.84
Total real estate loans	208,513	29.43	203,333	24.65	214,572	23.19	184,264	20.87	188,959	24.06
Consumer loans:										
Savings	534	0.07	324	0.04	277	0.03	358	0.04	814	0.10
Automobile	604	0.09	902	0.11	1,333	0.15	1,730	0.20	3,093	0.39
Home equity	18,127	2.56	21,396	2.59	22,961	2.48	20,249	2.29	21,181	2.70
Mobile home	764	0.11	977	0.12	1,316	0.14	1,699	0.19	2,052	0.26
Land/Lot loans	2,139	0.30	2,554	0.31	1,956	0.21	2,616	0.30	1,426	0.18
Other	2,790	0.39	4,777	0.58	3,087	0.33	2,007	0.23	2,192	0.28
Total consumer loans	24,958	3.52	30,930	3.75	30,930	3.34	28,659	3.25	30,758	3.91
Commercial business loans	68,962	9.73	76,936	9.33	90,458	9.78	90,688	10.27	65,347	8.32
Total non-real estate loans	93,920	13.25	107,866	13.08	121,388	13.12	119,347	13.52	96,105	12.23
Total fixed rate loans	302,433	42.68	311,199	37.73	335,960	36.31	303,611	34.39	285,064	36.29
Adjustable rate Loans										
Real estate:										
One-to-four family	59,111	8.34	66,937	8.12	73,299	7.92	60,456	6.85	58,751	7.48
Multi-family	25,187	3.56	47,811	5.80	24,589	2.66	23,120	2.62	23,624	3.01
Commercial	182,607	25.77	209,678	25.42	233,469	25.23	212,547	24.08	193,928	24.69
Construction or development	9,508	1.34	29,264	3.54	78,939	8.53	94,516	10.70	53,538	6.82
Total real estate loans	276,413	39.01	353,690	42.88	410,296	44.34	390,639	44.25	329,841	42.00
Consumer:										

Iome equity	44,647	6.30	50,061	6.07	52,194	5.64	51,322	5.81	54,328	6.91
Land/Lot loans	371	0.05	636	0.08	1,013	0.11	1,535	0.17	4,076	0.52
Other	627	0.09	588	0.07	2,464	0.27	3,393	0.39	686	0.09
Total consumer loans	45,645	6.44	51,285	6.22	55,671	6.02	56,250	6.37	59,090	7.52
Commercial business loans	84,077	11.87	108,589	13.17	123,317	13.33	132,271	14.99	111,423	14.19
Total non-real estate loans	129,722	18.31	159,874	19.39	178,988	19.35	188,521	21.36	170,513	21.71
Total adjustable rate loans	406,135	57.32	513,564	62.27	589,284	63.69	579,160	65.61	500,354	63.71
Total loans	708,568	100.00%	824,763	100.00%	925,244	100.00%	882,771	100.00%	785,418	100.00%
Less										
Loans in process *	0		0		0		3,011		5,252	
Unamortized (premiums) discounts	413		177		569		(11)		40	
Net deferred loan fees	1,086		1,518		2,529		2,245		2,021	
Allowance for losses on loans	42,828		23,812		21,257		12,438		9,873	
Total loans receivable, net	$ 664,241		$ 799,256		$ 900,889		$ 865,088		$ 768,232	

* *- Core data processing systems converted in 2008, loans in process amounts are reflected in loan amounts in table.*

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The following table illustrates the interest rate maturities of the Company s loan portfolio at December 31, 2010. Loans which have adjustable or renegotiable interest rates are shown as maturing in the period during which the contract is due. Scheduled repayments of principal are reflected in the year in which they are scheduled to be paid. The schedule does not reflect the effects of possible prepayments or enforcement of due-on-sale clauses.

During Years Ending mber 31,	One-to-four family Amount	Weighted Average Rate	Real Estate Multi-family and Commercial Amount	Weighted Average Rate	Construction or Development Amount	Weighted Average Rate	Consumer Amount	Weighted Average Rate	Commercial Business Amount	Weighted Average Rate	Total Amount	Weig Ave Ra
[1]	$ 22,446	5.54%	$ 86,887	4.53%	$ 8,308	3.12%	$ 4,046	9.03%	$ 61,539	4.29%	$ 183,226	4.
	6,840	6.11	39,971	5.22	1,665	4.93	2,784	7.56	48,829	5.84	100,089	5.
	7,169	5.35	69,533	5.28	2,333	0.00	5,000	6.32	17,665	4.24	101,700	5.
through 2015	2,578	6.63	31,894	5.86	566	4.26	9,981	6.51	8,472	6.76	53,491	6.
through 2020	13,942	5.74	68,829	6.37	0	0.00	4,208	7.58	15,517	6.77	102,496	6.
through 2035	24,434	4.49	43,723	6.26	650	6.00	44,576	5.67	1,017	6.17	114,400	5.
and thereafter	51,126	5.54	303	5.25	1,729	4.88	8	0.00	0	0.00	53,166	5.
	$ 128,535		$ 341,140		$ 15,251		$ 70,603		$ 153,039		$ 708,568	

[1] Includes demand loans, loans having no stated maturity and overdraft loans.

The total amount of loans due after December 31, 2011 that have predetermined interest rates is $219.9 million, while the total amount of loans due after such date that have floating or adjustable interest rates is $305.4 million. At December 31, 2010, construction or development loans were $10.7 million for one-to-four family dwellings, $3.9 million for multi-family and $0.7 million for nonresidential.

The aggregate amount of loans and extensions of credit that the Bank is permitted to make to any one borrower is generally limited to 15% of unimpaired capital and surplus. In addition to the 15% limit, the Bank is permitted to lend an additional amount equal to 10% of unimpaired capital and surplus if the additional amount is fully secured by readily marketable collateral having a current market value of at least 100% of the loan or extension of credit. Similarly, the Bank is permitted to lend additional amounts equal to the lesser of 30% of unimpaired capital and surplus or $30 million for certain residential development loans. Applicable law establishes a number of rules for combining loans to separate borrowers. Loans or extensions of credit to one person may be attributed to other persons if: (i) the proceed of a loan or extension of credit are used for the direct benefit of the other person; or (ii) a common enterprise is deemed to exist between persons. At December 31, 2010, based upon the 15% limitation, the Bank s regulatory limit for loans to one borrower was approximately $13.7 million. At December 31, 2010, excluding loans subject to an exception to the 15% lending limit, loans to two borrowers exceeded the current 15% limitation, by $216,000 and $434,000, respectively. These loans are not considered to be a violation of the regulatory lending limit requirements as they were within the Bank s lending limit when originated and the Bank is making efforts to bring these loans into compliance with the current lending limit. As of December 31, 2010, other loans also exceeded the 15% limit but were subject to additional limits referenced above. At December 31, 2010, the Bank s largest aggregate amount of loans to one borrower totaled $24.4 million. All of the loans for the largest borrower were performing in accordance with their terms and the borrower had no affiliation with the Bank other than its relationship as a borrower.

All of the Bank s lending is subject to its written underwriting standards and to loan origination procedures. Decisions on loan applications are made on the basis of detailed applications and property valuations determined by an independent appraiser. The loan applications are designed primarily to determine the borrower s ability to repay. The more significant items on the application are verified through the use of credit reports, financial statements, tax returns or confirmations.

One-to-four family loans that are equal to or less than the conforming/saleable loan dollar limits as established by FHLMC/FNMA may be approved by a Market President or designated underwriter. This limit was $417,000 for both 2010 and 2009. Loans up to and including $500,000, need the approval of one of the above personnel and a Loan Committee Member. Loans over $500,000 need approval from the Board of Directors or its Executive Committee.

The Bank s individual commercial loan officers have the authority to approve loans that meet the guidelines established by the Bank s commercial loan policy for loans up to $250,000 based on their individual delegated aggregate relationship authority. Individual delegated aggregate relationship authority varies by loan officer, with the highest individual authorities being $250,000. The aggregate relationship amount is determined by the total customer credit commitments outstanding plus the new loan request amount. The Business Banking Department Managers can approve loans up to a $500,000 aggregate relationship. The Chief Commercial Credit Officer and Limited Committee (consisting of the lender and the Business Banking Department Manager) or the Chief Credit Officer and Limited Committee have approval authorities for $1.0 million aggregate and $2.0 million aggregate, respectively. New relationship loan requests greater than $2.0 million to our internal loan limit to one borrower of $4.5 million, or existing loan relationship requests greater than $2.0 million to $7.5 million, are approved by the Senior Loan Committee. Any loan requests greater than these limits must be approved by the Bank s Board of Directors or its Executive Loan Committee.

The Bank generally requires title insurance on its mortgage loans, as well as fire and extended coverage casualty insurance in amounts at least equal to the principal amount of the loan or the value of improvements on the property. The Bank also requires flood insurance to protect the property securing its interest when the property is located in a flood plain.

One-to-Four Family Residential Real Estate Lending. At December 31, 2010, the Company s one-to-four family real estate loans, consisting of both fixed rate and adjustable rate loans, totaled $128.5 million, a decrease of $16.1 million, from $144.6 million at December 31, 2009. The decrease in the one-to-four family loans in 2010 is the result of selling more of the loans that were originated into the secondary market, instead of placing them into the portfolio, in order to reduce the Company s interest rate risk position. The Company s short term

strategy is to continue to sell the majority of the loans originated into the secondary market at least until market interest rates increase from their current levels.

The Company offers conventional fixed rate one-to-four family loans that have maximum terms of 30 years. In order to manage interest rate risk, the Company typically sells the majority of fixed rate loan originations with terms to maturity of 15 years or greater that are eligible for sale in the secondary market. The interest rates charged on the fixed rate loan products are based on the secondary market delivery rates, as well as other competitive factors. The Company also originates fixed rate loans with terms up to 30 years that are insured by the Federal Housing Authority (FHA), Veterans Administration, Minnesota Housing Finance Agency or Iowa Finance Authority.

The Company also offers one-year adjustable rate mortgages (ARMs) at a margin (generally 275 to 375 basis points) over the yield on the Average Monthly One Year U.S. Treasury Constant Maturity Index for terms of up to 30 years. The ARM loans offered by the Company allow the borrower to select (subject to pricing) an initial period of one year, three years, or five years between the loan origination and the date the first interest rate change occurs. The ARMs generally have a 200 basis point annual interest rate change cap and a lifetime cap of 600 basis points over or under the initial rate. The Company s originated ARMs do not permit negative amortization of principal, generally do not contain prepayment penalties and are not convertible into fixed rate loans. Because of the low interest rate environment that has existed over the last couple of years, a limited number of ARM loans have been originated as consumers have opted for the longer term fixed rate loans.

In underwriting one-to-four family residential real estate loans, the Company evaluates the borrower s credit history; ability to make principal, interest and escrow payments; the value of the property that will secure the loan; and debt to income ratios. Properties securing one-to-four family residential real estate loans made by the Company are appraised by independent appraisers. The Company originates residential mortgage loans with loan-to-value ratios up to 95% for owner-occupied homes and up to 90% for non-owner occupied homes; however, private mortgage insurance is generally required to reduce the Company s exposure to 80% of value or less on most loans. In addition, all non-owner occupied properties must be self supporting using the debt service ratio requirements, which usually requires approximately a 50% down payment on one-to-four family dwellings. The Company generally seeks to underwrite its loans in accordance with secondary market or FHA standards.

The Company s residential mortgage loans customarily include due-on-sale clauses giving it the right to declare the loan immediately due and payable in the event that, among other things, the borrower sells or otherwise disposes of the property subject to the mortgage.

Fixed rate loans in the Company s portfolio include both growing equity mortgages (GEM) loans and conventional fixed rate loans. The GEM loans require payments that increase after the first year. Under the GEM loans, the monthly payments required for the first year are established based on a 30-year amortization schedule. Depending upon the program selected, the payments may increase in the succeeding years by amounts ranging from 0% to 6.2%. Most of the GEM loans originated by the Company provide for at least four annual payment increases over the first five years of the loan. The increased payments required under GEM loans are applied to principal and have the effect of shortening the term to maturity; the GEM loans do not permit negative amortization. The Company currently offers one GEM product with a contractual maturity of approximately 15 years. The GEM loans are generally priced based upon loans with similar contractual maturities. The GEMs were targeted to consumers who anticipated future increases in income and who wanted an amortization schedule of less than 30 years. Low mortgage interest rates over the past several years have eliminated the demand for GEM loans as consumers have opted for shorter term fixed rate loans and none of these loans have been originated in the past three years. The decreased originations of GEM loans over the past several years has mitigated the risks associated with increasing loan payment amounts in a weakening economy with lower home values as those borrowers that have taken out these loans in the past have had time to build equity in their homes to offset a portion of the decline in value.

Commercial Real Estate and Multi-Family Lending. The Company originates permanent commercial real estate and multi-family loans secured by properties located primarily in its market area. It also purchases a limited amount of participations in commercial real estate and multi-family loans originated by third parties on properties outside of its market area. The commercial real estate and multi-family loan portfolio includes loans secured by motels, hotels, apartment buildings, churches, ethanol plants, manufacturing plants, office buildings, business facilities, shopping malls, nursing homes, golf courses, restaurants, warehouses and other non-residential building properties primarily located in the upper Midwestern portion of the United States.

Permanent commercial real estate and multi-family loans are generally originated for a maximum term of 10 years and may have longer amortization periods with balloon maturity features. The interest rates may be fixed for the term of the loan or have adjustable features that are tied to the prime rate or another published index. Commercial real estate and multi-family loans are generally written in amounts up to 80% of the lesser of the appraised value of the property or the purchase price and generally have a debt service coverage ratio of at least 120%. The debt service coverage ratio is the ratio of net cash from operations to debt service payments. The Company may originate construction loans secured by commercial or multi-family real estate, or may purchase participation interests in third party originated construction loans secured by commercial or multi-family real estate.

Appraisals on commercial real estate and multi-family real estate properties are performed by independent appraisers prior to the time the loan is made. For transactions less than $250,000, the Company may use an internal valuation. All appraisals on commercial and multi-family real estate are reviewed and approved by a commercial loan officer, credit manager, commercial department manager or a qualified third party. The Bank s underwriting procedures require verification of the borrower s credit history, income and financial statements, banking relationships and income projections for the property. The commercial loan policy generally requires personal guarantees from the proposed borrowers. An initial on-site inspection is generally required for all collateral properties for loans with balances in excess of $250,000. Independent annual reviews are performed for aggregate commercial lending relationships that exceed $500,000. The reviews cover financial performance, documentation completeness and accuracy of loan risk ratings.

Multi-family and commercial real estate loans generally present a higher level of risk than loans secured by one-to-four family residences. This greater risk is due to several factors, including the concentration of principal in a limited number of loans and borrowers, the effects of general economic conditions on income producing properties and the increased difficulty of evaluating and monitoring these types of loans. Furthermore, the repayment of loans secured by multi-family and commercial real estate is typically dependent upon the successful operation of the related real estate project. If the cash flow from the project is reduced (for example, if leases are not obtained or renewed), the borrower s ability to repay the loan may be impaired. At December 31, 2010, $36.7 million of loans in the commercial real estate portfolio were nonperforming, with the largest two relationships being an $5.9 million loan secured by a residential development in Minnesota and a $5.0 million loan secured by an alternative fuel plant in Nebraska.

Construction Lending. The Company makes construction loans to individuals for the construction of their residences and to builders for the construction of one-to-four family residences. It also makes a very limited number of loans to builders for houses built on speculation. Construction loans also include commercial real estate loans.

Almost all loans to individuals for the construction of their residences are structured as permanent loans. These loans are made on the same terms as residential loans, except that during the construction phase, which typically lasts up to twelve months, the borrower pays interest only. Generally, the borrower also pays a construction fee at the time of origination equal to the origination fee plus other costs associated with processing the loan. Residential construction loans are underwritten pursuant to the same guidelines used for originating residential loans on existing properties. Construction loans to builders or developers of one-to-four family residences generally carry terms of one year or less and may permit the payment of interest from loan proceeds.

Construction loans to owner occupants are generally made in amounts up to 95% of the lesser of cost or appraised value, but no more than 90% of the loan proceeds can be disbursed until the building is completed. The Company generally limits the loan-to-value ratios on loans to builders to 80%. Prior to making a commitment to fund a construction loan, the Company requires a valuation of the property, financial data, and verification of the borrower s income. The Company obtains personal guarantees for substantially all of its construction loans to builders. Personal financial statements of guarantors are also obtained as part of the loan underwriting process. Construction loans are generally located in the Company s market area.

Construction loans are obtained principally through continued business from builders and developers who have previously borrowed from the Bank, as well as referrals from existing customers and walk-in customers. The application process includes a submission to the Bank of accurate plans, specifications and costs of the project to be constructed. These items are used as a basis to determine the appraised value of the subject property to be built.

At December 31, 2010, construction loans totaled $15.3 million, of which one-to-four family residential totaled $10.7 million, multi-family residential totaled $3.9 million and commercial real estate totaled $0.7 million.

The nature of construction loans makes them more difficult to evaluate and monitor, especially in a market where home prices have been declining. The risk of loss on a construction loan is dependent largely upon the accuracy of the initial estimate of the property s value upon completion of the project, experience of the builder, and the estimated cost (including interest) of the project. If the estimate of value proves to be inaccurate, the Company may be confronted, at or prior to the maturity of the loan, with a project having a value that is insufficient to assure full repayment and/or the possibility of having to make substantial investments to complete and sell the project. Because defaults in repayment may not occur during the construction period, it may be difficult to identify problem loans at an early stage. In these cases, the Company may be required to modify the terms of the loan.

Consumer Lending. The Company originates a variety of consumer loans, including home equity loans (open-end and closed-end), automobile, mobile home, lot loans, loans secured by deposit accounts and other loans for household and personal purposes.

Consumer loan terms vary according to the type and value of collateral, length of contract and creditworthiness of the borrower. The Company s consumer loans are made at fixed or adjustable interest rates, with terms up to 20 years for secured loans and up to five years for unsecured loans.

The Company s home equity loans are written so that the total commitment amount, when combined with the balance of any other outstanding mortgage liens, may not exceed 95% of the appraised value of the property or an internally established market value. Internal market values are established using current market data, including tax assessment values and recent sales data, and are typically lower than third party appraised values. The closed-end home equity loans are written with fixed or adjustable rates with terms up to 15 years. The open-end home equity lines are written with an adjustable rate with a 10-year draw period that requires interest only payments followed by a 10-year repayment period that fully amortizes the outstanding balance. The consumer may access the open-end home equity line either by making a withdrawal at the Bank or writing a check on the home equity line of credit account. Open and closed-end equity loans, which are generally secured by second mortgages on the borrower s principal residence, represented 88.9% of the Company s consumer loan portfolio at December 31, 2010.

The underwriting standards employed by the Company for consumer loans include a determination of the applicant s payment history on other debts and ability to meet existing obligations and payments on the proposed loan. Although creditworthiness of the applicant is of primary consideration, the underwriting process also includes a comparison of the value of the security, if any, in relation to the proposed loan amount. Consumer loans may entail greater credit risk than do residential mortgage loans, particularly in the case of consumer loans that are unsecured or are secured by rapidly depreciable assets, such as automobiles or mobile homes. In these cases, any repossessed collateral for a defaulted consumer loan may not provide an adequate source of repayment

of the outstanding loan balance as a result of the greater likelihood of damage, loss or depreciation. In addition, consumer loan collections are dependent on the borrower s continuing financial stability, and thus are more likely to be affected by adverse personal circumstances. Furthermore, the application of various federal and state laws, including bankruptcy and insolvency laws, may limit the amount that can be recovered on such loans. At December 31, 2010, $0.2 million of the consumer loan portfolio was non-performing compared to $4.1 million at December 31, 2009.

Commercial Business Lending. The Company maintains a portfolio of commercial business loans to borrowers associated with the real estate industry as well as to retail, manufacturing operations and professional firms. The Company s commercial business loans generally have terms ranging from six months to five years and may have either fixed or variable interest rates. The Company s commercial business loans generally include personal guarantees and are usually, but not always, secured by business assets such as inventory, equipment, leasehold interests in equipment, fixtures, real estate and accounts receivable. The underwriting process for commercial business loans includes consideration of the borrower s financial statements, tax returns, projections of future business operations and inspection of the subject collateral, if any. The Company also purchases participation interests in commercial business loans originated outside of the Company s market area from third party originators. These loans generally have underlying collateral of inventory or equipment and repayment periods of less than ten years.

Unlike residential mortgage loans, which generally are made on the basis of the borrower s ability to make repayment from his or her income, and which are secured by real property with more easily ascertainable value, commercial business loans are of higher risk and typically are made on the basis of the borrower s ability to make repayment from the cash flow of the borrower s business. As a result, the availability of funds for the repayment of commercial business loans may be substantially dependent on the success of the business itself. Furthermore, the collateral securing the loans may depreciate over time, may be difficult to appraise and may fluctuate in value based on the success of the business. At December 31, 2010, $26.3 million of loans in the commercial business loan portfolio were non-performing compared to $17.8 million at December 31, 2009.

Originations, Purchases and Sales of Loans and Mortgage-Backed and Related Securities

Real estate loans are generally originated by the Company s salaried and commissioned loan officers. Loan applications are taken in all branch and loan production offices.

The Company originates both fixed and adjustable rate loans, however, its ability to originate loans is dependent upon the relative customer demand for loans in its markets. Demand for adjustable rate loans is affected by the interest rate environment and the number of adjustable rate loans remained low in 2010 due to the low long term fixed mortgage rates that existed during the year. The Company originated for its portfolio $5.5 million of one-to-four family adjustable rate loans during 2010, a decrease of $5.8 million, from $11.3 million in 2009. The Company also originated for its portfolio $7.6 million of fixed rate one-to-four family loans during 2010, a decrease of $3.5 million, from $11.1 million for 2009.

During the past several years, the Company has focused its portfolio loan origination efforts on commercial real estate, commercial business and consumer loans because these loans have terms to maturity and adjustable interest rate characteristics that are generally more beneficial to the Company in managing interest rate risk than single family fixed rate conventional loans. The Company originated $72.5 million of multi-family and commercial real estate, commercial business and consumer loans (which excludes commercial real estate loans in construction or development) during 2010, a decrease of $20.5 million, from originations of $93.0 million for 2009. The decrease in originations reflects the reduced demand for credit as a result of the difficult economic environment that existed in 2010.

In order to supplement loan demand in the Company s market area and geographically diversify its loan portfolio, the Company purchases participations in real estate loans from selected sellers, with yields based upon then-current market rates. The Company reviews and underwrites all loans purchased to ensure that they meet the

Company s underwriting standards and the seller generally continues to service the loans. The Company purchased $10.2 million of loans during 2010, an increase of $3.6 million, from $6.6 million during 2009. Purchases were increased in 2010 as a result of the reduced local commercial loan demand. The purchased commercial real estate and commercial business loans have terms and interest rates that are similar in nature to the Company s originated commercial and business portfolio. Refer to Notes 4 and 5 of the Notes to Consolidated Financial Statements in the Annual Report to Security Holders for the year ended December 31, 2010 for more information on purchased loans (incorporated by reference in Item 8 of Part II of this Form 10-K).

The Company has some mortgage-backed and related securities that are held, based on investment intent, in the available for sale portfolio. The Company did not purchase any mortgage-backed securities in 2010 or 2009. No mortgage-backed securities were purchased in 2010 as debt instruments issued by federal agencies such as Fannie Mae and Freddie Mac became more appealing to purchase due to their shorter duration given the low interest rate environment that existed in 2010. The Company did not sell any mortgage backed securities in 2010 and sold $98,000 in mortgage backed securities in 2009. See Investment Activities.

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The following table shows the loan and mortgage-backed and related securities origination, purchase, acquisition, sale and repayment activities of the Company for the periods indicated.

LOANS HELD FOR INVESTMENT

	Year Ended December 31,		
(Dollars in thousands)	2010	2009	2008
Originations by type:			
Adjustable rate:			
Real estate -			
- one-to-four family	$ 5,539	11,300	24,986
- multi-family	0	1,357	4,418
- commercial	12,504	3,966	38,700
- construction or development	3,042	4,596	49,093
Non-real estate -			
- consumer	9,413	20,295	19,560
- commercial business	11,539	18,881	44,968
Total adjustable rate	42,037	60,395	181,725
Fixed rate:			
Real estate -			
- one-to-four family	7,606	11,141	21,023
- multi-family	450	803	206
- commercial	15,165	8,142	14,936
- construction or development	6,492	1,917	26,650
Non-real estate -			
- consumer	14,745	15,184	18,251
- commercial business	8,732	24,403	38,926
Total fixed rate	53,190	61,590	119,992
Total loans originated	95,227	121,985	301,717
Purchases:			
Real estate -			
- commercial	5,683	904	4,505
- construction or development	625	388	1,596
Non-real estate -			
- commercial business	3,930	5,264	4,275
Total loans purchased	10,238	6,556	10,376
Sales, participations and repayments:			
Real estate -			
- one-to-four family	390	0	4,248
- multi-family	0	649	0
- commercial	3,921	3,579	21,827

- construction or development	0	0	7,712
Non-real estate -			
- consumer	1,813	423	440
- commercial business	6,230	975	38,559
Total sales	12,354	5,626	72,786
Transfers to loans held for sale	4,478	5,228	7,292
Principal repayments	181,716	191,870	172,350
Total reductions	198,548	202,724	252,428
Decrease in other items, net	(23,112)	(26,298)	(17,192)
Net increase (decrease)	$ (116,195)	(100,481)	42,473

LOANS HELD FOR SALE

(Dollars in thousands)	Year Ended December 31, 2010	2009	2008
Originations by type:			
Adjustable rate:			
Real estate -			
- one-to-four family	$ 0	399	1,009
Total adjustable rate	0	399	1,009
Fixed rate:			
Real estate -			
- one-to-four family	81,659	113,025	48,308
Total fixed rate	81,659	113,025	48,308
Total loans originated	81,659	113,424	49,317
Sales and repayments:			
Real estate -			
- one-to-four family	86,367	118,202	57,359
Total sales	86,367	118,202	57,359
Transfers from loans held for investment	(4,478)	(5,228)	(7,292)
Changes in deferred fees and market value	7	33	(37)
Total reductions	81,896	113,007	50,030
Net increase (decrease)	$ (237)	417	(713)

MORTGAGE-BACKED AND RELATED SECURITIES

(Dollars in thousands)	Year Ended December 31, 2010	2009	2008
Purchases:			
Mortgage-backed securities:			
FNMA MBSs	$ 0	0	59,556
Total purchases	0	0	59,556
Sales:			
Mortgage-backed securities:			
Fixed rate MBSs	0	(98)	0
CMOs and REMICs	0	(2,039)	0

Total sales	0	(2,137)	0
Principal repayments	(20,053)	(25,905)	(697)
Net increase (decrease)	$ (20,053)	(23,768)	58,859

Classified Assets and Delinquencies

Classification of Assets. Federal regulations require that each savings institution evaluate and classify its assets on a regular basis. In addition, in connection with examinations of savings institutions, the Office of Thrift Supervision (OTS) and the Federal Deposit Insurance Corporation (FDIC) examiners may identify problem assets and, if appropriate, require them to be classified with an adverse rating. There are three adverse classifications: substandard, doubtful and loss. Assets classified as substandard have one or more defined weaknesses and are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected. Assets classified as doubtful have the weaknesses of those classified as substandard, with additional characteristics that make collection in full on the basis of currently existing facts, conditions and values questionable, and there is a high possibility of loss. An asset classified as loss is considered uncollectible and of such little value that continuance as an asset on the balance sheet of the institution is not warranted. Assets classified as substandard or doubtful require the institution to establish prudent specific allowances for loan losses. If an asset, or portion thereof, is classified as loss, the institution must either establish specific allowances for loan losses in the amount of 100% of the portion of the asset classified as loss, or charge off such amount. If an institution does not agree with an OTS or FDIC examiner s classification of an asset, it may appeal the

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determination to the OTS District Director or the appropriate FDIC personnel, depending on the regulator. On the basis of management s review of its assets, at December 31, 2010, the Bank classified a total of $134.5 million of its loans and other assets as follows:

(Dollars in thousands)	One-to-Four Family	Real Estate Construction or Development	Commercial and Multi-family	Consumer	Commercial Business	Other Assets	Total
Substandard	$ 14,209	6,003	38,883	197	17,439	11,301	88,032
Doubtful	1,081	2,397	9,089	51	6,675	3,636	22,929
Loss	333	32	10,435	58	11,260	1,458	23,576
Total	$ 15,623	8,432	58,407	306	35,374	16,395	134,537

The Bank s classified assets consist of non-performing loans and loans and other assets of concern discussed in Management s Discussion and Analysis of Financial Condition and Results of Operations (incorporated by reference in Item 7 of Part II of this Form 10-K). At December 31, 2010, these asset classifications were materially consistent with those of the OTS and FDIC.

Delinquency Procedures. Generally, the following procedures apply to delinquent one-to-four family real estate loans. When a borrower fails to make a required payment on a loan, the Company attempts to cure the delinquency by contacting the borrower. A late notice is sent on all loans over 16 days delinquent. Additional written and verbal contacts are made with the borrower between 30 and 60 days after the due date. If the loan is contractually delinquent 90 days, the Company sends a 30-day demand letter to the borrower and after the loan is contractually delinquent 120 days, institutes appropriate action to foreclose on the property. If foreclosed, the property is sold at a sheriff s sale and may be purchased by the Company. Delinquent commercial real estate and commercial business loans are generally handled in a similar manner. The Company s procedures for repossession and sale of consumer collateral are subject to various requirements under state consumer protection laws.

Real estate acquired by the Company as a result of foreclosure is typically classified as real estate in judgment for six to twelve months and thereafter as real estate owned until it is sold. When property is acquired by foreclosure or deed in lieu of foreclosure, it is recorded at the lower of cost or estimated fair value, less the estimated cost of disposition as real estate owned. After acquisition, all costs incurred in maintaining the property are expensed. Costs relating to the development and improvement of the property, however, are capitalized to the extent of fair value less disposition cost.

The following table sets forth the Company s loan delinquencies by loan type, amount and percentage of type at December 31, 2010 for loans past due 60 days or more.

	Loans Delinquent For:						Total Delinquent Loans		
	60-89 Days			90 Days and Over					
(Dollars in thousands)	Number	Amount	Percent of Loan Category	Number	Amount	Percent of Loan Category	Number	Amount	Percent of Loan Category
One-to-four family real estate	10	$ 695	0.54%	26	$ 3,500	2.72%	36	$ 4,195	3.26%
Commercial real estate	2	4,163	1.42	12	19,298	6.59	14	23,461	8.01
Real estate construction or	0	0	0.00	4	5,133	33.66	4	5,133	33.66

development									
Consumer	9	163	0.23	11	207	0.29	20	370	0.52
Commercial business	1	45	0.03	19	20,908	13.66	20	20,953	13.69
Total	22	$ 5,066	0.71%	72	$ 49,046	6.92%	94	$ 54,112	7.64%

Loans delinquent for 90 days and over are non-accruing and are included in the Company s non-performing asset total at December 31, 2010.

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Investment Activities

The Company and the Bank utilize the available for sale securities portfolio in virtually all aspects of asset/liability management. In making investment decisions, the Investment-Asset/Liability Committee considers, among other things, the yield and interest rate objectives, the credit risk position, and the Bank s liquidity and projected cash flow requirements.

Securities. Federally chartered savings institutions have the authority to invest in various types of liquid assets, including United States Treasury obligations, securities of various federal agencies, certain certificates of deposit of insured banks and savings institutions, certain bankers acceptances, repurchase agreements and federal funds. Subject to various restrictions, the holding company of a federally chartered savings institution may also invest its assets in commercial paper, investment grade corporate debt securities and mutual funds whose assets conform to the investments that a federally chartered savings institution is otherwise authorized to make directly.

The investment strategy of the Company and the Bank has been directed toward a mix of high-quality assets (primarily government agency obligations) with short and intermediate terms to maturity. At December 31, 2010, the Company did not own any investment securities of a single issuer that exceeded 10% of the Company s stockholder s equity other than U.S. government agency obligations.

The Bank invests a portion of its liquid assets in interest-earning overnight deposits of the Federal Home Loan Bank of Des Moines (FHLB). Other investments include high grade medium-term (up to four years) federal agency notes, and a variety of other types of mutual funds that invest in adjustable rate mortgage-backed securities, asset-backed securities, repurchase agreements and U.S. Treasury and agency obligations. The Company invests in the same type of investment securities as the Bank and may also invest in taxable and tax exempt municipal obligations and corporate equities such as preferred and common stock. Refer to Note 3 of the Notes to Consolidated Financial Statements in the Annual Report to Security Holders for the year ended December 31, 2010 for additional information regarding the Company s securities portfolio (incorporated by reference in Item 8 of Part II of this Form 10-K).

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The following table sets forth the composition of the Company s securities portfolio, excluding mortgage-backed and related securities, at the dates indicated.

	December 31, 2010				December 31, 2009			
rt t	Adjusted To	Market Value	% of Total	Amort Cost	Adjusted To	Market Value	% of Total	Amor Cost
7,931	(48)	117,883	82.70%	$ 105,023	845	105,868	85.00%	$ 94,74
700	(525)	175	0.10	700	(525)	175	0.10	70
,631		118,058	82.80	105,723		106,043	85.10	95,44
,743		6,743	4.70	7,286		7,286	5.80	7,28
,374		124,801	87.50	113,009		113,329	90.90	102,72

mon Stock nber of es	Par Value	Additional Paid-In Capital	Accumulated Deficit	Other Comprehensive Income (Loss)	Total	Comprehensive Loss
386	$4,903	$430,195	$(449,785)	$ -	$(14,687)	
	-	-	(422,516)	-	(422,516)	$(422,516)
000	1,000	(1,000)	-	-	-	
386	$5,903	$429,195	$(872,301)	$ -	$(437,203)	
	-	-	(833,567)	-	(833,567)	
	-	-	-	(53,120)	(53,120)	$(886,687)
000	3,450	746,550	-	-	750,000	

	50	9,950	-	-	10,000	
	-	34,426	-	-	34,426	
886	$9,403	$1,220,121	$(1,705,868)	$ (53,120)	$(529,464)	
	-	-	(1,153,686)	-	(1,153,686)	
	-	-	-	50,614	50,614	$(1,103,072)
0	385	197,829	-	-	198,214	
000	1,700	301,871	-	-	303,571	
	-	310,000	-	-	310,000	
,886	$11,488	$2,029,821	$(2,859,554)	$ (2,506)	$(820,751)	
	-	-	(4,072,788)	-	(4,072,788)	
	-	-	-	(1,939)	(1,939)	$(4,074,727)
0	195	45,305	-	-	45,500	
000	1,900	3,323,100	-	-	3,325,000	
499	1,140	2,120,320	-	-	2,121,460	
	-	1,201,960	-	-	1,201,960	
24)	(610)	610	-	-	-	
,961	$14,113	$8,721,116	$(6,932,342)	$ (4,445)	$1,798,442	

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SIBERIAN ENERGY GROUP INC. (A Development Stage Company)

Consolidated Statements of Stockholders' Equity

For the cumulative period of Development Stage Activity - January 1, 2003 through June 30, 2010

	Common Stock Number of Shares	Par Value	Additional Paid-In Capital	Accumulated Deficit	Accumulated Other Comprehensive Income (Loss)	Total	Comprehensive Loss
	14,112,961	$ 14,113	$ 8,721,116	$ (6,932,342)	$ (4,445)	$ 1,798,442	
Loss for the year - 2007	-	-	-	(2,060,487)	-	(2,060,487)	
Foreign currency translation adjustment	-	-	-	-	(9,804)	(9,804)	$ (2,070,291)
Shares issued for employee stock option plan and warrants	566,935	567	(567)	-	-	-	
Shares issued for geological data	200,000	200	349,800	-	-	350,000	
Shares issued for accrued salaries	788,000	788	1,444,618	-	-	1,445,406	
Shares issued for licenses	2,000,000	2,000	1,318,000	-	-	1,320,000	
Shares issued for professional services	715,134	715	1,070,395	-	-	1,071,110	
Warrants granted for professional services	-	-	150,394	-	-	150,394	
	18,383,030	$ 18,383	$ 13,053,756	$ (8,992,829)	$ (14,249)	$ 4,065,061	

Balance, December 31, 2007							
Loss for the year - 2008	-	-	-	(5,863,560)	-	(5,863,560)	
Foreign currency translation adjustment	-	-	-	-	27,019	27,019	$ (5,836,541)
Shares issued for professional services and accrued salaries	155,000	155	41,595	-	-	41,750	
Warrants granted for professional services	-	-	6,303	-	-	6,303	
Shares issued for loan repayment and related interest	107,520	108	10,645	-	-	10,753	
Balance, December 31, 2008	18,645,550	$ 18,646	$ 13,112,299	$ (14,856,389)	$ 12,770	$ (1,712,674)	
Loss for the year - 2009	-	-	-	(666,116)	-	(666,116)	
Foreign currency translation adjustment	-	-	-	-	(19,714)	(19,714)	$ (685,830)
Shares issued for accrued salaries	60,000	60	3,540	-	-	3,600	
Options vested to employees and directors	-	-	45,852	-	-	45,852	
Balance, December 31, 2009	18,705,550	$ 18,706	$ 13,161,691	$ (15,522,505)	$ (6,944)	$ (2,349,052)	

Loss for six months - 2010	-	-	-	(293,099)	-	(293,099)	
Foreign currency translation adjustment	-	-	-	-	(7,146)	(7,146)	$ (300,245)
Balance, June 30, 2010	18,705,550	$ 18,706	$ 13,161,691	$ (15,815,604)	$ (14,090)	$ (2,649,297)	
See accompanying notes.							

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SIBERIAN ENERGY GROUP INC. (A Development Stage Company)

Condensed Consolidated Statements of Cash Flows

For the six months ended June 30,	2010	2009	For the cumulative period of Development Stage Activity- January 1, 2003 through June 30, 2010
Operating activities:			
Net loss (development stage)	$ (293,099)	$ (325,877)	$ (15,365,819)
Depreciation and amortization	335	299	105,193
Common stock and warrants issued			
for professional services and salaries and geological data	-	26,526	7,231,933
Gain from entrance into joint venture	-	-	(364,479)
Loss on disposition of office furniture	-	-	1,029
Loss on sale of investment, including deconsolidation of subsidiary	-	-	823,692
Loss on deemed disposition of oil and gas properties, unproved	-	-	3,928,000
Impairment charge on investment	-	-	525,947
Changes in other current assets and			
current liabilities:			
Management fee receivable	-	-	110,000
Prepaid expenses and other assets	(17)	(15)	(263,978)
Accounts payable and accrued expenses	299,708	305,406	4,291,125
Net operating activities	6,927	6,339	1,022,643
Investing activities:			
Expenditures for licenses and related	-	-	(528,961)
Expenditures for oil and gas properties	-	-	(770,750)
Expenditures for property and equipment	-	-	(6,244)
Proceeds of disposition of office furniture	-	-	107
Loan to affiliate	-	-	(29,500)
Cash received in acquisition	-	-	6
Cash received from entrance into joint venture	-	-	175,000
Net investing activities	-	-	(1,160,342)
Financing activities:			
Net proceeds from demand loans	-	-	72,500
Common stock issued for employee stock option plan	-	-	45,500
Additional paid-in capital	-	-	34,426
Net financing activities	-	-	152,426
Effect of exchange rates on cash	(7,173)	(6,319)	(14,222)
Net change in cash	(246)	20	505

Cash - beginning	751	739	-
Cash - ending	$ 505	$ 759	$ 505

See accompanying notes.

SIBERIAN ENERGY GROUP INC. (A Development Stage Company)

Notes to Condensed Consolidated Financial Statements

1. Basis of Presentation:

The accompanying unaudited consolidated financial statements of Siberian Energy Group Inc. (the Company) include the accounts of the Company and its 100% owned subsidiaries. These financial statements have been prepared pursuant to the rules of the Securities and Exchange Commission (SEC) interim reporting, and do not include all of the information and note disclosures required by generally accepted accounting principles. These consolidated financial statements and notes herein are unaudited, but in the opinion of management, include all the adjustments (consisting of only normal recurring adjustments) necessary for a fair presentation of the Company's financial positions, results of operations, and cash flows for the periods presented. Accounting policies used in fiscal 2010 are consistent with those used in the cumulative period of Development Stage Activity – January 1, 2003 through December 31, 2009. These financial statements should be read in conjunction with the Company's audited consolidated financial statements and notes thereto. Interim operating results are not necessarily indicative of operating results for any future interim period or the full year.

2. The Company and Description of Business:

Kondaneftegaz

The Company, through its subsidiary Kondaneftegaz, LLC (KNG), has been engaged in the business of exploiting and developing certain oil and gas and other petroleum products licenses issued for a period of five years by Russia's subsurface management authorities in October 2007. The two licensed areas lie in the Karabashsky zone in the Khanty-Mansiysk Autonomous area of the Russian Federation. KNG has its principal place of business in the city of Khanty-Mansiysk, Russia. KNG has prepared and coordinated with Russian authorities the Program of exploration works on the Karabashski 61 and Karabashski 67 license areas. KNG is evaluating the possibility of using prior seismic data in the current exploration program.

KNG was acquired together with the vast collection of geological information data (oil and gas properties, unproved) on the Karabashski zone of Khanty-Mansiysk Autonomous district of the Tuymen region of the Russian Federation through the issuance of shares and warrants as follows:

Restricted common shares issued for oil and gas properties, unproved in 2006	1,900,000
Restricted common shares issued in connection with license acquisition by KNG in 2007	2,000,000
Restricted common shares issued in 2006	200,000
Total restricted common shares issued	4,100,000

Stock warrants issued in 2006

for purchase option	250,000

As a result of the purchase, a calculated acquisition value of $3,928,000 was assigned to the oil and gas properties, unproved that considered the approximate market value of the stock issued ($1.75) on the transaction date including $3,675,000 assigned to 2,100,000 shares issued in 2006 and $253,000 assigned to 250,000 stock warrants issued. A value of $1,320,000 was assigned to the acquisition of licenses by KNG based on the market value of the 2,000,000 shares on the date of issue.

On September 30, 2008 the Company sold a 51% interest in KNG to a Russian oil and gas company, and a 5% interest to two Russian individuals for $223. This Russian company has committed to lead the exploration works on the licensed areas by accepting the operator’s role and agreeing to provide funding for KNG’s activities. Simultaneously with the sale of 56% of KNG, the Company made available all geological data to the operator to be used in the program of geological studies in the region. Since no consideration was received and the Company has no intent to further utilize this geological data, a loss on the deemed disposition of these unproven oil and gas properties of $3,928,000 has been recorded. Operations of KNG prior to September 30, 2008 are included in the consolidated accounts of the Company in the accompanying financial statements. Effective September 30, 2008, the Company's 44% investment in KNG is recorded on the equity method of accounting. At September 30, 2008, KNG’s assets were $13,572 and liabilities were $135,740. Since 56% of the Company was sold for a nominal amount, a non-cash impairment charge of $525,947 has been recorded to reduce the carrying value of the 44% investment in KNG to zero.

Zauralneftegaz

Zauralneftegaz Ltd. (ZNG, Ltd.) is the Company's 50% owned joint venture with Baltic Petroleum Limited, UK created in 2005, which operates through its Russian subsidiary Zaural Neftegaz (ZNG). ZNG has been involved in oil and gas research activities in the Kurgan region of the Russian Federation. During 2003 through 2008 it has completed seismic studies and drilling program in the Kurgan region, after which date Kurgan operations were put on hold until further economical advisability is confirmed. The Company believes ZNG, Ltd. has created value through the geological results of the two exploratory wells and other data gathered in the area and ZNG, Ltd. is considering its options with regard to realizing this value by either a farm out or a direct sale of geophysical and seismic data to a third party operating in the area.

Activities of ZNG for the period March 2003 through October 2005 are included in the consolidated accounts of the Company in the accompanying financial statements. Effective October 14, 2005, the Company's investment in Joint Venture has been recorded on the equity method of accounting. Since the cumulative losses of the Joint Venture exceed the Company's investment, the investment asset is carried at zero value as of and through June 30, 2010.

Both equity investments are recorded at zero on the accompanying balance sheets. Although management is hopeful, the Company is uncertain when and if any income will be realized from these investments. On a moving forward basis, the Company anticipates further business expansion. It is constantly evaluating new mineral resource assets, both explored and unexplored, as part of its growth strategy.

The Company was incorporated in the State of Nevada on August 13, 1997, and previously provided comprehensive outpatient rehabilitation services to patients suffering from work, sports and accident related injuries. All activities related to the Company's previous business ventures were essentially discontinued prior to January 1, 2000. Predecessor names of the Company since its inception include Trans Energy Group, Inc., King Incorporated and Advanced Rehab Technology Corporation.

3. Income Taxes:

At June 30, 2010, the Company effectively has U.S. tax net operating loss carryforwards totaling approximately $14,084,000. These carryforwards may be used to offset future taxable income, and expire in varying amounts through 2030. No tax benefit has been reported in the financial statements, however, because the Company believes there is at least a 50% chance that the carryforwards will expire unused. Accordingly, the $2,817,000 estimated cumulative tax benefit of the loss carryforwards have been offset by a valuation allowance of the same amount.

4. Loss Per Common Share:

Basic and diluted loss per common share is computed using the weighted average number of common shares outstanding during the period. Shares issuable for common stock options and warrants may have had a dilutive effect on earnings per share had the Company generated income during the periods through June 30, 2010.

5. Going Concern:

These financial statements have been prepared assuming the Company will continue as a going concern, however, since inception of its current endeavor in 2003, it has not earned substantial revenues and is considered to be in the development stage, which raises substantial doubt about its ability to continue as a going concern.

Management is of the opinion that its current and proposed oil and gas ventures will successfully generate allocable profits to the Company in the near term.

For the cumulative period ended June 30, 2010, the Company has obtained cash financing from organizing stockholders and employees in the form of loans, advances, and deferred salaries. However, there can be no certainty as to availability of continued financing in the future. Failure to obtain sufficient financing may require the Company to reduce its operating activities. A failure to continue as a going concern would then require stated amounts of assets and liabilities to be reflected on a liquidation basis which could differ form the going concern basis.

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS

CERTAIN STATEMENTS IN THIS QUARTERLY REPORT ON FORM 10-Q (THIS "FORM 10-Q"), CONSTITUTE "FORWARD LOOKING STATEMENTS" WITHIN THE MEANING OF SECTION 27A OF THE SECURITIES ACT OF 1934, AS AMENDED, AND THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995 (COLLECTIVELY, THE "REFORM ACT"). CERTAIN, BUT NOT NECESSARILY ALL, OF SUCH FORWARD-LOOKING STATEMENTS CAN BE IDENTIFIED BY THE USE OF FORWARD-LOOKING TERMINOLOGY SUCH AS "BELIEVES", "EXPECTS", "MAY", "SHOULD", OR "ANTICIPATES", OR THE NEGATIVE THEREOF OR OTHER VARIATIONS THEREON OR COMPARABLE TERMINOLOGY, OR BY DISCUSSIONS OF STRATEGY THAT INVOLVE RISKS AND UNCERTAINTIES. SUCH FORWARD-LOOKING STATEMENTS INVOLVE KNOWN AND UNKNOWN RISKS, UNCERTAINTIES AND OTHER FACTORS WHICH MAY CAUSE THE ACTUAL RESULTS, PERFORMANCE OR ACHIEVEMENTS OF SIBERIAN ENERGY GROUP INC. ("THE COMPANY", "WE", "US" OR "OUR") TO BE MATERIALLY DIFFERENT FROM ANY FUTURE RESULTS, PERFORMANCE OR ACHIEVEMENTS EXPRESSED OR IMPLIED BY SUCH FORWARD-LOOKING STATEMENTS. REFERENCES IN THIS FORM 10-Q, UNLESS ANOTHER DATE IS STATED, ARE TO JUNE 30, 2010.

Investors should also take note of the fact that some of the more technical terms relating to the Company's operations as described below are explained in greater detail under exhibit 99.1, incorporated by reference hereto.

BUSINESS DEVELOPMENT:

Siberian Energy Group Inc. was formed as a Nevada corporation on August 13, 1997, as Advanced Rehab Technology Corporation. Subsequently, on March 9, 2001, the Company changed its name to Talking Cards, Inc.; on February 12, 2002, the Company changed its name to Oysterking Incorporated; on December 3, 2002, the Company changed its name to 17388 Corporation Inc., at which point the controlling interest of the Company was sold and a new board of directors was appointed; on May 5, 2003, the Company changed its name to Trans Energy Group Inc.; and on December 3, 2003, the Company changed its name to Siberian Energy Group Inc.

On September 17, 1999, the Company affected a 1-for-30 reverse stock split. A subsequent 3-for-1 forward split was consummated on October 2, 2000 and a further 1:2 reverse stock split was affected on May 2, 2005 (collectively the “Stock Splits”). All share amounts subsequently listed are retroactively adjusted to reflect these stock splits unless otherwise provided.

In the spring of 2003, a majority of the Company's shares were purchased by new shareholders who stepped into the management of the Company and defined its new business direction as an oil and gas exploration company.

On May 9, 2003, the Company entered into an Acquisition Agreement (the "Acquisition Agreement") by and among the Company, Zaural Neftegaz, a Russian corporation ("ZNG"), the shareholders of ZNG and Oleg Zhuravlev, President of ZNG, and a former Director of the Company. Pursuant to the Acquisition Agreement, the Company acquired a 51% interest in ZNG by issuing to ZNG 2,000,000 shares of the Company's common stock. In June 2004, the Company purchased the remaining 49% of ZNG in exchange for 6,900,000 shares of the Company's common stock, making ZNG a wholly-owned subsidiary of the Company. The Company had no affiliation with ZNG prior to the acquisition in May 2003.

Currently, the operating activities of ZNG are carried out through the Joint Venture Shareholders' Agreement ("Joint Venture") entered into on October 14, 2005 with Baltic Petroleum (E&P) Limited ("BP" or "Baltic") and Zauralneftegaz Limited, the joint venture company ("ZNG, Ltd."), as contemplated by the Option Agreement, as amended (the "Option"). The Company closed the Joint Venture and transferred 100% of the outstanding stock of ZNG to ZNG, Ltd. in connection with the terms and conditions of the Joint Venture. As a result of such transfer, the

Company holds 50% of the outstanding stock of ZNG, Ltd., which holds 100% of the outstanding stock of the Company's former wholly-owned subsidiary, ZNG. ZNG, Ltd. operates through ZNG and is engaged in the exploration and development of, production and sale of, oil and gas assets in the Western Siberian region of the Russian Federation and the former Soviet Union.

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On December 13, 2006, we entered into an Interest Purchase Agreement (the "Purchase Agreement") with Key Brokerage LLC ("Key Brokerage"), pursuant to which we purchased 100% of the stock of Kondaneftegaz LLC ("KNG"), a Russian limited liability company, which was created in 2004 for the purpose of oil and gas exploration in the Khanty-Mansiysk district of Western Siberia, Russia. In addition to acquiring 100% of the stock of KNG, we received the geological information package on the Karabashski zone of Khanty-Mansiysk Autonomous district (Tuymen region of Russian Federation) ("Geological Data").

On or about September 30, 2008, we entered into an Agreement of Purchase and Sale with Limited Liability Company Neftebitum, a Russian limited liability company, and two Russian individuals, pursuant to which we sold fifty-six percent (56%) of the ownership interest of KNG, as described in greater detail below.

All dollar amounts used throughout this Report are in United States dollars, unless otherwise stated. All amounts in Canadian dollars used throughout this Report are preceded by CDN, for example CDN $500, is referring to $500 Canadian dollars.

BUSINESS OPERATIONS:

We are a development stage company which is seeking opportunities for investment in and/or acquisition of small to medium companies in Russia, specifically in the oil and gas industry.

We currently hold investments in ZNG, Ltd. and KNG. Both companies are operating in the Western Siberia region of Russia and are involved in oil and gas exploration, provided however, as described below, ZNG, Ltd. has advised us that it will no longer undertake any further exploration activities in Western Siberia.

Moving forward the Company plans to focus on those assets that involve less exploration risk and is also actively seeking and negotiating the acquisition of production or close-to-production assets in Russia and countries of the former Soviet Union; however, the Company has not entered into any definitive agreements to date, and there can be no assurance that any such agreements will be entered into on favorable terms, if at all.

Description of KNG

KNG was created in 2004 for the purpose of oil and gas exploration in the Khanty-Mansiysk district of Western Siberia, Russia. In October 2007, KNG was awarded two oil and gas exploration licenses in Khanty-Mansiysk region in Western Siberia, Russia for the Karabashsky-61 and Karabashsky-67 blocks located in the Khanty-Mansiysk Autonomous Region, Russian Federation. The license areas together cover 166,000 acres and are situated in the territory of the Urals oil and gas bearing area. KNG also has eight more outstanding applications for exploration licenses filed with the Russian authorities, which auctions have not occurred to date.

The right to use the subsurface resources of the Karabashski-61 and Karabashki-67 Fields is granted for the term of validity of the license (five (5) years), from the date of its state registration (October 22, 2007), subject to the completion of certain exploration activities on the license blocks. The term of use of the subsurface resources can be extended to finish exploration and estimation of deposit or for liquidation work, if the terms of usage of the subsurface resources are not breached.

KNG has prepared and coordinated with the Russian authorities an exploration works program on the Karabashski-61 and Karabashski-67 license areas to stay in compliance with the license agreements' requirements described below in further detail:

- o to begin 2D seismic works during the 2009-2010 fieldwork season and to perform not less than 176.26 linear kilometers of seismic profiles on Karabashky-61 and 158 linear kilometers on Karabashky-67 (minimal density of the profile not less than 1 linear kilometer per 1 square kilometer of license area), and

- o no later than 2011, to start drilling an exploratory well and to complete not less than 2 exploratory wells by April 1, 2012.

As of June 30, 2010 KNG has re-interpreted the existing seismic data from prior studies and updated its program of seismic works. 2D seismic studies are currently planned to start in the fourth quarter of 2010.

On or about September 30, 2008, we entered into an Agreement of Purchase and Sale with Limited Liability Company Neftebitum, a Russian limited liability company ("Neftebitum"), Sergey V. Prokopiev, an individual and Russian citizen, and Oleg G. Shelepov, an individual and Russian citizen (collectively, the "Purchasers" and the "Sale Agreement"). The Company's Board of Directors approved and ratified the Company's entry into the Sale Agreement and the transactions contemplated therein on or about October 30, 2008. Pursuant to the Sale Agreement, the Company agreed to sell to the Purchasers an aggregate of fifty-six percent (56%) of the registered capital of KNG for aggregate consideration of 5,600 Russian Rubles (approximately $223). Neftebitum agreed to purchase a 51% interest for total consideration of 5,100 Russian Rubles (approximately $203) and Mr. Prokopiev and Mr. Shelepov agreed to each purchase a 2.5% interest for consideration of 250 Russian Rubles each (approximately $10).

Pursuant to the Sale Agreement, the Sellers are obligated to maintain KNG's main priority of performing geological studies and exploring for hydrocarbon deposits in the Karabashsky-61 and Karabashsky-67 blocks (the "Blocks"). Further, the Purchasers are obligated to provide financing, by way of direct financing or third-party loans, in the amounts necessary to comply with the licensing agreements for the Blocks. The Company's and the Purchasers' relationship is to be regulated by the Operating Agreement (as described below), which was entered into in connection with the Sale Agreement. Lastly, the Sale Agreement provides that in connection with Neftebitum obtaining a majority interest in KNG, it is obligated to be a guarantor and accept joint responsibility with KNG for repayment of any financing the Purchasers obtain for KNG.

On or about November 5, 2008, and in connection with their entry into the Sale Agreement, Neftebitum, the Company and KNG entered into an Operating Agreement that defines the rights and responsibilities of the parties (the "Operating Agreement"). Pursuant to the Operating Agreement, Neftebitum is designated the exclusive Operator of KNG and all of its current and future mineral claims and has the right to appoint all members of KNG's management. As Operator, Neftebitum has exclusive control of all technical, management, operational and associated matters involving KNG and the Blocks and any potential hydrocarbon exploration and production licenses (the "Operations"). Neftebitum must manage and conduct the Operations by itself, its agents, independent contractors and/or servants in general accordance with standard oil and gas field practices. Neftebitum must use all reasonable endeavors to:

- Prepare annual programs and budgets pursuant to the Operating Agreement and the licensing agreements for the Blocks;

- Begin 2D seismic works on the Blocks during the 2009-2010 fieldwork season and perform not less than 176.26 linear kilometers of seismic profiles on the Karabashky-61 Block and not less than 158 linear kilometers of

seismic works on the Karabashky-67 Block;

- Start drilling an exploratory well no later than 2011, and complete no less than 2 exploratory wells by April 1, 2012;

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- Provide adequate financing to carry out KNG’s planned activities; and

- Supervise implementation of all programs and budgets and provide written progress reports on a quarterly basis relating to KNG’s activities and programs.

Further, as Operator, Neftebitum may enter into and negotiate contracts on behalf of KNG and the Company and represent KNG or the Company in all dealings with governmental and regulatory bodies. Neftebitum must guarantee any financial obligations entered into on KNG’s behalf. Neftebitum may be reimbursed for expenses incurred in its role as Operator, and if KNG has inadequate resources to reimburse such expenses, these unreimbursed expenses may be accounted for at the time of the distribution of profits from KNG’s operations, if any. Neftebitum, however, will not charge Operator’s management fees in connection with its role as Operator. Additionally, the Company made available to the Operator all of the geological data, to be used in the program of geological studies in the region and will not charge fees for the use of geological data it provides. Neftebitum must also use its best efforts to maintain insurance for the Company. Lastly, Neftebitum’s responsibilities as Operator under the Operating Agreement may not be assigned or transferred.

As of the date of this filing, Neftebitum has raised approximately $155,000 through the sale of debt to pay for the first stage of the seismic project and the government fees for the subsoil use.

As of June 30, 2010, the Company owned a 44% interest in KNG. Effective September 30, 2008, the Company's 44% investment in KNG is recorded on the equity method of accounting. The operations of KNG prior to September 30, 2008 are included in the consolidated accounts of the Company in the accompanying financial statements.

After careful consideration of the current financial position of KNG, the Company has applied an impairment charge to the value of investment in KNG which resulted in carrying it at zero value.

Description of ZNG

ZNG has been involved in the oil and gas research activities in the Kurgan region of the Russian Federation. During 2003-2008 it has completed seismic studies and a drilling program in the Kurgan region of Siberia, Russia. The Company believes ZNG, Ltd. has created value through the geological results of the two exploratory wells and other data gathered in the area and ZNG, Ltd. is considering its options with regard to realizing this value in connection with a potential direct sale of geophysical and seismic data to a third party operating in the area.

Between 2003 and 2007, ZNG carried out extensive seismic and gas seismotomographic studies on its 4 licensed blocks acquired in 2003 through a government tender (which have since expired): the Privolny, Mokrousovsky, West-Suersky and Orlovo-Pashkovsky blocks, and drilled 2 exploratory wells on the Privolny and Mokrousovsky blocks. Based on the interpretation of seismic and seismotomographic surveys and analysis of samples from the wells, ZNG prepared a comprehensive analysis of geological resources of the Kurgan region. Both the Privolny-1 and Mokrousovsky-1 studies confirmed the presence of hydrocarbons and contributed greatly to the understanding of geological resources in the region. However, a substantial amount of further exploration studies and work is required before a conclusion on the future potential of the blocks can be drawn. Upon the expiration of the license terms of these blocks in March 2008, ZNG kept the preferential right to re-apply for the licenses.

The Company’s investment in the Joint Venture is recorded on the equity method of accounting. Since cumulative losses of Joint Venture exceed the Company’s investment, the investment asset is carried at zero value as of and through June 30, 2010.

As of the date of this filing, Baltic has advised us that Baltic and as a result, ZNG, has withdrawn from any further exploration activities in the Kurgan region and that they will not expend any further resources on such activities moving forward. Baltic has however advised us that they believe they may be able to sell ZNG's previously prepared seismic and geological studies and data in the future, assuming other exploration companies in the area desire to purchase such information, of which there is no assurance.

Joint Venture

The operations of the Joint Venture were funded via loans provided to ZNG, Ltd. and ZNG by Caspian Finance Limited ("Caspian"), a financing company wholly-owned by Baltic. Loans are guaranteed by ZNG, Ltd.'s holdings in ZNG. As of June 30, 2010, the total funding provided to ZNG, Ltd. and ZNG by Baltic was equal to approximately $23.5 million plus accrued interest of approximately $5 million. The loans are not dilutive to the Company's ownership in ZNG.

Recent Events:

In April 2010, and effective as of January 1, 2010, the Company entered into extensions to the Employment Agreements of David Zaikin, its Chairman and Chief Executive Officer and Elena Pochapski, its Director and Chief Financial Officer, which Employment Agreements as extended expired on June 30, 2010. Mr. Zaikin's Employment Agreement extension set his annual compensation at $180,000 and Ms. Pochapski's Employment Agreement extension set her annual compensation at $75,000. The Company anticipates entering into agreements further extending the Employment Agreements of Mr. Zaikin and Ms. Pochapski subsequent to the date of this filing, which agreements and the terms and conditions thereof have not been finalized to date.

PLAN OF OPERATIONS FOR THE NEXT TWELVE MONTHS

In coordination with Neftebitum, the Company plans to focus on the exploration activities of KNG in the Khanty-Mansiysk region of Russia, to satisfy the requirements of the licensing agreements and to conduct preparatory work for the seismic surveys on these areas, funding permitting (which funding is the responsibility of Neftebitum), of which there can be no assurance.

Moving forward, we anticipate targeting other potential long term investments in Russia and countries in the former Soviet Union, separate from our involvement in the Joint Venture and KNG, funding permitting, of which there can be no assurance. Additionally, the Company currently plans to change its business focus from targeting early stage exploration projects to acquiring assets in producing fields, funding permitting, of which there can be no assurance, in order to decrease its exploration risks.

Currently we are evaluating different business opportunities in the oil and gas industry, including advanced development stage and revenue-producing enterprises and are in preliminary discussions with a potential partner which owns several oil and gas producing properties in Western Siberia; however, as no definitive agreement has been reached, we can provide no assurances that the discussions will result in any definitive understandings or partnerships, and it is likely that any agreement would be conditioned on us raising substantial additional funding, which we can provide no assurances will be available on favorable terms, if at all.

Historically, we have obtained cash financing from organizing stockholders in the form of loans and advances. Additionally, during the fourth quarter of 2005, we restructured much of our debt through the issuance of shares of our common stock to our creditors and obtained waiver letters, postponing certain of our liabilities until such time as we have generated sufficient profits to pay such debts. These waiver letters related to the payment of certain trade debts as well as shareholder loans and accrued salaries.

In connection with the Joint Venture, the Company previously received monthly management fees, which varied from $25,000 to $85,000 per month. Due to the "transition period" of the Joint Venture's exploration activities and subsequent decision of Baltic not to pursue further exploration activities through ZNG, no management fees have been paid since October 2007, and the Joint Venture will not pay any management fees in the future. As the Company will not receive any management fees moving forward, the Company believes that its organizing stockholders will continue to provide financing for the Company, of which there can be no assurance.

In the past, we have obtained cash financing from organizing stockholders in the form of loans and advances, as a result, amounts totaling $539,931 and $523,906 were payable to the stockholders as of June 30, 2010 and December 31, 2009, respectively. However, there can be no certainty as to the availability of continued financing in the future. Failure to obtain sufficient financing may require us to reduce our operating activities. A failure to continue as a going concern would then require stated amounts of assets and liabilities to be reflected on a liquidation basis which could differ from the going concern basis.

COMPARISON OF OPERATING RESULTS

RESULTS OF OPERATIONS FOR THE THREE MONTHS ENDED JUNE 30, 2010, COMPARED TO THE THREE MONTHS ENDED JUNE 30, 2009

We had no revenues and other income for the three months ended June 30, 2010 or 2009. Until October 2007, the Company received monthly management fees of between $25,000 and $85,000 pursuant to terms of the Joint Venture. However, the Company has not received any management fees since October 2007, and does not anticipate receiving any such fees moving forward.

We have not generated any revenues to date through the sale of oil and/or gas.

We had total expenses of $146,205 for the three months ended June 30, 2010, compared to total expenses for the three months ended June 30, 2009, of $182,226, which represented a decrease in total expenses from the prior period of $36,021 or 19.8%.

The main reasons for the decrease in total expenses for the three months ended June 30, 2010, compared to the three months ended June 30, 2009, were a $20,226 or 19.7% decrease in salaries, to $82,700 for the three months ended June 30, 2010, compared to $102,926 for the three months ended June 30, 2009, in connection with no options being granted to employees in 2010, compared with options granted to employees in 2009, which increased total salaries over that period, and a $13,154 or 80% decrease in marketing and other expenses to $3,284 for the three months ended June 30, 2010, compared to $16,438 for the three months ended June 30, 2009 in connection with a decrease in travel expenses in 2010.

The Company is currently taking steps to move its New York office space, and as such, the Chief Executive Officer has been personally paying the Company's office space rent and not billing the Company since approximately December 31, 2008, which resulted in the Company having no rent or occupancy expense for the three months ended June 30, 2010 and 2009.

We had a net loss of $146,205 for the three months ended June 30, 2010, compared to a net loss of $182,226 for the three months ended June 30, 2009, a decrease in net loss of $36,021 or 19.8% from the prior period.

RESULTS OF OPERATIONS FOR THE SIX MONTHS ENDED JUNE 30, 2010, COMPARED TO THE SIX MONTHS ENDED JUNE 30, 2009

We had no revenues and other income for the six months ended June 30, 2010 or 2009. Until October 2007, the Company received monthly management fees of between $25,000 and $85,000 pursuant to terms of the Joint Venture. However, the Company has not received any management fees since October 2007, and does not anticipate receiving any such fees moving forward.

We have not generated any revenues to date through the sale of oil and/or gas.

We had total expenses of $293,099 for the six months ended June 30, 2010, compared to total expenses for the six months ended June 30, 2009, of $325,877, which represented a decrease in total expenses from the prior period of $32,778 or 10.1%.

The main reasons for the decrease in total expenses for the six months ended June 30, 2010, compared to the six months ended June 30, 2009, were a $19,026 or 10.4% decrease in salaries, to $164,500 for the six months ended June 30, 2010, compared to $183,526 for the six months ended June 30, 2009, in connection with no options being granted to employees in 2010, compared with options granted to employees in 2009, which increased total salaries over that

period, and a $17,693 or 73.7% decrease in marketing and other expenses, to $6,300 for the six months ended June 30, 2010, compared to $23,993 for the six months ended June 30, 2009, in connection with a decrease in travel expenses in 2010.

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The Company is currently taking steps to move its New York office space, and as such, the Chief Executive Officer has been personally paying the Company's office space rent and not billing the Company since approximately December 31, 2008, which resulted in the Company having no rent or occupancy expense for the six months ended June 30, 2010 and 2009.

We had a net loss of $293,099 for the six months ended June 30, 2010, compared to a net loss of $325,877 for the six months ended June 30, 2009, a decrease in net loss of $32,778 or 10.1% from the prior period.

LIQUIDITY AND CAPITAL RESOURCES

We had current assets of $1,091 as of June 30, 2010, which included cash of $505; and prepaid expenses and other current assets of $586.

We had total assets of $2,050 as of June 30, 2010, which included current assets of $1,091 and non-current assets of $959 representing property and equipment, net.

We had total liabilities of $2,651,347 as of June 30, 2010, which were solely current liabilities and which included $539,931 of accounts payable to related party stockholders in connection with those shareholders paying certain of our expenses from the period between January 1, 2003 to June 30, 2010; $72,148 of accounts payable to Baltic in connection with a $29,000 loan advanced to the Company from Baltic, interest on such loan, and certain other expenses owed to Baltic; $719,661 of accounts payable to others for advisory and professional services rendered; and $1,319,607 of accrued payroll, which included $742,500 payable to our Chief Executive Officer, David Zaikin, of which $630,000 was accrued in 2007-2010, and $112,500 which was owed to Mr. Zaikin for services rendered prior to September 2005, at which time he agreed to stop accruing salary until January 2007, when he provided us notice of his intent to once again begin accruing salary until such time as we have sufficient funds to pay such accrued salary, $277,029 payable to our Chief Financial Officer, Elena Pochapski, and $69,242 of accrued salary payable to our former Chief Executive Officer, Shakeel Adam.

We had negative working capital of $2,650,256 and a total pre-development and development stage accumulated deficit of $15,815,604 as of June 30, 2010.

Because our cumulative losses associated with the operations of ZNG exceeded our investment as of the date of the Joint Venture, ZNG, Ltd. is carried on our balance sheet at $-0- as of June 30, 2010. Our investment in ZNG, Ltd. will exceed $-0- at such time as ZNG, Ltd. has cumulative earnings sufficient to repay all loans to Baltic as provided in the Joint Venture, if ever.

As of June 30, 2010, the Company owns a 44% interest in KNG. The Company's investment in KNG is recorded on the equity method of accounting effective October 1, 2008. After careful consideration of the current financial position of KNG, the Company applied an impairment charge to the value of the investment in KNG which resulted in carrying it at zero value.

We had $6,927 of net cash flows from operating activities for the six months ended June 30, 2010, which was mainly attributable to adjustments to reconcile $293,099 of net loss, offset by $299,708 of accounts payable and accrued expenses.

In connection with the Joint Venture (described under "Joint Venture," above), the Company historically received management fees, which varied from $25,000 to $85,000 per month. Due to the "transition period" of the Joint Venture's exploration activities, no management fees were paid during the year ended December 31, 2009, or the six months ended June 30, 2010, and the Company does not anticipate receiving any such fees moving forward. If the Company does not receive any management fees moving forward, the Company anticipates that its stockholders and

management will continue to provide financing for the Company, of which there can be no assurance.

In connection with the activities of KNG, we are not currently receiving compensation for the use of the Company's geological data. According to the Operating agreement with Neftebitum, such fees may be paid to us in future years depending on the financial position of KNG, of which there can be no assurance.

We are taking steps to raise equity capital and/or to borrow additional funds. There can be no assurance that any new capital will be available to us or that adequate funds for our operations, whether from our financial markets, or other arrangements will be available when needed or on terms satisfactory to us, if at all. We have no commitments from officers, directors or affiliates to provide funding. Our failure to obtain adequate financing may require us to delay, curtail or scale back some or all of our operations. Additionally, any additional financing may involve dilution to our then-existing shareholders.

Critical Accounting Policies

Use of Estimates:

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America (GAAP) requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

Principles of Consolidation:

The accompanying consolidated financial statements include the accounts of the Company and its then wholly-owned subsidiaries, ZNG (through October 14, 2005), Siberian Energy Group (Canada) and KNG (December 31, 2006 through September 30, 2008). All intercompany transactions and balances have been eliminated. After October 14, 2005, the Company's investment in ZNG is accounted for on the equity method of accounting. After September 30, 2008, the Company's investment in KNG is accounted for on the equity method of accounting. Accordingly, the assets, liabilities and equity are no longer presented on the Company's balance sheet.

Foreign Currency Translation:

The Russian subsidiaries ZNG and KNG use the Ruble as their functional currency; Siberian Energy Group (Canada) uses the Canadian dollar as its functional currency. The books and records of ZNG, KNG and Siberian Energy Group (Canada) are kept in their functional currencies. The Company translates to U.S. dollars the assets and liabilities of ZNG, KNG, and Siberian Energy Group (Canada) at the year-end exchange rates; and income statement amounts are converted at the average rates of exchange for the year. Translation gains and losses are included within other comprehensive income (loss).

Oil and Gas Properties:

The Company follows the full cost method of accounting for oil and gas properties. Accordingly, all costs associated with acquisition, exploration, and development of oil and gas reserves, including directly related overhead costs, are capitalized.

All capitalized costs of oil and gas properties, including the estimated future costs to develop proved reserves, will be amortized on the unit-of production method using estimates of proved reserves. Investments in unproved properties and major development projects are not amortized until proved reserves associated with the projects can be determined or until impairment occurs. When applicable, if the results of an assessment indicate that the properties are impaired, the amount of the impairment is added to the capitalized costs to be amortized.

In addition, the capitalized costs are subject to a “ceiling test,” which basically limits such costs to the aggregate of the “estimated present value,” discounted at a 10-percent interest rate of future net revenues from proved reserves, based on current economic and operating conditions, plus the lower of cost or fair market value of unproved properties.

Sales of proved and unproved properties are accounted for as adjustments of capitalized costs with no gain or loss recognized, unless such adjustments would significantly alter the relationship between capitalized costs and proved reserves of oil and gas, in which case the gain or loss is recognized in income. Abandonments of properties are accounted for as adjustments of capitalized costs with no loss recognized.

Property and Equipment:

Property and equipment is stated at cost, net of accumulated depreciation. Depreciation is provided using the straight-line method.

Long-Lived Assets:

Long lived assets to be held and used or disposed of other than by sale are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. When required, impairment losses on assets to be held and used or disposed of other than by sale are recognized based on the fair value of the asset. Long-lived assets to be disposed of by sale are reported at the lower of its carrying amount or fair value less cost to sell.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Pursuant to Item 305(e) of Regulation S-K (§ 229.305(e)), the Company is not required to provide the information required by this Item as it is a “smaller reporting company,” as defined by Rule 229.10(f)(1).

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Control and Procedures

We conducted an evaluation of the effectiveness of our disclosure controls and procedures as such term is defined in Rule 13a-15(e) of the Securities Exchange Act of 1934, as amended (the “Exchange Act”) as of June 30, 2010. This evaluation was carried out under the supervision and with participation of our Chief Executive Officer and Chief Financial Officer. Based upon this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that as of June 30, 2010, our disclosure controls and procedures are not effective as a result of the material weakness in internal control over financial reporting discussed below.

Notwithstanding the assessment that our internal control over financial reporting was not effective and that there were material weaknesses as identified in this report, we believe that our unaudited consolidated financial statements contained in this Report fairly present our financial position, results of operations and cash flows for the periods covered herein in all material respects.

As of December 31, 2009, management assessed the effectiveness of the Company's internal control over financial reporting based on the criteria for effective internal control over financial reporting established in Internal Control--Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") and SEC guidance on conducting such assessments. Based on that evaluation, management concluded that, during the period covered by our Annual Report on Form 10-K, such internal controls and procedures were not effective to detect the inappropriate application of US GAAP rules as more fully described below. This was due to deficiencies that existed in the design or operation of our internal control over financial reporting that adversely

affected our internal controls and that taken together may be considered to be a material weakness.

We are committed to improving our financial organization. As part of this commitment, we will, as soon as funds are available to the Company (1) appoint one or more outside directors to our board of directors who shall be appointed to the audit committee of the Company resulting in a fully functioning audit committee who will undertake the oversight in the establishment and monitoring of required internal controls and procedures; (2) create a position to segregate duties consistent with control objectives and will increase our personnel resources; and (3) hire independent third parties to provide expert advice.

We will continue to monitor and evaluate the effectiveness of our internal controls and procedures and our internal controls over financial reporting on an ongoing basis and are committed to taking further action and implementing additional enhancements or improvements, as necessary and as funds allow.

Changes in internal control over financial reporting

There were no changes in our internal control over financial reporting during our most recent fiscal quarter that materially affected, or were reasonably likely to materially affect, our internal control over financial reporting.

PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

In January 2007, we learned that certain of our former officers, Directors and shareholders, had attempted to transfer shares of our common stock, which those individuals had agreed to cancel in connection with the purchase of a majority of the Company's outstanding shares from those individuals by our current officers, Directors and majority shareholders in April 2003. In February 2007, we filed for a Temporary Restraining Order and Motion for Preliminary Injunction against those individuals in the District Court of Clark County, Nevada.

On February 20, 2007, our Temporary Restraining Order and Motion for Preliminary Injunction was heard by the District Court of Clark County, Nevada, and we were granted an indefinite injunction without a hearing by the court. As such, those individuals who previously attempted to transfer and sell the shares which they held will be prevented from transferring or selling such shares until they can show good cause with the court why such indefinite injunction should be lifted.

From time to time, we may become party to other litigation or other legal proceedings that we consider to be a part of the ordinary course of our business. We are not currently involved in legal proceedings that could reasonably be expected to have a material adverse effect on our business, prospects, financial condition or results of operations, other than the proceeding described above. We may become involved in material legal proceedings in the future.

ITEM 1A. RISK FACTORS

Our securities are highly speculative and should only be purchased by persons who can afford to lose their entire investment in our Company. If any of the following risks actually occur, our business and financial results could be negatively affected to a significant extent. The Company's business is subject to many risk factors, including the following:

RISK OF CONTINUING OUR BUSINESS PLAN WITHOUT ADDITIONAL FINANCING.

We depend to a great degree on the ability to attract external financing in order to conduct future exploratory and development activities. The Company believes it can satisfy its cash requirements during the next twelve months, estimated at approximately $300,000, through funding provided by existing stockholders. As of June 30, 2010, the total funding provided to ZNG, Ltd. and ZNG by Baltic was equal to $23.5 million plus accrued interest of approximately $5 million, which has been spent on various purposes, including seismic and gas seismotomography surveys, drilling of two exploratory wells, and paying consultants for services performed in connection with surveys performed on the previously licensed area. Our partner in ZNG, Baltic has informed us that they do not plan to move forward with any further exploration activities through ZNG. The Company's partner in KNG, Neftebitum, is responsible for financing the research work of KNG. Neftebitum is currently attempting to raise external funds; however, no significant amounts have been raised to date. If you invest in our Company and we are unable to raise the required funds, your investment could become worthless.

KNG WILL NEED SUBSTANTIAL FINANCING AND SUBSTANTIAL TIME BEFORE WE ANTICIPATE GENERATING REVENUES THROUGH KNG, IF ANY.

The Company anticipates the need for approximately $15,000,000 prior to KNG's expected generation of any revenues. In connection with the Agreement of Purchase and Sale, as described in more detail above, the Company sold a 56% interest in KNG to Neftebitum and various individuals in September 2008. Pursuant to this agreement and the related Operating Agreement, Neftebitum is responsible for providing financing for the operations of KNG. Currently, the Company is aware of Neftebitum raising only a small part of this financing and the Company can make

no assurances that sufficient financing will ever be raised. The Company also does not expect to generate any revenues through the operations of KNG, until such financing can be raised, of which there can be no assurance. Therefore, investors should keep in mind that even if Neftebitum is able to raise the substantial amounts of additional financing that KNG requires for its operations, it could still be years before KNG generates any revenue, if ever. If Neftebitum does not raise the $15,000,000 which the Company anticipates KNG needs to generate revenues, which, even if generated, will likely not be great enough to sustain KNG if no revenues are generated and hydrocarbon reserves are not discovered, KNG may be forced to abandon its business plan, and the Company could be forced to abandon or curtail its business plan as well, which could cause the value of the Company's common stock to substantially decline or become worthless.

OUR AUDITORS HAVE EXPRESSED SUBSTANTIAL DOUBT AS TO WHETHER OUR COMPANY CAN CONTINUE AS A GOING CONCERN.

Our Company is in its early development stage, as planned principal activities have not begun. We have generated only minimal revenues since inception and have incurred substantial losses including a net loss of $666,116 for the year ended December 31, 2009, a net loss of $146,205 and $293,099 for the three and six months ended June 30, 2010, respectively, and had total cash on hand of $505 and a total accumulated deficit of $15,815,604 as of June 30, 2010. These factors among others indicate that the Company may be unable to continue as a going concern, particularly in the event that it cannot generate sufficient cash flow to conduct its operations and/or obtain additional sources of capital and financing.

WE LACK AN OPERATING HISTORY WHICH YOU CAN USE TO EVALUATE US, MAKING ANY INVESTMENT IN OUR COMPANY RISKY.

Our Company lacks a long standing operating history which investors can use to evaluate our Company's previous earnings. Therefore, an investment in our Company is risky because we have no business history and it is hard to predict what the outcome of our business operations will be in the future.

WE MAY CONTINUE TO BE UNPROFITABLE AND MAY NOT GENERATE PROFITS TO CONTINUE OUR BUSINESS PLAN.

As a development stage company, we have had limited revenues and no profits to date and our net cumulative deficit attributable to our development stage as of June 30, 2010, was $15,365,819, and our total cumulative deficit was $15,815,604 which included $449,785 of pre-development stage deficit. We had $1,319,607 in accrued and unpaid salaries and a working capital deficit of $2,650,256 as of June 30, 2010. The Company is currently being funded by existing shareholders, but there can be no assurance this amount will be sufficient to continue our planned operations or that we will have enough money to repay our outstanding debts. If throughout KNG’s future oil exploration, if any, no viable wells are found, and consequently, we generate only minimal revenues through KNG, we will likely be forced to curtail or abandon our business plan. If this happens, you could lose your investment in our Company. If we are unable to generate profits, we will be forced to rely on external financing, of which there is no guarantee, to continue with our business plan.

LICENSES TO A TOTAL OF FOUR OF ZNG’S LICENSED BLOCKS EXPIRED IN MARCH 2008 AND THREE ADDITIONAL LICENSES HAVE SINCE EXPIRED, AND THERE IS A RISK THAT THE RIGHTS TO SUCH LICENSED BLOCKS MAY NOT BE RENEWED.

In or around March 2008, ZNG’s rights to four licensed blocks acquired in 2003, the Privolny, Mokrousovsky, West-Suersky and Orlovo-Pashkovsky blocks, expired and since that time, additional rights to three license blocks have expired. Between 2003 and 2007, ZNG carried out extensive seismic and gas seismotomographic studies on the four licensed blocks, and drilled 2 exploratory wells on the Privolny and Mokrousovsky blocks. Based on the interpretation of seismic and seismotomographic surveys and analysis of samples from the wells, ZNG prepared a comprehensive analysis of geological resources of the Kurgan region. Both the Privolny and Mokrousovsky studies confirmed the presence of hydrocarbons; however, a substantial amount of further exploration studies and work is required before a conclusion on the future potential of the blocks can be drawn. The licenses to four of the blocks expired in March 2008 and an additional three licenses have expired since then, and although ZNG kept the preferential right to re-apply for the licenses to continue exploration works on these blocks in the event it decides to restart exploration activities, there can be no assurance that such blocks will be able to be re-licensed by ZNG and/or that they will not be re-auctioned and awarded to alternative parties. If ZNG were to decide to re-license the blocks and they had already been auctioned off to other parties and/or were not eligible to be re-licensed, all of ZNG’s exploration work and studies performed on the previously licensed areas may become worthless and any exploration

expenditures made by ZNG for exploration wells and other expenditures will likely not be able to be recouped by ZNG. Additionally, if ZNG were unable to re-license the blocks, the value of the Company's securities could decline in value and/or become worthless.

WE HAVE A POOR FINANCIAL POSITION AND IF WE DO NOT GENERATE REVENUES, WE MAY BE FORCED TO ABANDON OUR BUSINESS PLAN.

Our Company currently has a poor financial position. We have generated only minimal revenues to date, and we have not discovered any hydrocarbon reserves or begun production on any wells. There is a risk that we will not find enough, or even any, viable wells which we require to generate enough profits for your investment in our Company to appreciate. If we never generate any revenues, our Company may be forced to curtail or abandon its business plan and your shares may become worthless.

OUR BUSINESS IS SPECULATIVE AND RISKY AND IF KNG DOES NOT FIND HYDROCARBON RESERVES, WE MAY BE FORCED TO CURTAIL OUR BUSINESS PLAN.

There is a risk that KNG will not find any hydrocarbon reserves and the cost of exploration will become too high for us to continue KNG’s business plan. As our only current operations are through our 44% ownership of KNG, if KNG were to cease operations, your investment in our Company could become devalued or could become worthless.

OUR INDUSTRY IS COMPETITIVE AND AS SUCH, COMPETITIVE PRESSURES COULD PREVENT US FROM OBTAINING PROFITS.

The main factor determining success in the oil exploration and extraction industry is finding viable wells. If our Company, through ZNG, Ltd., KNG or other joint ventures we may enter into in the future, are unable to find producing wells and our competition is, it is likely that our Company will be driven out of business. Additionally, our industry is subject to significant capital requirements and as such, larger companies may have an advantage should they compete with us for exploration licenses, because they may have resources substantially greater than ours. Investors should take into account the above factors and understand that if we are unable to raise additional capital or generate profits, the Company may be forced to liquidate its assets and an investment in our Company could become worthless.

OUR GROWTH WILL PLACE SIGNIFICANT STRAINS ON OUR RESOURCES.

The Company's growth is expected to place a significant strain on the Company's managerial, operational and financial resources. Furthermore, as the Company receives contracts, the Company will be required to manage multiple relationships with various customers and other third parties. These requirements will be exacerbated in the event of further growth of the Company or in the number of its contracts. There can be no assurance that the Company's systems, procedures or controls will be adequate to support the Company's operations or that the Company will be able to achieve the rapid execution necessary to succeed and implement its business plan. The Company's future operating results will also depend on its ability to add additional personnel commensurate with the growth of its business. If the Company is unable to manage growth effectively, the Company's business, results of operations and financial condition will be adversely affected.

WE RELY ON KEY PERSONNEL AND IF THEY LEAVE OUR COMPANY OUR BUSINESS PLAN COULD BE ADVERSELY AFFECTED.

We rely on the Company's Chief Executive Officer and Chief Financial Officer, David Zaikin and Elena Pochapski, for the success of our Company, who are not currently employed under employment agreements; provided that the Company anticipates entering into Employment Agreement extensions with such individuals subsequent to the date of this filing. Their experience and input create the foundation for our business and they are responsible for the directorship and control over the Company's development activities. The Company does not hold "key man" insurance on either member of management. Moving forward, should they be lost for any reason, the Company will incur costs associated with recruiting replacement personnel and any potential delays in operations. If we are unable to replace

Mr. Zaikin and/or Ms. Pochapski, or if Mr. Zaikin or Ms. Pochapski are unable to spend a sufficient amount of time on Company matters, the Company may be forced to scale back or curtail its business plan. As a result of this, any securities you hold in our Company could become devalued.

ZNG'S OR KNG'S PROJECTIONS, ESTIMATES AND STATISTICAL ANALYSIS MAY BE INACCURATE OR SUBSTANTIALLY WRONG, WHICH MAY PREVENT ZNG AND/OR KNG FROM EXECUTING THEIR BUSINESS PLANS.

Projections on future revenues as well as costs and required capital expenditures are based on estimates. Business statistical analysis is used in projection of drilling success ratios, average production costs, world oil price fluctuations and their correspondence to Russian domestic market. If ZNG's or KNG's projections or estimates are wrong or our statistical analysis faulty, ZNG's or KNG's revenues may be adversely affected which could prevent ZNG and/or KNG from executing their business strategy. As an investor, if this happens your securities in our Company could be adversely affected and you could lose your investment in our Company.

THERE IS UNCERTAINTY AS TO OUR ABILITY TO ENFORCE CIVIL LIABILITIES BOTH IN AND OUTSIDE OF THE UNITED STATES DUE TO THE FACT THAT OUR OFFICERS, DIRECTORS AND ASSETS ARE NOT LOCATED IN THE UNITED STATES.

Our officers and Directors, our properties and licenses, and the majority of our assets are located in countries other than the United States, including Canada and Russia. As a result, it may be difficult for shareholders to effect service of process within the United States on our officers and Directors. In addition, investors may have difficulty enforcing judgments based upon the civil liability provisions of the securities laws of the United States or any state thereof, both in and outside of the United States.

WE FACE RISKS ASSOCIATED WITH THE FACT THAT THE MAJORITY OF OUR OPERATIONS THROUGH OUR HOLDINGS ARE CONDUCTED IN RUSSIA, AND THE LICENSES OWNED THROUGH OUR HOLDINGS ARE IN RUSSIA.

Zauralneftegaz, Ltd. which we own 50% of through our Joint Venture, and KNG, which we own 44% of, hold certain licenses and rights to reapply for licenses to certain oil and gas properties in the Kurgan Region of Russia. As a result, we are subject to various risks associated with doing business in Russia relating to Russia's economic and political environment. As is typical of an emerging market, Russia does not possess a well-developed business, legal and regulatory infrastructure that would generally exist in a more mature free market economy and, in recent years, Russia has undergone substantial political, economic and social change. Furthermore, in recent years the Russian government has unilaterally annexed certain oil and gas properties and companies for the government, and there can be no assurance that if commercially exploitable oil and gas reserves are found on our properties, that such properties will not be annexed or otherwise claimed by the Russian government. Our failure to manage the risks associated with doing business in Russia could have a material adverse effect upon our results of operations.

IF WE ARE LATE IN FILING OUR QUARTERLY OR ANNUAL REPORTS WITH THE SEC, WE MAY BE DE-LISTED FROM THE OVER-THE-COUNTER BULLETIN BOARD.

Under Over-The-Counter Bulletin Board ("OTCBB") rules relating to the timely filing of periodic reports with the SEC, any OTCBB issuer who fails to file a periodic report (Form 10-Q's or 10-K's) by the due date of such report (not withstanding any extension granted to the issuer by the filing of a Form 12b-25), three (3) times during any twenty-four (24) month period are de-listed from the OTCBB. Such removed issuer would not be re-eligible to be listed on the OTCBB for a period of one-year, during which time any subsequent late filing would reset the one-year period of de-listing. Therefore, if we are late in filing a periodic report three times in any twenty-four (24) month period and are de-listed from the OTCBB, our securities may become worthless and we may be forced to curtail or abandon our business plan.

WE INCUR SIGNIFICANT COSTS AS A RESULT OF OPERATING AS A FULLY REPORTING COMPANY IN CONNECTION WITH SECTION 404 OF THE SARBANES OXLEY ACT, AND OUR MANAGEMENT IS REQUIRED TO DEVOTE SUBSTANTIAL TIME TO NEW COMPLIANCE INITIATIVES.

We anticipate incurring significant legal, accounting and other expenses in connection with our status as a fully reporting public company. The Sarbanes-Oxley Act of 2002 (the "Sarbanes-Oxley Act") and new rules subsequently implemented by the SEC have imposed various new requirements on public companies, including requiring changes in corporate governance practices. As such, our management and other personnel will need to devote a substantial amount of time to these new compliance initiatives. Moreover, these rules and regulations will increase our legal and financial compliance costs and will make some activities more time-consuming and costly. In addition, the Sarbanes-Oxley Act requires, among other things, that we maintain effective internal controls for financial reporting and disclosure of controls and procedures. Our testing may reveal deficiencies in our internal controls over financial reporting that are deemed to be material weaknesses. Our compliance with Section 404 will require that we incur substantial accounting expense and expend significant management efforts. We currently do not have an internal audit group, and we may need to hire additional accounting and financial staff with appropriate public company experience and technical accounting knowledge. Moreover, if we are not able to comply with the requirements of Section 404 in a timely manner, or if we identify deficiencies in our internal controls over financial reporting that are deemed to be material weaknesses, the market price of our stock could decline, and we could be subject to sanctions or investigations by the SEC or other regulatory authorities, which would require additional financial and management resources.

AS THERE IS CURRENTLY ONLY A LIMITED MARKET FOR OUR COMMON STOCK, THE MARKET FOR OUR COMMON STOCK MAY CONTINUE TO BE ILLIQUID, SPORADIC AND VOLATILE.

There is currently only a limited market for our common stock, and as such, we anticipate that such market will be illiquid, sporadic and subject to wide fluctuations in response to several factors moving forward, including, but not limited to:

(1) actual or anticipated variations in our results of operations;

(2) our ability or inability to generate new revenues;

(3) the number of shares in our public float;

(4) increased competition;

(5) the political atmosphere in Russia; and

(6) conditions and trends in the oil, gas, and energy industries in general.

Furthermore, because our common stock is traded on the Over-The-Counter Bulletin Board, our stock price may be impacted by factors that are unrelated or disproportionate to our operating performance. These market fluctuations, as well as general economic, political and market conditions, such as recessions, interest rates or international currency fluctuations may adversely affect the market price of our common stock. Additionally, at present, we have a limited number of shares in our public float, and as a result, there could be extreme fluctuations in the price of our common stock.

INVESTORS FACE A RISK THAT THE COMPANY WILL NOT BE SUBJECT TO THE REPORTING REQUIREMENTS OR WILL ENTER INTO A TRANSACTION THAT RESULTS IN NEW MANAGEMENT AND A NEW OPERATING BUSINESS OF THE COMPANY.

Management of the Company is analyzing steps to no longer be subject to the reporting requirements of the Securities and Exchange Commission (the "SEC") and/or considering entering into a reverse merger transaction. In the event that the Company is no longer subject to the reporting requirements of the SEC, the Company's stock would likely trade on the Pinksheets and would likely have less liquidity on such market and may trade at a lower share price than it currently trades. In the event that the Company enters into a reverse merger transaction, new management would run the Company and would likely operate a new business which may result in a loss on your investment.

STATE SECURITIES LAWS MAY LIMIT SECONDARY TRADING, WHICH MAY RESTRICT THE STATES IN WHICH AND CONDITIONS UNDER WHICH YOU CAN SELL SHARES.

Secondary trading in our common stock may not be possible in any state until the common stock is qualified for sale under the applicable securities laws of the state or there is confirmation that an exemption, such as listing in certain recognized securities manuals, is available for secondary trading in the state. If we fail to register or qualify, or to obtain or verify an exemption for the secondary trading of the common stock in any particular state, the common stock cannot be offered or sold to, or purchased by, a resident of that state. In the event that we do not apply for registration in, there is not a valid exemption for, and/or a significant number of states refuse to permit secondary trading in our common stock, the liquidity for the common stock could be significantly impacted.

INVESTORS MAY FACE SIGNIFICANT RESTRICTIONS ON THE RESALE OF OUR COMMON STOCK DUE TO FEDERAL REGULATIONS OF PENNY STOCKS.

Our common stock will be subject to the requirements of Rule 15(g)9, promulgated under the Securities Exchange Act as long as the price of our common stock is below $5.00 per share. Under such rule, broker-dealers who recommend low-priced securities to persons other than established customers and accredited investors must satisfy special sales practice requirements, including a requirement that they make an individualized written suitability determination for the purchaser and receive the purchaser's consent prior to the transaction. The Securities Enforcement Remedies and Penny Stock Reform Act of 1990, also requires additional disclosure in connection with any trades involving a stock defined as a penny stock.

Generally, the Commission defines a penny stock as any equity security not traded on an exchange or quoted on NASDAQ that has a market price of less than $5.00 per share. The required penny stock disclosures include the delivery, prior to any transaction, of a disclosure schedule explaining the penny stock market and the risks associated with it. Such requirements could severely limit the market liquidity of the securities and the ability of purchasers to sell their securities in the secondary market.

In addition, various state securities laws impose restrictions on transferring "penny stocks" and as a result, investors in the common stock may have their ability to sell their shares of the common stock impaired.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

The Company has previously agreed to pay its President, Helen Teplitskaia, 10,000 shares of common stock per month for her service to the Company. As such, in June 2009, the Company issued Ms. Teplitskaia an aggregate of 60,000 shares, 10,000 shares per month from January 2009 to June 2009. The Company also owes Ms. Teplitskaia an additional 140,000 shares for services rendered during the months of July, August, September, October, November and December 2009 and the months of January, February, March, April, May, June, July and August 2010, which shares the Company has agreed to issue to Ms. Teplitskaia for services rendered during the months of July 2009

through August 2010, which shares have not been issued to date and have not been included in the total number of outstanding shares disclosed throughout this report.

The Company claims an exemption from registration afforded by Section 4(2) of the Securities Act of 1933, as amended, since the foregoing issuance did not involve a public offering, the recipient took the securities for investment and not resale and the Company took appropriate measures to restrict transfer.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES.

None.

ITEM 4. (REMOVED AND RESERVED)

None.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

Exhibit No.	Description of Exhibit
10.1(1)	Option Agreement with Baltic Petroleum Limited dated April 28, 2005
10.2(1)	License Agreement between OOO Zauralneftegaz and Baltic Petroleum Limited dated April 28, 2005
10.3(1)	Loan Agreement between OOO Zauralneftegaz and Baltic Petroleum Limited dated April 28, 2005
10.4(1)	Guarantee by Siberian Energy Group, Inc. dated April 28, 2005
10.5(1)	Pledge and Security Agreement between Siberian Energy Group, Inc. and Baltic Petroleum Limited dated April 28, 2005
10.6(2)	Option Agreement with Baltic Petroleum Limited dated April 28, 2005
10.7(2)	License Agreement between OOO Zauralneftegaz and Baltic Petroleum Limited dated April 28, 2005
10.8(2)	Loan Agreement between OOO Zauralneftegaz and Baltic Petroleum Limited dated April 28, 2005
10.9(2)	Guarantee by Siberian Energy Group, Inc. dated April 28, 2005
10.10(2)	Pledge and Security Agreement between Siberian Energy Group, Inc. and Baltic Petroleum Limited dated April 28, 2005
10.11(3)	Clarification to the Contract of Purchase and Sale of the Share in Charter Capital of LLC "Zauralneftegaz" dated 15 May 2004

10.12(3)	Agreement with Business - Standard (translated from Russian version)
10.13(3)	Supplementary Agreement to Business - Standard Agreement (translated from Russian version)
10.14(3)	Supplementary Agreement No. 2 to Business - Standard Agreement (translated from Russian version)

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10.15(3) Deed of Amendment between ZNG and BP

10.16(3) Deed of Amendment between the Company and BP

10.17(4) Joint Venture Shareholders' Agreement with Baltic Petroleum (E&P) Limited and Zauralneftegaz Limited dated October 14, 2005

10.18(5) Amendment to the Employment Agreement Dated August 1, 2003, with Elena Pochapski

10.19(5) Form of Waiver Agreement

10.20(6) Loan Agreement between OOO Zauralneftegaz and Caspian Finance Limited

10.21(6) Deed of Novation between Baltic Petroleum Limited, Caspian Finance Limited and OOO Zauralneftegaz

10.22(6) Deed of Release

10.23(6) Release of Pledge

10.24(6) Guarantee

10.25(6) Debenture

10.26(6) Agreement for the Pledge of the Participatory Interest in OOO Zauralneftegaz (Russian translation removed)

10.27(6) Sale and Purchase Agreement

10.28(8) Option Agreement with Key Brokerage

10.29(8) Warrant Agreement with Key Brokerage

10.30(9) July 26, 2006 Deed of Agreement

10.31(10) Consulting Agreement with Business Standard

10.32(11) Addition to the Loan Agreement of November 9, 2005

10.33(11) Gross Overriding Royalty Agreement

10.34(12) Amendment No. 2 to the Employment Agreement Dated August 1, 2003 with Elena Pochapski

10.35(13) Deed of Variation to the Loan Agreement Dated 9th of November 2005, Entered into in June 2007

10.36(15) Agreement of Purchase and Sale with Limited Liability Company Neftebitum, Sergey V. Prokopiev, and Oleg G. Shelepov

10.37(15) Operating Agreement with Limited Liability Company Neftebitum

10.38(16) One Year Extension to the Employment Agreement of August 1, 2004 with David Zaikin

10.39(16) One Year Extension to the Employment Agreement of August 1, 2004 with Elena Pochapski

10.40(16)	Stock Option Agreement for David Zaikin
10.41(16)	Stock Option Agreement for Elena Pochapski
10.42(17)	Extension of Employment Agreement of David Zaikin
10.43(17)	Extension of Employment Agreement of Elena Pochapski
21.1(14)	Subsidiaries
31.1*	Certificate of the Chief Executive Officer pursuant Section 302 of the Sarbanes-Oxley Act of 2002
31.2*	Certificate of the Chief Financial Officer pursuant Section 302 of the Sarbanes-Oxley Act of 2002
32.1*	Certificate of the Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2*	Certificate of the Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
99.1(7)	Glossary

* Filed herein.

(1) Filed as Exhibit 10.1, 10.2, 10.3, 10.4 and 10.5 to the Company's Form 8-K filed with the Commission on May 20, 2005, and incorporated herein by reference.

(2) Filed as Exhibits to the Company's Form 8-K filed with the Commission on May 20, 2005, and incorporated herein by reference.

(3) Filed as Exhibits to the Company's Report on Form 10-QSB, filed with the Commission on August 22, 2005, and incorporated herein by reference.

(4) Filed as Exhibits to the Company's Report on Form 8-K, filed with the Commission on October 28, 2005, and incorporated herein by reference.

(5) Filed as Exhibits to our Report on Form 10-QSB for the period ending September 31, 2005, which was filed with the Commission on November 21, 2005, and is incorporated herein by reference.

(6) Filed as Exhibits to our Report on Form 8-K, filed with the Commission on December 2, 2005, and incorporated herein by reference.

(7) Filed as Exhibit 99.1 to our Report on Form 10-KSB for the years ended December 31, 2005, and incorporated herein by reference.

(8) Filed as Exhibits to our Report on Form 8-K, filed with the Commission on September 19, 2006, and incorporated herein by reference.

(9) Filed as an Exhibit to our Report on Form 10-QSB, filed with the Commission on November 14, 2006, and incorporated herein by reference.

(10) Filed as an Exhibit to our Form 8-K filed with the Commission on February 20, 2007, and incorporated herein by reference.

(11) Filed as Exhibits to our Report on Form 10-KSB filed with the Commission on February 2, 2007, and incorporated herein by reference.

(12) Filed as an Exhibit to our Report on Form 10-QSB filed with the Commission on May 15, 2007, and incorporated herein by reference.

(13) Filed as an Exhibit to our Report on Form 10-QSB filed with the Commission on August 14, 2007, and incorporated herein by reference.

(14) Filed as an Exhibit to our Report on Form 10-K filed with the Commission on April 14, 2009, and incorporated herein by reference.

(15) Filed as an Exhibit to our Report on Form 8-K filed with the Commission on November 14, 2008, and incorporated herein by reference.

(16) Filed as an Exhibit to our Report on Form 10-Q filed with the Commission on May 19, 2009, and incorporated herein by reference.

(17) Filed as an Exhibit to our Report on Form 10-Q filed with the Commission on May 21, 2010, and incorporated herein by reference.

SIGNATURES

In accordance with Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

SIBERIAN ENERGY GROUP INC.

DATED: August 16, 2010	By: /s/ David Zaikin David Zaikin Chief Executive Officer (Principal Executive Officer)
DATED: August 16, 2010	By: /s/ Elena Pochapski Elena Pochapski Chief Financial Officer (Principal Accounting Officer)