

Edgar Filing: Siberian Energy Group Inc. - Form 10QSB

Siberian Energy Group Inc.  
Form 10QSB  
November 14, 2006

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

FORM 10-QSB

(Mark One)

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

For the quarterly period ended September 30, 2006

TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE  
ACT

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

Commission file number 333-118902

SIBERIAN ENERGY GROUP INC.  
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(Exact name of small business issuer as specified in its charter)

NEVADA 52-2207080  
(State or other jurisdiction of (IRS Employer Identification No.)  
incorporation or organization)

275 Madison Ave, 6th Floor, New York, NY 10016, USA  
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(Address of principal executive offices)

(212) 828-3011  
-----

(Registrant's telephone number)

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

As of November 8, 2006, 12,125,496, shares of Common Stock of the issuer were outstanding ("Common Stock").

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

Traditional Small Business Disclosure Format (Check One): Yes  No .

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

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SIBERIAN ENERGY GROUP INC.  
(A DEVELOPMENT STAGE COMPANY)

CONDENSED CONSOLIDATED  
FINANCIAL STATEMENTS

SEPTEMBER 30, 2006

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders  
Siberian Energy Group Inc.

We have reviewed the accompanying condensed consolidated balance sheet of Siberian Energy Group Inc. (a development stage company) as of September 30, 2006, and the related condensed consolidated statements of operations, stockholders' equity, and cash flows for the three and nine months ended September 30, 2006 and 2005, and the cumulative period of development stage activity (January 1, 2003 through September 30, 2006). These financial statements are the responsibility of the Company's management.

We conducted our review in accordance with standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures to financial data and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the auditing standards of the Public Company Accounting Oversight Board, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to the accompanying interim financial statements referred to above for them to be in conformity with accounting principles generally accepted in the United States of America.

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We have previously audited, in accordance with auditing standards of the Public Company Accounting Oversight Board, the consolidated balance sheet as of December 31, 2005, and the related consolidated statements of operations, stockholders' equity and cash flows for the year then ended (not presented herein); and in our report dated March 27, 2006, we included an explanatory paragraph describing conditions that raised substantial doubt about the Company's ability to continue as a going concern. In our opinion, the information set forth in the accompanying condensed consolidated balance sheet as of December 31, 2005 is fairly stated, in all material respects, in relation to the balance sheet from which it has been derived.

Lumsden & McCormick, LLP  
 Buffalo, New York  
 November 8, 2006

### SIBERIAN ENERGY GROUP INC. (A Development Stage Company)

#### CONDENSED CONSOLIDATED BALANCE SHEETS

	(UNAUDITED) SEPTEMBER 30, 2006	December 31, 2005
	-----	-----
<b>ASSETS</b>		
<b>CURRENT ASSETS:</b>		
Cash	\$ 32,096	\$ 11,551
Management fee receivable	25,000	50,000
Prepaid expenses and other	270	270
	-----	-----
	57,366	61,821
	-----	-----
Investment in joint venture	-	-
Investment purchase option	177,000	-
Property and equipment, net	1,308	1,539
	-----	-----
	\$ 235,674	\$ 63,360
	-----	-----
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>CURRENT LIABILITIES:</b>		
Demand loan from individual, interest at 6.5%	\$ -	\$ 62,500
Accounts payable:		
Related party - stockholders	348,593	328,376
Related party - Baltic Petroleum	49,083	43,664
Others	100,725	117,230
Accrued payroll	327,539	304,341
	-----	-----
	825,940	856,111
	-----	-----

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### STOCKHOLDERS' EQUITY:

Common stock - authorized 100,000,000 shares, \$.001 par value, 12,125,461 and 11,487,886 issued and outstanding	12,126	11,488
Additional paid-in capital	4,146,793	1,786,286
Accumulated deficit		
Pre-development stage	(449,785)	(449,785)
Development stage	(4,292,968)	(2,138,234)
Accumulated other comprehensive income (loss)	(6,432)	(2,506)
	(590,266)	(792,751)
	\$ 235,674	\$ 63,360

See accompanying notes.

SIBERIAN ENERGY GROUP INC. (A Development Stage Company)

### CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

	For the three months ended		For the nine months ended	
	SEPTEMBER 30, 2006	September 30, 2005	SEPTEMBER 30, 2006	September 30, 2005
Revenues and other income:				
Management fees from joint venture	\$ 75,000	\$ -	\$ 225,000	\$ -
Gain from entrance into joint venture	-	-	-	-
Other	-	-	-	-
Total revenues and other income	75,000	-	225,000	-
Expenses:				
Salaries	32,994	103,920	101,556	315,396
Professional and consulting fees	166,111	86,324	1,755,256	1,045,111
Rent and occupancy	9,912	28,162	29,658	87,924
Depreciation and amortization	86	9,385	253	2,911
Finance charges and interest	2,626	31,514	8,890	28,890
Marketing and other	130,903	77,304	484,121	1,045,111
Total expenses	342,632	336,609	2,379,734	2,425,323
Loss before income taxes	267,632	336,609	2,154,734	-425,323

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Provision for income taxes (benefit)	-	-	-	
	-----	-----	-----	-----
Net loss (development stage)	\$ 267,632	\$ 336,609	\$ 2,154,734	\$
	-----	-----	-----	-----
Basic and diluted loss per common share	\$ (0.02)	\$ (0.04)	\$ (0.19)	\$
	-----	-----	-----	-----
Weighted average number of basic and diluted common shares outstanding	11,671,174	9,477,886	11,582,245	9,
	-----	-----	-----	-----

See accompanying notes.

SIBERIAN ENERGY GROUP INC. (A Development Stage Company)

### CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

For the cumulative period of Development Stage Activity - January 1, 2003 through  
September 30, 2006

	Number of Shares	Common Stock ----- Par Value	Additional Paid-In Capital	Accumulated Deficit	Compr Income
	-----	-----	-----	-----	-----
Balance, January 1, 2003 (pre-development stage)	4,902,886	\$ 4,903	\$ 430,195	\$ (449,785)	\$
Loss for the year - 2003	-	-	-	(422,516)	
Shares issued in acquisition	1,000,000	1,000	(1,000)	-	
	-----	-----	-----	-----	-----
Balance, December 31, 2003	5,902,886	5,903	429,195	(872,301)	
	-----	-----	-----	-----	-----
Loss for the year - 2004	-	-	-	(833,567)	
Foreign currency translation adjustment	-	-	-	-	
Shares issued in acquisition	3,450,000	3,450	746,550	-	
Shares issued for professional services	50,000	50	9,950	-	

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Other	-	-	34,426	-	
Balance, December 31, 2004	9,402,886	9,403	1,220,121	(1,705,868)	
Loss for the year - 2005	-	-	-	(882,151)	
Foreign currency translation adjustment	-	-	-	-	
Shares issued for professional services	385,000	385	138,365	-	
Shares issued for accrued salaries	1,700,000	1,700	210,800	-	
Warrants granted for professional services	-	-	217,000	-	
Balance, December 31, 2005	11,487,886	11,488	1,786,286	(2,588,019)	
Loss for nine months - 2006	-	-	-	(2,154,734)	
Foreign currency translation adjustment	-	-	-	-	
Shares issued for employee stock option plan	142,500	143	13,857	-	
Shares issued for professional services	1,104,499	1,105	1,635,243	-	
Warrants granted for professional services	-	-	710,797	-	
Shares cancelled	(609,424)	(610)	610	-	
	12,125,461	\$ 12,126	\$ 4,146,793	\$ (4,742,753)	\$

See accompanying notes.

SIBERIAN ENERGY GROUP INC. (A Development Stage Company)

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

For the  
cumulative  
period of  
Development  
Stage Activities  
January 1,  
through  
SEPTEMBER 30, September 30, September

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	2006	2005	2006
	-----	-----	-----
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net loss (development stage)	\$ (2,154,734)	\$ (880,150)	\$ (4,292,000)
Depreciation and amortization	253	28,153	102,000
Common stock and warrants issued			
for professional services and salaries	2,107,645	15,000	2,748,000
Gain from entrance into joint venture	-	-	(364,000)
Changes in other current assets and			
current liabilities:			
Prepaid expenses and other assets	25,000	(23,914)	(178,000)
Accounts payable and accrued expenses	32,307	47,263	3,102,000
	-----	-----	-----
NET CASH FLOWS FROM (FOR) OPERATING ACTIVITIES	10,471	(813,648)	1,117,000
	-----	-----	-----
CASH FLOWS FROM INVESTING ACTIVITIES:			
Expenditures for licenses and related	-	(348,137)	(528,000)
Expenditures for oil and gas properties	-	(36,532)	(770,000)
Expenditures for property and equipment	-	(1,710)	(2,000)
Cash received in acquisition	-	-	-
Cash received from entrance into joint venture	-	-	175,000
	-----	-----	-----
NET CASH FLOWS FOR INVESTING ACTIVITIES	-	(386,379)	(1,127,000)
	-----	-----	-----
CASH FLOWS FROM FINANCING ACTIVITIES:			
Net proceeds from loans	-	1,171,149	-
Common stock issued for employee stock option plan	14,000	-	14,000
Additional paid-in capital	-	1,631	34,000
	-----	-----	-----
NET CASH FLOWS FROM FINANCING ACTIVITIES	14,000	1,172,780	48,000
	-----	-----	-----
Effect of exchange rates on cash	(3,926)	29,224	(6,000)
	-----	-----	-----
Net increase in cash	20,545	1,977	32,000
Cash - beginning	11,551	-	-
	-----	-----	-----
Cash - ending	\$ 32,096	\$ 1,977	\$ 32,000
	-----	-----	-----

See accompanying notes.

SIBERIAN ENERGY GROUP INC. (A Development Stage Company)

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. BASIS OF PRESENTATION:

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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 2006 are consistent with those used in the cumulative period of Development Stage Activity - January 1, 2003 through December 31, 2005. 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:

Through October 14, 2005, the Company operated through its wholly owned subsidiary, Zaural Neftegaz (ZNG). ZNG is engaged in the business of exploiting and developing certain oil and gas and other petroleum products licenses issued by Russia's Kurgan Provincial Government for the Eastern part of Kurgan Province. ZNG has its principal place of business in Kurgan City, Kurgan Province, Russia, and is the sole and exclusive owner of the exploration licenses.

On October 14, 2005, the Company entered into a joint venture agreement with a third party, Baltic Petroleum Limited (Baltic). The Company transferred 100% of its ownership interest in ZNG to the Joint Venture and transferred 50% of the Joint Venture interest to Baltic for \$175,000 and the agreement by Baltic to provide future funding to the Joint Venture as detailed in a Joint Venture Shareholder's Agreement. Joint Venture will be engaged in the exploration for, development, production and sale of oil and gas assets in the Western Siberian region of the Russian Federation and the former Soviet Union.

Upon signing of the Joint Venture agreement, Baltic, ZNG, and a financing company wholly owned by Baltic, entered into a deed of novation regarding a previous loan made to ZNG by Baltic and immediately thereafter the financing company entered into a loan agreement with ZNG. Under the loan agreement, the lender agreed to provide a loan of \$6,874,325 for the purpose of research activities in the Kurgan region.

Baltic released the Company from its obligations under a guarantee and security interest given by the Company to Baltic regarding an initial loan to ZNG.

In connection with the current program of seismic studies and drilling of the first four (4) wells in ZNG's license blocks, additional funds of \$15 million were raised by Baltic's parent through a placement of shares. It is anticipated that ZNG will enter into a new loan agreement covering such funds as well as a gross override royalty agreement with Baltic. The new loan will not be dilutive to the Company's ownership in ZNG.

Additional details surrounding the Company's involvement in the Joint Venture follow:

- During the arrangement, the Company will receive a monthly management fee of \$25,000 from ZNG;
- Profits from the Joint Venture are allocated 50% to the Company



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- only after all financing of ZNG are settled with Baltic and Baltic's financing subsidiaries;
- Although the Company and Baltic each own 50% of the Joint Venture's shares and each appoint 50% of the Directors to the Joint Venture, Baltic always has an additional casting vote on Board of Director related issues;
- The Company has essentially no liability to guarantee the debts of the Joint Venture;
- The Company recognized a settlement gain of \$364,479 as a result of the initial joint venture transaction. This resulted primarily to adjust the Company's negative investment to zero as of the agreement date. All activity of ZNG before the agreement date is otherwise included in these financial statements.

Effective October 14, 2005, the Company's investment in 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 September 30, 2006 and December 31, 2005. Loan financing balances outstanding of Joint Venture to Baltic and Baltic's financing subsidiaries at September 30, 2006 total approximately \$7,800,000. Activities of ZNG prior to October 14, 2005 are otherwise included in the consolidated accounts of the Company in the accompanying financial statements.

In June 2006, ZNG won auctions and was awarded three new oil and gas exploration and production licenses, bringing the total number of licenses to seven and the total area covered by the licenses to 1 million acres. In connection with the license acquisitions, the Company issued 600,000 shares to a consulting company in consideration for its assistance in the application process as well as obtaining existing geological information (seismic, gravimetric) relevant to potential licensed areas. The value of these shares totaled \$1,113,000 and are included in professional and consulting fees in the accompanying condensed consolidated statements of operations.

On September 14, 2006, the Company entered into an Option Agreement with Key Brokerage, Inc., a Delaware Corporation, the sole owner of Kondaneftegaz, LLC, a Russian limited liability company. Under the terms of the agreement, the Company has the exclusive right for up to sixty days to purchase seventy-five percent (75%) of the shares of Kondaneftegaz. The purchase is expected to be completed in the fourth quarter of 2006. Value of the options granted are included in the financial statements under investment purchase option.

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., 17388 Corporation Inc., Talking Cards Inc., Oyster King Incorporated and Advanced Rehab Technology Corporation.

### 3. INCOME TAXES:

At September 30, 2006, the Company has estimated U.S. tax net operating loss

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carryforwards totaling approximately \$3,936,000. These carryforwards may be used to offset future taxable income, and expire in varying amounts through 2026. 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 \$787,000 estimated cumulative tax benefit of the loss carryforward has 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 may have had a dilutive effect on earnings per share had the Company generated income during the periods through September 30, 2006.

#### 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 the Joint Venture arrangement established in 2005 will successfully generate allocable profits to the Company in the near term.

For the cumulative period ended September 30, 2006, 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 be reflected on a liquidation basis which could differ from the going concern basis.

### ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION

CERTAIN STATEMENTS IN THIS QUARTERLY REPORT ON FORM 10-QSB (THIS "FORM 10-QSB"), 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. ("SIBERIAN", 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-QSB, UNLESS ANOTHER DATE IS STATED, ARE TO SEPTEMBER 30, 2006.

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.

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### 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 effected a 1-for-30 reverse stock split. A subsequent 3-for-1 forward split was consummated on October 2, 2000. All share amounts subsequently listed are retroactively adjusted to reflect these stock splits unless otherwise provided. All activities related to the Company's business were discontinued prior to January 1, 2000 and the Company began looking for opportunities to acquire an operating business.

In the spring of 2003, the balance of the Company's shares was 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. In contemplation of the Company's acquisition of a Russian oil and gas exploration company, the Company changed its name to Trans Energy Group, Inc.

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. 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. ZNG holds seven (7) oil and gas licenses (see "Patents, Trademarks and Licenses" below) for the rights to prospect, explore, drill and remove oil

and gas (the "Exploration Rights") in the eastern parts of Kurgan Province in Russia. The Company had no affiliation with ZNG prior to the acquisition in May 2003.

On May 2, 2005, the Company effected a 1:2 reverse stock split and all share amounts listed throughout this report on Form 10-QSB reflect such split unless otherwise stated.

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 are currently evaluating investment and joint venture opportunities throughout Russia.

Until October 14, 2005, the Company's operations were conducted solely through its then wholly owned subsidiary, Zaural Neftegaz ("ZNG") a development stage oil and gas exploration company located in the Western Siberian Region of Russia. However, on October 14, 2005, the Company entered into a Joint Venture agreement, whereby the Company transferred 100% of the ownership of ZNG to a

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newly formed Joint Venture company, Zauralneftegaz Limited ("ZNG, Ltd."), of which the Company owns 50% of pursuant to the Joint Venture agreement entered into on October 14, 2005 (as described in greater detail below under Joint Venture Agreement). As a result of the Joint Venture and the transfer of 100% of ZNG to the Joint Venture, the Company anticipates targeting other potential long term investments in Russia, and working with its partner in the Joint Venture, Baltic Petroleum (E&P) Limited ("BP" or "Baltic"), to continue the oil and gas exploration activities through their co-ownership of the Joint Venture and ZNG.

### DESCRIPTION OF ZNG

ZNG was created to explore and develop new hydrocarbon fields and oil and gas properties in the Kurgan region of South-West Siberia, Russia. ZNG has compiled data in the Eastern part of the Kurgan region by analyzing prior geological, geophysical and lithographic exploration works in the region, data, maps, and reports from 12 test wells drilled between 1979-1986, profile sections, correlation schemes, and geographic maps of the region. ZNG has also obtained core samples from parametric wells drilled in prior years on the licensed areas and adjacent territories in the Eastern part of Kurgan region during the initial search for oil and gas in the region, and performed analysis of the data provided by the samples.

In March 2003, ZNG acquired four 5-year exploration licenses through a government tender, which licenses expire in March 2008, and which licenses are for concessions covering a total territory of 643,000 acres. Upon expiration of

the licenses, ZNG will have, subject to the signing of the Subsoil Legislation, preferential right to apply for the full production license for the term of 25 years.

The Mokrousovsky license is the largest of the four licenses, encompassing a total of 240,000 acres, followed by the West Suersky, which covers 230,000 acres, the Privolny, which covers 123,000 acres, and the Orlovo-Pashkovsky license, which covers 50,000 acres.

In June 2006 through participation in governmental auctions, ZNG successfully obtained three more oil and gas licenses in the Kurgan region of Siberia, Russia: the Yuzhno-Voskresenski, Petuhovski, and Lebyashevsky parcels. The new licenses are for the period of 25 years and allow both exploration and production on the licensed areas. The total cost paid at the auctions for the three new licenses by ZNG was approximately \$425,000.

Brief characteristics of the three new blocks are given below:

#### YUZHNO-VOSKRESENSKI BLOCK

Total area approximately 130,000 acres (520 square kilometers)

The Yuzhno-Voskresenski block is located in the Kurgan region of Russia, 10-40 km to the west of the center of the administrative region Chastoozerye.

The territory of the block has significant prior exploration data. The area is covered by a geological survey (1:200,000 scale), a gravimetric survey (1:100,000 scale), and an aeromagnetic survey (1:50,000 scale). From 1979 to 1980, seismic surveys were carried out on the block implementing refraction sounding and deep seismic sounding methods, which partially covered the block area. Regional seismic profiling and 2D seismic surveys and seismic reflection method were also performed here. Additionally, three parametric wells along the Kurgan regional geological and geophysical profile have been drilled during the prior initial exploration works. ZNG

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has obtained the source geological data from these wells.

Through these studies, two structures were identified and the placement of wildcat wells with the purpose of uncovering and testing of oil-source rocks was determined.

### PETUKHOVSKY BLOCK

Total area approximately 208,000 acres (840 square kilometers)

The Petukhovsky block is located between the towns of Makushino and Petukhovo, Russia, further to the south of the Kurgan Region boundary.

Prior exploration works on the block are represented by a general geological survey (1:200,000 scale). From 1979 to 1980, seismic surveys were carried out by refraction sounding and deep seismic sounding methods, which partially covered the block area. The Kurgan regional seismic profile

crosses the block and to the South-West of the block is Sukhmensky regional seismic profile acquired by seismic reflection and correlation refraction methods.

Four deep cored wells drilled both in the territory of the block and in the adjacent areas provide an idea of the geological structure of the block.

### LEBYAZHEVSKY BLOCK Total area 42,000 acres (170 square kilometers)

The Lebyazhevsky block, with a total area of 170 square kilometers (approximately 43,990 acres), is located in the Kurgan Region, of Siberia, Russia, 13-22 km to the South-East of the center of administrative region of Lebyazhye.

The block is covered by a general geological survey (1:200,000 scale), gravimetric survey (1:100,000 scale), aeromagnetic survey (1:50,000 scale) and partially by seismic surveys by common-midpoint (CMP) and seismic reflection method.

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The acquisition of the three new licenses increased the total area covered by the licenses held by ZNG from 643,000 acres to over 1 million acres. All seven licensed areas are located in the Eastern part of Kurgan region, have well-developed infrastructure, including close proximity to the major oil pipeline, and have available existing prior geological data.

ZNG also has outstanding applications for two more parcels in the same area - Zapadno-Petukhovski and Orlovo-Pashkovsky-2. Auctions for these licenses are expected to take place in the fourth quarter of 2006; however there can be no assurance that ZNG will be awarded the licenses to the parcels at auction.

Following detailed data collection, survey and seismic testing ZNG will proceed with development of the most prospective licenses first. As of November 1, 2006 ZNG has performed the following research and exploration works on its licensed areas:

- Obtained core samples from parametric wells drilled in prior years on the licensed areas and adjacent territories in the Eastern part of Kurgan region during the initial search for oil and gas in the region, and performed analysis of the data provided by the samples.
- Completed a 2D seismic survey on West-Suersky block.

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- Performed gravimetric surveys on the West-Suersky, Privolny and Mokrousovsky blocks.
- Completed approximately 822 linear kilometers of gas seismotomographic and geochemical surveys performed by Exotrad on the Privolny and Mokrousovsky blocks, which surveys are currently continuing on the other 5 blocks.
- Completed high definition 2D seismic surveys across the grids made by the gas seismotomography surveys, using Bashneftegeofizika,

which has been completed on the northern part of Privolny block, and is currently underway on the Mokrousovsky block, which surveys are planned to follow on other 5 licensed blocks.

- Scientific and technical analysis is being performed by the team of geologists, which includes experts from Exploration Consultants Limited ("ECL"), a leading international oil and gas consulting firm (part of RPS Group). Initial analysis was completed by June 30, 2006 and such data will be combined with the results of seismic studies, which are described in greater detail below under "Results of Seismic Studies."

### JOINT VENTURE

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On October 14, 2005, the Company entered into a Joint Venture Shareholders' Agreement ("Joint Venture") 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., will, operate through ZNG and be 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 and as a result of such transfer, the Company no longer has any separate oil and gas exploration activities in Kurgan, Russia, other than through its ownership of ZNG, Ltd.

On November 9, 2005, ZNG entered into a New Loan with Caspian (the "New Loan"). Under the loan agreement, Caspian Finance Limited ("Caspian") agreed to provide a loan of up to approximately \$6,874,325 representing the assumed commitment under a prior loan equal to \$1,739,658, of which ZNG had received \$1,110,624 as of November 9, 2005, and a new commitment of up to \$5,134,667, to be used for operations in the Kurgan region in 2005 and through the first half of 2006. The New Loan is available to ZNG until the sixth anniversary of the date of the New Loan, or November 9, 2011 (the "Term"). The New Loan had a total outstanding balance, including principal and accrued interest of \$5,471,288 as of November 1, 2006.

Interest on any amounts loaned under the New Loan bear interest at the following rates, calculated and accrued on a daily basis, 14% per annum during the first two years of the Term, 13% per annum during the third year of the Term; and 12% thereafter until the end of the Term. In the event that ZNG does not make the Interest Payments when due, interest on the unpaid amounts shall be payable from the due date to the date paid at the rate of 6% per annum, calculated and accrued on a daily basis. The New Loan is unsecured by ZNG, but Caspian reserved the right to request security over all or some of the assets and/or undertaking of ZNG at any time prior to any drawdown of the New Loan, or while any money is outstanding under the New Loan.

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Pursuant to the New Loan, ZNG is responsible for satisfying all requirements of Russian Federation law and regulations in connection with each advance made under the New Loan, and ZNG shall indemnify Caspian for any loss or damage it may suffer as a result of the New Loan.

The New Loan provided for the payment of certain debts of ZNG, which were incurred before the Joint Venture. Payments under the New Loan will included:

1) \$352,665 which was paid upon the Company signing the loan agreement, which was used for:

- o payment of salaries of ZNG for August and September (\$32,000); o payment of 50% of the amount of director's and shareholder's loans (\$170,000);
- o 50% of outstanding rent payments (\$44,000);
- o mineral tax for the second quarter of 2005 (\$3,865); and
- o \$102,800 for gathering and coordination of data in respect to the new licenses ZNG has recently applied for.

2) \$882,699 which was paid upon the Company receiving licenses to the two additional license blocks which were received during the nine months ended September 30, 2006, which was spent as follows:

- o further payment for gathering and coordination of data in connection with the new licenses (up to \$340,000);
- o final payments for seismic and gravimetric works performed on the West-Suerski field (up to \$324,834);
- o to repay the remaining amounts owed by ZNG to directors and shareholders (\$170,000);
- o to pay the remaining amount of outstanding rent payments (\$44,000); and
- o to pay mineral tax for the third quarter of 2005 (\$3,865).

In addition to the amounts agreed to be loaned pursuant to the New Loan, ZNG Ltd. agreed to lend \$78,000 to the Company to pay for legal and consulting services in connection with establishing of the Joint Venture. The Company received \$29,000 of this amount in November 2005; and the additional \$49,000 will be paid after ZNG submits a letter from the relevant license authority of

the Ministry of Natural resources of the Russian Federation confirming that five new licenses were awarded to ZNG, of which three have been awarded to date. There is no assurance the additional two licenses will be awarded to ZNG.

On November 9, 2005, ZNG, Ltd. and Caspian entered into a Debenture, whereby ZNG, Ltd. granted Caspian a security interest in substantially all of its assets, including its 100% ownership of ZNG, to secure the repayment of the New Loan Agreement. Pursuant to the Debenture, ZNG, Ltd. granted Caspian a continuing security interest for the payment, performance and discharge of all the liabilities owing to Caspian by ZNG, Ltd., in the following assets, both present and future, from time to time to the extent owned by ZNG, Ltd., or to the extent in which it has an interest.

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Additionally, on November 9, 2005, ZNG, Ltd. and Caspian entered into an "Agreement for the Pledge of the Participatory Interest in OOO Zauralneftegaz" (the "Pledge Agreement"). Pursuant to the Pledge Agreement, ZNG, Ltd., pledged its 100% ownership interest in ZNG to Caspian, which included any proceeds, dividends, distributions or income deriving from ZNG and any compensation, whether monetary or in-kind, deriving from ZNG, received due to the liquidation or reorganization of ZNG. The Pledge Agreement shall remain in effect until all amounts owed to Caspian by ZNG, Ltd. are repaid. Pursuant to the Pledge Agreement, ZNG, Ltd., agreed to hold all dividends, interest and other income deriving from and by it for the account of Caspian, and agreed to pay such dividends, interest and other income to Caspian upon Caspian's request.

If ZNG, Ltd., fails to pay the amounts owed to Caspian, pursuant to the Pledge Agreement, Caspian can sell the 100% interest in ZNG at public auction, in one or several sales, with an opening bid price of seventy-five percent (75%) of the value set forth for the value of ZNG in the Pledge Agreement (\$7,705,079) at the first public auction and fifty percent (50%) of the value set forth in the Pledge Agreement at the second public auction. If the opening bid for ZNG is not met at either the first or second public auction, Caspian shall have the right to retain ZNG, with its value equal to 90% of the value set at the second auction, and set-off its claims secured by ZNG, Ltd. by such value. If ZNG is sold at public auction, any and all proceeds from such sale received by Caspian shall be applied towards the discharge of the amounts owed by ZNG, Ltd. to Caspian.

### AGREEMENT WITH ALTERNATIVE ENERGY FINANCE, LTD.

We previously agreed to issue Alternative Energy Finance Ltd. ("AEF"), of which Tim Peara is the Managing Director as well as a Director of the Company, certain warrants in connection with Mr. Peara introducing the parties who formed the joint venture. Pursuant to an agreement between AEF and the Company, AEF will receive compensation based on the total investment made by Baltic Petroleum Ltd. in the Joint Venture. This compensation included a commission of approximately \$18,024 (1% of Baltic's first \$1,802,441 investment in the Joint Venture), which amount has not been paid as of the date of this filing, and 50,068 options to purchase shares of our common stock at \$0.63 per share which were granted to Mr. Peara on March 6, 2006 and a commission of \$6,673 (1% of Baltic's \$667,313 investment in the Joint Venture in the first quarter 2006), which amount has not

been paid to AEF to date and 17,561 options to purchase shares of our common stock at \$0.67 per share for the first quarter of 2006, which were granted to Mr. Peara on March 31, 2006, which options contain a cashless exercise provision.

On June 30, 2006, in connection with our agreement with AEF, we agreed to grant AEF a warrant to purchase 20,412 shares of our common stock at an exercise price of \$2.02, which warrants contained a cashless exercise feature. The warrants expire three years from the grant date. We were also obligated to pay AEF \$23,562 during the quarter ended June 30, 2006 (equal to 1% of Baltic's \$2,356,153 investment in the Joint Venture in the second quarter 2006), which amount has not been paid to AEF to date.

On September 30, 2006, in connection with our agreement with AEF, we agreed to grant AEF a warrant to purchase 20,952 shares of our common stock at an exercise price of \$1.53 per share, which warrants contained a cashless exercise feature. The warrants expire three years from the grant date. We were also obligated to pay AEF \$18,303 during the quarter ended September 30, 2006 (equal to 1% of Baltic's \$1,830,292 investment in the Joint Venture in the third quarter 2006), which amount has not been paid to AEF to date.



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As of August 1, 2006, we owed approximately \$66,273 to AEF in connection with AEF's introduction of the parties of the Joint Venture, as described above. We are currently in discussions with AEF to pay all or a portion of the amount owed to AEF in the form of shares of common stock, however we can make no assurance that such discussions will result in the consummation of a debt conversion agreement.

### RECENT EVENTS

#### OPTION AGREEMENT

On September 14, 2006, Siberian Energy Group Inc. ("we," and "us") entered into an Option Agreement with Key Brokerage, Inc., a Delaware corporation ("Key Brokerage" and the "Option Agreement"). Key Brokerage is the sole owner of Kondaneftegaz, LLC, a Russian limited liability company ("Kondaneftegaz").

Kondaneftegaz has applied for ten (10) oil and gas licenses in the Khanty-Mansiysk district of Western Siberia, Russia, which will be proposed for distribution by the Russian government through a tender auction in 2006 and 2007.

The Option Agreement provided us the exclusive right for up to sixty (60) days from the date of the Option Agreement, subject to us conducting due diligence, to enter into a transaction with Key Brokerage whereby we would purchase seventy-five percent (75%) of the shares of Kondaneftegaz (the "Option").

In consideration for agreeing to the Option, we granted Key Brokerage 250,000 warrants to purchase shares of our common stock at an exercise price of \$2.20 per share, exercisable for up to two (2) years from the date of the Option Agreement (the "Warrants"). In the event we choose to extend the Option, we have

agreed to grant Key Brokerage additional warrants on identical terms as the Warrants, with the exception that such additional warrants will be exercisable until the second anniversary of the date the Option is extended. We hope to consummate the Option by an entry into a final agreement with Key Bank during the fourth quarter of 2006 or the first quarter of 2007, and purchase an interest in Konaneftegaz for shares of our common stock, of which there can be no assurance.

#### RESULTS OF SEISMIC STUDIES

In October 2006, ZNG received the results of its 822 linear kilometers of seismotomographic and geochemical survey of the Privolny and Morkrousovsky blocks, which study included high definition 2D seismic studies conducted on the north portion of its licensed Privolny block. The results of the study included the identification of two drilling prospects with a combined area of approximately 29 square kilometers in ZNG's northern Privolny license area.

The survey was conducted by Exotrad Limited, a gas seismotomography specialist with more than 16 years of experience, including work for international companies such as Victoria Oil & Gas. Actual data values, sample layout geometry, data density and processing limitations were used to evaluate potential subsurface hydrocarbon prospective accumulations, and sophisticated multivariate statistical models were used to identify four sites for detailed seismic studies and drilling.

ZNG's Board of Directors subsequently decided to drill up to four exploration

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wells in ZNG's Kurgan Region license blocks in connection with such surveys. At least two of these wells are proposed to be drilled in northern locations in the Privolny block and the other two wells are proposed to potentially be drilled on the Mokrousovsky block, following the completion of 2D studies on that block which is expected to be completed in the fourth quarter of 2006. It is anticipated that the first well will be drilled on the Privolny block to a maximum depth of 2000 meters, with logging and coring undertaken in accordance with a program designed by RPS Energy and the Tyumen State Oil and Gas Institute in Russia, which will be used as the basis for a drilling license application.

In the event that the wells prove successful in establishing the presence of hydrocarbons, of which there can be no assurance, the Board of Directors of ZNG intends that production testing will be supervised by a leading firm of reservoir evaluation consultants and the Board will then determine the most appropriate means of commercializing the license blocks.

The total budget for the exploration program and further seismic studies, which the Board has proposed to shoot on ZNG's Lebyazhevsky licensed block, totals approximately 8 million British pounds or \$15 million US dollars. The funds were raised by BP's parent via a placement of shares and it is anticipated that ZNG will enter into a new loan agreement covering such funds as well as a gross override royalty agreement with BP, which loan is not dilutive to our ownership of ZNG, subsequent to the filing of this report as described below under "Deed of Agreement," of which there can be no assurance.

### DEED OF AGREEMENT

On July 26, 2006, we entered into a Deed of Agreement with Baltic Petroleum (E&P) Limited ("BP" or "Baltic") and ZNG. Pursuant to the Deed of Agreement, BP agreed to allow the drawdown by ZNG, within 10 days of the date of the Deed of Agreement, of certain funds from Caspian under the New Loan, including:

- o \$185,000 to be paid to Business Standard, which was owed to Business Standard from ZNG in consideration for Business Standard assisting ZNG with the process of the granting of the three oil and gas licenses awarded to ZNG in June 2006;
- o \$170,000 to be paid to Mr. Victor Repin (a significant shareholder of the Company) and Sergey Potapov (a Director of the Company) in final settlement of amounts due to them by ZNG; and
- o \$44,000 to ZNG's landlord in full settlement of all sums due in connection with the rent on ZNG's offices in Kurgan, Russia.

The Deed of Agreement also contemplated ZNG's entry into a further loan agreement with Caspian (assuming Caspian is able to raise such financing on terms acceptable to BP), substantially with the same terms as the New Loan (other than due dates and interest amounts), whereby Caspian would provide ZNG funds for seismic drilling and work programs of approximately \$12,000,000 (the "Additional Loan").

The Deed of Agreement also provided that upon the entry into the Additional Loan, we, BP and ZNG will enter into a gross override royalty agreement, whereby ZNG will grant a gross override royalty ("GOR") to BP equal to 3% of the gross turnover on all production of oil and gas at the wellhead in Kurgan by ZNG until BP has received in aggregate \$20,000,000 from such GOR (the "GOR Sum"); however in the event the actual amount loaned to ZNG is less than or greater than \$12,000,000, the GOR Sum shall be decreased or increased proportionately. We hope to enter into a final Additional Loan in the fourth quarter of 2006 or the first quarter of 2007, of which there can be no assurance.

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### ESTIMATE OF AMOUNT OF TIME SPENT ON RESEARCH AND DEVELOPMENT

Initial business plan was developed over the course of three months in 2003. During that time period, market research was conducted. Research and development activities on the licensed blocks in the Kurgan Region were directly borne by the Company up to the time the Joint Venture was closed in October 2005. As a result of the closing of the Joint Venture, these research and development costs

are now borne both by ZNG, Ltd. (as described above) and ZNG. Research activities include gravimetric, seismic works and seismotomography studies on the licensed areas. Costs incurred by ZNG and ZNG Ltd. in connection with these studies as of September 30, 2006 totaled approximately \$4,100,000.

### EMPLOYEES

Siberian Energy Group Inc. ("SEG"), currently employs two (2) employees in management. Zaural Neftegaz ("ZNG"), which is 50% owned by the Company through its joint venture ZNG, Ltd., employs six (6) employees in management and ten (10) employees in support and technical functions.

### PLAN OF OPERATIONS

As a result of the Joint Venture, the Company will work with its partner in the Joint Venture, Baltic Petroleum (E&P) Limited ("BP" or "Baltic") to continue the oil and gas exploration activities through their co-ownership of the Joint Venture, ZNG, Ltd., which in turn owns ZNG. The Company believes that ZNG has adopted an aggressive but sensible work program. In connection with the Joint Venture, BP will supply ZNG with both the technical and financial support that is required to fulfill the work program. If circumstances permit and ZNG is awarded additional blocks in the Kurgan Region, we believe that BP will be able to ensure that adequate funding is available to support the Work Programs on these blocks.

Moving forward, we anticipate targeting other potential long term investments in Russia, separate from our involvement in the Joint Venture. Currently we are evaluating different business opportunities in the oil and gas industry, including both development stage and revenue-producing enterprises. As of the filing of this report on Form 10-QSB, the Company is researching certain other projects which involve the potential purchase of oil and gas interests in Western Siberia, Russia; however no formal agreements or understandings have been entered into as of the filing date of this report, other than the Option with Key Brokerage described above.

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 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 (described under "Joint Venture Agreement," above), the Company will receive \$25,000 per month in management fees in connection with the Joint Venture. The Company, however, can make no assurance that \$25,000 per month will be adequate to pay its upcoming expenses and liabilities, in which case the Company plans that its organizing stockholders will continue to provide financing for the Company, of which there can be no assurance.

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In the past, we have obtained cash financing from organizing stockholders in the form of loans and advances, as a result, amounts totaling \$348,593 and \$328,376 were payable to the stockholders as of September 30, 2006 and December 31, 2005, 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.

### RESULTS OF OPERATIONS FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2006, COMPARED TO THE THREE MONTHS ENDED SEPTEMBER 30, 2005

We had revenues and other income of \$75,000 for the three months ended September 30, 2006, which was solely due to \$25,000 of monthly management fees received from ZNG, Ltd. We had \$-0- of revenue and other income for the three months ended September 30, 2005. We have not generated any revenues to date through the sale of oil and/or gas.

We had total expenses of \$342,632 for the three months ended September 30, 2006, compared to total expenses for the three months ended September 30, 2005, of \$336,609, which represented an increase in total expenses from the prior period of \$6,023 or 2%.

Total expenses for the three months ended September 30, 2006, included \$32,994 of salaries, which included \$18,243 which was paid to our Chief Financial Officer, Elena Pochapski; \$166,111 of professional and consulting fees, including amounts paid to our legal counsel and accountant in connection with the preparation and filing of our quarterly report on Form 10-QSB and warrants granted for consulting services rendered during the three months ended September 30, 2006, as described herein; \$9,912 in rent and occupancy; \$86 of depreciation and amortization; \$2,626 of finance charges and interest, attributable to interest paid on the advances we received from BP; and \$130,903 of marketing and other expenses, in connection with marketing and advertising in connection with road shows, various general and administration expenses relating to the Company, and travel and hotel expenses in connection with research on potential business acquisitions. Our Chief Executive Officer, David Zaikin has agreed to waive his salary and any accrual of his salary until such time as we have sufficient funds to pay such salary to Mr. Zaikin.

The main items leading to the increase in total expenses for the three months ended September 30, 2006, compared to the three months ended September 30, 2005, were an increase of \$79,787 or 92% in professional and consulting fees, to \$166,111 for the three months ended September 30, 2006, compared to \$86,324 for the three months ended September 30, 2005, and an increase in marketing and other expenses of \$53,599 or 69% to \$130,903 for the three months ended September 30, 2006, compared to \$77,304 for the three months ended September 30, 2005. The increase in professional and consulting fees during the three months ended September 30, 2006, compared to the three months ended September 30, 2005, is largely attributable to \$18,750 of advisory services in connection with the

Company's business development activities, \$17,561 of legal and accounting fees and the grant of warrants valued at \$129,800 for consulting services during the three months ended September 30, 2006, as described herein. Certain other of our expenses during the three months ended September 30, 2006 decreased, including salaries, which declined by \$70,927 or 68% to \$32,993 for the three months ended September 30, 2006 compared to \$103,920 for the three months ended September 30, 2005, and rent and occupancy, which declined by \$18,250 or 65%

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during the same period, which decreases were due to the fact that the expenses of ZNG, our former wholly owned subsidiary, which is currently solely owned by ZNG, Ltd., which we own 50% of, are no longer included in our consolidated statement of operations due to the fact that ZNG is no longer our wholly owned subsidiary, but which expenses were included in our consolidated statement of operations during the three months ended September 30, 2005.

We had a net loss of \$267,632 for the three months ended September 30, 2006, compared to a net loss of \$336,609 for the three months ended September 30, 2005, a decrease in net loss of \$68,977 or 20% from the prior year. The decrease in net loss was mainly attributable to an increase of \$75,000 in revenue for the three months ended September 30, 2006, compared to \$-0- of revenue for the three months ended September 30, 2005.

### RESULTS OF OPERATIONS FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2006, COMPARED TO THE NINE MONTHS ENDED SEPTEMBER 30, 2005

We had revenues and other income of \$225,000 for the nine months ended September 30, 2006, which was solely due to \$25,000 of monthly management fees received from ZNG, Ltd. We had \$-0- of revenue and other income for the nine months ended September 30, 2005. We have not generated any revenues to date through the sale of oil and/or gas.

We had total expenses of \$2,379,734 for the nine months ended September 30, 2006, compared to total expenses for the nine months ended September 30, 2005, of \$880,150, which represented an increase in total expenses from the prior period of \$1,499,584 or 170%.

Total expenses for the nine months ended September 30, 2006, included \$101,556 of salaries, of which \$57,305 was attributable to the salaries and payroll taxes paid to the Company's Chief Financial Officer, Elena Pochapski, and \$44,250 which was paid to various other employees and consultants; \$1,755,256 of professional and consulting fees, including amounts paid to our legal counsel and accountant in connection with the preparation and filing of our annual report on Form 10-KSB and 10-QSB, and certain warrants and shares granted for professional services during the nine months ended September 30, 2006; \$29,658 in rent and occupancy; \$253 of depreciation and amortization; \$8,890 of finance charges and interest, attributable to interest paid on the advances we received from BP and other loans; and \$484,121 of marketing and other expenses, including marketing and advertising in connection with road shows, various general and administration expenses relating to the day to day operations of the Company,

and travel and hotel expenses in connection with the research on potential business acquisitions. Our Chief Executive Officer, David Zaikin has agreed to waive his salary and any accrual of his salary until such time as we have sufficient funds to pay such salary to Mr. Zaikin, if at all.

The main items leading to the increase in total expenses for the nine months ended September 30, 2006, compared to the nine months ended September 30, 2005, were an increase of \$1,588,087 or 949% in professional and consulting fees, to \$1,755,256, an increase in marketing and other expenses of \$270,336 or 126% to \$484,121 for the nine months ended September 30, 2006, compared to \$213,785 for the nine months ended September 30, 2005. The professional and consulting fees for the nine months ended September 30, 2006 included the following expenses: \$40,625 of advisory services in connection with the Company's business development, \$1,113,000, representing the value of 600,000 shares of common stock issued to a consulting company in consideration for its assistance to ZNG in obtaining geological information relevant to new potential licensed areas and its assistance in the application process for such licenses (see "Description Of ZNG," above for information on these new licenses), and the grant of certain

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warrants valued at \$618,300 for consulting services rendered during the nine months ended September 30, 2006. The increase in marketing and other expenses is attributable to increased marketing and advisory services in connection with our operations. Certain other expenses were less during the nine months ended September 30, 2006, compared to the nine months ended September 30, 2005, including salaries, which declined by \$251,088 or 71% from the prior period, and rent and occupancy, which declined by \$41,134 or 58% from the prior period, which decreases were due to the fact that the expenses of ZNG, our former wholly owned subsidiary, which is currently solely owned by ZNG, Ltd., which we own 50% of, are no longer included in our consolidated statement of operations due to the fact that ZNG is no longer our wholly owned subsidiary, but which expenses were included in our consolidated statement of operations during the nine months ended September 30, 2005. Additionally, the fact that David Zaikin agreed to not receive or accrue a salary from the Company until such time as the Company had sufficient capital to pay such salary, if at all in September 2005, led to a decrease in our salary expense for the nine months ended September 30, 2006, compared to the nine months ended September 30, 2005, and as a result our total expenses for such periods.

We had a net loss of \$2,154,734 for the nine months ended September 30, 2006, compared to a net loss of \$880,150 for the nine months ended September 30, 2005, an increase in net loss of \$1,274,584 or 145% from the prior period. The increase in net loss was mainly attributable to increases in total expenses, namely the increases in professional and consulting fees and other expenses, described above, which were not sufficiently offset by the \$225,000 increase in revenue for the nine months ended September 30, 2006, compared to \$-0- of revenue for the nine months ended September 30, 2005.

### LIQUIDITY AND CAPITAL RESOURCES

We had current assets of \$57,366 as of September 30, 2006, which included cash of \$32,096; management fee receivable of \$25,000, which represented amounts owed

to us by ZNG, Ltd. in management fees, which amount has been paid to date; and prepaid expenses and other of \$270. This represented a decrease in current assets of \$4,455 or 7.2%, from \$61,821 of current assets as of December 31, 2005, which decrease was mainly due to a decrease in management fees receivable of \$25,000 and an increase of \$20,545 in cash, which cash was received from ZNG, Ltd., in connection with our \$25,000 monthly management fees, which ZNG, Ltd. is obligated to pay to us.

We had total assets of \$235,674 as of September 30, 2006, which included current assets of \$57,366 and non-current assets of \$178,308. Non-current assets included \$1,308 relating to net property and equipment and \$177,000 relating to the value of the warrants granted to Key Brokerage for our option for the right to purchase 75% of Kondaneftegaz as described above. This represented an increase of \$172,314 or 271% in total assets of \$63,360 as of December 31, 2005, versus total assets of \$235,674 as of September 30, 2006, which increase was mainly attributable to the above mentioned investment in the Kondaneftegaz purchase option.

We had total liabilities of \$825,940 as of September 30, 2006, which were solely current liabilities and which included \$348,593 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 September 30, 2006; \$49,083 of accounts payable to Baltic in connection with the \$29,000 loan advanced to the Company from Baltic, as described above under "Description of Business" and certain other expenses owed to Baltic; \$100,725 of accounts payable to others for advisory and professional services rendered; and \$327,539 of accrued payroll, which included \$112,500 payable to our Chief Executive Officer, David

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Zaikin which amount was owed to Mr. Zaikin prior to September 2005, at which time he agreed to stop accruing salary until such time as we have sufficient monies to pay such salary, \$90,338 payable to our Chief Financial Officer, Elena Pochapski, and \$69,241.97 of accrued salary payable to our former Chief Executive Officer, Shakeel Adam. Current liabilities of \$825,940 as of September 30, 2006, represented a decrease in current liabilities of \$30,171 or 3.5% from total current liabilities of \$856,111 as of December 31, 2005. The main reasons for this decrease was the repayment of a \$62,500 loan to an individual through the issuance of Company shares, the payment of current amounts owed for professional and advisory services, which was partially offset by an increase in accrued payroll of \$23,198 and an increase in net amount owed to related party stockholders by \$20,217 which was due to certain expenses paid on the Company's behalf by the Company's Chief Executive Officer, David Zaikin, as well as certain unpaid commissions payable to AEF (as described herein).

We had negative working capital of \$768,574 and a total pre development and development stage accumulated deficit of \$4,742,753 as of September 30, 2006.

Because our cumulative losses associated with the operations of ZNG exceeded our investment as of the date of the Joint Venture, ZNG is carried on our balance sheet at \$-0- as of September 30, 2006. Our investment in ZNG will exceed \$-0- at such time as ZNG has cumulative earnings sufficient to repay all loans to Baltic as provided in the Joint Venture, if ever.

We had \$10,471 of net cash flows from operating activities for the nine months ended September 30, 2006, which included \$2,107,645 of common stock and warrants issued for professional services and salaries, \$32,307 of accounts payable and accrued expenses, \$25,000 of prepaid expenses and other assets and \$253 of depreciation and amortization, which was offset by \$2,154,734 of net loss.

We had \$-0- of net cash flows for investing activities for the nine months ended September 30, 2006.

We had \$14,000 of net cash flows from financing activities for the nine months ended September 30, 2006, which was solely due to \$14,000 of net proceeds from common stock issued to an employee, which was in connection with the exercise of all 100,000 of our Chief Financial Officer Elena Pochapski's, 2003 stock options, at an exercise price of \$0.14 per share in February 2006.

As of November 1, 2006, ZNG had received \$5,070,015 pursuant to the New Loan, which amount includes \$1,110,624 assumed by ZNG in connection with a previous loan made to ZNG. Total interest accrued as of November 1, 2006 is \$401,273, including \$189,520 of interest on the New Loan and \$211,753 of interest on the previous loan.

Additionally, in July 2006, we entered into a Deed of Agreement, whereby Baltic agreed (funding permitting) to loan ZNG approximately \$12,000,000 to be used on seismic studies, drilling and a work program, which funds have not been loaned to date.

Under the Joint Venture, we will receive \$25,000 per month as a management fee from ZNG, Ltd. In addition to the monthly management fee, ZNG Ltd. agreed to lend \$78,000 to us to pay for legal and consulting services in connection with establishing the Joint Venture. We received \$29,000 of this amount in November 2005; and will receive the additional \$49,000 if all five of the new licenses are awarded to ZNG, of which three have been awarded to date, and ZNG submits a letter from the relevant license authority of the Ministry of Natural Resources of the Russian Federation confirming such awards, of which there can be no assurance.

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Since our transfer of ZNG to the Joint Venture, we have no oil and gas operations separate from the Joint Venture, which has not started production and is not currently generating any cash from production, which makes it difficult for us to pay our maturing obligations. However, we believe that in the long run a number of trends will favorably affect our liquidity. These trends include the steady trend of economic growth in Russia in the recent years which is improving the liquidity of our potential customers, and may favorably impact our debt management and the increasing overall credit rating in Russia, which we hope will lead to increased foreign investment in Russian companies and which will benefit us as well.

We are taking steps in an attempt 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.

### 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 through funding provided by existing stockholders and with amounts received from the Joint Venture (described above), including \$25,000 a month which the Company is to receive from ZNG, Ltd., pursuant to the Joint Venture. Additionally, ZNG has received approximately \$1,110,624 from BP pursuant to a prior loan and another \$3,959,391 pursuant to the New Loan, which had a total outstanding balance, including the assumed balance of the prior loan and accrued and unpaid interest on the prior loan and the New Loan as of November 1, 2006, of \$5,471,288, which has been spent on various purposes, including paying consultants for services performed in connection with surveys previously performed on the licensed area. As the Joint Venture is now responsible for the funding of the operations of ZNG, we believe our expenditures in connection with ZNG will decrease in the upcoming periods. If we are unable to raise the additional funds required for the planned activities of the Joint Venture and for additional activities, separate than the Joint Venture, our Company may be forced to abandon its current business plan. If you invest in our Company and we are unable to raise the required funds, your investment could become worthless.

ADDITIONAL LOANS UNDER THE NEW LOAN ARE CONTINGENT UPON ZNG OBTAINING RIGHTS TO TWO ADDITIONAL LICENSES IN THE KURGAN REGION, WHICH ZNG APPLIED FOR IN AUGUST AND SEPTEMBER 2005.

Approximately \$654,000 in loans, which ZNG is to receive in connection with the New Loan are contingent upon ZNG obtaining rights to the two new licenses applied for in August and September 2005. The Russian government and Ministry of



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Natural Resources together with Rosnedra Federal Agency set the dates for the auctions on the two blocks, the Pichuginski and Mihailovski parcels, which

auctions we anticipate occurring in the fourth quarter of 2006. The licenses may be bid on by companies with resources much greater than ZNG, and as a result, ZNG may not win the rights to the licenses applied for. If this were to happen, the approximately \$654,000 in loans which are contingent upon ZNG obtaining such licenses may not be granted. As a result, ZNG may be forced to curtail or abandon its business operations and consequently, our investment in ZNG and the value of our securities may become worthless.

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

The Company anticipates the need for approximately \$15,000,000 prior to ZNG's expected generation of any revenues. Currently the Company has not raised any of this financing and the Company can make no assurances that this financing will ever be raised. The Company also does not expect to generate any revenues through the operations of ZNG, other than the \$25,000 a month that it will receive from ZNG, Ltd., until 2007, of which there can be no assurance. Therefore, investors should keep in mind that even if ZNG is able to raise the substantial amounts of additional financing it requires for its operations, it could still be years before ZNG generates any revenue, if ever. If ZNG does not raise the \$15,000,000 which it anticipates needing to generate revenues, which, even if generated, will likely not be great enough to sustain ZNG if no revenues are generated and hydrocarbon reserves are located, ZNG may be forced to abandon or curtail its current business plan. As the Company's only current operations are through its 50% ownership of ZNG, Ltd., which in turn owns 100% of ZNG, if ZNG were forced to abandon its business plan, 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 become worthless.

WE WILL NEED SUBSTANTIAL FINANCING PRIOR TO ENTERING INTO ANY ADDITIONAL JOINT VENTURES OR ACQUISITIONS.

The Company anticipates the need for approximately \$10,000,000 to \$25,000,000 to enter into additional joint ventures and/or acquisitions in the future. Currently the Company has not raised any of this financing and the Company can make no assurances that this financing will ever be raised. Even if the Company does raise this money and enter into other joint ventures or acquisitions in the future, it could still be years before the Company generates any revenue, if ever. If the Company does not raise the \$10,000,000 to \$25,000,000 which it anticipates needing to enter into additional joint ventures or acquisitions, the Company may be forced to abandon or curtail its current business plan. Additionally, the raising of this money may include issuing securities with greater rights than our common stock shareholders and/or may result in substantial dilution to our existing shareholders.

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 not generated any revenues since inception and have incurred substantial losses including a net loss of \$267,632 for the three months ended September 30, 2006, a net loss of \$2,154,734 for the nine months ended September 30, 2006 and a total accumulated deficit of \$4,742,753 as of September 30, 2006. These factors among others indicate that the Company may be unable to continue as a going concern, particularly in the event that it cannot

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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 no revenues or profits to date and our net cumulative deficit attributable to our development stage as of September 30, 2006, was \$4,292,968, and our total cumulative deficit was \$4,742,753 which included \$449,785 of pre-development stage deficit. We had \$327,539 in accrued and unpaid salaries and a working capital deficit of \$825,940 as of September 30, 2006. The Company is currently being funded by existing shareholders and the \$25,000 monthly payments, which the Company receives from the Joint Venture in connection with management fees, 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. There is a risk that ZNG will never begin production and our Company will never generate any revenues through our ownership of ZNG, Ltd. If throughout ZNG's oil exploration, it finds no viable wells, and consequently, we generate only minimal revenues through ZNG, Ltd., 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.

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 not generated any revenues, 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 ZNG DOES NOT FIND HYDROCARBON RESERVES, WE MAY BE FORCED TO CURTAIL OUR BUSINESS PLAN.

There is a risk that ZNG will not find any hydrocarbon reserves and the cost of exploration will become too high for ZNG, Ltd. to continue ZNG's business plan. As our only current operations are through our 50% ownership of ZNG, Ltd., which in turn owns 100% of ZNG, if ZNG or ZNG, Ltd. 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. 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 such as LUKoil, BP-TNK,

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Surgutneftegaz and Sibneft 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 the 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, both of whom are employed under contracts. 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, 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 PROJECTIONS, ESTIMATES AND STATISTICAL ANALYSIS MAY BE INACCURATE OR SUBSTANTIALLY WRONG, WHICH MAY PREVENT ZNG FROM EXECUTING ITS BUSINESS PLAN.

Risks from these factors are intertwined with the risky nature inherent in the oil and gas industry. 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, etc. If ZNG projections or estimates are wrong or our statistical analysis faulty, ZNG's revenues may be adversely affected which could ZNG from executing its 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 due to the fact that our only current oil and gas operations are through our 50% ownership of ZNG, Ltd., which in turn owns 100% of ZNG.

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 new 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-QSB's or 10-KSB's) by the due date of such report (not

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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.

IF THERE IS A MARKET FOR OUR COMMON STOCK, OUR STOCK PRICE MAY BE VOLATILE.

If there is a market for our common stock, we anticipate that such market will be subject to wide fluctuations in response to several factors, 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 NASD 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. Further, due to the limited volume of our shares which trade and our limited public float, we believe that our stock prices (bid, asked and closing prices) are entirely arbitrary, are not related to the actual value of the Company, and do not reflect the actual value of our common stock (and in fact reflect a value that is much higher than the actual value of our Common Stock). Shareholders and potential investors in our Common Stock should exercise caution before making an investment in the Company, and should not rely on the publicly quoted or traded stock prices in determining our Common Stock value, but should instead determine value of our Common Stock based on the information contained in the Company's public reports, industry information, and those business valuation methods commonly used to value private companies.

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 \$4.00 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 \$4.00 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.

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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.

### CRITICAL ACCOUNTING POLICIES

Our discussion and analysis of our financial condition and results of Operations is based upon our audited financial statements, which have been prepared in accordance with accounting principals generally accepted in the United States. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of any contingent assets and liabilities. On an on-going basis, we evaluate our estimates, including those related to uncollectible receivable, investment values, income taxes, the recapitalization and contingencies. We base our estimates on various assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

### ITEM 3. CONTROLS AND PROCEDURES

(a) Evaluation of disclosure controls and procedures. Our Chief Executive Officer and Principal Financial Officer, after evaluating the effectiveness of our "disclosure controls and procedures" (as defined in the Securities Exchange Act of 1934 Rules 13a-15(e) and 15d-15(e)) as of the end of the period covered by this Quarterly Report on Form 10-QSB (the "Evaluation Date"), have concluded that as of the Evaluation Date, our disclosure controls and procedures are effective to provide reasonable assurance that information we are required to disclose in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Principal Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

(b) Changes in internal control over financial reporting. There were no significant 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

From time to time, we may become party to 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. We may become involved in material legal proceedings in the future.

#### ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES

In July 2006, the Company issued 10,000 shares of restricted common stock to IRG in connection with the IRG Agreement, for investor relations services rendered to the Company for the month ended July 2006. The Company claims an exemption

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from registration afforded by Section 4(2) of the Act since the foregoing issuance did not involve a public offering, the recipient took the shares for investment and not resale and the Company took appropriate measures to restrict transfer. No underwriters or agents were involved in the foregoing issuance and no underwriting discounts or commissions were paid by the Company.

We previously agreed to issue Alternative Energy Finance Ltd. ("AEF"), of which Tim Peara is the Managing Director as well as a Director of the Company, certain warrants in connection with Mr. Peara introducing the parties who formed the joint venture. Pursuant to an agreement between AEF and the Company, AEF will receive compensation based on the total investment made by Baltic Petroleum Ltd. in the Joint Venture. This compensation included a commission of approximately \$18,024 (1% of Baltic's first \$1,802,441 investment in the Joint Venture), which amount has not been paid as of the date of this filing, and 50,068 options to purchase shares of our common stock at \$0.63 per share and a commission of \$6,673 (1% of Baltic's \$667,313 investment in the Joint Venture in the first quarter 2006), which amount has not been paid to AEF to date and 17,561 options to purchase shares of our common stock at \$0.67 per share for the first quarter of 2006, which were granted to Mr. Peara on March 6, 2006, and March 31, 2006 respectively, which options contain a cashless exercise provision.

On June 30, 2006, in connection with our agreement with AEF, we agreed to grant AEF a warrant to purchase 20,412 shares of our common stock at an exercise price of \$2.02, which warrants contained a cashless exercise feature. The warrants expire three years from the grant date. We were also obligated to pay AEF \$23,562 during the quarter ended June 30, 2006 (equal to 1% of Baltic's \$2,356,153 investment in the Joint Venture in the second quarter 2006), which amount has not been paid to AEF to date. The Company claims an exemption from registration afforded by Section 4(2) of the Act since the foregoing 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. No underwriters or agents were involved in the foregoing and no underwriting discounts or commissions were paid by the Company.

In July 2006, the Company issued 13,500 shares of restricted common stock to Harbinger Research, LLC ("Harbinger"), in connection with the Company's entry into an Investment Report Services Agreement with Harbinger (the "Harbinger Agreement"), whereby Harbinger agreed to prepare and distribute an investment report for the Company to approximately 1,500,000 individual investors. The consideration for the entry into the Harbinger Agreement and the preparation and dissemination of the report was 13,500 restricted shares of common stock. The Company claims an exemption from registration afforded by Section 4(2) of the Act since the foregoing issuance did not involve a public offering, the recipient took the shares for investment and not resale and the Company took

appropriate measures to restrict transfer. No underwriters or agents were involved in the foregoing issuance and no underwriting discounts or commissions were paid by the Company.

In September 2006, in connection with our entry into the Option Agreement with Key Brokerage (as described above) we granted Key Brokerage an aggregate of 250,000 warrants to purchase shares of our common stock at an exercise price of \$2.20 per share, exercisable until September 14, 2008. We claim an exemption from registration afforded by Section 4(2) of the Securities Act of 1933 since the foregoing grant of warrants did not involve a public offering, the recipient took the shares for investment and not resale and any shares issuable in connection with an exercise of the warrants will be restricted once issued. No underwriters or agents were involved in the foregoing grant and no underwriting discounts or commissions were paid by us.

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In August 2006, we agreed to issue restricted shares of our common stock to certain individuals and entities to which we owed money as of August 2006. The shares were issued at a 30% discount to the then current market price of our common stock, being the discount for the restrictive nature of the shares.

In August 2006, two individuals agreed to be issued an aggregate of 113,530 restricted shares of common stock in consideration for the forgiveness of \$182,783 in money which we owed the individuals in connection with loans they provided us in December 2005 and in connection with such individuals representing us in Moscow, Russia.

In September 2006, we issued an aggregate of 417,469 restricted shares of common stock to Business Standard (and nominees thereof), of which 400,000 shares were issued in consideration for consulting services rendered in connection with the application for and subsequent grant of two (2) oil and gas exploration and production licenses in the Kurgan region of Siberia, Russia (the "Licenses"), to Zauralneftegaz, Ltd., a Russian company ("ZNG"), which is wholly owned by Zauralneftegaz, Ltd., a United Kingdom company, which we own 50% of through a joint venture in connection with our agreement with Business Standard, whereby we agreed to issue Business Standard 200,000 restricted shares of our common stock for each license ZNG receives. The remaining 17,469 shares of restricted common stock were issued to Business Standard in connection with Business Standard forgiving \$28,125 in amounts owed for consulting services rendered.

We claim an exemption from registration afforded by Section 4(2) of the Securities Act of 1933 since the foregoing issuances did not involve a public offering, the recipients took the shares for investment and not resale and we took appropriate measures to restrict transfer. No underwriters or agents were involved in the foregoing issuances and no underwriting discounts or commissions were paid by us.

In September 2006, we agreed to issue 10,000 shares of our restricted common stock to the Investor Relations Group, Inc. ("IRG"), in accordance with a contract entered into on March 16, 2006. Pursuant to the contract (the "IRG Agreement"), IRG agreed to perform investor relations and public relations services, including the overall management of a corporate communications program, as well as agreeing to design a corporate fact sheet, and organizing

road shows for the Company. The Company's Board of Directors approved the issuance of 150,000 restricted shares of the Company upon signing of the agreement, which shares have previously been issued and agreed to issue IRG 10,000 restricted shares per month for the six (6) month duration of the contract, of which 10,000 shares were issued in September 2006 for investor relations services rendered in the month of August 2006. We claim an exemption from registration afforded by Section 4(2) of the Act since the foregoing issuance did not involve a public offering, the recipient took the shares for investment and not resale and we took appropriate measures to restrict transfer. No underwriters or agents were involved in the foregoing issuance and no underwriting discounts or commissions were paid by us.

On September 30, 2006, in connection with our agreement with AEF, we agreed to grant AEF a warrant to purchase 20,952 shares of our common stock at an exercise price of \$1.53 per share, which warrants contained a cashless exercise feature. The warrants expire three years from the grant date. We were also obligated to pay AEF \$18,303 during the quarter ended September 30, 2006 (equal to 1% of Baltic's \$1,830,292 investment in the Joint Venture in the third quarter 2006), which amount has not been paid to AEF to date. When such warrant is issued, we will claim an exemption from registration afforded by Section 4(2) of the Act since the foregoing issuance will not involve a public offering, the recipient will take the shares for investment and not resale and we will take appropriate

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measures to restrict transfer. No underwriters or agents will be involved in the foregoing issuance and no underwriting discounts or commissions will be paid by us.

### ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

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

None.

### ITEM 5. OTHER INFORMATION

None.

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

#### a) Exhibits

Exhibit No.	Description
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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 May 14, 2004
10.12(3)	Agreement with Business - Standard (translated from



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	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)
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 Zauralneftgaz Limited dated October 14, 2005
10.18(5)	Loan Agreement between OOO Zauralneftgaz and Caspian Finance Limited
10.19(5)	Deed of Novation between Baltic Petroleum Limited, Caspian Finance Limited and OOO Zauralneftgaz
10.20(5)	Deed of Release
10.21(5)	Release of Pledge
10.22(5)	Guarantee
10.23(5)	Debenture
10.24(5)	Agreement for the Pledge of the Participatory Interest in OOO Zauralneftgaz (Russian translation removed)
10.25(5)	Sale and Purchase Agreement
10.26(7)	Option Agreement with Key Brokerage
10.27(7)	Warrant Agreement with Key Brokerage
10.28*	July 26, 2006 Deed of Agreement
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(6)	Glossary

\* Filed Herein.

(1) Filed as Exhibits 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.

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(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 8-K, filed with the Commission on December 2, 2005, and incorporated herein by reference.

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

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

### b) Reports on Form 8-K

We filed the following reports on Form 8-K during the three months covered by this report:

September 14, 2006 - To report our entry into a preliminary extension with Baltic regarding the terms of our Joint Venture Agreement.

September 19, 2006 - To report our entry into an option agreement with Key Brokerage, Inc.

September 22, 2006 - To report the issuance of various shares of common stock in forgiveness of debt owed to various parties in August and September 2006.

We filed the following reports on Form 8-K subsequent to the period covered by this report:

October 23, 2006 - To report that ZNG had received results of the 2D Seismic analysis conducted on its licensed blocks.

October 25, 2006 - To further report the results of ZNG's 2D Seismic analysis conducted on its licensed blocks.

November 6, 2006 - To report ZNG's plans for drilling in its licensed blocks.

### SIGNATURES

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

SIBERIAN ENERGY GROUP INC.

DATED: November 14, 2006

By: /s/ David Zaikin

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David Zaikin

