PetroHunter Energy Corp
Form 10-Q
August 13, 2008

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

Form 10-Q

(Mark One)

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2008

or

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

For the transition period from _____ to _____

Commission file number: 000-51152

PETROHUNTER ENERGY CORPORATION
(Exact name of registrant as specified in its charter)

Maryland (State or other jurisdiction of incorporation or organization)	98-0431245 (I.R.S. Employer Identification No.)
1600 Stout Street Suite 2000, Denver, Colorado (Address of principal executive offices)	80202 (Zip Code)

(303) 572-8900
Registrant’s telephone number, including area code

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer,

or a smaller reporting company. See definition of “accelerated filer,” “large accelerated filer”, and “smaller reporting company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer [ ]   Accelerated filer [ ]   Non-accelerated filer [ ]   Smaller reporting company [X]

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

As of July 31, 2008, the registrant had 340,743,469 shares of common stock outstanding.

Unless otherwise noted in this report, any description of “us” or “we” refers to PetroHunter Energy Corporation and our subsidiaries. All amounts expressed herein are in U.S. dollars unless otherwise indicated.

FORWARD-LOOKING STATEMENTS

Certain statements contained in this Quarterly Report on Form 10-Q constitute "forward-looking statements." These statements, identified by words such as "plan," "anticipate," "believe," “estimate,” “should,” “expect” and similar expressions include our expectations and objectives regarding our future financial position, operating results and business strategy. These statements reflect the current views of management with respect to future events and are subject to risks, uncertainties and other factors that may cause our actual results, performance or achievements, or industry results, to be materially different from those described in the forward-looking statements. All forward-looking statements herein as well as all subsequent written and oral forward-looking statements attributable to us, or persons acting on our behalf, are expressly qualified in their entirety by cautionary statements set forth in the “Risk Factors” section of our Prospectus on Form S-1 filed with the Securities and Exchange Commission (“SEC”) on June 30, 2008 and in Item 1A “Risk Factors” appearing in our Annual Report on Form 10-K for the fiscal year ended September 30, 2007. We assume no duty to update or revise our forward-looking statements based on changes in internal estimates or expectations or otherwise. We advise you to carefully review the reports and documents we file from time to time with the SEC.

GLOSSARY

Unless otherwise indicated in this document, oil equivalents are determined using the ratio of six Mcf of natural gas to one barrel of crude oil, condensate or natural gas liquids so that six Mcf of natural gas are referred to as one barrel of oil equivalent.

API Gravity. A specific gravity scale developed by the American Petroleum Institute (API) for measuring the relative density of various petroleum liquids, expressed in degrees. API gravity is gradated in degrees on a hydrometer instrument and was designed so that most values would fall between 10° and 70° API gravity. The arbitrary formula used to obtain this effect is: API gravity = (141.5/SG at 60°F) — 131.5, where SG is the specific gravity of the fluid.

Bbl. One stock tank barrel, or 42 U.S. gallons liquid volume, used in reference to oil or other liquid hydrocarbons.

Bcf. One billion cubic feet of natural gas at standard atmospheric conditions.

Capital Expenditures. Costs associated with exploratory and development drilling (including exploratory dry holes); leasehold acquisitions; seismic data acquisitions; geological, geophysical and land-related overhead expenditures; delay rentals; producing property acquisitions; other miscellaneous capital expenditures; compression equipment and pipeline costs.

Carried Interest. The owner of this type of interest in the drilling of a well incurs no liability for costs associated with the well until the well is drilled, completed and connected to commercial production/processing facilities.

Completion. The installation of permanent equipment for the production of oil or natural gas.

Developed Acreage. The number of acres that are allocated or assignable to producing wells or wells capable of production.

Development Well. A well drilled within the proved area of an oil or natural gas reservoir to the depth that is known to be productive.

Drilled and Cased. Involves drilling a well and installing casing to a specified depth in the wellbore for future completion.

Exploitation. The continuing development of a known producing formation in a previously discovered field. To make complete or maximize the ultimate recovery of oil or natural gas from the field by work including development wells, secondary recovery equipment or other suitable processes and technology.

Exploration. The search for natural accumulations of oil and natural gas by any geological, geophysical or other suitable means.

Exploratory Well. A well drilled to find and produce oil or natural gas in an unproved area, to find a new reservoir in a field previously found to be productive of oil or natural gas in another reservoir, or to extend a known reservoir.

Farm-In or Farm-Out. An agreement under which the owner of a working interest in a natural gas and oil lease assigns the working interest or a portion of the working interest to another party who desires to drill on the leased acreage. Generally, the assignee is required to drill one or more wells in order to earn its interest in the acreage. The assignor usually retains a royalty or reversionary interest in the lease. The interest received by an assignee is a “farm-in” while the interest transferred by the assignor is a “farm-out”.

Field. An area consisting of either a single reservoir or multiple reservoirs, all grouped on or related to the same individual geological structural feature and/or stratigraphic condition.

Finding and Development Costs. The total capital expenditures, including acquisition costs, and exploration and abandonment costs, for oil and gas activities divided by the amount of proved reserves added in the specified period.

Force Pooling. The process by which interests not voluntarily participating in the drilling of a well, may be involuntarily committed to the operator of the well (by a regulatory agency) for the purpose of allocating costs and revenues attributable to such well.

Gross Acres or Gross Wells. The total acres or wells, as the case may be, in which we have a working interest.

Lease. An instrument which grants to another (the lessee) the exclusive right to enter to explore for, drill for, produce, store and remove oil and natural gas on the mineral interest, in consideration for which the lessor is entitled to certain rents and royalties payable under the terms of the lease. Typically, the duration of the lessee’s authorization is for a stated term of years and “for so long thereafter” as minerals are producing.

Mcf. One thousand cubic feet of natural gas at standard atmospheric conditions.

MCFE. One thousand cubic feet of gas equivalent. Gas equivalents are determined using the ratio of six Mcf of gas (including gas liquids) to one Bbl of oil.

Net Acres or Net Wells. A net acre or well is deemed to exist when the sum of our fractional ownership working interests in gross acres or wells, as the case may be, equals one. The number of net acres or wells is the sum of the fractional working interests owned in gross acres or wells, as the case may be, expressed as whole numbers and fractions thereof.

Operator. The individual or company responsible to the working interest owners for the exploration, development and production of an oil or natural gas well or lease.

Overriding Royalty. A revenue interest in oil and gas, created out of a working interest which entitles the owner to a share of the proceeds from gross production, free of any operating or production costs.

Payout. The point at which all costs of leasing, exploring, drilling and operating have been recovered from production of a well or wells, as defined by contractual agreement.

Productive Well. A well that is found to be capable of producing hydrocarbons in sufficient quantities such that proceeds from the sale of the production exceed production expenses and taxes. Productive wells consist of producing wells and wells capable of production, but specifically exclude wells drilled and cased during the fiscal year that have yet to be tested for completion.

Prospect. A specific geographic area which, based on supporting geological, geophysical or other data and also preliminary economic analysis using reasonably anticipated prices and costs, is deemed to have potential for the discovery of commercial hydrocarbons.

Proved Reserves. The estimated quantities of oil, natural gas and natural gas liquids which geological and engineering data demonstrate with reasonable certainty to be commercially recoverable in future years from known reservoirs under existing economic and operating conditions.

Reserves. Natural gas and crude oil, condensate and natural gas liquids on a net revenue interest basis, found to be commercially recoverable.

Reservoir. A porous and permeable underground formation containing a natural accumulation of producible natural gas and/or oil that is confined by impermeable rock or water barriers and is separate from other reservoirs.

Royalty. An interest in an oil and natural gas lease that gives the owner of the interest the right to receive a portion of the production from the leased acreage, or of the proceeds of the sale thereof, but generally does not require the owner to pay any portion of the costs of drilling or operating the wells on the leased acreage. Royalties may be either landowner’s royalties, which are reserved by the owner of the leased acreage at the time the lease is granted, or overriding royalties, which are usually reserved by an owner of the leasehold in connection with a transfer to a subsequent owner.

Spud. To start the well drilling process by removing rock, dirt and other sedimentary material.

Stratigraphic. Relating to vertical position in a rock column. More generally, relating to relative geological age, since typically, in any given sequence of sedimentary rock, older rock is lower than newer.

3-D Seismic. The method by which a three-dimensional image of the earth’s subsurface is created through the interpretation of reflection seismic data collected over a surface grid. 3-D seismic surveys allow for a more detailed understanding of the subsurface than do conventional surveys and contribute significantly to field appraisal, exploitation and production.

Undeveloped Acreage. Lease acres on which wells have not been drilled or completed to a point that would permit the production of commercial quantities of oil and gas regardless of whether or not such acreage contains proved reserves.

Working Interest. An interest in an oil and gas lease that gives the owner of the interest the right to drill and produce oil and gas on the leased acreage and requires the owner to pay a share of the costs of drilling and production operations. The share of production to which a working interest owner is entitled will always be smaller than the share of costs that the working interest owner is required to bear, with the balance of the production accruing to the owners of royalties.

PETROHUNTER ENERGY CORPORATION

FORM 10-Q

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PART I. FINANCIAL INFORMATION
Item 1. Financial Statements
PETROHUNTER ENERGY CORPORATION
(A Development Stage Company)
CONDENSED CONSOLIDATED BALANCE SHEETS
(unaudited; $ in thousands, except share and per share amounts)

	June 30, 2008	September 30, 2007
ASSETS		
Current Assets		
Cash and cash equivalents	$ 695	$ 120
Restricted cash	531	—
Receivables		
Oil and gas receivables, net	280	487
Other receivables	62	59
Due from related parties	—	500
GST receivable	485	—
Note receivable — related party	—	2,494
Prepaid expenses and other assets	406	187
Total Current Assets	2,459	3,847
Property and Equipment, at cost		
Oil and gas properties under full cost method, net	146,184	162,843
Furniture and equipment, net	422	569
Total Property and Equipment	146,606	163,412
Other Assets		
Joint interest billings	—	13,637
Restricted cash	524	599
Deposits and other assets	130	—
Deferred financing costs	1,657	529
Intangible asset	4,142	—
Total Assets	$ 155,518	$ 182,024
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities		
Notes payable — short-term	$ 1,055	$ 4,667
Convertible notes payable	400	400
Accounts payable and accrued expenses	9,873	26,631
Note payable — related party — current portion	2,622	3,755
Note payable — current portion of long-term liabilities	120	120
Accrued interest payable	6,302	2,399
Accrued interest payable — related party	18	516
Due to shareholder and related parties	440	1,474
Contract payable — oil and gas properties	—	1,750
Contingent purchase obligation	4,142	—
Total Current Liabilities	24,972	41,712
Non-current obligations		

Notes payable — net of discount	37,207	27,944
Subordinated notes payable — related parties	106	9,050
Convertible notes payable — net of discount	684	—
Asset retirement obligation	73	136
Net Non-current Obligations	38,070	37,130
Total Liabilities	63,042	78,842
Common Stock Subscribed	—	2,858
Commitments and Contingencies (Note 13)		
Stockholders' Equity		
Preferred stock, $0.001 par value; authorized 100,000,000 shares; none issued	—	—
Common stock, $0.001 par value; authorized 1,000,000,000 shares; 338,065,950 and 278,948,841 shares issued and outstanding at June 30, 2008 and September 30, 2007, respectively	338	279
Additional paid-in-capital	199,968	172,672
Accumulated other comprehensive gain (loss)	33	(5)
Deficit accumulated during the development stage	(107,863)	(72,622)
Total Stockholders' Equity	92,476	100,324
Total Liabilities and Stockholders' Equity	$ 155,518	$ 182,024

See accompanying notes to condensed consolidated financial statements.

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CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(unaudited; $ in thousands except per share amounts)

	Three months ended June 30, 2008	Three months ended June 30, 2007 (restated)	Nine months ended June 30, 2008	Nine months ended June 30, 2007 (restated)	Cumulative From Inception (June 20, 2005) to June 30, 2008
Revenues					
Oil and gas revenues	$ 567	$ 847	$ 1,349	$ 2,285	$ 4,206
Other revenues	13	—	222	—	222
Total revenues	580	847	1,571	2,285	4,428
Costs and expenses					
Lease operating expenses	164	211	404	597	1,201
General and administrative	2,554	5,395	8,245	13,396	41,193
Property development — related party	—	—	—	1,815	7,205
Impairment of oil and gas properties	—	600	—	9,551	24,053
Consulting fees – related party	—	75	—	150	—
Depreciation, depletion, amortization and accretion	334	805	774	2,018	2,093
Total operating expenses	3,052	7,086	9,423	27,527	75,745
Loss from operations	(2,472)	(6,239)	(7,852)	(25,242)	(71,317)
Other income (expense):					
Loss from conveyance of property	(15,220)	—	(15,220)	—	(15,220)
Gain on foreign exchange	—	—	11	—	33
Interest income	6	6	33	20	72
Interest expense	(1,801)	(846)	(9,226)	(2,677)	(18,444)
Trading security losses	—	—	(2,987)	—	(2,987)
Total other expense	(17,015)	(840)	(27,389)	(2,657)	(36,546)
Net loss	$ (19,487)	$ (7,079)	$ (35,241)	$ (27,899)	$ (107,863)
Net loss per common share — basic and diluted	$ (0.06)	$ (0.03)	$ (0.11)	$ (0.12)	
Weighted average number of common shares outstanding — basic and diluted	324,147	256,906	317,811	221,802	

See accompanying notes to condensed consolidated financial statements

CONDENSED CONSOLIDATED STATEMENTS OF
STOCKHOLDERS' EQUITY AND COMPREHENSIVE LOSS
(unaudited, $ in thousands except share and per share amounts)

	Common Stock Shares	Common Stock Amount	Additional Paid-in Capital	Deficit Accumulated During the Development Stage	Accumulated Other Comprehensive Loss	Total Stockholders' Equity	Total Comprehensive Loss
Balances, June 20, 2005 (inception)	—	$ —	$ —	$ —	$ —	$ —	$ —
Shares issued to founder at $0.001 per share	100,000,000	100	—	—	—	100	—
Stock-based compensation costs for options granted to non employees	—	—	823	—	—	823	—
Net loss	—	—	—	(2,119)	—	(2,119)	(2,119)
Balances, September 30, 2005	100,000,000	100	823	(2,119)	—	(1,196)	(2,119)
Shares issued for property interests at $0.50 per share	3,000,000	3	1,497	—	—	1,500	—
Shares issued for finder's fee on property at $0.50 per share	3,400,000	3	1,697	—	—	1,700	—
Shares issued upon conversion of debt, at $0.50 per share	44,063,334	44	21,988	—	—	22,032	—
Shares issued for commission on convertible debt at $0.50 per share	2,845,400	3	1,420	—	—	1,423	—
Sale of shares and warrants at $1.00 per unit	35,442,500	35	35,407	—	—	35,442	—
Shares issued for commission on sale of units	1,477,500	1	1,476	—	—	1,477	—
Costs of stock offering:							
Cash	—	—	(1,638)	—	—	(1,638)	—
Shares issued for commission at $1.00 per share	—	—	(1,478)	—	—	(1,478)	—
Exercise of warrants	1,000,000	1	999	—	—	1,000	—
Recapitalization of shares issued upon merger	28,700,000	30	(436)	—	—	(406)	—
Stock-based compensation	—	—	9,189	—	—	9,189	—
Net loss	—	—	—	(20,692)	—	(20,692)	(20,692)
Balances, September 30, 2006	219,928,734	220	70,944	(22,811)	—	48,353	(20,692)
Shares issued for property interests at $1.62 per share	50,000,000	50	80,950	—	—	81,000	—
Shares issued for property interests at $1.49 per share	256,000	—	382	—	—	382	—

	Common Stock Shares	Common Stock Amount	Additional Paid-in Capital	Deficit Accumulated During the Development Stage	Accumulated Other Comprehensive Loss	Total Stockholders' Equity	Total Comprehensive Loss
Shares issued for commission costs on property at $1.65 per share	121,250	—	200	—	—	200	—
Shares issued for finance costs on property at $0.70 per share	642,857	1	449	—	—	450	—
Shares issued for property and finance interests at various costs per share	8,000,000	8	6,905	—	—	6,913	—
Foreign currency translation adjustment	—	—	—	—	(5)	(5)	(5)
Discount on notes payable	—	—	4,670	—	—	4,670	—
Stock-based compensation	—	—	8,172	—	—	8,172	—
Net loss	—	—	—	(49,811)	—	(49,811)	(49,811)
Balances, September 30, 2007	278,948,841	279	172,672	(72,622)	(5)	100,324	(49,816)
Shares issued for property interests at $0.31 per share	25,000,000	25	7,725	—	—	7,750	—
Shares issued for finance costs at $0.23 per share	16,000,000	16	3,664	—	—	3,680	—
Shares issued in conjunction with asset sale at $0.25 per share	5,000,000	5	1,245	—	—	1,250	—
Shares returned for property and retired at prices ranging from $0.23 per share to $1.72 per share	(6,400,000)	(6)	(5,524)	—	—	(5,530)	—
Shares issued for finance costs at $0.28 per share	200,000	—	56	—	—	56	—
Shares issued for vendor settlements at $0.20 per share	16,879,219	17	3,723	—	—	3,740	—
Shares issued for finance costs at $0.20 per share	2,037,890	2	—	—	—	2	—
Shares issued for option to purchase CCES	400,000	—	80	—	—	80	—
Warrant value associated with amendment & waiver on convertible debt	—	—	209	—	—	209	—
Discounts associated with beneficial conversion feature and detachable warrants on convertible debenture issuance	—	—	6,956	—	—	6,956	—
Warrant value associated with convertible debenture issuance	—	—	21	—	—	21	—
Warrant value associated with related party amendment	—	—	705	—	—	705	—

Forgiveness of amounts due to shareholder and related party debt	—	—	4,067	—	—	4,067	—
Origination fees on Global debt	—	—	1,895	—	—	1,895	—
Discount on notes payable	—	—	336	—	—	336	—
Foreign currency translation adjustment	—	—	—	—	38	38	38
Stock-based compensation	—	—	2,138	—	—	2,138	—
Net loss	—	—	—	(35,241)	—	(35,241)	(35,241)
Balances, June 30, 2008	338,065,950	$ 338	$ 199,968	$ (107,863)	$ 33	$ 92,476	$ (85,019)

See accompanying notes to condensed consolidated financial statements.

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CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(unaudited, $ in thousands)

	Nine months ended June 30, 2008	Nine months ended June 30, 2007 (restated)	Cumulative From Inception (June 20, 2005) to June 30, 2008
Cash flows used in operating activities			
Net loss	$ (35,241)	$ (27,899)	$ (107,868)
Adjustments used to reconcile net loss to net cash used in operating activities:			
Stock for expenditures advanced	—	—	100
Stock-based compensation	2,138	7,305	20,322
Detachable warrants recorded as interest expense	813	—	813
Depreciation, depletion, amortization and accretion	774	2,268	2,092
Impairment of oil and gas properties	—	4,400	24,053
Stock for financing costs	—	1,338	1,623
Amortization of discount and deferred financing costs on notes payable	2,576	458	3,612
Loss on trading securities	2,987	—	2,987
Loss on conveyance of property	15,220	—	15,220
Gain on foreign exchange	(11)	—	(34)
Changes in assets and liabilities			
Receivables	6	(894)	(540)
Due from related party	(61)	848	(3,055)
Prepaids and other	(102)	(54)	(147)
Deferred financing costs	(484)	—	(484)
Accounts payable, accrued expenses, and other liabilities	(5,063)	(2,508)	(209)
Due to shareholder and related parties	(525)	1,291	949
Net cash used in operating activities	(16,973)	(13,447)	(60,089)
Cash flows provided by (used in) investing activities			
Proceeds from CD redemption	50	—	50
Additions to oil and gas properties	(21,205)	(13,212)	(70,596)
Proceeds from sale of oil and gas properties	28,066	—	28,066
Sale of trading securities	2,541	—	2,541
Due from joint interest owner	—	(16,274)	—
Deposit on oil and gas property acquisition	—	(2,244)	—
Additions to property and equipment	(22)	(260)	(22)
Restricted cash	—	475	(1,077)
Net cash provided by (used in) investing activities	9,430	(31,515)	(44,220)
Cash flows from financing activities			
Proceeds from the sale of common stock	—	300	35,742
Proceeds from common stock subscribed	—	2,768	2,858
Proceeds from the issuance of notes payable	8,250	31,700	39,800
Payments on long-term debt	(101)	—	(101)
Borrowing on short-term notes payable	1,655	—	2,155
Payments on short-term notes	(6,436)	—	(6,436)

Payments on contracts payable		(250)		—		(250)
Payments on related party borrowing		(1,805)		(600)		(1,805)
Proceeds from related party borrowing		420		—		695
Proceeds from the exercise of warrants		—		—		10,000
Cash received upon recapitalization and merger		—		—		21
Proceeds from issuance of convertible notes		6,334		—		27,166
Offering and financing costs		—		180		(1,638)
Net cash provided by financing activities		8,067		34,348		99,207
Effect of exchange rate changes on cash		(35)		—		(38)
Net increase (decrease) in cash and cash equivalents		575		(10,614)		695
Cash and cash equivalents, beginning of period		120		10,632		—
Cash and cash equivalents, end of period	$	695	$	18	$	695
Supplemental schedule of cash flow information						
Cash paid for interest	$	1,088	$	1	$	1,483
Cash paid for income taxes	$	—	$	—	$	—

See accompanying notes to condensed consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(unaudited, dollars in thousands except per share amounts)

Note 1 — Organization and Basis of Presentation

We are a development stage global oil and gas exploration and production company committed to acquiring and developing primarily unconventional natural gas and oil prospects that we believe have a very high probability of economic success. Since our inception in 2005, our principal business activities have been raising capital through the sale of common stock and convertible notes and acquiring oil and gas properties in the western United States and Australia. Currently, we own property in Colorado, where we have drilled five wells on our Buckskin Mesa property, and Australia, where we have drilled one well on our property in the Northern Territory, and in Montana, where we hold a land position in the Bear Creek area. The wells on these properties have not yet commenced oil and gas production. We own working interests in eight additional wells in Colorado which are operated by EnCana Oil & Gas USA (“EnCana”) and are currently producing gas. In November 2007, we sold 66,000 net acres of land and two wells in Montana and 177,445 acres of land in Utah (see “Heavy Oil” in Note 4) and on May 30, 2008, we sold 625 net acres, 16 wells which had been drilled but not completed or connected to a pipeline and rights to participate in an additional 8 wells in the Southern Piceance Basin in Colorado (see Note 12).

Our predecessor, Digital Ecosystems Corp. (“Digital”), was incorporated on February 21, 2002 under the laws of the state of Nevada. On February 10, 2006, Digital entered into a Share Exchange Agreement (the “Exchange Agreement”) with GSL Energy Corporation (“GSL”) and certain shareholders of GSL pursuant to which Digital acquired more than 85% of the issued and outstanding shares of common stock of GSL in exchange for shares of Digital’s common stock. The Exchange Agreement was completed on May 12, 2006. At that time, GSL’s business, which was formed in 2005 for the purpose of acquiring, exploring, developing and operating oil and gas properties, became Digital’s business and GSL became a subsidiary of Digital. Since this transaction resulted in the former shareholders of GSL acquiring control of Digital, for financial reporting purposes, the business combination was accounted for as an additional capitalization of Digital (a reverse acquisition with GSL as the accounting acquirer). In accounting for this transaction:

i. GSL was deemed to be the purchaser and parent company for financial reporting purposes. Accordingly its net assets were included in the consolidated balance sheet at their historical book value; and
ii. control of the net assets and business of Digital was effective May 12, 2006 for no consideration.

Subsequent to the closing of the Exchange Agreement, Digital acquired all the remaining outstanding stock of GSL, and effective August 14, 2006, Digital changed its name to PetroHunter Energy Corporation (“PetroHunter”). Likewise, in October 2006, GSL changed its name to PetroHunter Operating Company.

PetroHunter is considered a development stage company as defined by Statement of Financial Accounting Standards (“SFAS”) 7, Accounting and Reporting by Development Stage Enterprises, as we have not yet commenced our planned principal operations. A development stage enterprise is one in which planned principal operations have not commenced, or if its operations have commenced, there have been no significant revenue therefrom.

Unless otherwise noted in this report, any description of “us” or “we” refers to PetroHunter Energy Corporation and our subsidiaries. Financial information in this report is presented in U.S. dollars.

Note 2 — Summary of Significant Accounting Policies

Basis of Accounting. The accompanying financial statements have been prepared on the basis of accounting principles applicable to a going concern, which contemplates the realization of assets and extinguishment of liabilities in the normal course of business. As shown in the accompanying statements of operations, we have incurred a cumulative loss in the amount of $107.9 million for the period from inception (June 20, 2005) to June 30, 2008, have a working capital deficit of approximately $22.5 million as of June 30, 2008, and were not in compliance with the covenants of several loan agreements. As of June 30, 2008, we have earned oil and gas revenue from our initial operating wells, but will require significant additional funding to sustain operations and satisfy contractual obligations for planned oil and gas exploration, development and operations in the future. These factors, among others, may indicate that we may be unable to continue in existence. Our financial statements do not include adjustments related to the realization of the carrying value of assets or the amounts and classification of liabilities that might be necessary should we be unable to continue in existence. Our ability to establish ourselves as a going concern is dependent upon our ability to obtain additional financing to fund planned operations and to ultimately achieve profitable operations. Management believes that we can be successful in obtaining equity and/or debt financing and/or sell interests in some of our properties, which will enable us to continue in existence and establish ourselves as a going concern. We have raised approximately $106.4 million through June 30, 2008 through issuances of common stock and convertible and other debt.

For the three and nine month periods ending June 30, 2008 and 2007, the condensed consolidated financial statements include the accounts of PetroHunter and our wholly-owned subsidiaries. For the period from June 20, 2005 through September 30, 2005, the consolidated financial statements include only the accounts of GSL. All significant intercompany transactions have been eliminated upon consolidation.

The accompanying financial statements should be read in conjunction with our Registration Statement on Form S-1 filed June 30, 2008 and our Annual Report on Form 10-K for the year ended September 30, 2007. The accompanying condensed consolidated financial statements are unaudited; however, in the opinion of management, they include all normal recurring adjustments necessary for a fair presentation of our consolidated financial position at June 30, 2008 and the consolidated results of our operations and cash flows for the three and nine month periods ending June 30, 2008 and 2007. The results of operations for the three and nine-month periods ending June 30, 2008 are not necessarily indicative of the results that may be expected for the full fiscal year ending September 30, 2008 or for any other interim period in the September 2008 fiscal year. Further, the accompanying balance sheet as of September 30, 2007 was derived from audited financial statements.

Use of Estimates. Preparation of our financial statements in accordance with Generally Accepted Accounting Principles (“GAAP”) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the financial statements and the reported amounts of revenues and expenses for the reporting period. Actual results could differ from those estimates.

In the course of preparing the consolidated financial statements, management makes various assumptions, judgments and estimates to determine the reported amounts of assets, liabilities, revenue and expenses, and to disclose commitments and contingencies. Changes in these assumptions, judgments and estimates will occur as a result of the passage of time and the occurrence of future events and, accordingly, actual results could differ from amounts initially established.

The more significant areas requiring the use of assumptions, judgments and estimates relate to volumes of natural gas and oil reserves used in calculating depletion, the amount of expected future cash flows used in determining possible impairments of oil and gas properties and the amount of future capital costs estimated for such calculations. Assumptions, judgments and estimates are also required to determine future abandonment obligations, the value of undeveloped properties for impairment analysis and the value of deferred tax assets.

Reclassifications. Certain prior period amounts have been reclassified in the consolidated financial statements to conform to the current period presentation. Such reclassifications had no effect on our net loss.

Marketable Securities, Trading. In November 2007, we sold our Heavy Oil assets (see Note 4, Oil and Gas Properties). As partial consideration, we accepted a total of 1,539,975 shares of common stock of the purchaser, Pearl Exploration and Production Ltd. These shares were sold subsequent to a holding period, and were classified as held for sale in the short term at December 31, 2007. During the intervening period from closing through the date of sale in March 2008, we accounted for them by marking them to market with unrealized losses recognized in our operating results in the period incurred. We recognized a loss on the disposition of our trading securities in the amount of $3.0 million recorded as Trading Security Losses in our consolidated statement of operations during the nine months ended June 30, 2008.

Joint Interest Billings. Joint interest billings represents our working interest partners’ share of costs that we paid, on their behalf, to drill certain wells. During the first quarter of 2008, we entered into a transaction whereby we increased our interest in 14 wells to 100% (see Note 4, Oil and Gas Properties) and we therefore reclassified $12.6 million of costs related to those wells from Joint interest billings to Oil and Gas Properties. In May 2008, we sold the remaining wells for which we had joint billing arrangements as part of the Laramie transaction, as described further in Note 12.

Oil and Gas Properties. We utilize the full cost method of accounting for our oil and gas activities. Under this method, subject to a limitation based on estimated value, all costs associated with property acquisition, exploration and development, including costs of unsuccessful exploration, are capitalized within a cost center on a by-country basis. No gain or loss is recognized upon the sale or abandonment of undeveloped or producing oil and gas properties unless the sale represents a significant portion of oil and gas properties and the gain or loss significantly alters the relationship between capitalized costs and proved oil and gas reserves of the cost center. Depletion and amortization

of oil and gas properties is computed on the units-of-production method based on proved reserves. Amortizable costs include estimates of future development costs of proved undeveloped reserves.

Asset Retirement Obligation. Asset retirement obligations associated with tangible long-lived assets are accounted for in accordance with SFAS 143, Accounting for Asset Retirement Obligations (“SFAS 143”). The estimated fair value of the future costs associated with dismantlement, abandonment and restoration of oil and gas properties is recorded generally upon acquisition or completion of a well. The net estimated costs are discounted to present values using a risk adjusted rate over the estimated economic life of the oil and gas properties. Such costs are capitalized as part of the related asset. The asset is depleted on the units-of-production method on a field-by-field basis. The liability is periodically adjusted to reflect (1) new liabilities incurred, (2) liabilities settled during the period, (3) accretion expense, and (4) revisions to estimated future cash flow requirements. The accretion expense is recorded as a component of depletion, amortization and accretion expense in the accompanying consolidated statements of operations.

Guarantees. As part of a Gas Gathering Agreement we have with CCES Piceance Partners1, LLC (“CCES”), we have guaranteed that, should there be a mutual failure to execute a formal agreement for long-term gas gathering services in the future, we will repay CCES for certain costs they have incurred in relation to the development of a gas gathering system and repurchase certain

gas gathering assets we sold to CCES. We have accounted for this guarantee using Financial Accounting Standards Board ("FASB") Interpretation No. 45 as amended, Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others ("FIN 45") , which requires us to recognize a liability for the obligations undertaken upon issuing the guarantee in order to have a more representationally faithful depiction of the guarantor's assets and liabilities. Accordingly, we have recognized a $4.1 million contingent purchase obligation on our balance sheet. See further explanation at Note 13.

Impairment. We use the full cost method of accounting for our oil and gas properties and as such, these properties are subject to SEC Regulation S-X Rule 4-10, Financial Accounting and Reporting for Oil and Gas Producing Activities Pursuant to the Federal Securities Laws and the Energy Policy and Conversion Act of 1975 ("Rule 4-10"). Rule 4-10 requires that each regional cost center's (by country) capitalized cost, less accumulated amortization and related deferred income taxes not exceed a cost center "ceiling." The ceiling is defined as the sum of:

- the present value of estimated future net revenues computed by applying current prices of oil and gas reserves to estimated future production of proved oil and gas reserves as of the balance sheet date less estimated future expenditures to be incurred in developing and producing those proved reserves to be computed using a discount factor of 10%; plus

- the cost of properties not being amortized; plus

- the lower of cost or estimated fair value of unproven properties included in the costs being amortized; less

- income tax effects related to differences between the book and tax basis of the properties.

If unamortized costs capitalized within a cost center, less related deferred income taxes, exceed the cost center ceiling, the excess is charged to expense. During the three and nine month periods ended June 30, 2007, we recorded impairment charges of $0.6 million and $9.6 million. We did not impair any of our properties in the three and nine months ended June 30, 2008.

Fair Value. The carrying amount reported in the consolidated balance sheets for cash, receivables, prepaids, accounts payable and accrued liabilities approximates fair value because of the immediate or short-term maturity of these financial instruments. Based upon the borrowing rates currently available to us for loans with similar terms and average maturities, the fair value of payable notes approximates their carrying value.

Environmental Contingencies. Oil and gas producing activities are subject to extensive environmental laws and regulations. These laws, which change frequently, regulate the discharge of materials into the environment and may require us to remove or mitigate the environmental effects of the disposal or release of petroleum or chemical substances at various sites. Environmental expenditures are expensed or capitalized depending on their future economic benefit. Expenditures that relate to an existing condition caused by past operations and that have no future economic benefit are expensed. Liabilities for expenditures of a non-capital nature are recorded when environmental assessment and/or remediation is probable and the costs can be reasonably estimated.

Revenue Recognition. We recognize revenues from the sales of natural gas and crude oil related to our interests in producing wells when delivery to the customer has occurred and title has transferred. We currently have no gas balancing arrangements in place.

Loss per Common Share. Basic loss per share is based on the weighted average number of common shares outstanding during the period. Diluted loss per share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock. Convertible equity instruments such as stock options and convertible debentures are excluded from the computation of diluted loss per share, as the effect of the assumed exercises would be anti-dilutive. The dilutive weighted-average number of common

shares outstanding excluding potential common shares from; stock options, warrants and convertible debt of 221,582 and 61,553 respectively for the periods ended June 30, 2008 and 2007.

Recently Issued Accounting Pronouncements. In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities ("SFAS 159"), which allows entities to choose, at specified election dates, to measure eligible financial assets and liabilities at fair value that are not otherwise required to be measured at fair value. If a company elects the fair value option for an eligible item, changes in that item's fair value in subsequent reporting periods must be recognized in current earnings. SFAS 159 also establishes presentation and disclosure requirements designed to draw comparison between entities that elect different measurement attributes for similar assets and liabilities. SFAS 159 will be effective for us on October 1, 2008. We have not yet assessed the impact of SFAS 159 on our consolidated results of operations, cash flows or financial position.

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements ("SFAS 157"), which provides guidance for using fair value to measure assets and liabilities. The standard also responds to investors' requests for more information about: (1) the extent to which companies measure assets and liabilities at fair value; (2) the information used to measure fair value; and (3) the effect that fair value measurements have on earnings. SFAS 157 will apply whenever another standard requires (or permits) assets or liabilities to be measured at fair value. SFAS 157 does not expand the use of fair value to any new circumstances. SFAS 157

will be effective for us on October 1, 2008. We have not yet assessed the impact of SFAS 157 on our consolidated results of operations, cash flows or financial position.

Supplemental Cash Flow Information. Supplement cash flow information for the nine months ended June 30, 2008 and 2007, respectively, and cumulative from inception (June 2005) is as follows:

	Nine Months Ended June 30, 2008	Nine Months Ended June 30, 2007 (restated)	Cumulative From Inception (June 20, 2005) to June 30, 2008
	($ in thousands)		
Supplemental disclosures of non-cash investing and financing activities			
Shares issued for expenditures advanced	$ —	$ —	$ 100
Contracts for oil and gas properties	$ (7,030)	$ 2,900	$ 6,494
Shares issued for debt conversion	$ 3,376	$ —	$ 22,032
Shares issued for commissions on offerings	$ 50	$ 200	$ 250
Shares issued for property	$ 1,250	$ 81,275	$ 82,525
Shares issued for property and finder's fee on property	$ 2,037	$ —	$ 9,644
Non-cash uses of notes payable, accounts payable and accrued liabilities	$ —	$ —	$ 26,313
Convertible debt issued for property	$ —	$ —	$ 1,200
Common stock issuable	$ —	$ 4,510	$ —
Shares issued for common stock offerings	$ —	$ —	$ 2,900
Debt issued for common stock previously subscribed	$ 2,858	$ —	$ 2,858
Assignment of rights in properties in exchange for equity and forgiveness of related party notes payable	$ 15,959	$ —	$ 15,959
Satisfaction of receivable by reduction of related party note payable	$ 3,202	$ —	$ 3,202
Debt discount related to convertible debt	$ 6,956	$ —	$ 6,956
Increase in oil and gas properties related to relief of joint interest billings	$ 12,608	$ —	$ 12,608
Warrants issued recorded as debt discount	$ 729	$ 3,952	$ 5,220
Warrants issued recorded as deferred finance costs	$ 1,898	$ —	$ 1,898
Common stock issued for purchase option	$ 80	$ —	$ 80

Note 3 — Agreements with MAB Resources LLC

We were a party to various agreements (the "MAB Agreements") with MAB Resources LLC ("MAB"), a company that is controlled by our largest beneficial shareholder, Marc A. Bruner. All the MAB Agreements described below were terminated as of June 30, 2008. The following is a summary of those prior MAB Agreements.

The Development Agreement. From July 1, 2005 through December 31, 2006, we and MAB operated pursuant to a Development Agreement and a series of individual property agreements (collectively, the "EDAs"). The Development Agreement defined MAB's and our long term relationship regarding the ownership and operation of all jointly-owned properties and stipulated that we and MAB would sign a joint operating agreement governing all operations. The Development Agreement specified, among other things, that:

- MAB assign to us a 50% undivided interest in any and all oil and gas leases, production facilities and related assets (collectively, the "Properties") that MAB was to acquire from third parties in the future,

- we would be operator of the jointly owned properties, with MAB Operating Company LLC as sub-operator, and each party would pay its proportionate share of costs and receive its proportionate share of revenues, subject to certain adjustments, including our burden to carry MAB for specified costs, pay advances, and
  - to make an overriding royalty payment of 3% (gross, or 1.5% net) to MAB out of production and sales.

A more thorough description of the Development Agreement is included in Item 8 of our Annual Report on Form 10-K, Financial Statements and Supplementary Data - Note 3.

The Consulting Agreement. Effective January 1, 2007, we and MAB began operating under an Acquisition and Consulting Agreement (the "Consulting Agreement") which replaced in its entirety the Development Agreement described above. Upon execution of the Consulting Agreement, MAB conveyed its entire remaining working interest in the Properties to us in consideration for a $13.5 million promissory note, 50 million shares of PetroHunter Energy Corporation and an additional 50 million shares (the "Performance Shares") provided we met certain thresholds based on proven reserves. Furthermore, MAB would receive:

- 7% of the issued and outstanding shares of any new subsidiary with assets comprised of the subject properties

- A 5% overriding royalty interest on certain of the properties, to be accrued and deferred for three years, provided these royalties do not render our net revenue interest to be less than 75%, and
- $25,000 per month for consulting services (which was later rescinded by Amendment 1 to the Consulting Agreement, effective retroactively to January 1, 2007).

Our obligation to pay up to $700.0 million in capital costs for MAB's 50% interest as well as the monthly project cost advances against such capital costs was also eliminated.

We accounted for the acquisition component of the Consulting Agreement in accordance with the purchase accounting provisions of SFAS 141 Business Combinations. Accordingly, at the date of acquisition, we recorded oil and gas properties of $94.5 million, notes payable of $13.5 million, and common stock and additional-paid-in capital totaling $81.0 million (equal to the 50.0 million shares issued to MAB at the trading price of $1.62 per share for our common stock on the trading date immediately preceding the closing date of the transaction).

In the first quarter of the current fiscal year ending September 30, 2008, the Consulting Agreement was amended three times, resulting in the following changes:

- MAB relinquished portions of its overriding royalty interest effective October 1, 2007 such that the override currently only applies to our Australian properties and Buckskin Mesa property;
- MAB received 25.0 million additional shares of our common stock;
- MAB relinquished all rights to the Performance Shares described above;
- MAB's consulting services were terminated effective retroactively back to January 1, 2007;
- MAB waived all past due amounts and all claims against PetroHunter; and
- the note payable to MAB was reduced in accordance with and in exchange for the following:

o by $8.0 million in exchange for 16.0 million shares of our common stock with a value of $3.7 million based on the closing price of $0.23 per share at November 15, 2007 and warrants to acquire 32.0 million shares of our common stock at $0.50 per share. The warrants expire on November 14, 2009 and were valued at $0.7 million;

o by $2.9 million in exchange for our release of MAB's obligation to pay the equivalent amount as guarantor of the performance of Galaxy Energy Corporation under the subordinated unsecured promissory note dated August 31, 2007 (see Note 10);

o a reduction to the note payable to MAB of $0.5 million for cash payments made during the first quarter of 2008; and

o by $0.2 million for MAB assuming certain costs that Paleo Technology owed to us.

The net effect of the reduction of debt and issuance of our common shares resulted in a net benefit to us of $3.8 million and has been reflected as additional paid-in-capital during the six months ended March 31, 2008. Monthly payments on the revised promissory note in the amount of $2.0 million commenced February 1, 2008 and are due in full in two years.

Effective June 30, 2008, MAB sold all its interest in the above-mentioned overriding royalty (in our Buckskin Mesa and Australian properties) to a third party.

Note 4 — Oil and Gas Properties

	June 30,	September 30,
Oil and gas properties consisted of the following:	2008	2007
Oil and gas properties, at cost, full cost method	($ in thousands)	
Unproved		

United States	$	73,738	$	107,239
Australia		25,350		23,569
Proved – United States		48,794		57,168
Total		147,882		187,976
Less accumulated depreciation, depletion, amortization and impairment		(1,698)		(25,133)
Total	$	146,184	$	162,843

Included in oil and gas properties above is capitalized interest of $0.0 million and $0.8 million for three months ended June 30, 2008 and 2007, respectively. In the nine months ended June 30, 2008 and 2007, oil and gas properties included capitalized interest of $0.2 million and $1.1 million, respectively.

Included below is a summary of significant activity related to oil and gas properties during the three and nine month periods ended June 30, 2008.

PICEANCE BASIN

Buckskin Mesa Project. As of June 30, 2008, we had drilled five wells, with two wells having been completed and shut-in, awaiting installation of the gathering system, and the remaining 3 wells awaiting completion. We are required to drill 16 wells during the calendar year ending December 31, 2008, three during the first quarter and four during each of the second and third calendar quarters of 2008 and five during the fourth calendar quarter of 2008, under the terms of an agreement between us and a third party assignor, Daniels Petroleum Company ("DPC"). If we do not satisfy these quarterly drilling requirements, our agreement with DPC requires that we pay DPC $0.5 million for each undrilled well on the last day of the applicable quarter. At the end of the first calendar quarter of 2008, we extended and subsequently exercised our right to pay $0.5 million in penalties for three wells that were required to be drilled that quarter by agreeing to pay the $1.5 million fee, plus a $1.0 million additional penalty. These amounts were paid on April 28, 2008, thereby reducing the total number of wells we are committed to drill for the remainder of calendar year 2008 to 13. Prior to June 30, 2008 (the due date for commencing the next four wells), we determined that we could not obtain the materials necessary to commence such operations by June 30, and we provided written notice of such force majeure condition to DPC. We were otherwise prepared to comply with all obligations regarding the referenced commitment. DPC objected to the notice. On June 30, 2008, we filed an action in Denver District Court requesting the court to issue a declaratory judgment concerning this dispute. See Note 11 for further discussion of this case. As of June 30, 2008, we had not recorded a loss with respect to this case as we believe we are in full compliance with our contractual obligations.

Piceance II Project. On May 30, 2008, we completed the sale of 625 net acres of land, 16 wells which had been drilled but not completed or connected to a pipeline and rights to participate in an additional 8 wells to Laramie Energy II, LLC, as described more fully in Note 12. Additionally, as of June 30, 2008, as part of this transaction, we held $0.8 million in escrow relating to a dispute between us and the lessor of 435 acres of land in the Southern Piceance in which the lessor of this land claims that the lease will be terminated in conjunction with the Laramie transaction, as described more fully in Notes 11 and 12. On August 1, 2008, we transferred the $0.8 million in escrow back to Laramie and retained the 435 acres of land relating to the escrowed amount. We still retain all of our interest in eight producing wells in Garfield County, which are operated by EnCana Oil & Gas (USA) Inc.

Sugarloaf Project. We failed to make payments in accordance with the agreement related to this prospect and as a result, on December 4, 2007, the agreement was terminated and we instructed the escrow agent to return all assignments which were being held in escrow to the seller (See Note 6).

AUSTRALIA

Beetaloo Project. We own four exploration licenses comprising 7.0 million net acres in the Beetaloo Basin (owned by our wholly-owned subsidiary, Sweetpea Petroleum Pty Ltd., ["Sweetpea"]). In July 2007, we drilled and cased one well to a depth of 4,724 feet, with the intention to deepen the well at a later date.

We have a 100% working interest in this project with a royalty interest of 10% to the government of the Northern Territory and an overriding royalty interest of 1% to 2%, 8% and 5% to the Northern Land Council, the original assignor of the licenses, and to MAB, respectively, leaving a net revenue interest of 75% to 76% to us. We have received an extension on our drilling commitments related to this property and are currently committed to drill 8 wells in 2009 at a total estimated cost of $36 million. We are not currently committed to drilling any wells on this property in 2008.

Northwest Shelf Project. Effective February 19, 2007, the Commonwealth of Australia granted an exploration permit in the shallow, offshore waters of Western Australia to Sweetpea. The permit has a six year term and encompasses almost 20,000 net acres. We have committed to an exploration program with geological and geophysical data acquisition in the first two years with a third year drilling commitment and additional wells to be drilled in the subsequent three year period depending upon the results of the initial well.

POWDER RIVER BASIN

On December 29, 2006, we entered into a purchase and sale agreement (the “Galaxy PSA”) with Galaxy Energy Corporation (“Galaxy”) and its wholly-owned subsidiary, Dolphin Energy Corporation (“Dolphin”), both of which are related parties to us. Pursuant to the Galaxy PSA, we agreed to purchase all of Galaxy’s and Dolphin’s oil and gas interests in the Powder River Basin of Wyoming and Montana (the “Powder River Basin Assets”), and to assume operations as contract operator, pending the purchase.

In January 2007, we paid a $2.0 million earnest money deposit to Galaxy, which was due under the terms of the Galaxy PSA. As contract operator of the Powder River Basin Assets, we incurred $0.8 million in expenses. The Galaxy PSA expired by its terms on August 31, 2007. Upon expiration and under the terms of the Galaxy PSA, we obtained a note receivable in the amount of $2.5 million (the “Galaxy Note”) which consisted of the $2.0 million earnest deposit plus a portion of operating costs paid by us. As guarantor of the Galaxy Note, MAB repaid the balance in November 2007 by offsetting it against amounts owed by us to MAB under the MAB Note (see Notes 3 and 7).

MONTANA COALBED METHANE

Bear Creek Project. We have retained 13,905 acres of the original 25,278 acres of leasehold acquired through an assignment from MAB. The remaining 11,373 acres of leasehold have expired. The acres retained have been reflected in unproved oil and gas properties and are subject to further evaluation. The acres released have been reflected in unproved properties but included in evaluated costs subject to amortization and in the full cost ceiling test at the lower of cost or market value.

HEAVY OIL

Sale of Heavy Oil Projects. On November 6, 2007 and effective October 1, 2007, we sold all of our interest in our Heavy Oil Projects, including the West Rozel, Fiddler Creek and Promised Land Projects in Utah and Montana, to Pearl Exploration and Production Ltd. ("Pearl"). The purchase price was a maximum of $30.0 million, payable as follows: (a) $7.5 million in cash at closing; (b) the issuance of up to 2.5 million shares of Pearl equivalent to $10 million (based on a price of $4.00 Canadian dollars per share, as stipulated in the purchase and sale contract), and (c) a performance payment (the "Pearl Performance Payment") of $12.5 million in cash at such time as either: (i) production from the assets reaches 5,000 barrels per day or (ii) proven reserves from the assets is greater than 50.0 million barrels of oil as certified by a third party reserve engineer. In the event that these targets have not been achieved by September 30, 2010, the Pearl Performance Payment obligation will expire. As of June 30, 2008, no amounts have been accrued in relation to the Pearl Performance Payment as the triggering events have not yet occurred. In addition, the number of shares included in (b) above may be reduced by 960,025 shares (valued in the contract at $3.8 million based on a price of $4.00 per share, as above) if a satisfactory agreement is not made between Pearl and the lessor ("ECA") of certain of the properties within 6 months of the date of closing (that being May 6, 2008). No such satisfactory agreement was reached between Pearl and ECA and therefore, the total amount conveyed in (b) above was 1,539,975 shares.

We originally accounted for the sale of the Heavy Oil Project assets to Pearl to include the sale of the ECA properties, as we believed at that time it was probable Pearl and ECA would reach agreement and the ECA assets would be conveyed to Pearl within the six month period contemplated in our agreement with Pearl. During the second quarter, we were informed that agreement between Pearl and ECA would not be reached, and that the ECA assets would not transfer to Pearl. As a result, we reviewed the original accounting for the transaction and determined that we had inappropriately included the 960,025 shares of Pearl stock relating to the ECA assets in our marketable securities as of December 31, 2007, and further, we had recorded unrealized losses on those shares during the first quarter in error. During the second quarter, we recorded correcting entries in our financial statements which resulted in (a) the reversal of $0.9 million of unrealized losses on the shares of Pearl stock we did not ultimately receive, and (b) the reversal into our full cost pool of $3.5 million of marketable securities we originally recorded in anticipation of closing the sale of the ECA assets. During March 2008, we sold all of the 1,539,975 shares of Pearl stock we did receive, which resulted in net proceeds of $2.5 million. The difference between the value of these shares at closing of $5.5 million and the net proceeds received upon sale, was recorded as Trading Security Losses in our consolidated results of operations for the nine months ended June 30, 2008.

The sale of assets to Pearl also resulted in amendments to existing agreements with third parties, including MAB's relinquishment of its rights and obligations in all PetroHunter properties in Utah and Montana, and termination of PetroHunter's obligation to pay an overriding royalty and a per barrel production payment to American Oil & Gas, Inc. ("American") and Savannah Exploration, Inc. ("Savannah"), in consideration for: (a) 5 million common shares of PetroHunter common stock to be issued to American and Savannah; and (b) a contingent obligation to pay a total of $2.0 million to American and Savannah in the event PetroHunter receives the Pearl Performance Payment.

Note 5 — Asset Retirement Obligation

We recognize an estimated liability for future costs associated with the abandonment of our oil and gas properties. A liability for the fair value of an asset retirement obligation and a corresponding increase to the carrying value of the related long-lived asset are recorded at the time a well is completed or acquired. The increase in carrying value is included in proved oil and gas properties in the consolidated balance sheets. We deplete the amount added to proved oil and gas property costs and recognize accretion expense in connection with the discounted liability over the remaining estimated economic lives of the respective oil and gas properties.

Our estimated asset retirement obligation liability is based on estimated economic lives, estimates as to the cost to abandon the wells in the future, and federal and state regulatory requirements. The liability is discounted using a credit-adjusted risk-free rate estimated at the time the liability is incurred or revised. The credit-adjusted risk-free rates used to discount our abandonment liabilities range from 8% to 15%. Revisions to the liability are due to increases in estimated abandonment costs and changes in well economic lives, or in changes to federal or state regulations regarding the abandonment of wells.

A reconciliation of our asset retirement obligation liability is as follows:

	June 30, 2008	September 30, 2007
	($ in thousands)	
Beginning asset retirement obligation	$ 136	$ 522
Liabilities incurred	1	30
Liabilities settled	(35)	—
Revisions to estimates	(27)	(429)
Accretion expense	(2)	13
Ending asset retirement obligation	$ 73	$ 136

Note 6 — Contract Payable

On November 28, 2006, MAB entered into a Lease Acquisition and Development Agreement (the "Maralex Agreement") with Maralex Resources, Inc. and Adelante Oil & Gas LLC (collectively, "Maralex") for the acquisition and development of the Sugarloaf Prospect in Garfield County, Colorado. MAB subsequently assigned the Maralex Agreement to us in January 2007 (the "Assignment"). By the terms of the Maralex Agreement and subsequent Assignment, we paid $0.1 million at closing, with the remaining cash of $2.9 million and the issuance of 2.4 million shares of our common stock due on January 15, 2007. We recorded the $2.9 million obligation as Contract payable — oil and gas properties, and $4.1 million as stockholders' equity (equal to 2.4 million shares at the $1.70 closing price of our common stock on the date of the closing).

The terms of the Maralex Agreement and Assignment were amended on several occasions since the original Agreement was executed, amending the payment dates, issuing 5.6 million additional shares of our common stock and agreeing to increase the amount of cash due under the agreement by a total of $0.3 million. By the terms of the Maralex Agreement, we were required to pay to Maralex an amount equal to 5% of the outstanding payable for each 20 days past due.

We failed to make payments in accordance with the Maralex Agreement and as a result, on December 4, 2007, Maralex terminated the Maralex Agreement and notified us that, in accordance with the terms of the Maralex Agreement, they returned 6.4 million shares of common stock and we instructed the escrow agent to reassign to Maralex all leases which were being held in escrow pursuant to the Maralex Agreement.

During the nine months ended June 30, 2008, in accordance with the termination of this agreement, we (i) reclassified the balance of Contract payable — Oil and gas properties in the amount of $1.5 million to Oil and gas properties; (ii) recorded the return of 80% of the additional equity consideration as a reduction of Oil and gas properties and equity and (iii) reversed the remaining accrued liabilities to Oil and gas properties.

Note 7 — Notes Payable

Notes payable are summarized below:

	June 30, 2008	September 30, 2007
	($ in thousands)	
Notes payable – short-term:		
Shareholder note	$ 850	$ —
Vendor	—	4,050
Global Project Finance AG	—	500
Flatiron Capital Corp.	205	117

Notes payable – short-term	$	1,055	$	4,667
Convertible notes payable	$	400	$	400
Notes payable – related party – current portion:				
Bruner Family Trust	$	2,622	$	—
MAB- current portion		—		3,755
Notes payable – related party – current portion	$	2,622	$	3,755
Subordinated notes payable — related party:				
Bruner Family Trust	$	106	$	275
MAB		—		8,775

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Subordinated notes payable — related party