

MILLER PETROLEUM INC
Form 10QSB
March 24, 2008

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

FORM 10-QSB

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

For the quarterly period ended January 31, 2008

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

For the transition period from _____ to _____

Commission File No. 33-2249-FW

MILLER PETROLEUM, INC.

(Exact name of small business issuer as specified in its Charter)

TENNESSEE
(State or Other Jurisdiction of
incorporation or organization)

62-1028629
(I.R.S. Employer I.D. No.)

3651 Baker Highway
Huntsville, Tennessee 37756

(Address of principal executive offices)

(423) 663-9457
Issuer's telephone number

N/A

(Former name, former address and former fiscal year if changed from last report.)

Check whether the issuer: (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

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

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As of January 31, 2008, the Registrant had a total of 14,466,856 shares of Common Stock, \$.0001 par value, outstanding.

Transitional Small Business Disclosure Format (check one): YES NO

Miller Petroleum, Inc.
Form 10-QSB
For the Quarter Ended January 31, 2008
Table of Contents

PART 1-FINANCIAL INFORMATION

Item 1. Condensed Consolidated Financial Statements

Condensed Consolidated Balance Sheets as of January 31, 2008 (Unaudited) and April 30, 2007 3-4

Condensed Consolidated Statements of Operations for the Three Months Ended January 31, 2008 and 2007 (Unaudited) and the Nine Months Ended January 31, 2008 and 2007 (Unaudited) 5

Condensed Consolidated Statement of Stockholders' Deficit for the Nine Months Ended January 31, 2008 (Unaudited) 6

Condensed Consolidated Statements of Cash Flows for the Nine Months Ended January 31, 2008 and 2007 (Unaudited) 7

Notes to Condensed Consolidated Financial Statements (Unaudited) 8

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations 13

Item 3. Controls and Procedures 17

PART II - OTHER INFORMATION

Item 1. Legal Proceedings 17

SIGNATURES 18

MILLER PETROLEUM, INC.
Consolidated Balance Sheets

| | January 31 2008 Unaudited | April 30 2007 |
|---|---------------------------------|---------------------|
| ASSETS | | |
| CURRENT ASSETS | | |
| Cash | \$ 13,980 | \$ |
| Accounts receivable | 92,289 | 67,276 |
| Accounts receivable - related parties | 194,976 | 180,699 |
| Note receivable | 7,900 | 7,900 |
| Inventory | 190,142 | 114,691 |
| Total Current Assets | 499,287 | 370,566 |
| FIXED ASSETS | | |
| Machinery and equipment | 843,736 | 912,592 |
| Vehicles | 287,995 | 344,427 |
| Buildings | 315,835 | 315,835 |
| Office Equipment | 30,083 | 30,083 |
| | 1,477,649 | 1,602,937 |
| Less: accumulated depreciation | (820,531) | (862,717) |
| Total Fixed assets | 657,118 | 740,220 |
| OIL AND GAS PROPERTIES | 1,769,214 | 1,462,439 |
| (On the basis of successful efforts accounting) | | |
| PIPELINE FACILITIES | - | 181,597 |
| OTHER ASSETS | | |
| Investments in joint venture at cost | - | 801,319 |
| Land | 496,500 | 496,500 |
| Investments | 500 | 500 |
| Well equipment and supplies | 427,948 | 427,948 |
| Cash - restricted | 83,000 | 83,000 |
| Total Other Assets | 1,007,948 | 1,809,267 |
| TOTAL ASSETS | \$ 3,933,567 | \$ 4,564,089 |

See notes to consolidated financial statements.

MILLER PETROLEUM, INC.
Consolidated Balance Sheets

| | January 31 2008 Unaudited | April 30 2007 |
|--|---------------------------------|---------------------|
| LIABILITIES AND STOCKHOLDERS' DEFICIT | | |
| CURRENT LIABILITIES | | |
| Bank overdraft | \$ - | \$ 16,933 |
| Accounts payable - trade | 269,201 | 276,783 |
| Accounts payable - related parties | 167,816 | 88,809 |
| Accrued expenses | 189,748 | 93,874 |
| Notes payable - related parties | 80,200 | 114,500 |
| Current portion of notes payable | 262,189 | 202,234 |
| Liability for stock repurchase | 4,350,000 | - |
| Total Current Liabilities | 5,319,154 | 793,133 |
| LONG-TERM LIABILITIES | | |
| Notes payable | | |
| Other | 333,641 | 326,880 |
| Total Long-Term Liabilities | 333,641 | 326,880 |
| Total Liabilities | 5,652,795 | 1,120,013 |
| TEMPORARY EQUITY | - | 4,350,000 |
| PERMANENT STOCKHOLDERS' DEFICIT | | |
| Common Stock: 500,000,000 shares authorized at \$0.0001 par value, 11,566,856 and 11,466,856 shares issued and outstanding | 1,156 | 1,146 |
| Additional paid-in capital | 7,995,007 | 7,936,724 |
| Unearned compensation | (1,406,285) | (1,587,033) |
| Accumulated deficit | (8,309,106) | (7,256,761) |
| Total Stockholders' Deficit | (1,719,228) | (905,924) |
| TOTAL LIABILITIES, TEMPORARY EQUITY AND PERMANENT STOCKHOLDERS' DEFICIT | \$ 3,933,567 | \$ 4,564,089 |

See notes to consolidated financial statements.

MILLER PETROLEUM, INC.
Consolidated Statements of Operations
(UNAUDITED)

| | For the Three Months Ended January 31 | | For the Nine Months Ended January 31 | |
|--|--|---------------------|---|---------------------|
| | 2008 | 2007 | 2008 | 2007 |
| REVENUES | | | | |
| Oil and gas revenue | \$ 181,582 | \$ 110,162 | \$ 492,044 | \$ 373,195 |
| Service and drilling revenue | 63,455 | 89,887 | 190,445 | 740,412 |
| Total Revenue | 245,037 | 200,049 | 682,489 | 1,113,607 |
| COSTS AND EXPENSES | | | | |
| Cost of oil and gas revenue | 13,537 | 12,118 | 51,698 | 41,051 |
| Cost of service and drilling revenue | 58,512 | 161,093 | 249,169 | 735,562 |
| Selling, general and administrative | 413,972 | 472,932 | 1,179,858 | 1,031,026 |
| Depreciation, depletion and amortization | 57,350 | 29,403 | 167,598 | 120,153 |
| Total Costs and Expense | 543,371 | 675,546 | 1,648,323 | 1,927,792 |
| LOSS FROM OPERATIONS | (298,334) | (475,497) | (965,834) | (814,185) |
| OTHER INCOME (EXPENSE) | | | | |
| Interest Income | 991 | 9,716 | 1,703 | 10,002 |
| Gain on sale of equipment | - | | 89,369 | |
| Interest expense | (23,859) | (2,527) | (119,290) | (13,783) |
| Loan Fees and Warrants | (15,000) | (40,000) | (58,293) | (79,000) |
| Total Other Income (Expense) | (37,868) | (32,811) | (86,511) | (82,781) |
| NET LOSS | \$ (336,202) | \$ (508,308) | \$ (1,052,345) | \$ (896,966) |
| BASIC & DILUTED | | | | |
| NET LOSS PER SHARE | \$ (0.02) | \$ (0.04) | \$ (0.07) | \$ (0.06) |
| WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING | | | | |
| | 14,466,856 | 14,366,856 | 14,431,349 | 14,366,856 |

See notes to consolidated financial statements.

MILLER PETROLEUM, INC
Consolidated Statement of Permanent Stockholders' Deficit
(UNAUDITED)

| | Common Shares | Shares Amount | Additional Paid-in Capital | Unearned Compensation | Accumulated Deficit | Total |
|---|------------------|------------------|----------------------------------|--------------------------|------------------------|----------------|
| Balance, April 30, 2007 | 11,466,856 | \$ 1,146 | \$ 7,936,724 | \$ (1,587,033) | \$ (7,256,761) | \$ (905,924) |
| Amortization of unearned compensation | | | | 180,748 | | 180,748 |
| Issuance of warrants for financing cost | | | 24,293 | | | 24,293 |
| Issuance of stock for financing cost | 100,000 | 10 | 33,990 | | | 34,000 |
| Net loss for the nine months ended January 31, 2008 | | | | | (1,052,345) | (1,052,345) |
| Balance January 31, 2008 | 11,566,856 | \$ 1,156 | \$ 7,995,007 | \$ (1,406,285) | \$ (8,309,106) | \$ (1,719,228) |

See notes to consolidated financial statements.

MILLER PETROLEUM, INC.
Consolidated Statement of Cash Flows
(UNAUDITED)

| | For the Nine Months Ended January 31, 2008 | For the Nine Months Ended January 31, 2007 |
|--|--|--|
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Net Loss | \$ (1,052,345) | \$ (896,966) |
| Adjustments to Reconcile Net Loss to Net Cash Provided (Used) by Operating Activities: | | |
| Depreciation, depletion and amortization | 167,598 | 120,153 |
| Gain on sale of equipment | (89,369) | 9,852 |
| Amortization of unearned compensation | 180,748 | |
| Issuance of stock for financing cost | 34,000 | 284,823 |
| Warrant costs | 24,293 | 79,000 |
| Changes in Operating Assets and Liabilities: | | |
| Accounts receivable | (39,290) | 410,844 |
| Unbilled service and drilling cost | | 76,944 |
| Inventory | (75,451) | 9,077 |
| Bank overdraft | (16,933) | 15,460 |
| Accounts payable | 71,425 | (144,079) |
| Accrued expenses | 95,874 | 31,836 |
| Net Cash Provided (Used) by Operating Activities | (699,450) | (3,056) |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Purchase of Equipment | | (122,924) |
| Proceeds from sale of equipment | 104,603 | 90,000 |
| Proceeds from sale of wells and pipeline | 576,500 | |
| Net Cash Provided (Used) by Investing Activities | 681,103 | (32,924) |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Payments on notes payable | (285,873) | (21,620) |
| Proceeds from borrowing | 318,200 | 22,500 |
| Change in note receivable | | 35,100 |
| Net Cash Provided by Financing Activities | 32,327 | 35,980 |
| NET INCREASE (DECREASE) IN CASH | 13,980 | 0 |
| CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD | 0 | 0 |
| CASH AND CASH EQUIVALENTS, END OF PERIOD | \$ 13,980 | \$ 0 |
| CASH PAID FOR | | |
| INTEREST | \$ 40,668 | \$ 13,783 |
| INCOME TAXES | | \$ 0 |

See notes to consolidated financial statements.

MILLER PETROLEUM, INC.
Notes to the Condensed Consolidated Financial Statements

(1) INTERIM REPORTS / GOING CONCERN

The condensed consolidated financial statements have been prepared assuming the Company will continue as a going concern. However, in addition to successive losses for three years, declining revenues, a net loss of \$1,052,345 for the nine months ended January 31, 2008, and net deficit of \$1,719,228, on February 7, 2008, the Company was also ordered under binding arbitration to redeem 2.9 million shares of stock owned by Wind City and previously carried on the Company's books as temporary equity in the amount of \$4,350,000 (See Note 4). Management believes that the Company will therefore need total additional financing of approximately \$5,000,000 to effect the repurchase and continue to operate as planned during the year subsequent to January 31, 2008. Management is exploring various financing opportunities in this regard; however, there can be no assurance that we will be able to obtain financing sufficient to repurchase such shares. These conditions raise substantial doubt about the Company's ability to continue as a going concern.

Management is currently in negotiations with two companies that have the resources to provide the capital to buy back the stock and to provide us with additional drilling capital to drill the 22,000 acre Koppers South Field. These negotiations have been hampered by the fact that the leases have not been reassigned to us. The Arbitrator's Award requires that the leases be returned to us, which will help us obtain the necessary capital. There is no assurance that these negotiations will be successful.

Certain information and footnote disclosures normally included in the financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted. It is suggested that these financial statements be read in conjunction with the Registrant's April 30, 2007 Annual Report on Form 10-KSB. The results of operations for the period ended January 31, 2008 are not necessarily indicative of operating results for the full year. In the opinion of management, all adjustments (consisting of only normal recurring accruals) considered necessary for a fair presentation have been included.

(2) PARTICIPANT RECEIVABLES AND RELATED PARTY RECEIVABLES

Participant and related party receivables consist of receivables contractually due from our various joint venture partners in connection with routine exploration, betterment and maintenance activities. Our collateral for these receivables generally consists of lien rights over the related oil producing properties at both April 30, 2007 and January 31, 2008. Approximately \$193,000 included in the balance sheet among Related Party Receivables is due from Wind Mill Oil & Gas, LLC, a related party. See Note 4 regarding the status of the Wind Mill Joint Venture.

(3) LONG-TERM DEBT, WARRANTS, LOAN FEES AND RESTRICTED CASH

The Company had the following debt obligations at January 31, 2008 and April 30, 2007

| | January 31, 2008 | April 30, 2007 |
|--|------------------|----------------|
| <i>Notes Payable - Related Parties:</i> | | |
| Note payable to the Company's CEO and Chairman of the Board of Directors, Deloy Miller, secured by equipment and truck titles, interest at 10.750%, due April 18, 2008 | \$ 80,200 | \$ 0 |

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| | | |
|--|--------|---------|
| Note payable to board member Herman Gettlefinger, unsecured, dated February 21, 2007, bearing interest at 11% and due November 1, 2007. This note was paid December 14, 2007 | 0 | 42,000 |
| Note payable to Sharon Miller, Unsecured, dated April 5, 2007 to May 17, 2007, bearing interest at 11%, due November 1, 2007. This note was paid December 14, 2007 | 0 | 72,500 |
| | 80,200 | 114,500 |

MILLER PETROLEUM, INC.
Notes to the Condensed Consolidated Financial Statements

(3) LONG-TERM DEBT, WARRANTS, LOAN FEES AND RESTRICTED CASH (CONTINUED)

Notes Payable - Other

| | | |
|---|----------------|----------------|
| Note payable to American Fidelity Bank, secured by a trust deed on property, bearing interest at prime, due in monthly payments of \$2,500, with the final payment due in August 2008 | 343,641 | 344,114 |
| Note payable to Jade Special Strategy, LLC, unsecured, dated March 7, 2007, bearing interest based on a sliding scale approximating 120% and due April 30, 2008, and now accruing interest at 12% (see note below) | 110,000 | 110,000 |
| Note payable to Jade Special Strategy, LLC, unsecured, dated April 17, 2007, bearing interest based on a sliding scale approximating 120% and due April 30, 2008, and now accruing interest at 12% (see note below) | 40,000 | 40,000 |
| Note Payable to Jade Special Strategy, LLC, unsecured, dated August 2, 2007, bearing interest based on a sliding scale approximating 120% and due April 30, 2008, and now accruing interest at 12% (see note below) | 65,000 | 0 |
| Note payable to Petro Capital Securities, unsecured, dated May 24, 2007, bearing interest at 10% and due June 30, 2008 | 35,000 | 35,000 |
| Note payable to Delta Producers, dated June 20, 2007, due July 20, 2007, with interest at 11%, the note is in default | 2,189 | 0 |
| | 595,830 | 529,114 |
| Total Notes Payable | 676,030 | 643,614 |
| Less current maturities on related party notes payable | 80,200 | 114,500 |
| Less current maturities on other notes payable | 262,189 | 202,234 |
| Notes Payable - Long-term | 333,641 | 326,880 |

Note: On February 14, 2008 Jade Special Strategy, LLC agreed to extend the notes to April 30, 2008 at a nominal interest rate of 18% per annum, the re-pricing of 200,000 warrants from \$0.33 and \$0.29 to \$0.01, and the issuance of an additional 100,000 warrants at par value. The options represent loan fees and will be valued at approximately \$59,000. This amount will be included as a component of interest expense during the fourth quarter of the Company's year ending April 30, 2008.

Accordingly, the maturities reflected above represent the maturities of the debt entered into subsequent to January 31, 2008.

(4) WIND MILL OIL & GAS, LLC JOINT VENTURE, ARBITRATION, SUBSEQUENT EVENT AND RECLASSIFICATIONS

On December 23, 2005 the Company executed an LLC agreement (the "Agreement") with Wind City Oil & Gas, LLC ("Wind City") to form Wind Mill Oil & Gas, LLC ("Wind Mill"), the primary purpose of which was to develop the Company's existing oil and gas leases, including but not limited to its Koppers South prospect. According to terms of the Agreement, the Company's contribution to Wind Mill consisted of substantially all of its undeveloped properties (listed as Exhibit A in the Agreement). The Agreement included a provision providing for the purchase by Wind Mill of 2.9 million shares of the Company's stock at a price of \$4.35 million. Upon Wind City seeking dissolution of the joint venture in accordance with terms of the Agreement's unwind provision this stock was subject to a put, provided the exercise of the put fell within certain time restrictions. Accordingly, the Company classified the stock issued to Wind City as temporary equity on its balance sheet. The Company's contribution of its undeveloped leases was reclassified at cost on its balance sheet as its investment in the Joint Venture.

MILLER PETROLEUM, INC.
Notes to the Condensed Consolidated Financial Statements

(4) WIND MILL OIL & GAS, LLC JOINT VENTURE (CONTINUED)

Under the Joint Venture, from May 1, 2006 to April 30, 2007, the Company received \$353,640 of salary reimbursements and drilling and service revenue of \$534,944. From May 1, 2007 to January 31, 2008, the Company received no salary reimbursements or service and drilling revenue.

In August and September 2006, Wind City commenced litigation to unwind the Agreement. Issues surrounding the timeliness and propriety of Wind City's actions and their legal effect eventually led the court in which Wind City commenced litigation to direct the parties to submit the matter to arbitration. The Company, reflecting its belief in the legal merits of its case, continued to classify, at cost, its investment in the leases as an investment in the Joint Venture and Wind City's outstanding stock as temporary equity.

The arbitration was held in Knoxville, Tennessee on January 17 and 18, 2008. The Arbitrator's Decision and Award in connection therewith is dated March 7, 2008. The Arbitrator determined that Wind City properly and timely terminated the Operating Agreement between the parties with respect to Wind Mill. The Arbitrator also rendered an award that ordered and directed that Wind City deliver to the Company the assets listed in Exhibit A of the Operating Agreement simultaneously with the delivery by the Company to Wind City of a stock re-purchase agreement that provides for the repurchase by the Company of the shares for \$4,350,000 to be paid (3) months after the date of execution of such re-purchase agreement. The assets to be returned to the Company consist of seven parcels of land, excluding certain wells already drilled together with an offset of 40 acres of land surrounding each such well. All other claims by both parties asserting various damages were denied by the Arbitrator. Wind City has filed papers with the court seeking to confirm in part and vacate in part the Award of the Arbitrator. Wind City seeks to vacate that portion of the Award directing the return of the aforesaid assets to the Company. The Company plans to timely file documents required to confirm the Arbitrator's Award.

Matters submitted for resolution to the arbitrator but left undecided included the appropriate interest rate applying to the \$4.35 million debt. The Operating Agreement specified interest toll at 1.5% per annum, and Wind City has alleged a "scrivener's error" pertaining to this rate.

As a result of the arbitration and to reflect the Company's intentions, the Company has reclassified the stock held by Wind City as short-term debt, at its face value, or \$4.35 million. Accordingly, the investment in the joint venture has also been reclassified to investment in oil & gas properties on the Company's January 31, 2008 balance sheet. All known and estimated expenses pertaining to the arbitration have been reflected in the Company's operations as of January 31, 2008.

(5) STOCKHOLDERS' EQUITY

Penalty warrants for 120,000 common shares at a price of \$1.15 per share, and a five-year term were issued during the nine months ended January 31, 2008. The warrants were valued at \$15,000.

The Company presents "basic" earnings (loss) per share and, if applicable, "diluted" earnings per share pursuant to the provisions of Statement of Financial Accounting Standards No. 128. The calculation of diluted earnings per share is similar to that of basic earnings per share, except that the denominator is increased to include the number of additional common shares that would have been outstanding if all potentially dilutive common shares, such as those issuable upon the exercise of stock options and warrants, were issued during the period. Since the Company had a net loss for the nine month periods ended January 31, 2008 and 2007, and for the year ended April 30, 2007, the assumed effects

from the exercise of outstanding options and warrants would have been anti-dilutive, and, therefore only basic earnings per share is presented.

(6) RECENT ACCOUNTING PRONOUNCEMENTS

In June 2006, FIN 48, "*Accounting for Uncertainty in Income Taxes*," an interpretation of SFAS No. 109, clarifies the accounting for uncertainties in income taxes recognized in an enterprise's financial statements. The Interpretation requires that we determine whether it is more likely than not that a tax position will be sustained upon examination by the appropriate taxing authority. If a tax position meets the more likely than not recognition criteria, FIN 48 requires the tax position be measured at the largest amount of benefit greater than fifty percent (50%) likely of being realized upon ultimate settlement. This accounting standard is effective for fiscal years beginning after December 15, 2006. The effect of adopting FIN 48 did not have a material affect on our financial position and results of operations.

MILLER PETROLEUM, INC.
Notes to the Condensed Consolidated Financial Statements

(6) RECENT ACCOUNTING PRONOUNCEMENTS (CONTINUED)

In September 2006, the Staff of the SEC issued Staff Accounting Bulletin No. 108, “Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements” (“SAB No. 108”). SAB No. 108 provides guidance on the consideration of the effects of prior year misstatements in quantifying current year misstatements for the purpose of determining whether the current year’s financial statements are materially misstated. SAB 108 is effective for the Company’s fiscal year 2007 annual financial statements. The adoption of SAB 108 did not have an impact on our financial position, results of operations or cash flows.

In September 2006, the FASB issued Statement No. 157, “Fair Value Measurements” (“SFAS 157”). This standard defines fair value, establishes the framework for measuring fair value in accounting principles generally accepted in the United States and expands disclosure about fair value measurements. This pronouncement applies under other accounting standards that require or permit fair value measurements. Accordingly, this statement does not require any new fair value measurement. This statement is effective for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. We are currently evaluating the requirements of SFAS No. 157 and have not yet determined the impact on our financial statements.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities—including an amendment of FAS 115 (“SFAS No.159”). SFAS No. 159 allows companies 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. Unrealized gains and losses shall be reported on items for which the fair value option has been elected in earnings at each subsequent reporting date. SFAS No. 159 also establishes presentation and disclosure requirements. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007 and will be applied prospectively. We are currently evaluating the impact of adopting SFAS No. 159 on our financial position, results of operations or cash flows.

In December 2006, the FASB issued FASB Staff Position No. EITF 00-19-2, Accounting for Registration Payment Arrangements, (“FSP No. EITF 00-19-2”), which addresses an issuer’s accounting for registration payment arrangements. FSP No. EITF 00-19-2 specifies that the contingent obligation to make future payments or otherwise transfer consideration under a registration payment arrangement, whether issued as a separate agreement or included as a provision of a financial instrument or other agreement, should be separately recognized and measured in accordance with FASB Statement No. 5, Accounting for Contingencies. The guidance in FSP No. EITF 00-19-2 amends FASB Statements No. 133, Accounting for Derivative Instruments and Hedging Activities, and No. 150, Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity, and FASB Interpretation No. 45, Guarantor’s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others, to include scope exceptions for registration payment arrangements. FSP No. EITF 00-19-2 further clarifies that a financial instrument subject to a registration payment arrangement should be accounted for in accordance with other applicable generally accepted accounting principles (GAAP) without regard to the contingent obligation to transfer consideration pursuant to the registration payment arrangement. FSP No. EITF 00-19-2 shall be effective immediately for registration payment arrangements and the financial instruments subject to those arrangements that are entered into or modified subsequent to the date of issuance of FSP No. EITF 00-19-2. For registration payment arrangements and financial instruments subject to those arrangements that were entered into prior to the issuance of FSP No. EITF 00-19-2, this guidance shall be effective for financial statements issued for fiscal years beginning after December 15, 2006, and interim periods within those fiscal years. We adopted FSP No. EITF 00-19-2 effective January 1, 2007. We have not had any transactions subject to EITF 00-19-2 since its adoption, so there has been no material impact to the Company’s financial position, results of operations or cash flows.

MILLER PETROLEUM, INC.
Notes to the Condensed Consolidated Financial Statements

(7) LITIGATION / GOING CONCERN

The outcome of our current litigation with Wind City could have a material adverse effect on our financial condition.

As previously discussed in Notes 1 and 4, Wind City Oil & Gas, LLC has filed suit to force the exercise of the put provision of the stock purchase agreement. In accordance with the arbitration award as discussed in Note 4, we are required to re-purchase the shares; accordingly, since we will likely have a significant cash flow shortfall, we will require additional financing in order to effectuate the re-purchase. There is no assurance that such financing will be obtained on favorable terms, or at all. In such event, our financial condition could be materially adversely affected and our ability to continue as a going concern could be jeopardized.

(8) SALE OF GAS WELLS AND PIPELINE

On September 14, 2007 we entered into an option to sell our interest in eight gas wells, a pipeline to service the wells and certain right-of-ways for a total consideration of \$576,500. We transferred approximately 320 acres of leases in this transaction. The buyers paid \$50,000 for the option. The transaction closed December 14, 2007, and we received approximately \$526,500 of additional proceeds at the closing.

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

Introduction

The following discussion is intended to facilitate an understanding of our business and results of operations and includes forward-looking statements that reflect our plans, estimates and beliefs. It should be read in conjunction with our audited consolidated financial statements and the accompanying notes to the consolidated financial statements included herein. Our actual results could differ materially from those discussed in these forward-looking statements.

Overview

We are actively engaged in the exploration, development, production and acquisition of crude oil and natural gas primarily in eastern Tennessee. During 2006 the Company conducted significant operations in conjunction with its partner Wind City Oil & Gas, LLC ("Wind City") under a Joint Venture ("Wind Mill") agreement, the primary purpose of which was to develop the Company's existing oil and gas leases, including but not limited to its Koppers South prospect. According to terms of the Agreement, the Company's contribution to Wind Mill consisted of substantially all of its undeveloped properties (listed as Exhibit A in the Agreement). The Agreement included a provision providing for the purchase by Wind Mill of 2.9 million shares of the Company's stock at a price of \$4.35 million. Upon Wind City seeking dissolution of the joint venture in accordance with terms of the Agreement's unwind provision this stock was subject to a put option, provided the exercise of the put fell within certain time restrictions. Accordingly, the Company classified its stock issued to Wind City as temporary equity on its balance sheet. The Company's contribution of its undeveloped leases was reclassified at cost on its balance sheet as its investment in the Joint Venture.

In August and September 2006, Wind City commenced litigation to unwind the Agreement. Issues surrounding the timeliness and propriety of Wind City's actions and their legal effect eventually led the court in which Wind City commenced litigation to direct the parties to submit the matter to arbitration. The Company, reflecting its belief in the legal merits of its case, continued to classify, at cost, its investment in the leases as an investment in the Joint Venture and Wind City's outstanding stock as temporary equity.

The arbitration was held in Knoxville, Tennessee on January 17 and 18, 2008. The Arbitrator's Decision and Award in connection therewith is dated March 7, 2008. The Arbitrator determined that Wind City properly and timely terminated the Operating Agreement between the parties with respect to Wind Mill. The Arbitrator also rendered an award that ordered and directed that Wind City deliver to the Company the assets listed in Exhibit A of the Operating Agreement simultaneously with the delivery by the Company to Wind City of a stock re-purchase agreement that provides for the repurchase by Miller of the shares for \$4,350,000 to be paid three (3) months after the date of execution of such re-purchase agreement. The assets to be returned to the Company consist of seven parcels of land, excluding certain wells already drilled together with an offset of 40 acres of land surrounding each such well. All other claims by both parties asserting various damages were denied by the Arbitrator. Wind City has filed papers with the court seeking to confirm in part and vacate in part the Award of the Arbitrator. Wind City is seeking to vacate that part of the Award that directs the return of the aforesaid assets to the Company. The Company plans to timely file documents required to confirm the Arbitrator's Award.

Matters submitted for resolution to the arbitrator but left undecided included the appropriate interest rate applying to the \$4.35 million debt. The Operating Agreement specified interest toll at 1.5% per annum, and Wind City has alleged a "scrivener's error" pertaining to this rate

Our present financial condition precludes us from being able to repurchase the shares under the put. We are exploring various financing opportunities in this regard; however, there can be no assurance that we will be able to obtain financing sufficient to repurchase such shares. In the event that we are unable to obtain financing on acceptable terms

sufficient to consummate the repurchase, our business and financial condition could be materially adversely affected and our ability to continue operations as a going concern could be jeopardized.

Liquidity and Capital Resources

Cash used by operating activities was \$699,450 for the nine months ended January 31, 2008, an increase of \$696,394 over cash used by operating activities for the nine months ended January 31, 2007 of \$3,056. Our principal source of liquidity has been oil and gas revenues, loans from related parties and directors, private placement transactions of our common stock, and participation with investors in various oil and gas wells. During the current quarter we sold gas wells and a pipeline for \$576,500. The increase in oil and gas prices along with our opportunity under the arbitrators' decision to regain our rights to approximately 45,000 acres under lease in Tennessee enhances our ability to attract investors and to pursue joint ventures in oil and gas.

On December 23, 2005 we entered into the Wind Mill Oil & Gas LLC Agreement (“Wind Mill”) and also sold 2,900,000 shares of common stock to Wind City Oil & Gas, LLC (“Wind City”) for \$4,350,000. These funds were used to pay off the \$4,150,000 of loans and to provide some working capital. Wind City also contributed \$10,000,000 to Wind Mill and we contributed oil and gas leases as part of the Wind Mill agreement. For the nine months ended January 31, 2007 we received \$353,640 of administrative salary reimbursements and revenue of \$506,615 for various labor, parts and use of equipment. The cessation of operations with Wind Mill has had a major impact on our cash flow.

Our long-term cash flows are subject to a number of variables including the level of production and prices as well as various economic conditions that have historically affected the oil and gas business. A material drop in oil and gas prices or a reduction in production and reserves would reduce our ability to fund capital expenditures, service new debt, meet financial obligations and remain profitable. We operate in an environment with numerous financial and operating risks, including, but not limited to, the inherent risks of the search for, development and production of oil and gas, the ability to buy properties and sell production at prices which provide an attractive return and the highly competitive nature of the industry. Our ability to expand our reserve base is, in part, dependent on obtaining sufficient capital through internal cash flow or the issuance of debt or equity securities. There can be no assurance that internal cash flow and other capital sources will provide sufficient funds to maintain capital expenditures that we believe are necessary to offset future declines in production and proved reserves.

Results of Operations

Three Months Ended January 31, 2008 compared to Three Months Ended January 31, 2007

| | For the Three Months Ended January 31 | | Increase / (Decrease) |
|--|--|---------------------|--------------------------|
| | 2008 | 2007 | 2007 to 2008 |
| REVENUES | | | |
| Oil and gas revenue | \$ 181,582 | \$ 110,162 | \$ 71,420 |
| Service and drilling revenue | 63,455 | 89,887 | (26,432) |
| Total Revenue | 245,037 | 200,049 | 44,988 |
| COSTS AND EXPENSES | | | |
| Cost of oil and gas revenue | 13,537 | 12,118 | 1,419 |
| Cost of service and drilling revenue | 58,512 | 161,093 | (102,581) |
| Selling, general and administrative | 413,972 | 472,932 | (58,960) |
| Depreciation, Depletion and amortization | 57,350 | 29,403 | 27,947 |
| Total Costs and Expenses | 543,371 | 675,546 | (132,175) |
| INCOME (LOSS) FROM OPERATIONS | (298,334) | (475,497) | 177,163 |
| OTHER INCOME (EXPENSE) | | | |
| Interest income | 991 | 9,716 | (8,725) |
| Interest expense | (23,859) | (2,527) | (21,332) |
| Loan fees and warrants | (15,000) | (40,000) | 25,000 |
| Total Other Income (Expense) | (37,868) | (32,811) | (5,057) |
| NET INCOME (LOSS) | \$ (336,202) | \$ (508,308) | \$ 172,106 |

Revenue

Oil and gas revenue was \$181,582 for the three months ended January 31, 2008 as compared to \$110,162 for the three months ended January 31, 2007, an increase of \$71,420. This resulted from the rise in the price of oil and increased production.

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Service and drilling revenue was \$63,455 for the three months ended January 31, 2008 as compared to \$89,887 for the three months ended January 31, 2007, a decrease of \$26,432. This resulted from a decrease in drilling activity due to the litigation with Wind Mill Oil & Gas, LLC.

Cost and Expense

The cost of oil and gas revenue was \$13,537 for the three months ended January 31, 2008 as compared to \$12,118 for the three months ended January 31, 2007, an increase of \$1,419. This resulted from the cost associated with increased production.

The cost of service and drilling revenue was \$58,512 for the three months ended January 31, 2008 as compared to \$161,093 for the three months ended January 31, 2007, a decrease of \$102,581. This was due to the decrease in drilling activities due to the litigation with Wind Mill Oil & Gas, LLC. Additionally, the Company incurred significant indirect labor included in costs of service and drilling revenue in 2006 connected with the termination of the joint venture for which there were minimal corresponding revenues.

Selling, general and administrative expense was \$413,972 for the three months ended January 31, 2008 as compared to \$472,932 for the three months ended January 31, 2007, a decrease of \$58,960. This resulted from a decrease in consulting, legal and professional fees.

Depreciation, depletion and amortization was \$57,350 for the three months ended January 31, 2008 as compared to \$29,403 for the three months ended January 31, 2007, an increase of \$27,947. This was due to an increase in oil and gas production.

Interest expense was \$23,859 for the three months ended January 31, 2008 as compared to \$2,527 for the three months ended January 31, 2007, an increase of \$21,332. This resulted from the interest on additional borrowings during the period ended January 31, 2008.

Nine Months Ended January 31, 2008 compared to Nine Months Ended January 31, 2007

| | For the Nine Months Ended January 31 | | Increase / (Decrease) |
|--|---|------------------|--------------------------|
| | 2008 | 2007 | 2007 to 2008 |
| REVENUES | | | |
| Oil and gas revenue | \$ 492,044 | \$ 373,195 | \$ 118,849 |
| Service and drilling revenue | 190,445 | 740,412 | (549,967) |
| Total Revenue | 682,489 | 1,113,607 | (431,118) |
| COSTS AND EXPENSES | | | |
| Cost of oil and gas revenue | 51,698 | 41,051 | 10,647 |
| Cost of service and drilling revenue | 249,169 | 735,562 | (486,393) |
| Selling, general and administrative | 1,179,858 | 1,031,026 | 148,832 |
| Depreciation, Depletion and amortization | 167,598 | 120,153 | 47,445 |
| Total Costs and Expenses | 1,648,323 | 1,927,792 | (279,469) |
| INCOME (LOSS) FROM OPERATIONS | (965,834) | (814,185) | (151,649) |
| OTHER INCOME (EXPENSE) | | | |
| Interest income | 1,703 | 10,002 | (8,299) |

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| | | | |
|------------------------------|----------------|--------------|--------------|
| Gain on sale of equipment | 89,369 | - | 89,369 |
| Interest expense | (119,290) | (13,783) | (105,507) |
| Loan fees and warrants | (58,293) | (79,000) | 35,707 |
| Total Other Income (Expense) | (86,511) | (82,781) | 11,270 |
| NET INCOME (LOSS) | \$ (1,052,345) | \$ (896,966) | \$ (140,379) |

15

Revenue

Oil and gas revenue was \$492,044 for the nine months ended January 31, 2008 as compared to \$373,195 for the nine months ended January 31, 2007, an increase of \$118,849. This resulted from the rise in the price of oil and increased production.

Service and drilling revenue was \$190,445 for the nine months ended January 31, 2008 as compared to \$740,412 for the nine months ended January 31, 2007, a decrease of \$549,967. This resulted from a decrease in drilling activity, due to litigation with Wind Mill Oil & Gas, LLC.

Cost and Expense

The cost of oil and gas revenue was \$51,698 for the nine months ended January 31, 2008 as compared to \$41,051 for the nine months ended January 31, 2007, an increase of \$10,647. This increase resulted from the cost associated with production.

The cost of service and drilling revenue was \$249,169 for the nine months ended January 31, 2008 as compared to \$735,562 for the nine months ended January 31, 2007, a decrease of \$486,393. This was due to the decrease in drilling activities due to the litigation with Wind Mill Oil & Gas, LLC.

Selling, general and administrative expense was \$1,179,858 for the nine months ended January 31, 2008 as compared to \$1,031,026 for the nine months ended January 31, 2007, an increase of \$148,832. This is due to the termination of salary reimbursements by Wind Mill Oil & Gas, LLC. For the nine months ended January 31, 2007 Wind Mill reimbursed the Company for \$353,640 of salaries.

Depreciation, depletion and amortization was \$167,598 for the nine months ended January 31, 2008 as compared to \$120,153 for the nine months ended January 31, 2007, an increase of \$47,445. This resulted from an increase in oil and gas production.

Interest expense was \$119,290 for the nine months ended January 31, 2008 as compared to \$13,783 for the nine months ended January 31, 2007, an increase of \$105,507. This resulted from the interest on additional borrowings during the period ended January 31, 2008.

Gain on sale of equipment was \$89,369 for the nine months ended January 31, 2008 as compared to \$0 for the nine months ended January 31, 2007, an increase of \$89,369. This resulted from equipment sold during the current period.

Item 3 Controls and Procedures

An evaluation was performed under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934) as of the end of the period covered by this report. Based on the evaluation and communication from Rodefer Moss & Co, PLLC, our registered public accountants, to our Audit Committee in March 2008 that identified an issue with respect to our disclosure controls and procedures, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures are not effective.

The ineffective disclosure controls and procedures consist of deficiencies with respect to the authorization, recording, processing, summarizing and reporting of non-cash transactions. Specifically, certain stock issuances relating to outstanding notes payable were not properly recorded.

As a result of the identified ineffective disclosure controls and procedures, in preparing our financial statements for the quarter ended January 31, 2008, we performed additional analysis and other post-close procedures to ensure that such financial statements were stated fairly in all material respects in accordance with U.S. generally accepted accounting principles.

PART II - OTHER INFORMATION

Item 1 Legal Proceedings

The arbitration relating to the pending litigation with Wind City was held in Knoxville, Tennessee on January 17 and 18, 2008. The Arbitrator's Decision and Award in connection therewith is dated March 7, 2008.

The Arbitrator determined that Wind City properly and timely terminated the Operating Agreement between the parties with respect to Wind Mill. The Arbitrator also rendered an award that ordered and directed that Wind City deliver to Miller the assets listed in Exhibit A of the Operating Agreement, simultaneously with the delivery by Miller to Wind City of a stock re-purchase agreement that provides for the re-purchase by the Company of the shares for \$4,350,000 to be paid three (3) months after the date of the execution of such re-purchase agreement. The assets to be returned to the Company consist of seven parcels of land, excluding certain wells already drilled, together with 40 acres of land surrounding each such well.

All other claims by both parties asserting various damages were denied by the Arbitrator. Wind City has filed papers with the court seeking to confirm in part and vacate in part the Award of the Arbitrator. Wind City seeks to vacate that part of the Award that directs the return of the aforesaid assets to the Company. The Company intends to seek confirmation of the Arbitration Award.

SIGNATURES

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

MILLER PETROLEUM, INC.

Date: March 21, 2008

By: /s/ DELOY MILLER

Deloy Miller
Chief Executive Officer, principal executive officer

Date: March 21, 2008

By: /s/ LYLE H. COOPER

Lyle H. Cooper
Chief Financial Officer, principal financial and
accounting officer