

GEOPETRO RESOURCES CO  
Form 10-K  
March 31, 2008

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

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**Form 10-K**

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

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

**For the fiscal year ended December 31, 2007**

**OR**

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

**For the transition period from                      to**

**Commission File Number 001-16749**

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**GeoPetro Resources Company**

(Exact name of registrant as specified in its charter)

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**California**  
(State of incorporation)

**94-3214487**  
(IRS Employer Identification Number)

**One Maritime Plaza, Suite 700**  
**San Francisco, CA**  
(Address of principal executive offices)

**94111**  
(Zip Code)

**(415) 398-8186**

(Registrant's telephone number, including area code)

**Securities registered pursuant to Section 12(b) of the Act:**

<b>Title of Each Class</b>	<b>Name of Each Exchange on Which Registered</b>
Common Stock, No Par Value	American Stock Exchange

**Securities registered pursuant to Section 12(g) of the Act: None**

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

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  No

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  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller Reporting Company

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

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The aggregate market value of the registrant's common stock held by non-affiliates was approximately \$71,888,148 based on the closing sale price of \$2.65 per share as reported by the American Stock Exchange on March 28, 2008.

The number of shares of the registrant's common stock outstanding on March 31, 2008 was 31,950,970.

### **DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the registrant's Proxy Statement relating to the 2007 Annual Meeting of Shareholders to be filed on or before April 29, 2008 are incorporated by reference into Part III of this Form 10-K.

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**GEOPETRO RESOURCES COMPANY**

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*This Annual Report on Form 10-K contains forward-looking statements within the meaning of Section 27A of the Securities Act as of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended and we intend that such forward-looking statements be subject to the safe harbors created thereby. These statements are related to future events or our future financial performance. We have attempted to identify forward-looking statements with terminology, including anticipate, believe, can, continue, could, estimate, expect, intend, may, plan, will, or similar expressions as they relate to us and our business, industry and markets. All statements other than statements of historical fact are statements that could be deemed forward-looking statements, such as those statements that address activities,*

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*events or developments that we expect, believe or anticipate will or may occur in the future. These statements are based on certain assumptions and analyses made by us in light of our experience and perception of historical trends, current conditions, expected future developments and other factors we believe are appropriate in the circumstances. Such forward looking statements are subject to change based on factors beyond our control. Certain factors that may affect our financial condition and results of operations are discussed in Item 1A Risk Factors and Item 7A Quantitative and Qualitative Disclosures About Market Risk of this Annual Report on Form 10-K, and may be discussed from time to time in our reports filed with the Securities and Exchange Commission subsequent to this report. We assume no obligation, nor do we intend to update these forward-looking statements, unless required by law. Unless the context requires otherwise, references in this Annual Report on Form 10-K to GeoPetro, we, us and our refer to GeoPetro Resources Company and its consolidated subsidiaries.*

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**PART I**

**Item 1. *Business***

We were incorporated in the State of Wyoming in August 1994 under the name GeoPetro Company as an oil and gas exploration, development drilling and production company. In June 1996, we merged with our wholly-owned subsidiary, GeoPetro Resources Subsidiary Company, a California corporation, and the resulting merged company is incorporated in the state of California under the California General Corporation Law under the name GeoPetro Resources Company.

Our principal and registered office is located at One Maritime Plaza, Suite 700, San Francisco, California, USA 94111. We maintain a website located at [www.geopetro.com](http://www.geopetro.com).

**Intercorporate Relationships**



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We hold 100% of the shares of Redwood Energy Company, a Texas corporation, **Redwood**. Redwood is the general partner of, and holds a 5% interest in, Redwood Energy Production, L.P., **Redwood LP**, a Texas limited partnership. We are the sole limited partner of Redwood LP and own the remaining 95% partnership interest in Redwood LP.

In addition, we hold a 12% interest in Continental-GeoPetro (Bengara II) Ltd., **C-G Bengara** which is a British Virgin Islands company and a 50% interest in CG Xploration Inc., **CG Xploration**, which is a Delaware corporation.

We also hold 100% of the shares of GeoPetro Canada Ltd., **GeoPetro Canada**, an Alberta company, 100% of the shares of GeoPetro Alaska LLC **GeoPetro Alaska**, an Alaska limited liability company, and 100% of the shares of South Texas GeoPetro, LLC, **South Texas GeoPetro**, a Texas limited liability company.

### GENERAL DEVELOPMENT OF THE BUSINESS





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During the past five years, we have conducted leasehold acquisition, exploration and drilling activities on our North American, Australian and Indonesian prospects. These projects currently encompass approximately 372,317 gross (158,401 net) acres, consisting of mineral leases, production sharing contracts and exploration permits that give us the right to explore for, develop and produce oil and natural gas. Most of these properties are in the exploration, appraisal or development drilling phase and have not begun to produce revenue from the sale of oil and natural gas. Excluding minor interest and dividend income, our only cash inflows until 2003 were the recovery of capital invested in projects through sale or other divestiture of interests in oil and gas prospects to industry partners.

In December 2000, we acquired working interests in oil and natural gas leases in the Madisonville Field in Madison County, Texas, including interests in the Rodessa Formation. Also included in the acquisition was the Magness Well, an existing well that had been drilled, cased and production tested in the Rodessa Formation. In October 2001, we re-completed and tested the Magness Well over a 12-day period. In October 2002, we drilled, completed and successfully tested an injection well to dispose of waste products resulting from the treating process for gas produced from the Rodessa Formation. The Madisonville Field gas treatment plant and associated pipelines, which were built specifically for this project, were placed into service in May 2003, and the Magness Well began production in late May 2003. Since 2003, substantially all of our revenue has been generated from natural gas sales derived from the Madisonville Field. The Madisonville Project is expected to be our primary source of revenue in 2008. The first development well in the Madisonville Field, the Fannin Well, was drilled in 2004 and was tested at rates of up to 25.7 MMcf/d. In 2006, we drilled the Wilson and Mitchell wells. Presently, the Fannin, Mitchell and Magness wells are producing while the Wilson well is shut-in awaiting a fracture stimulation. We own a 100% working interest in the four wells. Historically, our wells have been production constrained by the gas treatment plant at the Madisonville Field, which had a treating capacity limit of approximately 18,000 Mcf per day. We entered into an agreement with the plant owner, Madisonville Gas Processing, LP ( MGP ), an unaffiliated third party, which required, among other things, that MGP expand the design treating capacity of the plant from 18,000 to 68,000 Mcf per day to treat additional volumes from our producing wells. In early October 2007, MGP completed the additional treating facilities and the additional treating capacity at such facilities, however operations at the additional treating facilities were suspended in December 2007 in order to make modifications to more effectively deal with the presence of diamondoids in the gas stream produced from the Rodessa Formation. See [Properties](#) [Description of the Properties](#) [Texas](#) [The Madisonville Gas Treatment Plant and Gathering Facilities](#).

As of March 31, 2008 we have 31,950,970 shares of common stock outstanding as a result of raising approximately \$54.9 million of equity, net of offering costs, by way of private placements and a public offering in Canada. These funds have been used primarily to acquire, explore and develop our oil and natural gas prospects.

Most recently, on August 13, 2007, we sold, pursuant to a private placement, 2,002,599 units of our securities at a price of \$3.85 per unit, for total gross proceeds of \$7,710,006. Each unit consists of one share of our common stock and a warrant to purchase three-tenths of a common share. Each one whole warrant shall entitle the holder to acquire one share of common stock at a price of \$4.50 per share for a period of five years from the closing date. The units were purchased by a small number of accredited investors. We filed a re-sale registration statement covering the common shares and warrants exercisable for common shares sold in such placement, which registration statement was declared effective by the Securities and Exchange Commission in October 2007. The gross proceeds from the sale have been, and will be, used to fund the Company's exploration and development program and for general working capital purposes.

### **Growth Strategy**



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Our strategy is to maximize shareholder value through the exploration and development drilling of oil and natural gas prospects. To carry out this philosophy we employ the following business strategies:

- identify and pursue potential projects which individually have the potential to be company makers which we define as projects which could generate a minimum unrisks net present value of \$50 million net to our interest using a 10% discount factor;
- perform geological, engineering and geophysical evaluations;
- gain control of key acreage;
- generate high quality drillable exploration and development drilling prospects;
- retain a large working interest in those projects which involve low risk appraisal or development drilling, exploitation or appraisal of proven, probable and possible reserves; and
- minimize early investment and exploration risk in higher risk exploratory prospects through farmouts to other oil and natural gas companies and maintain meaningful interests with a carry through the exploration phase.

### **Risks Associated With Foreign Operations**



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Our business activities in Indonesia, Canada and the United States are subject to political and economic risks, including: loss of revenue, property and equipment as a result of unforeseen events like expropriation, nationalization, war, terrorist attacks and insurrection; risks of increases in import, export and transportation regulations and tariffs, taxes and governmental royalties; renegotiation of contracts with governmental entities; changes in laws and policies governing operations of foreign-based companies in Indonesia; exchange controls, and numerous other factors. While we expect these risks are greater in Indonesia, especially political risk, any one or more of such political or economic conditions could change in the United States or Canada to our detriment. For a related discussion of the risks attendant with foreign operations, see Risk Factors.

### **Financial Information About Geographic Areas**

Please see the notes to the financial statements for information concerning oil and gas properties located in the United States and foreign countries.











**Regulations**



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Domestic exploration for, and production and sale of, oil and gas are extensively regulated at both the federal and state levels. Our business is and will be directly or indirectly affected by numerous governmental laws and regulations applicable to the energy industry, including:

- Federal environmental laws and regulations
- State environmental laws and regulations
- Local environmental laws and regulations
- Conservation laws and regulations
- Tax and other laws and regulations pertaining to the energy industry

Legislation, rules and regulations affecting the oil and gas industry are under constant review for amendment or expansion, frequently increasing the regulatory burden. Any changes in the existing legislation, rules or regulations could adversely affect our business. The regulatory burdens are often costly to comply with and carry substantial penalties for failure to comply.

As of December 2007, we have re-completed an existing production well and drilled three additional production wells and an injection well in the Madisonville Project as operator. In addition, we may drill oil, gas and disposal wells in the future as the operator and will be required to obtain local government and other permits to drill such wells. There can be no assurance that such permits will be available on a timely basis or at all. Texas and other states have statutes or regulations pertaining to conservation matters which, among other matters, regulate the unitization or pooling of gas properties and the spacing, plugging and abandonment of such wells and set limits on the maximum rates of natural gas that can be produced from gas wells.

Our operations and activities are subject to numerous federal, state and local environmental laws and regulations. These laws and regulations:

- Require the acquisition of permits
- Restrict the type, quantities and concentration of various substances that can be discharged into the environment
- Limit or prohibit drilling and other activities on wetlands and other designated, protected areas

- Regulate the generation, handling, storage, transportation, disposal and treatment of waste materials
  
- Impose criminal or civil liabilities for pollution resulting from oil and natural gas operations

We expect that with the increase in our exploratory and development drilling activities, the impact of environmental laws and regulations on our business and operations will also increase. We may be required in the future to make substantial outlays of money to comply with environmental laws and regulations. Additional changes in operating procedures and expenditures to comply with future environmental laws cannot be predicted.

Other than our U.S. projects, we do not operate oil and gas properties in which we own an interest. In those instances, we are not in the position to exert direct control over compliance with most of the rules and regulations discussed above. We are substantially dependent on the operators of our non-operated oil and gas properties to monitor, administer and oversee such compliance. The failure of the operator to comply with such rules and regulations could result in substantial liabilities to us.

As the operator of the Madisonville Project, among other various environmental laws and regulations, we are subject to the U.S. Comprehensive Environmental Response, Compensation and Liability Act ( **CERCLA** ) and any comparable legislation adopted by Texas which imposes strict, joint and several liability on owners and operators of properties and on persons who dispose or arrange for the disposal of hazardous substances found on or under the sites of such properties.

Under CERCLA, one owner, lessee or other party, having responsibility for and an interest in a site requiring cleanup may, under certain circumstances, be required to bear a disproportionate share of liability for the cost of such cleanup if payments cannot be obtained from other responsible parties. The Resource Conservation and Recovery Act ( **RCRA** ) and comparable rules adopted by Texas and other states regulate the generation, management and disposal of hazardous oil and gas waste.

The Texas Railroad Commission has been delegated the responsibility and authority to regulate and prevent pollution from oil and gas operations, including the prevention of pollution of surface or subsurface water resulting from the drilling of oil and gas wells and the production of oil and gas. In addition to regulating the generation, management and disposal of hazardous oil and gas waste, the Texas Railroad Commission has been delegated authority to regulate underground hydrocarbon storage, saltwater disposal pits and injection wells.

The drilling of oil and gas wells in Texas requires operators to obtain drilling permits, file an organization report and a performance bond or other form of financial security, such as a letter of credit, and obtain a permit to maintain pits to store and dispose of drilling fluids, saltwater and waste as well as other types of pits for other purposes. The issuance of such permits is conditioned upon the Texas Railroad Commission's determination that these pits will not result in waste or pollution of surface or subsurface water.

Other states in which we have an interest in oil and gas properties may impose similar or more stringent regulations than imposed under CERCLA or RCRA.

In re-completing the existing well on the Madisonville Project, we were required to drill a well for injection or disposal of produced waste gas from wells. Injection wells are subject to regulation under the Safe Drinking Water Act ( **SDWA** ) and the regulations and procedures which have been adopted by the Environmental Protection Agency ( **EPA** ) under that Act. Generally, enforcement procedures under the SDWA are administered by the EPA unless such authority has been delegated by the EPA to a state which has primary enforcement responsibility based on the EPA's determination that the state has adopted drinking water regulations no less stringent than the national primary drinking water regulations and meets certain other criteria. Underground injection wells not used for the underground injection of natural gas for storage are generally unlawful and subject to penalties under the SWDA unless authorized by:

- permit issued by the EPA or a state having primary enforcement responsibility, or
- rule pursuant to an underground injection control program established by a state or the EPA.

The regulatory burden on the natural gas and oil industry increases our cost of doing business and affects our financial condition. Future developments, such as stricter requirements of environmental or health and safety laws and regulations affecting our business or more stringent interpretations of, or enforcement policies with respect to, such laws and regulations, could adversely affect us. To meet changing permitting and operational standards, we may be required, over time, to make site or operational modifications at our facilities, some of which might be significant and could involve substantial expenditures. There can be no assurance that material costs or liabilities will not arise from these or additional environmental matters that may be discovered or otherwise may arise from future requirements of law.

#### **Overseas Regulations**





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We own a working interest in an oil and gas project located in Indonesia. We have farmed out our interest in this project to a third party who is the operator of this project. In exploring for, drilling and developing this property, this operator will be required to comply with the environmental, conservation, tax and other laws and regulations of Indonesia. We own non-operated working interests in oil and gas projects located in Canada. In exploring for, drilling and developing these properties, these operators will be required to comply with the environmental, conservation, tax and other laws and regulations in Canada.

### **Technology**

We participate in projects utilizing economically feasible exploration technology in our exploration and development drilling activities to reduce risks, lower costs, and more efficiently produce oil and gas. We believe that the availability of

cost effective 2-D and 3-D seismic data makes its use in exploration and development drilling activities attractive from a risk management perspective in certain areas.

Briefly, through the use of a seismograph, a seismic survey sends pulses of sound from the surface down into the earth, and records the echoes reflected back to the surface. By calculating the speed at which sound travels through the various layers of rock, it is possible to estimate the depth to the reflecting surface. It then becomes possible to infer the structure of rock deep below the earth's surface. We evaluate substantially all of our exploratory prospects using 2-D seismic data. In addition, we own approximately 12 square miles of 3-D seismic data covering our leasehold and adjacent lands in the Madisonville Project.

The use of seismic technology does not entirely remove the risk of exploration and development drilling of oil and natural gas deposits. It is important to consider the following:

- we may not recognize significant geological features due to errors in interpretation, processing limitations, the presence of certain geological environments that are out of our control or other factors; and
- seismic generally becomes less reliable with increasing depth of the geological horizon; and
- the use of this technology may increase our finding cost over that if it is not used.

#### **Principal Products**



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Our principal products are the production of natural gas and crude oil from properties in which we own an interest. Since our inception, we have realized only limited production of natural gas and crude oil from the properties in which we own an interest. We have working interests in various undeveloped oil and gas properties. See [Properties](#) for a general description of these properties.

During the last three fiscal years, 100% of our revenues have been derived from the sale of natural gas. Substantially all of our natural gas sales, approximately 99%, have been generated by three producing wells, the Magness #1, Fannin #1 and Mitchell #1 wells, located in the Madisonville Field in East Texas. Natural gas produced by the wells is sold at the wellhead where it is delivered to a gathering pipeline and transported to a nearby gas treatment plant where it is treated to remove impurities. The gas is then transported nine miles to one of two common carrier pipelines from which point it is delivered to the greater Dallas, Texas area. The price received for the natural gas is the Houston Ship Channel price index less certain adjustments for the quality of the gas delivered. The adjustments for the quality of gas delivered at the wellsite as well as the gathering and transportation costs presently amount to approximately \$1.75 per Mcf of untreated gas delivered at the wellsite.

For financial information regarding our business activities by segment, please see our Financial Statements beginning on page F-1 of this annual report. Substantially all of our revenue is produced from natural gas sales in the Madisonville Field located in East Texas.

### **Reserves**



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The volume of production from oil and natural gas properties generally declines as reserves are depleted, with the rate of decline depending on reservoir characteristics. Our proved reserves will decline as reserves are produced from our properties unless we are able to acquire or develop new reserves.

### **Acquisition of Producing Properties**





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We may supplement our exploration efforts with acquisitions of producing oil and gas properties. We may seek to acquire producing properties that are underperforming relative to their potential.



**Patents, Trademarks, Licenses, Franchises and Concessions Held**



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Permits and licenses are important to our operations, since they allow the search for the extraction of any oil, gas and minerals discovered on the areas covered. See [Properties](#) for a general description of the permits and licenses under which we operate. Provided we establish a commercial discovery thereon, the Bengara PSC in Indonesia grants us the right to produce oil and gas from the PSC area until 2027.

### **Seasonality of Business**



Our business is not seasonal.

**Working Capital Items**





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The majority of our current assets are in the form of cash and deposits in trust received from the sale of natural gas from our Madisonville Project in Texas and from the sale of common stock in private placements. We are required to use this cash to pay for the cost of our operations and activities. See further, Management's Discussion and Analysis of Financial Condition and Results of Operations.

### **Customers**



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Substantially all of our revenues to date have been derived from sales by MGP to two customers, Luminant Energy Company, and ETC Katy Pipeline, Ltd., of natural gas produced from our Madisonville Project in Texas. We have not committed any forward sales of our natural gas. We contract to sell the gas with spot-market based contracts that vary with market forces on a monthly basis. No other customer accounts for in excess of 10% of our revenues. The loss of either of these customers could result in the loss of our revenues, which would have a material adverse effect on our results of operations. See Risk Factors .

### **Competition**



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The natural gas and oil industry is intensely competitive and speculative in all of its phases. We encounter competition from other natural gas and oil companies in all areas of our operations. In seeking suitable natural gas and oil properties for acquisition, we compete with other companies operating in our areas of interest, including large natural gas and oil companies and other independent operators, which have greater financial resources and in many instances, have been engaged in the exploration and production business for a much longer time than we have. Many of our competitors also have substantially larger operating staffs than we do. Many of these competitors not only explore for and produce natural gas and oil but also market natural gas and oil and other products on a regional, national or worldwide basis. These competitors may be able to pay more for productive natural gas and oil properties and exploratory prospects and define, evaluate, bid for and purchase a greater number of properties and prospects than us. In addition, these competitors may have a greater ability to continue exploration activities during periods of low market prices. Our ability to acquire additional properties and to discover reserves in the future will depend on our ability to evaluate and select suitable properties and to consummate transactions in a highly competitive environment.

The prices of our natural gas production are controlled by market forces. However, competition in the natural gas and oil exploration industry also exists in the form of competition to acquire leases and obtain favorable transportation prices. We are relatively small and may have difficulty acquiring additional acreage and/or projects and may have difficulty arranging for the transportation of our production. We also face competition in obtaining natural gas and oil drilling rigs and in sourcing the manpower to run them and provide related services.

### **Employees**



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Currently, we have 10 employees, all of whom are full time. We use the services of independent consultants and contractors to perform various professional services, including reservoir engineering, land, legal, environmental and tax services. On those properties where we are not the operator, we rely on outside operators to drill, produce and market our natural gas and oil.









**Item 1A. Risk Factors**

In addition to risks and uncertainties in the ordinary course of business that are common to all businesses, important factors that are specific to our industry and our company could materially impact our future performance and results of operations. We have provided below a list of these risk factors that should be reviewed when considering our securities. These are not all the risks we face and other factors currently considered immaterial or unknown to us may impact our future operations.

**Risks Related to Our Business**



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*As of December 31, 2007 we have capitalized costs totaling \$53.28 million as evaluated and unevaluated oil and gas properties whereas we have generated revenues of only \$29.9 million since January 1, 2003 and revenues of only \$6.9 million during the fiscal year ended December 31, 2007.*

Since inception, our activities have been primarily related to acquiring and exploring leasehold interests in oil and natural gas properties in Texas, California, Alaska, Alberta, Indonesia and Australia. We incur substantial acquisition and exploration costs and overhead expenses in our operations, and until 2003, excluding minor interest and dividend income, our only significant cash inflows were the recovery of capital invested in projects through sale or other divestitures of interests in oil and gas prospects to industry partners. As a result, we have sustained an accumulated deficit through December 30, 2007 of \$12,010,789. Our production activities commenced in May 2003. Since May 2003, over 90% of our revenue has been generated from natural gas sales derived from wells in the Madisonville Field in Texas. It is possible that in the future we will be unable to continue to generate revenues from our sales of natural gas from our Madisonville Field wells because our proved reserves decline as reserves are produced from the wells. The drilling of exploratory oil and natural gas wells is highly speculative and often unproductive. Our participation in future drilling activities to explore, develop and exploit the properties in which we have an interest, or in which we may acquire interests, may be unsuccessful, may fail to generate positive cash flow, and may not enable us to maintain profitability in the future.

***Approximately 99% of our current revenues are generated by our interest in the Madisonville Project. Delays or interruptions of the Madisonville Project natural gas drilling and production operations including, but not limited to, events beyond our control or the failure of third parties on which we rely to provide key services, could negatively impact our revenues.***

Approximately 99% of our oil and natural gas revenues for the years ended December 31, 2007 and 2006 were derived from the Madisonville Project. In connection with that project, we have contracted with third parties to provide key services, including:

- (a) Madisonville Gas Processing, LP, or MGP, which owns and operates gathering pipelines and a dedicated natural gas treatment plant which we utilize to treat impurities in the Madisonville Project natural gas; and
- (b) Gateway Processing Company, or Gateway which operates a sales pipeline for such natural gas.

The failure of MGP or Gateway to perform their contractual obligations to us could impose delays or interruptions in our production operations and prevent us from generating revenues. In addition, events which are beyond our control, or that of Gateway or MGP, could affect our production operations. Such events include, but are not limited to:

- events referred to as force majeure, such as an act of God, act of a public enemy, war, blockade, public riot, lightning, fire, storm, flood, explosion and any other causes whether of the kind enumerated or otherwise not reasonably within the control of MGP, Gateway or our company.
- subsurface conditions or formations encountered during the drilling of wells, whether natural or mechanical, including but not limited to blowout, igneous rock, salt, saltwater flow, loss of circulation, loss of hole, abnormal pressures, or any other impenetrable substance or adverse condition, which renders further drilling of a well impossible or impractical.

- the inability to secure raw materials or equipment,

- transportation accidents, and
  
- labor disputes and equipment failures.

**In excess of 90% of our revenues to date have been derived from sales by MGP to two customers. The loss of one or both these customers could have a material adverse impact on our oil and gas revenues.**

Approximately 99% of our oil and natural gas revenues for the years ended December 31, 2007 and 2006 were derived from the Madisonville Project. During 2007 and 2006, approximately 99% of our revenues have been derived from sales by MGP to two customers, Luminant Energy Company, LLC, and ETC Katy Pipeline, Ltd. The loss of one of these customers could impact the price we receive for our gas sold due to lessened competition. The loss of both customers could result in a total loss of our revenue.

*Unless we replace our oil and natural gas reserves, our reserves and production will decline.*





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The volume of production from oil and natural gas properties generally declines as reserves are depleted, with the rate of decline depending on reservoir characteristics. Our proved reserves will decline as reserves are produced from our properties unless we are able to acquire or develop new reserves. The business of exploring for, developing or acquiring reserves is capital intensive. For example, as of December 30, 2007 we have capitalized costs totaling \$53,276,945 as evaluated and unevaluated oil and gas properties. To the extent cash flow from operations is reduced and external sources of capital become limited or unavailable, our ability to make the necessary capital investment to maintain or expand our asset base of oil and natural gas reserves will be impaired. Even if we are able to raise capital to develop or acquire additional properties, no assurance can be given that our future exploitation and development drilling activities will result in the discovery of any reserves.

***Our exploration and development drilling activities may not be commercially successful. The drilling of exploratory oil and natural gas wells is expensive, highly speculative and often unproductive.***

Exploration for oil and natural gas on unproven prospects is expensive, highly speculative and involves a high degree of risk, including the risk that no commercially productive oil or natural gas reservoirs will be encountered. Reserves are dependent on our ability to successfully complete drilling activity on proven prospects.

The cost of drilling, completing and operating wells is often uncertain, and drilling operations may be curtailed, delayed or cancelled as a result of a variety of factors, including:

- unexpected drilling conditions, pressure or irregularities in formations;
- equipment failures or accidents, adverse weather conditions;
- compliance with governmental requirements; and
- shortages or delays in the availability of drilling rigs and the delivery of equipment.

***Our evaluations of the oil and gas prospects of our properties may be wrong.***



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With the exception of the Madisonville Project, the properties in which we have an interest are prospects in which the presence of oil and natural gas reserves in commercial quantities has not been established. Any decision to engage in exploratory drilling or other activities on any of these properties will be dependent in part on the evaluation of data compiled by petroleum engineers and geologists and obtained through geophysical testing and geological analysis.

Reservoir engineering, geophysics and geology are not exact sciences and the results of studies and tests used to make such evaluations are sometimes inconclusive or subject to varying interpretations. As such, there is no certain way to know in advance whether any of our prospects will yield oil and natural gas in commercial quantities. Further, it is possible that we will participate in the drilling of more dry holes than productive wells or that all or substantially all of the wells drilled will

be dry holes. The drilling of dry holes on prospects in which we have an interest could adversely affect their values and our decision to undertake further exploration and development drilling of such prospects. It is not certain or predictable whether, and no assurance can be made that, the wells drilled on the properties in which we have an interest will be productive or, if productive, that we will recover all or any part of our investment in the properties. In sum, our participation in future drilling activities may not be successful and, if unsuccessful, such failure will negatively impact our revenues and have a material adverse effect on our results of operations and financial condition. Our oil and natural gas revenues were \$6,890,777 and \$6,716,360 for the years ended December 31, 2007 and 2006, respectively. Future revenues could decline from those levels if our future drilling efforts are not successful. Furthermore, as of December 30, 2007 we have capitalized costs totaling \$53.28 million as evaluated and unevaluated oil and gas properties. Should our future drilling activities be unsuccessful, we may then be required to record an impairment charge equal to a portion of, or all, of the capitalized costs resulting in an immediate adverse impact on our results of operations and financial position.

*Our business may be harmed by failures of third party operators on which we rely.*



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Our ability to manage and mitigate the various risks associated with certain of our exploration and operations in Alberta, Canada, and Indonesia is limited since we rely on third parties to operate our projects. We are a non-operating interest owner in our Canadian and Indonesian properties. With respect to our interests outside of the United States, we have entered into agreements with third party operators for the conduct and supervision of drilling, completion and production operations. In the event that commercial quantities of oil and natural gas are discovered on one of our properties, the success of the oil and natural gas operations on that property depends in large measure on whether the operator of the property properly performs its obligations. The failure of such operators and their contractors to perform their services in a proper manner could result in materially adverse consequences to the owners of interests in that particular property, including us.

***Our percentage share of oil and gas revenues from our Indonesian property is diminished by the terms of our production sharing contract in the Bengara Block.***

C-G Bengara owns 100% of the underlying rights to explore for and produce oil and natural gas within the Bengara Block. We have a 12% interest in C-G Bengara. C-G Bengara is subject to a production sharing contract, which means generally that C-G Bengara is entitled to receive, from production proceeds, 100% of expenditures in the block as cost recovery. Once these costs are recovered, C-G Bengara's production share will be reduced to approximately 26.7% of oil produced and 62.5% of all natural gas produced. We are entitled to 12% of C-G Bengara's reduced share of any such production. See the discussion under Properties for more information concerning the production sharing contract.

***Drilling and completion equipment, services, supplies and personnel are scarce and may not be available when needed, which could significantly disrupt or delay our operations.***



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From time to time, there has been a general shortage of drilling rigs, equipment, supplies and oilfield services in North America and Indonesia, which may intensify with current increased industry activity. In addition, the costs and delivery times of rigs, equipment and supplies have risen. There can be no assurance that sufficient drilling and completion equipment, services and supplies will be available when needed. Shortages could delay our proposed exploration, development drilling,



and sales activities, which could have a material adverse effect on our results of operations. Our oil and natural gas revenues were \$6.9 million for the year ended December 31, 2007. Future revenues could decline from those levels if we experience delays in our proposed exploration, development drilling, and sales activities. The demand for, and wage rates of, qualified rig crews have risen in the drilling industry due to the increasing number of active rigs in service. If the demand for qualified rig crews continues to rise in the drilling industry, then the oil and gas industry may experience shortages of qualified personnel to operate drilling rigs. This could delay our drilling operations and adversely affect our financial condition and results of operations.

*Our working interest in properties, and our ability to realize any profits from such properties, will be diminished to the extent that we enter into farmout arrangements with unaffiliated third parties.*

We have previously entered into, and may in the future enter into, farmout arrangements with third parties willing to drill natural gas and oil wells on leaseholds in which we originally acquired working interests, in exchange for our assignment of part or all of our leasehold interests. As a consequence of these arrangements, our retained interests in properties which are subject to farmout arrangements have been or may be diminished. Our opportunity to realize revenues and profits from properties which are successfully developed under farmout arrangements will be diminished to the extent of our reduced interests.

*Competition with other oil and natural gas exploration and development drilling companies for viable oil and natural gas properties may limit our success.*



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It is likely that in seeking future property acquisitions, we will compete with companies which have substantially greater financial and management resources. Our competition comes primarily from three sources:

- (a) those competitors that are seeking oil and gas fields for expansion, further drilling, or increased production through improved engineering techniques;
- (b) income-seeking entities purchasing a predictable stream of earnings based upon historic production from fields being acquired; and
- (c) junior companies seeking exploration opportunities in unknown, unproven territories.

Our competitors may be able to pay more for productive oil and natural gas properties and may be able to define, evaluate, bid for and purchase a greater number of properties and prospects than we can. Our ability to acquire additional properties in the future will depend upon our ability to conduct efficient operations, evaluate and select suitable properties, implement advanced technologies and consummate transactions in a highly competitive environment.

***Estimates of oil and natural gas reserves are inherently imprecise. Any material inaccuracies in these reserve estimates or underlying assumptions will affect materially the quantities and present value of our reserves.***

Estimates of proved oil and natural gas reserves and the future net cash flows attributable to those reserves are prepared by independent petroleum engineers and geologists. There are numerous uncertainties inherent in estimating quantities of proved oil and natural gas reserves and cash flows attributable to such reserves, including factors beyond our control and that of our engineers. Reserve engineering is a subjective process of estimating underground accumulations of oil and natural gas that cannot be measured in an exact manner. Different reserve engineers may make different estimates of reserves and cash flows based on the same available data. The accuracy of an estimate of quantities of reserves, or of cash flows attributable to such reserves, is a function of the available data, assumptions regarding future oil and natural gas prices and expenditures for future development drilling and exploration activities, and of engineering and geological interpretation and judgment. Additionally, reserves and future cash flows may be subject to material downward or upward revisions, based upon production history, development drilling and exploration activities and prices of oil and natural gas. Actual future production, revenue, taxes, development drilling expenditures, operating expenses, underlying information, quantities of recoverable reserves and the value of cash flows from such reserves may vary significantly from the assumptions and underlying information set forth herein.

***Competitive pressures may force us to implement new technologies at substantial cost and our limited financial resources may limit our ability to implement such technologies at the same rate as our competitors.***

The oil and gas industry is characterized by rapid and significant technological advancements and introductions of new products and services utilizing new technologies. Other oil and gas companies may have greater financial, technical and personnel resources that allow them to enjoy technological advantages and may in the future allow them to implement new technologies before we do. There can be no assurance that we will be able to respond to such competitive pressures and implement such technologies on a timely basis or at all. One or more of the technologies currently utilized by us or implemented in the future may become obsolete.

***We will require additional capital to fund our future activities. Our ability to pursue our business plan may be restricted by our access to additional financing.***

Until such time as the properties in which we own interests are generating sufficient cash flow to fund planned capital expenditures, we will be required to raise additional capital through the issuance of additional securities or otherwise sell or farm out interests in our oil and natural gas properties to third parties. If and when the properties in which we own interests become productive and have adequate reserves, we may borrow funds to finance our future oil and natural gas operations and exploratory and development drilling activities. We may not be able to raise additional funds in the future from any source or, if such additional funds are made available to us, we may not be able to obtain such additional financing on terms acceptable to us. To the extent such funds are not available from any of those sources, our operations and activities will be limited to those operations and activities we can afford with the funds then available to us. We have committed to a three well drilling program in our Madisonville project to facilitate the expansion of the gas treatment plant. The commitment is not discretionary. While we have fulfilled the commitment to drill the first two wells of the three well commitment, we are further required to drill a third well sufficient to test the Smackover Formation (estimated to be encountered at approximately 18,000 feet) on or before September 30, 2008. This well is expected to cost approximately \$12 million to drill and complete. We have granted MGP a security interest in the Madisonville Field properties to secure the three well commitment. Subject to events of force majeure, and the availability of suitable drilling rigs, well services, and equipment, our failure to drill this well could result in the loss of our interest in the Madisonville Project. Our larger competitors, by reason of their size and relative financial strength, may be more easily able to access capital markets than us.

***The volatility in crude oil and natural gas prices could adversely affect our financial results and ability to raise additional capital.***

Our revenues, cash flows and profitability are substantially dependent on prevailing prices for both oil and natural gas. Decreases in natural gas prices will decrease revenues and cash flows from the Madisonville Project and our other producing properties, if any, and decreases in oil and natural gas prices could deter potential investors from investing in our company and generally impede our ability to raise additional financing to fund our exploration and development drilling activities. Historically, oil and natural gas prices and markets have been volatile, and they are likely to continue to be volatile in the future. Prices for oil and natural gas are subject to wide fluctuations in response to relatively minor changes in the supply of, and demand for, oil and natural gas, market uncertainty and a variety of additional factors that are beyond our control. These factors include, but are not limited to, political conditions in the Middle East and other regions, internal and political decisions of OPEC and other oil and natural gas producing nations to decrease or increase production of crude oil, domestic and foreign supplies of oil and natural gas, consumer demand, weather conditions, domestic and foreign government regulations, transportation costs, the price and availability of alternative fuels and overall economic conditions.

Our current operations are particularly exposed to volatility in natural gas prices because a portion of the fees we pay to process natural gas at the Madisonville gas treatment plant is fixed. The sale price of natural gas must be above a minimum price of approximately \$3.00 per Mcf at the present time before we earn any net revenues from the sale of natural gas.

*We are subject to a number of operational risks beyond our control against which we may not have, or be able to obtain insurance.*

Our operations are subject to the many risks and hazards incident to exploring and drilling for, and producing and transporting, oil and natural gas, including among other risks:

- blowouts, fires, craterings, pollution and equipment failures that may result in damage to or destruction of wells, producing formations, production facilities and equipment;
- personal injuries or death due to accidents, human error or acts of God;

- unavailability of materials and equipment to drill and complete or re-complete wells; unfavorable weather conditions; engineering and construction delays;
- fluctuations in product markets and prices; proximity and capacity of pipeline, and trucking or termination facilities to our oil and natural gas reserves; hazards resulting from unusual or unexpected geological or environmental conditions; environmental regulations and requirements;
- accidental leakage of toxic or hazardous materials, such as petroleum liquids or drilling fluids into the environment, remediation and clean-up costs; and
- political instability and civil unrest, insurrections or disruptions in foreign countries in which some of our interests are located.

If one or more of these events occurs, we could incur substantial liabilities to third parties or governmental entities, the payment of which could have a material adverse effect on our financial condition and results of operations, or we could lose properties in which we have invested significant sums (totaling \$53.28 million) which are capitalized as evaluated and unevaluated oil and gas properties as of December 30, 2007.

*A loss not covered by insurance could result in substantial expenses to us.*

We do not insure fully against all business risks either because such insurance is not available or because premium costs are prohibitive. This is a common practice in the oil and gas industry. However, a loss not fully covered by insurance could result in expenses to us and could have a material adverse effect on our financial position and results of operations. Uninsured losses in excess of \$1.0 million would be materially adverse.

*We are subject to extensive government regulations that can change from time to time, compliance with which are costly and could negatively impact our production, operations and financial results.*

The oil and gas industry is subject to extensive government regulations in the countries in which we operate. Matters subject to regulation include discharge permits for drilling operations, drilling bonds, reports concerning operations, unitization and pooling of properties and taxation. Historically, our costs of complying with these regulations have not exceeded \$100,000 per year. From time to time, regulatory agencies have imposed price controls and limitations on production by restricting the rate of flow of oil and natural gas wells below actual production capacity in order to conserve supplies of oil and natural gas. We are also subject to changing and extensive tax laws, the effects of which cannot be predicted. Legal requirements are frequently changed and subject to interpretation, and we are unable to predict the ultimate cost of compliance with these requirements or their effects on our operations. Future laws, or existing laws or regulations, as currently interpreted or reinterpreted or changed in the future, could result in increased operating costs, fines and liabilities, in amounts which are unknown at this time, any of which could materially adversely affect our results of operations and financial condition.

*Our industry is subject to extensive environmental regulation that may limit our operations and negatively impact our production.*

Extensive national, state, provincial and local environmental laws and regulations in the United States and foreign jurisdictions affect nearly all of our operations. These laws and regulations set various standards regulating certain aspects of health and environmental quality, provide for penalties and other liabilities for the violation of such standards and establish in certain circumstances obligations to remediate current and former facilities and locations where operations are or were conducted. In addition, special provisions may be appropriate or required in environmentally sensitive areas of operation.

Environmental legislation may require that we, among other things:

- acquire permits before commencing drilling;
- restrict spills, releases or emissions of various substances produced in association with our operations;

- limit or prohibit drilling activities on protected areas such as wetlands or wilderness areas;
- take reclamation measures to prevent pollution from former operations;
- take remedial measures to mitigate pollution from former operations, such as plugging abandoned wells and remediating contaminated soil and groundwater;
- take remedial measures with respect to property designated as a contaminated site.

The cost of any of these actions is presently unknown but is likely to be significant.

***Compliance with existing or future environmental legislation is unknown but could be substantial.***

Compliance with such legislation can require significant expenditures and a breach may result in the imposition of fines and penalties. The discharge of oil, natural gas or other pollutants into the air, soil or water may give rise to liabilities to governments and third parties and may require us to incur substantial costs to remedy such discharge. Under these laws and regulations, we could be liable for personal injury, clean-up costs and other environmental and property damages, as well as administrative, civil and criminal penalties. We could be required to cease production on properties if environmental damage occurs. Environmental legislation is evolving in a manner expected to result in stricter standards and enforcement, larger fines and liability and potentially increased capital expenditures and operating costs. Changes in, or enforcement of, environmental laws may result in a curtailment of our production activities, or a material increase in the costs of production, development drilling or exploration, any of which could have a material adverse effect on our financial condition and results of operations or prospects. We are not presently aware of any environmental liabilities or able to predict the ultimate cost of liabilities not yet recognized. We have recorded an asset retirement obligation in connection with the estimated future costs to plug certain wells in our Madisonville Project in Texas upon abandonment totaling approximately \$53,726 as of December 31, 2007.

***Our natural gas deliveries to the Madisonville gas treatment plant may be affected by the demands of Crimson Exploration, Inc. (Crimson) and other third parties for access to the plant, and as a result, our access to the plant could be restricted.***

We are dependent upon the Madisonville gas treatment plant to treat our natural gas. We have committed all natural gas production from our interest in the Madisonville Project to MGP, which has in turn committed to provide treatment capacity of up to 68 MMcf/d for our natural gas. Third parties may seek access to the gas treatment plant through regulatory proceedings, which could restrict our access to the plant, disrupt our production operations and negatively impact our revenues. An example of such a proceeding is the complaint filed by Crimson with the Texas Railroad Commission described under Properties Description of the Properties Texas The Madisonville Gas Treatment Plant and Gathering Facilities. On August 9, 2006, the Texas Railroad Commission issued an order requiring MGP to ratably process, take, transport or purchase natural gas produced by Crimson into the Madisonville gas treatment plant. MGP completed additional treating facilities to increase the design capacity from 18 MMcf/d to 68 MMcf/d in November of 2007, but operations in these additional facilities were suspended in December 2007 in order to more effectively deal with the presence of diamondoids in the gas stream produced from the Rodessa Formation. There is no guarantee that we will be able to obtain full access to treatment capacity of up to 68 MMcf/d once the phase-in is completed because, for example,



Crimson now has the right to have its natural gas treated at the plant, which may reduce the plant's ability to treat all of our natural gas, unless the plant's capacity is further expanded.

*Political and/or economic conditions in Indonesia, Canada or the United States could change in manners that negatively affect our operations and prospects in those countries.*

Our business activities in Indonesia, Canada and the United States are subject to political and economic risks, including: loss of revenue, property and equipment as a result of unforeseen events like expropriation, nationalization, war, terrorist attacks and insurrection; increases in import, export and transportation regulations and tariffs, taxes and governmental royalties; renegotiation of contracts with governmental entities; changes in laws and policies governing operations of foreign-based companies; exchange controls, currency fluctuations and other uncertainties arising out of foreign government sovereignty over international operations; laws and policies affecting foreign trade, taxation and investment; and the possibility of being subject to the exclusive jurisdiction of foreign courts in connection with legal disputes and the possible inability to subject foreign persons to the jurisdiction of courts in the United States.

*Terrorist attacks could have an adverse effect on our oil and natural gas operations, especially overseas.*

To date, our operations have not been disrupted by terrorist activity. It is uncertain how terrorist activity will affect us in the future, or what steps, if any, the Indonesian, Canadian or American government may take in response to terrorist activities. The attack on the New York World Trade Center in 2001 and the subsequent wars in Afghanistan and Iraq have increased the likelihood that U.S. citizens and U.S. owned interests may be targeted by terrorist groups operating both in the United States and in foreign countries, especially in Indonesia.

*We could lose our entire Production Sharing Contract ( PSC ), if BP Migas ascertains we have not discovered commercially producible hydrocarbons.*

It is possible that BP Migas could terminate our entire Production Sharing Contract ( PSC ) if it is determined that the hydrocarbons we have discovered are not in commercially producible quantities. Our Indonesian PSC requires us and our partners to submit to and receive approval from BP Migas for a Plan of Development by specified dates in order to maintain our oil and natural gas rights. See Properties Description of the Properties Indonesia. If we do not establish commerciality and receive an approved Plan of Development for the PSC, or successfully renegotiate the terms, all or part of our contract may be terminated. If this contract is terminated, we would also lose all of our investment in that overseas prospect. If we forfeit our interest in the contract area, it will be necessary to record an impairment write-down equal to the net capitalized costs recorded for the area forfeited. This could have a material adverse impact on our financial condition and results of future operations in future periods. If approval of a Plan of Development is not obtained and if further deferrals of such obligations are not secured, we will need to record an impairment charge equal to the amount of costs capitalized which were approximately \$582,946 as of December 31, 2007, and we may lose all of our rights in the Bengara Block.

*We may not be able to sell our natural gas production in Indonesia, limiting our ability to obtain a return on our investment there.*

Our Indonesian operations lack a local market for natural gas, and if we produce natural gas in Indonesia, it will most likely have to be transported to an area where there is a demand. If no market for natural gas develops locally, we may incur costs for transportation. If we are not able to sell our natural gas production at a commercially acceptable price or at all, we may not be able to obtain a return on our investment in our Indonesian property.

*We could lose our ownership interests in our properties due to a title defect of which we are not presently aware.*

As is customary in the oil and gas industry, only a perfunctory title examination, if any, is conducted at the time properties believed to be suitable for drilling operations are first acquired. Before starting drilling operations, a more thorough title examination is usually conducted and curative work is performed on known significant title defects. We typically depend upon title opinions prepared at the request of the operator of the property to be drilled. The existence of a title defect on one or more of the properties in which we have an interest could render it worthless and could result in a large expense to our business. Industry standard forms of operating agreements usually provide that the operator of an oil and natural gas property is not to be monetarily liable for loss or impairment of title. The operating agreements to which we are a party provide that, in the event of a monetary loss arising from title failure, the loss shall be borne by all parties in proportion to their interest owned.

*Our acquisition activities are subject to uncertainties, may not be successful and provide a return to us on our investments.*

We have grown primarily through acquisitions and intend to continue acquiring undeveloped oil and gas properties. Although we perform a review of the properties proposed to be acquired, such reviews are subject to uncertainties. It generally is not feasible to review in detail every individual property involved in an acquisition. Ordinarily, management review efforts are focused on the higher-valued properties; however, even a detailed review of all properties and records may not reveal existing or potential problems; nor will it permit us to become sufficiently familiar with the properties to assess fully their deficiencies and capabilities. Inspections are not always performed on every well, and potential problems, such as mechanical integrity of equipment and environmental conditions that may require significant remedial expenditures, are not necessarily observable even when an inspection is undertaken.







***We are dependent upon our key officers and employees and our inability to retain and attract key personnel could significantly hinder our growth strategy and cause our business to fail.***

While no assurances can be given that our current management resources will enable us to succeed as planned, a loss of one or more of our current directors, officers or key employees could severely and negatively impact our operations and delay or preclude us from achieving our business objectives. Stuart Doshi, David Creel and Chris Steinhauser, the three members of our senior management team, have a combined experience of approximately 100 years in the oil and gas industry. Although we have entered into employment agreements with Messrs. Doshi, Creel and Steinhauser, we could suffer the loss of key individuals for one reason or another at any time in the future. There is no guarantee that we could attract or locate other individuals with similar skills or experience to carry out our business objectives. We maintain key man insurance with respect to our Chief Executive Officer, Stuart Doshi.

***Some of our directors may become subject to conflicts of interest which could impair their abilities to act in our best interest.***

Nick DeMare, one of our directors, is a director, officer and/or significant shareholder of other natural resource companies and David Anderson, another one of our directors, is a director and officer of Dundee Securities Corporation, an investment banking firm that was the lead underwriter of our public offering of common stock in Canada and concurrent previous private placement of common shares with qualified institutional buyers in the U.S. Their association with these other companies in the oil and gas business may give rise to conflicts of interest from time to time. For example, they could be presented with business opportunities in their capacities as our directors, which they could, in turn, offer to the other companies for whom they also serve as directors, rather than to us, whose interests might be competitive with ours. Our directors are required by law to act honestly and in good faith with a view to our best interests and to disclose any interest which they may have in any project or opportunity to us; however, their interests in the other companies may affect their judgment and cause such directors to act in a manner that is not necessarily in our best interests.

***Our directors and officers hold significant positions in our shares and their interests may not always be aligned with those of our other shareholders.***

As of December 31, 2007 our directors and officers beneficially own approximately 20% of our outstanding common stock. This shareholding level will allow the directors, officers and certain beneficial owners to have a significant degree of influence on matters that are required to be approved by shareholders, including the election of directors and the approval of significant transactions. The short-term interests of our directors, officers and certain beneficial owners may not always be aligned with the long-term interests of our public shareholders, and vice versa. Because our directors, officers and certain beneficial owners have a significant degree of influence on matters that are required to be approved by our shareholders, they could influence the approval of transactions.

***Our failure to manage internal or acquisition-based growth may cause operational difficulties and negatively affect our financial performance.***

We expect to experience internal and/or acquisition-based growth, which may bring many challenges. Growth in the number of employees, sales and operations will place additional pressure on already limited resources and infrastructure. No assurances can be given that we will be able to effectively manage this or future growth. Our growth may place a significant strain on our managerial, operational, financial and other resources. Our success will depend upon our ability to manage our growth effectively which will require that we continue to implement and improve our operational, administrative and financial and accounting systems and controls and continue to expand, train and manage our employee base. Our systems, procedures and controls may not be adequate to support our operations and our management may not be able to achieve the rapid execution necessary to exploit the market for our business model. If we are unable to manage internal and/or acquisition-based growth effectively, our business, results of operations and financial condition will be materially adversely affected.





## **Risks Related to Our Common Stock**

*The shareholding position of holders of our common stock could be diluted by future issuances and conversions of other securities.*

If our options and warrants are exercised for common shares, holders of our common stock will experience immediate and, depending on the magnitude of the exercises, substantial dilution. As of the date of this report, 2,441,688 shares of our common stock are issuable upon exercise of warrants and 2,670,000 shares of our common stock are issuable upon exercise of options.

Investors may be subject to further dilution if we sell additional common shares or issue additional common shares in connection with future financings. If a significant number of our common shares are sold in the public market, the market price of our common shares could be depressed. This could hamper our ability to raise capital by issuing additional equity securities.

*Our results may be affected by fluctuations in currency exchange rates.*

Our financial statements are reported in U.S. dollars and all of our revenue, and most of our operating costs, are currently denominated in U.S. dollars; however, we have operations outside the United States and we plan to expend money in Indonesia and Canada, where our operating costs will be denominated in local currencies. Fluctuations in exchange rates may increase our relative cost of operating in these countries, and may therefore have a negative effect on our financial results.

*Non- U.S. holders of our common shares may be subject to U.S. federal income tax on the sale of our common shares and purchasers may have IRS withholding requirements*

Since we believe that we are a United States real property holding corporation, gain recognized by a non U.S. holder on the sale of our common shares will be subject to U.S. federal income tax at normal graduated rates, and a purchaser will be required to withhold for the benefit of the IRS 10% of the purchase price, unless certain trading requirements are met. There is an exemption from U.S. federal income tax for non-U.S. holders of 5% or less of our common shares (and therefore no tax withholding requirements) if our common shares are regularly traded on an established securities market. In the event that 100 or fewer persons own 50% or more of our common shares (which had been, may now be and may continue to be, the case), temporary Treasury Regulations provide that our common shares will be regularly traded on an established securities market for a calendar quarter if the established securities market is located in the United States and our common shares are regularly quoted by more than one broker or dealer making a market in our common shares; our common shares are currently listed on the American Stock Exchange (which constitutes an established United States securities market for this purpose) and are being regularly quoted. There can be no assurance, however, that our common shares will continue to be regularly traded on an established securities market for this purpose in any particular calendar quarter so as to avoid U.S. federal income tax on the sale of our common shares by non-U.S. holders of 5% or less of our common shares and the withholding requirement on the purchaser.

At such time that it is no longer the case that 100 or fewer persons own 50% or more of our common shares, under temporary Treasury Regulations, our common shares would also be regularly traded on an established securities market for a calendar quarter if: (a) our common shares trade, other than in de minimis quantities, on at least 15 days during the calendar quarter; (b) the aggregate number of our common shares traded during the calendar quarter is at least 7.5% of the average number of our common shares outstanding during such calendar quarter

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(reduced to 2.5% if there are 2,500 or more record shareholders); and (c) in the event that our common shares are traded on an established securities market located outside the United States, the common shares are registered under Sec. 12 of the Securities Exchange Act of 1934 (which is presently the case). See [Material Income Tax Consequences](#) [Dispositions of Common Shares](#) for a more detailed discussion.

***There is a limited public market for our common shares, and the ability of our shareholders to dispose of their common shares may be limited.***

Our common shares have been listed on The Toronto Stock Exchange since March 2006, and have been trading on the American Stock Exchange since February 15, 2007. We cannot foresee the degree of liquidity that will be associated with our common shares. A holder of our common shares may not be able to liquidate his, her or its investment in a short time period or at the market prices that currently exist at the time the holder decides to sell. The purchase and sale of relatively small common share positions may result in disproportionately large increases or decreases in the price of our common shares. A trade involving a large number of common shares could have an exaggerated effect on the reported market price of our common shares.

*Our stock price may fluctuate significantly.*

The stock market in general and the market for natural gas and oil exploration companies have experienced price and volume fluctuations that are often unrelated or disproportionate to the operating results or asset values of companies. These broad market and industry factors may seriously impact the market price and trading volume of our common shares regardless of our actual operating performance. The market price of our common stock could also fluctuate significantly as a result of:

- actual or anticipated quarterly variations in our operating results and our reserve estimates;
- changes in expectations as to our future financial performance or changes in financial estimates, if any, of public market analysts;
- announcements relating to our business or the business of our competitors;
- conditions generally affecting the oil and natural gas industry, including changes in oil and natural gas prices;
- speculation in the press or investment community;
- general market and economic conditions;
- the success of our operating strategy; and
- the operating and stock price performance of other comparable companies.

*The sale of large numbers of our common stock may depress the market price of our common stock.*

The sale of a substantial number of shares of our common stock in the public market, or the perception that substantial sales may occur, could cause the market price of our common stock to decrease. Substantially all of the shares of our common stock are freely transferable or will be transferable in compliance with restrictions under the Securities Act of 1933, as amended.

*We will continue to incur significant expenses as a result of being a public company, which may negatively impact our financial performance.*

We have incurred and will continue to incur significant legal, accounting, insurance and other expenses as a result of being a public company. The Sarbanes-Oxley Act of 2002, as well as related rules implemented by the Securities and Exchange Commission, or SEC, and the American Stock Exchange, have required changes in corporate governance practices of public companies. Compliance with these laws, rules and regulations has increased our expenses, including our legal and accounting costs, and made some activities more time-consuming and costly. We also believe these laws, rules and regulations have made it more expensive for us to obtain director and officer liability insurance, and in the future we may be required to accept reduced policy limits and coverage or incur substantially higher costs to obtain the same or similar coverage. As a result, it may be more difficult for us to attract and retain qualified persons to serve on our board of directors or as officers. Furthermore, any additional increases in legal, accounting, insurance and certain other expenses that we may experience in the future could negatively impact our financial performance and have a material adverse effect on our results of operations and financial condition.

**Item 1B. Unresolved Staff Comments**

None.

**Item 2. Properties**

Our principal executive office consists of 2,956 square feet and is located at One Maritime Plaza, Suite 700, San Francisco, CA 94111.



**Description of the Properties**



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Our current oil and natural gas exploration, appraisal and development drilling activities are focused in three distinct project areas as follows:

- **United States Texas** (onshore South and East Texas regions), **Alaska** (onshore Cook Inlet area) and **California** (onshore San Joaquin basin);
- **Canada Alberta** (central Alberta basin); and
- **Indonesia** onshore East Kalimantan Province;

We do not fully insure against all business risks either because such insurance is not available or because premium costs are prohibitive. This is a common practice in the oil and gas industry. We believe our property is adequately insured in view of the nature of our operations and industry practices in this regard.

*Texas*





*Madisonville Project, Madison County, East Texas*



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We own and operate the interest in the Madisonville Project in Madison County, Texas. We own working interests in approximately 4,941 gross and net acres of leases in the Rodessa Formation interval, as well as approximately 4,348 gross and net acres of leases as to depths below the Rodessa Formation interval. We also own a license as to 12.5 square miles of 3-D seismic data over the Madisonville Field.

The Madisonville Field, located approximately 100 miles north of Houston, has produced oil and natural gas from four different horizons above the Rodessa Formation for over 50 years. The field was discovered in 1945 with the Boring No. 1 well, which was drilled to the Rodessa Formation. The well blew out at an uncontrolled rate for three days during a test; however, due to hydrogen sulphide, carbon dioxide and nitrogen in the Rodessa Formation natural gas, the gas reserves were never developed. Over 125 wells were drilled in the Madisonville Field to shallower intervals above the Rodessa Formation. In 1994, nearly 50 years after the initial discovery, United Meridian Corporation ( **UMC** ) drilled the Magness Well as the first follow-up well into the Rodessa Formation to the Boring No. 1 well. The Magness Well had 139 feet of net pay but the natural gas was found to contain 28% impurities.

UMC previously production tested the Magness Well in 1994 through perforations in the lower most ten feet of the indicated Rodessa Formation pay interval. The well tested at a rate of 12 MMcf/d from this limited interval on a 22/64ths inch choke with flowing wellhead pressures increasing from 3,915 to 3,919 pounds per square inch. In 2001, we re-entered and recompleted the Magness Well. A total of 139 feet of interval has been perforated in the Rodessa Formation at approximately 12,000 feet of depth for this well. The well was production tested over a 12-day period in 2001 on various choke sizes with flowing rates ranging up to approximately 20.8 MMcf/d. We own a 100% working interest (75.1333% net revenue interest) in the Magness Well located in the surrounding production unit consisting of 629 gross and net acres. The Magness Well commenced production in May of 2003.

The first development well, the Fannin Well, was drilled and completed in 2004. We own a 100% working interest (69.2483% net revenue interest) in the Fannin Well located in the surrounding production unit consisting of 704 gross (704 net) acres. A total of 146 feet of indicated pay was perforated in the well and a flow test of the well was completed in December 2004 from the Rodessa Formation at rates of up to 25.7 MMcf/d. We commenced production from the Fannin Well in early 2006.

In 2006, we drilled the Wilson and Mitchell wells. We own a 100% working interest (70% net revenue interest) in the Wilson and Mitchell wells. Presently, the Fannin and Magness wells are producing at a combined restricted rate of approximately 13.5 MMcf/d while the Wilson and Mitchell wells are shut-in. The production rate is presently restricted while awaiting a planned expansion of the Madisonville Field gas treatment plant to 68 MMcf/d treating capacity.

The Madisonville Field is a geologic feature encompassing approximately 5,800 acres at the Rodessa limestone at about 11,800 feet of depth. A 3-D seismic program shot in early 1998 confirmed the size of the structure and slightly increased its size over earlier interpretations.

Our working interest covers the Rodessa Formation at approximately 12,000 feet of depth. The Rodessa reserves are being developed through the recompletion of the Magness Well and the drilling of additional proved and probable undeveloped locations. Production began in May 2003 and stabilized at a rate of 18 MMcf/d of raw gas from the Magness Well. The Magness and Fannin wells are currently producing at a combined restricted rate of approximately 13.5 MMcf/d. Current net sales production is approximately 8 MMcf/d. In addition, we own a working interest in certain leases and farmout rights which cover depths below the Rodessa Formation.

The hydrogen sulphide, carbon dioxide and nitrogen combined comprise about 28% of the gas content. As described below, an unaffiliated third party purchases the untreated natural gas from us at the well site point of delivery for a net price equal to the weighted average price per MMBTU that the third party receives for the natural gas delivered to the sales pipeline less certain gathering, treatment and transportation charges. As a result of the charges, we receive a net price that is substantially lower than we would otherwise receive if the gas did not contain the 28% of impurities. In addition, the high concentrations of hydrogen sulphide and carbon dioxide result in higher capital and operating costs for our wells. For example, the hydrogen sulphide and carbon dioxide are corrosive to the wellbores. This means we have to utilize higher grade specification well tubing and casing which is more expensive than what we would utilize absent the impurities. In addition, we continuously treat the wellbores with chemicals designed to inhibit the corrosive effects of the impurities. We also maintain field personnel at or near the wellsites who monitor the wells on a twenty four hour basis and equip the wellsites with extensive safety equipment systems due to the toxic properties of the hydrogen sulphide and carbon dioxide. These factors and others result in higher capital and operating costs for our wells in the Madisonville Project.

*The Madisonville Gas Treatment Plant and Gathering Facilities*



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In order to produce the proven gas reserves from the Rodessa Formation, we developed an onsite plan to treat and remove impurities from the Madisonville Project natural gas in order to meet pipeline-quality specifications. On June 15, 2001, we, through our subsidiary Redwood LP, entered into an agreement, which agreement was subsequently amended and restated, together with certain related agreements (collectively, the **Hanover Agreement**), with Hanover Compression Limited Partnership pursuant to which Hanover committed to fund, construct and operate a dedicated natural gas treatment plant to process our Rodessa Formation natural gas. The Hanover Agreement also provided for the installation by Gateway of field gathering pipelines and an approximately nine-mile sales pipeline with an estimated capacity of approximately 70 MMcf/d to transport the Madisonville Field natural gas to a major pipeline. By April of 2003, the construction and installation of Hanover's natural gas treatment plant and Gateway's associated pipeline and gathering facilities were completed. Gas production from the Magness Well commenced in May 2003. We received the first revenues from the sale of natural gas from the Madisonville Project in July 2003. The natural gas plant is currently capable of treating approximately up to 15 MMcf/d of inlet natural gas.

On July 25, 2005, MGP purchased the natural gas treatment plant from Hanover and purchased the gathering pipelines upstream of the gas treatment plant from Gateway. Concurrent with MGP's purchase of the gas treatment plant and gathering pipelines, we, through our subsidiary Redwood LP, Gateway and MGP terminated the Hanover Agreement and entered into a new agreement, (the **MGP Agreement**), to treat and transport our gas production from the Madisonville Project. As a result of the MGP Agreement, MGP committed to install and make operational additional treating facilities capable of treating 50 MMcf/d, which combined with the capacity of the current in-service treating facilities will represent a total treating capacity of 68 MMcf/d for the Madisonville treatment plant. The MGP Agreement provides that the newly installed gas treatment facilities will be electrically driven. Currently, the existing in-service treatment plant utilizes some of the natural gas produced and delivered from our well(s). The conversion to electricity on the expanded portion of the treatment plant is expected to reduce shrinkage of our natural gas that occurs in the treating process.

Originally, the MGP Agreement required MGP to complete the additional treating facilities by March 1, 2006. However, due to events of force majeure, construction of the additional treating facilities were just completed in October 2007 and early phase operations at the additional treating facilities were recently suspended. In early November 2007, MGP began accepting 20 million cubic feet of gas per day MMcfd at the inlet of the additional treating facilities. Subsequently in December 2007, MGP temporarily suspended the operations of the additional treating facilities in order to make modifications to more effectively deal with the presence of diamondoids in the gas stream produced from the Rodessa Formation. A diamondoid is a rare, naturally occurring compound that can segregate out of the gas stream upon a decrease in temperature and pressure

and as such, could cause operational problems for the nitrogen rejection portion of the additional treating facilities. MGP has obtained a detailed laboratory composition analysis of the diamondoids and is currently finalizing plans for modifications to the operating system. MGP indicates that removal of the diamondoids will require flowing the natural gas stream through a diesel contactor after the gas stream has had the hydrogen sulfide and carbon dioxide removed. Through this contactor process, the diesel will absorb the diamondoids from the gas stream prior to entry into the nitrogen removal tower. MGP expects to complete installation of the system modifications required in the new plant by the second quarter of 2008. In the meantime, the existing, in service portion of the plant continues to treat approximately 15 million cubic feet per day of inlet gas.

We have proceeded to drill and complete our new development wells notwithstanding MGP's delay in completing the expansion of the treatment plant and subsequent suspension of operations in December 2007. To the extent that production begins at the new wells before operations resume, as is the case with the Fannin Well which was placed on production in March 2006, production of the wells will be restricted as necessary. The term of the MGP Agreement commenced August 1, 2005 and continues so long as we own any oil and gas leases in the Madisonville Field, provided that it shall terminate on July 31, 2035 unless extended. Under the terms of the MGP Agreement, we have committed all natural gas production from our interest in the Madisonville Project to MGP. MGP purchases the untreated natural gas from us at the well site point of delivery for a net price equal to the weighted average price per MMBTU that MGP receives for the natural gas delivered to the sales pipeline less certain gathering, treatment and transportation charges. The gathering, treatment and transportation price adjustments are described below. All proceeds from MGP's sale of Rodessa Formation gas are deposited in an escrow account and then disbursed in accordance with the joint direction of MGP and ourselves.

The MGP Agreement provides that certain gathering, treating and transportation fees shall be paid to MGP from the escrow account. The MGP Agreement provides that MGP will receive a gathering and marketing fee of \$0.07 and \$0.01 per Mcf, respectively, of gas measured and delivered to the natural gas treatment plant. In addition, for the first 18,000 Mcf/d of gas measured and delivered to the inlet flange of the gas treatment plant, MGP will receive a treating fee of \$1.50 per Mcf. This treating fee will remain in effect until September 30, 2010. For any gas volumes in excess of 18,000 Mcf/d of gas delivered to the inlet flange of the gas treatment plant, MGP will receive a treating fee of \$1.10 per Mcf. Beginning October 1, 2010, this fee of \$1.10 per Mcf shall be charged for all gas measured and delivered to the plant. One-quarter (1/4) of the foregoing treating fees are adjusted using the Producer Price Index for Industrial Commodities ( **PPI** ) and one-quarter (1/4) using the Consumer Price Index ( **CPI** ). One-half (1/2) of the foregoing gathering and marketing fees are adjusted using the CPI. We have the right, upon giving 60 days notice, to terminate the marketing fee whereupon we shall assume the sole responsibility of marketing the natural gas sold. The **PPI** and the **CPI** are price indices published by the U.S. Department of Labor.

For the first 18,000 Mcf/d of gas measured and delivered to the inlet flange of the gas treatment plant, Gateway will receive a transportation fee of \$0.10 per Mcf. This fee will remain in effect through July 31, 2008. Beginning August 1, 2008 and terminating on July 31, 2010, the fee shall be reduced to \$0.08 per Mcf for the first 18,000 Mcf/d of gas measured and delivered to the inlet flange of the gas treatment plant. For any gas volumes in excess of 18,000 Mcf/d of gas measured and delivered to the inlet flange of the gas treatment plant, Gateway will receive a transportation fee of \$0.12 per Mcf measured and delivered from the outlet flange of the plant. This fee will remain in effect through July 31, 2008 and shall be reduced to \$0.10 per Mcf thereafter. After July 31, 2010, this transportation fee shall be \$0.10 per Mcf for all volumes delivered from the outlet flange of the plant.

The foregoing gathering, treatment and transportation price adjustments are inclusive of all costs and expenses to gather, separate, treat, dehydrate and transport natural gas produced and delivered from our well(s).

Our natural gas deliveries to the Madisonville gas treatment plant may be affected by third party demands for access to the plant. On July 20, 2005 Crimson Exploration Inc. ( **Crimson** ) filed a complaint with the Texas Railroad Commission ( **TRC** ) against Gateway and Hanover. The complaint alleged discrimination by Hanover and Gateway, and requested that the TRC issue an order requiring Hanover and Gateway to ratably



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process, take, transport, or purchase natural gas produced by Crimson into the Madisonville Field gas treatment plant. The complaint did not allege any wrongdoing by Redwood or Redwood LP; however, the complaint referred to the contractual relationship between each of Redwood LP, Hanover, and Gateway which was terminated July 25, 2005 as the basis for its discrimination complaint. Redwood received a subsequent notice dated January 13, 2006 from the TRC informing Redwood that (i) Crimson had filed a request to docket its complaint against MGP for failure to ratably take gas pursuant to Texas regulations and (ii) a pre-hearing conference was held on January 25, 2006 relating to the complaint. Redwood withdrew from the proceeding.

On January 23, 2006, our counsel received a letter from counsel for MGP reaffirming that regardless of the outcome of the proceedings before the TRC, MGP nonetheless recognizes that it has a contractual obligation to treat 68 MMcf/d of natural gas produced by Redwood LP and delivered to the treatment plant. After consultation with legal counsel, we believe that our contract with MGP is fully enforceable.

On August 9, 2006, the Texas Railroad Commission issued an order requiring MGP to ratably process, take, transport or purchase natural gas produced by Crimson into the Madisonville gas treatment plant. The gas treatment plant is currently operating at capacity. There is no guarantee that we will be able to maintain full access to treatment capacity of up to 68 MMcf/d at the Madisonville Plant at all times because, for example, Crimson now has the right to have its natural gas treated at the plant, which may reduce the plant's ability to treat all of our natural gas, unless the plant's capacity is further expanded.

To date, Crimson has permitted four wells to be drilled to the Rodessa Formation. The drilling of two of these wells has been completed to a depth of approximately 12,635 feet. Crimson has also drilled an injection well for disposal of waste products resulting from the treatment of their natural gas. Crimson is presently delivering gas to the treatment plant.

We have committed to a three-well drilling program to facilitate the expansion of the gas treatment plant. We have drilled two of the three required wells to the Rodessa formation. The commitment requires us to drill the third well sufficient to test the Smackover Formation (estimated to be encountered at approximately 18,000 feet) on or before September 30, 2008. We estimate the 18,000 foot well will cost \$12 million to drill and complete. We have granted MGP a security interest in the Madisonville Field properties to secure the three well commitment. The security interest shall be subordinated to any third party lender in the event we secure future debt against the property. MGP granted us a similar security interest in the gas treatment plant to secure its obligation to expand the treatment plant on a timely basis.

*Other Interests in the Madisonville Project*



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Our working interest in the Madisonville Project is subject to a net profits interest in favor of the third party that sold us our working interests in the Madisonville Project. The net profits interest is 12.5% (proportionately reduced to our interest) of the net operating profits until payout is achieved. After payout, the net profits interest increases to 30% (proportionately reduced to our interest). Payout, for purposes of the net profits interest, is defined and achieved at such time as we have recouped from net operating cash flows our total net investment in the Madisonville Project plus a 33% cash on cash return.

### *South Dry Hollow Project, Lavaca County, South Texas*

We own a 15% non-operated working interest in approximately 2,000 gross and 300 net acres of leases in Lavaca County, South Texas. A test well, the Willstar Eichhorn No. 1 well (the Willstar well), has commenced drilling and is expected to be drilled to a total depth of 17,000 feet. The primary objective of this well is to test the Rochelle sands in the Lower Wilcox formation. Secondary objectives include the 10,500, Peck, Dagg, Lampley and Massive sandstone formations in the Wilcox formation. The Willstar well is a vertical well located approximately 800 feet south of the Eichhorn Gas Unit No. 1 well drilled by Newfield Exploration Company (the Newfield well) in 2002. The Newfield well was completed in 2002 in the Lampley member of the Wilcox formation at an initial rate of 3.8 MMcfd and has produced approximately 0.9 Bcf of natural gas. The Newstar well also encountered natural gas shows in the Rochelle, 10,500, Peck, Dagg, and Massive members of the Wilcox formation which were not tested.

### *Alaska*



*The Cook Inlet Alaska CBM Project*



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We entered into an agreement with Pioneer Oil Company, Inc. ( **Pioneer** ) dated April 20, 2005, wherein we secured the Cook Inlet Option to acquire a 100% working interest, 81% net revenue interest, in approximately 116,806 acres onshore



in Cook Inlet, Alaska. We have since acquired 5,368 additional acres. We believe this acreage to be prospective for both coal bed methane and conventional gas production.

The 122,174 acre lease position consists of two separate target areas that have been selected for exploration. These areas are called the Point MacKenzie and Trading Bay Prospects, respectively.

The Point MacKenzie Prospect is located twelve miles northwest of Anchorage. The Trading Bay Prospect is located 50 miles west of Anchorage across the Cook Inlet. The Cook Inlet basin contains a thick section of terrestrial Tertiary rocks which includes shales, sandstones, and coals. The coals occur in seams which are commonly 20 feet thick and can be as thick as 70 feet. Accessible onshore areas have 200 to 300 feet of coal shallower than 5,000 feet. Gas content for these coals ranges from 80 to 250 standard cubic feet per ton, but testing is restricted to a very small number of bore holes and is almost completely unknown for most of the inlet.

Markets for natural gas in the Cook Inlet area include power generation, heating, fertilizer production and liquefied natural gas exports. An extensive pipeline system supplies these facilities and crosses the Point MacKenzie Prospect and Trading Bay Prospect lease blocks. These pipelines are only partially filled with gas and could accommodate additional production.

In addition to coal bed methane reserve potential, preliminary log analysis indicates the Point MacKenzie Prospect and Trading Bay Prospect lease blocks may also contain conventional accumulations of natural gas reserves in Tertiary sandstones.

The terms of the Cook Inlet Option provide for us to pay total consideration of \$20 per acre, or approximately \$2.3 million, for the leases. The Cook Inlet Option provides that we will pay the total lease consideration in two installments. We paid the first installment totaling \$1,068,063 on August 17, 2005 and we have received assignment of the 100% working interest in the leases. Within three years from the date of receipt of assignment of the 100% working interest in the leases, we have the option to conduct a \$2.5 million work program on the leases over a three-year period, and, after completion of the work program and an evaluation of the results, to remit the final additional acreage consideration of \$10 per acre for the leases. The Cook Inlet Option provides that if we fail to pay the lease consideration when due, fail to perform the work program or otherwise default under the Cook Inlet Option, we shall forfeit our interest and reassign the leases to Pioneer, and we will have no further liability to Pioneer.

Approximately one to two miles of pipeline will be required to tie in any wells drilled at a currently preferred location at the Point MacKenzie Prospect, and approximately four to five miles of the pipeline will be required to tie in any wells drilled at a currently preferred location at the Trading Bay Prospect. We have not yet prepared an estimate of the cost to tie these wells in.

We are aware of two major pipelines which transverse the acreage blocks, the Enstar 20 line and the UnoCal-Marathon 16 line. We estimate the UnoCal-Marathon 16 line presently has available unused capacity of approximately 40 MMcf/d. In addition, we estimate the Enstar 20 line has available unused capacity of approximately 100 MMcf/d.

*California*



*Lokern Project*



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We have a working interest in the Lokern Project, located in the southern San Joaquin basin, near Bakersfield, California. The primary exploration objective is the Miocene Stevens formation. The secondary objectives include the Miocene Reef Ridge and Pliocene Etchegoin sands. The Stevens formation is Upper Miocene age.

The Lokern Project is being developed in part as a result of positive results from the Machii-Ross Ackerman show well drilled in 1979 on acreage currently controlled by us. Based on log analysis, we believe that well had approximately 240 feet of potential net oil pay and an additional 150 feet of potential pay in the Stevens zone. The Machii-Ross Ackerman well was drilled to a depth of 15,078 feet by Machii-Ross Petroleum Company and was plugged and abandoned as a dry hole. We believe, based on our log analysis, that the well may have been a bypassed producer.

We expect that a well will be drilled, either by us or through a farmout arrangement with a third party, to a depth of 15,000 feet in 2009.

Based on our review of title information from public authorities and other publicly available sources, we believe that we have a 100% working interest in the Lokern Project. As is customary in the U.S. oil and gas industry, we will not conduct a thorough title review with respect to our interest in the Lokern Project until we have made a definitive decision to drill in a particular lease area.

*Alberta*



*Swan Hills Project*





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The Swan Hills Project is located in the Central Alberta Basin, Alberta, Canada. The primary exploration objective is the Swan Hills Formation at approximately 9,000 feet. Secondary objectives will include the shallower Gilwood, Nordegg and Falher formations.

We, through our wholly-owned subsidiary, GeoPetro Canada, have reviewed 3-D seismic data over the prospect and plan to participate in the drilling of a test well. We have a 33% working interest in approximately 4,480 leased acres.

### *Indonesia*



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C-G Bengara owns 100% of the underlying rights to explore for and produce oil and natural gas within the contract area designated as the Bengara II Block, which rights have been granted under a production sharing contract dated December 4, 1997 (the **Bengara II PSC**) with Pertamina. Previously we owned 40% of CG Bengara and Continental Energy Corporation ( **Continental** ) owned the remaining 60% and, through it, the rights to the Bengara II PSC. On September 29, 2006, we executed a definitive agreement to sell 70% of our interest in C-G Bengara to CNPCHK (Indonesia) Limited ( **CNPC** ). We have retained a 12% stake in C-G Bengara and the Bengara II PSC. Continental has likewise sold its interest and retained an 18% interest in C-G Bengara and the Bengara II PSC.

The Bengara Block is located in the Tarakan Basin, mostly onshore but partially offshore astride the Bulungan River Delta in the Indonesian province of East Kalimantan. It originally covered a single contiguous area of approximately 1.2 million gross acres, of which 300,000 gross acres were relinquished in 2001 and an additional 300,000 gross acres were relinquished in 2007 by C-G Bengara in accordance with the terms of the Bengara II PSC. C-G Bengara has tendered an additional relinquishment such that the remaining acreage within the Bengara II PSC total approximately 240,000 acres, or 970 square kilometers. The remaining 240,000 acres is considered by C-G Bengara to be the most prospective portion of the original 1.2 million acre block and is pending approval from BP Migas.

*The Makapan Gas Field*



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Since 1938, only two wells have been drilled in the Bengara Block prior to 2007, one of which resulted in the discovery of the Makapan Gas Field. The Muara Makapan No. 1 well was drilled in 1988 by P.T. Deminex Indonesia from a swamp barge positioned on one of the Bulungan River Delta mouth channel distributaries. The well was drilled to a total depth of 10,800 feet and tested 19.5 million cubic feet of gas per day together with 600 bbls of 54 degree API condensate per day from a 33 feet thick sandstone section near 6,000 feet. The well was plugged and abandoned as a natural gas discovery. Several other gas zones indicated on logs were not tested. The well was not produced nor were any confirmation wells drilled due to the lack of a local natural gas market at the time the well was drilled. The Makapan Gas Field gas is a Wet gas with a high LPG fraction which may be commercial to extract at the wellhead for a third revenue source in addition to the gas and condensate. The Makapan Gas Field lies mostly offshore in very shallow water, less than 10 feet, amidst numerous islands of the Bulungan River Delta.

*Exploration in the Bengara Block*



We believe that the key to successful prospecting in the Bengara Block will be the identification of traps and understanding sand distribution.



Nearly 2,200 line kilometers of 2-D seismic data available within the Bengara Block appear to be adequate for both detailed and reconnaissance interpretation purposes. Some localized areas may benefit from reprocessing. New seismic data is required in places where insufficient data exists and for prospect confirmation in other locations.

Several separate and unique geologic plays within the Bengara Block as well as a number of prospects and leads have been identified. Some well-defined prospects present immediate drilling targets. Exploration within the Bengara Block is in its formative stages and it is premature to make meaningful resource or reserve estimates. However, the existing exploration work to date indicates that there may be potential petroleum accumulations in the Bengara Block. Analysis of source rocks indicates a propensity for both oil and natural gas.

*Terms of Participation in the Bengara Block*

The Bengara II PSC is a standard terms PSC employed by BP Migas for all oil and natural gas concessions in Indonesia. Generally, the joint venture participants are entitled to receive, from production proceeds, 100% of expenditures in the block as cost recovery. Once these costs are recovered, C-G Bengara is entitled to a production share of approximately 26.7% of oil produced and 62.5% of all natural gas produced. We will be entitled to 12% of C-G Bengara's share of any such production. Sharing terms for certain categories of oil vary slightly as defined in the Bengara II PSC. The term of the contract is thirty years from December 1997 or a shorter period if C-G Bengara elects to terminate its obligations under the contract or if no commercial hydrocarbons are discovered within the contract area. At the end of six years, unless mutually extended by C-G Bengara and BP Migas, the contract expires if no commercially producible hydrocarbons have been discovered in the contract area. C-G Bengara and BP Migas have mutually extended the early termination provisions until December 3, 2008. C-G Bengara may terminate the contract at any time by relinquishing all of its rights and obligations under the contract area. C-G Bengara is required to relinquish 25% of the contract area within the first three years of the contract, a further 25% of the contract area within six years from the commencement of the contract and an additional area within the first ten years so that the area retained thereafter shall not be in excess of 970 square kilometers, or 20% of the original total contract area, whichever is less. C-G Bengara may designate which areas are to be relinquished subject to approval by BP Migas. C-G Bengara's obligation to relinquish parts of the original contract area under these provisions does not apply to the surface area of any field in which petroleum has been discovered. To date, 600,000 gross acres have been relinquished by C-G Bengara in accordance with the terms of the Bengara II PSC. In 2007, C-G Bengara tendered an additional relinquishment such that the remaining acreage within the Bengara II PSC shall total approximately 240,000 acres, or 970 square kilometers. The remaining 240,000 acres is considered by C-G Bengara to be the most prospective portion of the original 1.2 million acre block and is pending approval from BP Migas.

C-G Bengara is required to pay to BP Migas specified amounts based on achieving certain cumulative production quantities of crude oil from the contract area when and if commercial production is established. These production bonuses are as follows:

<b>Cumulative Production</b>	<b>Cash Bonus Due</b>
25,000,000 boe	\$ 500,000
60,000,000 boe	\$ 1,500,000
100,000,000 boe	\$ 2,500,000

In order to maintain the Bengara II PSC in effect, C-G Bengara is required to complete the following work programs and expenditures during the first ten years of the contract, unless the requirement is extended or waived by BP Migas:







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Contract Year	Work Program	Amount	Our 12% Share
1998	Geologic and geophysical studies	\$ 500,000	\$ 60,000
1999	Seismic reprocessing	500,000	60,000
2000	Drill two wells	6,000,000	720,000
2001	Geologic and geophysical studies	1,000,000	120,000
2002	Drill one well	5,000,000	600,000
2003	Acquire seismic	3,750,000	450,000
2004	Drill one well	5,250,000	630,000
2005	Evaluate well results	1,000,000	120,000
2006	Geologic and geophysical studies	1,000,000	120,000
2007	Geologic and geophysical studies	1,000,000	120,000
	<b>TOTAL</b>	<b>\$ 25,000,000</b>	<b>\$ 3,000,000</b>

C-G Bengara has fulfilled the minimum work and cash expenditure requirements described above. Upon establishing commercial production, if ever, C-G Bengara and BP Migas shall share ratably in the first 20% of oil and natural gas produced in the contract area within a given year according to the percentages specified below. After the first 20% of production, C-G Bengara is entitled to receive 100% of production until cost recovery has been achieved. Cost recovery generally includes 100% of the operating and drilling costs and depreciation of fixed assets applicable to oil and natural gas operations within the contract area. After C-G Bengara has received oil and natural gas production with a value sufficient to achieve cost recovery in a given year, C-G Bengara and BP Migas shall then share ratably in the production according to the percentages specified below:

Description	BP Migas	C-G Bengara	Our net share
Oil production	73.2143%	26.7857%	3.2143%
Gas production	37.5%	62.5%	7.5%

Upon the completion of five years after commercial production commences, C-G Bengara is further subject to a domestic market obligation. This obligation requires C-G Bengara to sell and deliver to BP Migas, to meet Indonesia's domestic crude oil needs, a specified quantity of crude oil at a price which is only 15% of the market price of the oil. However, for new fields, for a period of five years starting on the month of the first delivery of crude oil produced from a new field, the fee per barrel for such crude oil supplied to the Indonesian domestic market shall be the market price, with the condition that the excess over the 15% of market price shall preferably be used to assist financing of continued exploration efforts in the contract area.

Upon the first commercial discovery of oil or natural gas in the contract area, BP Migas has the right to demand that 10% of C-G Bengara's undivided interest in the total rights and obligations under the Bengara II PSC be offered to itself or an entity owned by Indonesian nationals. The 10% interest shall be offered at a dollar amount equal to 10% of C-G Bengara's cumulative costs incurred in the contract area.

*Current and Planned Activities in the Bengara Block*

In accordance with the terms of our agreement dated September 29, 2006 which sold 70% of our interest in C-G Bengara to CNPC, CNPC:

1. Purchased 14,000 and 21,000 shares of C-G Bengara from us and Continental, respectively, at a cost of \$1 per share. As a result of the transaction, we and Continental own 6,000 and 9,000 C-G Bengara shares, respectively, retaining a 12% and 18% interest in C-G Bengara, respectively.

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2. Paid the sum of \$18.7 million (the **Earning Obligation** ) into a special joint venture account at a Hong Kong international bank. The funds are under joint signature control of CNPC, ourselves and Continental, and are being expended exclusively to pay for 2006 and 2007 exploration and/or appraisal drilling in the Bengara II PSC area.

3. Agreed to provide development loans to pay 100%, and thereby carry our share and Continental's share of all C-G Bengara's exploitation, drilling, and development expenditures attributable to the Bengara II PSC, after the Earning Obligation funds are expended and a Plan of Development has been approved by BP Migas, until an additional amount of U.S. \$41.3 million over and above the Earning Obligation funds has been expended.

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4. Agreed to pay a cash bonus totaling \$5,000,000, in the proportions of \$2,000,000 to us and \$3,000,000 to Continental, respectively, contingent upon and within fourteen business days of the receipt by C-G Bengara of the written approval from governmental authorities approving the development of the first commercial oil or gas discovery within the Bengara II PSC contract area.

During 2007, C-G Bengara drilled a total of four wells on the Bengara II PSC. The results are as follows:

A. The Seberaba-1 was originally planned to reach a total depth of 4,000 meters (13,120 feet). Drilling of the Seberaba-1 terminated at a depth of 2,914 meters (9,558 feet) in the third of three sidetracks made from the original wellbore. Testing activity of the Seberaba-1 has been suspended. Approximately 150 barrels of crude oil has been recovered by swabbing. Flow test and pressure build up tests to date have proved inconclusive due to apparent formation damage. Any future re-entry is expected to be conducted with a different drilling mud and testing fluid program to avoid damage to the target reservoir intervals.

B. Drilling of the Seberaba-3 has been completed to a total depth of 2,594 meters (8,508 feet). An open hole drill stem test successfully flowed oil and minor gas at surface from one zone. The open hole test confirms lateral continuity of the Seberaba reservoir with at least one of the three zones from which oil was recovered during testing of the Seberaba-1 discovery well. The Seberaba-3 has been logged and casing has been set.

C. Drilling activity on the Seberaba-4 has been terminated. Seberaba-4 failed to encounter an expected reservoir sand anticipated at 2,450 meters (8,036 feet) probably because the wellbore penetrated a normal fault and the expected reservoir interval was faulted out. The Seberaba-4 wellbore has been suspended and preserved for possible re-entry.

D. Drilling of the Punga-1 has been completed at a total depth of 2,500 meters (8,200 feet). The well has been logged and casing has been set. A testing program may be conducted in the future by CG-B2 to evaluate zones with oil and gas shows.

The technical information provided by drilling and testing results to date confirm the presence of an oil accumulation. However the data is not yet adequate to conclusively demonstrate the extent of the oil accumulation or that it has sufficient size of oil reserves to economically justify a full commercial development. Further technical information is required prior to commencing development. C-G Bengara has prepared a preliminary plan of development for the Seberaba discovery based upon drilling and testing results from the Seberaba-1 and 3 wells. Further testing of the Punga-1 well and Seberaba-3 well is expected to be conducted in 2008. In addition to these well test results, C-G Bengara feels additional technical information is needed prior to finalizing the formal plan of development and submitting it for approval to Indonesian oil and gas authorities. Approval of the formal plan of development will automatically invoke the final 20-year production period of the Bengara-II PSC through December 3, 2027. C-G Bengara has submitted the preliminary plan to the Indonesian authorities together with a request for additional time of three years to implement the plan and thereby obtain the additional data needed to further appraise and prove up the Seberaba discovery prior to completing and submitting the formal plan of development. Approval is expected but not assured.

*CG Xploration*





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In November 2005, we and Continental formed CG Xploration to pursue new venture oil and gas exploration and production projects and obtain new exploration concessions in Indonesia. CG Xploration Inc. is incorporated in Delaware and is owned 50% by us and 50% by Continental. CG Xploration Inc. will actively pursue and may acquire new venture opportunities on behalf of ourselves and Continental. To date, CG Xploration has made no acquisitions.

### **Natural Gas Reserves**



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Our estimated total net proved reserves of natural gas and oil as of December 31, 2007, 2006 and 2005, and the present values of estimated future net revenues attributable to those reserves as of those dates, are presented in the following tables.

**Proved developed oil and gas reserves** means reserves that can be expected to be recovered through existing wells with existing equipment and operating methods. Additional oil and gas expected to be obtained through the application of fluid injection or other improved recovery techniques for supplementing the natural forces and mechanisms of primary recovery should be included as proved developed reserves only after testing by a pilot project or after the operation of an installed program has confirmed through production response that increased recovery will be achieved.

**Proved developed nonproducing reserves** means reserves expected to be recovered from zones behind casing in existing wells.

**Proved oil and gas reserves** means estimated quantities of crude oil, natural gas, and natural gas liquids which geological and engineering data demonstrate with reasonable certainty to be recoverable in future years from known reservoirs under existing economic and operating conditions, i.e., prices and costs as of the date the estimate is made. Prices include consideration of changes in existing prices provided only by contractual arrangements, but not on escalations based upon future conditions.

(i) Reservoirs are considered proved if economic producibility is supported by either actual production or conclusive formation test. The area of a reservoir considered proved includes (A) that portion delineated by drilling and defined by gas-oil and/or oil-water contacts, if any; and (B) the immediately adjoining portions not yet drilled, but which can be reasonably judged as economically productive on the basis of available geological and engineering data. In the absence of information on fluid contacts, the lowest known structural occurrence of hydrocarbons controls the lower proved limit of the reservoir.

(ii) Reserves which can be produced economically through application of improved recovery techniques (such as fluid injection) are included in the proved classification when successful testing by a pilot project, or the operation of an installed program in the reservoir, provides support for the engineering analysis on which the project or program was based.

(iii) Estimates of proved reserves do not include the following:

(A) oil that may become available from known reservoirs but is classified separately as indicated additional reserves ;

(B) crude oil, natural gas, and natural gas liquids, the recovery of which is subject to reasonable doubt because of uncertainty as to geology, reservoir characteristics, or economic factors;

(C) crude oil, natural gas, and natural gas liquids, that may occur in undrilled prospects; and

(D) crude oil, natural gas, and natural gas liquids, that may be recovered from oil shales, coal, gilsonite and other such sources.

**Proved undeveloped reserves** means reserves that are expected to be recovered from new wells on undrilled acreage, or from existing wells where a relatively major expenditure is required for recompletion. Reserves on undrilled acreage shall be limited to those drilling units offsetting productive units that are reasonably certain of production when drilled. Proved reserves for other undrilled units can be claimed only where it can be demonstrated with certainty that there is continuity of production from the existing productive formation. Under no circumstances should estimate for proved undeveloped reserves be attributable to any acreage for which an application of fluid injection or other improved recovery technique is contemplated, unless such techniques have been proved effective by actual tests in the area and in the same reservoir.

The 2007 and 2006 estimates were prepared by MHA Petroleum Consultants, independent reservoir engineers, and are part of their reserve reports on our natural gas and oil properties. The 2005 estimates were prepared by Sproule Associates Inc., independent reservoir engineers, and are part of their reserve reports on our natural gas and oil properties. MHA Petroleum Consultants and Sproule Associates Inc.'s estimates were based on a review of geologic, economic, ownership and engineering data that we provided. In estimating the reserve quantities that are economically recoverable, MHA Petroleum Consultants and Sproule Associates Inc. used end-of-period natural gas and oil prices. In accordance with U.S. Securities and Exchange Commission regulations, no price or cost escalation or reduction was considered. All of our proved reserves are attributable to our Madisonville Project in Madison County, Texas.

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	AS OF DECEMBER 31,		
	2007 (MMcf)	2006 (MMcf)	2005 (MMcf)
Proved developed	10,495	12,335	4,645
Proved developed non-producing	12,644	12,365	8,903
Proved undeveloped			7,881
<b>Total</b>	<b>23,139</b>	<b>24,600</b>	<b>21,428</b>

In accordance with Securities and Exchange Commission regulations, estimates of our proved reserves and future net revenues are made using sales prices estimated to be in effect as of the date of such reserve estimates and are held constant throughout the life of the properties, except to the extent a contract specifically provides for escalation. Estimated quantities of proved reserves and future net revenues therefrom are affected by natural gas and oil prices, which have fluctuated significantly in recent years. We filed reports with the U.S. Department of Energy in June 2007 and the Alberta Securities Commission in March 2007 that included total proved reserves inclusive of royalties and net profits interests as of December 31, 2006 totaling 43,517 MMcf. The total net proved reserves, excluding royalties and net profits interests, as of December 31, 2006 was 24,600 MMcf. The difference between the two numbers represents proved reserves attributable to royalties and net profits interests.

*Standardized Measure of Discounted Future Net Cash Flows*



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For purposes of the following disclosures, estimates were made of quantities of proved reserves and the periods during which they are expected to be produced. Future cash flows were computed by applying year-end prices to estimated annual future production from proved gas reserves. The average year-end prices for gas were as indicated below. Future development drilling and production costs were computed by applying year-end costs to be incurred in producing and further developing the proved reserves. Future income tax expenses were computed by applying, generally, year-end statutory tax rates (adjusted for permanent differences, tax credits and allowances) to the estimated net future pre-tax cash flows. The discount was computed by application of a 10% discount factor. The calculations assume the continuation of existing economic, operating and contractual conditions. However, such arbitrary assumptions have not proven to be the case in the past. Other assumptions of equal validity could give rise to substantially different results.

	<b>YEAR ENDED DECEMBER 31,</b>			
	<b>2007</b>	<b>2006</b>		<b>2005</b>
	<b>(in thousands)</b>			
Future cash inflows	\$ 135,264	\$	101,867	\$ 162,459
Future production costs	(45,649)		(37,783)	(60,176)
Future development costs	(1,075)		(1,075)	(6,560)
Future income taxes	(13,762)		(8,128)	(18,941)
Future net cash flows	74,778		54,882	76,782
10% annual discount	(14,570)		(8,341)	(13,293)
Standardized measure of discounted future net cash flows	\$ 60,208	\$	46,541	\$ 63,489



*Pricing Assumptions*



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SEC regulations require that the gas and oil prices used in the MHA Petroleum Consultants and Sproule Associates Inc. reserve reports included herewith are the period-end prices for natural gas at December 31, 2007, 2006 and 2005, respectively. These prices are projected without inflation for the life of the wells included in the reserve reports. The pricing assumptions are listed below:

<b>2007 REPORT</b> Gas (\$/MMBtu)	<b>YEAR-END PRICE</b> <b>2006 REPORT</b> Gas (\$/MMBtu)	<b>2005 REPORT</b> Gas (\$/MMBtu)
\$6.81	\$5.40	\$7.80

**Drilling Activities**



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The following indicates the number of natural gas and oil wells drilled during the periods indicated.

	Productive		Dry		Total Wells	
	Gross	Net	Gross	Net	Gross	Net
Year ended December 31, 2007						
Exploratory	0	0	2	1	2	1
Development	0	0	0	0	0	0
Year ended December 31, 2006						
Exploratory	0	0	0	0	0	0
Development	2	2	0	0	2	2
Year ended December 31, 2005						
Exploratory	0	0	0	0	0	0
Development	0	0	0	0	0	0

**Acreage and Productive Wells**



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The following table sets forth our ownership interest in undeveloped acreage, developed acreage and productive wells in the areas indicated where we own a working interest as of December 31, 2007. Gross represents the total number of acres or wells in which we own a working interest. Net represents our proportionate working interest resulting from our ownership in gross acres or wells. Productive wells are wells in which we have a working interest and that are capable of producing natural gas or oil. Wells that are completed in more than one producing horizon are counted as one well.

	Undeveloped Acreage		Developed Acreage		Producing Wells		Non-Producing Wells	
	Gross	Net	Gross	Net	Gross	Net	Gross	Net
Indonesia	239,692	28,763						
Canada	4,480	1,493						
Texas	2,664	2,664	2,027	2,027	2	2.00	4	3.02
California	1,280	1,280						
Alaska	122,174	122,174						
<b>Total</b>	<b>370,290</b>	<b>156,374</b>	<b>2,027</b>	<b>2,027</b>	<b>2</b>	<b>2.00</b>	<b>4</b>	<b>3.02</b>

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The following table sets forth as of December 31, 2007, the expiration periods of the gross and net undeveloped acreage:

	United States		Undeveloped Acreage Indonesia		Canada	
	Gross	Net	Gross	Net	Gross	Net
Twelve months ended						
December 31, 2008	122,729	122,729	239,692	28,763		
December 31, 2009	1,585	1,585				
December 31, 2010	1,351	1,351				
December 31, 2011						
December 31, 2012 and thereafter	453	453			4,480	1,493
	126,118	126,118	239,692	28,763	4,480	1,493

**Volumes, Prices and Production Costs**





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Substantially all of our production is derived from our Madisonville Project in Madison County, Texas. The following table sets forth information with respect to our production volumes, average prices received and average production costs for the periods indicated:

	YEAR ENDED DECEMBER 31,		
	2007	2006	2005
<b>Production:</b>			
Natural gas (MMcf)	2,005	2,229	1,991
Natural gas (MMcfd)	5.49	6.81	5.46
<b>Average Sales Prices (1)</b>			
Natural gas (\$per Mcf)	\$ 3.44	\$ 3.01	\$ 4.01
<b>Lease Operating Expense</b>			
(\$per Mcf)	\$ 0.78	\$ 0.72	\$ 0.44

- (1) Represents sales price realized net of treatment costs.

**Business Risks and Other Special Considerations**



Refer to Risk Factors in this report for a discussion of business risks and other special considerations.

**Item 3. Legal Proceedings**

From time to time, we are party to litigation or other legal and administrative proceedings that we consider to be a part of the ordinary course of our business. Currently, we are not involved in any legal proceedings nor are we party to any pending or threatened claims that could, individually or in the aggregate, reasonably be expected to have a material adverse effect on our financial condition, cash flow or results of operations.

**Item 4. Submission of Matters to a Vote of Security Holders**

Not applicable.

**PART II****Item 5. Market for the Registrant's Common Equity, Related Shareholder Matters and Issuer Purchases of Equity Securities**

Our common stock trades on the American Stock Exchange under the symbol GPR. Our common stock is also listed on the Toronto Stock Exchange under the symbol GEP.s. On March 28, 2008, the last reported sale prices for our common stock on the American Stock Exchange and Toronto Stock Exchange were \$2.65 and \$2.60, respectively. The following table sets forth the high and low sale prices of our common shares as reported on the American Stock Exchange and the Toronto Stock Exchange and bid prices as quoted in the United States in the pink sheets over-the-counter market for the periods presented. Prior to the first quarter of 2006, there was no trading market for our common shares.

	American Stock Exchange (1)		Toronto Stock Exchange (2)		U.S. Pink Sheets	
	High	Low	High	Low	High	Low
<b>2008</b>						
First Quarter through March , 2008	\$ 3.58	\$ 2.00	\$ 3.00	\$ 2.25	N/A	N/A
<b>2007</b>					N/A	N/A
Fourth Quarter	\$ 4.20	\$ 2.79	\$ 4.00	\$ 2.50	N/A	N/A
Third Quarter	\$ 4.05	\$ 3.55	\$ 3.35	\$ 2.50	N/A	N/A
Second Quarter	\$ 4.75	\$ 3.50	\$ 2.95	\$ 2.30	N/A	N/A
First Quarter	\$ 6.25	\$ 2.66	\$ 3.39	\$ 2.61	\$ 4.10	\$ 2.66
<b>2006</b>						
Fourth Quarter	N/A	N/A	\$ 3.05	\$ 2.35	\$ 3.25	\$ 2.25
Third Quarter	N/A	N/A	\$ 3.40	\$ 2.76	\$ 3.50	\$ 2.25
Second Quarter	N/A	N/A	\$ 3.98	\$ 3.15	\$ 9.00	\$ 3.68
First Quarter	N/A	N/A	\$ 3.50	\$ 3.50	\$ 10.05	\$ 3.50

- (1) Our common stock commenced trading on the American Stock Exchange on February 15, 2007.
  
- (2) Our common stock is quoted in U.S. dollars on the Toronto Stock Exchange. Our common stock commenced trading on the Toronto Stock Exchange on March 30, 2006.

As of March 28, 2008, there were 369 holders of record of our common shares.

Over-the-counter market quotations reflect inter-dealer prices, without retail mark-up, mark-down or commission, and may not necessarily represent actual transactions.

### **Dividends**

On March 28, 2007, all outstanding shares of Series AA 8% Convertible Preferred Stock converted to common shares. Dividends on Series AA preferred stock are no longer payable. The holders of Series AA preferred stock were entitled to receive ratably such cash dividends, as were declared from time to time by the board of directors out of funds legally available therefore and, when declared, dividends were paid at the rate of \$0.28 per share per annum, paid on a calendar quarter basis. Prior to the conversion, we had declared and paid dividends on a quarterly basis with respect to all outstanding shares of Series AA preferred stock at the rate of \$0.28 per share per year from the time the Series AA stock was issued.

The holders of our common stock shall be entitled to receive ratably such lawful dividends as may be declared by the Board of Directors. We have never paid any dividends, whether cash or property, on our common stock. For the foreseeable future it is anticipated that any earnings which may be generated from our operations will be used to finance our growth and that dividends will not be paid to common stockholders.

### Use of Proceeds

On our registration statement on Form S-1 (Reg. No. 333-135485) we registered up to 16,499,991 shares of our common stock, no par value per share, including 5,943,105 shares of common stock issuable upon exercise of warrants and options, for resale by selling shareholders. The registration statement was declared effective by the Securities and Exchange Commission in February 2007. The offering commenced on in February 2007 and has not terminated. On our registration statement on Form S-1 (Reg. No. 333-146557) we registered up to 2,002,599 shares of outstanding common stock and the resale of up to 780,857 shares of common stock issuable upon exercise of warrants, for resale by selling shareholders. The registration statement was declared effective by the Securities and Exchange Commission in October 2007. The offering commenced in October 2007 and has not terminated. We will not receive any proceeds from the sale of our common stock by the selling shareholders under the registration statements; however if all warrants and options to acquire our common stock being registered thereunder are exercised, we will realize cash proceeds of approximately \$13,787,973, which we expect to use for general working capital purposes and the drilling of wells in our Texas, Alaska, California and Indonesian prospects.

If less than the \$13,787,973 proceeds are realized from the exercise of such warrants and options, the proceeds will be spent in the following order of priority:

1. Alaska Cook Inlet Project, up to approximately \$3.0 million will be expended for the drilling of pilot program wells.
2. Madisonville Project, Madison County, Texas. Up to approximately \$12 million will be expended in the Madisonville Field area towards the drilling and completion of one deep exploratory well location to an estimated depth of 18,000 feet.
3. General working capital.

We do not know if, or how many, of the warrants or options will be exercised. This is our best estimate of our use of proceeds generated from the possible exercise of warrants or options based on the current state of our business operations, our current plans and current economic and industry conditions. Any changes in the projected use of proceeds will be made at the sole discretion of our board of directors.

### Unregistered Sales of Securities

On November 1, 2007, we issued 50,000 shares of common stock to an officer and director, an accredited investor, pursuant to an exercise of stock options at \$2.00 per share for proceeds of \$100,000. On November 29, 2007 we issued 50,000 shares of common stock to a former officer and director, pursuant to an exercise of stock options at \$2.00 per share for proceeds of \$100,000. These shares were issued pursuant to Rule 701 promulgated under the Securities Act, in that they were offered and sold pursuant to a written contract relating to compensation, as provided by Rule 701.

On November 9, 2007, we issued 18,000 shares of common stock pursuant to an exercise of stock warrants at \$3.50 per share for proceeds of \$63,000. These shares were issued to one investor. The private placement was exempt from the registration requirements of the Securities Act



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pursuant to Section 4(2) of the Securities Act and Rule 506 of Regulation D. The investor in the private placement was either an accredited investor, as defined in Rule 501(a), or one we reasonably believed to be. The purchase agreement signed by the investor contained customary and appropriate representations and warranties regarding the investor's status as an accredited investor, and that the investor was acquiring the securities for his or her own account and not with a view to resale or distribution. It also contained questions further attesting to his or her status as an accredited investor. In addition, we did not accomplish the offer or sale of the securities sold in the private placement through any manner of general solicitation or general advertising. Moreover, it was disclosed to the investor prior to sale that, except as otherwise may be provided in any registration rights granted to him or her, the securities purchased would not be registered under the Securities Act and could therefore not be resold unless first registered under the Securities Act or an exemption from registration was available. We placed a legend on each certificate representing the securities sold stating that the securities have not been registered under the Securities Act and further setting forth customary and appropriate restrictions on the transferability of the securities. Finally, we made available to the investor, prior to purchase, the opportunity to ask questions and receive answers concerning the terms and conditions of the private placement.

During December 2007, we issued 121,662 shares of common stock to one individual who is both an officer and a director, two individuals who are directors, and one individual who is an employee, all pursuant to a net exercise of stock options. All of the options were exercisable at \$2.00 per share. A net exercise is the security holder's election to receive that

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number of shares of our common stock that is equal to the quotient of: i) the fair market value of such shares, less the exercise price then in effect, multiplied by the number of shares that the security holder would otherwise have been entitled to purchase; over ii) the fair market value of the common stock. In the case of those individuals who were employees at the time of exercise, the number of common shares issued to these individuals is further reduced by the quotient of: the employee's shares of payroll taxes attributable to the option exercise over the fair market value of the common stock. The common shares issued pursuant to the net exercise were as follows:

# Shares Issued	Exercise Price	Date of Exercise
78,767	2.00	12/19/2007
9,870	2.00	12/12/2007
17,272	2.00	12/21/2007
15,753	2.00	12/26/2007
121,662		

These shares were issued pursuant to Rule 701 promulgated under the Securities Act, in that they were offered and sold pursuant to a written contract relating to compensation, as provided by Rule 701.

In December 2007, we issued 128,301 shares of common stock to an individual who is both an officer and director pursuant to a net exercise of stock options at \$2.00 per share. Because the individual was an employee at the time of exercise, the number of common shares issued to this individual was further reduced by the quotient of: the employee's share of payroll taxes attributable to the option exercise over the fair market value of the common stock. The private placement was exempt from the registration requirements of the Securities Act pursuant to Section 4(2) of the Securities Act and Rule 506 of Regulation D. The investor in the private placement was an accredited investor, as defined in Rule 501(a). The option exercise agreement signed by the investor contained customary and appropriate representations and warranties regarding the investor's status as an accredited investor, and that the investor was acquiring the securities for his or her own account and not with a view to resale or distribution. It also contained questions further attesting to his or her status as an accredited investor. In addition, we did not accomplish the offer or sale of the securities sold in the private placement through any manner of general solicitation or general advertising. Moreover, it was disclosed to the investor prior to sale that, except as otherwise may be provided in any registration rights granted to him or her, the securities purchased would not be registered under the Securities Act and could therefore not be resold unless first registered under the Securities Act or an exemption from registration was available. We placed a legend on each certificate representing the securities sold stating that the securities have not been registered under the Securities Act and further setting forth customary and appropriate restrictions on the transferability of the securities. Finally, we made available to the investor, prior to purchase, the opportunity to ask questions and receive answers concerning the terms and conditions of the private placement.

### Performance Graph

The following graph shows a comparison from February 15, 2007 (the date our common stock began trading on the American Stock Exchange) through December 31, 2007 of cumulative stockholders total return for our common stock, companies we deem to be in our industry peer group and the Russell Microcap Index (IWC). The comparable companies are Kodiak Oil and Gas Corporation (KOG), Petro Resources Corporation (PRC), and American Oil & Gas Incorporated (AEZ).

**All of these cumulative returns are computed assuming the value of the investment in GeoPetro common stock and each stock as \$100.00 on February 15, 2007, and the reinvestment of dividends at the frequency with which dividends were paid during the applicable months. The months compared are February through December of 2007. Since our common stock began trading on the American Stock Exchange, we have not declared any dividends to be paid to our common stockholders and do not have any present plans to declare dividends.**

**COMPARISON OF CUMULATIVE RETURN AMONG GEOPETRO RESOURCES COMPANY,  
RUSSELL MICROCAP INDEX ( IWC ) AND SELECTED PEER GROUP ISSUERS**

**Item 6. *Selected Consolidated Financial Data***

The following selected consolidated financial data should be read in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations and our consolidated financial statements and the related notes to those statements included elsewhere in this report. The consolidated statements of operations data for the years ended December 31, 2005, 2006 and 2007 and the balance sheet data as of December 31, 2006 and 2007 are derived from our audited consolidated financial statements included elsewhere in this report. The consolidated statements of operations data for the years ended December 31, 2003 and 2004 and the balance sheet data as of December 31, 2003, 2004 and 2005 are derived from our audited consolidated financial statements not included in this report. Historical results are not necessarily indicative of the results to be expected in the future, and the results for the years presented should not be considered indicative of our future results of operations.

	For The Years Ended December 31,				
	2007	2006	2005	2004	2003
<b>Consolidated Statement of Operations:</b>					
<b>Revenues</b>	\$ 6,890,777	\$ 6,716,360	\$ 7,975,990	\$ 5,825,072	\$ 2,452,648
<b>Lease operating expense</b>	1,558,900	1,602,932	878,176	780,237	582,889
<b>General and administrative</b>	2,807,091	2,347,447	1,551,747	1,963,649	1,259,269
<b>Net profits expense</b>	679,337	632,708	856,837	579,590	225,869
<b>Impairment expense</b>	1,111,151	38,849		2,038,422	473,496
<b>Depreciation and depletion expense</b>	2,269,995	2,406,612	1,832,693	2,077,004	798,555
<b>Earnings (loss) from operations</b>	(1,535,697)	(312,188)	2,856,537	(1,613,830)	(887,430)
<b>Net income (loss)</b>	(1,616,804)	(482,406)			