

**PART I. FINANCIAL INFORMATION**

**ITEM 1. Financial Statements.**

**GEOPETRO RESOURCES COMPANY  
INDEX TO FINANCIAL STATEMENTS**

[Consolidated Balance Sheets as of September 30, 2007 \(unaudited\) and December 31, 2006](#)

[Consolidated Statements of Operations for the three and nine months ended September 30, 2007 and September 30, 2006 \(unaudited\)](#)

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**GEOPETRO RESOURCES COMPANY**

**CONSOLIDATED BALANCE SHEETS**

	September 30, 2007 (Unaudited)	December 31, 2006
<b><u>ASSETS</u></b>		
<b>Current Assets:</b>		
Cash and cash equivalents	\$ 8,487,644	\$ 734,561
Accounts receivable — oil and gas sales	815,078	394,337
Accounts receivable — other	70,400	115,770
Related party notes receivable	—	1,000,000
Prepaid expenses	184,814	121,413
Total current assets	9,557,936	2,366,081
<b>Oil and Gas Properties, at cost (full cost method):</b>		
Unevaluated properties	5,060,316	4,503,481
Evaluated properties	45,822,411	43,701,510
Less—accumulated depletion and impairments	(13,777,047)	(11,557,257)
Net oil and gas properties	37,105,680	36,647,734
<b>Furniture, Fixtures and Equipment, at cost, net of depreciation</b>	32,038	41,547
<b>Other Assets</b>	6,869	6,116
<b>Total Assets</b>	\$ 46,702,523	\$ 39,061,478
<b><u>LIABILITIES AND SHAREHOLDERS' EQUITY</u></b>		
<b>Current Liabilities:</b>		
Trade payables	\$ 318,542	\$ 654,427
Short term notes payable	1,881,895	982,301
Interest payable	100,252	73,205
Dividends payable	—	133,438
Production taxes payable	335,263	662,905
Other taxes payable	9,540	9,206
Royalty owners payable	1,030,995	951,271
Net profits interest payable	185,919	137,589
Total current liabilities	3,862,406	3,604,342
<b>Asset Retirement Obligations</b>	52,461	48,842

*See accompanying notes to these consolidated financial statements.*

	September 30, 2007 (Unaudited)	December 31, 2006
<b>Commitments and Contingencies (Note 9)</b>	—	—
<b>Shareholders' Equity:</b>		
Series AA preferred stock, no par value; 5,000,000 shares authorized, 0 shares after conversion on March 28, 2007 and 1,890,710 shares issued and outstanding at December 31, 2006. Liquidation value was \$6,750,923 at December 31, 2006	—	5,924,068
Common stock, no par value; 100,000,000 shares authorized 31,583,007 and 27,423,758 shares issued and outstanding at September 30, 2007 and December 31, 2006, respectively	52,821,111	40,112,265
Additional paid-in capital	2,202,492	918,381
Treasury stock, at cost; 1,257,043 shares held at September 30, 2007 and December 31, 2006, respectively	(1,152,435)	(1,152,435)
Accumulated deficit	(11,083,512)	(10,393,985)
Total shareholders' equity	<u>42,787,656</u>	<u>35,408,294</u>
<b>Total Liabilities and Shareholders' Equity</b>	<u>\$ 46,702,523</u>	<u>\$ 39,061,478</u>

*See accompanying notes to these consolidated financial statements.*

**GEOPETRO RESOURCES COMPANY**

**CONSOLIDATED STATEMENTS OF OPERATIONS**

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2007	2006	2007	2006
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)
<b>Revenues</b>				
Oil and gas sales	\$ 1,231,370	\$ 1,705,140	\$ 5,443,562	\$ 5,172,657
<b>Costs and expenses:</b>				
Lease operating expense	315,982	572,664	1,162,089	1,290,593
General and administrative	482,388	508,085	2,009,307	1,795,705
Net profits interest	118,916	179,907	547,504	540,378
Impairment expense	495,874	—	495,874	—
Depreciation and depletion expense	509,436	712,459	1,739,306	1,818,621
Total costs and expenses	<u>1,922,596</u>	<u>1,973,115</u>	<u>5,954,080</u>	<u>5,445,297</u>
<b>Loss from operations</b>	<u>(691,226)</u>	<u>(267,975)</u>	<u>(510,518)</u>	<u>(272,640)</u>
<b>Other Income (Expense):</b>				
Interest expense	(92,626)	(87,748)	(271,071)	(213,778)
Interest income	38,161	90,831	94,362	182,725
Total other income (expense)	<u>(54,465)</u>	<u>3,083</u>	<u>(176,709)</u>	<u>(31,053)</u>
<b>Net Loss Before Taxes</b>	(745,691)	(264,892)	(687,227)	(303,693)
Income tax expense	—	(90,895)	(2,300)	(112,186)
<b>Net Loss</b>	(745,691)	(355,787)	(689,527)	(415,879)
Preferred stock dividend	—	(133,437)	—	(395,962)
<b>Net Loss Available to Common Shareholders</b>	<u>\$ (745,691)</u>	<u>\$ (489,224)</u>	<u>\$ (689,527)</u>	<u>\$ (811,841)</u>
<b>Loss per Share:</b>				
Basic	\$ (0.02)	\$ (0.02)	\$ (0.02)	\$ (0.03)
Diluted	\$ (0.02)	\$ (0.02)	\$ (0.02)	\$ (0.03)
<b>Weighted Average Number of Common Shares Outstanding:</b>				
Basic	30,603,475	27,348,758	29,215,952	25,532,531
Diluted	30,603,475	27,348,758	29,215,952	25,532,531

*See accompanying notes to these consolidated financial statements.*

**GEOPETRO RESOURCES COMPANY**

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

**Nine months ended September 30,**

**2007                      2006**

(Unaudited)

**Cash Flows From Operating Activities:**

Net loss	(689,527)	(415,879)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and depletion	1,739,306	1,818,621
Stock compensation expense	104,805	170,980
Non-cash interest expense	162,537	141,593
Impairment expense	495,874	—
Asset retirement obligations	2,419	1,974
Changes in operating assets and liabilities:		
(Increase) decrease in accounts receivable	(420,741)	315,232
(Increase) decrease in other receivables	45,370	(99,531)
Increase in prepaid expenses	(63,401)	(103,896)
(Increase) decrease in deposits and other noncurrent assets	(750)	466
Decrease in trade payables	(335,890)	(31,642)
Increase in interest payable	27,047	71,310
Decrease in dividends payable	(133,438)	—
Increase (decrease) in production taxes payable	(327,642)	199,724
Increase (decrease) in other taxes payable	334	(427)
Increase in royalty owners payable	79,724	347,347
Increase (decrease) in net profit interest payable	48,331	(62,913)
Increase in asset retirement obligations	1,200	—
Net cash provided by operating activities	735,558	2,352,959

**Cash Flows from Investing Activities:**

Oil and gas property expenditures	(2,645,202)	(16,003,073)
Acquisition of furniture, fixtures & equipment	(5,881)	(3,682)
(Increase) decrease in notes receivable	1,000,000	(1,000,000)
Net cash used in investing activities	(1,651,083)	(17,006,755)

*See accompanying notes to these consolidated financial statements.*

Nine months ended September 30,

2007

2006

(Unaudited)

**Cash Flows from Financing Activities:**

Proceeds from sale of common shares, option and warrant exercises, net	7,825,608	16,541,494
Payments of preferred dividends	—	(395,962)
Proceeds from promissory notes, net	1,000,000	1,900,000
Payments of loan fee	(57,000)	(30,000)
Repayments of promissory notes	(100,000)	—
Deferred offering costs	—	(1,213,789)
Net cash provided by financing activities	<u>8,668,608</u>	<u>16,801,743</u>

**Net Increase in Cash and Cash Equivalents:**

7,753,083

2,147,947

**Cash and Cash Equivalents:**

Beginning of period	734,561	914,826
End of period	<u>\$ 8,487,644</u>	<u>\$ 3,062,773</u>

**Supplemental Disclosure of Cash Flow Information:**

Cash paid for interest	<u>\$ 108,535</u>	<u>\$ —</u>
Cash paid for income taxes	<u>\$ 1,500</u>	<u>\$ 112,186</u>

*See accompanying notes to these consolidated financial statements.*

**GEOPETRO RESOURCES COMPANY**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited — Prepared by Management)**

**1. ORGANIZATION AND NATURE OF OPERATIONS:**

These financial statements are included herein pursuant to the rules and regulations of the Securities and Exchange Commission (“SEC”). Certain information and footnote disclosure normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations. The Company believes the disclosures made are adequate to make the information not misleading and recommend that these condensed financial statements be read in conjunction with the financial statements and notes included in our Form 10-K for the year ended December 31, 2006. In the opinion of management, the financial statements herein contain all adjustments, consisting only of normal recurring accruals, necessary for a fair presentation of the results for such periods. The results of operations for interim periods are not necessarily indicative of the results of operations for the full fiscal year.

*GeoPetro* — GeoPetro Resources Company (“GeoPetro”, “Company”, “we” or “us”) was originally incorporated as GeoPetro Company under the laws of the State of Wyoming in 1994 to participate in the oil and gas acquisition, exploration, development and production business in the United States and internationally. GeoPetro Company was subsequently merged into GeoPetro Resources Subsidiary Company, a California corporation, on June 28, 1996. GeoPetro’s name was then changed to GeoPetro Resources Company. GeoPetro’s corporate offices are in San Francisco, California. The accompanying consolidated financial statements include the accounts of GeoPetro and its wholly-owned subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation.

*Operations* — Although GeoPetro is not a development stage enterprise, the company has a limited operating history upon which an evaluation of its business prospects can be based. The risks, expense, and difficulties encountered by early stage companies must be considered when evaluating GeoPetro’s business prospects. GeoPetro had net loss of \$689,527 and \$811,841 for the nine months ended September 30, 2007 and 2006, and had an accumulated deficit at September 30, 2007 of \$11,083,512. GeoPetro expects to make significant capital expenditures in the foreseeable future. Management believes that GeoPetro will be successful in obtaining adequate sources of cash to fund its anticipated capital expenditures through the end of 2007 and to follow through with plans for continued investments in oil and gas properties. GeoPetro’s success, in part, depends on its ability to generate additional financing, farm-out certain of its projects and manage its relations with the companies that provide exploration and development services. GeoPetro’s success also depends on its ability to effectively manage growth and develop proven reserves. Additionally, GeoPetro’s operations are subject to all of the environmental and operational risks normally associated with the oil and gas industry. GeoPetro maintains insurance that is customary in the industry.

Since its inception, GeoPetro has participated as a working interest owner in the acquisition of undeveloped leases, seismic options, lease options and foreign concessions and has participated in seismic surveys and the drilling of test wells on its undeveloped properties. Further leasehold acquisitions and seismic operations are planned for 2007 and future periods. In addition, drilling is scheduled during 2007 and future periods on GeoPetro’s undeveloped properties. It is anticipated that these exploration activities together with others that may be entered into may impose financial requirements which may exceed the existing working capital of GeoPetro. Management may raise additional equity and/or debt capital, and has farmed-out certain of its projects to finance its continued participation in planned activities. In the opinion of GeoPetro management, GeoPetro can continue as a going concern even if additional financing is unavailable. However, if additional financing is not available, GeoPetro may be compelled to reduce the scope of its business activities. If GeoPetro is unable to fund planned expenditures, it may be necessary to:

1. forfeit its interest in wells that are proposed to be drilled;
2. farm-out its interest in proposed wells;
3. sell a portion of its interest in prospects and use the sale proceeds to fund its participation for a lesser interest; and
4. reduce general and administrative expenses.

In order for GeoPetro to maintain its interest in the Indonesian contract area, certain work and expenditure commitments must be met or an extension must be granted by the applicable governing authority. In the event that GeoPetro does not meet the commitments and no extensions are granted for meeting the commitments, GeoPetro will forfeit its interest in the contract or permit areas requiring an impairment write-down equal to the capitalized costs recorded for the area forfeited. This could have a material adverse impact on GeoPetro's results of operations in future periods.

In July 2005, GeoPetro entered into agreements with unaffiliated companies that have purchased and are operating a dedicated gas treatment plant and related pipelines to process and transport GeoPetro's gas from the Madisonville Project in Madison County, Texas. These agreements are discussed in detail in Note 10 to the financial statements included in our Form 10-K for the year ended December 31, 2006. In connection with the Madisonville Project, GeoPetro re-completed an existing well (the Magness #1 well) for production from the Rodessa formation interval at approximately 11,800 feet of depth and completed an injection well for disposal of waste gasses from the production well. GeoPetro initiated gas sales from the Madisonville Project in May 2003. A second well (the Fannin #1 well) was drilled, tested and completed during 2004. Two additional development wells (the Wilson #1 and the Mitchell #1 well) were drilled during 2006. The Fannin #1 and the Magness #1 well are presently producing on a restricted rate awaiting a planned expansion of the gas treatment plant. Another well is planned for drilling during 2008 in the Madisonville Project.

Other than the above work and expenditure commitments, the timing of most of GeoPetro's capital expenditures is discretionary. GeoPetro has no material long-term commitments associated with its capital expenditure plans or operating agreements. Consequently, GeoPetro has a significant degree of flexibility to adjust the level of such expenditures as circumstances warrant. The level of capital expenditures will vary in future periods depending on the success of exploratory drilling activities, gas and oil price conditions and other related economic factors.

## **2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:**

U.S. GAAP—The Company's financial statements have been prepared in accordance with accounting principles generally accepted within the United States of America ("U.S. GAAP").

Use of Estimates and Significant Estimates—Certain amounts in GeoPetro's financial statements are based upon significant estimates, including oil and gas reserve quantities which form the basis for the calculation of depreciation, depletion, amortization and impairment of oil and gas properties. Actual results could materially differ from those estimates.

Oil and Gas Properties—GeoPetro follows the full cost method of accounting for oil and gas producing activities and, accordingly, capitalizes all costs incurred in the acquisition, exploration, and development of proved oil and gas properties, including the costs of abandoned properties, dry holes, geophysical costs, and annual lease rentals. All general corporate costs are expensed as incurred. In general, sales or other dispositions of oil and gas properties are accounted for as adjustments to capitalized costs, with no gain or loss recorded. Amortization of evaluated oil and gas properties is computed on the units of production method based on all proved reserves on a country by country basis. Unevaluated oil and gas properties are assessed for impairment either individually or on an aggregate basis. The net capitalized costs of evaluated oil and gas properties (full cost ceiling limitation) are not to exceed their related estimated future net revenues discounted at 10%, and the lower of cost or estimated fair value of unproved properties, net of tax considerations.

Asset Impairment—Under full cost accounting, a ceiling test is performed to ensure that unamortized capitalized costs in each cost center (country) do not exceed their fair value. Impairment is recognized when the carrying value is greater than the undiscounted future cash flows. In the event of impairment, the amount by which the carrying value exceeds the estimated fair value of the long-lived asset is charged to earnings. The present value of estimated future net revenues is computed by applying current oil and gas prices to estimated future production of proved oil and gas reserves as of period-end, less estimated future expenditures to be incurred in developing and producing the proved reserves assuming the continuation of existing economic conditions. As of three months and nine months ended September 30, 2007, the impairment test was met for the United States.

For the unproved properties, the Company evaluates the possibility of potential impairment on a quarterly basis. During the three months ended September 30, 2007, approximately \$495,874 of unproved property costs related to Goodwin project were reclassified to proved property and an impairment was recorded in the Canadian pool due to a dry hole drilled.

Joint Ventures—Some exploration and production activities are conducted jointly with others and, accordingly, the accounts reflect only GeoPetro's proportionate interest in such activities.

**Revenue Recognition** — Revenue is recognized upon delivery of oil and gas production and is shown net of applicable royalty payments, processing and transportation fees. In addition, the Company recognizes revenue from the Madisonville Field net of applicable fees to gather, treat and transport the Company’s natural gas production. The applicable fees are paid to unrelated third parties. Revenue from the Madisonville Field is recognized when the price for gas delivered becomes fixed and determinable. The price for gas delivered to the purchaser, Madisonville Gas Processing LP (“MGP”), becomes fixed and determinable after the gas has been gathered, treated, and transported to a common carrier pipeline where it is then resold by MGP to the common carrier pipeline on a spot market basis. The proceeds from the sale of the gas are deposited directly into an escrow account under the joint signature control of the Company and MGP. The fees to gather, treat and transport the gas are distributed to MGP in accordance with agreements between them and the Company. The remaining net proceeds are distributed to the Company.

**Asset Retirement Obligation** — In accordance with Statement of Financial Accounting Standards No. 143, *Accounting for Asset Retirement Obligations* (“SFAS 143”), the fair value of an asset retirement cost, and corresponding liability, should be recorded as part of the cost of the related long-lived asset and subsequently allocated to expense using a systematic and rational method. GeoPetro recorded an asset retirement obligation to reflect GeoPetro’s legal obligations related to future plugging and abandonment of its oil and gas wells. GeoPetro estimated the expected cash flow associated with the obligation and discounted the amount using a credit-adjusted, risk-free interest rate. At least annually, GeoPetro reassesses the obligation to determine whether a change in the estimated obligation is necessary. GeoPetro evaluates whether there are indicators that suggest the estimated cash flows underlying the obligation have materially changed. Should those indicators suggest the estimated obligation has materially changed, GeoPetro will accordingly update its assessment.

	September 30, 2007	December 31, 2006
Asset retirement obligations, beginning of period	\$ 48,842	\$ 26,641
Liabilities incurred	1,200	19,537
Accretion expense	2,419	2,664
Asset retirement obligations, end of period	<u>\$ 52,461</u>	<u>\$ 48,842</u>

**Furniture, Fixtures and Equipment** — Furniture, fixtures and equipment are stated at cost. Depreciation is provided on furniture, fixtures and equipment using the straight-line method over an estimated service life of three to seven years.

**Income Taxes** — GeoPetro accounts for income taxes using the asset and liability method wherein deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which the temporary differences are expected to be recovered or settled. Because management has determined that realization of deferred tax assets is not likely, the net deferred tax assets are fully reserved.

**Concentrations of Credit Risk** — Credit risk represents the accounting loss that would be recognized at the reporting date if counterparties failed completely to perform as contracted. Concentrations of credit risk (whether on or off balance sheet) that arise from financial instruments exist for groups of customers or counterparties when they have similar economic characteristics that would cause their ability to meet contractual obligations to be similarly affected by changes in economic or other conditions described below. The credit risk amounts for cash and accounts receivable do not take into account the value of any collateral or security.

GeoPetro maintains several cash accounts with three financial institutions. Accounts at each institution are insured by the Federal Deposit Insurance Corporation up to \$100,000. As of September 30, 2007, the uninsured bank balance was \$9,015,477. GeoPetro has not experienced any losses in such accounts and believes it is not exposed to any significant credit risk.

For the nine months ended September 30, 2007 and year ended December 31, 2006, the Company had sales to customers exceeding 10% of total sales as follows:

	September 30, 2007	December 31, 2006
Customer A	86%	79%
Customer B	14%	21%

At September 30, 2007, the Company had accounts receivable balances from Customer A of \$815,078 or 92%, and \$394,337 or 77% at December 31, 2006 of total accounts receivable respectively.

Allowance for Doubtful Accounts — Trade accounts receivable are recorded at net realizable value. If the financial condition of GeoPetro's customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required. Delinquent trade accounts receivable are charged against the allowance for doubtful accounts once uncollectibility has been determined. The allowance is determined through an analysis of the past-due status of accounts receivable and assessments of risk that are based on historical trends and an evaluation of the impact of current and projected economic conditions. There was no activity in the allowance for doubtful accounts as of September 30, 2007 and December 31, 2006.

Fair Value of Financial Instruments — The estimated fair values for financial instruments are determined at discrete points in time based on relevant market information. These estimates involve uncertainties and cannot be determined with precision. For certain of GeoPetro's financial instruments, including cash, accounts receivable, accounts payable and current portion of notes payable, the carrying amounts approximate fair value due to their maturities.

Stock-Based Compensation — Effective January 1, 2006, the Company adopted the fair value recognition provisions of Statement of Financial Accounting Standard 123(R) "Share-Based Payment" ("SFAS 123(R)") using the modified prospective transition method. In addition, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 107 "Share-Based Payment" ("SAB 107") in March, 2005, which provides supplemental SFAS 123(R) application guidance based on the views of the SEC. Under the modified prospective transition method, compensation cost recognized in the nine months ended September 30, 2007 includes: (a) compensation cost for all share-based payments granted prior to, but not yet vested as of January 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of SFAS No. 123, and (b) compensation cost for all share-based payments granted beginning January 1, 2006, based on the grant date fair value estimated in accordance with the provisions of SFAS 123(R). In accordance with the modified prospective transition method, results for prior periods have not been restated.

The adoption of SFAS 123(R) resulted in stock compensation expense for the nine months ended September 30, 2007 \$104,805 to income from continuing operations and income before income taxes, of which the entire amount was recorded to general and administrative expenses. The Company did not recognize a tax benefit from the stock compensation expense because the Company considers it is more likely than not that the related deferred tax assets, which have been reduced by a full valuation allowance, will not be realized.

The fair value of each option grant was estimated on the date of grant using the Black-Scholes option pricing model with the following weighted-average assumptions used for grants in 2003 and 2005: risk-free, weighted-average interest rates ranging from 2.52 to 3.75 percent, expected dividend yield of 0 percent, expected life of 5 years from the date of grant, and expected volatility of 10 and 25 percent. After the initial public offering on March 30, 2006, an expected volatility factor of 58% was used for the newly issued common stock options and the extension of common stock options and warrants during 2006. A newly issued stock option is an option that was granted on or after March 30, 2006 or a previously granted stock option that is modified on or after March 30, 2006. The fair value of all newly issued stock options grants in 2006 is estimated using the Black-Scholes option pricing model with the following weighted average assumptions used for grants and modifications of prior grants made on or after March 30, 2006 for the nine months ended September 30, 2007: risk-free, weighted average interest rate of 4.9 percent based on the U.S. Treasury yield curve in effect at the time of grant, expected dividend yield of 0 percent, expected life of 5 years from the date of grant (the remaining term of the option in the case of option extensions), and expected volatility of 58%. GeoPetro selected 10 publicly traded "small cap" companies whose primary business is oil and gas exploration and production. Small cap, for purposes of this analysis, is defined as companies with a market capitalization under \$1 billion. From this peer group of similar companies, GeoPetro randomly selected 10 companies and derived expected volatility factors for the most recent completed fiscal years for each entity as reported in their recently filed 10K or 10KSB Annual Reports with the Securities and Exchange Commission. Where the expected volatilities were expressed as a range, a simple average of the range is used as an expected volatility for that entity.

A description of the common stock options outstanding as of September 30, 2007 is included in Note 6.

Income (Loss) Per Common Share — Basic earnings per share excludes dilution and is calculated by dividing net income or loss by the weighted average number of common shares outstanding for the period. Diluted earnings per share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted

into common stock or resulted in the issuance of common stock that then shared from the earnings of the entity. Potential common shares for the three and nine month periods ended September 30, 2007 and September 30, 2006 were excluded from the earnings per share computation because the Company incurred net losses and were anti-dilutive.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2007	2006	2007	2006
Net Loss and Adjustments:				
Net Loss Available to Common Shareholders	\$ (745,691)	\$ (489,224)	\$ (689,527)	\$ (811,841)
Adjustments	Anti-dilutive	Anti-dilutive	Anti-dilutive	Anti-dilutive
Net Loss for Diluted Calculation	\$ (745,691)	\$ (489,224)	\$ (689,527)	\$ (811,841)
Shares:				
Weighted Average Shares Outstanding	30,603,475	27,348,758	29,215,952	25,532,531
Outstanding Options	Anti-dilutive	Anti-dilutive	Anti-dilutive	Anti-dilutive
Outstanding Warrants	Anti-dilutive	Anti-dilutive	Anti-dilutive	Anti-dilutive
Average Number of Shares for Diluted Calculation	30,603,475	27,348,758	29,215,952	25,532,531
Diluted EPS	\$ (0.02)	\$ (0.02)	\$ (0.02)	\$ (0.03)

**Cash Equivalents** —Cash and cash equivalents include cash on hand, amounts held in banks and highly liquid investments purchased with an original maturity of three months or less.

**New Accounting Pronouncements** — In July 2006, the Financial Accounting Standards Board (“FASB”) issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN 48). It became effective for the Company on January 1, 2007. FIN 48 clarifies the accounting for income taxes by prescribing a minimum recognition threshold that a tax position is required to meet before being recognized in the financial statements. FIN 48 also provides guidance on measurement, classification, interim accounting and disclosure. We adopted FIN 48 effective January 1, 2007 (See Note 8).

In September 2006, FASB issued SFAS No. 157, *Fair Value Measurements*. SFAS No. 157 defines fair value, establishes a framework for measuring fair value, and expands disclosure requirements regarding fair value measurement. Where applicable, this statement simplifies and codifies fair value related guidance previously issued within GAAP. Although this statement does not require any new fair value measurements, its application may, for some entities, change current practice. SFAS No. 157 will be effective for the Company beginning January 1, 2008. The adoption of SFAS No. 157 is not expected to have a material impact on our financial statements.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*, which permits entities to choose to measure many financial instruments and certain other items at fair value. The objective is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. SFAS No. 159 applies to all entities and is effective for fiscal years beginning after November 15, 2007. Adoption of SFAS No. 159 is not required for these financial statements, and we are currently determining the impact, if any, that SFAS No. 159 will have on our future financial statements.

### 3. **SHORT TERM DEBT:**

Short term non-convertible debt at nine months ended September 30, 2007 and December 31, 2006 consisted of the following:

	September 30, 2007 (unaudited)	December 31, 2006
Promissory note dated January 31, 2006, payable to Pinehill Capital; collateralized with an undivided 5% of the net cash flow in GeoPetro's Madisonville Project; payable on or before October 31, 2007 (a)	\$ 1,000,000	\$ 1,000,000
Promissory note dated February 1, 2007 payable on or before October 31, 2007 (b)	500,000	—
Promissory note dated February 6, 2007 payable on or before October 31, 2007 (c)	300,000	—
Promissory note dated February 1, 2007 payable on or before October 31, 2007 (d)	100,000	—
	<u>1,900,000</u>	<u>1,000,000</u>
Less discount on promissory notes	(18,105)	(17,699)
	<u>\$ 1,881,895</u>	<u>\$ 982,301</u>

- (a) The Company issued a \$1,000,000 short term promissory note on January 31, 2006 with a maturity date of January 31, 2007. The note may be repaid at any time without penalty. In the event the note is not repaid by the maturity date, the Company has agreed to dedicate 5% of the net cash flow from the Madisonville Project in Texas toward the repayment of the note and any accrued interest thereon. In connection with the note, the Company paid a loan origination fee of \$30,000 and granted a three-year warrant exercisable to purchase 150,000 Common Shares at \$3.50 per share. The fair value of the warrants on the date of issuance, \$182,390, as well as the \$30,000 loan origination fee, was recorded as a debt discount and is being amortized over the life of the promissory note. On February 1, 2007, the maturity date was extended to October 31, 2007. The Company has paid \$80,000 accrued interest thru January 31, 2007. In connection with the extension, the Company paid a loan extension fee of \$30,000 and granted a three-year warrant exercisable to purchase 50,000 Common Shares at \$3.50 per share. The fair value of the warrants on the date of issuance, \$57,242, together with the \$30,000 loan extension fee, were recorded as a debt discount and are being amortized over the life of the promissory note. As of September 30, 2007, the unamortized debt discount was \$9,693.
- (b) The Company issued a \$500,000 short term promissory note payable on February 1, 2007 with a maturity date of October 31, 2007. The note may be repaid at any time without penalty. The principal plus accrued interest on the note are due on the maturity date. In connection with the note, the Company paid a loan origination fee of \$15,000 and granted a three-year exercisable warrant to purchase 25,000 Common Shares at \$3.50 per share. The fair value of the warrants on the date of issuance, \$27,072, as well as the \$15,000 loan origination fee, was recorded as a debt discount and is being amortized over the life of the promissory note. As of September 30, 2007, the unamortized debt discount was \$4,674.
- (c) The Company issued a \$300,000 short term promissory note payable on February 6, 2007 with a maturity date of October 31, 2007. The note may be repaid at any time without penalty. The principal plus accrued interest on the note are due on the maturity date. In connection with the note, the Company paid a loan origination fee of \$9,000 and granted a three-year exercisable warrant to purchase 15,000 Common Shares at \$3.50 per share. The fair value of the warrants on the date of issuance, \$16,214, as well as the \$9,000 loan origination fee, was recorded as a debt discount and is being amortized over the life of the promissory note. As of September 30, 2007, the unamortized debt discount was \$2,802.
- (d) The Company issued a \$100,000 short term promissory note payable on February 1, 2007 with a maturity date of October 31, 2007. The note may be repaid at any time without penalty. The principal plus accrued interest on the note are due on the maturity date. In connection with the note, the Company paid a loan origination fee of \$3,000 and granted a three-year exercisable warrant to purchase 5,000 Common Shares at \$3.50 per share. The fair value of the warrants on the date of issuance, \$5,414, as well as the \$3,000 loan origination fee, was recorded as a debt

discount and is being amortized over the life of the promissory note. As of September 30, 2007, the unamortized debt discount was \$936.

#### 4. **RELATED PARTY TRANSACTIONS:**

There were no material changes in related party transactions from those disclosed in the audited annual consolidated financial statements for the year ended December 31, 2006, except:

On April 25, 2007, May 9, 2007, and June 13, 2007, an officer and director, exercised warrants to purchase 80,000, 70,000 and 33,333 shares of common stock at an exercise price of \$2.00, \$2.00 and \$4.00 per share, respectively. The warrants were granted on June 18, 2000 and had expiration dates of between June 18 and June 30, 2007.

On February 12, 2007, Stuart J. Doshi, President and CEO, loaned \$100,000 to the Company. The note bore interest at 8% annually and was payable on demand. The note plus accrued interest was repaid on March 28, 2007.

On June 7, 2006, the Company loaned \$1,000,000 to G. Carter Sedanoui, a 5% shareholder, evidenced by a short term promissory note payable to the Company with an original maturity date of March 31, 2007. On March 30, 2007, the Company extended the maturity date of the note to June 30, 2007. The note plus the accrued interest were paid in full on June 29, 2007.

#### 5. **SHAREHOLDERS' EQUITY:**

GeoPetro's articles of incorporation allow for the issuance of 100,000,000 shares of common stock, 1,000,000 shares of Series A preferred stock ("Series A Stock"), 5,000,000 shares of Series AA preferred stock ("Series AA Stock"), and an additional 44,000,000 shares of preferred stock which may be issued from time to time in one or more series.

During the nine months ended September 30, 2007, the following issuances of common stock were made:

	Preferred Stock Series A		Preferred Stock Series AA		Common Stock	
	Shares	Amount	Shares	Amount	Shares	Amount
Balances, December 31, 2006	—	\$ —	1,890,710	\$ 5,924,068	27,423,758	\$ 40,112,265
Issuance of common stock for cash	—	—	—	—	2,268,539	7,825,608
Series AA preferred stock conversion			(1,890,710)	(5,924,068)	1,890,710	5,924,068
Fair value of warrants issued with private placement	—	—	—	—	—	(1,040,830)
Balances, September 30, 2007	—	\$ —	—	\$ —	31,583,007	\$ 52,821,111

**Conversion of Series AA Preferred Stock**—On March 28, 2007, all 1,890,710 of the Company's outstanding shares of Series AA Preferred Stock automatically converted into 1,890,710 shares of our common stock, no par value per share. Under the Company's Amended and Restated Articles of Incorporation, and as more fully described in Note 7 included in our Form 10K for the year ended December 31, 2006, the Series AA Preferred Stock automatically converted into common shares on a one-for-one share basis effective the first trading day after the reported high selling price for our common shares was at least \$5.25 per share for any consecutive ten trading days, which condition was met on March 27, 2007. Dividends accrued on the Series AA Preferred Stock at a rate of \$0.28 per annum, per share, while the Series AA Preferred Stock was outstanding. In 2006, dividends paid on the Series AA Preferred Stock totaled \$529,400. Pursuant to the terms of the Series AA Preferred Stock, no dividends were payable for the first quarter of 2007.

**Common Stock Offering**—On August 13, 2007, the Company sold, pursuant to a private placement, 2,002,599 units of the Company at a subscription price of \$3.85 per Unit for total gross proceeds of \$7,710,006. Each unit consisted of one share of common stock of the Company and three-tenths common share purchase warrant of the Company. Each one whole warrant entitles 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 group of private investors. The Company filed a

registration statement covering the common shares on October 9, 2007 which was declared effective by the Securities and Exchange Commission on October 26, 2007. The gross proceeds of the sale of common shares will be used to fund the Company's exploration and development program and for general working capital purposes.

## 6. COMMON STOCK OPTIONS:

There were no material changes to common stock options from those disclosed in the audited annual consolidated financial statements for the year ended December 31, 2006. The options outstanding as of September 30, 2007 have the following contractual lives:

<u>Number of Options Outstanding</u>	<u>Number of Options Exercisable</u>	<u>Exercise Prices</u>	<u>Weighted Average Remaining Contractual Life</u>
750,000	750,000	0.50	0.58
1,290,000	1,290,000	2.00	0.25
1,750,000	1,380,000	2.10	5.68
150,000	30,000	3.85	3.55
10,000	4,000	4.25	2.26
10,000	4,000	6.25	2.70
<u>3,960,000</u>	<u>3,458,000</u>		

As of September 30, 2007, there are 3,458,000 options which are exercisable. The remaining 502,000 options will become exercisable over the next four years.

## 7. COMMON STOCK WARRANTS:

On February 12, 2007, the Company issued a two-year exercisable common stock warrant to purchase 20,000 Common Shares at \$3.50 per share to an unaffiliated third party for geophysical services. The purchase right under the warrant has an expiration date of February 12, 2009 unless terminated earlier in accordance with the stock warrant purchase agreement.

On February 28, 2007, the Company issued a two-year exercisable common stock warrant to purchase 5,000 Common Shares at \$4.51 per share to the same party as above for geophysical services. The purchase right under the warrant has an expiration date of February 28, 2009 unless terminated earlier in accordance with the stock warrant purchase agreement.

The fair value of the warrants totaled \$32,533 and was capitalized in oil and gas properties as part of the U.S. cost pool.

In addition, during the nine months ended September 30, 2007, the Company issued common stock warrants in connection with promissory notes payable. These warrant issuances are discussed in Note 3.

On August 13, 2007, the Company issued common stock warrants in connection with a private placement. These warrant issuances are discussed in Note 5.

## 8. INCOME TAXES:

The Company adopted the provisions of FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes, on January 1, 2007. As a result of the adoption of FIN 48, the Company has unrecognized tax benefits of \$86,000 as of the date of adoption. No corresponding interest and penalties have been accrued as the Company is in a net operating loss position.

The Company files income tax returns in the U.S. federal jurisdiction and various states. A federal income tax audit for the 2004 tax year was completed on October 15, 2007. There were no material adjustments to the Company's

2004 tax return as a result. There are currently no other federal or state income tax examinations underway for these jurisdictions. Furthermore, the Company is no longer subject to U.S. federal income tax examinations by the Internal Revenue service for tax years before 2003 and for state and local tax authorities for years before 2002. The Company does, however, have net operating losses generated in tax years 1995 and thereafter, which remain open for examination.

The Company provides for income taxes in accordance with Statement of Financial Accounting Standards No. 109, Accounting for Income Taxes ("SFAS 109"). SFAS 109 requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of temporary differences between the financial statement carrying amounts and the tax basis of the assets and liabilities. Where it is more likely than not that a tax benefit will not be realized, a valuation allowance is recorded to reduce the deferred tax asset to its realizable value.

A valuation allowance has been provided against the Company's net deferred tax assets as the Company believes that it is more likely than not that the net deferred tax assets will not be realized. As a result of this valuation allowance, the effective tax rate for the nine months ended September 30, 2007 and for the year ended December 31, 2006 is zero percent.

## **9. COMMITMENTS AND CONTINGENCIES:**

There were no material changes to commitments and contingencies from those disclosed in the audited annual consolidated financial statements for the year ended December 31, 2006 except as disclosed in Note 9 herein, and as follows:

Salary Increases —On December 18, 2006, the independent members of the board of directors, acting on the recommendations of Stuart J. Doshi, the President and CEO, voted to increase the salaries of Messrs. Creel and Steinhauser, officers of the Company, to \$163,200 annually effective January 1, 2007.

Sale of Australian Interests, EP 381 & EP 408 -On June 20, 2007, the Company agreed to sell and transfer all of its remaining property interests in Australia to an unrelated party for cash consideration and a Petroleum Sales Royalty Payment equal to 25% of the future annual earnings before interest, taxes, depreciation and amortization from the property interests. The agreement is subject to satisfaction of certain terms and conditions. Specifically, the agreement provides that the Company will be paid consideration for the sale and transfer of its property interests as follows:

1. Initial cash consideration of \$175,000 subject to certain closing conditions;
2. a second cash payment of \$175,000 upon a successful flow test of petroleum from a well located on the property interests. A successful flow test is defined for purposes of this agreement to be a test of at least 7 million standard cubic feet of natural gas for a continuous and uninterrupted 24 hour period (or an equivalent oil/condensate rate based on a conversion ratio of 6000 cubic feet of gas to a barrel of oil or condensate); and,
3. a Petroleum Sales Royalty Payment equal to 25% of the future annual earnings before interest, taxes, depreciation and amortization from the property interests up to a total amount of \$2,200,000.

Goodwin Prospect, Central Alberta, Canada — On June 21, 2007, the Company entered into a participation agreement wherein it acquired a 50% non-operated working interest in the Goodwin Prospect, which is located in the Central Alberta Basin, Canada. A total of 12,000 acres can be earned by the Company by the drilling of wells. During July and August 2007, the Nexstar Goodwin 16-1958-12 Well was drilled. The Company has production tested this well and determined that it is non-commercial. The Company has plugged and abandoned this well. As a result, the Company recorded an impairment charge in amount of \$495,874 in the three months ended September 30, 2007.

## **10. SUBSEQUENT EVENTS:**

Promissory Notes Paid in Full: The Company paid off all the short term non-convertible promissory notes discussed in Note 3 plus accrued interest on October 31, 2007.

Stock Option Exercises: On November 1, 2007, an officer and director exercised options to purchase 50,000 shares of common stock at an exercise price of \$2.00 per share. The options were granted on December 29, 2000 and had an expiration date of December 29, 2007.

Swan Hills Prospect, Central Alberta, Canada — On October 17, 2007, the Company acquired a 33 1/3% non-operated working interest in 4,480 gross (1,493 net) acres in the Swan Hills Prospect, Central Alberta, Canada. The Company paid \$273,581 to purchase the leases in this prospect.