

TIDELANDS OIL & GAS CORP/WA
Form 10-Q
November 19, 2007

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

Form 10-Q

(MARK ONE)

**QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2007**

OR

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF
THE SECURITIES EXCHANGE ACT
For the transition period from _____ to _____**

Commission File Number: 0-29613

TIDELANDS OIL & GAS CORPORATION

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

Nevada
(State of incorporation)

66-0549380
(IRS Employer ID Number)

1862 West Bitters Rd., San Antonio, TX 78248
(Address of principal executive offices)

(210) 764-8642
(Issuer's telephone number)

Securities registered under Section 12 (b) of the Exchange Act: None

Securities registered under Section 12(g) of the Exchange Act:

Common Stock - \$0.001 par value

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definitions of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer

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

APPLICABLE ONLY TO CORPORATE ISSUERS

As of November 14, 2007, there were 107,941,748 shares of Common Stock issued and outstanding.

Transitional Small Business Disclosure Format: Yes No

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TIDELANDS OIL & GAS CORPORATION
FORM 10-Q

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CONDENSED CONSOLIDATED BALANCE SHEETS****ASSETS**

	September 30, 2007 (Unaudited)	December 31, 2006
Current Assets:		
Cash	\$ 818,173	\$ 367,437
Accounts and Other Receivable	422,462	388,754
Inventory	102,315	84,030
Prepaid Expenses	329,608	148,551
Total Current Assets	1,672,558	988,772
Property Plant and Equipment, Net	9,718,681	12,364,359
Investment in Affiliate	210,980	-
Other Assets:		
Deposits	252,762	56,708
Cash Restricted	54,120	52,642
Deferred Charges	-	565,221
Goodwill	1,158,937	1,158,937
Total Other Assets	1,465,819	1,833,508
Total Assets	\$ 13,068,038	\$ 15,186,639

LIABILITIES AND STOCKHOLDERS' EQUITY

Current Liabilities:		
Current Maturities - Note Payable	\$ 7,410,514	\$ 225,000
Accounts Payable and Accrued Expenses	2,554,299	1,624,752
Customer Deposits	10,350	-
Reserve for Litigation	2,250,000	2,250,000
Total Current Liabilities	12,225,163	4,099,752
Long-Term Debt	-	8,934,294
Total Liabilities	12,225,163	13,034,046
Commitments and Contingencies	-	-
Stockholders' Equity:		
Common Stock, \$.001 Par Value per Share, 250,000,000 Shares Authorized, 107,941,748		

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and 86,457,922 Shares Issued and Outstanding at

September 30, 2007 and December 31, 2006, Respectively	107,942	86,459
Additional Paid-in Capital	55,814,216	46,703,202
Subscriptions Receivable	-	(220,000)
Minority Interest	-	-
Accumulated Deficit	(55,079,283)	(44,417,068)
Total Stockholders' Equity	842,875	2,152,593
Total Liabilities and Stockholders' Equity	\$ 13,068,038	\$ 15,186,639

See Accompanying Notes to Consolidated Financial Statements

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TIDELANDS OIL & GAS CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)

	Three Months Ended September 30, 2007	Three Months Ended September 30, 2006
Revenues:		
Gas Sales and Pipeline Fees	\$ 332,693	\$ 355,937
Construction Services	59,903	13,289
Total Revenues	392,596	369,226
Costs and Expenses:		
Cost of Sales	272,083	272,631
Operating Expenses	85,144	102,010
Depreciation	24,564	18,129
Impairment Loss	-	-
Stock-Based Compensation – Related Parties	139,265	348,000
Selling, General and Administrative	586,053	881,528
Total Costs and Expenses	1,107,109	1,622,298
Loss From Operations	(714,513)	(1,253,072)
Other Income (Expenses)		
Loss on Sale of Assets	(172,555)	(4,500)
Interest Expense	(245,749)	(2,572,249)
Interest and Dividend Income	3,077	53,500
Gain on Sale of Subsidiary	156,480	-
Miscellaneous	95,485	(743)
Total Other Income (Expenses)	(163,262)	(2,523,992)
Net Loss	\$ (877,775)	\$ (3,777,064)
Net Loss Per Common Share:		
<u>Basic and Diluted</u>	\$ (0.01)	\$ (0.05)
Weighted Average Number of Common Shares Outstanding	106,425,048	82,551,543

See Accompanying Notes to Condensed Consolidated Financial Statements

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TIDELANDS OIL & GAS CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)

	Nine Months Ended September 30, 2007 (Restated - Note 8)	Nine Months Ended September 30, 2006
Revenues:		
Gas Sales and Pipeline Fees	\$ 1,739,947	\$ 1,420,551
Construction Services	240,619	157,693
Total Revenues	1,980,566	1,578,244
Costs and Expenses:		
Cost of Sales	1,237,620	1,047,377
Operating Expenses	261,247	286,128
Depreciation	79,368	58,464
Impairment Loss	2,605,061	-
Stock-Based Compensation – Related Parties	5,011,763	1,535,400
Selling, General and Administrative	2,757,058	3,136,873
Total Costs and Expenses	11,952,117	6,064,242
Loss From Operations	(9,971,551)	(4,485,998)
Other Income (Expenses)		
Loss on Sale of Assets	(179,443)	(4,500)
Interest Expense	(774,175)	(3,057,258)
Interest and Dividend Income	10,951	115,239
Gain on Sale of Subsidiary	156,480	-
Miscellaneous	95,523	(743)
Total Other Income (Expenses)	(690,664)	(2,947,262)
Net Loss	\$ (10,662,215)	\$ (7,433,260)
Net Loss Per Common Share:		
<u>Basic and Diluted</u>	\$ (0.11)	\$ (0.09)
Weighted Average Number of Common		
Shares Outstanding	97,199,835	81,516,543

See Accompanying Notes to Condensed Consolidated Financial Statements

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TIDELANDS OIL & GAS CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

	Nine Months Ended September 30, 2007 (Restated)	Nine Months Ended September 30, 2006
Cash Flows Provided From		
Operating Activities:		
Net Loss	\$ (10,662,215)	\$ (7,433,260)
Adjustments to Reconcile Net Loss		
To Net Cash Used In		
Operating Activities:		
Depreciation	333,214	345,887
Loss on Disposal of Equipment	179,443	4,500
Gain on Sale of Affiliate	(156,480)	-
Impairment Loss	2,605,061	-
Issuance of Common Stock:		
For Services Provided – Related Parties	5,011,763	1,535,400
For Services Provided – Other	1,049,791	375,400
For Payment of Interest	-	1,696,982
Changes in:		
Accounts Receivable	(33,708)	177,490
Inventory	(18,285)	67,615
Prepaid Expenses	(153,974)	(128,980)
Deferred Charges	565,221	(880,256)
Deposits	(65,438)	(50,000)
Accounts Payable and Accrued Expenses	1,272,791	219,622
Customer Deposits	10,350	-
Net Cash Used In Operating Activities	(62,466)	(4,069,600)
Cash Flows From		
Investing Activities:		
Investment in Affiliate	(62,601)	-
(Increase) Decrease in Restricted Cash	(1,478)	24,644
Proceeds from Sale of Assets	1,310,236	21,500
Acquisitions of Property, Plant and Equipment	(1,774,175)	(2,556,439)
Net Cash Used In Investing Activities	(528,018)	(2,510,295)

See Accompanying Notes to Condensed Consolidated Financial Statements

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TIDELANDS OIL & GAS CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(CONTINUED)

(UNAUDITED)

	Nine Months Ended September 30, 2007 (Restated)	Nine Months Ended September 30, 2006
Cash Flows From		
Financing Activities:		
Proceeds from Stock Subscriptions Receivable	-	220,000
Proceeds from Exercise of Stock Options	790,000	-
Proceeds from Long-Term Loans	-	6,737,276
Proceeds from Short-Term Loans	251,220	-
Repayment of Long-Term Loans	-	(608,750)
Proceeds from Repayment of Loan by Related Party	-	4,652
Net Cash Provided by Financing Activities	1,041,220	6,353,178
Net Increase (Decrease) in Cash	450,736	(226,717)
Cash at Beginning of Period	367,437	1,113,911
Cash at End of Period	\$ 818,173	\$ 887,194
Supplemental Disclosures of Cash Flow Information:		
Cash Payments for Interest	\$ 125,817	\$ 1,153,116
Cash Payments for Income Taxes	\$ -	\$ -
Non-Cash Operating, Investing and Financing Activities:		
Issuance of Common Stock:		
Payments of Accrued Expenses & Accounts Payable	\$ 343,244	\$ 445,000
Conversion of Debentures	2,000,000	-
Legal Fee – Retainer	130,616	385,542
Prepaid Legal Fees	27,083	-
Cancellation of Common Stock:		
In Settlement of Stock Subscriptions	(220,000)	-
Total Non-Cash Operating, Investing and Financing Activities	\$ 2,280,943	\$ 830,542

See Accompanying Notes to Condensed Consolidated Financial Statements

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TIDELANDS OIL & GAS CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2007
(UNAUDITED)

NOTE 1—BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements for the three-month and nine-month periods ended September 30, 2007, and 2006, have been prepared in conformity with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Form 10-Q and Regulation S-X. Please note that the prior year's presentations for the Condensed Consolidated Statement of Operations and the Condensed Consolidated Statements of Cash Flows were changed to conform to current year's presentation. The financial information as of December 31, 2006, is derived from the registrant's Form 10-K for the year ended December 31, 2006. Certain information or footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission.

The preparation of condensed consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. In the opinion of management, the accompanying financial statements include all adjustments necessary (which are of a normal and recurring nature) for the fair presentation of the results of the interim periods presented. While the registrant believes that the disclosures presented are adequate to keep the information from being misleading, it is suggested that these accompanying financial statements be read in conjunction with the registrant's audited consolidated financial statements and notes for the year ended December 31, 2006, included in the registrant's Form 10-K for the year ended December 31, 2006.

Operating results for the three-month and nine-month periods ended September 30, 2007, are not necessarily indicative of the results that may be expected for the remainder of the fiscal year ending December 31, 2007. The accompanying unaudited condensed consolidated financial statements include the accounts of the registrant, its wholly-owned subsidiaries, Rio Bravo Energy, LLC, Sonterra Energy Corporation, Arrecefe Management, LLC, Reef Ventures, LP, Reef International, LLC, Reef Marketing, LLC, Terranova Energia S. de R. L. de C. V., Esperanza Energy, LLC, and Tidelands Exploration & Production Corporation. All significant inter-company accounts and transactions have been eliminated in consolidation. The accounts of Tidelands Exploration and Production Corporation and Sonora Pipeline LLC are shown up through the date of sale of the assets or the subsidiary.

NOTE 2—GOING CONCERN

The Company has sustained recurring losses and negative cash flows from operations. Over 2006, the Company's growth had been funded through issuance of convertible debentures. As of September 30, 2007, the Company had approximately \$818,173 of unrestricted cash. However, the Company has experienced and continues to experience negative cash flows from operations, as well as an ongoing requirement for substantial additional capital investment. The Company needs to raise substantial additional capital to accomplish its business plan this year and over the next several years. The Company is seeking to obtain such additional funding through private equity sources, from financial partners for some of its projects and the possible sale of certain operating assets along with a continued reduction of operating expenses. There can be no assurance as to the availability or terms upon which such financing

and capital might be available or that asset sales will be possible at suitable pricing.

The Company's ability to continue as a going concern will depend on management's ability to successfully implement a business plan which will increase revenues, control costs, and obtain additional forms of debt and/or equity financing or financial partners. These financial statements do not include any adjustments that might be necessary if the Company is unable to continue as a going concern.

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TIDELANDS OIL & GAS CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2007
(UNAUDITED)

NOTE 3- IMPAIRMENT CHARGE

The Company incurred a non-cash impairment charge as of September 30, 2007, to reflect the difference between the carrying value and the market value of the affected asset which is its natural gas pipeline between Eagle Pass, Texas and Mexico. The charge taken was \$2,605,061 which reduced the gross value of the Company's cost basis to \$3,501,194 from \$6,106,255 before taking accumulated depreciation into account.

NOTE 4- SALE OF 80% INTEREST IN THE BURGOS HUB IMPORT/EXPORT PROJECT

On September 28, 2007, Tidelands Oil & Gas Corporation (the "Company") and its subsidiary, Terranova Energia S. de R.L. de C.V., entered into an Equity Purchase Agreement (the "Purchase Agreement") with Grand Cheniere Pipeline, LLC, ("Cheniere") pursuant to which the Company has sold an 80% interest in the Company's "Burgos Hub Project", which, as described in greater detail in the Company's annual report filed on Form 10-K, involves the development and construction of an integrated pipeline project traversing the United States and Mexico border and the construction of a related subterranean storage facility in Mexico.

In connection with the Purchase Agreement, the Company formed a new subsidiary, Frontera Pipeline, LLC, a Delaware limited liability company ("Frontera"), and agreed, upon approval of applicable governmental authorities, to transfer all rights, permits and assets of the Burgos Hub Project to Frontera. The Company then sold 80% of the equity interest in Frontera to Cheniere, effectively providing Cheniere with an 80% ownership stake in the Burgos Hub Project.

At the closing of the transaction, the Company contributed 100% of the ownership of its subsidiary, Sonora Pipeline, LLC, ("Sonora") to Frontera. Sonora has been engaged in obtaining Federal Energy Regulatory Commission ("FERC") permits for two pipelines to be located between the US and Mexico which would be part of the Burgos Hub Project.

Pursuant to the sale of the 80% equity interest in Frontera, the Company (i) received an up-front payment of \$1 Million and (ii) is eligible to earn three additional, separate earn-out payments of \$4.8 Million, \$1.2 Million, and \$2.0 Million. The Company is also entitled to receive royalty payments based on the capacity of transportation or storage service subscribed with the Burgos Hub Project, ranging from \$0.008 per Mmbtu/d for Phase I to \$0.002 per Mmbtu/d for Phase II to \$0.02 per Mmbtu/year for Phase III, subject to certain caps. The earn-out payments are dependent upon Cheniere electing to proceed with development of the Burgos Hub Project, which is divided into three phases, as set forth in Frontera's Limited Liability Company Agreement (the "Operating Agreement"), which is filed as an exhibit to Form 8-K filed on October 4, 2007.

Concurrently with the execution of the Purchase Agreement, Frontera executed an Independent Consulting Agreement (the "Consulting Agreement") with the Company, pursuant to which the Company will be paid \$25,000 per month for 24 months for consulting services in connection with the Burgos Hub Project. The Consulting Agreement also provides that the Company will not compete with the Burgos Hub Project for a period of three years after termination or expiration of the Consulting Agreement.

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TIDELANDS OIL & GAS CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2007
(UNAUDITED)

NOTE 5- PROPERTY, PLANT AND EQUIPMENT

A summary of property, plant and equipment at September 30, 2007 and December 31, 2006 is as follows:

	September 30, 2007	December 31, 2006	Estimated Economic Life
Pre-Construction Costs:			
International Crossings to Mexico	\$ -	\$ 818,271	N/A
Mexican Gas Storage Facility and Related Pipelines	2,761,829	2,359,451	N/A
Domestic LNG System	2,709,313	1,567,642	N/A
Total	5,471,142	4,745,364	
Office Furniture, Equipment and			
Leasehold Improvements	182,799	185,174	5 Years
Pipeline – Eagle Pass, TX to Piedras			
Negras, Mexico	3,501,194	6,106,255	20 Years
Tanks & Lines – Propane Distribution			
System	1,939,750	1,908,247	5 Years
Machinery and Equipment	75,185	67,357	5 Years
Trucks, Autos and Trailers	126,464	126,464	5 Years
Pipeline – South TX Gas Production	-	490,000	15 Years
Well Equipment	-	2,060	5 Years
Leaseholds	-	10,000	N/A
Total	11,296,534	13,640,921	
Less: Accumulated Depreciation	1,577,853	1,276,562	
Net Property, Plant and Equipment	\$ 9,718,681	\$ 12,364,359	

Depreciation expense for the nine months ended September 30, 2007 and 2006 was \$333,214 and \$345,887, respectively. Depreciation expense for the three months ended September 30, 2007 and 2006 was \$87,470 and \$114,085, respectively.

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TIDELANDS OIL & GAS CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2007
(UNAUDITED)

NOTE 6– LONG-TERM DEBT

A summary of long-term debt at September 30, 2007 and December 31, 2006 is as follows:

	September 30, 2007	December 31, 2006
Note Payable, Secured by Reef International Pipeline, Interest Bearing at 2% Over Prime Rate Per Annum, Maturing May 25, 2008	\$ 5,036,223	\$ 4,785,003
Convertible Debentures, Unsecured, Including Prepaid Interest at 9% Per Annum, Maturing January 20, 2008	2,374,291	4,374,291
	7,410,514	9,159,294
Less: Current Maturities	7,410,514	225,000
Total Long-Term Debt	\$ -	\$ 8,934,294

NOTE 7– COMMON STOCK TRANSACTIONS

A summary of common stock transactions for the nine months ended September 30, 2007 is as follows:

The Company issued 500,000 shares of its common stock valued at \$135,000 to the former President in accordance with the terms of his Severance Agreement.

The Company issued 7,436,618 shares of its common stock valued at \$1,274,620 to four law firms for legal services related to securities law matters, various litigation and other Company legal needs.

The Company cancelled 1,000,000 shares of its common stock valued at \$220,000 held by the President and a former officer which were offset against stock subscriptions due from them to the Company.

The Company issued a total of 2,298,848 shares of its common stock to a holder of its Convertible Debentures for conversion of \$2,000,000.

The Company issued 345,000 shares of its restricted common stock valued at \$70,000 for 2006 and 2007 investor public relations services.

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TIDELANDS OIL & GAS CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2007
(UNAUDITED)

NOTE 7- COMMON STOCK TRANSACTIONS (CONTINUED)

The Company issued 2,642,858 shares of its common stock valued at \$550,000 to each of two Directors for a total of 5,285,716 shares valued at \$1,100,000. In addition to their customary duties as directors, these board members provided regular and ongoing management services to the Company. This compensation to the two Directors represents their compensation for 2007.

The Company issued 69,000 shares of its restricted common stock valued at \$14,490 for preparation of a Research Report.

The Company issued 4,619,047 shares to a Director for \$790,000 as a result of his exercise of 2,619,047 stock options at \$0.21 per share and 2,000,000 stock options at \$0.12 per share.

The Company issued 376,819 shares of its common stock valued at \$54,873 to a Director for Corporate Secretary services and related costs.

The Company issued 527,778 shares of its common stock valued at \$100,139 to two Officer/employees in accordance with their employment contracts.

The Company issued 312,500 shares of its restricted common stock valued at \$62,313 to three employees as stock bonuses.

The Company issued 112,500 shares of its common stock valued at \$20,813 to two employees as stock bonuses.

The Company issued a total of 550,000 shares of its restricted common stock valued at \$84,250 to two of its Officers as stock bonuses.

The Company issued a total of 50,000 shares of its common stock valued at \$8,000 to Officers as a stock bonus.

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TIDELANDS OIL & GAS CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2007
(UNAUDITED)

NOTE 8 – SUMMARY OF RESTATED INTERIM REPORTS

On November 14, 2007, the Board of Directors of the Company determined that the accounting treatment of certain options issued to its directors (the “Options”) originally reported on its (i) Quarterly Report of Form 10-Q for the three months ended March 31, 2007, and (ii) Quarterly Report for the three and six months ended June 30, 2007 (the “Prior Reports”), was incorrect and required revision. Therefore, the Board of Directors has determined that the financial statements in the Company’s Prior Reports should not be relied upon and should be restated.

The adjustments to the Prior Reports listed below correct the accounting treatment of the Options to comply with the provisions of Financial Accounting Standards Board Statement No. 123 Share Based Payment (FAS 123(R)). FAS 123(R) was adopted by the Company on January 1, 2006; however, with respect to the Options, the Company inadvertently failed to record the appropriate expense for such Options in accordance with FAS 123(R).

The Company uses the Black-Scholes option pricing model to compute the fair value of stock options, which requires the Company to make the following assumptions:

- § The risk-free interest rate is based on the short-term Treasury bond at date of grant.
- § The dividend yield on the Company’s common stock is assumed to be zero since the Company does not pay dividends and has no current plans to do so.
- § The market price volatility of the Company’s common stock is based on daily historical prices for the twelve months previous to the grant date.
- § The term of the grants is the current year since all grants are vested at the time of the grants; therefore, the entire fair value of stock-based compensation was recorded in 2007.

The Company has now recognized the fair value stock option compensation expense as follows:

Quarterly Report of 10-Q for the Three Months	
Ended March 31, 2007	\$ 2,667,000
Quarterly Report of 10-Q for the Three Months	
Ended June 30, 2007	971,000
Total for the Six Months Ended June 30, 2007	\$ 3,638,000

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TIDELANDS OIL & GAS CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2007
(UNAUDITED)

NOTE 8– SUMMARY OF RESTATED INTERIM REPORTS (CONTINUED)

The transactions referred to above relate to non-cash charges and did not affect the Company's revenues, cash flows from operations, liquidity, assets, liabilities or total stockholders' equity.

	Three Months Ended March 31, 2007		
	Previously Reported	Restatement Adjustment	Restated Amount
Consolidated Balance Sheets:			
Total Assets	\$ 15,475,483	\$ -	\$ 15,475,483
Total Liabilities	11,531,967	-	11,531,967
Stockholders' Equity			
Common Stock	98,690	-	98,690
Additional Paid-in Capital	50,823,250 (1)	2,667,000	53,490,250
Subscriptions Receivable	(110,000)	-	(110,000)
Accumulated Deficit	(46,868,424) (3)	(2,667,000)	(49,535,424)
Total Stockholders' Equity	\$ 3,943,516	\$ -	\$ 3,943,516
Consolidated Statement of Operations:			
Revenues	\$ 1,103,971	\$ -	\$ 1,103,971
Expenses	3,555,952 (2)	2,667,000	6,222,952
Net (Loss) from Operations	(2,451,981)	(2,667,000)	(5,118,981)
Other Income	625	-	625
Net (Loss)	\$ (2,451,356)	\$ (2,667,000)	\$ (5,118,356)
Net (Loss) per Common Share:			
<u>Basic and Diluted</u>	\$ (0.03)		\$ (0.06)
Weighted Average Number of Common Shares			
Outstanding:			
<u>Basic and Diluted</u>	92,573,416		92,573,416

(1) Adjust additional paid-in capital to record fair value of stock options issued.

(2) Adjust expenses to reflect fair value of stock-based compensation.

(3) Adjust accumulated deficit to reflect additional losses as a result of stock-based compensation expense.

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TIDELANDS OIL & GAS CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2007
(UNAUDITED)

NOTE 8– SUMMARY OF RESTATED INTERIM REPORTS (CONTINUED)

	Previously Reported	Six Months Ended June 30, 2007		Restated Amount
		Restatement Adjustment		
Consolidated Balance Sheets:				
Total Assets	\$ 13,171,782	-	\$	13,171,782
Total Liabilities	11,944,188	-		11,944,188
Stockholders' Equity				
Common Stock	104,909	-		104,909
Additional Paid-in Capital	51,796,193	(1)	3,638,000	55,434,193
Subscriptions Receivable	(110,000)	-		(110,000)
Accumulated Deficit	(50,563,508)	(3)	(3,638,000)	(54,201,508)
Total Stockholders' Equity	\$ 1,227,594	-	\$	1,227,594
Consolidated Statement of Operations:				
Revenues	\$ 1,587,970	-	\$	1,587,970
Expenses	7,735,434	(2)	3,638,000	11,373,434
Net (Loss) from Operations	(6,147,464)	-	(3,638,000)	(9,785,464)
Other Income	1,024	-		1,024
Net (Loss)	\$ (6,146,440)	-	\$	(9,784,440)
Net (Loss) per Common Share:				
<u>Basic and Diluted</u>	\$ (0.06)		\$	(0.10)
Weighted Average Number of Common Shares Outstanding:				
<u>Basic and Diluted</u>	95,683,133			95,683,133

(1) Adjust additional paid-in capital to record fair value of stock options issued.

(2) Adjust expenses to reflect fair value of stock-based compensation.

(3) Adjust accumulated deficit to reflect additional losses as a result of stock-based compensation expense.

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NOTE 9– STOCK OPTIONS, STOCK WARRANTS AND SHARES RESERVED FOR CONVERTIBLE DEBENTURES

The following table presents the activity for options, warrants and shares reserved for issuance upon conversion of outstanding convertible debentures for the nine months ending September 30, 2007.

	Stock Options	Stock Warrants	Shares Reserved for Convertible Debentures	Total Shares	Weighted Average Exercise Price
Outstanding – December 31, 2006	250,000	18,138,051	5,027,916	23,415,967	\$ 1.070
<u>First Quarter</u>					
Granted / Issued	15,000,000	-	-	15,000,000	0.210
Exercised/Converted	(952,381)	-	(2,298,848)	(3,251,229)	0.677
Expired	-	(7,551,432)	-	(7,551,432)	1.275
Cancelled	-	-	-	-	-
Outstanding – March 31, 2007	14,297,619	10,586,619	2,729,068	27,613,306	0.598
<u>Second Quarter</u>					
Granted / Issued	10,000,000	-	-	10,000,000	0.120
Exercised/Converted	(1,666,666)	-	-	(1,666,666)	0.210
Expired	-	-	-	-	-
Cancelled	-	-	-	-	-
Outstanding – June 30, 2007	22,630,953	10,586,619	2,729,068	35,946,640	0.483
<u>Third Quarter</u>					
Granted / Issued	-	-	-	-	-
Exercised/Converted	(2,000,000)	-	-	(2,000,000)	0.120
Expired	-	-	-	-	-
Cancelled	-	-	-	-	-
Outstanding – September 30, 2007	20,630,953	10,586,619	2,729,068	33,946,640	\$ 0.504

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NOTE 10- SEGMENT REPORTING

The following tables are summaries of the results of operations and other financial information by major segment for the three months and nine months ended September 30, 2007 and 2006:

Third Quarter 2007	Propane Sales and Related Services	Pipeline Transportation Fees	All Other and Corporate	Total
Revenue	\$ 366,356	\$ 17,848	\$ 8,392	\$ 392,596
Depreciation	\$ 31,877	\$ 43,765	\$ 11,828	\$ 87,470
Interest	\$ 392	\$ -	\$ 245,357	\$ 245,749
Net (Loss)	\$ (16,654)	\$ (41,883)	\$ (819,238)	\$ (877,775)
Total Assets	\$ 2,475,818	\$ 2,399,878	\$ 8,192,342	\$ 13,068,038

2007 Year to Date	Propane Sales and Related Services	Pipeline Transportation Fees	All Other and Corporate	Total
Revenue	\$ 1,838,848	\$ 96,381	\$ 45,337	\$ 1,980,566
Depreciation	\$ 95,630	\$ 196,421	\$ 41,163	\$ 333,214
Interest	\$ 1,871	\$ -	\$ 772,304	\$ 774,175
Net Income (Loss)	\$ 266,154	\$ (2,799,833)	\$ (8,128,536)	\$ (10,662,215)
Total Assets	\$ 2,475,818	\$ 2,399,878	\$ 8,192,342	\$ 13,068,038

Third Quarter 2006	Propane Sales and Related Services	Pipeline Transportation Fees	All Other and Corporate	Total
Revenue	\$ 288,664	\$ 80,562	\$ -	\$ 369,226
Depreciation	\$ 31,221	\$ 76,329	\$ 6,535	\$ 114,085
Interest	\$ 312	\$ -	\$ 2,571,937	\$ 2,572,249
Net (Loss)	\$ (153,478)	\$ (5,748)	\$ (3,617,838)	\$ (3,777,064)
Total Assets	\$ 2,922,274	\$ 5,386,091	\$ 7,923,154	\$ 16,231,519

2006 Year to Date	Propane Sales and Related Services	Pipeline Transportation Fees	All Other and Corporate	Total
Revenue	\$ 1,374,606	\$ 203,638	\$ -	\$ 1,578,244

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Depreciation	\$ 97,551	\$ 228,985	\$ 19,351	\$ 345,887
Interest	\$ 1,402	\$ -	\$ 3,055,856	\$ 3,057,258
Net (Loss)	\$ (142,543)	\$ (56,068)	\$ (7,234,649)	\$ (7,433,260)
Total Assets	\$ 2,922,274	\$ 5,386,091	\$ 7,923,154	\$ 16,231,519

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NOTE 11– RELATED PARTY TRANSACTION

During the nine months ended September 30, 2007, the Company issued 376,819 shares of its common stock valued at \$54,874 to a Director for Corporate Secretary services and related costs.

NOTE 12– LITIGATION

Matter No. 1:

On January 6, 2003, we were served as a third party defendant in a lawsuit titled Northern Natural Gas Company vs. Betty Lou Sheerin vs. Tidelands Oil & Gas Corporation, ZG Gathering, Ltd. and Ken Lay, in the 150th Judicial District Court, Bexar County, Texas, Cause Number 2002-C1-16421. The lawsuit was initiated by Northern Natural Gas (“Northern”) when it sued Betty Lou Sheerin (“Sheerin”) for her failure to make payments on a note she executed payable to Northern in the original principal amount of \$1,950,000.

This matter is further described in Tidelands’ Form 10-K for the year ended December 31, 2006 and the Form 10-Q for the three and six months ended June 30, 2007.

No major developments took place in the quarter ended September 30, 2007, and settlement negotiations have not been successful to date. A trial date has been set for January 7, 2008. Based on prior negotiations, the Company has reserved \$2,250,000 as an estimated litigation settlement and that amount has been included in this report. However, if the matter proceeds to trial, such reserve may or may not be adequate.

Matter No. 2:

Cause No. GN 500948, Goodson Builders, Ltd., Plaintiff, vs. Jim Blackwell, BNC Engineering, Et. Al, Defendants, was filed April 7, 2005, in the 345th District Court of Travis County, Texas. This case involves a claim that Defendant Toll Brothers Property, LP (“Toll Brothers”) sold Plaintiff Goodson Builder, Ltd. (“Plaintiff” or “Goodson”) property without disclosing a propane easement. Plaintiff sued Sonterra Energy Corp. (“Sonterra”) for trespassing through the use of the easement. Goodson’s primary claim is against the seller for fraud and non-disclosure. Toll Brothers has responded with a claim for sanctions because the claim is frivolous. Toll Brothers offers a witness who is Plaintiff’s former employee and took pictures of the propane tank prior to the Plaintiff’s purchase. Goodson seeks damages in the hundreds of thousands of dollars. Insurance would not cover these damages.

On May 9, 2007, the trial court found summary judgment against Plaintiff and in favor of all Defendants as to the existence of an easement. The judgment explicitly states that there is an easement for the propane tank and for our maintenance of the tank. Plaintiff has now amended his petition to include a claimed violation of setback requirements for the tank. Jim Blackwell is in contact with the Texas Railroad Commission regarding the tank’s compliance with the setback requirements. At this time, both Blackwell and Toll Brothers have pending motions for sanctions. On July 5, 2007, Blackwell had a partial hearing on his motion and the trial court indicated that it would grant sanctions if Plaintiff did not adequately address the motion in its pleadings. The matter is ripe for another hearing on the sanctions motion, but Plaintiff has made a settlement offer to Toll Brothers that may settle the case. The Company is contesting the case vigorously.

Matter No. 3:

Cause No. GM 501625, Senna Hills, Ltd., Plaintiff, vs. Sonterra Energy Corp., Defendant, was filed in the 53rd Judicial District of Travis County, Texas and Cause No. GN 501626, HBH Development Co., LLC, Plaintiff, vs. Sonterra Energy Corp., Defendant, was filed in the 98th Judicial District Court of Travis County, Texas. The above matters were each filed against Sonterra in May 2005 and involve the same claims arising from the same propane service agreement. In each case, the plaintiff initially brought claims against Sonterra arising from Sonterra's failure, as an assignee of the agreement, to pay easement use fees to the plaintiff. Sonterra obtained summary judgment as to the plaintiffs' respective breach of contract and failure of assignment claims arising from the failure to pay easement use fees. The cases were not, however, fully dismissed because the plaintiffs added new causes of action for failure to pay easement use fees, claims for unpaid developer bonus, reformation of the agreements to require payment of easement use fees and alleged failure of assignment. These separate lawsuits have since been consolidated into one suit for purposes of pretrial and trial. The trial date will likely be reset in March 2008; however, the Company expects to file a motion for summary judgment prior to December 1, 2007.

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