

Edgar Filing: FOOTHILLS RESOURCES INC - Form 10QSB

FOOTHILLS RESOURCES INC  
Form 10QSB  
August 14, 2007  
UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-QSB

☒ Quarterly Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended June 30, 2007.

-----

☐ Transition Report pursuant to 13 or 15(d) of the Securities Exchange Act of 1934

For the transition period \_\_\_\_\_ to \_\_\_\_\_.

Commission File Number: 001-31547

\_\_\_\_\_

**FOOTHILLS RESOURCES, INC.**

(Name of small business issuer in its charter)

**Nevada**

(State or other jurisdiction  
of incorporation or organization)

**4540 California Avenue, Suite 550**

**Bakersfield, California**

(Address of principal executive offices)

**(661) 716-1320**

(Issuer's telephone number, including area code)

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

**None**

(Title of Class)

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

**98-0339560**

(I.R.S. Employer  
Identification Number)

**93309**

(Zip Code)

**None**

(Name of Each Exchange  
on Which Registered)

Edgar Filing: FOOTHILLS RESOURCES INC - Form 10QSB

**Common Stock, \$0.001 par  
value**  
(Title of Class)

**None**  
(Name of Each change  
on Which Registered)

Check whether the issuer (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 that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes ☒ No ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes ☐ No ☒

State the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: 60,462,670 shares of \$0.001 par value common stock outstanding as of July 31, 2007.

Transitional Small Business Issuer Format (check one):

Yes ☐ No ☒

**PART I - FINANCIAL INFORMATION**

**Item 1. Financial Statements.**

**FOOTHILLS RESOURCES, INC.**

**CONSOLIDATED BALANCE SHEETS**

(dollars in thousands, except per share amounts)

	<b>June 30, 2007 (unaudited)</b>	<b>December 31, 2006</b>
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 5,041	\$ 8,673
Accounts receivable	1,529	1,452
Prepaid expenses	365	212
Fair value of derivative financial instruments	43	833
	6,978	11,170
Property and equipment, at cost:		
Oil and gas properties, using full-cost accounting -		
Proved properties	67,095	64,850
Unproved properties not being amortized	676	420
Other property and equipment	529	475
	68,300	65,745
Less accumulated depreciation, depletion and amortization	(2,080)	(814)
	66,220	64,931
Other assets	616	1,466
	\$ 73,814	\$ 77,567

The accompanying notes are an integral part of these consolidated financial statements.

## FOOTHILLS RESOURCES, INC.

## CONSOLIDATED BALANCE SHEETS

(dollars in thousands, except per share amounts)

	<b>June 30, 2007 (unaudited)</b>	<b>December 31, 2006</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Current portion of long-term debt	\$ 3,032	\$ 2,509
Accounts payable and accrued liabilities	1,137	2,600
Fair value of derivative financial instruments	75	-
Liquidated damages	1,193	-
	5,437	5,109
Long-term debt	30,887	29,666
Asset retirement obligations	592	570
Fair value of derivative instruments	728	-
Stockholders' equity:		
Preferred stock, \$0.001 par value		
10,000,000 shares authorized, none outstanding	-	-
Common stock, \$0.001 par value -		
100,000,000 shares authorized		
60,462,670 shares outstanding	60	60
Additional paid-in capital	44,772	44,331
Accumulated deficit	(7,902)	(3,764)
Accumulated other comprehensive income (loss)	(760)	1,595
	36,170	42,222
	<b>\$ 73,814</b>	<b>\$ 77,567</b>

The accompanying notes are an integral part of these consolidated financial statements.

## FOOTHILLS RESOURCES, INC.

## CONSOLIDATED STATEMENTS OF OPERATIONS

(dollars in thousands, except per share amounts)

(unaudited)

	Three Months Ended		Six Months Ended	
	June 30, 2007	2006	June 30, 2007	2006
Income:				
Oil and gas revenues	\$ 3,462	\$ -	\$ 7,303	\$ -
Interest income	78	78	162	82
	3,540	78	7,465	82
Expenses:				
Production costs	1,362	-	2,359	-
General and administrative	890	1,524	1,647	1,652
Interest	2,474	-	5,131	-
Liquidated damages	753	-	1,193	-
Depreciation, depletion and amortization	599	5	1,273	5
	6,078	1,529	11,603	1,657
Net loss	\$ (2,538)	\$ (1,451)	\$ (4,138)	\$ (1,575)
Basic and diluted net loss per share	\$ (0.04)	\$ (0.03)	\$ (0.07)	\$ (0.05)
Weighted average number of common shares outstanding basic and diluted	60,418,335	46,209,649	60,397,697	31,871,979

The accompanying notes are an integral part of these consolidated financial statements.



## FOOTHILLS RESOURCES, INC.

## CONSOLIDATED STATEMENTS OF CASH FLOWS

(dollars in thousands)

(unaudited)

	<b>Six Months Ended June 30,</b>	
	<b>2007</b>	<b>2006</b>
Cash flows from operating activities:		
Net loss	\$ (4,138)	\$ (1,575)
Adjustments to reconcile net loss to		
net cash used for operating activities -		
Stock-based compensation	252	114
Depreciation, depletion and amortization	1,251	5
Accretion of asset retirement obligation	22	-
Amortization of discount on long-term debt	1,744	-
Amortization of debt issue costs	104	-
Changes in assets and liabilities -		
Accounts receivable	(63)	-
Prepaid expenses	(170)	(227)
Accounts payable and accrued liabilities	(1,407)	37
Liquidated damages	1,193	-
Net cash used for operating activities	(1,212)	(1,646)
Cash flows from investing activities:		
Additions to oil and gas properties	(2,332)	(4,965)
Additions to other property and equipment	(54)	(128)
Increase in other assets	-	(92)
Net cash used for investing activities	(2,386)	(5,185)
Cash flows from financing activities:		
Members' capital contributions	-	50
Proceeds from issuance of common stock and warrants		12,766
Stock issuance costs	(34)	(699)
Net cash provided by (used for) financing activities	(34)	12,117
Net increase (decrease) in cash and cash equivalents	(3,632)	5,286
Cash and cash equivalents at beginning of the period	8,673	-
Cash and cash equivalents at end of the period	\$ 5,041	\$ 5,286
Supplemental disclosures of cash flow information:		
Cash paid for -		
Interest	\$ 3,300	\$ -
Income taxes	\$ -	\$ -

The accompanying notes are an integral part of these consolidated financial statements.

## FOOTHILLS RESOURCES, INC.

## CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY

(dollars in thousands, except per share amounts)

	Common Stock		Addi-	Mem-	Accum-	Accum-	
	Number	Par Value	tional Paid-in Capital	bers Capital	ulated Deficit	ulated Other Comprehensive Income (Loss)	Total
Balance, December 29, 2005 (date of inception)	-	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Contributions	-	-	-	50	-	-	50
Balance, December 31, 2005	-	-	-	50	-	-	50
Contributions	-	-	-	50	-	-	50
Exchange of members' capital for common shares and conversion from limited liability company to corporation	17,375,000	17	83	(100)	-	-	-
Issuance of common stock and warrants	42,112,753	42	42,972	-	-	-	43,014
Exercise of warrants	889,076	1	888	-	-	-	889
Stock-based compensation	-	-	388	-	-	-	388
Change in fair value of derivative financial instruments	-	-	-	-	-	1,595	1,595
Net loss	-	-	-	-	(3,764)	-	(3,764)

Edgar Filing: FOOTHILLS RESOURCES INC - Form 10QSB

Balance, December 31, 2006

60,376,829	60	44,331	-	(3,764)	1,595	42,222
------------	----	--------	---	---------	-------	--------

The accompanying notes are an integral part of these consolidated financial statements.

## FOOTHILLS RESOURCES, INC.

## CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY

(dollars in thousands, except per share amounts)

	Common Stock		Addi-	Mem-	Accum-	Accum-	
	Number	Par Value	tional Paid-in Capital	bers Capital	ulated Deficit	ulated Other Comprehensive Income (Loss)	Total
Issuance of common stock (unaudited)	85,841	-	223	-	-	-	223
Stock-based compensation (unaudited)	-	-	252	-	-	-	252
Change in fair value of derivative financial instruments (unaudited)	-	-	-	-	-	(2,355)	(2,355)
Stock issuance costs (unaudited)	-	-	(34)	-	-	-	(34)
Net loss (unaudited)	-	-	-	-	(4,138)	-	(4,138)
Balance, June 30, 2007 (unaudited)	60,462,670	\$ 60	\$44,772	\$ -	\$ (7,902)	\$ (760)	\$36,170

The accompanying notes are an integral part of these consolidated financial statements.

8

---

**FOOTHILLS RESOURCES, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**JUNE 30, 2007**

**(unaudited)**

**Note 1 Summary of Operations**

Foothills Resources, Inc. ( Foothills ), a Nevada corporation, and its subsidiaries are collectively referred to herein as the Company. The Company is a growth-oriented independent energy company engaged in the acquisition, exploration, exploitation and development of oil and natural gas properties. The Company currently holds interests in properties in the Texas Gulf Coast area, in the Eel River Basin in northern California, and in the Anadarko Basin in southwest Oklahoma.

The Company took its current form on April 6, 2006, when Brasada California, Inc. ( Brasada ) merged with and into an acquisition subsidiary of Foothills. Brasada was formed on December 29, 2005 as Brasada Resources LLC, a Delaware limited liability company, and converted to a Delaware corporation on February 28, 2006. Following the merger, Brasada changed its name to Foothills California, Inc. ( Foothills California ) and is now a wholly owned operating subsidiary of Foothills. This transaction was accounted for as a reverse takeover of the Company by Foothills California. The Company adopted the assets, management, business operations and business plan of Foothills California. The financial statements of the Company prior to the merger were eliminated at consolidation.

These financial statements have been prepared by the Company without audit, and include all adjustments (which consist solely of normal recurring adjustments) which, in the opinion of management, are necessary for a fair presentation of financial position and results of operations. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted, although the Company believes that the disclosures are adequate to make the information presented not misleading. It is suggested that these financial statements be read in conjunction with the Company's audited financial statements and the notes thereto for the year ended December 31, 2006.

**Note 2 New Accounting Pronouncements**

During February 2007, the Financial Accounting Standards Board ( FASB ) issued Statement of Financial Accounting Standards ( SFAS ) No 159, The Fair Value Option for Financial Assets and Financial Liabilities ( SFAS 159 ), which permits all entities to choose, at specified election dates, to measure eligible items at fair value. SFAS 159 permits entities to choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value, and thereby mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. The statement also establishes presentation and disclosure requirements designed to facilitate comparisons between entities that choose different measurement attributes for similar types of assets and liabilities. SFAS 159 is effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007. The Company is evaluating the impact that this statement will have on its financial statements.

In September 2006, the FASB issued SFAS No. 158, Employers' Accounting for Defined Benefit Plans and Other Postretirement Plans ( SFAS 158 ). The statement requires employers to recognize any overfunded or underfunded status of a defined benefit postretirement plan as an asset or

## Edgar Filing: FOOTHILLS RESOURCES INC - Form 10QSB

liability in their financial statements. Unrealized components of net periodic benefit costs are reflected in other comprehensive income, net of tax. SFAS 158 requires recognition of the funded status and related disclosures as of the end of the fiscal year ending after December 15, 2006. Adoption of this statement had no impact on the Company's financial position or results of operations.



## Edgar Filing: FOOTHILLS RESOURCES INC - Form 10QSB

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements ( SFAS 157 ). SFAS 157 defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. This statement is effective for financial statements issued for fiscal years beginning after November 15, 2007. The Company is continuing to assess the potential impacts this statement might have on its consolidated financial statements and related footnotes.

During September 2006, the Securities and Exchange Commission ( SEC ) issued Staff Accounting Bulletin ( SAB ) No. 108. This Bulletin provides the Staff's views on the consideration of the effects of prior year misstatements in quantifying current year misstatements for the purpose of a materiality assessment. The guidance in SAB No. 108 is effective for financial statements of fiscal years ending after November 15, 2006. Adoption of this guidance did not impact the Company's financial statements.

In July 2006, the FASB issued Financial Interpretation No. 48, Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109, to clarify certain aspects of accounting for uncertain tax positions, including issues related to the recognition and measurement of those tax positions. This interpretation is effective for fiscal years beginning after December 15, 2006. Adoption of this statement had no impact on the Company's financial position or results of operations.

In March 2006, the FASB issued SFAS No. 156, Accounting for Servicing of Financial Assets ( SFAS 156 ), which requires all separately recognized servicing assets and servicing liabilities be initially measured at fair value. SFAS 156 permits, but does not require, the subsequent measurement of servicing assets and servicing liabilities at fair value. Adoption is required as of the beginning of the first fiscal year that begins after September 15, 2006. The adoption of SFAS 156 did not have a material effect on the Company's consolidated financial position, results of operations or cash flows.

In February 2006, the FASB issued SFAS No. 155, Accounting for Certain Hybrid Financial Instruments, an amendment of FASB Statements No. 133 and 140 ( SFAS 155 ). SFAS 155 clarifies certain issues relating to embedded derivatives and beneficial interests in securitized financial assets. The provisions of SFAS 155 are effective for all financial instruments acquired or issued after fiscal years beginning after September 15, 2006. Adoption of this statement had no impact on the Company's financial position or results of operations.

### Note 3 Asset Retirement Obligation

The following table sets forth a reconciliation of the beginning and ending asset retirement obligation for the six months ended June 30, 2007 (in thousands):

Asset retirement obligation, beginning of period	\$ 570
Accretion expense	22
Asset retirement obligation, end of period	\$ 592

### Note 4 Long-term Debt

Long-term debt at June 30, 2007 and December 31, 2006 consisted of the following (in thousands):

	<b>June</b>	<b>December</b>	
	<b>30, 2007</b>	<b>31, 2006</b>	
Secured promissory note	\$ 42,500	\$ 42,500	
Less: unamortized discount	(8,581	) (10,325	)
	33,919	32,175	
Less: current portion	(3,032	) (2,509	)
	\$ 30,887	\$ 29,666	

## Edgar Filing: FOOTHILLS RESOURCES INC - Form 10QSB

To finance a portion of the acquisition of certain producing properties in the Texas Gulf Coast area (the *Texas Acquisition* ) in 2006, the Company executed a credit agreement (the *Credit Agreement* ) with a financial institution (the *Lender* ), whereby the Company may borrow funds under a credit facility in an amount not to exceed \$42,500,000 (the *Facility* ). As of June 30, 2007, \$42,500,000 was outstanding under the Facility.

The Facility will terminate and all amounts borrowed under the Facility will be due and payable on September 7, 2010. The interest rate on the Facility was initially LIBOR plus 700 basis points, and was increased by 100 basis points on each of September 22, 2006, October 23, 2006 and November 22, 2006 when the Company did not satisfy a requirement of the credit agreement to raise an additional \$5,000,000 in equity capital on or before those dates. The interest rate at June 30, 2007 was 15.4%. The Company is required to make quarterly interest and principal payments on the Facility equal to the adjusted net cash flow attributable to the properties acquired in the Texas Acquisition. The Facility is secured by liens and security interests on substantially all of the assets of the Company, including 100% of the Company's oil and gas reserves, and prohibits any dividends on or redemptions of Foothills' capital stock.

The terms of the Facility require the Company to maintain certain covenants. As of June 30, 2007, the Company was in compliance with all of the financial covenants.

The Company issued to an affiliate of the Lender a warrant to purchase 3,000,000 shares of its common stock for five years at an exercise price of \$2.75 per share. In addition, the Company conveyed to the Lender a 5% overriding royalty interest in all oil and gas leases associated with the Texas Acquisition, but excluding new exploration projects relating to other formations on these properties, to the extent they are distinct from operations included in the Lender's approved plan of development and the related engineering report for the Texas Acquisition and are funded through equity capital. The fair values of the warrant and the overriding royalty interest amounted to an aggregate of \$11,426,000. This amount was recorded as debt issue discount, which is being amortized using the interest method.

### **Note 5   Stockholders' Equity**

#### *Registration rights payments*

The purchasers of units consisting of shares of common stock and warrants issued by Foothills in private placement financings in 2006 have registration rights, pursuant to which the Company agreed to register for resale the shares of common stock and the shares of common stock issuable upon exercise of the warrants. In the event that the registration statements are not declared effective by the Securities and Exchange Commission ( *SEC* ) by specified dates, the Company is required to pay liquidated damages to the purchasers.

The purchasers of 17,142,857 units issued in April 2006 are entitled to liquidated damages in the amount of 1% per month of the purchase price for each unit, payable each month that the registration statement is not declared effective following the mandatory effective date (January 28, 2007). The total amount recorded at June 30, 2007 for these liquidated damages was \$316,000. Amounts payable as liquidated damages cease when the shares can be sold under Rule 144 of the Securities Act of 1933, as amended. The Company has determined that liquidated damages ceased on April 6, 2007 as to a minimum of 16,192,613 units, and expects that liquidated damages will cease no later than July 6, 2007 as to the remaining units.

## Edgar Filing: FOOTHILLS RESOURCES INC - Form 10QSB

The purchasers of an aggregate of 10,093,804 units issued in September 2006 are entitled to liquidated damages in the amount of 1% per month of the purchase price for each unit, payable each month that the registration statement is not declared effective following the applicable mandatory effective dates (March 7, 2007 for 10,000,000 units and March 28, 2007 for the remaining 93,804 units). The total amount recorded at June 30, 2007 for these liquidated damages was \$877,000. The investors in the September 2006 private placement financing have the right to take the liquidated damages either in cash or in shares of Foothills common stock, at their election. If the Company fails to pay the cash payment to an investor entitled thereto by the due date, the Company will pay interest thereon at a rate of 12% per annum (or such lesser maximum amount that is permitted

## Edgar Filing: FOOTHILLS RESOURCES INC - Form 10QSB

to be paid by applicable law) to such investor, accruing daily from the date such liquidated damages are due until such amounts, plus all such interest thereon, are paid in full. The total amount of liquidated damages will not exceed 10% of the purchase price for the units or \$2,271,000.

The Company filed the required registration statement but the registration statement has not yet become effective. As a result, the Company had incurred the obligation to pay a total of approximately \$1,193,000 in liquidated damages as of June 30, 2007, which amount has been recorded as liquidated damages expense in the consolidated statement of operations.

### *Stock-based employee compensation plan*

Foothills' 2006 and 2007 Equity Incentive Plans (the "Plans") enable the Company to provide equity-based incentives through grants or awards to present and future employees, directors, consultants and other third party service providers. Foothills' Board of Directors reserved an aggregate total of 7,000,000 shares of Foothills' common stock for issuance under the Plans. The compensation committee of the Board administers the Plans. The Plans authorize the grant to participants of nonqualified stock options, incentive stock options, restricted stock awards, restricted stock units, performance grants intended to comply with Section 162(m) of the Internal Revenue Code, as amended, and stock appreciation rights. Generally, options are granted at prices equal to the fair value of the stock at the date of grant, expire not later than 10 years from the date of grant, and vest ratably over a three-year period following the date of grant. From time to time, options with differing terms have been granted, as approved by the Board of Directors.

The estimated fair value of the options granted during the six months ended June 30, 2007 was calculated using a Black Scholes Merton option pricing model ("Black Scholes"). The following schedule reflects the various assumptions included in this model as it relates to the valuation of options:

Risk free interest rate	4.9	5.2	%
Expected volatility	85	116	%
Weighted-average volatility	88		%
Dividend yield	0		%
Expected years until exercise	0.5	3.0	

The Black Scholes model incorporates assumptions to value stock-based awards. The risk-free rate of interest for periods within the expected term of the option was based on a zero-coupon U.S. government instrument over the expected term of the equity instrument. Because Foothills' common stock has limited trading history, expected volatility was based on the historical volatility of a representative stock with characteristics similar to the Company. The Company has no historical experience upon which to base estimates of employee option exercise timing ("expected term") within the valuation model, and utilized estimates for the expected term based on criteria required by SFAS No. 123 (revised 2004), Share-Based Payment ("SFAS 123R").

Option activity under the Plans during the six months ended June 30, 2007 was as follows:

Shares	Weighted	Weighted	Aggregate
	Average	Average	Intrinsic

Edgar Filing: FOOTHILLS RESOURCES INC - Form 10QSB

		<b>Exercise</b>	<b>Remaining</b>	<b>Value</b>
		<b>Price</b>	<b>Contractual</b>	
			<b>Term In</b>	
			<b>Years</b>	
Outstanding at January 1, 2007	1,790,000	\$ 1.53		
Granted	90,000	1.17		
Exercised	-	-		
Forfeited	-	-		
Outstanding at June 30, 2007	1,880,000	\$ 1.52	9.0	\$ 328,000

# Edgar Filing: FOOTHILLS RESOURCES INC - Form 10QSB

Exercisable at June 30, 2007	895,000	\$ 1.62	8.9	\$ 164,000
------------------------------	---------	---------	-----	------------

Stock-based compensation for the three months and the six months ended June 30, 2007 totaling \$139,000 and \$252,000, respectively, has been recognized as a component of general and administrative expenses in the accompanying consolidated financial statements. The weighted-average grant-date fair value of options granted during the six months ended June 30, 2007 was \$0.46. As of June 30, 2007, \$836,000 of total unrecognized compensation cost related to stock options is expected to be recognized over a weighted-average period of approximately 2.6 years. The aggregate intrinsic value in the table above represents the total pre-tax intrinsic value (the difference between the closing stock price on the last trading day of June 2007 and the exercise price, multiplied by the number of in-the-money options) that would have been received by the option holders had all option holders exercised their options on June 30, 2007. The amount of aggregate intrinsic value will change based on the fair market value of the Company's stock. As of June 30, 2007, 5,120,000 shares were available for future grants under the Plans. No stock options were exercised during the six months ended June 30, 2007.

## Note 6 Derivative Instruments and Price Risk Management Activities

The Company has entered into derivative contracts to manage its exposure to commodity price risk. These derivative contracts, which are placed with a major financial institution that the Company believes is a minimal credit risk, currently consist only of swaps. The oil prices upon which the commodity derivative contracts are based reflect various market indices that have a high degree of historical correlation with actual prices received by the Company for its oil production. Swaps are designed to fix the price of anticipated sales of future production. The Company entered into most of the contracts at the time it acquired certain operated oil and gas property interests as a means to reduce the future price volatility on its sales of oil production, as well as to achieve a more predictable cash flow from its oil and gas properties. The Company has designated its price hedging instruments as cash flow hedges in accordance with SFAS No. 133. The Company recognizes gains or losses on settlement of its hedging instruments in oil and gas revenues, and changes in their fair value as a component of other comprehensive income, net of deferred taxes. The Company recognized pre-tax income of \$213,000 and \$637,000, respectively, in oil and gas revenues for the three months and six months ended June 30, 2007 due to realized settlements of its price hedging contracts. The Company recorded unrealized losses on cash flow hedging contracts of \$1,041,000 and \$2,355,000, respectively, net of deferred taxes of zero, for the three months and six months ended June 30, 2007. As of June 30, 2007, the Company anticipates that \$32,000 of unrealized losses, net of deferred taxes of zero, will be reclassified into earnings within the next 12 months. No cash flow hedges were determined to be ineffective during 2007. Irrespective of the unrealized gains or losses reflected in other comprehensive income, the ultimate impact to net income over the life of the hedges will reflect the actual settlement values. Further details relating to the Company's hedging activities are as follows:

Hedging contracts held as of June 30, 2007 were as follows:

		NYMEX	
Contract Period and Type		Total Volume	Fair Value (in thousands)
Crude oil contracts (barrels)			
Swap contracts:			
July 2007	December 2007	70,840	\$ 33
January 2008	December 2008	148,994	(188)
January 2009	December 2009	135,041	(361)
January 2010	September 2010	74,206	(244)
		Total	\$ (760)





**Item 2. Management's Discussion and Analysis or Plan of Operation.**

**Forward Looking Statements**

This quarterly report contains forward-looking statements that involve risks and uncertainties. We use words such as anticipate, believe, plan, expect, future, intend and similar expressions to identify such forward-looking statements. You should not place too much reliance on these forward-looking statements. Our actual results are likely to differ materially from those anticipated in these forward-looking statements for many reasons. Readers are urged to carefully review and consider the various disclosures made by us in our reports filed with the Securities and Exchange Commission which attempt to advise interested parties of the risks and factors that may affect our business, financial condition, results of operation and cash flows.

**Overview**

Foothills Resources, Inc. ( Foothills ), a Nevada corporation, and its subsidiaries are collectively referred to herein as the Company. The Company is a growth-oriented independent energy company engaged in the acquisition, exploration, exploitation and development of oil and natural gas properties. The Company currently holds interests in properties in the Texas Gulf Coast area, in the Eel River Basin in northern California, and in the Anadarko Basin in southwest Oklahoma.

The Company took its current form on April 6, 2006, when Brasada California, Inc. ( Brasada ) merged with and into an acquisition subsidiary of Foothills. Brasada was formed on December 29, 2005 as Brasada Resources LLC, a Delaware limited liability company, and converted to a Delaware corporation on February 28, 2006. Following the merger, Brasada changed its name to Foothills California, Inc. ( Foothills California ) and is now a wholly owned operating subsidiary of Foothills.

In April 2006, we closed a private offering of an aggregate of 17,142,857 units consisting of one share of our common stock and warrants to acquire three-quarters of a share of common stock for five years, at an exercise price of \$1.00 per whole share. In this offering, we received aggregate consideration of \$12,000,000. Some of the consideration for the units sold in this offering was in the form of debentures that we sold prior to the closing date of the offering to accredited investors. These debentures converted into units in the offering on a dollar-for-dollar basis upon the closing date of the offering.

In September 2006, we closed a private offering of units consisting of shares of our common stock and warrants to acquire our common stock. Each unit we sold in the offering consisted of one share of common stock and a warrant to acquire one-half share of common stock for five years at an exercise price of \$2.75 per share. On September 8, 2006, we received \$22,500,000 in proceeds from the offering, through the sale of 10,000,000 units, issuing to investors in the offering 10,000,000 shares of common stock and warrants to acquire 5,000,000 shares of common stock. On September 27, 2006, we received proceeds of an additional \$211,059 through the sale of an additional 93,804 units to additional investors in the offering.

To finance a portion of the acquisition of properties in Texas in September 2006, the Company executed a credit agreement with a financial institution, whereby the Company may borrow funds under a credit facility in an amount not to exceed \$42,500,000 (the Facility ). As of June 30, 2007, \$42,500,000 was outstanding under the Facility.

## Edgar Filing: FOOTHILLS RESOURCES INC - Form 10QSB

The Facility will terminate and all amounts borrowed under the Facility will be due and payable on September 7, 2010. The interest rate on the Facility was initially LIBOR plus 700 basis points, and was increased by 100 basis points on each of September 22, 2006, October 23, 2006 and November 22, 2006 when the Company did not satisfy a requirement of the credit agreement to raise an additional \$5,000,000 in equity capital on or before those dates. The Company is required to make quarterly interest and principal payments on the Facility equal to the adjusted net cash flow attributable to the properties acquired in the acquisition. The Facility is secured by liens and security interests on substantially all of the assets of the Company, including 100% of the Company's oil and gas reserves, and prohibits any dividends on or redemptions of Foothills capital stock.

## Edgar Filing: FOOTHILLS RESOURCES INC - Form 10QSB

On January 3, 2006, Foothills California entered into a Farmout and Participation Agreement with INNEX California, Inc., a subsidiary of INNEX Energy, L.L.C. ( INNEX ), to acquire, explore and develop oil and natural gas properties located in the Eel River Basin, the material terms of which are as follows:

Foothills California serves as operator of a joint venture with INNEX, and has the right to earn an interest in approximately 4,000 existing leasehold acres held by INNEX in the basin, and to participate as operator with INNEX in oil and gas acquisition, exploration and development activities within an area of mutual interest consisting of the entire Eel River Basin.

The agreement provides for drill-to-earn terms, and consists of three phases.

In Phase I, Foothills California was obligated to pay 100% of the costs of drilling two shallow wells, acquiring 1,000 acres of new leases, and certain other activities. The Company has fulfilled its obligations under Phase I, and will receive an assignment from INNEX of a 75% working interest (representing an approximate 56.3% net revenue interest) in the leases held by INNEX in the two drilling units to the deepest depth drilled in the two Phase I obligation wells.

Foothills California then had the option, but not the obligation, to proceed into Phase II. It elected to proceed into Phase II, and has paid the costs of conducting a 3D seismic survey covering approximately 12.7 square miles and will be obligated to pay 100% of the costs of drilling one additional shallow well. Upon completion of Phase II, the Company will receive an assignment from INNEX of a 75% working interest (representing an approximate 56.3% net revenue interest) in the leases held by INNEX in the drilling unit for the well drilled in Phase II and a 75% working interest (representing an approximate 59.3% net revenue interest) in all remaining leases held by INNEX to the deepest depth drilled in the three Phase I and II obligation wells.

Foothills California will then have the option, but not the obligation, to proceed into Phase III. In Phase III, it will be obligated to pay 100% of the costs of drilling one deep well. Upon completion of Phase III, the Company will receive an assignment from INNEX of a 75% working interest (representing an approximate 56.3% net revenue interest) in the leases held by INNEX in the drilling unit and a 75% working interest (representing an approximate 59.3% net revenue interest) in all remaining leases held by INNEX with no depth limitation.

After completion of Phase III, the two parties will each be responsible for funding their working interest share of the joint venture's costs and expenses. Foothills California will generally have a 75% working interest in activities conducted on specified prospects existing at the time of execution of the agreement, and a 70% working interest in other activities. Each party will be able to elect not to participate in exploratory wells on a prospect-by-prospect basis, and a non-participating party will lose the opportunity to participate in development activities and all rights to production relating to that prospect.

Foothills California is also entitled to a proportionate assignment from INNEX of its rights to existing permits, drill pads, roads, rights-of-way, and other infrastructure, as well as its pipeline access and marketing arrangements.

INNEX has an option to participate for a 25% working interest in certain producing property acquisitions by the Company in the area of mutual interest.

### Results of Operations

The merger of Brasada into our acquisition subsidiary on April 6, 2006 was accounted for as a reverse takeover of the Company by Foothills California. The Company adopted the assets, management, business operations and business plan of Foothills California, which was formed on December 29, 2005.



## Edgar Filing: FOOTHILLS RESOURCES INC - Form 10QSB

The financial statements of the Company prior to the merger were eliminated at consolidation. Consequently, direct comparisons of current results of operations with those of the comparable periods of the preceding year are not meaningful.

### *Three Months Ended June 30, 2007 compared with the Three Months Ended June 30, 2006*

The Company had no operating revenues for the three months ended June 30, 2006 and reported a net loss of \$1,451,000 for the quarter, which was comprised of \$78,000 of interest income, \$1,524,000 of general and administrative expenses, and \$5,000 of depreciation.

For the three months ended June 30, 2007, the Company reported a net loss of \$2,538,000, or \$0.04 per basic and diluted share. Results of operations for the quarter were negatively impacted by the effect of planned and/or non-recurring workover and well servicing operations on certain wells in Texas, which temporarily halted production from those wells during the workover and servicing operations. The costs of such operations also increased total reported production costs for the quarter. In addition, production from certain wells was shut-in for part of the quarter awaiting the availability of a service barge. Oil and gas revenues were \$3,462,000, including \$213,000 of realized gains from the Company's oil and gas cash flow hedges. The average sales price received by the Company during this period for its oil and gas production was \$60.26 per barrel of oil equivalent ( BOE ), excluding the effects of gains from cash flow hedges. The Company's net daily production for the quarter was 593 BOE. Production costs, including lease operating and workover expenses, marketing and transportation expenses, and production and ad valorem taxes, were \$1,362,000, or \$25.27 per BOE. Depreciation, depletion and amortization totaled \$599,000, including \$10.46 per BOE for the capitalized costs of oil and gas properties. General and administrative expenses during the period amounted to \$890,000. The Company incurred interest expense of \$2,474,000, including \$826,000 of non-cash charges for the amortization of debt discount and debt issue costs. Liquidated damages of \$753,000 relate to amounts payable to our stockholders as a result of the registration statements for our securities issued in 2006 not becoming effective within the periods specified in the share registration rights agreements for those securities.

### *Six Months Ended June 30, 2007 compared with the Six Months Ended June 30, 2006*

The Company had no operating revenues for the six months ended June 30, 2006 and reported a net loss of \$1,575,000 for the period, which was comprised of \$82,000 of interest income, \$1,652,000 of general and administrative expenses, and \$5,000 of depreciation.

For the six months ended June 30, 2007, the Company reported a net loss of \$4,138,000, or \$0.07 per basic and diluted share. Results of operations for the period were negatively impacted by the effect of planned and/or non-recurring workover and well servicing operations on certain wells in Texas, which temporarily halted production from those wells during the workover and servicing operations. The costs of such operations also increased total reported production costs for the period. In addition, production from certain wells was shut-in for part of the period awaiting the availability of a service barge. Oil and gas revenues were \$7,303,000, including \$637,000 of realized gains from the Company's oil and gas cash flow hedges. The average sales price received by the Company during this period for its oil and gas production was \$57.45 per barrel of oil equivalent ( BOE ), excluding the effects of gains from cash flow hedges. The Company's net daily production for the period was 641 BOE. Production costs, including lease operating and workover expenses, marketing and transportation expenses, and production and ad valorem taxes, were \$2,358,000, or \$20.32 per BOE. Depreciation, depletion and amortization totaled \$1,273,000, including \$10.38 per BOE for the capitalized costs of oil and gas properties. General and administrative expenses during the period amounted to \$1,647,000. The Company incurred interest expense of \$5,131,000, including \$1,848,000 of non-cash charges for the amortization of debt discount and debt issue costs. Liquidated damages of \$1,193,000 relate to amounts payable to our stockholders as a result of the registration statements for our securities issued in 2006 not becoming effective within the periods specified in the share registration rights agreements for those securities.

### **Off-Balance Sheet Arrangements**

We have no off-balance sheet arrangements.

**Item 3. Controls and Procedures.**

(a) Evaluation of Disclosure Controls and Procedures

The term "disclosure controls and procedures" is defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). This term refers to the controls and procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files under the Exchange Act is recorded, processed, summarized, and reported within the required time periods.

The Company's Chief Executive Officer and Chief Financial Officer carried out an evaluation of the effectiveness of the design and operation of the Company's disclosure controls and procedures as required by Rule 13a-15 of the Exchange Act. Based on their evaluation of our disclosure controls and procedures, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures are effective in ensuring that information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange Commission's rules and forms and in timely alerting the Chief Executive Officer and Chief Financial Officer to material information required to be included in the Company's periodic reports filed or furnished with the SEC.

(b) Changes in Internal Control over Financial Reporting

No change in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) occurred during the period covered by this report that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

**PART II - OTHER INFORMATION**

**Item 1. Legal Proceedings.**

The Company is not aware of any legal proceedings contemplated by any governmental authority or any other party involving the Company or its properties. As of the date of this report, no director, officer or affiliate is a party adverse to the Company in any legal proceeding or has an adverse interest to the Company in any legal proceedings. The Company is not aware of any other legal proceedings pending or that have been threatened against the Company or its properties.

**Item 2. Unregistered Sales of Equity Securities & Use of Proceeds.**

None.

**Item 3. Defaults Upon Senior Securities.**

None.

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

None.

**Item 5. Other Information.**

None.

**Item 6. Exhibits.**

<b>Exhibit No.</b>	<b>Description</b>	<b>Reference</b>
31.1	Certification of the Chief Executive Officer pursuant to Rule 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.*	
31.2	Certification of the Chief Financial Officer pursuant to Rule 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302	



Edgar Filing: FOOTHILLS RESOURCES INC - Form 10QSB

of the Sarbanes-Oxley Act of 2002.\*

- 32.1 Certification of the Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.\*
- 32.2 Certification of the Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.\*

\* Filed herewith.

**SIGNATURES**

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

Dated: August 14, 2007

FOOTHILLS RESOURCES, INC.

Dennis B. Tower

Chief Executive Officer

(Principal Executive Officer)

/s/ Dennis B. Tower

W. Kirk Bosché

Chief Financial Officer

(Principal Financial Officer and

Principal Accounting Officer)

/s/ W. Kirk Bosché