

VICTORY ENERGY CORP  
Form 10-Q  
August 15, 2011

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 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 June 30, 2011

TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE EXCHANGE ACT

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

Commission file number 002-76219NY

VICTORY ENERGY CORPORATION  
(Exact Name of Company as Specified in its Charter)

Nevada  
(State or other jurisdiction of  
incorporation or organization)

87-0564472  
(I.R.S. Employer  
Identification No.)

20341 Irvine Avenue, Newport Beach, California  
(Address of principal executive offices)

92660

(Zip Code)

(714) 480-0300

\_\_\_\_\_  
(Registrant's telephone number, including area code)

\_\_\_\_\_  
(Former name, former address and former fiscal year, if changed since last report)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

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

Large accelerated filer

Accelerated filer

Non-accelerated filer   
(Do not check if a smaller reporting company)

Smaller reporting company

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

Applicable only to issuers involved in bankruptcy proceedings during the preceding five years

Check whether the registrant filed all documents and reports required to be filed by Section 12, 13 or 15(d) of the Exchange Act after the distribution of securities under a plan confirmed by a court.  
Yes  No

Applicable only to corporate issuers:

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date. As of August 9, 2011, there were 382,307,294 shares of common stock, par value \$0.001, issued and outstanding.

---

VICTORY ENERGY CORPORATION  
QUARTERLY REPORT ON  
FORM 10-Q  
FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2011  
TABLE OF CONTENTS

	Page
<b>PART I—FINANCIAL INFORMATION</b>	
Item 1. Financial Statements	4
Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations	16
Item 3. Quantitative and Qualitative Disclosures about Market Risk.	21
Item 4. Controls and Procedures	21
<b>PART II—OTHER INFORMATION</b>	
Item 1. Legal Proceedings	22
Item 1A. Risk Factors	22
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds	22
Item 3. Default Upon Senior Securities	23
Item 4. Removed and Reserved	23
Item 5. Other Information	23
Item 6. Exhibits	23
<b>SIGNATURES</b>	

Cautionary Notice Regarding Forward Looking Statements

Victory Energy Corporation desires to take advantage of the “safe harbor” provisions of the Private Securities Litigation Reform Act of 1995. This report contains a number of forward-looking statements that reflect management's current views and expectations with respect to business, strategies, future results and events and financial performance. All statements made in this Annual Report other than statements of historical fact, including statements that address operating performance, events or developments that management expects or anticipates will or may occur in the future, including statements related to revenues, cash flow, profitability, adequacy of funds from operations, statements expressing general optimism about future operating results and non-historical information, are forward looking statements. In particular, the words “believe,” “expect,” “intend,” “anticipate,” “estimate,” “may,” “will,” variations words, and similar expressions identify forward-looking statements, but are not the exclusive means of identifying such statements and their absence does not mean that the statement is not forward-looking.

Readers should not place undue reliance on these forward-looking statements, which are based on management’s current expectations and projections about future events, are not guarantees of future performance, are subject to risks, uncertainties and assumptions and apply only as of the date of this report. Victory Energy Corporation’s actual results, performance or achievements could differ materially from the results expressed in, or implied by, these forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, the “Risk Factors” as well as those discussed elsewhere in this report, and the risks discussed in press releases and other communications to stockholders issued by Victory Energy Corporation from time to time which attempt to advise interested parties of the risks and factors that may affect the business. Except as may be required under the federal securities laws, Victory Energy Corporation undertakes no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

## Part I

## Item 1. Financial Statements

VICTORY ENERGY CORPORATION AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEETS  
(Unaudited)

	June 30, 2011	December 31, 2010
<b>CURRENT ASSETS</b>		
Cash and cash equivalents	\$467,712	\$ 111,572
Accounts receivable, net	70,580	74,828
Prepaid expenses	15,074	24,898
<b>Total current assets</b>	<b>553,366</b>	<b>211,298</b>
<b>FIXED ASSETS</b>		
Furniture and equipment	10,623	2,294
Accumulated depreciation	(2,491 )	(2,294 )
<b>Total furniture and fixtures, net</b>	<b>8,132</b>	<b>-</b>
Option to acquire leases and mineral interests	25,000	25,000
Oil and natural gas properties	1,774,980	1,466,813
Accumulated depletion	(983,491 )	(953,084 )
<b>Oil and natural gas properties, net</b>	<b>816,489</b>	<b>538,729</b>
<b>OTHER ASSETS</b>		
Funds held at court	13,006	13,006
<b>TOTAL ASSETS</b>	<b>\$1,390,993</b>	<b>\$ 763,033</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)</b>		
<b>CURRENT LIABILITIES</b>		
Accounts payable	\$307,397	\$ 342,285
Accrued liabilities	95,695	74,088
Accrued interest	57,036	10,501
Line of credit - bank	62,487	68,667
Notes payable - related parties	-	50,000
Liability for unauthorized preferred stock issued	32,164	85,654
<b>Total current liabilities</b>	<b>554,779</b>	<b>631,195</b>
<b>OTHER LIABILITIES</b>		
Senior convertible debenture, net of debt discount	89,264	127,338
Deferred tax liability	482,124	238,000
Asset retirement obligation	27,282	27,282
<b>TOTAL LIABILITIES</b>	<b>1,153,449</b>	<b>1,023,815</b>
<b>STOCKHOLDERS' EQUITY (DEFICIT)</b>		
	382,308	136,720

Edgar Filing: VICTORY ENERGY CORP - Form 10-Q

Common Stock, \$0.001 par value, 490,000,000 shares authorized, 382,307,294 and 136,719,608 issued and outstanding respectively

Additional paid in capital	33,891,976	31,740,090
Accumulated deficit	(34,036,740)	(32,137,592)
TOTAL STOCKHOLDERS' EQUITY (DEFICIT)	237,544	(260,782)

TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)	\$ 1,390,993	\$ 763,033
--	--------------	------------

VICTORY ENERGY CORPORATION AND SUBSIDIARIES  
CONSOLIDATED STATEMENT OF OPERATIONS  
(Unaudited)

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2011	2010	2011	2010
<b>REVENUES</b>	\$ 109,830	\$ 118,928	\$ 218,150	\$ 268,299
<b>COSTS AND EXPENSES</b>				
Costs of production	67,031	39,904	136,191	51,786
General and administrative expense	473,693	186,774	1,162,121	345,202
Depletion and accretion	18,402	24,983	30,604	49,966
Gain on settlement with former officer	-	-	-	(404,623 )
Total expenses	559,126	251,661	1,328,916	42,331
<b>INCOME (LOSS) FROM OPERATIONS</b>	(449,296 )	(132,733 )	(1,110,766 )	225,968
<b>OTHER EXPENSE</b>				
Interest expense	965,303	10,869	1,178,415	19,121
Total other expense	965,303	10,869	1,178,415	19,121
<b>NET INCOME (LOSS) BEFORE TAX BENEFIT</b>	(1,414,599 )	(143,602 )	(2,289,181 )	206,847
<b>TAX BENEFIT</b>	331,927	-	390,032	-
<b>NET INCOME (LOSS)</b>	\$(1,082,672 )	\$(143,602 )	\$(1,899,149 )	\$206,847
Weighted average shares, basic and diluted	150,660,143	136,719,608	143,728,385	136,719,608
Net income (loss) per share, basic and diluted	\$(0.01 )	\$(0.00 )	\$(0.01 )	\$0.00

VICTORY ENERGY CORPORATION AND SUBSIDIARIES  
CONSOLIDATED STATEMENT OF CASH FLOW  
(Unaudited)

	For the Six Months Ended June 30,	
	2011	2010
<b>CASH FLOW FROM OPERATING ACTIVITIES</b>		
Net income (loss)	\$ (1,899,149 )	\$ 206,847
Adjustment to reconcile net income (loss) from operations to net cash used in operating activities		
Amortization of debt discount and financing warrents	98,171	-
Depletion	30,407	49,966
Depreciation	197	-
Debentures converted to common stock	976,255	-
Gain on settlement with former officer	-	(404,623 )
Tax benefit of debenture discount	(390,032 )	-
Warrants for services	35,200	6,030
Change in working capital		
Accounts receivable	4,248	20,515
Prepaid expense	9,824	23,144
Accounts payable	(34,887 )	43,054
Accrued liabilities	106,082	(11,466 )
Net cash used in operating activities	(1,063,684 )	(66,533 )
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Drilled wells	(308,167 )	-
Purchase of wells	(8,329 )	-
Net cash used in investing activities	(316,496 )	-
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Sale of debentures	1,792,500	-
Bank line of credit - net repayments	(6,180 )	(11,705 )
Proceeds from notes payable to related parties	-	125,000
Payments on notes payable to related party	(50,000 )	-
Net cash provided by financing activities	1,736,320	113,295
Net change in cash and cash equivalents	356,140	46,762
Beginning cash and cash equivalents	111,572	22,076
Ending cash and cash equivalents	\$ 467,712	\$ 68,838
Supplemental schedule of non-cash investing and financing activities:		
Preferred stock converted to common stock	\$ 53,490	\$ -
Debentures exchanged for common stock	\$ 1,112,500	\$ -
Common stock exchanged for accrued interest	\$ 37,940	\$ -
Deferred tax liability	\$ 302,229	\$ -

Supplemental disclosures of cash flow information:

Cash paid during the period for		
Interest	\$ -	\$ -
Income taxes	\$ -	\$ -

6

---

Victory Energy Corporation and Subsidiary  
Notes to the Consolidated Financial Statements  
(Unaudited)

Note 1 – Financial Statement Presentation

Basis of Presentation

The accompanying consolidated balance sheet as of December 31, 2010, which has been derived from audited financial statements, and the accompanying interim consolidated financial statements as of June 30, 2011, for the three and six month periods ended June 30, 2011 and 2010, have been prepared by management pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC") for interim financial reporting. These interim consolidated financial statements are unaudited and, in the opinion of management, include all adjustments (consisting only of normal recurring adjustments and accruals) necessary to present fairly the financial condition, results of operations and cash flows of Victory Energy Corporation and subsidiary (hereinafter collectively referred to as the "Company") as of and for the periods presented in accordance with accounting principles generally accepted in the United States of America ("GAAP"). Operating results for the three and six month periods ended June 30, 2011 are not necessarily indicative of the results that may be expected for the year ending December 31, 2011 or for any other interim period during such year. Certain information and footnote disclosures normally included in financial statements prepared in accordance with GAAP have been omitted in accordance with the rules and regulations of the SEC. The accompanying consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto contained in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2010 filed with the SEC on May 16, 2011.

Organization and nature of operations

Victory Energy Corporation (Pink Sheets symbol VYEEY), formerly known as Victory Capital Holdings Corporation (the "Company") was organized under the laws of the State of Nevada on January 7, 1982, under the name All Things, Inc. On March 21, 1985 the Corporation's name was changed to New Environmental Technologies Corporation and on April 28, 2003 to Victory Capital Holdings Corporation. The name was changed finally to Victory Energy Corporation on May 3, 2006.

The business of the Company is to acquire, develop, produce and exploit oil and natural gas properties. The Company's major oil and natural gas properties are located in Texas. The Company's executive offices are located in Newport Beach, California and its operations offices are located in Austin, Texas.

The Company's initial authorized capital consisted of 100,000,000 shares of \$0.001 par value common voting stock and, as of the date of this filing, has authorized capital of 490,000,000 shares of \$0.001 par value common stock.

Going Concern

As presented in the consolidated financial statements, we had a net loss of \$1,899,149 for the six months ended June 30, 2011. Almost half of the loss results from non-cash accounting charges related to the sale and conversion of the Company's 10% Senior Secured Convertible Debentures. The cash proceeds from the debentures have allowed the Company to continue operations and invest in new oil and gas properties. The Company also incurred significant accounting, consulting, audit and legal expenses in six month period ended June 30, 2011, associated with bringing the Company current on its Security and Exchange Commission filings. Losses are expected to continue in the near term and, as of June 30, 2011, the Company has a deficit in its working capital of \$1,413 and an accumulated deficit is \$34,036,740. Management anticipates that significant additional capital expenditures will be necessary to develop

the Company's oil and natural gas properties before significant positive operating cash flows will be achieved.

Management plans to alleviate these conditions by pursuing business partnering arrangements for the acquisition and development of its properties as well as debt and equity funding through private placements. Without outside investment from the sale of equity securities, debt financing or partnering with other oil and natural gas companies, operating activities and overhead expenses will be reduced to a pace that available operating cash flows will support.

The accompanying consolidated financial statements are prepared as if the Company will continue as a going concern. The consolidated financial statements do not contain adjustments, including adjustments to recorded assets and liabilities, which might be necessary if the Company were unable to continue as a going concern.

## Note 2 – Summary of Significant Accounting Policies

### Principles of consolidation

The accompanying consolidated financial statements are presented in accordance with accounting principles generally accepted in the United States. The consolidated financial statements include the accounts of the Company and Aurora Energy Partners, A Texas General Partnership. The Company holds a 15% equity interest in Aurora Energy Partners. Since the Company serves as managing partner and is responsible for managing all business operations of the partnership, the financial statements of Aurora have been consolidated with the Company. All significant intercompany transactions have been eliminated. The consolidated financial statements reflect necessary adjustments, all of which were of a recurring nature and are in the opinion of management necessary for a fair presentation.

### Property and equipment

Property and equipment are recorded at cost. Cost of repairs and maintenance are expensed as they are incurred. Major repairs that extend the useful life of equipment are capitalized and depreciated over the remaining estimated useful life. When property and equipment are sold or otherwise disposed, the related costs and accumulated depreciation are removed from the respective accounts and the gains or losses realized on the disposition are reflected in operations. The Company uses the straight-line method in computing depreciation for financial reporting purposes.

### Revenue Recognition

We use the sales method of accounting for oil and natural gas revenues. Under this method, revenues are recognized based on actual volumes of gas and oil sold to purchasers. The volumes sold may differ from the volumes to which we are entitled based on our interests in the properties. Differences between volumes sold and entitled volumes create oil and gas imbalances which are generally reflected as adjustments to reported proved oil and gas reserves and future cash flows in our supplemental oil and gas disclosures. If our excess takes of natural gas or oil exceed our estimated remaining proved reserves for a property, a natural gas or oil imbalance liability is recorded in the consolidated balance sheet. There were no such imbalance liabilities recorded at June 30, 2011 and December 31, 2010.

### Allowance for Doubtful Accounts

We recognize an allowance for doubtful accounts to ensure trade receivables are not overstated due to uncollectability. Bad debt reserves are maintained for all customers based on a variety of factors, including the length of time receivables are past due, macroeconomic conditions, significant one-time events and historical experience. An additional reserve for individual accounts is recorded when we become aware of a customer's inability to meet its financial obligations, such as in the case of bankruptcy filings or deterioration in the customer's operating results or financial position. If circumstances related to customers change, estimates of the recoverability of receivables would be further adjusted. There were allowance for doubtful accounts balances at June 30, 2011 and December 31, 2010.

### Fair Value of Financial Instruments

The Company's financial instruments consist of cash and cash equivalents, accounts receivable, other assets, fixed assets, derivative liability, deferred revenue, accounts payable, accrued liabilities and short-term debt. The estimated fair value of cash, accounts receivable, other assets, accounts payable, deferred revenue and accrued liabilities

approximated their carrying amounts due to the short-term nature of these instruments. The carrying value of short-term debt also approximates fair value since their terms are similar to those in the lending market for comparable loans with comparable risks. None of these instruments are held for trading purposes.

The Company utilizes various types of financing to fund its business needs, including debt with warrants attached and other instruments indexed to its stock. The Company reviews its warrants and conversion features of securities issued as to whether they are freestanding or contain an embedded derivative and if so, whether they are classified as a liability at each reporting period until the amount is settled and reclassified into equity with changes in fair value recognized in current earnings.

Inputs used in the valuation to derive fair value are classified based on a fair value hierarchy which distinguishes between assumptions based on market data (observable inputs) and an entity's own assumptions (unobservable inputs). The hierarchy consists of three levels:

- Level one – Quoted market prices in active markets for identical assets or liabilities;
- Level two – Inputs other than level one inputs that are either directly or indirectly observable; and
- Level three – Unobservable inputs developed using estimates and assumptions, which are developed by the reporting entity and reflect those assumptions that a market participant would use.

Determining which category an asset or liability falls within the hierarchy requires significant judgment. The Company evaluates its hierarchy disclosures each quarter. The following table presents all assets that were measured and recognized at fair value as of June 30, 2011 and for the three months then ended on a non-recurring basis. The assets shown below were presented at fair value due to the impairment analysis indicating an estimated fair value below the carrying value for the proved oil and gas properties.

Fair value of assets measured and recognized at fair value on a non-recurring basis as of June 30, 2011 were as follows:

Description	Level 1	Level 2	Level 3	Total Realized (Loss) due to valuation	Total Unrealized (Loss)
Proved Properties (net)	\$ —	\$ —	\$ 483,322	\$ —	\$ —
Totals	\$ —	\$ —	\$ 483,322	\$ —	\$ —

The Company valued the Proved Properties at their fair value in accordance with the applicable Accounting Standards Codification (“ASC”) standard due to the impairment indicators prevalent as of June 30, 2011. The inputs that were used in determining the fair value of these assets were Level 3 inputs. These inputs consist of but are not limited to the following: estimates of reserve quantities, estimates of future production costs and taxes, estimates of consistent pricing of commodities, 10% discount rate, etc. No impairment expense was recorded as of June 30, 2011.

#### Concentrations

There is a ready market for the sale of crude oil and natural gas. During the six months ended June 30, 2011, each of our fields sold all of its oil production to one purchaser for each field and all of its natural gas production to one purchaser for each field. However, because alternate purchasers of oil and natural gas are readily available at similar prices, we believe that the loss of any of our purchasers would not have a material adverse effect on our financial results.

#### Accounting estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the periods reported.

Actual results could differ from these estimates.

Significant estimates include volumes of oil and natural gas reserves used in calculating depletion of proved oil and natural gas properties, future net revenues and abandonment obligations, impairment of proved and unproved properties, future income taxes and related assets and liabilities, the fair value of various common stock, warrants and option transactions, and contingencies. Oil and natural gas reserve estimates, which are the basis for unit-of-production depletion and the calculation of impairment, have numerous inherent uncertainties. The accuracy of any reserve estimate is a function of the quality of available data, the engineering and geological interpretation and judgment. Results of drilling, testing and production subsequent to the date of the estimate may justify revision of such estimate. Accordingly, reserve estimates are often different from the quantities of oil and natural gas that are ultimately recovered. In addition, reserve estimates are vulnerable to changes in wellhead prices of crude oil and natural gas. Such prices have been volatile in the past and can be expected to be volatile in the future.

These significant estimates are based on current assumptions that may be materially affected by changes to future economic conditions such as the market prices received for sales of volumes of oil and natural gas, interest rates, the fair value of the Company's common stock and corresponding volatility, and the Company's ability to generate future taxable income. Future changes to these assumptions may affect these significant estimates materially in the near term.

#### Oil and natural gas properties

The Company accounts for its oil and natural gas properties using the successful efforts method of accounting. Under this method, all costs associated with property acquisitions, successful exploratory wells, all development wells, including dry hole development wells, and asset retirement obligation assets are capitalized. Additionally, interest is capitalized while wells are being drilled and the underlying property is in development. Costs of exploratory wells are capitalized pending determination of whether each well has resulted in the discovery of proved reserves. Oil and natural gas mineral leasehold costs are capitalized as incurred. Items charged to expense generally include geological and geophysical costs, costs of unsuccessful exploratory wells, and oil and natural gas production costs. Capitalized costs of proved properties including associated salvage are depleted on a well-by-well or field-by-field (common reservoir) basis using the units-of-production method based upon proved producing oil and natural gas reserves. The depletion rate is the current period production as a percentage of the total proved producing reserves. The depletion rate is applied to the net book value of property costs to calculate the depletion expense. Proved reserves materially impact depletion expense. If the proved reserves decline, then the depletion rate (the rate at which we record depletion expense) increases, reducing net income. Dispositions of oil and natural gas properties are accounted for as adjustments to capitalized costs with gain or loss recognized upon sale. A gain (loss) is recognized to the extent the sales price exceeds or is less than original cost or the carrying value, net of impairment. Oil and natural gas properties are also subject to impairment at the end of each reporting period. Unproved property costs are excluded from depletable costs until the related properties are developed. See impairment discussed in "Long-lived assets and intangible assets" below.

We depreciate other property and equipment using the straight-line method based on estimated useful lives ranging from five to 10 years.

#### Long-lived assets and intangible assets

The Company accounts for intangible assets in accordance with the applicable ASC. Intangible assets that have defined lives are subject to amortization over the useful life of the assets. Intangible assets held having no contractual factors or other factors limiting the useful life of the asset are not subject to amortization but are reviewed at least annually for impairment or when indicators suggest that impairment may be needed. Intangible assets are subject to impairment review at least annually or when there is an indication that an asset has been impaired. While there are prospects for possible capital funding (either debt or equity), much is left to the market and outside instability. As such, at this time, management cannot anticipate with a comfortable degree of certainty if the appropriate amount of funding will be achieved and any funding will be diverted fully to its exploration and production activities. For unproved property costs, management reviews these investments for impairment on a property-by-property basis if a triggering event should occur that may suggest that impairment may be required.

The Company reviews its long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. If the carrying amount of the asset, including any intangible assets associated with that asset, exceeds its estimated future undiscounted net cash flows, the Company will recognize an impairment loss equal to the difference between its carrying amount and its estimated fair value. The fair value used to calculate the impairment for producing oil and natural gas field that produces from a common reservoir is first determined by comparing the undiscounted future net cash flows associated with total proved properties to the

carrying value of the underlying evaluated property. If the cost of the underlying evaluated property is in excess of the undiscounted future net cash flows, the future net cash flows are discounted at 10%, which the Company believes approximates fair value, to determine the amount of impairment.

The Company recorded no impairment for the three and six months ended June 30, 2011.

#### Asset retirement obligation

In accordance with the ASC, the Company recognizes the fair value of the liability for asset retirement costs in an entity's balance sheet, as both a liability and an increase in the carrying values of such assets, in the periods in which such liabilities can be reasonably estimated. The present value of the estimated future asset retirement obligation ("ARO"), as of the date of acquisition or the date at which a successful well is drilled, is capitalized as part of the costs of proved oil and natural gas properties and recorded as a liability. The asset retirement costs are depleted over the production life of the oil and natural gas property on a unit-of-production basis.

The ARO is recorded at fair value and accretion expense is recognized as the discounted liability is accreted to its expected settlement value. The fair value of the ARO liability is measured by using expected future cash outflows discounted at the Company's credit adjusted risk free interest rate.

Amounts incurred to settle plugging and abandonment obligations that are either less than or greater than amounts accrued are recorded as a gain or loss in current operations. Revisions to previous estimates, such as the estimated cost to plug a well or the estimated future economic life of a well, may require adjustments to the ARO and are capitalized as part of the costs of proved oil and natural gas property.

#### Income taxes

The Company accounts for income taxes in accordance with ASC 740 "Income Taxes" which requires an asset and liability approach for financial accounting and reporting of income taxes. Deferred income taxes reflect the impact of temporary differences between the amount of assets and liabilities for financial reporting purposes and such amounts as measured by tax laws and regulations. Deferred tax assets include tax loss and credit carry forwards and are reduced by a valuation allowance if, based on available evidence, it is more likely than not that some portion or all of the deferred tax assets will not be realized.

On January 1, 2007, the Company adopted the Financial Accounting Standards Board ("FASB") Interpretation on accounting for uncertainty in income taxes. The interpretation prescribes a measurement process for recording in the financial statements uncertain tax positions taken or expected to be taken in a tax return. Additionally, the interpretation provides guidance regarding uncertain tax positions relating to derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. The Company will classify any interest and penalties associated with income taxes as interest expense.

#### Stock based compensation

Beginning January 1, 2006, the Company adopted the FASB standard for accounting for stock based compensation to account for its issuance of warrants to key partners, directors and officers. The standard requires all share-based payments, including employee stock options, warrants and restricted stock, be measured at the fair value of the award and expensed over the requisite service period (generally the vesting period). The fair value of common warrants granted to key partners, directors and officers is estimated at the date of grant using the Black-Scholes option pricing model by using the historical volatility of comparable public companies. The calculation also takes into account the common stock fair market value at the grant date, the exercise price, the expected life of the common stock option or warrant, the dividend yield and the risk-free interest rate.

The Company from time to time may issue stock options, warrants and restricted stock to acquire goods or services from third parties. Restricted stock, options or warrants issued are recorded on the basis of their fair value, which is measured as of the date issued. The options or warrants are valued using the Black-Scholes option pricing model on the basis of the market price of the underlying equity instrument on the "valuation date," which for options and warrants related to contracts that have substantial disincentives to non-performance, is the date of the contract, and for all other contracts is the vesting date. Expense related to the options and warrants is recognized on a straight-line basis over the shorter of the period over which services are to be received or the vesting period.

The Company recognized stock-based compensation expense from warrants granted to directors for the three and six months ended June 30, 2011 was \$16,240 and \$35,200, respectively.

#### Earnings per share

Basic earnings per share are computed using the weighted average number of common shares outstanding. Diluted earnings per share reflect the potential dilutive effects of common stock equivalents such as options, warrants and convertible securities. The Company showed positive net income of \$206,487 for the six months ended June 30, 2010 which resulted from a one-time gain on a settlement with a former officer of \$404,623. Had the gain not occurred, the Company would have shown a net loss of \$197,776 for the six months ended June 30, 2010. To avoid possible confusion surrounding the effect of this one-time gain, basic and diluted net income and net loss per share are stated as being the same when the net income is the result of a one-time gain. Given the historical and projected future losses of the Company, all potentially dilutive common stock equivalents are anti-dilutive.

## Note 3 – Oil and natural gas properties

Oil and natural gas properties are comprised of the following as of:

	June 30, 2011	December 31, 2010
Option on oil and gas property	\$ 25,000	\$ 25,000
Drilling in process costs	308,167	-
Proved property – drilled wells	1,753,026	1,753,026
Proved property – purchased wells	3,015,322	3,015,322
Total oil and natural gas properties, cost	5,101,515	4,793,348
Less: accumulated depletion and impairment	(4,285,026)	(4,254,619)
Oil and natural gas properties, net	\$ 816,489	\$ 538,729

Drilling in process costs for the six months ended June 30, 2011 reflects the acquisition costs and our share of the operating and drilling costs for our respective working interest in a producing well operated by CO Energy, a working interest in the Tunis Creek project operated by V-F Petroleum Inc., a working interest in the Alwan West natural gas prospect in Wharton County, Texas operated by Miramar Petroleum, Inc., and the Atwood oil project in Hughes County, Oklahoma. In each case, participation in the operating costs was part of the respective consideration given in the acquisition.

## Note 4 –Loans payable to related parties

On March 24, 2011 the former CEO and shareholder waived his claim to his loan payable as part of a comprehensive settlement agreement with the Company (see Note 7). The Company realized a gain on settlement of \$404,623 at December 31, 2010 as a result of the cancellation of this debt.

## Note 5 – Unsecured notes payable to related parties

Unsecured notes payable to related parties were as follows as of:

	June 30, 2011	December 31, 2010
Note payable to an affiliate of a shareholder and director, unsecured, 10% interest payable at maturity due on March 31, 2011 was settled for cash on March 25, 2011.	-	50,000
Total notes payable to related parties	\$ -	\$ 50,000

## Note 6 – Line of credit payable to Wells Fargo Bank

On October 7, 2008, the Company executed an unsecured Business Line of Credit Agreement with Wells Fargo Bank, National Association. The Credit Agreement provides the Company with a line of credit facility in the aggregate amount of \$96,761. Interest on the loan is payable monthly, at the rate of 10.0% per annum. The line of credit was personally guaranteed by the Company's former CEO and shareholder.

During the three months ended December 31, 2010, the Company defaulted on its monthly loan payments to Wells Fargo Bank and the loan was referred to the Wells Fargo Bank's workout department. The Company has negotiated an informal repayment program with the Wells Fargo Bank's workout department whereby the Wells Fargo Bank will not institute collection actions provided the Company continues to make monthly principal payments of \$2,200 monthly

Edgar Filing: VICTORY ENERGY CORP - Form 10-Q

to Wells Fargo Bank. As of June 30, 2011, the Company was current on the workout terms of this line of credit. The note was settled for cash on August 4, 2011.

	June 30, 2011	December 31, 2010
Line of credit payable to Wells Fargo Bank, 10% interest payable at maturity, currently in workout phase	\$ 62,487	\$ 68,667

Note 7 – Separation Settlement Payable to former officer and shareholder

On May 15, 2009, the Company entered into a “Separation Agreement and General Release of Claims” with Jon Fullenkamp (“Fullenkamp”) and the Virgin Family Trust. The terms of the Agreement include (a) termination of an employment agreement between the Company and Fullenkamp; (b) payment of all accrued salaries, unreimbursed expenses, and shareholder advances previously made by Fullenkamp; (c) reduction of shareholder advances from estimated balance owed at the time of settlement of \$1,665,375 to a balance of \$500,000 (the “Separation Settlement”); (d) Payment terms of the Separation Settlement of \$10,000 monthly commencing June 1, 2009, and payable over a fifty (50) month period, including imputed interest at the rate of 3.52% per annum; (e) cancellation of 2,000,000 shares of preferred stock, convertible at the rate of 100 shares of common, (d) lockup agreement with respect to all shares owned directly or indirectly by Fullenkamp for a period of five years, (e) Fullenkamp was to cooperate with the Company to recover misappropriated funds and agreed to bring litigation or induce others to bring litigation against the Company.

At the time of the agreement, Fullenkamp was owed the sum of approximately \$1,665,375 in shareholder advances which were settled for \$500,000, resulting in a gain on the settlement of this debt of \$1,199,748. After the first payment of \$10,000 the Company recorded a discount of 3.25% on \$490,000, the minimum federal rate in the amount of \$34,373 against the note. The discount is amortized to interest expense over the period of estimated maturity. During the year ended December 31, 2009, the Company recorded interest expense of \$8,997 and the note had an unamortized discount of \$24,476. During the year ended December 31, 2009, the Company paid \$51,004 of the principal of the Separation Settlement, reducing the outstanding balance as of December 31, 2009 to \$404,623.

During the year ended December 31, 2009, Fullenkamp filed a lawsuit against the Company. The Company subsequently filed a lawsuit against Fullenkamp and others on January 19, 2010, in Midland County, Texas.

On March 24, 2011 the Company, James Capital Energy, LLC and other related parties entered into a comprehensive Settlement Agreement with Jon Fullenkamp. Under the Settlement Agreement, Victory agreed to i) dismiss Jon Fullenkamp from the Texas lawsuit with prejudice, ii) provide him with a general release from all acts related thereto, and iii) pay him \$30,000 over 70 days. In turn, Jon Fullenkamp agreed to i) dismiss with prejudice the lawsuit he filed against the Company and others in California; ii) transfer to Victory 2,000,000 shares of Victory preferred stock; iii) transfer to Victory 400,000 warrants for Victory common stock; iv) transfer to James Capital Energy, LLC 16,144,563 shares of Victory common stock; v) voluntarily appear for his deposition to discuss events that occurred at the Adams-Baggett Ranch; vi) waive the claim he had to the \$430,000 severance payment under the May 15, 2009 Separation Agreement; and vii) provide Victory James Capital Energy, LLC and other related parties with a general release.

Note 8 – Liability for Unauthorized Preferred Stock Issued

During the year ended December 31, 2006, the Company authorized 10,000,000 shares of Preferred Stock, convertible to common stock at the rate of 100 shares of common for every share of preferred. During 2006, the Company issued 715,517 shares of this preferred stock for cash of \$246,950. The Company subsequently issued additional preferred stock and had several preferred shareholders converted their shares into common stock during the years ended December 31, 2009, 2008, and 2007.

During the course of the Company’s internal investigation, it was determined by the Company’s legal counsel that the preferred shares had not been duly authorized by the State of Nevada. Since the Company had issued and received consideration for the preferred stock, notwithstanding that the stock was not legally authorized, the Company reclassified the preferred stock into a liability. The Company has offered to settle the debt with the remaining holders of the unauthorized preferred stock by honoring the terms of conversion of one share of preferred into 100 shares of

common stock.

On April 25, 2011, 155,000 shares of the Companies preferred stock held by three affiliates of the Company were converted to 15,500,005 shares of the Company's common stock in accordance with the terms on which such preferred stock has been converted.

The preferred stock liability consisted of the following as of:

	June 30, 2011	December 31, 2010
Liability for unauthorized preferred stock	\$ 32,164	\$ 85,654

## Note 9 – Senior Secured Convertible Debentures

Between October 15, 2010, and July 25, 2011, the Company entered into agreements with 47 accredited investors for the cash sale by the Company of an aggregate of \$2,917,275 of 10% Senior Secured Convertible Debentures (the “Debentures”) which are convertible into an aggregate of 583,455,000 shares of the Company’s common stock at a conversion price of \$0.005 per share of common stock, subject to adjustment. The maturity date of the Debentures is September 30, 2013, but may be extended at the sole discretion of the Company to December 31, 2013. The Debentures are immediately convertible by the holder into shares of the Company’s common stock at a conversion price of \$0.005 per share, subject to customary adjustments for stock splits, stock dividends, recapitalizations and the like. The Company has the right to force conversion of the Debenture if, among other things, the closing sales price of the Company’s common stock is equal to or exceeds \$0.025 for twenty (20) consecutive trading days. In connection with this offering, the Company also issued five (5) year warrants to purchase an aggregate of 2,917,275 shares of the Company’s common stock at an exercise price of \$0.005 per share, subject to adjustment, to the investors. The cash proceeds of \$2,917,275 were allocated to working capital. The Debentures are secured under the terms of a Security Agreement by a security interest in all of the Company’s personal property. The relative fair value of the warrants and beneficial conversion features of the debentures were determined at the time of issuance using the methodology prescribed by current accounting guidance.

During the three months ended June 30, 2011, the Company issued \$882,500 of these debentures for cash of \$882,500. The Company determined the initial fair value of the beneficial conversion feature was approximately \$857,416. The Company also determined that the relative fair value of the warrants upon issuance was \$25,084 which was calculated under a Black-Scholes option pricing model using as assumptions an expected life of 5 years, a stock volatility ranging from 679.1% to 682.9% , a risk free interest rate ranging from 1.74% to 2.2%, and no expected dividend yield. The initial fair value of the warrants of \$25,084 and the beneficial conversion feature of \$857,416 were recorded by the Company as a financing discount of \$882,500 which the Company is amortizing to interest expense over the life of the notes.

On June 30, 2011, \$1,112,500 of the convertible debentures were converted into 222,500,000 shares of the Company’s common stock in accordance with the terms of the debentures.

Senior secured convertible debentures consisted of the following as of:

	June 30, 2011	December 31, 2010
Convertible debentures, interest at 10% per annum payable quarterly, due September 30, 2013 with detachable warrants	\$ 2,067,500	\$ 275,000
Convertible debentures, interest at 10% per annum payable quarterly, due September 30, 2013 issued in exchange for notes payable and accrued interest to related party	552,275	552,275
Convertible debentures converted to common stock	(1,112,500)	--
Subtotal	1,507,275	827,275
Debt discount	(1,418,011)	(699,937)
Net book value	\$ 89,264	\$ 127,338

Amortization of the debt discount and related financing warrants totaled \$98,171 for the six months ended June 30, 2011.

In May 2011, a majority of the investors in the private placement agreed to an amendment proposed by the Company to remove a condition under which the Company would be required to unilaterally adjust the conversion price of the debentures and the exercise price of the warrants if the Company issued securities at a price below the stated

conversion price of \$.005 per share.

As the Company did not intend to be unilaterally required to adjust the conversion price of the debentures because the conversion price included in the offering of the debentures is so low, the Company is treating the amendment as a correction to the original offering documents.

#### Note 10 – Shareholders Equity

During the three months ended June 30, 2011, the following unregistered securities were issued for the purposes noted.

On April 25, 2011, 155,000 shares of the Companies preferred stock held by three affiliates of the Company were converted to 15,500,005 shares of the Company's common stock in accordance with the terms on which such preferred stock has been converted.

On June 30, 2011, \$1,112,500 of the face value of the Company's 10% Senior Secured Convertible Debentures held by six affiliated and six non affiliated entities were converted to 222,500,000 shares of the Company's common stock in accordance with the terms of the debentures.

On June 30, 2011, 7,587,671 of the Company's common stock were issued to six affiliated and six non affiliated entities in full satisfaction of the \$37,940 in accrued interest on the debentures converted on that date.

During the three months ended June 30, 2011, we issued 10% Senior Secured Convertible Debentures with the total face value of \$750,000 to 15 individual or investment entities who are non-affiliates of the Company in exchange for \$750,000. The debentures are convertible into 150,000,000 shares of common stock at a conversion price of \$0.005 per share.

During the three months ended June 30, 2011, we issued warrants to purchase a total of 750,000 shares of common stock to 15 individual or investment entities who are non-affiliates of the Company at an exercise price of \$0.005 as part of the terms of the sale of the debentures. The warrants are convertible into 750,000 shares of the Company's common stock.

During the three months ended June 30, 2011, we issued 10% Senior Secured Convertible Debentures with the total face value of \$132,500 to three individual or investment entities who are affiliates of the Company in exchange for \$132,500. The debentures are convertible into 26,500,000 shares of common stock at a conversion price of \$0.005 per share.

During the three months ended June 30, 2011, we issued warrants to purchase a total of 132,500 shares of common stock to three individual or investment entities who are affiliates of the Company at an exercise price of \$0.005 as part of the terms of the sale of the debentures. The warrants are convertible into 132,500 shares of the Company's common stock.

On June 30, 2011, we agreed to issue warrants to purchase a total of 400,000 shares of common stock to board members of the Company at an exercise price of \$0.01 per share in exchange for services. Of these warrants, each board member is to receive warrants to purchase 100,000 shares. These warrants will be issued by us to the individuals on December 31, 2011.

#### Note 11 – Income Taxes

As a result of net operating losses and the inability to record a benefit for its deferred income tax assets, the Company has no income tax provision for the six months ended June 30, 2011 or for the year ended December 31, 2010.

The Internal Revenue Code of 1986, as amended, imposes substantial restrictions on the utilization of net operating losses in the event of an "ownership change" of a corporation. Accordingly, a company's ability to use net operating losses may be limited as prescribed under Internal Revenue Code Section 382 ("IRC Section 382"). Events which may cause limitations in the amount of the net operating losses that the company may use in any one year include, but are not limited to, a cumulative ownership change of more than 50% over a three-year period. There have been transactions that have changed the Company's ownership structure since inception that may have resulted in one or more ownership changes as defined by the Internal Revenue Code of 1986.

At December 31, 2010, the Company had available approximately \$2,896,000 in Federal and state net operating loss to reduce future taxable income. The Federal net operating loss carry forward begins to expire in 2025.

Given the Company's history of net operating losses, management has determined that it is more-likely-than-not the Company will not be able to realize the tax benefit of the carry forwards. Current standards require that a valuation allowance be established when it is more likely than not that all or a portion of deferred tax assets will not be realized.

Accordingly, the Company has recorded a full valuation allowance against its net deferred tax assets at December 31, 2010. Upon the attainment of taxable income by the Company, management will assess the likelihood of realizing the tax benefit associated with the use of the carry forwards and will recognize a deferred tax asset at that time.

Accounting principles generally accepted in the United States requires the recognition of a deferred tax liability for the tax benefit associated with the beneficial conversion feature related to the Company's 10% Senior Secured Convertible Debentures. The beneficial conversion value is created whenever the market price of the Company's stock is less than the conversion price of the debentures. The resulting deferred tax liability is designed to reflect the potential tax credit associated with the difference between the basis of the debentures for accounting purposes and the basis of the

debentures for tax purposes. During the three and six months ended June 30, 2011, the Company recognized a benefit of \$331,927 and \$390,032, respectively, as a result of this difference.

Note 12 – Subsequent Event

On August 5, 2011, the company settled the litigation that it filed on March 18, 2011, against its former independent public accounting firm, John Kinross-Kennedy, for professional negligence. The Company executed a Settlement Agreement and Mutual Release with Mr. Kinross-Kennedy as the matter has been satisfactorily resolved.



the Company current on its Security and Exchange Commission filings. Losses are expected to continue in the near term and, as of June 30, 2011, the Company has a deficit in its working capital of \$1,413 and an accumulated deficit of \$34,036,740. Management anticipates that significant additional capital expenditures will be necessary to develop the Company's oil and natural gas properties before significant positive operating cash flows will be achieved.

Management plans to alleviate these conditions by pursuing business partnering arrangements for the acquisition and development of its properties as well as debt and equity funding through private placements. Without outside investment from the sale of equity securities, debt financing or partnering with other oil and natural gas companies, operating activities and overhead expenses will be reduced to a pace that available operating cash flows will support.

Edgar Filing: VICTORY ENERGY CORP - Form 10-Q

Three Months Ended June 30, 2011 Compared to the Three Months Ended June 30, 2010

Our revenue, operating expenses, and net income for the three months ended June 30, 2011 as compared to the three months ended June 30, 2010 were as follows:

	Three Months Ended June 30,		Change	Percentage Change Inc (Dec)
	2011	2010		
<b>REVENUES</b>	\$ 109,830	\$ 118,928	\$ (9,098 )	(7.7 %)
<b>COSTS AND EXPENSES</b>				
Costs of production	67,031	39,904	27,127	68.0 %
General and administrative expense	473,693	186,774	286,919	154 %
Depletion and accretion	18,402	24,983	(6,581 )	(26.3 %)
Total expenses	559,126	251,661	307,465	122 %
<b>LOSS FROM OPERATIONS</b>	(449,296 )	(132,733 )	(316,563 )	(238 %)
<b>OTHER INCOME AND EXPENSE</b>				
Interest expense	965,303	10,869	954,434	8,781 %
Total other expense	965,303	10,869	954,434	
<b>INCOME (LOSS) BEFORE TAX BENEFIT</b>	(1,414,599 )	(143,602 )	(1,270,997)	(885 %)
<b>TAX BENEFIT</b>	331,927	-	\$ 331,927	
<b>NET INCOME (LOSS)</b>	\$ (1,082,672 )	\$ (143,602 )	\$ (939,070 )	(654 %)
<b>Weighted average shares, basic and diluted</b>				
	150,660,143	136,719,608		
Net loss per share, basic and diluted	\$ (0.01 )	\$ (0.00 )		

Revenues: All of our revenue was derived from the sale of oil and natural gas. Our revenues decreased \$9,098 or 7.7% to \$109,830 for the three months ended June 30, 2011 from \$118,928 for the three months ended June 30, 2010. The decrease reflects a decline in volume of gas sold to 16,352 MCF (thousand cubic feet) in the three months ended June 30, 2011 compared to 21,032 MCF for the three months ended June 30, 2010 offset by an increase in the average natural gas price received of \$6.61 per MCF for the three months ended June 30, 2011 compared to \$5.73 for the three months ended June 30, 2010. The decline in gas production is attributable to the normal productivity decline that occurs with these types of wells over time.

Costs of Production: Our cost of production, including royalties, lease, operations, production taxes and expenses increased \$27,127 or 68% to \$67,031 for the three months ended June 30, 2011 from \$39,904 for the three months ended June 30, 2010. This increase is due to additional operating expenses and other one-time charges associated with on-going well production.

General and Administrative Expense: General and administrative expenses increased \$286,919 or 154% to \$473,693 for the three months ended June 30, 2011 from \$186,774 for the three months ended June 30, 2010. The increase

reflects a number of one-time charges including accounting, auditing, and legal expenses to bring the Company current on its SEC filings, and the increase in salaries and expenses associated with the opening of the Austin office in January, 2011.

Depletion and Accretion: Depletion, accretion, and depreciation declined \$6,581 or 26.3% to \$18,402 for the three months ended June 30, 2011 from \$24,983 for the three months ended June 30, 2010. The decrease was due to the lower amount of asset cost basis available to deplete following the impairment adjustment of 2010.

Interest Expense: Interest expense increased \$954,434 to \$965,303 for the three months ended June 30, 2011 from \$10,869 for the three months ended June 30, 2010. Of this amount, \$904,340 represents the amortization of the non-cash debt discount associated with the sale and conversion of the 10% Senior Secured Debentures and \$60,963 represents the actual interest expense due on the 10% Senior Secured Convertible Debentures and the bank line of credit.

Income Taxes: There is no provision for income tax recorded for either the three months ended June 30, 2011 or for the three months ended June 30, 2010 due to the expected operating losses of both years. We had available Federal income tax net operating loss ("NOL") carry forwards of approximately \$5,472,000 at December 31, 2010. Our NOL generally begins to expire in 2025. We recognize the tax benefit of NOL carry forwards as assets to the extent that management believes that the realization of the NOL carry forward is more likely than not. The realization of future tax benefits is dependent on our ability to generate taxable income within the carry forward period. This valuation allowance is provided for all deferred tax assets.

The Company recognized a tax benefit of \$331,927 due to the timing difference in tax effect between the accounting and tax basis of the Company's 10% Senior Secured Convertible Debentures sold and converted during the three month period ended June 30, 2011.

Net Loss: We had a net loss of \$1,082,672 for the three months ended June 30, 2011 compared to a net loss of \$143,602 for the three months ended June 30, 2010. Of this loss, approximately \$316,563 represents a net decrease in operating income and \$954,434 represents increases in cash and non cash financing interest costs. This net loss should be viewed in light of the cash flow from operations discussed below.

Edgar Filing: VICTORY ENERGY CORP - Form 10-Q

Six Months Ended June 30, 2011 Compared to the Six Months Ended June 30, 2010

Our revenue, operating expenses, and net income (loss) for the six months ended June 30, 2011 as compared to the six months ended June 30, 2010 were as follows:

	Six Months Ended June 30,		Change	Percentage Change Inc (Dec)
	2011	2010		
<b>REVENUES</b>	\$ 218,150	\$ 268,299	\$ (50,149 )	(18.7 %)
<b>COSTS AND EXPENSES</b>				
Costs of production	136,191	51,786	84,405	163 %
General and administrative expense	1,162,121	345,202	816,919	237 %
Depletion and accretion	30,604	49,966	(19,362 )	(38.8 %)
Loss (gain) on settlements	-	(404,623 )	404,623	n/m
Total expenses	1,328,916	42,331	1,286,585	3,039 %
<b>INCOME (LOSS) FROM OPERATIONS</b>	(1,110,766 )	225,968	(1,336,734)	(591 )%
<b>OTHER INCOME AND EXPENSE</b>				
Interest expense	1,178,415	19,121	1,159,294	6,063 %
Total other expense	1,178,415	19,121	1,159,294	
<b>INCOME (LOSS) BEFORE TAX BENEFIT</b>	(2,289,181 )	206,847	(2,496,028)	(1,207 %)
<b>TAX BENEFIT</b>	390,032	-	\$ 390,032	
<b>NET INCOME (LOSS)</b>	\$ (1,899,149 )	\$ 206,847	\$ (2,105,996)	(1,018 %)
Weighted average shares, basic and diluted				
	143,728,385	136,719,608		
<b>Net loss per share, basic and diluted</b>	\$ (0.01 )	\$ 0.00		

Revenues: All of our revenue was derived from the sale of oil and natural gas. Our revenues decreased \$50,149 or 18.7% to \$218,150 for the six months ended June 30, 2011 from \$268,299 for the six months ended June 30, 2010. The decrease reflects a decline in volume of gas sold to 33,982 MCF (thousand cubic feet) in the six months ended June 30, 2011 compared to 42,438 MCF for the six months ended June 30, 2010 offset by the increase in the average natural gas price received of \$6.71 per MCF for the six months ended June 30, 2011 compared to \$6.45 for the six months ended June 30, 2010. The decline in gas production is attributable to the normal productivity decline that occurs with these types of wells over time.

Costs of Production: Our cost of production, including royalties, lease, operations, production taxes and expenses increased \$84,405 or 163% to \$136,191 for the six months ended June 30, 2011 from \$51,786 for the six months ended June 30, 2010. This increase is due to additional operating expenses and other one-time charges associated with on-going well production.

General and Administrative Expense: General and administrative expenses increased \$816,919 or 237% to \$1,162,121 for the six months ended June 30, 2011 from \$345,202 for the six months ended June 30, 2010. The increase reflects a number of one-time charges including accounting, auditing, and legal expenses to bring the Company current on its SEC filings, the legal cost related to the final settlement with the former officer of the Company, and the increase in salaries and expenses associated with the operations of the Austin office.

**Depletion and Accretion:** Depletion, accretion, and depreciation declined \$19,362 or 38.8% to \$30,604 for the six months ended June 30, 2011 from \$49,966 for the six months ended June 30, 2010. The decrease was due to the lower amount of asset cost basis available to deplete following the impairment adjustment of 2010.

**Gain on Settlement:** On March 24, 2011, we entered into a comprehensive Settlement Agreement with Jon Fullenkamp in which Fullenkamp gave up his claim to several amounts reported by us as owing to him. The elimination of the claims were made to the financial statements in 2010 and reported in the both the 2010 Annual Report on Form 10-K and the 2010 Quarterly Reports on Forms 10-Q which had not been filed at the time of the settlement.

**Interest Expense:** Interest expense increased \$1,159,294 to \$1,178,415 for the six months ended June 30, 2011 from \$19,121 for the six months ended June 30, 2010. Of this amount, \$1,074,426 represents the amortization of the non-cash debt discount associated with the sale and conversion of the 10% Senior Secured Debentures and \$103,989 represents the actual interest expense due on the 10% Senior Secured Convertible Debentures.

**Income Taxes:** There is no provision for income tax recorded for either the six months ended June 30, 2011 or for the six months ended June 30, 2010 due to the expected operating losses of both years. We had available Federal income tax net operating loss ("NOL") carry forwards of approximately \$5,472,000 at December 31, 2010. Our NOL generally begins to expire in 2025. We recognize the tax benefit of NOL carry forwards as assets to the extent that management believes that the realization of the NOL carry forward is more likely than not. The realization of future tax benefits is dependent on our ability to generate taxable income within the carry forward period. This valuation allowance is provided for all deferred tax assets.

The Company recognized a tax benefit of \$390,032 due to the timing difference in tax effect between the accounting and tax basis of the Company's 10% Senior Secured Convertible Debentures sold and converted during the six month period ended June 30, 2011.

**Net Income (Loss):** We had a net loss of \$1,899,149 for the six months ended June 30, 2011. Of this amount, \$1,336,734 was from a net decrease in operating income and \$1,159,294 was from increased cash and non cash financing interest costs.

For the six months ended June 30, 2010, we had net income of \$206,847 due primarily to the one-time gain of \$404,623 on the settlement with our former executive officer. Without the one-time gain we would have incurred a net loss of \$197,776 for the six months ended June 30, 2010. This net income should be viewed in light of the cash flow from operations discussed below.

During the six months ended June 30, 2011, as with the six months ended June 30, 2010, we did not generate positive cash flow from normal operations. As a result, we funded our operations through the private sale of equity and debt securities, the issuance of our securities in exchange for services, and loans.

#### Liquidity and Capital Resources

The global financial and credit crisis may have impacts on our liquidity and financial condition that we currently cannot predict.

The continued credit crisis and related turmoil in the global financial system may have a material impact on our liquidity and our financial condition, and we may ultimately face major challenges if conditions in the financial markets do not improve. Our ability to access the capital markets or borrow money may be restricted at a time when we would like, or need, to raise capital, which could have an adverse impact on our flexibility to react to changing

economic and business conditions and on our ability to fund our operations and capital expenditures in the future. Additionally, the current economic situation could lead to reduced demand for natural gas and oil, or further reductions in the prices of natural gas and oil, or both, which could have a negative impact on our financial position, results of operations and cash flows. While the ultimate outcome and impact of the current financial crisis cannot be predicted, it may have a material adverse effect on our future liquidity, results of operations and financial condition.

Our cash and cash equivalents, total current assets, total assets, total current liabilities, and total liabilities as of June 30, 2011 as compared to June 30, 2010, are as follows:

	June 30,	
	2011	2010
Cash	\$ 467,712	\$ 68,838
Total current assets	553,366	172,316
Total assets	1,390,993	942,737
Total current liabilities	554,779	999,770
Total liabilities	1,153,449	1,034,747

At June 30, 2011, we had a working capital deficit of \$1,413 compared to a working capital deficit of \$827,454 at June 30, 2010. Current liabilities decreased to \$554,779 at June 30, 2011 from \$999,770 at June 30, 2010 primarily due to the conversion of short term notes payable and accrued interest due a related party to a 10% Senior Secured Debenture.

Net cash used in operating activities for the six months ended June 30, 2011 totaled \$1,063,684 after the cash used in the net loss of \$1,899,149 was decreased by \$750,198 in non-cash charges and increased by \$85,267 in net increases in the working capital accounts. This compares to cash used in operating activities for the six months ended June 30, 2010 of \$66,533 after the net income for the period of \$206,847 was reduced by \$348,627 in non cash charges and offset by \$75,247 in changes to the working capital accounts.

Net cash used in investing activities for the six months ended June 30, 2011 was \$316,496 of which \$308,167 was used for drilling costs related to the new working interest acquired during the period and \$8,329 was used in the purchase of furniture and equipment for the Austin office.

Net cash provided by financing activities for the six months ended June 30, 2011 was \$1,736,320. Of this amount, \$1,792,500 came from the sale of debentures offset by \$56,180 in payments on loans. This compares to \$113,295 in cash was provided by financing activities during the six months ended June 30, 2011 of which \$125,000 came from a related party loan and \$11,705 was used to pay down loans.

### Item 3. Qualitative and Quantitative Discussions About Market Risk

As a smaller reporting company we are not required to provide the information required by this Item. However, we did include market risk factors in our Annual Report on Form 10-K for the year ended December 31, 2010 filed with the SEC on May 16, 2011.

### Item 4. Controls and Procedures

#### Evaluation of Disclosure Controls and Procedures

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our reports filed or submitted under the Securities Exchange Act of 1934, as amended (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 that such information is accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate, to allow timely decisions regarding required disclosure.

Pursuant to Rule 13a-15(e) under the Exchange Act, the Company carried out an evaluation, with the participation of the Company's management, including the Company's Chief Executive Officer ("CEO") (the Company's principal executive officer) and Chief Financial Officer ("CFO") (the Company's principal financial and accounting officer), of the effectiveness of the Company's disclosure controls and procedures (as defined under Rule 13a-15(e) under the Exchange Act) as of June 30, 2011. Based upon that evaluation, our management concluded that our control over financial reporting and related disclosure controls and procedures were not effective as our accounting processes lacked appropriate segregation of responsibilities necessary for an effective system of internal control. Due to the small size of the company, the CEO of the Company is also the CFO of the Company. On the other hand, due to the small size of the Company and the active involvement of the Board of Directors, we believe that our lack of segregation of duties and inadequate controls over the control environment does not constitute a material weakness in our internal control.

#### Changes in Internal Controls

Our management, with the participation of our CEO/CFO, performed an evaluation as to whether any change in our internal controls over financial reporting occurred during the quarter ended June 30, 2011. Based on that evaluation, our CEO/CFO concluded that no change occurred in the Company's internal controls over financial reporting during

the quarter ended June 30, 2011 that has materially affected, or is reasonably likely to materially affect, the Company's internal controls over financial reporting.

Part II

Item 1. Legal Proceedings

We are subject to litigation and claims that have arisen in the ordinary course of business, the majority of which have resulted from our thorough restructuring and turnaround efforts resulting from the malfeasance that occurred in 2008. Many of these claims have been resolved. Management believes individually such litigation and claims will not have a material adverse impact on our financial position or our results of operations but these matters are subject to inherent uncertainties and management's view may change in the future. If an unfavorable final outcome were to occur, there exists the possibility of a material impact on our financial position and the results of operations for the period in which the effect becomes reasonably estimable.

The following updates the current legal action as detailed in Item 3 of the Annual Report on Form 10-K for the year ended December 31, 2010 filed with the SEC on May 16, 2011.

On August 5, 2011, we settled the litigation that filed on March 18, 2011, against its former independent public accounting firm, John Kinross-Kennedy, for professional negligence. The Company executed a Settlement Agreement and Mutual Release with Mr. Kinross-Kennedy as the matter has been satisfactorily resolved.

Item 1A. Risk Factors

As a smaller reporting company we are not required to provide the information required by this Item. However, we did include risk factors in our Annual Report on Form 10-K for the year ended December 31, 2010 filed with the SEC on May 16, 2011.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

During the three months ended June 30, 2011, the following unregistered securities were issued for the purposes noted.

On April 25, 2011, 155,000 shares of the Companies preferred stock held by three affiliates of the Company were converted to 15,500,005 shares of the Company's common stock in accordance with the terms on which such preferred stock has been converted.

On June 30, 2011, \$900,000 of the face value of the Company's 10% Senior Secured Convertible Debentures belonging to six non affiliates of the Company was converted to 180,000,000 shares of the Company's common stock in accordance with the terms of the debentures.

On June 30, 2011, 6,556,438 shares of the Company's common stock was issued to six non-affiliates of the Company in full satisfaction of the \$32,782 in accrued interest on the debentures converted on that date.

On June 30, 2011, \$212,500 of the face value of the Company's 10% Senior Secured Convertible Debentures belonging to six affiliates of the Company was converted to 42,500,000 shares of the Company's common stock in accordance with the terms of the debentures.

On June 30, 2011, 1,031,233 shares of the Company's common stock were issued to six affiliates of the Company in full satisfaction of the \$5,156 in accrued interest on the debentures converted on that date.

During the three months ended June 30, 2011, we issued 10% Senior Secured Convertible Debentures with the total face value of \$750,000 to 15 individuals or investment entities who are non-affiliates of the Company in exchange for

\$750,000. The debentures are convertible into shares of common stock at a conversion price of \$0.005 per share.

During the three months ended June 30, 2011, we issued warrants to purchase a total of 750,000 shares of common stock to 15 individual or investment entities who are non-affiliates of the Company at an exercise price of \$0.005 as part of the terms of the sale of the debentures.

During the three months ended June 30, 2011, we issued 10% Senior Secured Convertible Debentures with the total face value of \$132,500 to three individual or investment entities who are affiliates of the Company in exchange for \$132,500. The debentures are convertible into shares of common stock at a conversion price of \$0.005 per share.

During the three months ended June 30, 2011, we issued warrants to purchase a total of 132,500 shares of common stock to three individual or investment entities who are affiliates of the Company at an exercise price of \$0.005 as part of the terms of the sale of the debentures.

On June 30, 2011, we agreed to issue warrants to purchase a total of 400,000 shares of common stock to board members of the Company at an exercise price of \$0.01 per share in exchange for services. Of these warrants, each board member is to receive warrants to purchase 100,000 shares. These warrants will be issued by us to the individuals on December 31, 2011.

Unless otherwise indicated, we relied on the exemption from registration relating to offerings that do not involve any public offering pursuant to Section 4(2) under the Securities Act of 1933 (the "Act") and/or Rule 506 of Regulation D of the Act. We believe that each investor had adequate access to information about us through the investor's relationship with us.

Item 3. Default Upon Senior Securities

There is no information required to be reported under this Item.

Item 4. Removed and Reserved

There is no information required to be reported under this Item.

Item 5. Other Information

On August 5, 2011, the Company settled the litigation that it filed on March 18, 2011, against its former independent public accounting firm, John Kinross-Kennedy, for professional negligence. The Company executed a Settlement Agreement and Mutual Release with Mr. Kinross-Kennedy as the matter has been satisfactorily resolved.

As previously disclosed in prior filings with the SEC, the Company is selling Units to accredited investors in a private placement, each unit consisting of a 10% Senior Secured Convertible Debenture and warrant to purchase shares of common stock. The Company has authorized an additional increase in the total amount to be raised in the private placement from \$2.0 million to \$3.0 million. Additionally, the Company extended the closing of the private placement from its amended closing date of June 30, 2011 to August 31, 2011.

Item 6. Exhibits

- 31.1 Rule 13a-14(a)/15d-14(a) Certification of Robert Miranda
- 31.2 Rule 13a-14(a)/15d-14(a) Certification of Robert Miranda
- 32 Section 1350 Certification of Robert Miranda

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

VICTORY ENERGY CORPORATION

Date: August 15, 2011

By: /s/ Robert J. Miranda  
Robert J. Miranda  
Chief Executive Officer,  
Chief Financial Officer,  
Chairman, and Director