

VICTORY ENERGY CORP  
Form 10-Q  
May 23, 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 March 31, 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):

L a r g e Accelerated  
a c c e l e r a t e d filer   
filer

Non-accelerated  Smaller  
filer  reporting  
company  x

(Do not check if  
a 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  x

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 May 20, 2011, there were 136,719,608 shares of common stock, par value \$0.001, issued and outstanding.

VICTORY ENERGY CORPORATION  
QUARTERLY REPORT ON  
FORM 10-Q  
FOR THE THREE MONTHS ENDED MARCH 31, 2011  
TABLE OF CONTENTS

	Page
PART I—FINANCIAL INFORMATION	
Item 1. Financial Statements	4
Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations	15
Item 3. Quantitative and Qualitative Disclosures about Market Risk.	19
Item 4. Controls and Procedures	19
PART II—OTHER INFORMATION	
Item 1. Legal Proceedings	21
Item 1A. Risk Factors	21
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds	21
Item 3. Default Upon Senior Securities	22
Item 4. Removed and Reserved	22
Item 5. Other Information	22
Item 6. Exhibits	23
SIGNATURES	

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 SUBSIDIARY  
CONSOLIDATED BALANCE SHEETS

	March 31, 2011 (Unaudited)	December 31, 2010
<b>CURRENT ASSETS</b>		
Cash and cash equivalents	\$ 187,494	\$ 111,572
Accounts receivable, net	70,567	74,828
Prepaid expenses	22,745	24,898
Total current assets	280,806	211,298
<b>FIXED ASSETS</b>		
Furniture and equipment	10,623	2,294
Accumulated depreciation	(2,491 )	(2,294 )
Total furniture and fixtures	8,132	-
Option to acquire leases and mineral interests	25,000	25,000
Drilling in process costs	205,539	-
Oil and natural gas properties	1,466,813	1,466,813
Accumulated depletion	(965,089 )	(953,084 )
Oil and natural gas properties, net	732,263	538,729
<b>OTHER ASSETS</b>		
Fund held at court	13,006	13,006
<b>TOTAL ASSETS</b>	<b>\$ 1,034,207</b>	<b>\$ 763,033</b>
<b>LIABILITIES AND STOCKHOLDERS' DEFICIT</b>		
<b>CURRENT LIABILITIES</b>		
Accounts payable	\$ 388,097	\$ 342,285
Accrued liabilities	100,093	74,088
Accrued interest	41,994	10,501
Line of credit - bank	62,067	68,667
Notes payable - related parties	-	50,000
Liability for unauthorized preferred stock issued	85,654	85,654
Total current liabilities	677,905	631,195
<b>OTHER LIABILITIES</b>		
Senior convertible debenture, net of debt discount	297,424	127,338
Deferred tax liability	489,550	238,000
Asset retirement obligation	27,282	27,282
<b>TOTAL LIABILITIES</b>	<b>1,492,161</b>	<b>1,023,815</b>

## STOCKHOLDERS' DEFICIT

Common Stock, \$0.001 par value, 490,000,000 shares authorized, 136,719,608 and 136,719,608 issued and outstanding, respectively	136,720	136,720
Additional paid in capital	32,359,395	31,740,090
Accumulated deficit	(32,954,069 )	(32,137,592 )
TOTAL STOCKHOLDERS' DEFICIT	(457,954 )	(260,782 )
TOTAL LIABILITIES AND STOCKHOLDERS' DEFICIT	\$ 1,034,207	\$ 763,033

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

	For the Three Months Ending March 31,	
	2011	2010
REVENUES	\$ 108,320	\$ 149,371
<b>COSTS AND EXPENSES</b>		
Costs of production	69,160	11,882
General and administrative expense	688,428	158,428
Depletion, depreciation, and accretion	12,202	24,983
Gain on settlement with former officer	-	(404,623 )
Total expenses	769,790	(209,330 )
INCOME (LOSS) FROM OPERATIONS	(661,470 )	358,701
<b>OTHER EXPENSE</b>		
Interest expense	213,112	8,252
Total other expense	213,112	8,252
INCOME (LOSS) BEFORE TAX BENEFIT	(874,582 )	350,449
TAX BENEFIT	58,105	-
NET INCOME (LOSS)	\$ (816,477 )	\$ 350,449
Weighted average shares, basic and diluted	136,719,608	136,719,608
Net loss per share, basic and diluted	\$ (0.01 )	\$ 0.00

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

	For the Three Months Ended March 31,	
	2011	2010
<b>CASH FLOW FROM OPERATING ACTIVITIES</b>		
Net income (loss)	\$ (816,477 )	\$ 350,449
Adjustment to reconcile net income (loss) from operations to net cash used in operating activities		
Depletion and depreciation	12,202	24,983
Amortization of debt discount	170,086	-
Warrants for services	18,960	2,700
Gain on settlement with former officer	-	(404,623 )
Tax benefit of debenture discount		
Change in working capital		
Accounts receivable	4,261	2,731
Prepaid expenses	2,153	10,222
Accounts payable	45,812	(27,818 )
Accrued liabilities	57,498	(16,063 )
Net cash used in operating activities	(563,610 )	(57,419 )
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Drilling in progress costs	(205,539 )	-
Purchase of furniture and equipment	(8,329 )	-
Net cash used in investing activities	(213,868 )	-
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Bank line of credit net repayments	(6,600 )	(6,057 )
Repayment on note payable to related parties	(50,000 )	-
Proceeds from note payable to related parties	-	90,000
Proceeds from issuance of senior secured convertible debentures	910,000	-
Net cash provided by financing activities	853,400	83,943
Net change in cash and cash equivalents	75,922	26,524
Beginning cash and cash equivalents	111,572	22,076
Ending cash and cash equivalents	\$ 187,494	\$ 48,600
<b>Supplemental schedule of non-cash investing and financing activities</b>		
Deferred tax liability	\$ 309,655	\$ -
<b>Supplemental disclosures of cash flow information:</b>		
Cash paid during the period for		
Interest	\$ 10,274	\$ -
Income taxes	\$ -	\$ -





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 March 31, 2011, for the three-month periods ended March 31, 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-month period ended March 31, 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 \$816,477 for the three months ended March 31, 2011. For the most part, this loss is due to the one-time legal, audit, and accountings charges for the preparation and filing of the 2007, 2008, 2009 and 2010 audited financial statements with the SEC, the legal costs incurred in the final settlement with the former officer of the Company, as well as the non-cash charges associated with the sale of the Company's 10% Senior Secured Convertible Debentures. Losses are expected to continue in the near term. Current liabilities exceeded current assets by \$397,099 and the accumulated deficit is \$32,954,069 at March 31, 2011. The Company is currently in default on one of its debt obligations and the Company has no future borrowings or funding sources available under existing financing arrangements. 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.

### 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.

### 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 March 31, 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 March 31, 2011 were as follows:

Description	Level 1	Level 2	Level 3	Total Realized (Loss) due to valuation	Total Unrealized (Loss)
Proved Properties (net)	\$ —	\$ —	\$ 501,724	\$ —	\$ —
<b>Totals</b>	<b>\$ —</b>	<b>\$ —</b>	<b>\$ 501,724</b>	<b>\$ —</b>	<b>\$ —</b>

The Company valued the Proved Properties at their fair value in accordance with the applicable Financial Accounting Standards Board (“FASB”) standard due to the impairment indicators prevalent as of March 31, 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 March 31, 2011.

#### Concentrations

There is a ready market for the sale of crude oil and natural gas. During the three months ended March 31, 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 Accounting Standards Codification ("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 months ended March 31, 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 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 months ended March 31, 2011 of \$18,960.

#### 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 \$350,449 for the three months ended March 31, 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 \$54,174 for the three months ended March 31, 2010. To avoid possible confusion surrounding the effect of the one-time gain, basic and diluted net income and net loss per share are the 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:

	March 31, 2011	December 31, 2010
Option on oil and gas property	\$ 25,000	\$ 25,000
Drilling in process costs	205,539	-
Proved property - purchased wells	3,015,322	3,015,322
Proved property - drilled wells	1,753,026	1,753,026
Total oil and natural gas properties, cost	4,998,887	4,793,348
Less: accumulated depletion and impairment	(4,266,624)	(4,254,619)
Oil and natural gas properties, net	\$ 732,263	\$ 538,729

Drilling in process costs for the three months ended March 31, 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 and a working interest in the Tunis Creek project operated by V-F Petroleum Inc. 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:

	March 31, 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 (Note (a))	-	50,000
Totals, notes payable to related parties	\$ -	\$ 50,000

(a) note and accrued interest settled for cash on March 25, 2011.

## 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 Bank's workout department. The Company has negotiated an informal repayment program with the Bank's workout department whereby the Bank will not institute collection actions provided the Company continues to make monthly principal payments of \$2,200 monthly to the Bank. As of March 31, 2011, the Company was current on the workout terms of this line of credit.

	March 31, 2011	December 31, 2010
Line of credit payable to Wells Fargo Bank, 10% interest payable at maturity, currently in workout phase	\$ 62,067	\$ 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 of this preferred stock for cash of \$246,950. The Company subsequently issued additional preferred stock and had several preferred shareholders convert 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.

The preferred stock liability consisted of the following as of:

	March 31, 2011	December 31, 2010
Liability for unauthorized preferred stock	\$ 85,654	\$ 85,654

#### Note 9 – Senior Secured Convertible Debentures

Between October 15, 2010, and April 22, 2011, the Company entered into agreements with 33 accredited investors for the cash sale by the Company of an aggregate of \$1,535,000 of 10% Senior Secured Convertible Debentures (the “Debentures”) which are convertible into an aggregate of 307,000,000 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 1,535,000 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 \$1,535,000 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 March 31, 2011, the Company issued \$910,000 of these debentures for cash of \$910,000. The Company determined the initial fair value of the beneficial conversion feature was approximately \$910,000. The Company also determined that the relative fair value of the warrants upon issuance was \$15,195 which was calculated under a Black-Scholes option pricing model using as assumptions an expected life of 5 years, a stock volatility ranging from 674.5% to 678.7% , a risk free interest rate ranging from 1.9% to 2.4%, and no expected dividend yield. The initial fair value of the warrants of \$15,195 and the beneficial conversion feature of \$910,000 were recorded by the Company as a financing discount of \$925,195, which the Company is amortizing to interest expense over the life of the notes.

Senior secured convertible debentures consists of the following as of:

	March 31, 2011	December 31, 2010
Convertible debenture, interest at 10% per annum payable quarterly, due September 30, 2013 with separable warrants	\$ 1,185,000	\$ 275,000
Convertible debenture, 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
Subtotal	1,737,275	827,275
Debt discount	(1,439,851)	(699,937 )
Net book value	\$ 297,424	\$ 127,338

Amortization of debt discount totaled \$170,086 for the three months ended March 31, 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. The error in the private offering documents was identified and consents to the amendment were obtained after March 31, 2011. As such, the transactions were recorded as a Type 1 subsequent event as of March 31, 2011.

#### Note 10 – Shareholders Equity

During the three months ended March 31, 2011, the following unregistered securities were issued for the purposes noted.

On January 31, 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.

On February 28, 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.

On March 31, 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.

During the three months ended March 31, 2011, we issued 10% Senior Secured Convertible Debentures with the total face value of \$670,000 to 19 individual or investment entities who are non-affiliates of the Company in exchange for \$670,000. The debentures are convertible into shares of common stock at a conversion price of \$0.005 per share.

During the three months ended March 31, 2011, we issued warrants to purchase a total of 670,000 shares of common stock to 19 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 March 31, 2011, we issued 10% Senior Secured Convertible Debentures with the total face value of \$240,000 to 9 individual or investment entities who are affiliates of the Company in exchange for \$240,000. The debentures are convertible into shares of common stock at a conversion price of \$0.005 per share.

During the three months ended March 31, 2011, we issued warrants to purchase a total of 240,000 shares of common stock to a 9 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.

#### 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 three months ended March 31, 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 months ended March 31, 2011, the Company recognized a benefit of \$58,105 as a result of this difference.

## Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion is intended to assist you in understanding our business and results of operations together with our present financial condition. This section should be read in conjunction with our consolidated financial statements and the accompanying notes included elsewhere in this report. Statements in our discussion may be forward-looking statements. These forward-looking statements involve risks and uncertainties. We caution that a number of factors could cause future production, revenues and expenses to differ materially from our expectations.

The following is management's discussion and analysis of certain significant factors that have affected certain aspects of our financial position and results of operations during the periods included in the accompanying audited consolidated financial statements. You should read this in conjunction with the discussion under "Financial Information" and the audited consolidated financial statements included in our Annual Report on Form 10-K for the years ended December 31, 2010 and 2009.

### Forward Looking Statements

This Quarterly Report on Form 10-Q contains forward-looking statements concerning our beliefs, plans, objectives, goals, expectations, anticipations, estimates, intentions, operations, future results and prospects, including statements that include the words "may," "could," "should," "would," "believe," "expect," "will," "shall," "anticipate," "estimate," "in," "may," "could," "should," "would," "believe," "expect," "will," "shall," "anticipate," "estimate," "in," similar expressions. These forward-looking statements are based upon current expectations and are subject to risk, uncertainties and assumptions. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results may vary materially from those anticipated, estimated, expected, projected, intended, committed or believed. We provide the following cautionary statement identifying important factors (some of which are beyond our control) which could cause the actual results or events to differ materially from those set forth in or implied by the forward-looking statements and related assumptions.

### General Overview

We are an independent oil and natural gas company engaged in the production, acquisition and exploitation of oil and natural gas properties through our partnership with Aurora Energy Partners. We are geographically focused on the

onshore United States. Our operational focus is the acquisition, through the most cost effective means possible, of production or near production oil and natural gas field assets. Our areas of operation include Crockett County and South Padre Island, Texas.

Our revenue, profitability, cash flow, oil and natural gas reserves value, future growth, and ability to borrow funds or obtain additional capital, as well as the carrying value of our properties, are substantially dependent on prevailing prices of natural gas and oil. Historically, the markets for natural gas and oil have been volatile, and those markets are likely to continue to be volatile in the future. It is impossible to predict future natural gas and oil price movements with certainty. Prices for natural gas and oil are subject to wide fluctuations in response to relatively minor changes in the supply of and demand for natural gas and oil, market uncertainty, and a variety of additional factors beyond our control.

### Going Concern

As presented in the consolidated financial statements, we had a net loss of \$816,477 for the three months ended March 31, 2011. For the most part, this loss is due to the one-time legal, audit, and accountings charges for the preparation and filing of the 2007, 2008, and 2009 audited financial statements with the SEC, the legal costs incurred in the final settlement with the former officer of the Company, as well as the non-cash charges associated with the sale of the Company's 10% Senior Secured Convertible Debentures. Losses are expected to continue in the near term. Current liabilities exceeded current assets by \$397,099 and the accumulated deficit is \$32,954,069 at March 31, 2011. The Company is currently in default on one of its debt obligations and the Company has no future borrowings or funding sources available under existing financing arrangements. 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 we 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 we were unable to continue as a going concern.

Edgar Filing: VICTORY ENERGY CORP - Form 10-Q

Three Months Ended March 31, 2011 Compared to the Three Months Ended March 31, 2010

Our revenue, operating expenses, and net loss from operations for the three months ended March 31, 2011 as compared to the three months ended March 31, 2010 were as follows:

	Three Months Ended March 31,		Change	Percentage Change Inc (Dec)
	2011	2010		
REVENUES	\$ 108,320	\$ 149,371	\$ (41,051 )	(27.5 %)
<b>COSTS AND EXPENSES</b>				
Costs of production	69,160	11,882	57,278	482.1 %
General and administrative expense	688,428	158,428	530,000	334.5 %
Depletion, accretion, and depreciation	12,202	24,983	(12,781 )	(51.2 %)
Gain on settlement with former officer	-	(404,623 )	404,623	n/m
Total expenses	769,790	(209,330 )	979,120	(467.7 %)
INCOME (LOSS) FROM OPERATIONS	(661,470 )	358,701	(1,020,171 )	(284.4 %)
<b>OTHER EXPENSE</b>				
Interest expense	213,112	8,252	204,860	2482.5 %
Total other expense	213,112	8,252		
NET INCOME (LOSS) BEFORE TAX BENEFIT	(874,582 )	350,449		
TAX BENEFIT	58,105	-		
NET INCOME (LOSS)	\$ (816,477 )	\$ 350,449	\$ (1,166,926 )	(333.0 %)
Weighted average shares, basic and diluted	136,719,608	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 natural gas. Our revenues decreased \$41,051 or 27.5% to \$108,320 for the three months ended March 31, 2011 from \$149,371 for the three months ended March 31, 2010. The decrease reflects both a decline in volume of gas sold to 16,591 MCF (thousand cubic feet) in the three months ended March 31, 2011 compared to 21,406 MCF for the three months ended March 31, 2010 and the decrease in the average natural gas price received of \$6.53 per MCF for the three months ended March 31, 2011 compared to \$7.16 for the three months ended March 31, 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 \$57,278 or 482% to \$69,160 for the three months ended March 31, 2011 from \$11,882 for the three months ended March 31, 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 530,000 or 335% to \$688,428 for the three months ended March 31, 2011 from \$158,428 for the three months ended March 31, 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 final settlement with the former officer of the Company, and the increase in salaries and expenses associated with the start up of the Austin office.

**Depletion and Accretion:** Depletion, accretion, and depreciation declined \$12,781 or 51.2% to \$12,202 for the three months ended March 31, 2011 from \$24,983 for the three months ended March 31, 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 \$204,860 or 2,483% to \$213,112 for the three months ended March 31, 2011 from \$8,252 for the three months ended March 31, 2010. Of this amount, \$170,086 represents the amortization of the non-cash debt discount associated with the sale of the 10% Senior Secured Debentures and \$43,026 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 three months ended March 31, 2011 or for the three months ended March 31, 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 \$58,105 due to the timing difference in tax effect between the accounting and tax basis of the Company's 10% Senior Secured Convertible Debenture.

**Net Income:** We had a net loss of \$816,477 for the three months ended March 31, 2011. For the three months ended March 31, 2010, we had net income of \$350,449 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 \$54,174 during the three months ended March 31, 2010. This net income should be viewed in light of the cash flow from operations discussed below.

During the three months ended March 31, 2011, as with the three months ended March 31, 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 March 31, 2011 as compared to March 31, 2010, are as follows:

	March 31,	
	2011	2010
Cash	\$ 187,494	\$ 48,600
Total current assets	280,806	182,784
Total assets	1,034,207	978,188
Total current liabilities	677,905	894,949
Total liabilities	1,492,161	929,926

At March 31, 2011, we had a working capital deficit of \$397,099 compared to a working capital deficit of \$712,165 at March 31, 2010. Current liabilities decreased to \$677,905 at March 31, 2011 from \$894,949 at March 31, 2010 primarily due to the conversion of short term notes payable and accrued interest due a related party to a 10% Senior Debenture.

Net cash used by operating activities for the three months ended March 31, 2011 totaled \$563,610 after the cash used in the net loss of \$816,477 was decreased by \$143,143 in non-cash charges and increased by \$109,724 in net increases in the working capital accounts. This compares to cash used by operating activities for the three months ended March 31, 2010 was \$57,419 after the net income for the period of \$350,449 was reduced by \$376,940 in non cash gains and offset by \$30,928 in changes to the working capital accounts.

Net cash used in investing activities for the three months ended March 31, 2011 was \$213,868 of which \$205,539 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. There was no cash used in investing activities for the three months ended March 31, 2010.

Net cash provided by financing activities for the three months ended March 31, 2011 totaled \$853,400 of which \$910,000 came from sale of the 10% Senior Secured Convertible Debentures. Notes payable to a related party was paid off for \$50,000 and the bank line of credit was paid down by \$6,600. This compares to \$83,943 in cash used in financing activities for the three month period ended March 31, 2010 of which \$90,000 came from notes payable to a related party and \$6,057 was used to pay down the bank line of credit.

### 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(b) 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 March 31, 2011. Based upon that evaluation, our management concluded that our control over financial reporting and related disclosure controls and procedures were not effective because for the significant part of the year (a) we did not have adequate controls over our control environment, (b) our accounting processes lacked appropriate segregation of responsibilities necessary for an effective system of internal control, and (c) we were unable to complete the financial statements for the quarterly reporting periods in 2010 and for the year ended December 31, 2010, in a timely manner to enable us to file the Quarterly Reports on Forms 10-Q and the Annual Report on Form 10-K by the respective due dates. We believe that our lack of segregation of duties and inadequate controls over the control environment constitute material weaknesses in our internal control.

Management has taken steps to remediate the material weakness over our control over financial reporting and related disclosure controls and procedures by implementing the following controls:

During November, 2008, we hired a CFO who possesses the needed GAAP accounting and SEC reporting skills necessary to improve our internal controls over financial reporting.

During January, 2009, we appointed our CFO to the board of directors. While the CFO is qualified as an audit committee financial expert as defined in Item 407(d)(5)(ii) of Regulation S-K, he is not independent and, as such, his role on the board of directors does not meet the independence requirements of Item 407(d)(5)(ii) of Regulation S-K.

During February, 2011, we engaged a corporate accountant who has significant SEC financial reporting and accounting experience. This individual assisted with the accounting update for the year ended December 31, 2010, including preparation of the delinquent Quarterly Reports on Forms 10-Q for the quarterly periods ended March 31, 2010, June 30, 2010, and September 30, 2010. This individual also is assisting in preparing this Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2011.

#### Changes in Internal Controls

Our management, with the participation of our CEO and CFO, performed an evaluation as to whether any change in our internal controls over financial reporting occurred during the quarter ended March 31, 2011. Based on that evaluation, our CEO and CFO concluded that no change occurred in the Company's internal controls over financial reporting during the quarter ended March 31, 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 current legal action is 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. There were no material developments since the time of that filing.

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 March 31, 2011, the following unregistered securities were issued for the purposes noted.

On January 31, 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.

On February 28, 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.

On March 31, 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.

During the three months ended March 31, 2011, we issued 10% Senior Secured Convertible Debentures with the total face value of \$670,000 to 19 individual or investment entities who are non-affiliates of the Company in exchange for \$670,000. The debentures are convertible into shares of common stock at a conversion price of \$0.005 per share.

During the three months ended March 31, 2011, we issued warrants to purchase a total of 670,000 shares of common stock to 19 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.

Edgar Filing: VICTORY ENERGY CORP - Form 10-Q

During the three months ended March 31, 2011, we issued 10% Senior Secured Convertible Debentures with the total face value of \$240,000 to 9 individual or investment entities who are affiliates of the Company in exchange for \$240,000. The debentures are convertible into shares of common stock at a conversion price of \$0.005 per share.

During the three months ended March 31, 2011, we issued warrants to purchase a total of 240,000 shares of common stock to a 9 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.

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

None

Item 4. Removed and Reserved

None

Item 5. Other Information

Appointment of Officers; Compensatory Agreements of Officers

As previously disclosed in a Current Report on Form 8-K filed with the SEC on January 14, 2011, Kenneth Hill was appointed as our Vice President and Chief Operating Officer effective January 7, 2011. Contemporaneously with Mr. Hill's appointment, we entered into an Employment Agreement with Mr. Hill. The term of the agreement began on January 10, 2011, and will end upon notice by either party. Mr. Hill will receive a base annual salary of \$180,000 per year and he will participate in the employee benefit plans made available to our executive officers generally. A copy of the Employment Agreement is attached hereto and is incorporated by reference.

As previously disclosed in a Current Report on Form 8-K filed with the SEC on January 14, 2011, Stanley Lindsey was appointed as our Vice President of Exploration and Development effective January 7, 2011. Contemporaneously with Mr. Lindsey's appointment, we entered into an Employment Agreement with Mr. Lindsey. The term of the agreement began on January 10, 2011, and will end upon notice by either party. Mr. Lindsey will receive a base annual salary of \$180,000 per year and he will participate in the employee benefit plans made available to our executive officers generally. A copy of the Employment Agreement is attached hereto and is incorporated by reference.

Jones County, Texas Oil Well Interest

As previously disclosed in the Company's Annual Report on Form 10-K for the year ended December 31, 2010, Aurora acquired a two and a half percent (2.5%) working interest in the Young No. 1 well located in Jones County, Texas on February 28, 2011. This "Glen Thomas" wildcat well was completed and tested January 14, 2011. The well is now on production at a rate of 300 BOPD and 100 MCF of natural gas per day. Interest assignment of this production is effective February 1, 2011, with Aurora expecting revenue during the second quarter of 2011. The agreement also includes a working interest of no less than 1.5 percent in a sixty-four (64) square mile (40,966 acres) 3-D seismic imaging supported development area. The well operator, C.O. Energy, envisions drilling one to two wells per month until the targeted area is fully developed. Aurora maintains a thirty (30)-day first right of refusal to participate in each development well.

Amendment to Private Placement of 10% Senior Secured Convertible Debentures and related Warrants

As previously disclosed in the Company's Annual Report on Form 10-K for the year ended December 31, 2010, and in the Current Report on Form 8-K filed with the SEC on February 1, 2011, the Company is selling 75 Units of investment in the Company in a private placement to accredited investors. Each Unit is comprised of (i) a \$10,000

principal amount 10% Senior Secured Convertible Debenture, and (ii) a five-year warrant to purchase 10,000 shares of common stock at an exercise price of \$0.005 per share. 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. The error in the private offering documents was identified and consents to the amendment were obtained after March 31, 2011. As such, the transactions were recorded as a Type 1 subsequent event as of March 31, 2011.



The Company has also authorized an increase in the total amount to be raised in the private placement from \$750,000 to \$2.0 million. Additionally, the Company extended the closing of the private placement from its original closing date of March 31, 2011 to June 30, 2011.

Item 6. Exhibits

10.1 Employment Agreement by and between Victory Energy Corporation and Kenneth Hill dated January 10, 2011

10.2 Employment Agreement by and between Victory Energy Corporation and Stanley Lindsey dated January 10, 2011

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.

Date: May 23, 2011

VICTORY ENERGY CORPORATION

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