IMAX CORP
Form 10-Q
July 20, 2007

Table of Contents

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
Form 10-Q

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended March 31, 2007

OR

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

Commission File Number 0-24216
IMAX Corporation
(Exact name of registrant as specified in its charter)

Canada	98-0140269
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)
2525 Speakman Drive, Mississauga, Ontario, Canada	L5K 1B1
(Address of principal executive offices)	(Postal Code)

Registrant s telephone number, including area code (905) 403-6500
N/A

(Former name or former address, 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 Securities Exchange Act of 1934 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 þ No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12B-2 of the Exchange Act.
Large Accelerated Filer o Accelerated Filer þ Non-Accelerate Filer o

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

Indicate the number of shares of each of the issuer s classes of common stock, as of the latest practicable date:

Class	Outstanding as of June 30, 2007
Common stock, no par value	40,288,074

IMAX CORPORATION
TABLE OF CONTENTS

		Page
PART I.	**FINANCIAL INFORMATION**	
Item 1.	Financial Statements	3
Item 2.	Management s Discussion and Analysis of Financial Condition and Results of Operations	32
Item 3.	Quantitative and Qualitative Factors about Market Risk	48
Item 4.	Controls and Procedures	48
PART II.	**OTHER INFORMATION**	
Item 1.	Legal Proceedings	51
Item 1A.	Risk Factors	52
Item 6.	Exhibits	52
Signatures		53
EX-31.1		
EX-31.2		
EX-31.3		
EX-32.1		
EX-32.2		
EX-32.3		

SPECIAL NOTE REGARDING FORWARD-LOOKING INFORMATION

Certain statements included in this quarterly report may constitute forward-looking statements within the meaning of the United States Private Securities Litigation Reform Act of 1995. These forward-looking statements include, but are not limited to, references to future capital expenditures (including the amount and nature thereof), business and technology strategies and measures to implement strategies, competitive strengths, goals, expansion and growth of business, operations and technology, plans and references to the future success of IMAX Corporation together with its wholly-owned subsidiaries (the Company) and expectations regarding the Company s future operating results. These forward-looking statements are based on certain assumptions and analyses made by the Company in light of its experience and its perception of historical trends, current conditions and expected future developments, as well as other factors it believes are appropriate in the circumstances. However, whether actual results and developments will conform with the expectations and predictions of the Company is subject to a number of risks and uncertainties, including, but not limited to, general economic, market or business conditions; the opportunities (or lack thereof) that may be presented to and pursued by the Company; competitive actions by other companies; U.S. or Canadian regulatory inquiries; conditions in the in-home and out-of-home entertainment industries; changes in laws or regulations; conditions, changes and developments in the commercial exhibition industry; the acceptance of the Company s new technologies (including in particular its transition to digital projection technology); risks associated with investments and operations in foreign jurisdictions and any future international expansion, including those related to economic, political and regulatory policies of local governments and laws and policies of the United States and Canada; the potential impact of increased competition in the markets the Company operates within; and other factors, many of which are beyond the control of the Company. Consequently, all of the forward-looking statements made in this quarterly report are qualified by these cautionary statements, and actual results or anticipated developments by the Company may not be realized, and even if substantially realized, may not have the expected consequences to, or effects on, the Company. The Company undertakes no obligation to update publicly or otherwise revise any forward-looking information, whether as a result of new information, future events or otherwise.

IMAX®, IMAX® Dome, IMAX® 3D, IMAX® 3D Dome, *The* IMAX *Experience*®, *An* IMAX *Experience*®, IMAX DMR®, DMR®, IMAX MPX®, IMAX think big® and think big® are trademarks and trade names of the Company or its subsidiaries that are registered or otherwise protected under laws of various jurisdictions.

Table of Contents

IMAX CORPORATION

		Page
PART I	**FINANCIAL INFORMATION**	
Item 1.	**Financial Statements**	
	The following Condensed Consolidated Financial Statements are filed as part of this Report:	
	Condensed Consolidated Balance Sheets as at March 31, 2007 and December 31, 2006	4
	Condensed Consolidated Statements of Operations for the three month periods ended March 31, 2007 and 2006	5
	Condensed Consolidated Statements of Cash Flows for the three month periods ended March 31, 2007 and 2006	6
	Notes to Condensed Consolidated Financial Statements	7

Table of Contents

IMAX CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS
In accordance with United States Generally Accepted Accounting Principles
(in thousands of U.S. dollars)

	March 31, 2007 (unaudited)	December 31, 2006
Assets		
Cash and cash equivalents	$ 25,252	$ 25,123
Short-term investments	2,141	2,115
Accounts receivable, net of allowance for doubtful accounts of $3,362 (2006 - $3,253)	18,725	26,017
Financing receivables (note 4)	65,884	65,878
Inventories (note 5)	26,664	26,913
Prepaid expenses	2,552	3,432
Film assets	1,160	1,235
Property, plant and equipment	23,280	24,389
Other assets	10,623	10,365
Deferred income taxes (note 12)		
Goodwill	39,027	39,027
Other intangible assets	2,558	2,547
Total assets	$ 217,866	$ 227,041
Liabilities		
Accounts payable	$ 5,306	$ 11,426
Accrued liabilities (note 9(h),13(a), 16(a), 16(c))	53,643	51,052
Deferred revenue	57,643	56,694
Senior Notes due 2010 (note 6)	160,000	160,000
Total liabilities	276,592	279,172
Commitments and contingencies (notes 8 and 9)		
Shareholders equity (deficit)		
Capital stock (note 13) Common shares no par value. Authorized unlimited number. Issued and outstanding 40,285,574 (2006 40,285,574)	122,024	122,024
Other equity	3,054	2,937
Deficit	(185,147)	(178,274)
Accumulated other comprehensive income	1,343	1,182
Total shareholders deficit	(58,726)	(52,131)
Total liabilities and shareholders equity (deficit)	$ 217,866	$ 227,041

(the accompanying notes are an integral part of these condensed consolidated financial statements)

Table of Contents

IMAX CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
In accordance with United States Generally Accepted Accounting Principles
(in thousands of U.S. dollars, except per share amounts)
(unaudited)

	Three months ended March 31,	
	2007	**2006 As restated (note 3)**
Revenues		
Equipment and product sales	$ 7,105	$ 7,820
Services	17,645	13,434
Rentals	1,221	899
Finance income	1,186	1,112
	27,157	23,265
Cost of goods sold, services and rentals		
Equipment and product sales	3,943	4,206
Services	11,276	10,617
Rentals	549	465
	15,768	15,288
Gross margin	11,389	7,977
Selling, general and administrative expenses (note 10)	10,342	10,553
Research and development	1,495	915
Amortization of intangibles	136	192
Receivable provisions net of (recoveries) (note 11)	6	143
Loss from operations	(590)	(3,826)
Interest income	226	253
Interest expense	(4,249)	(4,157)
Loss from continuing operations before income taxes	(4,613)	(7,730)
(Provision for) recovery of income taxes	(167)	1,692
Net loss from continuing operations	(4,780)	(6,038)
Net earnings from discontinued operations		2,300
Net loss	$ (4,780)	$ (3,738)

Earnings (loss) per share
Earnings (loss) per share basic and diluted:

Net loss from continuing operations	$	(0.12)	$	(0.15)
Net earnings from discontinued operations	$		$	0.06
Net loss	$	(0.12)	$	(0.09)

Other comprehensive income consists of:				
Amortization of prior service credits (net of tax provision of $76)	$	161	$	

(the accompanying notes are an integral part of these condensed consolidated financial statements)

Table of Contents

IMAX CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
In accordance with United States Generally Accepted Accounting Principles
(in thousands of U.S. dollars)
(unaudited)

	Three months ended March 31,	
	2007	**2006 As restated (note 3)**
Cash provided by (used in):		
Operating Activities		
Net loss	$ (4,780)	$ (3,738)
Net (earnings) from discontinued operations		(2,300)
Items not involving cash:		
Depreciation and amortization	2,995	3,390
Write-downs	6	143
Change in deferred income taxes	(76)	(1,387)
Stock and other non-cash compensation	1,809	1,605
Non-cash foreign exchange gain	(109)	(29)
Interest on short-term investments	(26)	(85)
Investment in film assets	(1,340)	(1,651)
Changes in other non-cash operating assets and liabilities	2,139	(1,590)
Net cash provided by (used in) operating activities	618	(5,642)
Investing Activities		
Purchases of short-term investments	(2,124)	(4,098)
Proceeds from maturities of short-term investments	2,124	4,097
Purchase of property, plant and equipment	(99)	(92)
Increase in other assets	(245)	(187)
Increase in other intangible assets	(148)	(91)
Net cash used in investing activities	(492)	(371)
Financing Activities		
Common shares issued		254
Net cash provided by financing activities		254
Effects of exchange rate changes on cash	3	(35)

Increase (Decrease) in cash and cash equivalents from continuing operations	129	(5,794)
Increase in cash and cash equivalents provided by investing activities from discontinued operations		3,493
Increase (decrease) in cash and cash equivalents, during the year	129	(2,301)
Cash and cash equivalents, beginning of period	25,123	24,324
Cash and cash equivalents, end of period	$ 25,252	$ 22,023

(the accompanying notes are an integral part of these condensed consolidated financial statements)

Table of Contents

IMAX CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
In accordance with U.S. Generally Accepted Accounting Principles
(Tabular amounts in thousands of U.S. dollars unless otherwise stated)
(unaudited)

1. Basis of Presentation

IMAX Corporation, together with its subsidiaries, reports its results under United States Generally Accepted Accounting Principles (U.S. GAAP).

The condensed consolidated financial statements include the accounts of IMAX Corporation together with its subsidiaries (the Company), except subsidiaries which the Company has identified as variable interest entities (VIEs) where the Company is not the primary beneficiary. The nature of the Company s business is such that the results of operations for the interim periods presented are not necessarily indicative of results to be expected for the fiscal year. In the opinion of management, the information contained herein reflects all adjustments necessary to make the results of operations for the interim periods a fair statement of such operations.

The Company has evaluated its various variable interests to determine whether they are VIEs in accordance with Financial Accounting Standard Board (FASB) Interpretation No. 46R, Consolidation of Variable Interest Entities (FIN 46R). The Company has six film production companies that are VIEs. As the Company is exposed to the majority of the expected losses for one of the film production companies, the Company has determined that it is the primary beneficiary of this entity. The Company continues to consolidate this entity, with no material impact on the operating results or financial condition of the Company, as this production company has total assets and total liabilities of $nil as at March 31, 2007 (December 31, 2006 $nil). For the other five film production companies which are VIEs, however, the Company did not consolidate these film entities since it does not bear the majority of the expected losses or expected residual returns. The Company equity accounts for these entities. As of March 31, 2007, these five VIEs have total assets of $0.4 million (December 31, 2006 $0.4 million) and total liabilities of $0.4 million (December 31, 2006 $0.4 million).

All significant intercompany accounts and transactions, including all intercompany profits on transactions with equity-accounted investees, have been eliminated.

These financial statements should be read in conjunction with the financial statements included in the Company s Annual Report on Form 10-K for the year ended December 31, 2006 which should be consulted for a summary of the significant accounting policies utilized by the Company. These interim financial statements are prepared following accounting policies consistent with the Company s financial statements for the year ended December 31, 2006, except as noted below.

2. Change in Accounting Policy

Income Taxes

In June 2006, the FASB issued Interpretation No. 48, Accounting for Uncertainty in Income Taxes (an interpretation of FASB Statement Number 109), (FIN 48). This interpretation prescribes a more likely than not recognition threshold and a measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provided guidance on derecognition of a tax position, classification of a liability for unrecognized tax benefits, accounting or interest and penalties, accounting in interim periods, and expanded income tax disclosures. FIN 48 was effective for the Company on January 1, 2007. The cumulative effect of the change in accounting principle recorded in the first quarter of 2007 upon

adoption of FIN 48 is an increase to the tax liability of $2.1 million and a charge to opening deficit. For additional information see note 12.

IMAX CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
In accordance with U.S. Generally Accepted Accounting Principles
(Tabular amounts in thousands of U.S. dollars unless otherwise stated)
(unaudited)

3. Restatement of Previously Issued Financial Statements

In 2006, the Company effected a restatement of its prior period financial results due to discovery of certain errors related to: (a) revenue recognition resulting from the Company s review of its theater system arrangements over the 5 year period ended December 31, 2006 in response to comments received from the staff of both the United States Securities and Exchange Commission (SEC) and the Ontario Securities Commission (OSC) which indicated insufficient analysis of various sales and lease transactions and the accounting effect of certain contractual provisions within them; and misallocations of consideration to elements within certain multiple element arrangements; (b) capitalization of costs into inventory and films assets and amortization of film assets in accordance with American Institute of Certified Public Accountants Statement of Position 00-2 Accounting by Producers or Distributors of Films (SOP 00-2); (c) income tax liabilities resulting from failure to make certain tax elections on a timely basis and (d) certain other items described under Other Adjustments in this note. In addition, in the preparation of the consolidated financial statements for the year ended December 31, 2006, the Company recorded other adjustments related to prior periods unadjusted differences that had been deemed not to be material and adjustments related to prior periods recorded through 2006 opening retained earnings.

The sections which follow present additional detail with regard to the restatement and the impact on results of operations for the quarter ended March 31, 2006.

Revenue Recognition Theater Systems

The Company s revenue arrangements include multiple elements. In prior years, the Company considered each component of its theater systems to be a separate element. As a result, revenue was recognized when certain components were installed. As part of the review of its revenue recognition policy, the Company concluded its policy for revenue recognition on theater systems should be revised to treat all components of the theater system (including the projector, sound system, screen system and, if applicable, 3D glasses cleaning machine), theater design support, supervision of installation, projectionist training and the use of that IMAX brand as a single deliverable and a single unit of accounting. In addition, the Company revised its policy to require that (i) the projector, sound system and screen system be installed and be in full working condition, the 3D glasses cleaning machine, if applicable, be delivered and projectionist training be completed, and (ii) written customer acceptance thereon be received, or the public opening of the theater takes place, before revenue can be recognized. In conjunction with these changes, the Company undertook an extensive review of all of its revenue arrangements for theater systems for the period from 2002 to 2006. Three transactions which were originally recorded in 2005 (revenue and net earnings impact of $5.3 million and $2.7 million, respectively) were moved to the first quarter of 2006. One transaction which was originally recorded in the first quarter of 2006 (revenue and net earnings impact of $1.8 million and $0.4 million, respectively) was moved to the second quarter of 2006. The net impact of these adjustments was an understatement of net earnings of $2.3 million for the quarter ended March 31, 2006. The net impact of these adjustments was an increase in revenue and net earnings of $3.2 million and $2.1 million, respectively, for the quarter ended March 31, 2006.

Table of Contents

IMAX CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
In accordance with U.S. Generally Accepted Accounting Principles
(Tabular amounts in thousands of U.S. dollars unless otherwise stated)
(unaudited)

3. Restatement of Previously Issued Financial Statements (cont d)

Revenue Recognition Other

As a result of the review of the revenue arrangements, the Company identified additional errors including the following:

Based on an analysis of fair values of elements within arrangements separately priced maintenance and warranty agreements and film licenses, the Company determined that fair value previously allocated in certain multiple element arrangements was not appropriate and has adjusted these amounts.

The existence of certain non-standard contractual provisions resulted in the reclassification of: certain sales to sales-type lease transactions given lien rights were retained; certain sales-type leases to operating leases given substantially all of the benefits and risks of ownership had not passed to the customer and certain contractual default clauses impacted the timing of recognition of the minimum annual payments under the arrangements.

Finance income continued to be recognized when the related financing receivables were impaired. The Company has corrected the error by discontinuing the recognition of finance income until the impairment issues were resolved.

The impact of these adjustments was a decrease to net loss by $0.1 million for the three months ended March 31, 2006.

Inventory Costs

During the period from 2001 to 2006, the Company paid certain fees to a professional services firm to assist the Company in identifying sales opportunities and provide assistance in negotiating and concluding contracts in the developing Asian market. These fees were capitalized and allocated to theater systems inventory for various Asian customers. The Company has determined that these fees were promotional and selling expenses which should have been expensed as incurred as the costs were not direct and incremental costs to a contract. The net loss has been increased by less than $0.1 million for the three months ended March 31, 2006.

Film Accounting

The Company has determined that it had misclassified certain costs incurred in respect of co-produced film productions between 2004 and the third quarter of 2006. Marketing and advertising costs were co-mingled with film production costs, and both were capitalized to film assets, and subsequently amortized into the income statement over the estimated total ultimate revenues associated with the film productions. Film exploitation costs, which include marketing and advertising costs, as defined in SOP 00-2, should be expensed in the period incurred and not capitalized to film assets. In addition, certain costs were accrued by the Company prior to being incurred. These costs have been moved to the period they were incurred. On certain co-produced film productions the Company received production fees which should have been deferred and recognized over the film ultimates. These production fees were previously recognized when production of the film was complete. The Company also determined that it had not appropriately applied the individual-film-forecast computation method when it amortized its film assets and deferred production fees and accrued its participation liabilities for the periods between 2002 and the third quarter of 2006. SOP 00-2 requires changes in estimates of ultimate revenues used in the individual-film-forecast computation method to be adjusted prospectively from the beginning of the year of the change. The Company had applied changes in estimates on a retroactive basis from the original release date. In addition, the Company adjusted its amortization of prepaid print costs. The net loss has been increased by $0.3 million for the three months ended March 31, 2006.

Table of Contents

IMAX CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
In accordance with U.S. Generally Accepted Accounting Principles
(Tabular amounts in thousands of U.S. dollars unless otherwise stated)
(unaudited)

3. Restatement of Previously Issued Financial Statements (cont d)

Branch Level Interest Taxes

The Company did not properly account for tax liabilities for branch level interest tax. For the years ended December 31, 2002, 2003 and 2004, the Company failed to make timely tax elections that would have prevented an allocation of the Company s interest expense on its long-term indebtedness to the Company s U.S. branch income tax returns. In 2006, the Company was assessed branch level interest taxes, interest and penalties due to the fact that these tax elections were not filed on a timely basis. The Company has determined that an accrued liability for the tax obligations should have been recorded at the time elections should have been filed and the taxes were due to be paid, which was in the third quarter of each of the years ended December 31, 2003, 2004 and 2005. The net loss has been decreased by $0.2 million for the three months ended March 31, 2006.

Other Adjustments

During the preparation of executive compensation information for the 2006 Annual Report on Form 10-K, the Company determined that the two Co-Chief Executive Officers (Co-CEOs) were entitled to postretirement benefits since 2000 for which the obligation had not been included in the prior financial statements as required under SFAS No. 106, Employer s Accounting for Postretirement Benefits Other than Pensions . As a result the Company should have accrued $0.2 million in 2000. SG&A has been increased by less than $0.1 million for the three months ended March 31, 2006.

Statements of Cash Flows

There were no errors in the cash flow statements for the quarter ended March 31, 2006 other than conforming changes to the components of the reconciliation to net cash provided by or used in operating activities related to the restatement adjustments described above.

Table of Contents

IMAX CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
In accordance with U.S. Generally Accepted Accounting Principles
(Tabular amounts in thousands of U.S. dollars unless otherwise stated)
(unaudited)

3. Restatement of Previously Issued Financial Statements (cont d)

Nature of Errors (cont d)

Restated Statement of Operations for the Three Months Ended March 31, 2006

The following table presents the impact of the restatement on the Company s previously issued consolidated statements of operations for the three months ended March 31, 2006:

	As Previously Reported[1]	Revenue Recognition-Theater Systems	Revenue Recognition-Other	Inventory Costs	Film Accounting	Branch Level Interest Taxes	Other Adjustments	As Restated
Revenues								
Equipment and product sales	$ 4,679	$ 3,315	$ (174)	$	$	$	$	$ 7,820
Services	13,708		243		(517)			13,434
Rentals	854		45					899
Finance income	1,177	(81)	16					1,112
	20,418	3,234	130		(517)			23,265
Costs of goods sold, services and rentals								
Equipment and product sales	3,121	1,085						4,206
Services	10,828	14			(225)			10,617
Rentals	444		21					465
	14,393	1,099	21		(225)			15,288
Gross margin	6,025	2,135	109		(292)			7,977
Selling, general and administrative expenses	10,505			45			3	10,553
Research and development	915							915
Amortization of intangibles	192							192
Receivable provisions net of (recoveries)	143							143

	Col 1	Col 2	Col 3	Col 4	Col 5	Col 6	Col 7	Col 8
Earnings from operations	(5,730)	2,135	109	(45)	(292)		(3)	(3,826)
Interest income	253							253
Interest expense	(4,174)					17		(4,157)
Earnings (loss) from continuing operations before income taxes	(9,651)	2,135	109	(45)	(292)	17	(3)	(7,730)
Recovery of (provision for) income taxes	1,530					162		1,692
Net earnings (loss) from continuing operations	(8,121)	2,135	109	(45)	(292)	179	(3)	(6,038)
Net earnings from discontinued operations	2,300							2,300
Net earnings (loss)	$ (5,821)	$ 2,135	$ 109	$ (45)	$ (292)	$ 179	$ (3)	$ (3,738)
Earnings (loss) per share								
Earnings (loss) per share basic:								
Net earnings (loss) from continuing operations	$ (0.20)	$ 0.05	$	$	$	$	$	$ (0.15)
Net earnings from discontinued operations	$ 0.06	$	$	$	$	$	$	$ 0.06
Net (loss) earnings	$ (0.14)	$ 0.05	$	$	$	$	$	$ (0.09)
Earnings (loss) per share diluted:								
Net earnings (loss) from continuing operations	$ (0.20)	$ 0.05	$	$	$	$	$	$ (0.15)
Net earnings from discontinued operations	$ 0.06	$	$	$	$	$	$	$ 0.06

Net earnings (loss)	$ (0.14)	$ 0.05	$	$	$	$	$	$ (0.09)

(1) The Company has changed the presentation of revenues and cost of goods sold, services and rentals to conform to the presentation requirements specified in Regulation S-X of the Securities Exchange Act of 1934.

Table of Contents

IMAX CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
In accordance with U.S. Generally Accepted Accounting Principles
(Tabular amounts in thousands of U.S. dollars unless otherwise stated)
(unaudited)

4. Financing Receivables

Financing receivables, consisting of net investment in leases and receivables from financed sales of its theater systems, are as follows:

	March 31, 2007	December 31, 2006
Gross minimum lease amounts receivable	$ 88,175	$ 89,343
Residual value of equipment	368	368
Unearned finance income	(30,303)	(31,182)
Present value of minimum lease amounts receivable	58,240	58,529
Accumulated allowance for uncollectible amounts	(2,555)	(2,445)
Net investment in leases	55,685	56,084
Gross receivables from financed sales	14,697	14,268
Unearned income	(4,498)	(4,474)
Present value of financed sale receivables	10,199	9,794
Total financing receivables	$ 65,884	$ 65,878
Present value of financed sale receivables due within one year	$ 2,576	$ 1,886
Present value of financed sale receivables due after one year	$ 7,623	$ 7,908

As at March 31, 2007 the financed sale receivables had a weighted average effective interest rate of 8.7% (December 31, 2006 8.3%).

5. Inventories

	March 31, 2007	December 31, 2006
Raw materials	$ 11,496	$ 11,504
Work-in-process	2,612	2,677
Finished goods	12,556	12,732
	$ 26,664	$ 26,913

6. Senior Notes due 2010

As at March 31, 2007, the Company had outstanding $159.0 million aggregate principal of Registered Senior Notes and $1.0 million aggregate principal of Unregistered Senior Notes. The Registered Senior Notes and the Unregistered

Senior Notes are referred to herein as the Senior Notes.

The terms of the Company s Senior Notes require that annual and quarterly financial statements are filed with the Trustee within 15 days of the required public company filing deadlines. If these financial reporting covenants are breached then this is considered an event of default under the terms of the Senior Notes and the Company has 30 days to cure this default, after which the Senior Notes become due and payable.

In March 2007, the Company delayed the filing of its Annual Report on Form 10-K for the year ended December 31, 2006 beyond the required public company filing deadline due to the discovery of certain accounting errors, broadened its accounting review to include certain other accounting matters based on comments received by the Company from the SEC and OSC, and ultimately restated financial statements for certain periods during those years. The filing delay resulted in the Company being in default of a financial reporting covenant under the indenture dated as of December 4, 2003, and as thereafter amended and supplemented, governing the Company s Senior Notes due 2010 (the Indenture).

IMAX CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
In accordance with U.S. Generally Accepted Accounting Principles
(Tabular amounts in thousands of U.S. dollars unless otherwise stated)
(unaudited)

6. Senior Notes due 2010 (cont d)

On April 16, 2007 the Company completed a consent solicitation, receiving consents from holders of approximate 60% aggregate principal amount of the Senior Notes (the Consenting Holders) to execute a ninth supplemental indenture (the Supplemental Indenture) to the Indenture with the Guarantors named therein and U.S. Bank National Association. The Supplemental Indenture waived any defaults existing at such time arising from a failure by the Company to comply with the reporting covenant and extended until May 31, 2007, or at the Company s election until June 30, 2007 (the Covenant Reversion Date), the date by which the Company s failure to comply with the reporting covenant shall constitute a default, or be the basis for an event of default under the Indenture. The Company paid consent fees of $1.0 million to the Consenting Holders. On May 30, 2007, the Company provided notice to the holders of the Senior Notes of its election to extend the Covenant Reversion Date to June 30, 2007. The Company paid additional consent fees of $0.5 million to the Consenting Holders. Because the Company did not file its Annual Report on Form 10-K for the year ended December 31, 2006 and its Quarterly Report on Form 10-Q for the quarter ended March 31, 2007 by June 30, 2007, it was in default of the reporting covenant under the Indenture on July 1, 2007, and received notice of such default on July 2, 2007. The Company will cure such default under the Indenture, which provides for a 30-day cure period for defaults under the reporting covenant, by filing its 2006 10-K and this first quarter 2007 10-Q by the end of the 30-day cure period.

7. Credit Facility

On February 6, 2004, the Company entered into a Loan Agreement for a secured revolving credit facility as amended on June 30, 2005 and as further amended by the Second Amendment to the Loan Agreement which was entered into with effect from May 16, 2006 (the Credit Facility). The Credit Facility is a revolving credit facility expiring on October 31, 2009 with an optional one year renewal thereafter contingent upon approval by the lender, permitting maximum aggregate borrowings of $40.0 million, subject to a borrowing base calculation which includes the Company s financing receivables, operating leases, finished goods inventory and capital assets with certain reserve requirements and deductions for outstanding letters of credit. As at March 31, 2007, the Company s current borrowing capacity under such calculation is $22.4 million after deduction for outstanding letters of credit of $10.6 million. The Credit Facility bears interest at the applicable prime rate per annum or LIBOR plus a margin as specified therein per annum and is collateralized by a first priority security interest in all of the current and future assets of the Company. The Credit Facility contains typical affirmative and negative covenants, including covenants that restrict the Company s ability to: incur certain additional indebtedness; make certain loans, investments or guarantees; pay dividends; make certain asset sales; incur certain liens or other encumbrances; conduct certain transactions with affiliates and enter into certain corporate transactions. In addition, the Credit Facility agreement contains customary events of default, including upon an acquisition or a change of control that may have a material adverse effect on the Company or a guarantor. The Credit Facility also requires the Company to maintain, over a period of time, a minimum level of cash collections and a minimum level of adjusted earnings before interest, taxes, depreciation and amortization including film asset amortization, stock and other non-cash compensation, write downs (recoveries), and asset impairment charges, and other non-cash uses of funds calculated on a trailing four quarter basis, of not less than $20.0 million.

Under the terms of the Credit Facility, the Company has to comply with several reporting requirements including the delivery of audited consolidated financial statements within 120 days of the end of the fiscal year.

In March 2007, the Company delayed the filing of its Annual Report on Form 10-K for the year ended December 31, 2006 beyond the filing deadline in order to restate financial statements for certain periods during the fiscal years 2002 2006. On March 27, 2007, the Credit Facility lender waived the requirement for the Company to deliver audited consolidated financial statements within 120 days of the end of the fiscal year ended December 31, 2006, provided such statements and documents are delivered on or before June 30, 2007. On June 27, 2007, the Credit Facility lender

agreed that an event of default would not be deemed to have occurred unless the Company s 10-K filing does not occur by July 31, 2007 or upon the occurrence and continuance of an event of default under the Company s Indenture governing its Senior Notes which, has not been cured within the applicable grace period.

Page 13

Table of Contents

IMAX CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
In accordance with U.S. Generally Accepted Accounting Principles
(Tabular amounts in thousands of U.S. dollars unless otherwise stated)
(unaudited)

8. Commitments

(a) The Company s lease commitments consist of rent and equipment under operating lease. The Company accounts for any incentives provided over the term of the lease. Total minimum annual rental payments to be made by the Company under operating leases for premises and equipment as of March 31, 2007 for each of the years ended December 31, are as follows:

2007 (nine months remaining)	$ 4,637
2008	6,036
2009	5,854
2010	5,999
2011	6,136
Thereafter	14,636
	$ 43,298

(b) As at March 31, 2007, the Company has letters of credit of $10.6 million (December 31, 2006 - $9.4 million) outstanding under the Company s credit facility arrangement, which have been collateralized by cash deposits (see note 7). In addition, as at March 31, 2007, the Company has Performance Security Guarantees of $0.6 million (December 31, 2006 $0.6 million) outstanding that have been guaranteed through Export Development Canada.

(c) The Company compensates its sales force with both fixed and variable compensation. Commissions on the sale or lease of the Company s theater system components are due in graduated amounts from the time of collection of the customer s first payment to the Company up to the collection of the customer s last initial payment. At March 31, 2007, $0.2 million (December 31, 2006 $0.3 million) of commissions will be payable in future periods if the Company collects its initial payments as anticipated.

9. Contingencies and Guarantees

The Company is involved in lawsuits, claims, and proceedings, including those identified below, which arise in the ordinary course of business. In accordance with Statements of Financial Accounting Standards No. 5, Accounting for Contingencies , the Company will make a provision for a liability when it is both probable that a loss has been incurred and the amount of the loss can be reasonably estimated. The Company believes it has adequate provisions for any such matters. The Company reviews these provisions in conjunction with any related provisions on assets related to the claims at least quarterly and adjusts these provisions to reflect the impacts of negotiations, settlements, rulings, advice of legal counsel and other pertinent information related to the case. Should developments in any of these matters outlined below cause a change in the Company s determination as to an unfavorable outcome and result in the need to recognize a material provision, or, should any of these matters result in a final adverse judgment or be settled for significant amounts, they could have a material adverse effect on the Company s results of operations, cash flows, and financial position in the period or periods in which such a change in determination, settlement or judgment occurs. The Company expenses legal costs relating to its lawsuits, claims and proceedings as incurred.

Table of Contents

IMAX CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
In accordance with U.S. Generally Accepted Accounting Principles
(Tabular amounts in thousands of U.S. dollars unless otherwise stated)
(unaudited)

9. Contingencies and Guarantees (cont d)

(a) In March 2005, the Company, together with Three-Dimensional Media Group, Ltd. (3DMG), filed a complaint in the U.S. District Court for the Central District of California, Western Division, against In-Three, Inc. (In-Three) alleging patent infringement. On March 10, 2006, the Company and In-Three entered into a settlement agreement settling the dispute between the Company and In-Three. On June 12, 2006, the U.S. District Court for the Central District of California, Western Division, entered a stay in the proceedings against In-Three pending the arbitration of disputes between the Company and 3DMG. Arbitration was initiated by the Company against 3DMG on May 15, 2006 before the International Centre for Dispute Resolution in New York, alleging breaches of the license and consulting agreements between the Company and 3DMG. On June 15, 2006, 3DMG filed an answer denying any breaches and asserting counterclaims that the Company breached the parties license agreement. On June 21, 2007, the Arbitration Panel unanimously denied 3DMG s Motion for Summary Judgment filed on April 11, 2007 concerning the Company s claims and 3DMG s counterclaims. An evidentiary hearing on liability issues has been set for September 2007 with further proceedings on damages issues to be scheduled if and when necessary. The Company will continue to pursue its claims vigorously and believes that all allegations made by 3DMG are without merit. The Company further believes that the amount of loss, if any, suffered in connection with the counterclaims would not have a material impact on the financial position or operations of the Company, although no assurance can be given with respect to the ultimate outcome of the arbitration.

(b) In January 2004, the Company and IMAX Theater Services Ltd., a subsidiary of the Company, commenced an arbitration seeking damages of approximately $3.7 million before the International Court of Arbitration of the International Chambers of Commerce (the ICC) with respect to the breach by Electronic Media Limited (EML) of its December 2000 agreement with the Company. In June 2004, the Company commenced a related arbitration before the ICC against EML s affiliate, E-CITI Entertainment (I) PVT Limited (E-Citi), seeking $17.8 million in damages as a result of E-Citi s breach of a September 2000 lease agreement. The arbitration hearing on both claims took place in November 2005. On February 1, 2006, the ICC issued an award on liability finding unanimously in the Company s favor on all claims. The ICC hearings to determine the amount of damages to be awarded to the Company took place in July 2006, and a further hearing took place on December 2006. The ICC panel has not yet rendered its decision with respect to damages and no amount has yet been recorded for these damages.

(c) In June 2004, Robots of Mars, Inc. (Robots) initiated an arbitration proceeding against the Company in California with the American Arbitration Association pursuant to an arbitration provision in a 1994 film production agreement between Robots predecessor-in-interest and a subsidiary of the Company, asserting claims for breach of contract, fraud, breach of fiduciary duty and intentional interference with contract. Robots is seeking an accounting of the Company s revenues and an award of all sums alleged to be due to Robots under the production agreement, as well as punitive damages. The Company intends to vigorously defend the arbitration proceeding and believes the amount of the loss, if any, that may be suffered in connection with this proceeding will not have a material impact on the financial position or results of operations of the Company, although no assurance can be given with respect to the ultimate outcome of such arbitration.

Table of Contents

IMAX CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
In accordance with U.S. Generally Accepted Accounting Principles
(Tabular amounts in thousands of U.S. dollars unless otherwise stated)
(unaudited)

9. Contingencies and Guarantees (cont d)

(d) The Company and certain of its officers and directors were named as defendants in eight purported class action lawsuits filed between August 11, 2006 and September 18, 2006, alleging violations of U.S. federal securities laws. These eight actions were filed in the U.S. District Court for the Southern District of New York. The lawsuits, brought on behalf of shareholders who purchased the Company s common stock between October 28, 2004 and August 9, 2006, allege primarily that the defendants engaged in securities fraud by disseminating materially false and misleading statements during the class period regarding the Company s revenue recognition of theater system installations, and failing to disclose material information concerning the Company s revenue recognition practices. These lawsuits seek unspecified compensatory damages, costs, and expenses. On January 18, 2007, the Court consolidated all eight class action lawsuits and appointed Westchester Capital Management, Inc. as the lead plaintiff and Abbey Spanier Rodd Abrams & Paradis LLP as lead plaintiff s counsel. On April 26, 2007, the lead plaintiff and the Company entered into a stipulation extending the time in which the lead plaintiff must file a consolidated amended complaint until sixty days after the Company files its Annual Report on Form 10-K for the year ended December 31, 2006. The lawsuit is at a very early stage and as a result the Company is not able to estimate a potential loss exposure. The Company believes the allegations made against it in the complaints are meritless and will vigorously defend this matter, although no assurance can be given with respect to the outcome of such proceedings. The Company s directors and officers insurance policy provides for reimbursement for costs and expenses incurred in connection with this lawsuit as well as potential damages awarded, if any, subject to certain policy limits.

(e) A class action lawsuit was filed on September 20, 2006 in the Ontario Superior Court of Justice against the Company and certain of its officers and directors, alleging violations of Canadian securities laws. This lawsuit was brought on behalf of shareholders who acquired the Company s securities between February 17, 2006 and August 9, 2006. The lawsuit is in a very early stage and seeks unspecified compensatory and punitive damages, as well as costs and expenses. As a result, the Company is unable to estimate a potential loss exposure. The Company believes the allegations made against it in the statement of claim are meritless and will vigorously defend the matter, although no assurance can be given with respect to the ultimate outcome of such proceedings. The Company s directors and officers insurance policy provides for reimbursement for costs and expenses incurred in connection with this lawsuit as well as potential damages awarded, if any, subject to certain policy limits.

(f) On May 10, 2007, Catalyst Fund Limited Partnership II, a holder of Senior Notes, filed a complaint against the Company in the Supreme Court of the State of New York, New York County alleging common law fraud, challenging the consent solicitation through which the Company requested and obtained a waiver of any and all defaults arising from a failure to comply with the reporting covenant under the indenture governing the Senior Notes, and seeking a declaration that the consent solicitation was legally ineffective due to alleged misstatements made by the Company. The complaint further seeks a declaration that the Company has defaulted on its reporting obligations under the indenture as a result of its failure to timely file its annual and quarterly reports, and the Company s stated expectation that it will restate certain of the financial statements it filed during the 2001 through 2006 time period. The litigation is at a preliminary stage and as a result, the Company is not able to estimate a potential loss exposure. The Company believes this lawsuit is entirely without merit and plans to defend it vigorously. On June 29, 2007, the Company moved to dismiss the complaint in its entirety. The Company believes this lawsuit is entirely without merit and plans to defend it vigorously although no assurances can be given with respect to the outcome of such proceedings.

(g) In addition to the matters described above, the Company is currently involved in other legal proceedings which, in the opinion of the Company s management, will not materially affect the Company s financial position or future operating results, although no assurance can be given with respect to the ultimate outcome of any such proceedings.

(h) In the normal course of business, the Company enters into agreements that may contain features that meet the FASB issued Interpretation No. 45, Guarantor s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others (FIN 45) definition of a guarantee. FIN 45 defines a guarantee to be a contract (including an indemnity) that contingently requires the Company to make payments (either in cash, financial instruments, other assets, shares of its stock or provision of services) to a third party based on (a) changes in an underlying interest rate, foreign exchange rate, equity or commodity instrument, index or other variable, that is related to an asset, a liability or an equity security of the counterparty, (b) failure of another party to perform under an obligating agreement or (c) failure of another third party to pay its indebtedness when due.

Table of Contents

IMAX CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
In accordance with U.S. Generally Accepted Accounting Principles
(Tabular amounts in thousands of U.S. dollars unless otherwise stated)
(unaudited)

9. Contingencies and Guarantees (cont d)

Financial Gurantees

The Company has provided no significant financial guarantees to third parties.

Product Warranties

The following summarizes the accrual for product warranties that was recorded as part of accrued liabilities in the consolidated balance sheets as of March 31, 2007:

	2007
Balance at the beginning of the year	$ 38
Payments	
Warranties issued	
Revisions	
Balance as of March 31, 2007	$ 38

Director/Officer Indemnification

The Company s General By-law contains an indemnification of its directors/officers, former directors/officers and persons who have acted at its request to be a director/officer of an entity in which the Company is a shareholder or creditor, to indemnify them, to the extent permitted by the *Canada Business Corporations Act*, against expenses (including legal fees), judgments, fines and any amount actually and reasonably incurred by them in connection with any action, suit or proceeding in which the directors and/or officers are sued as a result of their service, if they acted honestly and in good faith with a view to the best interests of the Company. The nature of the indemnification prevents the Company from making a reasonable estimate of the maximum potential amount it could be required to pay to counterparties. The Company has purchased directors and officers liability insurance. No amount has been accrued in the consolidated balance sheet as of December 31, 2006, with respect to this indemnity.

Other Indemnification Agreements

In the normal course of the Company s operations, it provides indemnifications to counterparties in transactions such as: theater system lease and sale agreements and the supervision of installation or servicing of the theater systems; film production, exhibition and distribution agreements; real property lease agreements; and employment agreements. These indemnification agreements require the Company to compensate the counterparties for costs incurred as a result of litigation claims that may be suffered by the counterparty as a consequence of the transaction or the Company s breach or non-performance under these agreements. While the terms of these indemnification agreements vary based upon the contract, they normally extend for the life of the agreements. A small number of agreements do not provide for any limit on the maximum potential amount of indemnification, however virtually all of the Company s system lease and sale agreements limit such maximum potential liability to the purchase price of the system. The fact that the maximum potential amount of indemnification required by the Company is not

specified in some cases prevents the Company from making a reasonable estimate of the maximum potential amount it could be required to pay to counterparties. Historically, the Company has not made any significant payments under such indemnifications and no amount has been accrued in the accompanying condensed consolidated financial statements with respect to the contingent aspect of these indemnities.

10. Condensed Consolidated Statements of Operations Supplemental Information

(a) Included in selling, general and administrative expenses for the three months ended March 31, 2007 is a gain of $0.1 million (2006 less than $0.1 million gain), for net foreign exchange gains or losses related to the translation of foreign currency denominated monetary assets, liabilities and integrated subsidiaries.

Table of Contents

IMAX CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
In accordance with U.S. Generally Accepted Accounting Principles
(Tabular amounts in thousands of U.S. dollars unless otherwise stated)
(unaudited)

11. Receivable Provisions, Net of (Recoveries)

	Three months ended March 31,	
	2007	**2006**
Accounts receivable provisions, net of (recoveries)	$ (11)	$ 203
Financing receivables, net of (recoveries)	17	(60)
Receivable provisions, net of (recoveries)	$ 6	$ 143

12. Income Taxes

The Company s effective tax rate differs from the statutory tax rate and will vary from year to year primarily as a result of numerous permanent differences, investment and other tax credits, the provision for income taxes at different rates in foreign and other provincial jurisdictions, enacted Statutory tax rate increases or reductions in the year, changes in the Company s valuation allowance based on the Company s recoverability assessments of deferred tax assets, and favourable or unfavourable resolution of various tax examinations. There was no change in the Company s estimates of projected future earnings and the recoverability of its deferred tax assets based on an analysis of both positive and negative evidence.

As at March 31, 2007, the Company has net deferred income tax assets of $nil (December 31, 2006 - $nil). As of March 31, 2007, the Company had a gross deferred income tax asset of $53.8 million, against which the Company is carrying a $53.8 million valuation allowance.

In June 2006, the FASB issued Interpretation No. 48 (FIN 48), *Accounting for Uncertainty in Income Taxes An Interpretation of FASB Statement No. 109.* FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise s financial statements in accordance with SFAS No. 109, *Accounting for Income Taxes*. This Interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. This Interpretation also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. In connection with the Company s adoption of FIN 48, as of January 1, 2007, the Company recorded a net decrease to retained earnings of $2.1 million (including approximately $0.9 million related to accrued interest and penalties) related to the measurement of potential international withholding tax requirements and a decrease in reserves for income taxes. As of March 31, 2007 and January 1, 2007, the Company had total unrecognized tax benefits of $3.8 million and $3.7 comprised of (i) $3.6 million and $3.5 million for international withholding taxes, respectively, and (ii) $0.2 million related to Large Corporations Tax as of both periods. All of the unrecognized tax benefits could impact the Company s effective tax rate if recognized. While the Company believes it has adequately provided for all tax positions, amounts asserted by taxing authorities could be greater than our accrued position. Accordingly, additional provisions on federal and foreign tax-related matters could be recorded in the future as revised estimates are made or the underlying matters are settled or otherwise resolved.

Consistent with its historical financial reporting, the Company has elected to classify interest and penalties related to income tax liabilities, when applicable, as part of the interest expense in its Consolidated Statements of Operations rather than income tax expense. In conjunction with the adoption of FIN 48, the Company recognized approximately $0.1 million in potential interest and penalties associated with uncertain tax positions for the three months ended March 31, 2007.

IMAX CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
In accordance with U.S. Generally Accepted Accounting Principles
(Tabular amounts in thousands of U.S. dollars unless otherwise stated)
(unaudited)

13. Capital Stock

(a) Stock-Based Compensation

The Company has four stock-based compensation plans that are described below. The compensation costs charged to the statement of operations for these plans were $1.0 million and $0.8 million for the first quarters ended March 31, 2007 and 2006, respectively. No income tax benefit is recorded in the consolidated statement of operations for these costs.

Stock Option Plan

The Company s Stock Option Plan, which is shareholder approved, permits the grant of options to employees, directors and consultants.

The Company s policy is to issue new shares from treasury to satisfy stock options which are exercised.

The weighted average fair value of all common share options granted to employees in the first quarter of 2007 at the date of grant was $2.42 per share (2006 $3.75 per share). The Company utilizes a Binomial Model to determine the fair value of common share options at the grant date. For the three months ended March 31, the following assumptions were used:

	2007	2006
Average risk-free interest rate	4.72%	4.83%
Market risk premium	5.73%	5.33% - 5.60%
Beta	0.82	1.11 - 1.28
Expected option life (in years)	5.34	3.86 - 5.33
Expected volatility	61%	60%
Annual termination probability	11.87%	8.06%
Dividend yield	0%	0%

As the Company stratifies its employees into two groups in order to calculate fair value under the Binomial Model, ranges of assumptions used are presented for equity risk premium, Beta, expected option life and annual termination probability. The Company uses historical data to estimate option exercise and employee termination within the valuation model; separate groups of employees that have similar historical exercise behavior are considered separately for valuation purposes. The expected volatility rate is estimated based on the Company s historical share-price volatility. The market risk premium reflects the amount by which the return on the market portfolio exceeds the risk-free rate, where the return on the market portfolio is based on the Standard and Poors 500 index. The Company utilizes an expected term method to determine expected option life based on such data as vesting periods of awards, historical data that includes past exercise and post-vesting cancellations and stock price history.

Table of Contents

IMAX CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
In accordance with U.S. Generally Accepted Accounting Principles
(Tabular amounts in thousands of U.S. dollars unless otherwise stated)
(unaudited)

13. Capital Stock (cont d)

(a) Stock-Based Compensation (cont d)

Stock Option Plan (cont d)

As at March 31, 2007, the Company has reserved a total of 6,974,657 (December 31, 2006 6,974,657) common shares for future issuance under the Stock Option Plan, of which options in respect of 5,087,985 common shares are outstanding at March 31, 2007. Options are generally granted with an exercise price equal to the market value of the Company s stock at the grant date. The options generally vest between one and five years and expire 10 years or less from the date granted. The Plan provides that vesting will be accelerated if there is a change of control, as defined in the plan. At March 31, 2007, options in respect of 4,625,132 common shares were vested and exercisable.

The following table summarizes certain information in respect of option activity under the Stock Option Plan for the periods ended March 31:

	Number of shares		Weighted average exercise price per share	
	2007	**2006**	**2007**	**2006**
Options outstanding, beginning of period	5,100,995	5,262,824	$7.12	$ 6.82
Granted	16,390	33,335	4.40	9.06
Exercised		(66,533)		3.81
Forfeited	(16,350)	(14,000)	8.12	20.65
Expired		(8,000)		13.95
Cancelled	(13,050)	(2,467)	6.87	
Options outstanding, end of period	5,087,985	5,205,159	7.11	7.16
Options exercisable, end of period	4,625,132	4,238,422	7.07	7.12

In the first quarter of 2007, the Company cancelled 13,050 stock options from its Stock Option Plan (2006 2,467) surrendered by Company employees for $nil consideration.

As at March 31, 2007 4,945,309 options are fully vested or are expected to vest with a weighted average exercise price of $7.09, aggregate intrinsic value of $1.7 million and weighted average remaining contractual life of 4.3 years. As at March 31, 2007, options that are exercisable have an intrinsic value of $1.7 million and a weighted average remaining contractual life of 4.2 years. The intrinsic value of options exercised in the first quarter of 2006 was $0.4 million.

Not included in the table above are 502,500 options granted in the first quarter of 2006 that the Company determined in the fourth quarter of 2006, exceeded, by approximately 1.6%, certain cap limits for grants set by its

Stock Option Plan. These options were granted with a weighted average exercise price of $10.43. Of these options, 10,000 options with a weighted average exercise price of $10.69 were forfeited. The number of these options outstanding as at March 31, 2007 was 492,500 (2006 502,500) with a weighted average exercise price of $10.42 (2006 $10.43). The number of these options exercisable as at March 31, 2007 was 216,250 (2006 nil) with a weighted average exercise price of $10.63 (2006 nil). As the Company intended to settle the obligations for a significant number of these options in cash, these options have been treated as liability-based awards based on fair values as at March 31, 2007. 5,000 of these options were forfeited in May 2007, 150,000 of these options were voluntarily surrendered by the Co-CEOs for no consideration in June 2007; and 337,500 of these options were settled for cash in June 2007 in an amount of $0.3 million. Compensation cost recognized up to the cancellation date was not reversed for the options cancelled.

Options to Non-Employees

In the first quarter of 2007, an aggregate of 8,890 (2006 23,335) options to purchase the Company s common stock with an average exercise price of $4.31 (2006 $8.75) were issued to certain advisors and strategic partners of the Company. These options have a maximum contractual life of seven years. Certain of these options vest immediately and others upon the occurrence of certain events. These options were granted under the Stock Option Plan.

IMAX CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
In accordance with U.S. Generally Accepted Accounting Principles
(Tabular amounts in thousands of U.S. dollars unless otherwise stated)
(unaudited)

13. Capital Stock (cont d)

(a) Stock-Based Compensation (cont d)

Stock Option Plan (cont d)

Options to Non-Employees (cont d)

As at March 31, 2007, non-employee options outstanding amounted to 125,549 options (2006 63,340) with a weighted-average exercise price of $8.24 (2006 $9.51). 115,549 options (2006 53,340) were exercisable with an average weighted exercise price of $8.18 (2006 $9.62) and the vested options have an aggregate intrinsic value of less than $0.1 million. The Company has calculated the fair value of these options to non-employees to be less than $0.1 million (2006 $0.1 million), using a Binomial option-pricing model with the following underlying assumptions for periods ended March 31:

	2007	2006
Average risk-free interest rate	4.71%	4.60%
Contractual option life	6 years	5-7 years
Average expected volatility	60%	60%
Dividend yield	0%	0%

In the first quarter of 2007, the Company has recorded a charge of less than $0.1 million (2006 - $0.1 million) to film cost of sales related to the non-employee stock options.

Restricted Common Shares

Under the terms of certain employment agreements dated July 12, 2000, the Company is required to issue either 160,000 restricted common shares or pay their cash equivalent. The restricted shares are required to be issued, or payment of their cash equivalent, upon request by the employees at any time. The aggregate intrinsic value of the awards outstanding is $0.8 million. The Company accounts for the obligation as a liability, which is classified within accrued liabilities. The Company has recorded an expense of $0.2 million for the quarter ended March 31, 2007 (2006 $0.5 million), due to the changes in the Company s stock price during the period.

Stock Appreciation Rights

On February 15, 2007, 600,000 stock appreciation rights with an exercise price of $4.34 per right were granted to Company executives. Half of the rights vested and were exercisable immediately and the other 300,000 rights will vest and be exercisable by the end of 2007. These rights were measured at fair value at the date of grant and are remeasured each period until settled. At March 31, 2007, these rights had weighted average fair value of $1.12 based on the fair value of $nil for the rights that vested on date of grant and a fair value of $2.23 for the rights that vest during 2007. The Company has recorded a charge of $0.3 million to SG&A related to these rights. The following assumptions were used at March 31, 2007 for measuring the fair value of the rights that vest during 2007:

Risk-free interest rate	4.72%
Market risk premium	5.66%
Beta	0.90
Expected option life (in years)	4.51
Expected volatility	61%
Annual termination probability	0%
Dividend yield	0%

Warrants to Non-Employees

There were no warrants issued during the three months ended or outstanding as of March 31, 2007 and 2006.

Table of Contents

IMAX CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
In accordance with U.S. Generally Accepted Accounting Principles
(Tabular amounts in thousands of U.S. dollars unless otherwise stated)
(unaudited)

13. Capital Stock (cont d)

(b) Earnings (Loss) per Share

Reconciliations of the numerators and denominators of the basic and diluted per-share computations are comprised of the following:

	Three months ended March 31, 2007	Three months ended March 31, 2006 As restated
Net loss from continuing operations applicable to common shareholders	$ (4,780)	$ (6,038)
Weighted average number of common shares (000 s):		
Issued and outstanding, beginning of period	40,286	40,213
Weighted average number of shares issued during the period		12
Weighted average number of shares used in computing basic earnings per share	40,286	40,225
Assumed exercise of stock options, net of shares assumed repurchased		
Weighted average number of shares used in computing diluted earnings per share	40,286	40,225

The calculation of diluted earnings per share for the three months ended March 31, 2007 excludes 0.2 million (2006 1.8 million) common shares issuable upon exercise of options as the impact of these exercises would be antidilutive.

(c) Shareholders Deficit

The following summarizes the movement of Shareholders Deficit for the three months ended March 31, 2007:

Balance as of December 31, 2006	$ (52,131)
Net loss	(4,780)
Adjustment to paid-in-capital for employee stock options granted	96
Adjustment to paid-in-capital for non-employee stock options granted	21
Adjustment for adoption of FIN 48	(2,093)
Adjustment to amortize the prior service credit	161
Balance as of March 31, 2007	$ (58,726)

es your subscription certificate or your payment after that time, regardless of when you sent the subscription certificate and payment, unless you send the documents in compliance with the guaranteed delivery procedures described above. SHARES OF COMMON STOCK OUTSTANDING AFTER THE RIGHTS OFFERING

Approximately 48.2 million shares of our common stock will be issued and outstanding after the rights offering, assuming exercise in full of all rights. Approximately 12.1 million shares of our common stock are issued and outstanding as of the date hereof. EFFECTS OF RIGHTS OFFERING ON OUR STOCK OPTION PLANS AND OTHER PLANS As of December 15, 2003, there were outstanding options to purchase approximately 453,000 shares of our common stock issued or committed to be issued pursuant to stock options granted by the Company and its predecessors. None of the outstanding options has antidilution or other provisions for adjustment to exercise price or number of shares which will be automatically triggered by the rights offering. Each outstanding and unexercised option will remain unchanged and will be exercisable for the same number of shares of common stock and at the same exercise price as before the rights offering. EFFECTS OF RIGHTS OFFERING ON OUR PREFERRED STOCK As of December 15, 2003, there were issued and outstanding an aggregate of 70,720 shares of our preferred stock as follows: o 28,679 shares of our Series A Cumulative Convertible Preferred Stock, with each share having a liquidation preference of $100 and convertible into shares of our common stock at an initial conversion rate of $7.00 of liquidation preference per one share of common stock. As a result of adjustments made to date pursuant to the anti-dilution provisions of such preferred stock, the current conversion rate is $5.13 of liquidation preference per one share of common stock. Assuming that the rights offering is exercised in full, as a result of such anti-dilution provisions the conversion rate will be further reduced to $1.49 of liquidation preference per one share of common stock. o 27,550 shares of our Series B Cumulative Convertible Preferred Stock, with each share having a liquidation preference of $100 and convertible into shares of our common stock at an initial conversion rate of $9.00 of liquidation preference per one share of common stock. As a result of adjustments made to date pursuant to the anti-dilution provisions of such preferred stock, the current conversion rate is $7.68 or $11.04 of liquidation preference per one share of common stock, depending upon when such preferred stock was issued. Assuming that the rights offering is exercised in full, as a result of such anti-dilution provisions the conversion rate will be further reduced to $3.01 or $2.11 of liquidation preference per one share of common stock, depending on when such preferred stock was issued. o 14,491 shares of our Series C Cumulative Convertible Preferred Stock, with each share having a liquidation preference of $100 and convertible into shares of our common stock at an initial conversion rate of $5.00 of liquidation preference per one share of common stock. As a result of adjustments made to date pursuant to the anti-dilution provisions of such preferred stock, the current conversion rate is $4.69 of liquidation preference per one share of common stock. Assuming that the rights offering is exercised in full, as a result of such anti-dilution provisions the conversion rate will be further reduced to $1.38 of liquidation preference per one share of common stock. See "Description of Capital Stock." EFFECTS OF RIGHTS OFFERING ON DOLPHIN'S AND/OR OUR BOARD'S SECURITIES AND OWNERSHIP. Discussed below, for illustrative purposes only, are scenarios which indicate the effect the rights offering and related share issuance could have on Dolphin's and/or our entire Board's relative voting and economic interest. Dolphin, which is controlled by Peter E. Salas, is discussed here in light of his the status as one of our Board members and the controlling person of Dolphin, which is our largest stockholder and a creditor to which we owe loans in an aggregate principal amount of $2,625,000, plus accrued interest. As of the date hereof, Dolphin owns approximately 17.8% of our outstanding common stock and is deemed to beneficially own approximately 19.8% of our common stock. As of the date hereof, our entire Board of Directors as a group, including Mr. Salas, controls approximately 30.6% of our outstanding common stock and is deemed to beneficially own approximately 34.5% of our common stock. In the event that all shares of common stock offered in the rights offering are fully subscribed, then Dolphin would purchase 6,419,160 shares in the offering and would, immediately following closing, continue to own approximately 17.8% of our outstanding common stock and continue to be deemed to beneficially own 19.8% of our common stock. In the event that Dolphin were the only rights holder to acquire shares in the offering, then its ownership of outstanding shares would be limited by the terms of this offering to not more than 50% of all outstanding shares immediately following the closing. In the absence of this limitation, Dolphin might have been able to obtain ownership of up to approximately 79% of our outstanding shares in the event that it were the only rights holder to exercise its rights. In the event that all shares of common stock offered in the rights offering are fully subscribed, then our entire board of directors collectively would purchase 17,468,184 shares in the offering and would, immediately following closing, continue to own approximately 30.6% of our outstanding common stock and continue to be deemed to beneficially own approximately 34.5% of our common stock. In the event that the entire board were the only rights holders to acquire shares in the offering, then its aggregate ownership of outstanding shares would be approximately 81.9%. OTHER MATTERS We are not making this rights offering in any state or other

jurisdiction in which it is unlawful to do so, nor are we selling or accepting any offers to purchase any shares of our common stock from rights holders who are residents of those states or other jurisdictions. We may delay the commencement of the rights offering in those states or other jurisdictions, or change the terms of the rights offering, in order to comply with the securities law requirements of those states or other jurisdictions. We may decline to make modifications to the terms of the rights offering requested by those states or other jurisdictions, in which case, if you are a resident in those states or jurisdictions, you will not be eligible to participate in the rights offering. DESCRIPTION OF CAPITAL STOCK As of December 15, 2003, our authorized capital stock consisted of 50,000,000 shares of common stock, par value $0.001 per share, and 25,000,000 shares of preferred stock, par value $0.001 per share. As of that date, we had 12,049,977 shares of common stock outstanding and an aggregate of 70,720 shares of preferred stock outstanding. The following is a summary of the material terms of our capital stock. This summary does not purport to be complete or to contain all the information that may be important to you, and is qualified in our entirety by reference to our articles of incorporation, as amended, and bylaws, as amended. We encourage you to read the provisions of these documents to the extent they relate to your individual investment strategy. PREFERRED STOCK Our articles of incorporation authorize us to issue preferred stock in one or more series having designations, rights, and preferences determined from time to time by our Board of Directors. Accordingly, subject to applicable stock exchange rules and the terms of existing preferred stock, our Board of Directors is empowered, without the approval of the holders of common stock, to issue shares of preferred stock with dividend, liquidation, conversion, voting, or other rights that could adversely affect the voting power or other rights of the holders of common stock. In some cases, the issuance of preferred stock could delay a change of control of us or make it harder to remove incumbent management. Preferred stock could also restrict dividend payments to holders of our common stock. To date, we have issued shares of preferred stock as described below. SERIES A 8% CUMULATIVE CONVERTIBLE PREFERRED STOCK. We have outstanding 28,679 shares of our Series A Preferred Stock, with each share having a liquidation preference of $100. The Series A Preferred Stock has no voting rights prior to the conversion of such shares into shares of our common stock. Each $100 liquidation preference of Series A Preferred Stock is convertible at the election of the holder into shares of our common stock at an initial rate of $7.00 of liquidation preference of the Series A Preferred Stock per one share of our common stock. The conversion price will be adjusted downwards in the event of the issuance of any new shares of our common stock, or options or securities exercisable, convertible or exchangeable into new shares of our common stock, at a price per share of common stock less than $7.00, subject to further adjustment. As a result of adjustments already made to date to the initial conversion rate, the current conversion rate is $5.13 of liquidation preference of the Series A Preferred Stock per one share of our common stock. Assuming that the rights offering is exercised in full, as a result thereof the conversion rate of the Series A Preferred Stock will be further reduced to $1.49 of liquidation preference per one share of our common stock. The holders of the Series A Preferred Stock are entitled to a cumulative dividend at a rate of 8% of the liquidation preference per share per annum, payable quarterly on each March 31, June 30, September 30 and December 31, but only when, as and if declared by the Board of Directors out of funds legally available therefor. All accrued but unpaid dividends accrue interest after the respective payment date at a rate of 8% per annum. In the event that we fail to make any two of six consecutive quarterly dividend payments on the Series A Preferred Stock, the holders of the Series A Preferred Stock have the right to appoint directors that will constitute a majority of our board of directors. That appointed majority of our board of directors would remain until all accrued and unpaid dividends on the Series A Preferred Stock have been paid. During 2002, we failed to pay the third and fourth quarterly dividend payments on the Series A Preferred Stock. In February 2003, the holders of the Series A Preferred Stock designated four members of the board of directors, who were elected to vacancies on the board and who currently serve. We may redeem all, but not less than all, of the outstanding shares of Series A Preferred Stock upon the payment of the per share liquidation preference, plus accrued and unpaid dividends, subject to certain circumstances, including that our common stock has a closing sale price greater than 150% of the then conversion rate for the Series A Preferred Stock for sixty consecutive trading days prior to the date of redemption. In addition, we are required to redeem one-twentieth of the maximum number of shares of Series A Preferred Stock outstanding commencing on October 1, 2003 and each quarterly date thereafter that such shares are outstanding. If we adopt a plan of liquidation or of dissolution, or commence a voluntary case under the federal bankruptcy laws or similar laws or upon the occurrence of specified similar events, then the holders of Series A Preferred Stock shall have a liquidation preference over all other outstanding shares of our preferred stock. SERIES B 8% CUMULATIVE CONVERTIBLE PREFERRED

STOCK. We have outstanding 27,550 shares of our Series B Preferred Stock, with each share having a liquidation preference of $100. The Series B Preferred Stock has no voting rights prior to the conversion of such shares into shares of our common stock. Each $100 liquidation preference of Series B Preferred Stock is convertible at the election of the holder into shares of our common stock at an initial rate of $9.00 of liquidation preference of the Series B Preferred Stock per one share of our common stock. In addition, such conversion may be required by us as to all, but not less than all, of the outstanding Series B Preferred Stock in the event that our common stock has a closing sale price greater than 150% of the then conversion rate for the Series B Preferred Stock for twenty consecutive trading days prior to such forced conversion. The conversion price will be adjusted downwards in the event of the issuance of any new shares of common stock, or options or securities exercisable, convertible or exchangeable into new shares of our common stock, at a price per share of common stock less than $9.00, subject to further adjustment. As a result of adjustments already made to date to the initial conversion price, the current conversion rate is either $7.68 or $11.04 per one share of our common stock, depending upon when the Series B Preferred Stock was issued. Assuming that the rights offering is exercised in full, as a result thereof the conversion rate of the Series B Preferred Stock will be further reduced to either $3.01 or $2.11 of liquidation preference per one share of our common stock, depending on when the Series B Preferred Stock was issued. The holders of the Series B Preferred Stock are entitled to a cumulative dividend at a rate of 8% of the liquidation preference per share per annum, payable quarterly on each March 31, June 30, September 30 and December 31, but only when, as and if declared by the Board of Directors out of funds legally available therefor. All accrued but unpaid dividends accrue interest after the respective payment date at a rate of 8% per annum. We may redeem all, but not less than all, of the outstanding shares of Series B Preferred Stock upon the payment of the per share liquidation preference, plus accrued and unpaid dividends, subject to certain circumstances, including that our common stock has a closing sale price greater than 150% of the then conversion rate for the Series B Preferred Stock for sixty consecutive trading days prior to the date of redemption. In addition, we are required to redeem all of the outstanding Series B Preferred Stock at a price per share equal to the liquidation preference, plus any and all accrued and unpaid dividends, on the fifth anniversary of the first issuance of the Series B Preferred Stock, which anniversary will be in March 2005. If we adopt a plan of liquidation or of dissolution, or commence a voluntary case under the federal bankruptcy laws or similar laws or upon the occurrence of specified similar events, then the holders of Series B Preferred Stock shall have a liquidation preference equal to the liquidation preference of all other outstanding shares of our preferred stock, other than the Series A Preferred Stock, which is senior to the Series B Preferred Stock in this respect. SERIES C 6% CUMULATIVE CONVERTIBLE PREFERRED STOCK. We have outstanding 14,491 shares of our Series C Preferred Stock, with each share having a liquidation preference of $100. The Series C Preferred Stock has no voting rights prior to the conversion of such shares into shares of our common stock. Each $100 liquidation preference of Series C Preferred Stock is convertible at the election of the holder into shares of our common stock at an initial rate of $5.00 of liquidation preference of the Series C Preferred Stock per one share of our common stock. In addition, such conversion may be required by us as to all, but not less than all, of the outstanding Series C Preferred Stock in the event that our common stock has a closing sale price greater than 150% of the then conversion rate for the Series C Preferred Stock for twenty consecutive trading days prior to such forced conversion. The conversion price will be adjusted downwards in the event of the issuance of any new shares of common stock, or options or securities exercisable, convertible or exchangeable into new shares of our common stock, at a price per share of common stock less than $5.00, subject to further adjustment. As a result of adjustments already made to date to the initial conversion price, the current conversion rate is $4.69 per one share of our common stock. Assuming that the rights offering is exercised in full, as a result thereof the conversion rate of the Series C Preferred Stock will be further reduced to $1.38 of liquidation preference per one share of our common stock. The holders of the Series C Preferred Stock are entitled to a cumulative dividend at a rate of 6% of the liquidation preference per share per annum, payable quarterly on each March 31, June 30, September 30 and December 31, but only when, as and if declared by the Board of Directors out of funds legally available therefor. All accrued but unpaid dividends accrue interest after the respective payment date at a rate of 6% per annum. We may redeem all, but not less than all, of the outstanding shares of Series C Preferred Stock upon the payment of the per share liquidation preference, plus accrued and unpaid dividends, subject to certain circumstances, including that our common stock has a closing sale price greater than 150% of the then conversion rate for the Series C Preferred Stock for sixty consecutive trading days prior to the date of redemption. In addition, we are required to redeem all of the outstanding Series C Preferred Stock at a price per share equal to the liquidation preference, plus any and all accrued and unpaid dividends, on the fifth

anniversary of the first issuance of the Series C Preferred Stock, which anniversary will be in July 2006. If we adopt a plan of liquidation or of dissolution, or commence a voluntary case under the federal bankruptcy laws or similar laws or upon the occurrence of specified similar events, then the holders of Series B Preferred Stock shall have a liquidation preference equal to the liquidation preference of all other outstanding shares of our preferred stock, other than the Series A Preferred Stock, which is senior to the Series C Preferred Stock in this respect. COMMON STOCK VOTING RIGHTS. Each share of our common stock is entitled to one vote in the election of Directors and other matters. A majority of shares of our voting stock constitute a quorum at any meeting of stockholders. Common stockholders are not entitled to cumulative voting rights. DIVIDENDS. Subject to the preferential rights of any outstanding shares of preferred stock and the restrictive terms of our credit agreement, which prohibit the payment of dividends, dividends may be paid to holders of common stock as may be declared by our Board of Directors out of funds legally available for that purpose. We do not intend to pay dividends at the present time or in the foreseeable future. LIQUIDATION. If we liquidate, dissolve or wind-up our business, either voluntarily or not, common stockholders will receive pro rata all assets remaining after we pay our creditors and the holders of our preferred stock as described above. UNITED STATES FEDERAL INCOME TAX CONSEQUENCES The following discussion is a summary of the material federal income tax consequences of the rights offering to holders of common stock that hold such stock as a capital asset for federal income tax purposes. This discussion is based on laws, regulations, rulings and decisions in effect on the date hereof, all of which are subject to change (possibly with retroactive effect) and to differing interpretations. This discussion applies only to holders that are U.S. persons, which is defined as a citizen or resident of the United States, a domestic partnership, a domestic corporation, any estate the income of which is subject to U.S. federal income taxation regardless of its source, and any trust so long as a court within the United States is able to exercise primary supervision over the administration of the trust and one or more U.S. persons have the authority to control all substantial decisions of the trust. This discussion does not address all aspects of federal income taxation that may be relevant to holders in light of their particular circumstances or to holders who may be subject to special tax treatment under the Internal Revenue Code of 1986, as amended, including holders who are dealers in securities or foreign currency, foreign persons (defined as all persons other than U.S. persons), insurance companies, tax-exempt organizations, banks, financial institutions, broker-dealers, holders who hold common stock as part of a hedge, straddle, conversion or other risk reduction transaction, or holders that acquired common stock pursuant to the exercise of compensatory stock options or warrants or otherwise as compensation. We have not sought, and will not seek, an opinion of counsel or a ruling from the Internal Revenue Service regarding the federal income tax consequences of the rights offering or the related share issuance. The following summary does not address the tax consequences of the rights offering or the related share issuance under foreign, state, or local tax laws. ACCORDINGLY, EACH HOLDER OF COMMON STOCK SHOULD CONSULT ITS TAX ADVISOR WITH RESPECT TO THE PARTICULAR TAX CONSEQUENCES OF THE RIGHTS OFFERING OR THE RELATED SHARE ISSUANCE TO SUCH HOLDER. The federal income tax consequences for a holder of common stock on a receipt of subscription rights under the rights offering are as follows: A holder will not recognize taxable income for federal income tax purposes in connection with the receipt of subscription rights in the rights offering. Except as provided in the following sentence, the tax basis of the subscription rights received by a holder in the rights offering will be zero. If either (i) the fair market value of the subscription rights on the date such subscription rights are distributed is equal to at least 15% of the fair market value on such date of the common stock with respect to which the subscription rights are received or (ii) the holder elects, by attaching a statement to its federal income tax return for the taxable year in which the subscription rights are received, to allocate part of the tax basis of such common stock to the subscription rights, then upon exercise or transfer of the subscription rights, the holder's tax basis in the common stock will be allocated between the common stock and the subscription rights in proportion to their respective fair market values on the date the subscription rights are distributed. A holder's holding period for the subscription rights received in the rights offering will include the holder's holding period for the common stock with respect to which the subscription rights were received. We do not expect that the value of the rights will exceed 15% of the fair market value of the common stock with respect to which the subscription rights are received. A holder that allows the subscription rights received in the rights offering to expire will not recognize any gain or loss, and the tax basis of the common stock owned by such holder with respect to which such subscription rights were distributed will be equal to the tax basis of such common stock immediately before the receipt of the subscription rights in the rights offering. A holder will not recognize any gain or loss upon the exercise of the subscription rights received in the rights offering.

The tax basis of the common stock acquired through exercise of the subscription rights will equal the sum of the subscription price for the common stock and the holder's tax basis, if any, in the rights as described above. The holding period for the common stock acquired through exercise of the subscription rights will begin on the date the subscription rights are exercised. PLAN OF DISTRIBUTION On or about _________, 2003, we will distribute the subscription rights, subscription certificates, and copies of this prospectus to persons that owned shares of common stock on _______, 2003. If you wish to exercise your subscription rights and purchase shares of common stock, you should complete the subscription certificate and return it with payment for the shares, to the subscription agent, Mellon Investor Services LLC, at the address on page 53. If you have any questions, you should contact. We have agreed to pay the subscription agent a fee plus certain expenses, which we estimate will total approximately $15,000. We estimate that our total expenses in connection with the rights offering will be approximately $150,000. TENNESSEE ANTI-TAKEOVER LAW The Tennessee Control Share Acquisition Act strips a purchaser's shares of voting rights any time an acquisition of shares in a Tennessee corporation brings the purchaser's voting power to one-fifth, one-third or a majority of all voting power. The purchaser's voting rights can be reinstated only after a majority vote of the other stockholders. The purchaser may demand a special meeting of stockholders to conduct such a vote. A corporation may or may not redeem the purchaser's shares if the purchaser's shares are not granted voting rights. The Tennessee Control Share Acquisition Act applies only to a Tennessee corporation that has adopted a provision in its charter or bylaws expressly declaring that the Tennessee Control Share Acquisition Act applies to it. The Tennessee Control Share Acquisition Act currently does not apply to the Company .. The Tennessee Investor Protection Act applies to tender offers directed at corporations that have substantial assets in Tennessee and that are either incorporated in or have a principal office in Tennessee. The Act requires an offeror making a tender offer for such a corporation to file a registration statement with the Commissioner of Commerce and Insurance. If the offeror intends to gain control of the corporation, the registration statement must indicate any plans the offeror has for the corporation. The Commissioner may require additional information material to the takeover offer and may call for hearings. The Act does not apply to an offeror if the target corporation's board of directors recommends the offer to its stockholders. We do not believe that the Act applies to us and that in any event this offering is exempt. The Tennessee Investor Protection Act also requires the offeror and the corporation to deliver to the Commissioner all solicitation materials used in connection with the tender offer. This act also prohibits fraudulent, deceptive or manipulative acts or practices by the offeror or the target corporation. The Tennessee Business Combination Act requires a five-year moratorium on transactions between certain Tennessee corporations and an "interested stockholder" (generally, a 10% or greater stockholder) unless the transaction or the stockholder's becoming an "interested stockholder" is approved by the directors before the stockholder attains the status of "interested stockholder." A corporation that would otherwise be covered by this Act may exempt itself from the Act by adopting a charter provision specifically stating the corporation's option to be exempt. LIMITATION OF LIABILITY OF DIRECTORS [All directors are indemnified by us, both by operation of Tennessee Code Annotated Sections 48-18-501 through 509 and since 1995 by resolution of our board of directors, against liability and expenses including attorney's fees incurred by them as a result of serving on our board of directors. The statutory provisions require a finding that the conduct of the director was in good faith and in the best interest of the company and does not extend to cases where a director is found to be liable to the company itself. Such a finding may be made by uninvolved directors, a committee of the board or independent counsel. Tennessee Code Annotated Section 48-15-503 provides for the indemnification of directors and of corporate officers where the director or officer is successful in defense of any proceeding he or she became involved in as a result of being or having been in such position, unless the corporate charter forbids such indemnification. Our corporate charter contains no such bar or prohibition of indemnification of our directors or officers. Tennessee statutes further provide that the rights to indemnification of a director do not preclude other bases of indemnification, whether such rights arise by charter, bylaws, shareholder resolution, agreement or board resolution, provided there is no breach of duty of loyalty to the company, bad faith, intentional misconduct or knowing violation of law. Accordingly, our board of directors on August 17, 1995, unanimously resolved to indemnify directors and executive officers on a mandatory basis to the fullest extent of the laws referenced above for the entire period a party is subject to any possible legal action or claim by reason of having so served. Tennessee law permits, but does not require, insurance to be obtained to fund indemnity obligations. We do not have any such insurance. Holders of common stock have no preemptive, subscription, redemption, or conversion rights. The transfer agent and registrar for the common stock is Mellon Investor Services LLC. LEGAL MATTERS Certain legal matters with respect to the validity of the issuance

of the shares of common stock offered by this Prospectus will be passed upon for us by Cary V. Sorensen, Esq. EXPERTS Our consolidated financial statements as of December 31, 2002 and 2001 and for each of the three years in the period ended December 31, 2002 included in this Prospectus and in the Registration Statement on Form S-1 have been so included in reliance upon the reports of BDO Seidman LLP, independent certified public accountants to the extent and for the periods set forth in their reports (which contain an explanatory paragraph regarding the Company's ability to continue as a going concern), given upon the authority of said firm as experts in accounting and auditing. Reserve analyses and information as of December 31, 2002, included in this Prospectus and the Registration Statement on Form S-1 have been so included in reliance on the reserve reports dated February 10, 2003 and March 28, 2003, respectively, prepared by Ryder Scott Company, L.P. of Houston, Texas. WHERE YOU CAN FIND MORE INFORMATION We are subject to the informational requirements of the Securities Exchange Act of 1934. Accordingly, we file reports, proxy statements and other information with the SEC. You may read and copy any materials that we file with the SEC at the SEC's Public Reference Room at 450 Fifth Street, N.W., Washington, D.C. 20549 upon payment of the prescribed fees. You may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC also maintains an Internet site that contains reports, proxy information statements and other materials that are filed through the SEC's Electronic Data Gathering, Analysis, and Retrieval, or EDGAR, system. You can access this web site at http://www.sec.gov. We have filed a registration statement on Form S-1 with the SEC with respect to this rights offering. This prospectus is a part of the registration statement, but does not contain all of the information included in the registration statement. You may wish to inspect the registration statement and the exhibit to that registration statement for further information with respect to us and the securities offered in this prospectus. Copies of the registration statement and the exhibit to such registration statement are on file at the offices of the SEC and may be obtained upon payment of the prescribed fee or may be examined without charge at the public reference facilities of the SEC described above. Statements contained in this prospectus concerning the provisions of documents are necessarily summaries of the material provisions of such documents, and each statement is qualified in our entirety by reference to the copy of the applicable document filed with the SEC. INDEX TO FINANCIAL STATEMENTS Independent Auditors' Report................... F-2 Consolidated Financial Statements Consolidated Balance Sheets................. F-3 and F-4 Consolidated Statements of Loss............. F-5 Consolidated Statements of Stockholders' Equity.................... F-6 and F-7 Consolidated Statements of Cash Flows........ F-8 through F-10 Notes to Consolidated Financial Statements... F-11 through F-34 Independent Auditors' Report Board of Directors Tengasco, Inc. and Subsidiaries Knoxville, Tennessee We have audited the accompanying consolidated balance sheets of Tengasco, Inc. and Subsidiaries as of December 31, 2002 and 2001, and the related consolidated statements of loss, stockholders' equity and cash flows for each of the three years in the period ended December 31, 2002. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion. In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Tengasco, Inc. and Subsidiaries as of December 31, 2002 and 2001, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2002 in conformity with accounting principles generally accepted in the United States of America. The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 1 to the financial statements, the Company has suffered recurring losses from operations and has an accumulated deficit of $27,776,726. Additionally, during 2002, the Company's primary lender has classified the remaining amount of $7,501,777 as immediately due and payable, resulting in a significant working capital deficiency. Such matters raise substantial doubt about the Company's ability to continue as a going concern. Management's plans in regard to these matters are also described in Note 1. The financial statements do not include any adjustments that might result from the outcome of this uncertainty. Atlanta, Georgia February 27, 2003 CONSOLIDATED BALANCE SHEETS SEPTEMBER 30, DECEMBER 31, 2002 2001 2003
==

(unaudited) Assets (Note 1) Current Cash and cash equivalents $ 184,130 $ 393,451 $ 332,185 Investments 34,500 150,000 34,500 Accounts receivable 730,667 661,475 795,916 Participant receivables 70,605 84,097 63,297 Inventory 262,748 159,364 262,748 Current portion of loan fees, net 323,856 - 210,380 Other - - 67,352 -- Total current assets 1,606,506 1,448,387 1,766,378 Oil and gas properties, net (on the basis Of full cost accounting) (Note 4) 13,864,321 13,269,930 13,096,898 Completed pipeline facilities, net (Note 5) 15,372,843 15,039,762 15,312,212 Other property and equipment, net (Note 6) 1,685,950 1,680,104 1,482,202 Restricted cash 0 120,872 0 Loan fees, net of accumulated amortization of $13,384 and $21,590, respectively 40,158 496,577 0 Other assets 14,613 72,613 5,213 -- $32,584,391 $32,128,245 $31,662,903 == SEE ACCOMPANYING NOTES TO CONSOLIDATED FINANCIAL STATEMENTS. SEPTEMBER 30, DECEMBER 31, 2002 2001 2003 == (unaudited) Liabilities and Stockholders' Equity Current liabilities Current maturities of long-term debt (Note 1) $ 7,861,245 $ 6,399,831 $ 6,724,998 Accounts payable - trade 1,396,761 1,208,164 839,553 Accrued interest payable 61,141 54,138 167,227 Accrued dividends payable (Note 9) 254,389 112,458 470,543 Current maturities of long term debt to related parties - - 2,234,000 Other accrued liabilities 31,805 - 627,016 -- Total current liabilities 9,605,341 7,774,591 11,063,337 Long term debt to related parties (Note 7) 750,000 - - Asset retirement obligations (Note 16) - - 666,421 Long term debt, less current maturities (Note 7) 1,256,209 3,902,757 590,055 -- Total liabilities 11,611,550 11,677,348 12,319,813 -- Commitments and contingencies (Notes 1 and 8) Mandatorily redeemable preferred stock, $.001 par value; authorized 25,000,000 shares (Note 9): Series A 8% cumulative, convertible, mandatorily redeemable; 28,679 and shares outstanding; redemption value $2,867,900 2,867,900 2,867,900 2,867,900 Series B 8% cumulative, convertible, mandatorily redeemable; 27,550 shares outstanding; redemption value $2,755,000, net of related commissions 2,591,150 2,591,150 2,591,150 Series C 6% cumulative, convertible, mandatorily redeemable; 14,491 shares outstanding; redemption value $1,449,100, net of related commissions 1,303,168 - 1,425,207 -- Total mandatorily redeemable preferred stock 6,762,218 5,459,050 6,884,257 -- Stockholders' equity (Notes 10 and 11) Common stock, $.001 par value; authorized 50,000,000 shares; 11,459,279, 10,560,605 And 12,018,477 shares issued, respectively 11,460 10,561 12,065 Additional paid-in capital 42,237,276 39,242,555 42,855,693 Accumulated deficit (27,776,726) (24,115,382) (30,147,538) Accumulated other comprehensive loss (115,500) - (115,500) Treasury Stock, at cost, 14,500 shares (145,887) (145,887) (145,887) -- Total stockholders' equity 14,210,623 14,991,847 12,458,833 -- $ $32,584,391 $32,128,245 $31,662,903 == SEE ACCOMPANYING NOTES TO CONSOLIDATED FINANCIAL STATEMENTS. CONSOLIDATED STATEMENTS OF LOSS NINE MONTHS ENDED JUNE 30, YEAR ENDED DECEMBER 31, 2002 2001 2000 2003 2002 === (unaudited) Revenues and other income Oil and gas revenues $5,437,723 $6,656,758 $5,241,076 $4,907,216 $3,859,050 Pipeline transportation revenues 259,677 296,331 - 145,472 197,333 Interest Income 3,078 43,597 45,905 766 2,782 --- Total revenues and other income 5,700,478 6,996,686 5,286,981 5,053,454 4,059,165 --- Costs and expenses Production costs and taxes 3,094,731 2,951,746 2,614,414 2,571,898 2,084,597 Depreciation, depletion and amortization (Notes 4, 5 and 6) 2,413,597 1,849,963 371,249 1,887,333 1,731,182 General and administrative costs 1,868,141 2,957,871 2,602,311 1,112,289 1,527,988 Interest expense 578,039 850,965 415,376 462,518 448,046 Public relations 193,229 293,448 106,195 29,131 176,098 Professional fees 707,296 355,480 719,320 485,270 539,198

-- Total costs and expenses 8,855,033 9,259,473 6,828,865 6,548,439 6,507,109 -- Net loss before cumulative effect of a change in accounting principle (3,154,555) (2,262,787) (1,541,884) (1,494,985) (2,447,944) Cumulative effect of a change in accounting principle (Note 16) - - - (351,204) - -- Net loss (3,154,555) (2,262,787) (1,541,884) (1,846,189) (2,447,944) Dividends on preferred Stock (506,789) (391,183) (257,557) 402,583 372,595 -- Net loss attributable to common stockholders $(3,661,344) (2,653,970) $(1,799,441) $(2,248,772) $(2,820,539) -- Earnings per share data: Net loss before cumulative effect of change in accounting principle $ (0.29) $(0.22) $(0.17) $(0.13) $(0.22) Cumulative effect of change in accounting principle - - - $(0.03) - Net loss (0.29) $(0.22) $(0.17) $(0.16) $(0.22) Dividends on preferred stock (0.04) $(0.04) $(0.02) $(0.03) $(0.04) Net loss attributable to common stockholder (0.33) $(0.26) $(0.19) $(0.19) $(0.26) Weighted average shares Outstanding 11,062,436 10,235,253 9,253,622 11,919,477 10,933,588 ==

SEE ACCOMPANYING NOTES TO CONSOLIDATED FINANCIAL STATEMENTS. CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY COMMON STOCK ADDITIONAL ----------------- PAID-IN SHARE AMOUNT CAPITAL ----- ------ ------- Balance, January 1, 2000 8,532,882 $ 8,533 $20,732,759 Net loss - - - Common stock issued on conversion of debt 73,669 74 449,920 Common stock issued for exercised options 20,715 21 179,992 Common stock issued on conversion of preferred stock 8,818 9 49,991 Stock option awards for professional services - - 242,000 Common stock issued in private placements, net of related expense 654,098 654 4,245,054 Stock issued for services 5,376 5 41,993 Dividends on convertible redeemable preferred stock - - - -- Balance, December 31, 2000 9,295,558 9,296 25,941,709 Net loss - - - Common stock issued with 5% stock dividend (Note 10) 498,016 498 6,374,111 Common stock issued on conversion of debt 93,069 93 523,157 Common stock issued for exercised options 274,932 275 2,340,725 Common stock issued on conversion of preferred stock 12,347 13 70,988 Common stock issued for services 10,000 10 69,990 Common stock issued in private placements, net of related expense 374,733 374 3,899,624 Common stock issued as a charitable donation 1,950 2 22,251 Treasury stock purchased - - - Dividends on convertible redeemable preferred stock - - - -- Balance, December 31, 2001 10,560,605 10,561 39,242,555 Net loss - - - Comprehensive loss Net loss - - - Other comprehensive loss - - - Comprehensive loss - - - Common stock issued in private placements, net of related expenses 850,000 850 2,676,150 Common stock issued on conversion of debt 20,592 20 119,980 Common stock issued in purchase of equipment 19,582 20 149,980 Common stock issued for services 8,500 9 48,611 Dividends on convertible redeemable preferred stock - - - -- Balance, December 31, 2002 11,459,279 $11,460 $42,237,276 Net loss (unaudited) - - - Common stock issued in private placement net of related expenses (unaudited) 227,275 227 249,773 Common stock issued for exercised options (unaudited) 94,000 94 46,906 Common stock issued in conversion of debt (unaudited) 60,528 61 69,538 Common stock issued for preferred dividend in arrears (unaudited) 154,824 154 170,155 Common stock issued for charity (unaudited) 3,571 4 5,710 Accretion of issue cost on preferred stock (unaudited) - - - Common stock issued for services (unaudited) 55,000 55 69,945 Common stock issued for litigation settlement (unaudited) 10,000 10 6,390 Dividends on convertible redeemable preferred stock (unaudited) - - - Cumulative effect of a change in accounting principle (unaudited) - - - -- Balance, September 30, 2003 (unaudited) 12,064,477 12,065 42,855,693 ==

ACCUMULATED OTHER COMPREHENSIVE ACCUMULATED COMPREHENSIVE TREASURY STOCK INCOME (LOSS) DEFICIT LOSS SHARES AMOUNT TOTAL -------------- ------- ---- ------ ------ ----- $ - $(13,287,362) - - 7,453,930 - (1,541,884) - - (1,541,884) - - - - 449,994 - - - - 180,013 - - - - 50,000 - - - - 242,000 - - - - 4,245,708 - - - - 41,998 - (257,557) - - (257,557) -- - (15,086,803) - - 10,864,202 (2,262,787) - - (2,262,787) - (6,374,609) - - - - - - 523,250 - - - - 2,341,000 - - - - 71,001 - - - 70,000 - - - - 3,899,998 - - - - 22,253 - - 14,500 (145,887) (145,887) - (391,183) - - (391,183)

-- - (24,115,382) 14,500 (145,887) 14,991,847 - (3,154,555) - - (3,154,555) - - (3,154,555) - - - (115,500) - (115,500) - - (115,500) ----------- ----------- - - (3,270,055) - - - - - - 2,677,000 - - - 120,000 - - - 150,000 - - - 48,620 - (506,789) - - (506,789) -- (115,500) $(27,776,726) 14,500 $(145,887) $14,210,623 - (1,494,985) - - (1,494,985) - - - - 250,000 - - - - 47,000 - - - - 69,599 - - - - 170,309 - - - - 5,714 - (122,040) - - (122,040) - - - - 70,000 - - - - 6,400 - (402,583) - - (402,583) - (351,204) - - (351,204) -- $(115,500) $(30,147,538) 14,500 $(145,887) $12,458,833

==

SEE ACCOMPANYING NOTES TO CONSOLIDATED FINANCIAL STATEMENTS. CONSOLIDATED STATEMENTS OF CASH FLOWS NINE MONTHS ENDED SEPTEMBER 30, YEARS ENDED DECEMBER 31, 2002 2001 2000 2003 2002

==

(unaudited) Operating activities: Net loss $(3,154,555) $(2,262,787) $(1,541,884) $(1,494,985) $(2,447,944) Adjustments to reconcile net loss to net cash used in operating activities: Cumulative effect of change in accounting principle - - - - - Depreciation, depletion and amortization 2,413,597 1,849,963 371,249 1,887,333 1,731,182 Charitable donation and services paid in stock or stock options - - - 122,714 48,620 Compensation and services paid in stock options, stock warrants and common stock 48,620 92,253 284,000 - - Gain on sale of equipment - (132,943) - - - Changes in assets and liabilities: Accounts receivable (69,192) 3,814 (301,421) (65,249) (41,340) Participant receivables 13,492 - - 7,308 - Inventory (103,384) 91,981 8,408 - - Other assets 58,000 - - - - Accounts payable--Trade 188,597 191,702 364,553 (557,208) (5,021) Accrued interest Payable 7,003 (2,519) 135,435 106,086 (9,581) Other accrued liabilities 31,805 (52,640) (140,955) 595,211 - Other - - - (57,952) - -- Net cash provided by (used in) operating activities (566,017) (221,176) (820,615) 543,258 (724,084) -- Investing activities: Additions to other property and equipment (214,897) (285,722) (1,276,783) - (154,526) Net additions to oil and gas Properties (1,982,529) (4,821,883) (1,456,996) (45,312) (1,796,600) Additions to pipeline facilities (841,750) (4,213,095) (6,834,196) (341,369) (739,162) Decrease (increase) in restricted cash 120,872 (120,872) 625,000 - 120,872 Other 28,367 32,888 6,112 - 19,432 -- Net cash used in investing activities (2,889,937) (9,408,684) (8,936,863) (386,681) (2,549,984) -- NINE MONTHS ENDED SEPTEMBER 30, YEARS ENDED DECEMBER 31, 2002 2001 2000 2003 2002

==

(unaudited) Financing activities: Proceeds from exercise of Options $ - $ 2,341,000 $ 180,013 - - Proceeds from borrowings 2,063,139 10,442,068 6,493,563 1,484,000 1,703,103 Repayments of borrowings (2,378,273) (8,833,325) (1,720,856) (1,742,522) (2,129,259) Net proceeds from issuance of common stock 2,677,000 3,900,000 4,245,700 250,000 2,677,000 Proceeds from private placements of convertible redeemable preferred stock, net 1,303,168 1,591,150 2,000,000 - 1,303,168 Dividends on convertible redeemable preferred stock (364,858) (357,503) (257,557) - (350,859) Purchase of treasury stock - (145,887) - - - Payment of loan fees (53,543) (518,167) - - - -- Net cash provided by financing activities 3,246,633 8,419,336 10,940,863 (8,522) 3,203,156 -- Net change in cash and cash equivalents (209,321) (1,210,524) 1,183,385 148,055 (70,912) Cash and cash equivalents, beginning of year 393,451 1,603,975 420,590 184,130 393,451 -- Cash and cash equivalents, end of period $ 184,130 $ 393,451 $ 1,603,975 $332,185 $322,539

==

Supplemental disclosure of non- cash investing and financing activities: During 2001, the Company issued a 5% stock dividend of 498,016 shares $ - $6,374,609 $ - $ - $ - During 2001 and 2000, the Company converted preferred stock to common stock $ - $ 71,000 $ 50,000 $ - $ - During 2002, 2001 and 2000, respectively, the Company issued

common stock on conversion of debt $ 120,000 $ 523,250 $ 450,000 $ 69,599 $120,000 During 2002, 2001 and 2000, respectively, the Company issued common stock and stock options for services received and charitable contributions made $ 48,620 $ 92,253 $ 284,000 $122,714 $ 48,620 During 2001, the Company sold equipment for equity investments $ - $ 150,000 $ - $ - $150,000 During 2002, the Company purchased equipment by issuing common stock $ 150,000 $ - $ - $150,000 $ - NINE MONTHS ENDED SEPTEMBER 30, YEARS ENDED DECEMBER 31, 2002 2001 2000 2003 2002

(unaudited) During 2003, the Company issued stock for preferred dividends in arrears $ - $ - $ - $170,309 $ - During 2003, the Company incurred accretion of issue cost on preferred stock $ - $ - $ - $(122,040) $ - During 2003, the Company declared dividends on preferred stock $ - $ - $ - $(402,583) $ -

SEE ACCOMPANYING NOTES TO CONSOLIDATED FINANCIAL STATEMENTS. NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Amounts presented relating to September 30, 2003 and the nine months ended September 30, 2003 and 2002 are unaudited) 1. GOING CONCERN The accompanying consolidated financial statements have been UNCERTAINTY prepared in conformity with accounting principles generally accepted in the United States of America, which contemplate continuation of the Company as a going concern and assume realization of assets and the satisfaction of liabilities in the normal course of business. The Company continues to be in the early stages of its oil and gas related operating history as it endeavors to expand its operations through the continuation of its drilling program in the Tennessee Swan Creek Field. Accordingly, the Company has incurred continuous losses through these operating stages and had an accumulated deficit of $27,776,726 and a working capital deficit of $7,998,835, as of December 31, 2002, and an accumulated deficit of $30,147,538 and a working capital deficit of $9,296,959, as of September 30, 2003. During 2002, the Company was informed by its primary lender that the entire amount of its outstanding credit facility was immediately due and payable, as provided for in the Credit Agreement (see Note 7). These circumstances raise substantial doubt about the Company's ability to continue as a going concern. The Company has disputed its obligation to make this payment and is attempting to resolve the dispute or to obtain alternative refinancing arrangements to repay this current obligation. There can be no assurance that the Company will be successful in its plans to obtain the financing necessary to satisfy their current obligations. 2. SUMMARY OF ORGANIZATION SIGNIFICANT ACCOUNTING Tengasco, Inc. (the "Company"), a publicly held corporation, was organized under the laws of the State of Utah on April 18, 1916, as Gold Deposit Mining and Milling Company. The Company subsequently changed its name to Onasco Companies, Inc. Effective May 2, 1995, Industrial Resources Corporation, a Kentucky corporation ("IRC"), acquired voting control of the Company in exchange for approximately 60% of the assets of IRC. Accordingly, the assets acquired, which included certain oil and gas leases, equipment, marketable securities and vehicles, were recorded at IRC's historical cost. The transaction was accomplished through the Company's issuance of 4,000,000 shares of its common stock and a $450,000, 8% promissory note payable to IRC. The promissory note was converted into 83,799 shares of Tengasco, Inc. common stock in December 1995. The Company changed its domicile from the State of Utah to the State of Tennessee on May 5, 1995 and its name was changed from "Onasco Companies, Inc." to "Tengasco, Inc." NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED) (Amounts presented relating to September 30, 2003 and the nine months ended September 30, 2003 and 2002 are unaudited) The Company's principal business consists of oil and gas exploration, production and related property management in the Appalachian region of eastern Tennessee and in the state of Kansas. The Company's corporate offices are in Knoxville, Tennessee. The Company operates as one reportable business segment, based on the similarity of activities. During 1996, the Company formed Tengasco Pipeline Corporation ("TPC"), a wholly-owned subsidiary, to manage the construction and operation of a 65-mile gas pipeline as well as other pipelines planned for the future. During 2001, TPC began transmission of natural gas through its pipeline to customers of Tengasco. BASIS OF PRESENTATION The consolidated financial statements include the accounts of the Company, Tengasco Pipeline Corporation and Tennessee Land and Mineral, Inc. All significant intercompany balances and transactions have been eliminated. USE OF ESTIMATES The accompanying financial statements are prepared in conformity with accounting principles generally accepted in the United States of America which require 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 reporting period. The actual results could

differ from those estimates. REVENUE RECOGNITION The Company recognizes revenues at the time of exchange of goods and services. CASH AND CASH EQUIVALENTS The Company considers all investments with a maturity of three months or less when purchased to be cash equivalents. INVESTMENT SECURITIES Investment securities available for sale are reported at fair value, with unrealized gains and losses, when material, reported as a separate component of stockholders' equity, net of the related tax effect. Other comprehensive losses of $115,500 were recorded during the year ended December 31, 2002 resulting from a decrease in the fair value of the securities. NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED) (Amounts presented relating to September 30, 2003 and the nine months ended September 30, 2003 and 2002 are unaudited) INVENTORY Inventory consists primarily of crude oil in tanks and is carried at market value. OIL AND GAS PROPERTIES The Company follows the full cost method of accounting for oil and gas property acquisition, exploration and development activities. Under this method, all productive and nonproductive costs incurred in connection with the acquisition of, exploration for and development of oil and gas reserves for each cost center are capitalized. Capitalized costs include lease acquisitions, geological and geophysical work, delay rentals and the costs of drilling, completing and equipping oil and gas wells. Gains or losses are recognized only upon sales or dispositions of significant amounts of oil and gas reserves representing an entire cost center. Proceeds from all other sales or dispositions are treated as reductions to capitalized costs. The capitalized costs of oil and gas properties, plus estimated future development costs relating to proved reserves and estimated costs of plugging and abandonment, net of estimated salvage value, are amortized on the unit-of-production method based on total proved reserves. The costs of unproved properties are excluded from amortization until the properties are evaluated, subject to an annual assessment of whether impairment has occurred. These reserves were estimated by Ryder Scott Company, Petroleum Consultants in 2000, 2001 and 2002. The capitalized oil and gas property, less accumulated depreciation, depletion and amortization and related deferred income taxes, if any, are generally limited to an amount (the ceiling limitation) equal to the sum of: (a) the present value of estimated future net revenues computed by applying current prices in effect as of the balance sheet date (with consideration of price changes only to the extent provided by contractual arrangements) to estimated future production of proved oil and gas reserves, less estimated future expenditures (based on current costs) to be incurred in developing and producing the reserves using a discount factor of 10% and assuming continuation of existing economic conditions; and (b) the cost of investments in unevaluated properties excluded from the costs being amortized. No ceiling writedown was recorded in 2002, 2001 or 2000. NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED) (Amounts presented relating to September 30, 2003 and the nine months ended September 30, 2003 and 2002 are unaudited) PIPELINE FACILITIES Phase I of the pipeline was completed during 1999. Phase II of the pipeline was completed on March 8, 2001. Both phases of the pipeline were placed into service upon completion of Phase II. The pipeline is being depreciated over its estimated useful life of 30 years, beginning at the time it was placed in service. OTHER PROPERTY AND EQUIPMENT Other property and equipment are carried at cost. The Company provides for depreciation of other property and equipment using the straight-line method over the estimated useful lives of the assets which range from five to ten years. IMPAIRMENT OF LONG-LIVED ASSETS AND LONG-LIVED ASSETS TO BE DISPOSED OF Management believes that carrying amounts of all of the Company's long-lived assets will be fully recovered over the course of the Company's normal future operations. Accordingly, the accompanying financial statements reflect no charges or allowances for impairment. STOCK-BASED COMPENSATION Statement of Financial Accounting Standards No. 123, ("SFAS 123"), "Accounting for Stock-Based Compensation" was implemented in January 1996. As permitted by SFAS 123, the Company has continued to account for stock compensation to employees by applying the provisions of Accounting Principles Board Opinion No. 25. If the accounting provisions of SFAS 123 had been adopted, net loss and loss per share would have been as follows: NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED) (Amounts presented relating to September 30, 2003 and the nine months ended September 30, 2003 and 2002 are unaudited) Nine Months Nine Months Ended Ended September 30, September 30, 2002 2001 2000 2003 2002

==

(unaudited) (unaudited) Net loss attributable to common shareholders as reported $(3,661,344) $(2,653,970) $(1,799,441) $(2,248,772) $(2,820,539) Stock based compensation (77,821) (257,328) 2,253,011 (47,209) (202,846) Pro forma $(3,739,165) (2,911,298) (4,052,452) $(2,295,981) $(3,023,335)

==

Basic and diluted loss per share As reported $ (0.33) $ (0.26) $ (0.19) $(0.19) $(0.26) Pro forma (0.34) (0.28) (0.44)

$(0.19) $(0.28)

==

ACCOUNTS RECEIVABLE Senior management reviews accounts receivable on a monthly basis to determine if any receivables will potentially be uncollectible. We include any accounts receivable balances that are determined to be uncollectible, along with a general reserve, in our overall allowance for doubtful accounts. After all attempts to collect a receivable have failed, the receivable is written off against the allowance. Based on the information available to us, we believe no allowance for doubtful accounts as of December 31, 2002 is necessary. However, actual write-offs may occur. INCOME TAXES The Company accounts for income taxes using the "asset and liability method." Accordingly, deferred tax liabilities and assets are determined based on the temporary differences between the financial reporting and tax bases of assets and liabilities, using enacted tax rates in effect for the year in which the differences are expected to reverse. Deferred tax assets arise primarily from net operating loss carryforwards. Management evaluates the likelihood of realization of such assets at year end reserving any such amounts not likely to be recovered in future periods. CONCENTRATION OF CREDIT RISK Financial instruments, which potentially subject the Company to concentrations of credit risk, consist principally of cash and accounts receivable. At times, such cash in banks is in excess of the FDIC insurance limit. NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED) (Amounts presented relating to September 30, 2003 and the nine months ended September 30, 2003 and 2002 are unaudited) The Company's primary business activities include oil and gas sales to several customers in the states of Tennessee and Kansas. The related trade receivables subject the Company to a concentration of credit risk within the oil and gas industry. The Company has entered into contracts to supply two manufacturers with natural gas from the Swan Creek field through the Company's pipeline. These customers are the Company's primary customers of natural gas sales. Additionally, the Company sells a majority of its crude oil primarily to two customers, one each in Tennessee and Kansas. Although management believes that customers could be replaced in the ordinary course of business, if the present customers were to discontinue business with the Company, it could have a significant adverse effect on the Company's projected results of operations. LOSS PER COMMON SHARE Basic loss per share is computed by dividing loss available to common shareholders by the weighted average number of shares outstanding during each year. Shares issued during the year are weighted for the portion of the year that they were outstanding. Diluted loss per share does not differ from basic loss per share since the effect of all common stock equivalents is anti-dilutive. Basic and diluted loss per share are based upon 11,062,436 shares for the year ended December 31, 2002, 10,235,253 shares for the year ended December 31, 2001, and 9,253,622 shares for the year ended December 31, 2000. Basic and diluted loss per share are based upon 11,919,477 and 10,933,588 weighted average shares outstanding for the nine months ended September 30, 2003 and 2002, respectively. Diluted loss per share does not consider approximately 1,473,000, 1,473,000, 943,000 and 1,001,000 potential weighted average common shares for the nine months ended September 30, 2003 and the years ended December 31, 2002, 2001 and 2000, respectively, related primarily to common stock options and convertible preferred stock and debt. These shares were not included in the computation of the diluted loss per share amount because the Company was in a net loss position and, thus, any potential common shares were anti-dilutive. All share and per share amounts have been adjusted to reflect the 5% stock dividend. FAIR VALUES OF FINANCIAL INSTRUMENTS Fair values of cash and cash equivalents, investments and short-term debt approximate their carrying values due to the short period of time to maturity. Fair values of long-term NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED) (Amounts presented relating to September 30, 2003 and the nine months ended September 30, 2003 and 2002 are unaudited) debt are based on quoted market prices or pricing models using current market rates, which approximate carrying values. RECENT ACCOUNTING PRONOUNCEMENTS A reporting issue has arisen regarding the application of certain provisions of SAFS No. 141 and SFAS No. 142 to companies in the extracting industries including oil and gas companies. The issue is whether SFAS No. 142 regulates registrants to classify the costs of mineral rights held under lease or other contractual arrangement associated with extracting oil and gas as intangible assets in the balance sheet, apart from other capitalized oil and gas property owned and provide specific footnote disclosures. Historically, the Company had included the costs of such mineral rights associated with extracting oil and gas as a component of oil and gas properties. If it is ultimately determined that SFAS No. 142 requires oil and gas companies to classify cost of mineral rights held under lease or other contractual arrangement associated with extracting oil and gas as a separate intangible asset line item on the balance sheet, the Company would be required to reclassify approximately $453,000 at September 30, 2003 and $346,000 at December 31, 2002,

respectively, out of oil and gas properties and into a separate intangible asset line item. The Company's cash flows and results of operations would not be affected since such intangible assets would continue to be depleted and amortized for impairment in accordance with full cost accounting rules. Further, the Company does not believe the classification of the cost of mineral rights associated with extracting oil and gas as intangible assets would have any impact on compliance with covenants under its debt agreements. In June 2001, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 143, "Accounting for Asset Retirement Obligations "SFAS No. 143 addresses financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement cost. This statement requires companies to record the present value of obligations associated with the retirement of tangible long-lived assets in the periods in which it is incurred. The liability is capitalized as part of the related long-lived assets carrying amount. Over time, accretion of the liability is recognized as an operating expense and the capitalized cost is depreciated over the expected useful life of the related asset. The Company's asset retirement obligations relate primarily to the plugging, dismantlement, removal site reclamation and similar activities of its oil and gas properties. Prior to adoption of this statement, such obligations were accrued ratably over the productive lives of the assets through its depreciation, depletion and amortization for oil and gas properties without recording a separate liability for such amounts. The impact of applying this statement as of January 1, 2003 and September 30, 2003 is discussed in footnote 10. NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED) (Amounts presented relating to September 30, 2003 and the nine months ended September 30, 2003 and 2002 are unaudited) In April 2002, the Financial Accounting Standards Board issued SFAS No. 145, "Rescission of SFAS No. 4, 44, 64, Amendment of SFAS No. 13, and Technical Corrections" ("SFAS 145"). SFAS 4, which was amended by SFAS 64, required all gains and losses from the extinguishment of debt to be aggregated and, if material, classified as an extraordinary item, net of related income tax effect. As a result of SFAS 145, the criteria in Accounting Principles Board opinion 30 will now be used to classify those gains and losses. SFAS 13 was amended to eliminate an inconsistency between the required accounting for sale-leaseback transactions and the required accounting for certain lease modifications that have economic effects that are similar to sale-leaseback transactions. The adoption of SFAS 145 will not have a current impact on the Company's consolidated financial statements. In July 2002, FASB issued SFAS No. 146, Accounting for Cost Associated with Exit or Disposal Activities. The standard requires companies to recognize cost associated with exit or disposal activities when they are incurred rather than at the date of commitment to an exit or disposal plan. Examples of cost covered by the standard include lease termination costs and certain employee severance costs that are associated with restructuring, discontinued operation, plant closing, or other exit or disposal activity. Previous accounting guidance was provided by EITF Issue No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)." Statement 146 replaces Issue 94-3. Statement 146 is to be applied prospectively to exit or disposal activities initiated after December 31, 2002. The Company does not currently have any plans for exit or disposal activities, and therefore does not expect this standard to have a material effect on the Company's consolidated financial statements upon adoption. In November 2002, the FASB issued FASB Interpretation ("FIN") No. 45. "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others", which clarifies disclosure and recognition/measurement requirements related to certain guarantees. The disclosure requirements are effective for financial statements issued after December 15, 2002 and here cognition/measurement requirements are effective on a prospective basis for guarantees issued or modified after December 31, 2002. The application of the requirements of FIN 45 did not have an impact on the Company's financial position or results of operations. NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED) (Amounts presented relating to September 30, 2003 and the nine months ended September 30, 2003 and 2002 are unaudited) In December 2002, the FASB issued SFAS No. 148, Accounting for Stock-Based compensation -- Transition and Disclosure -- an amendment of FASB Statement No. 123 ("Statement 148"). This amendment provides two additional methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. Additionally, more prominent disclosures in both annual and interim financial statements are required for stock-based employee compensation. The transition guidance and annual disclosure provisions of Statement 148 are effective for fiscal years ending after December 15, 2002. The interim disclosure provisions are effective for financial reports containing financial statements for interim periods beginning after December 15, 2002. The adoption of Statement 148 did not have a material impact on the Company's consolidated financial statements. In January 2003, the FASB issued FASB

Interpretation No. (FIN) 46, "Consolidation of Variable Interest Entities." This interpretation of Accounting Research Bulletin No. 51 "Consolidated Financial Statements" consolidation by business enterprises of variable interest entities, which possess certain characteristics. The Interpretation requires that if a business enterprise has a controlling financial interest in a variable interest entity, the assets, liabilities, and results of the activities of the variable interest entity must be included in the consolidated financial statements with those of the business enterprise. This Interpretation applies immediately to variable interest entities created after January 31, 2003 and to variable interest entities in which an enterprise obtains an interest after that date. The Company does not have any ownership in any variable interest entities. In May 2003, the FASB issued Statement No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity". SFAS No. 150 requires three types of freestanding financial instruments to be classified as liabilities in statements of financial position. One type is mandatory redeemable shares, which the issuing company is obligated to buy back in exchange for cash or other assets. A second type, which includes put options and forward purchase contracts, involves instruments that do or may require the issuer to buy back some of its shares in exchange for cash or other assets. The third type of instrument is obligations that can be settled with shares, the monetary value of which is fixed, tied solely or predominately to a variable such as a market index, or varies inversely with the value of the issuer's shares. The majority of the guidance in SFAS No. 150 is effective for all financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003. In accordance with SFAS No. 150, the Company adopted this standard on July 1, 2003. Adoption of SFAS No. 150 did not NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED) (Amounts presented relating to September 30, 2003 and the nine months ended September 30, 2003 and 2002 are unaudited) have a material impact on the Company's consolidated financial position and results of operations. RECLASSIFICATIONS Certain prior year amounts have been reclassified to conform with current year presentation. 3. RELATED PARTY During 2002 the Company received debt financing from a TRANSACTIONS director totaling $750,000 to fund operating cash flow needs and to finance continued development of the Swan Creek field. Interest incurred on this debt was 3. RELATED PARTY approximately $15,000 for the year ended TRANSACTIONS December 31, 2002. See Note 7. During 2002, the Company borrowed $110,000 from a former director. The advance was non-interest bearing and was repaid in July 2002. During 2001, the Company repaid all principal and interest due to related parties, using the proceeds from the line of credit with Bank One. Interest incurred to related parties was approximately $15,000, $546,000 and $135,000 for the years ended December 31, 2002, 2001 and 2000, respectively. During 2001, the Company converted debt of $200,000 payable to a director into 42,017 shares of common stock. During 2000, the Company paid approximately $270,000 in consulting fees and commissions on equity transactions to a member of the Board of Directors. On February 3, 2003 and February 28, 2003, Dolphin Offshore Partners, LP which owns more than 10% of the Company's outstanding common stock and whose general partner, Peter E. Salas, is a Director of the Company, loaned the Company the sum of $250,000 on each such date (cumulatively, $500,000) which the Company used to pay the principal and interest due to Bank One for February and March 2003 and for working capital needs. On May 20, 2003 an additional loan of $834,000 was loaned by a combination of Dolphin ($750,000) and Jeffrey R. Bailey who is a Director and President ($84,000) of the Company. On August 6, 2003 an additional loan of $150,000 was loaned by Dolphin. Each of these loans is evidenced by a separate promissory note each bearing interest at the rate of 12% per annum, with payments of interest only payable quarterly and the principal balance payable on January 4, 2004. Each of the February and March 2003 promissory notes is secured by an undivided 10% interest in the Company's pipelines. The May 20, 2003 loans provides Dolphin with a 30% interest and Bailey with a 3.36% interest in the Company's pipelines. The August note provides Dolphin with a 6% interest in the Company's pipelines. NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED) (Amounts presented relating to September 30, 2003 and the nine months ended September 30, 2003 and 2002 are unaudited) 4. OIL AND GAS The following table sets forth information concerning the PROPERTIES Company's oil and gas properties: DECEMBER 31, 2002 2001 == Oil and gas properties, at cost $17,099,753 $15,117,224 Accumulation depreciation, depletion and amortization (3,235,432) (1,847,294) -- Oil and gas properties, net $13,864,321 $13,269,930 == During the years ended December 31, 2002, 2001 and 2000, the Company recorded depletion expense of approximately $1,388,000, $1,342,000 and $197,000, respectively. 5. PIPELINE In 1996, the Company began construction of a 65-mile gas

FACILITIES pipeline (1) connecting the Swan Creek development project to a gas purchaser and (2) enabling the Company to develop gas distribution business opportunities in the future. Phase I, a 30-mile portion of the pipeline, was completed in 1998. Phase II of the pipeline, the remaining 35 miles, was completed in March 2001. The estimated useful life of the pipeline for depreciation purposes is 30 years. The Company recorded approximately $220,000 and $509,000, respectively in depreciation expense related to the pipeline for the years ended December 31, 2002 and 2001. No depreciation expense was recorded in 2000 as the pipeline was not yet complete. In January 1997, the Company entered into an agreement with the Tennessee Valley Authority ("TVA") whereby the TVA allows the Company to bury the pipeline within the TVA's transmission line rights-of-way. In return for this right, the Company paid $35,000 and agreed to annual payments of approximately $6,200 for 20 years. This agreement expires in 2017 at which time the parties may renew the agreement for another 20 year term in consideration of similar inflation-adjusted payment terms. NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED) (Amounts presented relating to September 30, 2003 and the nine months ended September 30, 2003 and 2002 are unaudited) 6. OTHER Other property and equipment consisted of the following: PROPERTY AND EQUIPMENT DECEMBER 31, 2002 2001 === Machinery and equipment $1,887,190 $1,737,189 Vehicles 675,411 610,510 Other 63,734 63,739 2,626,335 2,411,438 Less accumulated depreciation (940,385) (731,334) --- Other property and equipment - net $1,685,950 $1,680,104 === 7. LONG TERM DEBT Long-term debt to unrelated entities consisted of the following: September 30, DECEMBER 31, 2002 2001 2003 === (unaudited) Revolving line of credit with a bank, due November 2004. The loan agreement provides for increases or decreases to the borrowing base as changes in proved oil and gas reserves or other production levels arise. Borrowings bear interest at the bank's prime rate plus 0.25% (4.5% at December 31, 2002). Collateralized by the oil and gas properties and the related operations and revenues. $7,501,777 $9,101,777 $5,701,777 Unsecured note payable to an institution, with $65,000 principal payments due quarterly beginning January 1, 2000; remaining balance due October 2004; with interest payable monthly at 8% per annum. Note is convertible into common stock of the Company at a rate of $6.25 per share of common stock. 480,000 720,000 300,000 Convertible notes payable to five individuals; due January 2004, with interest payable quarterly at 8% per annum. Notes are convertible into common stock of the Company at a rate of $3.00 per share of common stock. 650,000 - 650,000 Unsecured note payable to an institution due May 1, 2004, with interest payable annually at 4.75% per annum. - - 297,171 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED) (Amounts presented relating to September 30, 2003 and the nine months ended September 30, 2003 and 2002 are unaudited) Note payable to a financial institution, with $1,773 principal payments due monthly beginning January 7, 2002 through December 7, 2006. Interest is payable monthly commencing on January 7, 2002 at 7.5% per annum. Note is guaranteed by a major shareholder and is collateralized by certain assets of the Company. 73,335 87,500 61,202 Installment notes bearing interest at the rate of 3.9% to 11.95% per annum collateralized by vehicles and equipment with monthly payments including interest of approximately $10,000 due various periods through 2006. 412,342 393,311 304,904 --- Total long term debt 9,117,454 10,302,588 7,315,054 Less current maturities (7,861,245) (6,399,831) (6,724,999) --- Long term debt, less current maturities 1,256,209 3,902,757 590,055 === The Company is subject to certain financial (ratio) covenants and restrictions on indebtedness, dividend payments, financial guarantees, business combinations, reporting requirements and other related items on the revolving line of credit with a bank. As of December 31, 2002, the Company is not in compliance with all covenants. During 2002, as a result of ongoing negotiations to refinance or repay the debt, the bank declared all amounts immediately due and payable. The Company is presently paying $200,000 per month. As a result of ongoing negotiations with Bank One, management has reclassified the loan fees associated with this note to a current asset as it is likely that these fees will be fully amortized in 2003. Long-term debt to related parties consisted of the following: September September 30, DECEMBER 31, 2002 2001 2003 === (unaudited) Unsecured note payable to a director due January 2004, with interest payable quarterly at 8% per annum. Note is convertible into common stock of the Company at a rate of $2.88 per share of common stock. $500,000 $ - $500,000 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED) (Amounts presented relating to September 30,

2003 and the nine months ended September 30, 2003 and 2002 are unaudited) Notes payable to a director due January 2004, with interest payable quarterly at 12% per annum. Note is secured by 10% of the pipeline. 250,000 - 1,734,000 --- Total long term debt to related Parties 750,000 - 2,234,000 Less current maturities - - (2,234,000) --- Long term debt to related parties, less current maturities $750,000 $ - $ - === The aggregate maturities of long term debt due to related parties and others as of December 31, 2002, are as follow: Year Amount --- 2003 $7,861,245 2004 1,720,463 2005 101,468 2006 101,803 Thereafter 82,470 --- $9,867,454 === 8. COMMITMENTS The Company is a party to lawsuits in the ordinary course of AND its business. While the damages sought in some of these CONTINGENCIES actions are material, the Company does not believe that it is probable that the outcome of any individual action will have a material adverse effect, or that it is likely that adverse outcomes of individually insignificant actions will be significant enough, in number or magnitude, to have a material adverse effect in the aggregate on its financial statements. In the ordinary course of business the Company has entered into various equipment and office leases which have remaining terms ranging from one to four years. Approximate future minimum lease payments to be made under noncancellable operating leases are as follows: Year Amount --- 2003 $ 60,158 2004 59,210 2005 56,970 2006 500 --- $176,838 === NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED) (Amounts presented relating to September 30, 2003 and the nine months ended September 30, 2003 and 2002 are unaudited) Office rent expense was approximately $84,000, $91,000 and $86,000 for each of the three years ended December 31, 2002, 2001 and 2000, respectively. 9. CUMULATIVE Shares of both Series A and B Preferred Stock are or will be CONVERTIBLE immediately convertible into shares of Common Stock. Each REDEEMABLE $100 liquidation preference share of preferred stock is PREFERRED convertible at a rate of $7.00 for the Series A per share of STOCK common stock. For the Series B, the conversion rate is the average market price of the Company's common stock for 30 days before the sale of the Series B preferred stock with a minimum conversion price of $9.00 per share. The conversion rate is subject to downward adjustment if the Company subsequently issues shares of common stock for consideration less than $7.00 and $9.00 for the Series A and Preferred Stock, respectively, per share. The conversion prices will be adjusted prospectively for stock dividends and splits. The holders of both the Series A and Series B Preferred Stock are entitled to a cumulative dividend of 8% per quarter. However, the payment of the dividends on the Series B Preferred Stock is subordinate to that of the Series A Preferred Stock. In the event that the Company does not make any two of six consecutive quarterly dividend payments, the holders of the Series A Preferred Stock may appoint those directors which would constitute of majority of the Board of Directors. In such a scenario, the holders of the Preferred Shares would be entitled to elect a majority of the Board of Directors until all accrued and unpaid dividends have been paid. The Company failed to pay the 3rd and 4th quarterly dividend payments of the Series A preferred stock during 2002. As a result, in February 2003, the Series A shareholders exercised their rights to place four new members on the Board of Directors. As of September 30, 2003, cumulative accrued and unpaid dividends on the Series A and B Preferred Stock amounted to $405,334. The Company may redeem both of the Series A and B Preferred Stock upon payment of $100 per share plus any accrued and unpaid dividends. Further, with respect to the Series A Preferred Stock, commencing on October 1, 2003 and at each quarterly date thereafter while the Series A Preferred Stock is outstanding, the Company is required to redeem one-twentieth of the maximum number of Series A Preferred Stock outstanding. With respect to the Series B Preferred Stock, on the fifth anniversary after issuance (March 2005), the Company is required to redeem all outstanding Series B Preferred Stock. During 2002, the Board of Directors authorized the sale of up to 50,000 shares of Series C Preferred Stock at $100 per share. The Company issued 14,491 shares, resulting in net proceeds after commissions of $1,303,168. The Series C NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED) (Amounts presented relating to September 30, 2003 and the nine months ended September 30, 2003 and 2002 are unaudited) Preferred Stock accrues a 6% cumulative dividend on the outstanding balance, payable quarterly. As of September 30, 2003, cumulative accrued and unpaid dividends on the Series C Preferred Stock amounted to $65,209. These dividends are subordinate to the dividends payable to the Series A and Series B Preferred Stock holders. This stock is

convertible into the Company's common stock at the average stock trading price 30 days prior to the closing of the sales of all the Series C Preferred Stock being offered or $5.00 per share, whichever is greater. The Company is required to redeem any remaining Series C Preferred Stock and any accrued and unpaid dividends in July 2006. 10. STOCK On August 1, 2001, the Company paid a 5% stock dividend DIVIDEND distributable on October 1, 2001 to shareholders of record of the Company's common stock on September 4, 2001. Based on the number of common shares outstanding on the record date, the Company issued 498,016 new shares. All references in the accompanying financial statements to the number of common shares and per share amounts are based on the increased number of shares giving retroactive effect to the stock dividend. 11. STOCK OPTIONS In October 2000, the Company approved a Stock Incentive Plan. The Plan is effective for a ten-year period commencing on October 25, 2000 and ending on October 24, 2010. The aggregate number of shares of Common Stock as to which options and Stock Appreciation Rights may be granted to Employees under the plan shall not exceed 1,000,000. Options are not transferable, fully vest after two years of employment with the Company, are exercisable for three months after voluntary resignation from the Company, and terminate immediately upon involuntary termination from the Company. The purchase price of shares subject to this Nonqualified Stock Option Plan shall be determined at the time the options are granted, but are not permitted to be less than 85% of the Fair Market Value of such shares on the date of grant. Furthermore, an employee in the plan may not, immediately prior to the grant of an Incentive Stock Option hereunder, own stock in the Company representing more than ten percent of the total voting power of all classes of stock of the Company unless the per share option price specified by the Board for the Incentive Stock Options granted such and Employee is at least 110% of the Fair Market Value of the Company's stock on the date of grant and such option, by its terms, is not exercisable after the expiration of five years 11. STOCK OPTIONS from the date such stock option is granted. NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED) (Amounts presented relating to September 30, 2003 and the nine months ended September 30, 2003 and 2002 are unaudited) Stock option activity in 2002, 2001 and 2000 is summarized below: 2002 2001 2000 ----------------- ----------------- ----------------- WEIGHTED WEIGHTED WEIGHTED AVERAGE AVERAGE AVERAGE EXERCISE EXERCISE EXERCISE SHARES PRICE SHARES PRICE SHARES PRICE == Outstanding, beginning of year 516,028 $9.23 1,017,450 $ 8.54 530,250 $6.91 Granted 160,742 2.86 78,750 12.39 855,451 8.69 Exercised - - (256,772) 8.69 (21,751) 8.69 Expired/canceled - - (323,400) 7.85 (346,500) 6.91 ------- ---------- -------- Outstanding, end of year 676,770 7.71 516,028 9.23 1,017,450 8.54 -- Exercisable, end of year 676,770 $7.71 474,889 $ 9.21 930,258 $8.49 == The share information disclosed above has been adjusted to reflect the 5% stock dividend declared during 2001. See note 10 above. The following table summarizes information about stock options outstanding at December 31, 2002: -- ------------ OPTIONS OPTIONS OUTSTANDING EXERCISABLE -- ------------ WEIGHTED AVERAGE WEIGHTED REMAINING AVERAGE CONTRACTUAL EXERCISE PRICE SHARES LIFE (YEARS) SHARES -- ------------- $ 2.86 160,742 2.67 160,742 $ 8.69 437,278 0.85 437,278 $ 14.44 21,000 1.13 21,000 $ 11.05 47,250 1.30 47,250 $ 12.70 10,500 1.71 10,500 ------- Total $ 7.71 676,770 676,770 == The weighted average fair value per share of options granted during 2002, 2001 and 2000 is $1.45, $3.62, and $3.41 respectively, calculated using the Black-Scholes Option-Pricing model. NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED) (Amounts presented relating to September 30, 2003 and the nine months ended September 30, 2003 and 2002 are unaudited) No compensation expense related to stock options were incurred in 2002, 2001 or 2000. The Company issued 70,715 options to non-employees and non-directors in 2000. The expense of $242,000 for these options has been included in professional fees expense because the options were issued to providers of such services. The expense was calculated using a fair market value of the options based on the Black-Scholes option-pricing model assumptions discussed below. For employees, the fair value of stock options used to compute pro forma net loss and loss per share disclosures is the estimated present value at grant date using the Black-Scholes option-pricing model with the following weighted average assumptions for 2002, 2001 and 2000; Expected volatility of 74.2% for 2002, 50% for 2001 and 50% for 2000; a risk free interest rate of 3.67% in 2002, 3.67% in 2001 and 5.86% in 2000; and an

expected option life of 3 years for 2002, 2001 and 2000. 12. INCOME TAXES The Company had no taxable income during the three year period ended December 31, 2002. A reconciliation of the statutory U.S. Federal income tax and the income tax provision included in the accompanying consolidated statements of loss is as follows: DECEMBER 31, 2002 2001 2003 == Statutory rate 34% 34% 34% Tax benefit at statutory rate $(1,073,000) $ (769,000) $(452,500) State income tax benefit (189,000) (136,000) (75,500) Other - - 24,000 Increase in deferred tax asset Valuation allowance 1,262,000 905,000 504,000 --- Total income tax provision $ - $ - $ - == DECEMBER 31, 2002 2001 2003 == Net operating loss carryforward $ 7,139,000 $5,877,000 $4,972,000 Capital loss carryforward 263,000 263,000 263,000 --- 7,402,000 6,140,000 5,235,000 Valuation allowance (7,402,000) (6,140,000) (5,235,000) --- Net deferred taxes $ - $ - $ - == The Company recorded a valuation allowance at December 31, 2002, 2001 and 2000 equal to the excess of deferred tax assets over deferred tax liabilities as management is unable NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED) (Amounts presented relating to September 30, 2003 and the nine months ended September 30, 2003 and 2002 are unaudited) to determine that these tax benefits are more likely than not to be realized. Potential future reversal of the portion of the valuation allowance relative to deferred tax asset resulting from the exercise of stock options will be recorded as additional paid in capital realized As of December 31, 2002, the Company had net operating loss carryforwards of approximately $18,217,000, which will expire between 2010 and 2022, if not utilized. 13. SUPPLEMENTAL The Company paid approximately $571,000, $853,500 and CASH FLOW $544,000 for interest in 2002, 2001 and 2000, respectively. INFORMATION The Company capitalized approximately $148,000 and $128,000 of this amount in 2001 and 2000, respectively. No interest was capitalizedduring 2002. The Company paid no income taxes in 2002, 2001 and 2000. 14. QUARTERLY The following table sets forth, for the fiscal periods DATA AND indicated, selected consolidated financial data. SHARE INFORMATION (UNAUDITED) FISCAL YEAR ENDING DECEMBER 31, 2003 -- First Second Third Fourth Quarter Quarter Quarter Quarter -- Revenues $1,971,603 $1,482,390 $1,599,461 - Net Income (loss) (659,350) (678,592) (508,247) - Net Income (loss) attributable to common Stockholders (793,545) (812,786) (642,441) - Earnings (loss) per common share Basic and diluted $ (0.07) $ (0.07) $ (0.05) - -- FISCAL YEAR ENDED DECEMBER 31, 2002 -- First Second Third Fourth Quarter Quarter Quarter Quarter -- Revenues $1,176,482 $1,297,668 $1,507,308 $1,719,020 Net loss (818,341) (858,197) (721,879) (756,138) Net loss attributable to common Stockholders (930,799) (984,139) (856,074) (890,332) -- Loss per common share Basic and diluted $ (0.09) $ (0.09) $ (0.08) $ (0.07) -- NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED) (Amounts presented relating to September 30, 2003 and the nine months ended September 30, 2003 and 2002 are unaudited) FISCAL YEAR ENDED DECEMBER 31, 2001 -- First Second Third Fourth Quarter Quarter Quarter Quarter -- Revenues $1,448,318 $1,863,068 $2,583,758 $1,101,542 Net loss (368,768) (336,034) (378,597) (1,179,388) Net loss attributable to common Stockholders (447,546) (423,523) (491,055) (1,291,846) -- Loss per common share Basic and diluted $ (0.05) $ (0.04) $ (0.05) $ (0.12) -- Third quarter 2001 results reflect the effect on depletion expense that resulted from a decrease in reserve estimates provided in a study performed by Ryder Scott Company, L.P. and issued August 10, 2001. The amount recorded during this quarter was $562,000 higher than the quarterly estimates made by management during the first three quarters as a result of a change in estimate arising from new information provided in the Ryder Scott Company, L.P. Report. Amounts disclosed above differ from those filed with the SEC during the third quarter of 2001 as a result of an error in recording this change in estimate to depletion at the time of the filing. Management amended the September 30, 2001 SEC Form 10-Q filing during 2002. 15. SUPPLEMENTAL Information with respect to the Company's oil and gas OIL AND GAS producing

activities is presented in the following tables. INFORMATION Estimates of reserve quantities, as well as future production and discounted cash flows before income taxes, were determined by Ryder Scott Company, L.P. as of December 31, 2002, 2001 and 2000. OIL AND GAS RELATED COSTS The following table sets forth information concerning costs related to the Company's oil and gas property acquisition, exploration and development activities in the United States during the years ended December 31, 2002, 2001 and 2000: 2002 2001 2003 == Property acquisition Proved $ - $ - $ - Unproved - - 5,702 Less - proceeds from sales of properties (100,000) (750,000) (1,176,411) Development costs 2,082,529 5,571,883 2,627,705 -- $ 1,982,529 $ 4,821,883 $ 1,456,996 == NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED) (Amounts presented relating to September 30, 2003 and the nine months ended September 30, 2003 and 2002 are unaudited) RESULTS OF OPERATIONS FROM OIL AND GAS PRODUCING ACTIVITIES The following table sets forth the Company's results of operations from oil and gas producing activities for the years ended: DECEMBER 31, 2002 2001 2003 == Revenues $5,437,723 $6,656,758 $5,241,076 Production costs and taxes (3,094,731) (2,951,746) (2,614,414) Depreciation, depletion and amortization (1,388,138) (1,342,000) (197,000) -- Income from oil and gas producing activities $ 954,854 $ 2,363,012 $ 2,429,662 -- In the presentation above, no deduction has been made for indirect costs such as corporate overhead or interest expense. No income taxes are reflected above due to the Company's tax loss carryforwards. OIL AND GAS RESERVES (UNAUDITED) The following table sets forth the Company's net proved oil and gas reserves at December 31, 2002, 2001 and 2000 and the changes in net proved oil and gas reserves for the years then ended. Proved reserves represent the estimated quantities of crude oil and natural gas which geological and engineering data demonstrate with reasonable certainty to be recoverable in the future years from known reservoirs under existing economic and operating conditions. The reserve information indicated below requires substantial judgment on the part of the reserve engineers, resulting in estimates which are not subject to precise determination. Accordingly, it is expected that the estimates of reserves will change as future production and development information becomes available and that revisions in these estimates could be significant. Reserves are measured in barrels (bbls) in the case of oil, and units of one thousand cubic feet (Mcf) in the case of gas. OIL (BBLS) GAS (MCF) == Proved reserves: Balance, January 1, 2000 3,227,203 74,795,287 Discoveries and extensions 56,103 1,059,147 Revisions of previous estimates (1,309,366) (27,998,986) Production (159,035) (315,577) -- Balance, December 31, 2000 1,814,905 47,539,871 Discoveries and extensions 62,254 4,915,431 Revisions of previous estimates (672,443) (25,263,634) Production (148,041) (1,311,466) -- Balance, December 31, 2001 1,056,675 25,880,202 Discoveries and extensions 34,968 937,000 Revisions of previous estimates 542,229 786,430 Production (157,973) (1,004,899) -- Proved reserves at, December 31, 2002 1,475,899 26,598,733 == NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED) (Amounts presented relating to September 30, 2003 and the nine months ended September 30, 2003 and 2002 are unaudited) Proved developed producing reserves at, December 31, 2002 1,108,293 6,592,711 == Proved developed producing reserves at, December 31, 2001 767,126 7,157,183 == Proved developed producing reserves at, December 31, 2000 1,553,759 2,888,769 == Of the Company's total proved reserves as of December 31, 2002 and 2001 and 2000, approximately 37%, 36% and 21%, respectively, were classified as proved developed producing, 19%, 26% and 34%, respectively, were classified as proved developed non-producing and 44%, 37% and 45%, respectively, were classified as proved undeveloped. All of the Company's reserves are located in the continental United States. STANDARDIZED MEASURE OF DISCOUNTED FUTURE NET CASH FLOWS (UNAUDITED) The standardized measure of discounted future net cash flows from the Company's proved oil and gas reserves is presented in the following table: AMOUNTS IN THOUSANDS ------------------------------ December 31, 2002 2001 2003

== Future cash inflows $152,180 $ 78,296 $ 505,733 Future production costs and taxes (41,870) (26,083) (41,689) Future development costs (11,348) (6,384) (8,225) Future income tax expenses - - (122,881) -- Net future cash flows 98,962 45,829 332,938 Discount at 10% for timing of cash flows (52,314) (24,095) (97,195) -- Discounted future net cash flows from proved reserves $ 46,648 $ 21,734 $ 235,743 == NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED) (Amounts presented relating to September 30, 2003 and the nine months ended September 30, 2003 and 2002 are unaudited) The following unaudited table sets forth the changes in the standardized measure of discounted future net cash flows from proved reserves during 2002, 2001 and 2000: AMOUNTS IN THOUSANDS ------------------------------ 2002 2001 2003 == Balance, beginning of year $ 21,734 $ 235,743 $ 100,882 Sales, net of production costs and taxes (2,343) (3,705) (2,627) Discoveries and extensions 1,686 4,167 1,778 Changes in prices and production costs 20,586 (299,527) 360,082 Revisions of quantity estimates 6,120 (33,449) (186,289) Development costs incurred - 1,236 Interest factor - accretion of discount 2,173 32,198 13,355 Net change in income taxes - 86,237 (53,572) Changes in future development costs (4,860) 2,666 (3,237) Changes in production rates and other 1,552 (2,596) 4,135 -- Balance, end of year $ 46,648 $ 21,734 $ 235,743 == Estimated future net cash flows represent an estimate of future net revenues from the production of proved reserves using current sales prices, along with estimates of the operating costs, production taxes and future development and abandonment costs (less salvage value) necessary to produce such reserves. The average prices used at December 31, 2002, 2001 and 2000 were $27.25, $17.03 and $25.62 per barrel of oil and $4.01, $2.33 and $9.66 per MCF of gas, respectively. No deduction has been made for depreciation, depletion or any indirect costs such as general corporate overhead or interest expense. Operating costs and production taxes are estimated based on current costs with respect to producing gas properties. Future development costs are based on the best estimate of such costs assuming current economic and operating conditions. The estimates of reserve values include estimated future development costs that the company does not currently have the ability to fund. If the company is unable to obtain additional funds, it may not be able to develop its oil and natural gas properties as estimated in its December 31, 2002 reserve report. Income tax expense is computed based on applying the appropriate statutory tax rate to the excess of future cash inflows less future production and development costs over the current tax basis of the properties involved, less applicable carryforwards, for both regular and alternative minimum tax. NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED) (Amounts presented relating to September 30, 2003 and the nine months ended September 30, 2003 and 2002 are unaudited) The future net revenue information assumes no escalation of costs or prices, except for gas sales made under terms of contracts which include fixed and determinable escalation. Future costs and prices could significantly vary from current amounts and, accordingly, revisions in the future could be significant. Effective January 1, 2003, the Company implemented the requirements of Statement of Financial Accounting Standards No. 143 (SFAS 143), "Accounting for Asset Retirement Obligations". Among other things, SFAS 143 requires entities to record a liability and corresponding increase in long-lived assets for the present value of material obligations associated with the retirement oftangible long-lived assets. Over the passage of time, accretion of the liability is recognized as an operating expense and the capitalized cost is depleted over the estimated useful life of the related asset. Additionally, SFAS 143 requires that upon initial application of these standards, the Company must recognize a cumulative effect of a change in accounting principle corresponding to the accumulated accretion and depletion expense that would have been recognized had this standard been applied at the time the long-lived assets were acquired or constructed. The Company's asset retirement obligations relate primarily to the plugging, dismantling and removal of wells drilled to date. Using a credit-adjusted risk free rate of 12%, an estimated useful life of wells ranging from 30-40 years, and estimated plugging and abandonment costs ranging from $5,000 per well to $10,000 per well, the Company has recorded a non-cash charge related to the cumulative effect of a change in accounting principle of $351,204 in its statement of loss. Oil and gas properties were increased by $260,191, which represents the present value of all future obligations to retire the wells at January 1, 2003, net of accumulated depletion on this cost through that date. A corresponding obligation totaling $611,395 has also been recorded as of January 1, 2003. For the nine month period ended September 30, 2003, the Company recorded accretion and depletion expenses of $77,952 associated with this

liability and its corresponding asset. These expenses are included in depletion, depreciation, and amortization in the consolidated statements of loss. Had the provisions of this statement been reflected in the financial statements for the year ended December 31, 2002, an asset retirement obligation of $476,536 would have been recorded as of January 1, 2002. The following is a roll-forward of activity impacting the asset retirement obligation for the nine months ended September 30, 2003: Balance, January 1, 2003: $611,395 Accretion expense through September 30, 2003 55,026 -------- Balance, September 30, 2003 $666,421 ======== PART II INFORMATION NOT REQUIRED IN PROSPECTUS ITEM 13. OTHER EXPENSES OF ISSUANCE AND DISTRIBUTION. The following is an itemization of all expenses (subject to future contingencies) incurred or to be incurred by us in connection with the issuance and distribution of the securities being offered. All items below are estimates other than the American Stock Exchange listing fee. The registrant will pay all of such expenses. Securities and Exchange Commission registration fee $ 2,500 AMEX listing fee... $22,500 Accounting fees and expenses.................................. $50,000 Legal fees and expenses....................................... $60,000 Subscription Agent fees and expenses........................... $15,000 -------- Total................................. $150,000 ITEM 14. INDEMNIFICATION OF DIRECTORS AND OFFICERS. Tennessee Code Annotated Sections 48-18-502 through 509 grant Tennessee corporations broad powers to indemnify their present and former directors and officers and those of affiliated corporations against expenses (including attorneys' fees), judgments, fines and amounts paid in settlement actually and reasonably incurred in connection with threatened, pending or completed actions, suits or proceedings to which they are parties or are threatened to be made parties by reason of being or having been such directors or officers, subject to specified conditions and exclusions; give a director or officer who successfully defends an action the right to be so indemnified; and permit a corporation to buy directors' and officers' liability insurance. Such indemnification is not exclusive of any other rights to which those indemnified may be entitled under any by-laws, agreement, vote of stockholders or otherwise. Tennessee Code Annotated Section 48-18-102(b) permits a Tennessee corporation to include in its certificate of incorporation a provision eliminating the potential monetary liability of a director to the corporation or its stockholders for breach of fiduciary duty as a director, provided that such provision may not eliminate the liability of a director (i) for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law, (ii) for any transaction from which the director receives an improper personal benefit or (iii) in connection with any proceeding in which the director was adjudged liable to the corporation. The registrant's certificate of incorporation does not provide that its directors shall not be liable to it or its stockholders for a breach of their duties to the fullest extent in which elimination or limitation of the liability of directors is permitted by the foregoing Section, which does not apply to the registrant. All directors are indemnified by the registrant, both by operation of Tennessee Code Annotated Sections 48-18-501 through 509 and since 1995 by resolution of the registrant's board of directors, against liability and expenses including attorney's fees incurred by them as a result of serving on the registrant's board of directors. The statutory provisions require a finding that the conduct of the director was in good faith and in the best interest of the company and does not extend to cases where a director is found to be liable to the company itself. Such a finding may be made by uninvolved directors, a committee of the board or independent counsel. Tennessee Code Annotated Section 48-15-503 provides for the indemnification of directors and of corporate officers where the director or officer is successful in defense of any proceeding he or she became involved in as a result of being or having been in such position, unless the corporate charter forbids such indemnification. The registrant's corporate charter contains no such bar or prohibition of indemnification of the registrant's directors or officers. Tennessee statutes further provide that the rights to indemnification of a director do not preclude other bases of indemnification, whether such rights arise by charter, bylaws, shareholder resolution, agreement or board resolution, provided there is no breach of duty of loyalty to the corporation, bad faith, intentional misconduct or knowing violation of law. Accordingly, the registrant's board of directors on August 17, 1995, unanimously resolved to indemnify directors and executive officers on a mandatory basis to the fullest extent of the laws referenced above for the entire period a party is subject to any possible legal action or claim by reason of having so served. Tennessee law permits, but does not require, insurance to be obtained to fund indemnity obligations. The registrant does not have any such insurance. ITEM 15. RECENT SALES OF UNREGISTERED SECURITIES Each of the following recent sales of unregistered securities was made pursuant to an exemption from the provisions of Section 5 of the Securities Act of 1933 under Section 4(2) of such Act. In approximately October 1998, the registrant sold 28,679 shares of its Series A 8% Cumulative Convertible Preferred Stock to private investors for an aggregate purchase price of $2,733,000, net of commissions to a placement agent in the aggregate amount of approximately

$135,000. In approximately August 2000 and June 2001, the registrant sold 27,550 shares of its Series B 8% Cumulative Convertible Preferred Stock to private investors for an aggregate purchase price of $2,614,600, net of commissions to a placement agent in the aggregate amount of approximately 140,000. In approximately May and June 2002, the registrant sold 14,491 shares of its Series C 6% Cumulative Convertible Preferred Stock to private investors for an aggregate purchase price of $1,303,168, net of commissions to a placement agent in the aggregate amount of approximately $116,000. On each of January 21, 2002 and April 9, 2002, Bill L. Harbert, who owns more than ten percent of the registrant's outstanding common stock and is now, but was not at those dates, a director of the registrant, purchased from the registrant in a private placement, 100,000 shares of the registrant's common stock, at prices of $6.32 and $4.80 per share, respectively. On July 5, 2002 and July 23, 2002, Dolphin Offshore Partners, L.P. ("Dolphin"), which owns more than ten percent of the registrant's outstanding common stock, and whose general partner, Peter E. Salas, is a director of the registrant, purchased from the registrant in a private placement, 400,000 and 250,000 shares of the registrant's common stock, respectively, at a price of $2.50 per share. In October 2002, Dolphin loaned to the registrant $500,000 and was issued an unsecured convertible promissory note by the registrant in the principal amount of $500,000 bearing 8% interest, with interest only payable quarterly and principal payable January 4, 2004. In December 2002, Dolphin loaned to the registrant $250,000 and was issued a secured promissory note bearing interest at the rate of 12% per annum, with interest only payable quarterly and the principal balance payable on January 4, 2004. In January 2003, Bill L. Harbert, a director of the registrant, purchased 227,275 shares of the registrant's common stock in a private placement at a price of $1.10 per share. On each of February 3, 2003 and February 28, 2003, Dolphin loaned to the registrant $250,000 and for each of these loans was issued a separate secured promissory note bearing interest at the rate of 12% per annum, with payments of interest only payable quarterly and the principal balance payable on January 4, 2004 On May 20, 2003, Dolphin loaned to the registrant $750,000 and Jeffrey R. Bailey, President and a director of the registrant, loaned to the registrant $84,000 and each was issued a separate secured promissory note bearing interest at the rate of 12% per annum, with payments of interest only payable quarterly and the principal balance payable on January 4, 2004. During the three months ended March 31, 2003, the registrant converted $60,000 of indebtedness and $9,600 of accrued interest owed to the holders of convertible notes into 60,528 shares of the registrant's common stock and issued 55,000 shares of its common stock for payment of consulting services valued at $70,000. During the nine months ended June 30, 2003, the registrant converted $70,309 of accrued dividends payable on its outstanding preferred stock into an aggregate of 154,824 shares of the registrant's common stock. On August 6, 2003, Dolphin loaned to the registrant $150,000 and was issued a secured promissory note bearing interest at the rate of 12% per annum, with payments of interest only payable quarterly and the principal balance payable on January 4, 2004. On December 3, 2003, Dolphin loaned to the registrant $225,000 and was issued a secured promissory note bearing interest at the rate of 12% per annum, with payments of interest only payable quarterly and the principal balance payable on January 4, 2004. On December 9, 2003, Dolphin loaned to the registrant $250,000 and was issued a secured promissory note bearing interest at the rate of 12% per annum, with payments of interest only payable quarterly and the principal balance payable on January 4, 2004. ITEM 16. EXHIBITS. EXHIBIT NUMBER DESCRIPTION -------------- ----------- 3.1 Charter (Incorporated by reference to Exhibit 3.7 to the registrant's registration statement on Form 10-SB filed August 7, 1997 (the "Form 10-SB")) 3.2 Articles of Merger and Plan of Merger (taking into account the formation of the Tennessee wholly-owned subsidiary for the purpose of changing the Company's domicile and effecting reverse split) (Incorporated by reference to Exhibit 3.8 to the Form 10-SB) 3.3 Articles of Amendment to the Charter dated June 24, 1998 (Incorporated by reference to Exhibit 3.9 to the registrant's annual report on Form 10-KSB filed April 15, 1999 (the "1998 Form 10-KSB")) 3.4 Articles of Amendment to the Charter dated October 30, 1998 (Incorporated by reference to Exhibit 3.10 to the 1998 Form 10-KSB) 3.5 Articles of Amendment to the Charter filed March 17, 2000 (Incorporated by reference to Exhibit 3.11 to the registrant's annual report on Form 10-KSB filed April 14, 2000 (the "1999 Form 10-KSB")) 3.6 By-laws (Incorporated by reference to Exhibit 3.2 to the Form 10-SB) 4.1* Form of Rights Certificate 5.1* Opinion of Cary V. Sorensen, Esq. 10.1 Purchase Agreement with IRC (Incorporated by reference to Exhibit 10.1(a) to the Form 10-SB) 10.2 Amendment to Purchase Agreement with IRC (Incorporated by reference to Exhibit 10.1(b) to the Form 10-SB) 10.3 General Bill of Sale and Promissory Note (Incorporated by reference to Exhibit 10.1(c) to the Form 10-SB) 10.4 Compensation Agreement - M.E. Ratliff (Incorporated by reference to Exhibit 10.2(a) to the Form 10-SB) 10.5 Compensation Agreement - Jeffrey D. Jenson (Incorporated by reference to Exhibit 10.2(b) to the Form 10-SB) 10.6 Compensation Agreement - Leonard W. Burningham

(Incorporated by reference to Exhibit 10.2(c) to the Form 10-SB) 10.7 Agreement with the Natural Gas Utility District of Hawkins County, Tennessee (Incorporated by reference to Exhibit 10.3 to the Form 10-SB) 10.8 Agreement with Powell Valley Electric Cooperative, Inc. (Incorporated by reference to Exhibit 10.4 to the Form 10-SB) 10.9 Agreement with Enserch Energy Services, Inc. (Incorporated by reference to Exhibit 10.5 to the Form 10-SB) 10.10 Amendment Agreement dated October 19, 1999 between Tengasco, Inc. and the Natural Gas Utility District of Hawkins County, Tennessee (Incorporated by reference to Exhibit 10.9 to the registrant's current report on Form 8-K filed October 25, 1999) 10.11 Natural Gas Sales Agreement dated November 18, 1999 between Tengasco, Inc. and Eastman Chemical Company (Incorporated by reference to Exhibit 10.10 to the registrant's current report on Form 8-K filed November 23, 1999) 10.12 Agreement between A.M. Partners LLC and Tengasco, Inc. dated October 6, 1999 (Incorporated by reference to Exhibit 10.11 to the registrant's 1999 Form 10-KSB) 10.13 Agreement between Southcoast Capital LLC and Tengasco, Inc. dated February 25, 2000 (Incorporated by reference to Exhibit 10.12 to the registrant's 1999 Form 10-KSB) 10.14 Franchise Agreement between Powell Valley Utility District and Tengasco, Inc. dated January 25, 2000 (Incorporated by reference to Exhibit 10.13 to the registrant's 1999 Form 10-KSB) 10.15 Amendment Agreement between Eastman Chemical Company and Tengasco, Inc. dated March 27, 2000 (Incorporated by reference to Exhibit 10.14 to the registrant's 1999 Form 10-KSB) Loan 10.16 Agreement between Tengasco Pipeline Corporation and Morita Properties, Inc. dated August 16, 2000 (Incorporated by reference to Exhibit 10.15 to the registrant's current report on Form 8-K dated August 22, 2000 (the "2000 8-K")) 10.17 Promissory note made by Tengasco Pipeline Corporation and Morita Properties, dated August 16, 2000 (Incorporated by reference to Exhibit 10.15(a) to the 2000 8-K) 10.18 Throughput Agreement between Tengasco Pipeline Corporation and Morita Properties, dated August 16, 2000 (Incorporated by reference to Exhibit 10.15(b) to the 2000 8-K) 10.19 Loan Agreement between Tengasco Pipeline Corporation and Edward W.T. Gray III dated August 16, 2000 (Incorporated by reference to Exhibit 10.16 to the 2000 8-K) 10.20 Promissory note made by Tengasco Pipeline Corporation and Edward W.T. Gray III dated August 16, 2000 (Incorporated by reference to Exhibit 10.16(a) to the 2000 8-K) 10.21 Throughput Agreement between Tengasco Pipeline Corporation and Edward W.T. Gray III dated August 16, 2000 (Incorporated by reference to Exhibit 10.16(b) to the 2000 8-K) 10.22 Loan Agreement between Tengasco Pipeline Corporation and Malcolm E. Ratliff dated August 16, 2000 (Incorporated by reference to Exhibit 10.17 to the 2000 8-K) 10.23 Promissory note made by Tengasco Pipeline Corporation and Malcolm E. Ratliff dated August 16, 2000 (Incorporated by reference to Exhibit 10.17(a) to the 2000 8-K) 10.24 Throughput Agreement between Tengasco Pipeline Corporation and Malcolm E. Ratliff dated August 16, 2000 (Incorporated by reference to Exhibit 10.17(b) to the 2000 8-K) 10.25 Loan Agreement between Tengasco Pipeline Corporation and Charles F. Smithers, Jr. dated August 16, 2000 (Incorporated by reference to Exhibit 10.18 to the 2000 8-K) 10.26 Promissory note made by Tengasco Pipeline Corporation and Charles F. Smithers, Jr. dated August 16, 2000 (Incorporated by reference to Exhibit 10.18(a) to the 2000 8-K) 10.27 Throughput Agreement between Tengasco Pipeline Corporation and Charles F. Smithers, Jr. dated August 16, 2000 (Incorporated by reference to Exhibit 10.18(b) to the 2000 8-K) Loan 10.28 Agreement between Tengasco Pipeline Corporation and Nick Nishiwaki dated August 16, 2000 (Incorporated by reference to Exhibit 10.19 to the 2000 8-K) 10.29 Promissory note made by Tengasco Pipeline Corporation and Nick Nishiwaki dated August 16, 2000 (Incorporated by reference to Exhibit 10.19(a) to the 2000 8-K) 10.30 Throughput Agreement between Tengasco Pipeline Corporation and Nick Nishiwaki dated August 16, 2000 (Incorporated by reference to Exhibit 10.19(b) to the 2000 8-K) 10.31 Memorandum Agreement between Tengasco, Inc. and the University of Tennessee dated February 13, 2001 (Incorporated by reference to Exhibit 10.19 to the registrant's annual report on Form 10-KSB filed April 10, 2001 (the "2000 Form 10-KSB")) 10.32 Natural Gas Sales Agreement between Tengasco, Inc. and BAE SYSTEMS Ordnance Systems Inc. dated March 30, 2001 (Incorporated by reference to Exhibit 10.20 to the 2000 Form 10-KSB) 10.33 Reducing and Revolving Line of Credit Up to $35,000,000 from Bank One, N.A. to Tengasco, Inc. Tennessee Land & Mineral Corporation and Tengasco Pipeline Corporation dated November 8, 2001 (Incorporated by reference to Exhibit 10.21 to the registrant's quarterly report on Form 10-Q filed November 14, 2001) 10.34 Tengasco, Inc. Incentive Stock Plan (Incorporated by reference to Exhibit 4.1 to the registrant's registration statement on Form S-8 filed October 26, 2000) 10.35** Promissory Note made by Tengasco, Inc. and Tengasco Pipeline Corporation to Dolphin Offshore Partners, LP dated October 7, 2002 in the principal amount of $500,000 10.36** Promissory Note made by Tengasco, Inc. and Tengasco Pipeline Corporation to Dolphin Offshore Partners, LP dated December 4, 2002 in the principal amount of $250,000 10.37** Promissory Note made by Tengasco, Inc. and Tengasco Pipeline Corporation to Dolphin Offshore Partners, LP dated

February 3, 2003 in the principal amount of $250,000 10.38** Promissory Note made by Tengasco, Inc. and Tengasco Pipeline Corporation to Dolphin Offshore Partners, LP dated February 28, 2003 in the principal amount of $250,000 10.39** Promissory Note made by Tengasco, Inc. and Tengasco Pipeline Corporation to Dolphin Offshore Partners, LP dated May 20, 2003 in the principal amount of $750,000 10.40** Promissory Note made by Tengasco, Inc. and Tengasco Pipeline Corporation to Dolphin Offshore Partners, LP dated August 6, 2003 in the principal amount of $150,000 10.41** Promissory Note made by Tengasco, Inc. and Tengasco Pipeline Corporation to Jeffrey R. Bailey dated May 20, 2003 in the principal amount of $84,000 10.42 Promissory Note made by Tengasco, Inc. and Tengasco Pipeline Corporation to Dolphin Offshore Partners, LP dated December 3, 2003 in the principal amount of $225,000 (Incorporated by reference to Exhibit 10.42 to the registrant's current report on Form 8-K dated December 3, 2003 (the "2003 Form 8-K") 10.43 Promissory Note made by Tengasco, Inc. and Tengasco Pipeline Corporation to Dolphin Offshore Partners, LP dated December 9, 2003 in the principal amount of $250,000 (Incorporated by reference to Exhibit 10.43 to the 2003 Form 8-K) 10.44 Continuing Security Agreement dated December 3, 2003 by the Company and Tengasco Pipeline Corporation as Obligors and Dolphin Offshore Partners, LP as Secured Party (Incorporated by reference to Exhibit 10.44 to the 2003 Form 8-K) 21 List of subsidiaries (Incorporated by reference to Exhibit 21 to the registrant's annual report on Form 10-KSB filed March 31, 2003 (the "2002 Form 10-KSB")) 23.1* Consent of Cary V. Sorensen, Esq. (contained in Exhibit 5.1 hereto) 23.2* Consent of BDO Seidman 23.3* Consent of Ryder Scott Company, L.P. 24.1* Power of Attorney 99.1 Ryder Scott Company, L.P. Report dated March 28, 2002 (Incorporated by reference to Exhibit 99.15 to the registrant's annual report on Form 10-KSB filed April 10, 2002) 99.2 Ryder Scott Company, L.P. Report dated February 10, 2003 (Incorporated by reference to Exhibit 99.17 to the 2002 Form 10-KSB) 99.3* Form of Instructions for Use of Rights Certificates 99.4* Form of Letter to be sent by Company to Holders of Record of the Rights 99.5* Form of Letter to be Sent to Beneficial Owners --------------- * Filed herewith ** Previously filed Item 17. Undertakings. (a) Regulation S-K, Item 512 Undertakings (1) The undersigned registrant hereby undertakes: (i) To file, during any period in which offers or sales are being made, a post-effective amendment to this registration statement: (a) To include any prospectus required by section 10(a)(3) of the Securities Act of 1933; (b) To reflect in the prospectus any facts or events arising after the effective date of the registration statement (or the most recent post-effective amendment thereof) which, individually or in the aggregate, represent a fundamental change in the information set forth in the registration statement. Notwithstanding the foregoing, any increase or decrease in volume of securities offered (if the total dollar value of securities offered would not exceed that which was registered) and any deviation from the low or high end of the estimated maximum offering range may be reflected in the form of prospectus filed with the Commission pursuant to Rule 424(b) if, in the aggregate, the changes in volume and price represent no more than 20% change in the maximum aggregate offering price set forth in the "Calculation of Registration Fee" table in the effective registration statement; and (c) To include any material information with respect to the plan of distribution not previously disclosed in the registration statement or any material change to such information in the registration statement; (ii) That, for the purpose of determining any liability under the Securities Act of 1933, each such post-effective amendment shall be deemed to be a new registration statement relating to the securities offered therein, and the offering of such securities at that time shall be deemed to be the initial bona fide offering thereof. (iii) To remove from registration by means of a post-effective amendment any of the securities being registered which remain unsold at the termination of the offering. (2) The undersigned registrant hereby undertakes that: (i) For purposes of determining any liability under the Securities Act of 1933, the information omitted from the form of prospectus filed as part of this registration statement in reliance upon Rule 430A and contained in a form of prospectus filed by the registrant pursuant to Rule 424(b)(1) or (4) or 497(h) under the Securities Act shall be deemed to be part of this registration statement as of the time it was declared effective. (ii) For the purpose of determining any liability under the Securities Act of 1933, each post-effective amendment that contains a form of prospectus shall be deemed to be a new registration statement relating to the securities offered therein, and the offering of such securities at that time shall be deemed to be the initial bona fide offering thereof. (3) The undersigned registrant hereby undertakes to supplement the prospectus, after the expiration of the subscription period, to set forth the results of the subscription offer, the transactions by the underwriters during the subscription period, the amount of unsubscribed securities to be purchased by the underwriters, and the terms of any subsequent reoffering thereof. If any public offering by the underwriters is to be made on terms differing from those set forth on the cover page of the prospectus, a post-effective amendment will be filed to set forth the terms of such offering. (4) Insofar as indemnification for liabilities arising under the Securities Act of 1933 may be permitted

to directors, officers and controlling persons of the registrant pursuant to the foregoing provisions, or otherwise, the registrant has been advised that in the opinion of the Securities and Exchange Commission such indemnification is against public policy as expressed in the Act and is, therefore, unenforceable. In the event that a claim for indemnification against such liabilities (other than the payment by the registrant of expenses incurred or paid by a director, officer or controlling person of the registrant in the successful defense of any action, suit or proceeding) is asserted by such director, officer or controlling person in connection with the securities being registered, the registrant will, unless in the opinion of our counsel the matter has been settled by controlling precedent, submit to a court of appropriate jurisdiction the question whether such indemnification by us are against public policy as expressed in the Act and will be governed by the final adjudication of such issue. SIGNATURES Pursuant to the requirements of the Securities Act of 1933, the Company has duly caused this registration statement to be signed on our behalf by the undersigned, thereunto duly authorized, in the city of Knoxville, Tennessee. TENGASCO INC. By: /S/ RICHARD T. WILLIAMS -------------------------------------- Richard T. Williams Chief Executive Officer Pursuant to the requirements of the Securities Act of 1933, this registration statement has been signed by the following persons in the capacities and on the dates indicated. SIGNATURE TITLE DATE /S/ RICHARD T. WILLIAMS Chairman of the Board; December 24, 2003 ------------------------ Chief Executive Officer Richard T. Williams (principal executive officer) * ------------------------ Director; President December 24, 2003 Jeffrey R. Bailey * Chief Financial Officer December 24, 2003 ------------------------ (principal financial and Mark A. Ruth accounting officer) * Director December 24, 2003 ------------------------ Stephen W. Akos * Director December 24, 2003 ------------------------ Joseph Earl Armstrong * Director December 24, 2003 ------------------------ John A. Clendening * Director December 24, 2003 ------------------------ Robert L. Devereux * Director December 24, 2003 ------------------------ Bill L. Harbert * Director December 24, 2003 ------------------------ Peter E. Salas * Director December 24, 2003 ------------------------ Charles M. Stivers */S/ RICHARD T. WILLIAMS December 24, 2003 ------------------------ Richard T. Williams, as attorney-in-fact EXHIBIT INDEX EXHIBIT NUMBER DESCRIPTION -------------- ----------- 3.1 Charter (Incorporated by reference to Exhibit 3.7 to the registrant's registration statement on Form 10-SB filed August 7, 1997 (the "Form 10-SB")) 3.2 Articles of Merger and Plan of Merger (taking into account the formation of the Tennessee wholly-owned subsidiary for the purpose of changing the Company's domicile and effecting reverse split) (Incorporated by reference to Exhibit 3.8 to the Form 10-SB) 3.3 Articles of Amendment to the Charter dated June 24, 1998 (Incorporated by reference to Exhibit 3.9 to the registrant's annual report on Form 10-KSB filed April 15, 1999 (the "1998 Form 10-KSB")) 3.4 Articles of Amendment to the Charter dated October 30, 1998 (Incorporated by reference to Exhibit 3.10 to the 1998 Form 10-KSB) 3.5 Articles of Amendment to the Charter filed March 17, 2000 (Incorporated by reference to Exhibit 3.11 to the registrant's annual report on Form 10-KSB filed April 14, 2000 (the "1999 Form 10-KSB")) 3.6 By-laws (Incorporated by reference to Exhibit 3.2 to the Form 10-SB) 4.1* Form of Rights Certificate 5.1* Opinion of Cary V. Sorensen, Esq. 10.1 Purchase Agreement with IRC (Incorporated by reference to Exhibit 10.1(a) to the Form 10-SB) 10.2 Amendment to Purchase Agreement with IRC (Incorporated by reference to Exhibit 10.1(b) to the Form 10-SB) 10.3 General Bill of Sale and Promissory Note (Incorporated by reference to Exhibit 10.1(c) to the Form 10-SB) 10.4 Compensation Agreement - M.E. Ratliff (Incorporated by reference to Exhibit 10.2(a) to the Form 10-SB) 10.5 Compensation Agreement - Jeffrey D. Jenson (Incorporated by reference to Exhibit 10.2(b) to the Form 10-SB) 10.6 Compensation Agreement - Leonard W. Burningham (Incorporated by reference to Exhibit 10.2(c) to the Form 10-SB) 10.7 Agreement with the Natural Gas Utility District of Hawkins County, Tennessee (Incorporated by reference to Exhibit 10.3 to the Form 10-SB) 10.8 Agreement with Powell Valley Electric Cooperative, Inc. (Incorporated by reference to Exhibit 10.4 to the Form 10-SB) 10.9 Agreement with Enserch Energy Services, Inc. (Incorporated by reference to Exhibit 10.5 to the Form 10-SB) 10.10 Amendment Agreement dated October 19, 1999 between Tengasco, Inc. and the Natural Gas Utility District of Hawkins County, Tennessee (Incorporated by reference to Exhibit 10.9 to the registrant's current report on Form 8-K filed October 25, 1999) 10.11 Natural Gas Sales Agreement dated November 18, 1999 between Tengasco, Inc. and Eastman Chemical Company (Incorporated by reference to Exhibit 10.10 to the registrant's current report on Form 8-K filed November 23, 1999) 10.12 Agreement between A.M. Partners LLC and Tengasco, Inc. dated October 6, 1999 (Incorporated by reference to Exhibit 10.11 to the registrant's 1999 Form 10-KSB) 10.13 Agreement between Southcoast Capital LLC and Tengasco, Inc. dated February 25, 2000 (Incorporated by reference to Exhibit 10.12 to the registrant's 1999 Form 10-KSB) 10.14 Franchise Agreement between Powell Valley Utility District and Tengasco, Inc. dated January 25, 2000 (Incorporated by reference to Exhibit 10.13 to the registrant's 1999 Form 10-KSB) 10.15

Amendment Agreement between Eastman Chemical Company and Tengasco, Inc. dated March 27, 2000 (Incorporated by reference to Exhibit 10.14 to the registrant's 1999 Form 10-KSB) 10.16 Loan Agreement between Tengasco Pipeline Corporation and Morita Properties, Inc. dated August 16, 2000 (Incorporated by reference to Exhibit 10.15 to the registrant's current report on Form 8-K dated August 22, 2000 (the "2000 8-K")) 10.17 Promissory note made by Tengasco Pipeline Corporation and Morita Properties, dated August 16, 2000 (Incorporated by reference to Exhibit 10.15(a) to the 2000 8-K) 10.18 Throughput Agreement between Tengasco Pipeline Corporation and Morita Properties, dated August 16, 2000 (Incorporated by reference to Exhibit 10.15(b) to the 2000 8-K) 10.19 Loan Agreement between Tengasco Pipeline Corporation and Edward W.T. Gray III dated August 16, 2000 (Incorporated by reference to Exhibit 10.16 to the 2000 8-K) 10.20 Promissory note made by Tengasco Pipeline Corporation and Edward W.T. Gray III dated August 16, 2000 (Incorporated by 10.20 reference to Exhibit 10.16(a) to the 2000 8-K) 10.21 Throughput Agreement between Tengasco Pipeline Corporation and Edward W.T. Gray III dated August 16, 2000 (Incorporated by reference to Exhibit 10.16(b) to the 2000 8-K) 10.22 Loan Agreement between Tengasco Pipeline Corporation and Malcolm E. Ratliff dated August 16, 2000 (Incorporated by 10.22 reference to Exhibit 10.17 to the 2000 8-K) 10.23 Promissory note made by Tengasco Pipeline Corporation and Malcolm E. Ratliff dated August 16, 2000 (Incorporated by reference to Exhibit 10.17(a) to the 2000 8-K) 10.24 Throughput Agreement between Tengasco Pipeline Corporation and Malcolm E. Ratliff dated August 16, 2000 (Incorporated by reference to Exhibit 10.17(b) to the 2000 8-K) 10.25 Loan Agreement between Tengasco Pipeline Corporation and Charles F. Smithers, Jr. dated August 16, 2000 (Incorporated by reference to Exhibit 10.18 to the 2000 8-K) 10.26 Promissory note made by Tengasco Pipeline Corporation and Charles F. Smithers, Jr. dated August 16, 2000 (Incorporated by reference to Exhibit 10.18(a) to the 2000 8-K) 10.27 Throughput Agreement between Tengasco Pipeline Corporation and Charles F. Smithers, Jr. dated August 16, 2000 (Incorporated by reference to Exhibit 10.18(b) to the 2000 8-K) 10.28 Loan Agreement between Tengasco Pipeline Corporation and Nick Nishiwaki dated August 16, 2000 (Incorporated by reference to Exhibit 10.19 to the 2000 8-K) 10.29 Promissory note made by Tengasco Pipeline Corporation and Nick Nishiwaki dated August 16, 2000 (Incorporated by reference to Exhibit 10.19(a) to the 2000 8-K) 10.30 Throughput Agreement between Tengasco Pipeline Corporation and Nick Nishiwaki dated August 16, 2000 (Incorporated by reference to Exhibit 10.19(b) to the 2000 8-K) 10.31 Memorandum Agreement between Tengasco, Inc. and the University of Tennessee dated February 13, 2001 (Incorporated by reference to Exhibit 10.19 to the registrant's annual report on Form 10-KSB filed April 10, 2001 (the "2000 Form 10-KSB")) 10.32 Natural Gas Sales Agreement between Tengasco, Inc. and BAE SYSTEMS Ordnance Systems Inc. dated March 30, 2001 (Incorporated by reference to Exhibit 10.20 to the 2000 Form 10-KSB) 10.33 Reducing and Revolving Line of Credit Up to $35,000,000 from Bank One, N.A. to Tengasco, Inc. Tennessee Land & Mineral Corporation and Tengasco Pipeline Corporation dated November 8, 2001 (Incorporated by reference to Exhibit 10.21 to the registrant's quarterly report on Form 10-Q filed November 14, 2001) 10.34 Tengasco, Inc. Incentive Stock Plan (Incorporated by reference to Exhibit 4.1 to the registrant's registration statement on Form S-8 filed October 26, 2000) 10.35** Promissory Note made by Tengasco, Inc. and Tengasco Pipeline Corporation to Dolphin Offshore Partners, LP dated October 7, 2002 in the principal amount of $500,000 10.36** Promissory Note made by Tengasco, Inc. and Tengasco Pipeline Corporation to Dolphin Offshore Partners, LP dated December 4, 2002 in the principal amount of $250,000 10.37** Promissory Note made by Tengasco, Inc. and Tengasco Pipeline Corporation to Dolphin Offshore Partners, LP dated February 3, 2003 in the principal amount of $250,000 10.38** Promissory Note made by Tengasco, Inc. and Tengasco Pipeline Corporation to Dolphin Offshore Partners, LP dated February 28, 2003 in the principal amount of $250,000 10.39** Promissory Note made by Tengasco, Inc. and Tengasco Pipeline Corporation to Dolphin Offshore Partners, LP dated May 20, 2003 in the principal amount of $750,000 10.40** Promissory Note made by Tengasco, Inc. and Tengasco Pipeline Corporation to Dolphin Offshore Partners, LP dated August 6, 2003 in the principal amount of $150,000 10.41** Promissory Note made by Tengasco, Inc. and Tengasco Pipeline Corporation to Jeffrey R. Bailey dated May 20, 2003 in the principal amount of $84,000 10.42 Promissory Note made by Tengasco, Inc. and Tengasco Pipeline Corporation to Dolphin Offshore Partners, LP dated December 3, 2003 in the principal amount of $225,000 (Incorporated by reference to Exhibit 10.42 to the registrant's current report on Form 8-K dated December 3, 2003 (the "2003 Form 8-K") 10.43 Promissory Note made by Tengasco, Inc. and Tengasco Pipeline Corporation to Dolphin Offshore Partners, LP dated December 9, 2003 in the principal amount of $250,000 (Incorporated by reference to Exhibit 10.43 to the 2003 Form 8-K) 10.44 Continuing Security Agreement dated December 3, 2003 by the Company and Tengasco Pipeline Corporation as Obligors and Dolphin Offshore Partners, LP as Secured Party

(Incorporated by reference to Exhibit 10.44 to the 2003 Form 8-K) 21 List of subsidiaries (Incorporated by reference to Exhibit 21 to the registrant's annual report on Form 10-KSB filed March 31, 2003 (the "2002 Form 10-KSB")) 23.1* Consent of Cary V. Sorensen, Esq. (contained in Exhibit 5.1 hereto) 23.2* Consent of BDO Seidman 23.3* Consent of Ryder Scott Company, L.P. 24.1** Power of Attorney 99.1 Ryder Scott Company, L.P. Report dated March 28, 2002 (Incorporated by reference to Exhibit 99.15 to the registrant's annual report on Form 10-KSB filed April 10, 2002) 99.2 Ryder Scott Company, L.P. Report dated February 10, 2003 (Incorporated by reference to Exhibit 99.17 to the 2002 Form 10-KSB) 99.3* Form of Instructions for Use of Rights Certificates 99.4* Form of Letter to be Sent by Company to Holders of Records of the Rights 99.5* Form of Letter to be Sent to Beneficial Owners -------------- * Filed herewith ** Previously filed