FELLOWS ENERGY LTD
Form 10QSB
August 21, 2007

United States
Securities And Exchange Commission

Washington, D.C. 20549

Form 10-QSB

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

FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2007

Commission File Number: 000-33321

Fellows Energy Ltd.
(Exact Name of Small Business Issuer as Specified in its Charter)

Nevada	**33-0967648**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

1942 Broadway St., Suite #320
Boulder, CO 80302

(Address of Principal Executive Offices)

(303) 926-4415
(Registrant's Telephone Number, Including Area Code)

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

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

¨ Yes x No

State the number of shares outstanding of each of the issuer's classes of common equity, as of the latest practicable date: As of August 17, 2007 there were 100,000,000 shares of the issuer’s $.001 par value common stock issued and outstanding.

Transitional Small Business Disclosure Format: ¨ Yes x No

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FELLOWS ENERGY LTD.

Quarterly Report on Form 10-QSB for the
Quarterly Period Ending June 30, 2007

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Part I: Financial Information

Item 1. Financial Statements

Fellows Energy Ltd.
Balance Sheets

	June 30, 2007 (Unaudited)	December 31, 2006
Assets		
Cash and Cash Equivalents	$ 35,494	$ 179,926
Interest Receivable	4,499	2,568
Accounts Receivable	42,907	80,258
Note Receivable	233,633	233,634
Prepaids	—	—
Total current assets	316,533	496,386
Proved and unproved oil & gas property	5,407,398	7,468,809
Equipment, net of $196,686 and $118,651 accumulated depreciation respectively	1,419,119	1,509,932
Deposits	28,000	
Restricted cash	160,000	160,000
Deferred financing costs	598,177	228,758
Total assets	$ 7,929,227	$ 9,863,885
Liabilities And Stockholders' Equity		
Accounts payable	$ 442,730	$ 359,662
Joint venture partner interest payable	116,347	99,167
Taxes payable	10,103	9,433
Interest payable current portion	245,700	205,700
Notes payable current portion	1,342,163	1,583,111
Convertible debenture current portion	3,313,174	1,608,433
Total current liabilities	5,470,217	3,865,506
Interest payable – net of current portion	106,250	154,819
Notes payable – related party	2,495,547	1,733,000
Notes payable – net of current portion	311,622	428,000
Convertible debenture – net of current portion	—	1,385,505
Stockholders' equity		
Preferred stock, $.001 par value; 25,000,000 shares authorized; none outstanding	—	—
Common stock, $.001 par value; 100,000,000 shares authorized; 100,000,000 and 73,447,619 shares issued and outstanding	100,000	73,447
Additional paid-in capital	22,200,000	19,963,497
Stock issuance obligation	154,830	61,055
Stock pledged as collateral	(1,665,000)	(1,665,000)
Accumulated deficit	(21,244,237)	(16,135,944)

Total stockholders’ equity		(454,408)		2,297,055
Total liabilities and stockholders’ equity	$	7,929,227	$	9,863,885

See accompanying notes to unaudited financial statements

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Fellows Energy Ltd.
Statements of Operations
(Unaudited)

	Three Months Ended June 30, 2007	Three Months Ended June 30, 2006	Six Months Ended June 30, 2007	Six Months Ended June 30, 2006
Revenue	$ —	$ 282,926	$ —	$ 343,841
Operating expense				
Exploration and production	—	348,124	—	564,196
General and administrative	219,565	1,302,310	1,780,204	1,994,445
Relinquishment of Property	2,075,368	—	2,075,368	—
Operating (loss)	(2,294,933)	(1,367,508)	(3,585,572)	(2,214,800)
Other income (expense)				
Interest expense	(114,383)	(59,758)	(777,378)	(76,757)
Project revenue applied as credit to purchase	—	—	—	198,361
Note receivable default penalty	—	—	—	80,000
Re-sale of pipe	—	34,644	—	34,644
Insurance rebates and project purchase credit	—	—	—	19,993
Miscellaneous income (expense)	3,739	365	16,430	365
Total other income (expense)	(110,645)	(24,749)	(760,948)	256,606)
Income (loss) from continuing operations before income tax	(2,422,189)	(1,392,257)	(4,616,520)	(1,958,194)
Income tax expense	—	—	—	—
Deferred tax benefit	—	—	—	—
Income (loss) from continuing operations	$ (2,405,578)	$ (1,392,257)	$ (4,616,520)	$ (1,958,194)
Revenue from discontinued operations	—	—	108,344	—
Expenses from discontinued operations	16,612	—	111,159	—
Income (loss) from discontinued operations	(16,612)	—	(2,815)	—
Other comprehensive income (loss)				
Unrealized holding gains on marketable securities	—	(9,641)	—	4,483
Comprehensive Income (loss)	$ (2,422,189)	$ (1,401,898)	$ (4,619,335)	$ (1,953,711)
Basic and diluted earnings (loss) per share	$ (0.03)	$ (0.02)	$ (0.07)	$ (0.03)
Basic and diluted weighted average shares outstanding	100,000,000	59,930,245	93,746,765	57,591,674

See accompanying notes to unaudited financial statements

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Fellows Energy Ltd.
Statements of Cash Flows
(Unaudited)

	Six Months Ended June 30, 2007	Six Months Ended June 30, 2006
Cash flow from operating activities:		
Net income (loss)	$ (4,619,335)	$ (1,958,194)
Adjustments to reconcile net income to net cash used in operating activities:		
Loss on sale of marketable securities	—	50,530
Debt issue costs and discount amortization	—	870,231
Depreciation	78,035	27,541
Expenses paid with stock issuance	1,581,710	—
Expenses paid with stock issuance obligation	93,774	—
Changes in operating assets and liabilities:		
Receivables	(27,356)	(320,484)
Prepaid expense	(8,065)	(213)
Deferred financing costs	—	152,506
Accounts payable	17,851	83,126
Interest payable	40,000	165,700
Joint venture partner interest payable	(83,068)	123,584
Net cash provided by (used in) operating activities	(2,760,317)	(805,673)
Cash flow from investing activities:		
Proceeds from sale of marketable securities	—	355,026
Deposits	(28,000)	554,000
Unproved oil and gas property additions	(8,675)	(686,000)
Unproved oil and gas property relinquishment	2,075,368	—
Restricted Cash	—	(25,000)
Purchase of equipment	7,496	(1,207,485)
Net cash provided by (used in) investing activities	2,046,190	(1,009,459)
Cash flow from financing activities:		
Proceeds from issuance of convertible debenture	714,500	—
Payments on convertible debenture	(50,183)	(501,453)
Borrowings on note payable	240,948	2,700,000
Payments on notes payable	(335,570)	(290,639)
Net cash provided by (used in) financing activities:	569,695	1,907,908
Net increase (decrease) in cash and equivalents	(144,432)	92,776
Cash and equivalents at beginning of period	179,926	347,558
Cash and equivalents at end of period	$ 35,494	$ 440,334
Supplemental Disclosure of Cash Flow and Non-cash Investing and Financing Activity:		
Income tax paid	$ —	$ —
Interest paid	$ 72,533	$ —
Non cash:		
Convertible debenture paid with stock issuance	$ 31,250	$ 1,696,424

Legal and advisory services in exchange for stock issuance obligation	$ 61,055	$ 159,493
Fees paid with stock	$ 1,581,710	$ —

See accompanying notes to unaudited financial statements

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Fellows Energy Ltd.
Notes to Unaudited Financial Statements
June 30, 2007

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Note 1—Basis of Presentation and Nature of Operations

We have prepared the accompanying unaudited condensed financial statements in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-QSB and itme 310(b) of Regulation S-B. They do not include all information and notes required by generally accepted accounting principles for complete financial statements. You should read these financial statements with our Annual Report on Form 10-KSB for the year ended December 31, 2006, as well as the 10-QSB for the quarters ended March 31, 2007 and September 30, 2006. In our opinion, we have included all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation. Operating results for the quarters presented are not necessarily indicative of the results that you may expect for the full year.

We are engaged in the exploration, extraction, processing and reclamation of coal bed methane, natural gas, and oil projects in the western United States. We were incorporated in the state of Nevada on April 9, 2001 as Fuel Centers, Inc. On November 12, 2003, we changed our name to Fellows Energy Ltd. Our principal offices are located in Broomfield, Colorado.

Use of Estimates

The preparation of the financial statements in conformity with generally accepted accounting principles in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those statements.

Accumulated Other Comprehensive Income (Loss)

Accumulated other comprehensive income reflects changes in equity that result from transactions and economic events from non-operating sources. For the Company, such items consisted of unrealized holding gains and losses on market securities for the current period.

Earnings (Loss) per share

We compute basic and diluted earnings (loss) per share as net income or loss divided by the weighted average number of shares of common stock outstanding for the period. Diluted earnings per share is similar to basic earnings per share but also presents the dilutive effect on a per share basis of securities convertible into common shares (e.g. stock options, warrants and other convertible securities) as if they had been converted at the beginning of the periods presented. In periods in which we incur losses we exclude potential shares from convertible securities from the computation of diluted loss per share as their effect is antidilutive in those periods.

Stock Options

On October 9, 2003, we adopted an incentive stock option plan, pursuant to which shares of our common stock are reserved for issuance to satisfy the exercise of options. The plan authorizes up to 2,000,000 shares of authorized common stock to be purchased pursuant to the exercise of options. Our stockholders approved the plan on November 10, 2003. On September 15, 2004, we granted an option for 200,000 shares to our CEO, 150,000 shares to our vice president and 125,000 shares to an employee. These options are exercisable at $0.80 per share, the price of our stock on the grant date. The options vested 50% on the grant date and vest 50% on September 15, 2005. On October 3, 2005, we granted an option for 100,000 shares to our CEO, 150,000 to our Vice President and 175,000 and 200,000 shares to two employees respectively. On November 1, 2006, we granted an option for 300,000 shares to our Vice President of Business Development.

In December 2004, the Financial Accounting Standards Board (“FASB”) issued SFAS No. 123(R), “Share-Based Payment” (“SFAS 123(R)”), which is a revision of SFAS No. 123, Accounting for Stock-Based Compensation. SFAS 123(R) is effective for public companies for the first fiscal year beginning after June 15, 2005, supersedes Accounting Principles Board Opinion No. 25 (“APB 25”), Accounting for Stock Issued to Employees, and amends SFAS 95, Statement of Cash Flows. SFAS 123(R) eliminates the option to use APB 25’s intrinsic value method of accounting and requires recording expense for stock compensation based on a fair value based method.

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On July 1, 2005, the Company adopted the "modified prospective method" which requires the Company to recognize compensation costs, for all share-based payments granted, modified or settled, in financial statements issued subsequent to July 1, 2005, as well as for any awards that were granted prior to the adoption date for which the required service has not yet been performed. The adoption of SFAS 123(R) did not have a material effect on the Company's financial condition or results of operations because subsequent to July 1, 2005, the Company did not enter into any share-based transactions.

Prior to July 1, 2005, the Company accounted for its stock-based compensation using APB 25 and related interpretations. Under APB 25, compensation expense was recognized for stock options with an exercise price that was less than the market price on the grant date of the option. For stock options with exercise prices at or above the market value of the stock on the grant date, the Company adopted the disclosure-only provisions of Statement of Financial Accounting Standards No. 123 "Accounting for Stock-Based Compensation" ("SFAS 123") for the stock options granted to the employees and directors of the Company. Accordingly, no compensation cost was recognized for these options prior to June 30, 2005.

Compensation expense has been recognized in the accompanying financial statements for stock options that were issued to our outside consultants. Had compensation expense for the options granted to our employees and directors been determined based on the fair value at the grant date for options, consistent with the provisions of SFAS 123, the Company's net (loss) income and net (loss) income per share for the six months ended June 30, 2007 and 2006 would have been the pro forma amounts indicated below.

We estimate the fair value of the options we grant at the date of grant using a Black-Scholes option pricing model with the following weighted-average assumptions for the quarter ended June 30, 2007: a risk-free interest rate of 4.37%; no expected dividend; a volatility factor of 97.5%; and a maturity date of ten years.

For purposes of pro forma disclosures, we amortize to expense the estimated fair value of the options over the options' vesting period. Our pro forma information for the second quarter of 2007 is as follows (in thousands, except per share amounts).

	Six Months Ended June 30, 2007	Six Months Ended June 30, 2006
Net loss as reported	$ (4,619,335)	$ (1,958,829)
Deduct: Total stock based employee compensation expense determined under fair value based method for all awards	(20,154)	(13,955)
Pro forma net loss	$ (4,639,489)	$ (1,972,784)
Basic and diluted loss per share—as reported	$ (0.00)	$ 0.00
Pro forma basic and diluted loss per share	$ (0.00)	$ nil-

The Black-Scholes option-pricing model was developed for use in estimating the fair value of traded options that have no vesting restrictions, are fully transferable, and are not subject to trading restrictions or blackout periods. In addition, option valuation models require the input of highly subjective assumptions, including the expected stock price volatility. Because our employee stock options have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, it is our opinion that the existing models do not necessarily provide a reliable single measure of the fair value of our employee stock options.

Reclassifications

We have made certain reclassifications to the 2006 financial statements to conform with the 2007 financial statement presentation.

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Note 2 – Asset Retirement Obligation

The Company follows Statement of Financial Accounting Standards ("SFAS") No. 143, *"Accounting for Asset Retirement Obligations"*, which requires that the fair value of a liability for an asset retirement obligation be recognized in the period in which it is incurred if a reasonable estimate of fair value can be made. The associated asset retirement costs are capitalized as part of the carrying amount of the long-lived asset. The increase in carrying value of a property associated with the capitalization of an asset retirement cost is included in proved oil and gas properties in the consolidated balance sheets.

The Company depletes the amount added to proved oil and gas property costs. The future cash outflows for oil and gas properties associated with settling the asset retirement obligations that have been accrued in the accompanying balance sheets are excluded from the ceiling test calculations. The Company's asset retirement obligation consists of costs related to the plugging of wells and removal of facilities and equipment on its oil and gas properties. The asset retirement liability is allocated to operating expenses using a systematic and rational method. At June 30, 2007, the asset retirement obligation and accretion expense were not considered to be material.

Note 3—Going Concern

As shown in the accompanying financial statements, we have incurred significant operating losses since inception and previously incurred a loss on our discontinued automotive fuel business. As of June 30, 2007, we have limited financial resources until such time that we are able to generate positive cash flow from operations. These factors raise substantial doubt about our ability to continue as a going concern. Our ability to achieve and maintain profitability and positive cash flow is dependent upon our ability to locate profitable mineral properties, generate revenue from our planned business operations, and control exploration cost. Management plans to fund its future operation by joint venturing, obtaining additional financing, and attaining additional commercial production. However, there is no assurance that we will be able to obtain additional financing from investors or private lenders, or that additional commercial production can be attained. Although management believes that production from the Carbon County and Creston projects will generate revenues sufficient to sustain the Company, no assurance can be given that such revenues will be generated from the projects.

Note 4—Deposits

In March of 2006, we acquired the interests in one producing property and maintained our interest in three other exploration oil and gas properties. The project we acquired is known as the Carbon County project. As of June 30, 2007, we have $28,000 held on deposit for properties.

Note 5—Notes Receivable

In August and September 2005 as part of our earn-in arrangement, we agreed to advance Mountain Oil and Gas a total of $66,000 for purposes of working capital in exchange for oilfield and rig services. Originally this balance was classified as a deposit, and has since been reclassified as a note receivable. As indicated in the agreement, in the event that sufficient services were not performed, the amount was to be treated as a loan, and would take on a 12% interest payable beginning February of 2006. The amount is secured with field equipment including a pumping unit, engine, treater, and rods. We are in the process of negotiating repayment, and consider the amount fully collectible.

In October 2005, we entered into an agreement to obtain up to a 75% working interest in certain well bores owned by Mountain Oil and Gas. In connection with this, we agreed to advance Mountain Oil and Gas a total of $100,000 for the purpose of well bonding and working capital. This was due and payable back to the Company on December 30, 2005 either in cash or labor towards the workover of the well bore. In the event that we were not paid by December

30, 2005, we are entitled to $160,000 of the net revenues from the 1-16A1E well beginning January 1, 2006. Repayment is secured by a pumping unit located on the Dye-Hall well for the value of the working capital and well bonding. As of June 30, 2007, we have collected $20,000 on the note, and are negotiating payment or collection of security for the remaining portion. We consider the remaining portion as fully collectible.

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Note 6—Notes Payable

At June 30, 2007, we owed $2,343,000 on an unsecured 8% demand note payable to an entity controlled by our CEO.

In 2006, we obtained $1.25 million in industry partner financing to carry the Creston project forward, in exchange for 1.6 million shares of restricted common stock and warrants to purchase 1.8 million shares at $0.70 per share. The repayment of the $1.25 million in financing is secured with 1.6 million shares of restricted stock held in escrow and is personally guaranteed by George S. Young, our CEO, and by his private company, Diamond Oil and Gas Corporation.

In March 2006, we borrowed $750,000 on a secured 12% note payable for a period of 36 months in exchange for a 5% overriding royalty interest in Carbon County, as well as the right to participate in any future exploration activities on the project on the basis of a 10% working interest. As of June 30, 2007, we have paid $226,000 towards the principal and interest.

In May 2006, we borrowed $500,000 at 12% interest in exchange for a 2% overriding royalty interest in Carbon County as well as 50,000 shares of common stock. As of June 30, 2006, we have paid $170,000 towards the principal and interest.

Note 7—Related Party Transactions

At June 30, 2007 we owed $2,343,000 on an unsecured, 8% demand note payable to an entity controlled by our CEO.

In 2006, we obtained $1.25 million in industry partner financing to carry the Creston project forward, in exchange for 1.6 million shares of restricted common stock and warrants to purchase 1.8 million shares at $0.70 per share. The repayment of the $1.25 million in financing is secured with 1.6 million shares of restricted stock held in escrow and is personally guaranteed by George S. Young, our CEO, and by his private company, Diamond Oil and Gas Corporation.

Note 8—Common Stock

We issued 11,189,947 shares of common stock in the first quarter of 2007, for the debt service of our convertible debentures. The first quarter redemption share payments amounted to 1,075,343 shares, 118,057 shares, and 9,996,547 shares at an average price of $0.06 per share.

In addition to the redemption issuances above, we issued 5,454,546 at $0.1375, 1,449,825 at $0.09, and 6,458,063 at $0.09 in connection with the convertible debenture restructuring.

In January 2007, we issued 2,000,000 shares at $0.06 to our legal counsel as payment for services relating to the debenture restructuring as well as outstanding legal fees.

We issued no stock during the second quarter of 2007, as all authorized stock is issued and outstanding.

Note 9 —Convertible Debentures Restructuring

On February 15, 2007, we entered into a series of transactions to restructure securities issued pursuant to securities purchase agreements dated June 17, 2005 and September 21, 2005.

Background

June 2005 Financing

On June 17, 2005, we closed a financing pursuant to a securities purchase agreement with three accredited investors, Palisades Master Fund, L.P. ("Palisades"), Crescent International Ltd. ("Crescent") and JGB Capital L.P. ("JGB") for the issuance of $5,501,200 in face amount of debentures maturing September 16, 2008 (the "June Debentures"). The June Debentures were unsecured and we were obligated to pay 1/24th of the face amount of the debenture on the first of every month, starting October 1, 2005, which payment could be made in cash or in shares of our common stock. We could pay this amortization payment in cash or in stock at the lower of $0.60 per share or 80% of the volume weighted average price of our stock for the five trading days prior to the repayment date. In the event that we made the payment in cash, we paid 110% of the monthly redemption amount.

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In addition, we issued warrants to the investors, expiring June 17, 2008, to purchase 4,584,334 shares of restricted common stock, exercisable at a per share of $0.649 (the "June Warrants"). In addition, the exercise price of the June Warrants would be adjusted in the event we issued common stock at a price below the exercise price, with the exception of any securities issued pursuant to a stock or option plan adopted by our board of directors, issued in connection with the debentures issued pursuant to the securities purchase agreement, or securities issued in connection with acquisitions or strategic transactions.

If in any period of 20 consecutive trading days our stock price exceeds 250% of the June Warrants' exercise price, all of the June Warrants shall expire on the 30th trading day after we send a call notice to the June Warrant holders. If at any time after one year from the date of issuance of the June Warrants there is not an effective registration statement registering, or no current prospectus available for, the resale of the shares underlying the June Warrants, then the holder may exercise the June Warrant at such time by means of a cashless exercise.

September 2005 Financing

On September 21, 2005, we closed a financing pursuant to a securities purchase agreement with two accredited investors, Palisades and Crescent for the issuance of $3,108,000 in face amount of debentures maturing December 20, 2008 (the "September Debentures" and together with the June Debentures, the "Old Debentures"). The September

Debentures were unsecured and we were obligated to pay 1/24th of the face amount of the debenture on the first of every month, starting January 1, 2006, which payment could be made in cash or in shares of our common stock. We could pay this amortization payment in cash or in stock at the lower of $0.75 per share or 80% of the volume weighted average price of our stock for the five trading days prior to the repayment date. In the event that we made the payment in cash, we paid 110% of the monthly redemption amount.

In addition, we issued warrants to the investors, expiring September 21, 2008, to purchase 2,172,000 shares of restricted common stock, exercisable at a per share of $0.80 (the "September Warrants" and together with the June Warrants, the "Old Warrants"). In addition, the exercise price of the September Warrants would be adjusted in the event we issued common stock at a price below the exercise price, with the exception of any securities issued pursuant to a stock or option plan adopted by our board of directors, issued in connection with the debentures issued pursuant to the securities purchase agreement, or securities issued in connection with acquisitions or strategic transactions.

If in any period of 20 consecutive trading days our stock price exceeds 250% of the September Warrants' exercise price, all of the September Warrants shall expire on the 30th trading day after we send a call notice to the September Warrant holders. If at any time after one year from the date of issuance of the September Warrants there is not an effective registration statement registering, or no current prospectus available for, the resale of the shares underlying the September Warrants, then the holder may exercise the September Warrant at such time by means of a cashless exercise.

Restructuring

On February 15, 2007, the following transactions took place with regards to the Old Debentures and Old Warrants:

1) JGB entered into an assignment agreement with Crescent, pursuant to which Crescent purchased from JGB the June Debentures issued to JGB. The face value of the June Debentures issued to JGB at the time of the transaction was $333,333 and Crescent paid $250,000 to JGB for the assignment;
2) We entered into a settlement agreement with JGB for the sum of $83,333. We amended the terms of the Old Warrants held by JGB to remove the ratchet and call provisions and JGB agreed to release any shares reserved for issuance of the Old Warrants and to not exercise such Old Warrants until we obtain an increase in the authorized

shares of common stock. Upon obtaining the increase in authorized shares, we agreed to issue JGB 500,000 shares of restricted common stock;

3) We entered into a first amendment and waiver agreement with Palisades for the amendment of the Old Debentures issued to Palisades (the “Palisades Amendment Agreement”); and

4) We entered into a first amendment and waiver agreement with Crescent for the amendment of the Old Debentures issued to JGB (and purchased by Crescent) and Crescent (the “Crescent Amendment Agreement” and together with the Palisades Amendment Agreement, the “Restructuring Amendments”).

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Palisades and Crescent agreed to amend the Old Debentures to remove the mandatory monthly liquidation provision and to amend the fixed conversion price of the Old Debentures to $0.1375 (the "Fixed Conversion Price"). As a result, the principal amount remaining on the Old Debentures is now due and payable at maturity, unless sooner converted into shares of common stock by the investors, at the Fixed Conversion Price. Palisades and Crescent further agreed to waive any and all existing defaults under the Old Debentures.

Pursuant to the Palisades Amendment Agreement, we agreed to issue 7,025,789 shares of common stock (the "Monthly Redemption Shares") to Palisades upon conversion of $608,433 in principal amount of the Old Debentures. Such Monthly Redemption Shares were issued as payment for monthly redemptions owed to Palisades on December 1, 2006 and January 1, 2007 and February 1, 2007 pursuant to the Old Debentures. These Monthly Redemption Shares were not issued while we negotiated the terms of a potential buy-out or restructuring of the Old Debentures. The Monthly Redemption Shares were previously registered for resale pursuant to resale registration statements filed with the Securities and Exchange Commission and represent the remaining shares of common stock registered thereunder for Palisades pursuant to the Old Debentures. As a result of the Monthly Redemption Shares, the exercise price of the Old Warrants was reduced to $0.0866, which Palisades exercised on a cashless basis and received 2,970,758 shares of common stock which were previously registered for resale pursuant to resale registration statements filed with the Securities and Exchange Commission.

We agreed to pay Palisades a forbearance fee of $150,000 a month, for six months, which fee was paid in shares of common stock at an issuance price of $0.1375, for a total issuance of 5,454,546 shares of restricted common stock. In addition, we agreed to issue Palisades 1,449,825 shares of common stock as a commitment fee for the restructuring of the Old Debentures.

In connection with the restructuring, we executed a security agreement (the "Security Agreement") in favor of Palisades and JGB granting them a first priority security interest in all of our goods, inventory, contractual rights and general intangibles, receivables, documents, instruments, chattel paper, and intellectual property, except for our Carbon County prospect, which Palisades and JGB took a second priority interest and for our Carter Creek and Weston County prospects, which the investors were not granted any security interest. The Security Agreements state that if an event of default occurs under the Old Debentures or Security Agreement, the Investors have the right to take possession of the collateral, to operate our business using the collateral, and have the right to assign, sell, lease or otherwise dispose of and deliver all or any part of the collateral, at public or private sale or otherwise to satisfy our obligations under these agreements.

On February 15, 2007, we closed a financing pursuant to a securities purchase agreement with Palisades for the issuance of a $714,500 face amount debenture maturing September 15, 2007 (the "New Debenture"). The New Debenture does not accrue interest and the investors paid $500,000 for the New Debenture. We paid a commission of $100,000 to HPC Capital Management (a registered broker-dealer) in connection with the transaction, resulting in net proceeds to us of $400,000 before our legal fees. We used the net proceeds to pay our settlement agreement payment to JGB, repayment of a bridge loan to Petro Capital Securities, LLC and the remainder for general working capital purposes. We also issued HPC Capital Management 6,458,063 shares of restricted common stock and agreed to issue an additional 1,041,937 shares of restricted common stock upon obtaining an increase in our authorized shares of common stock, which shares are additional compensation for its services in connection with the transaction with the investors.

The convertible debentures are secured and are convertible into our common stock, at Palisades option, at a fixed conversion price of $0.1375. Based on this conversion price, the $714,500 secured convertible debenture is convertible into 5,196,364 shares of our common stock.

In the event of default, the investors may require payment, which shall be the greater of: (A) 130% of the principal amount of the face amount of the debenture to be prepaid, or (B) the principal amount of the debenture to be prepaid, divided by the conversion price on (x) the date the default amount is demanded or otherwise due or (y) the date the default amount is paid in full, whichever is less, multiplied by the closing price on (x) the date the default amount is demanded or otherwise due or (y) the date the default amount is paid in full, whichever is greater

The conversion price of the debenture may be adjusted in certain circumstances such as if we pay a stock dividend, subdivide or combine outstanding shares of common stock into a greater or lesser number of shares, or take such other actions as would otherwise result in dilution of the investor's position.

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The Company has agreed to file a registration statement with the Securities and Exchange Commission to cover the future sale by the investors of the shares issuable upon conversion of the Old and New Debentures. If the registration statement is not filed by the filing deadline or if the registration statement is not declared effective by the effective deadline, we are required to pay liquidated damages to the investors.

In connection with the sale of the interests in the Carbon County project, the Company negotiated, subject to final documentation and applicable approvals, to redeem the outstanding convertible debentures held by Palisades Master Fund, L.P. ("Palisades") and Crescent International Ltd. ("Crescent") (including those formerly held by JGB Capital L.P.). With the funds received from the sale of the Carbon County Project, Fellows redeemed a portion of the outstanding debentures, and will redeem, at a discount to face value, the remaining outstanding debentures issued to Palisades and Crescent by December 2007. Fellows plans to obtain the financing to make such payments from joint venture financings currently being negotiated on a portion of its other projects. See Note 11 – "Subsequent Events."

Note 10—Proved and Unproved Oil and Gas Property

Carbon County Project, Utah

On September 12, 2005, we entered into an option agreement to purchase a gas field in Carbon County, Utah which was producing approximately 30 million cubic feet of natural gas per month. The field comprises 5,953 gross acres (2,440 net acres) with three gas wells currently producing and has an additional five wells drilled that are presently shut-in. Production is derived from the Ferron Sandstone formation, and the gas is marketed into the adjacent gas pipeline operated by Questar Gas Resources. The acquisition included an associated gas gathering system and a 6 mile pipeline and compression facility servicing the project and adjacent production. The field has potential for 20 additional well sites on 160 acre spacing on the undeveloped acreage. The property is adjacent to our Gordon Creek project and to the very successful Drunkards Wash field originally developed by River Gas Corp.

The purchase option called for an acquisition price of $3 million, and we closed the purchase of the acquisition on March 13, 2006 with an industry partner, Thunderbird Energy Corporation ("TBD") formerly MBA Resource Corp. of Canada. TBD paid $1.5 million and arranged third party financing of $750,000 toward the $3 million purchase price in exchange for a 50% interest in the project. We previously paid a deposit toward the purchase price and received production credits since October 1, 2005. We thus acquired a 50% interest in the project with only an additional payment of $241,000. Together with TBD we formed Gordon Creek, LLC, a joint operating company incorporated in the state of Utah to carry out gas production and drilling operations as well as gas gathering activities for both project gas and adjacent third party production.

Subsequently on August 6, 2007, Fellows Energy Ltd. (the "Company") entered into a purchase and sale agreement (the "Agreement") with Thunderbird Energy Inc. ("Thunderbird"), pursuant to which the Company sold its interests in the Carbon County project ("Carbon County") to its joint venture partner, Thunderbird. Thunderbird paid $1.65 million in cash directly to Fellows debenture holders, approximately $12,800 to Thames River, LLC for services rendered to the Company and approximately $237,000 to the Company. Thunderbird also assumed $1.1 million in liabilities from the Company. See Note 11 - "Subsequent Events" for more discussion.

Creston Project, Uintah Basin, Utah

On October 25, 2005, we announced that we had entered into a participation agreement with Mountain Oil and Gas, Inc., Creston Resources Ltd, and Homeland Gas and Oil Ltd. (collectively "Creston"), and are completing arrangements with private investors, whereby we are to supply operating expertise and program supervision to earn working interests in up to 45 producing oil wells in the Uintah Basin of Utah. We have since commenced a rework program to re-complete previously-completed zones and extend behind pipe reserves in the wells, located primarily in the

Altamont-Bluebell Field. Creston will retain the current or historical production while we and the private investors will earn a variable percentage of the production increase resulting from the reworking operations. Work has commenced on two of the first four, and we plan on maintaining continuous operations until all wells have been brought to full potential.

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Under the participation agreement, we are to begin reworking wells as necessary to revitalize production across the 9,000 acres that pertain to the wells. Due to the over-pressured, fractured nature of reservoir in the field, as well as the large vertical extent of potential pay zones, many of the wells have formation damage resulting from high drilling mud weights and cementing operations. These conditions have left many zones unable to produce to their potential. We will employ a variety of conventional and innovative proprietary techniques to reduce the effects of formation damage and attempt to increase oil and gas recovery.

During the first quarter of 2006, we completed the workover on the first well which commenced production at a daily rate of 100 BOE. We are now evaluating the next wells to be re-completed. In addition, we received joint venture financing arrangements with private investors to provide for $1.25 million in funds to conduct the reworking program. The Company is now evaluating the results of the program to date prior to performing any additional work on the Creston wells. The Company is also considering working with other owners or operating companies in the area and may discont