

## Form 10QSB for NEW CENTURY ENERGY CORP.

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22-Aug-2005

### Quarterly Report

#### ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION

THE FOLLOWING MANAGEMENT'S DISCUSSION AND ANALYSIS OF OPERATIONS CONTAINS FORWARD LOOKING STATEMENTS WHICH INVOLVE RISKS AND UNCERTAINTIES WITHIN THE MEANING OF SECTION 27A OF THE SECURITIES ACT OF 1933, AS AMENDED AND SECTION 21E OF THE SECURITIES EXCHANGE ACT OF 1934, AS AMENDED. ALL STATEMENTS OTHER THAN STATEMENTS OF HISTORICAL FACT INCLUDED IN THIS SECTION REGARDING OUR FINANCIAL POSITION AND LIQUIDITY, STRATEGIC ALTERNATIVES, FUTURE CAPITAL NEEDS, BUSINESS STRATEGIES AND OTHER PLANS AND OBJECTIVES OF OUR MANAGEMENT FOR FUTURE OPERATIONS AND ACTIVITIES, ARE FORWARD LOOKING STATEMENTS. THESE STATEMENTS ARE BASED ON CERTAIN ASSUMPTIONS AND ANALYSES MADE BY OUR MANAGEMENT IN LIGHT OF ITS EXPERIENCE AND ITS PERCEPTION OF HISTORICAL TRENDS, CURRENT CONDITIONS, EXPECTED FUTURE DEVELOPMENTS AND OTHER FACTORS IT BELIEVES ARE APPROPRIATE UNDER THE CIRCUMSTANCES. SUCH FORWARD LOOKING STATEMENTS ARE SUBJECT TO UNCERTAINTIES THAT COULD CAUSE OUR ACTUAL RESULTS TO DIFFER MATERIALLY FROM SUCH STATEMENTS. SUCH UNCERTAINTIES INCLUDE BUT ARE NOT LIMITED TO: THE VOLATILITY OF THE OIL AND GAS INDUSTRY; CHANGES IN COMPETITIVE FACTORS AFFECTING OUR OPERATIONS; RISKS ASSOCIATED WITH THE ACQUISITION OF MATURE OIL AND GAS PROPERTIES, INCLUDING ESTIMATES OF RECOVERABLE RESERVES, FUTURE OIL AND GAS PRICES AND POTENTIAL ENVIRONMENTAL AND PLUGGING AND ABANDONMENT LIABILITIES; OUR DEPENDENCE ON KEY PERSONNEL AND CERTAIN CUSTOMERS; RISKS OF OUR GROWTH STRATEGY, INCLUDING THE

INHERENT RISK IN ACQUIRING MATURE OIL AND GAS PROPERTIES; OPERATING HAZARDS, INCLUDING THE SIGNIFICANT POSSIBILITY OF ACCIDENTS RESULTING IN PERSONAL INJURY, PROPERTY DAMAGE OR ENVIRONMENTAL DAMAGE; THE EFFECT ON OUR PERFORMANCE OF REGULATORY PROGRAMS AND ENVIRONMENTAL MATTERS INCLUDING POLITICAL AND ECONOMIC UNCERTAINTIES. THESE AND OTHER UNCERTAINTIES RELATED TO OUR BUSINESS ARE DESCRIBED IN DETAIL IN OUR ANNUAL REPORT ON FORM 10-KSB FOR THE YEAR ENDED DECEMBER 31, 2004. ALTHOUGH WE BELIEVE THAT THE EXPECTATION REFLECTED IN SUCH FORWARD LOOKING STATEMENTS ARE REASONABLE, WE CAN GIVE NO ASSURANCE THAT SUCH EXPECTATIONS WILL PROVE TO BE CORRECT. YOU ARE CAUTIONED NOT TO PLACE UNDUE RELIANCE ON THESE FORWARD LOOKING STATEMENTS, WHICH SPEAK ONLY AS OF THE DATE HEREOF. WE UNDERTAKE NO OBLIGATION TO UPDATE ANY OF OUR FORWARD LOOKING STATEMENTS FOR ANY REASON.

#### BUSINESS DEVELOPMENT

New Century Energy Corp. (the "Company"), was incorporated in Colorado on April 18, 1997 as "Perfection Development Corporation." On September 29, 1998, the Company entered into an agreement pursuant to which it would acquire all of the outstanding capital stock of Vertica Software, Inc., a California corporation ("Vertica California"). On December 31, 1998, Vertica California merged with and into the Company. The Company was the surviving corporation in the merger and the separate corporate existence of Vertica California ceased. Concurrently with the merger, the Company changed its name from Perfection Development Corporation to Vertica Software, Inc. ("Vertica").

On February 1, 2002, the Company's charter was automatically revoked by the Colorado Secretary of State for failure to file a periodic report. Because of the Colorado statute at that time, once a charter was revoked it could not be renewed and the Company was forced to file new a new Articles of Incorporation with the Colorado Secretary of State, which it did on December 22, 2003, as Vertica Software, Inc. The Company has filed a Statement of Merger with the Colorado Secretary of State to merge its former Colorado filings as Perfection Development Corporation/Vertica Software, Inc., with its current filings as New Century Energy Corp.

On January 28, 2004, the Company filed Articles of Amendment to the Company's Articles of Incorporation to authorize 5,000 shares of Series A Convertible Preferred Stock. On June 30, 2004, the Company filed Articles of Amendment to the Company's Articles of Incorporation to amend the Series A Convertible Preferred Stock ("Series A") designation and to authorize 2,000,000 shares of Series B Convertible Preferred Stock ("Series B"). Each share of Series A Preferred Stock is able to vote an amount equal to 300 shares of Common Stock. All shares of preferred stock rank prior to all other stock of the Company, as to payments of dividends and to distributions of assets upon liquidation, dissolution or winding up of the Corporation, whether voluntary or involuntary. Each share of Series B Preferred Stock is able to vote an amount equal to 2,958 shares of Common Stock. Each share of Series A Preferred Stock can be converted into 300 shares of the Company's Common Stock at the option of the holder, provided that there are a sufficient number of shares authorized but unissued and unreserved. Each share of Series B Preferred Stock can be converted into 98.6 shares of the Company's Common Stock at the option of the holder, provided that there are a sufficient number of shares authorized but unissued and unreserved. As of the date of the filing of this report there are 5,000 shares of Series A Preferred Stock outstanding and no shares of Series B Preferred Stock outstanding.

On September 30, 2004, the Company acquired 100% of the issued and outstanding common stock of Century Resources, Inc., a Delaware Corporation ("Century"), which was originally established for the acquisition, development, production, exploration for, and the sale of oil and natural gas in Texas, in exchange for 37,500,000 newly issued post 1:100 reverse split (described below) shares of the Company's Common Stock, pursuant to an Agreement and Plan of Reorganization whereby Century became a wholly-owned subsidiary of the Company (the "Exchange"). Also on September 30, 2004, the Company effected a 1:100 reverse stock split. Unless otherwise stated, all share amounts in this quarterly report on Form 10-QSB are provided in post reverse split shares.

In connection with the Exchange, the Company agreed to transfer all rights to the existing installation of hardware and software used to develop intellectual property, all trademarks, copyrights and marketing materials developed for sales and distribution of such products relating to Internet/Intranet software products and services and an Internet web site for the hazardous material to the Company's wholly owned subsidiary, ERC Solutions, Inc., a Delaware corporation ("ERC"), and changed its business focus to oil and gas exploration and production. On October 26, 2004, in connection with its new business focus, the Company filed Articles of Amendment with the Colorado Secretary of State, to change its name to "New Century Energy Corp." which became effective on November 1, 2004.

In November 2004, the Company filed a Certificate of Correction to the Company's previously filed Articles of Amendment, to correct the number of shares the Company is authorized to issue. As a result of this correction, the total number of authorized shares of the Company is 120,000,000, of which 100,000,000 are Common Stock, par value \$0.001 per share, and 20,000,000 are Preferred Stock, par value \$0.001 per share ("Preferred Stock").

On March 10, 2005, the Company entered into an agreement with its wholly owned subsidiary, ERC Solutions, Inc. ("ERC"), pursuant to which ERC agreed to assume all liabilities of the Company which the Company had at the time of the closing of the Exchange, and any other liabilities which are incurred by the Company in connection with the business of ERC.

In April 2005, we entered into an Exclusive Finder's Agreement with a third party, in connection with introductions to us in connection with the sale of equity, equity-related or debt securities. We did not

raise any money in connection with the sale of securities pursuant to the Exclusive Finder's Agreement and subsequently terminated the Finder's Agreement.

In June 2005, we entered into a finder's agreement with Energy Capital Solutions, LP, to provide services to us as a finder in connection with the sale of a debt-related security which would be convertible into shares of our Common Stock. The term of the finder's agreement was sixty days. In connection with the letter agreement, we agreed to pay Energy Capital Solutions, LP an amount equal to 4.0% of the net proceeds raised from any sale of a debt-related security and to issue it warrants equal to 6.0% of the total equity of any debt-related security sold in a placement of a debt-related security, with the same terms as that of the securities sold in such debt-related offering. We paid Energy Capital Solutions, LP \$599,000 and granted Energy Capital Solutions, LP 900,000 warrants exercisable at \$0.80 per share, with piggyback registration rights in connection with the Closing (described and defined below).

On June 6, 2005, we entered into a Settlement Agreement and Mutual Release (the "Settlement Agreement") with Core Concepts, LLC ("Core Concepts"), Timothy Novak ("Novak"), our former Director, and R. Paul Gray, our former Director ("Gray") (collectively the "Parties"). The parties renegotiated the amount of shares to be issued by us in consideration for monies advanced prior to the reverse merger transaction (the "Dispute").

Pursuant to the terms of the Settlement Agreement, we agreed to issue two hundred and fifty thousand (250,000) restricted shares of our Common Stock to Core Concepts in return for Core Concepts, Novak and Gray agreeing to release and forever discharge us, our current and former agents, attorney's, officers, directors, servants, representatives, successors, employees and assigns from any and all rights, obligations, claims, demands and causes of action, whether in contract, tort, or state and/or federal securities regulations arising from the Dispute, as well as any other potential claims. We also granted Core Concepts Piggyback Registration Rights in connection with the Settlement.

## **BUSINESS OVERVIEW**

Please note that this section and the Company's 10-QSB contain many technical terms used in the oil and gas industry and investors should look to the Glossary incorporated by reference to this Report on Form 10-QSB as Exhibit 99.1.

### **OPERATED PROPERTIES:**

As of June 30, 2005, we estimated that our current gross daily deliverability on Company operated properties was approximately 500 Mcf per day and 80 Bpd of crude oil. By the end of 2005, we hope to further increase our natural gas deliverability to between 1,000 and 5,000 Mcf per day and our oil production to 160 Bpd, of which we can give no assurances. We plan to continue our recompletion and drilling program on Company owned and operated properties and undeveloped acreage throughout 2005 and beyond. During the fourth quarter of 2004, we commenced reprocessing of our 3-D seismic data base in Matagorda County, Texas. We received results of our first reprocessed seismic data in January 2005 and completed the first phase of our structural and stratigraphic interpretation in June 2005. We believe that the reprocessed 3-D seismic data allows us to better locate and optimize the structural placement of our new drilling locations.

While it is extremely difficult to accurately forecast future production, we do believe that our drilling program in Matagorda County will provide long-term production growth potential and plan for it to be the backbone of our growth for the foreseeable future.

### **NON-OPERATED PROPERTIES:**

On June 30, 2005, we closed the acquisition of the various working, term royalty and overriding royalty interests in the Wishbone Field in McMullen County, Texas, with an effective date for ownership of April 1, 2005. As of June 30, 2005, we estimated that gross 8/8ths daily gas production in the

Wishbone Field was approximately 20 MMCF of gas per day, with net daily gas production to the Company's 6.2 % working interest of approximately 1.24 MMCF of gas per day. We believe this was a significant acquisition for us as we added considerable natural gas reserves, which we believe will increase our cash flow significantly. Our third party engineers have attributed over 3.4 billion cubic feet of net proved gas reserves to us, with approximately \$15 million of undiscounted future net income attributed to our interests. The acquisition of the Wishbone interest increased our proved gas reserves by over 300% from a total of approximately 1 billion cubic feet of gas to a total of over approximately 4 billion cubic feet of gas.

We currently have development plans in the Wishbone Field to drill additional new well locations to exploit proven, probable and possible gas reserves. In July 2005, drilling operations commenced on the Lindholm-Hanson Gas Unit #10 well, which reached a total depth of 13,350 feet on July 21, 2005. The well's objective sands were faulted out, and the decision was made to sidetrack the #10 well 700 feet to the north. The original well was plugged back to 10,600 feet and redrilled to 12,875 feet measured depth. The #10 well began producing in August 2005, and was frac stimulated (fracturing rock in the well under extremely high pressure) on August 15, 2005. Production to sales commenced on August 16, 2005 at approximately 8.0 MMCF gas per day. The field operator has presented Approval for Expenditure's ("AFE's") for additional drilling in the Wishbone Field and the Company has agreed to participate in the drilling of additional wells on this acreage in 2005. The Lindholm-Hanson Gas Unit #11 has been approved for drilling and the well spudded (began drilling operations) on August 15, 2005. The Company also agreed to participate for a 3.1% working interest in the drilling of the Lindholm-fee #1 on acreage outside the gas unit boundary, and drilling operation commenced on August 9, 2005.

Drilling and completion costs for the wells currently drilling and three (3) additional new locations in the Wishbone Field will require an expenditure by the Company of approximately \$1.25 million in 2005. On our operated properties, we will require approximately \$1.25 million in 2005 to execute our drilling and development plan. We plan to deploy capital raised from Laurus to accomplish and fund our drilling commitments and development plans on both the operated and non-operated properties, of which there can be no assurance.

## **DESCRIPTION OF THE COMPANY'S CURRENT BUSINESS FOCUS**

Since the date of the Exchange, the Company has focused on oil and gas exploration and production, and the discussion found below describes those activities.

## **BUSINESS STRATEGY**

As part of our corporate strategy, we believe in the following fundamental principles:

1. remain focused in the Texas Gulf Coast onshore region;
2. acquire properties and proven reserves where we believe additional value can be created through a combination of exploitation, development, exploration and marketing;
3. acquire properties that give us a majority working interest and operational control or where we believe we can ultimately obtain it;
4. maximize the value of our properties by increasing production and reserves while reducing cost; and
5. maintain a highly experienced team of operations and exploration consultants using state of the art technology.

## **JOINT VENTURES, AGREEMENTS AND RECENT EVENTS**

### **PURCHASE AND SALE AGREEMENT**

Effective on June 27, 2005, we entered into a Purchase and Sale Agreement with Hanson Resources Company, 4 Star Ventures, L.P., Bastante Mas, Ltd., A.M. Brown Family Limited Partnership, Fletcher

Ventures, LLC, William Kimble, Prescio Oil & Gas, LLC, Kaye Thompson, Sierra Vista Ventures, L.P., Linda C. Barber, B.J. Drehr, Barbara A. Hanson, Kurt M. Hanson, George E. Jochetz III,

Karen Smith, John J. Surko, Neil E. Hanson, and BSC Minerals, Ltd. (collectively the "Sellers"). The Sellers were sent payment for the sales price on June 30, 2005. The effective date for ownership of the acquired interests is April 1, 2005. Through the Purchase and Sale Agreement, we acquired certain working interests, overriding royalty interests, and term royalty interests, which together entitle us to a 6.2% working interest and a 5.464% net revenue interest in production from the Lindholm-Hanson Gas Unit and certain other licenses in the Wishbone Field in McMullen County, Texas, located 80 miles south of San Antonio, Texas (the "Assets"). We paid the sellers an aggregate of \$11,000,000 in cash (generated through the sale of a Secured Convertible Term Note to Laurus Master Fund, Ltd., described in greater detail below) and issued the Sellers an aggregate of 1,320,000 restricted shares of our Common Stock as consideration for the sale of the Assets.

### **SECURITIES PURCHASE AGREEMENT**

On June 30, 2005, we entered into a Securities Purchase Agreement with Laurus Master Fund, Ltd., a Cayman Islands company ("Laurus" and the "Closing"), whereby we sold a Secured Convertible Term Note in the principal amount of fifteen million dollars (\$15,000,000)(the "Note"), which is convertible into an aggregate of 24,193,548 shares of our Common Stock at a conversion price of \$0.62 per share; issued Laurus a warrant to purchase up to 7,258,065 shares of Common Stock at \$0.80 per share (the "Warrant"); issued an option to Laurus to purchase up to 10,222,784 shares of our Common Stock (representing 20% of our outstanding Common Stock on a fully-diluted basis [prior to the issuance of shares in connection with the Purchase and Sale Agreement]), for \$0.001 per share (the "Option"); and entered into a Master Security Agreement, Registration Rights Agreement, Stock Pledge Agreement and Funds Escrow Agreement with Laurus and Century Resources, Inc., our wholly owned subsidiary, entered into a Subsidiary Guaranty with Laurus. The Note, the Warrant, the Option, the Master Security Agreement, the Registration Rights Agreement, the Subsidiary Guaranty, the Stock Pledge Agreement, the Funds Escrow Agreement and all other documents, instruments and agreements entered into in connection with the Closing, shall be referred to as the "Related Agreements."

In connection with the Closing, we agreed to pay Laurus Capital Management, L.L.C., the manager of Laurus a fee equal to 3.50% of the aggregate principal amount of the Note, totaling \$525,000, and agreed to pay Energy Capital Solutions, LP \$599,000 and granted Energy Capital Solutions, LP 900,000 warrants exercisable at \$0.80 per share, with piggyback registration rights in connection with a finders agreement.

In connection with the Securities Purchase Agreement, we granted Laurus the right to invest up to an additional \$15,000,000, but not less than an additional \$1,000,000, under the same terms and conditions of the Note and including the issuance of a proportionate amount of warrants at the same exercise price (\$0.80), but no additional option, by March 27, 2006 (270 days from the Date of the Closing).

### **SUBSIDIARY GUARANTY AGREEMENT AND COLLATERAL ASSIGNMENT AGREEMENT**

Century Resources, Inc., our wholly owned subsidiary, entered into a Subsidiary Guaranty Agreement at the Closing with Laurus, whereby it agreed to guaranty the prompt payment of all amounts, when due, owed to Laurus under the Note and in connection with the Closing. We also entered into a Collateral Assignment Agreement at the Closing, whereby we agreed to assign and to grant a security interest to Laurus in all of our rights and benefits under the Purchase and Sale Agreement. Additionally, at the time of the Closing, we entered into a Master Security Agreement with Laurus, whereby we agreed to grant Laurus a continuing security interest in all of our assets, including without limitation, cash, cash equivalents, accounts, accounts receivable, deposit accounts, inventory, equipment, goods, fixtures and other tangible and intangible assets, which we now own or at any time in the future may acquire right, title or interest to.

**SECURED CONVERTIBLE NOTE**

In connection with the Securities Purchase Agreement, we issued Laurus a three year Secured Convertible Note in the amount of \$15,000,000, which bears interest at the prime rate (as published by the Wall Street Journal) plus 2% (currently 8.5%, with the prime rate at 6.5% as of August 10, 2005, the "Contract Rate") per year, and which at no time unless adjusted as described below, shall bear interest at less than 7% per year, which unpaid principal and unpaid accrued interest, if any, shall be due and payable on June 30, 2008 (the "Maturity Date"). The interest on the Note shall be payable monthly, in arrears, commencing on September 1, 2005 (each monthly date being a "Determination Date"). Additionally, if the Registration Statement covering the shares which the Note and Warrant are convertible into has been declared effective and our Common Stock has traded at least 25% above the "Fixed Conversion Rate," which is currently \$0.62 and which is subject to adjustment as described below, for the five trading days immediately preceding a Determination Date, then the Contract Rate shall be reduced by 1%, and shall be reduced by 1% for each incremental 25% increase in the market price of our Common Stock above the then applicable Fixed Conversion Rate (for example, if our Common Stock has traded at \$0.93 for the five trading days preceding a Determination Date, which amount is 50% above the current Fixed Conversion Rate (\$0.62), the Contract Rate will be reduced by an aggregate of two percentage points, one percentage point for each 25% increase that our Common Stock traded above the Fixed Conversion Rate), but, in no event shall the Contract Rate at any time be less than 0%.

Additionally, we agreed to make payments of the principal amount owing under the Note to Laurus on January 1, 2006, and on the first business day of each month thereafter, including the Maturity Date of the Note ("Principal Payment"). Each Principal Payment shall be in the amount of \$250,000 together with any accrued and unpaid interest on such portion of the unpaid portion of the Notes (together with any other amounts to be paid, including the Contract Rate, the "Monthly Amount") and to pay Laurus an amount equal to the outstanding principal amount of the Note and any accrued and unpaid interest on the Maturity Date.

Laurus must convert all or a portion of the Monthly Amount into shares of our Common Stock if: (i) the average closing price of our Common Stock for the five trading days immediately preceding such payment is greater than or equal to 110% of the Fixed Conversion Price; and (ii) the amount of such conversion does not exceed twenty-five percent of the aggregate dollar trading volume of the Common Stock for the period of twenty-two trading days immediately preceding such payment date; however if (i) is met and (ii) is not, Laurus may convert such amount of the Monthly Amount into shares of our Common Stock that meet (i), above, assuming that such conversion does not cause Laurus to hold more than 9.99% of our then issued and outstanding stock, as described and subject to the conditions listed below. Additionally, no amount of the Monthly Amount may be converted into shares of our Common Stock unless there is an effective Registration Statement covering such shares to be converted or an exemption from registration exists under Rule 144 for such shares, and there is no event of default (as defined below). If (i) above is not met, the Monthly Amount must be payable in cash and we must pay an amount of cash to Laurus equal to 102% of the Monthly Amount.

We may prepay the Note in cash by giving Laurus a notice of repayment, seven (7) days before such intent to prepay, and by paying Laurus an amount equal to 125% of the outstanding principal amount of the Note during the first year the Note is outstanding, 120% of the outstanding principal amount of the Note during the second year the Note is outstanding, and 115% of the outstanding principal amount of the Note during the period of time between the second anniversary of the Note until the Maturity Date.

The Note includes a provision whereby Laurus is not entitled to convert any amount of shares which would cause Laurus to become the beneficial owner of more than 9.99% of our outstanding Common Stock, which limitation automatically becomes null and void upon the occurrence and continuance of an event of default, or upon 75 days prior notice to us. In the event that we change our Common Stock into the same or a different number of securities by reclassification or otherwise, Laurus shall have the right to purchase an adjusted number of securities and kind of securities that would have been

issuable as the result of such change with respect to the Common Stock (i) immediately prior to or (ii) immediately after, such reclassification, or other change at the sole election of Laurus.

Additionally, the Fixed Conversion Price of the Note shall be adjusted automatically in the event that we issue any additional shares of Common Stock as a dividend or any preferred stock; subdivide our outstanding shares of Common Stock; or effect a reverse stock split, by multiplying the exercise price (currently \$0.62) by the number of our shares outstanding prior to such event and dividing that number by the number of our shares outstanding after such event. Additionally, if at any time prior to the full conversion or full repayment of the principal amount of the Note, we issue any shares, options, warrants, or other obligations, to anyone other than to Laurus (other than in connection with a company employee incentive stock plan, or to vendors for goods sold and services rendered (not to exceed 1,000,000 shares and not eligible to be sold by the holders of such shares until three years from June 30, 2005)), for consideration per share less than the Fixed Conversion Price, the Fixed Conversion Price shall immediately reset to such lower price.

Events of default under the Note include our failure to pay amounts due under the Note; breach of any covenants under the Note, if not cured within 15 days; breach of any warranties found in the Note or any other Related Agreement; the occurrence of any default under any agreement, which causes any contingent obligation to become due prior to its stated maturity or to become payable; any change or occurrence likely to have a material adverse effect on the business, assets, liabilities, financial condition, our operations or prospects; our bankruptcy; a judgment against us in excess of \$100,000, which has not been vacated, discharged or stayed, within thirty (30) days of the date of entry; our insolvency; a change in control of us; an indictment or other proceedings against us or any executive officer; if we breach any provision of the Securities Purchase Agreement, or any other Related Agreement; if the SEC puts a stop trade order or otherwise suspends our Common Stock from trading for a period of five (5) consecutive days or five (5) days during a period of ten (10) consecutive days; or our failure to deliver the Common Stock to Laurus pursuant to and in the form required by the Note.

If an event of default were to occur under the Note, Laurus may at its option, demand repayment in full of all obligations and liabilities owed to it by us under the Note, Securities Purchase Agreement and any Related Agreement . . .