

DEER VALLEY CORP  
Form 10-Q  
May 14, 2008  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
WASHINGTON, D.C. 20549

**FORM 10-Q**

(Mark One)

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

For the quarterly period ended March 31, 2008

OR

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

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

Commission file number 000-05388

**DEER VALLEY CORPORATION**

*(Exact name of Registrant as specified in its charter)*

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**Florida**  
(State or other jurisdiction of  
incorporation or organization)

**20-5256635**  
(I.R.S. employer  
identification no.)

**4218 W. Linebaugh Avenue, Tampa, FL**  
(Address of principal executive offices)

**33624**  
(Zip code)

**Registrant's telephone number, including area code: (813) 885-5998**

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  No

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

Large accelerated filer  Accelerated Filer  Non-accelerated filer  Smaller reporting company

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

The Registrant had 11,529,073 shares of Common Stock, par value \$0.001 per share, outstanding as of May 5, 2008.

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Unless otherwise indicated or the context otherwise requires, all references below in this filing to we, us, the Company, and Deer Valley are to Deer Valley Corporation, a Florida corporation, together with its wholly-owned subsidiary, Deer Valley Homebuilders, Inc., an Alabama corporation.

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**PART I FINANCIAL INFORMATION**

**Item 1. Financial Statements**

**Deer Valley Corporation & Subsidiary**  
**Condensed Consolidated Financial Statements**

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**Table of Contents****Deer Valley Corporation & Subsidiary****Consolidated Balance Sheets****ASSETS**

	<b>March 31, 2008 (unaudited)</b>
<b>Current Assets:</b>	
Cash	\$ 5,131,654
Accounts receivable	6,953,841
Inventory	2,672,450
Deferred tax asset	905,915
Prepaid expenses and other current assets	51,632
<b>Total Current Assets</b>	<b>15,715,492</b>
<b>Fixed Assets:</b>	
Property, plant and equipment, net	3,075,718
<b>Other Assets:</b>	
Goodwill	7,256,917
Other assets	166,444
<b>Total Other Assets:</b>	<b>7,423,361</b>
<b>Total Assets</b>	<b>\$ 26,214,571</b>

**LIABILITIES AND STOCKHOLDERS' EQUITY**

<b>Current Liabilities:</b>	
Current maturities on long term debt	\$ 61,806
Note payable	4,000,000
Accounts payable	1,181,331
Accrued expenses	2,356,323
Accrued warranties	2,160,000
Income tax payable	161,165
Accrued preferred dividends	1,965
<b>Total Current Liabilities</b>	<b>9,922,590</b>
<b>Long Term Liabilities:</b>	
Long-term debt, net of current maturities	1,807,479
Deferred tax liability	501,832
Put liability	532,617
<b>Total Long Term Liabilities</b>	<b>2,841,928</b>
<b>Total Liabilities</b>	<b>12,764,518</b>
<b>Stockholders' Equity:</b>	

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Series A Preferred stock, \$0.01 par value, 750,000 shares authorized, 619,150 shares issued and outstanding.	6,191,495
Series C Preferred stock, \$0.01 par value, 26,750 shares authorized, 22,463 shares issued and outstanding.	224
Series E Preferred stock, \$0.01 par value, 1,000,000 authorized, 1,000,000 shares issued and outstanding.	10,000
Common stock, \$0.001 par value, 100,000,000 shares authorized, 11,526,697 shares issued and outstanding.	11,527
Additional paid-in capital	36,692,360
Common stock escrowed under Earnout Agreement	(2,000,000)
Accumulated deficit	(27,455,552)
<b>Total Stockholders Equity</b>	<b>13,450,054</b>
<b>Total Liabilities and Stockholders Equity</b>	<b>\$ 26,214,571</b>

*See notes to consolidated financial statements*

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**Table of Contents****Deer Valley Corporation & Subsidiary****Consolidated Statements of Operations**

	<b>March 31, 2008 (unaudited)</b>	<b>March 31, 2007 (unaudited)</b>
<b>REVENUE</b>	\$ 16,693,815	\$ 11,812,342
<b>COST OF REVENUE</b>	13,468,745	10,436,409
<b>GROSS PROFIT</b>	3,225,070	1,375,933
<b>OPERATING EXPENSES:</b>		
Depreciation	15,425	63,091
Selling, general and administrative	2,028,638	1,424,529
<b>TOTAL OPERATING EXPENSES</b>	2,044,063	1,487,620
<b>OPERATING INCOME</b>	1,181,007	(111,687)
<b>OTHER INCOME (EXPENSES)</b>		
Derivative income (expense)	(17,071)	
Interest income	18,949	62,634
Interest expense	(40,651)	(39,664)
<b>TOTAL OTHER INCOME/(EXPENSES)</b>	(38,773)	22,970
<b>INCOME BEFORE INCOME TAXES</b>	1,142,234	(88,717)
<b>INCOME TAX EXPENSE</b>	(445,536)	(45,528)
<b>NET INCOME</b>	<b>\$ 696,698</b>	<b>\$ (134,245)</b>
Dividends to preferred stockholders	(21,562)	(91,777)
<b>Net Income Available to Common Shareholders</b>	<b>\$ 675,136</b>	<b>\$ (226,022)</b>
<b>Net Income/(Loss) Per Share (Basic)</b>	<b>\$ 0.06</b>	<b>\$ (0.03)</b>
<b>Net Income/(Loss) Per Share (Fully Diluted)</b>	<b>\$ 0.03</b>	<b>\$ (0.03)</b>
<b>Weighted Average Common Shares Outstanding</b>	<b>11,302,875</b>	<b>8,350,510</b>
<b>Weighted Average Common and Common Equivalent Shares Outstanding</b>	<b>23,507,759</b>	<b>8,350,510</b>

*See notes to consolidated financial statements*

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**Deer Valley Corporation & Subsidiary**  
**Consolidated Statements of Stockholders' Equity**  
**For the three month period ended March 31, 2008**

	Preferred A Shares	Preferred A \$	Preferred B Shares	Preferred B \$
<b>Balance at December 31, 2007</b>	<b>629,775</b>	<b>6,297,745</b>		
<b>Cumulative effect of change in accounting method</b>				
<b>Conversion of Series A Preferred</b>	<b>(10,625)</b>	<b>(106,250)</b>		
<b>Issuance of common stock dividend to Series A Preferred</b>				
<b>Accrued dividend</b>				
<b>Net Income</b>				
<b>Balance at March 31, 2008</b>	<b>619,150</b>	<b>6,191,495</b>		

*See notes to consolidated financial statements*

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**Deer Valley Corporation & Subsidiary**  
**Consolidated Statements of Stockholders' Equity**  
**For the three month period ended March 31, 2008**

	<b>Preferred C</b>	<b>Preferred D</b>
	<b>Shares</b>	<b>Shares</b>
<b>Balance at December 31, 2007</b>	<b>22,463</b>	<b>224</b>
<b>Cumulative effect of change in accounting method</b>		
<b>Conversion of Series A Preferred</b>		
<b>Issuance of common stock dividend to Series A Preferred</b>		
<b>Accrued dividend</b>		
<b>Net Income</b>		
<b>Balance at March 31, 2008</b>	<b>22,463</b>	<b>224</b>

*See notes to consolidated financial statements*

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**Deer Valley Corporation & Subsidiary**

**Consolidated Statements of Stockholders' Equity**

**For the three month period ended March 31, 2008**

	Series E		Common Stock	
	Shares	\$	Shares	\$
<b>Balance at December 31, 2007</b>	<b>1,000,000</b>	<b>10,000</b>	<b>11,121,629</b>	<b>11,122</b>
<b>Cumulative effect of change in accounting method</b>				
<b>Conversion of Series A Preferred</b>			<b>141,668</b>	<b>142</b>
<b>Issuance of common stock dividend to Series A Preferred</b>			<b>263,400</b>	<b>263</b>
<b>Accrued dividend</b>				
<b>Net Income</b>				
<b>Balance at March 31, 2008</b>	<b>1,000,000</b>	<b>10,000</b>	<b>11,526,697</b>	<b>11,527</b>

*See notes to consolidated financial statements*

**Table of Contents****Deer Valley Corporation & Subsidiary****Consolidated Statements of Stockholders' Equity****For the three month period ended March 31, 2008**

	Additional Paid in Capital	Common Stock Escrowed under Earnout Agreement	Retained Earnings	Total
<b>Balance at December 31, 2007</b>	<b>36,221,024</b>	<b>(2,000,000)</b>	<b>(28,152,248)</b>	<b>12,387,867</b>
<b>Cumulative effect of change in accounting method</b>	<b>165,654</b>			<b>165,654</b>
<b>Conversion of Series A Preferred</b>	<b>106,108</b>			
<b>Issuance of common stock dividend to Series A Preferred</b>	<b>221,136</b>			<b>221,399</b>
<b>Accrued dividend</b>	<b>(21,562)</b>			<b>(21,562)</b>
<b>Net Income</b>			<b>696,697</b>	<b>696,697</b>
<b>Balance at March 31, 2008</b>	<b>36,692,360</b>	<b>(2,000,000)</b>	<b>(27,455,552)</b>	<b>13,450,054</b>

*See notes to consolidated financial statements*

**Table of Contents****Deer Valley Corporation & Subsidiary****Consolidated Statements of Cash Flows**

	For the three month periods ended	
	March 31, 2008 (unaudited)	March 31, 2007 (unaudited)
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income (loss)	\$ 696,697	\$ (134,245)
Adjustments to reconcile net income (loss) to net cash provided for/used in operating activities:		
Depreciation and amortization	72,425	68,039
Derivative income(expense)	17,071	
Changes in assets and liabilities:		
(Increase)/decrease in receivables	(1,855,831)	(659,584)
(Increase)/decrease in inventories	(723,704)	(464,180)
(Increase)/decrease in prepayments and other	71,873	(7,380)
Increase/(decrease) in accounts payable	81,479	154,243
Increase/(decrease) in income tax payable	76,554	
Increase/(decrease) in estimated services and warranties	30,000	
Increase/(decrease) in accrued expenses	(113,547)	(745,163)
<b>CASH FLOW PROVIDED FOR/USED IN OPERATING ACTIVITIES</b>	<b>\$ (1,646,984)</b>	<b>\$ (1,788,270)</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Purchases of equipment	(64,171)	(62,123)
<b>CASH FLOW USED IN INVESTING ACTIVITIES</b>	<b>\$ (64,171)</b>	<b>\$ (62,123)</b>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Repayment of long-term debt	(19,525)	(19,002)
Proceeds (repayment) of notes payable, net	2,084,000	
Proceeds from the exercise of warrants		37,910
<b>CASH FLOW PROVIDED BY FINANCING ACTIVITIES</b>	<b>\$ 2,064,475</b>	<b>\$ 18,908</b>
<b>NET INCREASE (DECREASE) IN CASH</b>	<b>\$ 353,320</b>	<b>\$ (1,831,485)</b>
<b>CASH, Beginning</b>	<b>\$ 4,778,334</b>	<b>\$ 7,431,152</b>
<b>CASH, Ending</b>	<b>\$ 5,131,654</b>	<b>\$ 5,599,667</b>
<b>SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:</b>		
Cash paid during the period for:		
Interest	\$ 40,651	\$ 39,664
Taxes	\$ 110,000	\$ 285,000
<b>SUPPLEMENTAL DISCLOSURE OF NON CASH INVESTING AND FINANCING ACTIVITIES:</b>		
Dividends on preferred stock settled in common stock	\$ 221,399	\$ 91,777
Conversion of preferred stock for common stock-net	\$ 106,250	\$
Put liability	\$ 165,654	\$

*See notes to consolidated financial statements*

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**Deer Valley Corporation & Subsidiary**

**Notes to Condensed Consolidated Financial Statements**

**(unaudited)**

**1. BASIS OF PRESENTATION**

The accompanying unaudited consolidated financial statements for the three month period ended March 31, 2008 and 2007 have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and pursuant to the rules and regulations of the Securities and Exchange Commission for Form 10-Q. Accordingly, they do not include all the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements.

The unaudited financial information included in this report includes all adjustments which are, in the opinion of management, necessary to reflect a fair statement of the results for the interim periods. The operations for the three month periods ended March 31, 2008 and 2007 are not necessarily indicative of the results of the full fiscal year.

The condensed consolidated financial statements included in this report should be read in conjunction with the financial statements and notes thereto included in the Registrant's December 31, 2007 Annual Report on Form 10-KSB and subsequent filings on Form 8-K.

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**Fiscal Year** The Company's operating subsidiary, Deer Valley Homebuilders, Inc., operates on a 52-53 week fiscal year end. For presentation purposes, the reporting period has been presented as ending on March 31, the Company's quarter end.

**Stock Based Compensation** In December 2004, the FASB issued SFAS No. 123 (revised 2004), "Share-Based Payment". SFAS 123(R) will provide investors and other users of financial statements with more complete and neutral financial information by requiring that the compensation cost relating to share-based payment transactions be recognized in financial statements. That cost will be measured based on the fair value of the equity or liability instruments issued. SFAS 123(R) covers a wide range of share-based compensation arrangements including share options, restricted share plans, performance-based awards, share appreciation rights, and employee share purchase plans. SFAS 123(R) replaces FASB Statement No. 123, "Accounting for Stock-Based Compensation", and supersedes APB Opinion No. 25, "Accounting for Stock Issued to Employees". SFAS 123, as originally issued in 1995, established as preferable a fair-value-based method of accounting for share-based payment transactions with employees. However, that statement permitted entities the option of continuing to apply the guidance in Opinion 25, as long as the footnotes to financial statements disclosed what net income would have been had the preferable fair-value-based method been used. Public entities (other than those filing as small business issuers) were required to apply SFAS 123(R) as of the first interim or annual reporting period that begins after June 15, 2005. For public entities that file as small business issuers SFAS 123(R) is applicable as of the beginning of the first interim or annual reporting period that begins after December 15, 2005.

Prior to January 1, 2006, the Company accounted for Stock Options and Stock Based Compensation under the recognition and measurement provisions of APB Opinion No. 25, "Accounting for Stock Issued to Employees", and related Interpretations, as permitted by FASB Statement No. 123, "Accounting for Stock-Based Compensation". Effective January 1, 2006, the Company adopted the fair value recognition provisions of SFAS No. 123(R), Share-Based Payment, using the modified-prospective-transition method. Under that transition method, compensation cost for all share-based payments granted prior to, but not yet vested as of January 1, 2006 are based on (a) the grant date fair value estimated in accordance with the original provisions of SFAS No. 123, and (b) compensation cost for all share-based payments granted subsequent to January 1, 2006 are based on the grant-date fair value estimated in accordance with the provisions of SFAS No. 123(R). Results for prior periods have not been restated.

**2007 Long Term Incentive Plan**

On July 1, 2007 the Company established a Long Term Incentive (the 2007 Incentive Plan) plan for the purposes of advancing the interests of the Company and our shareholders by providing incentives to certain of our employees and other key individuals who perform services for us, including those who contribute significantly to the strategic and long-term performance objectives and growth of the Company. The 2007 Incentive Plan is administered by a committee (the Committee) appointed by the Board of Directors. Currently, the Committee is comprised of all members of the Board of Directors acting as a group. The Committee has the power to interpret the 2007 Incentive Plan and to prescribe rules, regulations and procedures in connection with the operations of the 2007 Incentive Plan. The Committee may delegate administrative responsibilities under the 2007 Incentive Plan to any one or more of its members or other persons, except as may otherwise be required under

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applicable law or listing standards for an exchange on which the Company's common stock may be listed. The 2007 Incentive Plan provides for the granting of several types of awards, including stock options, performance grants and other awards deemed by the Committee to be consistent with the purposes of the 2007 Incentive Plan. Awards may be granted alone, or in conjunction with one or more other awards, as determined by the Committee.

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The 2007 Incentive Plan was effective as of July 1, 2007, and was approved by the Company's board of directors. The Company's shareholders have not voted on approval of the 2007 Incentive Plan. A maximum of one million eight hundred thousand (1,800,000) shares of common stock has been authorized to be issued under the 2007 Incentive Plan in connection with the grant of awards, subject to adjustment for corporate transactions, including, without limitation, any stock dividend, forward stock split, reverse stock split, merger or recapitalization. Of this amount, no more than one million (1,000,000) shares of common stock may be issued as incentive stock options. Common stock issued under the 2007 Incentive Plan may be either newly issued shares, treasury shares, reacquired shares or any combination thereof. If common stock issued as restricted stock, restricted stock units or otherwise subject to repurchase or forfeiture rights is reacquired by us pursuant to such rights, or if any award is cancelled, terminates, or expires unexercised, the common stock which would otherwise have been issuable pursuant to such awards will be available for issuance under new awards. All awards under the 2007 Incentive Plan shall be granted within 10 years of the date the plan was adopted.

The Committee has exclusive discretion to select to whom awards will be granted; to determine the type, size, terms and conditions of each award; to modify or waive, within certain limits, the terms and conditions of any award; to determine the time when awards will be granted; to establish performance objectives; to prescribe the form of documents representing awards under the 2007 Incentive Plan; and to make all other determinations which it deems necessary, advisable or desirable in the interpretation and administration of the 2007 Incentive Plan. At the discretion of the Committee, awards may be made under the 2007 Incentive Plan in assumption of, or in substitution for, outstanding awards previously granted by the Company, any predecessor or a company acquired by the Company or with which it combines. The Committee has the authority to administer and interpret the 2007 Incentive Plan, and its decisions are final, conclusive and binding. We anticipate that all of our employees and directors will be eligible to participate in the 2007 Incentive Plan.

The following table summarizes the activity related to all Company stock options and warrants for the three month period ended March 31, 2008:

	Stock		Exercise Price Per Share		Weighted Average Exercise Price Per Share	
	Warrants	Options	Warrants	Options	Warrants	Options
<b>Outstanding at December 31, 2007</b>	<b>22,731,704</b>	<b>700,000</b>	<b>\$ 0.75-3.00</b>	<b>\$ 1.09-\$1.14</b>	<b>\$ 1.64</b>	<b>\$ 1.12</b>
Granted						
Exercised						
Cancelled or expired						
<b>Outstanding at March 31, 2008</b>	<b>22,731,704</b>	<b>700,000</b>	<b>\$ 0.75-3.00</b>		<b>\$ 1.64</b>	<b>\$ 1.12</b>
<b>Outstanding and exercisable at March 31, 2008</b>	<b>22,731,704</b>	<b>700,000</b>	<b>\$ 0.75-3.00</b>	<b>\$ 1.09-\$1.14</b>	<b>\$ 1.64</b>	<b>\$ 1.12</b>

The warrants expire at various dates ranging from January 2011 through November 2016. The stock options are fully vested and expire at various dates ranging from July 2017 to September 2017.

**Earning (Loss) Per Share** The Company uses SFAS No. 128, *Earnings Per Share* for calculating the basic and diluted loss per share. Basic income/(loss) per share is computed by dividing net income/(loss) and net income/(loss) attributable to common shareholders by the weighted average number of common shares outstanding. Diluted income/(loss) per share is computed similar to basic loss per share except that the denominator is increased to include the number of additional common shares that would have been outstanding if the potential shares had been issued and if the additional shares were dilutive. Common equivalent shares are excluded from the computation of net loss per share if they would be anti-dilutive.

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	For the three month periods ended March 31,	
	2008	2007
<b>Net income/( loss) available to common shareholders</b>	<b>\$ 696,697</b>	<b>\$ (226,022)</b>
Weighted average shares outstanding:		
Basic	11,302,875	8,350,510
Diluted	23,507,759	8,350,510
<b>Income/Loss per share:</b>		
<b>Basic</b>	<b>\$ 0.06</b>	<b>\$ (0.03)</b>
<b>Diluted*</b>	<b>\$ 0.03</b>	<b>\$ (0.03)</b>

\* Diluted weighted average shares outstanding for period ended March 31, 2007 does not include the effect of the Company's common stock equivalent shares because to do so would have been anti-dilutive. Accordingly, basic and diluted net loss per share for this period is the same. The Company's dilutive common stock equivalent shares as of March 31, 2008 and 2007 include all of the Convertible Preferred shares and any incremental shares, as defined by SFAS No. 128, *Earnings Per Share*, associated with the Company's outstanding warrants and stock options.

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See the detailed list of Common Stock Equivalents below.

Securities	Exercise Price	Common Stock Equivalents as of March 31,	
		2008	2007
<i>Preferred:</i>			
Series A Preferred		8,255,325	8,516,993
Series C Preferred		2,246,300	2,675,000
Series E Preferred		1,000,000	750,000
<b>Total</b>		<b>11,501,625</b>	<b>11,941,993</b>
<i>Warrants:</i>			
Class A Warrants	\$ 1.50	10,369,351	10,369,351
Class B Warrants	\$ 2.25	4,970,824	4,970,824
Class C Warrants	\$ 0.75	2,000,000	2,000,000
Class D Warrants	\$ 0.75	2,000,000	2,000,000
Class E Warrants	\$ 3.00	880,544	880,544
Class F Warrants	\$ 2.25	1,000,000	750,000
Class BD-2 Warrants	\$ 1.50	919,162	919,162
Class BD-3 Warrants	\$ 2.25	459,581	459,581
Class BD-4 Warrants	\$ 1.50	66,121	66,121
Class BD-5 Warrants	\$ 3.00	66,121	66,121
<b>Total</b>		<b>22,731,704</b>	<b>22,481,704</b>
<i>Stock Options:</i>			
7/1/07 Issuance	\$ 1.14	350,000	
9/7/07 Issuance	\$ 1.09	350,000	
<b>Total</b>		<b>700,000</b>	
<b>Total common stock equivalents</b>		<b>34,933,329</b>	<b>34,423,697</b>

**Income Taxes** The Company utilizes the liability method of accounting for income taxes as set forth in SFAS 109, Accounting for Income Taxes. Under the liability method, deferred taxes are determined based on the difference between the financial statement and tax basis of assets and liabilities using enacted tax rates in effect in the years in which the differences are expected to reverse.

For the three month period ended March 31, 2008, the Company increased its estimated tax provision by \$120,000 to provide additional deferred tax expense on the amortization of tax deductible goodwill.

**Recent Accounting Pronouncements**

In December 2007, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 141 (revised 2007), *Business Combinations*. This accounting principle requires the fundamental requirements of acquisition accounting (purchase accounting) be applied to all business combinations in which control is obtained regardless of consideration and for an acquirer to be identified for each business combination. Additionally, this accounting principle requires acquisition-related costs and restructuring costs at the date of acquisition to be expensed rather than allocated to the assets acquired and the liabilities assumed; minority interests, including goodwill, to be recorded at fair value at the acquisition date; recognition of the fair value of assets and liabilities arising from contractual contingencies and contingent

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consideration (payments conditioned on the outcome of future events) at the acquisition date; recognition of bargain purchase (acquisition-date fair value exceeds consideration plus any noncontrolling interest) as a gain; and recognition of changes in deferred taxes. This accounting principle will be adopted January 2009. The accounting requirements will be adopted prospectively. Earlier adoption is prohibited. Adoption is not expected to have an impact on consolidated financial position, results of operations or cash flows.

In December 2007, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 160, *Noncontrolling Interests in Consolidated Financial Statements*. This accounting principle eliminates noncomparable accounting for minority interests. Specifically, minority interests are presented as a component of shareholders' equity; consolidated net income includes amounts attributable to both the parent and minority interest and is disclosed on the face of the income statement; changes in the ownership interest are accounted for as equity transactions if ownership remains controlling; elimination of purchase accounting for acquisitions of noncontrolling interests and acquisitions of additional interests; and recognition of deconsolidated controlling interest based on fair value consistent with Statement of Financial Accounting Standards No. 141 (revised 2007), *Business Combinations*. This accounting principle will be adopted January 2009. The accounting requirements will be adopted prospectively, however presentation and disclosure will be adopted retrospectively for all periods presented. Earlier adoption is prohibited. Adoption is not expected to have an impact on consolidated financial position, results of operations or cash flows.

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FASB Interpretation No 48, *Accounting for Uncertainty in Income Taxes – an interpretation of FASB Statement No. 109* ( FIN 48 ), was issued in July 2006. This interpretation clarifies the accounting for uncertainty in income taxes recognized in an entity's financial statements in accordance with SFAS No. 109, *Accounting for Income Taxes*. It prescribes a recognition threshold and measurement attribute for financial statement disclosure of tax positions taken, or expected to be taken, on a tax return. The Company will be required to adopt FIN 48 in the first quarter of fiscal 2008. Management is currently evaluating the requirements of FIN 48 and has not yet determined the impact on the financial statements.

In September 2006, the SEC issued Staff Accounting Bulletin No. 108 ( SAB No. 108 ), *Considering the Effects of Prior Year Misstatements When Quantifying Misstatements in Current Year Financial Statements*. SAB No. 108 provides guidance to registrants for assessing materiality. SAB No. 108 states that registrants should use both a balance sheet approach and income statement approach when quantifying and evaluating the materiality of a misstatement. SAB No. 108 also provides guidance on correcting errors under the dual approach as well as transition guidance for correcting previously immaterial errors that are now considered material. We adopted SAB No. 108 as of January 1, 2007 without any impact on our financial statements.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurement* ( SFAS 157 ), which defines fair value, establishes a framework for measuring fair value and expands disclosures about assets and liabilities measured at fair value. The Company will be required to adopt SFAS 157 in the first quarter of fiscal 2009. Management is currently evaluating the requirements of SFAS 157 and has not yet determined the impact on the financial statements.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*. SFAS No. 159 permits entities to choose to measure many financial instruments and certain other items at fair value. SFAS No. 159 will be effective at the beginning of fiscal year 2008. We are presently evaluating the impact of the adoption of SFAS No. 159 on our results of operations and financial position.

**3. INVENTORY**

Inventory consisted of the following components:

	<b>March 31, 2008 (unaudited)</b>
Raw Materials	1,471,289
Work-in-Process	430,681
Finished Goods	770,480
<b>Total Inventory</b>	<b>\$ 2,672,450</b>

**4. PRODUCT WARRANTIES**

The Company provides the retail home buyer a one-year limited warranty covering defects in material or workmanship in home structure, plumbing and electrical systems. The Company estimated warranty costs are accrued at the time of the sale to the dealer following industry standards and historical warranty cost incurred. Periodic adjustments to the estimated warranty accrual are made as events occur which indicate changes are necessary. As of March 31, 2008, the Company has provided a liability of \$2,160,000 for estimated warranty costs relating to homes sold, based upon management's assessment of historical experience factors and current industry trends.

Management reviews its warranty requirements at the close of each reporting period and adjusts the reserves accordingly. The following tabular presentation reflects activity in warranty reserves during the periods presented:

	<b>March 31, 2008 (unaudited)</b>
<b>Balance at beginning of period</b>	<b>\$ 2,130,000</b>
Warranty charges	1,584,496

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Warranty payments	(1,554,496)
<b>Balance at end of period</b>	<b>\$ 2,160,000</b>

**5. COMMITMENTS AND CONTINGENCIES**

*Litigation-* The Company in the normal course of business is subject to claims and litigation. Management of the Company is of the opinion that, based on information available, such legal matters will not ultimately have a material adverse effect on the financial position or results of operation of the Company.

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**Reserve for Repurchase Commitments** Deer Valley Homebuilders, Inc. ( DVH ) is contingently liable under the terms of repurchase agreements with financial institutions providing inventory financing for retailers of DVH s products. These arrangements, which are customary in the industry, provide for the repurchase of products sold to retailers in the event of default by the retailer. The risk of loss under these agreements is spread over numerous retailers. The price DVH is obligated to pay generally declines over the period of the agreement (typically 18 to 24 months) and the risk of loss is further reduced by the sale value of repurchased homes. The maximum amount for which the Company is contingently liable under repurchase agreements is approximately \$16,370,000 at March 31, 2008. DVH to date has not experienced significant losses under these agreements, and management does not expect any future losses to have a material effect on the accompanying financial statements.

**Earnout Agreement** On January 18, 2006, the Company's wholly-owned subsidiary, DeerValley Acquisitions Corp. (dissolved on July 1, 2006), entered into an Earnout Agreement (the "Earnout Agreement"), between Deer Valley Homebuilders, Inc., DeerValley Acquisitions Corp., and the former owners of Deer Valley Homebuilders, Inc. In connection with the Capital Stock Purchase Agreement, the Company entered into the Earnout Agreement, pursuant to which, additional payments may be paid to the former owners of Deer Valley Homebuilders, Inc. as an earnout based upon the Net Income Before Taxes of Deer Valley Homebuilders, Inc. during the next five (5) years, up to a maximum of \$6,000,000. In any given year during the term of the Earnout Agreement, 50% of the pre-tax profit exceeding \$1,000,000 per year will be accrued and become distributable to the prior shareholders.

On November 19, 2007, the Company entered into an amendment to the Earnout Agreement dated January 18, 2006, with the original founders (the Founders ), now the core operating management for the Company s wholly owned subsidiary, Deer Valley Homebuilders, Inc. (the Earnout Amendment ).

In exchange for the elimination of future performance based cash accruals that were expected to total an additional \$2 million over the next 12 to 36 months, the Company issued to the Founders two million shares of Deer Valley s common stock. In addition, accrued liabilities, totaling \$2.75 million on December 31, 2007, were paid to the Founders just prior to year end. The common stock will be held in escrow for a period of approximately three and one half years pending completion of the employment agreement requirements. The final number of shares released to recipients may be reduced in accordance with vesting requirements if the original earnout criteria is not met. For those shares that are ultimately released, if the open market price of the shares at the time of the release should be less than \$1.00/share, the Company has agreed to either issue additional shares or pay a cash amount equal to the difference between \$1.00 and the share price (i.e make whole ).

The Company accounted for the right to be made whole as a put liability. The value of the put liability was \$681,200 as of December 31, 2007. The Company used the Black-Scholes option pricing model with a risk free interest rate of 3.57%, 3 year expected term, and expected volatility of 60.9% to value the put liability.

Like other option valuation models Black-Scholes requires the input of highly subjective assumptions, including the expected stock price volatility. Because the Company s put liability has characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, in management s opinion, the Black-Scholes option model did not necessarily provide the most reliable measure of the put liability.

During the current period the Company determined the fair value of the put liability with a commercially available software product that utilizes a proven Monte Carlo valuation methodology. The Monte Carlo model was utilized to incorporate more complex variables than closed-form models such as the Black-Scholes option valuation model. Based on this analysis, the value of the put liability was determined to be approximately \$522,046 at inception, \$515,547 at December 31, 2007 and \$532,617 as of March 31, 2008. The Company used the data below to estimate the fair value of the put liability at each measurement date:

	Inception	12/31/07	3/31/08
Expected volatility	43.75%-49.54%	43.75%-49.54%	43.75%-49.54%
Expected dividends			
Expected term in years	3	3	3
Risk free rate of return	3.16%	3.16%	3.16%

At December 31, 2007, the accrued Put liability was stated at \$681,200. During the first quarter of 2008, the method of determining this accrual was changed resulting in a reduction of the liability by \$165,654 with an offsetting increase to additional paid in capital by the same amount. Further, as a result of changes in the market price and volatility of the company s common shares during the three-month period ended March 31, 2008, a derivative expense of \$17,071 was incurred for the quarter resulting in the stated net Put liability of \$532,617 as of the end of the period.



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**Loans and Letter of Credit** On May 26, 2006, DVH entered into a Loan Agreement with Fifth Third Bank (the Lender ) providing for a loan of Two Million and No/100 Dollars (\$2,000,000) (the "Loan") evidenced by a promissory note and secured by a first mortgage on DVH s properties in Guin, Alabama and Sulligent, Alabama, including the structures and fixtures located thereon, as well as DVH s interest in any lease thereof. The purpose of the loan is to pay off an existing loan from another bank secured by the Guin property and to reduce the outstanding balance on DVH s revolving credit facility with the Lender. The net effect of the reduction in the revolving credit balance is to increase the credit available to the Company for working capital under its revolving facility. The Loan has a term from May 26, 2006 through June 1, 2011 and has a variable interest rate at 2.25% above LIBOR. There is no prepayment penalty. Future advances are available under the Loan Agreement, subject to approval by the Lender. Also on May 26, 2006, the Company and DVH guaranteed the Loan. Should Deer Valley default, thereby triggering acceleration of the Loan, the Company would become liable for payment of the Loan.

On April 11, 2007, Deer Valley Corporation entered into a new Loan and Security Agreement providing for a revolving line of credit in an amount not to exceed Two Million Five Hundred Thousand and No/100 Dollars (\$2,500,000) (the "DV Loan Agreement") evidenced by a revolving credit note and secured by accounts receivable, inventory, equipment and all other tangible and intangible personal property of Deer Valley Corporation and DVH. The purpose of the DV Loan Agreement is to provide a standby source of working capital, letters of credit required by the terms of certain repurchase agreements and performance bonds entered into in the normal course of the Company s business, and to provide financing for potential acquisition(s) of new manufacturing facilities or subsidiaries. The DV Loan Agreement has a one year term and has a variable interest rate at 2.60% above LIBOR. Upon issuance of a letter of credit, Deer Valley Corporation is charged a letter of credit fee equal to 1.00% of the face amount of the letter of credit. The DV Loan Agreement provides for conditions to meet prior to each advance, including financial ratios. See consolidation of credit facility in Note 7 Subsequent Events.

In addition to the above, on April 11, 2007, DVH renewed its existing Loan and Security Agreement providing for a revolving line of credit in an amount not to exceed Two Million Five Hundred Thousand and No/100 Dollars (\$2,500,000) (the "DVH Loan agreement") evidenced by a revolving credit note and secured by accounts receivable, inventory, equipment and all other tangible and intangible personal property of DVH and Deer Valley Corporation. The purpose of the DVH Loan is to provide standby working capital and letters of credit required by the terms of certain repurchase agreements and performance bonds entered into in the normal course of DVH s business. The DVH Loan Agreement has a one year term and has a variable interest rate at 2.60% above LIBOR. Upon issuance of a letter of credit, DVH is charged a letter of credit fee equal to 1.00% of the face amount of the letter of credit. The DVH Loan provides for conditions to meet prior to each advance, including financial ratios.

On August 10, 2007, Deer Valley Homebuilders, Inc. ( DVH ) entered into a Revolving Bridge Loan and Security Agreement with Fifth Third Bank, providing for a line of credit in an amount not to exceed Five Million and No/100 Dollars (\$5,000,000), evidenced by a revolving credit note and secured by accounts receivable, inventory, equipment and all other tangible and intangible personal property of DVH. The purpose of the new facility is to provide a standby source of working capital for fulfillment of one or more contracts with the State of Mississippi to construct housing units under the Mississippi Alternative Pilot Program. This facility has a six month term and has a variable interest rate at 2.50% above LIBOR. The Loan and Security Agreement permits acceleration upon certain payment and covenant defaults.

In addition to the revolving line of credit described in the preceding paragraph, DVH, during its normal course of business, is required to issue irrevocable standby letters of credit in the favor of independent third party beneficiaries to cover obligations under repurchase agreements. As of March 31, 2008, no amounts had been drawn on the above irrevocable letters of credit by the beneficiaries.

**Dividends Payable-** As of March 31, 2008 the total accrued dividend payable to Series A Preferred shareholders was \$21,562.

**6. EQUITY TRANSACTIONS**

**Series A Convertible Preferred Stock** During the three month period ended March 31, 2008 certain shareholders converted 10,625 shares of Series A Preferred stock, par value \$106,250, into 141,668 shares of the Company s common stock.

**Common Stock Dividends** During the three month period ended March 31, 2008, a dividend to holders of Series A Preferred Stock became due. The Company issued 263,400 shares of the Company s common stock to Series A Preferred shareholders as payment for \$221,399 of dividends.

**7. SUBSEQUENT EVENTS**

Effective April 12, 2008, DVH renewed and consolidated its existing revolving credit line of \$2,500,000 with Fifth Third Bank, and its existing revolving bridge line of credit of \$5,000,000 with Fifth Third Bank (the Consolidated Facility ). The Consolidated Facility is a revolving line of credit in an amount not to exceed \$7,500,000 evidenced by a revolving credit note and secured by accounts receivable, inventory, equipment and all other tangible and intangible personal property of DVH and guaranteed by Deer Valley Corporation. The purpose of the Consolidated

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Facility is to provide working capital and letters of credit required by the terms of certain repurchase agreements and performance bonds entered into in the normal course of the Company's business. The Consolidated Facility has a one-year term and has a variable interest rate at 2.50% above LIBOR and provides for conditions to meet, including financial ratios, prior to each advance.

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### **Item 2. Management's Discussion and Analysis Cautionary Notice Regarding Forward Looking Statements**

We desire to take advantage of the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. This filing contains a number of forward-looking statements which reflect management's current views and expectations with respect to our business, strategies, products, future results and events, and financial performance. All statements made in this filing other than statements of historical fact, including statements addressing operating performance, events, or developments which management expects or anticipates will or may occur in the future, including statements related to distributor channels, volume growth, revenues, profitability, new products, adequacy of funds from operations, statements expressing general optimism about future operating results, and non-historical information, are forward looking statements. In particular, the words believe, expect, intend, anticipate, estimate, may, variations of such words, and similar expressions identify forward-looking statements, but are not the exclusive means of identifying such statements, and their absence does not mean that the statement is not forward-looking. These forward-looking statements are subject to certain risks and uncertainties, including those discussed below. Our actual results, performance or achievements could differ materially from historical results as well as those expressed in, anticipated, or implied by these forward-looking statements. We do not undertake any obligation to revise these forward-looking statements to reflect any future events or circumstances.

Readers should not place undue reliance on these forward-looking statements, which are based on management's current expectations and projections about future events, are not guarantees of future performance, are subject to risks, uncertainties and assumptions (including those described below), and apply only as of the date of this filing. Our actual results, performance or achievements could differ materially from the results expressed in, or implied by, these forward-looking statements. Factors which could cause or contribute to such differences include, but are not limited to, risks discussed in our Annual Report on form 10-KSB. We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events, or otherwise.

#### **Overview**

The Company, through its wholly owned subsidiary Deer Valley Homebuilders, Inc. ( DVH ), manufactures and designs factory-built homes at its principal manufacturing plant located in Guin, Alabama and a separate manufacturing plant in Sulligent, Alabama the majority of which are sold to a network of independent dealers located primarily in the southeastern and south central regions of the United States.

In recent years, the factory-built housing industry has suffered a downturn in sales as a result of a tightening of credit standards, restricted availability of retail and wholesale financing, and excessive inventory levels. This industry decline began in 1999, approximately five years before we successfully launched and began to rapidly grow our business in January, 2004. We have excelled in a tough industry through efficient manufacturing at our production facilities, industry leading products, experienced and capable relations oriented sales and management teams, stringent cost controls, and attention to dealer support, customer satisfaction, and service efforts.

The Company's executives are continuing to focus on two matters relating to the industry-wide slowdown. First, management is addressing the well-publicized slowdown in the housing industry with a focus on sales. Second, in recognition of an important trend in the housing market toward modular homes and as part of the Company's strategic plan to continue its growth in a challenging industry, management plans will continue to increase the Company's involvement in the modular segment of the factory-built housing industry. As its initial entry into the modular segment, the Company has targeted the production of smaller units (less than 3,000 square feet) that are readily producible, in a cost efficient manner, using the Company's existing manufacturing capabilities. The Company intends to sell these models to large tract developers, government agencies and individuals through independent dealers.

Despite the recent downturns in sales for the housing industry, our revenues for the three-month period ended March 31, 2008 have increased by more than 40% over the same three-month period during 2007. The primary differences between the two periods are the Company's growth during this quarter of its modular segment and the success related to the contract with the State of Mississippi detailed below.

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Beginning in the second quarter of calendar year 2007, state and federal agencies, and other government sponsored entities, began distributing Requests for Proposals (RFPs) for housing designed to test and evaluate future disaster recovery housing units for the Gulf Coast region. The Company has aggressively taken advantage of its Alabama location and reputation in the Gulf Coast area to become a significant participant in the permanent rebuilding of the Gulf Coast region and the production of prototypes for future disaster recovery housing units. As an immediate result of its efforts, in June 2007 the Company's plant in Guin, Alabama was selected by the State of Mississippi to produce 50 two-bedroom and 100 three-bedroom cottages as part of a program, the Mississippi Alternative Pilot Program, that is designed to test and evaluate future disaster housing units. The total combined value of this initial pilot phase contract awarded to the Company was \$7,535,000. All units contracted for with the Company under this initial contract were produced and delivered before the end of the third quarter of 2007.

In October 2007, the Company was awarded a contract extension by the State of Mississippi for the production and delivery of an additional 150 two-bedroom cottages as part of the State of Mississippi's pilot program to test and evaluate future disaster housing units. As with the initial contract, the Company delivered the units to state designated staging areas located near the Gulf Coast. Total proceeds from this contract extension is \$7,185,000 which, when combined with the original contract for the manufacture of 50 two-bedroom and 100 three-bedroom cottages, brought the proceeds of the State of Mississippi contracts awarded to Deer Valley to a total of \$14,720,000.

In December 2007, the scope of the Company's contract with the State of Mississippi was further increased to provide for the production and delivery of an additional 100 two-bedroom cottages. The Company estimates that this increase in scope has generated an additional \$4,790,000 in revenue, which brings the Company's combined revenue from the State of Mississippi contract to a total of \$19,510,000. All of the units to be produced by the Company under the two contract extensions were delivered prior to March 31, 2008. The total amount received for the contracts with the State of Mississippi accounted for 15.3% of the Company's total sales in 2007.

In April 2008, the Company was granted another contract extension from the State of Mississippi providing for the production and delivery of 75 additional three-bedroom cottages. The contract extension is expected to contribute an additional \$3,855,000 to the Company's revenue during the second and third quarters of 2008, bringing Deer Valley's aggregate revenues from the State of Mississippi contract to approximately \$23,400,000. The Company cannot predict whether the State of Mississippi will provide any additional extensions of the initial contract beyond those that the Company has already received.

## **Manufacturing Operations**

We currently produce all of our factory-built homes at two manufacturing facilities in Guin and Sulligent, Alabama. Our facilities normally function on a single-shift, five-day work week basis. During the first quarter of 2008, the Company's average production rate was approximately 9.5 floors produced per day.

The principal raw materials used in the production of HUD Code and modular homes include wood, wood products, panels, steel, sheetrock, vinyl siding, gypsum wallboard, fiberglass insulation, carpet, appliances, electrical items, windows, roofing materials, electrical supplies, roof trusses, and plumbing fixtures. We believe that the raw materials used in the production of our factory-built homes are readily available from a wide variety of suppliers and that the loss of any single supplier would not have a material adverse effect on our business.

While our HUD Code and modular homes are constructed with many of the same components and building materials used in site-built homes, we utilize a cost-efficient assembly line manufacturing process which enables us to produce a quality home at a significantly lower cost per square foot than a traditional, site-built home. Our homes are built with residential features, including 1/2 inch drywall, thermally sealed double-paned windows from Capitol, enhanced insulation, oak cabinets, cultured marble vanities, and two inch by six inch exterior wall construction standards.

Because the cost of transporting a factory-built home is significant, substantially all of our homes are sold to dealers within a 500 mile radius of our manufacturing facility. DVH arranges, at dealers' expense, for the transportation of finished homes to dealer locations using independent trucking companies. Customary sales terms are cash-on-delivery or guaranteed payment from a floor-plan financing source. Dealers or other independent installers are responsible for placing the home on site and connecting utilities.

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When evaluating the Company's operating performance, the key performance indicators management examines are (1) the Company's production rate, in floors produced per day, (2) the cost of sales, and (3) the size of the Company's sales backlog. For more information on these performance indicators, please see the attached financial statements and notes thereto and the section of the Company's Annual Report on Form 10-KSB titled "Description of Business."

### **Results of Operations**

*The following discussion examines the results of the Company's operations for the three month period ended March 31, 2008. This discussion of our financial condition and results of operations should be read in conjunction with our financial statements and notes to the financial statements, included herewith. This discussion should not be construed to imply that the results discussed herein will necessarily continue into the future, or that any conclusion reached herein will necessarily be indicative of actual operating results in the future. Such discussion represents only the best present assessment by our management. It is also imperative that one read our December 31, 2007 Annual Report on Form 10-KSB and subsequent filings on Form 8-K.*

### **HISTORICAL RESULTS PERIODS ENDED MARCH 31, 2008 AND MARCH 31, 2007.**

**Revenues.** Overall gross revenue for the three month period ended March 31, 2008 was \$16,693,815 compared to \$11,812,342 for the three month period ended March 31, 2007. Revenue for the three month period ended March 31, 2008 increased over the same three period in 2007, primarily due to the Company's completion of its contract with the State of Mississippi for the production of two-bedroom and three-bedroom cottages as part of its program that is designed to test and evaluate future disaster housing units. For the three month period ending March 31, 2008, our cost of revenues as a percentage of revenue decreased to 80.7%, as compared to 88.4% for the corresponding period for 2007.

**Selling, General, and Administrative Expenses.** Selling, general and administrative expenses consisted of payroll and related expenses for executive, accounting, and administrative personnel, professional fees, and other general corporate expenses. Selling, general, and administrative expenses for the three month period ended March 31, 2008 was \$2,028,638, compared to \$1,424,529 for the three month period ended March 31, 2007. General and administrative costs increased for the three month period ending March 31, 2008, in comparison to the corresponding period for 2007, primarily due to increased production capacity, increased trade show participation, and increased administration cost associated with the MEMA project.

**Net Income.** The net income for the three month period ended March 31, 2008 was \$696,697, compared to net losses of \$134,245 for the three month period ended March 31, 2007. After accounting for the stock dividend payable to preferred stockholders, the net income to common stockholders for the three month period ended March 31, 2008 was 675,135 compared to net losses of \$226,022 for the three month period ended March 31, 2007. The significant increases in net income to common stockholders for the three month period ended March 31, 2008 versus that same period ended March 31, 2007 are primarily attributable to our increased production during the first three months of 2008 and the decrease in our cost of sales as a percentage of revenue. In addition, during the first portion of this quarter, the Company accrued its semi-annual common stock dividends for shareholders holding shares of the Company's Series A Preferred Convertible Stock (the "Series A Preferred Stock"). Pursuant to the terms of the Series A Preferred Stock, those dividends accrued by the Company represent the fourth and last dividends to be issued to such shareholders. Accordingly, the Company's accrual of the dividend for the period ended March 31, 2008, was relatively small compared with prior periods where such dividends accrued.

### **Liquidity and Capital Resources**

Management believes that the Company currently has sufficient cash flow from operations, available bank borrowings, cash, and cash equivalents to meet its short-term working capital requirements. The Company had \$5,131,654 in cash and cash equivalents as of March 31, 2008, compared to \$5,599,667 in cash and cash equivalents as of March 31, 2007. The Company's reduction in cash was primarily attributable to an increase in receivables due to the State of Mississippi contract and payment of the accrued liability resulting from payments to certain former

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owners of DVH relating to an earnout agreement discussed below in *Off-Balance Sheet Arrangements*. Should our costs and expenses prove to be greater than we currently anticipate, or should we change our current business plan in a manner which will increase or accelerate our anticipated costs or capital demand, such as through the acquisition of new products, our working capital could be depleted at an accelerated rate.

The net cash used in operating activities for the three month period ended March 31, 2008 was \$1,646,984. The net cash used in operating activities for the three month period ended March 31, 2007 was \$1,788,270. The reduction of cash used in operating activities for the first three months of 2008, in comparison to the same period from the Company's prior fiscal year, is attributable primarily to a temporary increase in receivables related to the Company's fulfillment of its contract with the State of Mississippi. During the last quarter of 2007 and the first quarter of 2008, the Company received payments from the State of Mississippi for a significant portion of the contract, and repaid all borrowings under its Revolving Bridge Loan with Fifth Third Bank. To further fund the most recent production of the State of Mississippi cottages, the Company again borrowed from its loan with Fifth Third Bank. The Company has been paid by the State of Mississippi in accordance with its contract terms and anticipates receiving all remaining payments from the State of Mississippi for the completion of the contract during the second quarter of 2008. The Company's accounts receivable as of March 31, 2008 was \$6,953,841, as compared to \$2,834,582 as of March 31, 2007.

The net cash used in investing activities for the three month period ending March 31, 2008 was \$64,171, which primarily reflects purchases of equipment. The net cash provided from financing activities for the three month period ending March 31, 2008 was \$2,064,475, which primarily relates to the Company's borrowings under its line of credit with its senior lender. The Company anticipates receiving payments during the second quarter of 2008 in connection with governmental contracts that were completed during the last quarter of 2007 and first quarter of 2008, thereby reducing its accounts receivable and its borrowings under its line of credit with its senior lender.

We are contingently liable under the terms of repurchase agreements with financial institutions providing inventory financing for retailers of our products. For more information on the repurchase agreements, including the Company's contingent liability thereunder, please see Reserve for Repurchase Commitments below.

## **Recent Developments**

In April 2008, the Company was awarded a \$16.1 million contract to build more than 120 twin-town home units for a 264-acre master-planned residential rental community in Ocean Springs, Mississippi by M&C Development LLC called Orleans Place. Construction and delivery of the first homes in Phase I of the development is expected to begin in the second quarter of 2008.

Also in April 2008, the Company was granted a contract extension from the State of Mississippi providing for the production and delivery of 75 additional three-bedroom cottages. The cottages are being purchased by the State as part of a \$280 million federal pilot program designed to test and evaluate future disaster relief housing. The contract extension is expected to contribute an additional \$3,855,000 to the Company's revenue during the second and third quarters of 2008. Delivery of this new group of cottages will bring Deer Valley's aggregate revenues from the pilot phase contracts to approximately \$23,400,000. Prior to the receipt of this most recent contract extension, the Company had produced 400 two-bedroom and three-bedroom cottages for the State of Mississippi.

Effective as of April 12, 2008, DVH renewed and consolidated its existing revolving credit line of \$2,500,000 with Fifth Third Bank, and its existing revolving bridge line of credit of \$5,000,000 with Fifth Third Bank (the Consolidated Facility). The Consolidated Facility is a revolving line of credit in an amount not to exceed \$7,500,000 evidenced by a revolving credit note and secured by accounts receivable, inventory, equipment and all other tangible and intangible personal property of DVH and guaranteed by Deer Valley Corporation. The purpose of the Consolidated Facility is to provide working capital and letters of credit required by the terms of certain repurchase agreements and performance bonds entered into in the normal course of the Company's business. The Consolidated Facility has a one-year term and has a variable interest rate at 2.50% above LIBOR and provides for conditions to meet, including financial ratios, prior to each advance.

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### **Critical Accounting Policies**

Our discussion and analysis of our financial condition and results of operations are based upon our financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these consolidated financial statements requires us to make estimates and judgments which affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosures of contingent assets and liabilities. For a description of those estimates, see Note 2, Summary of Significant Accounting Policies, contained in the explanatory notes to the Company's financial statements for the quarter ended March 31, 2008, contained in this filing and the Company's Form 10-KSB for December 31, 2007. On an ongoing basis, we evaluate our estimates, including those related to reserves, deferred tax assets, valuation allowances, impairment of long-lived assets, fair value of equity instruments issued to consultants for services, and estimates of costs to complete contracts. We base our estimates on historical experience and on various other assumptions which we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying value of assets and liabilities which are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions. However, we believe that our estimates, including those for the above-described items, are reasonable.

### **Critical Accounting Estimates**

Management is aware that certain changes in accounting estimates employed in generating financial statements can have the effect of making the Company look more or less profitable than it actually is. Management does not believe that either the Company or its auditors have made any such changes in accounting estimates. A summary of the most critical accounting estimates employed by the Company in generating financial statements follows below.

### **Warranties**

We provide our retail buyers with a one-year limited warranty covering defects in material or workmanship, including plumbing and electrical systems. We record a liability for estimated future warranty costs relating to homes sold, based upon our assessment of historical experience and industry trends. In making this estimate, we evaluate historical sales amounts, warranty costs related to homes sold and timing in which any work orders are completed. The Company has accrued a warranty liability reserve of \$2,160,000 on its balance sheet as of March 31, 2008. Although we maintain reserves for such claims, there can be no assurance that warranty expense levels will remain at current levels or that the reserves that we have set aside will continue to be adequate. A large number of warranty claims which exceed our current warranty expense levels could have a material adverse affect upon our results of operations.

### **Volume Incentives Payable**

We have relied upon volume incentive payments to our independent dealers who retail our products. These volume incentive payments are accounted for as a reduction to gross sales, and are estimated and accrued when sales of our factory-built homes are made to our independent dealers. Volume incentive reserves are recorded based upon the annualized purchases of our independent dealers who purchase a qualifying amount of home products from us. We accrue a liability to our dealers, based upon estimates derived from historical payout rates. Volume incentive costs represent a significant expense to us, and any significant changes in actual payouts could have an adverse affect on our financial performance. We had a reserve for volume incentives payable of \$459,635 as of March 31, 2008, as compared to \$467,845 as of March 31, 2007.

### **Reserve for Repurchase Commitments**

Most of our independent dealers finance their purchases under a wholesale floor plan financing arrangement under which a financial institution provides the dealer with a loan for the purchase price of the home and maintains a security interest in the home as collateral. When entering into a floor plan arrangement, the financial institution routinely requires that we enter into a separate repurchase agreement with the lender, under which we are obligated, upon default by the independent dealer, to repurchase the factory-built home at our original invoice price less the cost of administrative and shipping expenses. Our potential loss under a repurchase obligation depends upon the estimated net resale value of the home, as compared to the repurchase price that we are obligated to pay. This amount generally declines on a predetermined schedule over a period that usually does not exceed 24 months.

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The risk of loss that we face under these repurchase agreements is lessened by several factors, including the following:

- (i) the sales of our products are spread over a number of independent dealers,
- (ii) we have had only isolated instances where we have incurred a repurchase obligation,
- (iii) the price we are obligated to pay under such repurchase agreements declines based upon a predetermined amount over a period which usually does not exceed 24 months, and
- (iv) we have been able to resell homes repurchased from lenders at current market prices, although there is no guarantee that we will continue to be able to do so.

The maximum amount for which the Company is contingently liable under such agreements amounted to approximately \$16,370,000 as of March 31, 2008, as compared to \$15,765,000 as of March 31, 2007. As of March 31, 2008 and March 31, 2007, we had reserves of \$200,000 and \$84,650, respectively, established for future repurchase commitments, based upon our prior experience and evaluation of our independent dealers' financial conditions. Because Deer Valley to date has not experienced any significant losses under these agreements, management does not expect any future losses to have a material effect on our accompanying financial statements.

## **Revenue Recognition**

Revenue for our products sold to independent dealers are generally recorded when all of the following conditions have been met: (i) an order for the home has been received from the dealer, (ii) an agreement with respect to payment terms has been received, and (iii) the home has been shipped and risk of loss has passed to the dealer. When products are sold to the State of Mississippi, revenue is recognized upon its official receipt and inspection at a site designated by the State of Mississippi.

## **Recent Accounting Pronouncements**

In December 2007, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 141 (revised 2007), *Business Combinations*. This accounting principle requires the fundamental requirements of acquisition accounting (purchase accounting) be applied to all business combinations in which control is obtained regardless of consideration and for an acquirer to be identified for each business combination. Additionally, this accounting principle requires acquisition-related costs and restructuring costs at the date of acquisition to be expensed rather than allocated to the assets acquired and the liabilities assumed; minority interests, including goodwill, to be recorded at fair value at the acquisition date; recognition of the fair value of assets and liabilities arising from contractual contingencies and contingent consideration (payments conditioned on the outcome of future events) at the acquisition date; recognition of bargain purchase (acquisition-date fair value exceeds consideration plus any noncontrolling interest) as a gain; and recognition of changes in deferred taxes. This accounting principle will be adopted January 2009. The accounting requirements will be adopted prospectively. Earlier adoption is prohibited. Adoption is not expected to have an impact on consolidated financial position, results of operations or cash flows.

In December 2007, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 160, *Noncontrolling Interests in Consolidated Financial Statements*. This accounting principle eliminates noncomparable accounting for minority interests. Specifically, minority interests are presented as a component of shareholders' equity; consolidated net income includes amounts attributable to both the parent and minority interest and is disclosed on the face of the income statement; changes in the ownership interest are accounted for as equity transactions if ownership remains controlling; elimination of purchase accounting for acquisitions of noncontrolling interests and acquisitions of additional interests; and recognition of deconsolidated controlling interest based on fair value consistent with Statement of Financial Accounting Standards No. 141 (revised 2007), *Business Combinations*. This accounting principle will be adopted January 2009. The accounting requirements will be adopted prospectively, however presentation and disclosure will be adopted retrospectively for all periods presented. Earlier adoption is prohibited. Adoption is not expected to have an impact on consolidated financial position, results of operations or cash flows.

FASB Interpretation No 48, *Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109* (FIN 48), was issued in July 2006. This interpretation clarifies the accounting for uncertainty



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in income taxes recognized in an entity's financial statements in accordance with SFAS No. 109, *Accounting for Income Taxes*. It prescribes a recognition threshold and measurement attribute for financial statement disclosure of tax positions taken, or expected to be taken, on a tax return. The Company will be required to adopt FIN 48 in the first quarter of fiscal 2008. Management is currently evaluating the requirements of FIN 48 and has not yet determined the impact on the financial statements.

In September 2006, the SEC issued Staff Accounting Bulletin No. 108 ( *SAB No. 108* ), *Considering the Effects of Prior Year Misstatements When Quantifying Misstatements in Current Year Financial Statements*. SAB No. 108 provides guidance to registrants for assessing materiality. SAB No. 108 states that registrants should use both a balance sheet approach and income statement approach when quantifying and evaluating the materiality of a misstatement. SAB No. 108 also provides guidance on correcting errors under the dual approach as well as transition guidance for correcting previously immaterial errors that are now considered material. We adopted SAB No. 108 as of January 1, 2007 without any impact on our financial statements.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurement* ( *SFAS 157* ), which defines fair value, establishes a framework for measuring fair value and expands disclosures about assets and liabilities measured at fair value. The Company will be required to adopt SFAS 157 in the first quarter of fiscal 2009. Management is currently evaluating the requirements of SFAS 157 and has not yet determined the impact on the financial statements.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*. SFAS No. 159 permits entities to choose to measure many financial instruments and certain other items at fair value. SFAS No. 159 will be effective at the beginning of fiscal year 2008. We are presently evaluating the impact of the adoption of SFAS No. 159 on our results of operations and financial position.

### **Off-Balance Sheet Arrangements**

On January 18, 2006, the Company entered into the Earnout Agreement, which provided for contingent additional payments to the former owners of DVH, as an earnout, based upon the Net Income Before Taxes of DVH during the next five (5) years, up to a maximum of \$6,000,000.

On November 19, 2007, the Company entered into an amendment to the Earnout Agreement with the original founders (the *Founders* ), now the core operating management for the Company's wholly owned subsidiary, Deer Valley Homebuilders, Inc. (the *Earnout Amendment* ).

In exchange for the elimination of future performance based cash accruals that were expected to total an additional \$2 million over the next 12 to 36 months, the Company issued to the Founders two million shares of Deer Valley's common stock. In addition, accrued liabilities resulting from achievement of certain predetermined milestones related to the Company's success, totaling \$2.75 million on December 31, 2007, were paid to the Founders just prior to year end. The common stock will be held in escrow for a period of approximately three and one half years pending completion of the employment agreement requirements. The final number of shares released to recipients may be reduced in accordance with vesting requirements if the original earnout criteria is not met. For those shares that are ultimately released, if the open market price of the shares at the time of the release should be less than \$1.00/share, the Company has agreed to either issue additional shares or pay a cash amount equal to the difference between \$1.00 and the share price (i.e. *make whole* ).

The Company accounted for the right to be made whole as a put liability. The value of the put liability was \$681,200 as of December 31, 2007. The Company initially used the Black-Scholes option pricing model with a risk free interest rate of 3.57%, 3 year expected term, and expected volatility of 60.9% to value the put liability.

Like other option valuation models Black-Scholes requires the input of highly subjective assumptions, including the expected stock price volatility. Because the Company's put liability has characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, in management's opinion, the Black-Scholes option model did not necessarily provide the most reliable measure of the put liability.

Commencing with the first quarter of 2008, the Company determined the fair value of the put liability with a commercially available software product that utilizes a proven Monte Carlo valuation methodology. The Monte

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Carlo model was utilized to incorporate more complex variables than closed-form models such as the Black-Scholes option valuation model. Based on this analysis, the value of the put liability was determined to be approximately \$522,046 at inception, \$515,547 at December 31, 2007 and \$532,617 as of March 31, 2008.

At December 31, 2007, the accrued Put liability was stated at \$681,200. During the first quarter of 2008, the method of determining this accrual was changed resulting in a reduction of the liability by \$165,654 with an offsetting increase to additional paid in capital by the same amount. Further, as a result of changes in the market price and volatility of the company's common shares during the three-month period ended March 31, 2008, a derivative expense of \$17,071 was incurred for the quarter resulting in the stated net Put liability of \$532,617 as of the end of the period.

### **Item 4. Controls and Procedures**

#### **Evaluation of Disclosure Controls and Procedures**

The Company's Chief Executive Officer and acting Chief Financial Officer has evaluated the effectiveness of the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) as of the fiscal period ending March 31, 2008 covered by this Quarterly Report on Form 10-QSB. Based upon such evaluation, the Chief Executive Officer and acting Chief Financial Officer has concluded that, as of the end of such period, the Company's disclosure controls and procedures were effective as required under Rules 13a-15(e) and 15d-15(e) under the Exchange Act.

#### **Changes in Internal Controls over Financial Reporting**

During the quarter ended March 31, 2008, there have been no changes in our internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

#### **Inherent Limitations of the Effectiveness of Internal Control**

A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the internal control system are met. Because of the inherent limitations of any internal control system, no evaluation of controls can provide absolute assurance that all control issues, if any, within a company have been detected.

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**PART II OTHER INFORMATION**

**Item 1. Legal Proceedings**

Although the Company in the normal course of business is subject to claims and litigation, the Company is not a party to any material legal proceeding nor is the Company aware of any circumstance which may reasonably lead a third party to initiate legal proceeding against the Company.

As of the date of this filing, there are no material pending legal or governmental proceedings relating to our Company or properties to which we are a party, and to our knowledge there are no material proceedings to which any of our directors, executive officers, or affiliates are a party adverse to us or which have a material interest adverse to us.

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

**Series A Convertible Preferred Stock** During the three month period ending March 31, 2008 certain shareholders converted 10,625 shares of Series A Preferred Stock, par value \$106,250, into 141,668 shares of the Company's common stock. The securities were issued to existing shareholders, and the transaction was exempt under Section 3(a)(9) of the Securities Act, as amended.

**Common Stock Dividends** During the three month period ending March 31, 2008, the Company issued 263,400 shares of the Company's common stock to Series A Preferred shareholders as payment for \$221,399 of dividends.

**Item 3. Defaults Upon Senior Securities**

None.

**Item 4. Submission of Matters to a Vote of Security Holders**

None.

**Item 5. Other Information**

None

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**Item 6. Exhibits**

<b>Exhibit No.</b>	<b>Description</b>
3.01	Articles of Incorporation of Deer Valley Corporation. (1)
3.02	Bylaws of Deer Valley Corporation. (1)
4.01	Certificate of Designation, Rights, and Preferences of Series A Convertible Preferred Stock. (1)
4.02	Certificate of Designation, Rights, and Preferences of Series B Convertible Preferred Stock. (1)
4.03	Certificate of Designation, Rights, and Preferences of Series C Convertible Preferred Stock. (1)
4.04	Certificate of Designation, Rights, and Preferences of Series D Convertible Preferred Stock. (1)
4.05	Certificate of Designation, Rights, and Preferences of Series E Convertible Preferred Stock. (2)
10.01	Second Amendment to Loan Agreement (3)
10.02	Renewal and Consolidation Revolving Credit Note (3)
10.03	Continuing Guaranty of Deer Valley Corporation (3)
31.01	Certification of Chief Executive Officer pursuant to Rule 13a-14(a) and 15d-14(a) as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, dated May 14, 2008. (4)
31.02	Certification of Acting Chief Financial Officer pursuant to Rule 13a-14(a) and 15d-14(a) as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, dated May 14, 2008. (4)
32.01	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, dated May 14, 2008. (4)
32.02	Certification of Acting Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, dated May 14, 2008. (4)

- (1) Previously filed as an exhibit to the Form 8-K, filed with the SEC on July 28, 2006 and incorporated herein by reference.
- (2) Previously filed as an exhibit to the Form 10-QSB, filed with the SEC on November 20, 2006 and incorporated herein by reference.
- (3) Previously filed as an exhibit to the Form 8-K, filed with the SEC on May 13, 2008 and incorporated herein by reference.
- (4) Filed herewith.

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**SIGNATURE**

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

Deer Valley Corporation  
(Registrant)

Dated: May 14, 2008

By: */s/ Charles G. Masters*  
Charles G. Masters  
President & Chief Executive Officer