

DEER VALLEY CORP
Form 10-Q
November 05, 2010
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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 September 30, 2010

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.)
3111 W. Dr. MLK Blvd., Ste 100, Tampa, FL (Address of principal executive offices)	33607 (Zip code)
Registrant's telephone number, including area code: (813) 418-5250	

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 <input type="checkbox"/>	Accelerated Filer <input type="checkbox"/>
Non-accelerated filer <input type="checkbox"/>	Smaller reporting company <input checked="" type="checkbox"/>

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (Section 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

The Registrant had 17,334,585 shares of Common Stock, par value \$0.001 per share, outstanding as of November 4, 2010.

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

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements

Deer Valley Corporation & Subsidiaries

Condensed Consolidated Financial Statements

Contents:

<u>Consolidated Balance Sheets as of September 30, 2010 (unaudited) and December 31, 2009</u>	F-2
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Table of Contents**Deer Valley Corporation & Subsidiaries****Consolidated Balance Sheets**

	September 30, 2010 (unaudited)	December 31, 2009
ASSETS		
Current Assets:		
Cash	\$ 8,151,556	\$ 8,503,866
Restricted Cash	700,000	
Accounts receivable	826,613	828,492
Inventory	1,202,402	738,294
Deferred tax asset	686,679	720,560
Inventory finance notes receivable	1,887,754	380,226
Prepaid expenses and other current assets	73,404	113,269
Total Current Assets	13,528,408	11,284,707
Fixed Assets:		
Property, plant and equipment, net	2,529,691	2,704,502
Other Assets:		
Goodwill		
Inventory finance notes receivable - net	2,658,062	637,514
Deferred tax asset	2,034,931	2,080,767
Other assets	257,571	467,265
Total Other Assets:	4,950,564	3,185,546
Total Assets	\$ 21,008,663	\$ 17,174,755

LIABILITIES AND STOCKHOLDERS EQUITY

Current Liabilities:		
Current maturities on long term debt	\$ 1,640,608	\$ 95,336
Notes payable	2,700,000	
Accounts payable	450,306	204,835
Accrued expenses	1,867,599	1,747,627
Accrued warranties	1,430,000	1,530,000
Derivative liability	255,667	262,745
Income tax payable	148,364	46,638
Accrued earnout payable	2,000,000	
Total Current Liabilities	10,492,544	3,887,181
Long Term Liabilities:		
Long-term debt, net of current maturities		1,624,088
Deferred tax liability	77,813	123,684
Put liability		1,323,844

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Total Long Term Liabilities	77,813	3,071,616
Total Liabilities	10,570,357	6,958,797
Commitments and Contingencies		
Stockholders Equity:		
Series A Preferred stock, \$0.01 par value, 750,000 shares authorized, 21,500 and 25,250 shares issued and outstanding, respectively.	214,995	252,495
Series C Preferred stock, \$0.01 par value, 26,750 shares authorized, 22,463 and 22,463 shares issued and outstanding, respectively.	224	224
Series E Preferred stock, \$0.01 par value, 1,000,000 authorized, 1,000,000 and 1,000,000 shares issued and outstanding, respectively.	10,000	10,000
Common stock, \$0.001 par value, 100,000,000 shares authorized, 17,499,517 and 19,449,517 shares issued and 17,359,585 and 19,449,517 outstanding, respectively.	17,501	19,451
Additional paid-in capital	35,783,780	36,452,486
Common stock payable-Earnout Agreement		(2,000,000)
Treasury Stock, at cost; 139,932 shares	(60,549)	
Accumulated deficit	(25,527,645)	(24,518,698)
Total Stockholders Equity	10,438,306	10,215,958
Total Liabilities and Stockholders Equity	\$ 21,008,663	\$ 17,174,755

See notes to consolidated financial statements

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

	For The Three Month Period Ended September 30, 2010 (unaudited)	September 30, 2009 (unaudited)	For The Nine Month Period Ended September 30, 2010 (unaudited)	September 30, 2009 (unaudited)
REVENUE	\$ 8,299,270	\$ 6,840,725	\$ 23,609,454	\$ 19,516,349
COST OF REVENUE	6,372,677	5,478,287	19,321,667	15,951,015
GROSS PROFIT	1,926,593	1,362,438	4,287,787	3,565,334
OPERATING EXPENSES:				
Depreciation and Amortization	5,356		15,802	
Selling, general and administrative	1,020,151	905,263	3,014,730	3,029,421
Impairment charge			2,000,000	
TOTAL OPERATING EXPENSES	1,025,507	905,263	5,030,532	3,029,421
OPERATING INCOME (LOSS)	901,086	457,175	(742,745)	535,913
OTHER INCOME (EXPENSES)				
Derivative income (expense)	42,723	(374,377)	39,078	(479,953)
Other income (expense)		201		201
Interest income	6,197	25,306	15,776	86,602
Interest expense	(55,772)	(35,647)	(135,866)	(106,898)
TOTAL OTHER INCOME/(EXPENSES)	(6,852)	(384,517)	(81,012)	(500,048)
INCOME (LOSS) BEFORE INCOME TAXES	894,234	72,658	(823,757)	35,865
INCOME TAX (EXPENSE)/BENEFIT	(217,266)	(198,511)	(185,188)	(255,073)
NET INCOME (LOSS)	\$ 676,968	\$ (125,853)	\$ (1,008,945)	\$ (219,208)
Net Income/(Loss) Per Share (Basic)	\$ 0.04	\$ (0.01)	\$ (0.06)	\$ (0.01)
Net Income/(Loss) Per Share (Fully Diluted)	\$ 0.03	\$ (0.01)	\$ (0.06)	\$ (0.01)
Weighted Average Common Shares Outstanding	17,468,961	18,873,693	17,722,934	14,713,698
Weighted Average Common and Common Equivalent Shares Outstanding	21,001,904	18,873,693	17,722,934	14,713,698

See notes to consolidated financial statements

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

	For The Nine Month Periods Ended September 30, 2010 (unaudited)	September 30, 2009 (unaudited)
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income (loss)	\$ (1,008,945)	\$ (219,208)
Adjustments to reconcile net income (loss) to net cash provided for/used in operating activities:		
Depreciation and amortization	195,033	199,420
Derivative income(expense)	(39,078)	479,953
Goodwill impairment charge	2,000,000	
Bad debt expense	94,665	
Changes in assets and liabilities:		
(Increase)/decrease in receivables	(98,121)	(20,454)
(Increase)/decrease in inventories	(464,109)	(78,790)
(Increase)/decrease in deferred tax asset	79,717	214,605
(Increase)/decrease in inventory finance receivable	(3,622,741)	
(Increase)/decrease in prepayments and other	349,560	(548,304)
Increase/(decrease) in accounts payable	245,470	173,696
Increase/(decrease) in income tax payable	114,342	(90,279)
Increase/(decrease) in estimated services and warranties	(100,000)	(687,000)
Increase/(decrease) in accrued expenses	107,355	(346,602)
Increase/(decrease) in deferred tax liability	(45,871)	167,385
CASH FLOW USED IN OPERATING ACTIVITIES	\$ (2,192,723)	\$ (755,578)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Restricted Cash	(700,000)	
Purchases of equipment	(25,155)	
Proceeds from sale of property, plant and equipment	4,933	69,075
CASH FLOW PROVIDED BY (USED) IN INVESTING ACTIVITIES	\$ (720,222)	\$ 69,075
CASH FLOWS FROM FINANCING ACTIVITIES:		
Repayment of long-term debt	(78,816)	(58,121)
Proceeds (repayment) of notes payable, net	2,700,000	
Increase/(decrease) in treasury stock	(60,549)	
CASH FLOW PROVIDED BY (USED) IN FINANCING ACTIVITIES	\$ 2,560,635	\$ (58,121)
NET DECREASE IN CASH	\$ (352,310)	\$ (744,624)
CASH, Beginning	8,503,866	8,960,479
CASH, Ending	\$ 8,151,556	\$ 8,215,855

SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:

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Cash paid during the period for:

Interest	\$ 143,172	\$ 95,326
Taxes	\$ 37,000	\$ 163,304

SUPPLEMENTAL DISCLOSURE OF NON CASH INVESTING AND FINANCING ACTIVITIES:

Conversion of preferred stock for common stock-net	\$ 37,500	\$ 5,233,000
Put liability settlement	\$ 1,291,844	\$
Common stock canceled under earnout agreement	\$ 2,000,000	\$ 635,691

See notes to consolidated financial statements

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Deer Valley Corporation & Subsidiaries

Notes to Condensed Consolidated Financial Statements

(unaudited)

NOTE 1 BASIS OF PRESENTATION

The accompanying unaudited consolidated financial statements for the three and nine month periods ended September 30, 2010 and 2009 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 and nine month periods ended September 30, 2010 and 2009 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, 2009 Annual Report on Form 10-K and subsequent filings on Form 10-Q and Form 8-K.

NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation - The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. Intercompany accounts and transactions have been eliminated in consolidation.

Accounting Estimates - The Company's financial statements are prepared in conformity with accounting principles generally accepted in the United States of America which require management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Fiscal Year - The Company's operating subsidiaries, Deer Valley Homebuilders, Inc. (DVH) and Deer Valley Finance Corp. (DVFC), operate on a 52-53 week fiscal year end. For presentation purposes, the reporting period has been presented as ending on September 30, the Company's quarter end.

Cash Equivalents - The Company considers all highly liquid investments with original maturities of three months or less to be cash equivalents. The Company considers its investment in Variable Rate Demand Bonds (VRDB's) as highly liquid investments. These investments have maturity dates beyond three months and are considered cash equivalents, because the investor has a put option to sell the security with seven days notice. The VRDB's investments are akin to money market funds redeemable with seven days notice and are guaranteed by a Letter of Credit from Fifth Third Bank, and these investments are not insured by the Federal Deposit Insurance Corporation. At September 30, 2010, the Company owned \$2,234,195 of VRDB's.

The Company maintains its cash balances in two different financial institutions. At September 30, 2010 these balances totaled \$5,917,361. The balances are insured by the Federal Deposit Insurance Corporation up to \$250,000.

Restricted Cash - During the nine month period ended September 30, 2010, the Company escrowed \$700,000 due to the Former Owners under the Company's Earnout Agreement. The cash due to the Former Owners will be released from escrow before December 31, 2010. This amount is shown as restricted cash in the accompanying consolidated balance sheet. See Note 7 for additional disclosure related to the Company's Earnout Agreement.

Inventory Finance Notes Receivable - The Company offers inventory-secured financing for its products to qualified retail dealers and developers. Finance contracts require periodic installments of principal and interest over periods of up to 24 months. The Company periodically evaluates the collectability of our Notes receivable and considers the need to establish an allowance for doubtful accounts based upon our

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historical collection experience. We have established an allowance for doubtful accounts of \$94,665 as of September 30, 2010 and \$0 at September 30, 2009.

Goodwill - The Company tests goodwill for impairment, at least annually, during the fourth quarter and on an interim basis if an event or circumstance indicate that it is more likely than not that an impairment loss has been incurred. Recoverability of goodwill is evaluated using a two-step process. In the first step, the fair value of our reporting unit is compared to its carrying value. If the fair

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value of our reporting unit exceeds the carrying value of the net assets assigned to a reporting unit, goodwill is considered not impaired and no further testing is required. If the carrying value of the net assets assigned to a reporting unit exceeds the fair value of a reporting unit, the second step of the impairment test is performed in order to determine the implied fair value of a reporting unit's goodwill. Determining the implied fair value of goodwill requires valuation of a reporting unit's tangible and intangible assets and liabilities in a manner similar to the allocation of purchase price in a business combination. If the carrying value of a reporting unit's goodwill exceeds its implied fair value, goodwill is deemed impaired and is written down to its fair value. Similar to the review for impairment of other long-lived assets, the resulting fair value determination is significantly impacted by estimates of future sales for the Company's products, capital needs, economic trends and other factors. See Note 4 for further discussion regarding the Company's goodwill.

Impairment of Long-Lived Assets - Property and intangible assets are material to our financial statements. Further, these assets are subject to the potential negative effects arising from factors beyond the Company's control including changing economic conditions. The Company evaluates its tangible and definite-lived intangible assets for impairment annually during our fourth quarter or more frequently in the presence of circumstances or trends that may be indicators of impairment. The evaluation is a two step process. The first step is to compare our undiscounted cash flows, as projected over the remaining useful lives of the assets, to their respective carrying values. In the event that the carrying values are not recovered by future undiscounted cash flows, as a second step, the Company compares the carrying values to the related fair values and, if lower, record an impairment adjustment. For purposes of fair value, the Company generally uses replacement costs for tangible fixed assets and discounted cash flows, using risk-adjusted discount rates, for intangible assets. These estimates are made by competent employees, using the best available information, under the direct supervision of our management. For tangible property, plant and equipment, there have been no changes in assumptions or methodologies in the three and nine month period ended September 30, 2010 as compared to September 30, 2009. The Company did not have definite-lived intangible assets at September 30, 2010 and September 30, 2009.

In accordance with FASB Topic ASC 420 *Exit on Disposal Cost Obligations*, the Company evaluates the carrying value of long-lived assets to be held and used when events and circumstances warrant such a review. The carrying value of long-lived assets is considered impaired when the anticipated undiscounted cash flow from such assets is less than its carrying value. In that event, a loss is recognized based on the amount by which the carrying value exceeds the fair market value of the long-lived assets. Fair market value is determined primarily using the anticipated cash flows discounted at a rate commensurate with the risk involved. Losses on long-lived assets to be disposed of are determined in a similar manner, except that the fair market values are primarily based on independent appraisals and preliminary or definitive contractual arrangements less costs to dispose.

Revenue Recognition - Revenue for manufactured homes sold to independent dealers generally is recorded when all of the following conditions have been met; (a) an order for the home has been received from the dealer, (b) an agreement with respect to payment terms (usually in the form of a written or verbal approval for payment has been received from the dealer's flooring institution), and (c) the home has been shipped and risk of loss has passed to the dealer and collectability is reasonably assured.

Cost of Sales - The Company includes the following types of expenses in cost of sales: purchase and receiving costs, freight in, direct labor, supply costs, warehousing, direct and indirect overhead costs, inspection, transfer, actual and accrued warranty, depreciation, and amortization costs.

Selling, General and Administrative - The Company includes the following types of expenses in selling, general and administrative expense: sales salaries, sales commissions, bad debt expense, advertising, administrative overhead, administrative salaries and bonuses and legal and professional fees.

Derivative Financial Instruments - Upon the adoption of FASB ASC guidance on Topic 815 *Derivatives and Hedging* in *Determining Whether an Instrument (or Embedded Feature) Is Indexed to an Entity's Own Stock* on January 1, 2009, certain of our financial instruments with down-round protection features are no longer considered indexed to our Company's stock for purposes of determining whether they meet the first part of the scope exception ASC 815-10-15-74. As such, these instruments no longer meet the conditions to achieve equity classification and are required to be carried as derivative liabilities, at fair value, with changes in fair value reflected in our income (loss). See Note 10 *Derivative Liabilities* of the consolidated financial statements for additional disclosure data.

2007 Long Term Incentive Plan - On September 7, 2007, the Company's Board of Directors ratified the Company's 2007 Long Term Incentive Plan (the 2007 Incentive Plan). The 2007 Incentive Plan was effective as of July 1, 2007. A maximum of 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 1,000,000 shares of common stock may be issued as incentive stock options.

Pursuant to the 2007 Incentive Plan, each of the seven members of the Board of Directors was issued an option exercisable for 50,000 shares of the Company's common stock, at an exercise price of \$1.14. Such options were approved at a meeting of the Board of Directors in March 2007

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and were effective as of July 1, 2007. In addition, under the 2007 Incentive Plan, each of the seven members of the Board of Directors was issued an option exercisable for 50,000 shares of the Company's common stock, at an exercise price of \$1.09. The Company did not issue any stock options or warrants pursuant to an equity compensation plan during 2010 or 2009.

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In February 2010, the Company's Board of Directors approved the repurchase and cancellation of all 700,000 share options issued to the Board of Directors. These options were repurchased for the nominal sum of \$700.

Stock Based Compensation - The Company uses the guidance set forth under FASB topic ASC 718 Compensation - Stock Compensation and Staff Accounting Bulletin 107 to measure its share based payments. This guidance considers the historical volatility over a period generally commensurate with the expected or contractual term of the share option.

The Company estimates the expected term and volatility of options granted based on values derived from its industry peer group. In estimating our expected volatility and term, we have applied the guidance in Question 6 of Topic D of Staff Accounting Bulletin 107 and established a peer group consisting of five companies with similar characteristics to our Company and used a blended average of historical volatilities of these peers over historical periods commensurate with the expected term of each option. As a result, the expected term was generated using the trinomial lattice model. The model uses the contractual term of ten years and then arrives at the expected term based upon the assumptions used in valuing the instrument. Our decision to use these measures was based upon the lack of availability of actively traded options in the Company's own common stock and the Company's assessment that the peer group measure of volatility is more representative of future stock price trends than the Company's historical volatility. The Company bases the risk-free interest rate for option valuation on Constant Maturity Rates provided by the U.S. Treasury with remaining terms similar to the expected term of the options. The Company does not anticipate paying any cash dividends in the foreseeable future and therefore uses an expected dividend yield of zero in the option valuation model. In addition, forfeitures of share-based awards are estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. As this is the Company's initial issuance and no historical data exists to estimate pre-vesting option forfeitures the Company has recorded stock-based compensation expense for the all the awards vested. The Company uses the straight-line attribution as its expensing method of the value of share-based compensation for options and awards.

The Company uses a trinomial lattice model granted to determine the fair value of stock options and employee stock purchase plan shares. The determination of the fair value of share-based payment awards on the date of grant using an option-valuation model is affected by the Company's stock price as well as assumptions regarding a number of complex variables. These variables include the Company's expected stock price volatility over the term of the awards, projected employee stock option exercise behavior, expected risk-free interest rate and expected dividends. In addition to the minimum level of assumptions, we have incorporated into our model the impact of the post vesting exit rate of 50%. No options were granted during the nine month periods ended September 30, 2010 and 2009.

The following table summarizes the activity related to all Company stock options and warrants for the nine month period ended September 30, 2010:

	Warrants	Stock Options	Exercise Price		Weighted Average Exercise Price Per Share	
			Warrants	Options	Warrants	Options
Outstanding at December 31, 2009	21,821,160	700,000	\$ 0.75-3.00	\$ 1.09-\$1.14	\$ 1.59	\$ 1.12
Granted						
Exercised						
Cancelled or expired		(700,000)				
Outstanding at September 30, 2010	21,821,160 ⁽¹⁾		\$ 0.75-3.00	\$ 1.09-\$1.14	\$ 1.59	

The warrants expire at various dates ranging from August 2011 through August 2013. In February 2010, the Company's Board of Directors approved the repurchase and cancellation of all of the options 700,000 share options issued to the Board of Directors. These options were repurchased for the nominal sum of \$700.

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- (1) On October 14, 2010, the Company redeemed certain Common Stock Purchase Warrants exercisable for an aggregate of 15,846,702 shares of its common stock. The Company paid to the seller a total purchase price of \$40,000 to redeem such warrants. See Note 16 Subsequent events of the consolidated financial statements for additional disclosure data.

Earning (Loss) Per Share - The Company uses the guidance set forth under FASB topic ASC 260, *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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The Company's dilutive common stock equivalent shares as of September 30, 2010 and 2009 include all of the Convertible Preferred shares and any incremental shares associated with the Company's outstanding warrants and stock options.

See the detailed list of Common Stock Equivalents below.

Common Stock Equivalents

as of

Securities	Exercise Price	September 30,	
		2010	2009
<i>Preferred:</i>			
Series A Preferred		286,642	336,667
Series C Preferred		2,246,300	2,246,300
Series E Preferred		1,000,000	1,000,000
Total		3,532,942	3,582,967
<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		
Class F Warrants	\$ 2.25	1,000,000	1,000,000
Class BD-2 Warrants	\$ 1.50	899,162	899,162
Class BD-3 Warrants	\$ 2.25	449,581	449,581
Class BD-4 Warrants	\$ 1.50	66,121	66,121
Class BD-5 Warrants	\$ 3.00	66,121	66,121
Total		21,821,160	21,821,160
<i>Stock Options:</i>			
7/1/07 Issuance	\$ 1.14		350,000
9/7/07 Issuance	\$ 1.09		350,000
Total			700,000
Total common stock equivalents		25,354,102	26,104,127

On October 14, 2010, the Company redeemed certain Common Stock Purchase Warrants exercisable for an aggregate of 15,846,702 shares of its common stock. The Company paid to the seller a total purchase price of \$40,000 to redeem such warrants. See Note 16 Subsequent events of the consolidated financial statements for additional disclosure data.

Income Taxes - Income taxes are accounted for using the liability method of accounting. Under this method, deferred tax assets and liabilities are recognized for the expected future tax consequences of differences between the carrying amounts of assets and liabilities and their respective tax basis, using currently enacted tax rates. The effect on deferred assets and liabilities of a change in tax rates is recognized in income in the

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period when the change is enacted. Deferred tax assets are reduced by a valuation allowance when it is more likely than not that some portion or all of the deferred tax assets will not be realized.

NOTE 3 INVENTORY

Inventory consisted of the following components:

	September 30, 2010	December 31, 2009
Raw Materials	\$ 718,204	\$ 489,383
Work-in-Process	247,865	200,304
Finished Goods	236,333	48,607
Total Inventory	\$ 1,202,402	\$ 738,294

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The Company's goodwill is comprised of the following:

Total Goodwill as of December 31, 2008	\$ 7,256,917
Earnout for 2009	
Impairment Charges	(7,256,917)
Total Goodwill as of December 31, 2009	
Earnout for 2010	2,000,000
Impairment Charges	(2,000,000)
Total Goodwill as of September 30, 2010	\$

The Company's market capitalization was significantly impacted by the volatility in the U.S. equity and credit markets and was below the book value of shareholders' equity as of the end of the Company's first quarter. As a result, the Company evaluated whether the decrease in its market capitalization reflected factors that would more likely than not reduce the fair value of the Company's reporting units below their carrying value. Based on a combination of factors, including the economic environment, the sustained period of decline in the Company's market capitalization, and the implied valuation and discount rate assumptions in the Company's industry, the Company concluded there were sufficient indicators to perform an interim impairment test of the reporting units and related intangible assets.

The Company's estimate of the fair value was based on projections of revenues, operating costs, and cash flows considering historical and anticipated future results, general economic and market conditions, as well as the impact of planned business and operational strategies. The key assumptions impacting the fair value of the Company's reporting units during the impairment analysis were: (a) expected cash flow for a period of five years; (b) terminal value based upon zero terminal growth; and (c) a discount rate of 14.65% which was based on the Company's best estimate of the weighted average cost of capital adjusted for risks associated with the Company's reporting units. The Company believes the assumptions used in the impairment analysis were consistent with the risk inherent in the business models of the Company and within the Company's industry.

As a result of the Company's impairment analysis, the Company determined that the carrying value of goodwill exceeded its fair value. Accordingly, the Company performed further analysis to determine the implied fair value of the Company's goodwill. This analysis included a hypothetical valuation of the tangible and intangible assets of the Company as if it had been acquired in a business combination. The analysis disclosed that the carrying amount of goodwill exceeds the implied fair value of goodwill. The Company recognized a goodwill impairment charge of \$2,000,000 during the nine month period ended September 30, 2010.

NOTE 5 ACCRUED EXPENSES

Accrued expenses consisted of the following:

Category	September 30, 2010	December 31, 2009
Accrued dealer incentive program	\$ 358,098	\$ 320,629
Accrued third party billings	488,168	541,321
Accrued compensation	489,161	299,973
Accrued repurchase commitment	206,700	275,000
Other	325,472	310,704
Total Accrued Expenses	\$ 1,867,599	\$ 1,747,627

NOTE 6 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 September 30, 2010, the Company has recorded an accrued liability of \$1,430,000 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.

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The following tabular presentation reflects activity in warranty reserves during the periods presented:

	For The Three Month Period Ended		For The Nine Month Period Ended	
	September 30, 2010	September 30, 2009	September 30, 2010	September 30, 2009
Balance at beginning of period	\$ 1,495,000	\$ 1,660,000	\$ 1,530,000	\$ 2,220,000
Warranty charges	494,584	409,913	1,675,493	1,245,238
Warranty payments	(559,584)	(536,913)	(1,775,493)	(1,932,238)
Balance at end of period	\$ 1,430,000	\$ 1,533,000	\$ 1,430,000	\$ 1,533,000

NOTE 7 ACCRUED EARNOUT PAYABLE

Earnout Agreement - On January 18, 2006, the Company's wholly-owned subsidiary, Deer Valley Acquisitions Corp. (dissolved on July 1, 2006), entered into an Earnout Agreement (the "Earnout Agreement"), between Deer Valley Homebuilders, Inc., Deer Valley 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 ended January 18, 2011, 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. Through December 31, 2007, the Company paid \$4,000,000 to the Founders, under its Earnout Agreement, including \$2.75 million in December of 2007. At December 31, 2009, the Company Founders have vested rights amounting to \$2,000,000 under the Amended Earnout Agreement subject to completing requirements of the Founders employment agreement. The common stock was to be held in escrow until January 18, 2011 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 are 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 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 Company determines 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 \$1,291,844 at February 5, 2010. On February 5, 2010, the Put liability was settled in conjunction with the Second Amendment to the Earnout Agreement dated January 16, 2006.

On January 1, 2008 the Company adopted the guidance under FASB topic ASC 820 "Fair Value Measurements and Disclosures", for our financial assets and financial liabilities. The guidance defines fair value, provides guidance for measuring fair value and requires certain disclosures. The guidance discusses valuation techniques such as the market approach (comparable market prices), the income approach (present value of future income or cash flow), and the cost approach (cost to replace the service capacity of an asset or replacement cost). The guidance utilizes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value into three broad levels. The following is a brief description of those three levels:

Level 1: Observable inputs such as quoted prices (unadjusted) in active markets for identical assets or liabilities

Level 2: Inputs, other than quoted prices, that are observable for the asset or liability; either directly or indirectly. These include quoted prices for similar assets or liabilities in active markets and quoted prices for identical or similar assets or liabilities in markets that are not active.

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Level 3: Unobservable inputs that reflect the reporting entity's own assumptions.

We apply the provisions of ASC 820 Fair Value Measurement in valuing our derivative financial instruments. Assets and liabilities measured at fair value are classified in their entirety based on the lowest level of input that is significant to their fair value measurement. Our derivative financial instruments which are required to be measured at fair value on a recurring basis are all measured at fair value using Level 3 inputs. Level 3 inputs are unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

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The following table summarizes the inputs used to measure the put liability at fair value:

	February 5, 2010
Settlement guaranteed value	\$ 2,000,000
Indexed shares	2,000,000
Expected volatility	78.6%-99.85%
Effective strike price	\$ 1.00
Trading Market Price	\$ 0.37
Expected dividends	
Expected term in years	1-2 years
Risk free rate of return	.08%-.40%

As a result of the fair value adjustments, the Company has recognized income of \$0 and \$246,000 for the three month period ended September 30, 2010 and 2009, respectively. The Company recognized income for the nine month period ended September 30, 2010 and 2009 of \$32,000 and \$242,000, respectively.

On February 5, 2010, the Company entered into a Second 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 Second Earnout Amendment). The Former Owners agreed to extend the term of their Employment Agreements and Non-Compete Agreement for two additional years upon substantially the same terms and conditions, in exchange for the Company repurchasing the 2,000,000 shares currently in escrow at a price of \$.35 per share, and agreeing to exercise the existing option to pay the Price Guarantee differential, in cash, in lieu of shares.

As a result of the amended earnout agreement, the Company recorded the remaining liability of \$2,000,000 due to the Former owners under the Earnout Agreement. The Company agreed to repurchase the 2,000,000 shares held in escrow for the former owners for \$700,000 and this amount is held in escrow for the benefit of the Former owners (restricted cash) until paid. The remaining \$1,300,000 due to the former owners is payable in cash. This accrued earnout liability of \$2,000,000 will be paid to the former shareholders before December 31, 2010 as show in the accompanying consolidated balance sheet at September 30, 2010.

NOTE 8 REVOLVING CREDIT LOANS

On 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 (DVC). The purpose of the Consolidated Facility is to provide working capital and letters of credit required 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 be met, including financial ratios, prior to each advance.

Effective April 12, 2009, DVH renewed and amended its existing Loan and Security Agreement with Fifth Third Bank, providing for a line of credit secured by accounts receivable, inventory, equipment and all other tangible and intangible personal property of DVH. In connection with the renewal the maximum principal amount of the facility was reduced from \$7,500,000 to \$5,000,000. The purpose of the Credit Facility is to provide working capital and letters of credit required in the normal course of the Company's business. The Credit 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. See new revolving credit loan and security agreement dated October 14, 2009 for new credit facility as shown below.

On October 14, 2009, Deer Valley entered into Revolving Credit Loan and Security Agreement with Fifth Third Bank, which provides for a revolving line of credit in an amount not to exceed Seven Million Five Hundred Thousand Dollars (the \$7,500,000 Facility). The \$7,500,000 Facility is evidenced by a revolving credit note and secured by accounts receivable, inventory, equipment and all other tangible and intangible personal property of Deer Valley. The purpose of the \$7,500,000 Facility is to provide display model financing for dealers of the products

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produced by DVH. This financing will be provided through DVC's new subsidiary DVFC and administration of individual dealer loans will initially be handled by a third party administrator. The \$7,500,000 Facility has a two year term and has a variable interest rate at 4.00% above LIBOR or 4.38% at September 30, 2010. An event of default such as non-payment of amounts when due under the loan agreement or a breach of a covenant may accelerate the maturity date of the facility. The facility provides for conditions to be met prior to each advance, including financial ratios. As of September 30, 2010, the Company had an outstanding balance of \$1,925,000 under the revolving credit loan.

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On October 14, 2009, Deer Valley entered into Revolving Credit Loan and Security Agreement with Fifth Third Bank, which provides for a revolving line of credit in an amount not to exceed Five Million Dollars (the "\$5,000,000 Facility"). The \$5,000,000 Facility is evidenced by a revolving credit note and secured by accounts receivable, inventory, equipment and all other tangible and intangible personal property of Deer Valley. The \$5,000,000 Facility is to be utilized for short term working capital financing, letters of credit and as a bridge loan on financing the sale of retail units by DVH. Said financing will be provided through DVC's new subsidiary DVFC, and administration of individual dealer loans will initially be handled by a third party administrator. The \$5,000,000 Facility has a two year term and has a variable interest rate at 2.50% above LIBOR or 2.88% at September 30, 2010. An event of default such as non-payment of amounts when due under the loan agreement or a breach of a covenant may accelerate the maturity date of the facility. The facility provides for conditions to be met prior to each advance, including financial ratios. As of September 30, 2010, the Company had an outstanding balance of \$775,000 under the revolving credit loan.

The amount available under the revolving credit loans is equal to the lesser of \$12,500,000 or an amount based on defined percentages of accounts receivable and inventories reduced by any outstanding letters of credit. At September 30, 2010, \$3,625,139 was available under the revolving credit loans after deducting letters of credit of \$375,000.

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 September 30, 2010, no amounts had been drawn on the above irrevocable letters of credit by the beneficiaries.

NOTE 9 LONG-TERM DEBT

On May 26, 2006, DVH entered into a Loan Agreement with Fifth Third Bank (the "Lender") providing for a loan of Two Million 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 Loan has a term from May 26, 2006 through June 1, 2011 and has a variable interest rate at 2.25% above LIBOR. At September 30, 2010, the total amount due of \$1,640,608 is classified as a current liability. 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.

NOTE 10 DERIVATIVE LIABILITIES

Effective on January 1, 2009, we adopted the requirements of ASC 815 Derivatives and Hedging Activities that revised the definition of "indexed to a company's own stock" for purposes of continuing classification of derivative contracts linked to our equity instruments. Derivative contracts may be classified in equity only when they both are indexed to a company's own stock and meet certain conditions for equity classification. Under the revised definition, an instrument (or embedded feature) would be considered indexed to an entity's own stock if its settlement amount will equal the difference between the fair value of a fixed number of the entity's equity shares and a fixed monetary amount. We were unable to continue to carry 21,821,160 warrants in equity because they embodied anti-dilution protections that did not achieve the fixed-for-fixed definition. The reclassification of the fair value of the warrants, amounting to \$635,691, to liabilities was recorded on January 1, 2009 as a cumulative effect of a change in accounting principle wherein the original amounts recorded were removed from paid-in capital (\$6,172,913) and the difference (\$24,673,969), representing the fair value changes, was recorded as an adjustment to beginning accumulated deficit. These derivative liabilities are measured at fair value each reporting period and the changes in the fair value are recorded in our consolidated statement of operations.

The following is a list of the common shares indexed to derivative financial instruments as of September 30, 2010 and December 31, 2009, and other salient terms:

	Common shares indexed	Exercise Price	Remaining term to expiration (years)
Class A Warrants (Class A-1 & Class A-2)	10,369,351	\$ 1.50	.86
Class B Warrants	4,970,824	\$ 2.25	2.87

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Class C Warrants	2,000,000	\$ 0.75	.86
Class D Warrants	2,000,000	\$ 0.75	2.87
Class F Warrants (Class F-1 & Class F-2)	1,000,000	\$ 2.25	1.13-1.81
Class BD-2 Warrants	899,162	\$ 1.50	.86
Class BD-3 Warrants	449,581	\$ 2.25	.86
Class BD-4 Warrants	66,121	\$ 1.50	.86
Class BD-5 Warrants	66,121	\$ 3.00	.86

Total number of common shares indexed to derivative instruments 21,821,160

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We estimate fair values of derivative financial instruments using various techniques (and combinations thereof) that are considered to be consistent with the objective measuring fair values. In selecting the appropriate technique, we consider, among other factors, the nature of the instrument, the market risks that it embodies and the expected means of settlement. For less complex derivative instruments, such as free-standing warrants, we generally use the Black-Scholes-Merton (BSM) option valuation technique, adjusted for the effect of dilution, because it embodies all of the requisite assumptions (including trading volatility, estimated terms, dilution and risk free rates) necessary to fair value these instruments. Estimating fair values of derivative financial instruments requires the development of significant and subjective estimates that may, and are likely to, change over the duration of the instrument with related changes in internal and external market factors. In addition, option-based techniques (such as BSM) are highly volatile and sensitive to changes in the trading market price of our common stock. Since derivative financial instruments are initially and subsequently carried at fair values, our income (loss) will reflect the volatility in these estimate and assumption changes.

The following tables summarize the components of derivative liabilities as of September 30, 2010, December 31, 2009 and the remeasurement date, January 1, 2009:

	September 30, 2010	December 31, 2009	Remeasurement date January 1, 2009
Class A Warrants (Class A-1 & Class A-2)	\$ 15,296	\$ 92,201	\$ 143,308
Class B Warrants	106,376	42,749	143,657
Class C Warrants	13,000	45,400	113,400
Class D Warrants	115,600	65,800	207,000
Class F Warrants (Class F-1 & Class F-2)	4,050	5,950	11,200
Class BD-2 Warrants	1,079	7,913	12,319
Class BD-3 Warrants	180	1,978	3,597
Class BD-4 Warrants	79	582	906
Class BD-5 Warrants	7	172	304

Fair values	\$ 255,667	\$ 262,745	\$ 635,691
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Significant assumptions (or ranges):

Trading market values	\$ 0.40	\$ 0.37	\$ 1.20
Term (years)	.86 - 2.87	1.61 - 3.61	.61 - 4.61
Volatility	88.06% - 99.71%	65.44% - 91.90%	50.97% - 75.78%
Risk-free rate	.19% - .64%	1.14% - 1.70%	0.27% - 1.55%

Fair value hierarchy:

- (1) Level 1 inputs are quoted prices in active markets for identical assets and liabilities, or derived there from. Our trading market values and the volatilities that are calculated thereupon are level 1 inputs.
- (2) Level 2 inputs are inputs other than quoted prices that are observable. We use the current published yields for zero-coupon US Treasury Securities, with terms nearest the remaining term of the warrants for our risk free rate.
- (3) Level 3 inputs are unobservable inputs. Inputs for which any parts are level 3 inputs are classified as level 3 in their entirety. The remaining term used equals the remaining contractual term as our best estimate of the expected term.

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ASC 820-10-55-62 Fair Value Measurements and Disclosures provides for assets and liabilities measured at fair value on a recurring basis, using significant unobservable inputs (Level 3) during the period, provide a reconciliation of the beginning and ending balances. The reconciliation of our derivative liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) as of September 30, 2010 is as follows:

	Warrant Derivative
Beginning balance, January 1, 2009	\$ 635,691
Total (gains) or losses included in earnings	(372,946)
Issuances	
Ending balance, December 31, 2009	262,745
Total (gains) or losses included in earnings	155,653
Issuances	
Ending balance, March 31, 2010	\$ 418,398
Total (gains) or losses included in earnings	(120,008)
Issuances	
Ending balance, June 30, 2010	\$ 298,390
Total (gains) or losses included in earnings	(42,723)
Issuances	
Ending balance, September 30, 2010	\$ 255,667

The following tables summarize the effects on our income (loss) associated with changes in the fair values of our derivative financial instruments:

	Three Months Ended September 30, 2010	Nine Months Ended September 30, 2010
Class A Warrants (Class A-1 & Class A-2)	\$ 34,727	\$ 76,905
Class B Warrants	(9,445)	(63,627)
Class C Warrants	16,000	32,400
Class D Warrants	(6,000)	(49,800)
Class F Warrants (Class F-1 & Class F-2)	3,625	1,900
Class BD-2 Warrants	2,877	6,834
Class BD-3 Warrants	674	1,798
Class BD-4 Warrants	212	503
Class BD-5 Warrants	53	165
	\$ 42,723	\$ 7,078

On October 14, 2010, the Company redeemed certain Common Stock Purchase Warrants exercisable for an aggregate of 15,846,702 shares of its common stock. The Company paid to the seller a total purchase price of \$40,000 to redeem such warrants. See Note 16 Subsequent events of the consolidated financial statements for additional disclosure data.

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The components of the provision for income taxes are as follows:

	September 30, 2010
Current income tax expense	\$ 151,343
Deferred income tax expense	33,845
Total income tax expense	\$ 185,188

The items accounting for the difference between income taxes computed at the federal statutory rate and the provision for income taxes are as follows:

	September 30, 2010	
	Amount	Impact on Rate
Income tax expense (benefit) at federal rate	\$ (280,077)	34.00%
State tax, net of Federal effect	(34,812)	4.23%
Permanent Differences:		
Meals & Entertainment	16,897	-2.05%
Officers' Life Insurance	1,003	-0.12%
Derivative expense	(14,938)	1.81%
Total Permanent Differences	\$ 2,962	-0.36%
Deferred Tax Valuation Allowance	\$ 497,115	-60.35%
Total income tax expense	\$ 185,188	-22.48%

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amount of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of the Company's net deferred income taxes are as follows:

	September 30, 2010
Current Deferred Tax Assets:	
Warranty Reserve	\$ 546,632
Repurchase Reserve	79,013
Loan Loss Reserve	36,187

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Accrued Legal fees		22,936
Allowance for Doubtful Accounts		1,911
Total Current Deferred Tax Asset	\$	686,679
Non-Current Deferred Tax Assets:		
Goodwill impairment		2,532,046
Valuation Allowance		(497,115)
Total Non-Current Deferred Tax Assets	\$	2,034,931
Non-Current Deferred Tax Liability:		
Accelerated Depreciation	\$	(77,472)
Sale of Assets		(341)
Total Non-Current Deferred Tax Liability	\$	(77,813)
Total Deferred Tax Assets (Liabilities) - Net	\$	2,643,797

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NOTE 12 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.

Reserve for Repurchase Commitments - 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 \$4,500,000 at September 30, 2010. As of September 30, 2010 the Company reserved \$206,700 for future repurchase losses, based on prior experience and an evaluation of dealers' financial conditions. 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.

NOTE 13 EQUITY TRANSACTIONS

Series A Convertible Preferred Stock - During the three month period ended September 30, 2010 there were no conversions of Series A Preferred stock into shares of the Company's common stock. During the nine month period ended September 30, 2010 certain shareholders converted 3,750 shares of Series A Preferred stock, par value \$37,500, into 50,000 shares of the Company's common stock

Common Stock Dividends - There were no dividends paid during the nine month period ended September 30, 2010.

NOTE 14 RELATED PARTY

In connection with the Capital Stock Purchase Agreement, DVA 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 DVH during the five (5) years following January 18, 2006, up to a maximum of \$6,000,000. 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 former owners of DVH, the Founders, who consist of Joel Stephen Logan, II, the President and General Manager of DVH, Charles L. Murphree, Jr., the Vice President and Regional Sales Director of DVH, and John Steven Lawler, Chief Financial Officer of DVH. Messrs. Logan, Murphree, and Lawler are all directors of Deer Valley Corporation and of DVH. The business purpose of executing the Earnout Agreement was to set the purchase price of DVH by an objective standard, given that the owners of DVH, DVA, and the Company could not agree on an outright purchase price. On November 19, 2007, the Company entered into the Earnout Amendment to the Earnout Agreement with the Founders, now the core operating management for the Company's wholly owned subsidiary, DVH, to generally eliminate the Company's obligations under the Earnout Agreement in exchange for an issuance of two million shares of Deer Valley's common stock to the Founders and release of funds accrued through December 31, 2007.

On February 5, 2010, the Company entered into a second amendment to the Earnout Agreement dated January 18, 2006 (the "Second Earnout Amendment"). The Founders agreed to extend the term of their Employment Agreements and Non-Compete Agreements for two additional years upon substantially the same terms and conditions, in exchange for the Company repurchasing the 2,000,000 shares currently in escrow at a price of \$.35 per share, and agreeing to exercise the existing option to pay the Price Guarantee differential, in cash, in lieu of shares. The Company reassessed the classification of the contract and determined that the contract should be reclassified from equity to a liability. The contract was reclassified as of February 5, 2010 the date of the Second Earnout Amendment in the amount of \$2,000,000 and included in the accompanying consolidated balance sheet captioned accrued earnout payable at September 30, 2010. A discussion of the terms of the Earnout Amendment can be found at Note 7- Accrued Earnout Payable.

NOTE 15 SEGMENT INFORMATION

Our business segments consist of factory-built housing and financial services. Our financial services business commenced during the fourth quarter of 2009 to provide dealer inventory-secured financing for houses built by the Company. Our chief decision making officer considers income (loss) from operations as the basis to measure segment profitability. The following table summarizes net sales, income (loss) from operations, and identifiable assets by segment for the three and nine month period ended September 30, 2010 and 2009.

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	For The Three Months Ended		For The Nine Months Ended	
	September	September	September	September
	30,	30,	30,	30,
	2010	2009	2010	2009
Revenues from external customers				
Factory-built housing	\$ 8,219,265	\$ 6,840,725	\$ 23,437,969	\$ 19,516,349
Financial Services	80,005		171,485	
Total Revenues	\$ 8,299,270	\$ 6,840,725	\$ 23,609,454	\$ 19,516,349
Income (loss) from operations				
Factory-built housing	\$ 986,520	\$ 563,563	\$ (285,508) ⁽¹⁾	\$ 991,087
Financial services	23,409		22,966	
General corporate expenses	(108,843)	(106,388)	(480,203)	(455,174)
Total Income (loss) from operations	\$ 901,086	\$ 457,175	\$ (742,745) ⁽¹⁾	\$ 535,913
Derivative income (expense)	\$ 42,723	\$ (374,377)	\$ 39,078	\$ (479,953)
Other income (expense)	\$	\$ 201	\$	\$ 201
Interest income	6,197	25,306	15,776	86,602
Interest expense	(55,772)	(35,647)	(135,866)	(106,898)
	\$ (6,852)	\$ (384,517)	\$ (81,012)	\$ (500,048)
Income (loss) before income taxes	\$ 894,234	\$ 72,658	\$ (823,757) ⁽¹⁾	\$ 35,865
Identifiable assets				
Factory-built housing	\$ 16,225,452	\$ 22,507,598		
Financial Services	4,683,121			
Other	100,090	200,282		
	\$ 21,008,663	\$ 22,707,880		

(1) Includes \$2,000,000 of goodwill impairment charges

NOTE 16 SUBSEQUENT EVENTS

On October 14, 2010, the Company entered into a securities purchase agreement with Vicis Capital Master Fund to redeem certain common stock purchase warrants exercisable for an aggregate of 15,846,702 shares of common stock. The Company paid an aggregate purchase price of \$40,000 to redeem such warrants.

The following table summarizes the common shares indexed to common stock purchase warrants as of September 30, 2010 and after the redemption of the common stock purchase warrants on October 14, 2010:

	Balance	Redeemed	Balance
	September 30,	October 14,	October 14,
	2010	2010	2010
Class A Warrants (Class A-1 & Class A-2)	10,369,351	6,930,845	3,438,506

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Class B Warrants	4,970,824	3,283,333	1,687,491
Class C Warrants	2,000,000	2,000,000	
Class D Warrants	2,000,000	2,000,000	
Class F Warrants (Class F-1 & Class F-2)	1,000,000	1,000,000	
Class BD-2 Warrants	899,162	421,683	477,479
Class BD-3 Warrants	449,581	210,841	238,740
Class BD-4 Warrants	66,121		66,121
Class BD-5 Warrants	66,121		66,121
Total number of common shares indexed to derivative instruments	21,821,160	15,846,702	5,974,458

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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-K. 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 subsidiaries Deer Valley Homebuilders, Inc. (DVH) and Deer Valley Financial Corp (DVFC), designs and manufactures factory built homes and provides dealer inventory-secured financing for our factory built homes. The Company's manufacturing plant located in Guin, Alabama, produces homes which are marketed in 12 states through a network of independent dealers, builders, developers and government agencies located primarily in the southeastern and south central regions of the United States. Short-term inventory-secured loan financing is offered to qualified retail dealers and developers, through DVFC, a wholly owned subsidiary created in the fourth quarter 2009.

The Company's executives are continuing to focus on challenges faced by our industry and the general economy: (i) Management has been addressing the well-publicized slowdown in the housing industry by adjusting capacity and production rates with market demand. The Company will continue to monitor demand and may take additional steps to adjust production levels based on our views of and direction of the industry. (ii) In recognition of an important trend in the housing market toward modular homes and the need for emergency housing as part of the Company's strategic plan, management will seek to increase the Company's involvement in the modular segment of the factory-built housing industry. The Company believes that establishing alternative distribution channels will add stability and position the company for growth when market conditions improve. 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 sells these models to large tract developers, government agencies and individuals through independent dealers. (iii) Management has addressed the reduced availability of dealer inventory financing with its wholly owned subsidiary, Deer Valley Finance Corp (DVFC). The subsidiary was created to provide short-term inventory-secured loans to qualified retail dealers and developers. (iv) The Company continues to focus on operating activities to improve manufacturing efficiencies, reduce overall costs and increase gross margins.

Our business segments consist of factory-built housing and financial services. Our financial services business commenced during the fourth quarter of 2009 to provide qualified independent retail dealers and developers inventory-secured financing for homes the Company produces. Otherwise, the Company does not maintain separate operating segments for regions and does not separately report financial information by geographic sales area because they are similar products using similar production techniques and sold to the same class of

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customer. See Note 15 - Segment Information of the notes to Condensed Consolidated Financial Statements for information on our net sales, income (loss) from operations, and identifiable assets by segment for the three and nine months period ended September 30, 2010.

Manufacturing Operations

We produce all of our factory built homes at our plant in Guin, Alabama, which is functioning on an eight-hour shift, five-day work week. During the third quarter of 2010, the Company's average production rate was approximately 21 floors produced per week. As of September 30, 2010, our backlog of orders stood at 12 days.

Our plant in Guin, Alabama operated at a capacity of 59% during the quarter ended September 30, 2010. We have one idle plant located in Sulligent, Alabama.

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 (4) the prevailing market conditions. 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-K titled Description of Business.

Results of Operations

The following discussion examines the results of the Company's operations for the three and nine month period ended September 30, 2010. 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, 2009 Annual Report on Form 10-K and subsequent filings on Form 8-K.

HISTORICAL RESULTS THREE AND NINE MONTHS PERIOD ENDED SEPTEMBER 30, 2010 AND SEPTEMBER 30, 2009.

Revenues. The Company had revenues of \$8,299,270 for the three month period ended September 30, 2010, as compared to \$6,840,725 for the three month period ended September 30, 2009. Accordingly, revenues increased \$1,458,545 or a 21% increase compared to the three month period ended September 30, 2009. Revenues for the nine month period ended September 30, 2010 was \$23,609,454 compared to \$19,516,349 for the nine month period ended September 30, 2009. Accordingly, revenues increased \$4,093,105, or a 21% increase compared to the nine month period ended September 30, 2009. The increase in revenue for the three and nine month periods ended September 30, 2010, are in part attributable to the federal homebuyer tax credit, which favorable impacted our revenues for the second and third quarters 2010. However, the expiration of the federal homebuyer tax credit has also contributed to a softness of new orders during the third quarter, resulting in a reduced backlog of orders. Although we remain cautiously optimistic, several challenges such as persistently high unemployment levels, the expiration of the federal homebuyer's tax credit and the threat of more foreclosures continue to hinder a recovery in the housing market. If the current crisis in the national economy generally, or in the housing market specifically, continues for an extended period of time, our operating results could be significantly affected by such market forces. This ongoing crisis has materially impacted liquidity in the financial markets, reducing the availability of wholesale financing for our industry retailers and consumer financing for purchasers of a manufactured homes. The likelihood that we will be able to sustain our increased revenues or generate net income in the future must be considered in light of the difficulties facing the manufactured housing industry as a whole, the national and local economies, the credit markets and the financial services industry, the competitive environment in which we operate, and other risks and uncertainties.

Gross Profit. Gross profit for the three month period ended September 30, 2010 was \$1,926,593 or 23.2% of total revenue compared to \$1,362,438 or 19.9% of total revenue for the three month period ended September 30, 2009. Gross profit for the nine month period ended September 30, 2010 was \$4,287,787 or 18.2% of total revenue compared to \$3,565,334 or 18.3% of total revenue for the nine month period ended September 30, 2009. The increase in gross profit as percentage of revenue for the three month period September 30, 2010 as compared to the three month period September 30, 2009 is attributable to decreased raw material costs and overall easing of commodity pressures. In addition our average wholesale price per unit increased, which resulted in lower labor cost for the three month period ended September 30, 2010 as compared to the three month period ended September 30, 2009. For the nine month period ended September 30, 2010 compared to 2009, our gross profit remained constant

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as our labor cost decrease and service cost increases essentially offset each other. Another factor affecting our gross profit in 2009 is the decrease in our warranty reserve which decreased cost of sales by \$687,000 and accordingly increased of our gross profit for this period. Without the effect of our warranty reserve, our gross profit percentage was 14.7 % in the 2009 period. The Company includes the following types of expenses in cost of sales: purchase and receiving costs, freight in, direct labor, supply costs, warehousing, direct and indirect overhead costs, inspection, transfer, actual and accrued warranty, depreciation, and amortization costs.

Selling, General and Administrative Expenses. Selling, general and administrative expenses for the three month period ended September 30, 2010 were \$1,020,151 compared to \$905,263 for the three month period ended September 30, 2009. Selling, general and administrative costs increased \$114,888 for the three month period ending September 30, 2010, in comparison to the corresponding period for 2009. As a percentage of net sales, selling, general and administrative expenses decreased to 12.3% for the three month period ended September 30, 2010 compared to 13.2% for the three month period ended September 30, 2009. The increase of \$114,888 in our selling, general and administration expenses is due to an increase in our earnings and our revenues which caused our profit sharing expense to increase by \$70,518 and our sales commissions to increase by \$20,471. In addition our financial services segment increased selling, general and administration expenses by \$56,596 compared to the same corresponding period for 2009. Selling, general, and administrative expenses for the nine month period ended September 30, 2010 were \$3,014,730 compared to \$3,029,421 for the nine month period ended September 30, 2009. Selling, general and administrative costs decreased \$14,691 for the nine month period ending September 30, 2010, in comparison to the corresponding period for 2009. As a percentage of net sales, selling, general and administrative expenses decreased to 12.8% for the nine month period ended September 30, 2010 compared to 15.5% for the nine month period ended September 30, 2009. The decrease in selling, general and administrative expenses is primarily due to cost savings initiatives implemented with consolidation of manufacturing processes and product lines of \$188,239, which were offset by increases in general corporate expenses of \$25,209 and the addition of our financial services segment increased selling, general and administrative expenses by \$148,519. The Company includes the following types of expenses in selling, general and administrative expense: sales salaries, sales commissions, bad debt expense, advertising, administrative overhead, administrative salaries and bonuses and legal and professional fees.

Other Income (Expense). Derivative income (expense) for the three month period ended September 30, 2010 was \$42,723 compared to \$(374,377) for the three month period ended September 30, 2009. Derivative income (expense) for the nine month period ended September 30, 2010 was 39,078 compared to \$(479,953) for the nine month period ended September 30, 2009. Our derivative income represents changes in the fair value of our derivative warrants and the change in fair value of our put liability related to our earnout agreement. These derivative liabilities are sensitive to the volatility in our stock price. The current year derivative income is due primarily to changes in our stock price which have decreased over the comparable periods in the prior year. The three and nine month periods ended in our prior year reflect increased derivative expense because our stock price was at a higher level and the effect of the fair value measurements increased our expense. The put liability was settled in February 2010 in conjunction with an amendment to our earnout agreement and has not any had effect on derivative income or expense since then. See Note 10 - Derivative Liabilities and Note 7 - Accrued Earnout Payable of the notes to Condensed Consolidated Financial Statements for additional disclosure data.

Impairment Charge. Based on a combination of factors, including the economic environment, the Company's market capitalization, and the implied valuation and discount rate assumptions in the Company's industry, the Company concluded that the goodwill related to the acquisition of DVH was impaired. During the nine month period ended September 30, 2010 the Company recorded a non-cash impairment charge of \$2,000,000, which we recognized in February 2010. There will not be any additional impairment of goodwill related to the 2006 acquisition of DVH. See Note 4 - Goodwill of the notes to Condensed Consolidated Financial Statements for additional data disclosure.

Net Income. The net income for the three month period ended September 30, 2010 was \$676,968 compared to net income (loss) of \$(125,853) for the three month period ended September 30, 2009. The net loss for the nine month period ended September 30, 2010 was \$1,008,945 compared to net loss of \$219,208 for the nine month period ended September 30, 2009. The increase in net income for the three month period ended September 30, 2010 as compared to the three month period ended September 30, 2009 is primarily due to increased revenues, increased gross profit margins and derivative income of \$42,723 as compared to derivative expense of \$374,377. The increase in net loss for the nine month period ended September 30, 2010 as compared to the nine month period ended September 30, 2009 is primarily due to a non-cash goodwill impairment charge of \$2,000,000, which was offset by an increase in revenues. See Note 4 - Goodwill of the notes to Condensed Consolidated Financial Statements for additional data disclosure.

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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 \$8,151,556 in cash and cash equivalents as of September 30, 2010, compared to \$8,503,866 in cash and cash equivalents as of December 31, 2009. 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 or increased participation in alternative financing programs for our dealers, our working capital could be depleted at an accelerated rate.

The Company's operations may require significant use of cash reserves during 2010 compared to prior years. In October 2009, the Company created DVFC, a wholly owned subsidiary. The subsidiary was created to provide short-term inventory-secured loans to qualified retail dealers and developers. Although we anticipate that our dealer finance business will be largely funded by advances under its credit facility with Fifth Third Bank, it is possible that we may continue to use our cash to fund a portion of our financing business. In addition, before December 31, 2010, the Company will be required to pay the balance of \$1,300,000 due on the Earnout Agreement.

1 Cash flow from operating activities:

For the nine month period ended September 30, 2010, operating activities used net cash of \$2,192,723 primarily as a result of the following:

- (a) an increase in inventories of \$464,109 (a use of cash), primarily as a result of a return to normal production levels subsequent to the holiday shutdown period at December 31, 2009, and
- (b) an increase in inventory finance notes receivable of \$3,622,741 (a use of cash), the increase in inventory finance notes receivable is a result of the creation of DVFC in the fourth quarter 2009 to provide short-term inventory-secured loans to qualified retail dealers and developers, which were offset in part by
- (c) We incurred a net loss of \$1,008,945 that includes non cash items totaling \$2,189,801 related to our goodwill impairment charge, derivative income, and depreciation and deferred taxes. Without these non cash items we generated income of \$1,180,856.

For the nine month period ended September 30, 2009, operating activities used net cash of \$755,578 primarily as a result of the following:

- (a) an increase in prepayments and other assets of \$266,142 (use of cash), the increase in prepayments and other assets is primarily a result of modified retail dealer financing programs with traditional lenders of inventory financing. and
- (b) a decrease in estimated services and warranties of \$687,000 (use of cash), we decreased our warranty provision based on management's assessment of historical experience and current trends in wholesale shipments and dealer inventories, and
- (c) a decrease in accrued dealer incentive programs and other accrued expenses of \$346,602 (use of cash), the decrease in dealer incentives is a result of lower revenues.

2 Cash flow from investing activities:

The net cash used in investing activities for the nine month period ending September 30, 2010 was \$720,222, which reflects our deposit of \$700,000 in escrow pursuant to our commitments under the Earnout Agreement and capitalization of normal operating purchases of equipment. The net cash provided by investing activities for the nine month period ending September 30, 2009 was \$69,075, which reflects proceeds from the sale of equipment.

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3 Cash flow from financing activities:

The net cash provided in financing activities for the nine month period ending September 30, 2010 was \$2,560,635, which reflects a decrease in long-term debt due to scheduled principal payments of the Company's commercial real estate mortgage of \$78,816, advances under its credit facility to provide short-term inventory-secured loans to qualified retail dealers and developers of \$2,700,000 and treasury stock purchases of \$60,549. The net cash used in financing activities for the nine month period ending September 30, 2009 was \$58,121, which reflects a decrease in long-term debt due to scheduled principal payments of the Company's commercial real estate mortgage.

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The Company is contingently liable under the terms of the 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 there under, please see "Reserve for Repurchase Commitments" below.

DVH, during its normal course of business, is required to issue irrevocable standby letters of credit to cover obligations under its workmen compensation insurance policy in the amount of \$375,000. As of September 30, 2010, no amounts had been drawn on the above irrevocable letters of credit by the beneficiaries.

Recent Developments

The Company's Dealer Finance Program

The nationwide credit crisis has resulted in a precipitous reduction in the availability of inventory financing for retail outlets in the factory built housing industry. Because of the worldwide volatility and disruption in the capital markets, these traditional lenders have terminated, reduced or modified their retail dealer financing programs in an effort to reduce their asset based portfolios. This reduction in credit facilities has impaired the short-term marketing thrust and the long-term viability of many independent dealers and residential developers including some who distribute Deer Valley Homes.

Management has addressed the reduced availability of dealer inventory financing by the creation of DVFC, a wholly owned subsidiary. The subsidiary was created in the fourth quarter 2009 to provide short-term inventory-secured loans to qualified retail dealers and developers. Through the establishment of the new financial subsidiary, Deer Valley has moved to counter the credit squeeze that many of the Company's existing dealers have been experiencing. The existence of DVFC also positions the Company to maintain shelf space at existing independent sales centers and potentially gain shelf space at additional independent dealer sales centers in regions where the Company is not currently represented. The Company funded the new financial subsidiary through the reallocation of existing cash reserves in combination with funds available from an enhanced commercial bank credit facility with Fifth Third Bank. Administrative services for DVFC's inventory-secured loan program are provided by Triad Financial Services, Inc. (Triad) of Jacksonville, Florida. As of September 30, 2010, DVFC had \$4,640,481 in outstanding loans to 16 independent dealers participating in DVFC's inventory-secured loan program. At September 30, 2010, approximately \$925,000 was available under the revolving credit loans after deducting letters of credit of \$375,000.

On October 14, 2009, Deer Valley entered into Revolving Credit Loan and Security Agreement with Fifth Third Bank, which provides for a revolving line of credit in an amount not to exceed Seven Million Five Hundred Thousand Dollars (the "\$7,500,000 Facility"). The \$7,500,000 Facility is evidenced by a revolving credit note and secured by accounts receivable, inventory, equipment and all other tangible and intangible personal property of Deer Valley. The purpose of the \$7,500,000 Facility is to provide display model financing for dealers of the products produced by DVH. This financing will be provided through DVFC's new subsidiary DVFC, and administration of individual dealer loans will initially be handled by a third party administrator. The \$7,500,000 Facility has a two year term and has a variable interest rate at 4.00% above LIBOR or 4.38% at September 30, 2010. An event of default such as non-payment of amounts when due under the loan agreement or a breach of a covenant may accelerate the maturity date of the facility, including, failure to maintain compliance with the following financial ratios: (a) a global Debt Service Coverage Ratio of not less than 1.25 to 1.00, measured on a rolling 4-quarter basis, (b) a global Debt to Tangible Net Worth Ratio of not more than 3.00 to 1.00, measured on a quarterly basis, and (c) a global, unencumbered liquidity of not less than \$2,500,000.00, measured on a quarterly basis. The Debt Service Coverage Ratio is calculated as follows: (1) (A) Consolidated Net Income of Borrower, plus (B) Interest Expense, plus (C) Depreciation & Amortization, minus (D) Distributions, minus (E) Extraordinary Income/Non-Recurring Income, divided by (2) (A) Actual Required Debt Payments including Capital Leases, but not including debt payments payable to the Bank, plus (2) Interest Expense. The Debt to Tangible Net Worth Ratio is calculated as follows: (1) (A) Total Liabilities of each Borrower, minus (B) Subordinated Debt, divided by (2) (A) Net Worth, plus (B) Subordinated Debt, plus (C) Intangibles, minus (D) Related Party Receivables. The facility provides for conditions to be met prior to each advance, including compliance with the financial ratios described above. As of September 30, 2010, the Company had an outstanding balance of \$1,925,000 under the revolving credit loan.

On October 14, 2009, Deer Valley entered into Revolving Credit Loan and Security Agreement with Fifth Third Bank, which provides for a revolving line of credit in an amount not to exceed Five Million Dollars (the "\$5,000,000 Facility"). The \$5,000,000 Facility is evidenced by a revolving credit note and secured by accounts receivable, inventory, equipment and all other tangible and intangible personal property of Deer Valley. The

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\$5,000,000 Facility is to be utilized for short term working capital financing, letters of credit and as a bridge loan on financing the sale of retail units by DVH. Said financing will be provided through DVC's new subsidiary DVFC, and administration of individual dealer loans will initially be handled by a third party administrator. The \$5,000,000 Facility has a two year term and has a variable interest rate at 2.50% above LIBOR or 2.88% at September 30, 2010. An event of default such as non-payment of amounts when due under the loan agreement or a breach of a covenant may accelerate the maturity date of the facility. The \$5,000,000 Facility requires compliance with the same financial ratios described above in connection with the \$7,500,000 Facility. The facility provides for conditions to be met prior to each advance, including the financial ratios described above. As of September 30, 2010, the Company had an outstanding balance of \$775,000 under the revolving credit loan.

As of our fiscal quarter ending September 30, 2009, Deer Valley was in compliance with the financial ratios described above in connection with the \$7,500,000 Facility and the \$5,000,000 Facility.

Share Repurchases, Warrant Repurchases and Accrued Earnout

The Company has taken several strategic initiatives to improve shareholder value through a series of anti-dilutive securities repurchases. The Company expects the net result of these initiatives to contribute to greater per share earnings which will inherently create greater shareholder value.

On February 26, 2010 the Company repurchased and cancelled a block of 2 million shares of the Company's common stock being held in escrow for the benefit of the former owners and current managers of the Company's primary operating subsidiary (the Escrowed Shares). Pursuant to the Earnout Agreement dated January 18, 2006, as amended (the Earnout Agreement), the Escrowed Shares were issued in December 2007 and were being held in escrow until the scheduled release date, January 18, 2011. The Board authorized the repurchase of the Escrowed Shares for \$0.35/share (an aggregate of \$700,000). The purchase price of \$700,000 is held in escrow and replaces the shares in escrow. The Company had previously guaranteed that at the time of the escrow release, the total value of the escrow account assets would be equal to or greater than \$2 million (the escrow shortfall obligation), with the escrow shortfall obligation recorded as a put liability on the Company's balance sheet. The Company has agreed to exercise its option to satisfy the escrow shortfall obligation with a cash payment of \$1,300,000, accrued earnout payable, included in the accompanying consolidated balance sheet at September 30, 2010, thus eliminating the potential for any share dilution related to the escrow value guarantee. As a result, the put liability has been transferred to additional paid in capital. Pursuant to the Second Amendment to the Earnout Agreement effective as of February 26, 2010, the escrowed funds will be released, and the escrow shortfall obligation will be paid to the beneficiaries on or about December 31, 2010 in settlement of the Company's accrued earnout liability.

Also in February 2010, the Company repurchased and canceled one entire class of options that granted the holders the right to purchase an aggregate of 700,000 common shares at strike prices evenly divided between \$1.09 and \$1.14. The entire repurchase was accomplished for the nominal sum of \$700. The repurchase and cancellation of these options, all of which were formerly held by members of the Board, was another step toward simplifying the Company's capital structure and the elimination of a potential source of future earnings dilution.

To improve shareholder value in the near term and to further reduce future earnings dilution, the Board has authorized a limited stock repurchase plan allowing for the occasional open market purchase of the Company's common shares to a maximum cumulative expenditure of \$500,000. As of September 30, 2010, there had been 139,932 shares repurchased under the stock repurchase program at a cost of \$60,549 and reflected in our stockholders equity as treasury stock.

On October 14, 2010, the Company redeemed certain Common Stock Purchase Warrants exercisable for an aggregate of 15,846,702 shares of its common stock. The Company paid to the seller a total purchase price of \$40,000 to redeem such warrants. See Note 16 Subsequent events of the consolidated financial statements for additional disclosure data

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

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Significant Accounting Policies, contained in the explanatory notes to the Company's financial statements for the quarter ended September 30, 2010, contained in this filing and the Company's Form 10-K for December 31, 2009. 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 items described below, 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 believes the Company's estimates are reasonable. 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 \$1,430,000 on its balance sheet as of September 30, 2010. Based on management's assessment of historical experience and current trends in wholesale shipments and dealer inventories, we decreased our warranty provision by \$65,000 for the quarter year ended September 30, 2010. 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. Should we incur a large number of warranty claims which exceed our current warranty expense levels our results of operations could experience a material adverse affect.

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. We had a reserve for volume incentives payable of \$358,098 as of September 30, 2010.

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 often require 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.

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) historically we have had only isolated instances where we have incurred a repurchase obligation, although with the declining market and deteriorating financial conditions of dealer network there is no guarantee that such historical trends will continue,

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- (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

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- (iv) we have been able to resell homes repurchased from lenders with minimal discounts, 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 \$4,490,000 as of September 30, 2010, as compared to \$8,240,000 as of December 31, 2009. As of September 30, 2010 and December 31, 2009, we had reserves of \$206,700 and \$275,000, respectively, established for future repurchase commitments, based upon our prior experience and evaluation of our independent dealers' financial conditions. The decrease of \$3,750,000 in amounts contingently liable under repurchase commitments is primarily due to a shift in independent dealer inventory financing arrangements from national lenders, which require repurchase agreements to local bank financing arrangements, which typically do not require repurchase agreements.

Due to the downturn in the HUD Code housing industry and the difficulties that our dealers are experiencing in obtaining floor plan financing, we have increased our reserves as a percentage of our aggregate repurchase obligations. The current economic climate has caused stress on the financial condition of our dealer network, based on these changes we have elevated the probability of default for the group and adjusted our estimated reserves accordingly. During the nine month period ended September 30, 2010 we repurchased 3 homes due to dealer failures compared to 15 homes repurchased during the nine month period ended September 30, 2009. If the number of dealers become insolvent, or default on their inventory financing loans, exceeds our estimates this could have a material adverse affect upon our results of operations.

Reserve for Loan Losses

Reserves for credit losses are established for inventory finance notes receivables. Actual credit losses are charged to the reserve when incurred. The reserves established for such losses are determined based on historical loss experience and economic conditions. Management, in assessing the loss experience and economic conditions, adjusts reserves through periodic provisions. As of September 30, 2010, Deer Valley Finance Corp. had \$4,640,481 in outstanding loans to 16 independent dealers participating in DVFC's inventory-secured loan program and had reserves of \$94,665 established for future losses.

Impairment of Long-Lived Assets

Property and intangible assets are material to our financial statements. Further, they are subject to the potential negative effects arising from factors beyond the Company's control including changing economic conditions. The Company evaluates its tangible and definite-lived intangible assets for impairment annually or more frequently in the presence of circumstances or trends that may be indicators of impairment. The evaluation is a two step process. The first step is to compare our undiscounted cash flows, as projected over the remaining useful lives of the assets, to their respective carrying values. In the event that the carrying values are not recovered by future undiscounted cash flows, as a second step, the Company compares the carrying values to the related fair values and, if lower, record an impairment adjustment. For purposes of fair value, the Company generally uses replacement costs for tangible fixed assets and discounted cash flows, using risk-adjusted discount rates, for intangible assets. These estimates are made by competent employees, using the best available information, under the direct supervision of our management. For tangible property, plant and equipment, there have been no changes in assumptions or methodologies in the nine months ended September 30, 2010 as compared to December 31, 2009. The Company did not have definite-lived intangible assets at September 30, 2010.

Goodwill

Goodwill previously recorded in the Company's assets is related to the acquisition of DeerValley Acquisitions Corp. and Deer Valley Homebuilders, Inc on January 18, 2006. The Company tests goodwill for impairment at least annually, during the fourth quarter and on an interim basis if an event or circumstance indicates that it is more likely than not that an impairment loss has been incurred. Recoverability of goodwill is evaluated using a two-step process. In the first step, the fair value of our reporting unit is compared to its carrying value. If the fair value of our reporting unit exceeds the carrying value of the net assets assigned to a reporting unit, goodwill is considered not impaired and no further testing is required. If the carrying value of the net assets assigned to a reporting unit exceeds the fair value of a reporting unit, the second step of the impairment test is performed in order to determine the implied fair value of a reporting unit's goodwill. Determining the implied fair value of goodwill requires valuation of a reporting unit's tangible and intangible assets and liabilities in a manner similar to the allocation of purchase price in a business combination. If the carrying value of a reporting unit's goodwill exceeds its implied fair value, goodwill is deemed impaired and is written down to the extent of the difference. Similar to the review for impairment of other long-lived assets, the resulting fair value determination is significantly impacted by

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estimates of future sales for the Company's products, capital needs, economic trends and other factors. In February 2010, the Company recognized a goodwill impairment charge of \$2,000,000 eliminating the entire amount of goodwill on the Company's balance sheet. There will not be any additional impairment of goodwill related to the 2006 acquisition of DVH. See Note 4 - Goodwill of the notes to Condensed Consolidated Financial Statements for further discussion regarding the Company's goodwill.

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 and collectability is reasonably assured.

The Company provides limited inventory-secured financing for its independent dealers. Products shipped to dealers under the Company's inventory-secured financing program are recorded by the Company as sales and the dealers' obligations to the Company are reflected as inventory finance note receivables.

Derivative Liability

Effective on January 1, 2009, we adopted the requirements of ASC 815 Derivatives and Hedging Activities that revised the definition of indexed to a company's own stock for purposes of continuing classification of derivative contracts linked to our equity instruments. Derivative contracts may be classified in equity only when they both are indexed to a company's own stock and meet certain conditions for equity classification. Under the revised definition, an instrument (or embedded feature) would be considered indexed to an entity's own stock if its settlement amount will equal the difference between the fair value of a fixed number of the entity's equity shares and a fixed monetary amount. We were unable to continue to carry 21,821,160 warrants in equity because they embodied anti-dilution protections that did not achieve the fixed-for-fixed definition. The reclassification of the fair value of the warrants, amounting to \$635,691, to liabilities was recorded on January 1, 2009 as a cumulative effect of a change in accounting principle wherein the original amounts recorded were removed from paid-in capital (\$6,172,913) and the difference (\$24,673,969), representing the fair value changes, was recorded as an adjustment to beginning accumulated deficit. These derivative liabilities are measured at fair value each reporting period and the changes in the fair value are recorded in our consolidated statement of operations.

The fair value of the derivative warrant liability was \$262,745 on December 31, 2009, and \$255,667 on September 30, 2010. The change in the warrant liability resulted in a derivative income of \$7,078 for the nine month period ended September 30, 2010. See Note 10 - Derivative Liabilities of the notes to Condensed Consolidated Financial Statements for additional disclosure data.

On October 14, 2010, the Company redeemed certain Common Stock Purchase Warrants exercisable for an aggregate of 15,846,702 shares of its common stock. The Company paid to the seller a total purchase price of \$40,000 to redeem such warrants. See Note 16 Subsequent events of the consolidated financial statements for additional disclosure data.

Item 4T. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

The Company's Chief Executive Officer and 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 September 30, 2010 covered by this Quarterly Report on Form 10-Q. Based upon such evaluation, the Chief Executive Officer and Chief Financial Officer has concluded that, as of the end of such period, the Company's disclosure controls and procedures were not 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 September 30, 2010, there have been no changes in the Company's internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

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Inherent Limitations of the Effectiveness of Disclosure and Internal Controls

A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the disclosure control system or internal control system are met. Because of the inherent limitations of any disclosure control system or 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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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 nine month period ended September 30, 2010 certain shareholders converted 3,750 shares of Series A Preferred stock, par value \$37,500, into 50,000 shares of the Company's common stock.

ISSUER PURCHASES OF EQUITY SECURITIES

Period	(a) Total number of shares purchased	(b) Average price paid per share	(c) Total number of shares purchased as part of publicly announced plans or programs	(d) Maximum number (or approximate dollar value) of shares that may yet be purchased under the plans or programs
July 1 to July 31, 2010	10,300	\$.41	0	0
August 1 to August 31, 2010	19,632	\$.41	0	0
September 1 to September 30, 2010	110,000	\$.44	0	0
Total (1)	139,932	\$.43	0	0

(1) The totals do not include the Company's redemption, on October 14, 2010, of certain Common Stock Purchase Warrants exercisable for an aggregate of 15,846,702 shares of its common stock. The Company paid to the seller a total purchase price of \$40,000 to redeem such warrants.

Item 3. Defaults Upon Senior Securities

None.

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

None.

Item 5. Other Information

None.

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Item 6. Exhibits

Exhibit No.	Description
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)
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 November 5, 2010. (3)
31.02	Certification of 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 November 5, 2010. (3)
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 November 5, 2010. (3)
32.02	Certification of 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 November 5, 2010. (3)

- (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) 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: November 5, 2010

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