

DEER VALLEY CORP
Form 10-Q
May 11, 2011
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2011

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 Accelerated Filer
Non-accelerated filer Smaller reporting company
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

The Registrant had 17,249,098 shares of Common Stock, par value \$0.001 per share, outstanding as of May 6, 2011.

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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 March 31, 2011 (unaudited) and December 31, 2010</u>	F-2
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Table of Contents**Deer Valley Corporation & Subsidiaries****Consolidated Balance Sheets**

	March 31, 2011	December 31, 2010
ASSETS		
Current Assets:		
Cash	\$ 3,100,856	\$ 3,727,228
Short-term investments	3,099,295	3,168,445
Accounts receivable	813,203	482,846
Inventory	1,351,524	807,730
Deferred tax asset	565,754	622,052
Inventory finance notes receivable	2,201,388	1,675,856
Prepaid expenses and other current assets	92,492	94,744
Total Current Assets	11,224,512	10,578,901
Fixed Assets:		
Property, plant and equipment, net	2,418,531	2,463,151
Other Assets:		
Inventory finance notes receivable - net	2,791,714	2,912,467
Deferred tax asset	1,974,003	2,034,931
Other assets	213,910	256,410
Total Other Assets:	4,979,627	5,203,808
Total Assets	\$ 18,622,670	\$ 18,245,860
LIABILITIES AND STOCKHOLDERS EQUITY		
Current Liabilities:		
Current maturities on long term debt	\$ 1,591,048	\$ 1,624,088
Notes payable	3,475,000	2,725,000
Accounts payable	280,655	163,578
Accrued expenses	1,269,530	1,290,562
Accrued warranties	1,165,000	1,290,000
Warrant liability	127,104	418,682
Income tax payable		131,453
Total Current Liabilities	7,908,337	7,643,363
Long Term Liabilities:		
Deferred tax liability	78,470	88,028
Total Long Term Liabilities	78,470	88,028
Total Liabilities	7,986,807	7,731,391
Stockholders Equity:		
Series A Preferred stock, \$0.01 par value, 750,000 shares authorized, 21,500 and 21,500 shares issued and outstanding, respectively.	214,995	214,995

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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 17,499,517 shares issued and 17,252,892 and 17,271,997 outstanding, respectively.	17,501	17,501
Additional paid-in capital	35,783,780	35,783,780
Treasury Stock, at cost; 246,625 and 227,520 shares, respectively	(113,391)	(100,024)
Accumulated deficit	(25,277,246)	(25,412,007)
Total Stockholders Equity	10,635,863	10,514,469
Total Liabilities and Stockholders Equity	\$ 18,622,670	\$ 18,245,860

See notes to consolidated financial statements

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

	For The Three Month Period Ended	
	2011	March 31, 2010
REVENUE	\$ 4,352,114	\$ 6,117,933
COST OF REVENUE	3,586,022	5,375,857
GROSS PROFIT	766,092	742,076
OPERATING EXPENSES:		
Depreciation and Amortization	4,229	5,181
Selling, general and administrative	980,518	1,016,565
Impairment charge		2,000,000
TOTAL OPERATING EXPENSES	984,747	3,021,746
OPERATING LOSS	(218,655)	(2,279,670)
OTHER INCOME (EXPENSES)		
Derivative income (expense)	291,578	(123,653)
Interest income	6,387	4,782
Other income	(1,600)	
Interest expense	(31,296)	(35,251)
TOTAL OTHER INCOME/(EXPENSES)	265,069	(154,122)
INCOME/(LOSS) BEFORE INCOME TAXES	46,414	(2,433,792)
INCOME TAX BENEFIT (EXPENSE)	88,347	144,823
NET INCOME/(LOSS)	\$ 134,761	\$ (2,288,969)
Dividends to preferred stockholders		
Net Income/(Loss) Available to Common Shareholders	\$ 134,761	\$ (2,288,969)
Net Loss Per Share (Basic)	\$ 0.01	\$ (0.13)
Net Loss Per Share (Fully Diluted)	\$ 0.01	\$ (0.13)
Weighted Average Common Shares Outstanding	17,267,640	18,236,034
Weighted Average Common and Common Equivalent Shares Outstanding	20,800,583	18,236,034

See notes to consolidated financial statements

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

For The Three Month Periods Ended

	March 31,	
	2011	2010
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income/(loss)	\$ 134,761	\$ (2,288,969)
Adjustments to reconcile net income/(loss) to net cash (used in) operating activities:		
Depreciation and amortization	63,144	64,793
Derivative income (expense)	(291,578)	123,653
Loss on sale of equipment	1,600	
Goodwill impairment charge		2,000,000
Bad debt expense	8,280	46,600
Changes in assets and liabilities:		
(Increase)/decrease in receivables	(330,357)	(551,004)
(Increase)/decrease in inventories	(543,794)	(649,998)
(Increase)/decrease in deferred tax asset	117,226	97,708
(Increase)/decrease in inventory finance receivable	(413,059)	(1,411,899)
(Increase)/decrease in prepayments and other	44,754	(186,054)
Increase/(decrease) in accounts payable	117,077	290,365
Increase/(decrease) in income tax payable	(131,453)	(34,022)
Increase/(decrease) in estimated services and warranties	(125,000)	(110,000)
Increase/(decrease) in accrued expenses	(21,034)	29,291
Increase/(decrease) in deferred tax liability	(9,558)	(15,291)
CASH FLOW (USED) IN OPERATING ACTIVITIES	\$ (1,378,991)	\$ (2,594,827)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Restricted Cash		(700,000)
Purchases of equipment	(26,274)	(9,880)
Proceeds from sale of property, plant and equipment	6,150	
Purchases of available-for-sale securities		
Sales of available-for-sale securities	69,150	523,150
CASH FLOW PROVIDED BY/(USED IN) INVESTING ACTIVITIES	\$ 49,026	\$ (186,730)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Repayment of long-term debt	(33,040)	(30,517)
Proceeds (repayment) of notes payable, net	750,000	550,000
Increase/(decrease) in treasury stock	(13,367)	
CASH FLOW PROVIDED BY FINANCING ACTIVITIES	\$ 703,593	\$ 519,483
NET (DECREASE)/INCREASE IN CASH	\$ (626,372)	\$ (2,262,074)
CASH, Beginning	\$ 3,727,228	\$ 6,131,266
CASH, Ending	\$ 3,100,856	\$ 3,869,192

SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:

Cash paid during the period for:

Interest	\$	77,842	\$	45,761
Taxes	\$		\$	37,000

SUPPLEMENTAL DISCLOSURE OF NON CASH INVESTING AND FINANCING ACTIVITIES:

Put liability settlement	\$		\$	1,291,844
Common stock canceled under earnout agreement	\$		\$	2,000,000

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 month period ended March 31, 2011 and 2010 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 period. The operations for the three month period ended March 31, 2011 and 2010 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, 2010 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 March 31, 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 maintains its cash balances in two different financial institutions. At March 31, 2011 these balances totaled \$3,100,856. The balances are insured by the Federal Deposit Insurance Corporation up to \$250,000.

Investments - Short-term investments are comprised of Variable Rate Demand Bonds (VRDBs). In accordance with FASB Topic ASC 320, *Investments-Debt and Equity Securities*, based on our ability to market and sell these instruments and our intent to not hold such instruments until maturity, we classify such variable rate demand bonds as available-for-sale, and carry them at their fair value. VRDBs are similar to short-term debt instruments because their interest rates are reset periodically. Investments in these securities can be sold for cash on the auction date. We classify VRDBs as short-term or long-term investments based on the reset dates.

Prior to the end of fiscal year 2010, the Company classified VRDBs in cash and cash equivalents. Prior period information was reclassified to conform to the current year presentation. These reclassifications had no effect on previously reported income, net earnings or stockholders equity.

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 historical collection experience. We have established an allowance for doubtful accounts of \$123,280 as of March 31, 2011 and \$46,600 at March 31, 2010.

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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 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.

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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 month period ended March 31, 2011 as compared to March 31, 2010. The Company did not have definite-lived intangible assets at March 31, 2011 and March 31, 2010.

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 9 *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 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 the three month period ended March 31, 2011 and 2010.

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.

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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.

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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 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 three month period ended March 31, 2011 and 2010.

The following table summarizes the activity related to all Company stock options and warrants for the three month period ended March 31, 2011:

	Warrants	Stock Options	Exercise Price		Weighted Average
			Exercise Price		
			Per Share Warrants	Per Share Options	Per Share Warrants
Outstanding at December 31, 2010	4,179,638		\$ 1.50-3.00		\$ 1.74
Granted					
Exercised					
Cancelled or expired					
Outstanding at March 31, 2011	4,179,638⁽¹⁾		\$ 1.50-3.00		\$ 1.74

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.

The Company's dilutive common stock equivalent shares as of March 31, 2011 and 2010 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.

Table of Contents**Common Stock Equivalents**

as of

Securities	Exercise Price	2011	March 31, 2010
<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	2,218,690	10,369,351
Class B Warrants	\$ 2.25	1,112,487	4,970,824
Class C Warrants	\$ 0.75		2,000,000
Class D Warrants	\$ 0.75		2,000,000
Class E Warrants	\$ 3.00		
Class F Warrants	\$ 2.25		1,000,000
Class BD-2 Warrants	\$ 1.50	477,479	899,162
Class BD-3 Warrants	\$ 2.25	238,740	449,581
Class BD-4 Warrants	\$ 1.50	66,121	66,121
Class BD-5 Warrants	\$ 3.00	66,121	66,121
Total		4,179,638	21,821,160
<i>Stock Options:</i>			
7/1/07 Issuance	\$ 1.14		
9/7/07 Issuance	\$ 1.09		
Total			
Total common stock equivalents		7,712,580	25,404,127

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 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:

March 31, 2010	December 31, 2010
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Raw Materials	\$ 835,661	\$ 523,742
Work-in-Process	200,962	225,916
Finished Goods	314,901	58,072
Total Inventory	\$ 1,351,524	\$ 807,730

NOTE 4 GOODWILL

The Company's goodwill is comprised of the following:

Total Goodwill as of December 31, 2009	\$
Earnout for 2010	2,000,000
Impairment Charges	(2,000,000)
Total Goodwill as of December 31, 2010	
Additions for 2011	
Impairment Charges	
Total Goodwill as of March 31, 2011	\$

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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 three month period ended March 31, 2010.

The Company's goodwill has been fully impaired, there will not be any additional impairment charges related to the 2006 acquisition of DVH.

NOTE 5 ACCRUED EXPENSES

Accrued expenses consisted of the following:

Category	March 31, 2011	December 31, 2010
Accrued dealer incentive program	\$ 225,375	\$ 266,662
Accrued third party billings	441,590	425,315
Accrued compensation	251,522	102,156
Accrued repurchase commitment	146,745	167,300
Other	204,298	329,129
Total Accrued Expenses	\$ 1,269,530	\$ 1,290,562

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 March 31, 2011, the Company has recorded an accrued liability of \$1,165,000 for estimated warranty costs relating to homes sold, based upon management's assessment of historical experience factors and current industry trends. Management reviews its warranty requirements at the close of each reporting period and adjusts the reserves accordingly.

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

For The Three Month Period Ended	
March 31, 2011	March 31, 2010

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Balance at beginning of period	\$ 1,290,000	\$ 1,530,000
Warranty charges	327,961	573,198
Warranty payments	(452,961)	(683,198)
Balance at end of period	\$ 1,165,000	\$ 1,420,000

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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 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 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 March 31, 2011. 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 March 31, 2011, the Company had an outstanding balance of \$2,575,000 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 \$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 March 31, 2011. 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 March 31, 2011, the Company had an outstanding balance of \$900,000 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 March 31, 2011, \$4,231,939 was available under the revolving credit loans after deducting letters of credit of \$200,000.

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 March 31, 2011, no amounts had been drawn on the above irrevocable letters of credit by the beneficiaries.

NOTE 8 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 March 31, 2011, the total amount due of \$1,591,048 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 9 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.

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The following is a list of the common shares indexed to derivative financial instruments as of March 31, 2011 and December 31, 2010, and other salient terms:

	Exercise Price	Common shares indexed
Class A Warrants (Class A-1 & Class A-2)	\$ 1.50	2,218,690
Class B Warrants	\$ 2.25	1,112,487
Class BD-2 Warrants	\$ 1.50	477,479
Class BD-3 Warrants	\$ 2.25	238,740
Class BD-4 Warrants	\$ 1.50	66,121
Class BD-5 Warrants	\$ 3.00	66,121
Total number of common shares indexed to derivative instruments		4,179,638

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. Effective January 1, 2011, we changed our method for valuing our derivative warrants from a Black-Scholes Merton Model, adjusted to give effect to the anti-dilution features (the Noreen Wolfson Model) to Binomial Lattice. Binomial Lattice was considered by our management to be more appropriate because it both provides for early exercise scenarios and incorporates the down-round anti-dilution protection possibilities that could arise in early exercise scenarios.

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 Lattice models) 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 March 31, 2011, December 31, 2010 and activity in our derivative liability balances during the year:

	December 31, 2010	Derivative gains/ (losses)	March 31, 2011
Class A Warrants (Class A-1 & Class A-2)	\$ 138,091	\$ 129,068	\$ 9,023
Class B Warrants	226,360	109,771	116,589
Class BD-2 Warrants	41,092	39,851	1,241
Class BD-3 Warrants	9,396	9,324	72
Class BD-4 Warrants	3,022	2,850	172
Class BD-5 Warrants	721	714	7
Fair values	\$ 418,682	\$ 291,578	\$ 127,104

Significant assumptions (or ranges):

Trading market values (1)	\$ 0.72	\$ 0.72
Term (years)	0.61-2.61	0.37- 2.40
Volatility (1)	89.38% - 111.12%	18.05% -114.36%
Risk-free rate (2)	0.19% - 1.05%	0.09% - 0.80%

Fair value hierarchy:

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- (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 that for assets and liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) during the period, a reconciliation is required 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 March 31, 2011 is as follows:

	Warrant Derivative
Beginning balance, December 31, 2010	\$ 418,682
Total (gains) or losses included in earnings	(291,578)
Issuances	
Ending balance, March 31, 2011	\$ 127,104

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 March 31, 2011	Three months ended March 31, 2010
Class A Warrants (Class A-1 & Class A-2)	\$ 129,068	\$ (29,483)
Class B Warrants	109,771	(57,165)
Class C Warrants		(12,800)
Class D Warrants		(49,400)
Class F Warrants (Class F-1 & Class F-2)		(3,575)
Class BD-2 Warrants	39,851	(2,427)
Class BD-3 Warrants	9,324	(585)
Class BD-4 Warrants	2,850	(178)
Class BD-5 Warrants	714	(40)
Final adjustment Put liability		32,000
	\$ 291,578	\$ (123,653)

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

	March 31, 2011
Current income tax expense/(benefit)	\$ (196,015)
Deferred income tax expense	107,668
Total income tax benefit	\$ (88,347)

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

	March 31, 2011	
	Amount	Impact on Rate
Income tax expense (benefit) at federal rate	\$ 15,781	34.00%
State tax, net of Federal effect	1,961	4.23%
Permanent Differences:		
Meals & Entertainment	5,035	10.85%
Officer's Life Insurance	334	0.72%
Derivative expense	(111,459)	-240.14%
Total Permanent Differences	\$ (106,090)	-228.57%
Rounding	\$ 1	0.00%
Total income tax expense/(benefit)	\$ (88,347)	-190.34%

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:

	March 31, 2011
Current Deferred Tax Assets:	
Warranty Reserve	\$ 445,333
Repurchase Reserve	56,095
Loan Loss Reserve	47,125
Accrued Legal fees	15,290
Allowance for Doubtful Accounts	1,911
Total Current Deferred Tax Asset	\$ 565,754

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Non-Current Deferred Tax Assets:	
Goodwill impairment	2,376,622
Valuation Allowance	(402,619)
Total Non-Current Deferred Tax Assets	\$ 1,974,003
Non-Current Deferred Tax Liability:	
Accelerated Depreciation	\$ (78,129)
Sale of Assets	(341)
Total Non-Current Deferred Tax Liability	\$ (78,470)
Total Deferred Tax Assets (Liabilities) - Net	\$ 2,461,287

NOTE 11 COMMITMENTS AND CONTINGENCIES

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

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Reserve for Repurchase Commitments - 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 \$3,730,000 at March 31, 2011. As of March 31, 2011 the Company reserved \$146,745 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 12 EQUITY TRANSACTIONS

Series A Convertible Preferred Stock - During the three month period ended March 31, 2011 there were no conversions of Series A Preferred stock into shares of the Company's common stock.

Common Stock Dividends - There were no dividends paid during the three month period ended March 31, 2011.

Treasury Stock - Pursuant to a common stock repurchase program approved by our Board of Directors, a total of 19,105 shares were purchased during the three month period ended March 31, 2011 at a cost of \$13,367 and recorded as treasury stock.

NOTE 13 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 month period ended March 31, 2011 and 2010.

	For The Three Months Ended	
	March 31, 2011	March 31, 2010
Revenues from external customers		
Factory-built housing	\$ 4,247,136	\$ 6,084,678
Financial Services	104,978	33,255
Total Revenues	\$ 4,352,114	\$ 6,117,933
Income (loss) from operations		
Factory-built housing	\$ (40,988)	\$ (1,983,167) ⁽¹⁾
Financial services	37,460	(25,345)
General corporate expenses	(215,127)	(271,158)
Total Income (loss) from operations	\$ (218,655)	\$ (2,279,670)
Derivative income (expense)	\$ 291,578	\$ (123,653)
Other income (expense)	\$ (1,600)	\$
Interest income	6,387	4,782
Interest expense	(31,296)	(35,251)
	\$ 265,069	\$ (154,122)
Income (loss) before income taxes	\$ 46,414	\$ (2,433,792)

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Identifiable assets		
Factory-built housing	\$ 12,932,584	\$ 15,137,718
Financial Services	5,519,469	2,510,935
Other	170,617	40,611
	\$ 18,622,670	\$ 17,689,264

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

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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 customer. See Note 13 - 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 month period ended March 31, 2011.

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Manufacturing Operations

We produce all of our factory built homes at our plant in Guin, Alabama, which normally function on a single shift, five-day work week. During the first quarter of 2011, the Company's average production rate was approximately 13 floors produced per week. As of March 31, 2011, our backlog of orders stood at 12 days.

Our plant in Guin, Alabama operated at a capacity of 37% during the quarter ended March 31, 2011. 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, (3) the size of the Company's sales backlog, and (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 month period ended March 31, 2011. 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, 2010 Annual Report on Form 10-K and subsequent filings on Form 8-K.

HISTORICAL RESULTS - THREE MONTH PERIOD ENDED MARCH 31, 2011 AND MARCH 31, 2010.

Revenues. Overall gross revenue for the three month period ended March 31, 2011 was \$4,352,114 compared to \$6,117,933 for the three month period ended March 31, 2010, representing a decrease of \$1,765,819, or approximately 28.9%. The decrease in revenue for the three month period ended March 31, 2011 compared to three month ended March 31, 2010, is in part attributable to unusual harsh winter weather conditions causing a disruption of business services and delivery of goods, and the expiration of the federal homebuyer tax credit during 2010. The federal homebuyer tax credit favorable impacted our revenues for the three month period ended March 31, 2010. 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 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 March 31, 2011 was \$766,092 or 17.6% of total revenue compared to \$742,076 or 12.1% of total revenue for the three month period ended March 31, 2010. The increase in gross profit as percentage of revenue for the three month period March 31, 2011 as compared to the three month period March 31, 2010 is attributable to our average wholesale price per unit increased to approximately \$65,300 from \$58,800, for the three month period ended March 31, 2011 compared to the three month period ended March 31, 2010. The increase resulted in lower labor cost for the three month period ended March 31, 2011 as compared to the three month period ended March 31, 2010. Based on management's assessment of historical experience and current trends in wholesale shipments and dealer inventories we reduced our warranty provision by \$125,000 for the three month period ended March 31, 2011 and \$110,000 for the three month period ended March 31, 2010. 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.

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Selling, General, and Administrative Expenses. Selling, general, and administrative expenses for the three month period ended March 31, 2011 were \$980,518 compared to \$1,016,565 for the three month period ended March 31, 2010. The decrease in selling, general and administrative expenses is primarily due to decreases in general corporate expenses of \$56,031, which were offset by increases in health insurance cost of \$39,808. 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 for the three month period ended March 31, 2011 was \$291,578 compared to an expense of \$123,653 for the three month period ended March 31, 2010. Our derivative income represents a change in the fair value of our derivative warrants. Since derivative financial instruments are initially and subsequently carried at fair values, our derivative income/expense will reflect the volatility in these estimates and assumption changes. See Note 9 Derivative Liabilities and Note 11 Commitments and Contingencies of the consolidated financial statements for additional disclosure data.

Impairment Charge. The Company's goodwill was fully impaired in 2010. See Note 4 Goodwill of the consolidated financial statements for additional data disclosure.

Net Income. The net income (loss) for the three month period ended March 31, 2011 was \$134,761 compared to net income (loss) of \$(2,288,969) for the three month period ended March 31, 2010. This increase in net income is primarily due to a non-cash goodwill impairment charge of \$2,000,000 taken during the three month period ended March 31, 2010. See Note 4 Goodwill of the consolidated financial statements for additional data disclosure.

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 \$6,200,151 in cash and cash equivalents and short-term investments as of March 31, 2011, compared to \$6,895,673 in cash and cash equivalents and short-term investments as of December 31, 2010. 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 2011 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.

We obtained the \$7,500,000 Facility and the \$5,000,000 Facility (as described above) from Fifth Third Bank to partially fund our retail dealer financing program. As of March 31, 2011, the aggregate balance on the \$7,500,000 Facility and the \$5,000,000 Facility was \$3,475,000. In addition, we have a real estate loan from Fifth Third that had a balance, as of March 31, 2011, of \$1,591,048. The \$7,500,000 Facility and the \$5,000,000 Facility are currently scheduled to expire on October 14, 2011. In addition, the term for the real estate loan is scheduled to expire on June 1, 2011. Although we anticipate extending the terms for each of the \$7,500,000 Facility, the \$5,000,000 Facility, and the real estate loan, if we are unable to do so, and we are unable to find suitable replacement financing, we would be required to use a significant portion of our cash reserves.

1 - Cash flow from operating activities:

For the three month period ended March 31, 2011, operating activities used net cash of \$1,378,991 primarily as a result of the following:

- (a) an increase in inventories of \$543,794 (a use of cash), primarily as a result of a return to normal production levels subsequent to the holiday shutdown period at December 31, 2010, and
- (b) a increase in accounts receivable of \$330,357 (a use of cash, due to a seasonal increase as a result of scheduled production shutdown during December 2010, and

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- (c) an increase in inventory finance notes receivable of \$413,059 (a use of cash), the increase in inventory finance notes receivable is a result of expansion of DVFC to provide short-term inventory-secured loans to qualified retail dealers and developers, and
- (d) a decrease in estimated services and warranties of \$125,000 (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.

For the three month period ended March 31, 2010, operating activities used net cash of \$2,594,827 primarily as a result of the following:

- (e) an increase in inventories of \$649,998 (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
- (f) a increase in accounts receivable of \$551,004 (a use of cash, due to a seasonal increase as a result of scheduled production shutdown during December 2009, and
- (g) an increase in inventory finance notes receivable of \$1,411,899 (a use of cash), the increase in inventory finance notes receivable is a result of expansion of DVFC to provide short-term inventory-secured loans to qualified retail dealers and developers.

2 - Cash flow from investing activities:

The net cash provided in investing activities for the three month period ending March 31, 2011 was \$49,026, which reflects sales of available for sale securities, which offset in part by capitalization of normal operating purchases of equipment of \$26,274. The net cash used in investing activities for the three month period ending March 31, 2010 was \$186,730, which reflects our deposit of \$700,000 in escrow pursuant to our commitments under the Earnout Agreement, which were offset in part by purchases of available-for-sale securities.

3 - Cash flow from financing activities:

The net cash provided in financing activities for the three month period ending March 31, 2011 was \$703,593, which relates to proceeds from notes payable of \$750,000 used to finance our inventory finance notes receivable, which were offset in part by scheduled principal payments of the Company's commercial real estate mortgage of \$33,040, and treasury stock purchases of \$13,367. The net cash provided in financing activities for the three month period ending March 31, 2010 was \$519,483, which relates to proceeds from notes payable of \$550,000 used to finance our inventory finance notes receivable, which were offset in part by scheduled principal payments of the Company's commercial real estate mortgage of \$30,517.

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 \$200,000. As of March 31, 2011, no amounts had been drawn on the above irrevocable letters of credit by the beneficiaries.

Critical Accounting Policies

Our discussion and analysis of our financial condition and results of operations are based upon our financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these consolidated financial statements requires us to make estimates and judgments which affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosures of contingent assets and liabilities. For a description of those estimates, see Note 2, Summary of Significant Accounting Policies, contained in the explanatory notes to the Company's financial statements for the quarter ended March 31, 2011, contained in this filing and the Company's Form 10-K for December 31, 2010. 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

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which are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions. However, we believe that our estimates, including those for the above-described items, are reasonable.

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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 \$1,165,000 on its balance sheet as of March 31, 2011. Based on management's assessment of historical experience and current trends in wholesale shipments and dealer inventories we reduced our warranty provision by \$125,000 for the quarter year ended March 31, 2011. Although we maintain reserves for such claims, there can be no assurance that warranty expense levels will remain at current levels or that the reserves that we have set aside will continue to be adequate. A large number of warranty claims which exceed our current warranty expense levels could have a material adverse affect upon our results of operations.

Volume Incentives Payable

We have relied upon volume incentive payments to our independent dealers who retail our products. These volume incentive payments are accounted for as a reduction to gross sales, and are estimated and accrued when sales of our factory-built homes are made to our independent dealers. Volume incentive reserves are recorded based upon the annualized purchases of our independent dealers who purchase a qualifying amount of home products from us. We accrue a liability to our dealers, based upon estimates derived from historical payout rates. We had a reserve for volume incentives payable of \$225,375 as of March 31, 2011.

Reserve for Repurchase Commitments

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

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,
- (iii) the price we are obligated to pay under such repurchase agreements declines based upon a predetermined amount over a period which usually does not exceed 24 months, and
- (iv) we have been able to resell homes repurchased from lenders at current market prices, although there is no guarantee that we will continue to be able to do so.

The maximum amount for which the Company is contingently liable under such agreements amounted to approximately \$3,730,000 as of March 31, 2011, as compared to \$6,555,000 as of March 31, 2010. As of March 31, 2011 and March 31, 2010, we had reserves of \$146,745 and

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\$217,700, respectively, established for future repurchase commitments, based upon our prior experience and evaluation of our independent dealers' financial conditions. We have increased repurchase reserves as compared to amounts under repurchase obligation based on identified changes in dealers' financial conditions and the probability of default for the group of dealers identified at an elevated risk of default. Because Deer Valley to date has not experienced any significant losses under these agreements, management does not expect any future losses to have a material effect on our accompanying financial statements.

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Impairment of Long-Lived Assets

As previously discussed, the manufactured housing industry has experienced an overall market decline. Addressing the constriction of the retail housing market, in 2008 the Company idled its Sulligent, Alabama plant and thereafter consolidated its production operations at the Company's larger plant located in Guin, Alabama. In accordance with FASB Topic ASC 420 "Exit or 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. Based on our estimates of the fair value of idled facility no impairment charges have been recorded.

Goodwill

Goodwill 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 estimates of future sales for the Company's products, capital needs, economic trends and other factors. See Note 4 of 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.

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The fair value of the derivative warrant liability was \$418,682 on December 31, 2010, and \$ 127,104 on March 31, 2011. The change in the warrant liability resulted in a derivative income of \$291,578 for the three month period ended March 31, 2011. See Note 9 - Derivative Liabilities of the notes to Condensed Consolidated Financial Statements for additional disclosure data.

Recent accounting pronouncements

Recent accounting pronouncements - We have reviewed accounting pronouncements and interpretations thereof that have effectiveness dates during the periods reported and in future periods. We believe that the following impending standards may have an impact on our future filings. The applicability of any standard is subject to the formal review of our financial management and certain standards are under consideration.

In July 2010, the FASB issued Accounting Standards Update (ASU) 2010-20, *Receivables (Topic 310): Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses*, which requires entities to provide new disclosures in their financial statements about their financing receivables, including credit risk exposures and the allowance for credit losses on a disaggregated basis. The ASU is effective for public entities for reporting periods ending on or after December 15, 2010 for disclosures of financing receivables as of the end of a reporting period. The disclosures related to activity that occurs during a reporting period are required to be adopted for periods beginning on or after December 15, 2010. The Company adopted the provisions of ASU 2010-20 relating to period-end disclosures as of December 31, 2010.

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 March 31, 2011 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 March 31, 2011, there have been no changes in the Company's internal control over financial reporting that have materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

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 three month period ended March 31, 2011 there were no conversions of Series A Preferred stock into shares of the Company's common stock.

Treasury Stock - Pursuant to a common stock repurchase program approved by our Board of Directors, a total of 19,105 shares were purchased during the three month period ended March 31, 2011 at a cost of \$13,367 and recorded as treasury 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
<u>Month #1</u>				
Jan. 1 to Jan. 31, 2011	0	0	0	0
<u>Month #2</u>				
Feb. 1 to Feb. 28, 2011	0	0	0	0
<u>Month #3</u>				
March 1 to March 31, 2011	19,105	\$ 0.70	0	0

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Total (1)	19,105	\$.70	0	0
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- (1) Total does not include 3,794 shares of the Company's common stock repurchased by the Company between April 1, 2011 and May 6, 2011 at a price of \$.70 per share.

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)
31.01	Certification of Chief Executive Officer pursuant to Rule 13a-14(a) and 15d-14(a) as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, dated May 10, 2011. (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 May 10, 2011. (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 May 10, 2011. (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 May 10, 2011. (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)

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

Dated: May 10, 2011