
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-QSB

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

For the quarterly period ended December 31, 2007

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: 000-51549



TIMBERLINE RESOURCES CORPORATION

(Exact Name of Registrant as Specified in its Charter)

IDAHO

(State of other jurisdiction of incorporation or organization)

82-0291227

(I.R.S. Employer Identification No.)

101 EAST LAKESIDE AVENUE

COEUR D'ALENE, IDAHO

(Address of Principal Executive Offices)

83814

(Zip Code)

(208) 664-4859

(Registrant's Telephone Number, including Area Code)

(Former name, former address and former fiscal year, if changed since last report)

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the past 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. ☒ Yes ☐ No

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

Number of shares of issuer's common stock outstanding at February 8, 2008: 27,270,103

Transitional Small Business format (check one): ☐ Yes ☒ No

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PART I — FINANCIAL INFORMATION

ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

**TIMBERLINE RESOURCES CORPORATION AND
SUBSIDIARIES**

**Consolidated Financial Statements
December 31, 2007 and 2006**

TIMBERLINE RESOURCES CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

	December 31, 2007 (unaudited)	September 30, 2007 (audited)
ASSETS		
CURRENT ASSETS:		
Cash	\$ 5,287,039	\$ 3,949,988
Accounts receivable	1,738,257	3,882,275
Employee receivable	12,155	7,073
Materials and supplies inventory	2,498,936	1,925,392
Prepaid expenses	480,537	373,288
TOTAL CURRENT ASSETS	10,016,924	10,138,016
PROPERTY, MINERAL RIGHTS AND EQUIPMENT:		
Property, mineral rights and equipment, net of accumulated depreciation	9,208,619	8,008,928
OTHER ASSETS:		
Restricted cash	800,000	802,860
Deposits and other assets	203,948	147,058
Intangible assets, net of amortization	88,891	105,557
Goodwill	2,808,524	2,808,524
TOTAL OTHER ASSETS	3,901,363	3,863,999
TOTAL ASSETS	\$ 23,126,906	\$ 22,010,943
LIABILITIES, TEMPORARY EQUITY AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Note payable to bank	\$ 599,065	\$ 599,065
Accounts payable	2,882,411	3,617,165
Accrued expenses	985,021	944,627
Notes payable - related parties	60,000	787,000
Deferred revenue	118,332	250,000
Current portion of capital leases	480,952	476,032
Current portion of notes payable	313,842	300,638
TOTAL CURRENT LIABILITIES	5,439,623	6,974,527
LONG-TERM LIABILITIES:		
Capital leases, net of current portion	642,165	647,416
Notes payable, net of current portion	629,606	571,534
TOTAL LONG-TERM LIABILITIES	1,271,771	1,218,950
COMMITMENTS AND CONTINGENCIES	-	-
TEMPORARY EQUITY		
Series A Preferred stock, \$0.01 par value; liquidation and redemption value \$2,737,741; 5,000,000 shares authorized, 4,700,000 issued and outstanding	1,880,000	1,880,000
STOCKHOLDERS' EQUITY:		
Preferred stock, \$0.01 par value; 5,000,000 shares authorized, none issued and outstanding	-	-
Common stock, \$0.001 par value; 100,000,000 shares authorized, 26,504,103 and 24,801,108 shares issued and outstanding, respectively	26,503	24,801
Common stock subscribed	-	(802,761)
Additional paid-in capital	24,220,756	20,433,478
Accumulated deficit	(9,711,747)	(7,718,052)
TOTAL STOCKHOLDERS' EQUITY	14,535,512	11,937,466
TOTAL LIABILITIES, TEMPORARY EQUITY AND STOCKHOLDERS' EQUITY	\$ 23,126,906	\$ 22,010,943

See accompanying notes to consolidated financial statements.

TIMBERLINE RESOURCES CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

	Quarter Ended	
	December 31,	December 31,
	2007	2006
	(unaudited)	(unaudited)
REVENUES	\$ 6,435,125	\$ 3,208,337
COST OF REVENUES	4,949,665	2,844,189
GROSS PROFIT	1,485,460	364,148
OPERATING EXPENSES:		
Mineral exploration expenses	576,752	82,957
Other general and administrative expenses	2,915,765	1,344,761
Loss (gain) on sale of equipment	(14,641)	4,379
TOTAL OPERATING EXPENSES	3,477,876	1,432,097
LOSS FROM OPERATIONS	(1,992,416)	(1,067,949)
OTHER INCOME (EXPENSE):		
Other income	69,200	8,727
Interest income	75,089	1,808
Interest expense	(145,568)	(81,628)
TOTAL OTHER INCOME (EXPENSE)	(1,279)	(71,093)
NET LOSS BEFORE INCOME TAXES	(1,993,695)	(1,139,042)
INCOME TAX EXPENSE	-	-
NET LOSS	\$ (1,993,695)	\$ (1,139,042)
NET LOSS PER SHARE AVAILABLE TO COMMON STOCKHOLDERS, BASIC AND DILUTED	\$ (0.08)	\$ (0.10)
WEIGHTED AVERAGE NUMBER OF COMMON SHARES OUTSTANDING, BASIC AND DILUTED	25,781,215	11,025,909

See accompanying notes to consolidated financial statements.

TIMBERLINE RESOURCES CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Quarter Ended	
	December 31, 2007 (unaudited)	December 31, 2006 (unaudited)
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	\$ (1,993,695)	\$ (1,139,042)
Adjustments to reconcile net loss to net cash provided (used) by operating activities:		
Depreciation and amortization	204,288	313,740
Loss (gain) on sale of equipment	(14,641)	4,379
Common stock issued for consulting	70,898	36,249
Share based compensation	610,444	68,350
Changes in assets and liabilities:		
Accounts receivable	1,543,123	692,891
Materials and supplies inventory	(573,544)	(332,617)
Prepaid expenses, deposits, and other assets	(114,139)	(89,789)
Employee receivable	(5,082)	(10,270)
Accounts payable	(734,754)	(125,207)
Accrued expenses	40,593	(93,456)
Deferred revenue	(131,668)	-
Accrued interest - related party payables	-	(2,154)
Deferred lease income	-	(8,727)
Net cash used by operating activities	(1,098,177)	(685,653)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of equipment	(519,276)	(117,921)
Change in restricted cash	2,660	-
Purchase of investment in equity security	(50,000)	-
Proceeds from sale of equipment	14,641	8,536
Net cash used by investing activities	(551,975)	(109,385)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net proceeds from line of credit	-	596,065
Proceeds from related party notes payable	60,000	-
Payments on related party notes payable	(787,000)	(329,439)
Payments on notes payable	(79,265)	(41,688)
Payments on capital leases	(116,934)	(127,328)
Proceeds from exercise of warrants	817,273	-
Proceeds from issuances of stock and warrants, net of stock offering costs	3,093,129	2,665,000
Net cash provided by financing activities	2,987,203	2,762,610
Net increase in cash	1,337,051	1,967,572
CASH AT BEGINNING OF PERIOD	3,949,988	732,245
CASH AT END OF PERIOD	\$ 5,287,039	\$ 2,699,817
NON-CASH FINANCING AND INVESTING ACTIVITIES:		
Account receivable exchanged for equipment	\$ 600,895	\$ -
Capital lease for equipment purchase	228,672	-
Note payable issued for equipment purchase	38,472	17,560

See accompanying notes to consolidated financial statements.

TIMBERLINE RESOURCES CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 – ORGANIZATION AND DESCRIPTION OF BUSINESS:

Timberline Resources Corporation (“Timberline” or “the Company”) was incorporated in August of 1968 under the laws of the state of Idaho as Silver Crystal Mines, Inc., for the purpose of exploring for precious metal deposits and advancing them to production.

During the first quarter of 2006, the Company acquired Kettle Drilling, Inc. (“Kettle Drilling” or “Kettle”) and its Mexican subsidiary, World Wide Exploration S.A. de C.V. (“World Wide”). Kettle provides drilling services to the mining and mineral exploration industries across North America and worldwide.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

- a. *Basis of presentation* – The accompanying unaudited consolidated financial statements have been prepared by the Company in accordance with accounting principles generally accepted in the United States of America for interim financial information, as well as the instructions to Form 10-QSB. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. In the opinion of the Company’s management, all adjustments (consisting of only normal recurring accruals) considered necessary for a fair presentation of the interim financial statements have been included. Operating results for the three-month period ended December 31, 2007 are not necessarily indicative of the results that may be expected for the full year ending September 30, 2008.

For further information refer to the financial statements and footnotes thereto in the Company’s Annual Report on Form 10-KSB for the year ended September 30, 2007.

- b. *Principles of consolidation* – The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries, Kettle Drilling and World Wide after elimination of the intercompany accounts and transactions.
- c. *Exploration Expenditures* – All exploration expenditures are expensed as incurred. Significant property acquisition payments for active exploration properties are capitalized. If no mineable ore body is discovered, previously capitalized costs are expensed in the period the property is abandoned.
- d. *Estimates and assumptions* – The preparation of financial statements in accordance with accounting principles generally accepted in the United States of America requires the use of estimates and assumptions that affect the reported amounts of assets and liabilities at the dates of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates and assumptions and could have a material effect on the Company’s reported financial position and results of operations.
- e. *Reclassifications* – Certain amounts in the prior-period financial statements have been reclassified for comparative purposes to conform to current period presentation with no effect on previously reported net loss.
- f. *Investments* – The Company owns 1,000,000 restricted shares of Rae Wallace Mining Company, a public corporation. The investment is recorded at cost which management estimates approximates fair market value at December 31, 2007.

TIMBERLINE RESOURCES CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, (continued):

- g. *Provision for Taxes* – Income taxes are provided based upon the liability method of accounting pursuant to Statement of Financial Accounting Standards No. 109, “Accounting for Income Taxes” (hereafter “SFAS No. 109”). Under this approach, deferred income taxes are recorded to reflect the tax consequences in future years of differences between the tax basis of assets and liabilities and their financial reporting amounts at each year-end. A valuation allowance is recorded against the deferred tax asset if management believes it is more likely than not that some portion or all of the deferred tax assets will not be realized (See Note 9).
- h. *Stock-based compensation* – The Company adopted Statement of Financial Accounting Standards No. 123 (revised 2004), *Share-based Payment* (“SFAS 123(R)”), at the beginning of fiscal year 2007, which requires the measurement of the cost of employee services received in exchange for an award of an equity instrument on the grant-date fair value of the award. The Company has chosen to use the modified prospective transition method under SFAS 123(R). The Company’s financial statements for the year ended September 30, 2007 and the quarter ended December 31, 2007 reflect the impact of this adoption.

Under SFAS 123(R), the Company is required to select a valuation technique or option-pricing model that meets the criteria as stated in the standard. At present, the Company is continuing to use the Black-Scholes model, which requires the input of some subjective assumptions. These assumptions include estimating the length of time employees will retain their vested stock options before exercising them (“expected term”), the estimated volatility of the Company’s common stock price over the expected term (“volatility”), the risk-free interest rate and the dividend yield. Changes in the subjective assumptions can materially affect the estimate of fair value of stock-based compensation.

- i. *Net loss per share* – Statement of Financial Accounting Standards No. 128, *Earnings per Share* requires dual presentation of basic earnings per share (“EPS”) and diluted EPS on the face of all income statements issued after December 15, 1997, for all entities with complex capital structures. Basic EPS is computed as net income (loss) divided by the weighted average number of common shares outstanding for the period. Diluted EPS reflects the potential dilution that could occur from common shares issuable through stock options, warrants, and other convertible securities.

Cumulative but undeclared dividends on the Series A Preferred Stock (Note 6) for the three months ended December 31, 2007 have been considered in the EPS computation.

The dilutive effect of convertible and exercisable securities, in periods of future income as of December 31, 2007, is as follows:

Stock options	3,020,001
Warrants	3,223,649
Convertible preferred stock	<u>4,700,000</u>
Total possible dilution	<u>10,943,650</u>

At December 31, 2007 and 2006, the effect of the Company’s outstanding options and common stock equivalents would have been anti-dilutive.

TIMBERLINE RESOURCES CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, (continued):

- j. *New accounting pronouncements* – In September 2006, the Financial Accounting Standards Board (FASB) issued SFAS No. 157, *Fair Value Measurements*, (SFAS 157), which will become effective in our 2008 financial statements. SFAS 157 establishes a framework for measuring fair value and expands disclosure about fair value measurements, but does not require any new fair value measurements. The Company has not yet determined the effect that adoption of SFAS 157 may have on the results of operations or financial position.

The FASB issued Statement No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities – Including an Amendment of FASB Statement No. 115*, in the first quarter 2007. The statement allows entities to value financial instruments and certain other items at fair value. The statement provides guidance over the election of the fair value option, including the timing of the election and specific items eligible for the fair value accounting. Changes in fair values would be recorded in earnings. The Company is evaluating the impact the adoption of this statement will have, if any, on its financial statements.

On October 1, 2007, we adopted Financial Accounting Standards Board Interpretation No. 48, *Accounting for Uncertainty in Tax Positions* (“FIN48”). FIN48 prescribes a recognition threshold and measurement attribute for the recognition and measurement of tax positions taken or expected to be taken in income tax returns. FIN48 also provides guidance on de-recognition of income tax assets and liabilities, classification of current and deferred income tax assets and liabilities, and accounting for interest and penalties associated with tax positions. In the course of our assessment, we determined that we were subject to examination of our income tax filings in the United States and various state jurisdictions for the 2003 – 2006 tax years. Within each of these jurisdictions we examined our material tax positions to determine whether we believed they would be sustained under the more-likely-than-not guidance provided by FIN48. If interest and penalties were to be assessed, we would charge interest to interest expense, and penalties to other operating expense. As a result of our assessment, we have concluded that the adoption of FIN48 had no significant impact on the Company’s results of operations or balance sheet for the quarter ended December 31, 2007, and required no adjustment to opening balance sheet accounts as of October 1, 2007.

TIMBERLINE RESOURCES CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, (continued):

In December 2007, the FASB revised SFAS No. 141 “Business Combinations”. The revised standard is effective for transactions where the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. SFAS No. 141(R) will change the accounting for the assets acquired and liabilities assumed in a business combination.

- Acquisition costs will be generally expensed as incurred;
- Non-controlling interests (formally known as “minority interests”) will be valued at fair value at the acquisition date;
- Acquired contingent liabilities will be recorded at fair value at the acquisition date and subsequently measured at either the higher of such amount or the amount determined under existing guidance for non-acquired contingencies;
- In-process research and development will be recorded at fair value as an indefinite-lived intangible asset at the acquisition date
- Restructuring costs associated with a business combination will be generally expensed subsequent to the acquisition date; and
- Changes in deferred tax asset valuation allowances and income tax uncertainties after the acquisition date generally will affect income tax expense.

The adoption of SFAS No. 141(R) does not currently have a material effect on our Consolidated Financial Statements. However, any future business acquisitions occurring on or after the beginning of the first annual reporting period beginning on or after December 15, 2008 will be accounted for in accordance with this statement.

NOTE 3 – RELATED PARTY TRANSACTIONS:

In 2006, Kettle Drilling entered into loan agreements with its officers, David Deeds and Doug Kettle. These loans totaled \$160,000 and \$627,000, respectively as of September 30, 2007. David Deeds is the Chief Executive Officer of Kettle Drilling and a shareholder of the Company. Mr. Kettle is the President of Kettle Drilling and a shareholder of the Company. The loans bear interest at 10% and are due on demand. There was no accrued interest outstanding as of December 31, 2007 and September 30, 2007.

Related party notes payable consist of the following at December 31, 2007 and September 30, 2007:

	<u>Dec. 31, 2007</u>	<u>Sep. 30, 2007</u>
Doug & Brenda Kettle	\$ 60,000	\$ 627,000
David Deeds	0	160,000
Less current portion	(60,000)	(787,000)
	<u>\$ 0</u>	<u>\$ 0</u>

TIMBERLINE RESOURCES CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 4 – COMMON STOCK AND WARRANTS:

During September, 2007, the Company initiated a private placement of the Company's restricted common stock. Under the private placement subscription agreement, the Company can sell up to 2,545,455 units for a total of \$7,000,000, plus up to 5% in over-subscriptions. Each unit consists of one share of common stock and one half of one Class A Warrant; with each whole warrant exercisable to acquire one additional share of common stock at an exercise price of \$3.50 per share for the period of twenty-four months from the Issue Date. The units were sold for \$2.75 each, representing management's estimate of the fair value of the Company's unregistered common stock and warrants at the time of sale. In connection with this offering, the Company agreed to use commercially reasonable efforts to file a resale registration on Form SB-2 (or such other available form) no later than 60 days after the Closing Date and cause such registration to be declared effective no later than 120 days of the Closing Date (150 days if reviewed by the SEC). The registration statement is to register for resale the shares of common stock and the shares of common stock acquirable upon exercise of the warrants. The Company sold a total of 2,626,694 units for total proceeds of \$7,223,408; with 1,780,972 units for proceeds of \$4,897,673 closing on September 30, 2007, 288,182 units for proceeds of \$792,500 closing on October 1, 2007, and 557,540 units for proceeds of \$1,533,235 closing on October 11, 2007. As of December 31, 2007, there are 1,313,348 warrants outstanding from this placement.

During the quarter ended December 31, 2007, the Company granted 40,000 restricted shares to an executive of the company as compensation. The shares were valued at the Company's common stock trading price as of the close of business on the date of issuance which resulted in the recording of \$136,000 to expense.

During the quarter ended December 31, 2007, the Company issued 817,273 shares of common stock as a result of warrants exercised. The warrants were granted pursuant to a private placement during 2006 and were exercised at a price of \$1.00 per warrant.

The following is a summary of the Company's warrants outstanding:

	Warrants	Weighted Average Exercise Price
Outstanding at September 30, 2007	3,618,061	\$ 1.62
Issued	422,861	3.50
Exercised	(817,273)	(1.00)
Outstanding at December 31, 2007	3,223,649	2.02

These warrants expire as follows:

Warrants	Price	Expiration Date
811,501	\$1.00	January 31, 2008
1,098,800	\$1.00	December 31, 2008
1,313,348	\$3.50	September 30, 2009
3,223,649		

TIMBERLINE RESOURCES CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 5 – STOCK OPTIONS:

The Company has established a stock incentive plan as amended August 31, 2006, to authorize the granting of up to 2,750,000 stock options to employees, directors and consultants. The plan documents include a provision for all options granted to be exercised through a cashless exercise.

During October 2007, the Company granted 1,230,000 options to purchase common stock to directors and employees of the company as compensation for services rendered. The options have an exercise price of \$3.40, the market price of the common stock on that date, and vest over the next two years. These options expire five years from the grant date. The fair value of the options granted was estimated on their grant date using the Black-Scholes Option Price Calculation. The following assumptions were made in estimating fair value: risk-free interest rate of 3.75%; volatility of 82.3%; expected life of three years; dividend yield of zero. The options were valued at \$1.87 per share. 493,336 of these options vested immediately, however only 267,500 were available under the reserve limit of the plan. Accordingly, an expense relating to those that were available under the reserve of the plan was recognized during the quarter in the amount of \$500,225 and is included in Other general and administrative expenses. The expense was allocated on a pro-rata basis according to the number of options that vested immediately on the grant date. The remaining 225,836 options that did not vest because they were in excess of the reserve limit of the plan will only vest upon shareholder approval of an increase in the reserve limit. An additional 82,918 options vested during the quarter ended December 31, 2007 and an expense of \$45,118 was taken related to those vested options.

The current number of securities to be issued upon exercise of outstanding options exceeds the authorized shares to be issued under the Amended 2005 Equity Incentive Plan which was approved by shareholders on September 22, 2006. The Company plans to seek an increase in the number of authorized shares to be issued under the Amended 2005 Equity Incentive Plan at its next annual shareholder's meeting. If the requested increase in the number of authorized shares is not approved, only 2,750,000 options will vest and may be exercised. If the requested increase in the number of authorized shares to be issued under the Plan is approved, the expense related to the remaining options that were to vest immediately upon grant will be recognized in the period where shareholder approval is obtained. The Company cancelled 283,332 options during the quarter ended December 31, 2007 pursuant to the terms of the Amended 2005 Equity Incentive Plan. There are 926,255 options vested as of December 31, 2007 while 2,093,746 remain unvested and vest over the next 3 years.

TIMBERLINE RESOURCES CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 5 – STOCK OPTIONS (continued):

The following is a summary of the Company's options issued under the Amended 2005 Equity Incentive Plan:

	Options	Weighted Average Exercise Price
Outstanding at September 30, 2007	2,073,333	\$ 2.13
Granted	1,230,000	3.40
Exercised	-0-	-0-
Expired / Cancelled	<u>283,332</u>	<u>1.03</u>
Outstanding at December 31, 2007	<u>3,020,001⁽¹⁾</u>	\$ <u>2.75</u>
Exercisable at December 31, 2007	<u>700,419</u>	\$ <u>1.87</u>
Weighted average fair value of options granted during the period ended December 31, 2007		\$ <u>1.87</u>

The average remaining contractual term of the options outstanding and exercisable at December 31, 2007 is 4.20 and 3.36 years, respectively.

⁽¹⁾ As discussed above, options granted that are in excess of the reserve limit of the Company's Amended 2005 Equity Incentive Plan are subject to shareholder approval of an increased reserve limit.

NOTE 6 – PREFERRED STOCK:

Timberline is authorized to issue up to 10,000,000 shares of preferred stock, \$.01 par value. The Board of Directors of Timberline is authorized to issue the preferred stock from time to time in series and is further authorized to establish such series, to fix and determine the variations in the relative rights and preferences as between series, to fix voting rights, if any, for each series, and to allow for the conversion of preferred stock into Common Stock.

On February 26, 2006, our Board of Directors adopted a resolution creating a series of Five Million Shares (5,000,000) shares of voting, convertible Preferred Stock designated as Series A Preferred Stock. The Preferred Stock was issued to the Doug Kettle and Dave Deeds (the "Kettle Shareholders") as a part of the consideration delivered to them for the acquisition of Kettle Drilling.

As of December 31, 2007, there is \$152,741 of cumulative but undeclared dividends on the Series A Preferred Stock and the conversion price remains \$0.40.

TIMBERLINE RESOURCES CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 6 – PREFERRED STOCK (continued):

The Company has determined that the preferred stock of the Company should be classified as a temporary equity item on the Company's balance sheet. As a result, the preferred stock is classified in a "mezzanine" section of temporary equity presented between total liabilities and stockholders' equity.

NOTE 7 – COMMITMENTS AND CONTINGENCIES:

Real Estate Lease Commitments

The Company has real estate lease commitments related to its main office in Coeur d'Alene, Idaho, a facility in Butte, Montana, offices of Kettle Drilling in Coeur d'Alene, Idaho, a storage shop in Rathdrum, Idaho, and its operational facility in Elko, Nevada. The Company's Mexico subsidiary also leases facilities for its administrative office and warehouse under defined term lease agreements which are for one year. Total office and storage rental expense aggregated \$51,805 and \$31,682 for quarters ended December 31, 2007 and 2006, respectively.

Environmental Contingencies

The Company has in past years been engaged in mining in northern Idaho, which is currently the site of a federal Superfund cleanup project. Although the Company is no longer involved in mining in this or other areas at present, the possibility exists that environmental cleanup or other environmental restoration procedures could remain to be completed or mandated by law, causing unpredictable and unexpected liabilities to arise. At the date of these financial statements, the Company is not aware of any environmental issues or litigation relating to any of its current or former properties.

TIMBERLINE RESOURCES CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 8 – SEGMENT INFORMATION:

The Company has three operating segments at December 31, 2007: drilling revenues from Kettle Drilling; drilling revenues in Mexico through Kettle's subsidiary, World Wide Exploration; and Timberline's exploration activities.

Segment information (after intercompany eliminations) for the quarters ended December 31, 2007 and 2006 is as follows:

Revenues:	2007	2006
Timberline	\$ -	\$ -
Kettle Drilling	4,942,179	2,641,110
World Wide Exploration	1,492,946	567,227
Total revenues	<u>\$ 6,435,125</u>	<u>\$ 3,208,337</u>
Income / (Loss) before income taxes:		
Timberline	\$ (1,678,877)	\$ (534,094)
Kettle Drilling	(325,415)	(617,463)
World Wide Exploration	10,597	12,515
Income / (Loss) before income taxes	<u>\$ (1,993,695)</u>	<u>\$ (1,139,042)</u>
Total assets:		
Timberline	\$ 18,012,087	\$ 9,210,326
Kettle Drilling	4,204,515	2,187,322
World Wide Exploration	910,304	713,237
Total assets	<u>\$ 23,126,906</u>	<u>\$ 12,110,885</u>

The accounting policies of the segments are the same as those described in the notes to the consolidated financial statements included in the Company's annual report filed on Form 10-KSB for the fiscal year ended September 30, 2007, after considering newly adopted accounting pronouncements described elsewhere herein. Separate management of each segment is required because each business unit is subject to different marketing, production, and technology strategies.

During the quarter ended December 31, 2007, revenues from transactions with four customers each amounted to 10% or more of our total revenues. One such customer accounted for revenue of \$1,393,576, another customer accounted for revenue of \$1,286,734, another customer accounted for revenue of \$754,673, and another customer accounted for revenue of \$579,916. The revenue for all four of those customers is reported through Kettle Drilling.

The assets of Timberline are located in the United States. The assets of Kettle Drilling are also located in the United States and their revenues are derived from drilling contracts in the United States. The assets of World Wide Exploration are located in Mexico and their revenues are derived from drilling contracts in Mexico.

Timberline is not an operating entity at this point insofar as they are not generating revenues from the sales of their properties, but they are actively exploring several properties for their mining potential.

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

You should read the following discussion and analysis of our financial condition and results of operations together with our financial statements and related notes appearing elsewhere in this quarterly report. This discussion and analysis contains forward-looking statements that involve risks, uncertainties and assumptions. Our actual results may differ materially from those anticipated in these forward-looking statements as a result of many factors, including, but not limited to, those set forth under "Risk Factors and Uncertainties" in our Annual Report on Form 10-KSB, filed with the SEC on January 14, 2008.

Overview

We commenced our exploration stage in January 2004 with the change in the management of the Company. From January 2004 until March 2006, we were strictly a mineral exploration company. Beginning with the management appointments of John Swallow and Paul Dirksen and our acquisition of a drilling services company, Kettle Drilling, Inc. ("Kettle"), in March 2006, we have advanced a new, aggressive business plan. Prior to our new business model, the addition of new management, and the purchase of Kettle, the Company had no reported revenues and accumulated losses.

Our corporate objective is to provide investors with significant exposure to both the 'picks and shovels' and 'blue sky' aspects of our industry. We believe that our business model is highly scalable and uniquely well-positioned to take advantage of the environment that currently exists in the mining and exploration industries. We have the people and knowledge base to continue to evaluate growth opportunities – either organically or through mergers and acquisitions.

During the quarter we completed the final tranches of our earlier offering, raising an additional \$2.32-million, added Ron Guill and Jim Moore to our Board of Directors and announced the signing of a non-binding Letter of Intent (LOI) to acquire Small Mine Development, LLC ("SMD"), one of the largest underground mine contractors in the United States. We believe that upon receipt of shareholder approval and closing, the acquisition of SMD will roughly quadruple our revenue and provide us with the "critical mass" to be a significant player in the North American mining services industry. Furthermore, it is the opinion of management that the expansion of our Board of Directors and announcing the Letter of Intent to acquire SMD, LLC demonstrates our belief that a strong presence in both mining services and exploration are likely to provide excellent returns to our shareholders over the long term.

Additionally, during the quarter we accelerated our exploration, permitting and drilling activity and our expenditures are representative of our commitment to ramp up exploration activity during 2008 on a number of our properties. During the quarter we initiated a seven-hole drill program at our Butte Highlands project. As part of the Butte Highlands program, permitting was completed, access roads and drill pads constructed and a drill was mobilized to the site, however the onset of bad weather prevented completion of the first hole. The program is planned to be both resumed and expanded as weather and drill rig availability allows early in 2008. Also during the quarter, we received the approval to do a five-hole drill program on our Downeyville property in the Walker Lane area of Nevada. Drilling on that project began subsequent to the end of the quarter.

Kettle and its subsidiary, World Wide Exploration S.A. de C.V. ("WWE"), provide both surface and underground drilling services but specialize in underground, hard rock core drilling. Their clients include both mining and exploration companies in the United States and Mexico.

Results of Operations for Three Months Ended December 31, 2007 and 2006

Combined Results – Timberline Corporate, Timberline Exploration, Kettle Drilling and WWE

For the three months ended December 31, 2007, we reported \$6,435,125 in revenue compared to \$3,208,337 in the same period of 2006. Our revenues are derived entirely from our drilling subsidiaries and comprised of \$4,942,179 from Kettle Drilling and \$1,492,946 from WWE. Our revenue increase was primarily due to the growth in the number of drill rigs operating this year versus last year. Gross profit from Kettle and WWE was \$1,187,805 and \$297,655, respectively for the three months ended December 31, 2007.

Our overall after tax net loss for the three months ended December 31, 2007 was \$1,993,695 compared to an overall net loss of \$1,139,042 for the three months ended December 31, 2006. Our net loss for the three months ended December 31, 2007 is comprised of \$1,678,877 for Timberline Corporate and Exploration, \$325,415 for Kettle Drilling and offset by a gain of \$10,597 at WWE.

Timberline Corporate and Exploration Division

The after tax net loss of \$1,678,877 for the combined Timberline Corporate and the Exploration division is comprised of non-cash charges of \$708,332, exploration expenditures of \$576,752, and other general and administrative costs of \$393,793. Included in the non-cash charges are expenses related to common stock issuances for consulting services, stock based compensation, and for stock options that vested during the quarter. Also included in the non-cash charges is \$26,990 in Depreciation and Amortization.

Kettle Drilling and WWE

For the three months ended December 31, 2007, Kettle Drilling had revenues of \$4,942,179 as compared to \$2,641,110 for the three months ended December 31, 2006. WWE had revenues of \$1,492,946 for the three months ended December 31, 2007 as compared to \$567,227 for the three months ended December 31, 2006. The increase in revenues is attributable to the growth in the number of operating drill rigs at each company.

For the three months ended December 31, 2007, net loss before taxes from Kettle was \$325,415 while net income at WWE was \$10,597, as compared to a net loss of \$617,463 for Kettle and net income of \$12,515 for WWE for the three months ended December 31, 2006. At Kettle, the reduced loss from last year is attributable to stabilizing our growth, while the net income at WWE remained nearly the same as the corresponding quarter in 2006 in spite of substantial revenue growth due to the expenses related to the increased activity and number of drill rigs in Mexico.

Financial Condition and Liquidity

At December 31, 2007, we had assets of \$23,126,906 consisting of cash in the amount of \$5,287,039; accounts receivable in the amount of \$1,738,257; inventories valued at \$2,498,936; property, plant, and equipment, net of depreciation of \$9,208,619; and other assets of \$4,394,055.

Off-Balance Sheet Arrangements

We do not have any off balance sheet arrangements that are reasonably likely to have a current or future effect on our financial condition, revenues, results of operations, liquidity or capital expenditures.

Critical Accounting Policies and Estimates

See Note 2 to the financial statements contained elsewhere in this Quarterly Report for a complete summary of the significant accounting policies used in the presentation of our financial statements. The summary is presented to assist the reader in understanding the financial statements. The accounting policies used conform to accounting principals generally accepted in the United States of America and have been consistently applied in the preparation of the financial statements.

Our critical accounting policies are as follows:

Exploration Expenditures

All exploration expenditures are expensed as incurred. Significant property acquisition payments for active exploration properties are capitalized. If no mineable ore body is discovered, previously capitalized costs are expensed in the period the property is abandoned.

Revenue Recognition

Generally, the Company recognizes drilling service revenues as the drilling services are provided to the customer based on the actual amount drilled for each contract. In some cases, the customer is responsible for mobilization and “stand by” costs when the Company deploys its personnel and equipment to a specific drilling site, but for reasons beyond the Company’s control, drilling activities are not able to take place. Usually, the specific terms of each drilling job are agreed to by the customer and the Company prior to the commencement of drilling.

Intangible Assets

Intangible assets from the acquisition of Kettle Drilling, including employment contracts, and customer drilling contracts, are stated at the estimated value at the date of acquisition. Amortization of employment contracts is calculated on a straight-line basis over a useful life of three years. Amortization of the drilling contracts is calculated on a straight-line basis over the life of the contracts (typically one year or less). The value of employment and customer drilling contracts will be periodically tested for impairment. Any impairment loss revealed by this test would be reported in earnings for the period during which the loss occurred.

Inventories

The Company values its inventories at the lower of average cost or market, using the first-in-first-out (FIFO) method. Allowances are recorded for inventory considered to be in excess or obsolete. Inventories consist primarily of parts, operating supplies, drill rods and drill bits. The value of inventory previously used in drilling and still considered useable, is valued at 25-90% of cost depending on remaining life expectancy.

Review of Carrying Value of Property and Equipment for Impairment

The Company reviews the carrying value of property and equipment for impairment whenever events and circumstances indicate that the carrying value of an asset may not be recoverable from the estimated future cash flows expected to result from its use and eventual disposition. In cases where undiscounted expected future cash flows are less than the carrying value, an impairment loss is recognized equal to an amount by which the carrying value exceeds the fair value of the asset. The factors considered by management in performing this assessment include current operating results, trends and prospects, the manner in which the property is used, and the effects of obsolescence, demand, competition, and other economic factors.

Goodwill

Goodwill relates to the acquisition of Kettle Drilling. In accordance with Statement of Financial Accounting Standards No. 142, “Goodwill and Other Intangible Assets,” at least annually goodwill is tested for impairment by applying a fair value based test. In assessing the value of goodwill, assets and liabilities are assigned to the reporting units and a discounted cash flow analysis is used to determine fair value. There was no impairment loss revealed by this test as of September 30, 2007.

Derivative Financial Instruments

The Company does not use derivative instruments to hedge exposures to cash flow, market, or foreign currency risks. Derivative financial instruments are initially measured at their fair value. For derivative financial instruments that are accounted for as liabilities, the derivative instrument is initially recorded at its fair value, with changes in the fair value reported as charges or credits to income. For option-based derivative financial instruments, we use the Black-Scholes option pricing model to value the derivative instruments.

Certain information contained in this “Management Discussion and Analysis” constitutes forward looking information and actual results could differ from estimates, expectations or beliefs contained in such statements.

ITEM 3. DISCLOSURE CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

At the end of the quarter covered by this report, an evaluation was carried out under the supervision of and with the participation of the Company's management, including the Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO"), of the effectiveness of the design and operations of the Company's disclosure controls and procedures (as defined in Rule 13a – 15(e) and Rule 15d – 15(e) under the Exchange Act). Based on that evaluation the CEO and the CFO have concluded that as of the end of the period covered by this report, the Company's disclosure controls and procedures were adequately designed and effective in ensuring that: (i) information required to be disclosed by the Company in reports that it files or submits to the Securities and Exchange Commission under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in applicable rules and forms and (ii) material information required to be disclosed in our reports filed under the Exchange Act is accumulated and communicated to our management, including our CEO and CFO, as appropriate, to allow for accurate and timely decisions regarding required disclosure.

The CEO and the CFO reached this conclusion with respect to the Company's disclosure controls and procedures notwithstanding the fact that we determined that there were material weaknesses with respect to the Company's internal control over financial reporting, as discussed below. While the CEO and CFO believe there is overlap between disclosure controls and procedures and internal control over financial reporting, they have concluded that a material weakness in internal controls limited to those discussed below does not cause the Company's disclosure controls and procedures to be ineffective. The Company's CEO and CFO believe that the inter-relation of disclosure controls and procedures and internal control over financial reporting is specific to the particular control policies adopted by the Company and the Company's CEO and CFO have carefully considered such inter-relation of the Company's specific policies in reaching this conclusion. Specifically, the CEO and the CFO have considered whether the material weakness in internal controls over financial reporting, as discussed below, stemmed from or was indicative of a lapse in the Company's disclosure policies related to inter-company reporting policies and financial statement preparation policies.

Changes in Internal Control Over Financial Reporting

In reviewing our internal controls over financial reporting, the Company's management has determined that there were material weaknesses in our internal control over financial reporting. These material weaknesses have been conveyed to our Audit Committee. Management's assessment is that these weaknesses are primarily the result of not having enough sufficiently qualified accounting personnel involved in the preparation of the Company's consolidated financial statements.

Management is addressing these issues through increased utilization of the accounting system that was implemented at the Company's operating subsidiaries and by hiring more qualified accounting personnel for the Company and its operating subsidiaries to aid in the preparation and reporting of financial information. Additionally, subsequent to the end of the current quarter, we hired a corporate controller and will continue to devote additional resources to our internal controls over financial reporting.

PART II — OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS.

Timberline is not a party to any pending legal proceedings, and no such proceedings are known to be contemplated.

No director, officer or affiliate of Timberline and no owner of record or beneficial owner of more than 5.0% of our securities or any associate of any such director, officer or security holder is a party adverse to Timberline or has a material interest adverse to Timberline in reference to pending litigation.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS.

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES.

None.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS.

None.

ITEM 5. OTHER INFORMATION.

None.

ITEM 6. EXHIBITS.

31.1 Certification of Chief Executive Officer and Chief Financial Officer pursuant to Rule 13a-14 and Rule 15d-14(a), promulgated under the Securities and Exchange Act of 1934, as amended

32.1 Certification of Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act

SIGNATURES

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

TIMBERLINE RESOURCES CORPORATION

By: /s/ Randal Hardy

Randal Hardy
Chief Executive Officer and Chief Financial Officer
(On behalf of the registrant and as
Principal Executive Officer and Principal Accounting and
Financial Officer)

Date: February 14, 2008

EXHIBIT 31.1

CERTIFICATION

I, Randal Hardy, Chief Executive Officer and Chief Financial Officer of Timberline Resources Corporation, certify that:

1. I have reviewed this Quarterly Report on Form 10-QSB of Timberline Resources Corporation,
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the small business issuer as of, and for, the periods presented in this report;
4. The small business issuer's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the small business issuer and have:
 - (a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the small business issuer, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) evaluated the effectiveness of the small business issuer's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (c) disclosed in this report any change in the small business issuer's internal control over financial reporting that occurred during the small business issuer's most recent fiscal quarter (the small business issuer's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the small business issuer's internal control over financial reporting; and
5. The small business issuer's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the small business issuer's auditors and the audit committee of the small business issuer's board of directors (or persons performing the equivalent function):
 - (a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the small business issuer's ability to record, process, summarize and report financial information; and
 - (b) any fraud, whether or not material, that involves management or other employees who have a significant role in the small business issuer's internal controls over financial reporting.

Date: February 14, 2008

By: /s/ Randal Hardy

Randal Hardy
Chief Executive Officer & Chief Financial Officer

EXHIBIT 32.1

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of Timberline Resources Corporation (the “Company”) on Form 10-QSB for the period ended December 31, 2007, as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, Randal Hardy, Chief Executive Officer and Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: February 14, 2008

By: /s/ Randal Hardy

Randal Hardy
Chief Executive Officer & Chief Financial Officer