

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

FORM 10-Q

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

For the quarterly period ended June 30, 2009
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: 001-34055



TIMBERLINE RESOURCES CORPORATION

(Exact Name of Registrant as Specified in its Charter)

DELAWARE

(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)

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definition of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

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

Number of shares of issuer's common stock outstanding at August 12, 2009: 35,870,111

INDEX

	Page
PART I - FINANCIAL INFORMATION	
Item 1. Consolidated Financial Statements (Unaudited).	3
Consolidated Balance Sheets at June 30, 2009 and September 30, 2008	5
Consolidated Statements of Operations for the three months and nine months ended June 30, 2009 and 2008	6
Consolidated Statements of Cash Flows for the nine months ended June 30, 2009 and 2008	7
Notes to Consolidated Financial Statements	9
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.	19
Item 3. Quantitative and Qualitative Disclosures About Market Risk.	26
Item 4. Controls and Procedures.	26
PART II - OTHER INFORMATION	
Item 1. Legal Proceedings.	27
Item 1A. Risk Factors.	27
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.	27
Item 3. Defaults Upon Senior Securities.	27
Item 4. Submission of Matters to Vote of Security Holders.	27
Item 5. Other Information.	27
Item 6. Exhibits.	28
SIGNATURES	29

PART I — FINANCIAL INFORMATION

ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

**TIMBERLINE RESOURCES CORPORATION AND
SUBSIDIARIES**

Consolidated Financial Statements

June 30, 2009

Timberline Resources Corporation and Subsidiaries

Contents

	<i><u>Page</u></i>
<i>FINANCIAL STATEMENTS:</i>	
<i>Consolidated balance sheets</i>	<i>5</i>
<i>Consolidated statements of operations</i>	<i>6</i>
<i>Consolidated statements of cash flows</i>	<i>7 - 8</i>
<i>Notes to consolidated financial statements</i>	<i>9 - 19</i>

TIMBERLINE RESOURCES CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

	June 30, 2009 (unaudited)	September 30, 2008 (audited)
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 1,374,857	\$ 737,503
Accounts receivable, net of allowance for doubtful accounts of \$250,740 and \$150,740, respectively	1,128,155	3,499,371
Materials and supplies inventory	1,345,546	2,045,223
Deferred offering and acquisition costs	-	923,957
Deferred financing cost, net	-	202,550
Prepaid expenses and other current assets	381,921	481,529
TOTAL CURRENT ASSETS	4,230,479	7,890,133
PROPERTY, MINERAL RIGHTS AND EQUIPMENT:		
Property, mineral rights and equipment, net	7,278,481	9,224,550
TOTAL PROPERTY, MINERAL RIGHTS AND EQUIPMENT	7,278,481	9,224,550
OTHER ASSETS:		
Restricted cash	42,533	286,410
Deposits and other assets	208,780	160,170
Goodwill	2,808,524	2,808,524
TOTAL OTHER ASSETS	3,059,837	3,255,104
TOTAL ASSETS	\$ 14,568,797	\$ 20,369,787
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Accounts payable	\$ 1,092,601	\$ 2,159,857
Accrued expenses	889,537	945,809
Accrued offering and acquisition costs	50,000	923,957
Accrued payroll and benefits	361,446	482,714
Accrued taxes	468,562	2,173,362
Accrued severance	-	400,000
Current portion of customer advances	600,000	-
Deferred revenue	-	27,315
Current portion of capital leases	330,264	448,127
Current portion of long term debt	162,070	250,638
TOTAL CURRENT LIABILITIES	3,954,480	7,811,779
LONG-TERM LIABILITIES:		
Bridge loan financing	-	8,000,000
Long term debt, net of current portion	276,873	337,731
Convertible note payable to related party	5,000,000	-
Accrued interest on convertible note payable to related party, due at maturity	343,219	-
Accrued offering and acquisition costs	346,750	-
Obligation under capital leases, net of current portion	234,083	577,534
Customer advances	300,000	-
Put option on common stock	-	92,336
TOTAL LONG-TERM LIABILITIES	6,500,925	9,007,601
COMMITMENTS AND CONTINGENCIES (NOTE 11)	-	-
STOCKHOLDERS' EQUITY:		
Preferred stock, \$0.01 par value; 10,000,000 shares authorized, none issued and outstanding	-	-
Common stock, \$0.001 par value; 100,000,000 shares authorized, 34,920,111 and 28,739,903 shares issued and outstanding, respectively	34,920	28,739
Additional paid-in capital	27,606,678	21,343,416
Accumulated deficit	(23,528,206)	(17,821,748)
TOTAL STOCKHOLDERS' EQUITY	4,113,392	3,550,407
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$ 14,568,797	\$ 20,369,787

See accompanying notes to consolidated financial statements.

TIMBERLINE RESOURCES CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS

	Three Months Ended June 30,		Nine Months Ended June 30,	
	2009 (unaudited)	2008 (unaudited)	2009 (unaudited)	2008 (unaudited)
REVENUES	\$ 4,361,137	\$ 9,703,813	\$ 12,545,217	\$ 24,525,265
COST OF REVENUES	3,558,958	7,647,637	12,175,705	18,931,196
GROSS PROFIT	802,179	2,056,176	369,512	5,594,069
OPERATING EXPENSES:				
Mineral exploration expenses	61,561	167,098	374,180	1,166,818
Salaries and benefits	362,597	1,164,217	1,928,868	4,011,835
Insurance expense	120,334	161,277	432,998	381,856
Professional fees expense (recovery)	(390,731)	286,300	1,170,947	817,071
Severance benefits (recovery)	-	1,880,590	(350,000)	1,880,590
Other general and administrative expenses	380,508	771,521	1,426,239	1,905,363
TOTAL OPERATING EXPENSES	534,269	4,431,003	4,983,232	10,163,533
INCOME (LOSS) FROM OPERATIONS	267,910	(2,374,827)	(4,613,720)	(4,569,464)
OTHER INCOME (EXPENSE):				
Other income (expense)	52,339	(44,356)	90,118	(16,490)
Foreign exchange gain (loss)	81,020	45,260	(16,064)	188,303
Loss on derivative	-	-	(154,064)	-
Interest income	7,101	39,551	29,126	159,991
Interest expense	(167,309)	(54,924)	(1,186,943)	(306,864)
TOTAL OTHER INCOME (EXPENSE)	(26,849)	(14,469)	(1,237,827)	24,940
NET INCOME (LOSS) BEFORE INCOME TAXES	241,061	(2,389,296)	(5,851,547)	(4,544,524)
INCOME TAX BENEFIT (PROVISION)	-	(225,982)	145,089	(551,502)
NET INCOME (LOSS)	\$ 241,061	\$ (2,615,278)	\$ (5,706,458)	\$ (5,096,026)
EXCESS CONSIDERATION PAID ON REDEMPTION OF PREFERRED STOCK	-	(6,090,000)	-	(6,090,000)
NET INCOME (LOSS) AVAILABLE TO COMMON STOCKHOLDERS	241,061	(8,705,278)	(5,706,458)	(11,186,026)
NET INCOME (LOSS) PER SHARE AVAILABLE TO COMMON STOCKHOLDERS, BASIC AND DILUTED	\$ 0.01	\$ (0.32)	\$ (0.17)	\$ (0.42)
WEIGHTED AVERAGE NUMBER OF COMMON SHARES OUTSTANDING, BASIC AND DILUTED	34,916,155	27,325,782	32,996,638	26,726,289

See accompanying notes to consolidated financial statements.

TIMBERLINE RESOURCES CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

	Nine Months Ended	
	June 30,	
	2009	2008
	(unaudited)	(unaudited)
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	\$ (5,706,458)	\$ (5,096,026)
Adjustments to reconcile net loss to net cash used by operating activities:		
Depreciation and amortization	1,034,758	1,215,725
Allowance for doubtful accounts	100,000	150,740
Loss (gain) on sale of equipment	(54,339)	34,558
Stock based compensation	1,023,043	1,205,232
Amortization of deferred financing cost	202,550	-
Deferred offering and acquisition costs	923,957	-
Severance recovery	(350,000)	-
Loss on derivative	154,064	-
Impairment of mineral rights	55,000	-
Accrued offering and acquisition costs	(527,207)	-
Inventory writedown	-	535,658
Changes in assets and liabilities:		
Accounts receivable	2,166,996	(1,464,017)
Materials and supplies inventory	699,677	(658,616)
Prepaid expenses and other current assets, deposits and other assets	50,998	117,931
Accounts payable	(1,067,256)	(1,005,075)
Accrued expenses	(56,272)	490,817
Accrued payroll and benefits	(121,268)	(5,306)
Accrued taxes	(1,704,800)	1,601,692
Accrued severance	(50,000)	600,000
Deferred revenue	(27,315)	(121,336)
Accrued interest on convertible note payable to related party, due at maturity	343,219	-
Net cash used by operating activities	(2,910,653)	(2,398,023)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of equipment	(232,169)	(1,843,725)
Change in restricted cash	243,877	529,110
Purchase of investment in equity security	-	(50,000)
Proceeds from sale of equipment	1,247,039	40,014
Net cash provided (used) by investing activities	1,258,747	(1,324,601)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Repayment of bridge loan financing	(8,000,000)	-
Proceeds from long term debt	150,000	-
Proceeds from convertible note payable to related party	5,000,000	-
Payments on long term debt	(299,426)	(311,615)
Payments on capital leases	(461,314)	(364,339)
Proceeds from short term convertible note	5,000,000	-
Proceeds from customer advances	1,000,000	-
Payments on customer advances	(100,000)	-
Proceeds from related party notes payable	-	60,000
Payments on related party notes payable	-	(847,000)
Proceeds from exercise of warrants	-	1,508,873
Payment of note payable to bank	-	(599,065)
Proceeds from bridge loan financing	-	8,000,000
Redemption of Series A preferred stock	-	(7,500,000)
Deferred financing cost	-	(345,000)
Collection of common stock subscriptions	-	802,761
Proceeds from issuances of stock and warrants, net of stock offering costs	-	2,290,366
Net cash provided by financing activities	2,289,260	2,694,981
Net increase in cash	637,354	(1,027,643)
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	737,503	3,949,988
CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$ 1,374,857	\$ 2,922,345

See accompanying notes to consolidated financial statements.

TIMBERLINE RESOURCES CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

	Nine Months Ended	
	June 30,	
	2009	2008
	(unaudited)	(unaudited)
NON-CASH FINANCING AND INVESTING ACTIVITIES:		
Account receivable exchanged for equipment	\$ 104,220	\$ 700,895
Settlement of put option with common stock	246,400	-
Conversion of short term convertible note into stock	5,000,000	-
Long term debt refinancings	180,692	
Capital lease for equipment purchase	-	387,297
Long term debt issued for equipment purchase	-	129,423
Series A preferred stock exchanged for common stock	-	470,000
Common stock issued in connection with bridge loan financing	-	484,800

See accompanying 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.

In 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 in North America. In September 2008, Kettle Drilling, Inc. changed its name to Timberline Drilling Incorporated (“Timberline Drilling”).

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-Q. 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 and nine month periods ended June 30, 2009 are not necessarily indicative of the results that may be expected for the full year ending September 30, 2009.

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, 2008.

- b. *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.
- c. *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.
- d. *Accounts Receivable* – Accounts receivable are carried at original invoice amount less an estimate for doubtful accounts. Management determines the allowance for doubtful accounts by regularly evaluating individual customer receivables and considering a customer’s financial condition, credit history, and current economic conditions. Trade receivables are written off when deemed uncollectible. Recoveries of receivables previously written off are recorded as income when received.
- e. *Materials and supplies inventory* – Inventories consist primarily of parts, operating supplies, drill rods and drill bits. The Company values its materials and supplies inventory, with the exception of drill rods, at the lower of average cost or market. Drill rods are valued using their average cost less an allowance for rod usage on a per foot drilled basis. Allowances are recorded for inventory considered to be in excess or obsolete.
- f. *Goodwill* - Goodwill relates to the acquisition of Timberline 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, 2008.
- g. *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.

TIMBERLINE RESOURCES CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2009

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

- h. *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.
- i. *Stock-based compensation* – The Company accounts for its stock based compensation in accordance with Statement of Financial Accounting Standards No. 123 (revised 2004), Share-based Payment (“SFAS 123(R)”).

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 life”), the estimated volatility of the Company’s common stock price over the expected term (“volatility”), employee forfeiture rate, 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.

- j. *Net income (loss) per share* – 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.

The dilutive effect of convertible and exercisable securities, in periods of future income as of June 30, 2009 and 2008, would be as follows:

	June 30, 2009	June 30, 2008
Stock options	4,631,669	3,181,668
Warrants	1,337,934	2,401,734
Convertible debt	3,562,146	-
Total possible dilution	<u>9,531,749</u>	<u>5,583,402</u>

At June 30, 2009 and 2008, the effect of the Company’s outstanding options and common stock equivalents would have been anti-dilutive.

On June 27, 2008 the Company repurchased and cancelled 3,525,000 of the 4,700,000 Series A Preferred Stock. Under EITF D-53, the reduction in additional paid-in capital arising from this transaction is treated as a dividend for the purposes of calculating EPS for the three months and nine months ending June 30, 2008.

- k. *New accounting pronouncements* – In September 2006, the Financial Accounting Standards Board (“FASB”) issued SFAS No. 157, Fair Value Measurements, (“SFAS 157”). 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. Effective October 1, 2008, the Company adopted the provisions of SFAS 157 for our financial assets and financial liabilities without a material effect on the Company’s consolidated financial statements. In February 2008, FASB issued Staff position 157-2 which delays the effective date of SFAS 157 for non-financial assets and non-financial liabilities to fiscal years beginning after November 15, 2008. The Company is currently evaluating the impact of adopting SFAS 157 for non-financial assets and non-financial liabilities on our consolidated financial statements.

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. This 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 adoption of this statement on October 1, 2008 did not have a material effect on the Company’s consolidated financial statements.

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

In December 2007, FASB issued SFAS No. 141R “*Business Combinations*”, (“SFAS 141R”). 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. 141R will change the accounting for the assets acquired and liabilities assumed in a business combination.

- Acquisition costs will be generally expensed as incurred;
- Noncontrolling 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;
- 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.

It does not appear that the adoption of SFAS No. 141R will 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 on or after December 15, 2008 will be accounted for in accordance with the statement. In December 2007, FASB also issued SFAS No. 160, *Non-controlling Interests in Consolidated Financial Statements, an amendment of ARB 51* (“SFAS 160”). SFAS 160 will change the accounting and reporting for minority interests, which will be re-characterized as non-controlling interests and classified as a component of equity. SFAS 160 requires retroactive adoption of the presentation and disclosure requirements for existing minority interests. SFAS 160 is effective for fiscal years beginning on or after December 15, 2008 and interim periods within those fiscal years. The adoption of this statement is not expected to have a material effect on the Company’s future reported consolidated financial position or results of operations.

In March 2008, FASB issued SFAS No. 161 *Disclosures about Derivative Instruments and Hedging Activities – an amendment of SFAS 133*. This Statement requires enhanced disclosures about an entity’s derivative and hedging activities and thereby improves the transparency of financial reporting. This Statement is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged. This Statement encourages, but does not require, comparative disclosures for earlier periods at initial adoption. The adoption of this statement is not expected to have a material effect on the Company’s future reported financial position or results of operations.

In May 2008, FASB issued SFAS No. 162, *The Hierarchy of Generally Accepted Accounting Principles* (“SFAS 162”). SFAS 162 identifies the sources of accounting principles and the framework for selecting the principles to be used in the preparation of financial statements of nongovernmental entities that are presented in conformity with generally accepted accounting principles in the United States. It was effective November 15, 2008, following the SEC’s approval of the Public Company Accounting Oversight Board amendments to AU Section 411, *The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles*. The adoption of this statement is not expected to have a material effect on the Company’s consolidated financial statements.

In May 2009, FASB issued SFAS No. 165, *Subsequent Events* (SFAS 165). SFAS 165 establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued. This statement is effective for interim and annual periods ending after June 15, 2009. Accordingly, the Company has adopted SFAS 165 in its quarter ending June 30, 2009. The adoption of this statement did not have a material effect on the Company’s consolidated financial statements.

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

In June 2009, FASB issued SFAS No. 167, *Amendments to FASB Interpretation No. 46R* (“SFAS 167”). SFAS 167 amends FASB Interpretation No. (FIN) 46 (revised December 2003), *Consolidation of Variable Interest Entities* (FIN 46R) to require an analysis to determine whether a variable interest gives the entity a controlling financial interest in a variable interest entity. This statement requires an ongoing reassessment and eliminates the quantitative approach previously required for determining whether an entity is the primary beneficiary. This statement is effective for fiscal years beginning after Nov. 15, 2009. Accordingly, the Company will adopt SFAS 167 in fiscal year 2011 and is currently evaluating the impact of adopting this statement on the consolidated financial statements.

In June 2009, FASB issued SFAS No. 166, *Accounting for Transfers of Financial Assets* (“SFAS 166”). SFAS 166 removes the concept of a qualifying special-purpose entity (QSPE) from SFAS No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities* (SFAS 140) and removes the exception from applying FIN 46R. This statement also clarifies the requirements for isolation and limitations on portions of financial assets that are eligible for sale accounting. This statement is effective for fiscal years beginning after Nov. 15, 2009. Accordingly, the Company will adopt SFAS 166 in fiscal year 2011 and is currently evaluating the impact of adopting this statement on the consolidated financial statements.

NOTE 3 – RELATED PARTY TRANSACTIONS:

On March 10, 2008, the Company entered into an agreement with Douglas Kettle and David and Margaret Deeds providing for severance arrangements relating to the resignation of Messrs. Kettle and Deeds, the President and CEO, respectively, of Timberline Drilling.

Messrs. Kettle and Deeds resigned from Timberline Drilling on May 15, 2008. In connection with the resignations, the Company transferred certain personal property to Messrs. Kettle and Deeds and paid Mr. Kettle and Mr. Deeds a cash severance amount of \$600,000 each at the time of their resignation, as well as the balance of their 2007 bonuses (\$135,822 each) and additional cash severance of \$300,000.

During the quarter ended March 31, 2009, the Company entered into a Settlement and Release Agreement with Douglas Kettle and David and Margaret Deeds (“Kettle Affiliates”). Pursuant to the agreement, the Kettle Affiliates agreed to purchase certain non-utilized assets from the Company and to release any claims against the Company, including their claim to the remaining \$350,000 of severance owing to them on December 31, 2008. The Company released any claims against the Kettle Affiliates, including releasing Mr. Kettle and Mr. Deeds from the remainder of the term of their previous non-competition agreements.

On October 31, 2008, the Company entered into two convertible notes (see Notes 6 and 8); one with Ronald Guill, a director of the Company, and his wife, Stacey Guill, and the other with Small Mine Development, LLC (“SMD”), an Idaho limited liability company owned by Mr. Guill. The Company used the proceeds of the notes to pay off the \$8,000,000 million bridge loan previously provided to the Company by Auramet Trading, LLC (“Auramet”) (See Note 5) and for general working capital purposes.

NOTE 4 – CUSTOMER ADVANCES:

During the quarter ended June 30, 2009, a major customer provided an advance payment for drilling services of \$1,000,000 to the Company and extended its contract with the Company through February 2011. The advance is to be repaid by twenty monthly payments of \$50,000 beginning May 15, 2009 and ending December 15, 2010. The advance was provided pursuant to a contract change order which did not contain any provisions for interest or prepayment penalties, nor any specified right of offset. As of June 30, 2009 and September 30, 2008, customer advances were \$900,000 and none, respectively, and \$300,000 of the remaining customer advance balance was classified as a long-term liability as of June 30, 2009.

NOTE 5 – BRIDGE LOAN FINANCING:

On June 24, 2008, the Company entered into a bridge loan financing arrangement for \$8,000,000 with Auramet Trading, LLC (“Auramet”) under which the Company could draw funds at any time before June 30, 2008. On June 27, 2008 the Company withdrew \$8,000,000, net of a fee equal to 4% of the principal amount of the loan, to repurchase the Company’s then outstanding Series A Preferred Shares.

NOTE 5 – BRIDGE LOAN FINANCING, (continued):

The loan incurred interest at 12% per annum, with interest payable monthly in arrears commencing August 1, 2008, and the principal amount outstanding was due October 31, 2008. On October 31, 2008 the bridge loan principal amount was repaid in full.

Pursuant to the loan's terms, the Company also issued 160,000 shares of the Company's common stock to Auramet after the Company's drawdown of the loan on June 27, 2008. The fair market value of the 160,000 common shares (\$484,800) was recorded on the balance sheet in common stock, additional paid-in capital and deferred financing cost, net. The deferred financing costs were ratably charged to interest expense over the term of the loan. In addition, Auramet received a put option for the 160,000 shares of common stock issued, exercisable ninety days from the maturity date of the bridge loan. On January 29, 2009, Auramet had a onetime option to put some or all of the 160,000 common shares back to the Company at a redemption price of \$2.00 per share.

During the quarter ended March 31, 2009, Auramet indicated its intention to exercise the put option and return the shares to the Company. The Company and Auramet agreed that the Company would issue an additional 535,652 shares of common stock, valued at the trailing 30 day average closing price of the Company's stock of \$0.46 per share, to Auramet in lieu of settling the option with a cash payment. These shares were issued in March 2009 and the change in fair value of the derivative during the nine months ending June 30, 2009 is recorded in loss on derivative in the consolidated statement of operations.

NOTE 6 – CONVERTIBLE NOTE PAYABLE TO RELATED PARTY:

On October 31, 2008, the Company entered into a series of agreements with SMD in connection with a \$5 million loan from SMD. The loan documents included: a convertible note (the "Convertible Term Note"), a credit agreement (the "Credit Agreement"), a collateral assignment and pledge of stock and security agreement (the "Pledge Agreement"), a security agreement (the "Security Agreement") and a right of first refusal over the Company's Butte Highlands property (the "Right of First Refusal").

The Convertible Term Note has a principal amount of \$5 million and is collateralized with all of the stock of Timberline Drilling, Inc., and a Deed of Trust covering the Company's Butte Highlands property in Silver Bow County, Montana (the "Butte Highlands Property").

Pursuant to the terms of the Credit Agreement, the Convertible Term Note bears interest at 10% annually, compounded monthly, with interest due at maturity. The Convertible Term Note is convertible by SMD at any time prior to payment of the note in full, at a conversion price of \$1.50 per share. Should the Company issue any form of equity security other than the Company's common stock, SMD may also convert all or any portion of the outstanding amount under the Convertible Term Note into the new form of equity security at the issuance price of the new form of equity security. Management analyzed the conversion features contained in this note considering EITF No. 00-27 "Application of Issue No. 98-5 to Certain Convertible Instruments", EITF 00-19 "Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock," EITF No. 98-5, "Accounting for Convertible Securities with Beneficial Conversion Features or Contingently Adjustable Conversion Ratios", and APB 14, "Accounting for Convertible Debt and Debt Issued with Stock Purchase Warrants." Management's conclusion was that these convertible features are conventional convertible instruments and thus would qualify for equity classification under EITF 00-19. As conventional convertible instruments, the embedded conversion options qualify for the scope exception under FAS 133, and therefore would not be bifurcated from the host instrument.

The Convertible Term Note must be repaid on or before October 31, 2010, including interest due at maturity, and may be prepaid in whole or in part at any time without premium or penalty. If the Company defaults on the Convertible Term Note or any of the related agreements, SMD may declare the Convertible Term Note immediately due and payable, and the Company must pay SMD an origination fee in the amount of \$50,000.

Under the Right of First Refusal, the Company granted SMD a right of first refusal to purchase the Butte Highlands Property on the same terms as those of any bona fide offer from a third-party upon 60 days' notice from the Company of any such offer. In addition, the Company granted SMD a right to develop the Butte Highlands Property on the same terms as those of any bona fide offer to develop the property from a third-party upon 60 days' notice from the Company of any such offer.

TIMBERLINE RESOURCES CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2009

NOTE 7 – INCOME TAXES:

During the three months and nine months ended June 30, 2009, the Company realized an income tax benefit of none and \$145,089, respectively. This benefit represents the difference between the accrued and actual amount of Mexican income taxes paid by the Company's Mexican subsidiary, World Wide Exploration, for the 2008 calendar year.

For the fiscal year ended September 30, 2009 the Company anticipates an effective income tax rate of 31% in Mexico and 0% in the United States due to the availability of accumulated net operating losses to offset any U.S. income taxes.

NOTE 8 – COMMON STOCK AND WARRANTS:

In October, 2008, the Company entered into a short-term convertible note (the "Short-Term Convertible Note") for \$5 million with Ron Guill, a director of the Company, and his wife, Stacey Guill (see Note 3). The Short-Term Convertible Note principal automatically converted into 5,555,556 shares of Company stock (valued at \$0.90 per share) pursuant to the Subscription Agreement described below upon approval of the issuance of the additional shares for listing by the NYSE Amex which occurred in December 2008.

Under the Subscription Agreement, Mr. and Mrs. Guill subscribed to purchase 5,555,556 shares of the Company's common stock at a price of \$0.90 per share.

During the quarter ended March 31, 2009, the Company issued 535,652 shares of common stock, valued at the trailing 30 day average closing price of the Company's stock of \$0.46 per share (\$246,400), to Auramet in lieu of settling a put option held by Auramet with cash (see Note 5).

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

	Warrants		Weighted Average Exercise Price
Outstanding at September 30, 2008	2,301,734	\$	2.45
Issued	-		-
Expired	(963,800)		1.00
Outstanding at June 30, 2009	1,337,934		3.50

These warrants expire as follows:

Warrants	Price	Expiration Date
1,337,934	\$3.50	September 30, 2009
1,337,934		

NOTE 9 – STOCK OPTIONS:

The Company has established the 2005 Equity Incentive Plan (as amended August 31, 2006 and August 22, 2008) to authorize the granting of up to 7,000,000 stock options to employees, directors and consultants. Upon exercise of options, shares are issued from the available authorized shares of the Company. Option awards are granted with an exercise price equal to the market price of the Company's stock at the date of grant.

The fair value of option awards granted during the nine months ended June 30, 2009 and 2008, respectively, was estimated on the date of grant using the assumptions noted in the following table. Total compensation cost charged against operations under the plan for employees was \$38,543 and \$464,088 for the three months ended June 30, 2009 and 2008, respectively. Total compensation cost charged against operations under the plan for employees was \$828,330 and \$963,449 for the nine months ended June 30, 2009 and 2008, respectively. These costs are classified under salaries and

TIMBERLINE RESOURCES CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2009

NOTE 9 – STOCK OPTIONS, (continued):

benefits expense. Total compensation cost charged against operations under the plan for directors and consultants was \$7,950 and \$29,201 for the three months ended June 30, 2009 and 2008, respectively. Total compensation cost charged against operations under the plan for directors and consultants was \$172,153 and \$105,783 for the nine months ended June 30, 2009 and 2008, respectively. These costs are classified under other general and administrative expenses.

	Nine months ending	
	June 30, 2009	June 30, 2008
Expected volatility	105.30% - 106.60%	82.30%
Weighted-average volatility	105.30% - 106.60%	82.30%
Expected dividends	-	-
Expected term (in years)	3	3
Risk-free rate	1.02% - 1.38%	3.75%

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, 2008	3,917,502	\$ 2.65
Granted	3,005,000	0.33
Exercised	75,000	0.80
Expired and forfeited	(2,215,833)	2.91
Outstanding at June 30, 2009	4,631,669	\$ 1.05
Exercisable at June 30, 2009	2,170,434	\$ 1.23
Weighted average fair value of options granted during the nine months ended June 30, 2009		\$ 0.20

The average remaining contractual term of the options outstanding and exercisable at June 30, 2009 was 3.89 and 3.38 years, respectively. Options exercised were on a cashless basis, resulting in the issuance of 35,000 shares based on the current price of the Company's stock on the date of exercise. As of June 30, 2009, total unrecognized compensation expense related to options was \$1,040,271 and the related weighted-average period over which it is expected to be recognized is approximately 0.70 years. The aggregate intrinsic value of options exercised during the nine months ended June 30, 2009 and 2008 was \$52,500 and none, respectively. The aggregate intrinsic value of options outstanding and exercisable as of June 30, 2009 was \$53,633 and \$18,367, respectively.

NOTE 10 – 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.

NOTE 11 – 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 and a shop of Timberline Drilling in Coeur d'Alene, 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 \$72,168 and \$83,576 for the three months ended June 30, 2009 and 2008, respectively, and \$219,830 and \$208,722 for the nine months ended June 30, 2009 and 2008, respectively.

Offering Costs Arising From the Proposed Acquisition of SMD

On October 24, 2008, the Company and Ronald Guill mutually agreed by written consent to terminate the Stock Purchase Agreement previously entered into between the Company and Mr. Guill on February 23, 2008, which would have provided for the purchase by the Company of all of Mr. Guill's membership interests in SMD.

The Company had engaged a full service investment banking and institutional securities firm to render an opinion to the Company's Board as to whether the consideration to be paid by the Company for the membership interests of SMD was fair, from a financial point of view. The Company also engaged this firm to arrange for financing of the acquisition of SMD's membership interests. All fees to be paid by the Company for these services were contemplated to be paid out of proceeds raised during the financing.

Subsequent to the termination of the acquisition of SMD and the failure of the investment banking firm to arrange financing, an invoice was received by the Company from the investment banking firm for the provision of the fairness opinion, as well as legal fees incurred by the firm during the course of the financing. The total amount charged for the services provided was \$923,957, and these fees were classified with professional fees in the statement of operations during the quarter ended December 31, 2008. During the quarter ended June 30, 2009, the Company reached an agreement in principle with the investment banking firm to satisfy the outstanding invoice by payment of \$50,000 in cash and issuance of 950,000 common shares of the Company subject to approval by the NYSE Amex. The Stock Settlement and Release Agreement (the "Agreement") between the Company and the investment banking firm was finalized on July 14, 2009. As a result of the Agreement, the amount of accrued offering and acquisition costs included in current liabilities on the Company's consolidated balance sheet at June 30, 2009 has been reduced to \$50,000. The remaining \$346,750, equal to the fair market value of the 950,000 shares of the Company as of the date of the Agreement, has been classified as a long-term liability on the consolidated balance sheet since the liability was settled with common stock of the Company subsequent to the balance sheet date. A corresponding recovery of \$527,207 in professional fees has been recognized in the statement of operations for the three months and nine months ended June 30, 2009.

Unpaid IRS Interest and Penalties

The Company has received notice from the Internal Revenue Service ("IRS") that Timberline Drilling has been assessed late filing penalties for payroll taxes not paid on a timely basis during the period from October 1, 2007 through May 15, 2008. As of June 30, 2009, the balance of those unpaid interest and penalties is \$453,741.

The Company has negotiated a payment plan with the IRS relating to the unpaid interest and penalties owed as of June 30, 2009. In April 2009, the Company began making monthly installment payments on the outstanding balance of interest and penalties. During the nine months ended June 30, 2009, Timberline Drilling's assets became subject to a tax lien until all interest and penalties assessed by the IRS are satisfied. If the Company fails to comply with the negotiated payment plan or is otherwise unable to pay the interest and penalties owed to the IRS, the IRS could force the sale of certain assets of Timberline Drilling to satisfy the interest and penalties due.

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
June 30, 2009

NOTE 12 – SEGMENT INFORMATION:

The Company has three operating segments at June 30, 2009: drilling revenues from Timberline Drilling; drilling revenues in Mexico through Timberline Drilling's subsidiary, World Wide Exploration; and Timberline's exploration activities.

Segment information for the three months and nine months ended June 30, 2009 and 2008 are as follows:

	Three months ending June 30		Nine months ending June 30	
	2009	2008	2009	2008
Revenues:				
Timberline	\$ -	\$ -	\$ -	\$ -
Timberline Drilling	3,592,474	7,318,802	8,823,389	17,983,223
World Wide Exploration	768,663	2,385,011	3,721,828	6,542,042
Total revenues	<u>\$ 4,361,137</u>	<u>\$ 9,703,813</u>	<u>\$ 12,545,217</u>	<u>\$ 24,525,265</u>
Income / (Loss) before income taxes:				
Timberline	\$ (91,033)	\$ (1,325,486)	\$ (4,071,881)	\$ (4,060,370)
Timberline Drilling	270,380	(1,745,974)	(1,536,892)	(1,935,476)
World Wide Exploration	61,714	682,164	(242,774)	1,451,322
Income/ (Loss) before income taxes	<u>\$ 241,061</u>	<u>\$ (2,389,296)</u>	<u>\$ (5,851,547)</u>	<u>\$ (4,544,524)</u>
Total assets:		June 30, 2009		September 30, 2008
Timberline		\$ 1,722,661		\$ 2,803,202
Timberline Drilling		10,081,794		12,456,114
World Wide Exploration		2,764,342		5,110,471
Total assets		<u>\$ 14,568,797</u>		<u>\$ 20,369,787</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, 2008, 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 three months and nine months ended June 30, 2009, revenues from transactions with two customers each amounted to 10% or more of our total revenues. Customer A accounted for revenue of \$3,592,474 and customer B accounted for revenue of \$768,663 during the three months ended June 30, 2009. Customer A accounted for revenue of \$7,900,866 and customer B accounted for revenue of \$3,656,981 during the nine months ended June 30, 2009. The revenue for customer A is reported through Timberline Drilling, while the revenue for customer B is reported through World Wide Exploration.

The assets of Timberline are located in the United States. The assets of Timberline 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.

NOTE 13 – SUBSEQUENT EVENTS

Butte Highlands Joint Venture Operating Agreement

Subsequent to the quarter ended June 30, 2009, the Company entered into a Joint Venture Operating Agreement with Highland Mining, LLC (“Highland”), an entity controlled by Ronald Guill, a director of the Company. The joint venture entity, Butte Highlands JV, LLC (“BHJV”) was created for the purpose of developing and mining the Butte Highlands Gold Project. As a result of its contribution of the Company’s 100% interest in the Butte Highlands Gold Project to BHJV, the Company holds a 50% interest in BHJV. Under terms of the agreement, the Company will be carried to production by Highland, which will fund all future project exploration and mine development costs.

Under the operating agreement for BHJV, Highland will contribute property and fund all future mine development costs at Butte Highlands. Both the Company’s and Highlands’s share of costs will be paid out of proceeds from future mine production. The BHJV operating agreement stipulates that Highland shall appoint a manager of BHJV and that Highland will manage BHJV until such time as all mine development costs, less \$2 million, are distributed to Highland out of the proceeds from future mine production.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

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.

Forward-Looking Statements

This quarterly report and the exhibits attached hereto contain "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. Such forward-looking statements concern the Company's anticipated results and developments in the Company's operations in future periods, planned exploration and development of its properties, plans related to its business and other matters that may occur in the future. These statements relate to analyses and other information that are based on forecasts of future results, estimates of amounts not yet determinable and assumptions of management.

Any statements that express or involve discussions with respect to predictions, expectations, beliefs, plans, projections, objectives, assumptions or future events or performance (often, but not always, using words or phrases such as "expects" or "does not expect", "is expected", "anticipates" or "does not anticipate", "plans", "estimates" or "intends", or stating that certain actions, events or results "may", "could", "would", "might" or "will" be taken, occur or be achieved) are not statements of historical fact and may be forward-looking statements. Forward-looking statements are subject to a variety of known and unknown risks, uncertainties and other factors which could cause actual events or results to differ from those expressed or implied by the forward-looking statements, including, without limitation:

- risks related to our properties being in the exploration stage;
- risks related our mineral operations being subject to government regulation;
- risks related to our ability to obtain additional capital to develop our resources, if any;
- risks related to mineral exploration and development activities;
- risks related to our insurance coverage for operating risks;
- risks related to the fluctuation of prices for precious and base metals, such as gold, silver and copper;
- risks related to the competitive industry of mineral exploration;
- risks related to our title and rights in our mineral properties;
- risks related to our limited operating history;
- risks related the possible dilution of our common stock from additional financing activities;
- risks related to potential conflicts of interest with our management;
- risks related to our subsidiaries activities; and
- risks related to our shares of common stock.

This list is not exhaustive of the factors that may affect our forward-looking statements. Some of the important risks and uncertainties that could affect forward-looking statements are described further in our annual report on Form 10-KSB for the year ended September 30, 2008, filed with the Securities and Exchange Commission on December 30, 2008, as amended on May 21, 2009. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results may vary materially from those anticipated, believed, estimated or expected. We caution readers not to place undue reliance on any such forward-looking statements, which speak only as of the date made. We disclaim any obligation subsequently to revise any forward-looking statements to reflect events or circumstances after the date of such statements or to reflect the occurrence of anticipated or unanticipated events.

We qualify all the forward-looking statements contained in this report by the foregoing cautionary statements.

Corporate Background and History

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, the addition of Randal Hardy, our acquisition of a drilling services company, and the acquisition of Butte Highlands, we continue to advance our business plan. Prior to our new business model, the addition of new management, the purchase of Timberline Drilling (formerly known as Kettle Drilling), and a more active and focused exploration division, the Company had no reported revenues and accumulated losses.

Timberline Resources Corporation has taken the complementary businesses of drilling and mineral exploration and combined them into a unique, forward-thinking investment vehicle. The Timberline business model provides investors exposure to both the “picks and shovels” and “blue sky” aspects of the mining industry. The “picks and shovels” aspect of our business includes the mining services provided by Timberline Drilling and other potential operating businesses that we may acquire. We use the term “blue sky” to mean the potential of our exploration properties. Because of the nature of exploration for precious metals, a property’s exploration potential is not known until a significant amount of geologic information has been generated. As the work progresses, the potential of the property becomes more and more clear. If the exploration results are favorable, the value of the property may increase significantly. The term “blue sky” refers to the upside potential of that value. We believe our business model offers the opportunity to participate in both the “picks and shovels” and “blue sky” aspects of the business—our shareholders can participate in the markets for precious and base metal mining without the degree of risk inherent to mine operation and/or sole reliance on speculative early-stage drill-plays.

Corporate Overview

Timberline Resources Corp.’s business is comprised of an exploration division and two wholly-owned operating drilling subsidiaries.

Our exploration division is focused on district-scale gold projects with the potential for near-term, low-cost development. In addition to the evaluation of other potential properties and projects, the exploration division is responsible for the acquisition and advancement of our Butte Highlands Gold project that is part of a 50/50 joint venture agreement with Highland Mining, LLC and scheduled to begin development in the latter half of 2009.

Timberline Resources’ operating subsidiaries are Timberline Drilling and its Mexican subsidiary, World Wide Exploration S.A. de C.V. (“WWE”). They provide both surface and underground drilling services in the United States and Mexico, with their two largest clients being Newmont Mining and Exploraciones Mineras Penoles S.A. de C.V., respectively. Both units specialize in underground, hard rock core drilling – a niche business that we believe is well-positioned as the industry matures and exploration projects are advanced into producing mines.

Timberline is listed on the NYSE Amex (“Exchange”) and trades under the symbol “TLR”. On February 13, 2009, we received notice from the Exchange that as of September 30, 2008 the Company was below certain of the Exchange’s continued listing standards due to Timberline’s stockholders’ equity not meeting certain minimum requirements. Timberline submitted a plan of compliance to the Exchange on March 13, 2009.

On May 4, 2009 the Company received notice from the Exchange that the Exchange had accepted its plan of compliance and will continue listing Timberline on the Exchange, subject to certain conditions. While Timberline remains out of compliance with certain listing standards, the Exchange has granted the Company an extension until August 13, 2010 to regain compliance with the Exchange’s continued listing standards. Until Timberline regains compliance, the Company remains subject to periodic review by the Exchange.

Drilling Services

Our underground focus with established customers continues to provide a solid base of operations as a large percentage of the above-ground and more speculative exploration drilling has been cut back and/or delayed during the current industry slowdown. Many companies have delayed exploration plans and reduced their exploration spending in order to conserve cash. While the current economic environment continues to impact drilling demand, we believe that right-sizing efforts initiated at Timberline Drilling in 2008 and continued in 2009, a more balanced level of input costs, availability of qualified labor, and our ongoing focus on profitability will continue to improve the operating results of our drilling subsidiaries.

Over the past year, we have successfully established a new corporate culture in our drilling subsidiaries and have renewed our focus on underground drilling at established mining operations. We have reduced the layers of management between the head office and the field, streamlined our processes and operations, strengthened our balance sheet, and implemented new employee incentive programs. These objectives were achieved under extremely difficult market conditions.

In the previous quarter, Timberline Drilling extended its current contract with Newmont Mining through February 2011, enhancing an already solid relationship. We have established joint planning and safety review teams with Newmont and, furthermore, Newmont has provided us with mine site facilities to support our operations. We believe that the contract extension provides a higher degree of certainty in future cash flows for Timberline Drilling while presenting an excellent foundation for future stability and growth. This also allows us to focus on further improvements in customer service and safety with our largest client.

Also, during our second fiscal quarter, Timberline Drilling agreed to sell several under-utilized, non-core drill rigs, increasing the overall rig utilization rate and decreasing depreciation expenses. Additionally, former management of Timberline Drilling agreed to forego \$350,000 in severance payments. During the quarter ended June 30, 2009, the \$1 million proceeds from the drill sales were received and used to help retire more than \$1.9 million in liabilities.

Our Mexican subsidiary, World Wide Exploration (WWE), has two drills in service and has seen a significant slowdown in drilling activity in 2009. Sources of funding for junior exploration and mining companies are limited and many projects, both base and precious metals, have been delayed or cancelled. We have begun to see marginal increases in demand for drilling projects, but expected pricing levels have lowered anticipated margins to the point that we do not pursue certain contracts that would not be profitable. In addition to market and financing factors, the demand for drilling services in Mexico remains subdued due, in part, to a number of other factors, including increased violence in some areas and public health concerns. As evidenced by its previous results, we have a seasoned and experienced management team at WWE, and the overall situation in Mexico is being monitored closely by our management.

Exploration Division

Our Exploration Division continues to advance our Butte Highlands Gold Project in southwestern Montana. During the quarter, we continued the permitting process, mine and underground exploration planning, and our evaluation of the anticipated mineralization.

Previously, we completed a hydrogeologic study at Butte Highlands. In support of the study, the Company drilled a 1,167-foot groundwater monitoring well to identify groundwater quantity and quality at the project site and sampled surface water from local stream systems. The borehole tests yielded 12 gallons of water per minute for the full length of the monitoring well which is within the range anticipated by Timberline and Small Mine Development, LLC ("SMD"). The hydrogeologic study considered local geology, precipitation, hydrologic basins, and other pertinent information needed to predict water inflow into the anticipated underground workings. Resulting data was used by AMEC Geomatrix to develop a Conceptual Hydrological Model of the deposit to predict potential mine inflow during planned exploration and mine production activities. The positive results of this study represent a significant milestone in the permitting process and the proposed underground exploration and development schedule.

During this quarter we continued our exploration planning, including the requirements and locations for on-site facilities, water handling systems, and site disturbance calculations. All of this data was generated in order to submit a thorough application for the underground exploration permit. We submitted the underground exploration permit application to the State of Montana Department of Environmental Quality in early April 2009.

Subsequent to the quarter we finalized a 50/50 joint-venture agreement with Highland Mining, LLC ("Highland"), an affiliate of SMD and Ron Guill, at Butte Highlands. Under terms of the agreement, Timberline will be carried to production by Highland which will fund all project development costs and is expected to begin development in the summer of 2009. Timberline's 50-percent share of project costs is expected to be paid out of proceeds from future mine production. Given the uncertainty of the marketplace and credit markets, we believe that our strategic partnership with Highland at Butte Highlands provides an excellent opportunity for us and our shareholders by placing our most-advanced project on a development track with relatively small share dilution. We believe this partnership may be a model for future opportunities in underground mine development and mining with SMD and/or other contractors.

Pending proper approvals and permits, which we expect by late summer of this year, Highland and SMD are expected to begin development of the underground ramp to access the mineralized areas, which is expected to allow for additional underground drilling and exploration. The exploration and development phase of the program is expected to take approximately one year and, assuming acceptable permitting and results, is expected to be followed by production in late 2010.

We believe the global economic environment and monetary situation favor a solid and relatively steady gold price for the foreseeable future. Volatility is to be expected, however our view is that we don't require higher gold prices in order to advance our business model. As a company we are focused on our drilling subsidiaries, advancing Butte Highlands and are currently evaluating new opportunities. We have evaluated a number of projects and opportunities in both the services and production aspects of the business and will continue to do so. Our industry and the world have changed in the past year and we anticipate a number of changes in the year ahead. We feel we have the knowledge base to evaluate opportunities – either organically or through mergers and acquisitions – and continue to do so.

Results of Operations for the Three Month and Nine Month Periods ended June 30, 2009 and 2008

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

For the three months ended June 30, 2009, we reported \$4,361,137 in revenue compared to \$9,703,813 in the same period of 2008. For the nine months ended June 30, 2009, we reported revenues of \$12,545,217 versus revenues of \$24,525,265 in the same period of 2008. Our revenues are derived entirely from our drilling subsidiaries and are comprised of \$3,592,474 from Timberline Drilling and \$768,663 from WWE for the three months ended June 30, 2009. For the nine months ended June 30, 2009 Timberline Drilling and WWE reported revenues of \$8,823,389 and \$3,721,828, respectively. Gross profit from Timberline Drilling and WWE was \$679,796 and \$122,383, respectively, for the three months ended June 30, 2009 and \$20,693 and \$348,819, respectively, for the nine months ended June 30, 2009.

Our overall after tax net income for the three months ended June 30, 2009 was \$241,061 compared to an overall net loss of \$2,615,278 for the three months ended June 30, 2008. For the nine months ended June 30, 2009, our overall net loss was \$5,706,458 compared to \$5,096,026 for the same period in 2008. Our net income for the three months ended June 30, 2009 is comprised of a loss of \$91,033 for Timberline Corporate and Exploration, offset by net income of \$270,380 for Timberline Drilling and \$61,714 at WWE. Interest expense for the three months ended June 30, 2009 was \$167,309, compared to \$54,924 for the three months ended June 30, 2008. The increase in interest expense is attributable to interest accrued on the Company's long term debt owed to a related party.

Our net loss for the nine months ended June 30, 2009 is comprised of \$4,071,881 for Timberline Corporate and Exploration, \$1,536,892 for Timberline Drilling, and \$97,685 at WWE. Interest expense for the nine months ended June 30, 2009 was \$1,341,007, compared to \$306,864 for the nine months ended June 30, 2008. The increase in interest expense is attributable to interest expense on the Company's bridge loan financing, interest accrued on the Company's long term debt owed to a related party, and interest accrued on the Company's unpaid balance of payroll taxes to the IRS.

Overall the demand for drilling services has declined due to a decrease in demand from the exploration industry and the general economic downturn. Junior resource and exploration stage companies have been adversely affected by the state of the capital markets and many have scaled back or eliminated exploration and development activities. As a result, the demand for drilling services began a steep decline during the second half of 2008 and into 2009. The decline for drilling services and the resulting reduction in the number of Timberline Drilling's drill rigs operating this year versus last year has had an adverse affect on our revenues compared to last year, and we expect revenues for the remainder of 2009 to be less than our corresponding revenues the previous year. In response to the changes in the economic environment, we have implemented cost-cutting measures and stabilized our revenue stream in order to achieve profitability. We expect that our continued implementation of operational improvements and focus on financial prudence will result in continued positive earnings, more healthy margins, and more positive cash flow.

Timberline Drilling and WWE provide drilling services on a contract basis, which often requires long lead times based on drill rig availability. In the past, we have had a backlog related to several customers for drilling services work to be performed in future periods. Due to declining demand for drilling services, some of our drill rigs are currently idle, and our backlog consists of drilling services work to be performed for two major customers. While we have seen marginal increases in requests for proposals for drilling services, we cannot predict if demand for drilling services will increase in future periods.

Timberline Corporate and Exploration Division

The after tax net loss of \$91,033 for the combined Timberline Corporate and the Exploration division during the three months ended June 30, 2009 is comprised of non-cash charges of \$60,916, exploration expenditures of \$61,561, salaries and benefits of \$133,153, other general and administrative costs of \$117,945 and interest expense of \$121,654, less a net recovery of professional fees of \$402,124 and interest income of \$2,072. Included in the non-cash charges are \$46,493 in expenses related to stock options that vested during the quarter. Also included in the non-cash charges are \$9,023 in depreciation and amortization.

During this quarter, we entered into an agreement in principle with Jefferies & Co. (“Jefferies”) to settle an invoice with an outstanding balance of \$923,957 for advisory services and third party legal services provided during the course of our proposed acquisition of Small Mine Development, LLC in 2008. Jefferies agreed to the satisfaction of this outstanding balance by payment of \$50,000 in cash as well as the issuance of 950,000 shares of common stock of Timberline, along with registration rights for the shares. The agreement was finalized on July 14, 2009. The net result of this transaction was the recovery of previously-expensed professional fees of \$527,207. The Company incurred \$125,083 in professional fees during the quarter ended June 30, 2009, resulting in a net recovery of professional fees of \$402,124.

The after tax net loss of \$4,071,881 for the combined Timberline Corporate and the Exploration division during the nine months ended June 30, 2009 is comprised of non-cash charges of \$1,050,513, exploration expenditures of \$374,180, salaries and benefits of \$399,386, professional fees of \$1,019,998, other general and administrative costs of \$459,557, and interest expense of \$780,789, less interest income of \$12,542. \$396,750 of our professional fees during the nine months ended June 30, 2009 was related to legal and financial advisory costs associated with our proposed acquisition of SMD. Included in the non-cash charges are \$1,000,483 in expenses related to stock options that vested during the year to date. Also included in the non-cash charges are \$27,470 in depreciation and amortization.

Timberline Drilling and WWE

For the three months ended June 30, 2009, Timberline Drilling had revenues of \$3,592,474 as compared to \$7,318,802 for the three months ended June 30, 2008. WWE had revenues of \$768,663 for the three months ended June 30, 2009 as compared to \$2,385,011 for the three months ended June 30, 2008. Overall the demand for drilling services has declined due to the current economic crisis. Junior resource and exploration stage companies have been adversely affected by the state of the capital markets. As a result, the overall demand for drilling services decreased during the second half of 2008 and has continued in 2009. The decrease in revenues at both Timberline Drilling and WWE is attributable to the reduced demand for drilling services and the resulting reduction in the number of operating drill rigs compared to the previous year. We expect that our revenue for the remainder of 2009 will be less than the corresponding revenue in 2008 due to the reduced number of drill rigs operating.

For the three months ended June 30, 2009, net income before taxes from Timberline Drilling was \$270,380 while net income before taxes at WWE was \$61,714 as compared to a net loss before taxes of \$1,745,974 for Timberline Drilling and net income before taxes of \$682,164 for WWE for the three months ended June 30, 2008. At Timberline Drilling and WWE, the current quarter income is primarily attributable to decreased drilling revenue being more than offset by significantly decreased operating and general and administrative expenses.

For the nine months ended June 30, 2009, Timberline Drilling had revenues of \$8,823,389 as compared to \$17,983,223 for the nine months ended June 30, 2008. WWE had revenues of \$3,721,828 for the nine months ended June 30, 2009 as compared to \$6,542,042 for the nine months ended June 30, 2008. The decrease in revenues at Timberline Drilling and WWE is attributable to a reduction in the number of operating drill rigs.

For the nine months ended June 30, 2009, net loss before taxes from Timberline Drilling was \$1,536,892 while net loss before taxes at WWE was \$242,774 as compared to a net loss before taxes of \$1,935,476 for Timberline and net income before taxes of \$1,451,322 for WWE for the nine months ended June 30, 2008. At Timberline Drilling and WWE, the year to date loss is primarily attributable to significantly decreased drilling revenue despite decreased operating and general and administrative expenses.

We expect that the extension of our drilling contract for Newmont Mining and the resulting revenue stability, coupled with our continued focus on reducing operating and administrative costs and performance efficiencies, will result in continued positive earnings and cash flow from our drilling subsidiaries despite drilling revenues that are not expected to be as strong as last year.

Financial Condition and Liquidity

At June 30, 2009, we had assets of \$14,568,797 consisting of cash in the amount of \$1,374,857; accounts receivable, net of allowance for doubtful accounts, in the amount of \$1,128,155; inventories valued at \$1,345,546; property, mineral rights and equipment, net of depreciation of \$7,278,481; goodwill in the amount of \$2,808,524 and prepaid expenses and other assets of \$633,234.

The deteriorating economic conditions experienced in the second half of 2008 in the U.S. housing market and the credit quality of mortgage backed securities have continued during 2009 to date. This situation has caused a loss of confidence in

the broader U.S. and global credit and financial markets and has resulted in the collapse of, and government intervention in, several major banks, financial institutions and insurers. The contraction and unavailability of credit has created a climate of greater volatility, less liquidity, widening of credit spreads, a lack of price transparency, increased credit losses and tighter credit conditions. These disruptions in the current credit and financial markets have had a significant material adverse impact on a number of financial institutions and have limited access to capital and credit for many companies. These disruptions could, among other things, make it more difficult for us to obtain, or increase our cost of obtaining, capital and financing for our operations if needed. Access to additional capital may not be available on terms acceptable to us or at all if the current economic situation persists.

Economic conditions have had an adverse affect on junior resource and exploration stage companies. Market declines have adversely affected the ability to raise capital on acceptable terms, if at all, and many companies are significantly reducing investments in exploration, including drilling services. We expect to rely upon the cash flow generated by our drilling subsidiaries. However, the recent economic instability makes it difficult for the Company's management to accurately predict cash flows from these services through the remainder of the 2009 fiscal year. While the majority of Timberline Drilling's underground drilling rigs remained active during the fiscal year to date, surface drilling by our customers has been negatively impacted by the current economic instability. While we do not expect fiscal 2009 revenues to match 2008 levels, we also believe that revenues will increase above the year to date levels in future quarters and profitability and positive cash flows will be improved.

At June 30, 2009 the Company has a working capital surplus of \$275,999. Management expects to preserve, or increase, this working capital surplus through efforts to improve operating cash flows at the Company's drilling subsidiaries, reduction of exploration expenditures, reduced professional and consulting expenses, and, potentially, additional sales of capital assets. The current liabilities of the Company include outstanding interest and penalties due to the Internal Revenue Service in the amount of \$453,741. The Company is making monthly installment payments on the outstanding balance.

During our second fiscal quarter of 2009, Timberline Drilling agreed to sell several under-utilized, non-core drill rigs, increasing the overall rig utilization rate and decreasing depreciation expenses. Additionally, former management of Timberline Drilling agreed to forego \$350,000 in severance payments. During the quarter ended June 30, 2009, the \$1 million proceeds from the drill sales were received and used to help retire more than \$1.9 million in liabilities.

Management expects to continue to improve operating cash flows at the Company's drilling subsidiaries by further reducing hourly and salaried payroll expenses, reducing supplies inventory levels, and eliminating non-essential general and administrative costs. The Company plans to curtail exploration expenditures to focus on only our material exploration properties. This curtailment has already included a reduction in geological staff salaries expense and reduced use of outside geological consultants. The Company also expects to incur significantly reduced legal, accounting and financial advisory expenses in future periods as compared to the past fiscal year and first quarter of the current fiscal year due to the termination of our proposed acquisition of SMD. Finally, the Company's capital assets include drills, drilling related equipment and vehicles for which a resale market exists. The Company will consider sales of a portion of these capital assets, if necessary, to fund working capital.

Management believes that these remedies will provide it with sufficient working capital to meet the Company's ongoing operating expenses for the next 12 months. Additional financing may be required if the Company seeks to undertake further property acquisitions or expand its exploration or mine services operations.

If cash flow from our drilling subsidiaries is insufficient, our exploration activities and other operations will be reliant upon equity financings, or other outside funding, to continue into the future. The current market conditions could make it difficult or impossible for us to raise necessary funds to meet our capital requirements. We will continue to evaluate all available avenues to generate cash including, but not limited to, equity placements, asset sales, credit facilities or debt issuances.

On February 13, 2009, we received a notice from the NYSE Amex indicating that we were not in compliance with the exchange's continued listing requirements. During the quarter we submitted a compliance plan to the NYSE Amex to maintain our listing. On May 4, 2009 this compliance plan was accepted by the NYSE Amex, giving the Company until August 13, 2010 to regain compliance with the continued listing standards of the exchange. If we are unable to maintain our listing on the NYSE Amex and are unable to obtain a comparable listing, the liquidity of our common stock could decrease significantly and our ability to raise additional capital through equity or convertible debt could be impaired.

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 principles 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

The Company recognizes drilling service revenues as the drilling services are provided to the customer based on the actual amount drilled for each contract on a per foot or per hour drilled basis. In some cases, the customer is also responsible for paying for mobilization and stand-by costs. Mobilization is charged to a customer when the Company deploys its personnel and equipment to a specific drilling site. Stand-by is charged to a customer 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. Revenue related to reimbursement of mobilization and "stand by" costs is recognized in the same period as the costs of mobilization or stand-by are incurred by the Company. The specific terms of each drilling job are agreed to by the customer and the Company prior to the commencement of drilling. Contract losses are not recognized as the Company's agreements with its customers do not put the Company at a risk of loss.

Materials and Supplies Inventory

Inventories consist primarily of parts, operating supplies, drill rods and drill bits. The Company values its inventories, with the exception of drill rods, at the lower of average cost or market, using the first-in-first-out (FIFO) method. Drill rods are valued using their average cost less an allowance for rod usage on a per foot drilled basis. Allowances are recorded for inventory considered to be in excess or obsolete.

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 Timberline 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, 2008.

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.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Not applicable.

ITEM 4. CONTROLS AND PROCEDURES

Conclusions of Management Regarding Effectiveness of Disclosure Controls and Procedures

At the end of the period 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 and Chief Financial Officer, Randal Hardy ("CEO/CFO") and Chief Accounting Officer, Craig Crowell, ("CAO"), 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/CFO and the CAO 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/CFO and CAO, as appropriate, to allow for accurate and timely decisions regarding required disclosure.

Changes in Internal Controls over Financial Reporting

There were no changes in the Company's internal control over financial reporting that occurred during the Company's most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting

PART II — OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS.

On January 16, 2009, the Company filed a complaint in the United States District Court for the District of Idaho (the "Court") against American Drilling, LLC, American Drilling Corporation (along with American Drilling, LLC referred to as "American Drilling"), and Steven Elloway ("Elloway"). Timberline Drilling alleged that when Elloway left employment with the Company he immediately started American Drilling, and that Elloway and American Drilling have subsequently violated Elloway's Supplemental Income Agreement with Timberline Drilling, which restricted his post-termination competitive activities. Timberline Drilling also asserted that Elloway and American Drilling have converted confidential and proprietary Timberline Drilling information and documents, misappropriated trade secrets, tortiously and negligently interfered with Timberline Drilling's contractual relations with its business relationships and its prospective economic advantage, and that Elloway breached fiduciary duties to Timberline Drilling and unjustly enriched himself. In addition to seeking monetary damages, Timberline Drilling asked the Court to issue an injunction to prohibit future improper competition or use of Timberline Drilling trade secrets by Elloway or American Drilling.

A temporary restraining order was issued and arguments regarding the entry of a preliminary injunction were heard by the Court on February 11, 2009. On March 2, 2009, the Court stated that Timberline Drilling had demonstrated likelihood of success at trial on the merits, therefore a preliminary injunction was not issued due to no showing of irreparable harm. The Court also stated that given the probable success of Timberline Drilling at trial, Timberline Drilling would have a claim for damages related to its loss of business extending to the trial date of July 11, 2010. We are currently in the discovery phase and expect that Timberline Drilling will prevail at trial. Rather than incur elevated legal costs at this time, and given that damages are ongoing and expected to continue, we plan to accelerate our legal expenditures and preparations closer to the trial date.

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 1A. RISK FACTORS

There have been no material changes from the risk factors as previously disclosed in our Form 10-KSB for the year ended September 30, 2008 which was filed with the SEC on December 30, 2008.

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.

- 10.1** Operating Agreement with Highland Mining
- 10.2** Stock Settlement and Release Agreement with Jefferies & Company
- 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
- 31.2** Certification of Chief Accounting 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
- 32.2** Certification of Chief Accounting 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
(Principal Executive Officer and Principal Financial Officer)

Date: August 12, 2009

By: /s/ Craig Crowell

Craig Crowell
Chief Accounting Officer
(Principal Accounting Officer)

Date: August 12, 2009

OPERATING AGREEMENT
OF
BUTTE HIGHLANDS JV, LLC

I. FORMATION OF COMPANY.

1. Formation. On May 8, 2009, the Company was formed by filing the Articles of Organization with the Idaho Secretary of State in accordance with and pursuant to the Act.
2. Name. The name of the Company is Butte Highlands JV, LLC.
3. Principal Place of Business. The principal place of business of the Company is located at 967 East ParkCenter Boulevard, PMB 174, Boise, Idaho 83706.
4. Registered Agent and Office. The Company's registered agent and office in Idaho is Ron Guill, 967 East ParkCenter Boulevard, Boise, Idaho, 83706. The Company's registered agent and office in Montana is David Bjornson, 2809 Great Northern Loop, Suite 100, Missoula, Montana 59808.
5. Definition of Terms. Capitalized terms used in this Agreement shall have the meanings set forth in Section XV hereof or in the applicable provisions in which the terms are used.
6. Title to Property. All real and personal property owned by the Company shall be property of the Company and no Member shall have any ownership interest in such property in his or her individual name or right, and each Member's Interest in the Company shall be considered personal property for all purposes.

II. PURPOSE OF COMPANY BUSINESS. The Company is organized solely to own, explore, develop, process and sell mined ore from property owned, leased or in which the Company or a Member owns or leases or has an interest within five (5) miles of the Butte Highlands portal, which portal is located in Silver Bow County, Montana (collectively the "Property").

III. TERM. The term of the Company commenced on the date its Articles of Organization were filed with the Idaho Secretary of State and shall continue in perpetuity, unless sooner terminated pursuant to this Agreement.

IV. MEMBERS, INTERESTS AND CAPITAL CONTRIBUTIONS.

1. Members and Initial Contribution. The initial Members of the Company are Highland Mining, LLC ("Highland"), and Timberline Resources Corporation ("Timberline"). The U.S. mail addresses, email addresses, facsimile and phone numbers, as applicable, and the Percentage Interests of each Member of the Company are set forth on Exhibit "A". Timberline and Highland shall contribute the Property to the Company within thirty (30) days of the date of this Agreement. For the avoidance of doubt, the Property shall include all interests, such as unpatented and patented claims, leased property, and fee interests. Within the same time period, Highland shall enter into the Loan (defined below).

2. No Additional Contributions. Except as provided in this Agreement, no Member shall be required to make any additional contributions to the capital of the Company. No Member shall be entitled to interest on any Capital Contribution or on such Member's Capital Account. The Members may make additional Capital Contributions to the Company at such time and in such amounts as may be approved by the Management Committee.

3. Limitation on Liability of Members. No Member of the Company shall be personally liable for any debt, obligation or liability of the Company.

V. COMPANY MANAGEMENT.

1. Management.

A. Until the Members reach "Parity," the Company shall be managed by such manager or managers as Highland shall appoint in its sole discretion. Until the Members reach Parity, the Management Committee shall have an advisory role only, and shall have no authority. Subject to the terms of this Agreement, until the Members reach Parity, the manager(s) shall have full and complete authority, power and discretion to manage and control the business, affairs and properties of the Company, to make all decisions regarding those matters, and to perform any and all other activities customary or incident to the management of the Company's business. No Member shall individually have any authority to act for, or assume any obligation or responsibility on behalf of, any other Member or the Company.

B. After the Members reach "Parity," the Members shall direct, manage and control the business of the Company through the Management Committee. Subject to the terms of this Agreement, the Management Committee shall have full and complete authority, power and discretion to manage and control the business, affairs and properties of the Company, to make all decisions regarding those matters, and to perform any and all other activities customary or incident to the management of the Company's business. No Member shall individually have any authority to act for, or assume any obligation or responsibility on behalf of, any other Member or the Company.

2. Managers.

A. Number and Qualifications of Managers. The number of managers shall be the number appointed by Highland and acting as such from time to time, but shall not be less than one (1) nor more than three (3). Managers may be individuals or entities, and need not be members of the Company. The term of all Managers shall terminate when the Members reach Parity. Thereafter, the management of the Company shall be through and by the Management Committee subject to this Agreement. The initial Manager shall be Ron Guill.

B. Appointment of Managers. Managers shall be appointed by Highland. A manager shall serve until the manager's earlier death, resignation, or removal, or Parity is reached.

C. Authority. Subject to restrictions that may be imposed from time to time by the managers or Highland, each manager shall be an agent of the Company with authority to bind the Company in the ordinary course of its business. The managers shall have

no authority to bind the Company as to the following matters without first obtaining approval by vote of the members:

- 1) Sale, lease, exchange, mortgage, pledge, or other transfer or disposition of all or substantially all the assets of the Company;
- 2) Merger of the Company with another entity;
- 3) Amendment to the Articles of Organization;
- 4) Incurrence of indebtedness by the Company other than in the ordinary course of business; or
- 5) A change in the nature of the business of the Company.

D. Other Activities. Managers may have other business interests and may engage in other activities in addition to those relating to the Company. This Section does not change each manager's duty to act in a manner that the manager reasonably believes to be in the best interests of the Company.

E. Meetings; Notices; Quorum; Voting. Meetings of the managers may be called by any manager. Meetings shall be held at the place fixed by the managers or, if no such place has been fixed, at the principal office of the Company. Oral or written notice of the date, time, and place of any meeting shall be given at least twenty-four (24) hours in advance. Written notice may be delivered personally, given by facsimile or other form of wire communication, or by mail or private carrier, to each manager's business or home address. Written notice shall be effective at the earliest of the following: (a) when received, (b) when sent by facsimile or other form of wire communication, or (c) two business days after being mailed. A majority of the managers shall constitute a quorum. Each manager shall be entitled to one vote. The matter submitted to a vote of the managers shall be deemed approved if the votes in favor exceed those against the matter..

F. Resignation. A manager may resign at any time by delivering written notice to the other managers or to Highland. The resignation is effective when the notice is effective under the Act, unless the notice specifies a later effective date. Once delivered, a notice of resignation is irrevocable unless revocation is permitted by the managers. The resignation of a manager who is also a member shall not affect the manager's rights as a member and shall not constitute a withdrawal of the member.

G. Removal of a Manager. Highland may remove one or more managers with or without cause. A manager may be removed by Highland only at a meeting called for the purpose of removing the manager and the meeting notice must state that the purpose, or one of the purposes, of the meeting removal of the manager.

H. Vacancy. If a vacancy occurs in the number of managers, Highland shall fill the vacancy. A vacancy that will occur at a specific later date may be filled before the vacancy occurs but the new manager may not take office until the vacancy occurs.

I. **Salaries.** The salaries and other compensation of the managers shall be reasonable and fixed from time to time by Highland. A manager shall not be precluded from receiving a salary because the manager is also a Member.

J. **Other Agents.** The managers may, by vote, authorize any agent to enter into any lawful contract or to otherwise act on behalf of the Company. Such authority may be general or be confined to specific instances.

3. **Management Committee.** When the Members reach "Parity," a Management Committee shall be formed to manage the Company. The Management Committee will be comprised of four (4) Representatives, two (2) of which shall represent and be designated by Highland and two (2) by Timberline, unless there is a Change of Control of a Member and an additional representative is added as provided in Section XIII.4. Highland and Timberline may, by written notice to the other, remove and designate a replacement Representative at any time. The operations, meetings and deliberations of the Management Committee shall be governed by the provisions set forth in this Agreement. The Management Committee shall direct, manage and control the business and affairs of the Company and may in connection therewith, exercise or delegate any of the rights, powers and privileges which the Company might exercise to further the purposes thereof, subject to this Agreement. Except as otherwise provided herein, any act of the Company properly approved or authorized by the Management Committee shall be binding upon the Members.

4. **Limitation on Liability of the Representatives.** None of the Representatives shall be liable to the Company or any Member for any act or omission performed or omitted by it in good faith pursuant to the authority granted by this Agreement, other than an act constituting fraud, gross negligence, willful or wanton misconduct, or breach of fiduciary obligation in the performance of its duty to the Company or otherwise in breach of this Agreement.

5. **Indemnification of the Representatives.** The Company shall indemnify and hold harmless each Representative and any Manager of the Company from and against any loss, expense, damage, or injury which such Person may suffer or sustain by reason of any actual or alleged acts or omissions conducted on behalf of the Company or in furtherance of the interests of the Company (including any judgment, award, settlement, and any reasonable attorneys' fees and other costs or expenses incurred in connection with the defense of any actual or threatened action, proceeding, or claim). The foregoing shall apply only if the conduct of the Person to be indemnified did not constitute gross negligence and if such Person acted in good faith and in a manner such Person reasonably believed to be in the best interests of the Company and, in the case of a criminal proceeding, had no reasonable cause to believe his or her conduct was unlawful. The termination of any action, suit, or proceeding by judgment, order, settlement, conviction, or upon a plea of nolo contendere or its equivalent shall not, of itself, create a presumption that the Person to be indemnified did not act in good faith and in a manner which he or she reasonably believed to be in, or not opposed to, the best interests of the Company, or that such Person reasonably believed to be unlawful.

6. **The Staff.** The Management Committee or the Operations Manager may, after the Members reach Parity and subject to Section V.8, designate and determine such positions and offices of the Company from time to time as they may consider appropriate or desirable for the furtherance of the purposes of the Company, and may hire such individuals to fill such positions upon such terms and conditions as they may then consider appropriate or desirable.

7. **Tax Matters Member.** Highland shall be the tax matters partner within the meaning of Section 6211 et seq. of the Code. The appointment of the Company's tax matters partner may

be revoked only upon the act of the Management Committee pursuant to Section V.8. The tax matters partner shall have authority to take all action necessary or proper with respect to any action required or permitted to be taken in determining any Company tax item under the Code, and shall assist the Operations Manager with tax returns pursuant to Section XI.3.

8. **Major Actions.** After the Members have reached Parity, none of the following actions shall be taken by the Company or by any Member or other Person on behalf of or for the account of the Company, unless first approved by the Management Committee pursuant to Section VI:

- A. Any consolidation or liquidation of the Company.
- B. Any amendment to the Operating Agreement or other charter documents of the Company.
- C. Capital expenditures in excess of \$1,000,000, individually or in the aggregate, for any fiscal year.
- D. Approval or authorization of the incurrence of indebtedness for borrowed money.
- E. Selection of auditors and general counsel, and the settlement of litigation .
- F. Any loan, transaction or contract with Members or their Affiliates, other than de minimis product purchases made in the ordinary course of business.
- G. Any change in the distribution of earnings.
- H. Selection and supervision of executive officers, managers and other key personnel.
- I. Setting of policies and guidelines on employee compensation and benefits, as well as any change in compensation (including benefits) for (a) hourly personnel that is outside of the above policies and guidelines, and for (b) other personnel that is outside of normal industry ranges for such personnel.
- J. Approval of the Company's financial reporting requirements, annual budget, annual business plans, and any amendments thereto.
- K. Any contract (including, but not limited to, any lease or other oral or written agreement) or expenditure of money exceeding \$1,000,000.
- L. Causing the Company to become a surety, guarantor or endorser (except checks and drafts for deposit to the Company's accounts).
- M. The Company's acquisition of any ownership interest in any corporation or other legal entity or business enterprise, or the creation of any partnership or other legal entity in which the Company is or will be a partner, shareholder, member or similar participant.
- N. Any sale, lease or other transfer of any assets of the Company .

O. Creation or incurrence of any mortgage, pledge, lien, charge or encumbrance upon any of the property or assets now owned or hereafter acquired by the Company.

P. Approval of federal, state and other income tax returns.

9. **Enforcement of Contract Rights.** Notwithstanding anything in this Agreement to the contrary, after the Members reach Parity, when a Member is a party (either directly or through any Affiliate) to any contract with the Company, the rights of the Company thereunder shall be enforceable solely by the Representatives appointed by the other Member. Prior to reaching Parity, the Members acknowledge that a related party of Highland will be developing and operating the Property.

VI. **MEETINGS OF REPRESENTATIVES.**

1. **Quarterly Meetings.** The Management Committee shall have regular quarterly meetings.

2. **Special Meetings.** Special meetings of the Management Committee may be called at the request of at least two (2) Representatives for any purpose or purposes.

3. **Place of Meetings.** Meetings of the Management Committee shall be conducted at the principal business office of the Company, unless the Representatives unanimously designate such other place of meeting. The Representatives may participate in and hold a meeting by conference telephone or similar communications equipment by means of which all Persons participating in the meeting can hear each other. Such participation shall constitute attendance and presence in person at such meeting, except where a Person participates in the meeting for the express purpose of objecting to the transaction of any business on the ground that the meeting is not lawfully called or convened.

4. **Notice of Meetings.** No notice need be given to the Management Committee of regular quarterly meetings for which the Management Committee has previously designated a time and place for the meeting. Except as provided in Sections VI.5, VI.8, and VI.9, written notice stating the place, date and hour of any special meeting and the purpose or purposes for which the meeting is called, shall be prepared by the Representatives calling such special meeting and delivered not less than ten (10) nor more than sixty (60) days before the date of the meeting. Delivery shall be sufficient if made personally, by mail, e-mail, overnight courier service, telecopy or telegram to each Representative entitled to vote at such meeting.

5. **Meeting of All Representatives.** Should all of the Representatives meet at any time and place and consent to the holding of a meeting at such time and place, such meeting shall be valid without notice and lawful action may be thereat.

6. **Quorum.** Three (3) Representatives must be present to constitute a quorum for the transaction of business at any meeting of the Representatives.

7. **Manner of Acting.** The affirmative vote of three (3) Representatives shall be the act of the Members.

8. **Action by Management Committee Without a Meeting.** Any action required or permitted to be taken at a meeting of the Management Committee may be taken without a meeting if the action is evidenced by one or more written consents describing the action taken, signed by all the Representatives entitled to vote. Unless the consent specifies a different

effective date, action taken under this Section is effective when all such Representatives have signed the consent. A photostatic, facsimile or similar reproduction of a writing signed by a Representative shall be regarded as signed by the Representative for purposes of this Section.

9. **Waiver of Notice.** When any notice is required to be given to any Representative, a waiver thereof in writing signed by the person entitled to such notice, whether before, at or after the time stated therein, shall be equivalent to the giving of such notice.

10. **Proxies.** A Representative entitled to vote may vote either in person or by proxy executed in writing by the Representative. A photostatic, facsimile or similar reproduction of a writing signed by the Representative shall be regarded as duly executed for purposes of this Section.

VII. **OPERATIONS MANAGEMENT.**

1. **Appointment.** Once the Members reach Parity, the day to day operations of the Company shall be managed by an Operations Manager and a Controller. The Management Committee shall at all times have the right to appoint and remove the Operations Manager and Controller for the Company. The Operations Manager shall manage and direct the overall operations of the Company's business and facilities, and the Controller shall be responsible for the supervision and control of the financial and fiscal affairs of the Company, in each case pursuant to directions by the Management Committee. This Section VII notwithstanding, neither such officer shall take any action, make any expenditure or incur any obligation on behalf of the Company with respect to a matter within the scope of any of the major decisions set forth in Section V.8 unless such major decision has been approved by the Management Committee.

2. **Operating Plan.** The Operations Manager and Controller shall annually (or more or less frequently as approved by the Management Committee) prepare and submit for consideration and approval by the Management Committee an Operating Plan for the upcoming year (or other such period requested by the Management Committee). As used herein, the term "Operating Plan" means a description in reasonable detail of the activities to be carried out and the objectives of the Company, including a budget, for a year or any longer period. When approved by the Management Committee, the Operations Manager and Controller shall implement the Operating Plan and shall be authorized to make the expenditures and to incur the obligations provided for in the Operating Plan without the need for further approval by the Management Committee, subject to Section V.8..

3. **Additional Duties of the Operations Manager.**

A. The Operations Manager shall be responsible for managing the day-to-day business and affairs of the Company. The Operations Manager shall have the authority, on behalf of and in the name of the Company, to sign all documents and to make all expenditures and incur all obligations reasonably necessary for the management of the day-to-day business and affairs of the Company.

B. The Operations Manager shall, at the Company's expense, implement or cause to be implemented all decisions approved by the Management Committee and conduct or cause to be conducted the day-to-day business and affairs of the Company in accordance with and as limited by the Operating Plan and this Agreement, including the following:

- 1) Purchase or otherwise acquire all supplies, equipment, utilities, labor and logistics services required for the Company's operations;
- 2) Retain or employ and coordinate the services of all employees, as well as all leased or contracted employees and other Persons necessary or appropriate to carry out the purposes of the Company;
- 3) Apply for all permits, licenses and approvals necessary to the Company's operations;
- 4) Notify promptly the Management Committee of any alleged violations of applicable federal, state and local laws and regulations;
- 5) Prepare and file all reports or notices required for the Company's operations; and
- 6) Sign and execute contracts on behalf of the Company.

4. **Additional Duties of the Controller.** The Controller shall, at the Company's expense, implement all fiscal policies of the Company and generally oversee and be responsible for the financial management and recordkeeping of the Company in compliance with and subject to the Operating Plan and this Agreement. These duties will include the following:

- A. Review and, if appropriate, approve for payment all debts incurred in the operation of the Company and contained in an approved Operating Plan;
- B. Prepare and maintain all financial, accounting, tax and other books and records of the Company in accordance with Section XI;
- C. Timely pay all insurance premiums, debts and other obligations of the Company provided for in the approved Operating Plan;
- D. Maintain a separate bank account or accounts in the name of the Company, with such bank or banks selected by the Management Committee, in which there shall be deposited all Company funds including capital contributions and gross receipts from activities of the Company; and
- E. Make, when permitted or required by this Agreement, periodic distributions of cash or property to the Members in accordance with the provisions of this Agreement;

5. **Limitation on Liability.** Neither the Operations Manager nor the Controller shall be in default of any duty under this Section VII if his or her failure to perform results from the failure of any Member to perform acts or to contribute amounts required by this Agreement. Neither such officer shall be liable to either Member for any act or omission in his capacity as Operations Manager or Controller, as the case may be, and within the scope of his authority, except to the extent resulting in damage or loss caused by his willful misconduct.

VIII. **DEVELOPMENT.**

1. **Development.** The Members acknowledge that the Company shall enter into an agreement with Small Mine Development, LLC, an Idaho limited liability company ("SMD") for the development of the Property. The agreement between the Company and SMD shall be substantially in the form attached hereto as Exhibit B, which is attached hereto and made a part hereof (the "SMD Agreement."). The Members agree and acknowledge that Ron Guill, as manager of the Company, is authorized to sign and execute any such agreement, and any modifications or amendments thereto, on behalf of the Company.

2. **Other Services.** The Company and Highland will enter into the loan agreement, promissory note and other loan documents substantially in the form attached hereto, or to be attached hereto within thirty (30) days of the date of this Agreement, as Exhibit 'C' (the "Loan Documents"). The Members agree and acknowledge that Ron Guill as manager of the Company is authorized to sign and execute the Loan Documents and any and all documents necessary or convenient thereto. The Loan Documents will provide, among other things, that the loan evidenced by the Loan Documents (the "Loan") may be called any time at or after the point of a production decision, payable under the terms of this Agreement, and that Ron Guill as manager is authorized to make such decision in his sole discretion as manager of the Company.

IX. **DISTRIBUTIONS AND ALLOCATIONS.**

1. **Allocation of Profits and/or Losses.**

A. **Allocation of Profits.** Except as otherwise provided in Sections IX.3, IX.4, and IX.5 of this Agreement, Profits of the Company for each Fiscal Year shall be allocated to the Members as follows:

- 1) First, to 80% to Highland and 20% to Timberline until Parity is attained;
- 2) Second, to the Members, in proportion and to the extent of any Losses allocated to the Members pursuant to Section IX.1.B.4 below until each Member has been allocated an amount of cumulative Profits pursuant to this Section IX.1.A.2 in the current and all prior Fiscal Years equal to the cumulative Losses allocated to that Member pursuant to Section IX.1.B.4 below in all prior Fiscal Years;
- 3) Third, in proportion and to the extent of any Losses allocated to the Members pursuant to Section IX.1.B.3 below until each Member has been allocated an amount of cumulative Profits pursuant to this Section IX.1.A.3 in the current and all prior Fiscal Years equal to the cumulative Losses allocated to that Member pursuant to Section IX.1.B.3 below in all prior Fiscal Years;

- 4) Fourth, to the Members in accordance with their Percentage Interests

B. **Allocation of Losses.** Except as otherwise provided in Sections IX.3, IX.4, and IX.5 of this Agreement, Losses of the Company for each Fiscal Year shall be allocated to the Members as follows:

- 1) First, 100.00% to Highland and 0.00% to Timberline until Parity is attained;

2) Second, to the Members, in proportion and to the extent of the Profits allocated to Members pursuant to Section IX.1.A.4 above, until each Member has been allocated an amount of cumulative Losses pursuant to this Section IX.1.B.2 in the current and all prior Fiscal Years equal to the cumulative Profits allocated to that Member pursuant to Section IX.1.A.4 above in all prior Fiscal Years;

3) Third, to the Members pro rata in accordance with their Percentage Interests, but with respect to a Member, only to the extent of the positive balance in such Member's Capital Account, until all Members' Capital Accounts have been reduced to zero; and

4) Fourth, to the Members pro rata in accordance with their Percentage Interests.

2. Allocations In General.

A. Except as otherwise provided herein, all items of Company income, gain, loss and deduction shall be divided among the Members in accordance with their Percentage Interests.

B. The Members are aware of the income tax consequences of the allocations made by this Section and hereby agree to be bound by the provisions of this Section in reporting their shares of Company income, gain, loss and deduction hereunder for income tax purposes.

C. For purposes of determining the Profits, Losses, or any other items allocable to any Fiscal Year, such items shall be determined on a daily, monthly, or other basis, as determined by the Management Committee, using any permissible method under Code Section 706 and the Regulations thereunder.

3. Tax Allocations Required by Code Section 704(c). In accordance with Code Section 704(c) and the Regulations thereunder, income, gain, loss and deduction with respect to any property contributed to the capital of the Company shall be allocated among the Members so as to take account of any variation between the adjusted basis of such property to the Company for federal income tax purposes and its initial Gross Asset Value.

If the Gross Asset Value of any Company property is adjusted pursuant to paragraph (b) of the definition of Gross Asset Value, subsequent allocations of income, gain, loss and deduction with respect to such property shall take account of any variation between the adjusted basis of such property and its Gross Asset Value in the manner provided under Code Section 704(c) and the Regulations thereunder.

Any elections or other decisions relating to such allocations shall be made by the Management Committee in any manner that reasonably reflects the purpose and intention of Code Section 704(c) and the Regulations thereunder.

4. Regulatory Allocations.

A. Minimum Gain Chargeback. Except as otherwise provided in Regulation Section 1.704-2(f) and notwithstanding any provision of this Section to the contrary (other than Section 4.B), if there is a net decrease in Company Minimum Gain during

any Fiscal Year, each Member shall be specially allocated items of Company income and gain for such Fiscal Year (and, if necessary, subsequent Fiscal Years) in an amount equal to such Member's share of the net decrease in Company Minimum Gain, determined in accordance with Regulation Section 1.704-2(c). Allocations pursuant to the previous sentence shall be made in proportion to the respective amounts required to be allocated to each Member pursuant thereto. The items to be so allocated shall be determined in accordance with Regulations Sections 1.704-2(f)(6) and 1.704-2(j)(2). This Section 4.A is intended to comply with the minimum gain chargeback requirement in Regulation Section 1.704-2(f) and shall be interpreted consistently therewith. For purposes of this Agreement, the term "Company Minimum Gain" shall have the meaning set forth in Regulation Section 1.704-2(b)(2), as if the word "Company" were substituted for the word "partnership" in such Regulation.

B. Member Minimum Gain Chargeback. Except as otherwise provided in Regulation Section 1.704-2(i)(4) and notwithstanding any provision in this Section to the contrary (other than Section 4.A), if there is a net decrease in Member Nonrecourse Debt Minimum Gain attributable to a Member Nonrecourse Debt during any Fiscal Year, each Member who has a share of the Member Nonrecourse Debt Minimum Gain attributable to such Member Nonrecourse Debt, determined in accordance with Regulation Section 1.704-2(i)(5), shall be specially allocated items of Company income and gain for such Fiscal Year (and, if necessary, subsequent Fiscal Years) in an amount equal to such Member's share of the net decrease in Member Nonrecourse Debt, determined in accordance with Regulation Section 1.704-2(i)(4). Allocations pursuant to the previous sentence shall be made in proportion to the respective amounts required to be allocated to each Member pursuant thereto. The items to be so allocated shall be determined in accordance with Regulation Sections 1.704-2(i)(4) and 1.704-2(j)(2). This Section 4.B is intended to comply with the partner minimum gain chargeback requirement in Regulation Section 1.704-2(i)(4) and shall be interpreted consistently therewith. For purposes of this Agreement, the term "Member Nonrecourse Debt" shall have the meaning set forth in Regulation Section 1.704-2(b)(2), and the term "Member Nonrecourse Debt Minimum Gain" shall have the meaning set forth in Regulation Section 1.704-2(i)(2), in each case as if the word "Member" were substituted for the word "partner" in such Regulations.

C. Qualified Income Offset. If any Member unexpectedly receives any adjustment, allocation or distribution described in Regulation Section 1.704-1(b)(2)(ii)(d)(4), (5) or (6), items of Company income and gain shall be specially allocated to such Member in an amount and manner sufficient to eliminate (to the extent required in the Regulations) any deficit in the Member's Capital Account created by such adjustment, allocation or distribution as quickly as possible; provided that, an allocation pursuant to this Section 4.C shall be made only if and to the extent that the Member would have a deficit in his or her Capital Account after all other allocations provided for in this Section 4 have been tentatively made as if this Section 4.C were not in the Agreement. This Section 4.C is intended to constitute a "qualified income offset" within the meaning of Regulation Section 1.704-1(b)(2)(ii)(d)(3).

D. Gross Income Allocation. In the event any Member has a deficit balance in such Member's Capital Account at the end of any Fiscal Year, which is in excess of the sum of the amount such Member is obligated to restore pursuant to the penultimate sentences of Regulation Sections 1.704-2(g)(1) and 1.704-2(i)(5), each such Member shall be specially allocated items of Company income and gain in the amount of such excess as quickly as possible; provided however, that an allocation pursuant to this

Section 4.D shall be made only if and to the extent that such Member would have such Capital Account deficit (as so determined) in excess of such sum after all other allocations provided for in this Section have been tentatively made as if Section 4.C and this Section 4.D were not in this Agreement.

E. **Nonrecourse Deductions.** Nonrecourse Deductions for any Fiscal Year shall be specially allocated to the Members in proportion to their Percentage Interests. For purposes of this Agreement, the term "Nonrecourse Deduction" shall have the meaning set forth in Regulation Section 1.704-2(b)(1).

F. **Member Nonrecourse Deductions.** Any Member Nonrecourse Deductions for any Fiscal Year shall be specially allocated to the Member who bears the economic risk of loss with respect to the Member Nonrecourse Debt to which such Member Nonrecourse Deductions are attributable in accordance with Regulation Section 1.704-2(i)(1). For purposes of this Agreement, the term "Member Nonrecourse Deductions" shall have the meaning set forth in Regulation Section 1.704-2(i)(1), as if the word "Member" were substituted for the word "partner" in such Regulation.

G. **Loss Allocation Limitation.** Losses allocated pursuant to this Section shall not exceed the maximum amount of Losses that can be allocated without causing any Member to have a deficit in his or her Capital Account at the end of any Fiscal Year. In the event some but not all of the Members would have a deficit in their Capital Accounts as a consequence of an allocation of Losses under this Section, the limitation set forth in this Section 4.G shall be applied on a Member by Member basis and Losses not allocable to any Member as a result of such limitation shall be allocated to the other Members in accordance with the positive balances in such Members' Capital Accounts so as to allocate the maximum permissible Losses to each Member under Regulation Section 1.704-1(b)(2)(ii)(d).

H. **Section 754 Adjustments.** To the extent an adjustment to the adjusted tax basis of any Company property is required, pursuant to Code Sections 734(b) or 743(b) or Regulations Sections 1.704-1(b)(2)(iv)(m)(2) or 1.704-1(b)(2)(iv)(m)(4), to be taken into account in determining the Capital Accounts as the result of a distribution to a Member in complete liquidation of such Member's Interest in the Company, the amount of such adjustment to the Capital Accounts shall be treated as an item of gain (if the adjustment increases the basis of the property) or an item of loss (if the adjustment decreases the basis of the property) and such gain or loss shall be specially allocated to the Members in accordance with their Percentage Interests in the Company in the event Regulation Section 1.704-1(b)(2)(iv)(m)(2) applies, or to the Member to whom such distribution was made in the event Regulation Section 1.704-1(b)(2)(iv)(m)(4) applies.

5. **Curative Allocations.** The allocations set forth in Section 4 (the "Regulatory Allocations") are intended to comply with the requirements of Code Section 704(b) and the Regulations thereunder. It is the intent of the Members that, to the extent possible, all Regulatory Allocations shall be offset either with other Regulatory Allocations or with special allocations of other items of Company income, gain, loss or deduction pursuant to this Section 5. Therefore, notwithstanding any other provision of this Section (other than the Regulatory Allocations), the Management Committee shall make such offsetting special allocations of Company income, gain, loss or deduction in whatever manner the Management Committee determines appropriate so that, after such offsetting allocations are made, each Member's Capital Account balance is, to the extent possible, equal to the Capital Account balance such

Member would have had if the Regulatory Allocations were not part of the Agreement and all Company items were allocated pursuant to Sections 1, 2 and 3.

6. **Distributions.** Distributions shall be made to the Members on a quarterly basis, as follows, unless such Distributions are prohibited by the Code, the Regulations or by any other law or court decree:

A. Until Parity is reached, all Distributions shall be made in the ratio of 80% to Highland and 20% to Timberline (for the avoidance of doubt, Distributions shall include the repayment of the Loan to the Company by Highland pursuant to the Loan Documents);

B. When Parity is reached, Distributions shall be made in the ratio of 100% to Highland and 0% to Timberline until the Capital Accounts of the Members are equal;

C. After Parity is reached and Capital Accounts are equalized in Section 6.B, above, then to the Members in accordance with their Percentage Interests.

7. **Consent to Allocations and Distributions.** The methods set forth in this Section by which allocations and Distributions are made is expressly consented to by each Member as a condition of becoming a Member. Attached as Exhibit D is a schedule showing the intent of the allocations and distributions described in this Agreement.

8. **Distribution Among Members.** If a transfer of an Interest in the Company occurs during any accounting period as permitted hereunder, all Profits, Losses and other items attributable to such Interest for such period shall be divided and allocated between the transferor and the transferee by taking into account their varying interests during the period in accordance with Code Section 706(d), using any conventions permitted by law and selected by the Management Committee. All allocations and Distributions on or before the date of a permitted transfer shall be made to the transferor, and all allocations and Distributions thereafter shall be made to the transferee. Solely for purposes of making such allocations and Distributions, the Company shall recognize a permitted transfer not later than the end of the calendar month during which the transfer is effective, pursuant to Section X of this Agreement. Neither the Members, the Representatives nor the Company shall incur liability for making allocations and Distributions in accordance with the provisions of this Section 8, whether or not the Members, the Representatives or the Company have knowledge of any transfer of ownership of any Interest in the Company.

9. **Amounts Withheld.** All amounts withheld, pursuant to the Code or any provision of any federal, state or local tax law, with respect to any payment or Distribution to the Members shall be treated as amounts distributed to the Members pursuant to this Section for all purposes under this Agreement.

10. **Special Basis Adjustment.** In connection with any transfer of an Interest in the Company as permitted hereunder, the Management Committee may cause the Company, at the written request of the transferor or the transferee or if required by law, and at the time and in the manner provided in Regulation Section 1.754-1(b) and Code Sections 734(b) or 743(b), to make an election to adjust the basis of the Company's property in the manner provided in Code Sections 734(b) and 743(b) and any Regulations thereunder, and if such election is made, such transferee shall pay all costs and expenses incurred by the Company in connection therewith, including, without limitation, reasonable attorneys' and accountants' fees.

11. **Taxable as a Partnership.** Unless all of the Members otherwise agree in writing, the Company shall not elect to be treated as an association, taxable as a corporation, for federal or state income tax purposes; the Company shall be treated as a partnership for federal and state income tax purposes.

X. **TRANSFERABILITY OF INTERESTS.**

1. **No Transfer.** Neither the Company, the Management Committee nor the Members shall permit or recognize any sale, redemption, assignment, gift, bequest, pledge or other transfer, whether by operation of law or otherwise (collectively, "Transfer") of any Interest except in accordance with the provisions of this Section X and Section XIII.

2. **No Withdrawal.** No Member shall have the right or power to withdraw his or her share of the Company capital or compel a redemption of his or her Interests by the Company.

3. **Substituted Member.** Notwithstanding an otherwise valid transfer of an Interest, the transferee shall not become a Member and the transferring Member shall not be relieved of any of its obligations until the transferee has:

A. Accepted and assumed, in a form reasonably satisfactory to the non-transferring Member, all of the terms and provisions of this Agreement;

B. Executed such other documents or instruments as the non-transferring Member may reasonably require in order to effect the admission of the transferee as a Member; and

C. Paid such reasonable expenses as may be incurred by the Company in connection with the admission of the transferee.

4. **Effective Date.** The effective date of a Transfer of Interests shall be the last day of the calendar month in which such transfer occurs.

5. **Rights of Substituted Member.** After the effective date of a Transfer of Interests, a Substituted Member (admitted pursuant to Section X hereof) shall have all the rights of the Member from whom the Substituted Member received such Interest.

XI. **METHOD OF ACCOUNTING, RECORDS AND REPORTS.**

1. **Method of Accounting.** The Controller shall maintain the books, records and accounts of the Company in accordance with Generally Accepted Accounting Principles (GAAP), and shall report income for tax and income tax purposes, in each case consistent with Highland's accounting practices and as required by the reporting requirements of any Member. The Company's financial records shall be maintained at the Company's principal business office. Each Member shall have the right upon reasonable notice given to the other to inspect, extract and copy the Company's books and records.

2. **Unaudited Financial Reports.** The Controller shall provide combined quarterly unaudited income statements, balance sheets and statements of cash flow to the Management Committee relating to the Company operations with such content as the Management Committee shall direct on a regular and timely basis. Such quarterly financial statements shall cover each calendar month and be delivered within twenty-five (25) days following the end of each month.

3. **Tax Returns and Reports.** The Controller, with the assistance of the tax matters partner, shall cause the preparation and timely filing of all required federal and state tax returns and other reports for the Company each year. The Controller shall deliver copies of the Company's tax returns for each Fiscal Year to the Members by April 15th of the following Fiscal Year. The Controller shall deliver copies of each of the Company's other reports, if any, to the Management Committee within ten (10) days before the due date of the applicable report.

4. **Fiscal Year.** The Company shall adopt the calendar year for tax and financial reporting purposes (the "Fiscal Year").

XII. TERMINATION AND DISSOLUTION OF THE COMPANY.

1. **Termination.** Subject to Section XIII, the Company shall be terminated and dissolved upon the occurrence of the following:

A. The unanimous written consent of all the Members to the termination and dissolution of the Company;

B. The default by a Member to fulfill in any material respect any of its obligations under this Agreement (unless waived by the other Member);

C. The default by the Company to fulfill in any material respect any of its obligations under this Agreement; or

D. Upon the happening of any events ("Dissolution Events") listed in the Act (membership termination by dissolution) unless the business of the Company is continued pursuant to a majority vote of the remaining Member(s).

2. **Actions Following Termination.** Upon the occurrence of any event causing the termination and dissolution of the Company, the Members shall take full account of the Company's property and liabilities, and endeavor to liquidate the property promptly while maximizing the proceeds realizable therefrom. The proceeds realized from disposition of property shall be applied and distributed in the following order and within the following time periods:

A. To the payment of creditors of the Company, including affiliates or parties related to a Member, other than Members in the order of priority as provided by law, excluding creditors whose obligations will be assumed or otherwise transferred on liquidation of the Company;

B. To the payment of creditors of the Company who are Members;

C. To the setting up of reserves which the Members, by a unanimous vote, deem reasonably necessary for liabilities not then due and contingent liabilities of the Company;

D. To the Members in accordance with their positive Capital Accounts (after giving effect to all contributions, distributions and allocations for all periods, including taking into account all Capital Account adjustments for the Company's taxable year during which the liquidation occurs, by the end of such taxable year, or if later, within ninety (90) days after the date of such liquidation);

E. To the Members in accordance with their share of Distributions pursuant to Section IX of this Agreement.

3. Notice, Mitigation and Cure. An event of termination under Section 1.A shall not arise until and unless (a) the non-defaulting Member shall have given written notice to the defaulting Member of the facts constituting such breach or failure, and (b) unless such defaulting Member shall have failed, within thirty (30) days following receipt of such notice, to have cured, remedied or mitigated such breach or failure to the satisfaction of the non-defaulting Member.

4. No Election of Remedies. No action taken by a Member pursuant to this Agreement shall constitute an election of remedies, and such Member may pursue rights and remedies it may have at law or in equity.

5. Deficit Capital Accounts. Notwithstanding anything to the contrary contained in this Agreement, and notwithstanding any custom or rule of law to the contrary, upon dissolution of the Company, a deficit in a Member's Capital Accounting shall not be an asset of the Company and such Member shall not be obligated to contribute such amount to the Company to bring the balance of such Member's Capital Account to zero.

XIII. DEFAULT OPTIONS AND CHANGE OF CONTROL.

1. Highland Default Option. In the event of a default by Highland (or its Affiliate) as described in Sections XII.1.B or XII.1.C that remains uncured, a Dissolution Event with respect to Highland, or a default by the Company which may be waived by Timberline under Section XII.1.C., Timberline may elect to exercise the provisions of Section XIII.4. below.

2. Timberline Default Option. In the event of a default by Timberline (or its Affiliate) as described in Sections XII.1.B or XII.1.C. that remains uncured, a Dissolution Event with respect to Timberline, or a default by the Company which may be waived by Highland under Section XII.1.C., Highland may elect to exercise the provisions of Section XIII.4. below.

3. Deadlock Options. In the event of a Deadlock that commences on or after the Parity is reached, either party may elect to exercise the provisions of Section XIII.4. below.

4. Buy - Sell Election. If there is an election under Sections XIII. 1, 2, or 3 above to exercise the provisions of this Section 4, then the electing Member shall have the option to determine the price at which the electing Member will sell its entire Interest to the non electing Member, and at which it is willing to purchase the entire Interest of the non electing Member. The electing Member shall give such a notice (an "Option Notice") to the non electing Member of this price. The non electing Member shall have thirty (30) days to respond in writing to the electing Member (a "Response Notice"). The Response Notice shall indicate whether the non electing Member desires to purchase the Interest of the electing Member, or sell its Interest to the electing Member, at the price the electing Member provided in its Option Notice. The Members shall thereafter cooperate to close the purchase and sale of the Interest to be sold. Closing of the purchase and sale of the Interest to be sold shall be not later than one hundred and twenty (120) days after the date of the Response Notice.

5. Change of Control. If a Change of Control occurs with respect to a Member, then the other Member shall have the option of adding one additional voting representative to the Management Committee. Such representative may be added within thirty (30) days following the day of the Change of Control.

6. **Option Notice Requirements.** If a party elects to exercise any of its options pursuant to this Section XIII, such party shall deliver a Option Notice to the other Member. The Option Notice shall identify the option being exercised and the Member's proposed purchase price for its or the other Member's Interest, or in the case of a Change of Control, the notice shall provide that the electing Member is exercising its option to add a representative to the Management Committee, and the name and address of the additional representative. The closing of the purchase and sale of an Interest pursuant to this Section XIII shall take place as follows: (i) the purchase price shall be payable in cash at closing, (ii) the Interest shall be conveyed free and clear of all liens, claims and encumbrances.

XIV. **INDEMNIFICATION; REIMBURSEMENT**

1. **Indemnification.** Each Member hereby indemnifies defends and holds harmless and agrees to defend the other Members and the Company from and against any and all claims, losses, damages, demands, liabilities, obligations, penalties, actions or rights of action, judgments, suits, costs, expenses, or disbursements of any kind or nature which may arise as a result of any:

- A. Breach of this Agreement by the indemnifying Member; or
- B. Action by the indemnifying Member or any of its officers, directors, employees, or agents with respect to the Company, which action has not been authorized pursuant to the terms of this Agreement.

2. **Notice of Claims.** Any party entitled to indemnification ("Indemnified Party") agrees to give the indemnifying party (the "Indemnitor") notice of any and all claims asserted against the Indemnified Party for which indemnification is or may be sought under this Section XIV. Such notice shall be given within a reasonable time after receipt of written notice of such claim by the Indemnified Party. Failure to give such notice shall not abrogate or diminish the Indemnitor's obligation under this Section XIV if the Indemnitor has or receives knowledge of the existence of any such claim by any other means or if such failure does not prejudice the Indemnitor's ability to defend such claim.

3. **Defense of Claim.** In any litigation, administrative proceeding, negotiation or arbitration pertaining to any claim for which indemnification is sought under this Section XIV, the Indemnitor shall have the right to select legal counsel to represent the Indemnitor and to otherwise control such litigation, proceedings, negotiations and arbitration. If the Indemnitor elects to control such litigation, proceeding, negotiation or arbitration, the Indemnified Party shall at all times have the right to fully participate in the defense at its own expense. If the Indemnitor shall, within a reasonable time after notice, fail to defend, the Indemnified Party shall have the right, but not the obligation, to undertake the defense of and to compromise or settle the claim or other matter on behalf of, for the account of, and at the risk of, the Indemnitor.

4. **Reimbursement.** The Company shall reimburse Members for any amounts which, pursuant to approval by the Representatives or final judgment of any court of applicable jurisdiction, have been paid by such Member on behalf of or for the account of the Company with respect to: (i) any liability, obligation, undertaking, damage, or claim for which the Company shall or may, pursuant to contract or applicable law, be liable or responsible, or (ii) making good any loss or damage sustained by, or paying any duty, cost, claim, or damage incurred by the Company. If the Company fails to fully reimburse a Member that made such payment, then the other Members shall pay a proportionate amount, based on the Interests

held by such Member, of the amount still unpaid to the Member that made the original payment. This final payment shall be made within thirty (30) days of the date the reimbursement was requested from the Company

5. Relationship. Without the prior written consent of the Members or unless otherwise stated herein, no Member shall have the power or authority to act for or on behalf of the other or for the account of the Company. Each Member will look solely to the assets of the Company for the return of its respective capital, and if the assets remaining after payment or discharge, or provision for payment or discharge, of the Company's debts or liabilities are insufficient to return the capital to the Members, no Member will have any recourse against the separate assets of the other Member for that purpose; provided, however, that this provision will in no way limit the indemnification provisions contained in this Section.

XV. DEFINITION OF TERMS.

1. "Act" means the Idaho Limited Liability Company Act, as amended from time to time, or the provisions of any successor legislation.

2. "Agreement" means this Operating Agreement as originally executed and as amended from time to time.

3. "Affiliate" means a Person that directly, or indirectly through one or more intermediaries, owns or controls, is owned or is controlled by, or is under common ownership or control with a Member. As used herein, "control" means the power to direct the management or affairs of a Member or other Person, and "ownership" means the beneficial ownership of more than fifty percent (50%) of the equity securities of the Member or other Person.

4. "Ancillary Agreements" means the Agreement, the SMD Agreement, and the Loan Documents.

5. "Capital Account" means, with respect to any Member, a capital account maintained for such Member on the books of the Company in accordance with the following provisions:

A. To each Member's Capital Account there shall be credited (i) such Member's Capital Contributions, (ii) such Member's distributive share of the Profits and any items in the nature of income or gain which may be specially allocated to such Member pursuant to Section IX hereof, and (iii) the amount of any Company liabilities assumed by such Member or which are secured by any property distributed to such Member;

B. To each Member's Capital Account there shall be debited (i) the amount of cash and the Gross Asset Value of any property distributed to such Member pursuant to any provision of this Agreement, (ii) such Member's distributive share of the Losses and any items in the nature of expenses or losses which are specially allocated to such Member pursuant to Section IX hereof, and (iii) the amount of any liabilities of such Member assumed by the Company or which are secured by any property contributed by such Member to the Company; and

C. In the event any Interest in the Company is transferred in accordance with the terms of this Agreement, the transferee shall succeed to the Capital Account of the transferor to the extent the Capital Account relates to the transferred Interest.

The foregoing provisions and the other provisions of this Agreement relating to the maintenance of Capital Accounts are intended to comply with Regulation Section 1.704-1(b), and the Capital Accounts of the Members shall be maintained in a manner consistent with such Regulation. In the event the Management Committee shall determine that it is prudent to modify the manner in which the Capital Accounts, or any debits or credits thereto are computed in order to comply with such Regulation, the Management Committee may make such modification; provided that, it is not likely to have a material effect on the amounts distributable to any Member pursuant to Section XII hereof upon the dissolution of the Company. The Members also shall: (a) make any adjustments that are necessary or appropriate to maintain equality between the Capital Accounts of the Members and the amount of Company capital reflected on the Company's balance sheet, as computed for book purposes in accordance with Regulation Section 1.704-1(b)(2)(iv)(q); and, (b) make any appropriate modifications in the event unanticipated events might otherwise cause this Agreement not to comply with Regulation Section 1.704-1(b).

6. "Capital Contributions" means, with respect to any Member, the amount of cash and the Initial Gross Asset Value of any property (other than cash) contributed to the Company with respect to the Company Interest held by such Member pursuant to the terms of this Agreement. Such property shall include but not be limited to property received by the Company pursuant to a merger, exchange or similar transaction in which a Person transfers property to the Company in return for an Interest in the Company. The principal amount of a promissory note which is not readily traded on an established securities market and which is contributed to the Company by the maker of the promissory note shall not be included in the Capital Contribution of any Person until the Company makes a taxable disposition of the promissory note or until (and only to the extent) principal payments are made on the promissory note, all in accordance with Regulation Section 1.704-1(b)(2)(iv)(d)(2).

7. "Change of Control" means with (i) respect to Highland, an event after which causes the family of Ron Guill (including his spouse, children and children of his children) to own less than 50% of the membership interests of Highland and (ii) with respect to Timberline, if there is a change of more than 50% of the members of the board of directors of Timberline in any twelve (12) month period.

8. "Code" means the Internal Revenue Code of 1986, as amended from time to time (and any comparable or successor provisions to the Code sections referenced in this Agreement).

9. "Company" means the Company existing under the terms of this Agreement.

10. "Deadlock" means the failure of the Representatives appointed by each Member to agree on a major action enumerated in Section V.8 following (i) two (2) meetings in which such action has been discussed and a vote taken, and (ii) following a mediation of the action at which the Members cannot agree with respect to the major action. If there is a failure to agree on such a major action following two (2) such meetings, then the Members shall submit the major action to non-binding mediation within thirty (30) days following the second meeting. The mediator selected shall be acceptable to both Members. The Members shall act in good faith and reasonably cooperate with each other and with the mediator. The mediation shall be completed within ninety (90) days following the date the major action is submitted to mediation.

The results of the mediation shall not be binding upon the Members. The mediation shall occur at the principal place of business of the Company. If the mediation is not completed within such ninety (90) day period, then there shall be a Deadlock.

11. "Depreciation" means, for each Fiscal Year or other period, an amount equal to the depreciation, amortization, or other cost recovery deduction allowable with respect to an asset for such Fiscal Year or other period, except that if the Gross Asset Value of an asset differs from its adjusted basis for federal income tax purposes at the beginning of such Fiscal Year or other period, Depreciation shall be an amount which bears the same ratio to such beginning Gross Asset Value as the federal income tax depreciation, amortization, or other cost recovery deduction for such Fiscal Year or other period bears to such beginning adjusted tax basis; provided however, that if the federal income tax depreciation, amortization, or other cost recovery deduction for such Fiscal Year is zero, Depreciation shall be determined with reference to such beginning Gross Asset Value using any reasonable method selected by the Members.

12. "Distributable Cash" means the Company cash and cash equivalents on hand less cash required for operations of the Company and reasonable reserves for contingencies and anticipated obligations, all as determined by the Management Committee. The Members agree that there shall be no Distributable Cash until the Company has retained working capital of not less than Five Million Dollars (\$5,000,000).

13. "Distribution" means property, cash or Distributable Cash distributed to Members because of their status as Members, or as a lender to the Company.

14. "Gross Asset Value" means, with respect to any property, the property's adjusted basis for federal income tax purposes, except as follows:

A. The initial Gross Asset Value of any property contributed by a Member (including a former Member) to the Company shall be the gross fair market value of such property, as determined by the Members;

B. The Gross Asset Values of all Company property shall be adjusted to equal their respective gross fair market values as determined by the Members, as of the following times: (i) the acquisition of an additional Interest in the Company by any new or existing Member in exchange for more than a de minimis Capital Contribution; (ii) the Distribution by the Company to a Member of more than a de minimis amount of property as consideration for an Interest in the Company; and (iii) the liquidation of the Company within the meaning of Regulation Section 1.704-1(b)(2)(ii)(g); provided however, that adjustments pursuant to clauses (i) and (ii) above shall be made only if the Members reasonably determine that such adjustments are necessary or appropriate to reflect the relative economic interests of the Members in the Company;

C. The Gross Asset Value of any Company property (other than cash) distributed to any Member shall be the gross fair market value of such property on the date of Distribution; and

D. The Gross Asset Value of Company property shall be increased (or decreased) to reflect any adjustments to the adjusted basis of such assets pursuant to Code Section 734(b) or Code Section 743(b) but only to the extent that such adjustments are taken into account in determining the Members' Capital Accounts pursuant to either Regulation Section 1.704-1(b)(2)(iv)(m) or Code § 743(b) in the case of a substantial

built-in loss; provided however, that Gross Asset Values shall not be adjusted pursuant to this paragraph to the extent the Members determine that an adjustment pursuant to paragraph (b) above is necessary or appropriate in connection with a transaction that would otherwise result in an adjustment pursuant to this paragraph (d).

E. If the Gross Asset Value of any property has been determined or adjusted pursuant to this definition, such Gross Asset Value shall thereafter be adjusted by the Depreciation taken into account with respect to such property for purposes of computing Profits and/or Losses.

15. "Interest" when used alone without reference to specific type of Interest, a Member's Percentage Interest in the Company, represented by the Member's Capital Account, the right to share in Distributions and the right to vote as a Member and participate in the Company's management to the extent provided in this Agreement.

16. "Loan" means the loan from Highland to the Company evidenced by the Loan Documents. If the Loan is not called or terminated early, for any reason, and the loan is being repaid by the Company, then, when the balance of the Loan is \$2,000,000, the Loan shall be converted from loan to a Capital Contribution.

17. "Loan Documents" means the loan agreement, promissory note and other agreements and/or documents substantially in the form attached hereto as Exhibit C evidencing the loan from Highland to the Company.

18. "Management Committee" means the person or entity serving as Management Committee pursuant to Section V of this Agreement.

19. "Member" means each of the parties who executes a counterpart of this Agreement, or may hereafter be admitted, as a member of the Company in compliance with the terms of this Agreement (including a Substituted Member after being admitted pursuant to Section X.3).

20. "Parity" means the date at which the investment by Timberline is deemed equal to the investment by Highland. This shall not occur until the Loan from Highland, including all principal, interest and other related amounts, is repaid, except for principal in the amount of Two Million Dollars (\$2,000,000.00).

21. "Percentage Interest" means, with respect to any Member, the percentage determined by dividing the amount of such Member's Capital Account by the sum of all Members' Capital Accounts. The sum of all Members' Percentage Interests shall equal one hundred percent (100%). The Percentage Interests shall be set forth in Exhibit "A".

22. "Person" means any natural person, partnership (general or limited), corporation, association, limited liability company, trust, estate or other legal entity.

23. "Profits" and/or "Losses" means, for each Fiscal Year or other period, an amount equal to the Company's taxable income or loss for such Fiscal Year or period, determined in accordance with Code Section 703(a) (for this purpose, all items of income, gain, loss, or deduction required to be stated separately pursuant to Code Section 703(a)(1) shall be included in taxable income or loss), with the following adjustments (without duplication):

A. Any income of the Company that is exempt from federal income tax and not otherwise taken into account in computing Profits and/or Losses pursuant to this definition shall be added to such taxable income or loss;

B. Any expenditures of the Company described in Code Section 705(a)(2)(B) (relating to Company expenditures not deductible in computing taxable income and not properly chargeable to a capital account) or treated as Code Section 705(a)(2)(B) expenditures pursuant to Regulation Section 1.704-1(b)(2)(iv)(i), and not otherwise taken into account in computing Profits and/or Losses pursuant to this definition, shall be subtracted from such taxable income or loss;

C. If the Gross Asset Value of any Company property is adjusted pursuant to paragraph (b) or (d) of the definition of Gross Asset Value, the amount of such adjustment shall be taken into account as an item of gain (if the adjustment increases the Gross Asset Value) or an item of loss (if the adjustment decreases the Gross Asset Value) from the disposition of such property for purposes of computing Profits and/or Losses;

D. Gain or loss resulting from any disposition of property with respect to which gain or loss is recognized for federal income tax purposes shall be computed by reference to the Gross Asset Value of the property disposed of, notwithstanding that the adjusted tax basis of such property differs from its Gross Asset Value; and

E. In lieu of the depreciation, amortization, and other cost recovery deductions taken into account in computing such taxable income or loss, there shall be taken into account Depreciation for such Fiscal Year or other period, computed in accordance with the provisions hereof.

24. "Regulation" means the income tax regulation promulgated under the Code, as such regulation may be amended from time to time (and any comparable or successor provisions to the Regulation sections referenced in this Agreement).

25. "SMD Agreement" means the Agreement dated _____, 2009, between the Company and Small Mine Development, LLC, an Idaho limited liability company, for the development of the Property.

26. "Substituted Member" means a transferee of a Member's Interest who has succeeded as a Member to all of the rights inherent in the ownership of his or her Interest and as to whom all of the requirements of Section X have been satisfied.

XVI. MISCELLANEOUS.

1. Counterparts. This Agreement may be executed in several counterparts, and all copies so executed shall constitute one agreement, binding on all of the parties hereto, notwithstanding that all the parties are not signatories to the original or the same counterpart.

2. Notices. Unless otherwise provided, all notices under this Agreement shall be in writing and shall be given to the Person entitled thereto, by (i) personal delivery, (ii) U.S. registered or certified mail, or (iii) delivery via reputable overnight courier, to the address indicated in the Company's records for such Person. If mailed, such notice shall be deemed to be delivered two (2) business days after being deposited in U.S. mail, with postage prepaid to the applicable Person's address set forth on Exhibit "A".

3. **Application of Idaho Law.** This Agreement, and the application and interpretation hereof, shall be governed exclusively by its terms and by the laws of the State of Idaho and specifically the Act.
4. **Waiver of Action for Partition.** During the term of the Company, each Member irrevocably waives any right that such Member may have to maintain any action for partition with respect to the property of the Company. The Members intend that the Company is a limited liability company. The Members are not partners or joint venturers for any purposes other than federal and state income tax purposes, and this Agreement shall not be construed to provide otherwise.
5. **Construction.** Whenever a singular term is used in this Agreement, such term shall also include the plural version of the term when the context requires. Whenever a masculine term is used in this Agreement, such term shall also include the feminine and neutral versions of the term when the context requires.
6. **Headings.** The headings in this Agreement are inserted for convenience only and are in no way intended to describe, interpret, define, or limit the scope, extent or intent of this Agreement or any provision hereof.
7. **Waivers.** The failure of any party to seek redress for violation of, or to insist upon the strict performance of, any covenant or condition of this Agreement shall not prevent a party from seeking redress or insisting on strict performance for any subsequent violations of this Agreement by another party.
8. **Rights and Remedies Cumulative.** The rights and remedies provided by this Agreement are cumulative and the use of any one right or remedy by any party shall not preclude or waive the right of any party to use any or all other remedies available to a party under the law. The rights and remedies given to a party under this Agreement are given in addition to any other rights a party may have by law, statute, ordinance or otherwise.
9. **Severability.** If any provision of this Agreement or the application thereof to any Person or circumstance shall be invalid, illegal or unenforceable to any extent, the remainder of this Agreement and the application thereof shall not be affected and shall be enforceable to the fullest extent permitted by law.
10. **Binding Effect.** Each and all of the covenants, terms, provisions and agreements herein contained shall be binding upon and inure to the benefit of the parties hereto and their respective heirs, legal representatives, successors, assigns, owners, employees, agents, directors, officers and Management Committees, as applicable.

IN WITNESS WHEREOF, the Company and the Members hereby execute this Agreement effective as of the 22 day of July, 2009.

COMPANY:

BUTTE HIGHLANDS JV, LLC

By: Ronald W. Giff

Its: MANAGER

MEMBERS:

TIMBERLINE RESOURCES CORPORATION

By: Ronald L. Hardy

Its: CEO

HIGHLAND MINING, LLC

By: Ronald W. Giff

Its: MANAGER

EXHIBIT "A"
THE SCHEDULE

Name	U.S. Mail Address Phone Number Email Address (as applicable)	Percentage Interest
Timberline Resources Corporation	101 E. Lakeside Avenue Coeur d'Alene, ID 83814 Attn: Randal Hardy (208) 664-4859 Phone (208) 664-4860 Fax hardy@timberline-resources.com	50%
Highland Mining, LLC	967 East ParkCenter Blvd. PMB 174 Boise, ID 83702 Attn: Ron Guill (208) 338-8880 Phone (208) 338-8881 Fax rguill@undergroundmining.com	50%
TOTAL		100%

EXHIBIT "B"

SMD AGREEMENT

SMALL MINE DEVELOPMENT, LLC

967 E. PARKCENTER BLVD. PMB #386
BOISE, IDAHO 83708-8730
PH: 208-338-8380
FX: 208-338-8881

6/25/2009

TO: General Manager
Butte Highlands LLC - JV
FROM SMD-LLC
SUBJ: Butte Highlands JV Exploration Project

GENERAL SCOPE OF WORK - EXHIBIT A

- 1) Mobilization and surface site preparations
- 2) Establishment of Portal
- 3) Drive approximately 6,700' of drift/ramp/ventilation raise/bulk sample
- 4) Demobilization

PROPOSED RATES

	type work	size	unit price	unit	#units	notes	total price
1)	Mobilization		\$ 65,000.00	ls	1		\$ 85,000.00
2)	Surface excavations/preparations/pondelings (by others)		\$ 1,000,000.00	ls	1	estimate	\$ 1,000,000.00
3)	Surface setups including concrete/structure install/piping/etc.		\$ 1,250.00	chr	120	estimate	\$ 150,000.00
4)	Portal w/25'	16' X 14'	\$ 1,250.00	chr	80	estimate	\$ 100,000.00
5)	Drifting - single heading	16' X 14'	\$ 1,450.00	ft	5,000		\$ 7,250,000.00
6)	Drifting - multiple heading	16' X 14'	\$ 1,175.00	ft	600		\$ 705,000.00
7)	Drifting - ore development for bulk sample	16' X 14'	\$ 1,175.00	ft	500	estimate	\$ 587,500.00
8)	Ventilation raise (toreed by others or allinac)	10' x 10'	\$ 1,200.00	ft	600	estimate	\$ 720,000.00
9)	Shotcrete material - application	-1"	\$ 300.00	yd3	600	estimate	\$ 180,000.00
10)	8' resin bolts - intersections & as required	8'	\$ 48.00	ea	500	estimate	\$ 24,000.00
11)	Demobilization		\$ 65,000.00	ls	1		\$ 85,000.00
							10,298,000.00

NOTES:

- A) #1 - includes equipment freight + labor to site
- B) #2 - all surface excavations including portal cut, roads, ponds, ditching, linings, compacting, etc. (work to be subcontracted)
- C) #3 - includes all work required to get surface site setup and ready to start portal work after earth work is completed
- D) #4 - includes highwall preparations with bolts/wire/shotcrete + use of SMD trackhoe w/cutterhead for establishment of collar
- E) #4 - not expected to use steel @ portal
- F) #5, #6, #7 - all rates for drifting @ 16' X 14' and bolted utilizing 6' splitsets + 4" X 4" welded wire panels + shotcrete as required on this
- G) #5, #6, #7 - all drifts larger than 16' X 14' (224 ft2) will be based on equivalent footage (Aras/224)
- L) #6 - geotech hole required to determine which method will be used (exact price will vary and may be completed by subcontractor)
- M) #8 - shotcrete application to include equipment + labor + shotcrete materials
- N) #10 - rate for bolt installation as needed @ intersections
- O) #11 - includes equipment freight + site cleanup

SMD PERSONNEL

- 1) Project superintendent 4
 - 2) UGX mechanic 5
 - 3) UGX miners 16-20
- \$37.50/mhr
\$37.50/mhr

EXHIBIT A

PROPOSED WORK SCHEDULE

- 1) 2-12 hr. shifts/day
- 2) 7 on - 7 off schedule

\$1,250/labor + equip crew rate/hr

SMD SUPPLIED EQUIPMENT (as may be required)

- 1) 6 yd3 LHD
- 2) Tamrock twin boom jumbo
- 3) Tamrock bolter
- 4) Tamrock EJC-522 truck
- 5) Wet shrouded sprayer
- 6) Gehlman A64 ET
- 7) Gehlman A64 SD
- 8) 8042 skytrak
- 9) Elmac D410A water truck
- 10) R100 u/g grader
- 11) IF 825 diesel compressor
- 12) Cat 545 kw genset
- 13) Cat 320 kw genset
- 14) UYG tractor
- 15) Cat 17-28F surface loader
- 16) Pickup

2
1
1
2
1
1
1
2
1
1
1
1
1
2
1
1
6

SMD SUPPLIED MATERIALS (all general drifting + maintenance supplies including:)

- 1) Explosives
- 2) Diesel fuel/oil
- 3) Ground support materials (steel/tie/rope/male/wire/shotcrete/etc.)
- 4) Piping materials
- 5) 48" ventilation ducting + booster fans
- 6) All 13800V electrical distribution
- 7) All u/g electrical to 480V

NOTES:

- A) none

OWNER SUPPLIED MATERIALS/EQUIPMENT

- 1) Office
- 2) Dry/change room
- 3) Escape hoist (if necessary)
- 4) Shop tent
- 5) Water tank/drip system
- 6) Fuel tanks

NOTES:

- A) none

OTHER OWNER RESPONSIBILITIES/SUPPORT REQUIRED

- 1) Request and maintain all required federal/state/local permits
- 2) Provide site specific MSHA training for SMD personnel
- 3) Provide drill water as required

- 4) Provide use of Phone/fax as needed

OTHER SMD RESPONSIBILITIES

- 1) Provide owner with proof of 'Insurances' as appropriate
- 2) Provide all required MSHA training/records for SMD site personnel
- 3) Provide engineering/geologic controls as required

GENERAL PARAMETERS

- 1) It is assumed that this work will encounter no significant ground water inflow (>50 gpm)

PAYMENT TERMS

- 1) Due as earned, invoicing at the end of each month - payable to SMD by the 15th of the next mo.

After you have had a chance to review this information, please give me a call at 203-338-8880 so that I can answer any questions/concerns that you might have with any of the above numbers



Ronald W. Gull
Owner-Mgr / SMD

EXHIBIT "C"

LOAN DOCUMENTS

PROMISSORY NOTE

Maker: Butte Highlands JV, LLC
 Holder: Highland Mining, LLC
 Date of Making: July 22, 2009
 Place of Making: Boise, Idaho
 Principal Amount: Amount of Advances plus other amounts
 Interest Rate: Four percent (4.0%) per annum, compounded continuously
 Maturity Date: Upon demand (the "Maturity Date")

FOR VALUE RECEIVED, the undersigned, Butte Highlands JV, LLC, an Idaho limited liability company, whose address is 967 East ParkCenter Boulevard, Boise, Idaho 83716 ("Maker"), promises to pay to Highland Mining, LLC, an Idaho limited liability company, whose address is 967 East ParkCenter Boulevard, Boise, Idaho 83716 ("Holder"), at 967 East ParkCenter Boulevard, Boise, Idaho 83716, or such other place as may be designated from time to time in writing by the holder of this Note, the amounts advanced under this Note in the sole discretion of Holder, in lawful money of the United States of America, plus interest thereon at the rate set forth herein until paid in full. Interest shall be calculated on the basis of a 365 day year.

1. Interest Rates. Interest shall accrue on the unpaid principal balance of this Note at the rate of four percent (4.0%) per annum from July 22, 2009, until paid in full upon the demand of the Holder (the "Maturity Date").
2. Payment Terms. The principal balance and all accrued but unpaid interest, if any, shall be due and payable in full upon the demand of Holder.
3. Application of Payments. All payments on this Note shall be applied first to the payment of attorneys, fees, costs, and other charges to the extent, if any, provided herein; then to interest accruing hereon; and then to principal. The unpaid principal balance of this Note shall continue to bear interest until and including the date payment is received.
4. Prepayment. This Note may be prepaid in whole or in part at any time without premium or penalty.
5. Default. If default is made in the payment of principal or interest when due, and Maker fails to cure such default after ten (10) days after receiving written notice, then the whole sum of principal and accrued interest, shall at the option of the holder hereof, become immediately due and payable, anything contained herein or in any instrument now or hereafter relating to or securing the indebtedness evidenced hereby to the contrary thereof notwithstanding, time being of the essence of

this agreement, provided further, that such right to accelerate shall be in addition to any other rights or remedies available to Holder in equity or at law. Such option shall continue until all such defaults have been cured. Failure to exercise such option, or any other right the holder may have in such event, or be entitled to, shall not constitute a waiver of the right to exercise such option or any other rights in the event of any subsequent default.

6. Modifications. The undersigned and any party pledging collateral as security for the payment hereof agree that the Holder hereof may extend the time of payment or otherwise modify the terms of payment of any part or the whole of the indebtedness evidenced hereby or release and/or subordinate any security for this Note at any time at the request of anyone now or hereafter liable, and such consent shall not alter nor diminish the liability of any person or the enforceability of this Note or any security interest pledged as collateral for the payment hereof. Each and every party now or hereafter signing or endorsing this Note binds himself as a principal and not as a surety. All of the terms, covenants, provisions and conditions herein contained are made on behalf of, and shall apply to and bind the undersigned and their respective personal representatives, successors and assigns, jointly and severally.

7. Late Charge. If any payment required under this Note is not received by Holder within ten (10) days after the date on which such payment is due, Maker shall pay to Holder on demand a late charge in an amount equal to ten percent (10%) of the amount due. Maker and Holder agree that the late charge is intended to be a reasonable approximation of actual damages incurred by Holder as a result of such overdue payment, which damages are difficult to estimate. The imposition or collection of a late charge is in addition to and not in lieu of any other rights or remedies Holder may have as a result of late payment.

8. Costs of Enforcement. If, upon the occurrence of an event of default, the prevailing party shall be entitled to recover from the losing party all costs thereof, including reasonable attorneys' fees and costs of litigation. All such costs and attorneys' fee shall include, without limitation, those incurred on any appeal or review and in any proceeding under any present or future bankruptcy or similar proceeding or state receivership.

9. Interest Limitation. Interest, fees, and charges collected or to be collected in connection with the indebtedness evidenced by this Note shall not exceed the maximum, if any, permitted by applicable law. If any such law is interpreted so that any such interest, fees, or charges would exceed any such maximum, and if Maker is entitled to the benefit of such law, then (a) such interest, fees, or charges shall be reduced to the permitted maximum and (b) any sums already collected from Maker which exceed the permitted maximum shall be refunded. Holder may elect to make any such refund either by treating the payments, to the extent of the excess, as payments of principal (without application of any prepayment fee) or by making a direct payment to Maker.

10. No Security. This Note is unsecured.

11. Waiver. The Maker and endorsers hereof jointly and severally waive presentment for payment, protest, notice or protest and of non-payment of this note and agree that on default in payment of this Note, or any part, principal or interest, when due, the whole amount remaining unpaid shall, without notice of non-payment or demand of payment, immediately become due and payable.

12. Notices. Any notice to Maker under this Note shall be in writing and shall be deemed given when delivered by personal service or when placed in the U.S. Mail, postage prepaid, certified mail, return receipt requested, addressed to Maker, at the address set forth in the first paragraph of this Note or such other address as Maker may designate by written notice to Holder. Any notice to Holder under this Note shall be in writing and shall be deemed given when delivered by personal service or the day of placement in the U.S. Mails, postage prepaid, certified mail, return receipt requested, addressed to Holder at the address set forth in the first paragraph of this Note, or such other address as Holder may designate by written notice to Maker.

13. Modifications. Any modification to this Note must be set forth in writing and executed by the Maker and Holder.

14. Governing Law and Venue. This Note shall be governed by the laws, including conflicts of laws, in the State of Idaho as an agreement between residents of the State of Idaho and to be performed within the State of Idaho. Venue shall be in the Idaho State district court for Ada County, Idaho.

15. Binding Effect. This Note shall be binding upon and inure to the benefit of the parties hereto and their respective heirs, legal representatives, successors and assigns.

16. Time of Essence. All times provided for in this Note, or in any other document executed hereunder, for the performance of any act will be strictly construed, time being of the essence.

17. Remedies Cumulative. Each right, power and remedy provided for herein or now or hereafter existing in law, in equity, by statute or otherwise shall be cumulative and concurrent and shall be in addition to every other right, power or remedy provided for herein or now or hereafter existing at law, in equity, by statute or otherwise, and the exercise or beginning of the exercise or the forbearance of exercise by any the Holder of any one or more of such rights, powers or remedies shall not preclude the simultaneous or later exercise by the Holder of any or all of such other rights, powers or remedies.

18. Severability. If any term or provision of this Note shall, to any extent be determined by a court of competent jurisdiction to be invalid or unenforceable, the remainder of this Note shall not be affected thereby, and each term and provision of this Note shall be valid and be enforceable to the fullest extent permitted by law; and it is the intention of the parties that if any provision of this Note is capable of two constructions, one of which would render the provision void and the other of which would render the provision valid, the provision shall have the meaning which renders it valid.

[end of text]

This Promissory Note is executed effective the date first set forth above.

Butte Highlands JV, LLC

By: Robert W. Gault

Its: M.D. GALT

EXHIBIT D

SAMPLE OF ALLOCATIONS AND DISTRIBUTIONS

Butte Highlands JV
Hypothetical allocation

Facts:

Highland Mining, LLC contributes \$15,000,000 in cash as loan and contribution

Timberline Resources contributes \$2,000,000 in land in year 0.

All cash is spent on development in the year contributed.

In Years 2 and 3 \$20,000,000 is earned pro-rata per quarter.

At point party is reached equalizing distribution is made to make capital accounts equal

Totals for example		Distributions received	
Income all years			
Highland	7,500,000	5,000,000	
TLR	7,500,000	8,000,000	
	15,000,000	13,000,000	

	2008		2010		1st Quarter		2nd Quarter	
	+	-	+	-	1/1/2011	+	3/31/2011	+
Cash	-	(2,000,000)	-	(2,000,000)	-	5,000,000	5,000,000	(5,000,000)
Land	-	2,000,000	-	-	-	-	2,000,000	-
Due to Highland Mining	-	(2,000,000)	(2,000,000)	(11,000,000)	2,000,000	-	(13,000,000)	-
Highland Mining Equity	-	-	2,000,000	13,000,000	13,000,000	(4,000,000)	8,000,000	4,000,000
TLR Equity	-	(2,000,000)	(2,000,000)	-	12,000,000	(1,000,000)	(3,000,000)	1,000,000
Profit (loss)	-	-	-	(13,000,000)	-	5,000,000	-	-
Highland Contrib/Dist	-	-	-	2,000,000	-	-	-	-
TLR Contrib/Dist	-	2,000,000	-	-	-	-	-	1,000,000
Highland Loans	-	2,000,000	-	11,000,000	-	-	-	4,000,000

Allocation	100% Highland 0% TLR	(2,000,000)	100% Highland 0% TLR	(13,000,000)	80% Highland 20% TLR	4,000,000 1,000,000	80% Highland 20% TLR	4,000,000 1,000,000
Reasoning:	Not to party		Not to party		Not to party		Not to party	

No distributions/debt payments
can be raised for W/C
At time party is reached W/C will be readjusted

Butte Highlands JV
Hypothetical allocation

Facts:
Highland Mining, LLC for
Tribal Land Resources Co.
All cash is spent on new
in Years 2 and 3 \$20,000
At point parity is reached

	3rd Quarter		4th Quarter		1st Quarter		2nd Quarter		6/30/2012
	6/30/2011	9/30/2011	12/31/2011	3/31/2012	6/30/2012	9/30/2012	12/31/2012	3/31/2013	6/30/2013
Cash	5,000,000	5,000,000	5,000,000	5,000,000	5,000,000	5,000,000	5,000,000	5,000,000	5,000,000
Land	2,000,000	2,000,000	2,000,000	2,000,000	2,000,000	2,000,000	2,000,000	2,000,000	2,000,000
Due to Highland Mining	(9,000,000)	(9,000,000)	(9,000,000)	(9,000,000)	(9,000,000)	(9,000,000)	(9,000,000)	(9,000,000)	(9,000,000)
Highland Mining Equity	5,000,000	5,000,000	5,000,000	5,000,000	5,000,000	5,000,000	5,000,000	5,000,000	5,000,000
TLR Equity	(3,000,000)	(3,000,000)	(3,000,000)	(3,000,000)	(3,000,000)	(3,000,000)	(3,000,000)	(3,000,000)	(3,000,000)
Profit/Loss	-	-	-	-	-	-	-	-	-
Highland Contrib	-	-	-	-	-	-	-	-	-
TLR Contrib	-	-	-	-	-	-	-	-	-
Highland Loans	-	-	-	-	-	-	-	-	-

Allocation:	50% Highland	4,000,000	80% Highland	4,000,000	80% Highland	4,000,000	50% Highland	2,500,000
Releasing:	20% TLR	1,000,000	20% TLR	1,000,000	20% TLR	1,000,000	50% TLR	2,500,000
	Not to parity		Not to parity		Parity reached		Parity	

Distributions taken prior to date

Highland	-
TLR	3,000,000
Available cash for distribution	4,000,000
Highland to equalize	3,000,000
Remaining	1,000,000
0.5 Highland	500,000
0.5 TLR	500,000

STOCK SETTLEMENT AND RELEASE AGREEMENT

THIS STOCK SETTLEMENT AND RELEASE AGREEMENT (this "**Agreement**") is made as of this 14th day of July, 2009, by and between Timberline Resources Corporation ("**Timberline**"), a Delaware corporation, and Jefferies & Company, Inc. ("**Jefferies**").

RECITALS

WHEREAS, Jefferies provided Timberline financial advisory services in connection with a possible transaction or series of transactions involving Timberline and a target company, and was engaged by Timberline as a placement agent, arranger, or initial purchaser for the potential financing for such a transaction or transactions (the "**Services**"), pursuant to the terms of two agreements: an engagement agreement dated November 1, 2007 (the "**Advisory Engagement Agreement**"); and an engagement agreement dated April 4, 2008 (the "**Placement Agent Engagement Agreement**"), (together the "**Engagement Agreements**") each by and between Timberline and Jefferies; and

WHEREAS, pursuant to the Engagement Agreements, Timberline was to pay Jefferies a fee of \$500,000 for a Fairness Opinion, a cash fee and warrants in the event that securities were placed, and expenses including legal fees incurred by Jefferies pursuant to the provision of the Services (collectively, the "**Fees**"); and

WHEREAS, Jefferies has issued an invoice to Timberline, Invoice number 7291 dated Oct. 29, 2008, reference number ABE87, in the total amount of \$923,956.74 for the Fees (the "**Services Invoice**"), shown in Exhibit B; and

WHEREAS, neither a transaction nor a financing envisioned in the Engagement Agreements was consummated; and

WHEREAS, Timberline and Jefferies now desire that the Fees and the Services Invoice be satisfied by issuance of shares of common stock of Timberline, par value \$0.001 ("**Common Shares**") and payment of cash.

AGREEMENT

NOW, THEREFORE, in consideration of the foregoing and the promises and covenants contained herein, the sufficiency of which is hereby acknowledged, all parties hereto agree as follows:

A. ISSUANCE OF SHARES

1. **The Shares and Cash.** Subject to the satisfaction of the terms and conditions set forth in this Agreement, Timberline agrees to issue 950,000 Common Shares (the "**Exchange Shares**") and pay \$50,000.00 cash (the "**Exchange Cash**") to Jefferies in exchange for Jefferies' release of Timberline's payment in cash of the Fees reflected on the Services Invoice, and

Jefferies agrees to accept such Exchange Shares and Exchange Cash from Timberline as satisfaction, in full, of the Services Invoice.

2. Issuance of Shares. Timberline shall deliver the stock certificate(s) representing the Shares, registered with Timberline's Transfer Agent and delivered as set forth on Exhibit A attached hereto, free and clear from any restrictions on transfer, except those restrictions on transfer described in Section (B)(7) hereof, upon the later of: (i) three (3) business days following the execution of this Agreement by both parties or (ii) three (3) business days following the approval of the issuance of the Exchange Shares by the NYSE Amex ("*NYSE Amex*").

3. Payment of Cash. Timberline shall wire the Exchange Cash to Jefferies no later than the third business day following the execution of this Agreement by both parties. Jefferies' wiring instructions are as follows:

Bank of New York
ABA: 021000018
Account Number: 8900007001
Tax ID: 952622900
Reference: Timberline

B. REPRESENTATIONS AND WARRANTIES OF JEFFERIES

Jefferies represents, warrants and covenants (and acknowledges that Timberline is relying on such representations, warranties and covenants) that, as of the date of this Agreement:

1. Jefferies understands that, at the time Jefferies receives the Exchange Shares, (i) the Exchange Shares will not be registered under the U.S. Securities Act of 1933, as amended (the "U.S. Securities Act") or any applicable state securities laws and may not be offered or sold absent such registration or an available exemption from such registration requirements and (ii) the Exchange Shares will not be approved or disapproved by the United States Securities and Exchange Commission (the "SEC") or any state securities agency. Jefferies understands and agrees that the Exchange Shares are being issued to Jefferies in reliance upon the exemption provided under Rule 505 of Regulation D and/or section 4(2) under the U.S. Securities Act;

2. Jefferies is not an underwriter and Jefferies will acquire the Exchange Shares solely for investment purposes for its own account and not with a view to, or for, resale in connection with any distribution of securities within the meaning of the U.S. Securities Act; and the Exchange Shares will not be obtained with a view to or for the resale, distribution, subdivision or fractionalization thereof; and the undersigned has no contract, undertaking, understanding, agreement, or arrangement, formal or informal, with any person to sell, transfer, or pledge to any person the Exchange Shares; and it understands that the legal consequences of the foregoing representations and warranties to mean that it must bear the economic risk of the investment for an indefinite period of time because the Exchange Shares, at the time of receipt, will not be registered under the U.S. Securities Act, and, therefore, may be resold only if registered under the U.S. Securities Act or if an exemption from such registration requirement is available;

3. Jefferies is an "accredited investor" that satisfies one or more of the criteria set forth in Rule 501(a) of Regulation D of the U.S. Securities Act;

4. Jefferies understands that, except as provided in Section E hereof, Timberline is under no obligation to register the Exchange Shares or to cause or permit the Exchange Shares to be transferred in the absence of any such registration or exemption;

6. Jefferies has not purchased the Exchange Shares as a result of any form of general solicitation or general advertising (as such terms are used in Rule 502 (c) under Regulation D of the U.S. Securities Act);

7. Jefferies acknowledges that the Exchange Shares will be "restricted securities," as such term is defined under Rule 144 of the U.S. Securities Act, and may not be offered, sold, transferred, pledged, or hypothecated to any person in the absence of registration under the U.S. Securities Act or an opinion of counsel that registration is not required. Without limiting the generality or application of any other covenants, representations, warranties and acknowledgements of Jefferies respecting resale of the Exchange Shares, Jefferies will not offer, sell or otherwise transfer any of such Exchange Shares directly or indirectly, unless in accordance with the following legend, which Jefferies acknowledges the certificates representing the Exchange Shares delivered pursuant to this Agreement shall bear (until such time as the Exchange Shares have been registered under the U.S. Securities Act or an opinion of counsel is received that such legend is no longer required):

"THE SECURITIES REPRESENTED HEREBY HAVE NOT BEEN REGISTERED UNDER THE UNITED STATES SECURITIES ACT OF 1933, AS AMENDED (THE "U.S. SECURITIES ACT"). THESE SECURITIES MAY BE OFFERED, SOLD, PLEDGED OR OTHERWISE TRANSFERRED ONLY (A) TO TIMBERLINE, (B) IF THE SECURITIES HAVE BEEN REGISTERED IN COMPLIANCE WITH THE REGISTRATION REQUIREMENTS UNDER THE U.S. SECURITIES ACT AND IN ACCORDANCE WITH APPLICABLE STATE SECURITIES LAWS, (C) IN COMPLIANCE WITH THE EXEMPTION FROM THE REGISTRATION REQUIREMENTS UNDER THE U.S. SECURITIES ACT PROVIDED BY RULE 144, RULE 144A OR REGULATION S THEREUNDER, IF AVAILABLE, AND IN ACCORDANCE WITH APPLICABLE STATE SECURITIES LAWS, OR (D) IN ANOTHER TRANSACTION THAT DOES NOT REQUIRE REGISTRATION UNDER THE U.S. SECURITIES ACT OR ANY APPLICABLE STATE LAWS AND REGULATIONS GOVERNING THE OFFER AND SALE OF SECURITIES. AND THE HOLDER HAS, PRIOR TO SUCH SALE, FURNISHED TO TIMBERLINE AN OPINION OF COUNSEL, OR OTHER EVIDENCE OF EXEMPTION, REASONABLY SATISFACTORY TO TIMBERLINE. HEDGING TRANSACTIONS INVOLVING THE SECURITIES REPRESENTED HEREBY MAY NOT BE CONDUCTED UNLESS IN COMPLIANCE WITH THE U.S. SECURITIES ACT."

If Rule 144 under the U.S. Securities Act is applicable, then the undersigned may make sales of the Exchange Shares only under the terms and conditions prescribed by Rule 144 of the U.S. Securities Act or other exemptions therefrom (unless the Exchange Shares have been registered). Timberline shall use commercially reasonable efforts to cause its legal counsel to deliver an opinion or such other documentation as may reasonably be required to effect sales of the Exchange Shares under Rule 144;

8. Jefferies consents to Timberline making a notation on its records or giving instruction to the registrar and transfer agent of Timberline in order to implement the restrictions on transfer set forth and described herein;

9. Jefferies is a corporation and in good standing under the laws of its jurisdiction of incorporation; and

10. Jefferies acknowledges that Timberline has received notification from the NYSE Amex that Timberline does not currently meet the continued listing requirements of the NYSE Amex and that the common shares of Timberline could be de-listed from NYSE Amex, regardless of Timberline's commercially reasonable efforts to maintain such listing;

11. this Agreement has been duly executed and delivered by Jefferies and constitutes a legal, valid and binding obligation of Jefferies enforceable against Jefferies in accordance with its terms, except as enforcement thereof may be limited by bankruptcy, insolvency, reorganization, moratorium and other laws relating to or affecting the rights of creditors generally and except as limited by the application of equitable principles when equitable remedies are sought, and by the fact that rights to indemnity, contribution and waiver, and the ability to sever unenforceable terms, may be limited by applicable law.

C. REPRESENTATIONS AND WARRANTIES OF TIMBERLINE

Timberline represents, warrants and covenants (and acknowledges that Jefferies is relying on such representations, warranties and covenants) that, as of the date of this Agreement:

1. Timberline has been duly incorporated and is validly existing as corporation in good standing under the laws of its jurisdiction of incorporation and has the power and authority (corporate or other) to own, lease, and operate its properties and to conduct its business as so owned, leased or operated and conducted on the date of this Agreement;

2. All of the issued and outstanding shares of Timberline's common stock have been duly authorized and validly issued, are fully paid and nonassessable and have been issued in compliance with federal and state securities laws;

3. Timberline is duly qualified, registered and licensed to carry on business and is in good standing in the jurisdictions in which it carries on business or owns property where so required by the laws of that jurisdiction;

4. Timberline is not (i) in violation of any material term of or in material default under its certificate of incorporation, bylaws or other organizational document, (ii) in default (or, with the giving of notice or lapse of time, would be in default or constitute a default) ("Default") under any material term, covenant or condition contained in any indenture, mortgage, deed of trust, loan agreement or other agreement or instrument to which Timberline is a party or by which it or any of them may be bound, or to which any of the property or assets of Timberline is subject (each, an "Existing Instrument"), or (iii) in violation of any judgment, decree or order or any statute, ordinance, rule, law or regulation applicable to Timberline, where such violation would have a material adverse effect on Timberline. Timberline's execution, delivery and performance of this Agreement, the issuance of the Exchange Shares and the payment of the Exchange Cash (i) will not result in any material violation of the provisions of the charter or bylaws of Timberline, (ii) will not conflict with or constitute a material breach of, or Default under, or result in the creation or imposition of any security interest, mortgage, pledge, lien, charge, encumbrance or adverse claim upon any property or assets of Timberline pursuant to, or require the consent of any other party to any Existing Instrument or other third party and (iii) will not result in any violation of any law, administrative regulation or administrative or court decree applicable to Timberline. No consent, approval, authorization or other order of, or registration or filing with, any court or other governmental or regulatory authority or agency, is required for Timberline's execution, delivery and performance of this Agreement, issuance of the Exchange Shares and payment of the Exchange Cash, except: (i) as required by the state securities or "blue sky" laws, (ii) approval of the issuance of the Exchange Shares by the NYSE Amex and (iii) for such consents, approvals, authorizations, orders, filings or registrations that have been obtained or made and are in full force and effect;

5. Timberline represents that there are no placement agent's fees, financial advisory fees, or brokers' commissions or similar fees or payments due to any person relating to or arising out of the issuance of the Exchange Shares under this Agreement. Timberline shall pay, and hold Jefferies harmless against, any liability, loss or expense (including, without limitation, foreseeable and documented attorney's fees and out-of-pocket expenses) arising in connection with any such claim. Nothing herein shall be construed to hold Timberline responsible for any placement agent's fees, financial advisory fees, or brokers' commissions or similar fees or payments due in relation to or arising out of Jefferies' subsequent re-sale or transfer of the Exchange Shares, which fees or commissions remain the sole obligation of Jefferies;

6. Neither Timberline nor any person acting on its behalf, has, directly or indirectly, made any offers or sales of any security or solicited any offers to buy any security, under circumstances that would require registration of any of the Exchange Shares under the U.S. Securities Act or cause this offering of the Exchange Shares to be integrated with prior offerings by Timberline for purposes of the U.S. Securities Act. Neither Timberline nor any person acting on its behalf, will take any action or steps referred to in the preceding sentence that would require registration of the offer, issuance or sale of any of the Exchange Shares under the U.S. Securities Act or cause the offering of the Exchange Shares to be integrated with other offerings other than as required by this Agreement;

7. There are no legal or governmental actions, suits or proceedings pending or, to the best of Timberline's knowledge, threatened (i) against or affecting Timberline, (ii) which has as the subject thereof any officer or director of, or property owned or leased by, Timberline or (iii)

relating to environmental or discrimination matters, where in any such case (A) there is a reasonable possibility that such action, suit or proceeding might be determined adversely to Timberline or such officer or director, (B) any such action, suit or proceeding, if so determined adversely, would adversely affect the consummation of the transactions contemplated by this Agreement and (C) any such action, suit or proceeding is or would be material in the context of the sale of Exchange Shares.

8. Timberline has all necessary power and authority to issue and deliver the Exchange Shares; the Exchange Shares have been duly authorized, and, when duly issued and delivered to Jefferies pursuant to the terms of this Agreement, the Exchange Shares will be duly-issued, fully-paid and non-assessable securities of Timberline. None of the Exchange Shares will be issued in violation of any preemptive rights, rights of first refusal or other similar rights to subscribe for or purchase securities of Timberline;

9. this Agreement has been duly authorized by all necessary corporate action on the part of Timberline, and Timberline has full corporate power and authority to undertake its obligations under this Agreement and execute this Agreement;

10. this Agreement has been duly authorized, executed and delivered by Timberline and constitutes a valid and legally binding obligation of Timberline enforceable against it in accordance with its terms, except as enforcement thereof may be limited by bankruptcy, insolvency, reorganization, moratorium and other laws relating to or affecting the rights of creditors generally and except as limited by the application of equitable principles when equitable remedies are sought, and by the fact that rights to indemnity, contribution and waiver, and the ability to sever unenforceable terms, may be limited by applicable law;

11. no order ceasing, halting or suspending trading in securities of Timberline nor prohibiting the sale of such securities has been issued to and is outstanding against Timberline or its directors, officers or promoters, and, to the best of Timberline's knowledge, no investigations or proceedings for such purposes are pending or threatened;

12. neither Timberline nor any person acting on its or their behalf has engaged in or will engage in any form of "general solicitation" or "general advertising" (as such terms are used in Rule 502 (c) under Regulation D of the U.S. Securities Act) in the United States with respect to the Exchange Shares;

13. the shares of Timberline's common stock are registered pursuant to Section 12(b) of the Securities Exchange Act of 1934, as amended (the "Exchange Act") and are listed on the NYSE Amex, and Timberline has taken no action designed to, or likely to have the effect of, terminating the registration of the shares of common stock under the Exchange Act or delisting the shares of common stock from the NYSE Amex, nor has Timberline received any notification that the SEC is contemplating terminating such registration. Timberline represents that it has received notice of de-listing from the NYSE Amex, that the NYSE Amex has accepted Timberline's compliance plan pursuant to the rules of the NYSE Amex, and that as of the date of this Agreement Timberline is in compliance with such plan. Timberline shall cause the Exchange Shares to be listed on the NYSE Amex and shall use its commercially reasonable efforts to maintain the continued listing of its common shares on the NYSE Amex until the earlier of

twenty-four months after the execution of this Agreement or such date on which Jefferies shall have sold all the Exchange Shares;

14. any documents filed with the SEC by Timberline, at the time they were or hereafter are filed with the SEC, complied and will comply in all material respects with the requirements of the Exchange Act;

15. since March 31, 2009, there has been no material adverse change and no material adverse development in the business, properties, operations, condition (financial or otherwise), results of operations or prospects of Timberline; and

16. until the earlier of twenty-four months after the execution of this Agreement or such date on which Jefferies shall have sold all the Exchange Shares, Timberline shall timely file all reports required to be filed with the SEC pursuant to the Exchange Act, and Timberline shall not terminate its status as an issuer required to file reports under the Exchange Act even if the Exchange Act or the rules and regulations thereunder would otherwise permit such termination.

D. RELEASE

Subject to Section G(9) below, in consideration of the issuance of the Exchange Shares and the payment of the Exchange Cash as satisfaction, in full, of the Services Invoice, Jefferies (including its officers, employees, agents, representatives, assignees, and successors) hereby releases Timberline (including its officers, employees, agents, representatives, assignees, and successors) from any and all manner of action and causes of action, suits, debts, dues, accounts, contracts, agreements, judgments, claims and demands whatever, whether in law or in equity, which now exist or may subsequently arise out of the Services Invoice or the Engagement Agreements.

E. REGISTRATION RIGHTS

Within 30 days of the date hereof, Timberline agrees to include Jefferies or its nominee as a selling shareholder of the Exchange Shares in a registration statement under the U.S. Securities Act that Timberline will file with the SEC relating to the resale under the U.S. Securities Act of the Exchange Shares, and Timberline hereby agrees to cause such registration statement to become effective as quickly as practicable but in any event within 120 days of such filing and to use reasonable best efforts to ensure that such registration statement remains effective until the earlier of twenty-four months after the execution of this Agreement or such date on which Jefferies shall have sold all the Exchange Shares.

F. INDEMNITY

Timberline shall indemnify, defend and hold Jefferies harmless against any and all liabilities, loss, cost or damage, together with all reasonable costs and expenses related thereto (including reasonable legal and accounting fees and expenses), to the extent such are determined, by a final, non-appealable judgment by a court or arbitral tribunal, to have arisen from, related to, or connected with any untrue, inaccurate or breached statement, representation, warranty or covenant of Timberline set forth in this Agreement. Timberline undertakes for a period of 12

months after the execution of this Agreement to notify Jefferies within 2 business days of any change in any representation, warranty or covenant of Timberline set forth in this Agreement to be untrue.

Jefferies shall indemnify, defend and hold Timberline harmless against any and all liabilities, loss, cost or damage, together with all reasonable costs and expenses related thereto (including reasonable legal and accounting fees and expenses), to the extent such are determined, by a final, non-appealable judgment by a court or arbitral tribunal, to have resulted solely from Jefferies' gross negligence or willful misconduct under this Agreement.

G. MISCELLANEOUS PROVISIONS

1. Successors and Assigns. Except as otherwise provided herein, the terms and conditions of this Agreement shall inure to the benefit of and be binding upon the respective successors and assigns of the parties. Nothing in this Agreement, express or implied, is intended to confer upon any party, other than the parties hereto or their respective successors and assigns, any rights, remedies, obligations or liabilities under or by reason of this Agreement, except as expressly provided in this Agreement.

2. Governing Law. This Agreement shall be governed by and construed in accordance with the laws of the State of New York, without regards to conflict of law principles thereof.

3. Titles and Subtitles. The titles and subtitles used in this Agreement are used for convenience only and are not to be considered in construing or interpreting this Agreement.

4. Notices. All notices required or permitted hereunder shall be in writing and shall be deemed effectively given: (i) upon personal delivery to the party to be notified, (ii) when sent by confirmed telex or facsimile if sent during normal business hours of the recipient, if not, then on the next business day; (iii) five days after having been sent by registered or certified mail, return receipt requested, postage prepaid; or (iv) one day after deposit with a nationally recognized overnight courier, specifying next day delivery, with written verification of receipt, as follows:

If to Jefferies, to:	Jefferies & Company, Inc. 520 Madison Avenue New York, NY 10022 Attention: General Counsel
----------------------	---

If to Timberline, to:	Timberline Resources Corporation 101 E. Lakeside Coeur d'Alene, ID 83814 Attention: Randal Hardy
-----------------------	---

5. Amendments and Waivers. Any term of this Agreement may be amended and the observance of any term of this Agreement may be waived (either generally or in a

particular instance and either retroactively or prospectively), only with the written consent of Timberline and Jefferies.

6. Severability. If one or more provisions of this Agreement are held to be unenforceable under applicable law, such provision shall be excluded from this Agreement and the balance of the Agreement shall be interpreted as if such provision were so excluded and shall be enforceable in accordance with its terms.

7. Entire Agreement. This Agreement and the documents referred to herein constitute the entire agreement among the parties and no party shall be liable or bound to any other party in any manner by any warranties, representations or covenants except as specifically set forth herein or therein.

8. Counterparts. This Agreement may be executed in two or more counterparts, each of which shall be deemed an original, but all of which together shall constitute one and the same instrument.

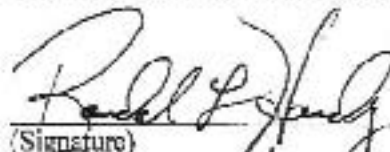
9. Material Breach of Agreement by Timberline. If prior to the earlier of twenty-four months after the execution of this Agreement or such date on which Jefferies shall have sold all the Exchange Shares, Timberline materially breaches any of the provisions of this Agreement, Jefferies shall promptly notify Timberline of any such material breach of the Agreement and demand that Timberline cure the breach. Upon receipt of the notice of a material breach of the Agreement and demand for cure from Jefferies, Timberline shall have 15 business days to cure the material breach to the satisfaction of Jefferies, not to be unreasonably withheld. If after the expiration of the 15-business-day cure period, the material breach of the Agreement has not been cured to the satisfaction of Jefferies, not to be unreasonably withheld, (A) all provisions of this Agreement except Sections F, G(2), G(4), G(6), G(9) and G(10) shall become null and void and (B) Jefferies shall be obligated to return any unsold Exchange Shares to Timberline. Upon surrender to Timberline of any unsold Exchange Shares, (A) the Service Invoice will be deemed "not satisfied", except that the amount of Fees owed to Jefferies under the Service Invoice shall be reduced by the Exchange Cash and the value of the aggregate proceeds received by Jefferies from the sale of any Exchange Shares, and (B) Jefferies will no longer be bound by the provisions of the release of section D of this Agreement.

10. Notice of Sales. To aid Timberline in meeting its obligations under this Agreement, until the earlier of twenty-four months from the date of execution of this Agreement or until such time as Jefferies has sold all of the Exchange Shares, Jefferies agrees to provide Timberline by the end of any month in which any sales or transfers of the Exchange Shares occurs with a notice detailing the number of Exchange Shares sold and the price at which such Exchange Shares are sold and Jefferies agrees to promptly notify Timberline when all Exchange Shares have been sold.

[SIGNATURE PAGE FOLLOWS]

IN WITNESS WHEREOF, the parties have executed this Agreement as of the date first above written.

TIMBERLINE RESOURCES CORPORATION:


(Signature)
Randal L. Hardy
(Print)
CEO
(Title)

JEFFERIES & COMPANY, INC.:



(Signature)
Jeffrey R. Whyte
(Print)
General Counsel - Investment Banking
(Title)

EXHIBIT A

Registration and Delivery Instructions

Registration Information

Registration of the certificates representing the securities should be made exactly as follows:
Jefferies & Company, Inc.

Delivery of Certificates

The certificates representing the securities is to be delivered as follows:

By overnight courier to:

**Mark Sahler
Jefferies & Company, Inc.
Harborside Financial Center
Plaza 3, Suite 705
Jersey City, New Jersey 07311**

INVOICE

Invoice Number: 7291
Invoice Date: 10/29/2008
Reference #: AEE87
Terms: Immediate

Timberline Resources Corporation
101 East Lakeside Avenue
Coeur d'Alene, ID 83814

Attention: Mr. John Swallow
Chairman of the Board

Re: Fairness Opinion and Expenses

Fairness Opinion	\$500,000.00
Jones Day Legal Fee	\$377,819.28
M&A and Financing Jefferies Expenses	\$46,337.46

TOTAL DUE **\$923,956.74**

Payment Details

Wire Instructions

Bank of New York
ABA #021000018
A/C: Jefferies & Company, Inc.
A/C #890-000-7901

Check Payment Instructions

Jefferies & Company, Inc.
11100 Santa Monica Blvd.
12th Floor
Los Angeles, CA 90025

Reference: AEE87-7291-Timber

CERTIFICATION

I, Randal Hardy, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q 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 registrant as of, and for, the periods presented in this report;
4. The registrant'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)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant 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 registrant, 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) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant'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
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (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 registrant'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 registrant's internal control over financial reporting.

Date: August 12, 2009

By: /s/ Randal Hardy

Randal Hardy
 Chief Executive Officer & Chief Financial Officer
 Principal Executive and Financial Officer

CERTIFICATION

I, Craig Crowell, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q 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 registrant as of, and for, the periods presented in this report;
4. The registrant'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)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant 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 registrant, 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) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant'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
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (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 registrant'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 registrant's internal control over financial reporting.

Date: August 12, 2009

By: /s/ Craig Crowell

Craig Crowell
Chief Accounting Officer
Principal Accounting Officer

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-Q for the period ended June 30, 2009, 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: August 12, 2009

By: /s/ Randal Hardy

Randal Hardy
Chief Executive Officer & Chief Financial Officer
Principal Executive and Financial Officer

The foregoing certification is being furnished solely pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (Section 1350 of Chapter 63 of Title 18 of the United States Code) and is not being filed as part of the Report or as a separate disclosure document.

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-Q for the period ended June 30, 2009, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Craig Crowell, Chief Accounting 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: August 12, 2009

By: /s/ Craig Crowell

Craig Crowell
Chief Accounting Officer
Principal Accounting Officer

The foregoing certification is being furnished solely pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (Section 1350 of Chapter 63 of Title 18 of the United States Code) and is not being filed as part of the Report or as a separate disclosure document.