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, 2010

OR

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

For the transition period from to

Commission file number: 001-34055

TIMBERLINE RESOURCES CORPORATION

(Exact Name of Registrant as Specified in its Charter)

DELAWARE	**82-0291227**
(State of other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
101 EAST LAKESIDE AVENUE **COEUR D'ALENE, IDAHO**	**83814**
(Address of Principal Executive Offices)	(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 10, 2010: 55,645,778

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PART I — FINANCIAL INFORMATION

ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

TIMBERLINE RESOURCES CORPORATION AND SUBSIDIARIES

Consolidated Financial Statements

June 30, 2010

Timberline Resources Corporation and Subsidiaries

Contents

TIMBERLINE RESOURCES CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

	June 30, 2010 (unaudited)	September 30, 2009 (audited)
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 6,278,711	$ 969,784
Accounts receivable, net of allowance for doubtful accounts of $257,456	1,410,368	1,422,951
Materials and supplies inventory	1,584,112	1,088,428
Prepaid expenses and other current assets	405,221	609,545
Note and accrued interest receivable from related party	101,500	-
TOTAL CURRENT ASSETS	9,779,912	4,090,708
PROPERTY, MINERAL RIGHTS AND EQUIPMENT:		
Property, mineral rights and equipment, net	18,661,250	6,302,531
TOTAL PROPERTY, MINERAL RIGHTS AND EQUIPMENT	18,661,250	6,302,531
OTHER ASSETS:		
Investment in joint venture	621,000	621,000
Restricted cash	141,986	42,687
Deposits and other assets	222,795	158,777
Goodwill	2,808,524	2,808,524
TOTAL OTHER ASSETS	3,794,305	3,630,988
TOTAL ASSETS	$ 32,235,467	$ 14,024,227
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Accounts payable	$ 1,908,137	$ 1,222,901
Accrued expenses	631,980	813,418
Accrued payroll and benefits	694,343	247,932
Accrued taxes	376,940	473,865
Current portion of long-term debt	281,860	159,320
Current portion of obligations under capital leases	333,666	403,820
Current portion of customer advances	300,000	600,000
Deferred revenue	35,000	-
TOTAL CURRENT LIABILITIES	4,561,926	3,921,256
LONG-TERM LIABILITIES:		
Convertible note payable to related party	5,000,000	5,000,000
Long-term debt, net of current portion	875,972	237,638
Obligations under capital leases, net of current portion	380,659	167,632
Asset retirement obligation	256,341	-
Accrued interest on convertible note payable to related party	-	477,916
Customer advances, net of current portion	-	150,000
TOTAL LONG-TERM LIABILITIES	6,512,972	6,033,186
COMMITMENTS AND CONTINGENCIES (NOTE 13)	-	-
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, 55,645,778 and 36,045,111 shares issued and outstanding, respectively	55,646	36,045
Additional paid-in capital	48,891,593	29,164,116
Accumulated deficit	(27,786,670)	(25,130,376)
TOTAL STOCKHOLDERS' EQUITY	21,160,569	4,069,785
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 32,235,467	$ 14,024,227

See accompanying notes to consolidated financial statements.

TIMBERLINE RESOURCES CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS

	Three Months Ended June 30, 2010 (unaudited)	Three Months Ended June 30, 2009 (unaudited)	Nine Months Ended June 30, 2010 (unaudited)	Nine Months Ended June 30, 2009 (unaudited)
REVENUES	$ 6,440,783	$ 4,361,137	$ 15,668,852	$ 12,545,217
COST OF REVENUES	5,410,889	3,558,958	12,933,380	12,175,705
GROSS PROFIT	1,029,894	802,179	2,735,472	369,512
OPERATING EXPENSES:				
Mineral exploration expenses	249,501	61,561	535,633	374,180
Salaries and benefits	373,639	362,597	1,344,470	1,928,868
Insurance expense	156,260	120,334	400,812	432,998
Professional fees expense (recovery)	246,861	(390,731)	858,121	1,170,947
Severance expense (recovery)	-	-	51,300	(350,000)
Other general and administrative expenses	626,750	380,508	1,799,788	1,426,239
TOTAL OPERATING EXPENSES	1,653,011	534,269	4,990,124	4,983,232
INCOME (LOSS) FROM OPERATIONS	(623,117)	267,910	(2,254,652)	(4,613,720)
OTHER INCOME (EXPENSE):				
Other income	1,010	52,339	43,080	90,118
Foreign exchange gain (loss)	(29,482)	81,020	31,821	(16,064)
Loss on derivative	-	-	-	(154,064)
Related party interest income	1,500	-	1,500	-
Interest income	3,732	7,101	15,000	29,126
Related party interest expense	(145,142)	(131,385)	(424,807)	(343,220)
Interest expense	(23,201)	(35,924)	(68,236)	(843,723)
TOTAL OTHER EXPENSE	(191,583)	(26,849)	(401,642)	(1,237,827)
NET INCOME (LOSS) BEFORE INCOME TAXES	(814,700)	241,061	(2,656,294)	(5,851,547)
INCOME TAX RECOVERY	-	-	-	145,089
NET INCOME (LOSS)	$ (814,700)	$ 241,061	$ (2,656,294)	$ (5,706,458)
NET INCOME (LOSS) PER SHARE AVAILABLE TO COMMON STOCKHOLDERS, BASIC AND DILUTED	$ (0.02)	$ 0.01	$ (0.06)	$ (0.17)
WEIGHTED AVERAGE NUMBER OF COMMON SHARES OUTSTANDING, BASIC AND DILUTED	45,662,405	34,916,155	41,617,487	32,996,638

See accompanying notes to consolidated financial statements.

TIMBERLINE RESOURCES CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

	Nine Months Ended June 30, 2010 (unaudited)	Nine Months Ended June 30, 2009 (unaudited)
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	$ (2,656,294)	$ (5,706,458)
Adjustments to reconcile net loss to net cash used by operating activities:		
Depreciation and amortization	1,073,735	1,034,758
Loss (gain) on disposal of equipment	50,625	(54,339)
Stock based compensation	555,839	1,023,043
Accretion of asset retirement obligation	6,252	-
Other non cash compensation	33,845	-
Inventory write-down	60,916	-
Impairment of mineral rights	35,000	55,000
Deferred offering and acquisition costs	-	923,957
Amortization of deferred financing cost	-	202,550
Allowance for doubtful accounts	-	100,000
Loss on derivative	-	154,064
Severance recovery	-	(350,000)
Accrued offering and acquisition costs	-	(527,207)
Changes in assets and liabilities:		
Accounts receivable	12,583	2,166,996
Materials and supplies inventory	(556,600)	699,677
Prepaid expenses and other current assets, deposits and other assets	159,990	50,998
Interest on note receivable from related party	(1,500)	-
Accounts payable	685,236	(1,067,256)
Accrued expenses	(181,438)	(56,272)
Accrued payroll and benefits	446,411	(121,268)
Accrued taxes	(96,925)	(1,704,800)
Accrued interest on convertible note payable to related party	(477,916)	343,219
Deferred revenue	35,000	(27,315)
Accrued severance	-	(50,000)
Net cash used by operating activities	(815,241)	(2,910,653)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of property, mineral rights and equipment	(960,693)	(232,169)
Change in restricted cash	(45,041)	243,877
Proceeds from sale of equipment	21,805	1,247,039
Net cash acquired in acquisition of Staccato Gold Resources Ltd.	4,421,033	-
Note receivable from related party	(100,000)	-
Net cash provided by investing activities	3,337,104	1,258,747
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from issuances of stock and warrants, net of stock offering costs	2,807,162	-
Proceeds from exercise of warrants	542,972	-
Proceeds from exercise of options	442,941	-
Deferred financing costs	(50,000)	-
Payments on long term debt	(159,305)	(299,426)
Payments on capital leases	(346,706)	(461,314)
Payments on customer advances	(450,000)	(100,000)
Repayment of bridge loan financing	-	(8,000,000)
Proceeds from short term convertible note	-	5,000,000
Proceeds from convertible note payable to related party	-	5,000,000
Proceeds from long term debt	-	150,000
Proceeds from customer advances	-	1,000,000
Net cash provided by financing activities	2,787,064	2,289,260
Net increase in cash and cash equivalents	5,308,927	637,354
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	969,784	737,503
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$ 6,278,711	$ 1,374,857

TIMBERLINE RESOURCES CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

	Nine Months Ended June 30, 2010 (unaudited)	Nine Months Ended June 30, 2009 (unaudited)
NON-CASH FINANCING AND INVESTING ACTIVITIES:		
Fair value of common stock, warrants and options issued in connection with an acquisition (see Note 6)	$ 15,398,164	$ -
Initial measurement of asset retirement obligation	250,089	-
Long term debt issued for property and equipment purchase	920,179	-
Capital lease for equipment purchase	489,579	-
Other current asset exchanged for equipment	100,000	-
Long term debt refinancing	128,263	180,692
Conversion of short term convertible note into common stock	-	5,000,000
Settlement of put option with common stock	-	246,400
Account receivable exchanged for equipment	-	104,220

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").

On June 2, 2010, the Company acquired Staccato Gold Resources Ltd. ("Staccato"), a Canadian corporation, engaged in the exploration for precious metal deposits and advancing them to production (See Note 6).

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, 2010 are not necessarily indicative of the results that may be expected for the full year ending September 30, 2010.

   For further information refer to the financial statements and footnotes thereto in the Company's Annual Report on Form 10-K for the year ended September 30, 2009.

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. 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, 2009.

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.

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

h. *Provision for Taxes* – Income taxes are provided based upon the liability method of accounting. 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 estimates the fair value of its stock based compensation using 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 securities, in periods of future income as of June 30, 2010 and 2009, would be as follows:

	June 30, 2010	June 30, 2009
Stock options	4,833,641	4,631,669
Warrants	8,050,375	1,337,934
Convertible debt	3,333,333	3,562,146
Total possible dilution	16,217,349	9,531,749

At June 30, 2010 and 2009, the effect of the Company’s outstanding options and common stock equivalents would have been anti-dilutive.

k. *Asset retirement obligation* – The Company accounts for asset retirement obligations by following the uniform methodology for accounting for estimated reclamation and abandonment costs as prescribed by authoritative accounting guidance. This guidance provides that the fair value of a liability for an asset retirement obligation (“ARO”) will be recognized in the period in which it is incurred if a reasonable estimate of fair value can be made. The ARO is capitalized as part of the carrying value of the assets to which it is associated, and depreciated over the useful life of the asset. The Company has an ARO associated with its underground exploration program at the Butte Highlands Gold Project (see Note 7).

l. *New accounting pronouncements* – In September 2006, the Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”) was updated to establish a framework for measuring fair value and expand disclosure about fair value measurements, but does not require any new fair value measurements. Effective October 1, 2008, the Company adopted the updated guidance for our financial assets and financial liabilities without a material effect on the Company’s consolidated financial statements. In February 2008, the FASB issued an update to the guidance which delayed the effective date for non-financial assets and non-financial liabilities to fiscal years beginning after November 15, 2008. Effective October 1, 2009, the Company adopted the updated guidance for non-financial assets and non-financial liabilities without a material effect on the Company’s consolidated financial statements.

In December 2007, the ASC guidance for business combinations was updated to provide new guidance for recognizing and measuring identifiable assets and goodwill acquired, liabilities assumed, and any noncontrolling interest in the acquire. The updated guidance also provides disclosure requirements to enable users of the financial statements to evaluate the nature and financial effects of the business combination. Effective October 1, 2009, the Company adopted the updated guidance for business combinations.

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

In December 2007, the ASC guidance for non-controlling interests was updated to establish accounting and reporting standards for minority interests, which will be re-characterized as non-controlling interests and classified as a component of equity. The updated guidance requires retroactive adoption of the presentation and disclosure requirements for existing minority interests. The updated guidance is effective for fiscal years beginning on or after December 15, 2008 and interim periods within those fiscal years. Effective October 1, 2009 the Company adopted the updated guidance without a material effect on the Company's consolidated financial statements.

In March 2008, the ASC guidance for derivatives and hedging was updated to require enhanced disclosures about an entity's derivative and hedging activities and thereby improve the transparency of financial reporting. The updated guidance is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged. The updated guidance encourages, but does not require, comparative disclosures for earlier periods at initial adoption. Effective October 1, 2009 the Company adopted the updated guidance without a material effect on the Company's consolidated financial statements.

In May 2008, the ASC guidance identifying 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 was updated. The guidance was effective November 15, 2008 and its adoption did not have a material effect on the Company's consolidated financial statements.

In May 2009, the ASC guidance for subsequent events was updated to establish 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 adopted the updated guidance 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.

In June 2009, the ASC guidance for consolidation accounting was updated 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 this updated guidance in fiscal year 2011 and is currently evaluating the impact of adopting this guidance on the consolidated financial statements.

In January 2010, the ASC guidance for fair value measurements was updated to require additional disclosures related to movements of assets among Levels 1 and 2 of the three-tier fair value hierarchy. Also, a reconciliation of purchases, sales, issuance, and settlements of anything valued with a Level 3 method is required. Disclosure regarding fair value measurements for each class of assets and liabilities will be required. The updated guidance was adopted by the Company in its quarter ending December 31, 2009, except for disclosures about the activity in Level 3 fair value measurements which are effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years. Adoption of this updated guidance did not have a material impact on the Company's consolidated financial statements.

NOTE 3 – FAIR VALUE MEASUREMENTS:

Effective October 1, 2008 for financial assets and liabilities, and October 1, 2009 for non-financial assets and liabilities, the Company has adopted expanded disclosure requirements to include the following information for each major category of assets and liabilities that are measured at fair value on a recurring or non recurring basis:

a. the fair value measurement;

b. the level within the fair value hierarchy in which the fair value measurements in their entirety fall, segregating fair value measurements using quoted prices in active markets for identical assets or liabilities (Level 1), significant other observable inputs (Level 2), and significant unobservable inputs (Level 3);

NOTE 3 – FAIR VALUE OF FINANCIAL INSTRUMENTS, (continued):

c. for fair value measurements using significant unobservable inputs (Level 3), a reconciliation of the beginning and ending balances, separately presenting changes during the period attributable to the following:

1) total gains or losses for the period (realized and unrealized), segregating those gains or losses included in earnings (or changes in net assets), and a description of where those gains or losses included in earnings (or changes in net assets) are reported in the statement of income (or activities);

2) the amount of these gains or losses attributable to the change in unrealized gains or losses relating to those assets liabilities still held at the reporting period date and a description of where those unrealized gains or losses are reported;

3) purchases, sales, issuances, and settlements (net); and

4) transfers in and/or out of Level 3.

The table below sets forth our assets and liabilities that were accounted for at fair value on a recurring basis as of June 30, 2010 and September 30, 2009, and the fair value calculation input hierarchy level that we have determined applies to each asset and liability category.

	June 30, 2010	September 30, 2009	Input Hierarchy Level
Assets:			
Cash and cash equivalents	$ 6,278,711	$ 969,784	Level 1
Restricted cash	141,986	42,687	Level 1
Investment in Rae Wallace	50,000	50,000	Level 2

The Company has one nonfinancial liability, its asset retirement obligation, that is accounted for at fair value on a non-recurring basis. Estimates of our asset retirement obligations fall within Level 3 of the fair value hierarchy, as the estimates of environmental remediation costs involve unobservable inputs.

NOTE 4 – CUSTOMER ADVANCES:

During the year ended September 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 being 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, 2010 and September 30, 2009, customer advances were $300,000 and $750,000, respectively, and $150,000 of the remaining customer advance balance was classified as a long-term liability as of September 30, 2009.

NOTE 5 – INVESTMENT IN JOINT VENTURE:

In July 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, carried on its balance sheet at the original purchase price of the Butte Highlands project ($621,000) 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 development costs will be paid from proceeds of 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.

NOTE 6 – ACQUISITION OF STACCATO GOLD RESOURCES LTD.:

On June 2, 2010, the Company completed its acquisition of all of the issued and outstanding common shares of Staccato Gold Resources Ltd. ("Staccato"), by way of a court approved Plan of Arrangement under the Business Corporations Act (British Columbia) in accordance with the terms of an Arrangement Agreement, dated March 22, 2010, by and between the Company and Staccato. The acquisition was also approved by the Timberline stockholders and Staccato's securityholders. Staccato was a publicly held Canadian corporation engaged in the exploration of precious metals properties in Nevada. Timberline acquired Staccato in order to further the exploration and development of mineral properties owned or leased by Staccato, as well as to increase the working capital of the Company.

This transaction was accounted for as a business combination. The Company acquired all of the issued and outstanding common shares of Staccato in consideration for the issuance of one share of common stock of the Company for every seven common shares of Staccato and $0.0001 in cash for each common share of Staccato. In addition, the Company acquired all of the issued and outstanding warrants to purchase common shares of Staccato and options to purchase common shares of Staccato, after giving effect to the exercise and cancellation of certain options immediately prior to closing, in consideration for the issuance by the Company of a warrant to purchase one share of common stock of the Company for every seven Staccato warrants or an option to purchase one share of common stock of the Company for every seven Staccato options, as applicable. Pre-acquisition Timberline shareholders own approximately 74% of the issued and outstanding common stock of the Company as of the acquisition date and former Staccato shareholders own approximately 26%. On a fully diluted basis, Timberline is owned 71% by pre-acquisition Timberline shareholders and 29% by former Staccato shareholders as of the acquisition date.

The purchase price of the transaction was $15,435,199, consisting of the issuance of 14,301,380 shares of Timberline common stock valued at $14,444,394; 6,352,437 warrants to purchase one share of Timberline common stock valued at $889,341; 102,143 options to purchase one share of Timberline common stock valued at $64,429; and cash of $37,035. The Company incurred $214,477 in expenses related to the acquisition, $205,541 of which are included in professional fees expense, $5,800 are included in mineral exploration expenses and $3,136 are included in other general and administrative expenses in the consolidated statement of operations.

Timberline's common stock issued as consideration was valued based upon the closing price of $1.01 per share of our common stock on the NYSE Amex on June 2, 2010. The warrants and options that were issued as consideration were valued on that date using the Black-Scholes pricing model, based upon the following principal assumptions:

	Warrants	**Options**
Risk-free interest rate	0.38%	0.22% - 1.30%
Dividend yield	N/A	N/A
Volatility factor	106.1%	57.7% - 121.6%
Remaining period to expiry date – warrants (weighted average) / Expected term - options	1.13 years	0.60 – 2.90 years

The purchase price allocation of the acquisition is summarized as follows:

Purchase price:		
Shares issued on acquisition	$	14,444,394
Warrants		889,341
Options		64,429
Cash		37,035
	$	15,435,199
Net assets acquired:		
Cash and cash equivalents	$	4,458,068
Other current assets		69,684
Restricted cash		54,258
Property, mineral rights and equipment, net		10,853,189
	$	15,435,199

The consolidated statement of operations of the Company for the three months and nine months ended June 30, 2010 includes expenses incurred by Staccato of $90,356 and no revenue since the acquisition date.

NOTE 6 – ACQUISITION OF STACCATO GOLD RESOURCES LTD., (continued):

The unaudited pro forma financial information below represents the combined results of the Company's operations as if the Staccato acquisition had occurred at the beginning of the periods presented. The unaudited pro forma financial information is presented for informational purposes only and is not indicative of the results of operations that would have occurred if the acquisition had taken place at the beginning of the periods presented, nor is it indicative of future operating results. The unaudited pro forma loss from operations, net loss and net loss per share available to common stockholders, basic and diluted, for the three months and nine months ended June 30, 2010 includes non-recurring severance and professional expenses incurred by Staccato in the amount of $1,622,248.

	Three months ending June 30		Nine months ending June 30	
	2010	**2009**	**2010**	**2009**
Revenues	$ 6,440,783	$ 4,361,137	$ 15,668,852	$ 12,545,217
Loss from operations	(2,707,852)	(127,568)	(5,349,653)	(3,475,987)
Net loss	(2,883,313)	(130,663)	(5,698,931)	(3,466,251)
Net loss per share available to common stockholders, basic and diluted	(0.05)	Nil	(0.10)	(0.07)

NOTE 7 – RELATED PARTY TRANSACTIONS:

Related party notes payable consist of the following at June 30, 2010 and September 30, 2009:

	June 30, 2010	**September 30, 2009**
Small Mine Development, LLC	$ 5,000,000	$ 5,000,000
Accrued interest on note payable to Small Mine Development, LLC	$ -	$ 477,916

On October 31, 2008, the Company entered into a series of agreements in connection with a $5 million loan from Small Mine Development, LLC ("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., as well as 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 the guidance provided in the ASC for derivatives and hedging. Management's conclusion was that these convertible features are conventional convertible instruments and thus would qualify for equity classification. As conventional convertible instruments, the embedded conversion options qualify for the scope exception provided in the guidance for derivatives and hedging, and therefore would not be bifurcated from the host instrument.

The Convertible Term Note was to 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.

NOTE 7 – RELATED PARTY TRANSACTIONS, (continued):

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.

In June 2010, SMD agreed to extend the Maturity Date of the Convertible Term Note to on or before April 30, 2012. All interest accrued through June 30, 2010 was paid by the Company to SMD at that time. The Company also paid a $50,000 extension fee to SMD in consideration for the extension of the Convertible Term Note. The extension fee has been recorded as a deferred financing cost and is being amortized over the life of the loan. The Convertible Term Note was also amended to require interest accrued subsequent to June 30, 2010 to be paid by the Company to SMD monthly, rather than accruing interest to maturity. All other terms of the loan were unchanged.

Butte Highlands Joint Venture Agreement

On October 27, 2008 the Company announced it had entered into discussions with Mr. Guill to form a 50/50 joint venture with SMD at Timberline's 100-percent owned Butte Highlands Gold Project.

On July 22, 2009, the Company entered into an Operating Agreement with Highland Mining, LLC ("Highland"), an affiliate of SMD, to form a 50/50 joint venture for development and mining of the Company's Butte Highlands Gold Project (See Note 5). Under the terms of the operating agreement, the Company contributed its Butte Highlands property to BHJV for a deemed value of $2 million, and Highland contributed property and will fund all future mine development costs. Both the Company's and Highland's share of costs will be paid out of proceeds from future mine production.

Mr. Guill, a director of the Company and an owner of Highland, will be the manager of BHJV until such time as income in an amount equal to all mine development costs less $2 million is distributed to Highland. At that time, a management committee, with equal representation from Highland and the Company, will be the manager of BHJV. Under the terms of the Operating Agreement, Highland will have preferential rights with respect to distributions until the investment by Highland is deemed equal to the investment by the Company.

At June 30, 2010 and September 30, 2009, the Company has a receivable from BHJV for expenses incurred on behalf of BHJV in the amount of $8,998 and $167,073, respectively. This amount is included in prepaid expenses and other current assets on the consolidated balance sheets at June 30, 2010 and September 30, 2009.

Swallow Consulting Agreement

In December 2009 the Company entered into an agreement with John Swallow, a former director and former executive of the Company, to provide advisory services as needed and requested by the Company through June 30, 2010. In exchange for these services the Company paid Mr. Swallow $170,000.

Bridge Loan to Rae Wallace Mining Company

In May 2010, the Company entered into an agreement with Rae Wallace Mining Company ("Rae Wallace"), a corporation and related party, to provide bridge loan financing. An unsecured loan for $100,000 was made by the Company to Rae Wallace, with an annual interest rate of 12%, due August 31, 2010. The loan balance receivable of $100,000, as well as interest receivable of $1,500, is included in note and accrued interest receivable from related party on the consolidated balance sheet at June 30, 2010. Subsequent to June 30, 2010, the entire loan balance was repaid, along with $2,467 of interest accrued up to the date of repayment, and the loan agreement was cancelled.

NOTE 8 – ASSET RETIREMENT OBLIGATION:

The Company has an asset retirement obligation ("ARO") associated with the underground exploration program at the Butte Highlands Gold Project being performed by BHJV (see Note 5). The ARO resulted from the reclamation and remediation requirements of the Montana Department of Environmental Quality as outlined in the Company's permit to carry out the exploration program.

NOTE 8 – ASSET RETIREMENT OBLIGATION, (continued):

Estimated reclamation costs were discounted using a credit adjusted risk-free interest rate of 5% from the time the Company expects to pay the retirement obligation to the time it incurred the obligation, which is estimated at 12 years.

The following table summarizes activity in the Company's ARO.

	Nine Months Ended June 30, 2010
Balance at September 30, 2009	-
Initial measurement	$ 250,089
Accretion expense	6,252
Balance at June 30, 2010	$ 256,341

NOTE 9 – INCOME TAXES:

During the three months and nine months ended June 30, 2010, the Company realized no income tax benefit or provision. During the three months and nine months ended June 30, 2009 the Company realized an income tax benefit of none and $145,089, respectively for Mexican income taxes.

For the fiscal year ending September 30, 2010 the Company anticipates an effective income tax rate of 31% in Mexico, 0% in the United States and 0% in Canada due to the availability of accumulated net operating losses to offset any U.S. and Canadian income taxes.

NOTE 10 – COMMON STOCK AND WARRANTS:

During November 2009, the Company initiated a private placement of the Company's restricted common stock. Under the private placement subscription agreement, the Company could sell up to 3,000,000 units at a price of $1.00 per unit for a total of $3,000,000. The Company reserved the right to increase the amount of the offering in the event that the offering was oversubscribed. Each unit consisted of one share of common stock and one half of one Class A Warrant; with each whole warrant exercisable to acquire one additional share of common stock at an exercise price of $1.50 per share until May 31, 2010, and thereafter at an exercise price of $1.75 per share until March 25, 2011. No registration rights were granted for the shares of common stock or the shares of common stock underlying the warrants. The units were sold for $1.00 each, representing management's estimate of the fair value of the unit. The Company sold a total of 3,003,400 units for gross proceeds of $3,003,400 and the placement closed on November 23, 2009. The Company incurred $196,238 in expenses with respect to the offering, resulting in net proceeds of $2,807,162. In connection with the offering, the Company also issued 196,238 warrants, with the same terms of exercise as described above, to brokers acting as agents for the private placement. The value of the 1,697,638 issued warrants, using the Black-Scholes option pricing model with a risk free interest rate of 0.29%, stock price on the date of closing of $1.18, volatility of 153.4%, dividend yield of 0% and an expected life equal to the term of the warrants, was $1,120,441.

In September 2009, the Company amended the terms of the Company's outstanding warrants to encourage warrant holders to exercise their warrants. At September 30, 2009, the Company had 1,337,934 warrants outstanding with an exercise price of $3.50 and expiration dates between September 30, 2009 and October 11, 2009. In order to induce the exercise of the warrants, the Company's Board of Directors authorized that the exercise price of the warrants be reduced. The amended exercise price for each warrant was $0.50. Additionally, to permit holders of the warrants adequate time to contemplate the repricing, the expiration dates of the warrants was extended until October 16, 2009. 1,085,944 of the 1,337,934 outstanding warrants were exercised by warrant holders on or before October 16, 2009, generating proceeds to the Company of $542,972.

NOTE 10 – COMMON STOCK AND WARRANTS, (continued):

In June 2010, as part of the Company's acquisition of Staccato, 6,352,437 warrants were issued in exchange for outstanding Staccato warrants at the June 2, 2010 acquisition date. The warrants have an exercise price of $3.34 and have terms expiring between July 4, 2011 and August 16, 2011. The value of the 6,352,437 issued warrants, using the Black-Scholes option pricing model with a risk free interest rate of 0.38%, stock price on the date of closing the Staccato acquisition of $1.01, volatility of 106.1%, dividend yield of 0% and an expected life equal to the term of the warrants, was $889,341. This value was included as part of the cost of the acquisition (see Note 6).

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

	Warrants		Weighted Average Exercise Price
Outstanding at September 30, 2009	1,337,934	$	0.50
Issued	8,050,375		3.00
Exercised	(1,085,944)		0.50
Expired	(251,990)		0.50
Outstanding at June 30, 2010[1]	8,050,375	$	3.00

[1] These warrants expire as follows:

Warrants	Price	Expiration Date
1,697,938	$1.75	March 25, 2011
2,485,488	$3.34	July 4, 2011
1,744,500	$3.34	July 18, 2011
1,362,857	$3.34	August 9, 2011
759,592	$3.34	August 16, 2011
8,050,375		

NOTE 11 – STOCK OPTIONS:

The Company has established the 2005 Equity Incentive Plan (as amended by shareholders of the Company on May 28, 2010) to authorize the granting of up to 10,000,000 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 fair market value of the Company's stock at the date of grant.

The fair value of option awards granted during the nine months ended June 30, 2010 and 2009, 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 $14,082 and $38,543 for the three months ended June 30, 2010 and 2009, and $273,319 and $828,330 for the nine months ended June 30, 2010 and 2009, respectively. These costs are classified under salaries and benefits expense. Total compensation cost charged against operations under the plan for directors and consultants was $7,082 and $7,950 for the three months ended June 30, 2010 and 2009, and $240,544 and $172,153 for the nine months ended June 30, 2010 and 2009, respectively. These costs are classified under other general and administrative expenses. During the three months ended June 30, 2010 the Company also granted 102,143 options as partial consideration for the acquisition of Staccato Gold Resources Ltd. The $64,429 fair value of these options was included as part of the cost of the acquisition (see Note 6).

NOTE 11 – STOCK OPTIONS, (continued):

	Nine months ending	
	June 30, 2010	**June 30, 2009**
Expected volatility	57.70% - 113.50%	105.30% - 106.60%
Weighted-average volatility	113.33%	106.60%
Expected dividends	-	-
Expected term (in years)	0.60 - 3.00	3.00
Risk-free rate	0.22% - 1.38%	1.02% - 1.38%
Expected forfeiture rate	0% - 10%	10%

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, 2009	6,235,168	$ 0.92
Granted	202,143	1.19
Exercised	(1,262,003)	0.44
Expired and forfeited	(341,667)	1.94
Outstanding at June 30, 2010	4,833,641	$ 0.99
Exercisable at June 30, 2010	3,938,148	$ 1.09
Weighted average fair value of options granted during the nine months ended June 30, 2010		$ 0.67

The average remaining contractual term of the options outstanding and exercisable at June 30, 2010 was 3.28 and 3.24 years, respectively. Of the options exercised, 286,668 were on a cashless basis, resulting in the issuance of 198,108 shares based on the current price of the Company's stock on the date of exercise. The Company received $442,941 from the exercise of the remaining 975,335 options. As of June 30, 2010, total unrecognized compensation expense related to options was $311,077 and the related weighted-average period over which it is expected to be recognized is approximately 0.34 years. The aggregate intrinsic value of options exercised during the nine months ended June 30, 2010 and 2009 was $776,096 and $52,500, respectively. The aggregate intrinsic value of options outstanding and exercisable as of June 30, 2010 was $1,770,794 and $1,316,138, respectively.

NOTE 12 – 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 13 – 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, and offices and a shop of Timberline Drilling in Coeur d'Alene, Idaho. 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 $48,265 and $72,168 for the three months ended June 30, 2010 and 2009, respectively, and $159,001 and $219,830 for the nine months ended June 30, 2010 and 2009, respectively.

NOTE 13 – COMMITMENTS AND CONTINGENCIES, (continued):

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, 2010, the balance of those unpaid interest and penalties is $272,105 and is included in accrued taxes on the consolidated balance sheet.

The Company has negotiated tacit approval to a payment plan with the IRS relating to the unpaid interest and penalties owed as of June 30, 2010. In April 2009, the Company began making $10,000 monthly installment payments on the outstanding balance of interest and penalties, increasing to $30,000 per month in April 2010. During the year ended September 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.

NOTE 14 – SEGMENT INFORMATION:

The Company has three operating segments at June 30, 2010: drilling revenues from Timberline Drilling; drilling revenues in Mexico through Timberline Drilling's subsidiary, World Wide Exploration; and Timberline's exploration activities, including exploration activities performed by Staccato.

Segment information for the three months and nine months ended June 30, 2010 and 2009 are as follows:

	Three months ending June 30		Nine months ending June 30	
Revenues:	**2010**	**2009**	**2010**	**2009**
Timberline	$ -	$ -	$ -	$ -
Timberline Drilling	5,871,331	3,592,474	14,238,348	8,823,389
World Wide Exploration	649,265	768,663	1,510,317	3,721,828
Elimination of intersegment revenues	(79,813)	-	(79,813)	-
Total revenues	$ 6,440,783	$ 4,361,137	$ 15,668,852	$ 12,545,217
Income / (Loss) before income taxes:				
Timberline	$ (1,078,324)	$ (91,033)	$ (3,294,595)	$ (4,071,881)
Timberline Drilling	637,265	270,380	1,418,867	(1,536,892)
World Wide Exploration	(373,641)	61,714	(780,566)	(242,774)
Income / (Loss) before income taxes	$ (814,700)	$ 241,061	$ (2,656,294)	$ (5,851,547)

Total assets:	**June 30, 2010**	**September 30, 2009**
Timberline	$ 17,640,228	$ 1,323,051
Timberline Drilling	12,264,831	9,997,792
World Wide Exploration	2,330,408	2,703,384
Total assets	$ 32,235,467	$ 14,024,227

NOTE 14 – SEGMENT INFORMATION, (continued):

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-K for the fiscal year ended September 30, 2009, 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, 2010, revenues from transactions with two customers and one customer, respectively, amounted to 10% or more of our total revenues. Customer A accounted for revenue of $5,660,810 and $13,950,773 during the three months and nine months ended June 30, 2010, respectively. The revenue for customer A is reported through Timberline Drilling. Customer B accounted for revenue of $649,265 during the three months ended June 30, 2010 but did not amount to 10% or more of total revenues for the nine months ended June 30, 2010. 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 it is not generating revenues from the sale of its properties, but the Company is actively exploring several properties for their mining potential.

NOTE 15 – SUBSEQUENT EVENTS

Settlement of Litigation

In January 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"). Subsequent to June 30, 2010, the parties entered into a mutual settlement and release whereby Elloway and American Drilling agreed to pay Timberline $150,000 in exchange for releasing Elloway and American Drilling from the complaint. The parties also mutually agreed to releases from any future litigation by all parties.

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-K for the year ended September 30, 2009, filed with the Securities and Exchange Commission on December 8, 2009 and under the heading "Item 1A. Risk Factors" in this quarterly report. 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, except as otherwise required by law.

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 Dircksen, the addition of Randal Hardy, our acquisition of a drilling services company, and the acquisition of Butte Highlands, we diversified our business plan to include drilling services and an underground mine with possible gold production. 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. In June 2010, the Company acquired Staccato Gold Resources Ltd., a Canadian corporation, engaged in exploring for precious metal deposits in Nevada and advancing them to production.

Timberline Resources is a diversified gold company comprised of three complementary business units: an underground mine with possible gold production, exploration, and drilling services. Its vertically-integrated business model provides investors exposure to potential gold production, the discovery opportunities of exploration, as well as the services sector of the mining industry. Timberline has contract core drilling subsidiaries in the western United States and Mexico and an exploration division focused on district-scale gold projects with the potential for near-term, low-cost development. 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. We believe our business model offers the opportunity for our shareholders to 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 a joint venture to develop and mine our Butte Highlands gold project located in southwestern Montana ("Butte Highlands Gold Project"), 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 advancement of the properties acquired in Nevada with the Staccato acquisition and 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 which began 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.

On June 2, 2010, the Company closed its acquisition of Staccato Gold Resources Ltd. ("Staccato"), a Canadian mineral exploration corporation listed on the TSX Venture Exchange. Under the terms of the acquisition, Staccato shareholders received one share of Timberline common stock for every seven shares of Staccato common stock held (the "Exchange Ratio") and $0.0001 for every share of Staccato common stock held. Pursuant to the acquisition, the holders of a portion of outstanding Staccato options and the holders of all Staccato warrants received Timberline options and warrants at the Exchange Ratio and with corresponding changes to the exercise prices based on the Exchange Ratio. The balance of the outstanding Staccato options were either exchanged for Staccato shares prior to the closing or cancelled at closing.

As a result of this acquisition, Timberline has acquired Staccato's South Eureka property, which includes a partially drill-tested exploration portfolio and the advanced-stage Lookout Mountain project, located along Nevada's Battle Mountain – Eureka trend, and approximately $4.5 million in cash. Upon completion of the acquisition, Timberline has approximately 56 million common shares issued and outstanding, with approximately 72 million shares on a fully diluted basis. Pre-acquisition Timberline shareholders own approximately 74% of the current shares outstanding and former Staccato shareholders own approximately 26%. On a fully diluted basis, Timberline is owned 71% by pre-acquisition Timberline shareholders and 29% by former Staccato shareholders. In conjunction with this acquisition, shares of Timberline's common stock are now listed on the TSX Venture Exchange in Canada where they trade under the symbol "TBR", in addition to the Company's NYSE Amex listing.

Timberline is listed on the NYSE Amex (the "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 would continue listing Timberline on the Exchange, subject to certain conditions. On May 27, 2010 the Company received notification from the Exchange that Timberline had resolved its continued listing deficiencies and the compliance period had ended.

Drilling Services

Our underground focus with established customers continues to provide a solid base of operations as 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. In spite of reduced drilling demand over the past year and a half, we believe that our continuous right-sizing efforts at Timberline Drilling, a more balanced level of input costs, availability and retention of qualified labor, and our ongoing focus on profitability will continue to improve the operating results of our drilling subsidiaries.

Over the past two years 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 operations in 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.

During the quarter ended June 30, 2010, Timberline Drilling extended its current contract with Newmont Mining through February 2014, 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.

Timberline Drilling also secured several contracts with junior exploration companies during the quarter to commence drill programs over the next several months. In addition, a supplementary contract was signed with Newmont for deep-hole drilling in Nevada that is expected to provide long-term surface drilling revenue. Timberline Drilling also commenced surface exploration drilling at the Company's Butte Highlands Gold Project during the quarter, and expects to commence underground resource definition drilling at Butte Highlands and surface exploration drilling at our newly-acquired South Eureka property in Nevada during the fourth fiscal quarter. As of June 30, 2010, Timberline Drilling has 14 drills operating and expects to have several additional drills operating in the fourth fiscal quarter.

Our Mexican subsidiary, WWE, had five drills operating at the end of the quarter, an increase of three drills from the two drills operating at the beginning of the quarter. Drilling activity in Mexico is picking up with our major client and at other exploration and development projects. However, while we have seen marginal increases in demand for drilling projects, 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. We have a seasoned and experienced management team at WWE, and the overall situation in Mexico continues to be monitored closely by our management.

Exploration Division

<u>Butte Highlands Project</u>

Our Exploration Division advanced our Butte Highlands Gold Project on several fronts during the quarter ended June 30, 2010. Our joint venture partner, Highland Mining, LLC, continued to advance the underground ramp to access the mineralized areas; to allow for underground exploration and ore definition drilling, as well as additional project exploration during the remainder of 2010. As of June 30, 2010, the underground ramp had been advanced approximately 1,000 feet toward the expected mineralization.

The application for our Hard Rock Operating Permit was submitted to the Montana Department of Environmental Quality in early May 2010. We, in conjunction with staff from the Butte Highlands Joint Venture, continue to refine the mine and underground exploration planning that is an integral part of our overall mine planning at the Butte Highlands Gold Project. The ongoing 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 mid 2011.

South Eureka Property

The South Eureka Property, including the Lookout Mountain project, was the primary asset acquired by Timberline in the Acquisition of Staccato Gold Resources, Ltd. in June 2010. The acquisition was predicated on the review and assumption that based on historic drill data, favorable metallurgical tests, a number of partially tested mineralized targets, a non-compliant gold resource, and current gold prices; a low-cost, low-grade, heap leachable gold mine could potentially be developed.

The Lookout Mountain project is located within the southern portion of Nevada's productive Battle Mountain-Eureka gold belt and is considered an advanced-stage gold project at the beginning of the pre-feasibility stage,. The South Eureka Property, exceeding 15,000 acres in size, includes a 4-mile strike length of structurally and stratigraphically controlled gold mineralization, all zones of which are open and will require additional in-fill and step-out drilling. The property has an extensive exploration, drilling, and gold production history by a number of companies since 1975, including Idaho Mining Corp, Norse-Windfall Mining, Amselco, Echo Bay Mines, and Barrick Gold. A total of 533 holes have been drilled on the property, totaling 267,000 feet. Gold mineralization tested to date is typical sediment hosted Nevada gold mineralization.

Timberline is permitting an aggressive core and rotary drill program at the South Eureka Property that began in August 2010. The program is designed to focus on in-fill, metallurgical, and geotechnical drilling, with a smaller drill program to test a number of out-lying exploration targets. The program objective is to confirm the existing gold resource and incorporate all technical and economic data and parameters into a preliminary economic scoping study.

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 continuous improvement at our drilling subsidiaries, advancing the Butte Highlands Gold Project toward expected gold production, advancing exploration programs on our South Eureka Property acquired in the Staccato acquisition, and continuing to evaluate new opportunities that fit with our business model. We have evaluated a number of projects and opportunities during the past several months and will continue to do so. We believe the combination of management and the Company's board of directors has 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, 2010 and 2009

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

For the three months ended June 30, 2010, we reported $6,440,783 in revenue compared to $4,361,137 in the same period of 2009. Our revenues are derived entirely from our drilling subsidiaries and are comprised of $5,791,518 from Timberline Drilling and $649,265 from WWE for the three months ended June 30, 2010. Total gross profit from our drilling subsidiaries was $1,029,894, with gross profit (loss) from Timberline Drilling and WWE of $1,271,153 and $(241,259), respectively, for the three months ended June 30, 2010.

Our overall after tax net loss for the three months ended June 30, 2010 was $814,700 compared to an overall net income of $241,061 for the three months ended June 30, 2009. The results for the three months ended June 30, 2009 included a recovery of previously expensed professional fees of $527,207. Our net loss for the three months ended June 30, 2010 is comprised of a loss of $1,078,324 for Timberline Corporate and Exploration and $373,641 at WWE, offset by net income of $637,265 for Timberline Drilling. Interest expense for the three months ended June 30, 2010 was $168,343, compared to $167,309 for the three months ended June 30, 2009.

For the nine months ended June 30, 2010, we reported $15,668,852 in revenue compared to $12,545,217 in the same period of fiscal 2009. Our revenues were comprised of $14,158,535 from Timberline Drilling and $1,510,317 from WWE for the nine months ended June 30, 2010. Total gross profit from our drilling subsidiaries was $2,735,472, with gross profit (loss) from Timberline Drilling and WWE of $3,213,656 and $(478,184), respectively, for the nine months ended June 30, 2010.

Our overall after tax net loss for the nine months ended June 30, 2010 was $2,656,294 compared to an overall net loss of $5,706,458 for the nine months ended June 30, 2009. The year to date loss is significantly lower than the previous year as a result of higher gross margins on drilling service revenues, reduced salaries and benefits expenses and lower professional fees expenses in the current year, offset somewhat by higher mineral exploration expenses. Our net loss for the nine months ended June 30, 2010 is comprised of a loss of $3,294,595 for Timberline Corporate and Exploration and $780,566 at WWE, offset by net income of $1,418,867 for Timberline Drilling. Interest expense for the nine months ended June 30, 2010 was $493,043, compared to $1,186,943 for the nine months ended June 30, 2009. The decrease in interest expense during the nine months ended June 30, 2010 is attributable primarily to the absence of interest expenses associated with a bridge loan that was owed by the Company in the previous year as well as a decrease in interest expense related to the Company's liability to the IRS for unpaid payroll taxes.

Over the past two years, 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. The demand for drilling services, however, appears to have stabilized, and, based upon our current and upcoming drilling activity, we expect revenues to increase slightly to approximately $21 million for fiscal 2010 as compared to $17.6 million in fiscal 2009.

In response to the changes in the economic and mining industry environment, we have implemented cost-cutting measures and stabilized our revenue stream. The result of this focus on cost-cutting and revenue stabilization has allowed our combined drilling entities to achieve profitability for five consecutive quarters in spite of difficult market conditions. We expect that our implementation of operational improvements and focus on financial discipline will result in continued positive earnings, improved gross margins, and more positive cash flow as demand for our services increases.

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 decreased 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 as well as three other customers. While we have seen increases in requests for proposals for drilling services, and secured additional drilling service contracts for new customers commencing in the second half of the Company's fiscal year, we cannot predict if demand for drilling services will increase in future periods.

Timberline Corporate and Exploration Division

The after tax net loss of $1,078,324 for the combined Timberline Corporate and the Exploration division during the three months ended June 30, 2010 is comprised of non-cash charges of $37,194, exploration expenditures of $266,261, salaries and benefits of $105,129, professional fees of $220,860, other general and administrative costs of $307,277, interest expense of $145,142 and foreign exchange loss of $1,057, less interest income of $4,596. Included in the non-cash charges are $21,164 in expenses related to stock options that vested during the quarter. Also included in the non-cash charges are $16,030 in depreciation, amortization and accretion of our asset retirement obligation.

The after tax net loss of $3,294,595 for the combined Timberline Corporate and the Exploration division during the nine months ended June 30, 2010 is comprised of non-cash charges of $594,962, exploration expenditures of $552,393, salaries and benefits of $343,160, professional fees of $773,957, other general and administrative costs of $647,649, interest expense of $424,807 and foreign exchange loss of $1,057, less other income of $31,977 and interest income of $11,413. Included in the non-cash charges are $555,839 in expenses related to stock options and stock awards that vested during the year to date. Also included in the non-cash charges are $39,123 in depreciation, amortization and accretion of our asset retirement obligation.

Timberline Drilling and WWE

For the three months ended June 30, 2010, Timberline Drilling had revenues of $5,791,518 as compared to $3,592,474 for the three months ended June 30, 2009. This increased revenue is attributable to a significantly higher utilization rate of our drill rigs as our major customer increased the number of drills required. WWE had revenues of $649,265 for the three months ended June 30, 2010 as compared to $768,663 for the three months ended June 30, 2009. Overall the demand for drilling services appears to have stabilized during the past few months. Junior resource and exploration stage companies are beginning to obtain access to capital for their drilling programs, and, as a result, the overall demand for drilling services, while not as robust as in 2007 and 2008, continues to show signs of improvement. Timberline Drilling's revenue per foot drilled during the quarter was also higher when compared to the previous year. It is evident that cost-cutting and team-building efforts implemented at Timberline Drilling, along with better processes and controls, retention of skilled labor, and our ongoing focus on profitability, have resulted in multiple consecutive quarters of profitable operations. The decrease in revenues at WWE is attributable to reduced demand for drilling services in Mexico and the resulting reduction in the number of operating drill rigs compared to the previous year. While the number of drills operating in Mexico during the fiscal third quarter increased to five by quarter end, they did not produce adequate footage to operate profitably. On a combined basis, we expect that our revenue from Timberline Drilling and WWE for fiscal year 2010 will be approximately $21 million due to greater overall utilization of our drill rigs.

For the three months ended June 30, 2010, net income before taxes from Timberline Drilling was $637,265 while net loss before taxes at WWE was $373,641 as compared to a net income before taxes of $270,380 for Timberline Drilling and net income before taxes of $61,714 for WWE for the three months ended June 30, 2009. At Timberline Drilling, the current quarter income is primarily attributable to increased drilling revenue and significantly decreased operating, general and administrative, and interest expenses. At WWE, the current quarter loss is primarily attributable to a decrease in drilling revenue and increase in operating costs, offset somewhat by reduced general and administrative and other expenses.

For the nine months ended June 30, 2010, Timberline Drilling had revenues of $14,158,535 as compared to $8,823,389 for the nine months ended June 30, 2009. WWE had revenues of $1,510,317 for the nine months ended June 30, 2010 as compared to $3,721,828 for the nine months ended June 30, 2009. The increase in revenues at Timberline Drilling during the year to date is attributable to significantly increased utilization of drill rigs compared to the previous year. Timberline Drilling's revenue per foot drilled and the average footage drilled by each operating drill rig during the year to date were also higher when compared to the previous year. The decrease in revenues at WWE is attributable to difficult operating conditions in Mexico, significantly reduced demand for drilling services, and the resulting reduction in the number of operating drill rigs compared to the previous year.

For the nine months ended June 30, 2010, net income before taxes from Timberline Drilling was $1,418,867 while net loss before taxes at WWE was $780,566 as compared to a net loss before taxes of $1,536,892 for Timberline Drilling and net loss before taxes of $242,774 for WWE for the nine months ended June 30, 2009. At Timberline Drilling, the year to date income is primarily attributable to increased drilling revenue and significantly decreased operating, general and administrative, and interest expenses. At WWE, the year to date loss is primarily attributable to a significant decrease in drilling revenue and gross profits, offset somewhat by reduced general and administrative and other expenses.

We expect that revenue stability resulting from our drilling contract with Newmont Mining in Nevada, coupled with our continued focus on reducing operating and administrative costs and improving performance efficiencies, will result in continued positive earnings and cash flow from our drilling subsidiaries on a combined basis as we have demonstrated for the past five consecutive fiscal quarters. Management is also closely monitoring the performance of WWE, and is implementing operational changes to reduce operating costs at our Mexican operations.

Financial Condition and Liquidity

At June 30, 2010, we had assets of $32,235,467 consisting of cash in the amount of $6,278,711; accounts receivable, net of allowance for doubtful accounts, in the amount of $1,410,368; materials and supplies inventories valued at $1,584,112; property, mineral rights and equipment, net of depreciation of $18,661,250; goodwill related to the acquisition of Timberline Drilling in the amount of $2,808,524 and other assets of $1,492,502.

There was a severe deterioration in global credit and equity markets in 2007 through 2009. This resulted in the need for government intervention in major banks, financial institutions and insurers and also resulted in greater volatility, increased credit losses and tighter credit conditions. These disruptions in the credit and financial markets had a significant material adverse impact on a number of financial institutions and have limited access to capital and credit for many companies. While market conditions have generally improved in 2010, access to capital and credit remains limited compared to capital markets before the deterioration in 2007. These continued 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. Our access to additional capital and financing may not be available on terms acceptable to us or at all.

We expect to rely upon our existing cash balances and the revenues generated by our contract drilling subsidiaries, however, the recent economic instability make it difficult for the Company's management to accurately predict revenues from these services for the remainder of the 2010 fiscal year and future fiscal years. If revenues from our contract drilling subsidiaries decline, our exploration activities and other operations will be reliant upon our cash on hand and equity financings 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. If we are unable to obtain financing through equity investments, we will seek multiple solutions including, but not limited to, credit facilities, debenture issuances or asset sales.

The current liabilities of the Company include outstanding interest and penalties due to the Internal Revenue Service in the amount of $272,105. The Company is making monthly installment payments on the outstanding balance and expects to pay the remaining balance within the next 12 months.

At June 30, 2010 the Company has a working capital surplus of $5,217,986. Management believes that the cash on hand and cash flow generated from its drilling company operations 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 drilling services operations.

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. In March 2009, 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. On May 27, 2010 the Company received notification from the NYSE Amex that Timberline had resolved its continued listing deficiencies and the compliance period had ended. The Company must maintain compliance with the continued listing standards in the future or risk being subject to delisting procedures again. 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 drilled or per hour worked 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, Mineral Rights and Equipment for Impairment

The Company reviews the carrying value of property, mineral rights 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. Goodwill is tested for impairment at least annually 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, 2009.

Asset retirement obligation

The Company accounts for asset retirement obligations by following the uniform methodology for accounting for estimated reclamation and abandonment costs as prescribed by authoritative accounting guidance. This guidance provides that the fair value of a liability for an asset retirement obligation (ARO) will be recognized in the period in which it is incurred if a reasonable estimate of fair value can be made. The ARO is capitalized as part of the carrying value of the assets to which it is associated, and depreciated over the useful life of the asset. The Company has an ARO associated with its underground exploration program at the Butte Highlands Gold Project

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.

In January 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 resigned his employment with the Company, he immediately started American Drilling, and that Elloway and American Drilling had subsequently violated Elloway's Supplemental Income Agreement with Timberline Drilling, which restricted his post-termination competitive activities. 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.

Subsequent to June 30, 2010, the parties entered into a mutual settlement and release whereby Elloway and American Drilling agreed to pay Timberline $150,000 in exchange for releasing Elloway and American Drilling from the complaint. The parties also mutually agreed to releases from any future litigation by all parties.

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

Except as provided below, there have been no material changes from the risk factors as previously disclosed in our Form 10-K for the year ended September 30, 2009 which was filed with the SEC on December 8, 2009.

Risks Related to the Acquisition of Staccato Gold Resources Ltd.

The combined company may not realize the benefits from the transaction because of various challenges.

The acquisition will involve the integration of companies that previously operated independently. Timberline's ability to realize the anticipated benefits of the acquisition will depend, in part, upon the following:

- the ability of Timberline to successfully integrate Staccato's business, employees and processes with those of Timberline;
- how efficiently Timberline's officers can manage the operations of the combined company;
- the amount of charges associated with the purchase accounting for the acquisition;
- economic conditions affecting both the general economy and the mining industry in particular;
- the actual closing date of the acquisition; and
- the diversion of management's attention from ongoing business concerns.

Some of these factors are also outside the control of either company. One or more of these factors could result in increased operating costs, lower revenues, lower earnings or losses or negative cash flows, any of which could reduce the price of Timberline's stock, harming your investment. To the extent Timberline pursues other acquisitions as part of its strategy, these risks may be exacerbated.

Timberline may raise funds for the exploration of Staccato's Lookout Mountain project through the issuance of shares of Timberline Common Stock, debt instruments or other securities convertible into shares of Timberline Common Stock and such financings may result in the dilution of present and prospective stockholdings.

In order to finance the exploration of Staccato's Lookout Mountain project, Timberline may raise funds through the issuance of Common Shares or the issuance of debt instruments or other securities convertible into shares of Timberline Common Stock. Any transaction involving the issuance of previously authorized but unissued shares of Timberline Common Stock, or securities convertible into shares of Timberline Common Stock, would result in dilution, possibly substantial, to present and prospective stockholding. This dilution may affect the earnings per share and voting rights of current holders of shares of Timberline Common Stock.

The increased number of shares of Timberline Common Stock as a result of the issuance of shares of Timberline Common Stock pursuant to the acquisition may increase the volatility of Timberline's share price.

Although the issuance of shares of Timberline Common Stock as a result of the acquisition should increase liquidity in the market for such shares of Timberline Common Stock, there may be greater volatility of market prices in the near term pending the creation of a stable stockholder base. Any such volatility could result in a decline in the market price of shares of Timberline Common Stock.

The value of shares of Timberline Common Stock may be adversely affected by any inability of the combined company to achieve the benefits expected to result from the completion of the acquisition.

Achieving the benefits of the acquisition will depend in part upon meeting the challenges inherent in the successful combination of business enterprises of the size and scope of Timberline and Staccato and the possible resulting diversion of management attention for an extended period of time. There can be no assurance that the combined company will meet these challenges and that such diversion will not negatively impact the operations of the combined company following the closing of the acquisition.

The combined company may not realize the benefits of its growth projects.

As part of its strategy, the combined company will continue existing efforts and initiate new efforts to develop gold and other mineral projects and will have a larger number of such projects as a result of the acquisition. A number of risks and uncertainties are associated with the development of these types of projects, including political, regulatory, design, construction, labor, operating, technical and technological risks and uncertainties relating to capital and other costs and financing risks. The failure to successfully develop any of these initiatives could have a material adverse effect on the combined company's financial position and results of operations.

The issuance of shares of Timberline Common Stock or securities convertible into shares of Timberline Common Stock may allow someone to exert substantial influence over Stockholder voting.

If a significant amount of securities issued pursuant to the acquisition or in a subsequent financing were acquired by one person or entity, then that person or entity would be able to exert substantial influence over or actually control the outcome of subsequent Stockholder votes.

As part of our business model, Timberline pursues a strategy that may cause us to expend significant resources exploring properties that may not become revenue-producing sites, including Staccato's Lookout Mountain project.

Part of Timberline's business model is to pursue a strategy which includes significant exploration activities, such as proposed exploration at Staccato's Lookout Mountain project. 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. We may spend significant resources exploring the Lookout Mountain projects and gathering certain geologic information only to determine that the project is not capable of being a revenue-producing property for the Company.

If Timberline's cash flows prove inadequate to service its debt and provide for its other obligations, it may be required to refinance all or a portion of such existing and future debt at terms that are unfavorable to it.

Timberline's ability to make payments on, and refinance, its debt and other obligations and to fund its operations and capital expenditures will depend on its ability to generate substantial operating cash flow. If Timberline's cash flows prove inadequate to meet its debt service obligations, it may be required to refinance all or a portion of its existing or future debt or to sell assets or to obtain additional financing. Timberline cannot assure you that any such refinancing or that any such sale of assets or additional financing would be possible on favorable terms, or at all.

Upon completion of the Arrangement, Timberline will be required to comply with Canadian securities regulations and be subject to additional regulatory scrutiny in Canada.

Timberline will become a 'reporting issuer' in the provinces of British Columbia and Alberta upon completion of the acquisition. As a result, Timberline will be subject to increased regulatory scrutiny and costs associated with complying with securities legislation in those provinces. For example, Timberline will be subject to civil liability for misrepresentations in written disclosure and oral statements. Legislation has been enacted in these provinces which creates a right of action for damages against a reporting issuer, its directors and certain of its officers in the event that the reporting issuer or a person with actual, implied or apparent authority to act or speak on behalf of the reporting issuer releases a document or makes a public oral statement that contains a misrepresentation or the reporting issuer fails to make timely disclosure of a material change. Timberline does not anticipate any particular regulation that would be difficult to comply with. However, failure to comply with regulations may result in civil awards, fines, penalties and orders that could have an adverse effect on Timberline.

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

All sales of unregistered equity securities during the period covered by this report were previously reported by the Company under cover of Form 8-K.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES.

None.

ITEM 4. [RESERVED]

ITEM 5. OTHER INFORMATION.

None.

ITEM 6. EXHIBITS.

10.1 Loan Amendment between the Company and Small Mine Development, dated June 21, 2010

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 11, 2010

By: /s/ Craig Crowell

Craig Crowell
Chief Accounting Officer
(Principal Accounting Officer)

Date: August 11, 2010

Exhibit 10.1

AMENDMENT NO. 1 TO
CONVERTIBLE TERM NOTE

This Amendment No. 1 ("*Amendment No. 1*") to the Term Note in principal amount of Five Million Dollars ($5,000,000) (the "*Principal Amount*") dated October 31, 2008 (the "*Note*") by and between Timberline Resources Corporation, a Delaware corporation (the "*Borrower*") and Small Mine Development, LLC, an Idaho limited liability company ("*SMD*"), is entered into effective as of June 30, 2010 (the *"Effective Date"*), by and among the Borrower and SMD.

Recitals

A. The Borrower and SMD entered into the Note pursuant to which the Borrower promised to pay to the order of SMD the Principal Amount together with interest at a rate of ten percent (10%) per annum, compounded monthly (the "*Interest Rate*"); and

B. The Note, including all interest and principal is due and payable in full on October 31, 2010 (the "*Due Date*"); and

C. The Borrower and SMD desire to extend the Due Date of the Note from October 31, 2010 to April 30, 2012 for the consideration to SMD as stated below.

Agreement

NOW, THEREFORE, for and in consideration of the covenants set forth in the Note and this Amendment No. 1, and other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the parties agree as follows:

1. As of the Effective Date, the definition of Term Loan Maturity Date in the Credit Agreement, which previously provided that the Note is due and payable in full on October 31, 2010, or such other date as SMD and Borrower may agree upon in writing from time to time, is hereby amended to read as follows:

   "**Term Loan Maturity Date**" means April 30, 2012, or such other date as SMD and Borrower may agree upon in writing from time to time."

2. In consideration for the extension of the Due Date of the Note to April 30, 2012, the Borrower shall pay to SMD all of the accrued interest due on the Note up to and through June 30, 2010 in cash upon the date of execution of this Amendment No. 1, as stated on the signature page hereto, such amount being US$902,724.17 as calculated and shown on Schedule A hereto (the "*Amendment Consideration*").

3. A Note extension fee of one percent (1%) will be paid as additional consideration, such amount being US$50,000.

4. The Amendment Consideration shall be paid by the Borrower to SMD by wire transfer on the date of execution of this Amendment No 1, as stated on the signature page hereto, pursuant to the wire transfer instructions provided by SMD on Schedule B hereto.

5. Interest on the Note will again begin accruing on the Principal Amount at the Interest Rate (10% per annum) on July 1, 2010 and will be payable in cash on the fifth of each month for the interest accrued the previous month, beginning on August 5, 2010.

6. Capitalized terms not defined herein have the meaning ascribed to them in the Note or the Credit Agreement.

7. All other provisions of the Note shall not be deemed to have been amended or altered and shall remain in full force and effect.

8. This Amendment No. 1 may be executed in one or more counterparts, each of which shall be deemed an original, but all of which shall constitute one and the same instrument.

IN WITNESS THEREOF, the Borrower and SMD have executed this Amendment No. 1 to the Note as of June 21, 2010.

TIMBERLINE RESOURCES CORPORATION

By: Randal L Hardy

Randal Hardy
Chief Executive Officer

SMALL MINE DEVELOPMENT, LLC

By: [illegible]

Ron Guill
Manager

Schedule A

Amendment Consideration

Small Mine Development, LLC
Timberline Resources Note Receivable
12/31/2008

Principle amount	5,000,000
Interest rate	10%
Compounding	Monthly
Begin date	10/31/2008

	Beginning Balance	Accrued Interest	Ending Balance
10/31/2008	-	-	5,000,000.00
11/30/2008	5,000,000.00	41,666.67	5,041,666.67
12/31/2008	5,041,666.67	42,013.89	5,083,680.56
1/31/2009	5,083,680.56	42,364.00	5,126,044.56
2/28/2009	5,126,044.56	42,717.04	5,168,761.60
3/31/2009	5,168,761.60	43,073.01	5,211,834.61
4/30/2009	5,211,834.61	43,431.96	5,255,266.57
5/31/2009	5,255,266.57	43,793.89	5,299,060.45
6/30/2009	5,299,060.45	44,158.84	5,343,219.29
7/31/2009	5,343,219.29	44,526.83	5,387,746.12
8/31/2009	5,387,746.12	44,897.88	5,432,644.00
9/30/2009	5,432,644.00	45,272.03	5,477,916.04
10/31/2009	5,477,916.04	45,649.30	5,523,565.34
11/30/2009	5,523,565.34	46,029.71	5,569,595.05
12/31/2009	5,569,595.05	46,413.29	5,616,008.34
1/31/2010	5,616,008.34	46,800.07	5,662,808.41
2/28/2010	5,662,808.41	47,190.07	5,709,998.48
3/31/2010	5,709,998.48	47,583.32	5,757,581.80
4/30/2010	5,757,581.80	47,979.85	5,805,561.65
5/31/2010	5,805,561.65	48,379.68	5,853,941.33
6/30/2010	5,853,941.33	48,782.84	5,902,724.17

Total Accrued Interest at 6/30/10: **$902,724.17**

EXHIBIT 31.1

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 11, 2010

By: /s/ Randal Hardy

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

EXHIBIT 31.2

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 11, 2010

By: /s/ Craig Crowell

Craig Crowell
Chief Accounting Officer
Principal Accounting Officer

EXHIBIT 32.1

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

In connection with the Quarterly Report of Timberline Resources Corporation (the "Company") on Form 10-Q for the period ended June 30, 2010, 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 11, 2010

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.

EXHIBIT 32.2

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, 2010, 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 11, 2010

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.