TELECOM COMMUNICATIONS INC
Form 10QSB
August 21, 2006

U.S. SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-QSB

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x **QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the Quarterly Period Ended June 30, 2006

o **TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT**

For the transition period from ________ to ________

Commission file number 333-62236

TELECOM COMMUNICATIONS, INC.
(Exact name of small business issuer as specified in its charter)

Delaware	**35-2089848**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

9/F., Beijing Business World
56 Dongxinglong Avenue
CW District
Beijing, China 100062
(Address of principal executive offices)

(86) 10 6702 6968
Issuer's telephone number

Suites 2412−13 Shell Tower, Times Square, 1 Matheson Street, Causeway Bay, Hong Kong
(Former name, former address and former fiscal year, if changed since last report)

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act 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 x No o

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

APPLICABLE ONLY TO CORPORATE ISSUERS

State the number of shares outstanding of each of the issuer's classes of common equity, as of the latest practicable date**:** 92,488,000 shares of Common Stock, $.001 Par Value Per Share, outstanding as of August 1, 2006.

Transitional Small Business Disclosure Format (Check One): Yes o No x

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TABLE OF CONTENTS

		Page
PART I. FINANCIAL INFORMATION		
ITEM 1.	FINANCIAL STATEMENTS	
	Condensed Consolidated Balance Sheet as of June 30, 2006.	1
	Condensed Consolidated Statements of Income and Comprehensive Income for the Nine Months and Three Months Ended June 30, 2006 and 2005	2
	Condensed Consolidated Statements of Cash Flows for the Nine Months Ended June 30, 2006 and 2005	3
	Notes to the Condensed Consolidated Financial Statements	4
ITEM 2.	MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITIONS AND RESULTS OF OPERATIONS	24
ITEM 3.	CONTROLS AND PROCEDURES	39
PART II. OTHER INFORMATION		
ITEM 1.	LEGAL PROCEEDINGS	39
ITEM 2.	UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS	39
ITEM 3.	DEFAULTS UPON SENIOR SECURITIES	39
ITEM 4.	SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS	39
ITEM 5.	OTHER INFORMATION	39
ITEM 6.	EXHIBITS	40
SIGNATURE		41

PART I. FINANCIAL INFORMATION

TELECOM COMMUNICATIONS, INC. AND SUBSIDIARIES

ITEM 1. FINANCIAL INFORMATION

CONDENSED CONSOLIDATED BALANCE SHEET

ASSETS		June 30, 2006 (Unaudited)
Current assets:		
Cash and cash equivalents	$	852,405
Accounts receivable - affiliate		480,000
Accounts receivable- others, less allowance for bad debt of $355,650		2,968,213
Due from related company		238,443
Deferred stock-based compensation - current portion		3,272,059
Prepaid expenses		3,597,853
Payment in advance		279,251
Other current assets		458,118
Total current assets		12,146,342
Software acquisition cost		3,000,000
Property, plant and equipment, net		6,725,852
Deferred stock-based compensation - non-current portion		865,833
Total assets	$	22,738,027
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$	1,536,293
Accrued expenses		74,737
Due to related companies		57,513
Other current liabilities		108,912
Total Current Liabilities		1,777,455
Minority interests		1,099,985
Commitments and contingencies (refer to note 7)		
Stockholders' equity :		
Preferred stock ($.001 Par Value: 50,000,000 shares authorized;		
no shares issued and outstanding)		-
Common stock ($.001 Par Value: 300,000,000 shares authorized		
89,188,000 shares issued and outstanding)		89,188
Additional paid in capital		13,683,489
Accumulated other comprehensive income		249
Retained earnings		6,087,661
		19,860,587
Total stockholders' equity		

Total liabilities and stockholders' equity	$	22,738,027

The accompanying notes are an integral part of the condensed consolidated financial statements.

1

TELECOM COMMUNICATIONS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME

	Nine Months Ended June 30,		Three Months Ended June 30,	
	2006 (Unaudited)	**Restated 2005** (Unaudited)	2006 (Unaudited)	**Restated 2005** (Unaudited)
Net revenues - affiliate	$ 1,080,000	$ 1,080,000	$ 360,000	$ 360,000
- others	9,799,607	5,221,132	2,419,690	2,476,972
	10,879,607	6,301,132	2,779,690	2,836,972
Cost of sales				
- Depreciation	1,381,624	1,047,211	446,594	371,456
- Other cost of sales	1,523,270	2,940,827	474,619	1,345,206
	2,904,894	3,988,038	921,213	1,716,662
Gross profit	7,974,713	2,313,094	1,858,477	1,120,310
Operating expenses:				
(Recovery) Allowance for bad debt	(170,190)	-	(1,147,264)	-
Depreciation	75,482	21,154	39,109	7,051
Salaries	392,811	-	5,872	-
Stock-based compensation expenses	2,676,005	438,750	1,101,030	146,250
Other selling, general and administrative	438,775	369,742	179,265	159,798
Total operating expenses costs	3,412,883	829,646	178,012	313,099
Income from operations	4,561,830	1,483,448	1,680,465	807,211
Other income/ (expense):				
Interest income	2,541	49	153	(96)
Other income	-	-	-	(7,590)
Interest expense	-	(1,614)	-	(388)
Gain on disposal of fixed assets	-	-	-	-
Total other income	2,541	(1,565)	153	(8,074)
Income from continuing operations before income tax	4,564,371	1,481,883	1,680,618	799,137
Income tax expenses	-	-	-	-
Net income after tax	4,564,371	1,481,883	1,680,618	799,137
Income (Loss) from discontinued operations				
Gain on disposal of subsidiary	295,533	53,431	295,533	53,431
(Loss) from discontinued operations	(239,776)	(23,272)	-	(23,272)
	55,757	30,159	295,533	30,159

Net income from discontinued operations								
Net income		4,620,128		1,512,042		1,976,151		829,296
Other comprehensive income								
Foreign currency translation difference		3		-		-		-
Comprehensive income	$	4,620,131	$	1,512,042	$	1,976,151	$	829,296
Earnings per Common Share:								
Discontinued operations								
Basic	$	0.0007	$	0.0004	$	0.0006	$	0.0004
Fully diluted	$	0.0006	$	0.0004	$	0.0005	$	0.0004
Continued operations								
Basic	$	0.056	$	0.021	$	0.022	$	0.011
Fully diluted	$	0.052	$	0.019	$	0.022	$	0.010
Weighted Average Common Share:								
Outstanding - Basic		82,040,000		71,125,500		88,353,000		70,188,000
Outstanding - Fully diluted		88,921,000		81,125,500		88,353,000		80,188,000

The accompanying notes are an integral part of the condensed consolidated financial statements.

2

TELECOM COMMUNICATIONS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS

	Nine Months Ended June 30, 2006 (Unaudited)	Restated 2005 (Unaudited)
Cash flows from operating activities:		
Net cash provided by (used in) operating activities	1,816,722	(399,491)
Cash flows from investing activities:		
Cash acquired in acquisition	82,253	-
Sales proceed of disposal of Island Media net of cash	9,454	-
Capital expenditure	(3,273,085)	(2,596,709)
Net cash (used in) investing activities	(3,181,378)	(2,596,709)
Cash flows from financing activities:		
Due to a stockholder		18,690
Due to a related party		(79,293)
Repayment of finance lease	(10,199)	(80,444)
Proceeds from loan payable	226,410	-
Proceeds from new issuance of common Stock	-	3,050,000
Net cash provided by financing activities	216,211	2,908,953
Effect of exchange rate changes in cash	3	(207)
Net (decrease) in cash and cash equivalents	(1,148,442)	(87,454)
Cash and cash equivalents - beginning of period	2,000,847	336,707
Cash and cash equivalents - end of period	$ 852,405	$ 249,253
Supplemental disclosure of cash flow information:		
Non cash investing and financing activities		
Accounts receivable used for acquisition of software - this is still a cash transaction	3,000,000	-
Common stock issued for acquisition of software	5,910,000	-

The accompanying notes are an integral part of the condensed consolidated financial statements.

TELECOM COMMUNICATIONS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS JUNE 30, 2006

GENERAL

The accompanying unaudited interim condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Form 10-QSB and Item 310 of Regulation S-B. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for annual financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation in order to make the financial statements not misleading have been included. The accounts of the Company and all of its subsidiaries are included in the unaudited interim condensed consolidated financial statements. All significant intercompany accounts and transactions are eliminated in consolidation. Operating results for the interim periods are not necessarily indicative of the results that may be expected for the year ending September 30, 2006. For further information, refer to the consolidated financial statements and footnotes thereto included in the Company's Form 10-KSB for the year ended September 30, 2005.

1. BUSINESS DESCRIPTION AND ORGANIZATION

DESCRIPTION OF BUSINESS

Telecom Communications, Inc. ("TCOM") and its subsidiaries (collectively with TCOM, the "Company"), is a fully integrated information and entertainment service provider to the market of the PRC. We sell our products through channel resellers, who are BVI companies, distributed to the SP market in the PRC. The channel resellers who then in turn supply our content, through various telecommunication providers, to the end users in the PRC. Our products that are ultimately sold to the SP market in the PRC are a combination of an integrated communications network solutions and entertainment and lifestyle content. Our products serve the voice, video, data, web and mobile communication markets.

ORGANIZATION

TELECOM COMMUNICATIONS, INC.

TCOM was incorporated on January 6, 1997 in the State of Indiana. TCOM has changed its state of incorporation from Indiana to Delaware, effected by a merger into a Delaware Corporation with the same name on February 28, 2005. The surviving Delaware company succeeds to all the rights, properties and assets and assumes all of the liabilities.

ARRAN SERVICES LIMITED

As of September 30, 2003, TCOM consummated a Stock Purchase Agreement with Arran Services Limited (“Arran”) and Arran had a 80% interest in IC Star MMS Limited (“IC Star”). Arran further acquired the 20% interest in IC Star on March 16, 2004. As of September 30, 2005, Arran owned 100% of the ownership interests of IC Star.

TELECOM COMMUNICATIONS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS JUNE 30, 2006

1. BUSINESS DESCRIPTION AND ORGANIZATION-CON'T

IC STAR MMS LIMITED

IC Star, formerly known as Sino Super Limited, was established in December 1991. IC Star links entertainment and lifestyle information to local communities across the PRC.

On March 16, 2004, Arran acquired from Auto Treasure Holdings Limited, an entity 100% owned by the majority shareholder, the remaining 20% interest of IC Star together with 100% interest of Huiri Electric (Panyu) Limited ("Huiri") for a consideration of 9,889,000 shares of TCOM common stock and 10,000,000 warrants to purchase 10,000,000 shares of TCOM common stock at $2 per share.

As a result, as of March 16, 2004, Arran owned 100% of IC Star and Huiri. This transfer was deemed to be a transfer between entities under common control and was therefore recorded on the Company's records at its historical cost basis. In connection with the new issuance of 9,889,000 shares of TCOM common stock and 10,000,000 warrants, which expire March 15, 2006, to acquire IC Star, the excess of the purchase price of $8,322,295 over the book value of the assets acquired from IC Star of $195,378 which totaled $8,126,917, was recorded as a return of capital. This return of capital was recorded as a reduction of additional paid in capital of TCOM.

ALPHA CENTURY HOLDINGS LIMITED

On December 15, 2003, TCOM formed Alpha Century Holdings Limited ("Alpha"), a wholly owned subsidiary of TCOM, in the British Virgin Islands. Alpha commenced its business on July 1, 2004 and its principal activity was providing total solution software with entertainment and lifestyle information and providing a mobile message service platform. Most of the company's business is presently conducted through Alpha. Substantially, all of the Company's operations are conducted through Alpha.

3G DYNASTY INC.

On February 21, 2005, TCOM formed 3G Dynasty Inc. ("3G Dynasty"), a wholly-owned subsidiary of TCOM, in the British Virgin Islands. 3G Dynasty commenced its business on April 1, 2005 and its principal activity was providing entertainment content for 3G mobile and Internet use.

ISLAND MEDIA INTERNATIONAL LIMITED

On June 2, 2005, TCOM subscribed 60% of the shares of Island Media International Limited ("Island Media"), which was registered in the British Virgin Islands. Island Media commenced its business on July 11, 2005 and its principal activity was as an investment holding company. Island Media currently holds 100% of the shares of both Talent Leader Entertainment & Productions Limited ("Talent Leader") and Talent Leader Advertising and Communications Limited ("Talent Leader Adv").

On April 1, 2006 , TCOM sold all its interests in Island Media with the net gain on the disposal of $295,533. Island Media's operating loss for the nine months ended June 30, 2006 of $239,776 was shown as Discontinued Operations in the condensed consolidated statements of Income and comprehensive income.

TALENT LEADER ENTERTAINMENT & PRODUCTIONS LIMITED

On July 20, 2005, Island Media subscribed 100% of the shares of Talent Leader Entertainment & Productions Limited, a limited company in Hong Kong. Talent Leader commenced its business on August 1, 2005 and its principal activity was as a public relations agent to artists.

On April 1, 2006 , TCOM sold all its interests in Talent Leader by selling all the interests in Island Media which held 100% of the shares of Talent Leader.

5

TELECOM COMMUNICATIONS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS JUNE 30, 2006

1. BUSINESS DESCRIPTION AND ORGANIZATION-CON'T

TALENT LEADER ADVERTISING AND COMMUNICATIONS LIMITED

On December 8, 2005, Island Media subscribed 100% of the shares of Talent Leader Advertising and Communications Limit ed, a limited company in Hong Kong. Talent Leader Adv commenced its business on January 1, 2006 and its principal activity was providing public relations, advertising and communication services.

On April 1, 2006, TCOM sold all its interests in Talent Leader Adv by selling all the interests in Island Media which held 100% of the shares of Talent Leader Adv.

HRDQ GROUP INC

On June 28, 2006, TCOM subscribed 53.92% of the shares of HRDQ Group Inc ("HRDQ"), a limited company in Delaware, USA. HRDQ's principal activity was as an investment holding company. As of June 30, 2006, HRDQ holds 100% of the shares of Guangzhou Panyu Metals & Minerals Import and Export Co., Limited and the website called Subaye.com.

GUANGZHOU PANYU METALS & MINERALS IMPORT & EXPORT CO., LTD.

On April 25, 2006, HRDQ acquired 100% of the shares of Guangzhou Panyu Metals & Minerals Import and Export Co., Limited ("Panyu M&M") from the sole shareholder, Wukang IE Limited (Formerly known as WayToPay China Holdings Limited) for $500,000 cash. Panyu M&M is a limited company in PRC and its principal activity was conducting imports and exports trade in PRC.

CONTROL BY PRINCIPAL STOCKHOLDERS

The directors, executive officers and their affiliates or related parties, own beneficially and in the aggregate, the majority of the voting power of the outstanding shares of the common stock of TCOM. Accordingly, the directors, executive officers and their affiliates, if they voted their shares uniformly, would have the ability to control the approval of most corporate actions, including increasing the authorized capital stock of TCOM and the dissolution, merger or sale of TCOM's assets or business.

TELECOM COMMUNICATIONS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS JUNE 30, 2006

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

PRINCIPLES OF CONSOLIDATION AND BASIS OF PRESENTATION

The condensed consolidated financial statements of the Company include the accounts of TCOM and its subsidiaries, namely Arran, Alpha, IC Star, 3G Dynasty, HRDQ and Panyu M&M. During the nine months ended June 30, 2006, TCOM sold all its interests in Island Media with the net gain on the disposal of $295,533. Island Media’s operating loss for the nine months ended June 30, 2006 of $239,776 was shown as Discontinued Operations in the condensed consolidated statements of Income and comprehensive income. The condensed consolidated statements have been prepared in accordance with accounting principles generally accepted in the United States of America. All significant intercompany transactions have been eliminated.

CREDIT RISK AND CUSTOMERS

We have a concentration of customers in our information service provider business segment market. We are diligent in attempting to ensure that we issue credit to credit-worthy customers. However, our customer base is small and our accounts receivable balances are usually over 90 days outstanding, and that exposes us to significant credit risk. Therefore, a credit loss can be very large relative to our overall profitability.

During the nine months ended June 30, 2006 we had 6 customers, each of which individually accounted for more than 10% of our revenues, and totaling $10,879,607, representing 100% of our total revenue. The loss of these customers, individually or in the aggregate, could have a material impact on our results of operations.

REGULATION OF TELECOMMUNICATION SERVICES IN THE PRC

The telecommunications industry, including certain wireless value-added services, is highly-regulated in the PRC. Regulations issued or implemented by the State Council, the Ministry of Information Industries, and other relevant government authorities cover many aspects of telecommunications network operations.

PROPERTY AND EQUIPMENT

Property and equipment is located in the PRC and Hong Kong and is recorded at cost. Depreciation is calculated using the straight-line method over the expected useful life of the asset. The Company generally uses the following depreciable lives for its major classifications of property and equipment:

Description	Useful Lives
Computer hardware	3 years
Computer software	3 years
Web site	3 years

Motor vehicles	3 years
Furniture and fixtures	5 years
Leasehold improvements	5 years

7

TELECOM COMMUNICATIONS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS JUNE 30, 2006

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES-CON'T

IMPAIRMENT OF LONG-LIVED ASSETS

Long-lived tangible assets and definite-lived intangible assets are reviewed for possible impairment whenever events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable. The Company uses an estimate of undiscounted future net cash flows of the assets over the remaining useful lives in determining whether the carrying value of the assets is recoverable. If the carrying values of the assets exceed the expected future cash flows of the assets, the Company recognizes an impairment loss equal to the difference between the carrying values of the assets and their estimated fair values. Impairment of long-lived assets is assessed at the lowest levels for which there are identifiable cash flows that are independent from other groups of assets. The evaluation of long-lived assets requires the Company to use estimates of future cash flows. However, actual cash flows may differ from the estimated future cash flows used in these impairment tests.

GOODWILL AND INTANGIBLE ASSETS

Goodwill represents the excess of the purchase price over the fair value of the identifiable assets and liabilities acquired as a result of the Company's acquisitions of interests in its subsidiaries. Under Statement of Financial Accounting Standards ("SFAS") No.142, "Goodwill and Other Intangible Assets ("SFAS 142")," goodwill is no longer amortized, but tested for impairment upon first adoption and annually, thereafter, or more frequently if events or changes in circumstances indicate that it might be impaired. The Company assesses goodwill for impairment periodically in accordance with SFAS 142

The Company applies the criteria specified in SFAS No.141, "Business Combinations" to determine whether an intangible asset should be recognized separately from goodwill. Intangible assets acquired through business acquisitions are recognized as assets separate from goodwill if they satisfy either the "contractual-legal" or "separability" criterion. Per SFAS 142, intangible assets with definite lives are amortized over their estimated useful life and reviewed for impairment in accordance with SFAS No.144, "Accounting for the Impairment or Disposal of Long-lived Assets." Intangible assets, such as purchased technology, trademark, customer list, user base and non-compete agreements, arising from the acquisitions of subsidiaries and variable interest entities are recognized and measured at fair value upon acquisition. Intangible assets are amortized over their estimated useful lives from one to ten years. The Company reviews the amortization methods and estimated useful lives of intangible assets at least annually or when events or changes in circumstances indicate that it might be impaired. The recoverability of an intangible asset to be held and used is evaluated by comparing the carrying amount of the intangible asset to its future net undiscounted cash flows. If the intangible asset is considered to be impaired, the impairment loss is measured as the amount by which the carrying amount of the intangible asset exceeds the fair value of the intangible asset, calculated using a discounted future cash flow analysis. The Company uses estimates and judgments in its impairment tests, and if different estimates or judgments had been utilized, the timing or the amount of the impairment charges could be different.

RELATED PARTY AND STOCKHOLDERS' LOANS

The caption "Due to Related Company" on the condensed consolidated Balance Sheet consists of loans that are unsecured, non-interest bearing and have no fixed terms of repayment, and therefore, are deemed payable on demand.

USE OF ESTIMATES

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

TELECOM COMMUNICATIONS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS JUNE 30, 2006

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES-CON'T

SIGNIFICANT ESTIMATES

Several areas require management's estimates relating to uncertainties for which it is reasonably possible that there will be a material change in the near term. The more significant areas requiring the use of management estimates related to valuation of the useful lives of the Company's equipment and valuation of contingent liabilities and the valuation of stock issued for services.

EARNINGS PER SHARE

Basic earnings per common share ("EPS") is calculated by dividing net earnings by the weighted average number of common shares outstanding during the period. Diluted earnings per common share are calculated by adjusting the weighted average outstanding shares, assuming conversion of all potentially dilutive common stock equivalents.

REVENUE RECOGNITION

In accordance with Securities and Exchange Commission ("SEC") Staff Accounting Bulletin No. 104, Revenue Recognition ("SAB 104"), the Company recognizes revenue when the following fundamental criteria are met: (i) persuasive evidence of an arrangement exists, (ii) delivery has occurred or services have been rendered, (iii) the price to the customer is fixed or determinable and (iv)collection of the resulting receivable is reasonably assured. These criteria are usually met at the time of product shipment or performance of service.

We enter into certain arrangements where we are obligated to deliver products and/or services (multiple elements). In these arrangements, our fee includes both the initial selling price of our software packaged products and the monthly subscription of the licensed products for contract period, usually for 2 years.

Revenue for sales of our software packaged products with database of entertainment contents, namely, total solution software, SEO4 mobile, and IBS 4.1 enterprise software package is recognized as products are shipped and installed. Revenue for the monthly subscription of the licensed products, including all post-delivery support and the right to receive unspecified upgrades/enhancements of the licensed products, is charged at a monthly basic price. Pursuant to the terms of the agreements, a fixed sum is due at the beginning of each month regardless of whether the customer requires service during that month. The Company recognizes the subscription on the first day of each month for which the support service agreement is in place, the Company maintains an allowance for doubtful accounts in the event that any such revenue recorded is not realized.

Consulting services revenue is recognized as services are rendered and calculated by the agreed sum on a straight-line basis over the contract period, usually for 2 years.

The company has a 3 year contract that it entered into on May 3, 2004 with a major customer, Taikang Capital Managements Corporation, who subsequently after the contract was executed became a major stockholder of the company. Pursuant to the terms of this contract, we supply our total solutions software product, from the period July

1, 2004 to June 30, 2007. With written notice at least 30 days prior to the expiration of the contract to the other party, either party can extend the term of contract. Income is recognized ratably over the life of the contract, as the our total solution product is provided to Taikang on a monthly subscription basis.

9

TELECOM COMMUNICATIONS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS JUNE 30, 2006

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES-CON'T

SOFTWARE DEVELOPMENT COSTS

We account for our software development costs in accordance with SFAS No. 86, "Accounting for the Cost of Computer Software to be Sold, Leased, or Otherwise Marketed." Under SFAS 86, we expense software development costs as incurred until we determine that the software is technologically feasible. Once we determine that the entertainment software is technologically feasible and we have a basis for estimating the recoverability of the development costs from future cash flows, we capitalize the remaining software development costs until the software product is released. For the periods ended June 30, 2006 and 2005, we have purchased all of our software from third parties.

Once we release our software as entertainment content, we commence amortizing the related capitalized software development costs. The Company records amortization expense as a component of cost of sales. We calculate the amortization of software development costs using two different methods, and then amortize the greater of the two amounts. Under the first method, the Company divides the current period gross revenue for the released software by the total of current period gross revenue and anticipated future gross revenue for the software and then multiplies the result by the total capitalized software development costs. Under the second method, the Company divides the software's total capitalized costs by the number of periods in the software's estimated economic life up to a maximum of twelve months. Differences between the Company's actual gross revenues and what it projected may result in adjustments in the timing of amortization. If we deem a title's capitalized software development costs unrecoverable based on our expected future gross revenue and corresponding cash flows, we write off the costs and record the charge to development expense or cost of revenue, as appropriate.

FOREIGN CURRENCY TRANSLATION

Transactions and balances originally denominated in U.S. dollars are presented at their original amounts. Transactions and balances in other currencies are converted into U.S. dollars in accordance with SFAS No. 52, "Foreign Currency Translation," and are included in determining net income or loss.

For foreign operations with the local currency as the functional currency, assets and liabilities are translated from the local currencies into U.S. dollars at the exchange rate prevailing at the balance sheet date. Revenues, expenses and cash flows are translated at the average exchange rate for the period to approximate translation at the exchange rate prevailing at the dates those elements are recognized in the financial statements. Translation adjustments resulting from the process of translating the local currency financial statements into U.S. dollars are included in determining comprehensive loss.

The Company has determined Hong Kong dollars to be the functional currency of Arran, IC Star and 3G Dynasty, Island Media, Talent Leader and the PRC Chinese Yuan Renminbi to be the functional currency of Panyu M&M. The financial statements of the subsidiaries are translated to U.S. dollars using year-end rates of exchange for assets and liabilities, and average rates of exchange for the period for revenues, costs, and expenses. Net gains and losses resulting from foreign exchange transactions are included in the consolidated statements of operations. The cumulative translation adjustment and effect of exchange rate changes as of June 30, 2006 was $249.

COMPREHENSIVE INCOME (LOSS)

Comprehensive income (loss) includes changes to equity accounts that were not the result of transactions with shareholders. Comprehensive income (loss) is comprised of net income (loss) and other comprehensive income and loss items. The Company's comprehensive income and losses generally consist of changes in the fair value of changes in the cumulative foreign currency translation adjustment.

10

TELECOM COMMUNICATIONS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS JUNE 30, 2006

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES-CON'T

INCOME TAXES

Income taxes are accounted for under the asset and liability method in accordance with SFAS 109. "Accounting for Income Taxes". Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carry forwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

STOCK-BASED COMPENSATION

In December 2004, the FASB issued SFAS No. 123R, "Share-Based Payments (revised 2004)." This statement replaces SFAS 123, "Accounting for Stock–Based Compensation" and supersedes Accounting Principles Board's Opinion No. 25 (ABP 25), "Accounting for Stock Issued to Employees." SFAS 123R requires companies to measure the cost of employee services received in exchange for an award of equity instruments based on the grant date fair value of the award. That cost will be recognized over the period during which an employee is required to provide services in exchange for the award - the requisite service period (usually the vesting period). In March 2005, the SEC staff expressed their views with respect to SFAS No. 123R in Staff Accounting Bulletin No. 107, "Share-Based Payment," (SAB 107). SAB 107 provides guidance on valuing options. We adopted SFAS 123R on January 1, 2006.

3. PROPERTY AND EQUIPMENT

Property and equipment, which is located in the PRC and Hong Kong, consisted of the following at June 30, 2006:

Computer hardware	$	129,202
Computer software		4,897,295
Web site		4,205,712
Copyrights		200,000
Motor vehicles		168,307
Furniture and fixtures		45,782
Leasehold improvements		200,000
Total		9,846,298
Less: accumulated depreciation		(3,120,446)
Property and Equipment - Net	$	6,725,852

TELECOM COMMUNICATIONS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS JUNE 30, 2006

4. BUSINESS ACQUISITIONS

Acquisition of HRDQ, Inc. (“HRDQ”)

On June 28, 2006, the Company acquired 53.92% of the outstanding common stock of $0.001 par value of HRDQ by acquiring 2,024,190 new shares of HRDQ at $0.52 per share. The Company paid a total of $1,060,000 for its interest in the common stock of HRDQ. As part of the total purchase consideration, the Company issued a promissory note of $1,000,000 to HRDQ. At the same date, HRDQ acquired assets by selling798,747 shares of its common stock to China Dongguan Networks, Inc, at $0.52 each (total consideration of $415,348) and 500,000 shares of its common stock to Top Rider Group Limited at $2.2 each. HRDQ (total consideration of $1,100,000).

, HRDQ also issued 200,000 Series A Convertible Preferred stock of $0.01 par value to Top Rider Group Limited at $3.3 each with a total consideration of $660,000. These Series A Convertible Preferred Stock is convertible, into 2 shares of Common Stock or a total of 400,000 shares of common stocks. The proceeds from the issuances of HRDQ’s common stock and preferred stock wereused primarily to acquire a new website, called Subaye.com (“Website”).

The Company adopted SFAS No. 141, Business Combinations, and SFAS No. 142, Goodwill and Other Intangible Assets, effective June 2001. SFAS No. 141 requires the use of the purchase method of accounting for any business combinations initiated after June 30, 2002, and further clarifies the criteria to recognize intangible assets separately from goodwill. Under SFAS No. 142, Goodwill and Other Intangible Assets, goodwill and indefinite–lived intangible assets are no longer amortized but are reviewed for impairment. The results of HRDQ and the estimated fair market values of the assets and liabilities have been included in our consolidated financial statements from the date of acquisition (June 28, 2006).

The purchase price for HRDQ was allocated to the assets acquired and liabilities assumed of HRDQ. The estimated fair value of the tangible assets acquired and liabilities assumed approximated the historical cost basis of these assets. The company has written off the negative goodwill amount of $369,509, which was the excess of acquisition cost (common stock value issued) over fair value of net assets of HRDQ's acquisition of its wholly own subsidiary Panyu M&M, acquired in April, 2006. We wrote down the Website acquired to $3,705,712 as its fair market value and was allocated to additional paid-in capital. All intangible and tangible assets acquired and liabilities assumed, based on their estimated fair values, were determined by management. We will finalize this allocation at year end, with the assistance of a qualified independent third-party appraiser.

Cash	$	82,253
Accounts receivables		356,707
Payment in advance		279,251
Website		3,705,712
Property, plant, and equipment		11,605
Liabilities assumed		(2,275,543)
Net assets value of HRDQ at June 28, 2006	$	2,159,985
Net assets acquired by TCOM (representing 49% of diluted interest in HRDQ, Inc.)		1,060,000
Purchased consideration		1,060,000

TELECOM COMMUNICATIONS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS JUNE 30, 2006

4. BUSINESS ACQUISITIONS - (CON'T)

Acquisition of HRDQ, Inc. ("HRDQ")

The operating results of the Company have been included in our statement of operations from June 28, 2006. The following table presents the unaudited results of operations of the Company as if the acquisition had been consummated as of October 1, 2005, and includes certain pro forma adjustment, including the negative goodwill written off of $369,509, which was the excess of acquisition cost over the preliminary valuation of the fair value of net assets for HRDQ's acquisition of its own subsidiary Panyu M&M in April, 2006:

	2006
Revenues	14,490,882
Net income	4,631,691
Net income per share - basic	0.056
Net income per share - diluted	0.052
Shares used for computing net income per share - basic	82,040,000
Shares used for computing net income per share - diluted	88,921,000

5. RELATED PARTY TRANSACTIONS

A stockholder of TCOM and a company owned by such stockholder advanced funds to TCOM for working capital purposes. As of June 30, 2006 and 2005, TCOM owed the stockholder and his company amounts totaling $57,513 and $18,690 respectively. The advances are non-interest bearing and are payable on demand and are recorded as Due to related company under current liabilities.

Grace Motion, Inc., a company in which a former officer of the Company has a beneficial interest, was paid a consulting fee amounting to $3,846 during the nine months ended June 30, 2006 and its service contract with TCOM was ceased during the period.

The Company signed a 3-year contract with Taikang Capital Managements Corporation (Taikang"), a principal stockholder of the Company, for total solution software on July 1, 2004. During the six ended June 30, 2006, the Company recognized income from Taikang amounting to $1,080,000. The amount due from the stockholder at June 30, 2006 of $480,000 was classified under the caption "Accounts receivable - affiliate".

TELECOM COMMUNICATIONS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS JUNE 30, 2006

6. STOCK TRANSACTIONS

On November 16, 2005, TCOM issued 1,000,000 shares of TCOM's common stock, par value $0.001 per share, to the Chief Financial Officer of TCOM as part of his compensation at market price of $.49 resulting in stock-based compensation expense of $490,000.

On December 20, 2005, TCOM issued 4,000,000 shares of TCOM's common stock, par value $0.001 per share, to two consultants of TCOM as consultancy fee at market price of $.43 resulting in an expense of $1,720,000. The consultants will provide the services to the Company for two years from December, 2005 to November, 2007. The Company will amortise $1,720,000 over 24 months. (See note 9 on the details of the amortization of the stock-based compensation expenses.)

On March 23, 2006, TCOM issued 3,000,000 shares of TCOM's common stock, par value $0.001 per share, to three consultants of TCOM as consultancy fee at market price of $.54 resulting in an expense of $1,620,000. The consultants will provide the service to the Company for one year from January, 2006 to December, 2006,. The Company will amortise $1,620,000 over 12 months. (See note 9 on the details of the amortization of the stock-based compensation expenses.)

On April 20, 2006, TCOM issued 2,500,000 shares of TCOM's common stock, par value $0.001 per share, to four vice presidents of TCOM as remuneration at market price of $.52 resulting in an expense of $1,300,000. The vice presidents will provide the service to the Company for two years from April, 2006 to March, 2008, The Company will amortise $1,300,000 over 24 months. (See note 9 on the details of the amortization of the stock-based compensation expenses.) At the same date, TCOM issued 1,500,000 shares of TCOM's common stock, par value $0.001 per share, to chief executive officer of TCOM as remuneration at market price of $.52 resulting in an expense of $780,000. The chief executive officer will provide the service to the Company for one year from April, 2006 to March, 2007, The Company will amortise $780,000 over 24 months. (See note 12 on the details of the amortization of the stock-based compensation expenses.)

TELECOM COMMUNICATIONS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS JUNE 30, 2006

7. INCOME TAXES

British Virgin Islands

Alpha, the primary operating subsidiary, is incorporated in the British Virgin Islands and, under the current laws of the British Virgin Islands, is not subject to income taxes.

Hong Kong

The Company's other subsidiaries, IC Star and Talent Leader are incorporated in Hong Kong and are subject to Hong Kong taxation on its activities conducted in Hong Kong and income arising in or derived from Hong Kong. No provision for Hong Kong profits tax has been made as the Company had no assessable income for Hong Kong. The applicable Hong Kong statutory tax rate for the quarter ended December 31, 2005 and 2004 are 17.5% and 17.5%, respectively.

PRC

Enterprise income tax in PRC is generally charged at 33% of a company's assessable profit, in which 30% is a national tax and 3% is a local tax. For foreign investment enterprises established in a Special Economic Zone or Coastal Open Economic Zone, and which are engaged in production-oriented activities, the national tax rate could be reduced to 15% or 24% respectively. Companies which are incorporated in PRC are subject to a PRC enterprise income tax at the applicable tax rates on the taxable income as reported in their Chinese statutory accounts in accordance with the relevant enterprise income tax laws applicable to foreign enterprises. Pursuant to the same enterprise income tax laws, the subsidiaries are fully exempted from PRC enterprise income tax for two years starting from the first profit-making year, followed by a 50% tax exemption for the next three years. For those foreign enterprises established in the mid-western region of PRC, a 50% tax exemption for the next three years. For those foreign enterprises established in the middle west of PRC, a 50% tax exemption is granted for a further three years after the tax holiday and concession stated above. The Company accounts for income taxes in accordance with the provisions of SFAS No. 109, "Accounting for Income Taxes." No provision for Enterprises income tax in PRC has been made as the subsidiary has no assessable income for the year/period.

No provision for Enterprise income tax in the PRC had been made for the nine months ended June 30, 2006 and 2005 The Company had no assessable taxable income in the PRC, due to the fact that it is exempt from PRC tax, based on the statutory provisions granting a tax holiday for a two year period, as stated above, or for the Company's operations, for the Company's years ended September 30, 2005 and 2006. The Company's first profit taking year was the year ended September 30, 2005, therefore tax will be due to the PRC, if the Company generates PRC taxable income, for the fiscal year ended September 30, 2007.

Based on the above statutory PRC tax provision, the Company believes that it is remote that any PRC tax liability will be due for the nine months ended June 30, 2006 and 2005

8. MINORITY INTERESTS

Minority interests comprise:

Minority interests in the subsidiary of HRDQ, Inc.		
1,729,627 common stock of $0.01 par value of HRDQ, Inc., representing 41% of diluted interest in HRDQ, Inc.	$	885,594
200,000 Series A Convertible Preferred stock of $0.01 par value of HRDQ, Inc., representing 10% of diluted interest in HRDQ, Inc.		214,391
	$	1,099,985

15

TELECOM COMMUNICATIONS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS JUNE 30, 2006

9. COMMITMENTS AND CONTINGENCIES

Operating Leases - In the normal course of business, the Company leases office space under operating lease agreements. The Company rents office space, primarily for regional sales administration offices, in commercial office complexes that are conducive to administrative operations. The operating lease agreements generally contain renewal options that may be exercised at the Company's discretion after the completion of the base rental term. In addition, many of the rental agreements provide for regular increases to the base rental rate at specified intervals, which usually occur on an annual basis. As of June 30, 2006, the Company had operating leases that have remaining terms of 24 months. The following table summarizes the Company's future minimum lease payments under operating lease agreements as of September 30, 2006:

Year ended September 30,		
2006	$	88,500
2007		354,002
2008		212,049
	$	654,551

The Company recognizes lease expense on a straight-line basis over the life of the lease agreement. Contingent rent expense is recognized as it is incurred. Total rent expense in continuing operations from operating lease agreements was $182,625 and $15,485 for the nine months ended June 30, 2006 and 2005 .

Obligations to purchase copyrights

On December 29, 2005, the Company had signed an agreement with Zestv Features Limited (“Zestv”) to purchase Zestv’s future rights to its music, films and TV programming copyrights of online content. The total obligation to Zestv is $2,500,000. As of June 30, 2006, the Company paid to Zestv a cumulative amount of $1,807,436 and recorded the payments as a prepaid expense.

On June 13, 2006, the Company had signed an agreement with Zestv Incorporation (Zestv”) to purchase two film’s copy rights of “Xiong Chu Mo” and “Da Dian Ying”, the cost of each film is $1,060,000. The total obligation to Zestv Incorporation is $2,120,000. As of June 30, 2006, the Company paid 50% of the cost amounting to $1,060,000 and recorded the payments as prepaid expenses. The Company needs to settle the balance of $1,060,000 within 30 days after Zestv Incorporation supplies the rights of using the film to the Company.

16

TELECOM COMMUNICATIONS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS JUNE 30, 2006

10. STOCK PLAN

On June 8, 2005, a Registration Statement on Form S-8 was filed by TCOM with the Securities and Exchange Commission pursuant to the Securities Act of 1933, as amended (the "Securities Act"), for registration under said Securities Act of an additional 30,000,000 shares of common stock in connection with TCOM's 2005 Stock Awards Plan (the "Plan").

All shares issued under the Plan may be either authorized and unissued shares or issued shares reacquired by TCOM. Under the Plan, no participant may receive in any calendar year (i) Stock Options relating to more than 10,000,000 shares, (ii) Restricted Stock or Restricted Stock Units that are subject to the attainment of Performance Goals of Section 13 hereof relating to more than 5,000,000 shares, (iii) Stock Appreciation Rights relating to more than 10,000,000 shares, or (iv) Performance Shares relating to more than 5,000,000 shares. No non-employee director may receive in any calendar year Stock Options relating to more than 1,200,000 shares or Restricted Stock Units relating to more than 500,000 shares. The shares reserved for issuance and the limitations set forth above shall be subject to adjustment. All of the available shares may, but need not, be issued pursuant to the exercise of Incentive Stock Options. The number of shares that may be issued under the Plan for benefits other than Stock Options or Stock Appreciation Rights shall not exceed a total of 30,000,000 shares.

In connection to TCOM's 2005 Stock Awards Plan, there were 12,000,000 shares of free traded stock, issued during the nine months ended June 30, 2006, refer to note 5. Total shares outstanding at June 30, 2006 were 89,188,000 shares.

TELECOM COMMUNICATIONS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS JUNE 30, 2006

11. DISCONTINUED OPERATIONS

On April 1, 2006 , TCOM sold all its interests in Island Media with the net gain on the disposal of $295,533. Island Media's operating loss for the nine months ended June 30, 2006 of $239,776 was shown as Discontinued Operations in the condensed consolidated statements of Income and comprehensive income. The followings shown the results of the Island Media from October 1, 2005 to March 31, 2006

		From October 1, 2005 to March 31, 2006 (Unaudited)
Net revenues - others	$	247,458
Cost of sales- Other cost of sales		202,860
Gross profit		44,598
Expenses:		
Depreciation		21,016
Salaries		199,238
Other selling, general and administrative		99,020
Total operating expenses costs		319,274
		(274,676)
Other income/ (expense):		
Interest income		173
Other income		35,899
Interest expense		(1.626)
Gain on disposal of fixed assets		454
Total other income		34,900
Income from continuing operations before income tax		(239,776)
Income tax expenses		-
(Loss) from discontinued operations , net	$	(239,776)

TELECOM COMMUNICATIONS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS JUNE 30, 2006

12. STOCK-BASED COMPENSATION EXPENSES

In connection to the 2,600,000 shares of the Company's common stock issued on April 12, 2004 to various employees and consultants as part of their compensation at market price of $.62 with a total of $1,612,000, the Company expensed the salary bonus of $570,000 in the profit and loss for the year ended September 30, 2004 and amortized the consultancy fee of $1,042,000 over the service period of 24 months period. The terms for these agreements are 24 months starting from January 1, 2004 to December 31, 2005. It resulted in an expense of $43,416 for each month and the total expenses of $130,250 and $390,750 for the nine months ended June 30, 2006 and 2005 respectively.

In connection to the 400,000 shares of the Company's common stock issued on June 12, 2004 to two consultants as part of their compensation at market price of $.32 with a total of $128,000, the terms for these agreements are 24 months starting from January 1, 2004 to December 31, 2005. It resulted in an expense of $5,333 for each month and the total expenses of $16,000 and $48,000 for the nine months ended June 30, 2006 and 2005 respectively.

In connection to the 3,500,000 shares of the Company's common stock issued in July 22, 2005 to two consultants as part of their compensation at market price of $.24 with a total of $840,000, the terms for 1,500,000 of these shares totaled $360,000, is for the services to be rendered over 17 months from August, 2005 to December, 2006. Therefore, the Company amortized the total expense over a 17 month period which resulted in an expense of $21,176 for each month and the total expenses of $190,585 and $0 for the nine months ended June 30, 2006 and 2005 respectively.

The terms for remaining 2,000,000 shares totaled $480,000, is for the services to be rendered over 24 months from August, 2005 to July, 2007. Therefore, we amortized the total expense over a 24 month period which resulted in an expense of $20,000 for each month and the total expenses of $180,000 and $0 for the nine months ended June 30, 2006 and 2005 respectively.

In connection to the 1,000,000 shares of the Company's common stock issued on November 16, 2005 to Chief Financial Officer as part of their compensation at market price of $.49 with a total of $490,000, this was for compensation for a salary bonus and we accordingly expensed the whole amount of $490,000 in the profit and loss and was included in the nine months ended March, 31, 2006.

In connection to the 4,000,000 shares of the Company's common stock issued in December 20, 2005 to two consultants as part of their compensation at market price of $.43 with a total of $1,720,000, the services are to be rendered over 24 months from December, 2005 to November, 2007. Therefore, we amortized the total expense over a 24 month period which resulted in an expense of $71,667 for each month and the total expense of $501,669 and $0 for the nine months ended June 30, 2006 and 2005 respectively.

In connection to the 3,000,000 shares of the Company's common stock issued in March 23, 2006 to consultants as part of their compensation at market price of $.54 with a total of $1,620,000, the services terms are 12 months from January, 2006 to December, 2006, therefore, the Company amortized the total over 12 months and then there will be $135,000 for each month and we have amortized six months of $810,000 for the quarter ended June 30, 2006.

In connection to the 2,500,000 shares of the Company's common stock issued in April 20, 2006 to vice presidents as part of their compensation at market price of $.52 with a total of $1,300,000, the services terms are 24 months from April, 2006 to March, 2008, therefore, the Company amortized the total over 24 months and then there will be $54,167 for each month and we have amortized three months of $162,501 for the quarter ended June 30, 2006 . In

connection to the 1,500,000 shares of the Company's common stock issued in April 20, 2006 to chief executive officer as part of their compensation at market price of $.52 with a total of $780,000, the services terms are 12 months from April, 2006 to March, 2007, therefore, the Company amortized the total over 12 months and then there will be $65,000 for each month and we have amortized three months of $195,000 for the quarter ended June 30, 2006 .

As a result, the total stock compensation being amortized $2,676,005 and $438,750 for the nine months ended June 30, 2006 and 2005 respectively.

19

TELECOM COMMUNICATIONS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS JUNE 30, 2006

13. RESTATEMENT OF PRIOR INTERIM CONDENSED FINANCIAL STATEMENTS - JUNE 30, 2005

The Company's interim financial statements have been restated to give effect to the following adjustment :

1) The Company bought the 20% of IC Star MMS on March 16, 2004. The Company recorded significant reorganization expenses in the statement of operations for the year ended September 30, 2004. Pursuant to SEC comments received after this filing, we have recorded these reorganization expenses as a deemed dividend paid out of additional paid in capital, instead of recording this transaction as an expense. This restatement does not change our total stockholders' equity but only increases our retained earnings and decreases our additional paid in capital.

2) Pursuant to the SEC comments received after the filing, we reallocated the depreciation of software related to the revenue of the company to cost of sales. Other depreciation expenses related to motor vehicles and office equipments and are stated in Selling, General and Administration Expenses. This had no impact on our prior earnings reported.

3) In March 2005, the SEC staff expressed their views with respect to SFAS No. 123R in Staff Accounting Bulletin No. 107, "Share-Based Payment," (SAB 107). SAB 107 provides guidance on valuing options. Now, we amortize the cost of employee services received in exchange for an award of equity instruments based on the grant date fair value of the award. Also, that cost is recognized over the period during which the employee is required to provide services in exchange for the award.

The accompanying financial statements for the nine months ended June 30, 2005 have been restated to reflect the corrections. The accumulated changes to the retained earnings at June 30, 2005 was increased by $8,565,667, including the decrease in the current earnings for the nine months ended June 30, 2005of $438,750 and the total increase in retained earnings as at September 30, 2004 of $8,858,167.

The following is a summary of the restatements for the nine months ended June 30, 2005

	Adjustment no:	Increase/(Decrease) in Current Earnings
Reclassification of the depreciation expenses on the software that sold to customers to cost of sales	2	$ (1,047,211)
Transfer of the depreciation which included in other selling, general and administrative to cost of sales and depreciation	2	1,047,211
Stock-based compensation expenses charged to Statement of Operation	3	(438,750)

Total decrease in the current earnings for the nine months ended June 30, 2005			(438,750)						
Credit to acquisition cost of the 20% interest of IC Star in 2004 and debit to the additional paid in capital		1	8,126,917						
Transfer to deferred stock-based compensation		3				50,000	$ 19.74	$ 139,000	
	04/11/2006	04/13/2006	8,333	25,000	25,000			$ 19.74	$ 69,500
	12/06/2006	12/06/2006					20,000	$ 27.94	$ 79,694

(1) We have made all payments related to specific non-equity incentive performance awards within each of the named executive officers employment agreements and has established no new non-equity incentive plan awards.

(2) Please read the narrative above regarding Mr. Lopus employment agreement and Performance Awards.

(3) The amounts shown in column (i) reflect the number of shares of stock granted to each named executive officer pursuant to our LTIP and terms of each executive s employment agreement.

(4) The exercise price is the closing sales price of a unit on the effective date of the grant or if there was no trading on such date, the preceding date on which there was trading.

(5) The amounts shown in column (l) represent the full grant date fair value for each award under FAS 123(R) granted to each named executive. Assumptions used in the calculation of these amounts are included in footnote 7 to our audited financial statements for the fiscal year ended December 31, 2006, included in our annual report on Form 10-K for the year ended December 31, 2006, which is incorporated by reference. The full grant fair value is the amount we would expense in our financial statements over the award s vesting period.

(6) In addition, the Committee granted our named executive officers the following restricted unit grants on January 19, 2007:

Executive	Unit Award	Value at Grant Date	
Michael C. Linn	150,000	$	4,852,500
Kolia Rockov	140,000	$	4,529,000
Lisa D. Anderson	15,000	$	485,250
Thomas A. Lopus	15,000	$	485,250

25

OUTSTANDING EQUITY AWARDS AT DECEMBER 31, 2006

	Option Awards							Unit Awards					
Name	Equity Incentive Awards Units Underlying Unexercised Exercisable Options	Number of Securities Underlying Unexercisable Options		Option Exercise Price ($)		Option Expiration Date(1)		Number of Unvested Restricted Units		Market Value of Unvested Restricted Units ($)(2)		Equity Incentive Plan Awards Number of Unvested Restricted Units	Market Value of Unvested Restricted Units ($)(2)
Michael C. Linn		111,250	(3)	$ 21.00		01/19/16		625,781		$ 19,993,703	(9)		
		125,000	(4)	$ 27.94		12/06/16					(4)		
Kolja Rockov		111,250	(3)	$ 21.00		01/19/16		228,909		$ 7,313,643	(10)		
		85,000	(4)	$ 27.94		12/06/16					(4)		
Mark E. Ellis		50,000	(5)	$ 32.18		12/18/16		200,000		$ 6,390,000	(5)		
Lisa D. Anderson		50,000	(6)	$ 20.25		07/18/16		50,000		$ 1,597,500	(6)		
		20,000	(4)	$ 27.94		12/06/16					(7)		
Thomas A. Lopus		50,000	(7)	$ 19.84		04/13/16					(8)	20,000	$ 639,000
	25,000		(8)	$ 19.84		12/06/16					(4)		
		20,000	(4)	$ 27.94		12/06/16							

(1) Options expire ten years from date of grant.

(2) Based on the closing sales price of our common units on December 29, 2006 of $31.95.

(3) These unit options vest in three equal annual installments beginning on January 19, 2006.

(4) These unit options vest in three equal annual installments beginning on December 6, 2006.

(5) These unit options vest one half on January 1, 2007 and the remainder in two equal annual installments thereafter.

(6) These unit options vest in three equal installments the first on January 1, 2007 and annually thereafter.

(7) These unit options vest in three equal annual installments beginning April 13, 2007.

(8) These unit awards vest in three equal annual installments beginning April 13, 2006, provided certain performance metrics have been achieved as described earlier.

(9) These units vested on January 20, 2007.

(10) These restricted units vest in two equal annual installments beginning on January 19, 2006.

2006 OPTION EXERCISES AND STOCK VESTED

None of our named executive officers exercised any stock options during 2006.

	Option Awards		Unit Awards(2)	
(a) Name	(b) Number of Shares Acquired on Exercise (#)	(c) Value Realized on Exercise ($)	(d) Number of Shares Acquired on Vesting (#)	(e) Value Realized on Vesting ($)
Michael C. Linn				
Kolja Rockov			114,455	$ 2,546,624
Mark E. Ellis				
Lisa D. Anderson				
Thomas Lopus				

(1) As provided for in Mr. Rockov s employment agreement, one third of the unit award issued in connection with our initial public offering vested immediately. The value presented reflects the closing price of our units on the date of vesting.

(2) All other awards issued in 2006 begin vesting in 2007.

26

PENSION BENEFITS

We do not provide pension benefits for our named executive officers or other employees. Retirement benefits are provided through the Retirement Savings Opportunity, as discussed previously.

NON-QUALIFIED DEFERRED COMPENSATION

We do not have a non-qualified deferred compensation plan and as such, no compensation has been deferred by our named executive officers or our other employees. The Savings Plan is a 401(k) deferred compensation arrangement and a qualified plan under section 401(a) of the Internal Revenue Code (the Code).

POTENTIAL PAYMENTS UPON TERMINATION OR CHANGE OF CONTROL

Payments Made Upon Termination

Regardless of the manner in which a named executive officer s employment terminates, the executive will be entitled to receive amounts earned (but unpaid) during his term of employment. Such amounts include:

- earned, but unpaid base salary;
- non-equity incentive compensation earned during the fiscal year;
- unused vacation pay; and
- amounts contributed and vested through our Savings Plan.

Payments Made Upon Termination Without Cause or for Good Reason

In addition to the payments described above, in the event of termination by us other than for Cause or termination by the executive for Good Reason, except as otherwise indicated in the narrative quantifying the payments to each executive set forth below, generally each executive s employment agreement provides for severance payments equal to one year of the executive s base salary payable in 12 monthly installments if the qualifying termination occurs prior to the executive s anniversary of employment with us, and, thereafter, 24 monthly installments at the executive s highest base salary in effect at any time during the 36 months prior to the date of the qualifying termination. We will also bear the full cost of the executive s COBRA continuation coverage for such period, as such coverage is required to be continued under applicable law.

In addition, in such event of termination by us other than for Cause or termination by the executive for Good Reason, all outstanding restricted unit and the unit option awards will vest in full.

We will have *Cause* to terminate an executive officer s employment under his or her respective agreement by reason of any of the following: (i) the employee s conviction of, or plea of *nolo contendere* to, any felony or to any crime or offense causing substantial harm to us or any of our direct or indirect subsidiaries (whether or not for personal gain) or involving acts of theft, fraud, embezzlement, moral turpitude or similar conduct; (ii) the executive officer s repeated intoxication by alcohol or drugs during the performance of his duties; (iii) malfeasance in the conduct of employee s duties, including, but not limited to, (A) willful and intentional misuse or diversion of any of the related parties funds, (B) embezzlement or (C) fraudulent or willful and material misrepresentations or concealments on any written reports submitted to us or our direct or indirect subsidiaries; (iv) the executive officer s material failure to perform the duties of the executive officer s employment consistent with executive officer s position, expressly including the provisions of the employment agreement, or material failure to follow or comply with the reasonable and lawful written directives of the Board; (v) a material breach of the employment agreement; or (vi) a material breach by the executive officer of our written policies concerning employee discrimination or harassment.

Good Reason means any of the following to which the executive officer will not consent in writing: (i) a reduction in the executive officer s base salary; (ii) a relocation of the executive officer s primary place of employment to a location more than 50 miles from the city of such primary place of employment; or, in some cases, (iii) any material reduction in the Officer s title, authority or responsibilities.

Payments Made Upon Death or Disability

In the event of the death or Disability of a named executive officer, the executive will receive amounts earned (but unpaid) during his term of employment as described above.

In addition, upon the death or Disability of an executive all outstanding restricted units and unit option awards will vest in full.

Disability means the determination by a physician selected by us that the executive officer has been unable to perform substantially the executive officer s usual and customary duties under their agreement for a period of at least one hundred twenty (120) consecutive days or a non-consecutive period of one hundred eighty (180) days during any twelve-month period as a result of incapacity due to mental or physical illness or disease. At any time and from time to time, upon reasonable request therefore by us, the executive officer will submit to reasonable medical examination for the purpose of determining the existence, nature and extent of any such disability.

Payments Made Upon a Termination Following a Change of Control

Our LTIP and the employment agreements with each named executive officer provide certain benefits if an executive s employment is terminated following a Change of Control (other than termination by us for Cause or by reason of death or Disability) or if the executive terminates his employment in certain circumstances defined in the agreement which constitute Good Reason, in addition to the earned benefits and amounts listed under the heading Payments Made Upon Termination :

- the named executive officer will receive:

- a lump sum severance payment of up to three times the sum of the executive s base salary and the highest annual bonus earned by the executive pursuant to the incentive compensation plans maintained by us in any of the three prior fiscal years;

- a lump sum amount representing a pro rata portion of any incentive compensation earned by the executive through the date of termination, assuming achievement of the target level of the performance goals;

- COBRA continuation coverage as described above upon a termination without Cause or for Good Reason.

- the named executive officer may receive, if approved by the Board an amount equal to the excise tax charged to the named executive officer as a result of the receipt of any change of control payments.

- all restricted unit and unit options awards held by the executive will automatically vest and become exercisable.

Each of the named executive officers employment agreements are substantially similar and all restricted unit and unit option awards are subject to the terms of our LTIP, under which a Change of Control is deemed to occur upon:

(i) the acquisition by any person, as such term is used in Sections 13(d) and 14(d) of the Securities Exchange Act of 1934, as amended (the Exchange Act), other than the Company or an Affiliate of the Company, of beneficial ownership (as defined in Rule 13d-3 under the Exchange Act), directly or indirectly, of securities of our company representing more than 35% of the combined voting power of our then outstanding securities entitled to vote generally in the election of our directors; provided, however, that any acquisition of securities from Quantum Energy Partners will be disregarded for purposes of determining whether a Change of Control has occurred; or

(ii) the consummation of a reorganization, merger, consolidation or other form of business transaction or series of business transactions, in each case, with respect to which persons who were the members of our company immediately prior to such reorganization, merger or consolidation or other transaction do not, immediately thereafter, own more than 50% of the combined voting power entitled to vote generally in the election of directors of the reorganized, merged or consolidated company s then outstanding voting securities; or

(iii) the sale, lease or disposition (in one or a series of related transactions) by us of all or substantially all of our assets to any person or our affiliates, other than us or our affiliates; or

(iv) a change in the composition of the Board, as a result of which fewer than a majority of the directors are Incumbent Directors. Incumbent Directors shall mean directors who either (A) are directors of our company as of the effective date of the initial public offering of our equity interests, or (B) are elected, or nominated for election, thereafter to the Board with the affirmative votes of at least a majority of the Incumbent Directors at the time of such election or nomination, or (C) are among the five original independent directors of our company, but Incumbent Director shall not include an individual whose election or nomination is in connection with (i) an actual or threatened election contest (as such terms are used in Rule 14a-11 of Regulation 14A promulgated under the Exchange Act) or an actual or threatened solicitation of proxies or consents by or on behalf of a Person other than the Board or (ii) a plan or agreement to replace a majority of the then Incumbent Directors; or

(v) the approval by the Board or the members of our company of a complete or substantially complete liquidation or dissolution of our company.

Excise Taxes

If any benefits payable or otherwise provided under each named executive s employment agreement would be subject to the excise tax imposed by Section 4999 of the Code (the *Excise Tax*), then the Board may, in its sole discretion, provide for the payment of, or otherwise reimburse the executive for, an amount up to such Excise Tax and any related taxes, fees or penalties thereon as the Board may consider to be customary and appropriate for a comparable public company

Non-Competition Provisions

The non-competition provisions of the employment agreements of each of the named executive officers are described above in the section of the Proxy Statement titled Narrative Disclosure to the 2006 Summary Compensation Table.

Quantification of Payments

The narrative below reflects the amount of compensation to each of our named executive officers in the event of termination of such executive s employment pursuant to his employment agreement and our LTIP. The amount of compensation payable to each named executive officer upon voluntary termination with Good Reason, involuntary termination other than for Cause, termination following a Change of Control and the occurrence of the Disability or death of the executive is shown below. The amounts shown are calculated assuming that such termination was effective as of December 31, 2006, and thus include amounts earned through such time (other than amounts payable pursuant to our Savings Plan) and are estimates of the amounts which would be paid out to the executives upon their termination. The actual amounts to be paid out can only be determined at the time of such executive s separation from us.

Mr. Linn

Mr. Linn s employment agreement provides that in the event of termination by us other than for Cause or termination by Mr. Linn for Good Reason, he will receive severance payments in 24 monthly installments at his base salary or $250,000 for 2006 if his employment is terminated before January 19, 2007 and thereafter at his

highest base salary in effect at any time during the 36 months prior to the date of termination. He would also be eligible for the pro rata portion of any earned, but unpaid bonus, which totaled $1,000,000 at December 31, 2006 and COBRA benefits estimated at a maximum $29,100. If, within one year of a Change of Control, we terminate his employment other than for Cause or Mr. Linn terminates his employment for Good Reason, he will also be entitled to receive a lump-sum payment equal to $750,000. In addition, all restricted units and unit option awards will vest in full upon a Change of Control or a termination without Cause, with Good Reason or upon Mr. Linn s death or Disability, the value of s early vesting would have been $1,719,438 on December 31, 2006. The maximum excise tax benefits related to a Change of Control, subject to Board approval, of $789,000 could have been paid at December 31, 2006.

Mr. Rockov

Mr. Rockov s, employment agreement provides that in the event of termination by us other than for Cause or termination by Mr. Rockov for Good Reason, he will receive severance payments in 24 monthly installments at his highest base salary in effect at any time during the 36 months prior to the date of termination, which was $200,000 as of December 31, 2006. He would also be eligible for the pro rata portion of any earned, but unpaid bonus, which totaled $900,000 at December 31, 2006 and COBRA benefits estimated at a maximum $34,500. If, within one year of a Change of Control, we terminate Mr. Rockov s employment other than for Cause or he terminates his employment for Good Reason, he will be entitled to receive a lump-sum payment equal to 36 months, which would have resulted in a lump sum payment of $600,000 if such termination had occurred on December 31, 2006. In addition, all restricted units and unit option awards will vest in full upon a Change of Control or a termination without Cause, with Good Reason or upon Mr. Rockov s death or Disability, the value of such early vesting would hav been $8,875,875 at December 31, 2006. The maximum excise tax benefits related to a Change of Control, subject to Board approval, of $737,000 could have been paid at December 31, 2006.

Mr. Ellis

Mr. Ellis employment agreement provides that in the event of termination by us other than for Cause or termination by Mr. Ellis for Good Reason, he will receive severance payments, (i) if such termination occurs prior to the first anniversary of his employment, in 12 monthly installments and (ii) if such termination occurs on or after the first anniversary, in 24 monthly installments, in either case, at his highest base salary in effect at any time during the 36 months prior to the date of termination, which was $250,000 at December 31, 2006. He would also be eligible for the pro rata portion of any earned, but unpaid bonus, which totaled $250,000 at December 31, 2006 and COBRA benefits estimated at a maximum of $34,500. If, within one year of a Change of Control, we terminate Mr. Ellis employment other than for Cause or he terminates his employment for Good Reason, he will be entitled to receive a lump-sum payment equal to the termination payment described previously, which would have resulted in a lump sum payment of $250,000 if such termination had occurred on December 31, 2006. In addition, all restricted units and unit option awards will vest in full upon a Change of Control or a termination without Cause, with Good Reason or upon Mr. Ellis death or Disability, the value of such early vesting would have been $6,378,500 at December 31, 2006. The maximum excise tax benefits related to a Change of Control, subject to Board approval, of $925,000 could have been paid at December 31, 2006.

Ms. Anderson

Ms. Anderson s, employment agreement provides that in the event of termination by us other than for Cause or termination by Ms. Anderson for Good Reason, she will receive severance payments, (i) if such termination occurs prior to the first anniversary of her employment, in 12 monthly installments and (ii) if such termination occurs on or after the first anniversary, in 24 monthly installments, in either case, at her highest base salary in effect at any time during the 36 months prior to the date of termination, which was $175,000 at December 31, 2006. She would also be eligible for the pro-rata portion of any earned, but unpaid bonus, which totaled $250,000 at December 31, 2006 and COBRA benefits estimated at a maximum $11,000. In the event of termination by the Company other than for Cause or termination by Ms. Anderson for Good Reason, on or prior to December 31, 2007, she will also be entitled to a cash payment equal to her pro-rata guaranteed bonus of $125,000 for 2007. If, within one year of a Change of Control, we terminate Ms. Anderson s employment other than for Cause or she terminates her employment for Good Reason, she will be entitled to receive a lump-sum payment

equal to the termination payment described previously, which would have resulted in a lump sum payment of $175,000 if such termination had occurred on December 31. 2006. In addition, all restricted units and unit option awards will vest in full upon a change of control or a termination without cause, with good reason or upon Ms. Anderson s death or disability, the value of such early vesting would have been $2,262,700 at December 31, 2006. There would have been no excise tax benefits related to a Change of Control, subject to Board approval, at December 31, 2006.

Mr. Lopus

Mr. Lopus employment agreement provides that in the event of termination by us other than for Cause or termination by Mr. Lopus for Good Reason, he will receive severance payments, (i) if such termination occurs prior to the first anniversary of his employment, in 12 monthly installments and, (ii) if such termination occurs on or after the first anniversary, in 24 monthly installments, in either case, at his highest base salary in effect at any time during the 36 months prior to the date of termination, which was $175,000 at December 31, 2006. In the event of termination for other than for Cause or termination by Mr. Lopus for Good Reason, on or prior to December 31, 2006 he would have been entitled to a cash payment equal to his pro-rata guaranteed bonus of $125,000 and COBRA benefits estimated at a maximum of $34,500. If, within one year of a Change of Control, we terminate his employment other than for Cause or Mr. Lopus terminates his employment for Good Reason, he will be entitled to receive a lump-sum payment equal to, his highest base salary if prior to April 3, 2007, two times his highest base salary if on or after April 3, 2007 and the Company s annualized distribution rate at the time of the Change of Control is at least $2.30 per unit, three times his highest base salary if on or after April 3, 2008 and before December 31, 2009 and the Company s annualized distribution rate at the time of the Change of Control is at least $2.76 per unit or up to three times his highest base salary if on or after December 31, 2009 depending upon whether or not the foregoing specified annual distribution rates were achieved by the Company in the specified time periods set forth above. If Mr. Lopus had incurred such a termination on December 31, 2006 he would have received a lump sum payment of $175,000. The maximum excise tax benefits related to a Change of Control, subject to Board approval, of $418,000 could have been paid at December 31, 2006.

All restricted units and unit option awards are subject to all provisions of our LTIP, and as such will vest in full upon a Change of Control or a termination without Cause, with Good Reason or upon Mr. Lopus death or Disability, provided those awards with performance requirements have achieved the established targets, which would have been $999,617.

DIRECTOR COMPENSATION

We use a combination of cash and stock-based incentive compensation to attract and retain qualified candidates to serve on our Board. In setting director compensation, we consider the significant amount of time that directors expend in fulfilling their duties to us as well as the skill-level required by us of members of our Board.

Annual Retainer and Fees. Each independent director (as determined by our Board pursuant to applicable NASDAQ listing standards) serving on our Board receives an annual cash retainer of $25,000. Additionally, each independent director serving on our audit committee receives cash compensation of $25,000. The chairmen of our audit, compensation and nominating committees receive an additional $2,000.

Prior to our initial public offering in January 2006, there were no compensation arrangements in effect for service as a director of our company.

Unit Option Awards. In connection with his or her initial appointment or election to our Board, each independent director is entitled to an option grant to purchase 10,000 units of our company under our LTIP at an exercise price equal to the closing price of the units on the grant date, vesting immediately. Upon any subsequent re-election to our Board, each independent director is entitled to an additional option grant to purchase 10,000 units of our company under our LTIP at an exercise price equal to the fair market value of the units on the grant date, vesting over three years from the grant date in annual one-third increments, with certain exceptions.

Phantom Unit Grant. During 2006, the Compensation Committee approved an award of 3,000 phantom units to each of our independent directors. The phantom units were granted under our LTIP. Under the terms of the

phantom unit grant agreement, the forfeiture restrictions on the phantom units lapse on the first anniversary of the grant date, provided that such director continues to serve on our Board on such date, or such director stood for re-election to our Board but was not elected. Additionally, if a director s service on our Board is terminated for cause at anytime after the grant date and regardless of whether the restricted period has terminated, then all phantom units awarded under the grant agreement shall be forfeited.

2006 Director Summary Compensation Table

The table below summarizes the compensation paid by the Company to independent Directors for the fiscal year ended December 31, 2006.

(a) Name (1)	(b) Fees Earned or Paid in Cash	(c) Unit Awards ($)(2)	(d) Option Awards ($)(3)	(e) Change in Pension Value and Deferred Compensation Earnings	(f) All Other Compensation	(g) Total ($)
George A. Alcorn	$ 52,000	$ 29,588	$ 25,200	n/a	$ 2,490	$ 106,278
Terrence S. Jacobs	$ 54,000	$ 29,588	$ 25,200	n/a	$ 2,490	$ 108,278
Jeffrey L. Swoveland	$ 52,000	$ 29,588	$ 25,200	n/a	$ 2,490	$ 106,278

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(1) Mssrs. Michael C. Linn, our Chairman, President and Chief Executive Office, and Alan L. Smith, director are not included in this table as they are not independent directors and thus receive no compensation for their services as directors. Mr. Linn is an employee of our company; his compensation is shown in the Summary Compensation Table above. Mr. Smith earns his compensation from Quantum Energy Partners, an affiliate of our company.

(2) Reflects the dollar amount recognized for financial statement reporting purposes for the fiscal year ended December 31, 2006 in accordance with FAS 123(R) and include amounts from awards granted in 2006. There were no awards made in prior years. As of December 31, 2006, each Director has the 3,000 phantom units, which vest on August 3, 2007, subject to certain forfeiture provisions, with units becoming issuable upon completion of their service as a director. Directors are paid distributions on phantom units. In addition, each Director has an option grant for 10,000 shares, which vests on August 3, 2007.

(3) Reflects the dollar amount recognized for financial statement reporting purposes for the fiscal year ended December 31, 2006 for distributions paid on the phantom units reported in column (c).

In April, 2007, the Board approved changes to the independent director compensation to take effect after the Annual Meeting. The annual cash retainer for each independent director will increase to $40,000, the annual cash retainer for the Compensation Committee and the Nominating and Governance Committee chairs will increase to $5,000 and the annual cash retainer for the Audit Committee chair will increase to $11,000. Each independent director will receive a board meeting fee of $1,500 per meeting and a committee meeting fee of $1,000 per meeting.

SECURITY OWNERSHIP

Security Ownership of Directors and Executive Officers

The following table sets forth the beneficial ownership of our units and class C units as of April 24, 2007, for each director and nominee for director, each executive officer named in the Summary Compensation Table herein, and by all directors (including nominees) and our executive officers as a group.

	Units (1)	Options Currently Exercisable Or Within 60 Days	Class C Units	Total Units and Unit Based Holdings
Michael C. Linn (2)	4,211,342	37,083		4,248,425
Kolja Rockov(3)	483,764	37,083		520,847
Mark E. Ellis	200,000	16,667		216,667
Lisa D. Anderson	65,000	16,667		81,667
Thomas A. Lopus	35,000	25,000		60,000
George A. Alcorn	2,000	10,000		12,000

32

	Units (1)	Options Currently Exercisable Or Within 60 Days	Class C Units	Total Units and Unit Based Holdings
Terrence S. Jacobs	4,750	10,000		14,750
Jeffrey C. Swoveland		10,000		10,000
Alan L. Smith (1)	10,147,085			10,147,085
All Directors and executive officers as a group (12)	15,719,563	176,417		15,895,980

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(1) Based solely on information furnished in the Schedule 13D/A (Amend. No. 1) filed by Quantum Energy Partners and certain of its affiliates with the SEC on February 17, 2006 and a Form 3 filed by Mr. Smith with the SEC on June 14, 2006. Mr. Alan L. Smith, a director of our company, is also a Managing Partner of Quantum Energy Partners, and can be deemed to beneficially own the units held by Quantum Energy Partners. Mr. Smith disclaims beneficial ownership in the reported securities in excess of his indirect pecuniary interest in the securities.

(2) Includes the 625,781 unit award to Mr. Linn, which was issued and immediately vested on January 20, 2007 under the terms of his employment agreement. In accordance with the LTIP, 226,561 units were redeemed for the satisfaction of statutory tax withholding and as such, of this award 399,220 units remain outstanding.

(3) Mr. Rockov has pledged his vested 228,910 units to secure a personal line of credit.

Securities Authorized for Issuance Under Equity Compensation Plans

The LTIP limits the number of units that may be awarded to 3.9 million units, provided that no more than 1.5 million (increased from 500,000 units by a January 2007 plan amendment approved by the unitholders) may be issued as restricted units.

Of the 930,500 unit options outstanding at December 31, 2006, none were vested and exercisable. Option awards are exercisable in three equal amounts of 310,167 in 2008, 2009 and 2010, respectively.

The Long-Term Incentive Plan is effective until termination of the Plan by the Compensation Committee. For additional information regarding the Plan and related equity awards, see Note 7 of the Notes to Consolidated Financial Statements included under Item 8 of our Annual Report on Form 10-K for the year ended December 31, 2006.

SECURITIES AUTHORIZED FOR ISSUANCE UNDER EQUITY COMPENSATION PLANS

The following table sets forth certain information as of December 31, 2006 regarding our LTIP, under which our units are authorized for issuance to our employees, consultants, affiliates and directors.

	Number of Securities to be Issued upon Exercise/Vesting of Outstanding Options, Warrants and Rights	Weighted Average Exercise Price of Outstanding Options, Warrants and Rights	Number of Units Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Units Reflected in Column (a))
		(a)	
Equity compensation plans approved by unitholders			
Equity compensation plan not approved by unitholders:			
Unit option awards	930,500	24.24	729,264
Units	740,236		
Restricted units	498,909		1,001,091
Total	2,169,645	$ 10.40	1,730,355

Our LTIP limits the number of units that may be awarded to 3.9 million units, provided that no more than 1.5 million (increased from 500,000 units by a January 2007 plan amendment approved by the unitholders) may be issued as restricted units. Of the 930,500 unit options outstanding at December 31, 2006, none were vested and exercisable. Option awards are exercisable in three equal amounts of 310,167 in 2008, 2009 and 2010, respectively.

Our LTIP is effective until termination of the Plan by the Compensation Committee. For additional information regarding the Plan and related equity awards, please read Note 7 of the Notes to Consolidated Financial Statements included under Item 8 of our Annual Report on Form 10-K for the year ended December 31, 2006.

SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The following table sets forth as of the Record Date the number of units beneficially owned by: (i) each person who is known to us to beneficially own more than 5% of a class of units; (ii) the current directors and nominees of our Board of Directors; (iii) each executive officer named in the 2006 Summary Compensation Table included under Executive Compensation ; and (iv) all current directors and executive officers as a group. We obtained certain information in the table from filings made with the SEC. Unless otherwise noted, each beneficial owner has sole voting power and sole investment power.

Name of Beneficial Owner	Units Beneficially Owned	Percentage of Units Beneficially Owned	
Quantum Energy Partners (1)	10,144,585	17.6	%
Michael C. Linn (2)(3)	4,211,342	7.3	%
Kolja Rockov (2)(4)	483,764	*	
Mark E. Ellis (2)(3)	200,000	*	
Lisa D. Anderson (2)(3)	65,000	*	
Roland Chip P. Keddie (2)	490,622	*	
Charlene Ripley (2)(3)	30,000	*	
Thomas A. Lopus (2)(3)	35,000	*	
Arden Walker (2)(3)	50,000	*	
George A. Alcorn	2,000	*	
Terrence S. Jacobs	4,750	*	
Alan L. Smith (1)	10,147,085	17.6	%
Jeffrey C. Swoveland	-0-	*	
All executive officers and directors as a group (12 persons)	15,719,563	27.2	%

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* Less than 1% of class.

(1) Based solely on information furnished in the Schedule 13D/A (Amend. No. 1) filed by QEP, QEM-LP and QEM-LLC (each as defined below) with the SEC on February 17, 2006 and a Form 3 filed by Mr. Smith with the SEC on June 14, 2006. Quantum Energy Partners owns its Units through Quantum Energy Partners II, LP (QEP). QEP is controlled by its general partner, Quantum Energy Management II, LP (QEM-LP), which is controlled by its general partner, Quantum Energy Management II, LLC (QEM-LLC), an affiliate of Quantum Energy Partners. Mr. Smith, a director of the Company, is also a Managing Partner of Quantum Energy Partners, and can be deemed to beneficially own the units held by QEP. Mr. Smith disclaims beneficial ownership in the reported securities in excess of his indirect pecuniary interest in the securities. Mr. Smith, QEP, QEM-LP and QEM-LLC can be contacted at the following address: c/o Quantum Energy Partners, 777 Walker Street, Suite 2530, Houston, Texas 77002.

(2) The address of each beneficial owner, unless otherwise noted, is c/o Linn Energy, LLC, 600 Travis, Suite 7000, Houston, Texas 77002.

(3) Includes unvested restricted Unit awards that vest in equal installments, generally over three years.

(4) Includes 114,455 restricted Units that vest in a final installment January 2008 and 400 Units as custodian under certain UGMA accounts for immediate family members as to which Mr. Rockov disclaims beneficial ownership. Mr. Rockov has pledged his vested 228,910 units to secure a personal line of credit.

CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

In the ordinary course of our business, we purchase products or services from, or engage in other transactions with, various third parties. Occasionally, these transactions may involve entities that are affiliated with one or more members of our Board of Directors. When they occur, these transactions are conducted in the ordinary course and on an arms-length basis.

Review and Approval of Related Party Transactions

We review all relationships and transactions in which our company and our directors and executive officers or their immediate family members are participants to determine whether such persons have a direct or indirect material interest. We have developed and implemented processes and controls to obtain information from our directors and executive officers with respect to related person transactions and for then determining, based on the facts and circumstances, whether we or a related person has a direct or indirect material interest in the transaction. As required under SEC rules, transactions that are determined to be directly or indirectly material to us or a related person are disclosed in our annual proxy statement. In addition, our Nominating and Governance Committee or Board of Directors (if appropriate) reviews and approves or ratifies any related person transaction that is required to be disclosed. In the course of its review and approval or ratification of a disclosable related party transaction, consideration is given to:

- the nature of the related person s interest in the transaction;
- the material terms of the transaction, including, without limitation, the amount and type of transaction;
- the importance of the transaction to the related person;
- the importance of the transaction to us;
- whether the transaction would impair the judgment of a director or executive officer to act in our best interest; and
- any other matters deemed appropriate.

Any director who is a related person with respect to a transaction under review may not participate in the deliberations or vote respecting approval or ratification of the transaction; provided, however, that such director may be counted in determining the presence of a quorum at the meeting where the transaction is considered.

Stakeholders Agreement

Prior to filing our registration statement relating to our initial public offering, we and all of the holders of pre-initial public offering membership interests in us, including Quantum Energy Partners, non-affiliated equity investors and certain members of our management, entered into an agreement relating to:

- the redemption and/or exchange, as applicable, of their respective membership interests in us;
- certain governance matters; and
- registration rights for the benefit of certain of our affiliates.

We refer to this agreement as our Stakeholders Agreement. The Stakeholders Agreement resulted from arm s-length negotiations among the parties, some of which are our affiliates. Toby R. Neugebauer, our former Chairman and Alan L. Smith, a current director, are principals of Quantum Energy Partners which is an affiliate of our company.

Redemption and Equity Exchange. Pursuant to the terms of the Stakeholders Agreement, at the closing of our initial public offering, a portion of our pre-offering members membership interests were redeemed for cash with proceeds from the offering, and immediately following such redemption, the remaining membership interests of all our pre-offering members were exchanged for units. Each pre-offering member was allocated cash and/or units based on a formula tied to the initial public offering price of $21.00 per unit. In addition, in connection with the exercise by the underwriters of their overallotment option in our initial public offering, Quantum Energy Partners and the pre-offering non-affiliated members of our company received cash in exchange for a portion of their units held immediately following our initial public offering.

Registration Rights. Pursuant to the Registration Rights Agreement, Quantum Energy Partners has the right to demand, for the benefit of itself and certain non-affiliated equity investors, the registration of the units acquired by them upon consummation of our initial public offering. Subject to the terms of the Registration Rights Agreement, Quantum Energy Partners and/or certain of its permitted transferees are entitled to make three such demands for registration. In addition, Quantum Energy Partners, the non-affiliated equity investors and/or their respective permitted transferees and certain officers of our company may include any of their units in a registration by us of other units, including units offered by us or any unitholder, subject to customary exceptions.

The following table sets forth the cash consideration and/or units received by related parties pursuant to the redemption transactions and equity exchange described above.

Related Party	**Cash Consideration Received (in Millions)**		**Equity Consideration Received (Units)**
Quantum Energy Partners (1)	$	108.6	10,144,585
Michael C. Linn	$	3.0	3,662,122
Gerald W. Merriam (2)			475,622
Roland Chip P. Keddie			475,622

(1) Amounts shown give effect to the redemption of a portion of such member s units with the proceeds received by us pursuant to the exercise by the underwriters of their over allotment option.

(2) Mr. Merriam resigned from our company in April 2006, at which time he was no longer considered a related party.

Other Transactions

For the year ended December 31, 2006, we made payments of approximately $0.4 million to a company owned by our Chairman, President and Chief Executive Officer, Michael C. Linn. The payments reflect reimbursement for maintenance and hourly usage fees for business use of an aircraft that was partially owned by Mr. Linn. These costs are included in general and administrative expense on the consolidated statement of operations. The fees and expenses associated with the reimbursements were consummated on terms equivalent to those that prevail in arm s-length transactions. In the third quarter of 2006, we purchased an ownership interest in an airplane for corporate travel from a third party; therefore, these reimbursements will not be ongoing. Simultaneous with this transaction, Mr. Linn was able to fully liquidate the investment in the aircraft owned by his company.

Eric P. Linn serves as the President of Mid Atlantic Well Service, Inc., a wholly-owned subsidiary of Linn Energy, LLC. Eric P. Linn is the brother of our Chairman, President and Chief Executive Officer, Michael C. Linn. Eric P. Linn s 2006 cash compensation included an annual base salary of $125,000 and a incentive payment of $125,000. He was granted a unit option award of 20,000 options in December 2006 and a restricted unit award of 15,000 units in January 2007 in recognition of his 2006 performance. These awards have a combined grant date value of $570,850. For 2007, his annual base salary was increased to $175,000. In addition, he is provided with use of a company vehicle.

In January 2007, Penn West Storage, LLC, an indirect wholly-owned subsidiary of Linn Energy, LLC, entered into an agreement to acquire certain assets (the Field Assets) of an unaffiliated third party for a purchase price of approximately $3.75 million. The closing of the transaction is subject to specified closing conditions including certain regulatory approvals. If the transaction is consummated, then Eric P. Linn will

receive

37

approximately $875,000 plus two percent of an 8/8ths overriding royalty on specified hydrocarbon production. In connection with commencing employment with our company in December 2005, Eric P. Linn assigned his indirect right to acquire the Field Assets for $2.0 million to an unaffiliated third party (the Assignee). As consideration for the assignment, the Assignee has agreed to compensate Eric P. Linn, directly or indirectly, in the amount of 50 percent of any net profit from any subsequent sale or transfer by the Assignee of the right to acquire the Field Assets. The Board of Directors has determined that the purchase price consideration to be paid if and when the proposed acquisition is consummated is fair to our company, and resulted from a competitive negotiation process involving our company and other third party bidders.

Piggyback Registration Rights

In connection with the execution of Mr. Linn s employment agreement, we agreed to provide Mr. Linn with piggyback registration rights with respect to the units to be issued to him pursuant to the unit option and unit grant following the earlier to occur of 18 months after our initial public offering or the date on which Quantum Energy Partners holds less than 50% of the units it owned immediately following our initial public offering.

In connection with the execution of Mr. Rockov s employment agreement, we agreed to provide Mr. Rockov with piggyback registration rights with respect to the units to be issued to him pursuant to the unit option, unit grant and the restricted unit awards following the earlier to occur of 18 months after our initial public offering or the date on which Quantum Energy Partners holds less than 50% of the units it owned immediately following our initial public offering.

UNITHOLDER PROPOSALS AND DIRECTOR NOMINATIONS

Unitholders may propose matters to be presented at unitholders meetings and may also recommend persons for nomination or nominate persons to be directors, subject to the formal procedures that have been established.

Proposals for 2008 Annual Meeting

Pursuant to rules promulgated by the SEC, any proposals of unitholders of our company intended to be presented at the Annual Meeting of Unitholders to be held in 2008 and included in our Proxy Statement and form of proxy relating to that meeting, must be received at our principal executive offices, 600 Travis, Suite 7000, Houston, Texas, 77002, no later than January 29, 2008, but no earlier than December 30, 2007. Such proposals must be in conformity with all applicable legal provisions, including Rule 14a-8 of the General Rules and Regulations under the Securities Exchange Act of 1934.

In addition to the SEC rules described in the preceding paragraph, pursuant to Section 11.13 of our limited liability company agreement, only proposals of business made in accordance with the following procedures are eligible for consideration by our unitholders at an annual meeting of unitholders. Proposals eligible for consideration by our unitholders at an annual meeting of unitholders may be made only (i) by or at the direction of our Board of Directors or (ii) by any holder of units who is entitled to vote at the meeting and who complied with the following notice procedures. For proposals to be properly brought before an annual meeting by a unitholder:

(i) the unitholder must have given timely notice thereof in writing to our Corporate Secretary,

(ii) such business must be a proper matter for unitholder action under our limited liability company agreement and the Delaware Act,

(iii) if the unitholder, or the beneficial owner on whose behalf any such proposal is made, has provided us with a solicitation notice, such unitholder or beneficial owner must have delivered a proxy statement and form of proxy to holders of at least the percentage of outstanding units required under our limited liability company agreement or Delaware law to carry any such proposal, and must have included in such materials the solicitation notice, and

(iv) if no solicitation notice relating thereto has been timely provided, the unitholder or beneficial owner proposing such business must not have solicited a number of proxies sufficient to have required the delivery of such a solicitation notice. Our limited liability company agreement provides that to be timely, a unitholder s notice must be delivered to our Corporate Secretary at our principal executive offices not less than 90 days or more than 120 days prior to the first anniversary of the date on which we first mailed our proxy materials for the preceding year s annual meeting. **For a proposal of business to be considered at the 2008 Annual Meeting of Unitholders, a unitholder s notice should be properly submitted to our Corporate Secretary at our principal executive offices, 600 Travis, Suite 7000, Houston, Texas, 77002, no later than January 29, 2008, but not earlier than December 30, 2007.**

A unitholder s notice to our Corporate Secretary must set forth (a) a brief description of the business desired to be brought before the meeting, the reasons for conducting such business at the meeting and any material interest in such business of such unitholder and the beneficial owner, if any, on whose behalf the proposal is made; and (b) as to the unitholder giving the notice and the beneficial owner, if any, on whose behalf the proposal is made (i) the name and address of such unitholder, as they appear on our books, and of such beneficial owner, (ii) the class and number of units which are owned beneficially and of record by such unitholder and such beneficial owner, and (iii) whether either such unitholder or beneficial owner intends to deliver a proxy statement and form of proxy to holders of at least the percentage of units required under our limited liability company agreement or Delaware law to carry the proposal.

Nominations for 2008 Annual Meeting and for Any Special Meeting

Pursuant to Section 11.13(b) of our limited liability company agreement, only persons who are nominated in accordance with the following procedures are eligible for election as directors. Nominations of persons for election to our Board of Directors may be made at a meeting of unitholders only (a) by or at the direction of our Board of Directors or (b) by any unitholder of our company: (i) who is entitled to vote at the meeting, (ii) who was a record holder of a sufficient number of units as of the record date for such meeting to elect one or more members to our Board of Directors assuming that such holder cast all of the votes it is entitled to cast in such election in favor of a single candidate and such candidate received no other votes from any other holder of units (or, in the case where such holder holds a sufficient number of units to elect more than one director, such holder votes its units as efficiently as possible for such candidates and such candidates receive no further votes from holders of outstanding units) and (iii) who complies with the following notice procedures. All nominations, other than those made by or at the direction of our Board of Directors, must be made pursuant to timely notice in writing to our Corporate Secretary. With respect to director elections held at our Annual Meetings, our limited liability company agreement provides that to be timely, a unitholder s notice must be delivered to our Corporate Secretary at our principal executive offices not less than 90 days or more than 120 days prior to the first anniversary of the date on which we first mailed our proxy materials for the preceding year s annual meeting. **For a nomination of any person for election to our Board of Directors to be considered at the 2008 Annual Meeting of Unitholders, it must be properly submitted to our Corporate Secretary at our principal executive offices, 600 Travis, Suite 7000, Houston, Texas, 77002, no later than January 29, 2008, but not earlier than December 30, 2007.** Our limited liability company also provides that unitholder nominations of persons for election to our Board of Directors may be made at a special meeting of unitholders at which directors are to be elected pursuant to our notice of meeting provided unitholder notice of the nomination is timely. To be timely, a unitholder s notice must be delivered to our Corporate Secretary not earlier than the ninetieth day prior to such special meeting and not later than the close of business on the later of the seventieth day prior to such special meeting or the tenth day following the day on which public announcement is first made of the date of the special meeting and of the nominees proposed by our Board of Directors to be elected at such meeting.

A unitholder s notice to our Corporate Secretary must set forth (a) as to each person whom the unitholder proposes to nominate for election or reelection as a director all information relating to such person that is required to be disclosed in solicitations of proxies for election of directors, or is otherwise required, in each case pursuant to Regulation 14A under the Securities Exchange Act of 1934, including such person s written consent to being named in the proxy statement as a nominee and to serving as a director if elected; and (b) as to the unitholder giving the notice and the beneficial owner, if any, on whose behalf the nomination is made (i) the name and address of such unitholder as they appear on our books and of such beneficial owner, (ii) the class and number of units which are owned beneficially and of record by such unitholder and such beneficial owner, and (iii) whether either such unitholder or beneficial owner intends to deliver a proxy statement and form of proxy to holders of a sufficient number of holders of units to elect such nominee or nominees.

Recommendation of Director Candidates to the Nominating and Governance Committee

A unitholder or a group of unitholders may recommend potential candidates for consideration by the Nominating and Governance Committee by sending a written request to our Corporate Secretary not earlier than the 150th calendar day and not later than the 90th calendar day before the first anniversary of the mailing of the proxy materials in connection with the preceding year s annual meeting. Such written request must be sent to our principal executive offices, 600 Travis, Suite 7000, Houston, Texas 77002, Attn: Corporate Secretary. The written request must include the candidate s name, contact information, biographical information and qualifications. The request must also include the potential candidate s written consent to being named in the proxy statement as a nominee and to serving as a director if nominated and elected. Additional information may be requested from time to time by the committee from the nominee or the unitholder or group of unitholders.

SOLICITATION AND MAILING OF PROXIES

The expense of preparing, printing and mailing this Proxy Statement and the proxies solicited hereby will be borne by us. In addition to the use of the mail, proxies may be solicited by our representatives in person or by telephone, electronic mail or facsimile transmission. These representatives will not be additionally compensated for such solicitation, but may be reimbursed for out-of-pocket expenses incurred in connection therewith. If undertaken, we expect the expenses of such solicitation by our representatives to be nominal. We will also request brokerage firms, banks, nominees, custodians and fiduciaries to forward proxy materials to the beneficial owners of our units as of the Record Date and will provide reimbursement for the cost of forwarding the proxy materials in accordance with customary practice.

If a unitholder wishes to give such holder s proxy to someone other than the names appearing in the proxy card, the names appearing in the proxy card must be crossed out and the name of another individual or individuals (not more than three) inserted. The signed card must be presented at the Annual Meeting by the individual or individuals representing such unitholder.

As a matter of policy, proxies, ballots, and voting tabulations that identify individual unitholders are kept private by us. Such documents are available for examination only by the inspectors of election and certain personnel associated with processing proxy cards and tabulating the vote. The vote of any unitholder is not disclosed except as necessary to meet legal requirements.

WHERE YOU CAN FIND MORE INFORMATION ABOUT US

We file annual, quarterly and current reports and proxy statements with the SEC. Our SEC filings are available to the public over the internet at the SEC s website at *www.sec.gov.* You may also read and copy any document that we file with the SEC at the SEC s Public Reference Room at 100 F Street, NE, Washington, D.C. 20549. You can call the SEC at 1-800-SEC-0330 for further information on the public reference room and its copy charges. We maintain a website at *www.linnenergy.com*, where we post our SEC filings.

You may request copies of our filings, including any documents incorporated by reference in this Proxy Statement as described below, without charge, by calling our Investor Relations representative at (281) 605-4100 or write to Investor Relations, 600 Travis, Suite 7000 Houston, Texas 77002.

If you would like to request documents from us, please do so at least five business days before the date of the Annual Meeting in order to receive timely delivery of the documents before the Annual Meeting. If you request any incorporated documents from us, we will mail them to you by first class mail or other equally prompt means within one business day of receipt of your request, provided that we will not mail any exhibits to the information that is incorporated by reference unless such exhibits are specifically incorporated by reference into the information that this Proxy Statement incorporates.

You should rely only on the information contained or incorporated by reference in this Proxy Statement to vote your units at the Annual Meeting. We have not authorized anyone to provide you with information that is different from what is contained or incorporated by reference in this Proxy Statement.

The information contained in this document or any document incorporated by reference herein speaks only as of the date indicated on the cover of this document or the document incorporated by reference unless the information specifically indicates that another date applies.

OTHER MATTERS FOR 2007 ANNUAL MEETING

As of the date of this Proxy Statement, our Board of Directors knows of no matters to be acted upon at the Annual Meeting other than the proposals included in the accompanying notice and described in this Proxy Statement. If any other matter requiring a vote of unitholders arises, including a question of adjourning the Annual Meeting, the persons named as proxies in the accompanying proxy card will have the discretion to vote thereon according to their best judgment of what they consider to be in the best interests of our company. The accompanying proxy card confers discretionary authority to take action with respect to any additional matters that may come before the Annual Meeting or any adjournment or postponement thereof.

By Order of the Board of Directors,

Charlene A. Ripley

Senior Vice President, General Counsel and

Corporate Secretary

Houston, Texas

April 27, 2007

Using a **black ink** pen, mark your votes with an X as shown in this example. Please do not write outside the designated areas.

Annual Meeting Proxy Card

PLEASE FOLD ALONG THE PERFORATION, DETACH AND RETURN THE BOTTOM PORTION IN THE ENCLOSED ENVELOPE.

A. Proposals The Board of Directors recommends a vote FOR all the nominees listed and FOR Proposal 2.

1. Election of Directors:	For	Withhold		For	Withhold		For	Withhold
01 - Michael C. Linn	o	o	02 - George A. Alcorn	o	o	03 - Terrence S. Jacobs	o	o
04 - Jeffrey C. Swoveland	o	o	05 - Alan L. Smith	o	o			

2. Appointment of KPMG LLP as independent auditors for the year ending December 31, 2007.	For	Against	Abstain
	o	o	o

B. Authorized Signatures This section must be completed for your vote to be counted. Date and Sign Below

Please sign exactly as name(s) appears hereon. Joint owners should each sign. When signing as attorney, executor, administrator, corporate officer, trustee, guardian, or custodian, please give full title.

Date (mm/dd/yyyy) Please print date below.	Signature 1 Please keep signature within the box.	Signature 2 Please keep signature within the box.

PLEASE FOLD ALONG THE PERFORATION, DETACH AND RETURN THE BOTTOM PORTION IN THE ENCLOSED ENVELOPE.

Proxy   Linn Energy, LLC

Meeting Details

Hyatt Regency Pittsburgh International Airport
1111 Airport Boulevard
Pittsburgh, PA 15231

Proxy Solicited by Board of Directors for Annual Meeting to be held on June 19, 2007 at 10:00 AM Eastern Standard Time

Michael C. Linn and Kolja Rockov, or any of them, each with the power of substitution, are hereby authorized to represent and vote the units of the undersigned, with all the powers which the undersigned would possess if personally present, at the Annual Meeting of Unitholders of Linn Energy, LLC, to be held on June 19, 2007 or at any postponement or adjournment thereof.

Units represented by this proxy will be voted by the Unitholder. If no such directions are indicated, the Proxies will have authority to vote FOR the election of Directors and FOR appointment of KPMG LLP as independent auditors for the year ending December 31, 2007.

In their discretion, the Proxies are authorized to vote upon such other business as may properly come before the meeting.

(Continued and to be voted on reverse side.)