

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

FORM 10-QSB

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

For the quarterly period ended June 30, 2008

OR

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

For the transition period from _____ to _____

Commission file number: 001-34055



TIMBERLINE RESOURCES CORPORATION

(Exact Name of Registrant as Specified in its Charter)

IDAHO

(State of other jurisdiction of incorporation or organization)

82-0291227

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

**101 EAST LAKESIDE AVENUE
COEUR D'ALENE, IDAHO**

(Address of Principal Executive Offices)

83814

(Zip Code)

(208) 664-4859

(Registrant's Telephone Number, including Area Code)

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

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

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

Number of shares of issuer's common stock outstanding at August 8, 2008: 28,639,903

Transitional Small Business format (check one): Yes No

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PART I — FINANCIAL INFORMATION

ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

**TIMBERLINE RESOURCES CORPORATION AND
SUBSIDIARIES**

Consolidated Financial Statements

June 30, 2008 and 2007

Timberline Resources Corporation and Subsidiaries

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TIMBERLINE RESOURCES CORPORATION AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

	June 30, 2008 (unaudited)	September 30, 2007 (audited)
ASSETS		
CURRENT ASSETS:		
Cash	\$ 2,922,345	\$ 3,949,988
Accounts receivable, net of allowance for doubtful accounts of \$150,740 and \$ -, respectively	4,594,657	3,882,275
Employee receivable	18,294	7,073
Materials and supplies inventory	2,048,350	1,925,392
Deferred financing cost	829,800	-
Prepaid expenses	301,250	373,288
TOTAL CURRENT ASSETS	10,714,696	10,138,016
PROPERTY, MINERAL RIGHTS AND EQUIPMENT:		
Property, mineral rights and equipment, net of accumulated depreciation	9,785,525	8,008,928
OTHER ASSETS:		
Restricted cash	273,750	802,860
Deposits and other assets	139,944	147,058
Intangible assets, net of accumulated amortization	-	105,557
Goodwill	2,808,524	2,808,524
TOTAL OTHER ASSETS	3,222,218	3,863,999
TOTAL ASSETS	\$ 23,722,439	\$ 22,010,943
LIABILITIES, TEMPORARY EQUITY AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Note payable to bank	\$ -	\$ 599,065
Accounts payable	2,612,090	3,617,165
Accrued expenses	800,252	220,578
Accrued payroll, benefits and taxes	2,831,578	724,049
Bridge loan financing	8,000,000	-
Notes payable - related parties	-	787,000
Deferred revenue	128,664	250,000
Current portion of capital leases	465,223	476,032
Current portion of notes payable	268,731	300,638
TOTAL CURRENT LIABILITIES	15,106,538	6,974,527
LONG-TERM LIABILITIES:		
Loan commitment fee payable	484,800	-
Capital leases, net of current portion	681,183	647,416
Notes payable, net of current portion	421,249	571,534
TOTAL LONG-TERM LIABILITIES	1,587,232	1,218,950
COMMITMENTS AND CONTINGENCIES		
	-	-
TEMPORARY EQUITY		
Series A Preferred stock, \$0.01 par value; liquidation and redemption value \$ - and \$2,738,500, respectively; 5,000,000 shares authorized, none and 4,700,000 issued and outstanding, respectively	-	1,880,000
STOCKHOLDERS' EQUITY:		
Preferred stock, \$0.01 par value; 5,000,000 shares authorized, none issued and outstanding	-	-
Common stock, \$0.001 par value; 100,000,000 shares authorized, 28,479,903 and 24,801,108 shares issued and outstanding, respectively	28,479	24,801
Common stock subscribed	-	(802,761)
Additional paid-in capital	19,814,270	20,433,478
Accumulated deficit	(12,814,080)	(7,718,052)
TOTAL STOCKHOLDERS' EQUITY	7,028,669	11,937,466
TOTAL LIABILITIES, TEMPORARY EQUITY AND STOCKHOLDERS' EQUITY	\$ 23,722,439	\$ 22,010,943

See accompanying notes to consolidated financial statements.

TIMBERLINE RESOURCES CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

	Three Months Ended		Nine Months Ended	
	June 30,		June 30,	
	2008	2007	2008	2007
	(unaudited)	(unaudited)	(unaudited)	(unaudited)
REVENUES	\$ 9,703,813	\$ 4,798,748	\$ 24,525,265	\$ 11,840,469
COST OF REVENUES	<u>7,647,637</u>	<u>3,996,672</u>	<u>18,931,196</u>	<u>9,428,122</u>
GROSS PROFIT	<u>2,056,176</u>	<u>802,076</u>	<u>5,594,069</u>	<u>2,412,347</u>
OPERATING EXPENSES:				
Mineral exploration expenses	167,098	130,472	1,166,818	285,420
Other general and administrative expenses	2,338,933	1,435,340	7,081,567	4,139,688
Severance benefits	1,880,590	-	1,880,590	-
Loss on sale of equipment	44,382	27,023	34,558	31,402
TOTAL OPERATING EXPENSES	<u>4,431,003</u>	<u>1,592,835</u>	<u>10,163,533</u>	<u>4,456,510</u>
LOSS FROM OPERATIONS	<u>(2,374,827)</u>	<u>(790,759)</u>	<u>(4,569,464)</u>	<u>(2,044,163)</u>
OTHER INCOME (EXPENSE):				
Other income	904	24,749	171,813	42,203
Interest income	39,551	-	159,991	-
Interest expense	(54,924)	(152,887)	(306,864)	(277,987)
TOTAL OTHER INCOME (EXPENSE)	<u>(14,469)</u>	<u>(128,138)</u>	<u>24,940</u>	<u>(235,784)</u>
NET LOSS BEFORE INCOME TAXES	<u>(2,389,296)</u>	<u>(918,897)</u>	<u>(4,544,524)</u>	<u>(2,279,947)</u>
INCOME TAX EXPENSE	<u>(225,982)</u>	<u>-</u>	<u>(551,502)</u>	<u>-</u>
NET LOSS	<u>\$ (2,615,278)</u>	<u>\$ (918,897)</u>	<u>\$ (5,096,026)</u>	<u>\$ (2,279,947)</u>
NET LOSS PER SHARE AVAILABLE TO COMMON STOCKHOLDERS, BASIC AND DILUTED	<u>\$ (0.32)</u>	<u>\$ (0.04)</u>	<u>\$ (0.42)</u>	<u>\$ (0.13)</u>
WEIGHTED AVERAGE NUMBER OF COMMON SHARES OUTSTANDING, BASIC AND DILUTED	<u>27,325,782</u>	<u>20,504,423</u>	<u>26,726,289</u>	<u>18,201,369</u>

See accompanying notes to consolidated financial statements.

TIMBERLINE RESOURCES CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

	Nine Months Ended	
	June 30, 2008 (unaudited)	June 30, 2007 (unaudited)
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	\$ (5,096,026)	\$ (2,279,947)
Adjustments to reconcile net loss to net cash used by operating activities:		
Depreciation and amortization	1,215,725	857,824
Allowance for doubtful accounts	150,740	-
Loss on sale of equipment	34,558	31,402
Inventory writedown	535,658	-
Common stock issued for consulting	105,783	551,017
Share based compensation	1,099,449	20,000
Changes in assets and liabilities:		
Accounts receivable	(1,464,017)	(827,249)
Materials and supplies inventory	(658,616)	(1,070,057)
Prepaid expenses, deposits, and other assets	129,152	9,633
Employee receivable	(11,221)	(2,567)
Accounts payable	(1,005,075)	677,908
Accrued payroll, benefits, taxes and expenses	2,687,203	(137,134)
Deferred revenue	(121,336)	-
Accrued interest - related party payables	-	(23,121)
Deferred lease income	-	(23,272)
Net cash used by operating activities	<u>(2,398,023)</u>	<u>(2,215,563)</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of equipment	(1,843,725)	(1,007,038)
Change in restricted cash	529,110	-
Purchase of investment in equity security	(50,000)	-
Proceeds from sale of equipment	40,014	16,294
Net cash used by investing activities	<u>(1,324,601)</u>	<u>(990,744)</u>
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from bridge loan financing	8,000,000	-
Redemption of Series A preferred stock	(7,500,000)	-
Deferred financing cost	(345,000)	-
Loan commitment fee payable	-	-
Net proceeds from line of credit	-	596,065
Proceeds from related party notes payable	60,000	-
Payments on related party notes payable	(847,000)	(330,955)
Proceeds from notes payable and capital leases	-	(1,758)
Payments on notes payable	(311,615)	(171,379)
Payments on capital leases	(364,339)	(371,608)
Payment of note payable to bank	(599,065)	-
Proceeds from exercise of options	-	21,017
Proceeds from exercise of warrants	1,508,873	1,759,664
Collection of common stock subscriptions	802,761	-
Proceeds from issuances of stock and warrants, net of stock offering costs	2,290,366	2,730,000
Net cash provided by financing activities	<u>2,694,981</u>	<u>4,231,046</u>
Net increase (decrease) in cash	(1,027,643)	1,024,739
CASH AT BEGINNING OF PERIOD	3,949,988	732,245
CASH AT END OF PERIOD	<u>\$ 2,922,345</u>	<u>\$ 1,756,984</u>
NON-CASH FINANCING AND INVESTING ACTIVITIES:		
Account receivable exchanged for equipment	\$ 700,895	\$ -
Capital lease for equipment purchase	387,297	412,797
Note payable issued for equipment purchase	129,423	681,580
Series A preferred stock exchanged for common stock	470,000	120,000
Financing charges payable with common stock	484,800	-

See accompanying notes to consolidated financial statements.

Timberline Resources Corporation and Subsidiaries

Notes to Consolidated Financial Statements

NOTE 1 – ORGANIZATION AND DESCRIPTION OF BUSINESS:

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

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

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

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

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

b. *Principles of consolidation* – The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries, Kettle Drilling and World Wide after elimination of the intercompany accounts and transactions.

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

d. *Estimates and assumptions* – The preparation of financial statements in accordance with accounting principles generally accepted in the United States of America requires the use of estimates and assumptions that affect the reported amounts of assets and liabilities at the dates of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates and assumptions and could have a material effect on the Company’s reported financial position and results of operations.

e. *Materials and supplies inventory* – The Company values its materials and supplies inventory at the lower of average cost or market. Allowances are recorded for inventory considered to be in excess or obsolete. Inventories consist primarily of parts, operating supplies, drill rods and drill bits. The value of used inventory, if considered still usable, is valued at 25-90% of cost depending on remaining life expectancy. During the quarter ended June 30, 2008, the Company undertook a detailed materials and supplies inventory analysis and determined that a charge to net income of \$535,658 was appropriate to reflect the net realizable value of the materials and supplies inventory.

Timberline Resources Corporation and Subsidiaries

Notes to Consolidated Financial Statements

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

- f. *Reclassifications* – Certain amounts in the prior-period financial statements have been reclassified for comparative purposes to conform to current period presentation with no effect on previously reported net loss.
- g. *Investments* – The Company owns 1,000,000 restricted shares of Rae Wallace Mining Company, a public corporation. The investment is recorded at cost which management estimates approximates fair market value at June 30, 2008.
- h. *Provision for Taxes* – Income taxes are provided based upon the liability method of accounting pursuant to Statement of Financial Accounting Standards No. 109, “Accounting for Income Taxes” (hereafter “SFAS No. 109”). Under this approach, deferred income taxes are recorded to reflect the tax consequences in future years of differences between the tax basis of assets and liabilities and their financial reporting amounts at each year-end. A valuation allowance is recorded against the deferred tax asset if management believes it is more likely than not that some portion or all of the deferred tax assets will not be realized (See Note 5).
- i. *Stock-based compensation* – The Company adopted Statement of Financial Accounting Standards No. 123 (revised 2004), *Share-based Payment* (“SFAS 123(R)”), at the beginning of fiscal year 2007, which requires the measurement of the cost of employee services received in exchange for an award of an equity instrument on the grant-date fair value of the award. The Company has chosen to use the modified prospective transition method under SFAS 123(R). The Company’s financial statements for the year ended September 30, 2007 and the three and nine months ended June 30, 2008 reflect the impact of this adoption.

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

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

On June 27, 2008, the Company repurchased and cancelled 3,525,000 of the 4,700,000 Series A Preferred Stock from the Kettle Shareholders for \$7,500,000 (see Note 8). Under EITF D-53, the reduction in Additional paid up capital arising from this transaction is treated as a dividend for purposes of calculating EPS.

Timberline Resources Corporation and Subsidiaries

Notes to Consolidated Financial Statements

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

The dilutive effect of convertible and exercisable securities, in periods of future income as of June 30, 2008 and 2007, is as follows:

	<u>June 30, 2008</u>	<u>June 30, 2007</u>
Stock options	3,181,668	2,140,000
Warrants	2,401,734	3,654,074
Convertible preferred stock	-	4,700,000
Total possible dilution	<u>5,583,402</u>	<u>10,494,074</u>

At June 30, 2008 and 2007, the effect of the Company's outstanding options and common stock equivalents would have been anti-dilutive.

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

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

On October 1, 2007, we adopted Financial Accounting Standards Board Interpretation No. 48, *Accounting for Uncertainty in Tax Positions* (“FIN48”). FIN48 prescribes a recognition threshold and measurement attribute for the recognition and measurement of tax positions taken or expected to be taken in income tax returns. FIN48 also provides guidance on de-recognition of income tax assets and liabilities, classification of current and deferred income tax assets and liabilities, and accounting for interest and penalties associated with tax positions. In the course of our assessment, we determined that we were subject to examination of our income tax filings in the United States and various state jurisdictions for the 2003 – 2006 tax years. Within each of these jurisdictions we examined our material tax positions to determine whether we believed they would be sustained under the more-likely-than-not guidance provided by FIN48. If interest and penalties were to be assessed, we would charge interest to interest expense, and penalties to other operating expense. As a result of our assessment, we have concluded that the adoption of FIN48 had no significant impact on the Company's results of operations or balance sheet for the nine months ended June 30, 2008, and required no adjustment to opening balance sheet accounts as of October 1, 2007.

Timberline Resources Corporation and Subsidiaries

Notes to Consolidated Financial Statements

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

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

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

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

NOTE 3 – RELATED PARTY TRANSACTIONS:

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

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

In 2006, Kettle Drilling entered into loan agreements with its former officers, David Deeds and Doug Kettle. These loans totaled \$160,000 and \$627,000, respectively as of September 30, 2007. David Deeds was the Chief Executive Officer of Kettle Drilling and a shareholder of the Company. Mr. Kettle was the President of Kettle Drilling and a shareholder of the Company. The loans bear interest at 10% and are due on demand. There was no accrued interest outstanding as of June 30, 2008 and September 30, 2007.

Timberline Resources Corporation and Subsidiaries

Notes to Consolidated Financial Statements

NOTE 3 – RELATED PARTY TRANSACTIONS, (continued):

Related party notes payable consist of the following at June 30, 2008 and September 30, 2007:

	Jun. 30, 2008	Sep. 30, 2007
Doug & Brenda Kettle	\$ -	\$ 627,000
David Deeds	-	160,000
Less current portion	-	(787,000)
	<u>\$ -</u>	<u>\$ -</u>

NOTE 4 – BRIDGE LOAN FINANCING:

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

The loan bears interest at 12% per annum, with interest payable monthly in arrears commencing August 1, 2008, and the principal amount outstanding is due October 27, 2008. The loan agreement includes certain affirmative covenants including a requirement that we maintain current all tax balances owing by the Company. At June 30, 2008, we were not in compliance with the tax covenant. Our lender has waived compliance with the tax covenant as of June 30, 2008.

Pursuant to the fee terms of the Term Sheet, the Company paid a fee equal to 4% of the principal amount of the loan and issued 160,000 common shares of the Company to Auramet after the Company’s drawdown of the loan on June 27, 2008. The 4% fee paid, as well as the fair market value of the 160,000 common shares issued by the Company will be charged to operations over the term of the loan. The 160,000 shares were not issued by the Company to Auramet until July 3, 2008, therefore the fair market value of the shares on June 27, 2008 of \$484,800 is reflected in the June 30, 2008 balance sheet as a long-term liability.

Timberline Resources Corporation and Subsidiaries

Notes to Consolidated Financial Statements

NOTE 5 – INCOME TAXES:

Income (loss) from continuing operations before income taxes for the nine months ended June 30, 2008 and 2007 are as follows:

	2008	2007
Current:		
Domestic	\$ (5,995,846)	\$ (2,692,296)
Foreign	1,451,322	412,349
	<u>\$ (4,544,524)</u>	<u>\$ (2,279,947)</u>

Significant components of income tax expense as of June 30, 2008 and 2007 are as follows:

	2008	2007
Current:		
Federal	\$ -	\$ -
State	-	-
Foreign	551,502	-
Total current income tax expense	<u>551,502</u>	<u>-</u>

Deferred:		
Federal	-	-
State	-	-
Foreign	-	-
Total deferred income tax expense	<u>-</u>	<u>-</u>
Total income tax expense	<u>\$ 551,502</u>	<u>\$ -</u>

	2008	2007
Statutory Federal income tax rate	34%	34%
Expected income tax expense (benefit) based on statutory rate	\$ (2,038,588)	\$ (775,182)
Non-recognition of tax benefits related to losses	2,038,588	775,182
Foreign tax expense	551,502	-
Total income tax expense	<u>\$ 551,502</u>	<u>\$ -</u>

Timberline Resources Corporation and Subsidiaries

Notes to Consolidated Financial Statements

NOTE 6 – COMMON STOCK AND WARRANTS:

During September, 2007, the Company initiated a private placement of the Company's restricted common stock. Under the private placement subscription agreement, the Company can sell up to 2,545,455 units for a total of \$7,000,000, plus up to 5% in over-subscriptions. Each unit consists of one share of common stock and one half of one Class A Warrant; with each whole warrant exercisable to acquire one additional share of common stock at an exercise price of \$3.50 per share for the period of twenty-four months from the Issue Date. The Company sold a total of 2,626,694 units for total proceeds of \$7,223,408; with 1,780,972 units for proceeds of \$4,897,673 closing on September 30, 2007, 288,182 units for proceeds of \$792,500 closing on October 1, 2007, and 557,540 units for proceeds of \$1,533,235 closing on October 11, 2007. As of June 30, 2008, there are 1,337,934 warrants outstanding from this placement.

During the quarter ended June 30, 2008, the Company issued 25,000 shares of common stock as a result of warrants exercised. The warrants were granted pursuant to a private placement during 2006 and were exercised at a price of \$1.00 per warrant.

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

	Warrants	Weighted Average Exercise Price
Outstanding at September 30, 2007	3,618,061	\$ 1.62
Issued	447,447	3.50
Exercised	<u>(1,663,774)</u>	<u>(1.00)</u>
Outstanding at June 30, 2008	<u>2,401,734</u>	<u>2.39</u>

These warrants expire as follows:

Warrants	Price	Expiration Date
1,063,800	\$1.00	December 31, 2008
<u>1,337,934</u>	<u>\$3.50</u>	<u>September 30, 2009</u>
<u>2,401,734</u>		

NOTE 7 – STOCK OPTIONS:

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

During October 2007, the Company granted 1,230,000 options to purchase common stock to directors and employees of the company as compensation for services rendered. The options have an exercise price of \$3.40, the market price of the common stock on that date, and vest over the next two years. These options expire five years from the grant date. The fair value of the options granted was estimated on their grant date using the Black-Scholes Option Price Calculation. The following assumptions were made in estimating fair value: risk-free interest rate of 3.75%; volatility of 82.3%; expected life of three years; dividend yield of zero. The options were valued at \$1.87 per share. 493,336 of these options vested immediately, however only 267,500 were available under the reserve

Timberline Resources Corporation and Subsidiaries

Notes to Consolidated Financial Statements

NOTE 7 – STOCK OPTIONS (continued):

limit of the plan. Accordingly, an expense relating to those that were available under the reserve of the plan was recognized during the quarter ended December 31, 2007 in the amount of \$500,225 and is included in Other general and administrative expenses. The expense was allocated on a pro-rata basis according to the number of options that vested immediately on the grant date. The remaining 225,836 options that did not vest because they were in excess of the reserve limit of the plan will only vest upon shareholder approval of an increase in the reserve limit. An additional 82,918 options vested during the quarter ended December 31, 2007 and an other general and administrative expense of \$45,118 was taken related to those vested options.

During January 2008, the Company granted 165,000 options to purchase common stock to two individuals for consulting services performed. The options have an exercise price of \$4.05, the market price of the common stock on that date, and vest over the next two years. These options expire five years from the grant date. The fair value of the options granted was estimated on their grant date using the Black-Scholes Option Price Calculation. The following assumptions were made in estimating fair value: risk-free interest rate of 3.11%; volatility of 81.8%; expected life of three years; dividend yield of zero. The options were valued at \$2.22 per share. These options did not vest because they were in excess of the reserve limit of the plan and will only vest upon shareholder approval of an increase in the reserve limit.

During February 2008, the Company granted 30,000 options to purchase common stock to an employee of the company. The options have an exercise price of \$3.20, the market price of the common stock on that date, and vest over the next two years. These options expire five years from the grant date. The fair value of the options granted was estimated on their grant date using the Black-Scholes Option Price Calculation. The following assumptions were made in estimating fair value: risk-free interest rate of 2.15%; volatility of 82.3%; expected life of three years; dividend yield of zero. The options were valued at \$1.73 per share. These options did not vest because they were in excess of the reserve limit of the plan and will only vest upon shareholder approval of an increase in the reserve limit. An additional 57,918 options vested during the quarter ended March 31, 2008 and an other general and administrative expense of \$30,601 was taken related to those vested options.

No option grants were made during the quarter ended June 30, 2008. An additional 324,587 options vested and an other general and administrative expense of \$493,289 was taken related to those vested options.

The current number of securities to be issued upon exercise of outstanding options exceeds the authorized shares to be issued under the Amended 2005 Equity Incentive Plan which was approved by shareholders on September 22, 2006. The Company plans to seek an increase in the number of authorized shares to be issued under the Amended 2005 Equity Incentive Plan at its next annual shareholder's meeting. If the requested increase in the number of authorized shares is not approved, only 2,750,000 options will vest and may be exercised. If the requested increase in the number of authorized shares to be issued under the Plan is approved, the expense related to the remaining options that were to vest immediately upon grant will be recognized in the period where shareholder approval is obtained. There are 1,363,730 options vested as of June 30, 2008 while 1,817,938 remain unvested and vest over the next 3 years.

Timberline Resources Corporation and Subsidiaries

Notes to Consolidated Financial Statements

NOTE 7 – STOCK OPTIONS (continued):

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

	<u>Options</u>	<u>Weighted Average Exercise Price</u>
Outstanding at September 30, 2007	2,073,333	\$ 2.13
Granted	1,425,000	3.47
Exercised	-0-	-0-
Expired / Cancelled	<u>(316,665)</u>	<u>1.24</u>
Outstanding at June 30, 2008	<u>3,181,668</u> ⁽¹⁾	\$ <u>2.82</u>
Exercisable at June 30, 2008	<u>1,137,924</u>	\$ <u>2.14</u>
Weighted average fair value of options granted during the period ended June 30, 2008		\$ <u>1.91</u>

The average remaining contractual term of the options outstanding and exercisable at June 30, 2008 is 3.75 and 3.17 years, respectively.

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

NOTE 8 – PREFERRED STOCK:

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

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

On June 27, 2008, the Company repurchased and cancelled 3,525,000 of the 4,700,000 Series A Preferred Stock from the Kettle Shareholders for \$7,500,000. The difference of \$6,090,000 between the purchase price and the \$1,410,000 carrying value of the Series A Preferred Stock was recognized as a reduction to Additional paid-in capital. The remaining 1,175,000 Series A Preferred Stock were converted to Common Stock by the Kettle Shareholders and sold to a third party investor.

As of June 30, 2008, none of the Series A Preferred stock remain outstanding.

Timberline Resources Corporation and Subsidiaries

Notes to Consolidated Financial Statements

NOTE 9 – COMMITMENTS AND CONTINGENCIES:

Real Estate Lease Commitments

The Company has real estate lease commitments related to its main office in Coeur d'Alene, Idaho, a facility in Butte, Montana, offices of Kettle Drilling in Coeur d'Alene, Idaho, a storage shop in Rathdrum, Idaho, and its operational facility in Elko, Nevada. The Company's Mexico subsidiary also leases facilities for its administrative office and warehouse under defined term lease agreements which are for one year. Total office and storage rental expense aggregated \$83,576 and \$19,553 for the three months ended June 30, 2008 and 2007, respectively, and \$208,722 and \$51,235 for the nine months ended June 30, 2008 and 2007, respectively.

Environmental Contingencies

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

Severance Agreements

As discussed in Note 3 - Related Party Transactions, during the quarter ended June 30, 2008 the Company announced a change in management at its Kettle Drilling subsidiary. As a result of this change, the Company has a commitment to pay total additional severance of \$600,000 in installments for the remainder of 2008.

NOTE 10 – SEGMENT INFORMATION:

The Company has three operating segments at June 30, 2008: drilling revenues from Kettle Drilling; drilling revenues in Mexico through Kettle's subsidiary, World Wide Exploration; and Timberline's exploration activities.

Segment information (after intercompany eliminations) for the three months and nine months ended June 30, 2008 and 2007 is as follows:

	Three months ending June 30		Nine months ending June 30	
	2008	2007	2008	2007
Revenues:				
Timberline	\$ -	\$ -	\$ -	\$ -
Kettle Drilling	7,318,802	3,855,351	17,983,223	9,351,425
World Wide Exploration	2,385,011	943,397	6,542,042	2,489,044
Total revenues	<u>\$ 9,703,813</u>	<u>\$ 4,798,748</u>	<u>\$ 24,525,265</u>	<u>\$ 11,840,469</u>
Income / (Loss) before income taxes:				
Timberline	\$ (1,325,486)	\$ (658,831)	\$ (4,060,370)	\$ (1,651,067)
Kettle Drilling	(1,745,974)	(395,071)	(1,935,476)	(1,044,406)
World Wide Exploration	682,164	135,005	1,451,322	415,526
Income / (Loss) before income taxes	<u>\$ (2,389,296)</u>	<u>\$ (918,897)</u>	<u>\$ (4,544,524)</u>	<u>\$ (2,279,947)</u>
			<u>June 30, 2008</u>	<u>September 30, 2007</u>
Total assets:				
Timberline		\$ 18,031,689	\$ 15,143,464	
Kettle Drilling		3,292,975	6,147,484	
World Wide Exploration		2,397,775	719,995	
Total assets		<u>\$ 23,722,439</u>	<u>\$ 22,010,943</u>	

Timberline Resources Corporation and Subsidiaries

Notes to Consolidated Financial Statements

NOTE 10 – SEGMENT INFORMATION (continued):

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

During the nine months ended June 30, 2008, revenues from transactions with four customers each amounted to 10% or more of our total revenues. Customer A accounted for revenue of \$5,897,763, customer B accounted for revenue of 4,167,572, customer C accounted for revenue of 2,971,372, and customer D accounted for revenue of \$2,860,772. The revenue for customers A, C and D is reported through Kettle Drilling, while the revenue for customer B is reported through World Wide Exploration.

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

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

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

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

Overview

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

Timberline Resources Corporation has taken the complementary businesses of mine development, contract mining, drilling and mineral exploration and combined them into a unique, forward-thinking investment vehicle. The Timberline business model provides investors exposure to both the "picks and shovels" and "blue sky" aspects of the mining industry. The "picks and shovels" aspect of our business includes the mining services provided by Kettle and the services which SMD will provide if the proposed acquisition is approved. We use the term "blue sky" to mean the potential of our exploration properties. Because of the nature of exploration for precious metals, a property's exploration potential is not known until a significant amount of geologic information has been generated. As the work progresses, the potential of the property becomes more and more clear. If the exploration results are favorable, the value of the property may increase significantly, and the term "blue sky" refers to the upside potential of that value. Our business model offers the opportunity to participate both the "picks and shovels" and "blue sky" aspects of the business—we can participate in the surging markets for precious and base metal mining without the degree of risk inherent to mine operation and/or sole reliance on speculative early-stage drill-plays. Following the closing of its proposed acquisition of SMD, we believe Timberline will be poised to become North America's premier vertically-integrated emerging resource company.

As we have announced previously, the Company's shares began trading on the American Stock Exchange (AMEX) during the quarter ended June 30. In addition to commencing trading on the AMEX, the Company was also added to the Russell Microcap Index during the quarter. We believe the Russell indexes are widely used by investment managers and institutional investors for index funds and as benchmarks for both passive and active investment strategies. These two events are significant milestones for the Company, as they both improve our access to capital markets and further validate our business model as a vehicle providing mainstream investors with exposure to the resource sector.

Kettle and its subsidiary, World Wide Exploration S.A. de C.V. ("WWE"), provide both surface and underground drilling services but specialize in underground, hard rock core drilling. Their clients include both mining and exploration companies in the United States and Mexico. For the second consecutive year, total revenues, both for the quarter and for the first nine months of 2008, increased approximately 100 percent compared to the prior year. Compared to the same quarter in the previous year, WWE showed an almost five-fold increase in net income before income taxes to \$682,164 and an over 300 percent increase in net income before taxes to \$1,451,322 for the nine months ended June 30, 2008. Once again, we are pleased with our performance in Mexico and expect profitability to continue.

During the quarter we implemented our previously announced management transition at Kettle, which included severance payments to the previous management that resulted in a one-time charge of \$1,880,590. As a part of this management transition, the Company undertook a detailed materials and supplies inventory analysis and determined that a charge to net income of \$535,658 was appropriate to reflect the net realizable value of the materials and supplies inventory. For the three months ended June 30, 2008, Kettle reported a net loss of \$1,745,974. Without the one-time severance payments and adjustment to inventory, Kettle would have reported a net income before taxes of \$670,274 for the quarter ended June 30, 2008 in addition to the net income before taxes of \$682,164 realized by WWE in the quarter. In addition, we obtained a loan to repurchase and retire the majority of the outstanding Series A Preferred shares held by the previous owners of Kettle Drilling.

As a part of this transition, we have a new and more focused corporate culture at Kettle with an emphasis on improving the performance of the U.S. operations. During the quarter we hired Martin Lanphere as President of Kettle. Mr. Lanphere brings a hands-on management and banking background to the Company. In addition to Mr. Lanphere and a number of other personnel changes at Kettle, subsequent to quarter end we hired Reggie Montgomery as General Manager in charge of all drilling

operations. Mr. Montgomery was most recently with Newmont Mining and was Manager of Drilling Services. Newmont is a current customer of Kettle and our drilling teams worked directly with Mr. Montgomery in Nevada.

We believe that our new management team and ongoing focus from rapid growth to profitability will continue to improve our operating results. As previously announced, and based on the revenues reported by our drilling operations for the first three quarters, we are confident that, barring unforeseen events, we will achieve our 2008 drilling revenue objective of \$30-million.

Subsequent to the end of the quarter, we announced the filing of our Definitive Proxy and Annual Meeting. The Proxy includes, among other items, our proposal to acquire Small Mine Development, LLC (“SMD”), one of the largest underground mine contractors in the United States. We believe that if we receive shareholder approval and complete the acquisition of SMD, this will provide us with the foundation to be a significant player in the North American mining services industry. We believe that our pursuit of SMD demonstrates our belief that a strong presence in both mining services and exploration is likely to provide excellent returns to our shareholders over the long term.

In our Exploration Division, during the quarter, as in previous quarters, we continued our exploration, permitting, and drilling activities. Our increased expenditures are representative of our commitment to ramp up exploration activity during 2008 on several of our properties. Subsequent to the end of the quarter, as announced, we mobilized a drill rig to the Butte Highlands property and drilling is currently underway on this project. Furthermore, we are moving forward with the permitting and planning necessary for additional drilling and exploration at Butte Highlands.

Also, as previously announced we received approval from Inyo County to proceed with exploration at Conglomerate Mesa and are awaiting final approval from the Bureau of Land Management for our planned road building and drill program. In preparation for our upcoming drill program, we conducted extensive mapping and sampling at this property, and we continue to build upon previous work performed by Newmont and BHP-Billiton as we explore and define this district-scale gold exploration prospect.

Results of Operations for the Three Month and Nine Month Periods ended June 30, 2008 and 2007

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

For the three months ended June 30, 2008, we reported \$9,703,813 in revenue compared to \$4,798,748 in the same period of 2007. For the nine months ended June 30, 2008 we reported revenues of \$24,525,265 versus revenues of \$11,840,469 in the same period of 2007. Our revenues are derived entirely from our drilling subsidiaries and are comprised of \$7,318,802 from Kettle Drilling and \$2,385,011 from WWE for the three months ended June 30, 2008. For the nine months ended June 30, 2008, Kettle Drilling and WWE reported revenues of \$17,983,223 and \$6,542,042, respectively. Our revenue increase was primarily due to the growth in the number of drill rigs operating this year versus last year. Gross profit from Kettle and WWE was \$1,271,632 and \$784,544, respectively, for the three months ended June 30, 2008, and \$3,664,286 and \$1,929,783, respectively, for the nine months ended June 30, 2008.

Our overall after tax net loss for the three months ended June 30, 2008 was \$2,615,278 compared to an overall net loss of \$918,897 for the three months ended June 30, 2007. For the nine months ended June 30, 2008, our overall net loss was \$5,096,026 compared to \$2,279,947 for the same period in 2007. Our net loss for the three months ended June 30, 2008 is comprised of \$1,325,486 for Timberline Corporate and Exploration and \$1,745,974 for Kettle Drilling, offset by income of \$456,182 at WWE. Our net loss for the nine months ended June 30, 2008 is comprised of \$4,060,370 for Timberline Corporate and Exploration and \$1,935,476 for Kettle Drilling offset by a gain of \$899,820 at WWE. Kettle Drilling’s net loss for the three months and nine months ended June 30, 2008 includes one-time severance benefits of \$1,880,590 to former managers of the company.

Timberline Corporate and Exploration Division

The after tax net loss of \$1,325,486 for the combined Timberline Corporate and the Exploration division during the three months ended June 30, 2008 is comprised of non-cash charges of \$493,289, exploration expenditures of \$167,098, and other general and administrative costs of \$670,130, less other income of \$5,031. A significant portion of other general and administrative costs during the quarter were related to legal and accounting costs associated with our proposed acquisition of SMD and our definitive proxy that was filed with the SEC subsequent to quarter end. Included in the non-cash charges are expenses related to stock options that vested during the quarter. Also included in the non-cash charges is \$12,734 in Depreciation and Amortization.

The after tax net loss of \$4,060,370 for the combined Timberline Corporate and the Exploration division during the nine months ended June 30, 2008 is comprised of non-cash charges of \$1,332,222, exploration expenditures of \$1,166,818, and other general and administrative costs of \$1,661,188, less other income of \$99,858. A significant portion of other general and administrative costs for the year to date were related to legal and accounting costs associated with our proposed acquisition of SMD and our definitive proxy that was filed with the SEC subsequent to quarter end. Included in the non-cash charges are expenses related to common stock issuances for consulting services, stock based compensation, and for stock options that vested during the year to date. Also included in the non-cash charges is \$139,724 in Depreciation and Amortization.

Kettle Drilling and WWE

For the three months ended June 30, 2008, Kettle Drilling had revenues of \$7,318,802 as compared to \$3,855,351 for the three months ended June 30, 2007. WWE had revenues of \$2,385,011 for the three months ended June 30, 2008 as compared to \$943,397 for the three months ended June 30, 2007. The increase in revenues is attributable to the growth in the number of operating drill rigs at each company.

For the three months ended June 30, 2008, net loss before taxes from Kettle was \$1,745,974 while net income before taxes at WWE was \$682,164 as compared to a net loss of \$395,071 for Kettle and net income of \$135,005 for WWE for the three months ended June 30, 2007. At Kettle, the current quarter loss is attributable to one-time severance expenses incurred as part of our management transition at the Company, while the net income at WWE grew substantially compared to the corresponding quarter in 2007 due to the increased activity and number of drill rigs in Mexico.

For the nine months ended June 30, 2008, Kettle Drilling had revenues of \$17,983,223 as compared to \$9,351,425 for the nine months ended June 30, 2007. WWE had revenues of \$6,542,042 for the nine months ended June 30, 2008 as compared to \$2,489,044 for the nine months ended June 30, 2007. The considerable increase in revenues is attributable to the growth in the number of operating drill rigs at each company.

For the nine months ended June 30, 2008, net loss before taxes from Kettle was \$1,935,476 while net income before taxes at WWE was \$1,451,322, as compared to a net loss of \$1,044,406 for Kettle and net income before taxes of \$415,526 for WWE for the nine months ended June 30, 2007. At Kettle, the increased loss from last year is attributable to one time severance expenses incurred as part of our management transition at the Company, while the net income at WWE grew substantially due to the increased activity and number of drill rigs in Mexico.

Financial Condition and Liquidity

At June 30, 2008, we had assets of \$23,722,439 consisting of cash in the amount of \$2,922,345; accounts receivable, net of allowance for doubtful accounts, in the amount of \$4,594,657; inventories valued at \$2,048,350; property, mineral rights and equipment, net of depreciation of \$9,785,525; and other assets of \$4,371,562. The Company believes that its cash and cash flow from continuing operations will be sufficient to fund our operations for the next twelve months.

Off-Balance Sheet Arrangements

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

Critical Accounting Policies and Estimates

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

Our critical accounting policies are as follows:

Exploration Expenditures

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

property is abandoned.

Revenue Recognition

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

Intangible Assets

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

Inventories

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

Review of Carrying Value of Property and Equipment for Impairment

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

Goodwill

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

Derivative Financial Instruments

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

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

ITEM 3. DISCLOSURE CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

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

As a non-accelerated filer as defined in Rule 12b-2 of the Exchange Act of 1934, as amended, the Company is not required to provide management's report on internal control over financial reporting until its annual report for the year ended September 30, 2008. Further, the Company's independent registered public accounting firm is not required to provide an attestation on the Company's internal control over financial reporting until the Company's annual report for the fiscal year ended September 30, 2010. The Company's management has not completed a review of internal control over financial reporting necessary to comply with the requirements for providing a management's report on internal control over financial reporting and the material weaknesses determined to exist by management are not the result of such a review.

Changes in Internal Control Over Financial Reporting

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

PART II — OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS.

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

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

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

The Company issued 766,000 shares of its common stock upon the exercise of warrants previously sold by the Company as part of units of the Company, as reported by the Company in its Current Report on Form 8-K, filed with the SEC on October 18, 2007. The shares of common stock issued upon exercise of the warrants were sold pursuant to exemptions from registration requirements of the Securities Act provided by Section 506 of Regulation D of the Securities Act and by Rule 903 of Regulation S of the Securities Act, such exemptions being available based on information obtained from the investors to the private placement.

On June 24, 2008, Timberline Resources Corporation (the "Company") and Auramet Trading, LLC ("Auramet") signed an Indicative Term Sheet (the "Term Sheet") under which Auramet would provide an \$8.0 million loan to the Company, at the Company's request, at any time before June 30, 2008. Pursuant to the fee terms of the Term Sheet, the Company paid a fee equal to 4% of the principal amount of the loan and issued 160,000 common shares of the Company to Auramet after the Company's drawdown of the loan on June 27, 2008. The shares were issued to Auramet pursuant to Section 4(2) of the Securities Act of 1933, as amended (the "Securities Act") and Rule 506 promulgated thereunder. Auramet has represented that they are an accredited investor and the securities issued to Auramet are "restricted securities" within the meaning of Rule 144 of the Securities Act.

On June 27, 2008, pursuant to the Term Sheet and subject to the terms laid out in the Promissory Note (as described below), Auramet provided \$8.0 million to the Company, \$7.5 million of which was used to repurchase 3,525,000 shares of Series A

Preferred Stock from Douglas Kettle, the sole holder of the Series A Preferred Shares, pursuant to the Preferred Shares Repurchase Agreement (the "Series A Preferred Shares Agreement") between the Company, Douglas Kettle and Auramet. Of the 4,700,000 Series A Preferred Shares held by Mr. Kettle, the Company repurchased and cancelled 3,525,000 Series A Preferred Shares for \$7.5 million. Pursuant to the Series A Preferred Shares Agreement, the remaining 1,175,000 Series A Preferred Shares were converted to 1,175,000 common shares of the Company and purchased from Mr. Kettle by a private investor. The common shares issued upon conversion of the Series A Preferred Shares were issued pursuant to Section 3(a)(9) of the Securities Act.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES.

On June 24, 2008, the Company entered into a bridge loan financing arrangement for \$8,000,000 with Auramet Trading, LLC ("Auramet") under which the Company could draw funds at any time before June 30, 2008. On June 27, 2008 the Company withdrew \$8,000,000, net of a fee equal to 4% of the principal amount of the loan.

The loan agreement includes certain affirmative covenants including a requirement that we maintain current all tax balances owing by the Company. At June 30, 2008, we were not in compliance with the tax covenant. Our lender has waived compliance with the tax covenant as of June 30, 2008.

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

None.

ITEM 5. OTHER INFORMATION.

See the events disclosed in Item 3.

ITEM 6. EXHIBITS.

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

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

SIGNATURES

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

TIMBERLINE RESOURCES CORPORATION

By: /s/ Randal Hardy

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

Date: August 14, 2008

CERTIFICATION

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

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

Date: August 14, 2008

By: /s/ Randal Hardy

Randal Hardy
Chief Executive Officer & Chief Financial Officer

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

In connection with the Quarterly Report of Timberline Resources Corporation (the “Company”) on Form 10-QSB for the period ended June 30, 2008, as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, Randal Hardy, Chief Executive Officer and Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

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

Date: August 14, 2008

By: /s/ Randal Hardy

Randal Hardy
Chief Executive Officer & Chief Financial Officer