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Regency Energy Partners LP
Form 10-Q
November 07, 2013
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q
(Mark One)

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

For the quarterly period ended September 30, 2013
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: 001-35262
REGENCY ENERGY PARTNERS LP
(Exact name of registrant as specified in its charter)

DELAWARE
(State or other jurisdiction of
incorporation or organization)

16-1731691
(I.R.S. Employer
Identification No.)

2001 BRYAN STREET, SUITE 3700
DALLAS, TX
(Address of principal executive offices)
(214) 750-1771
(Registrant's telephone number, including area code)

75201
(Zip Code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☒ No ☐

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

Large accelerated filer ☒ Accelerated filer ☐

Non-accelerated filer ☐ (Do not check if a smaller reporting company) Smaller reporting company ☐

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

The issuer had 210,714,852 common units and 6,274,483 Class F common units outstanding as of November 1, 2013.

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Introductory Statement

References in this report to the “Partnership,” “we,” “our,” “us” and similar terms refer to Regency Energy Partners LP and its subsidiaries. We use the following definitions in this quarterly report on Form 10-Q:

Name	Definition or Description
/d	Per day
AOCI	Accumulated Other Comprehensive Income (Loss)
ARO	Asset Retirement Obligation
Bbls	Barrels
bps	Basis points
ELG	Edwards Lime Gathering LLC and its wholly-owned subsidiaries, ELG Oil LLC and ELG Utility LLC
ETC	Energy Transfer Company, the name assumed by La Grange Acquisition, L.P. for conducting business and shared services, a wholly owned subsidiary of ETP
ETE	Energy Transfer Equity, L.P.
ETP	Energy Transfer Partners, L.P.
Finance Corp.	Regency Energy Finance Corp., a wholly-owned subsidiary of the Partnership
GAAP	Accounting principles generally accepted in the United States of America
General Partner	Regency GP LP, the general partner of the Partnership, or Regency GP LLC, the general partner of Regency GP LP, which effectively manages the business and affairs of the Partnership through Regency Employees Management LLC
Grey Ranch	A 50% joint venture between SUGS and a subsidiary of Sandridge Energy
Gulf States	Gulf States Transmission LLC, a wholly-owned subsidiary of the Partnership
Holdco	ETP Holdco Corporation
HPC	RIGS Haynesville Partnership Co., a general partnership, and its wholly-owned subsidiary, Regency Intrastate Gas LP
IDRs	Incentive Distribution Rights
Lone Star	Lone Star NGL LLC
LTIP	Long-Term Incentive Plan
MBbls	One thousand barrels
MEP	Midcontinent Express Pipeline LLC
MMBtu	One million BTUs. BTU is a unit of energy needed to raise the temperature of one pound of water by one degree Fahrenheit
NGLs	Natural gas liquids, including ethane, propane, normal butane, iso butane and natural gasoline
NYMEX	New York Mercantile Exchange
NMED	New Mexico Environmental Department
Partnership	Regency Energy Partners LP
PEPL Holdings	PEPL Holdings, LLC, a wholly-owned subsidiary of Southern Union
PVR	PVR Partners, L.P.
Ranch JV	Ranch Westex JV LLC
Regency Western	Regency Western G&P LLC, an indirectly wholly owned subsidiary of the Partnership
RGS	Regency Gas Services LP, a wholly-owned subsidiary of the Partnership
RIGS	Regency Intrastate Gas System
SEC	Securities and Exchange Commission
Senior Notes	The collective of 2018 Notes, 2020 Notes, 2021 Notes, 2023 5.5% Notes and 2023 4.5% Notes
Series A Preferred Units	Series A convertible redeemable preferred units

Services Co.	ETE Services Company, LLC
Southern Union	Southern Union Company
SUGS	Southern Union Gathering Company LLC
TCEQ	Texas Commission on Environmental Quality
WTI	West Texas Intermediate Crude

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Forward-Looking Statements

Certain matters discussed in this report include “forward-looking” statements within the meaning of Section 27A of the Securities Act of 1933, as amended (the “Securities Act”) and Section 21E of the Securities Exchange Act of 1934, as amended (the “Exchange Act”). Forward-looking statements are identified as any statement that does not relate strictly to historical or current facts. Statements using words such as “anticipate,” “believe,” “intend,” “project,” “will,” “plan,” “expect,” “continue,” “estimate,” “goal,” “forecast,” “may” or similar expressions help identify forward-looking statements. Although we believe our forward-looking statements are based on reasonable assumptions and current expectations and projections about future events, we cannot give assurances that such expectations will prove to be correct. Forward-looking statements are subject to a variety of risks, uncertainties and assumptions including without limitation the following:

- volatility in the price of oil, natural gas, condensate and NGLs;
- declines in the credit markets and the availability of credit for us as well as for producers connected to our pipelines and our gathering and processing facilities, and for our customers of our contract services business;
- the level of creditworthiness of, and performance by, our counterparties and customers;
- our access to capital to fund organic growth projects and acquisitions, and our ability to obtain debt or equity financing on satisfactory terms;
- our use of derivative financial instruments to hedge commodity and interest rate risks;
- the amount of collateral required to be posted from time-to-time in our transactions;
- changes in commodity prices, interest rates and demand for our services;
- changes in laws and regulations impacting the midstream sector of the natural gas industry, including those that relate to climate change and environmental protection and safety;
- weather and other natural phenomena;
- industry changes including the impact of consolidations and changes in competition;
- regulation of transportation rates on our natural gas and NGL pipelines;
- our ability to obtain indemnification related to cleanup liabilities and to clean up any hazardous materials release on satisfactory terms;
- our ability to obtain required approvals for construction or modernization of our facilities and the timing of production from such facilities; and
- the effect of accounting pronouncements issued periodically by accounting standard setting boards.

If one or more of these risks or uncertainties materialize, or if underlying assumptions prove incorrect, our actual results may differ materially from those anticipated, estimated, projected or expected.

Other factors that could cause our actual results to differ from our projected results are discussed in Item 1A of our December 31, 2012 Annual Report on Form 10-K and our Quarterly Report on Form 10-Q for the quarter ended June 30, 2013.

Each forward-looking statement speaks only as of the date of the particular statement and we undertake no obligation to update or revise any forward-looking statement, whether as a result of new information, future events or otherwise.

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PART I – FINANCIAL INFORMATION

Item 1. Financial Statements

Regency Energy Partners LP

Condensed Consolidated Balance Sheets

(in millions)

(unaudited)

	September 30, 2013	December 31, 2012
ASSETS		
Current Assets:		
Cash and cash equivalents	\$12	\$53
Trade accounts receivable, net	60	115
Accrued revenues	214	107
Related party receivables	18	8
Other current assets	63	57
Total current assets	367	340
Property, plant and equipment:		
Property, plant and equipment	4,812	4,086
Less accumulated depreciation	(570)	(400)
Property, plant and equipment, net	4,242	3,686
Other Assets:		
Investment in unconsolidated affiliates	2,081	2,214
Other, net of accumulated amortization of debt issuance costs of \$22 and \$17	58	43
Total other assets	2,139	2,257
Intangible assets, net of accumulated amortization of \$99 and \$77	690	712
Goodwill	1,128	1,128
TOTAL ASSETS	\$8,566	\$8,123
LIABILITIES AND PARTNERS' CAPITAL AND NONCONTROLLING INTEREST		
Current Liabilities:		
Drafts payable	\$17	\$10
Trade accounts payable	134	122
Accrued cost of gas and liquids	163	133
Related party payables	57	95
Accrued interest	52	30
Other current liabilities	45	82
Deferred revenues	15	17
Total current liabilities	483	489
Long-term derivative liabilities	23	25
Other long-term liabilities	38	39
Long-term debt, net	2,976	2,157
Commitments and contingencies		
Series A preferred units, redemption amounts of \$37 and \$85	32	73
Partners' capital and noncontrolling interest:		
Common units	3,990	3,207
Class F common units	145	—
General partner interest	783	326
Predecessor equity	—	1,733
Accumulated other comprehensive loss	—	(3)

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Total partners' capital	4,918	5,263
Noncontrolling interest	96	77
Total partners' capital and noncontrolling interest	5,014	5,340
TOTAL LIABILITIES AND PARTNERS' CAPITAL AND NONCONTROLLING INTEREST	\$8,566	\$8,123

See accompanying notes to condensed consolidated financial statements

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Regency Energy Partners LP

Condensed Consolidated Statements of Operations

(in millions except unit data and per unit data)

(unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
REVENUES				
Gas sales, including related party amounts of \$22, \$14, \$56 and \$29	\$213	\$141	\$600	\$330
NGL sales, including related party amounts of \$11, \$—, \$23 and \$24	286	267	766	709
Gathering, transportation and other fees, including related party amounts of \$6, \$9, \$20 and \$23	147	101	405	297
Net realized and unrealized (loss) gain from derivatives	(10	) 1	—	20
Other	29	17	73	57
Total revenues	665	527	1,844	1,413
OPERATING COSTS AND EXPENSES				
Cost of sales, including related party amounts of \$8, \$12, \$35 and \$25	477	369	1,309	959
Operation and maintenance, including related party amounts of \$—, \$2, \$— and \$21	78	61	220	159
General and administrative, including related party amounts of \$2, \$4, \$9 and \$13	13	21	64	78
(Gain) loss on asset sales, net	(1	) —	1	2
Depreciation and amortization	74	71	207	193
Total operating costs and expenses	641	522	1,801	1,391
OPERATING INCOME	24	5	43	22
Income from unconsolidated affiliates	37	21	103	87
Interest expense, net	(41	) (29	) (119	) (86
Loss on debt refinancing, net	—	—	(7	) (8
Other income and deductions, net	24	1	3	26
INCOME (LOSS) BEFORE INCOME TAXES	44	(2	) 23	41
Income tax expense (benefit)	2	(1	) (1	) (1
NET INCOME (LOSS)	\$42	\$(1	) \$24	\$42
Net income attributable to noncontrolling interest	(3	) (1	) (4	) (2
NET INCOME (LOSS) ATTRIBUTABLE TO REGENCY ENERGY PARTNERS LP	\$39	\$(2	) \$20	\$40
Amounts attributable to Series A preferred units	1	2	5	7
General partner's interest, including IDRs	3	2	8	7
Beneficial conversion feature for Class F units	2	—	3	—
Pre-acquisition loss from SUGS allocated to predecessor equity	—	—	(36	) (15
Limited partners' interest in net income (loss)	\$33	\$(6	) \$40	\$41
Basic and diluted net income (loss) per common unit:				
Amount allocated to common units	\$33	\$(6	) \$40	\$41
Weighted average number of common units outstanding	209,559,854	170,264,621	191,334,032	166,368,178

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Basic income (loss) per common unit	\$0.16	\$(0.04) \$0.21	\$0.25
Diluted income (loss) per common unit	\$0.05	\$(0.04) \$0.21	\$0.22
Distributions per common unit	\$0.47	\$0.46	\$1.395	\$1.38
Amount allocated to Class F units due to beneficial conversion feature	\$2	\$—	\$3	\$—
Total number of Class F units outstanding	6,274,483	—	6,274,483	—
Income per Class F unit due to beneficial conversion feature	\$0.27	\$—	\$0.45	\$—

See accompanying notes to condensed consolidated financial statements

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Regency Energy Partners LP

Condensed Consolidated Statements of Comprehensive Income (Loss)

(in millions)

(unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,		
	2013	2012	2013	2012	
Net income (loss)	\$42	\$(1	) \$24	\$42	
Other comprehensive income (loss):					
Net cash flow hedge amounts reclassified to earnings	—	(6	) —	(6)
Change in fair value of cash flow hedges	—	(6	) —	5	
Total other comprehensive loss	—	(12	) —	(1)
Comprehensive income (loss)	42	(13	) 24	41	
Comprehensive income attributable to noncontrolling interest	3	1	4	2	
Comprehensive income (loss) attributable to Regency Energy Partners LP	\$39	\$(14	) \$20	\$39	

See accompanying notes to condensed consolidated financial statements

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Regency Energy Partners LP

Condensed Consolidated Statements of Cash Flows

(in millions)

(unaudited)

	Nine Months Ended September	
	30,	2012
	2013	
OPERATING ACTIVITIES:		
Net income	\$24	\$42
Reconciliation of net income to net cash flows provided by operating activities:		
Depreciation and amortization, including debt issuance cost amortization and bond premium write-off and amortization	211	197
Income from unconsolidated affiliates	(103)	(87)
Derivative valuation changes	3	(11)
Loss on asset sales, net	1	2
Unit-based compensation expenses	5	3
Cash flow changes in current assets and liabilities:		
Trade accounts receivable, accrued revenues and related party receivables	(73)	9
Other current assets and other current liabilities	(26)	53
Trade accounts payable, accrued cost of gas and liquids, related party payables and deferred revenues	103	(33)
Distributions of earnings received from unconsolidated affiliates	108	92
Cash flow changes in other assets and liabilities	128	(11)
Net cash flows provided by operating activities	381	256
INVESTING ACTIVITIES:		
Capital expenditures	(762)	(380)
Capital contributions to unconsolidated affiliates	(125)	(273)
Distributions in excess of earnings of unconsolidated affiliates	232	50
Acquisitions, net of cash received	(463)	—
Proceeds from asset sales	13	22
Net cash flows used in investing activities	(1,105)	(581)
FINANCING ACTIVITIES:		
Borrowings (repayments) under revolving credit facility, net	(15)	363
Proceeds from issuances of senior notes	1,000	—
Redemptions of senior notes	(163)	(88)
Debt issuance costs	(24)	(1)
Drafts payable	8	(6)
Partner distributions and distributions on unvested unit awards	(282)	(240)
Common unit offering, net of issuance costs	—	297
Common units issued under equity distribution program, net of costs	149	15
Distributions to Series A preferred units	(5)	(6)
Contributions from noncontrolling interest	15	24
Contributions from previous parent	—	2
Net cash flows provided by financing activities	683	360
Net change in cash and cash equivalents	(41)	35
Cash and cash equivalents at beginning of period	53	1
Cash and cash equivalents at end of period	\$12	\$36

Supplemental cash flow information:

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Accrued capital expenditures	\$70	\$29
Accrued capital contribution to unconsolidated affiliate	\$—	\$13
Issuance of Class F and common units in connection with SUGS acquisition	\$961	\$—

See accompanying notes to condensed consolidated financial statements

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Regency Energy Partners LP

Condensed Consolidated Statement of Partners' Capital and Noncontrolling Interest

(in millions)

(unaudited)

	Regency Energy Partners LP						Noncontrolling Interest	Total
	Common Units	Class F Common Units	General Partner Interest	Predecessor Equity	AOCI			
Balance - December 31, 2012	\$3,207	\$—	\$326	\$ 1,733	\$(3)	\$ 77		\$5,340
Contribution of net investment to the Partnership	—	—	1,925	(1,928)	3	—		—
Issuance of common units in connection with the SUGS Acquisition, net of costs	819	—	(819)	—	—	—		—
Issuance of Class F common units in connection with the SUGS Acquisition, net of costs	—	142	(142)	—	—	—		—
Contribution of assets between entities under common control below historical cost	—	—	(504)	231	—	—		(273)
Common units issued under equity distribution program, net of costs	149	—	—	—	—	—		149
Conversion of Series A Preferred Units for common units	41	—	—	—	—	—		41
Unit-based compensation expenses	5	—	—	—	—	—		5
Partner distributions	(269)	—	(11)	—	—	—		(280)
Distributions on unvested unit awards	(2)	—	—	—	—	—		(2)
Contributions from noncontrolling interest	—	—	—	—	—	15		15
Net income (loss)	45	3	8	(36)	—	4		24
Distributions to Series A Preferred Units	(5)	—	—	—	—	—		(5)
Balance - September 30, 2013	\$3,990	\$145	\$783	\$—	\$—	\$ 96		\$5,014

See accompanying notes to condensed consolidated financial statements

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Regency Energy Partners LP

Notes to Condensed Consolidated Financial Statements

(Tabular dollar amounts, except per unit data, are in millions)
(unaudited)

1. Organization and Summary of Significant Accounting Policies

Organization. The unaudited condensed consolidated financial statements presented herein contain the results of Regency Energy Partners LP and its subsidiaries (the “Partnership”), a Delaware limited partnership. The Partnership and its subsidiaries are engaged in the business of gathering and processing, compression, treating and transportation of natural gas and the transportation, fractionation and storage of NGLs. Regency GP LP is the Partnership’s general partner and Regency GP LLC (collectively the “General Partner”) is the managing general partner of the Partnership and the general partner of Regency GP LP.

SUGS Acquisition. On April 30, 2013, the Partnership and Regency Western acquired SUGS from Southern Union, a wholly owned subsidiary of Holdco, for \$1.5 billion (the “SUGS Acquisition”). The Partnership financed the acquisition by issuing to Southern Union 31,372,419 Partnership common units and 6,274,483 recently created Class F common units. The Class F common units are not entitled to participate in the Partnership’s distributions for twenty-four months post-transaction closing. The remaining \$600 million, less \$107 million of closing adjustments, was paid in cash. In addition, ETE has agreed to forgo IDR payments on the Partnership common units issued with this transaction for twenty-four months post-transaction closing and to suspend a \$10 million annual management fee paid by the Partnership for two years post-transaction close.

The common units and Class F common units related to the SUGS Acquisition were issued in a private placement conducted in accordance with the exemption from registration requirements of the Securities Act of 1933, as amended, under Section 4(a)(2) thereof. The Class F common units will convert into common units on a one-for-one basis in May 2015.

The cash portion of the SUGS Acquisition was funded from the proceeds of senior notes issued by the Partnership on April 30, 2013 in a private placement. PEPL Holdings provided a guarantee of collection with respect to the payment of the principal amounts of the senior notes issued by the Partnership.

The Partnership accounted for the acquisition in a manner similar to the pooling of interest method of accounting as it was a transaction between commonly controlled entities. Under this method of accounting, the Partnership reflected historical balance sheet data for the Partnership and SUGS instead of reflecting the fair market value of SUGS assets and liabilities from the date of acquisition forward. The Partnership retrospectively adjusted its financial statements to include the balances and operations of SUGS from March 26, 2012 (the date upon which common control began). The SUGS Acquisition does not impact historical earnings per unit as pre-acquisition earnings were allocated to predecessor equity.

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The following table presents the revenues and net income for the previously separate entities and the combined amounts presented herein:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013 ⁽¹⁾	2012
Revenues:				
Partnership	\$665	\$313	\$1,576	\$983
SUGS	—	214	268	430
Combined	\$665	\$527	\$1,844	\$1,413
Net income (loss):				
Partnership	\$42	\$(1	) \$60	\$57
SUGS	—	—	(36	) (15
Combined	\$42	\$(1	) \$24	\$42

⁽¹⁾ The SUGS Acquisition closed on April 30, 2013. Therefore, amounts attributable to SUGS only include four months of activity for the nine months ended September 30, 2013.

PVR Acquisition. On October 10, 2013, the Partnership announced that it entered into a merger agreement with PVR (“PVR Acquisition”) pursuant to which, the Partnership intends to propose to acquire PVR. This acquisition will be a unit-for-unit transaction plus a one-time \$40 million cash payment to PVR unitholders which represented total consideration of \$5.6 billion, including the assumption of net debt of \$1.8 billion. The holders of PVR common units, PVR Class B Units and PVR Special Units (“PVR Unit(s)”) will receive 1.02 Partnership common units in exchange for each PVR Unit held on the applicable record date. The transaction is subject to the approval of PVR’s unitholders, Hart-Scott-Rodino Antitrust Improvements Act and other customary closing conditions.

The PVR Acquisition will enhance the Partnership’s geographic diversity with a strategic presence in the Marcellus and Utica shales in the Appalachian Basin and the Granite Wash shale in the Mid-Continent region.

Basis of Presentation. The unaudited financial information included in this Form 10-Q has been prepared on the same basis as the audited consolidated financial statements included in the Partnership’s Annual Report on Form 10-K for the year ended December 31, 2012. In the opinion of the Partnership’s management, such financial information reflects all adjustments necessary for a fair presentation of the financial position and the results of operations for such interim periods in accordance with GAAP. All inter-company items and transactions have been eliminated in consolidation. Certain information and footnote disclosures normally included in annual consolidated financial statements prepared in accordance with GAAP have been omitted pursuant to the rules and regulations of the SEC.

Use of Estimates. The unaudited condensed consolidated financial statements have been prepared in conformity with GAAP, which includes the use of estimates and assumptions made by management that affect the reported amounts of assets, liabilities, revenues, expenses and disclosure of contingent assets and liabilities that exist at the date of the condensed consolidated financial statements. Although these estimates are based on management’s available knowledge of current and expected future events, actual results could be different from those estimates.

Derivative Financial Instruments. Derivative transactions are recognized in the accompanying consolidated balance sheet at their fair value. On the date the derivative contract is entered into, SUGS designated the derivative as a hedge of a forecasted transaction or the variability of cash flows to be received or paid in conjunction with a recognized asset or liability (a cash flow hedge). The effective portion of changes in fair value is recorded in accumulated other comprehensive income (loss) in the consolidated balance sheet until the related hedge items impact earnings. Any ineffective portion of a cash flow hedge is reported in current period earnings. Fair value is determined based upon quoted market prices and pricing models using assumptions that market participants would use. All outstanding SUGS derivative transactions as of April 30, 2013 were terminated upon acquisition by the Partnership.

Asset Retirement Obligations. Legal obligations associated with the retirement of long-lived assets are recorded at fair value at the time the obligations are incurred, if a reasonable estimate of fair value can be made. Present value techniques are used which reflect assumptions such as removal and remediation costs, inflation, and profit margins

that third parties would demand to settle the amount of the future obligation. The Partnership does not include a market risk premium for unforeseeable circumstances in its fair value estimates because such a premium cannot be reliably estimated. Upon initial recognition of the liability, costs are

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capitalized as a part of the long-lived asset and allocated to expense over the useful life of the related asset. The liability is accreted to its present value each period with accretion being recorded to operating expense with a corresponding increase in the carrying amount of the liability. The ARO assets and liabilities as of September 30, 2013 and December 31, 2012 were \$5 million.

Environmental. The Partnership's operations are subject to federal, state and local laws and rules and regulations regarding water quality, hazardous and solid waste management, air quality control and other environmental matters. These laws, rules and regulations require the Partnership to conduct its operations in a specified manner and to obtain and comply with a wide variety of environmental registrations, licenses, permits, inspections and other approvals. Failure to comply with applicable environmental laws, rules and regulations may expose the Partnership to significant fines, penalties and/or interruptions in its operations. The Partnership's environmental policies and procedures are designed to achieve compliance with such applicable laws and regulations. These evolving laws and regulations and claims for damages to property, employees, other persons and the environment resulting from current or past operations may result in significant expenditures and liabilities in the future.

Income Taxes. The Partnership is generally not subject to income taxes, except as discussed below, because its income is taxed directly to its partners. The Partnership is subject to the gross margins tax enacted by the state of Texas. The Partnership has two wholly-owned subsidiaries that are subject to income tax and provides for deferred income taxes using the asset and liability method. Accordingly, deferred taxes are recorded for differences between the tax and book basis that will reverse in future periods. The Partnership's deferred tax liabilities of \$21 million and \$23 million as of September 30, 2013 and December 31, 2012, respectively, relate to the difference between the book and tax basis of property, plant and equipment and intangible assets and is included in other long-term liabilities in the accompanying consolidated balance sheets. The Partnership follows the guidance for uncertainties in income taxes where a liability for an unrecognized tax benefit is recorded for a tax position that does not meet the "more likely than not" criteria. The Partnership has not recorded any uncertain tax positions meeting the more likely than not criteria as of September 30, 2013 and December 31, 2012. The Partnership also recognized deferred income tax benefit of \$5 million offset by a \$4 million state deferred tax expense for the nine months ended September 30, 2013.

Although the SUGS operations were included in the Southern Union consolidated federal income tax return prior to the SUGS Acquisition, following their acquisition by the Partnership, their operations are now treated as a partnership. Therefore, other than one wholly-owned subsidiary, the historical operations exclude income taxes for all periods presented.

Effective with the Partnership's acquisition of SUGS on April 30, 2013, SUGS is generally no longer subject to federal income taxes and subject only to gross margins tax in the state of Texas. Substantially all previously recorded current and deferred tax liabilities were settled with Southern Union, along with all other intercompany receivables and payables at the date of acquisition.

2. Partners' Capital and Distributions

Predecessor equity included on the condensed consolidated statement of partners' capital and noncontrolling interest represents SUGS Member's capital prior to the acquisition date (April 30, 2013).

Beneficial Conversion Feature. The Partnership issued 6,274,483 Class F common units in connection with the SUGS Acquisition. At the commitment date (February 27, 2013), the sales price of \$23.91 per unit represented a \$2.19 discount from the fair value of the Partnership's common units as of April 30, 2013. Under FASB ASC 470-20, "Debt with Conversion and Other Options," the discount represents a beneficial conversion feature that is treated as a non-cash distribution for purposes of calculating earnings per unit. The beneficial conversion feature is reflected in income per unit using the effective yield method over the period the Class F common units are outstanding, as indicated on the statement of operations in the line item entitled "beneficial conversion feature for Class F common

units.” The Class F common units are convertible to common units on a one-for-one basis on May 8, 2015.

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Units Activity. The change in common and Class F units during the nine months ended September 30, 2013 was as follows:

	Common	Class F
Balance - December 31, 2012	170,951,457	—
Issuance of common units under LTIP, net of forfeitures and tax withholding	35,615	—
Issuance of common units under the Equity Distribution Agreement	5,712,138	—
Issuance of common units in exchange for conversion of Series A preferred units	2,629,223	—
Issuance of common units and Class F common units in connection with SUGS Acquisition	31,372,419	(1) 6,274,483 (2)
Balance - September 30, 2013	210,700,852	6,274,483

(1) ETE has agreed to forgo IDR payments on the Partnership common units issued with the SUGS Acquisition for twenty-four months post-transaction closing.

(2) The Class F common units are not entitled to participate in the Partnership's distributions or earnings for twenty-four months post-transaction closing.

Equity Distribution Agreement. During the nine months ended September 30, 2013, the Partnership received net proceeds of \$149 million from units issued pursuant to an Equity Distribution Agreement with Citi, which were used for general partnership purposes. As of September 30, 2013, \$34 million remains available to be issued under this agreement.

Quarterly Distributions of Available Cash. Following are distributions declared by the Partnership subsequent to December 31, 2012:

Quarter Ended	Record Date	Payment Date	Cash Distributions (per common unit)
December 31, 2012	February 7, 2013	February 14, 2013	\$0.460
March 31, 2013	May 6, 2013	May 13, 2013	\$0.460
June 30, 2013	August 5, 2013	August 14, 2013	\$0.465
September 30, 2013	November 4, 2013	November 14, 2013	\$0.470

3. Income (Loss) per Common Unit

The following tables provide a reconciliation of the numerator and denominator of the basic and diluted earnings per common unit computations for the three and nine months ended September 30, 2013 and 2012:

	Three Months Ended September 30, 2013			2012		
	Income (Numerator)	Units (Denominator)	Per-Unit Amount	Income (Numerator)	Units (Denominator)	Per-Unit Amount
Basic income (loss) per unit						
Amounts allocated to common units	\$33	209,559,854	\$0.16	\$(6)	170,264,621	\$(0.04)
Effect of Dilutive Securities:						
Common unit options	—	32,489		—	—	
Phantom units *	—	435,606		—	—	
Series A preferred units	(23)	2,047,571		—	—	
Diluted income (loss) per unit	\$10	212,075,520	\$0.05	\$(6)	170,264,621	\$(0.04)

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	Nine Months Ended September 30, 2013			2012		
	Income (Numerator)	Units (Denominator)	Per-Unit Amount	Income (Numerator)	Units (Denominator)	Per-Unit Amount
Basic income per unit						
Amounts allocated to common units	\$40	191,334,032	\$0.21	\$41	166,368,178	\$0.25
Effect of Dilutive Securities:						
Common unit options	—	23,931		—	13,113	
Phantom units *	—	351,811		—	320,452	
Series A preferred units	—	—		(3	) 4,651,884	
Diluted income per unit	\$40	191,709,774	\$0.21	\$38	171,353,627	\$0.22

* Amount assumes maximum conversion rate for market condition awards.

The following data show securities that could potentially dilute earnings per unit in the future that were not included in the computation of diluted earnings per unit because to do so would have been antidilutive for the periods presented:

	Nine Months Ended September 30, 2013	Three Months Ended September 30, 2012
Common unit options	—	9,147
Phantom units	—	313,378
Series A preferred units	2,047,571	4,651,884

4. Investment in Unconsolidated Affiliates

As of September 30, 2013, the Partnership has a 49.99% general partner interest in HPC, a 50% membership interest in MEP, a 30% membership interest in Lone Star, a 33.33% membership interest in Ranch JV, and a 50% interest in Grey Ranch. The carrying value of the Partnership's investment in each of the unconsolidated affiliates as of September 30, 2013 and December 31, 2012 is as follows:

	September 30, 2013	December 31, 2012
HPC	\$448	\$650
MEP	556	581
Lone Star	1,040	948
Ranch JV	36	35
Grey Ranch	1	—
	\$2,081	\$2,214

The following tables summarize the Partnership's investment activities in each of the unconsolidated affiliates for the three and nine months ended September 30, 2013 and 2012:

	Three Months Ended September 30, 2013			
	HPC ⁽¹⁾	MEP	Lone Star	Ranch JV
Contributions to unconsolidated affiliates	\$—	\$—	\$51	\$1
Distributions from unconsolidated affiliates	(196	) (18	) (16	) (1
Share of earnings of unconsolidated affiliates' net income	9	11	18	—
Amortization of excess fair value of investment	(1) —	—	—

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Three Months Ended September 30, 2012				
	HPC	MEP	Lone Star	Ranch JV
Contributions to unconsolidated affiliates	\$—	\$—	\$78	\$10
Distributions from unconsolidated affiliates	(16	) (18	) (21) —
Share of earnings of unconsolidated affiliates' net income	3	10	9	—
Amortization of excess fair value of investment	(1) —	—	—
Nine Months Ended September 30, 2013				
	HPC ⁽¹⁾	MEP	Lone Star	Ranch JV
Contributions to unconsolidated affiliates	\$—	\$—	\$100	\$2
Distributions from unconsolidated affiliates	(226	) (56	) (56	) (1
Share of earnings of unconsolidated affiliates' net income	28	31	48	—
Amortization of excess fair value of investment	(4) —	—	—
Nine Months Ended September 30, 2012				
	HPC	MEP	Lone Star	Ranch JV
Contributions to unconsolidated affiliates	\$—	\$—	\$253	\$33
Distributions from unconsolidated affiliates	(46	) (56	) (39) —
Share of earnings of unconsolidated affiliates' net income	28	31	32	—
Amortization of excess fair value of investment	(4) —	—	—

⁽¹⁾ The Partnership received a non-recurring return of capital of \$185 million from HPC in September 2013. HPC entered into a \$500 million 5-year revolving credit facility in September 2013. Concurrent with the closing of this facility, HPC borrowed \$370 million to fund a non-recurring return of capital to the partners. The Partnership pledged its 49.99% equity interest in Regency Intrastate Gas LP. The amounts outstanding under this facility was \$445 million as of September 30, 2013. The Partnership's contingent obligations with respect to the outstanding borrowings under this facility was \$222 million at September 30, 2013.

The following tables present selected income statement data for each of the unconsolidated affiliates, on a 100% basis, for the three and nine months ended September 30, 2013 and 2012:

Three Months Ended September 30, 2013				
	HPC	MEP	Lone Star	Ranch JV
Total revenues	\$38	\$66	\$537	\$4
Operating income	19	34	61	1
Net income	18	21	61	1
Three Months Ended September 30, 2012				
	HPC	MEP	Lone Star	Ranch JV
Total revenues	\$42	\$65	\$165	\$—
Operating income (loss)	21	33	31	(1
Net income (loss)	6	21	31	(1
Nine Months Ended September 30, 2013				
	HPC	MEP	Lone Star	Ranch JV
Total revenues	\$116	\$194	\$1,320	\$10
Operating income	58	101	162	2
Net income	56	63	160	2

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	Nine Months Ended September 30, 2012			
	HPC	MEP	Lone Star	Ranch JV
Total revenues	\$ 130	\$ 196	\$ 490	\$—
Operating income (loss)	71	101	110	(1)
Net income (loss)	55	63	110	(1)

5. Derivative Instruments

Policies. The Partnership established comprehensive risk management policies and procedures to monitor and manage the market risks associated with commodity prices, counterparty credit and interest rates. The General Partner is responsible for delegation of transaction authority levels, and the Audit and Risk Committee of the General Partner is responsible for the overall management of these risks, including monitoring exposure limits. The Audit and Risk Committee receives regular briefings on exposures and overall risk management in the context of market activities.

Commodity Price Risk. The Partnership is a net seller of NGLs, condensate and natural gas as a result of its gathering and processing operations. The prices of these commodities are impacted by changes in supply and demand as well as market forces. Both the Partnership's profitability and cash flow are affected by the inherent volatility of these commodities which could adversely affect its ability to make distributions to its unitholders. The Partnership manages this commodity price exposure through an integrated strategy that includes management of its contract portfolio, matching sales prices of commodities with purchases, optimization of its portfolio by monitoring basis and other price differentials in operating areas, and the use of derivative contracts. In some cases, the Partnership may not be able to match pricing terms or cover its risk to price exposure with financial hedges, and it may be exposed to commodity price risk. Speculative positions with derivative contracts are prohibited under the Partnership's policies.

The Partnership has swap contracts that settle against certain NGLs, condensate and natural gas market prices. On January 1, 2012, the Partnership de-designated its swap contracts and began accounting for these contracts using the mark-to-market method of accounting. As of December 31, 2012, SUGS had outstanding receive-fixed natural gas price swaps that were accounted for as cash flow hedges, with the effective portion of changes in their fair value recorded in AOCI and reclassified into revenues in the same periods during which the forecasted natural gas sales impact earnings. As of April 30, 2013, in connection with the SUGS Acquisition, these outstanding hedges were terminated.

Interest Rate Risk. The Partnership is exposed to variable interest rate risk as a result of borrowings under its revolving credit facility. As of September 30, 2013, the Partnership had \$176 million of outstanding borrowings exposed to variable interest rate risk.

Credit Risk. The Partnership's resale of NGLs, condensate and natural gas exposes it to credit risk, as the margin on any sale is generally a very small percentage of the total sales price. Therefore, a credit loss can be very large relative to overall profitability on these transactions. The Partnership attempts to ensure that it issues credit only to credit-worthy counterparties and that in appropriate circumstances any such extension of credit is backed by adequate collateral, such as a letter of credit or parental guarantee from a parent company with potentially better credit.

The Partnership is exposed to credit risk from its derivative contract counterparties. The Partnership does not require collateral from these counterparties. The Partnership deals primarily with financial institutions when entering into financial derivatives, and utilizes master netting agreements that allow for netting of swap contract receivables and payables in the event of default by either party. If the Partnership's counterparties failed to perform under existing swap contracts, the Partnership's maximum loss as of September 30, 2013 would be \$7 million, which would be reduced by \$2 million, due to the netting features. The Partnership has elected to present assets and liabilities under master netting agreements gross on the condensed consolidated balance sheets.

Embedded Derivatives. The Series A preferred units contain embedded derivatives which are required to be bifurcated and accounted for separately, such as the holders' conversion option and the Partnership's call option. These embedded derivatives are accounted for using mark-to-market accounting. The Partnership does not expect the embedded derivatives to affect its cash flows.

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The Partnership's derivative assets and liabilities, including credit risk adjustments, as of September 30, 2013 and December 31, 2012 are detailed below:

	Assets September 30, 2013	December 31, 2012	Liabilities September 30, 2013	December 31, 2012
Derivatives designated as cash flow hedges:				
Current amounts				
Commodity contracts	\$—	\$—	\$—	\$5
Total cash flow hedging instruments	\$—	\$—	\$—	\$5
Derivatives not designated as cash flow hedges:				
Current amounts				
Commodity contracts	\$6	\$4	\$5	\$1
Long-term amounts				
Commodity contracts	1	1	—	—
Embedded derivatives in Series A preferred units	—	—	23	25
Total derivatives	\$7	\$5	\$28	\$31

The Partnership's statements of operations for the three and nine months ended September 30, 2013 and 2012 were impacted by derivative instruments activities as follows:

		Three Months Ended September 30, 2013	2012
Derivatives in cash flow hedging relationships:		Change in Value Recognized in AOCI on Derivatives (Effective Portion)	
Commodity derivatives		\$—	\$(6)
Derivatives in cash flow hedging relationships:	Location of Gain/(Loss) Recognized in Income	Amount of Gain/(Loss) Reclassified from AOCI into Income (Effective Portion)	
Commodity derivatives	Revenues	\$—	\$6
Derivatives not designated in a hedging relationship:	Location of Gain/(Loss) Recognized in Income	Amount of Gain/(Loss) Recognized in Income on Derivatives	
Commodity derivatives	Revenues	\$(10)	\$(5)
Embedded derivatives in Series A preferred units	Other income & deductions, net	24	2
		\$14	\$(3)

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		Nine Months Ended September 30,	
		2013	2012
Derivatives in cash flow hedging relationships:		Change in Value Recognized in AOCI on Derivatives (Effective Portion)	
Commodity derivatives		\$—	\$5
Derivatives in cash flow hedging relationships:		Amount of Gain/(Loss) Reclassified from AOCI into Income (Effective Portion)	
Commodity derivatives		Revenues	\$— \$12
Derivatives not designated in a hedging relationship:		Amount of Gain/(Loss) Amortized from AOCI into Income	
Commodity derivatives		Revenues	\$— \$(6)
Derivatives not designated in a hedging relationship:		Amount of Gain/(Loss) Recognized in Income on Derivatives	
Commodity derivatives		Revenues	\$— \$14
Embedded derivatives in Series A preferred units		Other income & deductions, net	2 10
		\$2	\$24

6. Long-term Debt

Obligations in the form of senior notes and borrowings under the revolving credit facility are as follows:

	September 30, 2013	December 31, 2012
Senior notes	\$2,800	\$1,965
Revolving loans	176	192
Total	2,976	2,157
Less: current portion	—	—
Long-term debt	\$2,976	\$2,157
Availability under revolving credit facility:		
Total credit facility limit	\$1,200	\$1,150
Revolving loans	(176)	(192)
Letters of credit	(15)	(12)
Total available	\$1,009	\$946

Long-term debt maturities as of September 30, 2013 for each of the next five years are as follows:

Years Ending	Amount
December 31, 2013 (remainder)	\$—
2014	—
2015	—
2016	—
2017	—
Thereafter	2,976
Total	\$2,976

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Revolving Credit Facility

The weighted average interest rate on the total amounts outstanding under the Partnership's revolving credit facility was 2.19% as of September 30, 2013.

In May 2013, RGS entered into the Sixth Amended and Restated Credit Agreement to increase the commitment to \$1.2 billion with a \$300 million uncommitted incremental facility and extended the maturity date to May 21, 2018.

The material differences between the Fifth and Sixth Amended and Restated Credit Agreement include:

- A 75 bps decrease in pricing, with an additional 50 bps decrease upon the achievement of an investment grade rating;
- No limitation on the maximum amount that the loan parties may invest in joint ventures existing on the date of the credit agreement so long as the Partnership is in pro forma compliance with the financial covenants;
- The addition of a "Restricted Subsidiary" structure such that certain designated subsidiaries are not subject to the credit facility covenants and do not guarantee the obligations thereunder or pledge their assets in support thereof;
- The addition of provisions such that upon the achievement of an investment grade rating by the Partnership, the collateral package will be released; the facility will become unsecured; and the covenant package will be significantly reduced;
- An eight-quarter increase in the permitted Total Leverage Ratio; and
- After March 2015, an increase in the permitted Total Leverage Ratio for the two fiscal quarters following any \$50 million or greater acquisition.

The new credit agreement and the guarantees are senior to the Partnership's and the guarantors' secured obligations, including the Series A preferred units. As of September 30, 2013, the Partnership was in compliance with all of the financial covenants contained within the new credit agreement.

The Partnership treated the May 2013 amendment of the revolving credit facility as a modification of an existing revolving credit agreement and, therefore, wrote off debt issuance costs of less than \$1 million to interest expense, net in the period from January 1, 2013 to September 30, 2013. In addition, the Partnership capitalized \$7 million of loan fees which is being amortized over the remaining term.

4.5% Senior Notes Due 2023

In April 2013, in conjunction with financing the SUGS Acquisition, the Partnership and Finance Corp. issued \$600 million senior notes in a private placement (the "2023 4.5% Notes"). The 2023 4.5% Notes bear interest at 4.5% payable semi-annually in arrears on May 1 and November 1, commencing November 1, 2013 and mature on November 1, 2023.

At any time prior to August 1, 2023, the Partnership may redeem some or all of the 2023 4.5% Notes at a price equal to 100% of the principal amount plus a make-whole premium and accrued interest. On or after August 1, 2023, the Partnership may redeem some or all of the 2023 4.5% Notes at a price equal to 100% plus accrued interest.

9.375% Senior Notes Due 2016

In June 2013, the Partnership redeemed all of the \$163 million outstanding 9.375% Senior Notes due 2016 for \$178 million cash, inclusive of accrued and unpaid interest of \$7 million and other fees and expenses.

5.75% Senior Notes Due 2020

In September 2013, the Partnership and Finance Corp. issued \$400 million senior notes due September 1, 2020 (the "2020 Notes"). The 2020 Notes bear interest at 5.75% payable semi-annually on March 1 and September 1, commencing March 1, 2014, and mature on September 1, 2020.

At any time prior to June 1, 2020, the Partnership may redeem some or all of the 2020 Notes at a price equal to 100% of the principal amount plus a make-whole premium and accrued interest. On or after June 1, 2020, the Partnership may redeem some or all of the 2020 Notes at a price equal to 100% plus accrued interest.

Covenants

Upon a change of control, as defined in the indentures, followed by a ratings decline within 90 days, each holder of the 2023 4.5% Notes and the 2020 Notes will be entitled to require us to purchase all or a portion of its notes at a purchase price of 101% of the principal amount plus accrued interest and liquidated damages, if any. Our ability to purchase the notes upon a change of control will be limited by the terms of our debt agreements, including our revolving credit facility.

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The 2023 4.5% Notes and the 2020 Notes contain various covenants that limit, among other things, our ability, and the ability of certain of our subsidiaries, to:

- incur additional indebtedness;
- pay distributions on, or repurchase or redeem our equity interests;
- make certain investments;
- incur liens;
- enter into certain types of transactions with affiliates; and
- sell assets or consolidate or merge with or into other companies.

At September 30, 2013, the Partnership was in compliance with all covenants.

If the 2023 4.5% Notes and the 2020 Notes achieve investment grade ratings by both Moody's and S&P and no default or event of default has occurred and is continuing, we will no longer be subject to many of the foregoing covenants.

The 2023 4.5% Notes and the 2020 Notes are jointly and severally guaranteed by all of our consolidated subsidiaries, other than Finance Corp. and a minor subsidiary. The senior notes and guarantees are unsecured and rank equally with all of our and the guarantors' existing and future unsecured obligations. The senior notes and the guarantees will be senior in right of payment to any of our and the guarantor's future obligations that are, by their terms, expressly subordinated in right of payment to the notes and the guarantees. The senior notes and the guarantees will be effectively subordinated to our and the guarantors' secured obligations, including our revolving credit facility, to the extent of the value of the assets securing such obligations.

Finance Corp. has no operations and will not have revenues other than as may be incidental as co-issuer of the Senior Notes. Since the guarantees are fully unconditional and joint and several of its subsidiaries, except for a minor subsidiary, the Partnership has not included condensed consolidated financial information of guarantors of the Senior Notes.

7. Commitments and Contingencies

Legal. The Partnership is involved in various claims, lawsuits and audits by taxing authorities incidental to its business. These claims and lawsuits in the aggregate are not expected to have a material adverse effect on the Partnership's business, financial condition, results of operations or cash flows.

Four putative class action lawsuits challenging the merger have been filed, two in the Court of Chancery of the State of Delaware: (i) David Naiditch v. PVR Partners, L.P., et al. (Case No. 9015-VCL); and (ii) Robert P. Frutkin v. Edward B. Cloues II, et al. (Case No. 9020-VCL), and two in the Court of Common Pleas for Delaware County, Pennsylvania: (i) Charles Monatt v. PVR Partners, LP, et al. (Case No. 2013-10606); and [(ii) Steven Keene v. James L. Gardner, et al. (Case No. 2013-010723)]. All of the cases name PVR, PVR GP and the current directors of PVR GP, as well as the Partnership, the General Partner and RVP LLC, a subsidiary of the Partnership (collectively, the "Regency Defendants"), as defendants. Each of the lawsuits has been brought by a purported unitholder of PVR, both individually and on behalf of a putative class consisting of public unitholders of PVR. The lawsuits generally allege, among other things, that the directors of PVR GP breached their fiduciary duties to unitholders of PVR by agreeing to a transaction with inadequate consideration and unfair terms and pursuant to an inadequate process. The lawsuits allege further that PVR GP and the Regency Defendants aided and abetted the directors of PVR GP in the alleged breach of their fiduciary duties. The Naiditch and Monatt lawsuits allege further that PVR also aided and abetted the directors of PVR GP in the alleged breach of their fiduciary duties. The lawsuits seek, in general, (i) injunctive relief enjoining the transactions contemplated by the merger agreement, (ii) in the event the merger is consummated, rescission or an award of rescissory damages, (iii) an award of plaintiffs' costs, including reasonable attorneys' and experts' fees, (iv) the accounting by the defendants to plaintiffs for all damages caused by the defendants, and (v) such further relief as the court deems just and proper. Similar actions may be filed in the future.

Environmental. The Partnership is responsible for environmental remediation at certain sites on its gathering and processing systems, resulting primarily from releases of hydrocarbons. The Partnership's remediation program typically involves the management of contaminated soils and may involve remediation of groundwater. Activities vary with site conditions and locations, the extent and nature of the contamination, remedial requirements and complexity. The ultimate liability and total costs associated with these sites will depend upon many factors.

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The table below reflects the environmental liabilities recorded at September 30, 2013 and December 31, 2012. Except as described above, the Partnership does not have any material environmental remediation matters assessed as reasonably possible that would require disclosure in the financial statements.

	September 30, 2013	December 31, 2012
Current	\$2	\$5
Noncurrent	7	7
Total environmental liabilities	\$9	\$12

The Partnership recorded expenditures related to environmental remediation of \$4 million for the nine months ended September 30, 2013.

Air Quality Control. The Partnership is currently negotiating settlements to certain enforcement actions by the NMED and the TCEQ. The TCEQ recently initiated a state-wide emissions inventory for the sulfur dioxide emissions from sites with reported emissions of 10 tons per year or more. If this data demonstrates that any source or group of sources may cause or contribute to a violation of the National Ambient Air Quality Standards, they must be sufficiently controlled to ensure timely attainment of the standard. This may potentially affect three recovery units in Texas. It is unclear at this time how the NMED will address the sulfur dioxide standard.

Compliance Orders from the NMED. SUGS has been in discussions with the NMED concerning allegations of violations of New Mexico air regulations related to the Jal #3 and Jal #4 facilities. Hearings on the COs were delayed until March 2014 to allow the parties to pursue substantive settlement discussions. The Partnership has meritorious defenses to the NMED claims and can offer significant mitigating factors to the claimed violations. The Partnership has recorded a liability of less than \$1 million related to the claims and will continue to assess its potential exposure to the allegations as the matters progress.

CDM Sales Tax Audit. CDM Resource Management LLC (“CDM”), a subsidiary of the Partnership, has historically claimed the manufacturing exemption from sales tax in Texas, as is common in the industry. The exemption is based on the fact that CDM’s natural gas compression equipment is used in the process of treating natural gas for ultimate use and sale. In a recent audit by the Texas Comptroller’s office, the Comptroller has challenged the applicability of the manufacturing exemption to CDM. The period being audited is from August 2006 to August 2007, and liability for that period is potentially covered by an indemnity obligation from CDM’s prior owners. CDM may also have liability for periods since 2008, and prospectively, if the Comptroller’s challenge is ultimately successful. An audit of the 2008 period has commenced. In April 2013, an independent audit review agreed with the Comptroller’s position. While CDM continues to disagree with this position and intends to seek redetermination and other relief, we are unable to predict the final outcome of this matter.

In addition to the matters discussed above, the Partnership is involved in legal, tax and regulatory proceedings before various courts, regulatory commissions and governmental agencies regarding matters arising in the ordinary course of business.

8. Series A Preferred Units

In July 2013, certain holders of Series A Preferred Units exercised their right to convert 2,459,017 Series A Preferred Units into common units. Concurrent with this transaction, the Partnership recognized a \$26 million gain in other income and deductions, net, related to the embedded derivative and reclassified \$41 million from the Series A Preferred Units into common units. As of September 30, 2013, the remaining Series A Preferred Units were convertible into 2,047,571 common units, and if outstanding, are mandatorily redeemable on September 2, 2029 for \$35 million plus all accrued but unpaid distributions and interest thereon. The Series A Preferred Units receive fixed quarterly cash distributions of \$0.445 per unit if outstanding on the record dates of the Partnership’s common unit distributions. Holders can elect to convert Series A Preferred Units into common units at any time in accordance with the partnership agreement.

The following table provides a reconciliation of the beginning and ending balances of the Series A Preferred Units for the nine months ended September 30, 2013:

	Units	Amount
Outstanding at beginning of period	4,371,586	\$73

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Series A Preferred Units converted into common units	(2,459,017) (41)
Accretion to redemption value	N/A	—	
Outstanding at end of period	1,912,569	\$32	*

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* This amount will be accreted to \$35 million plus any accrued but unpaid distributions and interest by deducting amounts from

partners' capital over the remaining periods until the mandatory redemption date of September 2, 2029.

9. Related Party Transactions

As of September 30, 2013 and December 31, 2012, details of the Partnership's related party receivables and related party payables were as follows:

	September 30, 2013	December 31, 2012
Related party receivables		
HPC	\$ 1	\$ 1
ETE and its subsidiaries	17	5
Ranch JV	—	2
Total related party receivables	\$ 18	\$ 8
Related party payables		
HPC	\$ 1	\$ 1
ETE and its subsidiaries	56	94
Total related party payables	\$ 57	\$ 95

Transactions with ETE and its subsidiaries. Under the service agreement with Services Co., the Partnership paid Services Co.'s direct expenses for services performed, plus an annual fee of \$10 million, and received the benefit of any cost savings recognized for these services. The service agreement had a five year term which was to expire May 26, 2015, subject to earlier termination rights in the event of a change in control, the failure to achieve certain cost savings for the Partnership or upon an event of default. On April 30, 2013, in conjunction with the SUGS Acquisition, the Partnership entered into the first amendment (the "Services Agreement Amendment") to the Services Agreement, effective as of May 26, 2010, by and among the Partnership, ETE and Services Co. The Services Agreement Amendment provided for a waiver of the \$10 million annual fee effective as of May 1, 2013 through and including April 30, 2015 and clarified the scope and expenses chargeable as direct expenses thereunder.

On April 30, 2013, the Partnership entered into the second amendment (the "Operation and Service Amendment") to the Operation and Service Agreement (the "Operation and Service Agreement"), by and among the Partnership, ETC, the General Partner and RGS. Under the Operation and Service Agreement, ETC performs certain operations, maintenance and related services reasonably required to operate and maintain certain facilities owned by the Partnership, and the Partnership reimburses ETC for actual costs and expenses incurred in connection with the provision of these services based on an annual budget agreed upon by both parties. The Operation and Service Agreement Amendment describes the services that ETC will provide in the future.

The Partnership incurred total service fees related to the agreements described above from ETE and its subsidiaries of \$2 million and \$4 million for the three months ended September 30, 2013 and 2012, respectively, and \$9 million and \$13 million for the nine months ended September 30, 2013 and 2012, respectively.

In conjunction with distributions by the Partnership to the limited and general partner interests, ETE received cash distributions of \$16 million for each of the three months ended September 30, 2013 and 2012, and \$47 million and \$46 million for the nine months ended September 30, 2013 and

Loss before discontinued operations

(0.033

)

(2.535

)

Loss from discontinued operations

-

(0.260

)

Net loss per weighted average common share outstanding

\$

(0.033

)

\$

(2.795

)

Weighted average shares outstanding - basic & diluted (Note 1)

90,299,865

322,735

(Weighted average shares outstanding have been adjusted retroactively to

reflect a reverse stock split on November 1, 2004)

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

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NEXIA HOLDINGS, INC. AND SUBSIDIARIES
Consolidated Statements of Stockholders' Equity

	Preferred Stock		Additional
	Shares	Amount	Paid-In
			Capital
Balance Forward, October 1, 2004	8,000,000	\$ 8,000	\$ -
Return of common stock issued to a consultant			
Fair value of options issued to consultants			
Intrinsic value of options issued to employees			
Common stock issued for options exercised, consultants			
Common stock issued for options exercised, employees			
Common stock issued for services to consultants			
Common stock issued for compensation to employees			
Common stock issued for subscriptions receivable, consultants			
Balance Forward	8,000,000	\$ 8,000	\$ -

The accompanying notes are an integral part of these consolidated financial statements

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NEXIA HOLDINGS, INC. AND SUBSIDIARIES
Consolidated Statements of Stockholders' Equity

	Preferred Stock		Additional
	Shares	Amount	Paid-In
			Capital
Balance Forward	\$ 8,000,000	\$ 8,000	
Common stock issued for subscriptions receivable, employees			
Application of restricted common stock issued to reduce debentures liability			
Common stock issued for building improvements			
Common stock issued to consultants to apply to accounts payable			
Proceeds from consultant option stock sales applied to accounts payable			
Series C preferred stock issued for cash	100,000	100	49,900
Receipt of subscriptions receivable			
Debt discount convertible debenture discount factor			
Balance Forward	\$ 8,100,000	\$ 8,100	\$ 49,900

The accompanying notes are an integral part of these consolidated financial statement

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NEXIA HOLDINGS, INC. AND SUBSIDIARIES
Consolidated Statements of Stockholders' Equity

	Preferred Stock Shares	Amount	Additional Paid-In Capital
Balance Forward	8,100,000	\$ 8,100	\$ 49,900
Round up fraction shares resulting from 11-01-2004 reverse stock split			
Change in other comprehensive loss			
Net consolidated loss, year ended December 31, 2004			
Balance, year ended December 31, 2004	8,100,000	\$ 8,100	\$ 49,900
The accompanying notes are an integral part of these consolidated financial statement			

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NEXIA HOLDINGS, INC. AND SUBSIDIARIES
Consolidated Statements of Stockholders' Equity

	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Treasury Stock	Stock Subscriptions Receivable	Expenses Prepaid With Common Stock	Deferred Consulting	Other Comprehensive Income (Loss)	Accumulated Deficit
Balance Forward	1,747,945,332	\$1,747,945	\$ 12,346,486	\$(100,618)	\$(375,009)	-	\$ -	\$ (4,396)	\$(10,224,467)
Round up fraction shares resulting from 11-01-2004 reverse stock split	502	1	(1)						
Change in other comprehensive loss								(2,371)	
Net consolidated loss, year ended December 31, 2004									(3,004,155)
Balance, year ended December 31, 2004	1,747,945,834	\$1,747,946	\$ 12,346,485	\$(100,618)	\$(375,009)	-	\$ -	\$ (6,767)	\$(13,228,622)

The accompanying notes are an integral part of these consolidated financial statement

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NEXIA HOLDINGS, INC. AND SUBSIDIARIES
Consolidated Statement of Stockholders' Equity

	Preferred Stock Shares	Amount
December 31, 2002	-	\$ -
Common stock issued for loan fee	-	-
Disposition of treasury stock and stock subscription due to sale of subsidiary	-	-
Common stock issued for services	-	-
Common stock issued for Bonus	-	-
Common stock issued for services and prepaid services	-	-
Common stock issued for stock option exercise to employees	-	-
Intrinsic value of stock options issued to employees	-	-
Beneficial conversion feature on		

convertible debentures	-	-
Adjustment for marketable securities	-	-
Net loss for the year ended December 31, 2003	-	-
Balance, December 31, 2003	-	-

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NEXIA HOLDINGS, INC. AND SUBSIDIARIES
Consolidated Statement of Stockholders' Equity (continued)

	Preferred Stock Shares	Amount
Balance, December 31, 2003	-	\$ -
Cancellation of Common stock for subscription receivable	-	-
Common stock issued for services		
Common stock issued for building improvements and services	-	-
Common stock issued for stock option exercise to consultants	-	-
Common stock issued for stock option exercise to employees	-	-
Receipt of subscriptions receivable	-	-
Amoritzation of prepaid expenses	-	-
Intrinsic value of stock options issued to employees	-	-
Balance, Forward	-	-

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NEXIA HOLDINGS, INC. AND SUBSIDIARIES
Consolidated Statement of Stockholders' Equity

	Preferred Stock Shares	Amount
Balance, Forward	-	\$ -
Fair Value of options issued for prepaid consulting fees	-	-
Application of option grants to accounts payable	-	-
Adjustment for marketable securities	-	-
Common stock issued for services	-	-
Common stock issued for stock option exercise to consultants	-	-
Common stock issued for stock option exercise to employees	-	-
Common stock issued for subscriptions receivable,		

consultants			-	-
Common Stock issued for subscriptions receivable employees			-	-
Fair Value of stock options issued to consultants			-	-
Series B preferred stock issued for services	8,000,000	\$		8,000
Balance Forward	8,000,000	\$		8,000

The accompanying notes are an integral part of these consolidated financial statements

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NEXIA HOLDINGS, INC. AND SUBSIDIARIES
Consolidated Statement of Stockholders' Equity

	Preferred Stock Shares		Amount
Balance, Forward	8,000,000	\$	8,000
Intrinsic Value of stock options issued to employees	-		-
Shareholder proceeds from Option stock sales applied to A/P	-		-
Amortization of deferred consulting balance expensed	-		-
Adjustment for marketable securities	-		-
Net loss for the nine months ended September 30, 2004	-		-
Balance, September 30, 2004	8,000,000	\$	8,000

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NEXIA HOLDINGS, INC. AND SUBSIDIARIES
Consolidated Statements of Cash Flows

	For the Years Ended December 31,	
	2004	2003
CASH FLOWS FROM OPERATING ACTIVITIES		
Net Income (Loss)	\$ (3,004,155)	\$ (901,825)
Other comprehensive loss	(5,905)	-
Adjustments to reconcile net loss to net cash used in operating activities:		
Loss from sale of investments	-	5,421
Loss from sale of land and real property for sale	-	9,008
Loss on disposition of property, plant and equipment	-	29,559
(Gain) loss from sale of subsidiaries	899,971	(229,268)
Impairment of marketable securities	194,194	75,177
Impairment of long-lived assets	-	173,966
Change in minority interest	(184,450)	(65,113)
Depreciation and amortization	145,704	137,607
Intrinsic and fair value of stock options issued	1,619,352	49,600
Expenses prepaid with common stock	13,330	-
Issuance of Preferred Series B stock for services	8,000	-
Issuance of common stock for services	892,659	323,817
Beneficial conversion feature of debenture issued	83,571	-
Amortization of beneficial conversion feature	-	11,609
Bad debt expense	-	319,219
Revaluation and expense of variable deferred consulting	45,600	-
Change in operating asset and liability accounts:		
Increase in restricted cash	-	-
Accounts receivable	(81,625)	(21,820)
Prepaid expenses	(18,684)	23,401
Capitalized loan costs	22,180	-

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Other assets	-	7,144
Related party transactions	12,952	-
Accounts payable	55,254	(10,415)
Accrued liabilities	78,956	39,468
Deferred Revenue	(8,602)	(138,070)
Unearned rent	(5,361)	-
Deferred gain on sale of subsidiary	(21,770)	-
Refundable Deposits	(500)	9,041
Convertible debentures	(55,000)	-
Current portion of WVDEP liability	(20,000)	-
Current portion of long-term debt change due to modification of two loan agreements to remove an On Demand clause	(920,449)	-
Net cash provided (used) by operating activities	(254,778)	(152,474)
CASH FLOWS FROM INVESTING ACTIVITIES		
Cash paid for securities investment	(34,757)	-
Cash relinquished in sale of subsidiaries	-	(15,351)
Issuance of notes receivable	(120,431)	(60,000)
Proceeds from notes receivable	6,790	26,100
Proceeds from sale of marketable securities	195,608	23,032
Proceeds from sale of real property	-	49,000
Purchase of property, plant and equipment	(364,761)	(32,544)
Net cash provided (used) by investing activities	(317,551)	(9,763)

The accompanying notes are integral to the consolidated financial statements.

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NEXIA HOLDINGS, INC. AND SUBSIDIARIES
Consolidated Statements of Cash Flows

	For the Years Ended December 31,	
	2004	2003
CASH FLOWS FROM INVESTING ACTIVITIES		
Cash paid for securities investment	(34,757)	0
Cash relinquished in sale of subsidiaries	0	(15,351)
Issuance of notes receivable	(120,431)	(60,000)
Proceeds from notes receivable	6,790	26,100
Proceeds from sale of marketable securities	195,608	23,032
Proceeds from sale of real property	0	49,000
Purchase of property, plant and equipment	(364,761)	(32,544)
Net cash provided (used) by investing activities	(317,551)	(9,763)

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

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NEXIA HOLDINGS, INC. AND SUBSIDIARIES
Consolidated Statements of Cash Flows (Continued)

	For the Years Ended December 31,	
	2004	2003
CASH FLOWS FROM LONG TERM FINANCING ACTIVITIES		
Payments on related party notes payable		
Notes receivable	\$ (118,050)	\$ -
Payments on long-term debt	(88,508)	(134,928)
Proceeds from issuance of long-term debt	193,510	194,417
Proceeds from issuance of convertible debentures	200,000	60,000
Proceeds from stock option exercise	-	28,000
Issuance of common stock to redeem convertible debentures	50,000	-
Issuance of Preferred Series B stock	8,000	-
Issuance of Preferred Series C stock for cash	50,000	-
Receipt of stock subscriptions receivable	43,821	-
Issuance of common stock for stock option exercise	371,974	-
Net cash provided (used) by financing activities	710,747	147,489
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	138,418	(14,748)
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	94,073	108,821
CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$ 232,491	\$ 94,073
SUPPLEMENTAL DISCLOSURE OF INFORMATION		
CASH PAID FOR:		
Interest	\$ 346,250	\$ 331,488
Income taxes	\$ -	\$ -

SUPPLEMENTAL DISCLOSURE OF
NON-CASH:
INVESTING AND FINANCING
ACTIVITIES:

Preferred stock issued for services	\$	8,000	\$	-
Common stock issued for services	\$	892,659	\$	323,817
Common stock issued for subscriptions receivable	\$	417,830	\$	-
Common stock issued for variable deferred consulting	\$	43,988	\$	-
Office equipment acquired through a capital lease	\$	-	\$	19,815
Common stock issued for building improvements	\$	141,564	\$	-
Common stock issued for loan costs	\$	-	\$	50,000

The accompanying notes are integral to the consolidated financial statements.

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NEXIA HOLDINGS, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements
December 31, 2004 and 2003

NOTE 1 - ORGANIZATION AND SUMMARY OF SIGNIFICANT POLICIES

A. Organization

Nexia Holdings, Inc. (Nexia or The Company) was incorporated under the laws of the State of Colorado on April 20, 1987 as Metropolitan Acquisition Corporation. The name of the Company has changed several times, most recently, to Kelly's Coffee Group, Inc. (Kelly's) on April 22, 1994, and finally to Nexia Holdings, Inc. on March 15, 2002. Nexia became a development stage company on March 1, 1998.

On October 5, 2000, Nexia merged with a Nevada corporation with the same name, effectively changing its state of domicile from Colorado to Nevada and its authorized common stock from 100,000,000 shares with \$.001 par value to 1,000,000,000 shares with \$.001 par value.

On February 15, 2002, the Company entered into a Stock Purchase Agreement (Agreement) with Axia Group, Inc. (Axia), a related party, pursuant to which the Company issued to Axia 255,100,000 restricted shares of the Company's common stock in exchange for essentially all of the assets and liabilities of Axia. Axia's assets included a portfolio of securities, real estate holdings and publicly reporting shell-companies. The shares issued to Axia equaled approximately 82% of the issued and outstanding shares of the Company after the close of the transaction. Immediately prior to the Agreement, the Company had 55,252,760 shares of common stock issued and outstanding.

The acquisition was accounted for as a recapitalization. The subsidiaries consisted of Diversified Holdings I, Inc., Wichita Development Corporation, Golden Opportunity Development Corporation, Downtown Development Corporation, Wasatch Capital Corporation, Hudson Consulting Group, Inc., Oasis International Hotel and Casino, Inc., Canton Industrial Corporation of Salt Lake City Inc., Canton's Wild Horse Ranch II, Inc., West Jordan Real Estate Holdings, Inc., Salt Lake Development, Inc., Kearns Development Corporation and Canton Tire Recycling of West Virginia, Inc. (together "The Accounting Acquirer").

The subsidiaries of Axia which were transferred to the Company have been treated as the acquiring entities for accounting purposes and the Company is the surviving entity for legal purposes. The transaction is deemed to be an exchange of assets between entities under common control. The President of the Company was also the President of Axia.

As noted by Interpretation 39, the transfer of net assets or an exchange of shares between entities under common control is excluded from Opinion 16 and should be accounted for at historical cost. There was no adjustment to the carrying value of the assets or liabilities of the transferred subsidiaries, nor was there any adjustment to the carrying value of the net assets or liabilities of the Company. The combined statements of operations and other comprehensive income and cash flows for the year ended December 31, 2001 include only the activity of the accounting acquirer and through February 5, 2002 (date of agreement) after which the statement of operations reflect the operations of the accounting acquirer and Nexia. The statement of stockholders equity for the year ended December 31, 2001 has been presented to give proportionate effect to the number of shares issued by the Company as applied to the equity transactions of the accounting acquirer.

On June 19, 2003, in an inter-company tax free transaction, Wichita Development Corporation exchanged its shareholdings in Kearns Development Corporation for the Diversified Holdings 1, Inc. shareholdings in Salt Lake Development Corporation. At the time of the exchange all parties were subsidiaries of Nexia.

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NEXIA HOLDINGS, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements
December 31, 2004 and 2003

On June 20, 2003, the Company sold its interest in Wichita Development Corporation, and consequently, its interest in Salt Lake Development Corporation and Wichita Properties, Inc., to Diversified Financial Resources Corporation (DFRC) (See Note 12).

NOTE 1 a. ORGANIZATION

On December 31, 2004, Diversified Holdings I, Inc., a subsidiary of the Company, sold the stock of four of its subsidiaries to an unrelated party for \$100. The four entities sold were Oasis International Hotel & Casino, Inc., Golden Opportunity Development Corporation, Canton's Wild Horse Ranch II, Inc. and Canton Tire Recycling of West Virginia.

b. Basis of Consolidation

Diversified Holdings I, Inc. (DHI), a Nevada corporation and 99% owned subsidiary of the Company, was formed on March 22, 1996. DHI is a holding company which has majority ownership of the following subsidiaries:

Hudson Consulting Group, Inc. (Hudson) was incorporated in Nevada on April 16, 1996, as Diversified Holdings XIII, Inc. for the purpose of providing business consulting services. On March 5, 1997, its name was changed to Hudson Consulting Group, Inc. Hudson is 100% owned by DHI.

Canton Industrial Corporation of Salt Lake City (CICSLC), a Utah corporation, was incorporated on September 29, 1993 for the purpose of acquiring, owning and managing a specific property. CICSLC sold the property in December 1998, and currently holds a promissory note from the purchaser, secured by a deed of trust on the property, in the amount of \$255,000, bearing interest at 8%, principal and interest due August 10, 2002. CICSLC is 80% owned by DHI and 10% owned by Nexia.

West Jordan Real Estate Holdings, Inc. (WJREH), was formed on June 7, 1994 in Utah for the purpose of acquiring, owning and managing a specific property. WJREH sold its real estate holdings on April 20, 2005. Its only assets are cash and receivables of \$677,539 at May 1, 2005.

Kearns Development Corporation (Kearns), a Nevada corporation, was incorporated February 16, 1996 as Cyber Studio, Inc. On April 4, 2001, its name was changed to Kearns Development Corporation. During 2000, Kearns purchased a commercially rented building in Kearns, Utah. Prior to October 17, 2001, Kearns was owned 90.7% by DHI and on June 19, 2003 was sold back to DHI by WHDV.

Wasatch Capital Corporation (WCC), a Utah corporation, was incorporated on June 10, 1991. WCC owns a commercially rented building in downtown Salt Lake City. DHI owned 98% and 77% of Wasatch common stock as of December 31, 2004 and 2003 respectively. On September 16, 2004 Wasatch issued one million shares of its common stock to DHI in total satisfaction of its outstanding debt to DHI.

Downtown Development Corporation (Downtown) was incorporated by the Company on November 30, 1999 in Utah as A-Z South State Corporation. On August 22, 2001, its name was changed to Downtown Development Corporation.

Downtown owns a commercially rented building in Salt Lake City, Utah, and is 99.8% owned by DH1. In addition to DHI, the Company has majority ownership in the following subsidiaries:

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NEXIA HOLDINGS, INC, AND SUBSIDIARIES

Notes to Consolidated Financial Statements
December 31, 2004 and 2003

NOTE 1 b. BASIS OF CONSOLIDATION, continued

At December 31, 2004, the Company had a majority ownership in 14 other companies including CyberCosmetics, Inc., CyberBoy, Inc., CyberEye, Inc., CyberFishing, Inc., CyberLead, Inc., CyberLife, Inc., CyberOil, Inc., CyberSkiing, Inc., CyberSoccer, Inc., CyberTennis, Inc., CyberTyme, Inc., CyberWholesale, Inc., CSI Holdings, Inc. (formerly CyberWrestling, Inc.), CyberWrite, Inc. Each of these companies is inactive with little or no assets, liabilities or operating activities.

The financial statements of four subsidiaries of Diversified Holdings I, Inc., referred to in Note 1 a. Organization as having been sold on December 31, 2004, are not included in the consolidated financial statements as of December 31, 2004 and for the year then ended.

c. Accounting Method

The accompanying consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America applicable to a going concern, which contemplates the realization of assets and the liquidation of liabilities in the normal course of business.

d. Compensating Cash Balances

The Company's subsidiary, West Jordan Real Estate Holdings, Inc. has signed a note payable. As part of the note, WJREH has agreed to deposit \$3,750 monthly into a bank account to be used for capital improvements, tenant improvements and leasing commissions. The account balance was \$79,631 at December 31, 2004.

e. Provision for Taxes

Deferred taxes are provided on a liability method whereby deferred tax assets are recognized for deductible temporary differences and operating loss and tax credit carryforwards and deferred tax liabilities are recognized for taxable temporary differences. Temporary differences are the differences between the reported amounts of assets and liabilities and their tax bases. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will be realized. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment.

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Notes to Consolidated Financial Statements
December 31, 2004 and 2003

Net deferred tax assets consist of the following components as of December 31, 2004 and 2003:

	2004	2003
Deferred tax assets		
NOL Carryover	\$ 4,697,711	\$ 2,594,290
Capital loss	661,050	661,050
Other	36,820	33,700
Deferred tax liabilities:	-	-
Valuation allowance	(5,395,581)	(3,289,040)
Net deferred tax asset	-	-

The income tax provision differs from the amount of income tax determined by applying the U.S. federal and state income tax rates of 39% to pretax income from continuing operations for the years ended December 31, 2004 and 2003 due to the following:

	2004	2003
Book loss	\$ (3,004,155)	\$ (351,710)
Bad debt	-	124,495
Asset impairments	194,194	97,165
Other (Charitable contribution)	3,120	2,345
Stock for services/option expense	1,685,573	150,160
Valuation allowance	1,121,268	(22,455)
-	-	-

At December 31, 2004, the Company had net operating loss carryforwards of approximately \$8,558,175 that may be offset against future taxable income from the year 2004 through 2024. No tax benefit has been reported in the December 31, 2004 consolidated financial statements since the potential tax benefit is offset by a valuation allowance of the same amount.

Due to the change in ownership provisions of the Tax Reform Act of 1986, net operating loss carryforwards for Federal income tax reporting purposes are subject to annual limitations. Should a change in ownership occur, net operating loss carryforwards may be limited as to use in future years.

f. Depreciation

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The Company's property and equipment is depreciated using the straight-line Accounting method over the useful lives shown below for financial reporting purposes.

Useful Life	Asset
Computers	3 years
Equipment and fixtures	5 to 10 years
B u i l d i n g s a n d improvements	20 to 39 years

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NEXIA HOLDINGS, INC, AND SUBSIDIARIES

Notes to Consolidated Financial Statements
December 31, 2004 and 2003

g. Revenue Recognition

The Company recognizes revenue from its two main sources of revenue as follows:

Rental Revenue

Rental revenues are recorded in the period in which they are earned in accordance with rental agreements and lease contracts. Rent payments are typically due by the 1st of each month. Occasionally, the Company will receive rent payments at the end of preceding months for the following months rent. The Company will record these as deferred revenue until such time as the rent has been earned. Unearned rental revenue at the December 31, 2004 was \$23,094.

Consulting Revenue

The Company, through its subsidiaries, performs consulting services which consist of financial reporting, business acquisitions, and other public company reporting and support functions. The Company can receive payment for these services in a variety of ways. (1) the Company can be paid in cash; (2) the Company can be paid in restricted securities of the client; (3) the Company can be paid in a combination of cash and restricted securities of the client. The Company follows the revenue recognition provisions of SAB 101 >Revenue Recognition in Financial Statements and 5 >Recognition and Measurement in Financial Statements of Business Enterprises.

These statements require that revenue not be recognized unless collectibility is reasonably assured with recognition of revenue acceptable only when realizable or when assets received or held are readily convertible into known amounts of cash or claims to cash.

Accordingly, when the Company is to be paid in cash, the Company will record the revenue on an accrual basis when the services have been performed, the amounts are readily determinable and collection is reasonably assured. In the cases where the Company receives restricted securities from the client as payment, revenue is deferred until such time as the securities are sold, thereby meeting the requirements that the assets received are readily convertible into known amounts of cash. In the cases where the Company receives a combination of cash and restricted securities, the Company will record that cash as revenue as noted previously and will defer the recognition of the revenue from the securities until the securities are sold.

The Company records the securities received from consulting services in accordance with SFAS 115 >Accounting for Certain Investments in Debt and Equity Securities. This standard requires that the Company classify its investments as either trading, available for sale, or held to maturity securities. The Company typically classifies the securities received as payment for the consulting services as available for sale. Any unrealized gains and losses on these securities for which the revenue has been deferred are recorded as adjustments to the deferred revenue account until such time as the security is sold and the Company is able to recognize the revenue from the consulting services. The amount of deferred revenue related to consulting services performed for which the Company received restricted securities at December 31, 2004 was \$358. This represents the fair value of the portion of the available for sale securities for which revenue had been deferred at December 31, 2004.

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NEXIA HOLDINGS, INC, AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2004 and 2003

The Company will discontinue these services in 2005.

h. Marketable Securities

The Company follows the provisions of SFAS 115 regarding marketable securities. The Company's securities investments that are bought and held principally for the purpose of selling them in the near term are classified as trading securities. Trading securities are recorded at fair value on the balance sheet in current assets, with the change in fair value during the period included in earnings.

Securities investments that the Company has the positive intent and ability to hold to maturity are classified as held-to-maturity securities and recorded at amortized cost in investments and other assets. Securities investments not classified as either held-to-maturity or trading securities are classified as available-for-sale securities. Available-for-sale securities are recorded at fair value in investments and other assets on the balance sheet, with the change in fair value during the period excluded from earnings and recorded net of tax as a separate component of equity. All marketable securities held by the Company have been classified as available-for-sale securities.

i. Issuance of Common Stock

The Company frequently issues shares of its common stock to acquire assets, retire debt and pay for services. When stock is issued for assets, debt or services, the value of the stock, related assets, debt or services is determined by the most readily determinable value, i.e. the value of the common stock issued or the value of the assets, debt or services.

j. Environmental Compliance and Remediation

The Company determines potential liability on a site by site basis and records a liability when its existence is probable and reasonably estimable. Expenditures that do not have a future economic benefit are expensed as incurred. Expenditures that extend the life of the related property or mitigate or prevent future environmental contamination are capitalized.

k. Impairment of Long-Lived Assets

The Company evaluates its long-lived assets in accordance with Statement of Financial Accounting Standard No. 144, "Accounting for the Impairment or Disposal of Long Lived Assets". The Company recognizes impairment losses as the difference between historical cost and fair value of the asset, less costs to sell, when management determines that events and circumstances indicate a need to assess impairment, and when that assessment indicates that historical cost materially exceeds fair value, less costs to sell. Impairment expense totaled \$0 and \$173,966 for the years ended December 31, 2004 and December 31, 2003, respectively.

l. Advertising Expense

The Company expenses advertising costs as incurred. Advertising expense was \$2,232 and \$0 for the years ended December 31, 2004 and 2003, respectively.

Table of Contents**NEXIA HOLDINGS, INC, AND SUBSIDIARIES**

Notes to Consolidated Financial Statements
December 31, 2004 and 2003

m. Basic and Diluted Loss Per Common Share

The computation of basic and diluted loss per share of common stock is based on the weighted average number of shares outstanding during the period.

	For the Years Ended December 31,	
	2004	2003
Numerator:		
Loss before minority interest	\$ (3,011,331)	\$ (883,327)
Minority interest	7,176	65,113
Net loss before discontinued Operations	(3,004,155)	(818,214)
Discontinued operations	-	(83,611)
Net loss	\$ (3,004,155)	\$ (901,825)
Denominator:		
weighted average shares outstanding	90,299,865	322,735
Basic and diluted loss per Weighted average Common share:		
Loss per common share before minority interest	\$ (0.03)	\$ (2.74)
Minority interest in loss per common share	(0.00)	(0.20)
Net loss per common share before discontinued operations	(0.03)	(2.54)
Loss per common share on discontinued operations	-	(.26)
Net loss per common share, basic and diluted	\$ (0.03)	\$ (2.80)

The weighted average shares outstanding at December 31, 2003 were reported originally as 322,734,541. The

number has been changed to 322,735 to reflect the 1000:1 reverse stock split effective November 1, 2004.

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NEXIA HOLDINGS, INC, AND SUBSIDIARIES

Notes to Consolidated Financial Statements
December 31, 2004 and 2003

n. 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 the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

o. Newly Issued Accounting Pronouncements

During the year ended December 31, 2004, the Company adopted the following accounting pronouncements:

SFAS No. 143 -- In August 2001, the FASB issued SFAS No. 143, Accounting for Asset Retirement Obligations, which established a uniform methodology for accounting for estimated reclamation and abandonment costs. The statement was effective for fiscal years beginning after June 15, 2002. The adoption of SFAS No. 143 did not have a material effect on the financial statements of the Company.

SFAS No. 145 -- On April 30, 2002, the FASB issued FASB Statement No. 145 (SFAS 145), "Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections." SFAS 145 rescinds both FASB Statement No. 4 (SFAS 4), "Reporting Gains and Losses from Extinguishment of Debt," and the amendment to SFAS 4, FASB Statement No. 64 (SFAS 64), "Extinguishments of Debt Made to Satisfy Sinking-Fund Requirements." Through this rescission, SFAS 145 eliminates the requirement (in both SFAS 4 and SFAS 64) that gains and losses from the extinguishment of debt be aggregated and, if material, classified as an extraordinary item, net of the related income tax effect. However, an entity is not prohibited from classifying such gains and losses as extraordinary items, so long as it meets the criteria in paragraph 20 of Accounting Principles Board Opinion No. 30, Reporting the Results of Operations Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions. Further, SFAS 145 amends paragraph 14(a) of FASB Statement No. 13, "Accounting for Leases", to eliminate an inconsistency between the accounting for sale-leaseback transactions and certain lease modifications that have economic effects that are similar to sale-leaseback transactions. The amendment requires that a lease modification (1) results in recognition of the gain or loss in the financial statements, (2) is subject to FASB Statement No. 66, "Accounting for Sales of Real Estate," if the leased asset is real estate (including integral equipment), and (3) is subject (in its entirety) to the sale-leaseback rules of FASB Statement No. 98, "Accounting for Leases: Sale-Leaseback Transactions Involving Real Estate, Sales-Type Leases of Real Estate, Definition of the Lease Term, and Initial Direct Costs of Direct Financing Leases." Generally, SFAS 145 is effective for transactions occurring after May 15, 2002. The adoption of SFAS 145 did not have a material effect on the financial statements of the Company.

SFAS No. 146 -- In June 2002, the FASB issued SFAS No. 146, "Accounting for Exit or Disposal Activities" (SFAS 146). SFAS 146 addresses significant issues regarding the recognition, measurement, and reporting of costs that are associated with exit and disposal activities, including restructuring activities that are currently accounted for under EITF No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)." The scope of SFAS 146 also includes costs related to terminating a contract that is not a capital lease and termination benefits that employees who are involuntarily

terminated receive under the terms of a one-time benefit arrangement that is not an ongoing benefit arrangement or an individual deferred-compensation contract. SFAS 146 will be effective for exit or disposal activities that are initiated after December 31, 2002 and early application is encouraged. The provisions of EITF No. 94-3 shall continue to apply for an exit activity initiated under an exit plan that met the criteria of EITF No. 94-3 prior to the adoption of SFAS 146. The effect on adoption of SFAS 146 will change on a prospective basis the timing of when the restructuring charges are recorded from a commitment date approach to when the liability is incurred. The adoption of SFAS 146 did not have a material effect on the financial statements of the Company.

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SFAS No. 147 -- In October 2002, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 147, "Acquisitions of Certain Financial Institutions" which is effective for acquisitions on or after October 1, 2002. This statement provides interpretive guidance on the application of the purchase method to acquisitions of financial institutions. Except for transactions between two or more mutual enterprises, this Statement removes acquisitions of financial institutions from the scope of both SFAS 72 and Interpretation 9 and requires that those transactions be accounted for in accordance with SFAS No. 141, "Business Combinations" and No. 142, "Goodwill and Other Intangible Assets". The adoption of SFAS No. 147 did not have a material effect on the financial statements of the Company.

SFAS No. 148 -- In December 2002, the FASB issued SFAS No. 148, "Accounting for Stock Based Compensation-Transition and Disclosure-an amendment of FASB Statement No. 123" which is effective for financial statements issued for fiscal years ending after December 15, 2002. This Statement amends SFAS 123, Accounting for Stock-Based Compensation, to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, this Statement amends the disclosure requirements of SFAS 123 to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based compensation and the effect of the method used on reported results. The adoption of SFAS No. 148 did not have a material effect on the financial statements of the Company.

SFAS No. 149 -- In April 2003, the FASB issued SFAS No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities" which is effective for contracts entered into or modified after June 30, 2003 and for hedging relationships designated after June 30, 2003. This statement amends and clarifies financial accounting for derivative instruments embedded in other contracts (collectively referred to as derivatives) and hedging activities under SFAS 133. The adoption of SFAS No. 149 did not have a material effect on the financial statements of the Company.

SFAS No. 150 -- In May 2003, the FASB issued SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity" which is effective for financial instruments entered into or modified after May 31, 2003, and is otherwise effective at the beginning of the first interim period beginning after June 15, 2003. This Statement establishes standards for how an issuer classifies and measures in its statement of financial position certain financial instruments with characteristics of both liabilities and equity. It requires that an issuer classify a financial instrument that is within its scope as a liability (or an asset in some circumstances) because that financial instrument embodies an obligation of the issuer. The adoption of SFAS No. 150 did not have a material effect on the financial statements of the Company.

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SFAS No. 132 (revised 2003) - In December 2003 the FASB issued SFAS No. 132 (revised 2003) “Employers’ Disclosures about Pensions and Other Postretirement Benefits—an amendment of FASB Statements No. 87, 88, and 106” which is effective for financial statements with fiscal years ending after December 15, 2003. The interim-period disclosures required by this Statement are effective for interim periods beginning after December 15, 2003. This Statement does not change the requirements in measurement or recognition of those plans. Instead it retains the disclosure requirements and additionally requires disclosures to those in the original Statement 132 about the assets, obligations, cash flows, and net periodic benefit cost of defined benefit pension plans and other defined benefit postretirement plans. The required information should be provided separately for pension plans and for other postretirement benefit plans. The adoption of SFAS No. 132 (revised 2003) did not have a material effect on the financial statements of the company.

SFAS No. 151 - In November 2004 the FASB issued SFAS No. 151 “Inventory Costs—an amendment of ARB No. 43, Chapter 4” which is effective November 2004. This Statement amends the guidance in ARB No. 43, Chapter 4, “Inventory Pricing,” to clarify the accounting for abnormal amounts of idle facility expense, freight, handling costs, and wasted material (spoilage). It requires current-period recognition regardless of whether or not those items meet the criterion of “so abnormal”. Additionally, this Statement requires that allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. The adoption of SFAS No. 151 did not have a material effect on the financial statements of the company.

SFAS No. 152 - In June 2004 the FASB issued SFAS No. 152 “Accounting for Real Estate Time-Sharing Transactions - an amendment of FASB Statements No 66 and 67.” It amends FASB Statement No. 66 and AICPA Statement of Position 04-2 and states that the guidance for (a) incidental operations and (b) costs incurred to sell real estate projects does not apply to real estate time-sharing transactions. The accounting for those operations and costs is subject to the guidance in SOP 04-2. The adoption of SFAS No. 152 did not have a material effect on the financial statements of the company.

SFAS No. 153 - In December 2004 the FASB issued SFAS No. 153 “Exchanges of Nonmonetary Assets - an amendment of APB Opinion No. 29” which provides standards for the measurement of nonmonetary exchanges. It amends Opinion 29 to eliminate the exception for nonmonetary exchanges of similar productive assets and replaces it with a general exception for exchanges of nonmonetary assets that do not have commercial substance. A nonmonetary exchange has commercial substance if the future cash flows of the entity are expected to change significantly as a result of the exchange. The adoption of SFAS No. 153 did not have a material effect on the financial statements of the company.

SFAS No. 123 - In December 2004 the FASB issued SFAS No. 123 (revised 2004) “Share-Based Payment” which is effective for public entities that do not file as small business issuers—as of the beginning of the first interim or annual reporting period that begins after June 15, 2005. This Statement establishes standards for the accounting for transactions in which an entity exchanges its equity instruments for goods or services. It also addresses transactions in which an entity incurs liabilities in exchange for goods or services that are based on the fair value of the entity’s equity instruments or that may be settled by the issuance of those equity instruments. This Statement focuses primarily on accounting for transactions in which an entity obtains employee services in share-based payment transactions. This Statement does not change the accounting guidance for share-based payment transactions with parties other than

employees provided in Statement 123 as originally issued and EITF Issue No. 96-18, "Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services." This Statement does not address the accounting for employee share ownership plans, which are subject to AICPA Statement of Position 93-6, Employers' Accounting for Employee Stock Ownership Plans. The implementation of this SFAS will have a material effect on the Company's financial statements.

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FASB Interpretation No. 45 -- "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others B an Interpretation of FASB Statements No. 5, 57 and 107". The initial recognition and initial measurement provisions of this Interpretation are to be applied prospectively to guarantees issued or modified after December 31, 2002. The disclosure requirements in the Interpretation were effective for financial statements of interim or annual periods ending after December 15, 2002. The adoption of FASB Interpretation No. 45 did not have a material effect on the financial statements of the Company.

FASB Interpretation No. 46 -- In January 2003, the FASB issued FASB Interpretation No. 46 "Consolidation of Variable Interest Entities." FIN 46 provides guidance on the identification of entities for which control is achieved through means other than through voting rights, variable interest entities, and how to determine when and which business enterprises should consolidate variable interest entities. This interpretation applies immediately to variable interest entities created after January 31, 2003. It applies in the first fiscal year or interim period beginning after June 15, 2003, to variable interest entities in which an enterprise holds a variable interest that it acquired before February 1, 2003. The adoption of FIN 46 did not have a material impact on the Company's financial statements.

During the year ended December 31, 2003, the Company adopted the following Emerging Issues Task Force Consensuses: EITF Issue No. 00-21 "Revenue Arrangements with Multiple Deliverables", EITF Issue No. 01 B8 "Determining Whether an Arrangement Contains a Lease", EITF Issue No. 02-3 A Issues Related to Accounting for Contracts Involved in Energy Trading and Risk Management Activities", EITF Issue No. 02-9 "Accounting by a Reseller for Certain Consideration Received from a Vendor", EITF Issue No. 02-17, "Recognition of Customer Relationship Intangible Assets Acquired in a Business Combination", EITF Issue No. 02-18 "Accounting for Subsequent Investments in an Investee after Suspension of Equity Method Loss Recognition", EITF Issue No. 03-1, "The Meaning of Other Than Temporary and its Application to Certain Instruments", EITF Issue No. 03-5, "Applicability of AICPA Statement of Position 9702, >Software Revenue Recognition to Non-Software Deliverables in an Arrangement Containing More Than Incidental Software", EITF Issue No. 03-7, "Accounting for the Settlement of the Equity Settled Portion of a Convertible Debt Instrument That Permits or Requires the Conversion Spread to be Settled in Stock", EITF Issue No. 03-10, A Application of EITF Issue No. 02-16 by Resellers to Sales Incentives Offered to Consumers by Manufacturers.

FASB Interpretation No. 46 (revised) "Consolidation of Variable Interest Entities - an interpretation of ARB No. 51" - In December 2003 FASB issued this revision in which this Interpretation explains how to identify variable interest entities and how an enterprise assesses its interests in a variable interest entity to decide whether to consolidate that entity. FASB believes that the accounting for variable interest entities has become "fragmented and incomplete". Its purpose is not to restrict the use of variable interest entities. Instead it seeks to improve financial reporting by those enterprises that are involved with variable interest entities. The adoption of FIN 46R did not have a material impact on the Company's financial statements.

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FASB Interpretation No. 47“Accounting for Conditional Asset Retirement Obligations - an interpretation of FASB Statement No. 143” - In March 2005 FASB issued this interpretation to clarify timing issues with liability recognition for legal obligations associated with the retirement of a tangible long-lived asset when the timing and (or) method of settlement of the obligation are conditional on a future event. It also clarifies when an entity would have sufficient information to reasonably estimate the fair value of an asset retirement obligation.

p. Stock Based Compensation

As permitted by FASB Statement 148 "Accounting for Stock Based Compensation-Transition and Disclosure" (SFAS No. 148), the Company elected to measure and record compensation cost relative to employee stock option costs in accordance with Accounting Principles Board ("APB") Opinion 25, "Accounting for Stock Issued to Employees", and related interpretations and make pro forma disclosures of net income and earning per share as if the fair value method of valuing stock options had been applied. Under APB opinion 25, compensation cost is recognized for stock options granted to employees when the option price is less than the market price of the underlying common stock on the date of grant.

NOTE 2 - GOING CONCERN

The Company's consolidated financial statements are prepared using accounting principles generally accepted in the United States of America applicable to a going concern which contemplates the realization of assets and liquidation of liabilities in the normal course of business. The Company has incurred cumulative operating losses through December 31, 2004 of \$12,815,682, and has a working capital deficit of \$51,336 at December 31, 2004 all of which raise substantial doubt about the Company's ability to continue as a going concern.

Primarily, revenues have not been sufficient to cover the Company's operating costs. Management's plans to enable the Company to continue as a going concern include the following:

- Increasing revenues from rental properties by implementing new marketing programs
- Making certain improvements to certain rental properties in order to make them more marketable
- Reducing expenses through consolidating or disposing of certain subsidiary companies
- Raising additional capital through private placements of the Company's common stock
 - Purchasing revenue producing real estate
 - Decreasing payroll expenses and options
- Using stock and option-based compensation to cover payroll and other permissible labor costs

There can be no assurance that the Company can or will be successful in implementing any of its plans or that they will be successful in enabling the company to continue as a going concern. The Company's consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

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NEXIA HOLDINGS, INC. AND SUBSIDIARIES

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NOTE 3 - RELATED PARTY TRANSACTIONS

Surber has at various times been appointed to serve as an officer or director for some clients of Nexia. These appointments have been disclosed to the disinterested members of the board and the approval of the board of directors has been granted in each of these cases. As payment for services provided to these corporations, Surber has received securities of those corporations, and these transactions have been disclosed to the board of directors in each case.

Mr. Surber is licensed to practice law in the State of California and occasionally represents corporate clients on various corporate matters. Mr. Surber has disclosed the fact that he, on occasion, does act as counsel to several companies for which he receives fees for the legal services provided.

During April 2003, Hudson, a subsidiary of the Company, entered into an agreement to sell its interest in Unit A216 of the Brian Head North Condominiums in Iron County, Utah to related party. Hudson received \$1,000 in cash and was relieved of all obligations and liabilities relating to the property. The Company recognized a loss on sale of \$10,660.

During May 2003, Hudson entered into a one-year Consulting Agreement with Axia Group, Inc. (Axia) a related party. The agreement calls for Axia to issue 666,667 shares of common stock and pay \$10,000 per month or hourly billings on a monthly basis, whichever is greater. Amounts due under this agreement have been off-set against payables to Axia from the receipt by Hudson of \$64,413 in cash from the sale of Axia common stock. At December 31, 2004, Hudson had a net receivable of \$12,942 from Axia.

On January 29, 2004 the Company, and/or its subsidiaries entered the following agreements to settle debts and obligations with Axia Group, Inc., a related party of which Richard Surber, President of the Company, also served as an officer and director:

- Diversified Holdings I, Inc. accepted the assignment of certain rights to securities with a stated value of \$50,000 due in the settlement of Axia's litigation claim against America West Securities and Robert Kay.
- Diversified Holdings, I, Inc. also accepted an assignment of Axia's rights (presently being litigated) against Kevin Sheff for the recovery of 10,000 post-split shares of Axia Group, Inc.'s common stock.
- As settlement of compensation due under a May 2, 2003 Consultant Agreement with Hudson Consulting Group, Inc., Axia Group Inc. transferred 9,100,012 (pre-reverse split) shares of Nexia common stock to Hudson.
- Signed a full release and settlement of all claims against Axia Group, Inc. held by, Nexia Holdings, Inc., Wasatch Capital, Inc., Hudson Consulting Group, Inc. and West Jordan Real Estate Holdings, Inc.

The end result of the agreements was to resolve and settle all claims against Axia Group, Inc. held by the named entities, all subsidiaries of Nexia Holdings, Inc. Richard Surber, President of the Company, was formerly an officer and director of Axia Group, Inc. The purpose of the above described transaction was to settle the various claims and resolve the debts and obligations that existed between Axia and the Company and its subsidiaries.

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On September 28, 2004, the Company authorized the issuance of 8,000,000 shares of Series B Convertible Preferred Stock to the president of the Company, Richard Surber. The shares were issued as compensation for both his service as president of the Company and for acting as a guarantor on real estate mortgages for subsidiaries of the Company. The shares were issued in a private transfer exempt from registration under Section 4(2) of the Securities Act of 1933. This issuance was reported on a Form 8-K filing made on September 28, 2004.

NOTE 4 - NOTES RECEIVABLE

Notes receivable consist of the following at December 31, 2004:

Notes receivable from an individual, with interest at 8%, due August 10, 2002, secured by a building, net of full allowance	\$ 255,000
Note receivable from an individual for the sale of a vehicle with interest at 6.99%, due in 60 monthly payments of \$900, secured by vehicle	34,249
Note from a corporation, with interest at 115%, due in four monthly payments of \$31,250, including interest, from December 16, 2004 and unsecured	100,000
Note receivable from a company, non-interest bearing, due on demand, unsecured, net of full allowance.	81,700
Allowance for doubtful accounts	(315,950)
Total Notes Receivable	\$ 154,999

At December 31, 2004, two of the notes were in default. The Company has taken legal action against Creating Marketing Group, Inc. and its president.

NOTE 5 - FIXED ASSETS

Fixed assets consist of the following at December 31, 2004:

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Buildings and improvements	\$ 3,510,066
Furniture and equipment	182,311
Vehicles	3,650
Accumulated depreciation	(760,975)
Total property and equipment, net	2,935,052
Land	489,295
Total fixed assets	\$ 3,424,347

For the years ended December 31, 2004 and 2003, the Company recorded depreciation expense of \$135,704 and \$137,607, respectively.

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NOTE 6 - INVESTMENT IN MARKETABLE EQUITY SECURITIES

The following is a summary of the Company's investment in available-for-sale securities as of December 31, 2004:

	Gross Unrealized Profit	Available-for-Sale Gross Unrealized Losses	Fair Value
		2004	2004
Equity securities - free trading	\$ -	\$ 6,767	\$ 44,549
Equity securities - restricted	-	-	-
	\$ -	\$ 6,767	\$ 44,549

Changes in the unrealized loss on available-for-sale securities during the years ended December 31, 2004 and 2003 reported as a separate component of stockholders' equity are as follows:

	For the Years Ended December 31,	
	2004	2003
Beginning Balance	\$ (862)	\$ 873
Increase in unrealized holding gains (losses)	(5,905)	(1,735)
Ending Balance	\$ (6,767)	\$ (862)

During the years ended December 31, 2004 and 2003, the Company recognized \$194,194 and \$75,177 in permanent impairment expense on marketable securities.

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NEXIA HOLDINGS, INC, AND SUBSIDIARIES

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December 31, 2004 and 2003

NOTE 7 - PREFERRED STOCK

The Company has authorized up to 50,000,000 shares of preferred stock with a par value of \$.001 per share. The preferred stock can be issued in various series with varying dividend rates and preferences.

As of May 10, 2005, the number of shares of Series A Convertible Preferred Stock issued and outstanding is none. The Series A Convertible Preferred Shares have voting rights which equate to 100 shares of common stock for every 1 Series A Preferred share and may be converted into \$10 worth of common stock. A total of 10,000,000 shares have been designated and authorized as Series A Preferred Shares of a total number of 50,000,000 authorized shares of preferred stock.

On August 25, 2004, the Company filed with the Nevada Secretary of State a Certificate of Designation of the Rights and Preferences of Preferred Stock of Nexia Holdings, Inc. This designation created 10,000,000 shares, par value \$.001, of Series B Convertible Preferred Stock, out of the 50,000,000 authorized shares of preferred stock of the Company. The Series B Preferred Stock holds voting rights equal to 500 shares of common stock for each share of the Series B Preferred Stock issued, the shares do not have any conversion rights into common stock or any other class of stock of the Company. This filing was reported on an 8-K filing made on August 31, 2004.

On September 28, 2004, the Company authorized the issuance of 8,000,000 shares of Series B Convertible Preferred Stock to the president of the Company, Richard Surber. The shares were issued as compensation for both his service as president of the Company and for acting as a guarantor on real estate mortgages for subsidiaries of the Company. The shares were issued in a private transfer exempt from registration under section 4(2) of the Securities Act of 1933. This issuance was reported on a Form 8-K filing made on September 28, 2004.

On November 8, 2004, the Company filed with the Nevada Secretary of State a Certificate of Designation of the Rights and Preferences of Preferred Stock of Nexia Holdings, Inc. designated as Series C Preferred Stock. The designation of 5,000,000 shares of the 50,000,000 authorized as Series C Preferred Stock provides that the Series C shares will hold conversion rights into shares of the common stock of the Company equal in value to \$5.00 per share and are subject to redemption by the Company upon a \$5.00 cash payment. The Series C Preferred Shares hold no voting rights. This filing was reported on a Form 8-K filing made on November 10, 2004.

On November 10, 2004 an agreement was entered into with Joseph Corso, Jr. to sell him 100,000 shares of its Series C Preferred Stock in exchange for a cash payment of \$50,000. These shares had not been registered for sale and the exchange was handled as a private sale exempt from registration under section 4(2) of the Securities Act of 1933. This exchange was reported on a Form 8-K filing made on November 12, 2004.

The Company has not declared a cash dividend for any of its classes of stock during the fiscal year ended December 31, 2004.

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NOTE 8 B OUTSTANDING STOCK OPTIONS

As permitted by FASB Statement 148 "Accounting for Stock Based Compensation B Transition and Disclosure" (SFAS No. 148), the Company elected to measure and record compensation cost relative to employee stock option costs in accordance with Accounting Principles Board ("APB") Opinion 25, "Accounting for Stock Issued to Employees", and related interpretations and make pro forma disclosures of net income and earnings per share as if the fair value method of valuing stock options had been applied. Under APB opinion 25, compensation cost is recognized for stock options granted to employees when the option price is less than the market price of the underlying common stock on the date of grant.

On September 29, 2003, the Board of Directors of the Company authorized and adopted the 2003 Benefit Plan of Nexia Holdings, Inc. under which the Company was authorized to issue stock or options to purchase stock to employees, consultants, contractors, advisors or other individual persons. The total number of shares covered by the 2003 plan was 20,000,000 and the plan was terminated on January 7, 2004.

On February 1, 2005, the Board of Directors of the Company amended the "2004 Benefit Plan of Nexia Holdings, Inc." as originally adopted on January 12, 2004 for the 8th time to increase the number of shares of common stock that the Company may issue under the terms of the plan to its employees, consultants, contractors, advisors or other individual persons to 3,503,650,000 shares, post November 1, 2004, reverse-split shares.

On February 4, 2005, the Board of Directors of the Company adopted the "2005 Benefit Plan of Nexia Holdings, Inc." under which the Company may issue stock or stock options to employees, consultants, advisors or other individual persons. The total number of shares covered by the 2005 plan is 1,000,000,000 shares of the Company's common stock. This plan expires on the earlier of the date that is five years from the date the plan was adopted or the date on which the one billionth share is issued.

During 2004, the Company granted employees, consultants, advisors and others 1,283,752,898 options to purchase common stock at a floating option price set at 75% the market price at the time of exercise, resulting in the recording of \$2,562,343 in compensation expense for the intrinsic value and fair values.

A summary of the status of the Company's stock option plans as of December 31, 2004 and 2003 and changes during the years is presented below:

2004		2003	
Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Outstanding,			

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beginning of						
year	-	\$	-	\$	-	
Granted	1,283,752,898		-		5,600	0.01
Expired/Cancelled	-		-		5,600	0.01
Exercised	1,282,930,398				\$	
Outstanding end						
of year	822,500	\$	-		-	\$ -
Exercisable	-	\$	-		-	\$ -

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The Company estimated the fair value of each stock option issued during the year at the grant date by using the fair market value on the date issued. The numbers of options issued, exercised and outstanding in 2004 and 2003, as shown above, reflect the effect of the 1000:1 reverse stock split on November 1, 2004.

	For the Year Ended December 31, 2004
Risk free interest rate	0.00%
Expected life	0 years
Expected volatility	0.00%
Dividend yield	0.00%

NOTE 9 - LONG-TERM DEBT

On January 9, 2003, Kearns Development Corporation refinanced the underlying debt associated with certain land and real property. The new debt obligation is for \$660,000 with an interest rate of 7.16% with monthly installment payments of \$5,223 through January 9, 2013 at which time the remaining unpaid balance is due and payable in full. This debt obligation is secured by a first trust deed on the land and building and is personally guaranteed by the president of the Company. Proceeds from this refinancing were used to retire the previous debt associated with the land and real property having an outstanding balance of \$615,012 at December 31, 2002.

On January 30, 2003, West Jordan Real Estate Holdings, Inc. entered into a capital lease for a photocopy machine. The lease has a term of 5 years, calls for a \$1,056 advance payment with monthly payments of \$352 and an option to purchase the photocopy machine for fair market value at the end of the lease. The lease has an outstanding balance of \$12,322 at December 31, 2004.

On March 14, 2003, West Jordan Real Estate Holdings, Inc. executed a promissory note with an unrelated individual to borrow \$30,000 to be repaid on or before March 14, 2004. The obligation bears interest at a rate of 4% and is unsecured. In connection with this debt transaction, the Company issued to this individual 5,000,000 (pre-reverse split) shares of the Company's common stock as additional consideration for making the loan. The shares have been valued at fair market value on the date of the transaction, \$0.01 per share or \$50,000 in total. This amount was recognized as current balance costs and was amortized over the 12 month life of the loan.

On May 15, 2003, Hudson entered into an agreement to sell an automobile in exchange for the assumption of the monthly payments by the buyer and the release of Hudson of all obligations and liabilities relating to the vehicle. The Company recognized a gain on sale of \$701

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Note payable bearing interest at 8%, monthly payments of \$13,487, due on demand or in monthly payments through July 2012, secured by first trust deed on land and buildings	\$	958,416
Note payable bearing interest at 7.16%, monthly payments of \$5,223 through January 2013, secured by first trust deed on land and building, guaranteed by the Company's president and CEO. The note was amended in December 2004 to remove the "on demand" clause		630,203
Mortgage payable bearing interest at 7.5%, monthly payments of \$6,848 through May 2008, then lump sum balloon payment due, secured by first trust deed on land and building, and guaranteed by the Company's President and CEO		798,056
Note payable bearing interest at 7.16%, monthly payments of \$3,061, in monthly payments through December 2012, secured by deed of trust on land and buildings and guaranteed by the Company's President and CEO. The note was amended in December 2004 to remove the "on demand" clause		376,820
Note payable bearing interest at 6.99%, monthly payments of \$900, due November 2007, secured by vehicle		27,784
Notes payable, bearing interest at 4%, due January 14 2005, unsecured		21,353
Mortgage payable bearing interest at 8.25%, monthly payments of \$298, due September 2016, secured by first trust deed on building		27,964
Capital lease payable in monthly payments of \$330 through January 2008, secured by leased equipment		12,322
Convertible debenture payable bearing interest at 24%, due November 1, 2007, and interest payments to be made commencing November 1, 2004. After one year, all of the balance, except \$5,000, can be converted into shares of common stock at 70% of the average stock closing bid price for three trading days preceding the date of notice of conversion		200,000
		3,052,918

Less current portion	\$	(120,757)
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\$	2,932,161
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Scheduled principal reductions are as follows:

Year Ending December 31:

2005	\$	120,757
2006		106,240
2007		303,030
2008		106,140
2009		105,698
Thereafter		2,143,066
	\$	2,893,177

At December 31, 2004, the Company was current on all notes payable.

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NEXIA HOLDINGS, INC, AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2004 and 2003

NOTE 10 - TREASURY STOCK

The Company accounts for its treasury stock at cost. Treasury stock includes all shares of the Company owned by the Company and its subsidiaries. During the year ended December 31, 2003 the Company sold its subsidiary WHDV and accordingly, WHDV's treasury stock valued at \$7,123. At December 31, 2004, there were 20,038,340 (pre-reverse split) shares of common stock reflected as treasury stock at a cost of \$100,618.

NOTE 11 - COMMITMENTS AND CONTINGENCIES

The Company and various subsidiary companies have filed suit seeking recovery of assets and other redress relating to the sale of assets, subsidiary companies or the performance of consulting services. The ultimate outcome of these various actions and their potential impact, if any, on the Company's consolidated financial statements is not presently determinable.

NOTE 12 - SIGNIFICANT EVENTS

Disposition of Subsidiary

On August 27, 2002, the Company's subsidiary, Hudson, entered into a Stock Purchase Agreement (Agreement) for the sale of its' 79.77% ownership in Torchmail Communications, Inc. (Torchmail) to seven unrelated parties. The terms of the sale were that Hudson would transfer its 79.77% ownership in Torchmail for \$300,000. The purchase price was to be paid \$100,000 at closing, \$100,000 120 days following closing and \$100,000 180 days following closing. Payment of the \$200,000 due following closing was to be secured by 1,874,601 shares of common stock which was two-thirds of the 79.77% owned by Hudson and by 9,384,543 shares of Torchmail to be issued and sold in a separate transaction. The sale of Torchmail resulted in a gain of \$343,102. Since execution of the Agreement, the Company has received \$100,000 paid at closing and a second \$100,000 payment in February 2004. The remaining amounts owed were settled for a cash payment of \$117,000 and 3,753,531 shares of the common stock of Ohana Enterprises, Inc.

During June 2003, the Company's subsidiary, Hudson, sold two condominiums in Brian Head, Utah, one to a related party (See Note 3) for a loss of \$10,660. The other condominium was sold to a third party for \$48,000. The net book value of \$43,500, plus sale expenses of \$3,549, resulted in a gain on sale of \$951.

On June 19, 2003, in an inter-company tax free transaction, WHDV, a subsidiary of the Company, exchanged its shareholdings in Kearns for the DHI shareholdings in SLD. DHI, Kearns and SLD were all subsidiaries of Nexia at the time of the restructuring.

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NEXIA HOLDINGS, INC, AND SUBSIDIARIES

Notes to Consolidated Financial Statements
December 31, 2004 and 2003

On June 30, 2003, the Company sold its interest in WHDV to DFRC. The terms of the agreement are as follows:

- a) WHDV assigns to DH1 a promissory note in the amount of \$14,056;
- b) WHDV waives the \$112,517 receivable owed to it by Kearns;
- c) Nexia waives the \$1,565 receivable owed to it by WHDV, and DH1 waives the \$407,854 receivable owed to it by SLD;
- d) Wichita issues to DH1 a promissory note in the amount of \$150,000;
- e) DFRC transfers to DH1 1,148,251 shares of its restricted common stock with a guaranteed liquidation value of not less than \$1 per share. DFRC shares currently have a market price of approximately \$0.0001/share. The shares have been fully written off as of December 31, 2004.

Subsequently, it was determined that the receivable from WHDV was impaired, with the full allowance applied against the gain on sale. The Company recognized a net gain on sale of \$129,268.

In May 2004, Hudson Consulting, a subsidiary of the Company, sold its stock investment in Caye Chapel for \$90,573. There was a net gain on the sale of \$36,918 after payments of Caye Chapel creditors from the sale proceeds, as agreed to in the contract of sale.

In September 2004 the Company's subsidiary, Diversified Holdings I, Inc., recorded rental expense of \$105,000 for rent on the 400 South office building for 2004 until the date of move in November 2004, in accordance with an agreement with Diversified Financial Resources Corporation. The contra entry was to Gain on Sale of Subsidiary, Wichita Development Co., to recognize part of the gain from the sale.

On December 31, 2004, the stock of four subsidiary companies was sold to We are Electric, LLC, an unrelated company, for \$100. The four subsidiaries were Golden Opportunity Development Corporation, Canton Tire Recycling of West Virginia, Inc., Canton's Wild Horse Ranch-II and Oasis International Hotel and Casino, Inc.

On the basis of a written agreement, the intercompany accounts balances of the retained Nexia companies with the four companies sold were forgiven. This resulted in a net forgiveness of debt income to the retained Nexia companies of \$1,470,541. The sale of the four subsidiaries resulted in a net gain on sale of subsidiaries of \$242,352.

NOTE 13 -

SEGMENT INFORMATION

Using the guidelines set forth in SFAS No. 131, Information "Disclosures about Segments of an Enterprise and Related Information," Nexia Holdings has identified two reportable segments in which it operates based on the services it provides. The reportable segments are as follows: Real estate operations ("Real Estate"), which primarily purchases, sells and rents commercial real estate; and Consulting and other operations ("Consulting and other"), which primarily provides merger and acquisition structuring services and also capital restructuring, general corporate problem solving and shareholder relations services.

Common overhead costs are included in the Consulting and other segment as other expenses.

The accounting policies of the segments are the same as those described in the summary of significant accounting policies.

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Notes to Consolidated Financial Statements
December 31, 2004 and 2003

	For the Year Ended December 31,	Consulting and Other	Real Estate	Total
Revenues	2004	\$ 121,633	\$ 512,456	\$ 634,089
	2003	276,565	511,020	787,585
Cost of revenues (including mortgage interest)	2004	(1,069,329)	(1,055,139)	(2,124,468)
	2003	(287,209)	(650,121)	(937,330)
Expenses	2004	(1,349,885)	(652,765)	(2,002,650)
	2003	(252,648)	(694,788)	(947,436)
Interest income	2004	5,493	-	5,493
	2003	182	182	
Interest expense (not mortgage interest)	2004	-	(115,092)	(115,092)
	2003	-	(15,596)	(15,596)
Gain/loss on sale of subsidiaries	2004	565,110	-	565,110
	2003	229,268	-	229,268
Minority share of loss	2004	7,176	-	7,176
	2003	65,113	-	65,113
Income tax expense (benefit)	2004	-	-	-
Discontinued operations	2003	-	(83,611)	(83,611)
Net income (loss) applicable to segment	2004	(2,838,016)	(166,139)	(3,004,155)
	2003	31,271	(933,096)	(901,825)
Total assets	2004	471,584	3,534,476	4,006,060
(net of intercompany accounts)	2003	162,364	3,318,141	3,480,505
Property and equipment acquisitions	2004	6,308	358,453	364,761
	2003	-	52,359	52,359
Depreciation and amortization	2004	4,965	140,739	145,704
	2003	7,801	40,963	48,764

Table of Contents**NEXIA HOLDINGS, INC, AND SUBSIDIARIES**

Notes to Consolidated Financial Statements
December 31, 2004 and 2003

NOTE 14 - STOCK SUBSCRIPTION RECEIVABLE

The Company had stock subscriptions receivable of \$375,009 and \$28,000 at December 31, 2004 and 2003 respectively.

NOTE 15 B CONVERTIBLE DEBENTURES

On October 31, 2003, the Company issued two convertible debentures for \$30,000 each. The debentures accrue interest at 18% per annum, are due November 1, 2004 and are convertible at any time after 45 days into common stock at a conversion equal to 70% of the average closing bid price of the common stock for the three trading days immediately proceeding the date of election. The Company recognized a beneficial conversion feature debt discount of \$11,609 which was fully amortized to interest expense by December 31, 2003.

All except \$5,000 of the debentures were paid by cash or issuing Nexia stock as of December 31, 2004, and the \$5,000 balance was paid in January 2005.

On November 1, 2004, the Company issued a convertible debenture for \$200,000. The debenture accrues interest at 24% per annum, is due November 1, 2007 and is convertible, except for \$5,000, anytime after one year into common stock at a price equal to 70% of the average closing bid price of the common stock for three trading days immediately preceding the date of election. The Company recognized a beneficial conversion feature debt discount of \$83,571 which was fully expensed in 2004.

NOTE 16 B DISCONTINUED OPERATIONS

On June 20, 2003, the Company sold its interest in Wichita Development Corporation, and consequently, its interest in Salt Lake Development Corporation and Wichita Properties, Inc., to Diversified Financial Resources Corporation.

The following is summary of the loss from discontinued operations:

	For the Years Ended December 31,	
	2004	2003
REVENUE		
Rental revenue	\$ -	\$ 82,005
COST OF REVENUE		
Cost associated with rental revenue	-	94,572
Interest expense associated with rental revenue	-	50,860
Total Cost of Revenue	-	145,432

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	For the Years Ended December 31,	
	2004	2003
GROSS MARGIN (DEFICIT)	\$ -	\$ (63,427)
EXPENSES		
Impairment of marketable securities	-	-
Selling, general and administrative expense	-	22,156
Total Expenses	-	22,156
LOSS FROM OPERATIONS	-	(85,583)
OTHER INCOME (EXPENSE)		
Interest income	-	407
Other income	-	1,565
Total Other Income (Expense)	-	1,972
LOSS BEFORE MINORITY INTEREST	-	(83,611)
MINORITY INTEREST	-	-
NET LOSS	\$ -	\$ (83,611)

No income tax benefit has been attributed to the loss from discontinued operations.

NOTE 17 - SUBSEQUENT EVENTS

Through April 8, 2005, the board of directors of the Company has authorized the issuance of 1,350,000,000 shares of common stock pursuant to the S-8 Registration Statement of the Company for the payment of obligations owed to employees and contractors of the Company.

On February 1, 2005, the Board of Directors of the Company amended the “2004 Benefit Plan of Nexia Holdings, Inc.” as originally adopted on January 12, 2004 for the 8th time to increase the number of shares of common stock that the Company may issue under the terms of the plan to its employees, consultants, contractors, advisors or other individual persons to 3,503,650,000 shares, post November 1, 2004 reverse-split shares.

On February 4, 2005, the Board of Directors of the Company adopted the “2005 Benefit Plan of Nexia Holdings, Inc.” under which the Company may issue stock or stock options to employees, consultants, advisors or other individual persons. The total number of shares covered by the 2005 plan is 1,000,000,000 shares of the Company’s common stock. This plan expires on the earlier of the date that is five years from the date the plan was adopted or the date on

which the one billionth share is issued.

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Nexia Holdings, Inc.'s subsidiary, West Jordan Real Estate Holdings, Inc., sold its commercial property on April 20, 2004. The gross sales price was \$1,860,000, and net profit from the sale was \$829,166. The net cash received was \$785,030 after payment of expenses of sale and the mortgage loan balance of \$958,830. The sale eliminated the restriction on the use of a special savings account for build-out and major repairs at the Glendale Plaza. The Company received the balance of \$50,911 for other uses.

Nexia Holdings, Inc.'s subsidiary, West Jordan Real Estate Holdings, Inc. (WJREH) received a promissory note dated May 11, 2005 for \$230,000 from Diversified Financial Resources Corporation and BTA Mineral Servitude Corporation, S.A. DE C.V., a foreign corporation. The annual interest rate is 8%, and it is due in full May 11, 2006 for principal and any accrued but unpaid interest. In the event the note is not paid in full by the due date, monthly payments of not less than \$5,000 shall commence on June 11, 2006 at an annual interest rate of 18%. Security for the note is an assignment of royalty interest by BTA Mineral Servitude corporation, S.A. DE C.V. to WJREH.

The note is to be considered full payment and satisfaction of two previous notes to Nexia Holdings, Inc. of \$100,000 dated December 16, 2004 and \$30,000 dated April 1, 2005 and an additional \$100,000 in cash on the date of this note. WJREH issued a check for \$130,000 to Nexia to be considered full payment of the balance of the two notes, originally totaling \$130,000, and accrued interest.

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NEXIA HOLDINGS, INC.

Unaudited Financial Statements

for the Quarter Ended

September 30, 2005

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NEXIA HOLDINGS, INC. AND SUBSIDIARIES
Consolidated Balance Sheets

	September 30 2005 (Unaudited)	December 31 2004
ASSETS		
Cash and cash equivalents	\$ 343,487	\$ 152,413
Restricted cash	-	80,078
Accounts and notes receivable, trade, net	22,796	108,404
Accounts receivable - related party (Note 3)	-	23,808
Notes receivable - net of allowance of \$390,170 and \$315,950 respectively	66,132	137,799
Prepaid expenses	11,883	18,783
Marketable securities	207,362	44,549
TOTAL OF CURRENT ASSETS	651,660	565,834
PROPERTY AND EQUIPMENT		
Property and equipment, net	2,733,831	2,935,052
Land	689,295	489,295
TOTAL NET PROPERTY AND EQUIPMENT	3,423,126	3,424,347
OTHER ASSETS		
Loan costs, net	13,199	15,879
TOTAL OTHER ASSETS	13,199	15,879
TOTAL ASSETS	\$ 4,087,985	\$ 4,006,060

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

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NEXIA HOLDINGS, INC. AND SUBSIDIARIES
Consolidated Balance Sheets, (Continued)

	September 30	December 31
	2005	2004
	(Unaudited)	
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES		
Accounts payable	\$ 78,844	\$ 243,441
Accrued liabilities	223,860	209,480
Unearned rent	-	23,094
Deferred revenue	508	356
Refundable deposits	17,892	15,041
Convertible debentures	-	5,000
Current maturities of long-term debt	928,901	120,757
TOTAL CURRENT LIABILITIES	1,250,005	617,169
LONG-TERM LIABILITIES		
Convertible debenture	200,000	200,000
Long-term debt	1,492,127	2,732,161
TOTAL LONG-TERM LIABILITIES	1,692,127	2,932,161
TOTAL LIABILITIES	2,942,132	3,549,330
MINORITY INTEREST	92,499	15,315
STOCKHOLDERS' EQUITY (DEFICIT) (Note 5)		
Preferred Series B stock, \$0.001 par value, 50,000,000 shares authorized, 8,000,000 shares issued and outstanding	8,000	8,000
Preferred Series C stock, \$0.001 par value, 5,000,000 shares authorized, 100,000 shares issued and outstanding	100	100
Common stock \$0.001 par value, 10,000,000,000 shares authorized, 3,489,945,834 and 1,747,945,834 shares issued (post reverse split) and outstanding, respectively	3,489,946	1,747,946
Additional paid-in capital	10,933,287	12,396,385
Treasury stock -29,138 and 29,138 shares		

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at cost, respectively	(100,618)	(100,618)
Stock subscriptions receivable	(20,993)	(375,009)
Other comprehensive Loss	(23,944)	(6,767)
Accumulated deficit	(13,232,424)	(13,228,622)
Total Stockholders' Equity	1,053,354	441,415
TOTAL LIABILITIES AND STOCKHOLDERS'		
EQUITY	\$ 4,087,985	\$ 4,006,060

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

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	Three Months Ended September 30		Nine Months Ended September 30	
	2005	2004	2005	2004
REVENUE				
Consulting Revenue	\$ -	\$ 52,700	\$ -	\$ 109,133
Rental Revenue	46,880	132,947	254,702	379,958
TOTAL REVENUE	46,880	185,647	254,702	489,091
COSTS OF REVENUE				
Costs associated with consulting revenue	-	96,506	-	349,329
Costs associated with rental revenue	47,625	223,521	235,764	520,170
Interest associated with rental revenue	41,889	55,771	140,930	171,085
TOTAL COST OF REVENUE	89,514	375,798	376,694	1,040,584
GROSS DEFICIT				
Gross deficit from consulting operations	-	(43,806)	-	(240,196)
Gross deficit from real estate operations	(42,634)	(146,345)	(121,992)	(311,297)
GROSS DEFICIT	(42,634)	(190,151)	(121,992)	(551,493)
EXPENSES				
Impairment of marketable securities	-	6,935	-	194,827
General and administrative expense	165,860	192,955	717,314	1,052,374
TOTAL EXPENSES	165,860	199,890	717,314	1,247,201
OPERATING LOSS	(208,494)	(390,041)	(839,306)	(1,798,694)
OTHER INCOME (EXPENSE)				
Interest expense	(13,289)	(2,562)	(39,327)	(8,456)
Interest income	18,529	-	51,692	-
Income from litigation settlement	30,000	-	211,500	-
Gain on disposal of assets	-	-	756,471	-
Gain on settlement of debt	-	-	-	15,000
Gain on sale of subsidiaries	-	73,849	-	313,119
Gain (loss) on marketable securities	145	-	1,836	-

Other Expense - Forgive Debt	(71,342)		(71,342)	
Other Income (expense)	24	14,828	1,858	25,194
TOTAL OTHER INCOME (EXPENSE)	(35,933)	86,115	912,688	344,857
NET INCOME (LOSS) BEFORE MINORITY INTEREST	(244,427)	(303,926)	73,382	(1,453,837)
MINORITY INTEREST IN INCOME (LOSS)	1,486	2,350	(77,184)	3,025
NET INCOME(LOSS)	(242,941)	(301,576)	(3,802)	(1,450,812)
Other Comprehensive Loss	(356)	-	(23,944)	-
TOTAL COMPREHENSIVE INCOME (LOSS)	\$ (243,297)	\$ (301,576)	\$ (27,746)	\$ (1,450,812)

The accompanying notes are an integral of these consolidated financial statements.

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	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
Net income (loss) per common share, basic and diluted				
Income (loss) before minority loss	\$ (0.0001)	\$ (0.1533)	\$ -	\$ (1.5719)
Minority interest in income (loss)	-	-	-	-
Net income (loss) per weighted average common shares outstanding	\$ (0.0001)	\$ (0.1533)	\$ -	\$ (1.5719)
Weighted average shares outstanding - basic & diluted	3,933,316,000	1,966,904	3,053,249,863	922,947

(Weighted average shares
outstanding have been adjusted
retroactively to reflect a reverse
stock split on November 1, 2004)

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NEXIA HOLDINGS, INC. AND SUBSIDIARIES
Consolidated Statements of Cash Flows

For The Nine Months Ended
September 30

2005	2004
(Unaudited)	(Unaudited)

CASH FLOWS FROM OPERATING
ACTIVITIES

Net (Loss)	\$ (3,802)	\$ (1,450,812)
Adjustments to reconcile net income (loss) to net cash used in operating activities:		
Impairment of marketable securities	-	194,827
Change in minority interest	77,184	(3,025)
Depreciation	93,145	99,574
Intrinsic and fair value of stock options issued	56,750	396,985
Issued common stock for services	81,519	752,207
Issued preferred stock for services	-	8,000
Amortization of expense prepaid with common stock	-	13,333
Revaluation of variable deferred consulting	-	45,600
Bad debts expense	74,220	-
Changes in operating assets and liabilities:		
Increase in restricted cash	-	(79,674)
Accounts receivable	85,608	(87,502)
Accounts receivable, related party	23,808	(27,030)
Prepaid Expenses	6,900	(2,926)
Marketable securities	(1,988)	-
Other Assets	2,680	10,179
Accounts payable	(119,257)	71,814
Accrued liabilities	14,380	30,521
Unearned rent	(23,094)	-
Deferred revenue	152	6,184
Refundable deposits	2,851	(150)
Convertible debentures	(5,000)	-
Deferred gain on sale of subsidiary		(21,770)
Current portion of WVDEP liability		(20,000)
Net cash provided by (used) in operating activities	366,056	(63,665)

CASH FLOWS FROM INVESTING ACTIVITIES

Cash loaned on notes receivable	-	(20,431)
Cash received on notes receivable	-	6,790
Note receivable from litigation settlement	(20,000)	-
Adjustment between notes receivable and accounts receivable balances	(2,184)	-
Correction of duplicate entry, previous period	539	-

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Investment in a limited liability company	(20,000)	
Purchase of marketable securities		(34,757)
Purchase of marketable securities - restricted	(4,002)	-
Restricted stock received in litigation settlement	(154,000)	-
Purchase of property, plant and equipment	(154,584)	(255,553)
Sale of retail shopping plaza	987,659	-
Real estate from corp. acquisition	(903,603)	-
Net cash (used) in investing activities	(269,284)	(303,951)

The accompanying notes are an integral part of these consolidated financial statements

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NEXIA HOLDINGS, INC. AND SUBSIDIARIES
Consolidated Statements of Cash Flows, (Continued)

	For The Nine Months Ended September 30	
	2005	2004
CASH FLOWS FROM FINANCING ACTIVITIES	(Unaudited)	(Unaudited)
Principal payments on long-term debt	(91,474)	(97,351)
Proceeds from long-term debt	65,224	104,090
Proceeds from issuing stock	-	-
Receipt of stock subscriptions receivable	388,516	21,000
Issuance of common stock for stock option exercise	38,506	339,319
Pay off note payable, sale of retail shopping plaza	(938,255)	-
Acquisition of another corporation	551,707	
Net cash provided by financing activities	14,224	367,058
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	110,996	(558)
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	232,491	94,073
CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$ 343,487	93,515
SUPPLEMENTAL DISCLOSURE OF INFORMATION		
CASH PAID FOR:		
Interest	\$ 176,792	166,115
Income taxes	\$ -	-
SUPPLEMENTAL DISCLOSURE OF NON-CASH INVESTING AND FINANCING ACTIVITIES:		
Preferred stock issued for services	\$ -	\$ 8,000
Common stock issued for services	\$ 81,519	\$ 752,207
Intrinsic and fair value of options issued	\$ 56,750	\$ 341,036
Common stock issued for subscription receivable	\$ 34,500	\$ 22,281
Common stock issued for variable deferred consulting	\$ -	\$ 43,988

Common stock issued for building improvements	\$	22,287	\$	98,733
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The accompanying notes are an integral part of these consolidated financial statements

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NEXIA HOLDINGS, INC. AND SUBSIDIARIES
Notes to the Consolidated Financial Statements
September 30, 2005

NOTE 1 - BASIS OF FINANCIAL STATEMENT PRESENTATION

The accompanying unaudited consolidated financial statements for Nexia Holdings, Inc. and Subsidiaries (the Company) have been prepared by the Company pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles in the United States of America have been condensed or omitted in accordance with such rules and regulations. The information furnished in the interim consolidated financial statements includes normal recurring adjustments and reflects all adjustments, which, in the opinion of management, are necessary for a fair presentation of such financial statements. Although management believes the disclosures and information presented are adequate to make the information not misleading, it is suggested that these interim consolidated financial statements be read in conjunction with the Company's most recent audited consolidated financial statements and notes thereto included in its December 31, 2004 Annual report on Form 10-KSB. Operating results for the nine months ended September 30, 2005 are not indicative of the results that may be expected for the year ending December 31, 2005.

NOTE 2 - GOING CONCERN

The Company's consolidated financial statements are prepared using accounting principles generally accepted in the United States of America applicable to a going concern which contemplates the realization of assets and liquidation of liabilities in the normal course of business. The company has incurred cumulative operating losses through September 30, 2005 of \$13,232,424 which raises substantial doubt about the Company's ability to continue as a going concern. This represents an increase in the cumulative operating losses of \$242,941 for the quarter ended September 30, 2005. The Company had a negative working capital balance at September 30, 2005 of \$598,345.

Revenue has not been sufficient to cover the Company's operating costs. Management's plans to enable the company to continue as a going concern include the following:

- Increase revenue from rental properties by implementing new marketing programs.
- Make improvements to certain rental properties in order to make them more marketable.
- Reduce expenses through consolidating or disposing of certain subsidiary companies.
- Purchase revenue producing real estate.
- Decrease payroll expenses.
- Raise additional capital through equity line of credit of the Company's common stock.

- Use stock and option-based compensation to cover payroll and other permissible labor costs.

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There can be no assurance that the Company can or will be successful in implementing any of its plans or that they will be successful in enabling the company to continue as a going concern. The Company's consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

NOTE 3 - OUTSTANDING STOCK OPTIONS

A summary of the status of the Company's stock option plans as of September 30, 2005 and 2004 and changes during those periods is presented below. The numbers of options reflect the effect of the November 1, 2004 reverse stock split:

	Average Exercise		Average Exercise	
	Shares	Price	Shares	Price
Outstanding,				
Beginning of period	822,500	\$ -	-	\$ -
Granted	1,000,000	0.00016	2,897,524	0.003
Exercised	(1,000,000)	0.00016	(2,075,024)	0.003
Outstanding, end of period	822,500	0.00016	822,500	0.003
Exercisable	669,250	0.00016	822,500	0.003

The Company determined the fair value of the stock options issued during the periods at the grant dates by using the Fair Market Value on the date of option grant less the 75% share of cash received by the Company.

The outstanding end of period price of \$0.00016 is an average price per share.

NOTE 4 - COMMON STOCK

During the nine months ended September 30, 2005, the Company issued 1,650,000,000 shares of common stock pursuant to the Company's S-8 Registration Statement.

During the period January 1, 2005 to September 30, 2005, the Company issued 100,000,000 shares of common restricted stock. During the same period, 8,000,000 shares of common restricted stock issued during the quarter ended December 31, 2004 were returned and cancelled.

NOTE 5 - ACQUISITION OF SALT LAKE DEVELOPMENT CORPORATION

A stock purchase and release agreement dated August 8, 2005 was signed under which Nexia's subsidiary, Diversified Holdings 1, Inc., acquired 99% of the stock in Salt Lake Development Corporation for the payment of \$20,000 and settlement of \$308,000 of notes payable owed by Diversified Financial Resources Corporation to Nexia and two of its subsidiaries.

The primary asset of Salt Lake Development Corporation is an office building at 268 West 400 South, Salt Lake City, UT encumbered by a mortgage of approximately \$557,000. All of the assets, liabilities and equity of Salt Lake Development Corporation are included in the September 30, 2005 financial statements.

NOTE 6 - SUBSEQUENT EVENTS

Nexia subsidiary, Diversified Holdings 1, Inc., invested \$100,000 in Landis, LLC, for a 20% interest, on November 2, 2005. Landis is a new, upscale hair salon in Salt Lake City, UT which opened for business on November 10, 2005 at the corner of 900 East and 1300 South. Richard Surber, CEO of Nexia, holds a 60% interest in Landis, LLC, and he has made, or will make, a \$300,000 investment for his 60% interest. Consequently, the investment in Landis, LLC may be deemed a related party transaction.

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CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURES

On December 1, 2005, HJ & Associates, LLC (the “Former Accountant”) resigned as the auditors for the Company.

The reports of the Former Accountant on the financial statements of the Company for each of the two most recent fiscal years, did not contain an adverse opinion or disclaimer of opinion and was not qualified or modified as to uncertainty, audit scope or accounting principles for the two most recent fiscal years and the first two subsequent interim periods of 2005, except that the Former Accountant’s opinion in its report on the Company’s financial statements expressed substantial doubt with respect to the Company’s ability to continue as a going concern for the last two fiscal years.

During the Company’s two recent fiscal years and the subsequent interim periods through the date of resignation, there were no reportable events as the term described in Item 304(a)(1)(iv) of Regulation S-B except for the following:

The Former Accountant advised management that the most recent interim report, the 10-QSB for the period ended September 30, 2005 was filed prior to the Former Accountant completing its review and that they were requesting corrections be made to the consolidation and the accounting for the acquisition by the Company of Salt Lake Development Corporation. This report has been amended and a 10-QSB/A was filed on December 14, 2005, with the Company’s new accountant Bongiovanni & Associates, P.A. conducting the review, including changes to the consolidation and accountings related to the acquisition of Salt Lake Development Corporation.

During the Company’s two most recent fiscal years and the subsequent interim period through the date of resignation, there were no disagreements with the Former Accountant on any matters of accounting principles or practices, financial statement disclosure or auditing scope or procedure, which, if not resolved to the satisfaction of the Former Accountant, would have caused it to make reference to the subject matter of the disagreement in connection with its reports on these financial statements for those periods.

On December 8, 2005, Bongiovanni & Associates, P.A. (the “New Accountant”) of 17111 Kenton Drive, Suite 204-B, Cornelius, North Carolina 28031 was retained as the auditors for the Company.

In making the selection of the New Accountant the Company’s management and board of directors reviewed auditor independence issues and the absence of any pre-existing business or commercial relationship with the new accountant and concluded that there are no such relationships that would impair the independence of the New Accountant.

During the two fiscal years ended December 31, 2003 and December 31, 2004 and through December 8, 2005, the Company did not consult with Bongiovanni & Associates regarding any of the matters or events set forth in Item 304(a)(2)(i) and (ii) or Regulation S-B.

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PART II

INDEMNIFICATION OF DIRECTORS AND OFFICERS

Sections 78.7502 and 78.751 of the Nevada Business Corporation Act, as amended, provide for the indemnification of the Company's officers, directors, employees and agents under certain circumstances as follows:

NRS 78.7502 DISCRETIONARY AND MANDATORY INDEMNIFICATION OF OFFICERS, DIRECTORS, EMPLOYEES AND AGENTS: GENERAL PROVISIONS.

1. A corporation may indemnify any person who was or is a party or is threatened to be made a party to any threatened, pending or completed action, suit or proceeding, whether civil, criminal, administrative or investigative, except an action by or in the right of the corporation, by reason of the fact that he is or was a director, officer, employee or agent of the corporation, or is or was serving at the request of the corporation as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise, against expenses, including attorneys' fees, judgments, fines and amounts paid in settlement actually and reasonably incurred by him in connection with the action, suit or proceeding if he acted in good faith and in a manner which he reasonably believed to be in or not opposed to the best interests of the corporation, and, with respect to any criminal action or proceeding, had no reasonable cause to believe his conduct was unlawful. The termination of any action, suit or proceeding by judgment, order, settlement, conviction or upon a plea of nolo contendere or its equivalent, does not, of itself, create a presumption that the person did not act in good faith and in a manner which he reasonably believed to be in or not opposed to the best interests of the corporation, and that, with respect to any criminal action or proceeding, he had reasonable cause to believe that his conduct was unlawful.

2. A corporation may indemnify any person who was or is a party or is threatened to be made a party to any threatened, pending or completed action or suit by or in the right of the corporation to procure a judgment in its favor by reason of the fact that he is or was a director, officer, employee or agent of the corporation, or is or was serving at the request of the corporation as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise against expenses, including amounts paid in settlement and attorneys' fees actually and reasonably incurred by him in connection with the defense or settlement of the action or suit if he acted in good faith and in a manner which he reasonably believed to be in or not opposed to the best interests of the corporation. Indemnification may not be made for any claim, issue or matter as to which such a person has been adjudged by a court of competent jurisdiction, after exhaustion of all appeals therefrom, to be liable to the corporation or for amounts paid in settlement to the corporation, unless and only to the extent that the court in which the action or suit was brought or other court of competent jurisdiction determines upon application that in view of all the circumstances of the case, the person is fairly and reasonably entitled to indemnity for such expenses as the court deems proper.

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3. To the extent that a director, officer, employee or agent of a corporation has been successful on the merits or otherwise in defense of any action, suit or proceeding referred to in subsections 1 and 2, or in defense of any claim, issue or matter therein, the corporation shall indemnify him against expenses, including attorneys' fees, actually and reasonably incurred by him in connection with the defense.

NRS 78.751 AUTHORIZATION REQUIRED FOR DISCRETIONARY INDEMNIFICATION; ADVANCEMENT OF EXPENSES; LIMITATION ON INDEMNIFICATION AND ADVANCEMENT OF EXPENSES.

1. Any discretionary indemnification under NRS 78.7502 unless ordered by a court or advanced pursuant to subsection 2, may be made by the corporation only as authorized in the specific case upon a determination that indemnification of the director, officer, employee or agent is proper in the circumstances. The determination must be made: (a) By the stockholders; (b) By the board of directors by majority vote of a quorum consisting of directors who were not parties to the action, suit or proceeding; (c) If a majority vote of a quorum consisting of directors who were not parties to the action, suit or proceeding so orders, by independent legal counsel in a written opinion; or (d) If a quorum consisting of directors who were not parties to the action, suit or proceeding cannot be obtained, by independent legal counsel in a written opinion.

2. The articles of incorporation, the bylaws or an agreement made by the corporation may provide that the expenses of officers and directors incurred in defending a civil or criminal action, suit or proceeding must be paid by the corporation as they are incurred and in advance of the final disposition of the action, suit or proceeding, upon receipt of an undertaking by or on behalf of the director or officer to repay the amount if it is ultimately determined by a court of competent jurisdiction that he is not entitled to be indemnified by the corporation. The provisions of this subsection do not affect any rights to advancement of expenses to which corporate personnel other than directors or officers may be entitled under any contract or otherwise by law.

3. The indemnification and advancement of expenses authorized in or ordered by a court pursuant to this section: (a) Does not exclude any other rights to which a person seeking indemnification or advancement of expenses may be entitled under the articles of incorporation or any bylaw, agreement, vote of stockholders or disinterested directors or otherwise, for either an action in his official capacity or an action in another capacity while holding his office, except that indemnification, unless ordered by a court pursuant to NRS 78.7502 or for the advancement of expenses made pursuant to subsection 2, may not be made to or on behalf of any director or officer if a final adjudication establishes that his acts or omissions involved intentional misconduct, fraud or a knowing violation of the law and was material to the cause of action. (b) Continues for a person who has ceased to be a director, officer, employee or agent and inures to the benefit of the heirs, executors and administrators of such a person.

Articles of Incorporation.

The Company's Amended and Restated Articles of Incorporation provide that the personal liability of a director or officer of the Company to the Company or its stockholders for monetary damages for breach of fiduciary duty, for any action taken or for any failure to take any action, as a director or officer, shall be eliminated to the fullest extent permissible under Nevada law, except for (a) acts or omissions which involve intentional misconduct, fraud, infliction of harm on the Company or its stockholders or a knowing violation of criminal law, (b) the payment of distributions in violation of Section 78.300 of the Nevada Revised Statutes, or (c) the amount of a financial benefit received by a director to which he is not entitled.

Insofar as indemnification for liabilities arising under the Act may be permitted to directors, officers and controlling persons of the Company, the Company has been advised that in the opinion of the Securities and Exchange Commission such indemnification is against public policy as expressed in the Act and is, therefore, unenforceable. In the event that a claim for indemnification against such liabilities (other than the payment by the Company of expenses

incurred or paid by a director, officer or controlling person of the Company in the successful defense of any action, suit or proceedings) is asserted by such director, officer, or controlling person in connection with any securities being registered, the Company will, unless in the opinion of its counsel the matter has been settled by controlling precedent, submit to court of appropriate jurisdiction the question whether such indemnification by it is against public policy as expressed in the Act and will be governed by the final adjudication of such issues.

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OTHER EXPENSES OF ISSUANCE AND DISTRIBUTION

The following table sets forth the estimated expenses of this offering, all of which will be paid by Nexia:

SEC Registration Fee	\$ 633.50	
Accounting Fees and Expenses	10,000.00	
Legal Fees and Expenses		55,000.00
Printing Expenses	1,000.00	
Transfer Agent and Registrar Fees and Expenses	2,000.00	
Miscellaneous	<u>11,366.50</u>	
Total	\$80,000.00	

RECENT SALES OF UNREGISTERED SECURITIES

In March of 2003, a Stock Purchase Agreement was entered into between Nexia Holdings, Inc. and Chen Li, an individual resident of San Diego, California, whereby Nexia sold to Ms. Li Five Million (5,000,000) shares of restricted common stock of Nexia as consideration for Ms. Li making a loan in the sum of \$30,000 to Nexia's subsidiary corporation, West Jordan Real Estate Holdings, Inc. The Company issued the shares pursuant to section 4(2) of the Securities Act of 1933 in an isolated private transaction by the Company which did not involve a public offering. The Company made this offering based on the following factors: (1) The issuance was an isolated private transaction by the Company which did not involve a public offering, being made to a single entity; (2) there was only one offeree who was issued stock; (3) the offeree acquired the stock with investment intent; (4) there were no subsequent or contemporaneous public offerings of the stock; (5) the stock was not broken down into smaller denominations; and (6) the negotiations for the issuance of the stock took place directly between the offeree and the Company.

On August 25, 2003, Nexia issued Three Million (3,000,000) shares of common stock to The Company Reporter, Inc. in exchange for a six-month contract for investor relations services. The Company Reporter Inc. is a full service investor relations firm specializing in growth stock. The shares were issued pursuant to Section 4(2) of the Securities Act of 1933.

On January 29, 2004, the board of directors authorized the issuance of 10,000,000 shares of the Company's common stock to each of the Company's directors, Richard Surber, Gerald Einhorn, Adrienne Bernstein and John E. Fry, Jr. The stock was issued as compensation for the services provided by the directors and was issued with a restrictive legend and pursuant to Section 4(2) of the Securities Act of 1933.

On April 8, 2004, the Company's board of directors authorized the issuance of 5,000,000 shares of the Company's common stock to Ronald Friedman for services rendered to the Company. The shares were issued with a restrictive legend and issued pursuant to Section 4(2) of the Securities Act of 1933 in a private transaction.

On September 21, 2004, the Company authorized the issuance of 8,000,000 shares of its Series B Preferred Stock to Richard Surber. The shares were issued to retain Mr. Surber as a personal guarantor of certain mortgages for the Company and valued at \$8,000.

The Company issued 100,000,000 shares of its restricted common stock to Equitilink, LLC as compensation for public relations and communication services performed by Equitilink for the benefit of the Company. The shares were issued pursuant to a written contract for services as more fully set forth in the January 7, 2005 Form 8-K filed by the Company. The services contracted for with Equitilink included the development, implementation and maintenance of an ongoing program to increase the investment community's awareness of the Company's activities and to stimulate

the investment community's interest in the Company. The transaction was handled as a private sale exempt from registration under Section 4(2) of the Securities Act of 1993.

Table of Contents**EXHIBITS****INDEX OF EXHIBITS**

Exhibit No.	Exhibit Page No.	Description
3(i)(a)	120	<u>Articles of Incorporation of the Company in Colorado, 1987.</u>
3(i)(b)	128-131	<u>Articles of Amendment to change the name of the Company.</u>
3(i)(c)	132	<u>Articles of Incorporation of Kelly's Coffee Group, Inc. filed with the Secretary of State of Nevada on August 3, 2000.</u>
3(i)(d)	138	<u>Articles of Merger merging Kelly's Coffee Group, Inc., a Colorado Corporation into Kelly's Coffee Group, Inc., a Nevada Corporation, filed with the Secretary of State of Colorado on September 22, 2000, and with the Secretary of State of Nevada on October 5, 2000.</u>
3(i)(e)	145	<u>Restated Articles of Incorporation of the Company.</u>
3(i)(f)	148	<u>Amendment to the Articles of Incorporation changing the Company's name from Kelly's Coffee Group, Inc. to Nexia Holdings, Inc.</u>
3(ii)	150	<u>Bylaws of Nexia Holdings, Inc.</u>
4	162	<u>Form of certificate evidencing shares of "Common Stock" in the Company.</u>
5	163	<u>Legal Opinion.</u>
10(i)	165	<u>Investment Agreement between Nexia Holdings, Inc. and Dutchess Private Equities Fund, L.P.</u>
10(ii)	191	<u>Registration Rights Agreement between Nexia Holdings, Inc. and Dutchess Private Equities Fund, LP.</u>
23	203	<u>Consent of Auditor.</u>
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UNDERTAKINGS

A. Insofar as indemnification for liabilities arising under the Securities Act of 1933 (the "Act") may be permitted to directors, officers and controlling persons of the small business issuer pursuant to the foregoing provisions, or otherwise, the small business issuer has been advised that, in the opinion of the Securities and Exchange Commission, such indemnification is against public policy as expressed in the Act and is, therefore, unenforceable.

In the event that a claim for indemnification against such liabilities (other than the payment by the small business issuer of expenses incurred or paid by a director, officer or controlling person of the small business issuer in the successful defense of any action, suit or proceeding) is asserted by such director, officer or controlling person in connection with the securities being registered, the small business issuer will, unless in the opinion of its counsel the matter has been settled by controlling precedent, submit to a court of appropriate jurisdiction the question whether such indemnification by it is against public policy as expressed in the Securities Act and will be governed by the final adjudication of such issue.

B. Nexia will:

(1) For determining any liability under the Securities Act, treat the information omitted from the form of prospectus filed as part of this registration statement in reliance upon Rule 430A and contained in a form of prospectus filed by the small business issuer under Rule 424(b) (1) or (4) or 497(h) under the Securities Act as part of this registration statement at the time the Commission declared it effective.

(2) For determining any liability under the Securities Act, treat each post-effective amendment that contains a form of prospectus as a new registration statement for the securities offered in the registration statement, and that offering of the securities at that time as the initial bona fide offering of those securities.

C. Nexia will file, during any period in which it offers or sells securities, a post-effective amendment to this registration statement to:

(1) Include any prospectus required by section 10(a)(3) of the Securities Act of 1933, as amended;

(2) Reflect in the prospectus any facts or events which, individually or together, represent a fundamental change in the information in the registration statement. Notwithstanding the foregoing, any increase or decrease in volume of securities offered (if the total dollar value of securities offered would not exceed that which was registered) and any deviation from the low or high end of the estimated maximum offering range may be reflected in the form of prospectus filed with the SEC pursuant to Rule 424(b) (17 C.F.R. § 230.424(b)) if, in the aggregate, the changes in volume and price represent no more than a 20% change in the maximum aggregate offering price set forth in the "Calculation of Registration Fee" table in the effective registration statement; and

(3) Include any additional or changed material information on the plan of distribution.

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SIGNATURES

In accordance with the requirements of the Securities Act of 1933, the registrant certifies that it has reasonable grounds to believe that it meets all of the requirements for filing a Form SB-2 and authorized this registration statement to be signed on its behalf by the undersigned, thereunto duly authorized, in Salt Lake City, State of Utah, on December , 2005.

Nexia Holdings, Inc.

Date: December 21, 2005

By: /s/ Richard Surber

Richard Surber
President

In accordance with the requirements of the Securities Act of 1933, this registration statement has been signed by the following persons in the capacities and on the dates stated.

/s/ Richard Surber
Richard Surber
President and Director

December 28 , 2005

/s/ Gerald Einhorn .
Gerald Einhorn
Vice-President and Director

December 28, 2005

/s/ Adrienne Bernstein.
Adrienne Bernstein
Director

December 28, 2005

