CANO PETROLEUM, INC
Form SB-2
November 29, 2005

AS FILED WITH THE SECURITIES AND EXCHANGE COMMISSION ON NOVEMBER 29, 2005
REGISTRATION NO. 333-

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM SB-2

REGISTRATION STATEMENT UNDER THE SECURITIES ACT OF 1933

CANO PETROLEUM, INC.

(Name of small business issuer in its charter)

Delaware	**1311**	**77-0635673**
(State or jurisdiction of incorporation or organization)	(Primary Standard Industrial Classification Code Number)	(I.R.S. Employer Identification No.)

The Oil & Gas Commerce Building
309 West 7th Street, Suite 1600
Fort Worth, TX 76102
(817) 698-0900

(Address and telephone number of principal executive offices)

S. Jeffrey Johnson, Chief Executive Officer
The Oil & Gas Commerce Building
309 West 7th Street, Suite 1600

Fort Worth, TX 76102

(817) 698-0900

(Name, address and telephone number of agent for service)

Copies to:

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New York, New York 10018
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APPROXIMATE DATE OF PROPOSED SALE TO PUBLIC:

As soon as practicable after this registration statement becomes effective.

If any of the securities being registered on this Form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933 check the following box: ý

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, please check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. o

If this Form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. o

If this Form is a post-effective amendment filed pursuant to Rule 462(d) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. o

If delivery of the prospectus is expected to be made pursuant to Rule 434, please check the following box. o

CALCULATION OF REGISTRATION FEE

Title of each class of securities to be registered	Amount to be Registered(1)	Proposed Maximum Offering Price Per Security(2)	Proposed Maximum Aggregate Offering Price	Amount of Registration Fee
Common Stock, $.0001 par value per share	4,703,864(3)	$ 4.47	$ 21,026,272.08	$ 2,249.81
Total	4,703,864	$ 4.47	$ 21,026,272.08	$ 2,249.81

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(1) Pursuant to Rule 416 promulgated under the Securities Act of 1933, as amended, there are also registered hereunder such indeterminate number of additional shares as may be issued to the selling stockholders to prevent dilution resulting from stock splits, stock dividends or similar transactions.

(2) Estimated solely for purposes of calculating the registration fee in accordance with Rule 457(c) under the Securities Act of 1933, using the average of the high and low prices as reported on the American Stock Exchange on November 21, 2005, which was $4.47 per share.

(3) Represents currently outstanding shares of common stock.

The registrant hereby amends this Registration Statement on such date or dates as may be necessary to delay its effective date until the registrant shall file a further amendment which specifically states that this Registration Statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933 or until this Registration Statement shall become effective on such date as the Commission, acting pursuant to said Section 8(a) may determine.

The information in this prospectus is not complete and may be changed. We may not sell these securities until the registration statement filed with the Securities and Exchange Commission is effective. This prospectus is not an offer to sell these securities and is not soliciting an offer to buy these securities in any state where the offer or sale is not permitted.

PRELIMINARY PROSPECTUS, SUBJECT TO COMPLETION, DATED NOVEMBER 29, 2005

Cano Petroleum, Inc.

4,703,864 Shares of

Common Stock

This prospectus relates to the public offering of an aggregate of 4,703,864 currently outstanding shares of common stock, par value $.0001 per share, which may be sold from time to time by the selling stockholders of Cano Petroleum, Inc. named in this prospectus. The shares of common stock are being registered to permit the selling stockholders to sell the shares from time to time in the public market. The stockholders may sell the shares through ordinary brokerage transactions, directly to market makers of our shares or through any other means described in the section entitled *Plan of Distribution* beginning on page 9 of this prospectus. We cannot assure you that the selling stockholders will sell all or any portion of the shares offered in this prospectus.

We have paid the expenses of preparing this prospectus and the related registration expenses.

Our common stock is traded on the American Stock Exchange (AMEX) under the symbol CFW. The closing sales price for our common stock on November 14, 2005 was $4.39 per share.

The Securities offered hereby involve a high degree of risk.

See *Risk Factors* beginning on page 3.

We may amend or supplement this prospectus from time to time by filing amendments or supplements as required. You should read the entire prospectus and any amendments or supplements carefully before you make your investment decision.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

CANO PETROLEUM, INC.

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PROSPECTUS SUMMARY

The following summary highlights selected information contained in this prospectus. This summary does not contain all the information you should consider before investing in the securities. Before making an investment decision, you should read the entire prospectus carefully, including the RISK FACTORS section, the financial statements and the notes to the financial statements. As used throughout this prospectus, the terms Cano, we, us, and our refer to Cano Petroleum, Inc.

Cano Petroleum, Inc.

Cano Petroleum, Inc. is a growing independent oil and gas company that is actively pursuing enhanced oil recovery techniques to increase production and reserves at our existing properties and future acquisitions. Our primary focus is crude oil and our target acquisitions are onshore U.S. properties. We believe our focus on domestic, mature oil fields eliminates exploration risks and uncertainties of international sources. We use waterflooding and enhanced oil recovery techniques, such as surfactant-polymer flooding technology.

We were organized under the laws of the State of Delaware on May 29, 2003 as Huron Ventures, Inc. We did not conduct any business operations as Huron Ventures. Prior to the acquisition of Davenport Field Unit, Inc., as discussed below, Huron Ventures was inactive with no significant operations.

On May 28, 2004, our wholly owned subsidiary, Davenport Acquisition Corp., an Oklahoma corporation, merged with Davenport Field Unit, Inc., a Texas corporation that owns a 100% working interest in certain oil, gas and mineral leasehold estates and personal property related to such leasehold estates located in Lincoln County, Oklahoma covering approximately 2,178 acres. For this acquisition, we issued 5,165,000 shares of our common stock to the former Davenport Field Unit, Inc. shareholders and paid $1,650,000 towards certain costs associated with the Davenport Property and assumed debt. Pursuant to the terms of the merger, we changed our name to Cano Petroleum, Inc. on June 3, 2004.

On July 2, 2004, we acquired all of the outstanding common stock of the Ladder Companies, Inc., a Delaware corporation, for approximately $2.2 million, after purchase price adjustments. The Ladder Companies comprises two companies Ladder Energy Company, a Delaware corporation, and Tri-Flow, Inc., an Oklahoma corporation. Tri-Flow, Inc. and Ladder Energy Company together are referred to as the Ladder Companies. The Ladder Companies are engaged in oil and gas exploration and production activities and their assets include ownership of interests in 61 wells, including 51 that are located primarily in one field of approximately 4,500 acres in Grant County, Oklahoma. These properties are referred to as the Rich Valley properties in this prospectus.

On September 14, 2004, we acquired oil and gas producing leases from the Nowata Oil Properties LLC for approximately $2.6 million. These oil and gas leases are referred to as the Nowata Properties in this prospectus. The Nowata Properties leases include more than 220 producing wells producing from the Bartlesville Sandstone on 2,601 acres of land in Nowata County, Oklahoma.

On March 29, 2005, we completed the acquisition of Square One Energy, Inc. Square One Energy, Inc. is referred to as Square One in this prospectus. The value of the consideration we paid for Square One was $7.5 million, consisting of $4 million in cash and 888,888 shares of our common stock, which was valued at $3.96 per share. Square One s assets include a 100% working interest in 10,300 acres of mature oil fields in central Texas.

For the three months ended September 30, 2005, we generated $1,945,959 in revenue from crude oil and natural gas sales, we incurred $2,404,144 in total operating expenses, and we incurred a net loss of $457,957. For the fiscal year ended June 30, 2005, we generated $5,481,640 in revenue from crude oil and natural gas sales, we incurred $8,466,443 in total operating expenses, and we incurred a net loss of $2,973,142. For the fiscal year ended June 30, 2004, we generated $7,958 in revenue from crude oil and natural gas sales, we incurred $391,164 in total operating expenses, and we incurred a net loss of $383,206. As of September 30, 2005, we had $17,307,379 of working capital and an accumulated deficit of $10,463,952.

Our principal executive offices are located at The Oil & Gas Building, 309 West 7th Street, Suite 1600, Fort Worth, Texas 76102. Our telephone number is (817) 698-0900. Our website is located at www.canopetro.com.

The Offering

Common stock outstanding before the offering	25,040,838 shares.
Common stock offered by selling stockholders	4,703,864 shares.
Common stock to be outstanding after the offering	25,040,838 shares.
Use of proceeds	We will not receive any proceeds from sales made by the selling stockholders.
AMEX Symbol	CFW
Forward-Looking Statements	This prospectus contains forward-looking statements that address, among other things, our strategy to develop our business, projected capital expenditures, liquidity, and our development of additional revenue sources. The forward-looking statements are based on our current expectations and are subject to risks, uncertainties and assumptions. We base these forward-looking statements on information currently available to us, and we assume no obligation to update them. Our actual results may differ materially from the results anticipated in these forward-looking statements, due to various factors.

RISK FACTORS

Our business involves a high degree of risk. Potential investors should carefully consider the risks and uncertainties described below and the other information in this prospectus before deciding whether to invest in shares of our common stock. Each of the following risks may materially and adversely affect our business, results of operations and financial condition. These risks may cause the market price of our common stock to decline, which may cause you to lose all or a part of the money you paid to buy our common stock.

Risks Related to Our Business

IF WE CANNOT OBTAIN SUFFICIENT ADDITIONAL CAPITAL WHEN NEEDED, WE WILL NOT BE ABLE TO CONTINUE WITH OUR BUSINESS STRATEGY. IN ADDITION, SIGNIFICANT INFUSIONS OF ADDITIONAL CAPITAL MAY RESULT IN DILUTION TO YOUR OWNERSHIP AND VOTING RIGHTS IN OUR SECURITIES.

Our business strategy is to acquire mature oil fields with established reserves that have declined to marginal production levels, but possess significant remaining upside exploitation potential, and implement various secondary and tertiary enhanced oil recovery operations. We are focused on acquiring undervalued properties that feature enhanced recovery opportunities. As we continue to find acquisition candidates, we may require additional capital to finance the acquisitions. We may not be able to obtain additional financing in sufficient amounts or on acceptable terms when needed, which could adversely affect our operating results and prospects. If we cannot raise the additional capital required to implement our business strategy, we may be required to curtail operations or develop a different strategy, which could adversely affect our financial condition and results of operations. Further, additional debt financing must be repaid regardless of whether or not we generate profits or cash flows from our business activities. Equity financing may result in dilution to existing stockholders and may involve securities that have rights, preferences, or privileges that are senior to our common stock.

THE ACTUAL QUANTITIES AND PRESENT VALUE OF OUR PROVED RESERVES MAY PROVE TO BE LOWER THAN WE HAVE ESTIMATED.

This prospectus contains estimates of our proved reserves. The process of estimating oil and gas reserves is complex. The process involves significant decisions and assumptions in the evaluation of available geological, geophysical, engineering and economic data for each reservoir. Therefore, these estimates are inherently imprecise. Actual future production, oil and gas prices, revenues, taxes, development expenditures, operating expenses and quantities of recoverable oil and gas reserves most likely will vary from these estimates. Such variations may be significant and could materially affect the estimated quantities and present value of our proved reserves. In addition, we may adjust estimates of proved reserves to reflect production history, results of exploration and development drilling, prevailing oil and gas prices and other factors, many of which are beyond our control.

WE MAY NOT ACHIEVE THE PRODUCTION GROWTH WE ANTICIPATE FROM PROPERTIES WE ACQUIRE.

On May 28, 2004, we acquired Davenport Field Unit, which owns a 100% working interest in certain oil, gas and mineral leasehold estates and personal property related such leasehold estates located in Lincoln County, Oklahoma covering approximately 2,178 acres. On July 2, 2004, we

acquired all of the outstanding common stock of the Ladder Companies, which own interests in 61 wells, including 51 that are located primarily in one field of approximately 4,500 acres in Grant County, Oklahoma. On September 14, 2004, we acquired from the Nowata Properties more than 220 oil and gas producing wells on 2,601 acres of land in Nowata County, Oklahoma. On March 29, 2005, we acquired Square One, which owns a 100% working interest in 10,300 acres of mature oil fields in central Texas. Our operational strategy is to implement various secondary and tertiary enhanced oil recovery operations, including water and chemical floods, infill drilling and recompletions of existing wells. The performance of secondary and tertiary enhanced oil recovery operations is often difficult to predict and we may not achieve the anticipated production growth from properties we acquire.

ACQUISITIONS MAY PROVE TO BE WORTH LESS THAN WE PAID BECAUSE OF UNCERTAINTIES IN EVALUATING RECOVERABLE RESERVES AND POTENTIAL LIABILITIES.

Our recent growth is due in part to acquisitions of exploration and production companies, producing properties and undeveloped leaseholds. We expect acquisitions will also contribute to our future growth. Successful acquisitions require an assessment of a number of factors, including estimates of recoverable reserves, exploration potential, future oil and gas prices, operating costs and potential environmental and other liabilities. Such assessments are inexact and their accuracy is inherently uncertain. In connection with our assessments, we perform a review of the acquired properties which we believe is generally consistent with industry practices. However, such a review will not reveal all existing or potential problems. In addition, our review may not permit us to become sufficiently familiar with the properties to fully assess their deficiencies and capabilities. We do not inspect every well. Even when we inspect a well, we do not always discover structural, subsurface and environmental problems that may exist or arise. We are generally not entitled to contractual indemnification for pre-closing liabilities, including environmental liabilities. Normally, we acquire interests in properties on an as is basis with limited remedies for breaches of representations and warranties. As a result of these factors, we may not be able to acquire oil and gas properties that contain economically recoverable reserves or be able to complete such acquisitions on acceptable terms.

Additionally, significant acquisitions can change the nature of our operations and business depending upon the character of the acquired properties, which may have substantially different operating and geological characteristics or be in different geographic locations than our existing properties. It is our current intention to continue focusing on acquiring properties with development and exploration potential located in onshore United States. To the extent that we acquire properties substantially different from the properties in our primary operating regions or acquire properties that require different technical expertise, we may not be able to realize the economic benefits of these acquisitions as efficiently as in our prior acquisitions.

OIL AND GAS PRICES ARE VOLATILE. A DECLINE IN PRICES COULD ADVERSELY AFFECT OUR FINANCIAL POSITION, FINANCIAL RESULTS, CASH FLOWS, ACCESS TO CAPITAL AND ABILITY TO GROW.

Our revenues, operating results, profitability and future rate of growth depend primarily upon the prices we receive for the oil and gas we sell. Prices also affect the amount of cash flow available for capital expenditures and our ability to borrow money or raise additional capital. Historically, the markets for oil and gas have been volatile and they are likely to continue to be volatile. Wide fluctuations in oil and gas prices may result from relatively minor changes in the supply of and demand for oil and natural gas, market uncertainty and other factors that are beyond our control, including:

- worldwide and domestic supplies of oil and gas;
- weather conditions;
- the level of worldwide and domestic demand;
- the price and availability of alternative fuels;
- the availability of pipeline capacity;
- the price and level of foreign imports;

- domestic and foreign governmental regulations and taxes;

- the ability of the members of the Organization of Petroleum Exporting Countries to agree to and maintain oil price and production controls;

- political instability or armed conflict in oil-producing regions; and

- the overall economic environment.

These factors and the volatility of the energy markets make it extremely difficult to predict future oil and gas price movements with any certainty. Declines in oil and gas prices would not only reduce revenue, but could reduce the amount of oil and gas that we can produce economically and, as a result, could have a material adverse effect on our financial condition, results of operations and reserves.

EXPLORATION AND DEVELOPMENT DRILLING MAY NOT RESULT IN COMMERCIALLY PRODUCTIVE RESERVES.

We do not always encounter commercially productive reservoirs through our drilling operations. The new wells we drill or participate in may not be productive and we may not recover all or any portion of our investment in wells we drill or participate in. The seismic data and other technologies we use do not allow us to know conclusively prior to drilling a well that oil or gas is present or may be produced economically. The cost of drilling, completing and operating a well is often uncertain, and cost factors can adversely affect the economics of a project. Our efforts will be unprofitable if we drill dry wells or wells that are productive but do not produce enough reserves to return a profit after drilling, operating and other costs. Further, our drilling operations may be curtailed, delayed or canceled as a result of a variety of factors, including:

- unexpected drilling conditions;
- title problems;
- pressure or irregularities in formations;
- equipment failures or accidents;
- adverse weather conditions; and
- increases in the costs of, or shortages or delays in the availability of, drilling rigs and equipment.

OIL AND GAS DRILLING AND PRODUCING OPERATIONS CAN BE HAZARDOUS AND MAY EXPOSE US TO ENVIRONMENTAL LIABILITIES.

Oil and gas operations are subject to many risks, including well blowouts, cratering and explosions, pipe failure, fires, formations with abnormal pressures, uncontrollable flows of oil, natural gas, brine or well fluids, and other environmental hazards and risks. Our drilling operations involve risks from high pressures and from mechanical difficulties such as stuck pipes, collapsed casings and separated cables. If any of these events occur, we could sustain substantial losses as a result of:

- injury or loss of life;
- severe damage to or destruction of property, natural resources and equipment;
- pollution or other environmental damage;
- clean-up responsibilities;
- regulatory investigations and penalties; and
- suspension of operations.

Our liability for environmental hazards includes those created either by the previous owners of properties that we purchase or lease or by acquired companies prior to the date we acquire them. We maintain insurance against some, but not all, of the risks described above. Our insurance policies provide for $1,000,000 general liability coverage for bodily injury and property damage including pollution, underground resources, blow out and cratering. In addition, we have $100,000 coverage for our contractual obligations to our service contractors using their equipment downhole. We have a Hired and Non-Owned Commercial Automobile liability limit of $1,000,000. We also have secured $5,000,000 umbrella coverage in excess of the general liability and automobile liability. Our insurance may not be adequate to cover casualty losses or liabilities. Also, in the future we may not be able to obtain insurance at premium levels that justify its purchase.

THE DEPARTURE OF KEY PERSONNEL COULD ADVERSELY AFFECT OUR ABILITY TO RUN OUR BUSINESS.

Our future success is dependent on the personal efforts, performance and abilities of key management, including S. Jeffrey Johnson, our Chairman and Chief Executive Officer; Michael J. Ricketts, Chief Financial Officer; Thomas D. Cochrane, Executive Vice President of Engineering; and James K. Teringo, Jr., Vice President, General Counsel and Secretary. All of these individuals are integral parts of our daily operations. We have employment agreements with Messrs. Johnson, Ricketts, Cochrane and Teringo. We do not maintain any key life insurance policies for any of our executive officers or other personnel. Although, none of our senior management currently has any plans to retire or leave our company in the near future, the loss of any of them could significantly impact our business until adequate replacements can be identified and put in place.

GOVERNMENT REGULATION MAY ADVERSELY AFFECT OUR BUSINESS AND RESULTS OF OPERATIONS.

Oil and natural gas operations are subject to various federal, state and local government regulations, which may be changed from time to time. Matters subject to regulation include discharge permits for drilling operations, drilling bonds, reports concerning operations, the spacing of wells, unitization and pooling of properties and taxation. From time to time, regulatory agencies have imposed price controls and limitations on production by restricting the rate of flow of oil and natural gas wells below actual production capacity in order to conserve supplies of oil and natural gas. There are federal, state and local laws and regulations primarily relating to protection of human health and the environment applicable to the development, production, handling, storage, transportation and disposal of oil and natural gas, by-products thereof and other substances and materials produced or used in connection with oil and natural gas operations. The transportation and storage of refined products include the risk that refined products and other hydrocarbons may be suddenly or gradually released into the environment, potentially causing substantial expenditures for a response action, significant government penalties, liability to government agencies for natural resources damages, personal injury, or property damages to private parties and significant business interruption. We own or lease a number of properties that have been used to store or distribute refined products for many years. Many of these properties have also been operated by third parties whose handling, disposal, or release of hydrocarbons and other wastes were not under our control. As a result, we may incur substantial expenditures and/or liabilities to third parties or governmental entities which could have a material adverse effect on us.

WE FACE STRONG COMPETITION FROM LARGER OIL AND NATURAL GAS COMPANIES, WHICH MAKES IT DIFFICULT TO CONDUCT PROFITABLE OPERATIONS.

Our competitors include major integrated oil and natural gas companies and numerous independent oil and natural gas companies, individuals and drilling and income programs. Many of these competitors are large, well-established companies and have substantially larger operating staffs and greater capital resources than we do. We may not be able to successfully conduct our operations, evaluate and select suitable properties and consummate transactions in this highly competitive environment. Specifically, these larger competitors may be able to pay more for exploratory prospects and productive oil and natural gas properties and may be able to define, evaluate, bid for and purchase a greater number of properties and prospects than our financial or human resources permit. In addition, such companies may be able to expend greater resources on the existing and changing technologies that we believe are and will be increasingly important to attaining success in the industry.

Risks Related to Our Common Stock

OUR HISTORIC STOCK PRICE HAS BEEN VOLATILE AND THE FUTURE MARKET PRICE FOR OUR COMMON STOCK MAY CONTINUE TO BE VOLATILE. FURTHER, THE LIMITED MARKET FOR OUR SHARES WILL MAKE OUR PRICE MORE VOLATILE. THIS MAY MAKE IT DIFFICULT FOR YOU TO SELL OUR COMMON STOCK FOR A POSITIVE RETURN ON YOUR INVESTMENT.

The public market for our common stock has historically been very volatile. Since we acquired Davenport Field Unit on May 28, 2004 and through the fiscal quarter ended September 30, 2005, the market price for our common stock has ranged from $0.45 to $6.40. Any future market price for our shares may continue to be very volatile. This price volatility may make it more difficult for you to sell shares when you want at prices you find attractive. We do not know of any one particular factor that has caused volatility in our stock price. However, the stock market in general has experienced extreme price and volume fluctuations that often are unrelated or disproportionate to the operating performance of companies. Broad market factors and the investing public s negative perception of our business may reduce our stock price, regardless of our operating performance. Market fluctuations and volatility, as well as general economic, market and political conditions, could reduce our market price. As a result, this may make it difficult or impossible for you to sell our common stock for a positive return on your investment.

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IF WE FAIL TO MEET CONTINUED LISTING STANDARDS OF AMEX, OUR COMMON STOCK MAY BE DELISTED WHICH WOULD HAVE A MATERIAL ADVERSE EFFECT ON THE PRICE OF OUR COMMON STOCK.

Our common stock was listed on AMEX on May 5, 2005 under the symbol CFW. In order for our securities to be eligible for continued listing on AMEX, we must remain in compliance with certain listing standards. Among other things, these standards require that we remain current in our filings with the SEC and comply with certain provisions of the Sarbanes-Oxley Act of 2002. If we were to become noncompliant with AMEX s continued listing requirements, our common stock may be delisted which would have a material adverse affect on the price of our common stock.

IF WE ARE DELISTED FROM AMEX, OUR COMMON STOCK MAY BECOME SUBJECT TO THE PENNY STOCK RULES OF THE SEC, WHICH WOULD MAKE TRANSACTIONS IN OUR COMMON STOCK CUMBERSOME AND MAY REDUCE THE VALUE OF AN INVESTMENT IN OUR STOCK.

The Securities and Exchange Commission has adopted Rule 3a51-1 which establishes the definition of a penny stock, for the purposes relevant to us, as any equity security that has a market price of less than $5.00 per share or with an exercise price of less than $5.00 per share, subject to certain exceptions. For any transaction involving a penny stock, unless exempt, Rule 15g-9 require:

that a broker or dealer approve a person s account for transactions in penny stocks; and

the broker or dealer receive from the investor a written agreement to the transaction, setting forth the identity and quantity of the penny stock to be purchased.

In order to approve a person s account for transactions in penny stocks, the broker or dealer must:

obtain financial information and investment experience objectives of the person; and

make a reasonable determination that the transactions in penny stocks are suitable for that person and the person has sufficient knowledge and experience in financial matters to be capable of evaluating the risks of transactions in penny stocks.

The broker or dealer must also deliver, prior to any transaction in a penny stock, a disclosure schedule prescribed by the SEC relating to the penny stock market, which, in highlight form:

sets forth the basis on which the broker or dealer made the suitability determination; and

that the broker or dealer received a signed, written agreement from the investor prior to the transaction.

Generally, brokers may be less willing to execute transactions in securities subject to the penny stock rules. This may make it more difficult for investors to dispose of our common stock and cause a decline in the market value of our stock.

Disclosure also has to be made about the risks of investing in penny stocks in both public offerings and in secondary trading and about the commissions payable to both the broker-dealer and the registered representative, current quotations for the securities and the rights and remedies available to an investor in cases of fraud in penny stock transactions. Finally, monthly statements have to be sent disclosing recent price information for the penny stock held in the account and information on the limited market in penny stocks.

FORWARD-LOOKING STATEMENTS

Information in this prospectus contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. These forward-looking statements can be identified by the use of words such as believes, estimates, could, possibly, probably, anticipates, projects, expects, may, will, or should or other words. No assurances can be given that the future results anticipated by the forward-looking statements will be achieved. The above risk factors constitute cautionary statements identifying important factors with respect to those forward-looking statements, including certain risks and uncertainties that could cause actual results to vary materially from the future results anticipated by forward-looking statements.

USE OF PROCEEDS

This prospectus relates to shares of our common stock that may be offered and sold from time to time by the selling stockholders. We will not receive any proceeds from the sale of shares of common stock in this offering.

SELLING STOCKHOLDERS

The following table sets forth the common stock ownership and other information relating to the selling stockholders as of November 14, 2005. The selling stockholders purchased the below shares of common stock pursuant to private placements completed during September 2005, for a purchase price of $4.14 per share, which was the closing price of our common stock on September 13, 2005 on AMEX. None of the selling stockholders have held any position or office or had any other material relationship with us or any of our predecessors or affiliates within the past three years.

Name	Number of Shares Beneficially Owned Prior to the Offering	Number of Shares Offered Pursuant to this Prospectus	Shares Beneficially Owned After the Offering (1)	
			Number	Percent
BFS US Special Opportunities Trust PLC (2)	301,932	301,932	0	0
Crestview Capital Master, LLC (3)	1,000,000	1,000,000	0	0
Howard Hughes Medical Institute (4)	266,500	266,500	0	0
Laborers District Council and Contractors of Ohio Pension Fund (4)	48,800	48,800	0	0
New York Nurses Association Pension Plan (4)	153,400	153,400	0	0
Ohio Carpenters Pension Fund (4)	83,500	83,500	0	0
Public Sector Pension Investment Board (4)	349,600	349,600	0	0
Renaissance US Growth Investment Trust PLC (2)	301,932	301,932	0	0
Spindrift Investors (Bermuda) L.P. (4)	1,178,400	478,400	700,000	< 1%
Spindrift Partners, L.P. (4)	1,064,100	414,100	650,000	< 1%
The Robert Wood Johnson Foundation (4)	305,700	305,700	0	0
Touradji Global Resources Master Fund, Ltd. (5)	1,000,000	1,000,000	0	0
TOTAL SHARES OFFERED		4,703,864		

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(1) Assumes that all securities registered will be sold and that all shares of common stock underlying common stock purchase warrants and outstanding preferred stock will be issued.

(2) Russell Cleveland makes the investment decisions on behalf of BFS US Special Opportunities Trust PLC and Renaissance US Growth Investment Trust PLC, and has voting control over the securities beneficially owned by BFS US Special Opportunities Trust PLC and Renaissance US Growth Investment Trust PLC.

(3) Crestview Capital Partners, LLC makes the investment decisions on behalf of Crestview Capital Master, LLC and has voting control over the securities beneficially owned by Crestview Capital Master, LLC.

(4) Wellington Management Company, llp, an investment adviser registered under the Investment Advisors Act of 1940, as amended, shares investment discretion and shares voting power over the securities held by the Howard Hughes Medical Institute, Laborer s District Council and Contractor s of Ohio Pension Fund, New York Nurses Association Pension Fund, Ohio Carpenters Pension Fund, Public Sector Pension Investment Board, The Robert Wood Johnson Foundation, Spindrift Partners, L.P. and Spindrift Investors (Bermuda), L.P.

(5) Paul Touradji makes the investment decisions on behalf of Touradji Global Resources Master Fund, Ltd. and has voting control over the securities beneficially owned by Touradji Global Resources Master Fund, Ltd.

PLAN OF DISTRIBUTION

The selling stockholders and any of their respective pledgees, donees, assignees and other successors-in-interest may, from time to time, sell any or all of their shares of common stock on any stock exchange, market or trading facility on which the shares are traded or in private transactions. These sales may be at fixed or negotiated prices. The selling stockholders may use any one or more of the following methods when selling shares:

ordinary brokerage transactions and transactions in which the broker-dealer solicits the purchaser;

block trades in which the broker-dealer will attempt to sell the shares as agent but may position and resell a portion of the block as principal to facilitate the transaction;

purchases by a broker-dealer as principal and resale by the broker-dealer for its account;

an exchange distribution in accordance with the rules of the applicable exchange;

privately-negotiated transactions;

broker-dealers may agree with the selling stockholders to sell a specified number of such shares at a stipulated price per share;

through the writing of options on the shares;

a combination of any such methods of sale; and

any other method permitted pursuant to applicable law.

The selling stockholders may also sell shares under Rule 144 of the Securities Act, if available, rather than under this prospectus. The selling stockholders shall have the sole and absolute discretion not to accept any purchase offer or make any sale of shares if it deems the purchase price to be unsatisfactory at any particular time.

The selling stockholders or their respective pledgees, donees, transferees or other successors in interest, may also sell the shares directly to market makers acting as principals and/or broker-dealers acting as agents for themselves or their customers. Such broker-dealers may receive compensation in the form of discounts, concessions or commissions from the selling stockholders and/or the purchasers of shares for whom such broker-dealers may act as agents or to whom they sell as principal or both, which compensation as to a particular broker-dealer might be in excess of customary commissions. Market makers and block purchasers purchasing the shares will do so for their own account and at their own risk. It is possible that a selling stockholder will attempt to sell shares of common stock in block transactions to market makers or other purchasers at a price per share which may be below the then existing market price. We cannot assure that all or any of the shares offered in this prospectus will be issued to, or

sold by, the selling stockholders. The selling stockholders and any brokers, dealers or agents, upon effecting the sale of any of the shares offered in this prospectus, may be deemed to be underwriters as that term is defined under the Securities Exchange Act of 1933, as amended, the Securities Exchange Act of 1934, as amended, and the rules and regulations of such acts. In such event, any commissions received by such broker-dealers or agents and any profit on the resale of the shares purchased by them may be deemed to be underwriting commissions or discounts under the Securities Act.

We are required to pay all fees and expenses incident to the registration of the shares, including fees and disbursements of counsel to the selling stockholders, but excluding brokerage commissions or underwriter discounts.

The selling stockholders, alternatively, may sell all or any part of the shares offered in this prospectus through an underwriter. The selling stockholders have not entered into any agreement with a prospective underwriter and there is no assurance that any such agreement will be entered into.

The selling stockholders may pledge their shares to their brokers under the margin provisions of customer agreements. If a selling stockholder defaults on a margin loan, the broker may, from time to time, offer and sell the pledged shares. The selling stockholders and any other persons participating in the sale or distribution of the shares will be subject to applicable provisions of the Securities Exchange Act of 1934, as amended, and the rules and regulations under such Act, including, without limitation, Regulation M. These provisions may restrict certain activities of, and limit the timing of purchases and sales of any of the shares by, the selling stockholders or any other such person. In the event that any of the selling stockholders are deemed an affiliated purchaser or distribution participant within the meaning of Regulation M, then the selling stockholders will not be permitted to engage in short sales of common stock. Furthermore, under Regulation M, persons engaged in a distribution of securities are prohibited from simultaneously engaging in market making and certain other activities with respect to such securities for a specified period of time prior to the commencement of such distributions, subject to specified exceptions or exemptions. In addition, if a short sale is deemed to be a stabilizing activity, then the selling stockholders will not be permitted to engage in a short sale of our common stock. All of these limitations may affect the marketability of the shares.

If a selling stockholder notifies us that it has a material arrangement with a broker-dealer for the resale of the common stock, then we would be required to amend the registration statement of which this prospectus is a part, and file a prospectus supplement to describe the agreements between the selling stockholder and the broker-dealer.

MARKET FOR COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

Market Information

On May 5, 2005, our common stock began trading on AMEX under the symbol CFW. Previously, our common stock was traded on the OTC Bulletin Board under the symbol CAOP. For the periods indicated, the following table sets forth the high and low sales prices per share of common stock. Stock prices prior to May 5, 2005 reflect inter-dealer prices without retail mark-up, mark-down or commission and may not reflect actual transactions.

	Fiscal 2006		Fiscal 2005		Fiscal 2004	
Fiscal Quarter	**High**	**Low**	**High**	**Low**	**High**	**Low**
First Quarter Ended September 30	$ 5.90	$ 3.50	$ 4.25	$ 3.80	*	*
Second Quarter Ended December 31			$ 5.05	$ 3.87	*	*
Third Quarter Ended March 31			$ 4.64	$ 3.90	*	*
Fourth Quarter Ended June 30			$ 6.40	$ 4.02	$ 4.10	$ 0.45

* No reliable data is available during this period.

Holders

As of November 14, 2005, our shares of common stock were held by approximately 97 stockholders of record. In many instances, a record stockholder is a broker or other entity holding shares in street name for one or more customers who beneficially own the shares. We estimate that, as of November 14, 2005, there were approximately 8,000 beneficial holders who own our common stock in street name.

Dividends

We have not declared any dividends to date. We have no present intention of paying any cash dividends on our common stock in the foreseeable future, as we intend to use earnings, if any, to generate growth. The payment by us of dividends, if any, in the future, rests within the discretion of our Board of Directors and will depend, among other things, upon our earnings, our capital requirements and our financial condition, as well as other relevant factors. There are no restrictions in our articles of incorporation or bylaws that restrict us from declaring dividends.

DESCRIPTION OF BUSINESS

Introduction

Cano Petroleum, Inc. is a growing independent oil and gas company, based in Fort Worth, Texas, that is actively pursuing enhanced oil recovery techniques to increase production and reserves at our existing properties and future acquisitions. Our primary focus is crude oil and our target acquisitions are onshore U.S. properties. Our focus on domestic, mature oil fields eliminates exploration risks and uncertainties of international sources. We use waterflooding and enhanced oil recovery techniques, such as surfactant-polymer technology.

We were originally organized under the laws of the State of Delaware on May 29, 2003 as Huron Ventures, Inc. Cano was involved in the merger of Huron Ventures, Inc. and several entities, including the Davenport Field Unit, Inc., on May 28, 2004. Effective with the merger, Huron changed its name to Cano Petroleum, Inc. The merger is discussed in greater detail below. Prior to the merger, Huron was inactive with no significant operations.

Davenport Merger

On May 28, 2004, we entered into an Agreement and Plan of Merger with our wholly owned subsidiary, Davenport Acquisition Corp., an Oklahoma corporation; Davenport Field Unit, Inc., a Texas corporation; the shareholders of Davenport Field Unit; Cano Energy Corporation, a Texas corporation; and Big Sky Management Ltd., our principal stockholder. Our CEO, S. Jeffrey Johnson, is a principal shareholder in Cano Energy Corporation.

The Davenport Field Unit s sole asset consists of 100% working interest in certain oil, gas and mineral leasehold estates and personal property related such leasehold estates located in Lincoln County, Oklahoma covering approximately 2,178 acres. Under the terms of the merger, we issued 5,165,000 shares of our common stock to the former shareholders of the Davenport Field Unit and paid $1,650,000 to fund developmental costs associated with the Davenport Field Unit and assumed debt. Pursuant to the terms of the merger, we changed our name to Cano Petroleum, Inc. on June 3, 2004.

The 5,165,000 shares issued to the Davenport Field Unit shareholders were placed in escrow, a portion of which has been released and a portion of which is scheduled to be released from escrow pursuant to certain employment and performance goals. Refer to *Escrowed Shares Pursuant to the Davenport Merger*, beginning on page 32 of this prospectus for additional discussion.

Acquisitions Subsequent to the Davenport Merger

The Ladder Companies

On July 2, 2004, we acquired all of the outstanding common stock of Ladder Companies, Inc. (d/b/a Ladder Energy Company), a Delaware corporation, and Tri-Flow, Inc., an Oklahoma corporation, in consideration for approximately $2.2 million, after purchase price adjustments. Ladder Companies and Tri-Flow are engaged in oil and gas exploration and production. Their assets include ownership interests in 61 wells, including 51 that are located primarily in one field of approximately 4,500 acres in Grant County, Oklahoma. Current net production from these wells was approximately 120 barrels of oil equivalent (BOE) per day and, based on an independent engineer s most recent estimate, proven reserves were 780,000 BOE as of July 1, 2005, of which 587,000 BOE are proved producing reserves.

The Nowata Properties

On September 14, 2004, we acquired certain oil, gas and mineral assets from Nowata Oil Properties LLC for $2.6 million. The purchased assets consist of Nowata Oil Properties right, title and interest in and to specified oil, gas and mineral leasehold estates, including but not limited to non-producing property, mineral rights, subsurface rights, wells and well equipment, inventory and supplies, storage facilities, contract rights, easements and rights-of-way, permits and records belonging to, used or obtained in connection with the leasehold estates. The Nowata Properties include more than 220 producing wells. The wells produce from the Bartlesville Sandstone in the Nowata Field on 2,601 acres of land in Nowata County, Oklahoma. Current net production was approximately 205 BOE per day and, based on an independent engineer s most recent estimate, proved producing reserves were 1,537,000 BOE as of July 1, 2005.

Square One

On March 29, 2005, we acquired Square One Energy, Inc. The value of the consideration we paid for Square One was $7.6 million, consisting of $4 million in cash and 888,888 shares of our common stock, which was valued at $3.96 per share.

Square One was incorporated under the laws of the State of Texas in October 2001. Square One s assets include a 100% working interest in 10,300 acres of mature oil fields in north central Texas. Other assets include a gas processing plant, production equipment, a field office and an office building. Square One will continue to operate the 10,300 acre Desdemona and Hogtown Moore Units in Erath, Eastland and Comanche Counties.

Current net production was 55 barrels per day of natural gas liquids and crude oil. Original oil in place is estimated at 92 million barrels of oil. We plan to initiate a pilot waterflood in a down-dip area where there are active oil producers in the sand, then develop up-dip into the area currently producing gas. If we have a successful waterflood, we anticipate it will be followed with an ASP process to produce additional oil from the reservoir. Based on an independent engineer s most recent estimate, current proven reserves were 1,986,000 BOE as of July 1, 2005, of which 348,000 BOE are proved producing reserves.

Sabine Production Operating, LLC

On March 29, 2005, we entered into an agreement with Haddock Enterprises, LLC and Kenneth Q. Carlile (predecessor to Carlile Management, LLC) to explore the possibility of converting the Sabine Royalty Trust from a liquidating asset into a vehicle to acquire low risk assets. See also *Sabine Production Operating, LLC* under *Certain Relationships and Related Transactions* beginning on page 30 of this prospectus. We define low risk assets as mature oil fields that have a high exploitation potential for waterflooding and enhance oil recovery techniques. Each of the three parties owns a one-third interest in the Sabine Production Operating, LLC. Gerald W. Haddock is President of Haddock Enterprises, LLC and is a member of our Board of Directors. On August 4, 2005, we entered into an agreement in principle with Haddock and Carlile, that provides the basic terms of a proposed agreement between the members and the partnership including: (i) the resolution of related party transactions between the members and the partnership; (ii) the offering of and participation in transactions by the members in the partnership; (iii) the handling of confidential information; (iv) reimbursement of expenses incurred by the parties and partnership ; (v) restrictions on transfer of the interests of the members; and (vi) restrictions on competition between the partnership, Cano, Haddock and Carlile. As of September 30, 2005, we had incurred approximately $260,000 of costs pertaining to the joint venture, consisting of partnership contributions and other costs, of which $40,000 occurred as of June 30, 2005.

On November 4, 2005, we entered into: (1) an Omnibus Agreement with Haddock Enterprises, LLC, Carlile Management, LLC and Sabine Production Partners, LP (the Partnership); (2) Amended and Restated Regulations of Sabine Production Operating, LLC with Haddock Enterprises, LLC and Carlile Management, LLC (the Regulations); and (3) a Compensation Reimbursement Agreement with Sabine Production Operating, LLC. Each of the agreements described above was entered into pursuant to the Transaction Summary dated August 4, 2005 with Haddock Enterprises, LLC and Carlile Management, LLC.

Omnibus Agreement

The Omnibus Agreement does not become effective until the closing of the Partnership s acquisition of the assets of Sabine Royalty Trust as described in the Registration Statement, as amended, on Form S-4 No. 333-1273203, filed with the SEC (the Transaction Closing Date) and will expire on the second anniversary of the Transaction Closing Date; provided, that if the Transaction Closing Date has not occurred on or before December 31, 2006, the Omnibus Agreement will terminate at such time.

Pursuant to the Omnibus Agreement, beginning on the effective date until the termination thereof, together with Haddock Enterprises and its affiliates and Carlile Management, we must offer to the Partnership any oil and gas opportunities that any such party may become aware of (other than oil and gas opportunities that were identified prior to the Transaction Closing Date). During the development of an oil and gas opportunity, the sourcing member and the Partnership will each bear their own expenses in connection therewith, subject to a true-up if both parties ultimately participate in a transaction involving the oil and gas opportunity. Once definitive documentation for the oil and gas opportunity is prepared and ready for execution, the sourcing member and the Partnership must give notice whether they elect to participate in the oil and gas opportunity at specific percentages set forth in the agreement. Neither party will be obligated to so participate but if a party does not elect to participate, it will not be entitled to reimbursement from the other party of any expenses incurred by it in connection with the transaction.

We will not be entitled to participate in oil and gas opportunities presented by Haddock Enterprises, LLC or Carlile Management, LLC, and neither Haddock Enterprises, LLC nor Carlile Management, LLC will be entitled to participate in oil and gas opportunities presented by us. The Omnibus Agreement exempts Dr. Kenneth Q. Carlile, in his individual capacity and in the capacities in which he serves his affiliate entities, from the right of first offer and noncompetition obligations.

The Omnibus Agreement includes provisions requiring the non-disclosure and non-use of confidential information relating to oil and gas opportunities as well as other obligations of us, Haddock Enterprises, LLC and Carlile Management, LLC in respect of the Partnership.

The Omnibus Agreement provides that beginning on the effective date until termination thereof, none of the parties will compete with the Partnership with respect to oil and gas opportunities presented to the Partnership or other oil and gas properties of the Partnership.

Regulations

The Regulations, executed on November 4, 2005, became effective as of August 3, 2005 and govern the operation of Sabine Production Operating, LLC. Sabine Production Operating, LLC is the sole member of Sabine Production Management, LLC, the general partner of the Partnership (the General Partner). We are a member of Sabine Production Operating, LLC together with Haddock Enterprises, LLC and Carlile Management, LLC, each with an initial one-third membership interest. Each member has initially committed to contribute to Sabine Production Operating, LLC up to $325,000, of which each member has already contributed $225,000.

The Regulations restrict the transfer or other disposition of membership interests in Sabine Production Operating, LLC as follows. Until the second anniversary of the Transaction Closing Date, no member may dispose of its interest except for certain permitted dispositions to affiliates and certain permitted encumbrances. In addition, if a change of control of a member occurs prior to the second anniversary of the Transaction

Closing Date, then Sabine Production Operating, LLC will have the right to purchase the member s interest at 80% of its fair market value. From the date after the second anniversary of the Transaction Closing Date until the fourth anniversary of the Transaction Closing Date or earlier under certain circumstances, the members will have a right of first refusal with respect to the membership interests.

Prior to the second anniversary of the Transaction Closing Date, a member does not have the right or power to withdraw from Sabine Production Operating, LLC without the consent of all of the other members, but following the second anniversary of the Transaction Closing Date, a member may withdraw from Sabine Production Operating, LLC but will forfeit its economic rights with respect thereto.

For so long as each member and its affiliates own at least a 25% membership interest, each will be entitled to designate one member of the governing board of managers. Currently, the governing board of managers of Sabine Production Operating, LLC is comprised of four persons: Jeffrey Johnson, Gerald Haddock, Dr. Kenneth Carlile and Jack Tompkins. Within 90 days of the effective date of the Form S-4 Registration Statement, the governing board of managers will seek to appoint a fifth member, who satisfies the independence standards of the Securities and Exchange Commission and the New York Stock Exchange and within 12 months of the effective date of the Form S-4 Registration Statement, a sixth member, who satisfies the independence standards of the Securities and Exchange Commission and the New York Stock Exchange.

The consent of all of the members of Sabine Production Operating, LLC is required with respect to: (1) the amendment of the regulations of Sabine Production Operating, LLC or the regulations of the General Partner; (2) the amendment of the partnership agreement of the Partnership; (3) the dissolution of, or the merger or sale of all or substantially all of the assets of Sabine Production Operating, LLC or the disposition of the membership interests in the General Partner owned by Sabine Production Operating, LLC; (4) the dissolution of, or the merger or sale of all or substantially all of the assets of the General Partner or the Partnership and (5) the incurrence of debt by Sabine Production Operating, LLC, the General Partner or the Partnership that is recourse to any member.

The Regulations establish a conflicts committee procedure for the approval of certain related party transactions, including the Partnership s decision whether to accept or reject an oil and gas opportunity or the exercise of a co-investment right under the Omnibus Agreement.

Compensation Reimbursement Agreement

The Compensation Reimbursement Agreement does not become effective until the Transaction Closing Date and will expire on the second anniversary of the Transaction Closing Date; provided, that if the Transaction Closing Date has not occurred on or before December 31, 2006, the Compensation Reimbursement Agreement will terminate at such time. Under the Compensation Reimbursement Agreement, Sabine Production Operating, LLC will reimburse us for up to $110,000 annually for services provided by our President, Jeffrey Johnson, and up to $85,000 annually for services provided by our Executive Vice President - Engineering, Tom Cochrane, to Sabine Production Operating, LLC. The Compensation Reimbursement Agreement will terminate as to Mr. Johnson or Mr. Cochrane if he ceases to be an officer of Sabine Production Operating, LLC or ceases to be employed by us and will terminate completely if both Mr. Johnson and Mr. Cochrane cease to be an officer Sabine Production Operating, LLC or cease to be employed by the Company.

Growth Strategy

We believe significant growth opportunities exist primarily because the major energy companies and large independents continue to focus their attention and resources toward the exploration and production of large fields. In the past several years, the major companies have been divesting themselves of their mature, smaller oil fields. During recent years, the energy industry has predominately focused on natural gas exploration and production, and has been significantly less focused on crude oil. The recent economics of the oil and gas market have improved as prices have risen substantially. These conditions provide ample opportunities for smaller independent companies to acquire and exploit mature U.S. oilfields. We expect that there will be increased competition for such properties in the future.

We will continue to target potential acquisition candidates in a disciplined manner. By adhering to our disciplined approach, we expect to continue to find attractive economic acquisition and development opportunities. While our participation in Sabine Production Operating, LLC,

as more fully discussed above, may temporarily diminish our ability to exercise our strategy, we believe that the overall benefits of our participation are consistent with our strategy and will substantially outweigh any such diminishment by providing us access to significant portions of potential acquisitions that we would not otherwise have the ability to pursue.

Our competitive advantage is our in-house expertise and low internal overhead. We employ independent engineers and geologists to aid in evaluating the economic merits of drilling plans and potential acquisitions. We believe that the incremental cost of using independent engineering firms justifies the expense because they provide a check and balance on our acquisition and development plans. Further, using third party experts on a case-by-case basis enables us to maintain low operating expenses and adhere to our commitment to maintain low fixed costs.

Significant Opportunities

We believe significant opportunities exist to acquire mature fields that have upside exploitation potential. Given the planned property divestitures of major energy companies, we believe ample opportunities will exist for larger strategic acquisitions to be made during 2005 and 2006. We believe the major energy companies are focusing their attention and resources toward the discovery and development of large fields located outside the United States.

One reason for this is that the major energy companies have larger internal overhead costs which prevent them from fully developing production from existing, mature fields. These factors contribute ample opportunities for smaller, independent companies, to purchase mature U.S. fields which have been vacated by major energy companies.

Pursuit of Selective Complementary Acquisitions

We seek to acquire long-lived producing properties with a high degree of operating control that contain opportunities to profitably increase proven oil reserves and production levels through exploitation. Our reservoir enhancement techniques include the implementation of enhanced oil techniques, such as waterflooding and tertiary activities, such as ASP technology. We will also focus on long term cost improvement of field operations. We target acreage that we believe will expose us to high potential prospects located in areas that are geologically similar to neighboring areas with large developed fields.

Disciplined Approach

We intend to target potential acquisition candidates in a disciplined manner. We plan to focus on oil producing properties that will greatly benefit from secondary and enhanced oil recovery techniques. We are seeking properties that have relatively long reserve lives and highly predictable production profiles. We are seeking properties that have extensive production histories and production enhancement opportunities. While the properties may be geographically diversified, we intend to focus on producing fields that are concentrated within adjacent areas, allowing for economies of scale in production and cost-effective application of reservoir management techniques gained from prior operations.

Prudent Use of Third Party Expertise

We plan to use our in-house expertise and employ independent engineers and geologists to aid in evaluating the economic merits of drilling plans and potential acquisitions. We believe that the incremental cost of using independent engineering firms justifies the expense because they provide a check and balance on our acquisition and development plans. Further, using third party experts on a case-by-case basis enables us to keep our operating overhead low and adhere to our commitment to keep fixed costs low.

Working Interest Operator

We intend to be the working interest operator in a high proportion of our acquired and developed properties. This allows us to exercise more control over expenses, capital allocation, and the timing of development and exploitation activities in our fields. It also enables us to implement controls over our costs to ensure prudent expenditures.

Competition

We are a small independent oil production company that represents less than 1% of the oil and gas industry. We face competition from other oil and gas companies in all aspects of our business, including acquisition of producing properties and oil and gas leases, and obtaining goods, services and labor. Many of our competitors have substantially greater financial and other resources. Factors that affect our ability to acquire producing properties include available funds, available information about the property and our standards established for minimum projected return on investment. Since we are focusing on acquiring mature fields possessing large, underdeveloped reserves and have experience and expertise in exploiting these reserves, we believe that we can effectively compete

in the market.

Customers

We sell our crude oil production to two independent purchasers and our natural gas production to primarily a single independent purchaser. Title to the produced quantities transfers to the purchaser at the time the purchaser collects or receives the quantities. Prices for such production are defined in sales contracts and are readily determinable based on certain publicly available indices. The purchasers of such production have historically made payment for crude oil and natural gas purchases within thirty-five days of the end of each production month. We periodically review the difference between the dates of production and the dates we collect payment for such production to ensure that receivables from those purchasers are collectible. All transportation costs are accounted for as a reduction of oil and natural gas sales revenue.

Governmental Regulation

Our operations are subject to extensive and continually changing regulation affecting the oil and natural gas industry. Many departments and agencies, both federal and state, are authorized by statute to issue, and have issued, rules and regulations binding on the oil and natural gas industry and its individual participants. The failure to comply with such rules and regulations can result in substantial penalties. The regulatory burden on the oil and natural gas industry increases our cost of doing business and, consequently, affects our profitability. We do not believe that we are affected in a significantly different manner by these regulations than are our competitors.

Transportation and Sale of Natural Gas

Even though we are predominately focused on crude oil production, our natural gas sales were approximately 26% of our total sales during the twelve months ended June 30, 2005 and approximately 20% of our total sales during the three months ended September 30, 2005. The interstate transportation and sale for resale of natural gas is subject to federal regulation, including transportation rates and various other matters, by the Federal Energy Regulatory Commission (FERC). Federal wellhead price controls on all domestic natural gas were terminated on January 1, 1992 and none of our natural gas sales prices are currently subject to FERC regulation. We cannot predict the impact of future government regulation on any natural gas operations.

Regulation of Production

The production of crude oil and natural gas is subject to regulation under a wide range of state and federal statutes, rules, orders and regulations. State and federal statutes and regulations require permits for drilling operations, drilling bonds, and reports concerning operations. Texas and Oklahoma, the states in which we own and operate properties, have regulations governing conservation matters, including provisions for the unitization or pooling of oil and natural gas properties, the establishment of maximum rates of production from oil and natural gas wells, the spacing of wells, and the plugging and abandonment of wells and removal of related production equipment. Texas and Oklahoma also restrict production to the market demand for crude oil and natural gas. These regulations can limit the amount of oil and natural gas we can produce from our wells, limit the number of wells, or limit the locations at which we can conduct drilling operations. Moreover, each state generally imposes a production or severance tax with respect to production and sale of crude oil, natural gas and gas liquids within its jurisdiction.

Environmental Regulations

Our operations are subject to numerous stringent and complex laws and regulations at the federal, state and local levels governing the discharge of materials into the environment or otherwise relating to human health and environmental protection. These laws and regulations may, among other things, require acquisition of a permit before drilling or development commences, restrict the types, quantities and concentrations of various materials that can be released into the environment in connection with development and production activities, and limit or prohibit construction or drilling activities in certain ecologically sensitive and other protected areas. Failure to comply with these laws and regulations or to obtain or comply with permits may result in the assessment of administrative, civil and criminal penalties, imposition of remedial requirements and the imposition of injunctions to force future compliance. Our business and prospects could be adversely affected to the extent laws are enacted or other governmental action is taken that prohibits or restricts our development and production activities or imposes environmental protection requirements that result in increased costs to us or the oil and natural gas industry in general.

We conduct our development and production activities to comply with all applicable environmental regulations, permits and lease conditions, and we monitor subcontractors for environment compliance. While we believe our operations conform to those conditions, we remain at risk for inadvertent noncompliance, conditions beyond our control and undetected conditions resulting from activities by prior owners or operators of properties in which we own interests. Our insurance policies provide for $1,000,000 general liability coverage for bodily injury and property damage including pollution, underground resources, blow out and cratering. In addition, we have $100,000 coverage for our contractual obligations to our service contractors using their equipment downhole. We have a hired and non-owned commercial automobile liability limit of $1,000,000. We also have secured a $5,000,000 umbrella coverage in excess of the general liability, including pollution and automobile liability. There is a $1,000,000 policy for control of well, redrill, and pollution.

Occupational Safety Regulations

We are subject to various federal and state laws and regulations intended to promote occupational health and safety. Although all of our wells are drilled by independent subcontractors under our footage or day rate drilling contracts, we have adopted environmental and safety policies and procedures designed to protect the safety of our own supervisory staff and to monitor all subcontracted operations for compliance with applicable regulatory requirements and lease conditions, including environmental and safety compliance. This program includes regular field inspections of our drill sites and producing wells by members of our operations staff and internal assessments of our compliance procedures. We consider the cost of compliance a manageable and necessary part of our business.

Federal, State or Native American Leases

Our operations on federal, state or Native American oil and gas leases are subject to numerous restrictions, including nondiscrimination statutes. Such operations must be conducted pursuant to certain on-site security regulations and other permits and authorizations issued by the Bureau of Land Management, Minerals Management Service and other agencies.

Employees

As of November 14, 2005, we had 25 employees, all of whom are full-time employees. None of our employees are represented by a union. We have never experienced an interruption in operations from any kind of labor dispute, and we consider the working relationships among the members of our staff to be excellent.

PLAN OF OPERATION

Forward-Looking Statements

The information in this prospectus contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. This Act provides a safe harbor for forward-looking statements to encourage companies to provide prospective information about themselves provided they identify these statements as forward looking and provide meaningful cautionary statements identifying important

factors that could cause actual results to differ from the projected results. All statements other than statements of historical fact made in this report are forward looking. In particular, the statements herein regarding industry prospects and future results of operations or financial position are forward-looking statements. Forward-looking statements reflect management s current expectations and are inherently uncertain. Our actual results may differ significantly from management s expectations as a result of many factors, including, but not limited to, the volatility in prices for crude oil and natural gas, the timing of acquisitions, product demand, market competition, interruption in production, and the success of waterflooding and enhanced oil recovery techniques.

You should read the following discussion and analysis in conjunction with the consolidated financial statements of Cano Petroleum, Inc. and subsidiaries and notes thereto, included herewith. This discussion should not be construed to imply that the results discussed herein will necessarily continue into the future, or that any conclusion reached herein will necessarily be indicative of actual operating results in the future. Such discussion

represents only the best present assessment of management.

Overall Strategy

We are a growing independent oil and gas company that intends to actively pursue enhanced oil recovery techniques to increase production and reserves at our existing properties and future acquisitions. Our primary focus is crude oil and our target acquisitions are onshore U.S. properties. Our focus on domestic, mature oil fields eliminates exploration risks and uncertainties of international sources. We use waterflooding and enhanced oil recovery techniques, such as surfactant-polymer flooding technology.

We believe significant opportunities exist primarily because the major energy companies and large independents continue to focus their attention and resources toward the discovery and development of large fields. In the past several years, the major companies have been divesting themselves of their mature oilfields. Also, the recent economics of the oil and gas market have improved as prices have risen substantially. These conditions provide ample opportunities for smaller independent companies to acquire and exploit mature U.S. fields. We expect that there will be increased competition for such properties in the future.

We will continue to target potential acquisition candidates in a disciplined manner. By adhering to our disciplined approach, we expect to continue to find attractive economic acquisition and development opportunities. While our participation in Sabine Production Operating, LLC, as more fully discussed above, may temporarily diminish our ability to exercise our strategy, we believe that the overall benefits of our participation are consistent with our strategy and will substantially outweigh any such diminishment by providing us access to significant portions of potential acquisitions that we would not otherwise have the ability to pursue.

Our competitive advantage is our in-house expertise and low internal overhead. We employ independent engineers and geologists to aid in evaluating the economic merits of drilling plans and potential acquisitions. We believe that the incremental cost of hiring independent engineering firms justifies the expense because they provide a check and balance on our acquisition and development plans. Further, employing third party experts on a case-by-case basis enables us to maintain low operating expenses and adhere to our commitment to keep fixed costs low.

Liquidity and Capital Resources

We intend to finance future acquisitions of oil and gas properties, field development projects and operating activities with a combination of issuances of equity, debt financing, access to capital markets, and cash flow from operations. We cannot guarantee that any additional equity or debt financing will be available in sufficient amounts or on acceptable terms when needed. If such financing is not available in sufficient amounts or on acceptable terms, our results of operations and financial condition may be adversely affected. In addition, equity financing may result in dilution to existing stockholders and may involve securities that have rights, preferences, or privileges that are senior to our common stock, and any debt financing obtained must be repaid regardless of whether or not we generate profits or cash flows from our business activities.

For the three months ended September 30, 2005, we generated a loss applicable to common stock of $457,957, and had cash used in operations of $526,876. For the fiscal year ended June 30, 2005, we generated a loss applicable to common stock of $3,389,676, and had cash used in operating activities of $501,035. As of September 30, 2005, we had $17,307,379 of working capital and an accumulated deficit of $10,463,952.

On September 14, 2005 and September 16, 2005, we received written commitments for two private placement sales of 2,603,864 shares and 2,100,000 shares, respectively, of our common stock at a per share price equal to $4.14, which was the closing price on September 13, 2005 on the American Stock Exchange to the selling stockholders named in this prospectus. The transactions closed on or before September 30, 2005. The gross and net proceeds totaled $19.5 million and $18.5 million, respectively. The net proceeds of the issuance will be used for general corporate purposes, capital expenditures and working capital. The common stock sold in the private placement have not been registered under the Securities Act or state securities laws and may not be offered or sold in the United States absent registration with the Securities and Exchange Commission or an applicable exemption from the registration requirements.

In addition, we anticipate reducing our operating losses in fiscal 2006, and we will strive to improve cash flow. We are also contemplating additional financing transactions that will sufficiently fund our planned capital expenditures and working capital needs for a reasonable period of time. We cannot guarantee that any additional financing will be available in sufficient amounts or on acceptable terms when needed. If such financing is not

available in sufficient amounts or on acceptable terms, our results of operations and financial condition may be adversely affected. In addition, equity financing may result in dilution to existing stockholders and may involve securities that have rights, preferences, or privileges that are senior to our common stock.

Financing and Investing Activities

During the twelve months ended June 30, 2005, our financings consisted of the following:

We received net proceeds of $4.8 million from the issuance of 1,350,000 shares of common stock during March 2005 (See Note 5 of the accompanying June 30, 2005 financial statements).

We issued 888,888 common shares as part of the Square One acquisition, which was valued at $3.96 per share (See Note 3 of the accompanying June 30, 2005 financial statements).

We issued $5.35 million of preferred stock (See Note 4 of the accompanying June 30, 2005 financial statements). This increases our issuances of preferred stock to $8.5 million (net proceeds) since inception.

During March 2005, the preferred stockholders elected to convert their preferred shares to common shares. As discussed in Note 4 of the accompanying June 30, 2005 financial statements, the Series B and Series C Convertible Preferred Stock was converted into shares of our common stock at a price of $3.00 and $3.75 per share, respectively. The total converted shares amounted to 2,466,665 common shares. As of June 30, 2005, there were no outstanding shares of preferred stock.

As of June 30, 2005, our common stock is the only class of stock outstanding and we have no outstanding long-term debt financing.

The proceeds from our stock issuances were our primary source to fund the Davenport Merger, as discussed in Note 2 of the accompanying June 30, 2005 financial statements, and the following acquisitions and development activities occurred during the twelve months ended June 30, 2005:

Acquisition of the Nowata Oil Properties LLC for $2.6 million (See Note 3 of the accompanying June 30, 2005 financial statements).

Acquisition of the Ladder Companies, Inc. for $2.2 million (See Note 3 of the accompanying June 30, 2005 financial statements). For operational purposes, we refer to Ladder as the Rich Valley field.

Acquisition of the Square One Energy, Inc. valued at $7.6 million (See Note 3 of the accompanying June 30, 2005 financial statements), consisting of $4 million of cash and issuing 888,888 common shares. For operational purposes, we refer to Square One as the Desdemona field.

Purchase of an additional 10% revenue interest in the Davenport field for $0.7 million (See Note 6 of the accompanying June 30, 2005 financial statements).

Capital expenditures of $2.1 million, consisting primarily of drilling two wells in the Davenport field, and implementation of developmental activities and environmental safeguards.

Based on reserve reports prepared by independent petroleum engineers dated July 1, 2005, our total reserves are summarized as follows:

	Nowata	Rich Valley	Davenport	Desdemona	Total
Proved					
Oil - Mbbls	1,492	299	478	786	3,055
Gas - Mmcf	268	2,888	34	7,198	10,388
Proved Barrels of Equivalent Oil (MBOE)	**1,537**	**780**	**484**	**1,986**	**4,787**
Proved Producing (MBOE)	**1,537**	**587**	**127**	**348**	**2,599**

Capital Spending Plan for Fiscal Year 2006

Our capital spending plan for our remaining fiscal year ending June 30, 2006, excluding potential acquisitions, is projected to be $13.6 million to implement developmental projects at our existing fields to increase reserves and production as follows:

Desdemona Field. This field has not been previously waterflooded. We began pilot waterflood operations in May 2005 and expect an initial response in nine to twelve months. If the pilot waterfloods are successful, we intend to begin expanding the waterflood to the entire field in 2006. This field also has mineral rights to the Barnett Shale. We intend to sell these land rights and focus on our core expertise secondary and enhanced oil recovery.

Nowata Field. This field is currently being waterflooded. We intend to increase production and reserves by applying a chemical treatment known as surfactant-polymer flooding technology. We are continuing to optimize the surfactant-polymer chemistry in the laboratory and intend to begin implementing a surfactant-polymer pilot during the next three to six months.

Davenport Field. This field is currently being waterflooded. We intend to evaluate this field for surfactant-polymer flooding technology. This evaluation, coupled with the knowledge gained from the Nowata pilot, is expected to enhance this field s value as a surfactant-polymer candidate.

Rich Valley Field. We intend to drill seven infill development wells and conduct an evaluation for waterflood potential.

Energy lenders typically loan to oil and gas companies based on the value of the proved producing reserves, defined as reserves that can be reasonably expected to be recovered from existing wells with existing equipment and operating methods from known reservoirs under existing economic and operating conditions. We intend to seek debt financing secured by our proved producing reserves to provide an additional source of cash to fund our operating activities, capital expenditures and acquisitions.

As previously discussed under *Liquidity and Capital Resources,* we recently sold an aggregate of 4,703,864 shares of our common stock generating gross proceeds of $19,474,000. These funds will be used, in part, to fund the previously discussed capital expenditures.

Based on our current cash resources and other current assets, management believes we have sufficient liquidity to fund operations for the next twelve months. We are contemplating additional financing transactions that, if successful, are expected to sufficiently fund expenditures for potential acquisitions and other expansions of our business. We do not currently have any commitments for such financing and there is no assurance that we will be successful in obtaining such funds. If we cannot obtain additional financing, we will have to significantly curtail our acquisition plans.

Operating Activities

For the three months ended September 30, 2005 and 2004, net cash used in operating activities was $529,876 and $353,112, respectively. For the twelve months ended June 30, 2005, net cash used in operating activities was $501,035. We are seeking to improve cash flow from operational activities through operational improvements at our existing properties, a full twelve months of production from acquired properties, and future acquisitions. The increased cash flow from field operations could be offset, in part, by increased general and administrative costs to support our expanding operations. As previously discussed under *Liquidity and Capital Resources,* we recently sold 4,703,864 shares of our common stock to the selling stockholders named in this prospectus generating gross proceeds of $19,474,000. The combination of these factors are expected to provide sufficient working capital to support our operations.

<u>Results of Operations Three Months Ended September 30, 2005 and 2004</u>

Overall

For the quarter ended September 30, 2005 (current quarter), we had a loss applicable to common stock of $457,957, which is an improvement of $544,250 as compared to the $1,002,207 loss applicable to common stock incurred for the quarter ended September 30, 2004 (prior year quarter). Factors that contributed to the $544,250 improvement are higher income from oil and gas operations of $0.6 million, reduced preferred stock discount of $0.3 million and lower amortization of deferred compensation expense of $0.2 million. Partially offsetting these positive factors were higher general & administrative expenses of $0.6 million

Income from oil and gas operations consists of operating revenues less lease operating expenses, production taxes, accretion of asset retirement obligations, and depletion and depreciation. The current quarter includes a full three months of operations from our four fields Nowata, Rich Valley, Davenport and Desdemona. The prior year quarter only includes one month of Nowata operations and no operating effects from the Desdemona field. This is the primary reason that income from oil and gas operations has increased significantly when the current quarter is compared to the prior year quarter.

The reduced preferred stock discount amounting to $0.3 million occurred in the prior year quarter and was attributable to certain issuances of preferred stock during the prior year quarter. Since we did not issue preferred stock during the current quarter, there is no preferred stock discount in the current quarter.

Operating Revenues

The table below summarizes our operating revenues for the current and prior year quarters.

	Three Months Ended September 30, 2005	2004	Increase (Decrease)
Operating Revenues	$ 1,945,959	$ 843,160	$ 1,102,799
Sales			
Oil (MBbls)	28	13	15
Gas (MMcf)	42	44	(2)
Total (MBOE)	35	20	15
Average Price			
Oil ($/ Bbl)	$ 60.36	$ 44.29	$ 16.07
Gas ($/ Mcf)	$ 6.22	$ 5.86	$ 0.36

The current quarter operating revenues of $1.9 million represent an improvement of $1.1 million as compared to the prior year quarter of $0.8 million. The $1.1 million improvement is attributable to the higher prices received for oil and gas sales, and increased oil sales as the current quarter includes a full three months of operations from our four fields, as previously discussed under Results of Operations - Overall. The average price we received for crude oil sales is generally at or above market prices. The average price we receive for natural gas sales is

approximately the market price less transportation and marketing expenses.

Operating Expenses

For the current quarter, our total operating expenses were $2.4 million, or $0.9 million higher than the prior year quarter of $1.5 million. The $0.9 million increase is primarily attributed to higher lease operating expenses (LOE) of $0.4 million, increased production taxes from higher sales of $0.1 million and higher general & administrative expenses of $0.6 million, partially offset by lower deferred compensation expense of $0.2 million.

Our LOE consists of costs of producing crude oil and natural gas such as labor, supplies, repairs, maintenance, and utilities. The $0.4 million increase resulted from the current quarter including a full three months of operations from our four fields, as previously discussed under Results of Operations - Overall. For the current quarter, the LOE per BOE was $21.56 as compared to $19.38 per LOE for the prior year quarter. The current

quarter amount of $21.56 per BOE is an improvement as compared to the LOE per BOE of $22.88 that we incurred for the twelve month period ended June 30, 2005. We generally incur a high amount of LOE because we focus on long term cost improvement of operations at all fields. Since our acquisitions are mature fields, our initial focus is to evaluate the existing operations and make the necessary operational improvements to improve operating efficiency. Based on management s past experience, it generally requires six to twelve months to fully analyze the acquired field and spend the necessary funds to improve the field operations to meet our operational standards. We expect these expenditures should lead to increased operational efficiency and reduced operating expenses in future periods.

Our general and administrative expenses consist of support services for our operating activities and investor relations costs. The $0.6 million increase is primarily due to increased employee staffing ($0.2 million), higher legal fees to comply with regulatory requirements ($0.1 million), incentive payments to certain employees ($0.1 million), higher travel costs ($0.1 million) and increased insurance costs ($0.1 million).

Results of Operations Twelve Months Ended June 30, 2005 and 2004

A comparison of the summary results of operations for the twelve months ended June 30, 2005 and 2004 is presented below.

		2005		2004
Operating revenues	$	5,481,640	$	7,958
Operating expenses		8,466,443		391,164
Loss applicable to common stock		(3,389,676)		(383,206)

The two periods are not comparable since 2004 represents only one month of results from the Davenport Field and general office expenses, and the 2005 results represent a full twelve months and include the results of all four of our fields and general office expenses. The remaining discussion will focus on the twelve months ended June 30, 2005.

The table below summarizes our results of operations through June 30, 2005.

Net Loss Before Certain Accounting Charges	$	(1,294,357)
Less:		
Deferred Compensation Expense		1,678,785
Preferred Stock Discount		416,534
Loss Applicable to Common Stock	$	(3,389,676)

As shown above, we had a net loss before certain accounting charges of $1,294,357 for the twelve month period ended June 30, 2005. Although this is a non-GAAP measure, we excluded these certain accounting charges deferred compensation expense and preferred stock discount - because we expect these costs to be significantly less in the next twelve month period ended June 30, 2006. Since our acquisitions are mature fields, our initial focus is to evaluate the existing operations and make the necessary operational improvements to improve operating efficiency. Based on past experience, management believes it generally requires six to twelve months to fully analyze the acquired field and spend the necessary funds to improve the field operations to meet our operational standards. The net loss that we have experienced for the twelve months ended June 30, 2005, is a direct result of spending the necessary funds to improve the operational efficiency of our field facilities and to fund start-up costs we incurred to fund our support services. We expect these expenditures should lead to increased operational efficiency and reduced operating expenses in future periods.

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Operating Revenues

The table below summarizes our operating revenues for the twelve months ended June 30, 2005.

Operating Revenues	$	5,481,640
Sales		
Oil (MBbls)		89
Gas (MMcf)		180
Total (MBOE)		119
Average Price		
Oil ($/ Bbl)	$	48.36
Gas ($/ Mcf)	$	6.25

We expect future increases to sales through capital expenditures as previously discussed under *Plan of Operation - Capital Spending Plan for Fiscal Year 2006.*

Operating Expenses

For the twelve month period ended June 30, 2005, our total operating expenses were $8.5 million. Our operating expenses consist primarily of lease operating expenses, general and administrative, depletion and depreciation, and deferred compensation expense, as discussed in Note 1 to the financial statements.

Our lease operating expenses consist of costs of producing crude oil and natural gas such as labor, supplies, repairs, maintenance, and superintendence. For the twelve month period ended June 30, 2005, our lease operating expenses were $2.7 million and the lease operating expense per BOE was $22.88. We incurred an unusually high amount of LOE to implement the operational improvements at all fields, as previously discussed. We will continue to evaluate potential operational improvements for all four fields. We anticipate these expenditures will lead to improved operational efficiency and reduced operating expenses in future months.

Our general and administrative expenses, totaling $3.2 million, consist of support services for our operating activities and investor relation costs.

Contractual Obligations

As of June 30, 2005, our principal executive office, comprising 6,317 square feet, is subject to a lease that expires June 30, 2006 at a cost of $6,580 per month. This was our only material contractual obligation as of June 30, 2005. The following table summarizes our lease obligation at June 30, 2005:

	Total	Due Within 1 Year	2 - 5 Years
Leases	$ 78,960	$ 78,960	$

Off Balance Sheet Arrangements

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

Significant Accounting Policies

Use of Estimates

In preparing the accompanying consolidated financial statements, management has made certain estimates and assumptions that affect reported amounts in the consolidated financial statements and disclosures of contingencies. Actual results may differ from those estimates. Significant assumptions are required in the valuation of proved oil and gas reserves, which may affect the amount at which oil and gas properties are recorded. Our

operating revenues and accounts receivable also involve estimates and assumptions. It is at least reasonably possible these estimates could be revised in the near term, and these revisions could be material. We believe the following critical accounting policies affect our more significant judgments and estimates.

Oil and Gas Properties and Equipment

We follow the successful efforts method of accounting, capitalizing costs of successful exploratory wells and expensing costs of unsuccessful exploratory wells. All developmental costs are capitalized. We are predominately engaged in the acquisition and development of proved reserves as opposed to exploration activities. Depreciation and depletion of producing properties is computed on the units-of-production method based on estimated proved oil and gas reserves.

If conditions indicate that long-term assets may be impaired, the carrying value of property is compared to management s future estimated pre-tax cash flow from the properties. If impairment is necessary, the asset carrying value is written down to fair value. Cash flow pricing estimates are based on existing proved reserve and production information and pricing assumptions that management believes are reasonable. Impairment of individually significant undeveloped properties is assessed on a property-by-property basis, and impairment of other undeveloped properties is assessed and amortized on an aggregate basis.

Reserve Estimates

Proved reserves are estimated quantities of crude oil, natural gas and natural gas liquids that geological and engineering data demonstrate with reasonable certainty to be recoverable in future years from known reservoirs under existing economic and operating conditions. Proved developed reserves are reserves that can be expected to be recovered through existing wells with existing equipment and operating methods as well as oil and natural gas expected to be obtained through the application of enhanced recovery techniques after testing by a pilot project or after the operation of an installed program has been confirmed through production response that increased recovery will be achieved. Proved undeveloped reserves are reserves that are expected to be recovered from existing wells where a relatively major expenditure is required for implementing enhanced oil recovery techniques. We emphasize that the volume of reserves are estimates that, by their nature are subject to revision. The estimates are made using geological and reservoir data, as well as production performance data. These estimates are reviewed annually and revised, either upward or downward, as warranted by additional performance data. If the estimates of proved reserves were to decline, the rate at which we record depletion expense would increase. Holding all other factors constant, a reduction in our proved reserve estimate of 10% would result in an annual increase in depreciation, depletion and amortization expense of approximately $14,000.

Asset Retirement Obligation

Our financial statements reflect the provisions of Statement of Financial Accounting Standards No. 143, *Accounting for Asset Retirement Obligations*. SFAS No. 143 provides that, if the fair value for an asset retirement obligation can be reasonably estimated, the liability should be recognized in the period when it is incurred. Oil and gas producing companies incur this liability upon acquiring or drilling a well. Under the method prescribed by SFAS No. 143, the retirement obligation is recorded as a liability at its estimated present value at the asset s inception, with an offsetting increase to producing properties on the balance sheet. Periodic accretion of discount of the estimated liability is recorded as an expense in the statement of operations.

Revenue Recognition

We recognize revenue when crude oil and natural gas quantities are delivered to or collected by the respective purchaser. We sell our crude oil production to two independent purchasers and our natural gas production primarily to a single independent purchaser. Title to the produced quantities transfers to the purchaser at the time the purchaser collects or receives the quantities. Prices for such production are defined in sales contracts and are readily determinable based on certain publicly available indices. The purchasers of such production have historically made payment for crude oil and natural gas purchases within thirty-five days of the end of each production month. We periodically review the difference between the dates of production and the dates we collect payment for such production to ensure that receivables from those purchasers are collectible. All transportation

costs are accounted for as a reduction of oil and natural gas sales revenue.

Deferred Compensation

As discussed in *Escrowed Shares pursuant to the Davenport Merger,* beginning on page 32 of this prospectus, pursuant to the agreement terms of the Davenport Merger, eight individuals (six of whom are now employed by us, one former employee, and one who is a member of our board of directors) were issued 5,165,000 shares of common stock. These shares were placed in escrow. The shares will vest to the individuals based on a combination of continued employment (compensation shares) and achieving certain performance goals (performance shares) during the period ending June 30, 2006. The compensation shares amounted to 2,659,975 shares and the performance shares amounted to 2,505,025 shares. Any shares that are not released from escrow will be returned to Treasury Stock. We have accounted for these shares in accordance with the provisions of SFAS Nos. 123 and 148. At the merger date, we recognized $2,324,250 of Deferred Compensation and Additional Paid-in Capital in the Consolidated Balance Sheet. The shares were recorded based on the quoted market price at the time of the transaction and are being amortized to expense over the periods earned.

DESCRIPTION OF PROPERTY

Principal Executive Offices

Our principal executive offices are located at The Oil & Gas Commerce Building, 309 West 7th Street, Suite 1600, Fort Worth, TX 76102. Our principal executive offices comprise approximately 6,317 square feet and are subject to a lease that expires on June 30, 2006 at a cost of $6,580 per month.

Oil and Gas Properties

Reserves

Our proved oil and gas reserves have been estimated by independent petroleum engineers. Proved reserves are the estimated quantities that geologic and engineering data demonstrate with reasonable certainty to be recoverable in future years from known reservoirs under existing economic and operating conditions. Due to the inherent uncertainties and the limited nature of reservoir data, such estimates are subject to change as additional information becomes available. The reserves actually recovered and the timing of production of these reserves may be substantially different from the original estimate. Revisions result primarily from new information obtained from development drilling and production history and from changes in economic factors.

Based on reserve reports prepared by independent petroleum engineers dated July 1, 2005, we had estimated total proved reserves of 4,787 MBOE, of which 2,599 MBOE were proved producing reserves. A detail of these reserves is presented under *Financing and Investing Activities,* beginning on page 19 of this prospectus. We have not reported our reserves to any federal authority or agency.

Production

For the twelve months ended June 30, 2005, our total net production was approximately 89,000 barrels of oil and 180 MMcf of natural gas. The average prices received for our oil and gas sales were $48.36 per barrel and $6.25 per Mcf, respectively. Our average lifting cost per barrel of equivalent oil was $22.88 / barrel.

For the twelve months ended June 30, 2004, our total net production was 233 barrels of oil and the average price received was $34 per barrel.

Productive Wells and Acreage

As of June 30, 2005, we had 520 gross productive wells (511 net productive wells). Our oil wells totaled 462 gross productive wells (453 net productive wells) and our gas wells totaled 58 gross and net productive wells. We had total acreage of 19,579 acres, consisting of 9,484 developed acres and 10,095 undeveloped acres.

Drilling Activity

During the twelve months ended June 30, 2005, we drilled two (gross and net) developmental wells in the Davenport Field and one (gross and net) well in the Nowata Field for testing of ASP technology. As of September 8, 2005 and June 30, 2004, we did not have any drilling activity. At the Desdemona Field, we began pilot waterflood operations in May 2005.

There was no drilling activity during the twelve month period ended June 30, 2004.

Present Activities

We intend to implement the capital expenditures program as detailed under *Capital Spending Plan for Fiscal Year 2006,* beginning on page 20 of this prospectus.

Delivery Commitments

At June 30, 2005, we had no delivery commitments with our purchasers.

LEGAL PROCEEDINGS

We are not a party to any pending legal proceeding, nor is our property the subject of a pending legal proceeding, that is not in the ordinary course of business or otherwise material to the financial condition of our business.

MANAGEMENT

Executive Officers, Directors and Key Employees

The following table sets forth the names and ages of the members of our Board of Directors and our executive officers and the positions held by each.

Name	Age	Position
S. Jeffrey Johnson	40	Chief Executive Officer and Chairman of the Board of Directors
Michael J. Ricketts	47	Chief Financial Officer and Principal Accounting Officer
Thomas D. Cochrane	42	Executive Vice President - Engineering
James K. Teringo, Jr.	50	Vice President, General Counsel and Corporate Secretary
Donnie D. Dent	71	Director
Gerald W. Haddock	57	Director
Randall Boyd	47	Director
Dr. Jim Underwood	63	Director
Morris B. Sam Smith	61	Director

All directors hold office until the next annual meeting of our stockholders and until their successors have been duly elected and qualified. Our executive officers are elected by, and serve at the designation and appointment of the board of directors. Some of our directors and executive officers also serve in various capacities with our subsidiaries. There are no family relationships among any of our directors and executive officers.

Background of Executive Officers and Directors

S. Jeffrey Johnson, *Chief Executive Officer and Chairman*. Mr. Johnson was appointed Chief Executive Officer on May 28, 2004 and Chairman on June 25, 2004. Prior to joining Cano, Mr. Johnson served as the Chief Executive Officer of Cano Energy Corporation from 2001 through 2004, and he served as the Chief Executive Officer of Scope Operating Company from 1997 through 2004.

Michael J. Ricketts, *Chief Financial Officer and Principal Accounting Officer*. Mr. Ricketts was appointed Chief Financial Officer on May 28, 2004. Mr. Ricketts served as a member of our Board of Directors from June 25, 2004

until April 6, 2005. Mr. Ricketts is a Certified Public Accountant. Prior to joining Cano, Mr. Ricketts was employed by TNP Enterprises, Inc. and its subsidiaries, Texas-New Mexico Power Company and First Choice Power for 15 years. He served as Director, Treasury from 2003 to 2004. He served as Director, Business Development from 2002 2003. He was the Controller and Assistant Controller from 1998- 2002.

Thomas D. Cochrane, *Executive Vice-President of Engineering*. Mr. Cochrane was appointed Executive Vice-President of Engineering on September 9, 2005. From June 13, 2004 through September 9, 2005, Mr. Cochrane served as Executive Vice-President of Oil & Gas Operations. Prior to joining Cano, Mr. Cochrane spent his entire 16 year career with ExxonMobil Oil. From 1988 to 1998 he was an Operations Engineer for water floods and CO2 floods. From 1998-1999 he was the Maintenance Foreman of the Aneth area. From 1999-2000 he was the Production Superintendent of the Aneth Area. From 2000 to 2004 he worked as a Reservoir Engineer and Reservoir Engineering Mentor for water floods and CO2 floods, and served on the U.S. Drill Well Review Team approving technical work supporting drilling funding from 2003-2004.

James K. Teringo, Jr., *Vice President, General Counsel and Corporate Secretary*. Mr. Teringo was appointed to the positions of Vice President, General Counsel and Corporate Secretary on August 3, 2005. From June 1999 until December 2003, Mr. Teringo was Assistant General Counsel for Panda Energy International, Inc.

Donnie D. Dent, *Director*. Mr. Dent was appointed to our Board of Directors on June 25, 2004. Mr. Dent has been an investor since 1998. Prior to 1998, Mr. Dent was employed with various oil and gas companies. From 1995 to 1998, Mr. Dent served as President and CEO of RUSA Oil, Ltd., a company jointly formed by Dresser Industries and Petro-Hunt Corporation and engaged in the exploration and development of two large oil fields in Siberia. From 1991 to 1998 Mr. Dent served as a General Director of Khantymansiysknnefthunt, a Russo-American oil and gas joint venture. Prior to 1991 he was President of Box Energy Corporation Executive and Vice President at OKC Limited Partnership. Mr. Dent has also served as General Counsel at Mesa Petroleum Corporation and as a staff attorney for Gulf Oil Corporation.

Gerald W. Haddock, *Director.* Mr. Haddock was appointed to our Board of Directors on December 10, 2004. Mr. Haddock founded Haddock Enterprises, LLC, an entrepreneurial development company concentrating in oil and gas and real estate, located in Fort Worth, Texas, in 1999 and he has served as its President since that time. Mr. Haddock formerly served as President and CEO of Crescent Real Estate Equities from 1996 to 1999. Mr. Haddock is currently a Director and Audit Committee Chairman of ENSCO International, Inc., a leading global offshore oil and gas drilling service company listed on the NYSE. Mr. Haddock has been a member of the governing board of Sabine Production Partners, LP and a member of the Office of the Chief Executive Officer of Sabine Production Operating, LLC since its organization in May 2005. Mr. Haddock also joined the Board of Directors of Meritage Homes Corporation in early 2005, named Fastest Growing Public Homebuilder 2003 by Builder magazine. Mr. Haddock also serves for Baylor University on the Baylor Foundation Board of Directors and serves on the Dean s Strategic Council for the Graduate Tax Program at New York University.

Randall Boyd, *Director.* Mr. Boyd was appointed to our Board of Directors on October 25, 2004. Mr. Boyd began his

career with IBM in 1979 and served in various capacities including sales, market forecasting/pricing, and industry strategy. He joined Sky Chefs in 1989 and left the company in 2003. In 2001, he was appointed CEO of the Americas Regions, member of the Global Executive Board, and Global Executive Vice President of Marketing and Sales of Sky Chefs. Since 2004 he has been Executive Producer of the television production Honey Hole and has been president of R.C. Boyd Enterprises, LLC, the owner of the television production.

Dr. Jim Underwood, *Director.* Dr. Underwood was appointed a Director on January 6, 2005. Dr. Underwood has been a professor at Dallas Baptist University since 1989. Dr. Underwood has also served as the Vice President of Cornerstone Bank and as Vice President of Heritage National Bank. Since 1993, Dr. Underwood has served as an advisor and consultant in the field of corporate strategy for a number of companies, including American Airlines, Dale Carnegie International, EDS, IBM Corporation, Lockheed, Wall Street Journal, Texas Instruments and numerous divisions of Nortel Networks. In addition, Dr. Underwood has authored seven books including *The Significance Principle, Thriving In E-Chaos* (winner of the International Competia Award 2001), *The New Corporate Strategy*, *Complexity and Paradox*, *Corporate Intelligence,* and *What s Your Corporate IQ?* His book *More Than a Pink Cadillac* made the New York Times and the Wall Street Journal s Business Best Seller List in early 2003.

Morris B. Sam Smith, *Director.* Mr. Smith was appointed a Director and Chairman of our Audit Committee on March 22, 2005. In July 2004, Mr. Smith began serving as a management consultant for RBI International, Ltd., and has served as the chief financial officer at RBI since that time. He has also acted as Interim Chief Financial Officer of Stroud Oil Properties from October 2004 to January 2005. Mr. Smith is also Chairman of the Board of Trustees for McMurry University and was a Board Member and Audit Committee Chairman for Belden & Blake Corporation during 2005. Mr. Smith was a consultant from January 2004 to June 2004. From August 1, 2000 through December 31, 2003, Mr. Smith was Executive Vice President, Chief Financial Officer and Treasurer of Encore Acquisition Company. Mr. Smith also served as Corporate Secretary of Encore Acquisition Company from December 2002 to December 2003. From July 1996 to July 2000, Mr. Smith held the positions of Vice President of Finance and Chief Financial Officer of Union Pacific Resources.

Board of Directors

During the fiscal year ended June 30, 2005, our Board held four meetings and our Audit Committee held one meeting. All meetings of the Board of Directors and of the Audit Committee were attended by all then-current members.

Below is a description of the Audit Committee of the Board of Directors. The Board has determined that each member of the Audit Committee meets the applicable rules and regulations regarding independence and that each member is free of any relationship that would interfere with his or her individual exercise of independent judgment.

The Charter of the Audit Committee of the Board of Directors sets forth the responsibilities of the Audit Committee. The primary function of the Audit Committee is to oversee and monitor the Company s accounting and reporting processes and the audits of the Company s financial statements.

The Audit Committee is presently composed of three persons, including Morris B. Sam Smith, Dr. Jim Underwood and Donnie D. Dent, each of whom are considered independent under the rules promulgated by the American Stock Exchange and under Rule 10A-3 under the Exchange Act, and each of whom is financially sophisticated as required by the rules of the American Stock Exchange. Mr. Smith serves as the Chairman of the Audit Committee. The Board has determined that Mr. Smith is an audit committee financial expert as defined in Item 401 of Regulation S-B.

EXECUTIVE COMPENSATION

The following table sets forth information concerning the annual and long-term compensation of our Chief Executive Officer and the other named executive officers, for services as executive officers for the fiscal years ended June 30, 2005, June 30, 2004 and since our organization on May 29, 2003.

SUMMARY COMPENSATION TABLE

		Annual Compensation			Long-Term Compensation Awards		Payouts	
Name and Principal Position	**Year**	**Salary ($)**	**Bonus ($) (2)**	**Other Annual Compensation ($)**	**Restricted Stock Award(s) ($)**	**Securities Underlying Options/ SARs (#)**	**LTIP Payouts ($)**	**All Other Compensation ($) (3)**
S. Jeffrey	2005	$ 250,000	-0-	-0-	-0-	-0-	-0-	$ 10,200
Johnson, CEO and	2004	$ 31,250	-0-	-0-	-0-	-0-	-0-	-0-
Chairman (1)	2003	-0-	-0-	-0-	-0-	-0-	-0-	-0-
Thomas D.	2005	$ 125,000	-0-	-0-	-0-	-0-	-0-	-0-
Cochrane Vice President of Oil and Gas	2004	$ 10,416	$ 35,000	-0-	-0-	-0-	-0-	-0-
Operations (1)	2003	-0-	-0-	-0-	-0-	-0-	-0-	-0-
Michael J.	2005	$ 115,000	-0-	-0-	-0-	-0-	-0-	-0-
Ricketts Chief	2004	$ 14,375	-0-	-0-	-0-	-0-	-0-	-0-
Financial Officer (1)	2003	-0-	-0-	-0-	-0-	-0-	-0-	-0-

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(1) Messrs. Johnson, Cochrane and Ricketts were appointed to their executive positions on May 28, 2004. Mr. Johnson was appointed Chairman on June 25, 2005.

(2) Mr. Cochrane received a $35,000 signing bonus for accepting employment at Cano.

(3) Pursuant to Mr. Johnson s employment agreement, he received a vehicle allowance of $10,200 during the fiscal year ended June 30, 2005.

Compensation of Directors

We do not currently pay our directors for attending meetings of our Board of Directors, although we expect to adopt a director compensation policy in the future.

During our March 2005 Board meeting, the directors approved our 2005 Directors Stock Option Plan, the terms of which are described under *Securities Authorized for Issuance Under Equity Compensation Plans,* beginning on page 35 of this prospectus. To date, we have granted 25,000 options to each of our non-employee Directors under the Directors stock option plan: Donnie D. Dent, Gerald W. Haddock, Randall Boyd, Dr. Jim Underwood and Morris B. Sam Smith. Each of these options has an exercise price of $4.13 per share. The options vest on April 1, 2006 and expire on April 1, 2015.

Mr. Haddock has agreed to provide certain management and financial consulting services to us. In consideration for such services, the Company granted Mr. Haddock options to purchase 50,000 shares of our common stock at an exercise price of $4.00 per share. Such options became exercisable six months from the grant date (the Vest Date) and expire ten years from the Vest Date. In addition, we may grant Mr. Haddock options (the Additional Options) to purchase an additional 50,000 shares of our common stock at an exercise price of $4.00 per share, exercisable for a period of ten years. The grant of the Additional Options is based upon the successful performance and additional value provided to us for consulting services, and shall be at the discretion of our Board of Directors.

Employment Agreements

S. Jeffrey Johnson. Pursuant to the terms of an Employment Agreement dated May 28, 2004, we appointed Mr. Johnson as our Chief Executive Officer and President for a term of two years ending June 30, 2006. We also agreed to appoint Mr. Johnson to our board of directors, subject to compliance with applicable law. We agreed to pay Mr. Johnson a base salary of $250,000 during the first year of his agreement and $267,500 in the second year. In addition, we agreed to consider Mr. Johnson for an annual bonus (to be determined by our board of directors) of up to an additional $100,000 (to be paid in common stock based on the greater of $3.00 per share or the average closing price for the five days preceding the grant).

Michael J. Ricketts. Pursuant to the terms of an Employment Agreement dated May 28, 2004, we appointed Mr. Ricketts as our Chief Financial Officer and Secretary for a term of two years ending June 30, 2006. We also agreed to appoint

Mr. Ricketts to our board of directors, subject to compliance with applicable law. We agreed to pay Mr. Ricketts a salary of $115,000 during the first year of his agreement and $123,050 in the second year. In addition, we agreed to consider Mr. Ricketts for an annual bonus (to be determined by our board of directors) of up

to an additional 20% of his annual salary.

Thomas D. Cochrane. Pursuant to the terms of an Employment Agreement dated May 28, 2004, we appointed Mr. Cochrane as our Executive Vice-President of Engineering for a term of two years ending June 30, 2006. We agreed to pay Mr. Cochrane a salary of $125,000 during the first year of his agreement and $133,750 in the second year as well as a $35,000 signing bonus. In addition, we agreed to consider Mr. Cochrane for an annual bonus (to be determined by our board of directors) of up to an additional 20% of his annual salary.

James K. Teringo, Jr. On September 16, 2005, pursuant to recommendation by our Compensation Committee and approval by our Board of Directors, we entered into an employment agreement with James K. Teringo, Jr., our Vice President, General Counsel and Secretary effective as of July 11, 2005. Unless earlier terminated pursuant to the terms of the employment agreement, the employment agreement expires on July 11, 2007. Pursuant to the employment agreement, Mr. Teringo receives a base annual salary of $120,000 and stock options exercisable into 50,000 shares of common stock at an exercise price of $3.98 per share and is eligible for periodic cash or stock bonuses and raises in base salary at the sole discretion of the board of directors. Provided Mr. Teringo is still employed on July 11, 2006, all of the stock options will vest on such date. Unless earlier terminated pursuant to the terms of the stock option agreement, the stock option agreement terminates on September 16, 2015.

CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

Davenport Merger

Pursuant to the terms of the Merger Agreement, pursuant to which we acquired Davenport Field Unit, Eric Boehnke, our former CEO, former Secretary and former Director agreed to return to our treasury a total of 6,500,000 shares of common stock and forgive debts owed to him by us in the amount of $70,000. As a result of the foregoing, Eric Boehnke retained 392,993 shares of our common stock. We agreed to provide accounting services to Cano Energy Corporation based on cost plus a 10% incremental margin during a three-month transitional period. This arrangement ended in August 2004.

Transactions involving Cano Energy Corporation

On July 21, 2004, we agreed to purchase the furniture, fixtures, and office equipment of Cano Energy Corporation for approximately $114,000. The amount paid was based on an independent third party valuation. The purchase of these fixed assets was contemplated as part of the Merger Agreement, pursuant to which we acquired Davenport Field Unit. Our Chairman and Chief Executive Officer, S. Jeffrey Johnson, is a principal shareholder of Cano Energy Corporation.

On August 16, 2004, we agreed to purchase an additional 10% revenue interest in the Davenport field from Cano Energy Corporation. This increased our revenue interest in the Davenport field to 65%. In consideration for the additional 10% revenue interest, we agreed to pay Cano Energy Corporation $667,000 cash in installments. The final installment payment was made in October 2004.

Transactions involving Directors

In addition to serving as a member of our Board of Directors, Gerald Haddock agreed to provide certain management and financial consulting services to us. In consideration for such services, on December 16, 2004 we granted Mr. Haddock options to purchase 50,000 shares of common stock at an exercise price of $4.00 per share. The options are exercisable at any time, in whole or in part, during the ten-year option period which commenced six months following the date of grant (June 16, 2005) and expires on June 15, 2015. In addition, we may grant Mr. Haddock options to purchase an additional 50,000 shares of common stock at an exercise price of $4.00 per share, exercisable for a period of ten years. The grant of the Additional Options is based upon the successful performance and additional value provided to us for consulting services, and shall be at the discretion of our Board of Directors.

On October 8, 2004, we received gross proceeds of $750,000 from the sale of 750 shares of Series C Convertible Preferred Stock at a price of $1,000 per share to Randall Boyd, one of our current Directors.

Pursuant to an agreement dated December 16, 2004, we agreed with R.C. Boyd Enterprises, a Delaware corporation, to become the lead sponsor of a television production called Honey Hole (the Honey Hole Production). The sponsorship requires us to pay an aggregate of $100,000 to R.C. Boyd Enterprises in 2005. We are entitled to receive two thirty second commercials during all broadcasts of the Honey Hole Production and we will receive opening and closing credits on each episode. Randall Boyd, one of our current Directors, is the sole shareholder of R.C. Boyd Enterprises.

Sabine Production Operating, LLC

On March 29, 2005, we entered into an agreement with Haddock Enterprises, LLC and Kenneth Q. Carlile (predecessor to Carlile Management, LLC) to explore the possibility of converting the Sabine Royalty Trust from a liquidating asset into a vehicle to acquire low risk assets. Each of the three parties owns a one-third interest in the Sabine Production Operating, LLC. Gerald W. Haddock is President of Haddock Enterprises, LLC and is a member of our Board of Directors. As of September 30, 2005, we had incurred approximately $260,000 of costs pertaining to the joint venture, consisting of partnership contributions and other costs, of which $40,000 occurred as of June 30, 2005.

On August 3, 2005, our board of directors of granted Messrs. Haddock (a Cano Director), Johnson (our Chief Executive Officer and Director) and Cochrane (our Executive Vice President of Engineering) waivers to our Code of Ethics and Business Conduct for Officers, Directors and Employees of Cano Petroleum, Inc for their respective relationships with the Sabine Production Operating, LLC. On August 3, 2005, our board of directors also granted prospective waivers to Messrs. Haddock, Johnson and Cochrane as well as any other of our employees who, as a result of their employment by or positions with us, have obligations involving the Sabine Production Operating, LLC.

On November 4, 2005, we entered into: (1) an Omnibus Agreement with Haddock Enterprises, LLC, Carlile Management, LLC and Sabine Production Partners, LP; (2) Amended and Restated Regulations of Sabine Production Operating, LLC with Haddock Enterprises, LLC and Carlile Management, LLC; and (3) a Compensation Reimbursement Agreement with Sabine Production Operating, LLC. Each of the agreements described above was entered into pursuant to the Transaction Summary dated August 4, 2005 with Haddock Enterprises, LLC and Carlile Management, LLC. The material terms of these agreements are discussed beginning on page 12 of this prospectus.

Management believes that all of the above transactions were on terms at least as favorable as could have been obtained from unrelated third parties.

SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The following table sets forth certain information, as of November 14, 2005 with respect to the beneficial ownership of the outstanding common stock by: (i) any beneficial holder of more than five (5%) percent of our outstanding common stock; (ii) each of our executive officers and directors; and (iii) our directors and executive officers as a group. Except as otherwise indicated, each of the stockholders listed below has sole voting and investment power over the shares beneficially owned.

Name of Beneficial Owner (1)

	Common Stock Beneficially Owned (2)	Percentage of Common Stock (2)
S. Jeffrey Johnson (3)	3,896,850	15.4%
Michael J. Ricketts (3)	464,850	1.8%
Thomas D. Cochrane (3)	464,850	1.8%
James K. Teringo, Jr. (4)	50,000	*
Donnie D. Dent (3) (5)	125,000	*
Gerald W. Haddock (5) (6)	101,500	*
Randall Boyd (5)	225,000	*
Dr. Jim Underwood (5)	25,000	*
Morris B. Sam Smith (5)	25,000	*
Wellington Management Company, llp (7)	3,450,000	13.7%
All officers, directors and directors nominees as a group (9 persons)	**5,378,050**	**21.3%**

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* Less than 1%

(1) Except as otherwise indicated, the address of each beneficial owner is c/o Cano Petroleum, Inc., 309 West 7th Street, Suite 1600, Fort Worth, Texas 76102.

(2) Applicable percentage ownership is based on 25,056,621 shares of common stock issued as of November 14, 2005, together with shares of common stock issuable upon exercise of outstanding stock options described in footnotes 4, 5 and 6 below. Shares of common stock that a person has the right to acquire upon the exercise of stock options are deemed to be beneficially owned by the person holding such stock options for the purpose of computing the percentage of ownership of such person, but are not treated as outstanding for the purpose of computing the percentage ownership of any other person.

(3) Messrs. Johnson, Ricketts, Cochrane, and Dent were issued common shares as discussed below under Escrowed Shares Pursuant to the Davenport Merger.

(4) Mr. Teringo has the right to acquire 50,000 shares issuable upon exercise of outstanding stock options with an exercise price of $3.98 per share and which vest on July 11, 2006.

(5) Includes 25,000 shares issuable upon exercise of outstanding stock options with an exercise price of $4.13 per share and which vest on April 1, 2006, owned by each of Messrs. Dent, Haddock, Boyd, Underwood and Smith.

(6) Includes 50,000 shares issuable upon exercise of outstanding stock options with an exercise price of $4.00 per share.

(7) Wellington Management Company, llp, an investment adviser registered under the Investment Advisors Act of 1940, as amended, shares investment discretion and shares voting power over the securities held by certain of its investment advisory clients. In its capacity as an investment adviser, Wellington Management is deemed to have beneficial ownership over 3,450,000 shares after the offering and 1,350,000 shares before the offering. Their address is 75 State Street, Boston, Massachusetts 02109.

No Director, executive officer, affiliate or any owner of record or beneficial owner of more than 5% of any class of our voting securities is a party adverse to our business or has a material interest adverse to us.

Escrowed Shares Pursuant to the Davenport Merger

The Davenport Field Unit shareholders (Davenport Shareholders) comprise eight individuals - six who are now employed by us, one director, and one former employee. Pursuant to the terms of a Management Stock Pool Agreement, the 5,165,000 shares of common stock were placed in escrow. The shares vest to the individuals based on a combination of continued employment, referred to as compensation shares, and achieving certain performance goals during the next year, referred to as performance shares. Any shares that are not released from escrow will be returned to treasury stock. To date, shares returned to treasury totaled 15,783 shares.

The following table summarizes the shares placed in escrow under the Management Stock Pool Agreement:

	Compensation Shares	Performance Shares	Total Shares
Executive Davenport Shareholders			
S. Jeffrey Johnson	2,040,175	2,040,175	4,080,350
Michael J. Ricketts	232,425	232,425	464,850
Thomas D. Cochrane	232,425	232,425	464,850
Non-Executive Davenport Shareholders	154,950		154,950
Total Shares	**2,659,975**	**2,505,025**	**5,165,000**

The Management Stock Pool Agreement has the following terms:

In the event that any of the Davenport shareholders cease to be employees or director of Cano prior to May 28, 2006, all shares issued to such shareholder will be cancelled and returned to treasury.

The compensation shares issued to each Executive Davenport Shareholder were released to that Executive Davenport Shareholder on July 1, 2005.

The compensation shares issued to each Non-Executive Davenport Shareholder remaining in escrow will be released to that Non-Executive Davenport Shareholder on July 1, 2006.

The performance shares will be released to the Executive Davenport Shareholders as the following performance milestones are met:

in the event that we achieve both of the following performance milestones at June 30, 2006 one half of the performance shares issued to a particular Executive Davenport Shareholder are to be released from escrow:

We have proven reserves of not less than 2,833 MBOE, and

We have achieved a thirty day average barrel of oil per day production rate of not less than 1,521 barrels of oil per day.

In addition, in the event that we have proven reserves of not less than 3,777 MBOE at June 30, 2006 and have achieved for thirty days immediately prior to June 30, 2006, an average barrel of oil per day production rate of not less than 2,028 barrels of oil per day, all of the performance shares are to be released.

Any performance shares not released from escrow as per the above milestones will be returned to treasury on or before October 31, 2006.

Securities Authorized for Issuance Under Equity Compensation Plans

The following table shows information with respect to each equity compensation plan under which our common stock is authorized for issuance as of the fiscal year ended June 30, 2005.

EQUITY COMPENSATION PLAN INFORMATION

Plan category	Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)		Weighted average exercise price of outstanding options, warrants and rights (b)	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a) (c)
Equity compensation plans approved by security holders	-0-		-0-	-0-
Equity compensation plans not approved by security holders				
All Non-Employee Directors	125,000	$	4.13	525,000
Individual Director	50,000	$	4.00	50,000
Total	175,000	$	4.09	575,000

All Directors

During our March 2005 Board meeting, the directors approved our 2005 Directors Stock Option Plan. The

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purpose of the plan is to attract, retain and compensate highly qualified individuals who are not employees for service as members of the Board of Directors by providing them with competitive compensation and an ownership interest in our common stock. The plan became effective on April 1, 2005 and continues in effect for a term of ten years unless sooner terminated by the Board of Directors. The plan authorizes 150,000 shares of common stock which may be optioned and sold under the plan, plus an annual increase on the first day of each fiscal year beginning in 2005, 2006, 2007, 2008 and 2009 equal to the lesser of (a) 100,000 shares of common stock, (b) one-half of one percent (0.5%) of the shares of common stock outstanding on the last day of the immediately preceding fiscal year, or (c) such lesser number of shares as is determined by the Board of Directors. All options granted under the stock option plan will be nonstatutory options. In addition, options may be granted only to non-employee directors. Among other provisions, the plan grants to each non-employee director an option to purchase 25,000 shares upon initial appointment to the Board and subsequent annual options to purchase 25,000 shares. The exercise price of each option granted under the plan will equal 100% of the average of the fair market value per share of our common stock for the 20 trading days immediately preceding the date of grant of the option. The term of each option will be ten years unless sooner terminated in accordance with the plan.

To date, we have granted 25,000 options to each of our non-employee Directors under the Directors stock option plan: Donnie D. Dent, Gerald W. Haddock, Randall Boyd, Dr. Jim Underwood and Morris B. Sam Smith. Each of these options has an exercise price of $4.13 per share. The presently granted options vest on April 1, 2006 and expire on April 1, 2015.

Individual Director

Mr. Haddock agreed to provide certain management and financial consulting services to us. In consideration for such services, we granted Mr. Haddock options to purchase 50,000 shares of our common stock at an exercise price of $4.00 per share. Such options became exercisable six months from the grant date (the Vest Date) and expire ten years from the Vest Date. In addition, we may grant Mr. Haddock options (the Additional Options) to purchase an additional 50,000 shares of our common stock at an exercise price of $4.00 per share, exercisable for a period of ten years. The grant of the Additional Options is based upon the successful performance and additional value provided to us for consulting services, and shall be at the discretion of our Board of Directors.

DESCRIPTION OF SECURITIES

The following description of our capital stock is a summary and is qualified in its entirety by the provisions of our Articles of Incorporation, with amendments, all of which have been filed as exhibits to our registration statement of which this prospectus is a part.

Dividend Policy

Our proposed operations are capital intensive and we need working capital. Therefore, we will be required to reinvest any future earnings in our operations. Our Board of Directors has no present intention of declaring any cash dividends, as we expect to re-invest all profits in the business for additional working capital for continuity and growth. The future declaration and payment of dividends will be determined by our Board of Directors after considering the conditions then existing, including our earnings, financial condition, capital requirements, and other factors.

Capital Structure

Our Certificate of Incorporation authorizes the issuance of 50,000,000 shares of common stock, $.0001 par value per share, and 5,000,000 shares of preferred stock, $.0001 par value per share, of which 600 shares have been designated as Series A Convertible Preferred Stock, 8,000 shares have been designated as Series B Convertible Preferred Stock and 8,000 shares have been designated as Series C Convertible Preferred Stock. As of November 14, 2005, we had 25,056,621 and 25,040,838 shares of common stock issued and outstanding, respectively, and no shares of preferred stock issued and outstanding. The following summarizes the material terms of our capital stock.

Common Stock

Holders of shares of our common stock are entitled to one vote for each share on all matters to be voted on by our stockholders. Holders of our common

stock do not have cumulative voting rights. Holders of our common stock are entitled to share ratably in dividends, if any, as may be declared from time to time by our Board of Directors in their discretion from funds legally available therefore. In the event of a liquidation, dissolution or winding up of our business, the holders of our common stock are entitled to share pro rata all assets remaining after payment in full of all liabilities and any liquidation payment due to holders of our outstanding preferred stock. All of the outstanding shares of our common stock are fully paid and non-assessable.

Holders of our common stock have no preemptive rights to purchase our common stock. There are no conversion or redemption rights or sinking fund provisions with respect to our common stock.

Preferred Stock - General

Our Board of Directors is authorized to provide for the issuance of shares of preferred stock in series and, by filing a certificate pursuant to the applicable law, to establish from time to time the number of shares to be included in each such series, and to fix the designation, powers, preferences and rights of the shares of each such series and the qualifications, limitations or restrictions thereof without any further vote or action by the stockholders. Any shares of preferred stock so issued would have priority over the common stock with respect to dividend or liquidation rights. Any future issuance of preferred stock may have the effect of delaying, deferring or preventing a change in control without further action by the stockholders and may adversely affect the voting and other rights of the holders of common stock. The issuance of additional shares of preferred stock, or the issuance of rights to purchase such shares, could be used to discourage an unsolicited acquisition proposal. For instance, the issuance of a series of preferred stock might impede a business combination by including class voting rights that would enable the holder to block such a transaction, or facilitate a business combination by including voting rights that would provide a required percentage vote of the stockholders. In addition, under certain circumstances, the issuance of preferred stock could adversely affect the voting power of the holders of the common stock. Although our Board of Directors is required to make any determination to issue such stock based on its judgment as to the best interests of our stockholders, our Board of Directors could act in a manner that would discourage an acquisition attempt or other transaction that some, or a majority, of the stockholders might believe to be in their best interests or in which stockholders might receive a premium for their stock over the then market price of such stock. At present, we have no plans to issue any additional preferred stock nor adopt any series, preferences or other classification of preferred stock.

Series A Convertible Preferred Stock

We are currently authorized to issue 600 shares of Series A Convertible Preferred Stock. Each outstanding share of Series A Convertible Preferred Stock may be converted into shares of our common stock, at any time, on the basis of one share of preferred stock for that number of shares of common stock equal to $1,000 divided by the average closing bid price of our common stock for the five trading days immediately prior to the date of conversion, less a 25% discount. The Series A Convertible Preferred Stock does not pay dividends and carries no dividend preference or voting rights. As there is no limit on the number of shares of our common stock that could be issued upon conversion of outstanding Series A Convertible Preferred Stock, the lower the closing bid price of our common stock the greater number of shares of our common stock which could be issued upon conversion of our preferred stock. Accordingly, conversion of any Series A Convertible Preferred Stock that is outstanding could result in a change of control. In the event of a liquidation, dissolution or winding up of our business, the holders of Series A Convertible Preferred Stock are entitled to receive a liquidation amount of $1,000 per share after payment in full of liabilities.

Series B Convertible Preferred Stock

We are currently authorized to issue 8,000 shares of Series B Convertible Preferred Stock. The holders of Series B Convertible Preferred Stock are not entitled to receive any dividends. Except as required by Delaware law, the Series B Preferred Stock does not have any voting rights.

Each share of Series B Convertible Preferred Stock is convertible at any time while it is outstanding into 333 shares of our common stock. In the event we issue any shares of common stock during the 730 calendar days following the issuance date at a price less than $3.00 per share, the conversion rate will be adjusted to that number of shares of common stock equal to $1,000 divided by the price per share at which we issued the common stock.

In the event we fail to meet certain performance milestones, as defined in the Management Stock Pool Agreement dated May 28, 2004 with certain of our directors, officers and employees, or in the event that the terms of the Management Stock Pool Agreement are amended with the effect of reducing or eliminating the performance milestones, the conversion rate of the Series B Convertible Preferred Stock will be the greater of: (i) 333 shares of common stock for each one share of Series B Convertible Preferred Stock; or (ii) that number of shares of common stock equal to $1,000 divided by 75% of the average market price of our common stock for the five trading days immediately prior to the conversion date.

In the event of any liquidation, dissolution or winding up of our business, whether voluntary or involuntary, the Series B Convertible Preferred Stock ranks senior to our outstanding common stock and on parity with our outstanding Series C Convertible Preferred Stock, and holders of the Series B Convertible Preferred Stock are entitled to receive a preferential liquidation amount equal to $1,000 per share.

Series C Convertible Preferred Stock

We are currently authorized to issue 8,000 shares of Series C Convertible Preferred Stock. The holders of Series C Convertible Preferred Stock are not entitled to receive any dividends. Except as required by Delaware law, the Series C Preferred Stock does not have any voting rights.

Each share of Series C Convertible Preferred Stock is convertible at any time while it is outstanding into 266 shares of our common stock. In the event we issue any shares of common stock during the 730 calendar days following the issuance date at a price less than $3.75 per share, the conversion rate will be adjusted to that number of shares of common stock equal to $1,000 divided by the price per share at which we issued the common stock.

In the event we fail to meet certain performance milestones, as defined in the Management Stock Pool Agreement dated May 28, 2004 with certain of our directors, officers and employees, or in the event that the terms of the Management Stock Pool Agreement are amended with the effect of reducing or eliminating the performance milestones, the conversion rate of the Series C Convertible Preferred Stock will be the greater of: (i) 266 shares of common stock for each one share of Series C Convertible Preferred Stock; or (ii) that number of shares of common stock equal to $1,000 divided by 75% of the average market price of our common stock for the five trading days immediately prior to the conversion date.

In the event of any liquidation, dissolution or winding up of our business, whether voluntary or involuntary, the Series C Convertible Preferred Stock ranks senior to our outstanding common stock and on parity with our outstanding Series B Convertible Preferred Stock, and holders of the Series C Convertible Preferred Stock are entitled to receive a preferential liquidation amount equal to $1,000 per share.