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ISRAMCO INC  
Form 10-K/A  
October 17, 2006

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

FORM 10-K/A

(Amendment No. 1)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE  
ACT OF 1934 FOR THE FISCAL YEAR ENDED DECEMBER 31, 2005

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

COMMISSION FILE NUMBER: 0-12500

ISRAMCO, INC.

(Exact name of registrant as specified in its charter)

Delaware  
(State or Other Jurisdiction  
of Incorporation)

13-3145265  
IRS Employer Identification No.)

11767 KATY FREEWAY, HOUSTON, TX 77079  
(Address of Principal Executive Offices)

713-621-3882  
(Registrant's Telephone Number, including Area Code)

Securities registered under Section 12(b) of the Exchange Act: None

Securities registered under Section 12(g) of the Exchange Act:  
Common Stock, par value \$0.01  
(Title of Class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Securities Act of 1933. Yes  No

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

Indicate by check mark if disclosure of delinquent filers in response to Item 405 of Regulation S-K is not contained in this Form, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Large accelerated filer  Accelerated filer  Non-accelerated filer

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

As of March 23, 2006 there were 2,717,691 shares of the Registrant's common stock par value \$0.01 per share ("Common Stock") outstanding. The aggregate market value of the Common Stock held by non-affiliates of the Registrant at March 23, 2006 was approximately \$19.8 million. Such market value was calculated using the closing price of the Common Stock as of such date reported on the NASDAQ Market.

### DOCUMENTS INCORPORATED BY REFERENCE

The information called for in Items 10, 11, 12 and 13 in Part III are contained in the issuer's definitive proxy statement which the issuer filed with the Commission on May 1, 2006 and such information is incorporated herein by reference.

### EXPLANATORY NOTE

This Amendment No. 1 on Form 10-K/A (this "Amendment") amends the Annual Report on Form 10-K (the "Original Annual Report") for the year ended December 31, 2005, which was originally filed with the Securities and Exchange Commission (the "SEC") on March 24, 2006. The Registrant is filing this Amendment in response to a comment letter received from the SEC in connection with its review of the Original Annual Report. In response to the comment letter, we have included additional disclosures relating to (i) the registrant's effective tax rate for fiscal 2005 compared to fiscal 2004, included in Item 7 of this Amendment, (ii) quantitative and qualitative information with respect to foreign exchange rate, market and commodity price risks for certain investment and trading securities held by the registrant included in Item 7A of this Amendment, (iii) a discussion relating to the treatment of the registrant's interest in an affiliated entity included in Note A [19] to the financial statements accompanying this Amendment, (iv) a discussion relating to the treatment of certain derivative instruments included in Note G to the financial statements accompanying this Amendment. In addition, in response to the comment letter, the registrant has included (i) a revised report of its independent auditors opining on the registrant's 2004 financial statements, (ii) the audit reports for the year ended December 31, 2003 of other auditors of the registrant's subsidiaries on which the registrant's previous auditors relied and (iii) a revised Certifications (Exhibit 31).

Except as described above, the amendments included in this Amendment do not otherwise revise or restate the financial statements included in the Original Annual Report. In addition, except as described above, no attempt has been made in this Amendment to modify or update disclosures presented in the Original Annual Report. This Amendment does not reflect events occurring after the filing

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of the Original Annual Report or modify or update those disclosures. Accordingly, this Amendment should be read in conjunction with the registrants' filings with the SEC subsequent to the filing of the Original Annual Report.

### ISRAMCO, INC. 2004 FORM 10-K ANNUAL REPORT

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## FORWARD LOOKING STATEMENTS

CERTAIN STATEMENTS MADE IN THIS ANNUAL REPORT ON FORM 10-K ARE "FORWARD-LOOKING STATEMENTS" WITHIN THE MEANING OF THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995. FORWARD-LOOKING STATEMENTS CAN BE IDENTIFIED BY TERMINOLOGY SUCH AS "MAY", "WILL", "SHOULD", "EXPECTS", "INTENDS", "ANTICIPATES", "BELIEVES", "ESTIMATES", "PREDICTS", OR "CONTINUE" OR THE NEGATIVE OF THESE TERMS OR OTHER COMPARABLE TERMINOLOGY AND INCLUDE, WITHOUT LIMITATION, STATEMENTS BELOW REGARDING EXPLORATION AND DRILLING PLANS, FUTURE GENERAL AND ADMINISTRATIVE EXPENSES, FUTURE GROWTH, FUTURE EXPLORATION, FUTURE GEOPHYSICAL AND GEOLOGICAL DATA, GENERATION OF ADDITIONAL PROPERTIES, RESERVES, NEW PROSPECTS AND DRILLING LOCATIONS, FUTURE CAPITAL EXPENDITURES, SUFFICIENCY OF WORKING CAPITAL, ABILITY TO RAISE ADDITIONAL CAPITAL, PROJECTED CASH FLOWS FROM OPERATIONS, OUTCOME OF ANY LEGAL PROCEEDINGS, DRILLING PLANS, THE NUMBER, TIMING OR RESULTS OF ANY WELLS, INTERPRETATION AND RESULTS OF SEISMIC SURVEYS OR SEISMIC DATA, FUTURE PRODUCTION OR RESERVES, LEASE OPTIONS OR RIGHTS, PARTICIPATION OF OPERATING PARTNERS, CONTINUED RECEIPT OF ROYALTIES, AND ANY OTHER STATEMENTS REGARDING FUTURE OPERATIONS, FINANCIAL RESULTS, OPPORTUNITIES, GROWTH, BUSINESS PLANS AND STRATEGY. BECAUSE FORWARD-LOOKING STATEMENTS INVOLVE RISKS AND UNCERTAINTIES, THERE ARE IMPORTANT FACTORS THAT COULD CAUSE ACTUAL RESULTS TO DIFFER MATERIALLY FROM THOSE EXPRESSED OR IMPLIED BY THESE FORWARD-LOOKING STATEMENTS. ALTHOUGH THE COMPANY BELIEVES THAT EXPECTATIONS REFLECTED IN THE FORWARD-LOOKING STATEMENTS ARE REASONABLE, IT CANNOT GUARANTEE FUTURE RESULTS, PERFORMANCE OR ACHIEVEMENTS. MOREOVER, NEITHER THE COMPANY NOR ANY OTHER PERSON ASSUMES RESPONSIBILITY FOR THE ACCURACY AND COMPLETENESS OF THESE FORWARD-LOOKING STATEMENTS. THE COMPANY IS UNDER NO DUTY TO UPDATE ANY FORWARD-LOOKING STATEMENTS AFTER THE DATE OF THIS REPORT TO CONFORM SUCH STATEMENTS TO ACTUAL RESULTS.

## PART I

### ITEM 1. BUSINESS

#### GENERAL

Isramco, Inc. ("Isramco" or the "Company") is engaged in the exploration for and production of oil and gas in Israel and in the United States. In Israel, the Company holds a participation interest in two long-term off-shore leases and serves as the operator of one of those leases. See "Summary of exploration efforts in Israel".

In the United States, the Company, through its wholly-owned subsidiaries, Jay Petroleum LLC ("Jay Petroleum") and Jay Management LLC ("Jay Management"), is involved in oil and gas exploration and production in the United States. Jay Petroleum owns varying working interests in oil and gas wells in Louisiana, Texas, Oklahoma and Wyoming. Independent estimates of the reserves held by Jay Petroleum as of December 31, 2005 are approximately 106,638 net barrels of proved developed producing oil and 1,645 MMCFs of proved developed producing natural gas. See "Summary of Exploration Efforts in United States".

Isramco was incorporated in Delaware in 1982.

#### THE OPERATOR OF THE MED ASHDOD LEASE

The Company is currently the operator of the Med Ashdod Lease under a joint operating agreement (the "JOA") entered into among the participants in the lease. As operator, the Company carries out all the operations contemplated in the JOA, including directing the oil exploration and drilling activities of the

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venture, within the framework of work programs and budgets approved by the participants in the venture. The Company may be removed as operator for cause by notice in writing given by two or more of the other parties representing at least 65% of the total interests in the lease.

Under the JOA, each participant is responsible for the costs, expenses and obligations incurred in relation to the lease area in proportion to its rights and interests in the lease.

As operator, the Company charges the venture participant for all costs incurred in connection with the exploration and drilling activities conducted by the Med Ashdod venture and is entitled to receive a fee for its administrative overhead equal to 6% of all direct charges or minimum monthly compensation of \$6,000 per the lease. During the year ended December 31, 2005, the Company was paid a total of \$977,000 as operator fees.

With respect to the Med Yavne Lease, the Company furnishes to BG International Limited, a member of the British Gas Group ("BG"), the operator of the lease, consulting services of an administrative and technical nature for which it receives a monthly fee equal to \$10,000.

### GENERAL PARTNER OF THE ISRAMCO NEGEV 2 LIMITED PARTNERSHIP

In 1989 the Company transferred a substantial portion of its working interest in certain oil and gas assets in Israel to Isramco Negev 2 Limited Partnership, an Israeli limited partnership organized for the purpose of the exploration and the production of oil and gas in Israel (the "Limited Partnership") In exchange for the working interests, the Limited Partnership granted to the Company certain overriding royalties. In 1992, the Company transferred to the Limited Partnership additional rights in exchange for additional overriding royalties and reimbursement of expenses. The Company formed Isramco Oil and Gas Ltd. ("IOG"), an Israeli company and the company's wholly-owned subsidiary to act as the general partner for the Limited Partnership and also formed Isramco Management (1988) Ltd., an Israeli company and the company's wholly-owned subsidiary to act as the limited partner. The limited partner is the nominee of Limited Partnership units held by public investors in Israel.

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Pursuant to the Limited Partnership Agreement and the Trust Agreement, a supervisor was appointed on behalf of the Limited Partnership unit holders, with sole authority to appoint the sole director for Isramco Management (1988) Ltd. and to supervise its activities on behalf of and for the benefit of the Limited Partnership unit holders. Although control and management of the Limited Partnership rests with the general partner matters involving certain rights of the Limited Partnership unit holders are subject to the approval of the supervisor and in certain instances the approval of the Limited Partnership unit holders. The firm of Igal Brightman & Co., Accountants and Mr. David Valiano, Accountant have been appointed as supervisors.

Through IOG the Company currently receives a management fee of \$40,000 per month from the Limited Partnership for office space, management and other services.

The Company currently holds 6.65% of the issued Limited Partnership units and IOG holds an additional 0.008% of the Limited Partnership units. On December 31, 2005, the Limited Partnership had cash, cash equivalents, certificates of deposit and marketable securities with a value of approximately \$127 million.

Additionally, IOG (as the general partner of the Limited Partnership) is entitled to 5% overriding royalties in certain petroleum assets held by the

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Limited Partnership.

### NON-OIL AND GAS PROPERTIES

In June 2002, the Company purchased non-oil and gas producing real estate located in Israel at an aggregate cost of \$1,887,000. In January 2004, the Company entered into an agreement with a related entity pursuant to which the property was leased to such entity for a 24 month period at a monthly rent of \$7,000. On January 1, 2006, the Company entered into a new agreement with a related entity pursuant to which a significantly smaller part of the property is leased to such entity for a 24-month period at a monthly rent of \$550.

In March 2004, the Company purchased a luxury cruise liner for aggregate consideration of \$8,050,000. The vessel, a Bahamas registered ship, contains 270 passenger cabins on nine decks. The Company, through its wholly owned subsidiary, Magic 1 Cruise Line Corp., a British Virgin Island corporation leased the vessel to European based tour operator from April 2005 through October 2005.

In February 2006, the vessel was leased to the same tour operator for three specific periods. The first one is scheduled to commence on April 6, 2006 and terminate on November 5, 2006, the period thereafter to commence on March 29, 2007 and terminate on October 28, 2007 and the third period to commence on April 8, 2008 and terminate on November 7, 2008.

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### OIL AND GAS VENTURES AND PETROLEUM ASSETS

#### OIL AND GAS LEASES LOCATED IN ISRAEL

The table below sets forth the Working Interests of the Company and all affiliated and non-affiliated participants in the leases in Israel, the total acreage of each lease, and the expiration dates of each of the leases as of December 31, 2005. The Company also holds Overriding Royalties in the leases. See "Table of Overriding Royalties".

TABLE OF WORKING INTEREST  
IN THE LEASES (1)  
(% Interest of 100%)

| Name of Participant                      | Med Yavne Lease* | Med Ashdod Lease**(3) |
|--|------------------|-----------------------|
| The Company                              | 0.4584           | 0.3625                |
| Affiliates                               |                  |                       |
| Isramco Negev 2, Limited Partnership     | 32.411           | 19.1370               |
| I.O.C.                                   | 7.800            | 7.800                 |
| I.N.O.C. Dead Sea Limited Partnership    | --               | 5.0525                |
| Naphtha                                  | 1.8033           | --                    |
| Naphtha Explorations Limited Partnership | 2.2826           | 1.8411                |

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|                         |           |           |
|-------------------------|-----------|-----------|
| JOEL                    | 2.8807    | --        |
| Equital                 | 2.1639    | --        |
| Non-affiliated entities | 50.2      | 65.8069   |
| Total                   | 100.000   | 100.000   |
| Area (acres)            | 13,100    | 61,800    |
| Expiration Date (2)     | 6/10/2030 | 6/15/2030 |

\* The lease was granted in June 2000 and is scheduled to expire in June 2030.

\*\* The lease was granted in January 2002 and is scheduled to expire in June 2030.

(1) All of the oil and gas assets are subject to a 12.5% Overriding Royalty due to the Government of Israel under the Petroleum Law.

(2) The expiration dates are subject to the fulfillment of applicable provisions of the Israel Petroleum Law and Regulations, and the conditions and work obligations of each of the above leases.

(3) Under the Grant Agreement with the Government of Israel, the government may claim that the Company is contingently obligated to repay to the government the grant monies in the amount of \$110,000 and to pay a 6.5 % Overriding Royalty on all production from the area.

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### OVERRIDING ROYALTIES HELD BY THE COMPANY

The Company holds Overriding Royalties in certain oil and gas assets. Additionally, the Company is entitled to receive from certain participant in the Med Yavne and Med Ashdod leases overriding royalties equal to 2% of each such participant's rights to any oil/gas produced within those leases. The Company holds the following Overriding Royalties:

#### TABLE OF OVERRIDING ROYALTIES

From the Limited Partnership, on the first 10% of the Limited Partnership's share of the following leases

|                    | Before Payout<br>-----   | After Payout<br>----- |
|--------------------|--------------------------|-----------------------|
| Med Yavne Lease*   | 1%                       | 13%                   |
| Med Ashdod Lease** | 1%                       | 13%                   |
| From JOEL          | On 8% of JOEL's Interest |                       |

|                  | Before Payout<br>----- | After Payout<br>----- |
|------------------|------------------------|-----------------------|
| Med Ashdod Lease | 2.5%                   | 12.5%                 |

From Delek Oil Exploration Ltd.

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| (DOEX) (1) (2)   | On 6% of DOEX's Interest |                       |
|--|--------------------------|-----------------------|
|  | Before Payout<br>-----   | After Payout<br>----- |
| Med Ashdod Lease   | 2.5%                     | 12.5%                 |
| From Naphtha, Naphtha Exploration LP,<br>Joel, Equital, INOC Dead Sea L P<br>on oil and/or gas produced on the<br>Med Leases |                          | 2%                    |
| To IOC On Certain petroleum rights held by<br>Limited Partnership  |                          | 5%                    |

\* A 30 year lease covering an area of approximately 53 square kilometers (including the area of the gas discovery) was granted in June 2000.

\*\* A 30-year lease covering an area of approximately 250 square kilometers (including the area of the gas discovery) was granted in January 2002.

(1) The Working Interests of Delek and DOEX have been assigned to Delek Drilling Limited Partnership.

(2) The prospectus of the Delek Limited Partnership dated January 26, 1994 states that the interest which Delek L.P, received from Delek and DOEX is free from any encumbrances except that the Company may argue that the interests are subject to an Overriding Royalty. The Company has no information available to it as to why this statement is in the Delek L.P. prospectus.

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The Company has no direct financial obligation with regard to the Overriding Royalties, however, in the event the Limited Partnership, JOEL, DOEX or Delek, fails to fund its obligation with regard to the leases to which an Overriding Royalty exists, the Company could lose its interest in such Overriding Royalty . See also "Table of Working Interests" above.

SUMMARY OF EXPLORATION EFFORTS IN ISRAEL

MED YAVNE LEASE

Based on the gas finds known as "Or 1" and "Or South" , a 30 years lease was granted in June 2000 (hereinafter: the "Med Yavne Lease"). The Med Yavne Lease covers 53 square kilometers (approximately 13,000 acres) offshore Israel. The operator of the Med Yavne Lease is BG International Limited, a member of the British Gas Group ("BG").

According to the operator's estimates, which are based on the results of the drillings in the "Or 1" and "Or South" wells, and a three-dimensional seismic survey performed in the area of the lease which also covered parts of nearby gas reserves (outside the area of the lease), the recoverable gas reserves in the Med Yanve Lease is estimated at 93 billion cubic feet, out of which it is estimated that approximately 51 billion cubic feet are in Or 1. In November 2002, the Company received an opinion from a consulting firm in the United States that performed a techno-economic examination for the development of the "Or 1" reserve. The opinion indicates that, under certain assumptions, development of the reserve by connection to a nearby platform (at a distance of seven Miles) and from there via an existing transportation pipeline to the



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coast, may be economically feasible. In respect to the balance of the reserves (42 billions cubic feet) the Company does not currently believe that development is feasible or likely.

The Company's participation interest of the Med Yavne Lease is 0.4585%.

### MED ASHDOD LEASE

Following the results of "Nir 1" drilling, a 30 year lease was granted in January 2002. The Med Ashdod Lease covers approximately 250 square kilometers (approximately 62,000 acres) offshore Israel. The Company serves as the operator of the Med Ashdod Lease and holds a 0.3625% participation interest therein.

On February 28, 2005, the Company, on behalf of the Limited Partnership, a lease participant and an affiliate of the Company, issued a sole risk notice to the other participants in the lease to drill a gas well (the "Gad 1" well) to a total depth of 2,600 meter (8,350 feet) at a total budget of \$13 million. As a result of the sole risk notice, the rights of lease' participants who did not respond to the notice were transferred to the Limited Partnership as a result of which the Limited Partnership's interests in the Gad 1 well increased to 85.103%.

In August and September 2005, the Limited Partnership transferred a 40% working interests in the Gad 1 well to third parties. On September 25, 2005 the Gad 1 well was spudded. On November 16, 2005, the lease participants decided to plug and abandon the well. The total cost of the well was approximately \$16.4 million.

### SUMMARY OF EXPLORATION EFFORTS IN THE UNITED STATES

The Company, through its wholly-owned subsidiaries, Jay Petroleum LLC ("Jay Petroleum") and Jay Management LLC ("Jay Management"), is involved in oil and gas production in the United States. Jay Petroleum owns varying working interests in oil and gas wells in Louisiana, Texas, Oklahoma and Wyoming. Independent estimates of the reserves held by Jay Petroleum as of December 31, 2005 are approximately 106,368 net barrels of proved developed producing oil and 1,645 net MCFs of proved developed producing natural gas. Jay Management acts as the operator of certain of the producing oil and gas interests owned or acquired by Jay Petroleum.

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On November 1, 2005, Jay Petroleum purchased from Ness Energy International Inc., an oil and gas company based in Texas, a 15% working interests in certain Barnett Shale acreage in north central Texas (Parker County), for a purchase price of \$2.1 million. The purchase was financed from cash generated by operations. In addition, under the purchase agreement Jay Petroleum has the right to participate for up to 40% working interest in any well drilled by Ness in shallower formations from the surface to the top of the Barnett Shale. App. 80 locations for new development wells in the Barnett Shale have been so far identified in this acreage based on a 3D seismic survey. To date three gas wells have been drilled and completed to production in this acreage.

### NON-OIL AND GAS PROPERTIES

#### MIRAGE 1 CRUISE LINER

##### OVERVIEW

In March 2004, the Company purchased a luxury cruise liner (the "Vessel") for

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aggregate consideration of \$8,050,000. The Vessel, a Bahamas registered ship, contains 270 passenger cabins on nine decks. The Company leased the Vessel to tour operator for the period from April 4, 2005 through October 31, 2005 at a daily rate of \$8,000. Under the lease all maintenance and operating costs associated with the vessel were borne by the operator.

Title to the Vessel is in Magic 1 Cruise Line Corp., a British Virgin Islands corporation and a wholly owned subsidiary of the Company ("Magic"). As of December 31, 2005, the Company has expended approximately \$1.0 million in each of 2005 and 2004 in respect of the maintenance, repairs renovation, and upkeep of the vessel.

### CRUISE LINE BUSINESS

Cruise lines compete for consumers' leisure time spending with other vacation alternatives such as land-based resort hotels and sightseeing destinations. Demand for such activities is influenced by, among other things, geo-political and general economic conditions. The Company believes that cruise passengers currently represent only a small share of the vacation market and that a significant portion of cruise passengers carried are first-time cruisers.

The Company's principal operating strategy is to lease the Vessel through time charter or bareboat charter. Under a bareboat charter the lessee operates the vessel and solely bears all expenses associated with the operation, maintenance and upkeep of the vessel. Under a time charter the owner of the Vessel is responsible for those expenses and provides a crew. Under a time charter, the lessee is responsible for marketing, itinerary and providing all cruise line services to passengers. Generally, revenue from time charter is higher than with respect to bareboat charters.

Cruising season in the Mediterranean is generally from April to October. So long as the Vessel is leased for use in the Mediterranean, the Company anticipates that revenues from the lease of the vessel will remain seasonal. In May 2004, Magic entered into a time charter with an Israeli based tour operator for the period from July 1, 2004 through October, 2004 at a daily rate of \$21,500. The tour operator targeted the Israeli consumer market and promoted Vessel cruises to various destinations in the Mediterranean including Cyprus, Greek islands and Turkey.

In March 2005 Magic entered into a bareboat charter with a European based tour operator for the lease of the Vessel for the period from April 14, 2005 through October 31, 2005 at a daily rate of \$8,000. Under the bareboat charter the tour operator operated the Vessel in and around the Mediterranean and solely bore all outlays associated with the operation, maintenance and upkeep of the Vessel.

The Vessel was delivered by the Company to the operator on April 21, 2005 (due to necessary repairs which delayed the Vessel's delivery). Accordingly, it was agreed between the Company and the operator that the lease period was to commence on April 21, 2005 and conclude on October 27, 2005.

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Contemporaneous with its entry into the bareboat charter the tour operator entered into an agreement (the "Marketing Agreement") with a subsidiary of one of the leading transportation companies in Israel ("the "Marketing Party") pursuant to which the operator granted to the Marketing Party the exclusive marketing of the tours on the Vessel, and under which the operator is entitled to minimum payments from the Marketing Party.

In connection with the bareboat charter, on March 9, 2005, the Company furnished

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a limited guarantee (the "Guarantee") to and in favor of the Marketing Party, pursuant to which the Company undertook to indemnify the Marketing Party in an amount not exceeding \$1 million in respect of any loss or damage incurred by the Marketing Party arising out of the breach by the Operator of its obligations under the Marketing Agreement. To induce the Company to issue the Guarantee, the operator granted to the Company a security interest on all amounts due to it under the Marketing Agreement and agreed to provide the Company with a bank guarantee in the amount of \$600,000 (which will secure its obligations under the bareboat charter as well).

In February 2006, the Company entered into a bareboat charter with the same tour operator, pursuant to which the vessel is to be leased for three specific periods, with the first such period scheduled to commence on April 6, 2006 and terminate on November 5, 2006, the period thereafter to commence on March 29, 2007 and terminate on October 28, 2007 and the third period to commence on April 8, 2008 and terminating on November 7, 2008, at a daily rate of \$8,000. The operator may cancel the second charter period and the third charter period, by giving a written notice to the Company no later than November 1, 2006 and it may cancel the third charter period by giving a written notice to the Company no later than November 1, 2007.

### REGULATORY

The operation of the Vessel is subject to various international laws and regulations relating to environmental protection. Under such laws and regulations, the Company is prohibited from, among other things, discharging certain materials, such as petrochemicals and plastics, into the waterways. The Company has made, and will continue to make, capital and other expenditures to comply with environmental laws and regulations. From time to time, environmental and other regulators consider more stringent regulations which may affect operations and increase Company's compliance costs. The Company believes that the impact of cruise ships on the global environment will continue to be an area of focus by the relevant authorities throughout the world and, accordingly, this will likely subject to increasing compliance costs in the future.

The Company believes that The Company is in material compliance with all the regulations applicable to the Vessel and that have all licenses necessary to conduct our business. Health, safety, security and financial responsibility issues are, and believe will continue to be, an area of focus by the relevant government authorities. From time to time, various regulatory and legislative changes may be proposed that could impact our operations and would likely subject to increasing compliance costs in the future.

### REAL ESTATE IN ISRAEL

In June 2002, the Company purchased non oil and gas producing real estate located in Israel at an aggregate cost of \$1,887,000. As of December 1, 2004, the Company entered into an agreement with a related entity pursuant to which the property is leased to such entity for a 24 month period at a monthly rent of \$7,000 through December 31, 2005. On January 1, 2006, the Company entered into a new agreement with a related entity pursuant to which a significantly smaller part of the property is leased to such entity for a 24-month period at a monthly rent of \$550.

### EMPLOYEES

As of December 31, 2005, the Company had ten employees at its branch office in Israel and three employees in its office in Houston, Texas.

### RISK FACTORS

In addition to the other information contained in this Annual Report on Form

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10-K, investors should consider carefully the following risks. If any of these risks occurs, the Company's business, financial condition or operating results could be adversely affected.

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### RISKS RELATED THE COMPANY'S OIL AND GAS BUSINESS

#### OIL AND GAS DRILLING IS A SPECULATIVE ACTIVITY AND RISKY

The Company is engaged in the business of oil and natural gas exploration and the resulting development of productive oil and gas wells. The Company's growth will be materially dependent upon the success of its future drilling program. Drilling for oil and gas involves numerous risks, including the risk that no commercially productive oil or natural gas reservoirs will be encountered. The cost of drilling, completing and operating wells is substantial and uncertain, and drilling operations may be curtailed, delayed or cancelled as a result of a variety of factors beyond the Company's control, including unexpected drilling conditions, pressure or irregularities in formations, equipment failures or accidents, adverse weather conditions, compliance with governmental requirements and shortages or delays in the availability of drilling rigs or crews and the delivery of equipment. Although the Company believes that its use of 3-D seismic data and other advanced technology should increase the probability of success of its wells and should reduce average finding costs through elimination of prospects that might otherwise be drilled solely on the basis of 2-D seismic data and other traditional methods, drilling remains an inexact and speculative activity. In addition, the use of 3-D seismic data and such technologies requires greater pre-drilling expenditures than traditional drilling strategies and the Company could incur losses as a result of such expenditures. The Company's future drilling activities may not be successful and, if unsuccessful, such failure could have an adverse effect on the Company's future results of operations and financial condition. Although the Company may discuss drilling prospects that have been identified or budgeted for, the Company may ultimately not lease or drill these prospects within the expected time frame, or at all. The Company may identify prospects through a number of methods, some of which do not include interpretation of 3-D or other seismic data. The drilling and results for these prospects may be particularly uncertain. The final determination with respect to the drilling of any scheduled or budgeted wells will be dependent on a number of factors, including (i) the results of exploration efforts and the acquisition, review and analysis of the seismic data, (ii) the availability of sufficient capital resources to the Company and the other participants for the drilling of the prospects, (iii) the approval of the prospects by other participants after additional data has been compiled, (iv) economic and industry conditions at the time of drilling, including prevailing and anticipated prices for oil and natural gas and the availability of drilling rigs and crews, (v) the Company's financial resources and results (vi) the availability of leases and permits on reasonable terms for the prospects and (vii) the payment of royalties to lessors. There can be no assurance that these projects can be successfully developed or that the wells discussed will, if drilled, encounter reservoirs of commercially productive oil or natural gas. There are numerous uncertainties in estimating quantities of proved reserves, including many factors beyond the Company's control.

THE OIL AND NATURAL GAS RESERVE DATA INCLUDED IN THIS REPORT ARE ONLY ESTIMATES AND MAY PROVE TO BE INACCURATE.

There are numerous uncertainties inherent in estimating oil and natural gas reserves and their estimated values. The reserve data in this report represent only estimates that may prove to be inaccurate because of these uncertainties. Estimates of economically recoverable oil and natural gas reserves depend upon a

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number of variable factors, such as historical production from the area compared with production from other producing areas and assumptions concerning effects of regulations by governmental agencies, future oil and natural gas prices, future operating costs, severance and excise taxes, development costs and workover and remedial costs, some or all of these assumptions may in fact vary considerably from actual results. For these reasons, estimates of the economically recoverable quantities of oil and natural gas attributable to any particular group of properties, classifications of such reserves based on risk of recovery, and estimates of the future net cash flows expected therefrom prepared by different engineers or by the same engineers but at different times may vary substantially. Accordingly, reserve estimates may be subject to downward or upward adjustment. Actual production, revenue and expenditures with respect to the Company's reserves will likely vary from estimates, and such variances may be material.

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THERE IS A POSSIBILITY THAT THE COMPANY WILL LOSE THE LEASES TO ITS OIL AND GAS PROPERTIES.

The Company's oil and gas revenues are generated through leases to the oil and gas properties or, in the case of Israeli based properties, licenses that, subject to certain conditions, may result in leases being granted. The leases are subject to certain obligations and are renewable at the discretion of various governmental authorities, as such, the Company may not be able to fulfill its obligations under the leases which may result in the modification or cancellation of such leases, or such leases may not be renewed or may be renewed on terms different from the current leases. The modification or cancellation of the Company's leases may have a material impact on the Company's revenues.

COMPETITION IN THE INDUSTRY MAY IMPAIR THE COMPANY'S ABILITY TO EXPLORE, DEVELOP AND COMMERCIALIZE ITS OIL AND GAS PROPERTIES.

The oil and natural gas industry is very competitive. Competition is particularly intense in the acquisition of prospective oil and natural gas properties and oil and gas reserves. The Company competes with a substantial number of other companies having larger technical staffs and greater financial and operational resources. Many such companies not only engage in the acquisition, exploration, development and production of oil and natural gas reserves, but also carry on refining operations, electricity generation and the marketing of refined products. The Company also competes with major and independent oil and gas companies in the marketing and sale of oil and natural gas, and the oil and natural gas industry in general competes with other industries supplying energy and fuel to industrial, commercial and individual consumers. The Company competes with other oil and natural gas companies in attempting to secure drilling rigs and other equipment necessary for drilling and completion of wells. Such equipment may be in short supply from time to time.

THE COMPANY'S BUSINESS MAY BE AFFECTED BY OIL AND GAS PRICE VOLATILITY.

Historically, natural gas and oil prices have been volatile. These prices rise and fall based on changes in market demand and changes in the political, regulatory and economic climate and other factors that affect commodities markets that are generally outside of the Company's control. Some of the Company's projections and estimates are based on assumptions as to the future prices of natural gas and crude oil. These price assumptions are used for planning purposes. The Company expects that its assumptions will change over time and that actual prices in the future may differ from its estimates. Any substantial or extended decline in the actual prices of natural gas and/or crude

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oil may have a material adverse effect on the Company's financial position and results of operations (including reduced cash flow and borrowing capacity), the quantities of natural gas and crude oil reserves that it can economically produce and the quantity of estimated proved reserves that may be attributed to its properties

THE COMPANY HAS NO MEANS TO MARKET ITS OIL AND GAS PRODUCTION WITHOUT THE ASSISTANCE OF THIRD PARTIES.

The marketability of the Company's production depends upon the proximity of its reserves to, and the capacity of, facilities and third party services, including oil and natural gas gathering systems, pipelines, trucking or terminal facilities, and processing facilities. The unavailability or lack of capacity of such services and facilities could impair or delay the production of new wells or the delay or discontinuance of development plans for properties. A shut-in or delay or discontinuance could adversely affect the Company's financial condition. In addition, regulation of oil and natural gas production transportation in the United States or in other countries may affect its ability to produce and market its oil and natural gas on a profitable basis.

THE COMPANY IS SUBJECT TO RISKS ASSOCIATED WITH INTERNATIONAL OPERATIONS.

The Company conducts business from its facilities in Israel and the United States. Its international operations and activities subject the Company to a number of risks, including the risk of political and economic instability, difficulty in managing foreign operations, potentially adverse taxes, higher expenses and difficulty in collection of accounts receivable. Although the Company Israeli subsidiary receives most of its operating funds in U.S. dollars, a portion of its payroll and other expenses and certain of its investments are fixed in the currency of Israel. Because the Company's financial results are reported in U.S. dollars, they are affected by changes in the value of the various foreign currencies that the Company uses to make payments in relation to the U.S. dollar.

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THE COMPANY'S OPERATIONS MAY BE IMPACTED BY CERTAIN RISKS COMMON IN THE INDUSTRY.

The Company's exploration and drilling operations are subject to various risks common in the industry, including cratering, explosions, fires and uncontrollable flows of oil, gas or well fluids. The drilling operations are also subject to the risk that no commercially productive natural gas or oil reserves will be encountered. The cost of drilling, completing and operating wells is often uncertain, and drilling operations may be curtailed, delayed or canceled as a result of a variety of factors, including drilling conditions, pressure or irregularities in formations, equipment failures or accidents and adverse weather conditions.

In accordance with industry practice, the Company maintains insurance against some, but not all, of the risks described above. The Company cannot provide assurance that its insurance will be adequate to cover losses or liabilities. Also, it cannot predict the continued availability of insurance at premium levels that justify its purchase.

GOVERNMENT REGULATION AND LIABILITY FOR ENVIRONMENTAL MATTERS MAY ADVERSELY AFFECT THE COMPANY'S BUSINESS AND RESULTS OF OPERATIONS.

Oil and natural gas operations are subject to various federal, state and local

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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. In addition, the Company may be liable for environmental damages caused by previous owners of property it purchases or leases. As a result, the Company may incur substantial liabilities to third parties or governmental entities. The Company is also subject to changing and extensive tax laws, the effects of which cannot be predicted. The implementation of new, or the modification of existing, laws or regulations could have a material adverse effect on the Company's business.

### RISKS RELATED TO THE VESSEL

THE DESIGNATION OF THE VESSEL AS AN `ISRAELI VESSEL' COULD INCREASE THE COST OF OPERATING THE VESSEL AND MAY POTENTIALLY REDUCE THE INCOME FROM LEASING THE VESSEL.

In January 2005, Israeli authorities advised Naphtha Israel Petroleum Corp. that in their view the Vessel qualified as an Israeli vessel (notwithstanding its foreign registration and ownership) as Naphtha holds 49.8% of the issued and outstanding shares of the Company. Consequently, the authorities contend that certain Israeli maritime rules and regulations govern the Vessel and its operations. These rules impose certain requirements as to operation of the vessel and require among other things that the vessel be staffed by Israeli crew, satisfy certain security requirements and allow for the mobilization of the Vessel by the Israeli authorities during periods of war or hostilities.

In February 2005 Naphtha applied to the Israeli high court for a declaratory order that the Vessel is not an Israeli vessel. In the event that the Israeli court declines to grant Naphtha's application, the operating costs of the Vessel will increase and result in a reduction of potential charter (lease) opportunities for exploitation of the Vessel. In March 2005, Naphtha was advised that under a 'bareboat charter' the authorities will not deem the vessel to be an Israeli vessel.

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As of the filing of the annual report on Form 10-K, the Company cannot determine the outcome of the matter.

A POTENTIAL LOSS OF BUSINESS DUE TO COMPETITORS THROUGHOUT THE VACATION MARKET.

The Company faces significant competition from other cruise lines, in terms of the types of ships and services. Additionally, oceanline cruises are only one of many alternatives for people choosing a vacation. Therefore risk losing potential lessors of the Vessel due to competition from other cruise lines and also due to other vacation operators that provide other travel and leisure options, including hotels, resorts and package holidays and tours. Any failure to lease the Vessel for a significant period of time may adversely affect Company's results of operations and financial condition.

THE POLITICAL AND ECONOMIC CLIMATE AND OTHER WORLD EVENTS AFFECTING

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SAFETY AND SECURITY COULD ADVERSELY AFFECT THE DEMAND FOR CRUISES AND COULD HARM THE FUTURE LEASING AND PROFITABILITY.

Demand for cruises and other vacation options has been, and is expected to continue to be, affected by the public's attitude towards the safety of travel, the international political climate and the political climate of destination countries. Events such as the terrorist attacks in the U.S. on September 11, 2001 and the instability in much of the Mediterranean region (the region in which our Vessel operates) and the threats of attacks in the Mediterranean and elsewhere, concerns of an outbreak of additional hostilities, national government travel advisories, the resulting political instability and concerns over safety and security aspects of traveling, have had a significant adverse impact on demand and pricing in the travel and vacation industry and may continue to do so in the future. Demand for cruises is also likely to be increasingly dependent on the underlying economic strength of the countries from which cruise companies source their passengers. Economic or political changes that reduce disposable income or consumer confidence in the countries may affect demand for vacations, including cruise vacations, which are a discretionary purchase. Decreases in demand could adversely affect our ability to lease the Vessel and negatively affect profitability.

ACCIDENTS AND OTHER INCIDENTS OR ADVERSE PUBLICITY CONCERNING THE CRUISE INDUSTRY AND COULD AFFECT COMPANY'S REPUTATION AND HARM FUTURE LEASING AND PROFITABILITY.

The operation of cruise ships involves the risk of accidents, passenger and crew illnesses, mechanical failures and other incidents at sea or while in port, which may bring into question passenger safety, health, security and vacation satisfaction and thereby adversely effect future industry performance, sales and profitability. It is possible that these factors could adversely affect our leasing ability or existing charter, which would have an adverse affect on profitability. In addition, adverse publicity concerning the vacation industry in general or the cruise industry or us in particular could affect our reputation and impact demand and, consequently, have an adverse affect on our profitability.

NEW REGULATIONS OF HEALTH, SAFETY, SECURITY, ENVIRONMENTAL AND OTHER REGULATORY ISSUES COULD INCREASE COMPANY'S OPERATING COSTS AND ADVERSELY AFFECT NET INCOME.

The Company is subject to various international, national, state and local health, safety and security laws, regulations and treaties. We believe that health, safety, security and other regulatory issues will continue to be areas of focus by relevant government authorities. Resulting legislation or regulations, or changes in existing legislation or regulations, could impact Company's operations and would likely subject to increasing compliance costs in the future.

PROBLEMS ENCOUNTERED AT PORTS COULD REDUCE COMPANY'S PROFITABILITY.

Industrial actions and insolvency or financial problems of the ports where the Vessel is docked could adversely affect Company's profitability.

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### RISKS RELATED TO OPERATIONS GENERALLY

THE COMPANY IS SUBJECT TO RISKS ASSOCIATED WITH OPERATIONS IN ISRAEL.

The Company is involved in oil and gas exploration activities in Israel as



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operator of certain offshore licenses or otherwise. The Company also purchased significant non-oil and gas real-estate properties in Israel. The Company also maintains a significant presence within Israel. Accordingly, a significant portion of the Company's business is directly affected by prevailing economic, military and political conditions that affect Israel. Any major hostilities involving Israel might have a material adverse effect on the Company's business, financial condition or results of operations.

THE COMPANY'S STOCK PRICE IS VOLATILE AND COULD CONTINUE TO BE VOLATILE.

Investor interest in the Company's common stock may not lead to the development of an active or liquid trading market. The market price of the Company's common stock has fluctuated in the past and is likely to continue to be volatile and subject to wide fluctuations. In addition, the stock market has experienced extreme price and volume fluctuations. The stock prices and trading volumes for the Company's stock has fluctuated widely and may continue to do so for reasons that may be unrelated to business or results of operations. General economic, market and political conditions could also materially and adversely affect the market price of the Company's common stock and investors may be unable to resell their shares of common stock at or above their purchase price.

PENNY STOCK REGULATIONS ARE APPLICABLE TO INVESTMENT IN SHARES OF THE COMPANY'S COMMON STOCK.

Broker-dealer practices in connection with transactions in "penny stocks" are regulated by certain penny stock rules adopted by the Securities and Exchange Commission. Penny stocks generally are equity securities with a price of less than \$5.00 (other than securities registered on certain national securities exchanges or quoted on the Nasdaq system, provided that current prices and volume information with respect to transactions in such securities are provided by the exchange or system). The penny stock rules require a broker-dealer, prior to a transaction in a penny stock not otherwise exempt from the rules, to deliver a standardized risk disclosure document that provides information about penny stocks and the risks in the penny stock market. The broker-dealer also must provide the customer with current bid and offer quotations for the penny stock, the compensation of the broker-dealer and its salesperson in the transaction, and monthly account statements showing the market value of each penny stock held in the customer's account. In addition, the penny stock rules generally require that prior to a transaction in a penny stock the broker-dealer make a special written determination that the penny stock is a suitable investment for the purchaser and receive the purchaser's written agreement to the transaction. These disclosure requirements may have the effect of reducing the level of trading activity in the secondary market for a stock that becomes subject to the penny stock rules. Many brokers will not deal with penny stocks; this restricts the market.

### ITEM 2. PROPERTIES

The Company maintains offices in Houston, Texas. The Company leases office space premises (approximately 2,015 square feet) at 11767 Katy Freeway, Houston, TX 77079 under a lease expiring in October 2006 at a monthly rental of \$2,508. The Company anticipates that it will be able to extend the lease, or find replacement premises, on commercially reasonable terms.

The Company also leases office space in Israel from Naphtha at 8 Granit St., Petach Tikva, Israel. In 2005, the Company paid Naphtha an aggregate of \$235,000 for rental space, office services, secretarial services and computer services. The Company believes that the payment for the above services are reasonable compared to other similar locations.

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### ITEM 3. LEGAL PROCEEDING

From time to time, the Company is involved in disputes and other legal actions arising in the ordinary course of business. In management's opinion, none of these other disputes and legal actions is expected to have a material impact on the Company's consolidated financial position or results of operations.

#### RECENT DEVELOPMENT

On January 20, 2006 the "Company entered into a settlement agreement and mutual release (the "California Settlement") with the defendant parties named therein (the "California Defendants") relating to the lawsuit initiated by the Company against the Defendants on February 10, 2004 in the Superior Court of California, County of Los Angeles, alleging breach of contract and tort claims in connection with an agreement between the Company and the California Defendants to jointly purchase and develop certain parcels of real estate outside Los Angeles (the "California Action"). The California Settlement provides for the settlement of the California Action with no finding or admission of fault on the part of any party and, pursuant thereto, certain of the California Defendant paid to the Company \$2,500,000 as reimbursement for costs and expenses incurred by the Company in connection with its pursuit of the real estate investment opportunity that was the subject of the California Action. Under the California Settlement, the Company and the California Defendants mutually released one another from any claims or causes of actions arising out of or relating to the California Action, any claim that could have been asserted in the California Action, and any and all claims and/or allegations relating to the real estate (and the development thereof) that was the subject of the California Action.

On February 1, 2006 the Company entered into a settlement agreement and mutual release (the "Texas Settlement") with the defendant parties named therein (The "Texas Defendants") relating to the lawsuit initiated by the Company against the Texas Defendants on 2004 in the District court of Harris County, Texas, alleging a tort claim in connection with an agreement between the Company and a third Party pursuant to which the Company purchased all of the outstanding capital stock of a company that owns oil and gas assets in Illinois (the "Texas Action"). Under the Texas Settlement the Texas Defendants paid to the Company \$550,000 and the Company filed a motion to dismiss the Texas Action. As a result of the payment received under the California and Texas Settlements, the Company anticipates recording a net gain of approximately \$2,500,000 (after payment of legal fees and other expenses) during the first quarter of 2006.

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

During the fourth quarter of the fiscal year covered by this report, no matter was submitted to a vote of security holders of the Company.

## PART II

### ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

The number of record holders of the Company's Common Stock on March 23, 2006 was approximately 456, not including an undetermined number of persons who hold their stock in street name.

Our common stock is listed on the Nasdaq Capital Market under the symbol "ISRL". The following table sets forth for the periods indicated, the reported high and low closing prices for our common stock.

| Quarter Ended | Common Stock |     |
|---------------|--------------|-----|
|               | High         | Low |

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|              |          |          |
|--------------|----------|----------|
| -----        | -----    | -----    |
| 2005         |          |          |
| March 31     | \$ 8.99  | \$ 8.72  |
| June 30      | \$ 10.93 | \$ 9.60  |
| September 30 | \$ 15.09 | \$ 14.27 |
| December 31  | \$ 15.27 | \$ 14.91 |
| 2004         |          |          |
| March 31     | \$ 7.59  | \$ 7.01  |
| June 30      | \$ 6.50  | \$ 6.40  |
| September 30 | \$ 6.08  | \$ 6.08  |
| December 31  | \$ 5.28  | \$ 5.24  |

The Company has not declared or paid any cash dividends on its Common Stock. The Company does not anticipate paying any cash dividends on its Common Stock in the foreseeable future. The Company intends to retain all earnings for use in its business operations and in expansion.

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ITEM 6. SELECTED FINANCIAL DATA (CONSOLIDATED)

The data presented below with respect to the Company should be read in conjunction with the Consolidated Financial Statements and related Notes thereto of the Company included elsewhere in this Report and Item 7-- "Management's Discussion and Analysis of Financial Condition and Results of Operations." (in Thousands)

|  | 2005       | 2004     | 2003  |
|--|------------|----------|-------|
|  | -----      | -----    | ----- |
| Operator's fees  | \$ 977     | \$ 137   | \$    |
| Oil and Gas Sales                                      | \$ 3,319   | \$ 3,137 | \$ 3, |
| Revenue from vessel                                    | \$ 1,520   | \$ 2,034 |       |
| Interest income  | \$ 293     | \$ 729   | \$    |
| Office services to related parties and other           | \$ 912     | \$ 772   | \$    |
| Equity in earnings (losses) of investees               | \$ 661     | \$ 1,365 | \$ 1, |
| Gain from sale of oil and gas properties and equipment |            |          |       |
| Capital Gain   | --         | --       | \$    |
| Gain (Loss) on marketable securities                   | \$ 551     | \$ 240   | \$    |
| Other  | \$ (524)   | \$ 492   | \$    |
| Impairment of oil & gas properties                     | \$ 759     | \$ 268   | \$    |
| Impairment of Investment                               | \$ 110     | --       |       |
| Exploration costs                                      | --         | --       | \$    |
| Lease operating expenses and severance                 |            |          |       |
| Taxes  | \$ 1,458   | \$ 1,149 | \$    |
| Depreciation, depletion and Amortization               | \$ 2,139   | \$ 1,334 | \$    |
| Operator expense                                       | \$ 767     | \$ 807   | \$    |
| General and administrative expenses                    | \$ 2,314   | \$ 1,717 | \$ 2, |
| Interest Expense                                       | \$ 205     | \$ 168   | \$    |
| Accretion Expense                                      | \$ 25      | \$ 5     | \$    |
| Income tax expense (benefit)                           | \$ (40)    | \$ (576) | \$ 1, |
| Net Income (loss) before cumulative effect             | \$ (1,132) | \$ 993   | \$ 2, |
| Cumulative effect of change in accounting principles   | --         | --       | \$ (  |
| Basic and diluted earnings (loss) per share for:       |            |          |       |
| Net income (loss) before cumulative effect             | \$ (0.42)  | \$ 0.38  | \$ 0  |
| Cumulative effect of accounting change, net            |            | --       | \$ (0 |
| Net income (loss)                                      | \$ (0.42)  | \$ 0.38  | \$ 0  |

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|   |           |           |        |
|---|-----------|-----------|--------|
| Weighted average number of<br>Common shares outstanding - basic   | 2,709,355 | 2,639,853 | 2,639, |
| Weighted average number of<br>Common shares outstanding - diluted | 2,709,355 | 2,640,751 | 2,639, |

|                      | December  |           |        |
|----------------------|-----------|-----------|--------|
|                      | 2005      | 2004      | 2003   |
| Balance Sheet Data   |           |           |        |
| Total assets         | \$ 38,615 | \$ 41,358 | \$ 32, |
| Total liabilities    | \$ 10,122 | \$ 11,322 | \$ 2,  |
| Shareholders' equity | \$ 28,493 | \$ 30,036 | \$ 29, |

### ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

THE FOLLOWING COMMENTARY SHOULD BE READ IN CONJUNCTION WITH THE CONSOLIDATED FINANCIAL STATEMENTS AND RELATED NOTES CONTAINED ELSEWHERE IN THIS FORM 10-K. THE DISCUSSION CONTAINS FORWARD-LOOKING STATEMENTS THAT INVOLVE RISKS AND UNCERTAINTIES. THESE STATEMENTS RELATE TO

FUTURE EVENTS OR OUR FUTURE FINANCIAL PERFORMANCE. IN SOME CASES, YOU CAN IDENTIFY THESE FORWARD-LOOKING STATEMENTS BY TERMINOLOGY SUCH AS "MAY," "WILL," "SHOULD," "EXPECT," "PLAN," "ANTICIPATE," "BELIEVE," "ESTIMATE," "PREDICT," "POTENTIAL," "INTEND," OR "CONTINUE," AND SIMILAR EXPRESSIONS. THESE STATEMENTS ARE ONLY PREDICTIONS. OUR ACTUAL RESULTS MAY DIFFER MATERIALLY FROM THOSE ANTICIPATED IN THESE FORWARD-LOOKING STATEMENTS AS A RESULT OF A VARIETY OF FACTORS, INCLUDING, BUT NOT LIMITED TO, THOSE SET FORTH UNDER "RISK FACTORS" AND ELSEWHERE IN THIS FORM 10-K.

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#### OVERVIEW

Isramco, Inc., a Delaware corporation, is active in the exploration of oil and gas in Israel and the United States. The Company acts as an operator of certain leases and licenses and also holds participation interests in certain other interests. The Company also holds certain non-oil and gas properties discussed below.

#### CRITICAL ACCOUNTING POLICIES

Estimation of oil and gas reserves is important to the effective management of the Company. They are integral to making investment decisions about oil and gas properties such as whether development should proceed or enhanced recovery methods should be undertaken. Oil and gas reserve quantities are also used as the basis of calculating the unit-of-production rates for depreciation and evaluating for impairment. Oil and gas reserves are divided between proved and unproved reserves. Proved reserves are the 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; i.e., prices and costs as of the date the estimate is made. Unproved reserves are those with

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less than reasonable certainty of recoverability and are classified as either probable or possible.

The estimation of proved reserves is an ongoing process based on rigorous technical evaluations and extrapolations of well information such as flow rates and reservoir pressure declines. Although the company is reasonably certain that proved reserves will be produced, the timing and amount recovered can be affected by a number of factors including completion of development projects, reservoir performance, regulatory approvals and significant changes in long-term oil and gas price levels.

The calculation of unit-of-production depreciation is a critical accounting estimate that measures the depreciation of upstream assets. It is the ratio of (1) actual volumes produced to (2) total proved developed reserves (those proved reserves recoverable through existing wells with existing equipment and operating methods) applied to the (3) asset cost. The volumes produced and asset costs are known and, while proved developed reserves have a high probability of recoverability, they are based on estimates that are subject to some variability.

Our cruise line operation is capital intensive. At December 31, 2005, we have approximately \$8.5 million of net investment in the vessel recorded on our balance sheet. We depreciate our assets on a straight-line basis over their estimated useful lives. The estimates of the useful lives are based on the nature of the assets as well as our current operating strategy. Future events, such as property expansions, new competition and new regulations, could result in a change in the manner in which we are using certain assets requiring a change in the estimated useful lives of such assets. In assessing the recoverability of the carrying value of property and equipment, we must make assumptions regarding estimated future cash flows and other factors. If these estimates or the related assumptions change in the future, we may be required to record impairment charges for these assets.

The Company records an investment impairment charge when it believes an investment has experienced a decline in value that is other than is temporary. Future adverse changes in market conditions or poor operating results of underlying investments could result in losses or an inability to recover the carrying value of the investment that may not be reflected in an investment's current carrying value, thereby possibly requiring an impairment charge in the future.

The Company records a valuation allowance to reduce its deferred tax assets to the amount that is more likely than not to be realized. While the Company has considered future taxable income and ongoing prudent and feasible tax planning strategies in assessing the need for the valuation allowance, in the event that the Company were to determine that it would be able to realize its deferred tax assets in the future in excess of its net recorded amount, an adjustment to the deferred tax asset would increase net income in the period such determination was made.

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The Company does not participate in, nor has it created, any off-balance sheet special purpose entities or other off-balance sheet financing. In addition, the Company does not enter into any derivative financial instruments.

The Company records a liability for asset retirement obligation at fair value in the period in which it is incurred and a corresponding increase in the carrying amount of the related long live assets.

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### LIQUIDITY AND CAPITAL RESOURCES

The Company finances its operations primarily from cash generated by operations. The Company's operating activities provided net cash of \$1,545,000 and \$1,573,000 for the years ended December 31, 2005 and 2004, respectively. The availability of cash generated by operations could be affected by other business risks discussed in the "Risk Factors" section of this annual report.

Working capital (current assets minus current liabilities) was \$4,441,000 and \$6,590,000 at December 31, 2005 and 2004, respectively. The decrease in working capital is primarily attributable to the purchase of oil and gas assets, participation in drilling of two wells in United States and investments in repairs and renovation of the cruise line vessel. Net cash used in investing activities in fiscal 2005 was \$741,000 compared to \$8,195,000 in fiscal 2004. The decrease in net cash used in investing activities is primarily attributable to the purchase in March 2004 and maintenance, repairs and renovation of the Vessel (\$9,028,000) and the outlays associated with the drilling of wells in Texas and Oklahoma (\$1,096,000), offset by the increase in the value of marketable securities. The cash used in investing activities in 2005 was primarily attributable to purchase of oil and gas properties.

Capital expenditures for property and equipment were \$4,703,000 and \$10,126,000 in fiscal 2005 and 2004, respectively. Capital expenditures in 2005 were primarily attributable to purchase of oil and gas properties in the United States. Capital expenditures in 2004 were primarily attributable to purchase of the cruise line Vessel.

### RESULTS OF OPERATIONS

YEAR ENDED DECEMBER 31, 2005 COMPARED TO YEAR ENDED DECEMBER 31, 2004.

The Company reported net loss before cumulative effect of \$1,132,000 (loss of \$0.42 per share) in 2005 compared to a net profit of \$993,000 (loss of \$0.38 per share) in 2004. The decrease in the net income in 2005 compared to 2004 is primarily attributable to: (i) an increase in losses associated with the operation of the vessel, (ii) an increase in the impairment of oil and gas assets, (iii) an increase in lease operation expenses of the wells in the United States and (iv) an increase in the general and administration expenses.

Set forth below is a break-down of these results.

#### UNITED STATES

#### OIL AND GAS VOLUME AND REVENUES (IN THOUSANDS)

|                       | 2005  | 2004  |
|-----------------------|-------|-------|
|                       | ----- | ----- |
| Oil Volume Sold (Bbl) | 16    | 18    |
| Gas Volume Sold (MCF) | 355   | 470   |
| Oil Sales (\$)        | 806   | 678   |
| Gas Sales (\$)        | 2,525 | 2,524 |
| Average Unit Price    |       |       |
| Oil (\$/Bbl) *        | 51.25 | 38.12 |
| Gas (\$/MCF) **       | 7.11  | 5.38  |

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\* Bbl - Barrel Equivalent to 42 U.S. Gallons

\*\* MCF - 1,000 CUBIC FEET

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### OIL AND GAS EXPLORATION COSTS

In 2005 the Company incurred \$110,000 in exploration costs. These costs were incurred mainly for a well drilled in Israel that was plugged and abandoned.

### OPERATOR'S FEES

In 2005 the Company earned \$977,000 in operator fees compared to \$137,000 in 2004. The increase is due to the drilling of the Gad 1 well.

### OIL AND GAS REVENUES

In 2005 and 2004 the Company had oil and gas revenues of \$3,319,000 and \$3,174,000, respectively. The increase is due to the increase in oil and gas prices in 2005 partially offset by the decline in oil and gas production.

### LEASE OPERATING EXPENSES AND SEVERANCE TAXES

Lease operating expenses and severance taxes were incurred primarily in connection with oil and gas fields in the United States. Oil and gas lease operating expenses and severance taxes were \$1,458,000 and \$1,149,000 for 2005 and 2004, respectively. The increase in lease operating expenses and severance taxes is primarily attributable to workovers performed on two wells.

### INTEREST AND DIVIDEND INCOME

Interest income during the year ended December 31, 2005 was \$293,000 compared to \$729,000 for the year ended December 31, 2004. The decrease in interest income is primarily attributable to interest receivable on marketable securities (Debentures).

### GAIN ON MARKETABLE SECURITIES

In 2005, the Company recognized net realized and unrealized gain on marketable securities of \$551,000 compared to net realized and unrealized gain on marketable securities of \$240,000 in 2004.

Increases or decreases in the gains and losses from marketable securities are dependent on the market prices in general and the composition of the portfolio of the Company.

### OPERATOR EXPENSES

In 2005, the Company expended \$767,000 for operator expenses compared to \$807,000 in 2004.

### GENERAL AND ADMINISTRATIVE EXPENSES

In 2005, the Company incurred \$2,313,000 in general and administrative expenses compared to \$1,717,000 in 2004. The relatively higher amount in 2005 is primarily attributable to bonus payments totaling \$245,000 to the president, vice president and secretary, fees associated with lawsuits initiated by the Company and consultants' fees.

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### EQUITY IN NET INCOME OF INVESTEE

The Company's equity in the net income of investees for 2005 was \$661,000 compared to its equity in net income of investees of \$1,365,600 for 2004. The decrease is primarily attributable to the decrease in the gain of marketable securities held by the Limited Partnerships Isramco Negev 2 and I.O.C Dead Sea LP, affiliates of the Company.

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### CRUISE LINE VESSEL INCOME

Income from the leasing of the cruise line vessel for 2005 was \$1,520,000, compare to a net income of \$2,034,000 in 2004. The decrease is due to the fact that during 2004 the Vessel was leased under a time charter while in the year 2005 the Vessel was leased under a bareboat charter.

### CRUISE LINE VESSEL EXPENSES

Expenses of the Vessel for 2005 were \$1,051,000 compared to expenses of \$1,926,000 in 2004. The decrease in the expenses is due to the fact that during the year 2004 the Vessel was leased under a time charter while in the year 2005 the Vessel was leased under a bareboat charter.

### DEPRECIATION, DEPLETION AMORTIZATION AND IMPAIRMENT

Depreciation depletion and amortization expenses are connected to the producing wells in the United States and to the Cruise line vessel.

During 2005, the Company recorded \$2,139,000 compared to \$1,334,000 in 2004. The increase is attributable to an increase in depreciation of the Vessel from \$438,000 in 2004 to \$1,128,000 in 2005 resulting from a full year of depreciation in 2005 and only a partial year of depreciation in 2004.

During 2005 and 2004, the Company recorded impairment charges of \$759,000 and \$268,000, respectively, relating to oil and gas assets in the United States.

### OTHER INCOME

Other Income in 2005 was \$(524,000) compared to \$492,000 in 2004. Other Income in 2005 is primarily attributable to monthly income of \$7,000 related to lease of the real estate in Israel, \$195,000 received from the European tour operator of the cruise line vessel for office services provided by the Company and (\$671,000) related to net expense for the mark-to-market of swap contracts on oil and gas prices.

### INCOME TAXES

The Company recorded income tax expense of \$40,000 in 2005 compared to \$576,000 in 2004. The effective tax rate for 2005 was -3.7% compared to 36.7% for 2004. This decrease in effective tax rate is due to the Company's Israeli branch office having foreign tax expense of \$370,000 on income before tax of \$838,000 in 2005. During 2004, the Israeli branch office had income before tax of \$2,117,000 with no foreign tax due to the utilization of tax loss carryforward from prior years. The Company did not record a deferred tax asset for the foreign tax loss carryforwards due to the uncertainty of future profits to utilize the carryforwards. Additionally, the Company has historically treated the operations of the cruise line vessel as a separate entity for tax purposes through December 31, 2005. During 2005 and 2004, the Company recorded losses



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before income taxes of \$1,063,000 and \$527,000, respectively, from the cruise line vessel operations, and therefore there is no tax expense effect on the Company's financial statements. The Company expects the effective tax rate for 2006 to be approximately 37%.

### CONTRACTUAL OBLIGATIONS

The Company leases office facilities in Texas and in Israel and certain equipment pursuant to non-cancelable operating lease agreements. Future minimum lease payments pursuant to these leases as of December 31, 2005 were as follows (in thousands).

|                   | TOTAL<br>----- | 2006<br>---- | 2007<br>---- | 2008<br>---- | Thereafter<br>----- |
|-------------------|----------------|--------------|--------------|--------------|---------------------|
| Operating Leases: |                |              |              |              |                     |
| Texas:            | 26,000         | 26,000       | --           | --           | --                  |
|                   | --             | --           | --           | --           | --                  |

YEAR ENDED DECEMBER 31, 2004 COMPARED TO YEAR ENDED DECEMBER 31, 2003.

The company reported net income of \$993,000 (\$0.38 per share) in 2004 compared to a net income of \$2,256,000 (\$0.85 per share) in 2003. The decrease in the net income in 2004 compared to 2003 is primarily attributable to: (i) a decrease in operators' fee collected during 2004 (ii) decrease in oil and gas sales due to decline in gas production, (iii) decrease in the gain on marketable securities.

Set forth below is a break-down of these results.

### UNITED STATES

#### OIL AND GAS VOLUME AND REVENUES (IN THOUSANDS)

|                       | 2004<br>----- | 2003<br>----- |
|-----------------------|---------------|---------------|
| Oil Volume Sold (Bbl) | 18            | 19            |
| Gas Volume Sold (MCF) | 470           | 600           |
| Oil Sales (\$)        | 678           | 542           |
| Gas Sales (\$)        | 2,524         | 2,897         |
| Average Unit Price    |               |               |
| Oil (\$/Bbl) *        | 38.12         | 28.09         |
| Gas (\$/MCF) **       | 5.38          | 4.82          |

\* Bbl - Barrel Equivalent to 42 U.S. Gallons \*\* MCF - 1,000 Cubic Feet

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### THE OFFSHORE LICENSES (ISRAEL)

The Company did not expend any amount in respect of the offshore licenses compared to \$88,243 in 2003.

### OIL AND GAS EXPLORATION COSTS

During 2004 the Company did not expand any amounts in respect of oil and gas exploration, as compared to \$165,000 in 2003.

### OPERATOR'S FEES

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In 2004 the Company earned \$137,000 in operator fees compared to \$753,000 in 2003.

The decrease in operator fees is due to the decrease in oil and gas exploration activity in 2004 compared to 2003 in which the Company drilled the Nir 2 well offshore Israel.

### OIL AND GAS REVENUES

In 2004 and 2003 the Company had oil and gas revenues of \$3,174,000 and \$3,439,000, respectively. The decrease is due mainly to the decline of gas production in 2004.

### LEASE OPERATING EXPENSES AND SEVERANCE TAXES

Lease operating expenses and severance taxes were incurred primarily in connection with oil and gas fields in the United States. Oil and gas lease operating expenses and severance taxes were \$1,149,000 and \$872,000 for 2004 and 2003, respectively. The relatively higher amounts in 2004 in lease operating expenses and severance taxes is primarily due to the workovers performed in connection with producing wells in 2004.

### INTEREST AND DIVIDEND INCOME

Interest income during the year ended December 31, 2004 was \$729,000 compared to \$760,000 for the year ended December 31, 2003. The income is primarily attributable to interest receivable on marketable securities (Debentures).

### GAIN ON MARKETABLE SECURITIES

In 2004, the Company recognized net realized and unrealized gains on marketable securities of \$240,000 compared to net realized and unrealized gains on marketable securities of \$872,000 in 2003.

Increases or decreases in the gains and losses from marketable securities are dependent on the market prices in general and the composition of the portfolio of the Company.

### OPERATOR EXPENSES

In 2004 the Company expended \$807,000 in respect of operator expenses compared to \$795,000 in 2003.

### GENERAL AND ADMINISTRATIVE EXPENSES

In 2004, the Company incurred \$1,705,000 as general and administrative expenses compared to \$2,012,000 incurred in 2003. The relatively higher amount in 2003 is primarily attributable to bonuses awarded to senior officers and increase in legal and other professional fees paid by the Company.

### EQUITY IN NET INCOME OF INVESTEE

The Company's equity in the net income of Investee for 2004 was \$1,365,000 compared to its equity in net income of \$1,098,000 for 2003. The increase is primarily attributable to the increase in the marketable value of the marketable securities hold by Isramco Negev 2 and I.O.C Dead Sea LP, affiliates of the Company.

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### CRUISE LINE VESSEL INCOME AND EXPENSES

Income from the leasing of the cruise line vessel for 2004 (July through October 2004) were \$2,034,000. The associated expenses in 2004 were \$1,926,000 and are primarily attributable to insurance, maintenance, repair upkeep and payroll.

Additionally, depreciation expense of \$438,000 for the vessel was recorded in 2004.

### DEPRECIATION, DEPLETION AND AMORTIZATION

Depreciation depletion and amortization expenses are connected to the producing wells in the United States and to the Cruise line vessel.

During 2004, the Company recorded \$1,334,000 compared to \$621,000 in 2003. The increase in 2004 compared to 2003 is attributable to depreciation of the Vessel (\$438,000) and increase of \$315,000 in the depreciation of the wells in the United States due to the decline in production of the gas wells.

During 2004 and 2003, the Company recorded impairment charges of \$268,000 and \$617,000 respectively relating to oil and gas assets.

### OTHER INCOME

Other Income in 2004 was \$492,000 compared to \$475,000 in 2003. Other Income is primarily attributable to monthly income of \$7,000 related to lease of the real estate in Israel and \$369,000 related to a change of estimate for asset retirement obligations. Other Income in the year 2003 included the sum of \$350,000 which represents the settlement of a liability recorded in connection with a well drilled in Marine 9 permit offshore Congo, and was recorded during 2002 as exploration costs.

### RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

In December 2004, the FASB issued SFAS No. 123R, "Accounting for Stock-Based Compensation." SFAS No. 123R establishes standards for the accounting for transactions in which an entity exchanges its equity instruments for goods or services. This Statement focuses primarily on accounting for transactions in which an entity obtains employee services in share-based payment transactions. SFAS No. 123R requires that the fair value of such equity instruments be recognized as expense in the historical financial statements as services are performed. Prior to SFAS No. 123R, only certain pro forma disclosures of fair value were required. SFAS No. 123R shall be effective for small business issuers as of the beginning of the first interim or annual reporting period that begins after December 15, 2005. The adoption of this new accounting pronouncement is not expected to have a material impact on the financial statements of the Company during the calendar year 2006.

### ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company is exposed to market risk, including adverse changes in commodity prices.

The Company produces and sells natural gas and crude oil. As a result, the Company's financial results can be significantly affected if these commodity prices fluctuate widely in response to changing market forces.

The Company uses swap contracts to manage the risk on commodity prices. The Company's positions are monitored and managed on a daily basis to ensure compliance with the Company's risk management policy. The swap contracts are

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entered into principally with a major financial institution. All derivatives are recorded at fair value on the consolidated balance sheet with resulting gains and losses reflected in income. Fair values are derived principally from market quotes and other independent third-party quotes.

Each hypothetical 10 percent increase in the price of natural gas and crude oil would increase the liability of the natural gas derivative contracts by approximately \$236,000 and increase the liability of the crude oil sale derivative contracts by about \$76,000. The same hypothetical decrease in the prices of these commodities would result in the same opposite effects on the values of the contracts. The hypothetical effect on these contracts was estimated by calculating the cash value of the contracts as the difference between the hypothetical and contract delivery prices multiplied by the contract amounts.

### ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The information called for by this Item 8 is included following the "Index to Financial Statements" contained in this Annual Report on Form 10-K.

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### ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

On January 13, 2005, the audit committee of the board of directors (the "Audit Committee") of the Company accepted the resignation of UHY - Mann Frankfort Stein & Lipp CPAS, LLP ("UHY LLP") (formerly - Mann Frankfort Stein & Lipp CPAS, L.L.P.) as the Company's independent accountants. Concurrent with UHY LLP's resignation, the Audit Committee appointed Malone & Bailey, PC (the "New Accountants") as the independent accounting firm to audit the financial statements of the Company for the year ended December 31, 2004.

The reports by UHY LLP with respect to the Company's financial statements for the year ended December 31, 2003 did not contain any adverse opinion or disclaimer of opinion and were not qualified or modified as to uncertainty, audit scope or accounting principles. During the fiscal year ended December 31 2003 and during the subsequent interim period, there were no disagreements between the Company and UHY LLP on any matter of accounting principles or practices, financial statement disclosure or auditing scope or procedure, which, if not resolved to the satisfaction of UHY LLP, would have caused it to make reference to the subject matter of thereof in connection with its reports.

During the fiscal year ended December 31 2003, and through the date of their resignation, UHY LLP did not advise the Company with respect to any matters described in paragraphs (a)(1)(v)(A) through (D) of Item 304 of Regulation S-K.

During the fiscal year ended December 31, 2003, and through the date of their engagement, the Company did not consult with the New Accountants regarding either (i) the application of accounting principles to a specified transaction, either completed or proposed; (ii) the type of audit opinion that might be rendered on the Company's financial statements; (iii) any matter that was either the subject of disagreement (as defined in Item 304(a)(1)(iv) of Regulation S-K) or a reportable event (as defined in Item 304(a)(1)(v) of Regulation S-K).

### ITEM 9A. CONTROLS AND PROCEDURES

EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES. The Company maintains disclosure controls and procedures that are designed to ensure that information

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required to be disclosed in the Company's Exchange Act reports is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure based closely on the definition of "disclosure controls and procedures" in Rule 13a-14(c).

As of the end of the period covered by this report, we carried out an evaluation, under the supervision and with participation of management, including our Chief Executive Officer (and our Principal Financial Officer), of the effectiveness of the design and operation of our disclosure controls and procedures. Based on the foregoing, our Chief Executive Officer (and Principal Financial Officer) concluded that our disclosure controls and procedures were effective.

CHANGES IN INTERNAL CONTROLS OVER FINANCIAL REPORTING. During the quarter ended December 31, 2005, there have been no changes in our internal controls over financial reporting that have materially affected, or are reasonably likely to materially affect, these controls.

### ITEM 9B. OTHER INFORMATION

None.

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## PART III

The information called for by items 10, 11, 12 13 and 14 will be contained in the Company's definitive proxy statement which the Company intends to file within 120 days after the end of the Company's fiscal year ended December 31, 2005 and such information is incorporated herein by reference.

### GLOSSARY

"Grant Agreement" shall mean the agreement between the Company and the Government of Israel pursuant to which the Government of Israel has provided assistance to the Company in connection with its investment in the Negev 2 Venture by providing a grant of 44.34(cent) for each U.S. dollar (\$1.00) invested and expended by the Company in oil and gas activities in Israel within the framework of the Negev 2 Venture. The Government financing provided for under the Grant is repayable only from funds emanating from commercial production in any payout area and then, only to the extent of 30% of the recipient's share of the net revenue from said payout area, as and when received. The Grant Agreement entitles the Government of Israel, to receive a 12.5% royalty on oil sales, as well as an overriding royalty of 6.5% of the Company's share in the petroleum produced and saved after payout. If there is no commercial discovery of oil, the Company will not be required to repay the grant monies. A grant agreement was also entered into between the Government of Israel and HEI, Donesco, L.P.S. and Mazal Oil.

"Joint Operating Agreement" shall mean the Joint Operating Agreement of the Negev 2 Venture which was signed as of the 30th day of June, 1988, between the participants in the Negev 2 Venture, as amended or as shall be amended from time to time.

"Joint Venture Agreement" shall mean the Joint Venture Agreement of the Negev 2 Venture which was signed as of the 30th of June, 1988 between the participants in the Negev 2 Venture, as amended from time to time.

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"Limited Partnership" shall mean Isramco-Negev 2 Limited Partnership, a Limited Partnership founded pursuant to a Limited Partnership Agreement made on the 2nd and 3rd days of March, 1989 (as amended on September 7, 1989, July 28, 1991, March 5, 1992 and June 11, 1992) between the Trustee on part as Limited Partner and Isramco Oil and Gas Ltd., as General Partner on the other part.

"Limited Partnership Agreement" shall mean the Limited Partnership Agreement made the 2nd and 3rd days of March, 1989 (as amended September 7, 1989, July 28, 1991, March 5, 1992 and June 11, 1992), between Isramco Oil and Gas Ltd., as General Partner, and Isramco Management (1988) Ltd. as the Limited Partner.

"Negev 2 Venture Agreements" shall mean the Joint Venture Agreement, the Joint Operating Agreement, the Voting Agreement and every agreement into which the parties to said agreements have entered, in connection with the Negev 2 Venture.

"Overriding Royalty" shall mean a percentage interest over and above the base royalty and is free of all costs of exploration and production, which costs are borne by the Grantor of the Overriding Royalty Interest and which is related to a particular Petroleum License.

"Payout" shall mean the defined point at which one party has recovered its prior costs.

"Petroleum" shall mean any petroleum fluid, whether liquid or gaseous, and includes oil, natural gas, natural gasoline, condensates and related fluid hydrocarbons, and also asphalt and other solid petroleum hydrocarbons when dissolved in and producible with fluid petroleum.

"Petroleum Exploration" shall mean test drilling; any other operation or search for petroleum, including geological, geophysical, geochemical and similar investigations and tests; and, drilling solely for obtaining geological information.

"Petroleum Production" shall mean the production of petroleum from a petroleum field and all operations incidental thereto, including handling and treatment thereof and conveyance thereof to tankers, a pipe line or a refinery in or in the vicinity of the field.

"Preliminary Permit", "Preferential Right to Obtain a License", "License" shall have the meaning(s) set forth in the Petroleum Law of Israel.

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"Trust Agreement" shall mean the Trust Agreement made on the 3rd day of March, 1989 (as amended September 7, 1989, July 28, 1991, March 5, 1992 and June 11, 1992) for the Trust Company of Kesselman and Kesselman. "Working Interest" shall mean an interest in a Petroleum Asset granting the holder thereof the right to participate pro rata in exploiting the Petroleum Asset for petroleum exploration, development and petroleum production, subject to its pro rata participation in the expenses involved therein after acquiring the Working Interest.

"Israel Petroleum Law"

The Company's business in Israel is subject to regulation by the State of Israel pursuant to the Petroleum Law, 1952. The administration and implementation of the Petroleum Law is vested in the Minister of National Infrastructure (the "Minister") and an Advisory Council.

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The following includes brief statements of certain provisions of the Petroleum Law in effect at the date of this Prospectus. Reference is made to the copy of the Petroleum Law filed as an exhibit to the Registration Statement referred to under "Additional Information" and the description which follows is qualified in its entirety by such reference.

The holder of a preliminary permit is entitled to carry out petroleum exploration, but not test drilling or petroleum production, within the permit areas. The Commissioner determines the term of a preliminary permit and it may not exceed eighteen (18) months. The Minister may grant the holder a priority right to receive licenses in the permit areas, and for the duration of such priority right no other party will be granted a license or lease in such areas.

Drilling for petroleum is permitted pursuant to a license issued by the Commissioner. The term of a license is for three (3) years, subject to extension under certain circumstances for an additional period up to four (4) years. A license holder is required to commence test drilling within two (2) years from the grant of a license (or earlier if required by the terms of the license) and not to interrupt operations between test drillings for more than four (4) months. If any well drilled by the Company is determined to be a commercial discovery prior to expiration of the license, the Company will be entitled to receive a Petroleum Lease granting it the exclusive right to explore for and produce petroleum in the lease area. The term of a lease is for thirty (30) years, subject to renewal for an additional term of twenty (20) years.

The Company, as a lessee, will be required to pay the State of Israel the royalty prescribed by the Petroleum Law which is presently, and at all times since 1952 has been, 12.5% of the petroleum produced from the leased area and saved, excluding the quantity of petroleum used in operating the leased area.

The Minister may require a lessee to supply at the market price such quantity of petroleum as, in the Minister's opinion, is required for domestic consumption, subject to certain limitations.

As a lessee, the Company will also be required to commence drilling of a development well within six (6) months from the date on which the lease is granted and, thereafter, with due diligence to define the petroleum field, develop the leased area, produce petroleum therefore and seek markets for and market such petroleum.

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### ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES AND REPORTS ON FORM 8-K

#### (a) Exhibits

- 3.1 Articles of Incorporation of Registrant with all amendments filed as an Exhibit to the S-1 Registration Statement, File No. 2-83574.
- 3.2 Amendment to Certificate of Incorporation filed March 17, 1993, filed as an Exhibit with the S-1 Registration Statement, File No. 33-57482.
- 3.3 By-laws of Registrant with all amendments, filed as an Exhibit to the S-1 Registration Statement, File No. 2-83570.
- 10.1 Oil Marketing Agreement, filed as Exhibit with the S-1 Registration Statement, File No. 2-83574.
- 10.2 Joint Venture Agreement and Joint Operating Agreement dated June 30, 1988 by and among HEI Oil and Gas Limited Partnership, JOEL - Jerusalem Oil Exploration Ltd., Delek Oil Exploration Ltd., Delek, The Israel Fuel Corporation Ltd., the Company, Southern

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- Shipping and Energy (U.K.), Naphtha, Israel Petroleum Company Ltd., Oil Exploration of Pat Ltd., LPS Israel Oil Inc., Donesco Venture Fund One, a Limited Partnership and MazalOil Inc. filed as an Exhibit to Form 8-K for the month of September 1988.
- 10.3 Grant Agreement with the Government of Israel, undated, between the Company and the Government of Israel on behalf of the State of Israel, filed as an Exhibit to Form 10-Q for the Company for the period ending September 30, 1988 and incorporated herein by reference.
- 10.4 Translated from Hebrew, Indemnity Agreement between the Company and Isramco Management (1988) Ltd. dated March \_\_, 1989, filed as an Exhibit to Form 8-K for the month of March 1989 and incorporated herein by reference.
- 10.5 Amendment Agreement to Grant Agreement between the Company and the Government of Israel, filed as an Exhibit to this Post-effective Amendment No. 8 to Form S-1 Registration Statement. File No. 2- 83574.
- 10.6 Translated from Hebrew, Limited Partnership Agreement between Isramco Oil and Gas Ltd. and Isramco Management (1988) Ltd. dated March 2, 1989, filed as an Exhibit to Form 8-K for the month of March 1989 and incorporated herein by reference.
- 10.7 Translated from Hebrew, Trust Agreement between Isramco Management (1988) Ltd. and Kesselman and Kesselman dated March 3, 1989, filed as an Exhibit to Form 8-K for the month of March 1989 and incorporated herein by reference.
- 10.8 Translated from Hebrew, Indemnity Agreement between the Company and Isramco Management (1988) Ltd. dated March \_\_, 1989, filed as an Exhibit to Form 8-K for the month of March 1989 and incorporated herein by reference.
- 10.9 Equalization of Rights Agreement between Isramco-Negev 2 Limited Partnership and Delek Oil Exploration Ltd. and Delek - The Israel Fuel Corporation Ltd, filed as an Exhibit to Form 8-K for the month of January 1993 dated January 21, 1993 and incorporated herein by reference.
- 10.10 Option Agreement between Isramco Resources Inc. and Delek Oil Exploration Ltd. and Delek - The Israel Fuel Corporation Ltd. filed as an Exhibit to Form 8-K for the month of January 1993 dated January 21, 1993 and incorporated herein by reference.
- 10.11 Agreement by and among Naphtha Congo Ltd., Equital Ltd. and the Company dated September 4, 1997, filed as an Exhibit to Form 8-K for the month of September, 1997 and incorporated herein by reference.
- 10.12 Amendment to Consulting Agreement between Goodrich Global L.T.D. B.V.I. and the Company dated December \_\_, 1997, filed as an Exhibit to Form 8-K for the month of December, 1997 and incorporated herein by reference.
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- 10.13 Consulting Agreement between Romulas Investment Ltd. and the Company dated August \_\_, 1997, filed as an Exhibit to Form 8-K for the month of September, 1997 and incorporated herein by reference, assigned by Romulas Investment Ltd. on December 31, 1997 to Remarkable Holdings Ltd.
- 10.14 Inventory Services Management Agreement dated December 1997 between the Company and Equital Ltd. filed herewith as Exhibit 10.70.
- 10.15 Consulting Agreement dated as of November 1, 1999 between the Company and Worldtech, Inc.
- 10.16 Agreement dated June 12, 2002 between the Company and Mati



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- Properties and Construction Ltd. and Boaz Avrahami, filed as an Exhibit to the Form 10-Q for the quarter ended June 30, 2002.
- 14.1 Code of Ethics, filed as an Exhibit to Form 10-K for the year ended December 31, 2003.
- 31 Certification of Chief Executive and Principal Financial Officer pursuant to Section 302 of Sarbanes-Oxley Act \*
- 32 Certification of Chief Executive and Principal Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley act of 2002. \*
- 99.1 Financial Statements of Isramco Negev 2 Limited Partnership as of December 31, 2004 \*

\* Attached hereto as an exhibit

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SIGNATURES

In accordance with Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

/s/ HAIM TSUFF

-----  
HAIM TSUFF,  
CHAIRMAN OF THE BOARD, CHIEF EXECUTIVE  
OFFICER (AND PRINCIPAL FINANCIAL AND  
ACCOUNTING OFFICER)

DATE: OCTOBER 17, 2006

In accordance with the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, in the capacities and on the dates indicated.

| SIGNATURE                                     | TITLE               | DATE             |
|---|---------------------|------------------|
| -----   | -----               | ----             |
| /S/ JACKOB MAIMON<br>-----<br>JACKOB MAIMON   | PRESIDENT, DIRECTOR | OCTOBER 17, 2006 |
| /S/ AMIR ESKANDARI<br>-----<br>AMIR ESKANDARI | DIRECTOR            | OCTOBER 17, 2006 |
| /S/ MAX PRIDGEON<br>-----<br>MAX PRIDGEON     | DIRECTOR            | OCTOBER 17, 2006 |
| /S/ DONALD D. LOVELL<br>-----                 | DIRECTOR            | OCTOBER 17, 2006 |

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors  
Isramco, Inc. and Subsidiaries  
Houston, Texas

We have audited the accompanying consolidated balance sheet of Isramco, Inc. and subsidiaries as of December 31, 2005 and 2004, and the related consolidated statements of operations, shareholders' equity, and cash flows for the years then ended. These financial statements are the responsibility of Isramco, Inc.'s management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Isramco, Inc., as of December 31, 2005 and 2004, and the results of its operations and its cash flows for the periods described above in conformity with accounting principles generally accepted in the United States of America.

As described in Note S, the financial statements for 2004 have been restated.

MALONE & BAILEY, PC  
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Houston, Texas

# Edgar Filing: ISRAMCO INC - Form 10-K/A

March 20, 2006

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## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Shareholders and Board of Directors of Isramco, Inc. and Subsidiaries

We have audited the accompanying consolidated statements of operations, changes in shareholders' equity, and cash flows of Isramco, Inc. and subsidiaries (the "Company") for the year ended December 31, 2003. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We did not audit the financial statements of Isramco Oil and Gas, Ltd.; Isramco B.V., Cruquius; or Isramco, Inc. - Israel Branch, which are wholly - owned subsidiaries whose combined statements reflect total revenues of \$3,422,000 for the year ended December 31, 2003. Those statements were audited by other auditors whose reports have been furnished to us, and our opinion, insofar as it relates to the amounts included for these subsidiaries, is based solely on the reports of the other auditors.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit and the reports of the other auditors provide a reasonable basis for our opinion.

In our opinion, based on our audit and the reports of other auditors, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated results of the operations and the cash flows for the year ended December 31, 2003, in conformity with accounting principles generally accepted in the United States.

As discussed in Note A, the Company adopted the provisions of Statement of Financial Accounting Standards No. 143 "Accounting for Asset Retirement Obligations" as of January 1, 2003.

/S/ UHY MANN FRANKFORT STEIN & LIPP CPAS, LLP  
(FORMERLY MANN FRANKFORT STEIN & LIPP CPAS, L.L.P.)  
HOUSTON, TEXAS  
MARCH 5, 2004

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[KPMG logo]

Somekh Chaikin

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|                |                       |                          |
|----------------|-----------------------|--------------------------|
| Mail address   | Office address        | Telephone 972 3 684 8000 |
| PO Box 609     | KPMG Millennium Tower | Fax 972 3 684 8444       |
| Tel Aviv 61006 | 17 Ha'arba'a Street   |                          |
| Israel         | Tel Aviv 64739        |                          |
|                | Israel                |                          |

### AUDITORS' REPORT TO THE MANAGEMENT OF ISRAMCO OIL AND GAS LIMITED

We have audited the accompanying balance sheets of Isramco Oil and Gas Limited (hereinafter - "the Company") as at December 31, 2003 and 2002, and the related statements of income and the Cash flows for each of the years ended on such dates. These financial statements are the responsibility of the Company's Board of Director's and of its Management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards in Israel, including standards prescribed by the Auditors Regulations (Manner of Auditor's Performance) 1973. Such standards require that we plan and perform the audit to obtain reasonable assurance that the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by the Board of Director's and of its Management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

The above-mentioned financial statements were prepared on the basis of the historical cost convention and no information on the effect of changes in the general purchasing power of the Israeli currency on the operating results in the financial statements has been provided.

In our opinion, except for the non-inclusion of the information mentioned in the previous paragraph, the financial statements referred to above present fairly, in all material respects, the financial position of the Company as at December 31, 2003 and 2002 and the results of its operations and its cash flows for each of the years ended on such dates, in conformity with generally accepted accounting principles, in Israel.

Somekh Chaikin  
Certified Public Accountants (Isr.)

March 5, 2004

[KPMG logo]

Somekh Chaikin

|                |                       |                          |
|----------------|-----------------------|--------------------------|
| Mail address   | Office address        | Telephone 972 3 684 8000 |
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| Tel Aviv 61006 | 17 Ha'arba'a Street   |                          |
| Israel         | Tel Aviv 64739        |                          |
|                | Israel                |                          |

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## AUDITORS' REPORT TO THE MANAGEMENT OF ISRAMCO INC. - ISRAEL BRANCH

We have audited the accompanying balance sheets of Isramco Inc. - Israel Branch (hereinafter - "the Branch") as at December 31, 2003 and 2002, and the related statements of income and the Cash flows for each of the years ended on such dates. These financial statements are the responsibility of the Branch's Management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards in Israel, including standards prescribed by the Auditors Regulations (Manner of Auditor's Performance) 1973. Such standards require that we plan and perform the audit to obtain reasonable assurance that the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by the Management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

The above-mentioned financial statements were prepared on the basis of the historical cost convention and no information on the effect of changes in the general purchasing power of the Israeli currency on the operating results in the financial statements has been provided.

In our opinion, except for the non-inclusion of the information mentioned in the previous paragraph, the financial statements referred to above present fairly, in all material respects, the financial position of the Branch as at December 31, 2003 and 2002 and the results of its operations and its cash flows for each of the years ended on such dates, in conformity with generally accepted accounting principles, in Israel.

Somekh Chaikin  
Certified Public Accountants (Isr.)

March 5, 2004

### ISRAMCO INC. AND SUBSIDIARIES CONSOLIDATED BALANCE SHEETS (in thousands except for share information)

|                                  | DECEMBER 31 |          |
|----------------------------------|-------------|----------|
|                                  | 2005        | 2004     |
| ASSETS                           |             |          |
| CURRENT ASSETS                   |             |          |
| Cash and cash equivalents        | \$ 1,249    | \$ 1,249 |
| Marketable securities, at market | 5,570       | 5,570    |
| Accounts receivable - Trade      | 605         | 605      |

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|  |           |    |
|--|-----------|----|
| Prepaid expenses and other current assets  | 98        |    |
|  |           |    |
| TOTAL CURRENT ASSETS   | 7,522     |    |
| Property and equipment, net (successful efforts method for oil and gas properties)   | 5,110     |    |
| Real estate  | 1,887     |    |
| Marketable securities, at market   | 3,619     |    |
| Investment in affiliates   | 11,836    |    |
| Investment in Vessel   | 8,479     |    |
| Other  | 162       |    |
|  |           |    |
| TOTAL ASSETS   | \$ 38,615 | \$ |
|  |           |    |
| LIABILITIES AND SHAREHOLDERS' EQUITY   |           |    |
| CURRENT LIABILITIES  |           |    |
| Accounts payable and accrued expenses  | \$ 2,243  | \$ |
| Credit from banks  | 370       |    |
| Current portion of bank loan   | 1,010     |    |
|  |           |    |
| TOTAL CURRENT LIABILITIES  | 3,623     |    |
|  |           |    |
| LONG-TERM LIABILITIES  |           |    |
| Asset retirement obligations   | 343       |    |
| Deferred tax obligation  | 2,899     |    |
| Long-term bank loan  | 3,257     |    |
|  |           |    |
| TOTAL LONG-TERM LIABILITIES  | 6,499     |    |
|  |           |    |
| TOTAL LIABILITIES  | 10,122    |    |
|  |           |    |
| SHAREHOLDERS' EQUITY   |           |    |
| Common stock \$0.01 par value; authorized 7,500,000 shares; issued 2,746,958 in 2005 and 2,669,120 shares in 2004; outstanding 2,717,691 shares in 2005 and 2,639,853 shares in 2004 | 27        |    |
| Additional paid-in capital   | 26,240    |    |
| Retained earnings  | 1,557     |    |
| Accumulated other comprehensive income   | 833       |    |
| Treasury stock, 29,267 shares at cost  | (164)     |    |
|  |           |    |
| Total shareholders' equity   | 28,493    |    |
|  |           |    |
| Total liabilities and shareholders' equity   | \$ 38,615 | \$ |
|  |           |    |

See notes to the consolidated financial statements.

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ISRAMCO INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF OPERATIONS  
(in thousands except for share information)

|  | YEAR ENDED DECEMBER 31 |            |
|--|------------------------|------------|
|  | 2005                   | 2004       |
|  |                        | (RESTATED) |
| Revenues and other income :                              |                        |            |
| Operator fees from related party                         | \$ 977                 | \$ 137     |
| Oil and gas sales  | 3,319                  | 3,174      |
| Revenue from Vessel                                      | 1,520                  | 2,034      |
| Interest income  | 293                    | 729        |
| Office services  |                        |            |
| To related parties                                       | 476                    | 592        |
| To others  | 462                    | 180        |
| Capital gain   | --                     | --         |
| Gain on marketable securities                            | 551                    | 240        |
| Equity in net income of investees                        | 661                    | 1,365      |
| Other  | (524)                  | 492        |
|  | -----                  | -----      |
| Total revenues and other income                          | 7,735                  | 8,943      |
|  | -----                  | -----      |
| Expenses :   |                        |            |
| Interest expense   | 205                    | 168        |
| Cost of revenue from vessel                              | 1,051                  | 1,926      |
| Accretion expense  | 25                     | 5          |
| Depreciation, depletion and amortization                 | 2,139                  | 1,334      |
| Lease operation expense and severance taxes              | 1,458                  | 1,149      |
| Exploration costs  | 110                    | --         |
| Operator expense   | 767                    | 807        |
| General and administrative                               |                        |            |
| To related parties                                       | 503                    | 358        |
| To others  | 1,810                  | 1,359      |
| Impairment of oil and gas assets                         | 759                    | 268        |
|  | -----                  | -----      |
| Total expenses   | 8,827                  | 7,374      |
|  | -----                  | -----      |
| Income (loss) before income taxes                        | (1,092)                | 1,569      |
| Income (taxes) benefit                                   | (40)                   | (576)      |
|  | -----                  | -----      |
| Net income (loss) before cumulative effect               | (1,132)                | 993        |
| Cumulative effect of change in accounting principle, net | --                     | --         |
|  | -----                  | -----      |
| Net income (loss)  | \$ (1,132)             | \$ 993     |
|  | =====                  | =====      |
| Earnings (loss) per share                                |                        |            |
| Basic and diluted earnings (loss) per share for:         |                        |            |
| Net income (loss) before cumulative effect               | \$ (0.42)              | \$ 0.38    |

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|  |           |           |
|--|-----------|-----------|
| Cumulative effect of accounting change, net            | --        | --        |
| Net income (loss)                                      | \$ (0.42) | \$ 0.38   |
| Weighted average number of shares outstanding-basic    | 2,709,355 | 2,639,853 |
| Weighted average number of shares outstanding -diluted | 2,709,355 | 2,640,751 |

See notes to the consolidated financial statements.

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ISRAMCO INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY  
FOR THE YEARS ENDED DECEMBER 31, 2005, 2004 (RESTATE) AND 2003 (RESTATE)

|   | COMMON STOCK                          |        | ADDITIONAL<br>PAID-IN<br>CAPITAL | ACCUMULATED<br>OTHER<br>COMPREHENSIVE<br>INCOME (LOSS) | RE<br>EA<br>(ACC<br>D |
|---|---------------------------------------|--------|----------------------------------|--|-----------------------|
|   | NUMBER<br>OF SHARES                   | AMOUNT |                                  |  |                       |
|   | \$ IN THOUSANDS, EXCEPT SHARE AMOUNTS |        |                                  |  |                       |
| Balances at December 31, 2002   | 2,669,120                             | \$ 27  | \$ 26,240                        | \$ (544)   | \$                    |
| Comprehensive income:   |                                       |        |                                  |  |                       |
| Net Income  |                                       |        |                                  |  |                       |
| Net unrealized gain on available<br>for sale marketable<br>securities, net of taxes | --                                    | --     | --                               | 524  |                       |
| Net gain (loss) on foreign<br>exchange rate, net of taxes                           |                                       |        |                                  | 609  |                       |
| Balances at December 31, 2003   | 2,669,120                             | 27     | 26,240                           | 589  |                       |
| Net Loss  |                                       |        |                                  |  |                       |
| Net unrealized gain on available<br>for sale marketable<br>securities, net of taxes | --                                    | --     |                                  | 504  |                       |
| Net realized gain (loss) on foreign<br>exchange rate, net of taxes                  |                                       |        |                                  | 151  |                       |
| Total Comprehensive income  |                                       |        |                                  |  |                       |
| Balances at December 31, 2004   | 2,669,120                             | 27     | 26,240                           | 1,244  |                       |
| Shares issued for exercise of options   | 77,838                                | --     | --                               |  |                       |
| Net Loss  |                                       |        |                                  |  |                       |
| Net unrealized gain on available<br>for sale marketable securities,<br>net of taxes |                                       |        |                                  | 113  |                       |



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Net gain (loss) on foreign exchange rate, net of taxes (524)

Total Comprehensive income (loss)

|                               |           |       |           |        |       |
|-------------------------------|-----------|-------|-----------|--------|-------|
| Balances at December 31, 2005 | 2,746,958 | \$ 27 | \$ 26,240 | \$ 833 | \$    |
|                               | =====     | ===== | =====     | =====  | ===== |

See notes to the consolidated financial statements.

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ISRAMCO INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(in thousands)

|  | YEAR ENDED DEC |               |
|--|----------------|---------------|
|  | 2005           | 2004          |
|  | -----          | -----         |
|  |                | (RESTATE)     |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>   |                |               |
| Net income (loss)  | \$ (1,132)     | \$ 9          |
| Adjustments to reconcile net income (loss) to cash provided by operating activities: |                |               |
| Depreciation, depletion, amortization and provision for impairment                   | 2,898          | 1,1           |
| Accretion of asset retirement obligation   | 25             |               |
| Dry hole costs   | --             |               |
| Loss (gain) on marketable securities   | (550)          | (3            |
| Gain from sale of securities   | --             |               |
| Equity in net loss (income) of investees   | (661)          | (1,3          |
| Cumulative effect of an accounting change  | --             |               |
| Deferred taxes   | (355)          | 7             |
| Changes in assets and liabilities:   |                |               |
| Accounts receivables   | 172            | (2            |
| Prepaid expenses and other current assets  | 169            | 1             |
| Accounts payable and accrued expenses  | 980            | 4             |
| Marketable securities trading  | --             |               |
| Net cash provided by operating activities  | -----<br>1,545 | -----<br>1,5  |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>   |                |               |
| Purchase of property and equipment   | (4,703)        | (1,0          |
| Investment in vessel   |                | (9,0          |
| Proceeds from sale of oil and gas properties and equipment                           |                |               |
| Purchase of real estate  |                |               |
| Purchase of marketable securities  | (3,353)        | (4,8          |
| Proceeds from sale of marketable securities  | 7,315          | 6,1           |
| Proceeds from sale of other investment   | --             | 6             |
| Net cash used in investing activities  | -----<br>(741) | -----<br>(8,1 |

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### CASH FLOWS FROM FINANCING ACTIVITIES:

|  |           |        |
|--|-----------|--------|
| Receipt of loans from banks                              | --        | 9,8    |
| Payments on short-term debt                              | (1,336)   | (4,8   |
| Change in short-term credit from banks                   | (306)     | 1,2    |
|  | -----     | -----  |
| Net cash provided by financing activities                | (1,642)   | 6,2    |
|  | -----     | -----  |
| <br>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS | <br>(838) | <br>(3 |
| CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR           | 2,087     | 2,4    |
|  | -----     | -----  |
| CASH AND CASH EQUIVALENTS AT END OF YEAR                 | \$ 1,249  | \$ 2,0 |
|  | =====     | =====  |

### SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:

|  |        |       |
|--|--------|-------|
| CASH PAID DURING THE PERIOD FOR INTEREST | \$ 205 | \$ 1  |
|  | =====  | ===== |
| CASH PAID DURING THE PERIOD FOR TAXES    | \$ 65  | \$    |
|  | =====  | ===== |

See notes to the consolidated financial statements.

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### ISRAMCO INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(NOTE A) -- General and Summary of Significant Accounting Policies:

[1] The Company

Isramco Inc. (the "Company") is primarily engaged in the acquisition, exploration, operation and development of oil and gas properties. As of December 31, 2005, the Company had oil and gas interests in Texas, Louisiana, Oklahoma, Wyoming, New Mexico, and working interests in various properties located in Israel.

In addition, the Company owns real estate in Israel and a luxury cruise liner.

[2] Consolidation

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries: Jay Petroleum, L.L.C., a Texas limited liability company (Jay); Jay Management L.L.C., a Texas limited liability company (Jay Management); IsramTec Inc., a Delaware corporation (IsramTec); Isramco Oil and Gas Ltd., an Israeli company; and Magic 1 Cruise Line, Corp., a British Virgin Island corporation. Inter-company balances and transactions have been eliminated in consolidation.

[3] Method of Accounting for Oil and Gas Operations

The Company follows the "successful efforts" method of accounting for its oil and gas producing activities. Costs to acquire mineral interests in oil and gas properties, to drill and equip exploratory wells that find proved reserves, and to drill and equip development wells are capitalized. Costs to drill exploratory

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wells that do not find proved reserves, geological and geophysical costs, and costs of carrying and retaining unproved properties are expensed. Costs incurred for exploratory wells that find reserves that cannot yet be classified as proved are capitalized on the Company's balance sheet if (a) the well has found a sufficient quantity of reserves to justify its completion as a producing well and (b) the Company is making sufficient progress assessing the reserves and the economic and operating viability of the project. Otherwise, well costs are expensed if a determination as to whether proved reserves were found cannot be made within one year following the completion of drilling and these criteria are not met.

Management estimates that the salvage value of lease and well equipment will approximately offset the future liability for plugging and abandonment of the related wells. Accordingly, no accrual for such costs has been recorded.

### [4] Marketable Securities

Statement of Financial Accounting Standard No. 115 (SFAS No. 115), Accounting for Certain Investments in Debt and Equity Securities, requires the Company to classify its debt and equity securities in one of three categories: trading, available-for-sale and held-to-maturity. Trading securities are bought and held principally for the purposes of selling them in the near term. Held-to-maturity securities are those securities in which the Company has both the ability and intent to hold the security until maturity. All other securities not included in trading or held-to-maturity are classified as available-for-sale.

Trading and available-for-sale securities are recorded at fair market value. The Company holds no held-to-maturity securities. Unrealized holding gains and losses on trading securities are included in earnings. Unrealized holding gains or losses, net of the related tax effects, on available-for-sale securities are excluded from earnings and are reported net of applicable taxes as accumulated other comprehensive income, a separate component of shareholders' equity, until realized.

### [5] Investment in Affiliates

The Company uses the equity method to account for its investments in affiliate entities over which it has the ability to exercise significant influence over operating and financial policies.

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### [6] Equipment

Equipment, consisting of motor vehicles, office furniture and equipment, is carried at cost less accumulated depreciation, computed on the straight-line method over the estimated useful lives of the assets.

### [7] Translation of Foreign Currencies

Foreign currency is translated in accordance with Statement of Financial Accounting Standards No. 52, which provides the criteria for determining the functional currency for entities operating in foreign countries. The Company has determined its functional currency is the United States (U.S.) dollar since all of its contracts are in U.S. dollars. The financial statements of Oil and Gas and the Israel branch the Company's Israeli subsidiaries have been translated into U.S. dollars as follows: at rates prevailing during the year for revenue and expense items (except depreciation); at year-end rates for assets and liabilities except for fixed assets and prepaid expenses which are translated at the rate in effect at the time of their acquisition. Depreciation is translated

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based on the historical dollar cost of the underlying assets. The net effects of currency translations were not material in any period.

### [8] Earnings Per Share (EPS)

The Company follows SFAS No. 128, Earnings per Share, for computing and presenting earnings per share, which requires, among other things, dual presentation of basic and diluted loss per share on the face of the statement of operations. Basic EPS is computed by dividing income available to common shareholders by the weighted average number of common shares outstanding for the period. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common shares were exercised or converted into common shares or resulted in the issuance of common shares that then shared in the earnings of the entity. For the year ended December 31, 2005, the Company's stock options were anti-dilutive.

### [9] Cash Equivalents

Cash equivalents include short-term investments with original maturities of ninety days or less and are not limited in their use.

### [10] Non-compete Agreements

Non-compete agreements are amortized over the terms of the agreements, which are generally from three to five years.

### [11] Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and related notes. Actual results could differ from those estimates.

Oil and gas reserve quantities are the basis for the calculation of depreciation, depletion and impairment of oil and gas properties. An independent petroleum engineering firm estimates the Company's reserves. However, management emphasizes that reserve estimates are inherently imprecise and that estimates of more recent discoveries and non-producing reserves are more imprecise than those for properties with long production histories. At December 31, the Company's oil and gas reserves were attributable to non-producing reserves. Accordingly, the estimates of the Company's reserves are expected to change as additional information becomes available.

As mandated under SFAS No. 144, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets" (SFAS No. 144), the Company is required under certain circumstances to evaluate the possible impairment of the carrying value of its long-lived assets. For proved oil and gas properties, this involves a comparison to the estimated future undiscounted cash flows, as described in the paragraph below. In addition to the uncertainties inherent in the reserve estimation process, these amounts are affected by management's estimates for projected prices for oil and natural gas, which have typically been volatile. It is reasonably possible that the Company's oil and gas reserve estimates may materially change in the forthcoming year.

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### [12] Impairment of Long-Lived Assets

The Company adopted SFAS No. 144, effective as of January 1, 2002. This Statement requires that long-lived assets be reviewed for impairment whenever

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events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to undiscounted future cash flows expected to be generated by the asset or used in its disposal. If the carrying amount of an asset exceeds its estimated undiscounted future cash flows, an impairment charge is recognized equal to the amount by which the carrying amount exceeds the fair market value of the asset. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell.

During 2005 and 2004, the Company reported impairment charges of \$759,000 and \$50,000 respectively, relating to its proved properties. During 2003, the Company recorded impairment charges of \$248,000 relating to its proved properties and \$81,000 related to the retirement obligation assets.

Unproved oil and gas properties that are individually significant are periodically assessed for impairment value, and a loss is recognized to the extent, if any, that the cost of the property has been impaired. During 2005, 2004 and 2003, the Company recorded impairments of \$0, \$218,000 and \$288,000, respectively, relating to its unproved properties.

### [13] Income Taxes

The Company accounts for income taxes using the asset and liability method as prescribed by SFAS No. 109, Accounting for Income Taxes. Deferred tax assets and liabilities are determined based on differences between the financial reporting and tax bases of assets and liabilities, and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse. The measurement of deferred tax assets is reduced, if necessary, by a valuation allowance for any tax benefits that are not expected to be realized. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in the period that such tax rate changes are enacted.

### [14] Oil and Gas Revenues

The Company follows the entitlement method of accounting for recording oil and gas revenues under that method, any revenues received in excess of the Company's share is treated as a liability. If revenues received are less than the Company's share, the deficiency is recorded as an asset. The Company's imbalance position was not significant in terms of volumes or values at December 31, 2005 and 2004.

### [15] Environmental

The Company is subject to extensive federal, state, local and foreign environmental laws and regulations. These laws, which are constantly changing, regulate the discharge of materials into the environment and may require the Company to remove or mitigate the environmental effects of the disposal or release of petroleum or chemical substances at various sites. Liabilities for expenditures of no capital nature are recorded when environmental assessment and/or remediation is probable, and the costs can be reasonably estimated. No significant amounts for environmental liabilities were recorded at December 31, 2005 and 2004.

### [16] Stock-Based Compensation

SFAS No. 123, "Accounting for Stock-Based Compensation," encourages, but does not require, companies to record compensation cost for stock-based employee compensation plans at fair value. In December 2002, the FASB issued SFAS No. 148, to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. The statement also amends the disclosure requirements of SFAS No. 123 to require

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prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based compensation and the effect of the method used on reported results.

The Company has chosen to continue to account for stock-based compensation issued to employees using the intrinsic value method prescribed in Accounting Principles Board (APB) Opinion No. 25, "Accounting for Stock Issued to Employees," and related interpretations. Accordingly, compensation cost for stock options is

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measured as the excess, if any, of the quoted market price of the Company's stock at the date of the grant over the amount an employee must pay to acquire the stock.

The fair value of options is calculated using the Black-Scholes option-pricing model. Had the Company adopted the fair value method of accounting for stock based compensation, compensation expense would have been higher, and net loss and net loss attributable to common shareholders would have increased for the periods presented. No change in cash flows would occur. The effects of applying SFAS No. 123 in this pro forma disclosure are not indicative of future amounts.

|   | Year Ended December 31,<br>(in thousands) |         |          |
|---|---|---------|----------|
|   | 2005                                      | 2004    | 2003     |
| Net income (loss) reported.....   | \$ (1,132)                                | \$ 993  | \$ 2,256 |
| Deduct:   |   |         |          |
| Total stock based employee compensation expense<br>determined under fair value based method for all<br>awards, net of related income tax..... |   | --      | --       |
| Pro forma net (loss).....   | (1,132)                                   | 993     | 2,256    |
| Net Loss Per Share.....   |   |         |          |
| Basic-as reported.....  | \$ (0.42)                                 | \$ 0.38 | \$ 0.85  |
| Basic-pro forma.....  | (0.42)                                    | 0.38    | 0.85     |
| Diluted-as reported.....  | (0.42)                                    | 0.38    | 0.85     |
| Diluted-pro forma.....  | (0.42)                                    | 0.38    | 0.85     |

### [17] Accounting Changes

Effective January 1, 2003, the Company adopted SFAS No. 143 "Accounting for Asset Retirement Obligations" and recognized a loss of \$264,000 that is included as a cumulative effect of change in accounting principle. Effective January 1, 2002, the Company applied the provisions of Statement SFAS No.142 "Goodwill and Other Intangible Assets". In 2002, the Company performed the transitional impairment evaluation as provided in the said standard. Accordingly, the Company recognized for the year ended December 31, 2003 a gain in the amount of \$3,516,000 from a negative goodwill that is included as a cumulative effect of a change in accounting principle.

### [18] Reclassifications

Certain amounts in prior financial statements have been reclassified to conform

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to the 2005 financial statements presentation.

[19] New Pronouncements need to update

In April 2003, the Financial Accounting Standards Board issued SFAS No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities." The statement amends and clarifies accounting and reporting for derivative instruments, including certain derivative instruments embedded in other contracts, and hedging activities. This statement is designed to improve financial reporting such that contracts with comparable characteristics are accounted for similarly. The statement, which is generally effective for contracts entered into or modified after June 30, 2003, has been considered for the Company's derivative instruments.

In December 2004, the FASB issued SFAS No. 123R, "Accounting for Stock-Based Compensation." SFAS No. 123R establishes standards for the accounting for transactions in which an entity exchanges its equity instruments for goods or services. This Statement focuses primarily on accounting for transactions in which an entity obtains employee services in share-based payment transactions. SFAS No. 123R requires that the fair value of such equity instruments be recognized as expense in the historical financial statements as services are performed. Prior to SFAS No. 123R, only certain pro forma disclosures of fair value were required. SFAS No. 123R shall be effective for small business issuers as of the beginning of the first interim or annual reporting period that begins after December 15, 2005. The adoption of this new accounting pronouncement is not expected to have a material impact on the financial statements of the Company during the calendar year 2006.

In June 2005, the FASB ratified the conclusions of Emerging Issues Task Force No. 04-05 ( EITF 04-05), "Determining Whether a General Partner or the General Partners as a Group, Controls a Limited Partnership or Similar Entity When the Limited Partners Have Certain Rights." EITF 04-05 provides a framework for determining whether a general partner controls, and should consolidate, a limited partnership or similar entity. EITF 04-05 is effective for all limited partnerships beginning January 1, 2006. Under EITF 04-05, the Company will continue to account for the investment in Isramco Negev 2 Limited Partnership using the equity method because all major transactions of the partnership, such as raising equity and obtaining a license, require limited partner approval. Accordingly, the Company does not expect the adoption of EITF 04-05 will have a material impact on its financial statements.

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(NOTE B) - Transactions with Affiliates and Related Parties

The Company acts as operator for joint venture with related parties in Israel engaged in the exploration of oil and gas for which it receives operating fees equal to the larger of 6% of the actual direct costs or minimum monthly fees of \$6,000.

Operator fees earned and related operator expenses are as follows:

| YEAR ENDED DECEMBER 31, |                 |                 |
|-------------------------|-----------------|-----------------|
| 2005                    | 2004            | 2003            |
| \$ IN THOUSANDS         | \$ IN THOUSANDS | \$ IN THOUSANDS |
| -----                   | -----           | -----           |

Operator fees:

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|                   |    |       |    |       |    |       |
|-------------------|----|-------|----|-------|----|-------|
| Nir 2             | \$ | --    | \$ | --    | \$ | 559   |
| Gad 1             |    | 905   |    | --    |    | --    |
| Med Ashdod Lease  |    | 72    |    | --    |    | 56    |
| GAL C             |    | --    |    | 72    |    | --    |
| Marine North      |    | --    |    | --    |    | --    |
| Marine Center     |    |       |    | --    |    | 66    |
| Marine South      |    | --    |    | 65    |    | 72    |
|                   |    | ----- |    | ----- |    | ----- |
| Operator Income   | \$ | 977   | \$ | 137   | \$ | 753   |
|                   |    | ===== |    | ===== |    | ===== |
| Operator expenses | \$ | 767   | \$ | 807   | \$ | 795   |
|                   |    | ===== |    | ===== |    | ===== |

In December 2003, the Company entered into a consulting agreement with Doron Avraham, the Vice President of the Company. Pursuant to this agreement, the Company agreed to pay the consultant the sum of \$15,000 per month plus expenses in consideration of the services that he provides to the Company. The term of the consulting agreement expires in November 2007.

The Company paid Naphtha Israel Petroleum Corp., Ltd. ("Naphtha") \$235,000, \$228,000 and \$197,000 for the years ended December 31, 2005, 2004 and 2003, respectively, for rent and office, secretarial and computer services. Naphtha is the sole shareholder of Naphtha Holdings, Ltd., which is the record holder of 48.39% of the Company's outstanding common stock and which may be deemed to be controlled by Haim Tsuff, the Chairman of the Board of Directors and Chief Executive Officer of the Company.

The Company paid Equital Ltd. \$148,375 consulting fee for Isramco's projects in US and in Israel. Equital is company controlled by Haim Tsuff, the chairman of the Board and Chief Executive Officer of the Company.

Isramco Oil and Gas Ltd. ("IOG"), a wholly-owned subsidiary of the Company, is the general partner of Isramco-Negev 2 Limited Partnership, from which the Company received management fees and expense reimbursements of \$480,000 for each of the years ended December 31, 2005, 2004 and 2003.

In May 1996, the Company entered into a consulting agreement with Goodrich Global L.T.D. B.V.I., a company owned and controlled by Haim Tsuff, the Chairman of the Board of Directors and Chief Executive Officer of the Company. Pursuant to this consulting agreement, the Company pays the consultant \$144,000 per annum in installments of \$12,000 per month plus expenses in consideration of the services that Mr. Tsuff provides to the Company. In April 1997, the consulting fees payable under the agreement was increased to \$240,000 per annum in installments of \$20,000 per month. The term of the consulting agreement expires in May 2006. In the event that the Company terminates the agreement, the consultant will be entitled to receive a lump sum severance payment equal to the balance of the unpaid consulting fees due for the remaining term of the agreement.

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In November 1999, the Company entered into a consulting agreement with Worldtech Inc., a Mauritius company of which Jakob Maimon, the President of the Company, is a director. Pursuant to this consulting agreement, the Company pays the consultant \$240,000 per annum in installments of \$20,000 per month plus expenses in consideration of the services that he provides to the Company. The term of the agreement expires in May 2006. In the event that the Company terminates the agreement, , the consultant shall be entitled to receive a lump sum severance



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payment equal to the balance of the unpaid consulting fees due for the remaining term of the agreement.

In December 2003, the Company awarded bonuses of \$125,000 to its Chief Executive Officer and Chairman of the Board of Directors and \$125,000 to its President.

In December 2004, the Company awarded a bonus of \$150,000 to its Chief Executive Officer and Chairman of the Board of Directors.

In December 2005, the Company awarded bonuses of \$150,000 to its Chief Executive Officer and Chairman of the Boards of Directors, \$150,000 to its President and \$75,000 to its Vice President.

In December 2004, the Company leased real estate to I.O.C. Israel Oil Company LTD pursuant to a two-year lease at a monthly rental of \$7,000.

On January 1, 2001 the Company retained the services of I.O.C. Israel Oil Company LTD in connection with the operation of Jay Petroleum and Jay Management. The Company paid I.O.C. \$120,000 for each of the years 2005, 2004 and 2003. I.O.C is a company fully owned by Naphtha Israel Petroleum Corporation, a company controlled by Haim Tsuff.

### (NOTE C) - Investments in Affiliate

Isramco Oil and Gas Ltd. ("IOG"), a wholly-owned subsidiary of the Company, is the general partner of the Isramco Negev 2 Limited Partnership (the "Limited Partnership"). The daily management of the Limited Partnership is under the control of the general partner; however, matters involving the rights of the Limited Partnership unit holders are subject to supervision of a supervisor, appointed to supervise the Limited Partnership activities, and in some instances the approval of the Limited Partnership unit holders. Through IOG, the Company owns a 0.05% interest in the Limited Partnership, which is accounted for by the equity method of accounting due to the Company's ability to exercise significant influence over the Limited Partnership.

At December 31, 2005 and 2004, the Company owned 282,817,359 units (6.65% of the issued Limited Partnership units) of the Limited Partnership, with a cost of valued at \$4,050,000 and market value of \$6,768,000 and \$6,498,000, respectively. This investment is also accounted for under the equity method of accounting.

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Summarized financial information of the Limited Partnership is as follows (amounts in thousands) (unaudited):

|                     | AS OF DECEMBER 31, |            |
|---------------------|--------------------|------------|
|                     | 2005               | 2004       |
| Balance Sheet       |                    |            |
| Current Assets      | \$ 127,661         | \$ 128,016 |
| Other Assets        | 1,653              | 2,908      |
| Total Assets        | 129,314            | 130,924    |
| Current Liabilities | 109                | 129        |
| Equity              | \$ 129,205         | \$ 130,795 |

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|                              |    |         |    |         |
|------------------------------|----|---------|----|---------|
| Total Liabilities and equity | \$ | 129,314 | \$ | 130,924 |
|                              |    | =====   |    | =====   |

| Statement of Operations | Year Ended December 31, |           |           |
|-------------------------|-------------------------|-----------|-----------|
|                         | 2005                    | 2004      | 2003      |
| Income                  | \$ 15,509               | \$ 13,080 | \$ 19,700 |
| Expenses                | (7,267)                 | (807)     | (8,500)   |
| Net income              | \$ 8,242                | \$ 12,273 | \$ 11,200 |

At December 31, 2005 and 2004 the Company also owned 7,877,248 of units (24.97% of the issued Partnership units) of the I.N.O.C Dead Sea Limited Partnership with a cost of \$1,270,000 and value at \$2,530,000 and \$2,452,000, respectively. This investment is also accounted for under the equity method of accounting.

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Summarized financial information of I.N.O.C. Dead Sea Limited Partnership is as follows (amounts in thousands - unaudited):

| Balance Sheet                | AS OF DECEMBER 31, |           |
|------------------------------|--------------------|-----------|
|                              | 2005               | 2004      |
| Current Assets               | \$ 13,277          | \$ 13,752 |
| Other Assets                 | --                 | --        |
| Total Assets                 | \$ 13,277          | 13,752    |
| Current Liabilities          | 65                 | 71        |
| Equity                       | \$ 13,212          | \$ 13,681 |
| Total Liabilities and Equity | \$ 13,277          | \$ 13,752 |

| Statement of Operations | Year Ended December 31, |          |          |
|-------------------------|-------------------------|----------|----------|
|                         | 2005                    | 2004     | 2003     |
| Income                  | \$ 1,495                | \$ 2,488 | \$ 2,070 |
| Expenses                | (262)                   | (300)    | (1,400)  |
| Net income              | \$ 1,233                | \$ 2,188 | \$ 670   |

(NOTE D) - Marketable Securities

At December 31, 2005 and 2004, the Company had net unrealized gains on marketable securities (trading and available for sale) of \$1,538,000 and \$1,717,000 respectively. Sales of marketable securities resulted in realized gains of \$550,000, \$240,000 and \$872,000 for the years ended December 31, 2005,

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2004 and 2003, respectively.

Trading securities, which are primarily traded on the Tel-Aviv Stock Exchange, consists of the following:

|                                       | DECEMBER 31, 2005 |              | DECEMBER 31, 2004 |              |
|---------------------------------------|-------------------|--------------|-------------------|--------------|
|                                       | COST              | MARKET VALUE | COST              | MARKET VALUE |
| Debentures and Convertible Debentures | \$ 3,852,000      | \$ 3,981,000 | \$ 2,222,000      | \$ 2,222,000 |
| Equity securities                     | 1,476,000         | 1,432,000    | 2,433,000         | 2,433,000    |
| Investment Trust Funds                | 145,000           | 157,000      | 1,091,000         | 1,091,000    |
|                                       | \$ 5,473,000      | \$ 5,570,000 | \$ 5,746,000      | \$ 5,746,000 |

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Available-for-sale securities, which are primarily traded on the Tel-Aviv Stock Exchange and on the OTC Bulletin Board, consist of the following:

| DECEMBER 31, 2005 |              | DECEMBER 31, 2004 |              |
|-------------------|--------------|-------------------|--------------|
| COST              | MARKET VALUE | COST              | MARKET VALUE |
| \$ 2,178,000      | \$ 3,619,000 | \$ 4,955,000      | \$ 6,225,000 |

(NOTE E) - Other assets - Investment in a high-tech company.

The Company sold 203,000 shares of high tech Company, Eyeblaster for \$609,000 recognizing a gain of \$549,000 in December 2003.

(NOTE F) - Oil and Gas Properties and Equipment

Annual rates of depreciation are as follows:

|                                |          |
|--------------------------------|----------|
| Office equipment and furniture | 7%--20%  |
| Motor vehicles                 | 15%--30% |

|                             | 2005      | 2004      |
|-----------------------------|-----------|-----------|
| Transportation equipment    | 167,000   | 142,000   |
| Office equipment            | 100,000   | 100,000   |
|                             | 267,000   | 242,000   |
| Less accumulated depletion, | (174,000) | (170,000) |
| Equipment, net              | 93,000    | 72,000    |

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A summary of property and equipment is as follows:

|  | 2005         | 2004         |
|--|--------------|--------------|
|  | -----        | -----        |
| Unproved properties  | \$ 37,000    | \$ 37,000    |
| Proved Oil and gas properties  | 10,552,000   | 7,305,000    |
| Retirement obligation assets   | 230,000      | 108,000      |
| Equipment  | 271,000      | 242,000      |
|  | -----        | -----        |
|  | 11,090,000   | 7,692,000    |
| Less accumulated depletion, depreciation,<br>amortization and provision for impairment | (5,970,000)  | (4,502,000)  |
|  | -----        | -----        |
|  | \$ 5,110,000 | \$ 3,190,000 |
|  | =====        | =====        |

### (NOTE G) Derivative Instruments

The Company enters into derivative contracts to provide a measure of stability in the cash flows associated with the Company's oil and gas production and to manage exposure to commodity price. The Company's objective is to lock in a range of oil and gas prices.

Derivative contracts not designated as hedges are "marked to market" at each period end and the increases or decreases in fair values recorded as other revenue in the statement of operations. No derivative instruments have been designated as cash flow hedges. During 2005, 2004 and 2003, the Company had recorded losses of \$671,000, \$0 and \$0, respectively, related to its derivative instruments.

The Company uses swap contracts to manage the risk on commodity prices. The Company's positions are monitored and managed on a daily basis to ensure compliance with the Company's risk management policy. The swap contracts are entered into principally with a major financial institution. All derivatives are recorded at fair value on the consolidated balance sheet with resulting gains and losses reflected in income. Fair values are derived principally from market quotes and other independent third-party quotes.

The Company is exposed to credit risk in the event of nonperformance by the counter party to these contracts, Bank of Oklahoma. However, the Company periodically assesses their credit worthiness to mitigate this credit risk.

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### (NOTE H) Debt

The Company's debt consists of the following as of:

|  | DECEMBER 31, 2005 |
|--|-------------------|
|  | -----             |
| Bank loan, repayable in 19 equal quarterly installments<br>(of principal and interest) over the period beginning<br>June 20, 2005, interest rate of LIBOR + 1% per annum, due<br>December 20, 2009 | \$ 4,267,000      |
| Bank loan, due on March 29, 2005, interest of 3.35%  | --                |
|  | -----             |
| Total debt   | 4,267,000         |
| Less: current portion  | (1,010,000)       |
|  | -----             |

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Long term debt \$ 3,257,000  
=====

For purpose of securing its liability, the Company agreed to the placement of a lien on the cruise line vessel.

(NOTE I) EPS Computation

SFAS No. 128, "Earnings Per Share", requires a reconciliation of the numerator (income) and denominator (shares) of the basic EPS computation to the numerator and denominator of the diluted EPS computation. The company's reconciliation is as follows:

|                                | FOR THE YEAR ENDED DECEMBER 31, |           |            |           |        |
|--------------------------------|---------------------------------|-----------|------------|-----------|--------|
|                                | 2005                            |           | 2004       |           |        |
|                                | INCOME                          | SHARES    | INCOME     | SHARES    | INCOME |
| Earnings (loss) - basic        | \$(1,132,000)                   | 2,709,355 | \$ 993,000 | 2,639,853 | \$ 2,2 |
| Effect of dilutive securities: |                                 |           |            |           |        |
| Stock options                  | --                              | --        | --         | 898       |        |
| Earnings (loss) - diluted      | \$(1,132,000)                   | 2,709,355 | \$ 993,000 | 2,640,751 | \$ 2,2 |

(NOTE J) Stock Options

The 1993 stock option plan (the 1993 Plan) was approved at the annual meeting of shareholders held in August 1993. At December 31, 2005, 50,000 shares of common stock were reserved for issuance under the 1993 Plan. Options granted under the 1993 Plan may be either incentive stock options under the Internal Revenue Code or options which do not qualify as incentive stock options. Options granted under the 1993 Plan may be exercised for a period of up to ten years from the grant date. The exercise price for an incentive stock option may not be less than 100% of the fair market value of the Company's common stock on the date of grant. All the options granted under the 1993 Plan to date were fully vested on the date of grant. The administrator of the 1993 Plan may set the exercise price for a nonqualified stock option at less than 100% of the fair market value of the Company's common stock on the date of grant.

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A summary of the stock options outstanding under the 1993 Plan is presented below:

|                                  | WEIGHTED-AVERAGE |                |
|----------------------------------|------------------|----------------|
|                                  | OPTIONS          | EXERCISE PRICE |
| 1993 Plan:                       |                  |                |
| Outstanding at December 31, 2002 | 29,750           | \$ 21.00       |
| Granted                          | --               | --             |
| Expired                          | (24,250)         | 23.39          |
| Outstanding at December 31, 2003 | 5,500            | \$ 10.45       |
| Granted                          | --               | --             |
| Expired                          | (2,500)          | 16.92          |

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|                                  |         |    |      |
|----------------------------------|---------|----|------|
| Outstanding at December 31, 2004 | 3,000   | \$ | 5.06 |
| Expired                          | (3,000) |    | 5.06 |
| Outstanding at December 31, 2005 | --      | \$ | --   |

No stock options were granted during 2005, 2004 and 2003. Shares of common stock reserved for future issuance under the 1993 plane are 20,050 shares.

(NOTE K) -- Income Taxes

Income (loss) before income taxes from U.S. and foreign results of operations is as follows:

|         | YEAR ENDED DECEMBER 31, |              |              |
|---------|-------------------------|--------------|--------------|
|         | 2005                    | 2004         | 2003         |
| U.S.    | \$ (600,000)            | \$ 1,107,000 | \$ 1,022,000 |
| Foreign | (492,000)               | 462,000      | 2,426,000    |
| Total   | \$ (1,092,000)          | \$ 1,569,000 | \$ 3,448,000 |

Total income tax expense (benefit) for each of the years ended December 31, 2005, 2004 and 2003 were allocated as follows:

|   | Year Ended December 31, |            |              |
|---|-------------------------|------------|--------------|
|   | 2005                    | 2004       | 2003         |
| Income taxes (benefit)  | \$ 40,000               | \$ 576,000 | \$ 1,188,000 |
| Shareholders' equity for unrealized holding gains (losses) on marketable securities | 212,000                 | 260,000    | 80,000       |
| Total   | \$ 252,000              | \$ 836,000 | \$ 1,268,000 |

Income tax expense (benefit) attributable to income from continuing operations consist of:

|                  | YEAR ENDED DECEMBER 31, |            |              |
|------------------|-------------------------|------------|--------------|
|                  | 2005                    | 2004       | 2003         |
| Current:         |                         |            |              |
| State            | \$ 25,000               | \$ 24,000  | \$ 17,000    |
| Federal          | --                      | --         | 1,171,000    |
| Foreign          | 370,000                 | --         | --           |
| Deferred federal | (355,000)               | 552,000    | --           |
| Total            | \$ 40,000               | \$ 576,000 | \$ 1,188,000 |

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The deferred tax assets (liabilities) as of December 31, 2005 and 2004 are as follows:

|   | 2005           | 2004           |
|---|----------------|----------------|
|   |                | (RESTATED)     |
| Net unrealized depreciation (appreciation) of marketable securities | \$ (523,000)   | \$ (589,000)   |
| Investments in partnerships   | (2,510,000)    | (2,780,000)    |
| Basis differences in property and equipment                         | (708,000)      | (254,000)      |
| Losses carry-forward  | 456,000        | 154,000        |
| Foreign tax credit carry-forward                                    | 370,000        | --             |
| Other timing differences  | 16,000         | --             |
|   | \$ (2,899,000) | \$ (3,469,000) |

Reconciliation between the actual income tax expense (benefit) and income taxes computed by applying the U.S. Federal income tax rate to income before income taxes is as follows:

|  | YEAR ENDED DECEMBER 31, |            |         |
|--|-------------------------|------------|---------|
|  | 2005                    | 2004       | 2003    |
|  |                         | (RESTATED) |         |
| Computed at U.S. statutory rates           | (35.0)%                 | 35.0%      | 35.0%   |
| State income taxes, net of federal benefit | 2.3%                    | 1.1%       | 0.5%    |
| Foreign income taxes                       | 33.9%                   | --         | --      |
| Other                                      | 2.5%                    | 0.6%       | (1.05)% |
|  | 3.7%                    | 36.7%      | 34.45%  |

(NOTE L) -- Concentrations of Credit Risk

Financial instruments, which potentially expose the Company to concentrations of credit risk, consist primarily of trade accounts receivable. The Company's customer base includes several of the major United States oil and gas operating and production companies. Although the Company is directly affected by the well-being of the oil and gas production industry, management does not believe a significant credit risk existed at December 31, 2005.

The Company maintains deposits in banks, which may exceed the amount of federal deposit insurance available. Management periodically assesses the financial condition of the institutions and believes that any possible deposit loss is minimal.

A significant portion of the Company's cash and cash equivalents is invested in marketable securities. Substantially all marketable securities owned by the Company are held by banks in Israel and Switzerland.

(NOTE M) -- Luxury Cruise Liner

In March 2004, the Company purchased a luxury cruise liner for aggregate consideration of \$8,050,000.

In March 2004, the Company borrowed approximately \$7.5 million from commercial

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banks to finance the purchase of the vessel. The loans are secured by a lien on the vessel, marketable securities and a Company guarantee. As of December 31, 2005, approximately \$4.3 million in principal of the loans remain outstanding. Interest on the loan accrues at the per annum rate of LIBOR+1% per annum.

Title to the vessel is held by Magic 1 Cruise Line Corp., a wholly owned subsidiary of the Company ("Magic").

The Company leased the vessel to a European-based tour operator for the period from April 21, 2005 through October 27, 2005 at a daily rate of \$8,000.

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(NOTE N) -- Commitments and Contingencies

### COMMITMENTS:

The Company leases corporate office facilities under a three-year operating lease expiring in October 2006 at a monthly rental of \$2,400 with escalation to \$2,500 on November 2005. The Company is also responsible for its pro rate share of the operating expenses that exceed a certain threshold.

At December 31, 2005, future minimum lease payments under non-cancelable operating leases were approximately \$26,000. Future annual minimum lease payments are follows:

|      | Year Ending<br>December 31,<br>----- |
|------|--------------------------------------|
| 2006 | \$ 26,000<br>-----                   |
|      | \$ 26,000<br>=====                   |

### CONTINGENCIES:

The Company is involved in various other legal proceedings arising in the normal course of business. In the opinion of management, the Company's ultimate liability, if any, in these pending actions would not have a material adverse effect on the financial position, operating results or liquidity of the Company.

(NOTE O) - Geographical Segment Information

The Company's operations for 2005 involve two industry segments - the exploration, development production and transportation of oil and natural gas and holding and leasing its cruise line vessel. Prior to 2004, the Company operated in a single operating segment - oil and gas activities. Its current oil and gas activities are concentrated in the United States and Israel. Operating outside the United States subjects the Company to inherent risks such as a loss of revenues, property and equipment from such hazards as exploration, nationalization, war, terrorism and other political risks, risks of increased taxes and governmental royalties, renegotiation of contracts with government entities and change in laws and policies governing operations of foreign-based companies.

The Company's oil and gas business is subject to operating risks associated with the exploration, and production of oil and gas, including blowouts, pollution and acts of nature that could result in damage to oil and gas wells, production facilities of formations. In additions, oil and gas prices have fluctuated



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substantially in recent years as a result of events, which were outside of the Company's control. The Company does not directly operate the cruise line vessel. The Company leases the vessel to third party cruise line operators. This segment of the Company's business is subject to many risks all of which cannot be presently anticipated, including losses resulting from unexpected repairs and maintenance and competition.

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|   | GEOGRAPHIC SEGMENTS |          |                                   |
|---|---------------------|----------|-----------------------------------|
|   | -----               |          |                                   |
|   | (IN THOUSANDS)      |          |                                   |
|   | -----               |          |                                   |
|   | UNITED STATES       | ISRAEL   | TOTAL<br>OIL AND GAS<br>AND OTHER |
|   | -----               | -----    | -----                             |
| 2005  |                     |          |                                   |
| Sales and other operating revenue                           | \$ 3,319            | \$ 1,915 | \$ 5,234                          |
| Costs and operating expenses                                | (3,233)             | (897)    | (4,130)                           |
|   | -----               | -----    | -----                             |
| Operating profit (loss)                                     | 86                  | 1,018    | 1,104                             |
| Interest income   |                     |          |                                   |
| Interest expense  |                     |          |                                   |
| Gain on marketable securities and net gain<br>in investee   |                     |          |                                   |
| General corporate expenses                                  |                     |          |                                   |
| Other income  |                     |          |                                   |
| Income taxes  |                     |          |                                   |
| Net loss  |                     |          |                                   |
| Identifiable assets at December 31, 2005                    | \$ 5,236            | \$ 68    | \$ 5,304                          |
| Cash and corporate assets                                   |                     |          |                                   |
| Total assets at December 31, 2005                           |                     |          |                                   |
| 2004  |                     |          |                                   |
| Sales and other operating revenue                           | \$ 3,174            | \$ 909   | \$ 4,083                          |
| Costs and operating expenses                                | (2,309)             | (816)    | (3,125)                           |
|   | -----               | -----    | -----                             |
| Operating profit (loss)                                     | 865                 | 93       | 958                               |
| Interest income   |                     |          |                                   |
| Interest expense  |                     |          |                                   |
| General corporate expenses                                  |                     |          |                                   |
| Gain on marketable securities and<br>net income in investee |                     |          |                                   |
| Other income  |                     |          |                                   |
| Income taxes  |                     |          |                                   |
| Net loss  |                     |          |                                   |
| Identifiable assets at December 31, 2004                    | \$ 3,135            | \$ 59    | \$ 3,194                          |
| Cash and corporate assets                                   |                     |          |                                   |
| Total assets at December 31, 2004                           |                     |          |                                   |
| 2003  |                     |          |                                   |
| Sales and other operating revenue                           | \$ 3,582            | \$ 1,549 | \$ 5,131                          |
| Costs and operating expenses                                | 1,960               | (820)    | (2,780)                           |

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|  |          |        |          |
|--|----------|--------|----------|
| Operating profit (loss)                                | \$ 1,622 | \$ 729 | \$ 2,351 |
| Interest income and other corporate revenues           |          |        |          |
| Net gain in investee and gain on marketable securities |          |        |          |
| General corporate expenses                             |          |        |          |
| Internet expense                                       |          |        |          |
| Capital gain   |          |        |          |
| Other income   |          |        |          |
| Accretion expenses                                     |          |        |          |
| Income taxes   |          |        |          |
| Net income before cumulative effect                    |          |        |          |
| Identifiable assets at December 31, 2003               | \$ 2,987 | \$ 81  | \$ 3,068 |
| Net property and equipment                             |          |        |          |
| Cash and corporate assets                              |          |        |          |
| Total assets at December 31, 2003                      |          |        |          |

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(NOTE P) -- Asset Retirement Obligations

The Company recognizes the fair value of a liability for an asset retirement obligation in the period in which it is incurred. The associated asset retirement costs are capitalized as part of the carrying amount of the asset. The fair value of a liability for an asset retirement obligation is the amount for which that liability could be settled in a current transaction between willing parties. The Company uses the expected cash flow approach for calculating asset retirement obligations. The liability is discounted using the credit-adjusted risk-free interest rate in effect when the liability is initially recognized. The changes in the liability for an asset retirement obligation due to the passage of time are measured by applying an interest method of allocation to the amount of the liability at the beginning of the period. This amount is recognized as an increase in the carrying amount of the liability and as accretion expense classified as an operating item in the statement of operations.

Effective January 1, 2003, the Company adopted SFAS No. 143, "Accounting for Asset Retirement Obligations." SFAS No. 143 requires entities to record a liability for asset retirement obligations at fair value in the period in which it is incurred and a corresponding increase in the carrying amount of the related long-lived asset. As of January 1, 2003, the Company recorded asset retirement costs of \$458,581 and asset retirement obligations of \$650,240.

The cumulative effect of the change in accounting principles as of January 1, 2003 was \$263,955, after taxes of \$39,158.

The reconciliation of the beginning and ending asset retirement obligations for the years ended December 31, 2005 and 2004 is as follows (in thousands):

|   | 2005   | 2004   |
|---|--------|--------|
|   | -----  | -----  |
| Asset retirement obligations, as of beginning of the year | \$ 314 | \$ 766 |
| Liabilities incurred                                      | 7      | 8      |

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|   |        |        |
|---|--------|--------|
| Liabilities settled                             | --     | --     |
| Accretion expense                               | 19     | 18     |
| Revisions in estimated cash flows               | 3      | (478)  |
|   | -----  | -----  |
| Asset retirement obligations, as of end of year | \$ 343 | \$ 314 |
|   | =====  | =====  |

(NOTE Q) -- Common Stock

In March 2005, the Company issued 38,919 shares of its common stock to each of Haim Tsuff, Chairman of the Board of Directors and Chief Executive Officer of the Company, and Jakob Maimon, President of the Company. The shares were issued upon the exercise of options to purchase 69,995 shares common stock at an exercise price of \$4.28 per share granted to each of Mr. Tsuff and Mr. Maimon on March 25, 2000. The options were exercised pursuant to "cashless" exercise provisions under which the number of shares of common stock issued upon exercise was reduced by the number of shares, valued at the closing price of the common stock on the Nasdaq Small Cap Market on the trading day immediately prior to exercise, equal to the aggregate exercise price of the option.

(NOTE R) -- Subsequent Events

(i) In January 2006, the Company entered into a settlement agreement and mutual release with the defendant parties named therein relating to the lawsuit initiated by the Company against the defendants in February 2004 in the Superior Court of California, County of Los Angeles, alleging breach of contract and tort claims in connection with an agreement between the Company and the defendants to jointly purchase and develop certain parcels of real estate outside Los Angeles. The agreement provides for the settlement of the action with no finding or admission of fault on the part of any party and, pursuant thereto, certain of the defendants paid to the Company \$2,500,000 as reimbursement for costs and expenses incurred by the Company in connection with its

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pursuit of the real estate investment opportunity that was the subject of the action. Under the agreement, the Company and the defendants mutually released one another from any claims or causes of actions arising out of or relating to the action, any claim that could have been asserted in the action, and any and all claims and/or allegations relating to the real estate (and the development thereof) that was the subject of the action.

(ii) In February 2006, the Company entered into a settlement agreement and mutual release with the defendant parties named therein relating to the lawsuit initiated by the Company against the defendants in 2004 in the District Court of Harris County, Texas, alleging a tort claim in connection with an agreement between the Company and a third party pursuant to which the Company purchased all of the outstanding capital stock of a company that owns oil and gas assets in Illinois. Under the agreement the defendants paid the Company \$550,000 and the Company filed a motion to dismiss its claims against the defendants with prejudice.

As a result of the payment received under the settlements agreement, the Company anticipates recorded a net gain of approximately \$2,500,000 (after payment of legal fees and other expenses) during 2006.

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(NOTE S) -- Restatement

The Company has restated its 2004 financial statements from the amounts previously reported. The restatements include adjustments to the calculation of the deferred tax in 2004 related to temporary differences that originated prior to 2003. Following is a summary of the restatement adjustments:

|  | AS REPORTED | ADJUSTMENTS | AS RESTATED |
|--|-------------|-------------|-------------|
| <b>2004 SUMMARY BALANCE SHEET</b>      |             |             |             |
| Total assets                           | \$ 41,358   | --          | \$ 41,358   |
| Current Liabilities                    | 2,670       | --          | 2,670       |
| Assets retirement obligation           | 314         | --          | 314         |
| Deferred tax obligation                | 2,989       | 480         | 3,469       |
| Current portion of long-term bank loan | 4,869       | --          | 4,869       |
| Total Long term Liabilities            | 8,172       | 480         | 8,652       |
| Total Liabilities                      | 10,842      | 480         | 11,322      |
| Total Shareholder's Equity             | 30,516      | (480)       | 30,036      |

|   | AS REPORTED | ADJUSTMENTS | AS RESTATED |
|---|-------------|-------------|-------------|
| <b>2004 SUMMARY STATEMENT OF OPERATIONS</b> |             |             |             |
| Total Revenues                              | \$ 8,943    | \$ --       | \$ 8,943    |
| Total Expenses                              | 7,374       | --          | 7,374       |
| Income before taxes                         | 1,569       | --          | 1,569       |
| Income taxes                                | (1,589)     | 1,013       | (576)       |
| Net Income                                  | \$ (20)     | \$ 1,013    | \$ 993      |
| Earning Per Share                           | \$ --       | \$ 0.38     | \$ 0.38     |

(NOTE T) -- Supplementary Oil and Gas Information (Unaudited)

The following supplemental information regarding the oil and gas activities of the Company for 2005, 2004 and 2003 is presented pursuant to the disclosure requirements promulgated by the Securities and Exchange Commission and SFAS No. 69, "Disclosures About Oil and Gas Producing Activities." Capitalized costs relating to oil and gas activities and costs incurred in oil and gas property acquisition, exploration and development activities for each year are shown below.

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### CAPITALIZED COST OF OIL AND GAS PRODUCING ACTIVITIES (IN THOUSANDS)

|   | 2005          | 2004          | 2003          |        |
|---|---------------|---------------|---------------|--------|
|   | UNITED STATES | UNITED STATES | UNITED STATES | CONGO  |
| Unproved properties not being amortized                         | \$ --         | \$ --         | \$ --         | \$ 150 |
| Proved property being amortized                                 | 10,566        | 7,427         | 6,352         | --     |
| Accumulated depreciation, depletion amortization and impairment | (5,347)       | (4,316)       | (3,338)       | (150)  |

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|                       |          |          |          |       |
|-----------------------|----------|----------|----------|-------|
| Net capitalized costs | \$ 5,219 | \$ 3,111 | \$ 3,014 | \$ -- |
|                       | =====    | =====    | =====    | ===== |

COSTS INCURRED IN OIL AND GAS PROPERTY ACQUISITION, EXPLORATION, AND DEVELOPMENT ACTIVITIES (IN THOUSANDS)

|  | 2005          | 2004          | 2003          |       |
|--|---------------|---------------|---------------|-------|
|  | -----         | -----         | -----         | ----- |
|  | UNITED STATES | UNITED STATES | UNITED STATES | CONGO |
|  | -----         | -----         | -----         | ----- |
| Property acquisition costs--proved and unproved properties       |               |               |               |       |
| Exploration costs  | \$ 2,557      | \$ --         | \$ 260        | \$ -- |
| Development costs  | 110           | --            | 22            | 54    |
|  | 582           | 1,098         | 393           | --    |
| (Israel exploration costs in 2005-\$110, 2004-\$0 and 2003-\$88) |               |               |               |       |

RESULTS OF OPERATIONS FOR OIL AND GAS PRODUCING ACTIVITIES (IN THOUSANDS)

|  | 2005          | 2004          | 2003          |          |
|--|---------------|---------------|---------------|----------|
|  | -----         | -----         | -----         | -----    |
|  | UNITED STATES | UNITED STATES | UNITED STATES | CONGO    |
|  | -----         | -----         | -----         | -----    |
| Oil and gas sales  | \$ 3,319      | \$ 3,174      | \$ 3,439      | \$ --    |
| Lease operating expense and severance taxes                        | (1,457)       | (1,149)       | (872)         | --       |
| Depreciation, depletion, amortization and provision for impairment | 1,397         | (1,181)       | (1,088)       | (150)    |
| Exploration costs  | (160)         | --            | (22)          | (54)     |
| Income (Loss) before tax provision                                 | -----         | -----         | -----         | -----    |
| Provision for income taxes   | 305           | 843           | 1,457         | (204)    |
|  | --            | --            | --            | 71       |
| Results of operations  | -----         | -----         | -----         | -----    |
|  | \$ 305        | \$ 843        | \$ 1,457      | \$ (133) |
|  | =====         | =====         | =====         | =====    |

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OIL AND GAS RESERVES

Oil and gas proved reserves cannot be measured exactly. The engineers interpreting the available data, as well as price and other economic factor base reserve estimates on many factors related to reservoir performance, which require evaluation. The reliability of these estimates at any point in time depends on both the quality and quantity of the technical and economic data, the production performance of the reservoirs as well as extensive engineering judgment. Consequently, reserve estimates are subject to revision, as additional data become available during the producing life of a reservoir. When a commercial reservoir is discovered, proven reserves are initially determined

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based on limited data from the first well or wells. Subsequent data may better define the extent of the reservoir and additional production performance, well tests and engineering studies will likely improve the reliability of the reserve estimate. The evolution of technology may also result in the application of improved recovery techniques such as supplemental or enhanced recovery projects, or both, which have the potential to increase reserves beyond those envisioned during the early years of a reservoir's producing life.

The following table represents the Company's net interest in estimated quantities of proved developed and undeveloped reserves of crude oil, condensate, natural gas liquids and natural gas and changes in such quantities at December 31, 2005, 2004 and 2003, and for the years then ended. Net proved reserves are the estimated quantities of crude oil and natural gas which 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 proved reserve volumes that can be expected to be recovered through existing wells with existing equipment and operating methods. Proved undeveloped reserves are proved reserve volumes that are expected to be recovered from new wells on undrilled acreage or from existing wells where a significant expenditure is required for recompilation. All of the Company's proved reserves are in the United States. The Company's oil and gas reserves are priced at \$58.80 per barrel and \$9.30 per Mcf, respectively, at December 31, 2005.

|                                  | OIL BBLs | GAS MCF   |
|----------------------------------|----------|-----------|
|                                  | -----    | -----     |
| December 31, 2002                | 161,933  | 3,919,474 |
| Revisions of previous estimates  | 55,261   | (317,234) |
| Acquisition of minerals in place | --       | --        |
| Sales of minerals in place       | --       | --        |
| Production                       | (19,294) | (599,000) |
| December 31, 2003                | 197,900  | 3,003,240 |
|                                  | =====    | =====     |
| Revisions of previous estimates  | (40,031) | (522,242) |
| Acquisition of minerals in place |          |           |
| Sales of minerals in place       | --       | --        |
| Production                       | (17,789) | (469,558) |
| December 31, 2004                | 140,080  | 2,011,440 |
|                                  | =====    | =====     |
| Revisions of previous estimates  | (20,269) | (118,402) |
| Acquisition of minerals in place | 1,280    | 106,670   |
| Sales of minerals in place       | --       | --        |
| Production                       | (15,723) | (355,008) |
| December 31, 2005                | 105,368  | 1,644,700 |
|                                  | =====    | =====     |

The Company's proved developed reserves are as follows:

|                   | DEVELOPED |           | UNDEVELOPED |         |
|-------------------|-----------|-----------|-------------|---------|
|                   | OIL BBLs  | GAS MCF   | OIL BBLs    | GAS MCF |
|                   | -----     | -----     | -----       | -----   |
| December 31, 2005 | 105,368   | 1,644,700 | 20,652      | 484,101 |
| December 31, 2004 | 140,080   | 2,011,440 | 32,880      | 334,100 |
| December 31, 2003 | 197,900   | 3,003,240 | --          | 516,440 |
| December 31, 2002 | 161,933   | 3,919,474 | --          | 138,050 |

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Interest in proved reserves of unconsolidated affiliates

|                   | OIL BBLs | GAS MCF   |
|-------------------|----------|-----------|
|                   | -----    | -----     |
| December 31, 2005 |          | 1,979,000 |
| December 31, 2004 | --       | 1,979,000 |
| December 31, 2003 | --       | 1,979,000 |

STANDARDIZED MEASURE OF DISCOUNTED FUTURE NET CASH FLOW

The standardized measure of discounted future net cash flows relating to the Company's proved oil and gas reserves is calculated and presented in accordance with Statement of Financial Accounting Standards No. 69. Accordingly, future cash inflows were determined by applying year-end oil and gas prices to the Company's estimated share of the future production from proved oil and gas reserves.

Future production and development costs were computed by applying year-end costs to future years. Applying year-end statutory tax rates to the estimated net future cash flows derived future income taxes. A prescribed 10% discount factor was applied to the future net cash flows.

In the Company's opinion, this standardized measure is not a representative measure of fair market value. The standardized measure is intended only to assist financial statement users in making comparisons among companies.

|   | 2005          | 2004          |       |
|---|---------------|---------------|-------|
|   | -----         | -----         | ----- |
| Future cash inflows                                   | \$ 20,859,000 | \$ 16,308,760 | \$    |
| Future development costs                              | (158,000)     | (73,800)      |       |
| Future production costs                               | (4,547,000)   | (6,691,180)   |       |
|   | -----         | -----         | ----- |
| Future net cash flows                                 | 16,154,000    | 9,548,750     |       |
| Future income tax expenses                            | (1,965,000)   | (3,426,575)   |       |
| Annual 10% discount rate                              | (5,666,000)   | (300,190)     |       |
|   | -----         | -----         | ----- |
| Standardized measure discounted future net cash flows | \$ 8,523,000  | \$ 6,001,810  | \$    |
|   | =====         | =====         | ===== |

CHANGES IN STANDARDIZED MEASURE OF DISCOUNTED FUTURE NET CASH FLOWS

The principal sources of change in the standardized measure of discounted future net cash flows for the years ended December 31, 2005, 2004 and 2003 were as follows:

|  | 2005         | 2004         | 2003         |
|--|--------------|--------------|--------------|
|  | -----        | -----        | -----        |
| Beginning of the year  | \$ 6,001,810 | \$ 4,600,000 | \$ 4,600,000 |
| Sales and transfers of oil and gas produced, net of production costs | (1,862,000)  | (2,000,000)  | (2,000,000)  |

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|   |              |        |
|---|--------------|--------|
| Net changes in prices and production costs                                      | 12,533,000   | 2,4    |
| Net changes in income taxes   | 1,461,575    | 1,3    |
| Changes in estimated future development costs, net of current development costs | (84,200)     |        |
| Acquisition of minerals in place  | 3,656,740    | 1,0    |
| Revision of previous estimates and other  | (7,818,115)  | (5,9   |
| Changes in discount   | (5,365,810)  | 4,3    |
| End of year   | \$ 8,523,000 | \$ 6,0 |

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(NOTE U) -- SELECTED QUARTERLY FINANCIAL DATA (UNAUDITED)

| (amounts in thousands, except per share data)          | QUARTER ENDED    |                 |                      |                  |
|--|------------------|-----------------|----------------------|------------------|
|  | MARCH 31<br>2005 | JUNE 30<br>2005 | SEPTEMBER 30<br>2005 | DECEMBER<br>2005 |
| Total Revenues   | \$ 2,201         | \$ 1,621        | \$ 3,301             | \$ 6             |
| Net Income (loss) before taxes                         | \$ 460           | \$ (752)        | \$ 1,342             | \$ (2,1          |
| Cumulative effect of an accounting change              | \$ --            | \$ --           | \$ --                | \$               |
| Net Income (loss)                                      | \$ 304           | \$ (596)        | \$ 992               | \$ (1,8          |
| Earnings (loss) per Common Share<br>-Basic and Diluted | \$ 0.11          | \$ (0.22)       | \$ 0.36              | \$ (0.           |

| (amounts in thousands, except per share data)          | QUARTER ENDED    |                 |                      |                  |
|--|------------------|-----------------|----------------------|------------------|
|  | MARCH 31<br>2004 | JUNE 30<br>2004 | SEPTEMBER 30<br>2004 | DECEMBER<br>2004 |
| Total Revenues   | \$ 1,893         | \$ 1,526        | \$ 3,122             | \$ 2,4           |
| Net Income (loss) before taxes                         | \$ 915           | \$ 273          | \$ 588               | \$ (2            |
| Cumulative effect of an accounting change              | \$ --            | \$ --           | \$ --                | \$               |
| Net Income (loss)                                      | \$ 845           | \$ --           | \$ (595)             | \$ 7             |
| Earnings (loss) per Common Share<br>-Basic and Diluted | \$ 0.32          | \$ 0.00         | \$ (0.23)            | \$ 0.            |

| (amounts in thousands, except per share data) | QUARTER ENDED    |                 |                      |                  |
|---|------------------|-----------------|----------------------|------------------|
|   | MARCH 31<br>2003 | JUNE 30<br>2003 | SEPTEMBER 30<br>2003 | DECEMBER<br>2003 |
| Total Revenues                                | \$ 1,974         | \$ 2,942        | \$ 1,928             | \$ 2,0           |



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|   |          |          |         |         |
|---|----------|----------|---------|---------|
| Net Income (loss) before taxes            | \$ 852   | \$ 1,906 | \$ 826  | \$ 1    |
| Cumulative effect of an accounting change | \$ (264) | \$ --    | \$ --   | \$      |
| Net Income                                | \$ 588   | \$ 1,906 | \$ 808  | \$ (1,0 |
| Earnings (loss) per Common Share          |          |          |         |         |
| -Basic and Diluted                        | \$ 0.22  | \$ 0.72  | \$ 0.31 | \$ (0.  |

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