

US ENERGY CORP
Form 10-Q/A
April 05, 2006

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q/A

- ☒ Quarterly report pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934
For the six months and quarter ended September 30, 2005 or
- ☐ Transition report pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934
For the transition period from _____ to _____

Commission file number 0-6814

U.S. ENERGY CORP.

(Exact Name of Company as Specified in its Charter)

Wyoming

(State or other jurisdiction of
incorporation or organization)

83-0205516

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

877 North 8th West, Riverton, WY

(Address of principal executive offices)

82501

(Zip Code)

Company's telephone number, including area
code:

(307) 856-9271

Not Applicable

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

Indicate by check mark whether the Company (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Company was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

YES ☒ NO ☐

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

YES ☐ NO ☒

APPLICABLE ONLY TO ISSUERS INVOLVED IN BANKRUPTCY
PROCEEDINGS DURING THE PRECEDING FIVE YEARS:

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Section 12, 13, or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed

by a court.

YES o NO o

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class	Outstanding Shares at November 11, 2005
Common stock, \$.01 par value	18,860,746

Explanation

U.S. Energy Corp. ("USE" or "the Company") is filing this Amendment No. 1 on Form 10-Q/A (this "Form 10-Q/A") to amend our Quarterly Report on Form 10-Q for the third quarter ended September 30, 2005, as initially filed with the Securities and Exchange Commission (the "SEC") on November 14, 2005, and is being filed to reflect the restatement of our condensed consolidated balance sheet as of September 30, 2005 and the related consolidated statements of operations and cash flows for the three and nine months ended September 30, 2005, as discussed in Note 19 to the unaudited condensed consolidated financial statements.

All of the changes in these restated financial statements and corresponding notes to the financial statements relate specifically to:

1. The accounting treatment given to the beneficial conversion feature associated with a senior convertible debenture. The convertible debentures include beneficial conversion features. Pursuant to EITF 98-5~ *Accounting for Convertible Securities with Beneficial Conversion Features and Contingently Adjustable Conversion Ratios* and EITF 00-27~ *Application of Issue No. 98-5 to Certain Convertible Instruments*, the Company determined that the effective conversion price should be used to compute the intrinsic value of the embedded conversion option and;
2. An embedded derivative in shares of Enterra Acquisitions Class D shares that the Company received as a portion of the compensation for the sale of Rocky Mountain Gas, Inc. ("RMG"). The sale of RMG closed on June 1, 2005 and was effective April 1, 2005. Pursuant to SFAS 133 the Company determined that the embedded derivative needed to be accounted for and reflected in the consolidated statement of operations as an other revenue item.

Except for the foregoing amended information required to reflect the effects of the restated condensed consolidated balance sheet, statements of operations and cash flows this Form 10-Q/A continues to describe conditions as presented in the original report on Form 10-Q filed on November 14, 2005. Information not affected by the restatement is unchanged and reflects the disclosures made at the time of the original filing of the Form 10-Q.

Accordingly, this Form 10-Q/A should be read in conjunction with our filings made with the SEC subsequent to the filing of the original Form 10-Q, including any amendments to those filings.

U.S. ENERGY CORP. and SUBSIDIARIES

INDEX

	Page No.
PART I. FINANCIAL INFORMATION	
ITEM 1. Financial Statements.	
Condensed Consolidated Balance Sheets September 30, 2005 (unaudited) and December 31, 2004 (audited)	4-5
Condensed Consolidated Statements of Operations for the Three and Nine Months Ended September 30, 2005 and 2004 (unaudited)	6-7
Condensed Consolidated Statements of Cash Flows for the Three and Nine Months Ended September 30, 2005 and 2004 (unaudited)	8-10
Notes to Condensed Consolidated Financial Statements (unaudited)	11-19
ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operations	20-32
ITEM 3. Quantitative and Qualitative Disclosures about Market Risk	32-34
ITEM 4. Controls and Procedures	34
PART II. OTHER INFORMATION	
ITEM 1. Legal Proceedings	35-36
ITEM 2. Changes in Securities and Use of Proceeds	36
ITEM 3. Defaults Upon Senior Securities	37
ITEM 4. Submission of Matters to a Vote of Shareholders	37
ITEM 5. Other Information	37
ITEM 6. Exhibits and Reports on Form 8-K	38
Signatures	39
Certifications	See Exhibits

U.S. ENERGY CORP. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(UNAUDITED)
ASSETS

	September 30, 2005 (Restated)	December 31, 2004
CURRENT ASSETS:		
Cash and cash equivalents	\$ 8,079,900	\$ 3,842,500
Marketable securities	419,100	--
Accounts receivable		
Trade, net of allowance of \$111,300 each period	129,800	797,500
Affiliates	7,500	13,500
Other	63,500	52,700
Current portion of long-term note receivable, net	35,500	49,500
Prepaid expenses	426,400	489,700
Inventories	20,800	176,100
Total current assets	9,182,500	5,421,500
INVESTMENTS:		
Non-affiliated companies	18,324,200	957,700
Restricted investments	6,740,800	6,852,300
Total investments	25,065,000	7,810,000
PROPERTIES AND EQUIPMENT:		
	13,814,600	22,088,600
Less accumulated depreciation, depletion and amortization	(7,392,900)	(8,322,000)
Net properties and equipment	6,421,700	13,766,600
OTHER ASSETS:		
Note receivable trade	2,964,800	2,971,800
Deposits and other	435,500	733,800
Total other assets	3,400,300	3,705,600
Total assets	\$ 44,069,500	\$ 30,703,700

The accompanying notes are an integral part of these statements.

U.S. ENERGY CORP. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(UNAUDITED)
LIABILITIES AND SHAREHOLDERS' EQUITY

	September 30, 2005 (Restated)	December 31, 2004
CURRENT LIABILITIES:		
Accounts payable	\$ 237,900	\$ 1,751,300
Income taxes payable	--	--
Accrued compensation expense	371,400	181,700
Asset retirement obligation	192,700	192,700
Current portion of long-term debt	202,100	3,400,100
Deferred gain on sale of RMG	--	--
Other current liabilities	61,200	532,200
Total current liabilities	1,065,300	6,058,000
LONG-TERM DEBT, net of current portion		
	1,012,000	3,780,600
ASSET RETIREMENT OBLIGATIONS, net of current portion		
	7,693,700	7,882,400
OTHER ACCRUED LIABILITIES		
	1,565,400	1,952,300
DEFERRED GAIN ON SALE OF ASSET		
	1,279,000	1,279,000
MINORITY INTERESTS		
	733,800	871,100
COMMITMENTS AND CONTINGENCIES		
FORFEITABLE COMMON STOCK, \$.01 par value		
442,740 shares issued, forfeitable until earned	2,599,000	2,599,000
PREFERRED STOCK, \$.01 par value; 100,000 shares authorized		
No shares issued or outstanding	--	--
SHAREHOLDERS' EQUITY:		
Common stock, \$.01 par value; unlimited shares authorized; 18,554,237 and 15,231,237 shares issued net of treasury stock, respectively		
	185,500	152,300
Additional paid-in capital	66,885,600	59,157,100
Accumulated deficit	(35,651,200)	(49,321,700)
Treasury stock at cost, 974,725 and 972,306 shares respectively		
	(2,800,400)	(2,779,900)
Unrealized loss on marketable securities	(7,700)	--

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Accumulated comprehensive loss	--	(436,000)
Unallocated ESOP contribution	(490,500)	(490,500)
Total shareholders' equity	28,121,300	6,281,300
Total liabilities and shareholders' equity	\$ 44,069,500	\$ 30,703,700

The accompanying notes are an integral part of these statements.

-5-

U.S. ENERGY CORP. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

	Three months ended September 30,		Nine months ended September 30,	
	2005	2004	2005	2004
	(Restated)		(Restated)	
OPERATING REVENUES:				
Real estate operations	\$ 60,700	\$ 81,000	\$ 217,900	\$ 189,600
Management fees	106,400	191,300	474,100	361,500
	167,100	272,300	692,000	551,100
OPERATING COSTS AND EXPENSES:				
Real estate operations	76,400	75,800	211,800	213,600
Mineral holding costs	565,000	304,200	1,234,900	1,140,400
General and administrative	1,007,300	988,200	4,331,800	3,055,700
	1,648,700	1,368,200	5,778,500	4,409,700
OPERATING LOSS	(1,481,600)	(1,095,900)	(5,086,500)	(3,858,600)
OTHER INCOME & EXPENSES:				
Gain on sales of assets	1,219,900	12,400	1,229,400	44,200
Gain on sale of marketable securities	1,038,500	--	1,038,500	--
Gain on sale of investment	--	--	117,700	658,400
Gain of valuation derivatives	727,900	--	4,194,300	--
Dividend income	43,400	--	43,400	--
Interest income	50,800	58,000	241,200	197,600
Interest expense	(467,100)	(141,600)	(4,099,100)	(377,100)
	2,613,400	(71,200)	2,765,400	523,100
GAIN (LOSS) BEFORE MINORITY INTEREST, DISCONTINUED OPERATIONS, AND PROVISION FOR INCOME TAXES,	1,131,800	(1,167,100)	(2,321,100)	(3,335,500)
MINORITY INTEREST IN LOSS OF CONSOLIDATED SUBSIDIARIES				
	96,800	(135,100)	458,200	(129,100)
GAIN (LOSS) BEFORE DISCONTINUED OPERATIONS AND PROVISION FOR INCOME TAXES	1,228,600	(1,302,200)	(1,862,900)	(3,464,600)

DISCONTINUED OPERATIONS, net of taxes

Gain on sale of discontinued segment	(188,100)	--	15,533,500	--
Loss from discontinued operations	--	(302,000)	(326,100)	(1,523,800)
	(188,100)	(302,000)	15,207,400	(1,523,800)

The accompanying notes are an integral part of these statements.

U.S. ENERGY CORP. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

(continued)	Three months ended September 30,		Nine months ended September 30,	
	2005	2004	2005	2004
	(Restated)		(Restated)	
GAIN (LOSS) BEFORE PROVISION FOR INCOME TAXES	\$ 1,040,500	\$ (1,604,200)	\$ 13,344,500	\$ (4,988,400)
PROVISION FOR INCOME TAXES	--	--	--	--
NET GAIN (LOSS)	\$ 1,040,500	\$ (1,604,200)	\$ 13,344,500	\$ (4,988,400)
NET GAIN (LOSS) PER SHARE BASIC	\$ 0.06	\$ (0.12)	\$ 0.85	\$ (0.39)
NET GAIN (LOSS) PER SHARE DILUTED	\$ 0.05	\$ (0.12)	\$ 0.83	\$ (0.39)
BASIC WEIGHTED AVERAGE SHARES OUTSTANDING	17,229,336	13,490,917	15,681,519	12,896,476
DILUTED WEIGHTED AVERAGE SHARES OUTSTANDING	19,160,917	13,490,917	16,124,259	12,896,476

The accompanying notes are an integral part of these statements.

U.S. ENERGY CORP. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

Nine months ended September 30,
2005
(Restated) 2004

**CASH FLOWS FROM OPERATING
ACTIVITIES:**

Net gain (loss)	\$ 13,344,500	\$ (4,988,400)
Adjustments to reconcile net gain (loss) to net cash used in operating activities:		
Minority interest in loss of consolidated subsidiaries	(458,200)	129,100
Amortization of deferred charge	441,300	--
Depreciation, depletion and amortization	289,100	262,600
Accretion of asset retirement obligations	275,000	286,900
Amortization of debt discount	3,136,100	199,400
Non-cash interest expense	720,000	--
Non-cash services	35,600	66,400
(Gain) on valuation of derivatives	(4,194,300)	--
(Gain) on sale of investment	(15,533,500)	(702,600)
(Gain) on sale of assets	(890,600)	--
(Gain) on sale marketable securities	(1,156,200)	--
Non-cash compensation	270,900	219,800
Net changes in assets and liabilities:	(178,600)	106,300
NET CASH USED IN OPERATING ACTIVITIES	(3,898,900)	(4,420,500)

**CASH FLOWS FROM INVESTING
ACTIVITIES:**

Proceeds on sale of marketable securities	5,916,600	--
Investment in marketable securities	(338,800)	--
Development of unproved mining claims	(602,600)	--
Proceeds on sale of property and equipment	925,200	704,700
Proceeds from sale investments	117,700	--
Sale of RMG	(270,000)	--
Net change in restricted investments	111,500	78,900
Purchase of property and equipment	(361,600)	(175,500)
Net change in notes receivable	500	--
NET CASH PROVIDED BY BY INVESTING ACTIVITIES	5,498,500	703,600

The accompanying notes are an integral part of these statements.

U.S. ENERGY CORP. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Nine months ended September 30,	
	2005	2004
	(Restated)	
CASH FLOWS FROM FINANCING ACTIVITIES:		
Issuance of common stock	\$ 2,834,900	\$ 350,000
Issuance of subsidiary stock	--	1,256,200
Proceeds from long term debt	3,764,900	1,543,800
Repayments of long term debt	(3,285,000)	(418,500)
NET CASH PROVIDED BY FINANCING ACTIVITIES	3,314,800	2,731,500
Net cash (used in) provided by operating activities of discontinued operations	(453,500)	1,244,000
Net cash used in investing activities of discontinued operations	(215,000)	(5,457,200)
Net cash (used in) provided by financing Activities of discontinued operations	(8,500)	3,831,600
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	4,237,400	(1,367,000)
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	3,842,500	4,084,800
CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$ 8,079,900	\$ 2,717,800
SUPPLEMENTAL DISCLOSURES:		
Income tax paid	\$ --	\$ --
Interest paid	\$ 242,800	\$ 761,100

The accompanying notes are an integral part of these statements.

U.S. ENERGY CORP. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(continued)

	Nine months ended September 30,	
	2005	2004
	(Restated)	
NON-CASH INVESTING AND FINANCING ACTIVITIES:		
Issuance of stock warrants in conjunction with debt	\$ 1,226,200	\$ --
Issuance of stock as conversion of subsidiary stock	\$ 499,700	\$ --
Satisfaction of receivable - employee with stock in company	\$ 20,500	\$ 20,500
Acquisition of assets through issuance of debt	\$ 113,400	\$ --
Issuance of stock for services	\$ 35,600	\$ --
Initial valuation of new asset retirement obligations	\$ --	\$ 372,100
Acquisition of assets through issuance of stock	\$ --	\$ 1,396,200
Issuance of stock to satisfy debt	\$ 4,000,000	\$ 500,000
Accumulated comprehensive loss	\$ --	\$ 920,700

The accompanying notes are an integral part of these statements.

U.S. ENERGY CORP. & SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (Unaudited)

1) The Condensed Consolidated Balance Sheet as of September 30, 2005, the Condensed Consolidated Statements of Operations for the nine months ended September 30, 2005 and 2004 and the Condensed Consolidated Statements of Cash Flows for the nine months ended September 30, 2005 and 2004, have been prepared by the Company without audit. The Condensed Consolidated Balance Sheet at December 31, 2004 has been taken from the audited financial statements included in the Company's Annual Report on Form 10-K for the period then ended. In the opinion of the Company, the accompanying financial statements contain all adjustments (consisting of only normal recurring accruals) necessary to present fairly the financial position of the Company as of September 30, 2005 and December 31, 2004, the results of operations for the three and nine months ended September 30, 2005, and 2004 and cash flows for the nine months ended September 30, 2005 and 2004.

2) The accompanying condensed consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America, which contemplate continuation of the Company as a going concern. Although the Company recorded a profit of \$13,344,500 during the nine months ended September 30, 2005, it has sustained substantial losses from operations in recent years. The profit during the nine months ended September 30, 2005 was generated from the \$14,354,900 gain on the sale of Rocky Mountain Gas, Inc. and certain uranium property interests, not operations.

In view of the matters described in the preceding paragraph, recoverability of a portion of the recorded asset amounts shown in the condensed consolidated accompanying balance sheet is dependent upon continued operations of the Company, which in turn is dependent upon its ability to meet its financing requirements on a continuing basis, and to succeed in its future operations.

To ensure that the Company has adequate capital resources to satisfy its capital requirements, the Company is working with both strategic and financial investors. Although there is no assurance that funding will be available; we believe that our current business plan, if funded, will significantly improve our operating results and cash flow in the future.

3) Certain reclassifications have been made in the December 31, 2004 Financial Statements to conform to the classifications used in the September 30, 2005 Financial Statements.

4) Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted. It is suggested that these financial statements be read in conjunction with the Company's December 31, 2004 Form 10-K.

5) The condensed consolidated financial statements of the Company include its majority-owned and controlled subsidiaries: Energen Ltd. ("Energen")(90%); Crested Corp. ("Crested")(70.1%); Plateau Resources Limited ("Plateau")(100%); Sutter Gold Mining Inc. ("SGMI")(65.5%); Yellow Stone Fuels Corp. ("YSFC")(35.9%); Four Nines Gold, Inc. ("FNG")(50.9%); and the USECC joint venture ("USECC"), a consolidated joint venture which is equally owned by the Company and Crested, through which the bulk of their operations are conducted. Previous condensed consolidated financial statements of the Company included one additional majority-owned subsidiary, Rocky Mountain Gas, Inc. ("RMG", consolidated ownership of 95.6%), which was sold on June 1, 2005. RMG is therefore no longer included in the condensed consolidated financial statements of the Company. All material inter-company profits and balances have been eliminated.

U.S. ENERGY CORP. & SUBSIDIARIES**Notes to Condensed Consolidated Financial Statements (Unaudited)**

(Continued)

6) On June 1, 2005, Enterra US Acquisitions Inc. (a privately-held Washington corporation organized by Enterra for purposes of the RMG acquisition, hereafter "Acquisitions") acquired all the outstanding stock of RMG, for which Enterra paid \$500,000 cash and issued \$5,234,000 of Enterra units (the "Enterra Initial Units"), net of the \$266,000 adjustment for the purchase of overriding royalty interests (effected May 1, 2005); and Acquisitions issued \$14,000,000 of class D shares of Acquisitions. The Enterra Initial Units and the class D shares were issued pro rata to the RMG shareholders. USE's and Crested's participation in the consideration received was approximately \$18,341,600. USE's consolidated subsidiary, Yellowstone Fuels, Inc. ("YSFI") also received approximately \$296,700.

The Enterra Initial Units received by the Company and Crested were sold during the quarter ended September 30, 2005 resulting in a gain of \$1,038,500 and the Initial Units received by YSFC are reflected on the Company's consolidated balance sheet as \$115,800 in marketable securities and the Class D shares of Acquisitions are carried as \$17,366,600 as investments in non-affiliates. The Company is required to hold the class D shares of Acquisitions for a period of one year from June 1, 2005. After the holding period is satisfied, the Company can exchange these shares on a one for one basis for units in Enterra which will then be saleable on the Toronto Stock Exchange - Vancouver ("TSX-V"). The conversion feature is treated as an imbedded derivative under SFAS 133. At September 30, 2005 the value of the derivative was \$4,194,300 using a volatility of 40.8% and a risk free interest rate of 4.38%. The value is computed using the Black Scholes pricing model and is recorded as income at September 30, 2005. The value of the conversion is included in the carrying value of the Acquisitions Class D shares.

7) Comprehensive Income

Unrealized gains on investments, which consist of Enterra Initial Units are excluded from net income but are reported as comprehensive income on the Condensed Consolidated Balance Sheet under Shareholders' equity. The following table illustrates the effect on net income (loss) if the company had recognized comprehensive income:

	Nine months ended Sept 30,	
	2005	2004
Net gain (loss)	\$ 13,344,500	\$ (4,988,400)
Add: Comprehensive income from the unrealized gain on marketable securities	(7,700)	--
Comprehensive Income (loss)	\$ 13,336,800	\$ (4,988,400)

8) Based on the provisions of SFAS No. 115, the Company accounts for marketable equity securities as marketable securities which are available for sale. Available for-sale securities are measured at fair value, with net unrealized gains and losses excluded from earnings and reported as a separate component of comprehensive income until realized.

Investments in marketable securities consisted of the following at September 30, 2005:

Unrealized

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	Cost	Market Value	Loss
Equity Securities	\$ 426,800	\$ 419,100	\$ (7,700)

-12-

U.S. ENERGY CORP. & SUBSIDIARIES**Notes to Condensed Consolidated Financial Statements (Unaudited)**

(Continued)

These securities were acquired in connection with the Enterra transaction discussed in Note 6 and 1,000,000 shares of Uranium Power Corp. common stock discussed in Note 17. In addition to these transactions, the Company sold 307,500 shares of Ruby Mining Company ("Ruby") common stock and recognized a gain of \$117,700 during the nine months ended September 30, 2005. Ruby common stock has no carrying value.

9) The Company has adopted the disclosure requirements of SFAS No. 148 "Accounting for Stock - Based Compensation - Transition and Disclosure" and has elected to continue to record employee compensation expense utilizing the intrinsic value method permitted under Accounting Principles Board (APB) Opinion No. 25, "Accounting for Stock Issued to Employees" and its related interpretations. The Company has two employee stock incentive plans. There were no options granted to employees or directors under either employee stock incentive plan during the nine months ended September 30, 2005. No stock-based employee compensation cost is reflected in net income, as all options granted under the plans had an exercise price equal to the market value of the underlying common stock on the date of grant. The following table illustrates the effect on net income and earnings per share if the Company had applied the fair value recognition provisions of Financial Accounting Standards Board Statement ("FASB") No. 123, Accounting for Stock-Based Compensation, to stock-based employee compensation.

	Nine months Ended September 30,	
	2005	2004
Net gain (loss), as reported	\$ 13,344,500	\$ (4,988,400)
Deduct: Total stock-based employee compensation expense determined under fair value based method for all award, net of related tax effects	(311,100)	(110,400)
Pro forma net profit (loss)	\$ 13,033,400	\$ (5,098,800)
Earnings per share:		
Basic - as reported	\$ 0.85	\$ (0.39)
Basic - pro forma	\$ 0.83	\$ (0.40)
Diluted - as reported	\$ 0.83	\$ (0.39)
Diluted - pro forma	\$ 0.81	\$ (0.40)
Basic weighted average shares outstanding	15,681,519	12,896,476
Diluted weighted average shares outstanding	16,124,259	12,896,476

U.S. ENERGY CORP. & SUBSIDIARIES**Notes to Condensed Consolidated Financial Statements (Unaudited)**

(Continued)

10) Components of Properties and Equipment at September 30, 2005, consist of mining and oil properties, land, buildings and equipment.

	Cost	Accumulated Amortization Depletion and Depreciation	Net Book Value
Mining and oil properties	\$ 2,457,100	\$ (1,773,600)	\$ 683,500
Buildings, land and equipment	11,357,500	(5,619,300)	5,738,200
Totals	\$ 13,814,600	\$ (7,392,900)	\$ 6,421,700

The Company has impaired a portion of historical costs associated with its properties in prior periods. The Company will provide additional impairments if necessary in the future. No additional impairments are required at September 30, 2005.

11) Income Taxes - The components of deferred taxes at September 30, 2005 are as follows:

	September 30, 2005
Deferred tax assets:	
Deferred compensation	\$ 519,200
Net operating loss carry-forwards	9,146,900
Nondeductible reserves and other	521,400
Tax basis in excess of book basis	67,800
Tax credits	235,000
Total deferred tax assets	\$ 10,490,300
Deferred tax liabilities:	
Book basis in excess of tax basis	\$ (2,824,000)
Development and exploration costs	(109,400)
Total deferred tax liabilities	(2,933,400)
Net deferred tax assets - all non-current	7,556,900
Valuation allowance	(7,556,900)
Net deferred tax liability	\$ --

At December 31, 2004, the Company had available for federal income tax purposes, consolidated net operating loss carry-forwards ("NOL") of approximately \$24,063,200 which expire from 2005 through 2023. Based on anticipated income for the year ending December 31, 2005, the Company expects to utilize approximately \$10,824,000 of this consolidated NOL. The Company has established a valuation allowance for the full amount of the net deferred tax assets due to the recurring losses of the Company and the uncertainty of the Company's ability to generate future

taxable income to utilize the NOL carry-forwards. In addition, the use of the NOL carry-forwards may be limited by Internal Revenue Service provisions governing significant change in company ownership.

-14-

U.S. ENERGY CORP. & SUBSIDIARIES**Notes to Condensed Consolidated Financial Statements (Unaudited)**

(Continued)

The income tax provision is different from the amounts computed by applying the statutory federal income tax rate to income before taxes. The reasons for these differences are as follows:

	Nine Month Ended September 30, 2005
Expected federal income tax expense	\$ 4,684,800
Net operating loss not previously benefited and other	(4,449,800)
Consolidated income taxes	\$ 235,000

\$235,000 in alternative minimum tax was paid as of September 30, 2005 as a result of the sale of RMG to Enterra. For information regarding the tax to book differences and components of deferred taxes at December 31, 2004, please refer to the Company's Form 10-K for that period.

12) The Company presents basic and diluted earnings per share in accordance with the provisions of Statement of Financial Accounting Standards No. 128, "Earnings per Share". Basic earnings per common share is based on the weighted average number of common shares outstanding during the period. Diluted earnings per share is computed based on the weighted average number of common shares outstanding adjusted for the incremental shares attributed to outstanding options to purchase common stock, if dilutive. Potential common shares relating to options and warrants are excluded from the computation of diluted earnings (loss) per share for the nine months ended September 30, 2005, because they are anti-dilutive, but are included for the three months ended September 30, 2005. These options and warrants totaled 5,559,645 and 5,775,820 shares at September 30, 2005 and 2004, respectively. Stock options and warrants have a weighted average exercise price of \$3.07 and \$2.87 per share at September 30, 2005 and 2004, respectively. Potential common shares relating to convertible debt at September 30, 2004 are excluded from the computation of diluted loss per share, because they are antidilutive. There are no potential shares from convertible debt at September 30, 2005.

13) Long term debt at September 30, 2005 consists of:

Current portion of long term debt	\$ 202,100
Long term portion of debt for the purchase of aircraft and equipment at various interest rates and due dates	1,012,000
	\$ 1,214,100

Debt to a third party lender, Geddes and Company ("Geddes") of Phoenix, AZ, in the amount of \$3,000,000 was completely retired with cash during the quarter ended September 30, 2005. Other cash payments on third party debt totaled \$204,600. These cash payments along with the non cash retirement of debt mentioned above resulted in a total reduction of debt during the nine months ended September 30, 2005 of \$10,773,900.

U.S. ENERGY CORP. & SUBSIDIARIES**Notes to Condensed Consolidated Financial Statements (Unaudited)**

(Continued)

14) The Company has uranium properties that are in a shut-down status in Wyoming and southern Utah and it is responsible for the reclamation expense. The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America, requires management to make estimates for these reclamation expenses based on certain assumptions. These estimates and assumptions affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period.

The Company accounts for the reclamation of its mineral properties pursuant to SFAS No. 143, "Accounting for Asset Retirement Obligation." Under the provisions of this accounting statement, the Company records the estimated fair value of the reclamation liability on its mineral properties as of the date that the liability is incurred with a corresponding increase in the property's book value. Actual costs could differ from those estimates. The reclamation liabilities are reviewed each quarter to determine whether estimates for the total asset retirement obligation are sufficient to complete the reclamation work required.

The Company deducts any actual funds expended for reclamation from the asset retirement obligations during the quarter in which it occurs. As a result of the Company taking impairment allowances in prior periods on its shut-down mining properties, it has no remaining book value for these properties. Any upward revisions of retirement costs on its mineral properties will therefore be expensed in the quarter in which they are recorded. Retirement obligations related to mineral properties, result in increases to the property costs which are depleted over the economic life of the properties.

The following is a reconciliation of the total liability for asset retirement obligations (unaudited):

	2005
Beginning Balance December 31, 2004	\$ 8,075,100
Impact of adoption of SFAS No. 143	--
Addition to Liability	--
Liability Settled	(463,700)
Accretion Expense	275,000
Ending Balance September 30, 2005	\$ 7,886,400

U.S. ENERGY CORP. & SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (Unaudited)

(Continued)

15) During the nine months ended September 30 2005, the Company issued 3,323,000 shares of its common stock. The following table details the number of shares issued and the dollar values received.

	Common Stock Shares	Amount	Additional Paid-In Capital
Balance December 31, 2004	15,231,237	\$ 152,300	\$ 59,157,100
Conversion of RMG Investment	54,720	\$ 600	\$ 169,400
Conversion of 100,000 RMG Series A Preferred Shares	91,743	\$ 900	\$ 299,100
Dividend on RMG Series A Preferred Shares	44,195	\$ 400	\$