ZION OIL & GAS INC
Form 10-K
March 06, 2014

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

FORM 10-K

MARK ONE:

x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the Fiscal Year ended December 31, 2013

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

Commission file number: 001-33228

ZION OIL & GAS, INC.
(Exact name of registrant as specified in its charter)

Delaware (State or other Jurisdiction of Incorporation or Organization)	20-0065053 (I.R.S. Employer Identification No.)
6510 Abrams Rd., Suite 300 Dallas, TX (Address of Principal Executive Offices)	75231 (Zip Code)

(214) 221-4610
(Registrant's telephone number, including area code)

Securities registered under Section 12 (b) of the Exchange Act:

Common Stock, par value $0.01 per share (Title of Class)	NASDAQ Global Market (Name of each exchange on which registered)

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

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

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

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

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the 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. ¨

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

Large accelerated filer ¨	Accelerated filer ¨	Non-accelerated filer ¨	Smaller Reporting Company x

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes¨ Nox

The aggregate market value of the voting and non-voting common stock held by non-affiliates of the registrant as of June 30, 2013 was approximately $72.1 million. This amount is based on the registrant’s common stock on the NASDAQ Global Market on that date.

The registrant had 34,175,292 shares of common stock, par value $0.01, outstanding as of February 24, 2014.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant’s definitive proxy statement for its 2014 Annual Meeting of Stockholders to be held on June 9, 2014, are incorporated by reference herein in Items 10, 11, 12, 13 and 14 of Part III of this report.

2013 ANNUAL REPORT (SEC FORM 10-K)

INDEX

Securities and Exchange Commission
Item Number and Description

FORWARD LOOKING STATEMENTS

This Annual Report on Form 10-K (herein, “Annual Report”) and the documents included or incorporated by reference in this Annual Report contain statements concerning our expectations, beliefs, plans, objectives, goals, strategies, future events or performance and underlying assumptions and other statements that are not historical facts. These statements are “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995. You generally can identify our forward-looking statements by the words “anticipate,” “believe,” “budgeted,” “continue,” “could,” “estimate,” “expect,” “forecast,” “goal,” “intend,” “may,” “objective,” “plan,” “potential,” “predict,” “projection,” “sc “will” or other similar words. These forward-looking statements include, among others, statements regarding:

- our ability to explore for and develop natural gas and oil resources successfully and economically within our license areas;
- our ability to obtain the exploration license rights to continue our petroleum exploration program;
- the availability of equipment, such as seismic trucks, drilling rigs, and transportation pipelines;
- the impact of governmental regulations, permitting and other legal requirements in Israel relating to onshore exploratory drilling;
- our estimates of the timing and number of wells we expect to drill and other exploration activities and planned expenditures and the time frame within which they will be undertaken;
- changes in our drilling plans and related budgets;
- the quality of existing and future license areas with regard to, among other things, the existence of reserves in economic quantities;
- anticipated trends in our business;
- our future results of operations;
- our liquidity and our ability to raise capital to finance our exploration and development activities;
- our capital expenditure program;
- future market conditions in the oil and gas industry; and
- the demand for oil and natural gas, both locally in Israel and globally.

More specifically, our forward-looking statements include, among others, statements relating to our schedule, business plan, targets, estimates or results of our applications for new exploration rights and future drilling, including the number, timing and results of wells, the timing and risk involved in drilling follow-up wells, planned expenditures, prospects budgeted and other future capital expenditures, risk profile of oil and gas exploration, acquisition of seismic data (including number, timing and size of projects), planned evaluation of prospects, probability of prospects having oil and natural gas, expected production or reserves, acreage, working capital requirements, hedging activities, the ability of expected sources of liquidity to implement our business strategy, future hiring, future exploration activity, production rates, all and any other statements regarding future operations, financial results, business plans and cash needs and other statements that are not historical fact.

Such statements involve risks and uncertainties, including, but not limited to, those relating to the uncertainties inherent in exploratory drilling activities, the volatility of oil and natural gas prices, operating risks of oil and natural gas operations, our dependence on our key personnel, factors that affect our ability to manage our growth and achieve our business strategy, risks relating to our limited operating history, technological changes, our significant capital requirements, the potential impact of government regulations, adverse regulatory determinations, litigation, competition, the uncertainty of reserve information and future net revenue estimates, property acquisition risks, industry partner issues, availability of equipment, weather and other factors detailed herein and in our other filings with the Securities and Exchange Commission (the “SEC”).

We have based our forward-looking statements on our management’s beliefs and assumptions based on information available to our management at the time the statements are made. We caution you that assumptions, beliefs, expectations, intentions and projections about future events may and often do vary materially from actual results. Therefore, we cannot assure you that actual results will not differ materially from those expressed or implied by our forward-looking statements.

Some of the factors that could cause actual results to differ from those expressed or implied in forward-looking statements are described under “Risk Factors” in this Annual Report and in our other periodic reports filed with the SEC. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual outcomes may vary materially from those indicated. All subsequent written and oral forward-looking statements attributable to us or persons acting on our behalf are expressly qualified in their entirety by reference to these risks and uncertainties. You should not place undue reliance on our forward-looking statements. Each forward-looking statement speaks only as of the date of the particular statement, and we undertake no duty to update any forward-looking statement.

PART I

ITEM 1. BUSINESS

Overview

Zion Oil and Gas, Inc., a Delaware corporation (referred to herein as “we”, “our”, “us”, “Zion”, “Zion Oil”, or the “Company”) an initial stage oil and gas exploration company with a history of over 13 years of oil and gas exploration in Israel. We were incorporated in Florida on April 6, 2000 and reincorporated in Delaware on July 9, 2003. We completed our initial public offering in January 2007. Our common stock currently trades on the NASDAQ Global Market under the symbol “ZN.”

Zion currently holds three petroleum exploration licenses, all onshore Israel, comprised of the newly granted Megiddo-Jezreel License (covering approximately 98,842 acres), the Asher-Menashe License (covering approximately 78,834 acres), and the Jordan Valley License (covering approximately 55,845 acres). Zion’s total license area currently amounts to approximately 233,521 acres.

As a result of ongoing evaluation of previous and newly acquired geological and geophysical data relating to our license areas, we are re-focusing our exploration strategy with a primary emphasis on the Megiddo-Jezreel License and portions of the Jordan Valley License area.

To date, we have drilled four exploratory wells. While the presence of hydrocarbons was indicated while drilling certain of these wells, none of the exploratory wells that we have drilled to date have been deemed capable of producing oil or gas in commercial quantities.

At present, we have no revenues or operating income and are classified as a "development stage" company. Our ability to generate future revenues and operating cash flow will depend on the successful exploration and exploitation of our current and any future petroleum rights or the acquisition of oil and/or gas producing properties, and the volume and timing of such production. In addition, even if we are successful in producing oil and gas in commercial quantities, our results will depend upon commodity prices for oil and gas, as well as operating expenses including taxes and royalties.

Our executive offices are located at 6510 Abrams Road, Suite 300, Dallas, Texas 75231, and our telephone number is (214) 221-4610. Our field office’s new address in Israel is at 9 Halamish Street, North Industrial Park, Caesarea 3088900, and the telephone number is +972-4-623-8500. Our website address is: www.zionoil.com.

Company Background

In 1983, during a visit to Israel, John M. Brown (our Founder, Chairman, and Chief Executive Officer) became inspired and dedicated to finding oil and gas in Israel. During the next 17 years he made several trips each year to Israel, hired oil and gas consultants in Israel and Texas, met with Israeli government officials, made direct investments with local exploration companies, and assisted Israeli exploration companies in raising money for oil and gas exploration in Israel. This activity led Mr. Brown to form Zion Oil & Gas, Inc. in April 2000, in order to receive the award of a small onshore petroleum license from the Israeli government.

Zion’s vision, as exemplified by John Brown, of finding oil and/or natural gas in Israel, is biblically inspired. The vision is based, in part, on biblical references alluding to the presence of oil and/or natural gas in territories within the State of Israel that were formerly within certain ancient biblical tribal areas. While John Brown provides the broad vision and goals for our company, the actions taken by the Zion Board of Directors and management team as it actively explores for oil and gas in Israel, are based on modern science and good business practice. Zion’s oil and gas exploration activities are supported by appropriate geological, geophysical and other science-based studies and surveys typically carried out by companies engaged in oil and gas exploration activities.

Upon the award of our first petroleum right (License No. 298/“Ma'anit” or the "Ma'anit License") in May 2000, the Israeli government gave us access to most of its data with respect to previous exploration in the area, including geologic reports, seismic records and profiles, drilling reports, well files, gravity surveys, geochemical surveys and regional maps. We also gathered information concerning prior and ongoing geological, geophysical and drilling activity relevant to our planned activities from a variety of publicly accessible sources.

Map #1 (below) shows the outline of our current Megiddo-Jezreel, Asher-Menashe and Jordan Valley License areas. The Israeli government conducted most of the seismic surveys during the 1970s and 1980s to provide data to encourage oil companies to invest in exploratory drilling. Private and public Israeli, American and international companies conducted additional seismic surveys and drilled most of the wells in the period since 1980. We have also acquired and processed additional 2-D seismic lines and other geological and geophysical data in an effort to identify and refine any potential drilling prospects.

EXPLORATION LICENSE AREAS CURRENTLY HELD BY ZION

Map #1
Zion's Petroleum Exploration Licenses as of February, 2014.

In the event we drill an oil or gas discovery in any of our license areas, current Israeli law entitles us to convert the relevant portions of our licenses to 30-year production leases, extendable to 50 years, subject to compliance with a field development work program and production.

Summary of Exploration Plans in our License Areas

Megiddo-Jezreel Petroleum License

Under the terms of this new License, the Company has until July 1, 2015 to identify and submit a drilling prospect, enter into a drilling contract by October 1, 2015, and begin drilling or "spud" a well to a minimum proposed total depth of approximately 4,000 meters (~ 13,125 feet) by December 1, 2015. These and other geological and geophysical milestones should be achievable before the stated deadlines.

The Company continues to work with Geomage, an Israel-based geophysical company, to reprocess existing seismic lines in an effort to improve our subsurface imaging ability in the license area. This effort will aid us in high-grading exploration leads to develop them into drillable prospects. We have completed reprocessing the first six seismic lines (86 kilometers) and we recently instructed Geomage to reprocess another six lines (82 kilometers) for a total of 12 lines (168 kilometers). We are also working with our Israel exploration staff to identify locations to acquire new seismic data in conjunction with the Geophysical Institute of Israel. The exploration staff is also collecting potential source rock samples to evaluate their oil generation potential. Finally, we are evaluating proposals from various environmental firms to prepare an extensive environmental impact document which is a prerequisite for a drilling permit.

Asher-Menashe License

On May 23, 2013, Zion submitted to Israel's Petroleum Commissioner an application seeking a one-year extension for its Asher-Menashe License to conduct additional in-well testing operations at the Elijah #3 well in hopes of finding commercially productive hydrocarbons. On July 7, 2013, the Commissioner notified us that the Company's Asher-Menashe License was extended a final time to June 9, 2014. Under the terms of the extension, the Company is required to perform a perforation and stimulation operation at the Elijah #3 well and conduct a production test. If the outcome of the test is negative, the well is to be plugged and abandoned ("P&A") and within 60 days thereafter, a final report should be submitted and the license returned.

The Company originally planned to re-enter the Elijah #3 well during October/November 2013, but we were delayed primarily due to problems that Lapidoth, our drilling contractor, experienced while drilling another well with a third party in Israel. On January 5, 2014, we initiated Elijah #3 re-entry operations and on January 30, 2014, the Lapidoth rig was released. Although we had hoped to encounter producible hydrocarbons, we did not (other than minimal amounts of gas), and we will now work to finalize all remaining plugging and abandonment procedures for that well, including submitting a final report. The Company currently has no plans to continue exploration activity in this license area.

As a result of the aforementioned activities, the Company recorded a non-cash impairment charge of approximately $1,438,000 of its unproved oil and gas properties. The impairment charge is for all remaining capitalized costs of the Asher-Menashe License and the results of the Elijah #3 well re-entry operations. Impairments on both licenses are due principally to a decision to prioritize available financial resources and focus Zion's efforts on the Megiddo-Jezreel and portions of the Jordan Valley License areas.

Jordan Valley License

The Jordan Valley License is scheduled to expire on April 12, 2014, subject to additional one-year extensions at the option of the Petroleum Commissioner through April 2018. The Company may seek an extension of this license beyond 2014, although no assurance can be given that the Petroleum Commissioner will grant such extension or that the terms will be agreeable to the Company.

Under the terms of the Jordan Valley License, we were to identify a drilling prospect in the license area and contract for the drilling of such prospect by October 13, 2012 and to drill a well to a target depth of approximately 5,000 meters (16,400 feet) by April 13, 2013. Additional license terms call for Zion to prepare and submit various geological, geophysical and geochemical maps and analyses during the license's primary term. We timely submitted our Jordan Valley License Prospect Report and informed the Petroleum Commissioner that we did not plan to drill a well in the Jordan Valley License area at the time so we would not be entering into a drilling contract or drilling a well by April 2013. Based on our analysis of the data, we determined that the exploration risks of drilling that particular deep prospect were too high. Accordingly, we are not currently in compliance with the express terms of the Jordan Valley License.

As we reassessed our existing seismic data to prepare to submit our new Megiddo-Jezreel License application, we identified several exploration leads in our existing Jordan Valley License area. The Company continues to work with Geomage, an Israel-based geophysical company, to reprocess existing seismic lines in an effort to improve our subsurface imaging ability in this license area as well. This effort will aid us in high-grading exploration leads to develop them into drillable prospects. Additional pre-drilling exploratory work is needed before a drillable prospect, if any, can be matured and recommended in this license area. These additional studies could include acquiring additional seismic data and conducting basin history and petroleum system modeling, among other possibilities.

Zion’s Former Joseph License

On April 10, 2013, Zion submitted to Israel’s Petroleum Commissioner an application seeking a one-year extension for its Joseph License. On May 12, 2013, the Commissioner notified us that Zion’s Joseph License was extended only for six months, until October 10, 2013. Field operations were conducted from late August to mid-October, 2013 and on November 18, 2013, the Company, in accordance with the license terms, submitted our Final Plugging Report for the Ma’anit Rehoboth #2 and Ma’anit Joseph #3 wells. The Company has no current plans to continue exploration activity in this license area. The Company has completed the plugging obligations of all wells within the Joseph License area and acknowledges its obligation to complete the abandonment of the wells in accordance with guidance from the Environmental Ministry even though the Joseph License period has technically expired.

In March 2013, the Company recorded a non-cash impairment charge of approximately $1,851,000 of its unproved oil and gas properties. The impairment charge is for all remaining capitalized costs of the Joseph License.

At this point, we are unable to assess the implications of our non-compliance with the express terms of any of our Licenses. We are not in compliance with some of the terms of our existing petroleum exploration licenses and such non-compliance could result in the loss or forfeiture of such license(s). The loss or forfeiture of any of our licenses may have an adverse effect on our business and prospects. See Risk Factors.

Exploration Plans Going Forward

As a result of ongoing evaluation of previous and newly acquired geological and geophysical data relating to our license areas, we are re-focusing our exploration strategy with a primary emphasis on the recently-granted Megiddo-Jezreel License as well as portions of the Jordan Valley License. We believe that of all of the areas available to the Company for exploration in Israel, these areas represent the greatest likelihood that the geologic conditions conducive to an active petroleum system and trapping mechanism are present.

Prior to any actual drilling in these areas of interest, we will need to continue to reprocess existing seismic data, acquire additional seismic data and other geologic data to better evaluate where we would drill our next exploratory well. See “Risk Factors”.

With respect to the Jordan Valley License area, in conjunction with a license extension application, we may prepare and submit to the Petroleum Commissioner a work program for additional non-drilling exploratory activities in such license area. If accepted, our work program would cure our current non-compliance with the express license terms. However, no assurance can be given that the Petroleum Commissioner will in fact accept our proposed work program. See “Risk Factors”.

After we identify the site of our next exploratory well, we will need to begin the procedure of obtaining the needed authorizations and permits. We have already sought proposals from various environmental firms in Israel to assist us with the preparation of a required environmental impact document - a detailed and extensive document representing months of advance work. Under Israel’s regulatory system, this environmental document is a prerequisite for a drilling permit. We anticipate that the newly promulgated regulations will considerably increase the time needed to obtain all of the needed permits and authorizations from regulatory and local bodies in Israel, and there is no assurance that the Company will ultimately be granted such permission to drill. See the discussion under “Energy Related Regulations - The Onshore Petroleum Exploration Permitting Process in Israel” below.

Finally, prior to actually drilling our next exploratory well, we will need to enter into a contract with a drilling rig operator with the appropriate rig, equipment, and experienced drilling crew. We have not yet entered into any legally binding agreements for the use of a rig. In the event that we decide to import a drilling rig into Israel, we will need to obtain the appropriate regulatory consents and approvals for the importation of the rig. We will also need to obtain appropriate permits, regulatory consents and approvals with respect to the actual drilling site that we will ultimately determine. In addition, we will need to obtain the necessary approvals from the surface owners.

We estimate that, in order to be commercially productive, any of the wells we may eventually drill would need to be capable of producing at least 150 barrels of oil equivalent per day. Such production levels will not likely pay out the cost of drilling the well, but only the costs of operating the well on a current basis. In order to justify the costs of drilling additional wells, there would need to be the expectation that each additional well would have initial production rates of at least 500 barrels of oil equivalent per day, based upon minimum oil prices of $90.00 per barrel.

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Exploration Expenditures

The following table summarizes the amounts we expended on our exploration efforts during 2012 and 2013:

	2013 US$ (000)	2012 US$ (000)
Joseph License (expired on October 10, 2013)		
Geological & Geophysical Operations	65	529
Plug and abandonment Operations	371	-
Asher-Menashe License		
Geological & Geophysical Operations	546	2,134
Jordan Valley License		
Geological & Geophysical Operations	98	447
Megiddo-Jezreel Valley License		
Geological & Geophysical Operations	342	-
Other costs	-	20
Total	1,422	3,130

Employees

As of December 31, 2013, we had 21 employees of whom all but one are on a full time basis. Of these employees, 11 work out of our Dallas office and 10 work out of the Caesarea office. None of our current employees is subject to any collective bargaining agreements, and there have been no strikes. We regularly utilize independent consultants and contractors to perform various professional services, particularly for services connected to drilling operations, such as specialized engineering, logging, cementing and well-testing.

Competition and Markets

The oil and gas exploration industry in Israel currently consists of a number of exploration companies. These include relatively small local or foreign companies with limited financial resources and consortia of local Israeli and foreign participants with substantial financial resources. Most groups are engaged primarily in off-shore activities, which is not an area in which we are currently active. So long as we hold each of our three licenses, Israeli law conveys an exclusive exploration right to Zion such that no additional companies may compete in our license areas.

Historically, primarily for geopolitical reasons, Israel (particularly onshore) has not been an area of interest for international integrated or large or mid-size independent oil and gas exploration companies. Since the announcement of the Tamar and Leviathan discoveries, this situation has changed somewhat. However, given the current limited availability in Israel of oil field service companies, equipment and personnel, in periods of increased exploration interest and activity as at present, there is competition for available equipment and services. In this market Zion has no particular advantage. We attempt to enhance our position by developing and maintaining good professional relations with oil field service providers and a high level of credibility in making and meeting commercial commitments.

The oil & gas industry is cyclical, and from time to time there is a shortage of drilling rigs, equipment, supplies and qualified personnel. During these periods, the costs and delivery times of rigs, equipment and supplies are substantially greater. If the unavailability or high cost of drilling rigs, equipment, supplies or qualified personnel were particularly severe in the areas where we operate, we could be materially and adversely affected. We believe that there are potential alternative providers of drilling services and that it may be necessary to establish relationships with new contractors as our activity level and capital program grows. However, there can be no assurance that we can establish such relationships or that those relationships will result in increased availability of drilling rigs.

If any of our exploratory wells are commercially productive, we would install the appropriate production equipment which includes among other items oil and gas separation facilities and storage tanks. Under the terms of the Petroleum Law, we may be required by the Minister of Energy and Water Resources to offer first refusal for any oil and gas discovered to Israeli domestic purchasers at market prices.

Because Israel imports all of its crude oil needs and the market for crude oil in Israel is limited to two local oil refineries, no special marketing strategy need be adopted initially with regard to any oil that we may ultimately discover. We believe that we would have a ready local market for our oil at market prices and would have the option of exporting to the international market, if any of our future exploratory wells are commercially productive.

Israel's Petroleum Law

Our business in Israel is subject to regulation by the State of Israel under the Petroleum Law. The administration and implementation of the Petroleum Law is vested in the Minister of Energy and Water Resources, the Petroleum Commissioner and an advisory council. The following discussion includes a brief summary review of certain provisions of the Petroleum Law as currently in effect. This review is not complete and it should not be relied on as a definitive restatement of the law related to petroleum exploration and production activities in Israel.

Petroleum resources are owned by the State of Israel, regardless of whether they are located on state lands or the offshore continental shelf. No person is allowed to explore for or produce petroleum without being granted a specific right under the Petroleum Law.

License. The "license" is a petroleum exploration right, bestowing an exclusive right for further exploration work and requiring the drilling of one or more test wells. The initial term of a license is up to three years and it may be extended for up to an additional four years (in one year increments). A license area may not exceed 400,000 dunam (approximately 98,842 acres). One dunam is equal to 1,000 square meters (approximately 0.24711 of an acre). No one entity may hold more than 12 licenses or hold more than a total of four million dunam in aggregate license area.

Production lease. Upon discovery of petroleum in commercial quantities, a licensee has a statutory "right" to receive a production "lease." The initial lease term is 30 years, extendable for an additional 20 years (up to a maximum period of 50 years). A lease confers upon the lessee the exclusive right to explore for and produce petroleum in the lease area and requires the lessee to produce petroleum in commercial quantities (or pursue test or development drilling). The lessee is entitled to transport and market the petroleum produced, subject, however, to the right of the government to require the lessee to supply local needs first, at market price.

Petroleum rights fees. The holders of licenses and leases are required to pay fees to the government of Israel to maintain the rights. The fees vary according to the nature of the right, the size and location (onshore or offshore) of the right, acreage subject of the right and, in the case of a license, the period during which the license has been maintained. For a license, the initial year fees are approximately New Israeli Shekels (NIS) 110 (approx. US $31.5 at the Bank of Israel representative rate published on December 31, 2013) per thousand dunams (approx. 247.11 acres) per year. Every subsequent year, the license fee increases incrementally.

Requirements and entitlements of holders of petroleum rights. The holder of a petroleum right (license or lease) is required to conduct its operations in accordance with a work program set as part of the petroleum right, with due diligence and in accordance with the accepted practice in the petroleum industry. The holder is required to submit progress and final reports; provided, however, the information disclosed in such reports remains confidential for as long as the holder owns a petroleum right on the area concerned.

If the holder of a petroleum right does not comply with the work program provided by the terms of the right, the Petroleum Commissioner may issue a notice requiring that the holder cure the default within 60 days of the giving of the notice, together with a warning that failure to comply within the 60-day cure period may entail cancellation of the right. If the petroleum right is cancelled following such notice, the holder of the right may, within 30 days of the date of notice of the Commissioner's decision, appeal such cancellation to the Minister of Energy and Water Resources. No petroleum right shall be cancelled until the Minister of Energy and Water Resources has ruled on the appeal.

We are obligated, according to the Petroleum Law, to pay royalties to the Government of Israel on the gross production of oil and gas from the oil and gas properties of Zion located in Israel (excluding those reserves serving to operate the wells and related equipment and facilities). The royalty rate stated in the Petroleum Law is 12.5% of the produced reserves. At December 31, 2013 and 2012, the Company did not have any outstanding obligation with respect to royalty payments, since it is in the development stage and, to this date, no proved reserves have been found.

In March 2011, the Israeli parliament enacted the Petroleum Profits Taxation Law, 2011, which imposes a new levy on oil and gas production. Under the new tax regime, the Israeli Government repealed the percentage depletion deduction and imposed a levy at an initial rate of 20% on profits from oil and gas which will gradually rise to 44.56%, depending on the levy coefficient (the R-Factor). The R-Factor refers to the percentage of the amount invested in the exploration, the development and the establishment of the project, so that the 20% rate will be imposed only after a recovery of 150% of the amount invested (R-Factor of 1.5) and will range linearly up to 44.56% after a recovery of 230% of the amount invested (R-Factor of 2.3). For purposes of the levy rate calculation, the minimal gas sale price that will be accepted by the State is the bi-annual average local price. The present 12.5% royalty imposed on oil revenues remains unchanged.

The grant of a petroleum right does not automatically entitle its holder to enter upon the land to which the right applies or to carry out exploration and production work thereon. Entry requires the consent of the private or public holders of the surface rights and of other public regulatory bodies (e.g. planning and building authorities, Nature Reserves Authority, municipal and security authorities, etc.). The holder of a petroleum right may request the government to acquire, on its behalf, land needed for petroleum purposes. The petroleum right holder is required to obtain all other necessary approvals.

Petroleum Taxation. Our activities in Israel will be subject to taxation both in Israel and in the United States. Under the U.S. Internal Revenue Code, we will be entitled to claim either a deduction or a foreign tax credit with respect to Israeli income taxes paid or incurred on our Israeli source oil and gas income. As a general rule, we anticipate that it will be more advantageous for us to claim a credit rather than a deduction for applicable Israeli income taxes on our U.S tax return. A tax treaty exists between the U.S. and Israel that would provide opportunity to use the tax credit.

Exploration and development expenses. Under current US and Israeli tax laws, exploration and development expenses incurred by a holder of a petroleum right can, at the option of such holder, either be expensed in the year incurred or capitalized and expensed (or amortized) over a period of years. Most of our expenses to date have been expensed for both U.S. and Israeli income tax purposes.

Depletion allowances. Until 2011, the holder of an interest in a petroleum license or lease was allowed a deduction for income tax purposes on account of the depletion of the petroleum reserve relating to such interest. This may have been by way of percentage depletion or cost depletion, whichever is greater. In 2010, the Finance Minister of Israel established an advisory committee to study the country’s fiscal policy as it relates to the upstream oil and natural gas sector, as well as various options, including an increase in royalties or cancellation of tax incentives. In January 2011, the Finance Ministry advisory committee issued its final recommendations which included cancellation of currently existing tax incentives, including the depletion allowance. In 2011, the depletion allowance was abolished.

Corporate tax. Under current Israeli tax laws, whether a company is registered in Israel or is a foreign company operating in Israel through a branch, it is subject to Israeli Companies Tax on its taxable income (including capital gains) from Israeli sources at a flat rate of 25%, effective January 1, 2012 and 26.5% effective January 1, 2014.

Import duties. Insofar as similar items are not available in Israel, the Petroleum Law provides that the owner of a petroleum right may import into Israel, free of most customs, purchase taxes and other import duties, all machinery, equipment, installations, fuel, structures, transport facilities, etc. (apart from consumer goods and private cars and similar vehicles) that are required for the petroleum exploration and production purposes, subject to the requirement that security be provided to ensure that the equipment is exported out of Israel within the agreed upon time frame.

Israeli Energy Related Regulations

Our operations are subject to legal and regulatory oversight by energy-related ministries or other agencies of Israel, each having jurisdiction over certain relevant energy or hydrocarbons laws.

The Onshore Petroleum Exploration Permitting Process in Israel

The permitting process in Israel with respect to petroleum exploration is undergoing significant modification, the result of which is to considerably increase the time period needed to obtain the necessary permits to undertake exploratory drilling once a drilling prospect was identified. Applications for new exploration licenses will need to comply with more demanding requirements relating to a license applicant's financial capability, experience and access to experienced personnel.

In June 2012, the Ministry of Energy and Water Resources issued initial guidelines relating to onshore exploratory licensing. Under the adopted guidelines, an application must meet certain specified conditions and provide detailed information with respect to the requested license area. The applicant must engage, at a minimum, an exploration manager, geologist, geophysicist and engineer with minimum years of experience in oil and gas exploration, and at least one of these persons must be a resident of Israel. Additionally, if the license application relates to an area that has produced reserves in the past, and the submitted work plans include production of oil and gas from this area, then the applicant must also engage a production engineer. The applicant must also demonstrate the financial resources to support the estimated costs of non-drilling exploratory activities, and at least 50% of the estimated drilling costs, but in any event of not less than $5 million. The applicant will be deemed to have the requisite financial resources if it has liquid assets or equity equal to the required amount, less undertakings pursuant to other licenses or permits. The application will be published in a daily newspaper and the Ministry's web site, and other prospective license applicants will then have an opportunity to submit an application for the requested license area within three months from such publication. In the event of more than one application for a license area, the winner will be determined by a grading system that factors certain deemed pertinent factors (i.e., experience of the applicant, experience of the staff, financial resources, etc.). A condition to the issuance of any license is the submission by the licensee of a performance bank guarantee in an amount equal to 10% of the cost of the proposed work program. The performance bank guarantee is required at or prior to the award of the exploration rights.

In October 2012, the Energy Ministry published proposed guidelines relating to the submission of performance guarantees for new and existing onshore and offshore exploration licenses. Under the proposed guidelines, an applicant for a new onshore exploration license must submit a performance bank guarantee for 10% of the cost of the proposed work program upon the award by the Petroleum Commissioner (the “Commissioner”) of the requested license. An existing onshore exploration license owner will be required to submit a performance bank guarantee equal to 10% of the cost of the balance of the planned work program by the earlier of (a) the application for a license extension, (b) the application for transfer of license rights, or (c) the application for changes to the work program. The face amount of the performance bank guarantee for existing licenses will be based on an estimated budget for the balance of the planned work program that an existing license owner is to submit to the Commissioner, which budget is subject to approval by the Commissioner. In the event that the licensee violates (whether intentionally or not) any of the license terms, then the Commissioner is entitled to demand payment of the bank guarantee, after giving the licensee notice and an opportunity to cure.

In November 2012, the Association of Oil and Gas Exploration Industries in Israel (of which we are a member) submitted a response to the Ministry’s proposed guidelines, objecting to the guidelines.

In December 2012 the Ministry published additional proposed guidelines relating to the submission of bank guarantees for potential drilling-related environmental damages. The guidelines will apply to all petroleum exploration licenses to be granted on or after June 30, 2013. Under the proposed guidelines, prior to receiving the approval of the Commissioner to a proposed drilling program, the licensee must submit a bank guarantee in the amount of $100,000 with respect to a drilling depth of up to (and including) 1,000 meters and, if the drilling depth is more than 1,000 meters, the bank guarantee amount increases to $250,000. The Commissioner is entitled to demand a bank guarantee in excess of $250,000 in the event that the Commissioner determines that there is a substantial risk of environmental damage. In the event that the licensee causes environmental damage, the Commissioner is entitled to demand payment of the bank guarantee, after giving the licensee notice and an opportunity to respond to the allegation of damages. In January 2013, the Association of Oil and Gas Exploration Industries in Israel (of which we are a member) submitted a response to the Ministry’s proposed guidelines, objecting to the guidelines. These proposed guidelines have not yet been fully adopted.

On December 3, 2013, the Commissioner awarded the Company the Megiddo-Jezreel Petroleum Exploration License No. 401. Subsequently, the Company secured a $930,000 bank guarantee in accordance with the performance guarantee guidelines. With these two actions, Zion believes it has met the requirements of the June 2012 onshore exploratory licensing guidelines and the performance guarantee guidelines.

On February 6, 2014, the Ministry of Energy and Water Resources issued guidelines for bank guarantees and insurance requirements with respect to oil rights. Under these guidelines, applicants for and existing holders of exploration rights will be required to submit certain bank guarantees and insurance policies, not currently required. The Company's management is studying the new guidelines and evaluating the additional negative impact on the Company.

As it relates to existing onshore license holders like Zion, the Company must obtain a base guarantee in the New Israeli Shekel equivalent of $500,000, by the earlier of:

- The date of approval of the application for extension of the license;
- The date of submission of an application for transfer of rights;
- The date of submission of an application for approval of drilling; or
- 45 days after the date of publication of the guidelines (late March 2014).

The Petroleum Commissioner, under exceptional circumstances, may demand a lower or higher guarantee sum.

Also, as it relates to existing onshore license holders, prior to the start of drilling, an additional bank guarantee in the New Israeli Shekel equivalent of $250,000 will be required.

Existing onshore license holders must have an insurance policy in place at least 30 days prior to the planned drilling date of a well. The insurance policy must include that which is usually taken out by international oil or gas exploration or production companies, in accordance with specific requirements set out in the guidelines.

The Company believes that these and other new regulations will significantly increase the expenditures associated with and serve as a disincentive for operators to engage in oil and gas exploration in Israel. On February 24, 2014, the Company received a request seeking that the Company arrange for three bank guarantees totaling $1.5 million. The Company disputes that is obligated to obtain the three bank guarantees even under the new regulations. The Company awaits word on the Israel Oil & Gas Association petition where the association is contemplating a legal challenge in Israel's Supreme Court and does not plan on providing any of the bank guarantees until the matter is resolved.

Environmental/Safety

Oil and gas drilling operations could potentially harm the environment if there are polluting spills caused by the loss of well control. The Petroleum Law and regulations provide that the conduct of petroleum exploration and drilling operations be pursued in compliance with "good oil field practices" and that measures of due care be taken to avoid seepage of oil, gas and well fluids into the ground and from one geologic formation to another. The Petroleum Law and regulations also require that, upon the abandonment of a well, it be adequately plugged and marked. Recently, as a condition for issuing the required permit for the construction of a drilling site, the planning commissions have required the submission of a site remediation plan, subject to approval of the environmental authorities. The costs of future restoration and remediation can be estimated as the restoration and remediation are typical for the industry and part of "oil field best practices". At this time, we anticipate that the future cost of the environmental requirements, site remediation and plugging will not be greater than approximately $220,000 per well drilled on our existing license areas. Our operations are also subject to claims for personal injury and property damage caused by the release of chemicals or petroleum substance by us or others in connection with the conduct of petroleum operations on our behalf.

In August 2011, the Government of Israel approved a draft law entitled "Prevention of Land Contamination and Remediation of Contaminated Land". In order for the draft law to become law, the Israeli Parliament must approve it after a second and third hearing. If ultimately adopted, this Government-sponsored proposed law will provide for a regulatory regime that will require persons engaged in activities involving "polluted materials" (which are defined to include also petroleum crude oil or any other materials defined as such by the commissioner) including their production, treatment, handling, storage and transportation, that may affect land or water resources to prepare environmental impact statements and remediation plans either prior to commencing activities or following the occurrence of an event that may cause pollution to land or water resources or endanger public health. Under the proposal, persons responsible for violation of the law, directly or indirectly, will be liable for the clean-up costs. Also, violations of the law may result in criminal sanctions. We do not know and cannot predict whether any legislation in this area will be enacted and, if so, in what form and which of its provisions, if any, will relate to and affect our activities, how and to what extent nor what impact, if any, it might have on our financial statements. There are no known proceedings instituted by governmental authorities, pending or known to be contemplated against us under any environmental laws. We are not aware of any events of noncompliance in our operations in connection with any environmental laws or regulations and we are not aware of any potentially material contingencies related to environmental issues. However, we cannot predict whether any new or amended environmental laws or regulations introduced in the future will have a material adverse effect on our future business.

In March 2011, the Ministry of Environmental Protection issued initial guidelines relating to oil and gas drilling. This is the first time that the Ministry published specific environmental guidelines for oil and gas drilling operations, relating to onshore and offshore Israel.

The guidelines are detailed and provide environmental guidelines for all aspects of drilling operations, commencing from when an application for a preliminary permit is filed, and continuing through license, drilling exploration, production lease, petroleum production and abandonment of the well. The guidelines address details that must be submitted regarding the drill site, surrounding area, the actual drilling operations, the storage and removal of waste and the closing or abandoning of a well. Following meetings between the Ministry and industry representatives in 2011, the Ministry indicated that certain of their initial published guidelines will be revised.

In April 2012, the "Environmental Protection Law (Emissions and Transfers to the Environment) Reporting Requirements and Register 2012" became effective. This statute imposes reporting obligations on entities engaged in oil and gas exploration activities (amongst others) in Israel relating to quantities of pollutants emitted into the air, water, land and sea (on an annual basis) and the off-site transfer of waste generated in the facility for treatment. The annual report that is to be furnished does not apply to the Company's operations until we establish oil and/or gas production.

In July 2013, the Environmental Ministry published: "Environmental Guidelines for the preparation of an environmental document supplementary to a license for searching – experimental drilling and land extraction tests." This document extensively details the requirements for a supplemental environmental document to an oil and gas exploration plan.

The Company believes that these new environmental regulations will significantly increase the time, effort, and expenditures associated with obtaining all of the necessary authorizations and approvals prior to drilling.

Proposed Fuel Market Law Legislation

In March 2012, the Ministry of Energy and Water Resources presented a draft law entitled "Fuel Market Law". Under the proposal as currently drafted, the following activities among others as they relate to crude oil and its products would require licenses by the Director of the Fuel Authority in the Ministry of Energy and Water Resources: import, export, refining, storage, dispensing and loading, transport, marketing and sale. Further under the proposal a condition for the receipt of a license is that the licensee be a corporation incorporated under the Israeli Companies Law. As currently drafted, the proposal does not provide for exceptions for entities holding petroleum rights under the Petroleum Law; however, it is not certain that, even if enacted as currently proposed, the provisions of the proposed law would supersede the provisions of the Petroleum Law. We submitted comments to the Ministry with the aim of clarifying that any law to be presented for enactment clarify that the rights of holders of licenses and leases granted under the Petroleum Law will not be compromised. In July 2012 the Israeli Parliament approved at the first hearing the draft Fuel Market Law.

We do not know and cannot predict the results of any attempt to enact the proposed Fuel Market Law, as currently drafted or as may be amended or, if enacted, the effect of such law on our rights under the Petroleum Law or the results of any legal challenge to the law by a holder of a license or lease issued under the Petroleum Law.

Planning & Building

On April 24, 2012, new regulations entitled "The Petroleum Regulations (Authorization to Deviate from the Provisions of the Planning and Building Law) 5772-2012" were adopted and detail a new permitting process. Among other things, the new regulations require the submission, to the local regulatory and permitting authorities, of a detailed environmental report relating to the proposed drilling site and surroundings. The report is to address, in detail, the environmental implications of the drilling, including hydrological analysis, surface water management, risk assessment, environmental impact, and abandonment and remediation of the drill site, among others.

The drilling application must be published and there are specified time frames (approximately 100 days) for any person (including environmental and other interested bodies) to comment on the drilling application. As a result, we believe that the time periods to obtain the necessary permits (prior to spudding a well) have been considerably increased. Currently, we are unable to accurately assess the time period that we would require to obtain the necessary permits to allow us to spud our next exploratory well.

Transfer of Petroleum Related Rights

In May 2011, the Ministry of National Infrastructure published draft regulations, entitled "Petroleum Regulations (Transferring Petroleum Rights)." The draft regulations apply to the transfer of petroleum and related rights, including rights to a preliminary permit, license and production lease as well as rights to profit, royalties or information. The right to transfer these rights pursuant to the draft regulations, in many circumstances, will be much more limited than under the present regime. To date, these draft regulations have not yet been formally adopted.

Political Climate

We are directly influenced by the political, economic and military conditions affecting Israel. Specifically, we could be adversely affected by:

- any major hostilities involving Israel;
- the interruption or curtailment of trade between Israel and its present trading partners;
- a full or partial mobilization of the reserve forces of the Israeli army; and
- a significant downturn in the economic or financial condition of Israel.

Since the establishment of the State of Israel in 1948, a number of armed conflicts have taken place between Israel and its Arab neighbors, and a state of hostility, varying from time to time in intensity and degree, has led to security and economic problems for Israel. In an attempt to stop missile strikes from the Gaza Strip against Israelis, in January 2009 Israel became engaged in an armed conflict with Hamas in the Gaza Strip, during which missile attacks aimed at populated areas in parts of southern Israel (some of which are in vicinity of warehouse space we use) continued daily, disrupting most day-to-day civilian activity in these areas. In November 2012, Israel and the Hamas militant group were engaged in air strikes and rocket attacks resulting in civilian deaths. Although a ceasefire is currently in effect, some level of conflict is likely to continue. These developments have further strained relations between Israel and the Palestinians. Any on-going or future violence between Israel and the Palestinians, armed conflicts, terrorist activities, tension along Israel’s northern borders, or political instability in the region would likely disrupt international trading activities in Israel and may materially and negatively affect our business conditions and could harm our prospects and business.

In addition, civil unrest, often accompanied by violence associated with the so-called “Arab Spring” has spread throughout the region over the last several years in areas such as Egypt, Syria, Jordan, and Lebanon. Protestors have demanded economic and political reforms, and to date, there have been several regime changes. Civil unrest could continue to spread throughout the region or grow in intensity, leading to more regime changes resulting in governments that are hostile to the United States and Israel, civil wars, or regional conflict. International tensions over Iran continue to exist regarding their possible development of nuclear weapons. Certain countries have considered actions ranging from economic sanctions to pre-emptive strikes on suspected nuclear sites, and Iranian officials have threatened retaliation by, among other actions, closing the Strait of Hormuz, through which a significant portion of the global crude oil supply is transported. There is also concern in Israel that the internal conflict in Syria, with which Israel shares a border, may spill over into Israel.

We cannot predict the effect, if any, on our business of renewed hostilities between Israel and its neighbors or any other changes in the political climate in the area.

Foundations

If we are successful in finding commercial quantities of hydrocarbons in Israel, 6% of our gross revenues from production will go to fund two charitable foundations that we established with the purpose of donating to charities in Israel, the U.S. and elsewhere in the world.

For charitable activities concerning Israel, the Bnei Joseph Foundation (R.A.) was established. On November 11, 2008, both the Articles of Association and Incorporation Certificate were certified by the Registrar of Amutot (i.e. Charitable Foundations) in Israel.

For the U.S. and worldwide charitable activities, the Abraham Foundation - in Geneva, Switzerland was established. On June 20, 2008, the Articles of Incorporation were executed and filed by the Swiss Notary in the Commercial Registrar in Geneva. On June 23, 2008, the initial organizational meeting of the founding members was convened in Israel. Regulations for the Organization of the Abraham Foundation, signed by the founding members, were then filed with the Registrar. On November 19, 2008, the Swiss Confederation approved the Foundation as an international foundation under the supervision of the federal government. On December 8, 2008, the Republic of Geneva and the Federal government of Switzerland issued a tax ruling providing complete tax exemption for the Foundation.

Our shareholders, in a resolution passed at the 2002 Annual Meeting, gave authority to the Zion Board of Directors to transfer a 3% overriding royalty interest to each of the two foundations with regard to the Joseph and Asher-Menashe licenses. In accordance with that resolution, we took steps to legally donate a 3% overriding royalty interest to the Bnei Joseph Foundation (in Israel) and a 3% overriding royalty interest to the Abraham Foundation (in Switzerland).

On June 22, 2009, we received an official letter from the Commissioner informing us that the 3% overriding royalty interest to each of the Bnei Joseph Foundation and the Abraham Foundation had been registered in the Israeli Oil Register with regard to the Joseph and Asher-Menashe licenses. On November 9, 2011, we received an official letter from the Commissioner informing us that the 3% overriding royalty interest to each of the Bnei Joseph Foundation and the Abraham Foundation had been registered in the Israeli Oil Register with regard to the Jordan Valley License.

On February 5, 2014, the Company submitted applications to the Petroleum Commissioner, requesting royalty interest transfers from the Megiddo-Jezreel License of 3% overriding royalties to the Bnei Joseph Amutot and the Abraham Foundation, respectively.

Available Information

Zion's internet website address is "www.zionoil.com". We make available, free of charge, on our website, under "SEC Reports", our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, Forms 3, 4 and 5 filed on behalf of directors and executive officers and amendments to those reports, as soon as reasonably practicable after providing the SEC such reports.

Our Corporate Governance Policy, the charters of the Audit Committee, the Compensation Committee and the Nominating and Governance Committee, and the Code of Ethics for directors, officers, employees and financial officers are also available on our website under "Corporate Governance" and in print to any stockholder who provides a written request to the Corporate Secretary at Zion Oil & Gas, Inc., 6510 Abrams Rd., Suite 300, Dallas, TX 75231, Attn: Corporate Secretary.

We file annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, proxy statements and other documents with the SEC under the Securities Exchange Act of 1934, as amended. The public may read and copy any materials that we file with the SEC at the SEC's Public Reference Room at 450 Fifth Street, N.W., Washington, D.C.20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. Also, the SEC maintains an internet website that contains reports, proxy and information statements, and other information regarding issuers, including Zion Oil & Gas, Inc., that file electronically with the SEC. The public can obtain any document we file with the SEC at www.sec.gov. Information contained on or connected to our website is not incorporated by reference into this Form 10-K and should not be considered part of this report or any other filing that we make with the SEC.

ITEM 1A. RISK FACTORS

In evaluating our company, the risk factors described below should be considered carefully. The occurrence of one or more of these events could significantly and adversely affect our business, prospects, financial condition and results of operations.

Risks Associated with our Company

We are a development stage company with no current source of revenue. Our ability to continue in business depends upon our continued ability to obtain significant financing from external sources and the ultimate success of our petroleum exploration efforts in onshore Israel, none of which can be assured.

We were incorporated in April 2000 and are still a development stage company. We have incurred negative cash flows from our operations, and presently all exploration activities and overhead expenses are financed solely by way of the issue and sale of equity securities. The recoverability of the costs we have incurred to date is uncertain and is dependent upon achieving commercial production or sale, none of which can be assured. Our operations are subject to all of the risks inherent in exploration stage companies with no revenues or operating income. Our potential for success must be considered in light of the problems, expenses, difficulties, complications and delays frequently encountered in connection with a new business, especially the oil and gas exploration business, and in particular the deep, wildcat exploratory wells in which we are engaged in Israel. We cannot warrant or provide any assurance that our business objectives will be accomplished.

We expect to incur substantial expenditures in our exploration and development programs. Our existing cash balances will not be sufficient to satisfy our exploration and development plans going forward. We are considering various alternatives to remedy any future shortfall in capital. We may deem it necessary to raise capital through equity markets, debt markets or other financing arrangements, including participation arrangements that may be available. Because of the current absence of any oil and natural gas reserves and revenues in our license areas, there can be no assurance this capital will be available on commercially acceptable terms (or at all) and if it is not, we may be forced to substantially curtail or cease exploration expenditures which could lead to our inability to meet all of our commitments.

The spudding of our next exploratory well is subject to many contingencies outside of our control, and any considerable delay in obtaining all of the needed licenses, approvals and authorizations prior to actual drilling may severely impair our business.

Even though we were granted the Megiddo-Jezreel License, there are a number of risks and contingencies involved in identifying our next exploratory well prospect. We need to acquire, process and interpret additional seismic and other geological and geophysical studies in these areas. We need to contract with the Geophysical Institute of Israel (GII), or some other appropriate seismic services provider, to undertake these studies. Historically, we have had a significant time lag in contracting for and the actual performance of these seismic services by GII. GII is the only seismic services provider in Israel. We can provide no assurance that we will be able to undertake the needed studies in a timely manner.

Finally, even after we are able to perform the necessary geological and geophysical studies in a timely manner and are successful in identifying our next exploratory well drilling prospect, the newly implemented onshore exploration permitting process in Israel is anticipated to considerably increase the time needed to obtain all of the needed regulatory and local permits and approval needed to spud our next exploratory well. We estimate that the permitting process alone may take between 12 and 18 months following the identification of the site of our next exploratory well. See the discussion under “Energy Related Regulation -The Onshore Exploration Permitting Process in Israel”, the “New Onshore Licensing Guidelines” and “Israeli Governmental Regulations”.

For the reasons above, we cannot accurately estimate when we will be able to drill our next exploratory well. Additionally, prior to actually commencing drilling, we will need to contract with a drilling rig operator with the appropriate drilling rig and crew to carry out the drilling. See “We have not signed an agreement with a drilling contractor….”

We require significant capital to realize our business plan.

Our planned work program is expensive. We believe that our current cash resources are sufficient to allow us to undertake non-drilling exploratory activities in our current license areas and in the additional areas of interest that we have identified which are currently outside of our exploration license areas and otherwise meet our plans through March 31, 2015. We estimate that, when we are not actively drilling a well, our monthly expenditure is approximately $494,000 per month. However, when we are engaged in active drilling operations, we estimate that there is an additional cost of approximately $2,500,000 per month. Additionally, the newly enacted onshore licensing and environmental and safety related regulations promulgated by the various energy related ministries in Israel during 2012-2013 are likely to render obtaining new explorations licenses increasingly expensive. For example, at the time of the award of any new exploration license, we will be required to submit performance bank guarantees for 10% of the cost of the planned drilling program as well as other amounts to cover potential environmental damages. See “Israel Energy Related Governmental Regulations”.

We have no commitments for any financing and no assurance can be provided that we will be able to raise funds when needed. Further, we cannot assure you that our actual cash requirements will not exceed our estimates. Even if we were to discover hydrocarbons in commercial quantities, we will require additional financing to bring our interests into commercial operation and pay for operating expenses until we achieve a positive cash flow. Additional capital also may be required in the event we incur any significant unanticipated expenses.

Under the current capital and credit market conditions, we may not be able to obtain additional equity or debt financing on acceptable terms. Even if financing is available, it may not be available on terms that are favorable to us or in sufficient amounts to satisfy our requirements.

If we are unable to obtain additional financing, we may be unable to implement our business plan and our growth strategies, respond to changing business or economic conditions and withstand adverse operating results. If we are unable to raise further financing when required, our planned exploration activities may have to be scaled down or even ceased, and our ability to generate revenues in the future would be negatively affected.

Additional financing could cause your relative interest in our assets and potential earnings to be significantly diluted. Even if we have exploration success, we may not be able to generate sufficient revenues to offset the cost of dry holes and general and administrative expenses.

We are not in compliance with some of the terms of our existing petroleum exploration licenses and such non-compliance may result in the loss or forfeiture of such license(s). The loss or forfeiture of any of our licenses may have an adverse effect on our business and prospects

Based on the results of seismic and other geological and geophysical tests that we have undertaken, we did not drill a well in the Jordan Valley License by April 13, 2013. We may prepare and submit to the Petroleum Commissioner a new work program to perform additional non-drilling exploratory work in the Jordan Valley License area. Thus, we are currently non-compliant with some of the express terms of our Jordan Valley License. Accordingly, we cannot assess the consequences of our non-compliance with the express terms of the current licenses, which may include the forfeiture of existing license rights. See discussion under "Summary of Exploration Efforts" and "Exploration Plans Going Forward".

The loss or forfeiture of one or more of current licenses or the refusal to extend such licenses when they are up for renewal may adversely affect our business and prospects.

We have not signed an agreement with a drilling contractor and thus, we may be unable to affect any future drilling operations within the contemplated time-frame.

Following the completion of the Ma'anit-Joseph #3 well, the drilling rig that we used to drill our last three exploratory wells was exported by the owner from Israel, in January 2012. Until such time as we sign a legally binding agreement, there can be no assurance that we will be able to come to an agreement with the drilling contractor to drill any future exploratory well(s) on commercially reasonable terms, or at all. Any delay in locating and contracting with an appropriate drilling rig owner/operator can have a material adverse effect on the expanded and new exploration rights that we are seeking and on the implementation of our business plan.

We rely on independent experts and technical or operational service providers over whom we may have limited control.

The success of our oil and gas exploration efforts is dependent upon the efforts of various third parties that we do not control. These third parties provide critical engineering, geological, geophysical and other scientific analytical services, including 2-D seismic imaging technology to explore for and develop oil and gas prospects. Given our small size and limited resources, we do not have all the required expertise on staff. As a result, we rely upon various companies and other third persons to assist us in identifying desirable hydrocarbon prospects to acquire and to provide us with technical assistance and services. In addition, we rely upon the owners and operators of drilling rigs and related equipment.

If any of these relationships with third-party service providers are terminated or are unavailable on commercially acceptable terms, we may not be able to execute our business plan. Our limited control over the activities and business practices of these third parties, any inability on our part to maintain satisfactory commercial relationships with them, their limited availability or their failure to provide quality services could materially and adversely affect our business, results of operations and financial condition.

We typically commence exploration drilling operations without undertaking extensive analytical testing thereby potentially increasing the risk (and associated costs) of drilling a non-producing well.

Larger oil and gas exploration companies typically conduct extensive analytical pre-drilling testing. These include 3-D seismic imaging, the drilling of an expendable "pilot" well or "stratigraphic test" to collect data (logs, cores, fluid samples, pressure data) to determine if drilling a well capable of producing oil or gas well (full completion with casing and well testing) is justified. The use of pilot or stratigraphic tests is often used in areas where there is little or no offset well data, like Israel, where our exploration license and permits areas are located. While 3-D seismic imaging data is more useful than 2-D data in identifying potential new drilling prospect, its acquisition and processing costs are many multiples greater than that for 2-D data, and GII, our primary provider of geophysical data, has limited ability to acquire and process onshore 3-D data. In addition to using 2-D seismic technology prior to drilling, we have historically also utilized gravity and magnetic data, built cross section maps from offset wells and utilized geophysical analysis from similar geologic targets. We believe that the additional months, delays and associated costs associated with more extensive pre-drilling testing typically undertaken by larger oil and gas exploration companies is not necessarily justified when drilling vertical exploration wells (as we have historically been doing). Nonetheless, the absence of more extensive pre-drilling testing may potentially increase the risk of drilling a non-producing well, which would in turn result in increased costs and expenses. Additionally, we are typically engaged in drilling very deep onshore wildcat wells in Israel where only approximately 500 total wells have ever been drilled, the vast majority of which are relatively shallower. As such, exploration risks are inherently very substantial.

Exploratory well drilling locations that we decide to drill may not yield oil or natural gas in commercially viable quantities.

There is no way to predict in advance of drilling and testing whether any particular location will yield oil or natural gas in sufficient quantities to recover drilling or completion costs or to be economically viable. The use of technologies and the study of producing fields in the same area will not enable us to know conclusively prior to drilling whether oil, natural gas liquids (NGLs) or natural gas will be present or, if present, whether oil or natural gas will be present in sufficient quantities to be economically viable. Even if sufficient amounts of oil, NGLs or natural gas exist, we may damage the potentially productive hydrocarbon bearing formation or experience mechanical difficulties while drilling or completing a well, resulting in a reduction in production from the well or abandonment of the well. If we drill exploratory wells that we identify as dry holes in our future drilling locations, our business may be materially harmed. We cannot assure you that the analogies we draw from available data from other wells, more fully explored locations or producing fields will be applicable to our drilling locations. Ultimately, the cost of drilling, completing and operating any well is often uncertain, and new wells may not be productive.

Deterioration of political, economic and security conditions in Israel may adversely affect our operations.

Any major hostilities involving Israel, a substantial decline in the prevailing regional security situation or the interruption or curtailment of trade between Israel and its present trading partners could have a material adverse effect on our operations. Since the establishment of the State of Israel in 1948, a number of armed conflicts have taken place between Israel and its Arab neighbors and a state of hostility, varying in degree and intensity, has led to security and economic problems for Israel. Beginning in September 2000, the overall relationship and security situation between Israel and the Palestinians deteriorated significantly and continues to be marked by ongoing violence, also varying in its degree of severity. During the summer of 2006, Israel was engaged in an armed conflict with Hezbollah, a Lebanese Islamist Shiite militia group and political party; and during the winter of 2008-2009 and as recently as November 2012, Israel was engaged in an armed conflict with Hamas, a militia group and political party operating in the Gaza Strip. These conflicts involved missile strikes against civilian targets in various parts of Israel. To date, these matters have not had any material effect on our business and results of operations, but there can be no assurance that they will not do so in the future.

Civil unrest, often accompanied by violence associated with the so-called “Arab Spring” has spread throughout the region over the last several years in areas such as Egypt, Syria, Jordan, and Lebanon. Protestors have demanded economic and political reforms, and to date, there have been several regime changes. Civil unrest could continue to spread throughout the region or grow in intensity, leading to more regime changes resulting in governments that are hostile to the United States and Israel, civil wars, or regional conflict. International tensions continue to exist over Iran regarding their possible development of nuclear weapons. Certain countries have considered actions ranging from economic sanctions to pre-emptive strikes on suspected nuclear sites, and Iranian officials have threatened retaliation by, among other actions, closing the Strait of Hormuz, through which a significant portion of the global crude oil supply is transported. There is also concern in Israel that the internal conflict in Syria, with which Israel shares a border, may spill over into Israel.

Prolonged and/or widespread regional conflict in the Middle East could have the following results, among others:

- capital market reassessment of risk and subsequent redeployment of capital to more stable areas making it more difficult for us to obtain financing for potential development projects;

- security concerns in Israel, making it more difficult for our personnel or supplies to enter or exit the country;

- security concerns leading to evacuation of our personnel;
- damage to or destruction of our wells, production facilities, receiving terminals or other operating assets;
- inability of our service and equipment providers to deliver items necessary for us to conduct our operations in Israel, resulting in delays; and
- lack of availability of drilling rig and experienced crew, oilfield equipment or services if third party providers decide to exit the region.

Loss of property and/or interruption of our business plans resulting from hostile acts could have a significant negative impact on our earnings and cash flow. In addition, we may not have enough insurance to cover any loss of property or other claims resulting from these risks.

We have a history of losses and we cannot assure you that we will ever be profitable.

We incurred net losses of $9,077,000 for the year ended December 31, 2013, and $10,294,000 for the year ended December 31, 2012. We have incurred total net losses of $128,040,000 for period from April 6, 2000 (inception) to December 31, 2013. We cannot provide any assurance that we will ever be profitable.

Earnings, if any, will be diluted due to charitable contributions and key employee incentive plans.

We are legally bound to fund in the form of a royalty interest or equivalent net operating profits interest, 6% of our gross sales revenues, if any, to two charitable foundations. In addition, we may allocate 1.5% royalty interest or equivalent net operating profits interest to a key employee incentive plan designed as bonus compensation over and above our executive compensation payments. This means that the total royalty burden on our property (including the government royalty of 12.5%) may be up to 20% of gross revenue. As our expenses increase with respect to the amount of sales, these donations and allocation could significantly dilute future earnings and, thus, depress the price of the common stock.

Risks Associated with our Business

We are subject to increasing Israeli governmental regulations and environmental requirements that may cause us to incur substantial incremental costs and/or delays in our drilling program.

Our business is subject to laws and regulations promulgated by the State of Israel relating to the exploration for, and the development, production and marketing of, crude oil and natural gas, as well as safety matters. Legal requirements are frequently changed and subject to interpretation and we are unable to predict the ultimate cost of compliance with these requirements or their effect on our operations. We may be required to make substantial expenditures to comply with governmental laws and regulations.

Environmental laws and regulations change frequently and the implementation of new, or the modification of existing, laws or regulations could adversely impact our operations. The discharge of natural gas, crude oil, or other pollutants into the air, soil or water may give rise to substantial liabilities on our part to government agencies and third parties and may require us to incur substantial costs of remediation. In addition, we may incur costs and penalties in addressing regulatory agency procedures involving instances of possible non-compliance.

Our lack of diversification increases the risk of an investment in us, and our financial condition and results of operations may deteriorate if we fail to diversify.

Our business focus is on oil and gas exploration on a limited number of properties in Israel and exploitation of any significant reserves that are found within our license areas. As a result, we lack diversification, in terms of both the nature and geographic scope of our business. We will likely be impacted more acutely by factors affecting our industry or the regions in which we operate than we would if our business were more diversified. If we are unable to diversify our operations, our financial condition and results of operations could deteriorate.

We currently have no proved reserves or current production and we may never have any.

We do not have any proved reserves or current production of oil or gas. We cannot assure you that any wells will be completed or produce oil or gas in commercially profitable quantities.

Oil and gas exploration is an inherently risky business.

Exploratory drilling involves enormous risks, including the risk that no commercially productive oil or natural gas reservoirs will be discovered. Even when properly used and interpreted, seismic data analysis and other computer simulation techniques are only tools used to assist geoscientists in trying to identify subsurface structures and hydrocarbon indicators. They do not allow the interpreter to know conclusively if hydrocarbons are present or economically available. The risk analysis techniques we use in evaluating potential drilling sites rely on subjective judgments of our personnel and consultants. Additionally, we are typically engaged in drilling deep onshore wildcat exploratory wells in Israel where only approximately 500 total wells have ever been drilled, the vast majority of which are relatively shallower. As such, exploration risks are inherently very substantial.

A substantial and extended decline in oil or natural gas prices could adversely impact our future rate of growth and the carrying value of our unproved oil and gas assets.

Prices for oil and natural gas fluctuate widely. Fluctuations in the prices of oil and natural gas will affect many aspects of our business, including our ability to attract capital to finance our operations, our cost of capital, and the value of our unproved oil and natural gas properties. Prices for oil and natural gas may fluctuate widely in response to relatively minor changes in the supply of and demand for oil and natural gas, market uncertainty and a wide variety of additional factors (such as the current political turmoil in the Middle East) that are beyond our control, such as the domestic and foreign supply of oil and natural gas, the ability of members of the Organization of Petroleum Exporting Countries to agree to and maintain oil price and production controls, technological advances affecting energy consumption, and domestic and foreign governmental regulations. Significant and extended reductions in oil and natural gas prices could require us to reduce our capital expenditures and impair the carrying value of our assets.

If we are successful in finding commercial quantities of oil and/or gas, our revenues, operating results, financial condition and ability to borrow funds or obtain additional capital will depend substantially on prevailing prices for oil and natural gas. Declines in oil and gas prices may materially adversely affect our financial condition, liquidity, ability to obtain financing and operating results. Lower oil and gas prices also may reduce the amount of oil and gas that we could produce economically.

Historically, oil and gas prices and markets have been volatile, with prices fluctuating widely, and they are likely to continue to be volatile, making it impossible to predict with any certainty the future prices of oil and gas.

The insurance we carry is insufficient to cover all of the risks we face, which could result in significant financial exposure.

Exploration for and production of crude oil and natural gas can be hazardous, involving natural disasters and other un-fortuitous events such as blowouts, well cratering, fire and explosion and loss of well control which can result in damage to or destruction of wells, injury to persons, loss of life, or damage to property and the environment. Exploration and production activities are also subject to risk from political developments such as terrorist acts, piracy, civil disturbances, war, expropriation or nationalization of assets, which can cause loss of or damage to our property.

As is customary within our industry, we maintain insurance against many, but not all, potential perils confronting our operations and in coverage amounts and deductible levels that we believe to be economic. Consistent with that profile, our insurance program is structured to provide us financial protection from unfavorable loss resulting from damages to or the loss of physical assets or loss of human life, liability claims of third parties, and exploratory drilling interruption attributed to certain assets and including such occurrences as well blowouts and resulting oil spills, at a level that balances cost of insurance with our assessment of risk and our ability to achieve a reasonable rate of return on our investments. Although we believe the coverage and amounts of insurance carried are adequate and consistent with industry practice, we do not have insurance protection against all the risks we face, because we chose not to insure certain risks, insurance is not available at a level that balances the cost of insurance and our desired rates of return, or actual losses exceed coverage limits. We regularly review our risks of loss and the cost and availability of insurance and revise our insurance program accordingly.

If an event occurs that is not covered by insurance or not fully protected by insured limits, it could have a significant adverse impact on our financial condition, results of operations and cash flows.

We face various risks associated with the trend toward increased activism against oil and gas exploration and development activities.

Opposition toward oil and gas drilling and development activity has been growing globally and is particularly pronounced in OECD countries which include the U.S., the U.K and Israel. Companies in the oil and gas industry, such as us, are often the target of activist efforts from both individuals and non-governmental organizations regarding safety, human rights, environmental compliance and business practices. Future activist efforts could result in the following:

- delay or denial of drilling permits;
- shortening of lease terms or reduction in lease size;
- restrictions on installation or operation of gathering or processing facilities;
- restrictions on the use of certain operating practices, such as hydraulic fracturing;
- legal challenges or lawsuits;
- damaging publicity about us;
- increased costs of doing business;
- reduction in demand for our products; and
- other adverse effects on our ability to develop our properties and expand production.

Our need to incur costs associated with responding to these initiatives or complying with any resulting new legal or regulatory requirements resulting from these activities that are substantial and not adequately provided for, could have a material adverse effect on our business, financial condition and results of operations.

Economic risks may adversely affect our operations and/or inhibit our ability to raise additional capital.

Economically, our operations in Israel may be subject to:

- exchange rate fluctuations;
- royalty and tax increases and other risks arising out of Israeli State sovereignty over the mineral rights in Israel and its taxing authority; and
- changes in Israel's economy that could cause the legislation of oil and gas price controls.

Consequently, our operations may be substantially affected by local economic factors beyond our control, any of which could negatively affect our financial performance and prospects.

Legal risks could negatively affect our market value.

Legally, our operations in Israel may be subject to:

- changes in the Petroleum Law resulting in modification of license and permit rights;
- adoption of new legislation relating to the terms and conditions pursuant to which operations in the energy sector may be conducted;
- changes in laws and policies affecting operations of foreign-based companies in Israel; and
- changes in governmental energy and environmental policies or the personnel administering them.

The Israeli Ministry of Energy and Water Resources is considering proposed legislation relating to licensing requirements for entities engaged in the fuel sector that, if adopted as currently proposed, may result in our having to obtain additional licenses to market and sell hydrocarbons that may be discovered by us. We cannot now predict whether or in what form the proposed legislation may be adopted or, if adopted, its possible impact on our operations.

Further, in the event of a legal dispute in Israel, we may be subject to the exclusive jurisdiction of Israeli courts or we may not be successful in subjecting persons who are not United States residents to the jurisdiction of courts in the United States, either of which could adversely affect the outcome of a dispute.

The Ministry of Environmental Protection is considering proposed legislation relating to polluted materials, including their production, treatment, handling, storage and transportation, that may affect land or water resources. Persons engaged in activities involving these types of materials will be required to prepare environmental impact statements and remediation plans either prior to commencing activities or following the occurrence of an event that may cause pollution to land or water resources or endanger public health. We do now know and cannot predict whether any legislation in this area will be enacted and, if so, in what form and which of its provisions, if any, will relate to and affect our activities, how and to what extent.

There are limitations on the transfer of interests in our petroleum rights, which could impair our ability to raise additional funds to execute our business plan.

The Israeli government has the right to approve any transfer of rights and interests in any license or other petroleum right we hold or may be granted and any mortgage of any license or other petroleum rights to borrow money. If we attempt to raise additional funds through borrowings or joint ventures with other companies and are unable to obtain required approvals from the government, the value of your investment could be significantly diluted or even lost.

Our dependence on the limited contractors, equipment and professional services available in Israel may result in increased costs and possibly material delays in our work schedule.

Due to the lack of competitive resources in Israel, costs for our operations may be more expensive than costs for similar operations in other parts of the world. We are also more likely to incur delays in our drilling schedule and be subject to a greater risk of failure in meeting our required work schedule. Similarly, some of the oil field personnel we need to undertake our planned operations are not necessarily available in Israel or available on short notice for work in Israel. Any or all of the factors specified above may result in increased costs and delays in the work schedule.

Our dependence on Israeli local licenses and permits as well as new regulations calling for enhanced bank guarantees and insurance coverage may require more funds than we have budgeted and may cause delays in our work schedule.

In connection with drilling operations, we are subject to a number of Israeli local licenses and permits. Some of these are issued by the Israeli security forces, the Civil Aviation Authority, the Israeli Water Commission, the Israel Lands Authority, the holders of the surface rights in the lands on which we intend to conduct drilling operations, local and regional planning commissions and environmental authorities.

In the event of a commercial discovery and depending on the nature of the discovery and the production and related distribution equipment necessary to produce and sell the discovered hydrocarbons, we will be subject to additional licenses and permits, including from various departments in the Ministry of Energy and Water Resources, regional and local planning commissions, the environmental authorities and the Israel Lands Authority. If we are unable to obtain some or all of these permits or the time required to obtain them is longer than anticipated, we may have to alter or delay our planned work schedule, which would increase our costs.

If we are successful in finding commercial quantities of oil and/or gas, our operations will be subject to laws and regulations relating to the generation, storage, handling, emission, transportation and discharge of materials into the environment, which can adversely affect the cost, manner or feasibility of our doing business. Many Israeli laws and regulations require permits for the operation of various facilities, and these permits are subject to revocation, modification and renewal. Governmental authorities have the power to enforce compliance with their regulations, and violations could subject us to fines, injunctions or both.

If compliance with environmental regulations is more expensive than anticipated, it could adversely impact the profitability of our business.

Risks of substantial costs and liabilities related to environmental compliance issues are inherent in oil and gas operations. It is possible that other developments, such as stricter environmental laws and regulations, and claims for damages to property or persons resulting from oil and gas exploration and production, would result in substantial costs and liabilities. This could also cause our insurance premiums to be significantly greater than anticipated.

The unavailability or high cost of drilling rigs, equipment, supplies, other oil field services and personnel could adversely affect our ability to execute our exploration and development plans on a timely basis and within our budget.

Our industry is cyclical and, from time to time, there is a shortage of drilling rigs, equipment, supplies and oilfield services. There may also be a shortage of trained and experienced personnel. During these periods, the costs of such items are substantially greater and their availability may be limited, particularly in locations that typically have limited availability of equipment and personnel, such as the Eastern Mediterranean, where our operations are located.

During periods of increasing levels of industry exploration and production, the demand for, and cost of, drilling rigs and oilfield services increases. The recovery of global crude oil prices during 2012 and 2013 is resulting in increased global exploration and production activity, thus increasing demand pressure for drilling rigs and oilfield services, which could result in sector inflation. As a result, drilling rigs and oilfield services may not be available at rates that provide a satisfactory return on our investment.

Risks Related to our Common Stock

Our failure to comply with NASDAQ’s listing standards could result in the delisting of our common stock by NASDAQ from the NASDAQ Global Market and severely limit the ability to sell our common stock.

Our common stock is currently traded on the NASDAQ Global Market. Under NASDAQ’s listing maintenance standards, if the closing bid price of our common stock is under $1.00 per share for 30 consecutive trading days, NASDAQ will notify us that we may be delisted from the NASDAQ Global Market. If the closing bid price of our common stock does not thereafter regain compliance for a minimum of 10 consecutive trading days during the 180 days following notification by NASDAQ, NASDAQ may delist our common stock from trading on the NASDAQ Global Market. There can be no assurance that our common stock will remain eligible for trading on the NASDAQ Global Market. In addition, if our common stock is delisted, our stockholders would not be able to sell our common stock on the NASDAQ Global Market, and their ability to sell any of our common stock would be severely, if not completely, limited.

Between January 31 and February 26, 2013, the per share price of our common stock closed at between $0.85 and $1.16 on the NASDAQ Global Market. If we are not able to maintain compliance with such continuing listing requirements going forward, our stock may be delisted from the NASDAQ Global Market, which could have a negative effect on the price of our common stock, as well as on our ability to raise additional funds.

We will likely issue additional common stock in the future, which would dilute our existing stockholders.

In the future we anticipate issuing additional securities in connection with capital raising efforts, including shares of our common stock or securities convertible into or exchangeable for our common stock, resulting in the dilution of the ownership interests of our stockholders. We are authorized under our amended and restated certificate of incorporation to issue 100,000,000 shares of common stock. As of February, 24, 2014, there were 34,175,292 shares of our common stock issued and outstanding.

We have an effective shelf registration statement on Form S-3 (File No. 333-174266) from which additional shares of our common stock and other securities can be issued. In addition, we may also issue additional shares of our common stock or securities convertible into or exchangeable for our common stock in connection with the hiring of personnel, future acquisitions, future private placements of our securities for capital raising purposes or for other business purposes. Future issuances of our common stock, or the perception that such issuances could occur, could have a material adverse effect on the price of our common stock. The current registration statement was declared effective by the SEC on May 26, 2011 and therefore, is effective until May 25, 2014 plus 180 days thereafter.

On January 13, 2014, a Form S-3 Registration Statement, which is a replacement registration statement for our currently effective registration statement, was filed with the SEC using a “shelf” registration process. The replacement Form S-3 stated that from time to time, we may offer up to an aggregate of approximately $120,350,000 (the amount remaining under our existing shelf registration) of any combination of the securities described in this prospectus, either individually or in units. We will not sell under this registration statement and prospectus common stock or other securities with a market value exceeding one-third of the aggregate market value of our outstanding common stock owned by non-affiliates, or the public float, in any 12-month period; provided, however, if the aggregate market value of our public float equals or exceeds $75 million, such limitation shall not apply to sales made pursuant to the registration statement and prospectus on or subsequent to such date.

When we offer a particular series of securities, we will describe the intended use of the net proceeds from that offering in a prospectus supplement. The actual amount of net proceeds we spend on a particular use will depend on many factors, including, our future capital expenditures, the amount of cash required by our operations, and our future revenue growth, if any. Therefore, we will retain broad discretion in the use of the net proceeds.

Because we have no plans to pay dividends on our common stock, stockholders must look solely to appreciation of our common stock to realize a gain on their investments.

We do not know when or if we will pay dividends. We currently intend to retain future earnings, if any, to finance the expansion of our business. Our future dividend policy is within the discretion of our board of directors and will depend upon various factors, including our business, financial condition, results of operations, capital requirements and investment opportunities. Accordingly, stockholders must look solely to appreciation of our common stock to realize a gain on their investment. This appreciation may not occur.

Our stock price and trading volume may be volatile, which could result in losses for our stockholders.

The public market for our common stock has been characterized by significant price and volume fluctuations. There can be no assurance that the market price of our common stock will not decline below its current or historic price ranges. The market price may bear no relationship to the prospects, stage of development, existence of oil and gas reserves, revenues, earnings, assets or potential of our company and may not be indicative of our future business performance. The trading price of our common stock could be subject to wide fluctuations. Fluctuations in the price of oil and gas and related international political events can be expected to affect the price of our common stock. In addition, the stock market in general has experienced extreme price and volume fluctuations that have affected the market price for many companies, sometimes unrelated to the operating performance of these companies. These market fluctuations, as well as general economic, political and market conditions, may have a material adverse effect on the market price of our common stock.

Some of the factors that could negatively affect our share price or result in fluctuations in the price or trading volume of our common stock include:

- actual or anticipated quarterly variations in our operating results,
- changes in expectations as to our future financial performance or changes in financial estimates, if any,
- announcements relating to our business or the business of our competitors,
- conditions generally affecting the oil and natural gas industry,
- the success of our operating strategy, and
- the operating and stock performance of other comparable companies.

Many of these factors are beyond our control, and we cannot predict their potential effects on the price of our common stock. In addition, the stock market is subject to extreme price and volume fluctuations. This volatility has had a significant effect on the market price of securities issued by many companies for reasons unrelated to their operating performance and could have the same effect on our common stock.

In addition, following periods of volatility in the market price of a company's securities, securities class action litigation has often been instituted against such companies. Such litigation, if instituted, and irrespective of the outcome of such litigation, could result in substantial costs and a diversion of management's attention and resources and have a material adverse effect on our business and financial condition.

ITEM 1B. UNRESOLVED STAFF COMMENTS

Not Applicable.

ITEM 2. PROPERTIES

Our current oil and gas interests consist of three petroleum exploration licenses, all onshore Israel, comprised of the Megiddo-Jezreel License (covering approximately 98,842 acres), the Asher-Menashe License (covering approximately 78,834 acres) and the Jordan Valley License (covering approximately 55,845 acres of land in the Jordan Valley area). We were awarded the Megiddo-Jezreel License in December 2013. We have continuously held the Asher-Menashe License since June 2007. We were awarded the Jordan Valley License in April 2011.

The table below summarizes certain data for our license areas for the year ended December 31, 2013:

Type of Right	Name	Area (Approx.Acres)	Working Interest	Expiration Date
License	Asher-Menashe	78,834	100%(1)	June 9, 2014(2) (5)
License	Megiddo-Jezreel	98,842	100%(1)	December 2, 2016(3) (5)
License	Jordan Valley	55,845	100%(1)	April 12, 2014(4) (5)

(1) All of the rights are subject to a 12.5% royalty interest due to the government of Israel under the Petroleum Law. Zion has also donated the equivalent of a 6% royalty interest (or equivalent net operating profits interest) to two foundations. In addition, Zion may allocate a 1.5% royalty interest (or equivalent net operating profits interest) to a key employee incentive plan that may be established.

(2) Set to expire on June 9, 2014.

(3) After the initial primary term of three years, extendable through December 2, 2020, one year at a time at the commissioner’s discretion, subject to compliance with the terms of the license as may be amended.

(4) Extendable through April 2018, one year at a time at the commissioner’s discretion, subject to compliance with the terms of the license as may be amended. As discussed above, we are currently not in full compliance with the terms of this license.

(5) Declaration of a commercial discovery during the license term, as may in certain circumstances be extended for two years to define the boundaries of the field, would entitle Zion to receive a 30-year lease (extendable for up to an additional 20 years - 50 years in all) subject to compliance with a field development work program and production.

Surface Rights

The surface rights to any prospective drill site in the Joseph License area are held under a long-term lease by Kibbutz Ma'anit. The rights are owned by the State of Israel and administered by the Israel Lands Authority. Permission has been granted to Zion by both Kibbutz Ma'anit and the Israel Lands Authority for the use of the surface rights. The Company has completed the plugging obligations of all wells within the Joseph License area and acknowledges its obligation to complete the abandonment of the wells in accordance with guidance from the Environmental Ministry even though the Joseph License period has technically expired.

The surface rights to any prospective drill site in the Asher-Menashe License area are held under a long-term lease by Kibbutz Ein Carmel. The rights are owned by the State of Israel and administered by the Israel Lands Authority. Permission has been granted to Zion by both Kibbutz Ein Carmel and the Israel Lands Authority for the use of the surface rights. The Company is in the process of completing the plugging obligations of the only well within the

Asher-Menashe License area and acknowledges its obligation to complete the abandonment of the well in accordance with guidance from the Environmental Ministry. The Company currently has no plans to continue exploration activity in this license area.

After the Company identifies a specific drill site or sites in the new Megiddo-Jezreel License area, we will seek surface rights from the appropriate owner.

Summary of Exploration Activities/ Present Activities

Please refer to the discussion above under Item 1, under the caption “Summary of Exploration Activities” and “Exploration Plans Going Forward”.

Office Properties

(i) The Company has a lease for 3,600 square feet of corporate office space in Dallas, Texas, which expired on October 31, 2011. On October 11, 2011, the Company and the landlord entered into an amended lease for its current office premises in Dallas, Texas as well as the addition of adjacent space in the building. Pursuant to the lease amendment, the lease term on the existing office space as well as the additional premises was extended to October 31, 2015.

Rent is paid on a monthly basis and was $6,996 per month for each month from November 1, 2011 through October 31, 2012; thereafter, $7,534 for each month through October 31, 2013; $7,534 for each month through October 31, 2014 and $8,072 for each month through October 31, 2015. Notwithstanding the foregoing, the parties agreed that so long as there was no event of default under the lease amendment, monthly payments of $1,434 through October 31, 2012 and $1,544 thereafter through October 31, 2013 were to be abated.
(ii) The Company's field office in Caesarea Israel consists of 5,565 square feet. The sublease term continues through March 31, 2014. Rent is paid on a monthly basis in the base amount of approximately NIS 28,400 per month (approximately $8,100 per month at the exchange rate in effect on the date of this report). The Company is also obligated to pay all cost of living adjustments, as well as its pro-rated portion of all taxes, utilities, and insurance and maintenance payments during the sublease term.

With the sublease for the company's field office in Caesarea, Israel expiring in March 2014, on December 19, 2013 the Company signed a new lease agreement with Caesarea Asset Management and Development companies for new premises containing 6,566 square feet. The lease term is five years from February 1, 2014 to January 31, 2019. Rent is to be paid on a monthly basis in the base amount of approximately NIS 37,800 per month (approximately $10,800 per month at the exchange rate in effect on the date of this report and is linked to an increase (but not a decrease) in the CPI. The Company is also obligated to pay all related taxes, utilities, insurance and maintenance payments during the lease term. Pursuant to the lease, twenty-four months from the commencement of the lease term, the Company may terminate the agreement upon three months' notice, provided the Company secures a replacement lessee approved by the lessor at its discretion.

The Company has an option to renew the lease for another five years, provided it is not in breach of the agreement, where it is required as well to furnish a notice of intent to exercise the option six months prior to termination of lease and furnishes a bank guarantee and insurance confirmation prior to commencement of option period. Under the lease agreement, the Company is authorized to further sublease part of the leased premises to a third party that is pre-approved by the sub-lessor. Rent and its related taxes, utilities, insurance and maintenance expenses for 2013 and 2012 were $256,000 and $238,000, respectively.

ITEM 3. LEGAL PROCEEDINGS

On September 12, 2008, the Company entered into a drilling contract with Aladdin Middle East Ltd. ("AME") pursuant to which AME shipped into Israel its 2,000 horsepower rig for use in the drilling contemplated by the Company's business plan. The rig arrived in Israel and cleared customs in April 2009 and was used to drill the Ma'anit-Rehoboth #2 well, the Elijah #3 and the Ma'anit-Joseph #3 well. Drilling operations on the Ma'anit-Joseph #3 well were concluded in July 2011, whereupon the Company released the rig.

As previously disclosed, AME is part of a group of privately owned affiliated entities. The Company also disclosed that Guyney Yildizi Petrol UretimSondajmut, vc Tic A.S. ("GYP"), an affiliated entity of AME, advised the Company in April 2011 that GYP was the owner of the rig and, following further investigation by the Company, the Company agreed to remit the payments payable under the drilling contract between it and AME directly to GYP. The Company obtained an indemnity from GYP with respect to any damages and costs resulting from such payments to GYP.

In the context of finalizing amounts owed to GYP under the drilling contract, in April, 2012 GYP advised the Company in writing that approximately $1.5 million remain outstanding under the drilling contract, which amount purportedly included $550,000 in rig demobilization fees.

In May, 2012, the Company and GYP agreed that the Company would pay GYP $627,000 in full and final settlement of past bills, and such amount was paid on May 15, 2012. However, the matter related to GYP’s demand for $550,000 for rig demobilization was excluded from the settlement. The drilling contract between the Company and AME, which was assumed by GYP, provides that all disputes are to be settled by arbitration in London, United Kingdom.

On February 25, 2013, GYP advised the Company in writing of GYP's intention to seek arbitration under the drilling contract; however, GYP also indicated its desire to find an amicable solution in lieu of initiating arbitration proceedings and offered a deep discount to resolve the matter. The Company, which denies it owes anything, offered a nuisance amount to resolve the matter. The Company's offer has not been accepted by GYP to date, and periodic communications continue between it and the Company.

On October 13, 2013, the Company received a new letter from GYP requesting payment of the $550,000 with no reference to arbitration. By written response on October 29, 2013, the Company respectfully denied any liability on GYP's claim. On October 31, 2013, the Company received an email from GYP disagreeing with the Company's analysis and threatening arbitration if no satisfactory solution can be found. By written response on November 6, 2013, the Company, citing relevant provisions of the drilling contract, again respectfully denied any liability on GYP's claim.

On March 4, 2014, the Company received from GYP a request for arbitration. The Company continues to deny GYP's claim and intends to vigorously defend itself.

ITEM 4. MINE SAFETY DISCLOSURES

Not Applicable.

PART II

ITEM 5. MARKET FOR THE REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

We completed the initial public offering of our common stock in January 2007. From January 3, 2007 and through September 1, 2009, shares of our common stock were traded on the NYSE Amex under the symbol "ZN". Since September 2, 2009, our common stock has been trading on the NASDAQ Global Market, also under the symbol "ZN".

The following table sets forth the high and low sales prices for the common stock for the periods indicated, as reported by the NASDAQ Global Market.

Fiscal Year 2013:	High	Low
First Quarter	$ 1.80	$ 0.85
Second Quarter	$ 2.60	$ 1.25
Third Quarter	$ 2.40	$ 1.65
Fourth Quarter	$ 1.90	$ 1.38

Fiscal Year 2012:	High	Low
First Quarter	$ 3.00	$ 2.31
Second Quarter	$ 2.68	$ 1.55
Third Quarter	$ 2.86	$ 1.66

Fourth Quarter	$ 2.30	$ 1.70

The closing per share sales price of our Common Stock on March 5, 2014 was $1.89.

Holders

As of March 5, 2014 there were approximately 5,300 shareholders of record of our common stock. A significant number of shares of our Common Stock are held in either nominee name or street name brokerage accounts and, consequently, we are unable to determine the number of beneficial owners of our stock.

Dividends

We have never paid dividends on our common stock and do not plan to pay dividends on the common stock in the foreseeable future. Whether dividends will be paid in the future will be in the discretion of our board of directors and will depend on various factors, including our earnings and financial condition and other factors our board of directors considers relevant. We currently intend to retain earnings to develop and expand our business.

Issuer Purchases of Equity Securities

We do not have a stock repurchase program for our common stock.

ITEM 6. SELECTED FINANCIAL DATA

The following selected financial data should be read in conjunction with the financial statements and the notes thereto and the information contained in Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations." Historical results are not necessarily indicative of future results. The selected financial data for the years ended December 31, 2011, 2010 and 2009 are derived from our audited financial statements not included in this report. All data is in thousands of USD, except share data:

Statement of Operations Data	2013	2012	2011	2010	2009	Period from April 6, 2000 (inception) to December 31, 2013
Revenues	—	—	—	—	—	—
General and administrative expenses:						
Legal and professional	1,065	1,188	1,265	895	861	10,368
Salaries	2,553	3,890	3.730	2,393	2,360	20,634
Other	2,216	3,310	4,530	2,366	1,344	17,420
Impairment of unproved oil and gas properties	3,289	1,965	42,488	22,022	-	79,258
Other (expense) income, net	46	59	(169)	18	141	(360)
Net loss	(9,077)	(10,294)	(52,182)	(27,658)	(4,424)	(128,040)
Net loss per share of common stock	(0.27)	(0.33)	(1. 86)	(1.25)	(0.34)	(8.32)
Balance Sheet Data						

Cash and cash equivalents	10,414	14,983	22,231	21,243	20,734	-
Unproved oil and gas properties	2,446	4,700	3,535	25,882	23,759	-
Current liabilities	2,095	2,859	3,847	2,595	2,601	-
Total liabilities	2,272	3,058	4,275	2,934	2,786	-
Stockholders' equity	12,667	18,246	22,492	46,369	43,439	-

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

Introduction

The following discussion and analysis should be read in conjunction with Item 6, “Selected Financial Data” and our accompanying financial statements and the notes to those financial statements included elsewhere in this Annual Report. Some of our discussion is forward-looking and involve risks and uncertainties. For information regarding factors that could have a material adverse effect on our business, refer to Risk Factors under Item 1A of this Report.

Overview

Zion Oil and Gas is an initial stage oil and gas exploration company with a history of over 13 years of oil and gas exploration in Israel. We were incorporated in Florida on April 6, 2000 and reincorporated in Delaware on July 9, 2003. We completed our initial public offering in January 2007. Our common stock currently trades on the NASDAQ Global Market under the symbol “ZN”.

Zion currently holds three petroleum exploration licenses, all onshore Israel, comprised of the newly granted Megiddo-Jezreel License (covering approximately 98,842 acres), the Asher-Menashe License (covering approximately 78,824 acres), and the Jordan Valley License (covering approximately 55,845 acres). Zion’s total license area currently amounts to approximately 233,511 acres.

As a result of ongoing evaluation of previous and newly acquired geological and geophysical data relating to our license areas, we are re-focusing our exploration strategy with a primary emphasis on the Megiddo-Jezreel and portions of the Jordan Valley License areas. After we identify the site of our next exploratory well, we will need to begin the procedure of obtaining the needed authorizations and permits. We anticipate that the newly promulgated regulations will considerably increase the time needed to obtain all of the needed permits and authorizations from regulatory and local bodies in Israel. See the discussion under “The Onshore Petroleum Exploration Permitting Process in Israel” discussed above. Finally, prior to actually spudding our next exploratory well, we will need to contract with an appropriate rig contractor. We anticipate that we will need to raise significant funds in order to complete any exploratory well that we spud. To date, we have funded our operations through the issuance of our securities. We anticipate that we will need to raise funds through the issuance of equity securities (or securities convertible into or exchangeable for equity securities). No assurance can be provided that we will be successful in raising the needed equity on favorable terms (or at all).

To date, we have drilled four exploratory wells. While the presence of hydrocarbons was indicated while drilling certain of these wells, none of the exploratory wells that we have drilled to date have been deemed capable of producing oil or gas in commercial quantities.

At present, we have no revenues or operating income and are classified as a "development stage" company. Our ability to generate future revenues and operating cash flow will depend on the successful exploration and exploitation of our current and any future petroleum rights or the acquisition of oil and/or gas producing properties, and the volume and timing of such production. In addition, even if we are successful in producing oil and gas in commercial quantities, our results will depend upon commodity prices for oil and gas, as well as operating expenses including taxes and royalties.

Our executive offices are located at 6510 Abrams Road, Suite 300, Dallas, Texas 75231, and our telephone number is (214) 221-4610. Our field office in Israel is located at 9 Halamish Street, North Industrial Park, Caesarea 3088900, and the telephone number is +972-4-623-8500. Our website address is: www.zionoil.com.

Principal Components of our Cost Structure

Our operating and other expenses primarily consist of the following:

- Impairment of Unproved Oil and Gas Properties: Impairment expense is recognized if a determination is made that a well will not be able to be commercially productive. The amounts include amounts paid in respect of the drilling operations as well as geological and geophysical costs and various amounts that were paid to Israeli regulatory authorities.

- General and Administrative Expenses: Overhead, including payroll and benefits for our corporate staff, costs of managing our exploratory operations, audit and other professional fees, and legal compliance are included in general and administrative expense. General and administrative expense also includes non-cash stock-based compensation expense, investor relations related expenses, lease and insurance and related expenses.

- Depreciation, Depletion, Amortization and Accretion. The systematic expensing of the capital costs incurred to explore for natural gas and oil. As a full cost company, we capitalize all costs associated with our exploration, and apportion these costs to each unit of production, if any, through depreciation, depletion and amortization expense. As we have yet to have production, the costs of abandoned wells are written off immediately versus being included in this amortization pool.

Critical Accounting Policies

Management's discussion and analysis of financial condition and results of operations is based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expense during the reporting period.

We have identified the accounting principles which we believe are most critical to the reported financial status by considering accounting policies that involve the most complex of subjective decisions or assessment.

Impairment of Oil and Gas Properties

We follow the full-cost method of accounting for oil and gas properties. Accordingly, all costs associated with acquisition, exploration and development of oil and gas reserves, including directly related overhead costs, are capitalized.

All capitalized costs of oil and gas properties, including the estimated future costs to develop proved reserves, are amortized on the unit-of-production method using estimates of proved reserves. Investments in unproved properties and major development projects are not amortized until proved reserves associated with the projects can be determined or until impairment occurs. If the results of an assessment indicate that the properties are impaired, the amount of the impairment is included in income from continuing operations before income taxes and the adjusted carrying amount of the unproved properties is amortized on the unit-of-production method.

Our oil and gas properties represent an investment in unproved properties. These costs are excluded from the amortized cost pool until proved reserves are found or until it is determined that the costs are impaired. All costs excluded are reviewed at least quarterly to determine if impairment has occurred. The amount of any impairment is charged to expense since a reserve base has not yet been established. A further impairment requiring a charge to expense may be indicated through evaluation of drilling results, relinquishing drilling rights or other information.

Abandonment of properties is accounted for as adjustments to capitalized costs. The net capitalized costs are subject to a “ceiling test” which limits such costs to the aggregate of the estimated present value of future net revenues from proved reserves discounted at ten percent based on current economic and operating conditions, plus the lower of cost or fair market value of unproved properties. The recoverability of amounts capitalized for oil and gas properties is dependent upon the identification of economically recoverable reserves, together with obtaining the necessary financing to exploit such reserves and the achievement of profitable operations.

In March 2013, the Company recorded a non-cash impairment charge of approximately $1,851,000 of its unproved oil and gas properties. The impairment charge is for all remaining capitalized costs of the Joseph License.

In December 2013, the Company recorded a non-cash impairment charge of approximately $1,438,000 of its unproved oil and gas properties. The impairment charge is for all remaining capitalized costs of the Asher-Menashe License and the results of the Elijah #3 well re-entry operations. Impairments on both licenses are due principally to a decision to prioritize available financial resources and focus Zion’s efforts on the Megiddo-Jezreel and portions of the Jordan Valley License areas.

Following the conclusion of the re-entry operations into the Elijah #3 well and related geological and geophysical testing in the third-fourth quarters of 2012, we recorded in the quarter ended December 31, 2012 a non-cash impairment charge of $1,965,000 to our unproved oil and gas properties, comprised of $1,913,000 in respect of the Elijah #3 re-entry well operations and $52,000 in respect of the withdrawal of the three applications for petroleum exploration rights originally submitted in 2011.

Following the impairment charges noted above, the total net book value of our unproved oil and gas properties under the full cost method is $2,446,000 at December 31, 2013.

Currency Utilized

Although our oil & gas properties and our principal operations are in Israel, we report all our transactions in United States dollars. Certain dollar amounts in the financial statements may represent the dollar equivalent of other currencies.

Valuation of Deferred Taxes

We record a valuation allowance to reduce our deferred tax asset to the amount that we believe is likely to be realized in the future. In assessing the need for the valuation allowance we have considered not only future taxable income but also feasible and prudent tax planning strategies. In the event that we were to determine that it would be likely that we would, in the future, realize our deferred tax assets in excess of the net recorded amount, an adjustment to the deferred tax asset would be made. In the period that such a determination was made, the adjustment to the deferred tax asset would produce an increase in our net income.

Asset Retirement Obligation

We record 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 lived assets.

RESULTS OF OPERATIONS

The following table sets forth our Statements of Operations data for the years ended December 31 (all data is in thousands of USD):

	2013	2012
General and administrative expenses:		
Legal and professional	1,065	1,188
Salaries	2,553	3,890
Other	2,216	3,310
Impairment of unproved oil and gas properties	3,289	1,965
Total General and administrative expenses	9,123	10,353
Other (income) expense, net	(46)	(59)
Net loss	9,077	10,294

FOR THE YEAR ENDED DECEMBER 31, 2013 COMPARED TO DECEMBER 31, 2012

Revenue. We currently have no revenue generating operations as we are still a development stage company.

General and administrative expenses. General and administrative expenses for the year ended December 31, 2013 were $9,123,000 compared to $10,353,000 for the year ended December 31, 2012. The decrease in general and administrative expenses in 2013 compared to 2012 is primarily attributable to a deliberate effort to run the Company more efficiently, resulting in reduced costs in salaries and other expenses. Legal and professional fees for 2013 were

$1,065,000 compared to $1,188,000 for 2012. The decrease in legal and professional fees is primarily attributable to the decreased utilization of legal services resulting from the decrease in operational activity in 2013. Salary expenses for the year ended December 31, 2013 were $2,553,000 compared to $3,890,000 for the year ended December 31, 2012. The decrease in salary expenses in 2013 compared to 2012 is primarily attributable to a lesser salary cost due to a reduction in workforce coupled with a lesser non-cash expense recorded in connection with stock option grants that were awarded during 2013, 2012 and 2011. Other general and administrative expenses for the year ended December 31, 2013 were $2,216,000 compared to $3,310,000 for the year ended December 31, 2012. Other general and administrative expenses are comprised of non-compensation and non-professional expenses incurred. The decrease in other general and administrative expenses in 2013 compared to 2012 is primarily attributable to decreased marketing and investor relations related expenses and operational expenses. Impairment of unproved oil and gas properties expenses for the year ended December 31, 2013 were $3,289,000 compared to $1,965,000 for the year ended December 31, 2012. The increase in impairment of unproved oil and gas properties expenses in 2013 compared to 2012 is attributable to the impairment charge of $3,289,000 recorded during the year ended December 31, 2013 in respect of all remaining capitalized costs of the Joseph and Asher – Menashe Licenses and the Elijah #3 re-entry operations, in comparison to the impairment charge of $1,965,000 recorded during the year ended December 31, 2012 in respect the Elijah #3 well re-entry.

Other (income) expense, net. Other (income) expense, net for the year ended December 31, 2013 was ($46,000) compared to ($59,000) for the year ended December 31, 2012.

Net Loss. Net loss for the year ended December 31, 2013 was $9,077,000 compared to $10,294,000 for the year ended December 31, 2012.

Liquidity and Capital Resources

Liquidity is a measure of a company's ability to meet potential cash requirements. As discussed above, we have historically met our capital requirements through the issuance of common stock (or securities convertible into common stock) as well as proceeds from the exercise of warrants and options to purchase common equity.

At December 31, 2013, we had approximately $10,414,000 in cash and cash equivalents compared to $14,983,000 at December 31, 2012. Our working capital (current assets minus current liabilities) was $10,045,000 at December 31, 2013 and $13,409,000 at December 31, 2012.

As of December 31, 2013, the Company provided bank guarantees to various governmental bodies (approximately $1,143,000) and others (approximately $109,000) in respect of its drilling operation in the aggregate amount of approximately $1,252,000. The restricted cash in the Company's bank account represents those guarantees and is in interest-bearing deposits.

During the year ended December 31, 2013, cash used in operating activities totaled $4,648,000. Cash provided by financing activities during the year ended December 31, 2013 was $2,479,000 and is attributable to proceeds received from the DSPP (the "Plan") which offers investors the ability to purchase units and shares of our common stock directly from us. Net cash used in investing activities such as unproved oil and gas properties, other assets and restricted bank deposits was $2,400,000 for the year ended December 31, 2013.

We expect to incur additional significant expenditures to further our exploration programs. We estimate that, when we are not actively drilling a well, our expenditures are approximately $494,000 per month excluding exploratory operational activities. However, when we become engaged in active drilling operations, we estimate an additional minimum expenditure of approximately $2,500,000 per month. The above estimates are subject to change. Management believes that our existing cash balance will be sufficient to finance our plan of operations through March 31, 2015. However, there are factors that can adversely impact our ability to fund our operating needs through such date, including (without limitation), unexpected or unforeseen cost overruns in planned non-drilling exploratory work (e.g., seismic acquisition, drilling and environmental permit acquisition costs, etc.) in existing and newly sought license areas and the costs associated with extended delays in undertaking the required exploratory work, which is typical of what we have experienced in the past, or plugging and abandonment activities. We are considering various alternatives with respect to raising additional capital but to date have made no specific plans or arrangements, except for the launch in March 2013 of the DSPP. We expect that when we seek to raise additional capital it will be through the sale of equity securities, debt or other financing arrangements. Due in part to our lack of any oil and natural gas reserves, there can be no assurance this capital will be available and if it is not, we may be forced to substantially curtail or cease exploration and development expenditures.

Dividend Reinvestment and Direct Stock Purchase Plan

On March 27, 2013, the Company filed with the SEC the prospectus supplement dated as of March 27, 2013 and accompanying base prospectus (collectively, the "Prospectus") relating to the Company's Dividend Reinvestment and Direct Stock Purchase Plan (the "DSPP"). The Prospectus forms a part of the Company's current Registration Statement on Form S-3.

Under the Prospectus, the Company is offering (a) shares of common stock and (b) through February 28, 2014, units of the Company's securities with each unit comprised of (i) one share of common stock and (ii) a warrant to purchase an additional share of the Company's common stock at an exercise price of $2.00 per share for five years. The securities are being offered by the Company in accordance with the terms of the DSPP as described in the Prospectus.

On August 26, 2013, the Company extended the expiration date for the Unit program under its DSPP to November 29, 2013.

On November 25, 2013, the Company extended the expiration date for the Unit program under its DSPP to February 28, 2014.

On February 21, 2014, the Company extended the expiration date for the Unit program under its DSPP to June 30, 2014. The extensions were made, in part, to allow interested investors to utilize a new and more convenient electronic enrollment procedure with the TeleCheck Internet Check Acceptance service as a payment method.

As of December 31, 2013, the Company and its registered agent, Registrar and Transfer Company ("RTC"), had collected approximately $2,478,000 from the DSPP. As a result, the Company issued a total of 1,099,486 shares of its common stock, comprised of 790,975 units (unit comprised of (i) one share of common stock and (ii) a warrant) and 308,511 shares.

Tabular Disclosure of Contractual Obligations

The following summarizes our contractual financial obligations for continuing operations at December 31, 2013 and the effect such obligations are expected to have on our liquidity and cash flow in future periods.

	Payment due by period (in Thousands of USD)					
	2014	2015	2016	2017	Thereafter	Total
Exploration Related Commitments	2,012	-	-	-	-	2,012
Operating Leases	335	304	174	171	186	1,170
Employment Agreements	1,073	-	-	-	-	1,073
Total	3,420	304	174	171	186	4,255

Off-Balance Sheet Arrangements

We do not currently use any off-balance sheet arrangements to enhance our liquidity or capital resource position, or for any other purpose.

Recently Issued Accounting Pronouncements

During 2013, there were no recently issued accounting pronouncements which were issued and which have relevancy to our business.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Market risk is a broad term for the risk of economic loss due to adverse changes in the fair value of a financial instrument. These changes may be the result of various factors, including interest rates, foreign exchange rates, commodity prices and/or equity prices. In the normal course of doing business, we are exposed to the risks associated with foreign currency exchange rates and changes in interest rates.

Foreign Currency Exchange Rate Risks. A portion of our expenses, primarily labor expenses and certain supplier contracts, are denominated in New Israeli Shekels (“NIS”). As a result, we have significant exposure to the risk of fluctuating exchange rates with the U.S. Dollar (“USD”), our primary reporting currency. Since December 2010, the NIS has experienced a re-evaluation of approximately 0.3% against the USD. Continued re-evaluation of the NIS (against the USD) should result in higher operating costs for us from NIS denominated expenses. Since December 31, 2012 and 2011 to December 31, 2013, the USD has weakened by approximately 7.0% and 9.2% respectively against the NIS. Continuing devaluation of the US dollar against the NIS will result in higher operating costs from NIS denominated expenses. To date, we have not hedged any of our currency exchange rate risks, but we may do so in the future.

Interest Rate Risk. Our exposure to market risk relates to our cash and investments. We maintain an investment portfolio of short term bank deposits and money market funds. The securities in our investment portfolio are not leveraged, and are, due to their very short-term nature, subject to minimal interest rate risk. We currently do not hedge interest rate exposure. Because of the short-term maturities of our investments, we do not believe that a change in market interest rates would have a significant negative impact on the value of our investment portfolio except for reduced income in a low interest rate environment. At December 31, 2013, we had cash, cash equivalents and short-term bank deposits of approximately $11,801,000. The weighted average annual interest rate related to our cash and cash equivalents for the year ended December 31, 2013 was approximately 0.18%.

The primary objective of our investment activities is to preserve principal while at the same time maximizing yields without significantly increasing risk. To achieve this objective, we invest our excess cash in short-term bank deposits and money market funds that may invest in high quality debt instruments.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The financial statements required by this item are included beginning at page F-1 below.

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

None.

ITEM 9A. CONTROLS AND PROCEDURES

EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES.

We carried out an evaluation required by the Exchange Act, under the supervision and with the participation of our principal executive officer and principal financial and accounting officer, of the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rule 13a-15(e) of the Exchange Act, as of December 31, 2013. Based on this evaluation, our principal executive officer and our principal financial and accounting officer concluded that our disclosure controls and procedures were effective, as of December 31, 2013, to provide reasonable assurance that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms and to provide reasonable assurance that such information is accumulated and communicated to our management, including our principal executive officer and principal financial and accounting officer, as appropriate to allow timely decisions regarding required disclosures.

MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING; CHANGES IN INTERNAL CONTROLS OVER FINANCIAL REPORTING.

Our management is responsible for establishing and maintaining adequate internal control over financial reporting. Our management, including our principal executive officer and principal financial officer, conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on its evaluation under the framework in Internal Control - Integrated Framework, our management concluded that our internal control over financial reporting was effective as of December 31, 2013. Management reviewed the results of their assessment with our Audit Committee.

Limitations on Controls

Our disclosure controls and procedures and internal control over financial reporting are designed to provide reasonable assurance of achieving their objectives as specified above. Management does not expect, however, that our disclosure controls and procedures or our internal control over financial reporting will prevent or detect all error and fraud. Any control system, no matter how well designed and operated, is based upon certain assumptions and can provide only reasonable, not absolute, assurance that its objectives will be met. Further, no evaluation of controls can provide absolute assurance that misstatements due to error or fraud will not occur or that all control issues and instances of fraud, if any, within the Company have been detected.

Changes in Internal Control over Financial Reporting

During the quarter ended December 31, 2013, 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.

PART III

ITEM 10.DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The information required by this item is incorporated by reference to such information as set forth in our definitive Proxy Statement (the "2014 Proxy Statement") for our 2014 annual meeting of stockholders. The 2014 Proxy Statement will be filed with the SEC not later than 120 days subsequent to December 31, 2013.

Sadly, on January 26, 2014, memorial services were held for Mr. Robert Render, former member of the Board of Directors of Zion Oil and Gas. Robert Render, age 83, was appointed a director in January 2011.

Board member Forrest Garb is filling the vacancy on the Audit Committee until March 31, 2014. Board member Kent Siegel will fill the vacancy on the Audit Committee and will replace Paul Oroian on the Compensation Committee effective April 1, 2014.

ITEM 11.EXECUTIVE COMPENSATION

The information required by this item is incorporated herein by reference to the 2014 Proxy Statement for the 2014 annual meeting of stockholders, which will be filed with the SEC not later than 120 days subsequent to December 31, 2013.

ITEM 12.SECURITY OWNERSHIP OF

CERTAIN
BENEFICIAL
OWNERS AND
MANAGEMENT
AND RELATED
STOCKHOLDER
MATTERS

The information required by this item is incorporated herein by reference to the 2014 Proxy Statement for the 2014 annual meeting of stockholders, which will be filed with the SEC not later than 120 days subsequent to December 31, 2013.

ITEM 13.CERTAIN
RELATIONSHIPS
AND RELATED
TRANSACTIONS
AND DIRECTOR
INDEPENDENCE

The information required by this item is incorporated herein by reference to the 2014 Proxy Statement for the 2014 annual meeting of stockholders, which will be filed with the SEC not later than 120 days subsequent to December 31, 2013.

ITEM 14.PRINCIPAL
ACCOUNTANT
FEES AND
SERVICES

The information required by this item is incorporated herein by reference to the 2014 Proxy Statement for the 2014 annual meeting of stockholders, which will be filed with the SEC not later than 120 days subsequent to December 31, 2013.

PART IV

ITEM 15.
EXHIBITS,
FINANCIAL
STATEMENT
SCHEDULES

(a) (1) Financial Statements:

Report of Independent Registered Public Accounting Firm – MaloneBailey, LLP

Report of Independent Registered Public Accounting Firm – KPMG Somekh Chaikin

Report of Independent Registered Public Accounting Firm – Lane Gorman Trubitt, PLLC

Balance Sheets as of December 31, 2013 and 2012

Statements of Operations for the Years Ended December 31, 2013 and 2012 and the Period from April 6, 2000 (Inception) to December 31, 2013.

Statements of Changes in Stockholders' Equity for the Period from April 6, 2000 (Inception) to December 31, 2013.

Statements of Cash Flows for the Years Ended December 31, 2013 and 2012 and the Period from April 6, 2000 (inception) to December 31, 2013.

Number	Description
3.1	Certificate of Amendment to Amended and Restated Certificate of Incorporation of Zion Oil & Gas, Inc. Incorporation (incorporated herein by reference to the Company’s Quarterly Report on Form 10-Q, for the quarter ended June 30, 2011, filed with the SEC on August 9, 2011, Exhibit 3.1)
3.2	Amended and Restated Bylaws of Zion Oil & Gas, Inc. (incorporated by reference to Exhibit 3.2 to the Company’s Form 10-KSB for the year ended December 31, 2007 as filed with the SEC on March 28, 2008)
10.1	Joseph License (incorporated by reference to Exhibit 10.1 to the Company’s Current Report on Form 8-K as filed with the SEC on October 16, 2007)
10.2	Asher –Menashe License (incorporated by reference to Exhibit 10.2 to the Company’s Form 10-QSB for the quarter ended June 30, 2007 as filed with the SEC on August 20, 2007) Memorandum
10.3	Executive Employment and Retention Agreements (Management Agreements)
	(i) Employment Agreement dated November 13, 2013 and made effective January 1, 2014 between Zion Oil & Gas, Inc. and John Brown (incorporated by reference to Exhibit 10.1 to the Company’s Current Report on Form 8-K as filed with the SEC on November 19, 2013)

(ii) Amended and Restated Employment Agreement dated as of March 19, 2012 between Zion Oil & Gas, Inc. and Victor G. Carrillo (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K as filed with the SEC on March 20, 2012)

(iii) Third Amended and Restated Employment Agreement dated as of April 29, 2012 between Zion Oil & Gas, Inc. and Ilan Sheena (incorporated by reference to Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2012 as filed with the SEC on May 3, 2012)

(iv) First Amended and Restated Employment Agreement dated June 25, 2012 between the Company and Mr. Richard Rinberg (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K as filed with the SEC on June 29, 2012)

(iv) First Amended and Restated Employment Agreement dated June 25, 2012 between the Company and Mr. Richard Rinberg (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K as filed with the SEC on June 29, 2012)

(v) Agreement, dated as of October 18, 2012 between Zion Oil & Gas, Inc. and Richard Rinberg (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K as filed with the SEC on June 29, 2012).

10.4	2005 Stock Option Plan (incorporated by reference to Exhibit 10.5 to the Company's Form 10-KSB for the year ended December 31, 2005 as filed with the SEC on September 14, 2006)
10.5	Office Sublease Agreement dated as of December 30, 2010 between Zion Oil & Gas, Inc. and Spectrum Dynamics (Israel) Ltd., as sublessor (incorporated by reference to Exhibit 10.14 to the Company's Annual Report Form 10-K for the year ended December 31, 2010 as filed with the SEC on March 16, 2011)
10.6	Jordan Valley License (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K as filed with the SEC on June 1, 2011).
10.7	Third Amendment to Lease Agreement dated as of October 11, 2011 between Zion Oil & Gas, Inc. and Hermosa LP (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K as filed with the SEC on October 17, 2011)
10.8	2011 Equity Incentive Plan (filed as Annex B to the Company's Definitive Proxy Statement on Schedule 14 A field with the SEC on May 9, 2011)
10.9	2011 Non-Employee Directors Stock Option Plan (filed as Annex C to the Company's Definitive Proxy Statement on Schedule 14 A field with the SEC on May 9, 2011)
10.10	Amendment to Jordan Valley License (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K as filed with the SEC on April 26, 2012)
10.11	Extension to Asher-Menashe License (incorporated by reference to Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2012 as filed with the SEC on May 3, 2012)
10.12	Memorandum of Understanding dated as of June 4, 2012 between Zion Oil & Gas, Inc. and Lapidoth Israel Oil Prospectors Corp. Ltd. (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K as filed with the SEC on June 7, 2012)
10.13	Extension to Joseph License (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K as filed with the SEC on October 27, 2011) (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K as filed with the SEC on August 16, 2012) (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K as filed with the SEC on May 23, 2013)
10.14	Extension to Asher-Menashe License (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K as filed with the SEC on July 9, 2013)
10.15	Megiddo-Jezreel License (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K as filed with the SEC on December 10, 2013)
14.1	Code of Ethics (incorporated by reference to Exhibit 14.1 to the Company's Current Report on Form 8-K as filed with the SEC on December 10, 2007)
23.1*	Consent of MaloneBailey, LLP

23.2*	Consent of Lane Gorman Trubitt, PLLC
23.3*	Consent of Somekh Chaikin, a member of KPMG International
31.1*	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2*	Certification of Chief Financial and Accounting Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1*	Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2*	Certification of Chief Financial and Accounting Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

101.INS* (1)	XBRL Instance Document
101.SCH*(1)	XBRL Taxonomy Extension Schema
101.CAL*(1)	XBRL Taxonomy Extension Calculation Linkbase
101.DEF*(1)	XBRL Taxonomy Extension Definition Linkbase
101.LAB*(1)	XBRL Taxonomy Extension Label Linkbase
101.PRE*(1)	XBRL Taxonomy Extension Presentation Linkbase

*filed herewith

1. In accordance with Rule 406T of Registration S-T, these exhibits are deemed not filed or part of a registration statement or prospectus for purposes of Section 11 or 12 of the Securities Act of 1933 or Section 18 of the Securities Exchange Act of 1934 and otherwise not subject to liability under these sections.

SIGNATURES

Pursuant to the requirements of 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.

ZION OIL & GAS, INC.
(Registrant)

By:	/s/ John Brown John Brown Chief Executive Officer & Executive Chairman (Principal Executive Officer)	By:	/s/ Ilan Sheena Ilan Sheena, Chief Financial Officer (Principal Financial Officer and Accounting Officer)
Date:	March 6, 2014	Date:	March 6, 2014

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated:

Signature	Title	Date
/s/ John M. Brown John M. Brown	Chairman of the Board of Directors, Chief Executive Officer and Director (Principal Executive Officer)	March 6, 2014
/s/ Ilan Sheena Ilan Sheena	Chief Financial Officer (Principal Financial Officer and Principal Accounting Officer)	March 6, 2014
/s/ Victor G. Carrillo Victor G. Carrillo	President, Chief Operating Officer and Director	March 6, 2014
/s/ William H. Avery William H. Avery	General Counsel and Director	March 6, 2014
/s/ Paul Oroian Paul Oroian	Director	March 6, 2014
/s/ Yehezkel Druckman Yehezkel Druckman	Director	March 6, 2014
/s/ Forrest A. Garb Forrest A. Garb	Director	March 6, 2014
/s/ Kent Siegel Kent Siegel	Director	March 6, 2014
/s/ Gene Scammahorn	Director	March 6, 2014

Gene Scammahorn

/s/ Justin W. Furnace Justin W. Furnace	Director	March 6, 2014
/s/ Glen Perry Glen Perry	Director	March 6, 2014

Zion Oil & Gas, Inc.
(A Development Stage Company)

INDEX TO FINANCIAL STATEMENTS

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Stockholders
Zion Oil & Gas, Inc.
(a development stage company)
Dallas, Texas

We have audited the accompanying balance sheets of Zion Oil & Gas, Inc. (a development stage company) (the "Company") as of December 31, 2013 and 2012, and the related statements of operations, changes in stockholders' equity, and cash flows for each of the years then ended and for the period from April 6, 2000 (inception) through December 31, 2013. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. The financial statements for the period from April 6, 2000 (inception) through December 31, 2010 were audited by other auditors whose reports have been furnished to us. Our opinion, insofar as it relates to amounts for the period from April 6, 2000 (inception) through December 31, 2010 is based solely on the report of other auditors.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform an audit of its internal control over financial reporting. Our audits include consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Zion Oil & Gas, Inc as of December 31, 2013 and 2012, and the results of its operations and its cash flows for each of the years then ended and for the period from April 6, 2000 (inception) through December 31, 2013, in conformity with accounting principles generally accepted in the United States of America.

/s/ MALONEBAILEY, LLP
www.malone-bailey.com
Houston, Texas

March 6, 2014

Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders
Zion Oil & Gas, Inc.

We have audited the accompanying statements of operations, changes in stockholders' equity, and cash flows of Zion Oil & Gas, Inc. (a development stage company) for the period from April 6, 2000 (inception) to December 31, 2010. These financial statements are the responsibility of Zion Oil & Gas, Inc.'s management. Our responsibility is to express an opinion on these financial statements based on our audits.

The cumulative statements of operations, stockholders' equity, and cash flows for the period from April 6, 2000 (inception) to December 31, 2010 include amounts for the period from April 6, 2000 (inception) to December 31, 2010 and for each of the years in the four-year period ending December 31, 2004 which were audited by other auditors whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for the period from April 6, 2000 (inception) through December 31, 2004 is based solely on the report of other auditors.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit 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, based on our audits and the report of other auditors, the financial statements referred to above present fairly, in all material respects, the results of Zion Oil & Gas, Inc.'s operations and its cash flows for the period from April 6, 2000 (inception) to December 31, 2010, in conformity with U.S generally accepted accounting principles.

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 1 to the financial statements as of December 31, 2010, the Company is in its development stage and has no operating revenue, limited capital resources and a loss from operations, all of which raise substantial doubt about its ability to continue as a going concern. Management's plans in regard to these matters are also described in Note 1. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

/s/ Somekh Chaikin
Certified Public Accountants (Isr.),
A Member of KPMG International
Tel Aviv, Israel
March 16 2011

Report of Independent Registered Public Accounting Firm

Board of Directors and Stockholders
Zion Oil & Gas, Inc.

We have audited the cumulative amounts from April 6, 2000 (inception) to December 31, 2004 included in the statements of operations, changes in stockholders' equity, and cash flows of Zion Oil & Gas, Inc. (a development stage company). These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these cumulative financial statements based on our audit.

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 audit 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 provides a reasonable basis for our opinion.

In our opinion, the cumulative amounts since inception to December 31, 2004 referred to above present fairly, in all material respects, the results of operations and cash flows of Zion Oil & Gas, Inc. since inception to December 31, 2004, in conformity with accounting principles generally accepted in the United States of America.

As described in the first paragraph in Note 1B to the 2013 financial statements, the financial statements for all periods from April 6, 2000 (inception) until December 31, 2004 were previously restated.

The cumulative amounts referred to above have been prepared assuming that the Company will continue as a going concern. As discussed in Note 1 to the 2011 financial statements, the Company is in its development stage and has insignificant operating revenue. In addition, the Company has limited capital resources and has initiated a new phase of activity, all of which raise substantial doubt about its ability to continue as a going concern. Management's plans in regard to these matters are also discussed in Note 1 to the 2011 financial statements. The financial statements do not include any adjustments that might result from the outcome of this uncertainty

/s/ Lane Gorman Trubitt, PLLC
Dallas, Texas
April 15, 2005, except for the first
paragraph in Note 1B as to
which the date is July 26, 2006

Zion Oil & Gas, Inc.

(A Development Stage Company)

Balance Sheets as of

	December 31 2013 US$ thousands	December 31 2012 US$ thousands
Current assets		
Cash and cash equivalents	10,414	14,983
Fixed short term bank deposits - restricted	1,387	284
Prepaid expenses and other	294	394
Other receivables	45	607
Total current assets	12,140	16,268
Unproved oil and gas properties, full cost method	2,446	4,700
Property and equipment		
Net of accumulated depreciation of $332,000 and $246,000	209	222
Other assets		
Assets held for severance benefits	144	114
Total assets	14,939	21,304
Liabilities and Stockholders’ Equity		
Current liabilities		
Accounts payable	138	631
Asset retirement obligation	483	870
Accrued liabilities	1,474	1,358
Total current liabilities	2,095	2,859
Provision for severance benefits	177	199
Total liabilities	2,272	3,058
Commitments and contingencies (See Note 8)		
Stockholders’ equity		
Common stock, par value $.01; Authorized: 100,000,000 at December 31, 2013 and 2012: Issued and outstanding: 34,005,696 and 32,768,710 shares at December 31, 2013 and 2012 respectively	340	328
Additional paid-in capital	140,367	136,881
Deficit accumulated in development stage	(128,040)	(118,963)
Total stockholders’ equity	12,667	18,246

Total liabilities and stockholders' equity	14,939	21,304

The accompanying notes are an integral part of the financial statements.

Zion Oil & Gas, Inc.
(A Development Stage Company)

Statements of Operations

	For the year ended December 31, 2013 US$ thousands	2012 US$ thousands	Period from April 6, 2000 (inception) to December 31 2013 US$ thousands
General and administrative expenses			
Legal and professional	1,065	1,188	10,368
Salaries	2,553	3,890	20,634
Other	2,216	3,310	17,420
Impairment of unproved oil and gas properties	3,289	1,965	79,258
Loss from operations	(9,123)	(10,353)	(127,680)
Other income (expense), net			
Termination of initial public offering	-	-	(527)
Other income, net	-	-	80
Foreign exchange gain (loss)	41	27	(108)
Interest income, net	5	32	195
Loss before income taxes	(9,077)	(10,294)	(128,040)
Income taxes	-	-	-
Net loss	(9,077)	(10,294)	(128,040)
Net loss per share of common stock - basic and diluted (in US$)	(0.27)	(0.33)	(8.32)
Weighted-average shares outstanding – basic and diluted (in thousands)	33,049	31,321	15,393

The accompanying notes are an integral part of the financial statements.

Zion Oil & Gas, Inc.
(A Development Stage Company)

Statements of Changes in Stockholders' Equity

	Preferred Stock		Common Stock		Additional	Deficit Accumulated in	
	Shares	Amount	Shares	Amount	Paid-in capital	development stage	Total
	Thousands	US$ thousands	Thousands	US$ thousands	US$ thousands	US$ thousands	US$ thousands
Balances on April 6, 2000	-	-	-	-	-	-	-
Issued for cash ($0.001 per share)	-	-	2,400	* -	2	-	2
Issuance of shares and warrants in a private offering ($1 per share)	-	-	100	* -	100	-	100
Costs associated with the issuance of shares	-	-	-	-	(24)	-	(24)
Waived interest on conversion of debt	-	-	-	-	* -	-	* -
Value of warrants granted to employees	-	-	-	-	2	-	2
Net loss	-	-	-	-	-	(5)	(5)
Balances as of December 31, 2000	-	-	2,500	* -	80	(5)	75
Issuance of shares and warrants in a private offering in January 2001 ($1 per share)	-	-	135	* -	135	-	135
Issuance of shares and warrants in a private offering which closed in September 2001 ($1 per share)	-	-	125	* -	125	-	125
Payment of accounts payable through issuance of shares and warrants	-	-	40	* -	40	-	40

Payment of note payable through issuance of shares and warrants	-	-	25	* -	25	-	25
Issuance of shares and warrants in a private offering which closed in November 2001 ($1 per share)	-	-	175	* -	175	-	175
Costs associated with the issuance of shares	-	-	-	-	(85)	-	(85)
Waived interest on conversion of debt	-	-	-	-	1	-	1
Value of warrants granted to employees	-	-	-	-	37	-	37
Value of warrants granted to directors and consultants	-	-	-	-	3	-	3
Net loss	-	-	-	-	-	(207)	(207)
Balances as of December 31, 2001	-	-	3,000	* -	536	(212)	324

* Represents an amount less than US$ 1 thousand.

Zion Oil & Gas, Inc.
(A Development Stage Company)

Statements of Changes in Stockholders' Equity (cont'd)

	Preferred Stock Shares	Preferred Stock Amount	Common Stock Shares	Common Stock Amount	Additional Paid-in Capital	Deficit Accumulated in Development Stage	Total
	Thousands	US$ thousands	Thousands	US$ thousands	US$ thousands	US$ thousands	US$ thousands
Change in par value of common shares from $ 0.0001 per share to $0.01 per share	-	-	-	30	(30)	-	-
Issuance of shares and warrants in a private offering which closed in January 2002 ($1 per share)	-	-	20	* -	20	-	20
Issuance of shares and warrants in a private offering which closed in November 2002 ($10 per share)	25	* -	22	* -	254	-	254
Payment of accounts payable through issuance of preferred shares and warrants	13	* -	-	-	127	-	127
Payment of accounts payable through issuance of common shares and warrants	-	-	111	1	131	-	132
Payment of note payable through issuance of shares and warrants	5	* -	-	-	50	-	50
Payment of accounts payable to employee through issuance of shares upon exercise of warrants	-	-	400	4	76	-	80

Costs associated with the issuance of shares	-	-	-	-	(160)	-	(160)
Waived interest on conversion of debt	-	-	-	-	3	-	3
Deferred financing costs on debt conversions / modifications	-	-	-	-	21	-	21
Value of warrants granted to employees	-	-	-	-	1	-	1
Value of warrants granted to directors and consultants	-	-	-	-	13	-	13
Net loss	-	-	-	-	-	(403)	(403)
Balances as of December 31, 2002	43	* -	3,553	35	1,042	(615)	462

* Represents an amount less than US$ 1 thousand.

Zion Oil & Gas, Inc.
(A Development Stage Company)

Statements of Changes in Stockholders' Equity (cont'd)

	Preferred Stock		Common Stock		Additional	Deficit Accumulated in	
	Shares	Amount	Shares	Amount	Paid-in Capital	Development Stage	Total
	Thousands	US$ thousands	Thousands	US$ thousands	US$ thousands	US$ thousands	US$ thousands
Issuance of shares in connection with executive employment	-	-	50	1	49	-	50
Issuance of share on warrants exercise	-	-	165	2	31	-	33
Issuance of dividend shares to record holders as of December 31, 2002	4	* -	-	-	* -	-	-
Issuance of shares and warrants in a private offering which closed in February 2003 ($10 per share):							
for cash consideration	10	* -	-	-	105	-	105
for reduction of accounts payable	5	* -	-	-	45	-	45
Issuance of shares and warrants as compensation for extension of $100,000 line of credit	1	* -	-	-	10	-	10
Payment of account payable through issuance of shares and warrants	* -	* -	-	-	1	-	1
Conversion of preferred shares to common shares in reincorporation merger	(63)	* (-)	763	7	(7)	-	-
Issuance of shares in a private offering which closed in July 2003 ($3 per							

share):							
for cash consideration	-	-	33	* -	99	-	99
for reduction of accounts payable	-	-	3	* -	9	-	9
Issuance of shares upon exercise of warrants:							
for cash consideration	-	-	25	* -	25	-	25
for reduction of accounts payable	-	-	124	1	142	-	143
Issuance of shares upon exercise of warrants for cash consideration	-	-	63	1	82	-	83
Payment of account payable through issuance of shares	-	-	80	1	139	-	140
Costs associated with the issuance of shares	-	-	-	-	(58)	-	(58)
Value of warrants granted to employees	-	-	-	-	47	-	47
Deferred financing costs on debt conversions / modifications	-	-	-	-	(10)	-	(10)
Net loss	-	-	-	-	-	(873)	(873)
Balances as of December 31, 2003	-	-	4,859	48	1,751	(1,488)	311

* Represents an amount less than US$ 1 thousand.

Zion Oil & Gas, Inc.
(A Development Stage Company)

Statements of Changes in Stockholders' Equity (cont'd)

	Common Stock Shares	Amounts	Additional Paid-in Capital	Deficit Accumulated in Development Stage	Total
	Thousands	US$ thousands	US$ thousands	US$ thousands	US$ thousands
Issuance of shares on warrants exercise	123	1	183	-	184
Issuance of shares and warrants in a private offering	251	3	1,002	-	1,005
Payment of officer salaries through issuance of shares and warrants	46	1	184	-	185
Payment of accounts payable to officers and consultants upon exercise of warrants	80	1	99	-	100
Payment of director honorariums through issuance of shares and warrants	11	* -	45	-	45
Payment of account payable through issuance of shares and warrants	13	* -	50	-	50
Payment of bridge loan through issuance of shares and warrants	125	1	499	-	500
Payment of bridge loan interest and commitment fee through issuance of shares and warrants	8	* -	30	-	30
Payment of bridge loan finders fee through issuance of shares and warrants	2	* -	7	-	7
Payment of service bonus through issuance of shares and warrants	20	* -	20	-	20
Costs associated with the issuance of shares	-	-	(59)	-	(59)
Value of warrants granted to employees	-	-	41	-	41
Deferred financing costs on debt conversions / modifications	-	-	30	-	30

Net loss	-	-	-	(1,737)	(1,737)
Balances as of December 31, 2004	5,538	55	3,882	(3,225)	712

* Represents an amount less than US$ 1 thousand.

Zion Oil & Gas, Inc.

(A Development Stage Company)

Statements of Changes in Stockholders' Equity (cont'd)

	Common Stock Shares	Amounts	Additional Paid-in Capital	Deficit Accumulated in Development Stage	Total
	Thousands	US$ thousands	US$ thousands	US$ thousands	US$ thousands
Issuance of shares on warrants exercised:					
For cash	493	5	872	-	877
For payment of deferred officer salaries	17	* -	21	-	21
For exchange of shares of common stock	120	1	(1)	-	-
Issuance of shares and warrants in a private offering that closed in March 2005:					
For cash	519	5	2,070	-	2,075
For payment of deferred officer salaries	10	* -	40	-	40
For payment of accounts payable	6	* -	25	-	25
Issuance of shares and warrants in a private offering that closed in June 2005:					
For cash	259	3	1,292	-	1,295
For payment of directors honoraria	14	* -	70	-	70
For payment of accounts payable	3	* -	15	-	15
Issuance of shares in a private offering that closed in October 2005:					
For cash	584	6	2,914	-	2,920
For payment of deferred officer salaries	40	* -	200	-	200
For payment of accounts payable	22	* -	110	-	110
Issuance of shares in a private offering that closed in December 2005	80	1	439	-	440
Shares to be issued for services provided by director	-	-	42	-	42
Value of warrants and options granted to employees	-	-	216	-	216
Value of warrants granted to directors and consultants	-	-	16	-	16
Deferred financing costs on debt conversions /modifications	-	-	44	-	44

Costs associated with the issuance of shares	-	-	(275)	-	(275)
Net loss	-	-	-	(1,605)	(1,605)
Balances as of December 31, 2005	7,705	76	11,992	(4,830)	7,238

* Represents an amount less than US$ 1 thousand.

Zion Oil & Gas, Inc.
(A Development Stage Company)

Statements of Changes in Stockholders' Equity (cont'd)

	Common Stock Shares	Common Stock Amounts	Additional Paid-in Capital	Deficit Accumulated in Development Stage	Total
	Thousands	US$ thousands	US$ thousands	US$ thousands	US$ thousands
Issuance of shares on warrants exercised:					
For cash	253	3	1,151	-	1,154
For debt	60	1	276	-	277
Issuance of shares and warrants in private offering closings in first quarter 2006:					
For cash	66	1	362	-	363
For payment of accounts payable	3	* -	14	-	14
Shares issued for services provided by officer	200	2	248	-	250
Issuance of shares and warrants in a private offering that closed in September 2006 for cash	23	* -	126	-	126
Value of options granted to employees	-	-	162	-	162
Value of warrants granted to underwriter	-	-	20	-	20
Value of shares gifted to directors, employees and service providers	-	-	147	-	147
Costs associated with the issuance of shares	-	-	(681)	-	(681)
Funds received from public offering for subscription shares:					
For cash	410	4	2,867	-	2,871
For debt	27	* -	188	-	188
Net loss	-	-	-	(2,510)	(2,510)
Balances as of December 31, 2006	8,747	87	16,872	(7,340)	9,619

* Represents an amount less than US$ 1 thousand.

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Zion Oil & Gas, Inc.
(A Development Stage Company)

Statements of Changes in Stockholders' Equity (cont'd)

	Common Stock Shares Thousands	Amounts US$ thousands	Additional Paid-in Capital US$ thousands	Deficit Accumulated in Development Stage US$ thousands	Total US$ thousands
Funds received from public offering for subscription shares:					
For cash	1,336	14	9,338	-	9,352
For debt	33	*	235	-	235
Compensation in respect of shares previously issued for services provided by officer	-	-	208	-	208
Value of options granted to employees	-	-	337	-	337
Value of warrants granted to underwriter	-	-	79	-	79
Value of shares granted to employees	5	*	25	-	25
Value of shares gifted to employees	-	-	7	-	7
Costs associated with the issuance of shares	-	-	(1,027)	-	(1,027)
Net loss	-	-	-	(13,047)	(13,047)
Balances as of December 31, 2007	10,121	101	26,074	(20,387)	5,788

* Represents an amount less than US$ 1 thousand.

Zion Oil & Gas, Inc.
(A Development Stage Company)

Statements of Changes in Stockholders' Equity (cont’d)

	Common Stock Shares	Common Stock Amounts	Additional Paid-in Capital	Deficit Accumulated in Development Stage	Total
	Thousands	US$ thousands	US$ thousands	US$ thousands	US$ thousands
Funds received from Unit Offering for subscription shares:					
For cash	405	4	4,040	-	4,044
For debt	12	*	120	-	120
Value of warrants and options granted to employees	-	-	266	-	266
Value of options granted to directors and consultants	-	-	44	-	44
Value of shares granted to employees	4	*	25	-	25
Value of shares gifted to employees	-	-	101	-	101
Costs associated with the issuance of shares	-	-	(815)		(815)
Net loss	-	-	-	(4,018)	(4,018)
Balances as of December 31, 2008	10,542	105	29,855	(24,405)	5,555

* Represents an amount less than US$ 1 thousand.

Zion Oil & Gas, Inc.
(A Development Stage Company)

Statements of Changes in Stockholders' Equity (cont'd)

	Common Stock Shares	Common Stock Amounts	Additional Paid-in capital	Deficit Accumulated in Development Stage	Total
	Thousands	US$ thousands	US$ thousands	US$ thousands	US$ thousands
Funds received from Unit Offering for subscription shares:					
For cash	237	3	2,370	-	2,373
For debt	13	*-	126	-	126
Funds received from Rights Offering	4,200	42	20,958	-	21,000
Funds received from Second Rights Offering	3,600	36	17,964	-	18,000
Funds received from warrant exercises	59	1	414	-	415
Underwriter warrants exercised in cashless exercise	13	-	-	-	-
Director warrants and options exercised in cashless exercises	37	-	-	-	-
Value of options granted to employees	-	-	494	-	494
Value of options granted to directors and consultants	-	-	328	-	328
Value of shares granted to consultants for services	5	*	46	-	46
Value of shares gifted to employees	-	-	4	-	4
Costs associated with the issuance of shares	-	-	(478)	-	(478)
Net loss	-	-	-	(4,424)	(4,424)
Balances as of December 31, 2009	18,706	187	72,081	(28,829)	43,439

* Represents an amount less than US$ 1 thousand.

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Zion Oil & Gas, Inc.
(A Development Stage Company)

Statements of Changes in Stockholders' Equity (cont'd)

	Common Stock Shares	Common Stock Amounts	Additional Paid-in Capital	Deficit Accumulated in Development Stage	Total
	Thousands	US$ thousands	US$ thousands	US$ thousands	US$ thousands
Funds received from the Third Rights Offering	2,471	25	12,331	-	12,356
Funds received from the Fourth Rights Offering	3,643	36	18,178	-	18,214
Funds received from warrant exercises	*	*	3	-	3
Funds received from option exercises	44	*	-	-	-
Value of options granted to employees	-	-	479	-	479
Value of shares granted to consultants for services	3	*	15	-	15
Costs associated with the issuance of shares	-	-	(479)	-	(479)
Net loss	-	-	-	(27,658)	(27,658)
Balances as of December 31, 2010	24,867	248	102,608	(56,487)	46,369

* Represents an amount less than US$ 1 thousand.

Zion Oil & Gas, Inc.
(A Development Stage Company)

Statements of Changes in Stockholders' Equity (cont'd)

	Common Stock Shares	Amounts	Additional paid-in capital	Deficit accumulated in development stage	Total
	Thousands	US$ thousands	US$ thousands	US$ thousands	US$ thousands
Funds received from warrant exercises	457	5	1,820	-	1,825
Funds received from option exercises	194	2	-	-	2
Funds received from the Fifth Rights Offering	4,915	49	24,528	-	24,577
Value of options granted to employees	-	-	2,149	-	2,149
Costs associated with the issuance of shares	-	-	(248)	-	(248)
Net loss	-	-	-	(52,182)	(52,182)
Balances as of December 31, 2011	30,433	304	130,857	(108,669)	22,492

Zion Oil & Gas, Inc.
(A Development Stage Company)

Statements of Changes in Stockholders' Equity (cont'd)

	Common Stock Shares	Common Stock Amounts	Additional paid-in capital	Deficit accumulated in development stage	Total
	Thousands	US$ thousands	US$ thousands	US$ thousands	US$ thousands
Funds received from warrant exercises	2,262	23	3,950	-	3,973
Funds received from option exercises	74	1	*	-	1
Value of options granted to employees	-	-	2,074	-	2,074
Net loss	-	-	-	(10,294)	(10,294)
Balances as of December 31, 2012	32,769	328	136,881	(118,963)	18,246

* Represents an amount less than US$ 1 thousand

Zion Oil & Gas, Inc.
(A Development Stage Company)

Statements of Changes in Stockholders' Equity (cont'd)

	Common Stock Shares US$ thousands	Common Stock Amounts US$ thousands	Additional paid-in capital US$ thousands	Deficit accumulated in development stage US$ thousands	Total US$ thousands
Balances as of December 31, 2012	32,769	328	136,881	(118,963)	18,246
Funds received from sale of DSPP units and shares	1,099	11	2,467	-	2,478
Funds received from option exercises	138	1	-	-	1
Value of options granted to employees, directors and others	-	-	1,019	-	1,019
Net loss	-	-	-	(9,077)	(9,077)
Balances as of December 31, 2013	34,006	340	140,367	(128,040)	12,667

The accompanying notes are an integral part of the financial statements.

Zion Oil & Gas, Inc.
(A Development Stage Company)

Statements of Cash Flows

	For the year ended December 31 2013 US$ thousands	2012 US$ thousands	Period from April 6, 2000 (inception) to December 31, 2013 US$ thousands
Cash flows from operating activities			
Net loss	(9,077)	(10,294)	(128,040)
Adjustments required to reconcile net loss to net cash used in operating activities:			
Depreciation	86	74	338
Officer, director and other fees, paid via common stock	-	-	2,330
Value of options issued to employees, directors & others	953	1,893	7,163
Interest on short term bank deposits	(20)	(15)	(41)
Interest paid through issuance of common stock	-	-	17
Write-off of costs associated with public offering	-	-	507
Loss on disposal of equipment	-	-	4
Change in Asset retirement obligation	(387)	-	(97)
Impairment of unproved oil and gas properties	3,289	1,965	79,258
Change in assets and liabilities, net:			
Decrease in inventories	-	-	150
Prepaid expenses and other	100	(47)	(294)
Change in other receivables	562	(607)	(45)
Severance pay, net	(52)	(197)	33
Accounts payable	2	(176)	735
Accrued liabilities	(104)	(1.378)	1,668
Increase in deferred officers' compensation (net)	-	-	240
Net cash used in operating activities	(4,648)	(8,782)	(36,074)
Cash flows from investing activities			
Investment in short term bank deposits - restricted	(1,083)	-	(1,346)
Acquisition of property and equipment	(57)	(57)	(533)
Investment in unproved oil and gas properties	(1,260)	(2,383)	(80,769)
Net cash used in investing activities	(2,400)	(2,440)	(82,648)
Cash flows from financing activities			
Deferred financing costs on debt conversions and modification	-	-	89
Loan proceeds – related party	-	-	259

Loan principal repayments – related party	-	-	(259)
Loan proceeds – other	-	-	500
Proceeds from sale of stock and exercise of warrants	2,479	3,974	133,037
Costs associated with the issuance of stock and warrants	-	-	(4,490)
Net cash provided by financing activities	2,479	3,974	129,136
Net increase (decrease) in cash and cash equivalents	(4,569)	(7,248)	10,414
Cash and cash equivalents – beginning of period	14,983	22,231	-
Cash and cash equivalents– end of period	10,414	14,983	10,414

The accompanying notes are an integral part of the financial statements.

Zion Oil & Gas, Inc.
(A Development Stage Company)

Statements of Cash Flows (cont'd)

	For the year ended December 31 2013 US$ thousands	2012 US$ thousands	Period from April 6, 2000 (inception) to December 31, 2013 US$ thousands
Supplemental information			
Cash paid for interest	-	-	78
Cash paid for income taxes	-	-	-
Non-cash investing and financing activities:			
Payment of note payable through issuance of common stock	-	-	575
Payment of accounts payable through issuance of note payable	-	-	35
Financing costs paid through issuance of common stock	-	-	25
Increase in accounts payable for financing costs	-	-	382
Waived interest on debt conversions	-	-	4
Shares issued for debt conversion	-	-	940
Value of options capitalized to unproved oil & gas properties	66	181	664
Value of warrants granted to underwriters	-	-	99
Investment in oil & gas properties	291	566	1,003
Deferred financing costs	-	-	85
Transfer of inventory to unproved oil & gas properties	-	-	150

The accompanying notes are an integral part of the financial statements.

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Note 1 - Nature of Operations and Basis of Presentation

A. Nature of Operations

Zion Oil & Gas, Inc., a Delaware corporation (“we”, “our”, “Zion” or the “Company”) is a development stage oil and gas exploration company with a history of more than 13 years of oil & gas exploration in Israel.

As of December 31, 2013, the Company has no revenues from its oil and gas operations, so the Company’s activities are considered to be those of a “Development Stage Enterprise”. Consequently, the Company’s financial statements must be identified as those of a development stage enterprise. In addition, the statements of operations, stockholders’ equity and cash flows are required to disclose all activity since the Company’s date of inception. The Company will continue to prepare its financial statements and related disclosures as those of a development stage enterprise until such time that the Company achieves a discovery and has revenues from sales of oil and/or gas.

Exploration Rights /Exploration Activities

The Company currently holds three petroleum exploration licenses, all onshore Israel, comprised of the newly granted Megiddo-Jezreel License (covering approximately 98,842 acres), the Asher-Menashe License (covering approximately 78,834 acres), and the Jordan Valley License (covering approximately 55,845 acres of land). Zion’s total license area currently amounts to approximately 233,521 acres.

(1) In April 2013, Zion submitted to Israel’s Petroleum Commissioner an application seeking a new petroleum exploration license in the Megiddo-Jezreel Valley area, adjacent to and westward of Zion’s existing Jordan Valley License, onshore Israel. The Megiddo-Jezreel Petroleum Exploration License No. 401 was awarded on December 3, 2013 for a three-year primary term through December 2, 2016 with the possibility of additional one-year extensions up to a maximum of seven years. The Megiddo-Jezreel License covers an area of approximately 98,842 acres of onshore land south and west of Zion’s existing Jordan Valley License.

(2) The Asher-Menashe License covers an area of approximately 78,834 acres located on the Israeli coastal plain and the Mount Carmel range between Caesarea in the south and Haifa in the north. The Asher-Menashe License, having commenced on June 10, 2007 is scheduled to expire on June 9, 2014.

(3) The Jordan Valley License covers approximately 55,845 acres, just south of the Sea of Galilee in the Jordan Valley area. The Jordan Valley License, having commenced on April 13, 2011, has an initial three year term which expires on April 12, 2014, which may be extended for additional one-year periods through April 2018 at the option of the Commissioner.

The Joseph License covered approximately 83,272 acres on the Israeli coastal plain south of the Asher-Menashe License between Caesarea in the north and Netanya in the south. The Joseph License, having commenced on October 11, 2007, expired as of October 10, 2013.

Megiddo-Jezreel Petroleum License

Under the terms of this new License, the Company has until July 1, 2015 to identify and submit a drilling prospect, enter into a drilling contract by October 1, 2015, and begin drilling or "spud" a well to a minimum proposed total depth of approximately 4,000 meters (~ 13,125 feet) by December 1, 2015. These and other geological and geophysical milestones should be achievable before the stated deadlines.

Asher-Menashe License

On May 23, 2013, Zion submitted to Israel's Petroleum Commissioner an application seeking a one-year extension for its Asher-Menashe License to conduct additional in-well testing operations at the Elijah #3 well in hopes of finding commercially productive hydrocarbons. On July 7, 2013, the Commissioner notified us that the Company's Asher-Menashe License was extended a final time to June 9, 2014. Under the terms of the extension, the Company is required to perform a perforation and stimulation operation at the Elijah #3 well and conduct a production test. If the outcome of the test is negative, the well is to be plugged and abandoned ("P&A") and within 60 days thereafter, a final report should be submitted and the license returned.

The Company originally planned to re-enter the Elijah #3 well during October/November 2013, but we were delayed primarily due to problems that Lapidoth, our drilling contractor, experienced while drilling another well with a third party in Israel. On January 5, 2014, we initiated Elijah #3 re-entry operations and on January 30, 2014, the Lapidoth rig was released. Although we had hoped to encounter producible hydrocarbons, we did not (other than minimal amounts of gas), and we will now work to finalize all remaining plugging and abandonment procedures for that well.

See Note 2C and 4 with respect to impairment charges recorded by the Company during the year ended December 31, 2013.

Jordan Valley License

The Jordan Valley License is scheduled to expire on April 12, 2014, subject to additional one-year extensions at the option of the Petroleum Commissioner through April 2018. As we reassessed our existing seismic data to prepare to submit our new Megiddo-Jezreel License application, we identified several exploration leads in our existing Jordan Valley License area.

Zion's Former Joseph License

On April 10, 2013, Zion submitted to Israel's Petroleum Commissioner an application seeking a one-year extension for its Joseph License. On May 12, 2013, the Commissioner notified us that Zion's Joseph License was extended only for six months, until October 10, 2013. Field operations were conducted from late August to mid-October, 2013 and on November 18, 2013, the Company, in accordance with the license terms, submitted our Final Plugging Report for the Ma'anit Rehoboth #2 and Ma'anit Joseph #3 wells. The Company has completed the plugging obligations of all wells within the Joseph License area and acknowledges its obligation to complete the abandonment of the wells in accordance with guidance from the Environmental Ministry even though the Joseph License period has technically expired.

See Note 2C and 4 with respect to impairment charges recorded by the Company during the year ended December 31, 2013.

B. Basis of Presentation

The financial statements for all periods from inception (April 6, 2000) until December 31, 2005 were previously restated to reflect additional expenses related to stock warrants issued to employees and non-employees during the above mentioned period and compensation cost with respect to equity awards provided with new debt issuances and/or debt modification.

Note 2 - Summary of Significant Accounting Policies

A. Financial Statements in United States Dollars

The currency of the primary economic environment in which the operations of the Company are conducted is the United States dollar ("dollar"). Therefore, the dollar has been determined to be the Company's functional currency. Non-dollar transactions and balances have been translated into dollars in accordance with the principles set forth in Accounting Standards Codification ("ASC") 830 "Foreign Currency Matters". Transactions in foreign currency (primarily in New Israeli Shekels – "NIS") are recorded at the exchange rate as of the transaction date. Monetary assets and liabilities denominated in foreign currency are translated on the basis of the representative rate of exchange at the balance sheet date. Non-monetary assets and liabilities denominated in foreign currency are stated at historical exchange rates. All exchange gains and losses from re-measurement of monetary balance sheet items denominated in non-dollar currencies are reflected in the statement of operations as they arise.

B. Cash and Cash Equivalents

The Company maintains cash balances with three banks, of which two banks are located in the United States and one in Israel and money market mutual funds. For purposes of the statement of cash flows and balance sheet, the Company considers all highly liquid investments with a maturity of three months or less to be cash equivalents. At times, the Company maintains deposits in financial institutions in excess of federally insured limits. The Company has not experienced any losses in such accounts and does not believe it is exposed to any significant credit risk on cash.

C. Oil and Gas Properties and Impairment

The Company follows the full-cost method of accounting for oil and gas properties. Accordingly, all costs associated with acquisition, exploration and development of oil and gas reserves, including directly related overhead costs, are capitalized.

All capitalized costs of oil and gas properties, including the estimated future costs to develop proved reserves, are amortized on the unit-of-production method using estimates of proved reserves. Investments in unproved properties and major development projects are not amortized until proved reserves associated with the projects can be determined or until impairment occurs. If the results of an assessment indicate that the properties are impaired, the amount of the impairment is included in loss from continuing operations before income taxes and the adjusted carrying amount of the unproved properties is amortized on the unit-of-production method.

The Company's oil and gas property represents an investment in unproved properties. These costs are excluded from the amortized cost pool until proved reserves are found or until it is determined that the costs are impaired. All costs excluded are reviewed at least quarterly to determine if impairment has occurred. The amount of any impairment is charged to expense since a reserve base has not yet been established. Impairment requiring a charge to expense may be indicated through evaluation of drilling results, relinquishing drilling rights or other information.

During the year ended December 31, 2013, the Company recorded a non-cash impairment charge of $3,289,000 of its unproved oil and gas properties (see Note 4 and 10) which was comprised of:

1) $250,000 incurred in connection with the Elijah #3 re-entry well operations. This decision was based on the fact that no economically producible hydrocarbons were encountered and we will now work to finalize all remaining plugging and abandonment procedures for that well.

2) $1,188,000 incurred in connection with the Asher-Menashe License. The Company no longer plans to pursue additional exploration activities in the Asher-Menashe License area.

3) $1,851,000 incurred in connection with all remaining capitalized costs of the Joseph License and is due principally to a decision to prioritize available financial resources and focus Zion's efforts on the Megiddo-Jezreel and Jordan Valley License areas (see Notes 4 and 10).

Currently, the Company has no economically recoverable reserves and no amortization base. Excluding the impairment charges discussed above in the aggregate amount of $79,258,000, the Company's unproved oil and gas properties consist of capitalized exploration costs of $2,446,000 and $4,700,000 as of December 31, 2013 and 2012, respectively.

D. Property and Equipment

Property and equipment other than oil and gas property and equipment is recorded at cost and depreciated over its estimated useful lives of three to fourteen years. Depreciation charged to expense amounted to $86,000, $74,000 and $338,000 for the years ended December 31, 2013, and 2012 and for the period from April 6, 2000 (inception) to December 31, 2013, respectively.

E. Assets Held for Severance Benefits

Assets held for employee severance benefits represent contributions to severance pay funds and insurance policies that are recorded at their current redemption value.

F. Costs Associated with Public and Private Equity Offerings

Costs associated with each specific private or public equity offering are accumulated until either the closing of the offering or its abandonment. If the offering is abandoned, the costs are expensed in the period the offering is abandoned. If the offering is completed and funds are raised, the accumulated costs are recorded as a reduction to additional paid-in capital attributable to the equity offering. Capital issuance costs not attributable to any specific offering are charged to expense as incurred. Costs associated with public and private equity offerings charged to additional paid in capital amounted to $nil, $nil and $4,490,000 for the years ended December 31, 2013, and 2012 and for the period April 6, 2000 (inception) to December 31, 2013, respectively.

G. Use of Estimates

The preparation of the accompanying financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions about future events. These estimates and the underlying assumptions affect the amounts of assets and liabilities reported, disclosures about contingent assets and liabilities, and reported amounts of revenues and expenses. Such estimates include the valuation of unproved oil and gas properties, deferred tax assets, asset retirement obligations and legal contingencies. These estimates and assumptions are based on management's best estimates and judgment. Management evaluates its estimates and assumptions on an ongoing basis using historical experience and other factors, including the current economic environment, which management believes to be reasonable under the circumstances. The Company adjusts such estimates and assumptions when facts and circumstances dictate. Illiquid credit markets, volatile equity, foreign currency, and energy markets have combined to increase the uncertainty inherent in such estimates and assumptions. As future events and their effects cannot be determined with precision, actual results could differ significantly from these estimates. Changes in those estimates resulting from continuing changes in the economic environment will be reflected in the financial statements in future periods.

H. Income Taxes

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carry forwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled (see Note 7). The effect on deferred tax assets and liabilities of a change in tax rates is recognized in the statements of operations in the period that includes the enactment date.

Based on ASC 740-10-25-6, "Income Taxes", the Company recognizes the effect of income tax positions only if those positions are more likely than not of being sustained. Recognized income tax positions are measured at the largest amount that is greater than 50% likely of being realized. Changes in recognition or measurement are reflected in the period in which the change in judgment occurs. The Company accounts for interest and penalties related to unrecognized tax benefits, if and when required, as part of income tax expense in the statement of operations. No liability for unrecognized tax benefits was recognized as of December 31, 2013 and 2012.

I. Environmental Costs and Loss Contingencies

Liabilities for loss contingencies, including environmental remediation costs not within the scope of FASB ASC Subtopic 410-20, Asset Retirement Obligations and Environmental Obligations – Asset Retirement Obligations, arising from claims, assessments, litigation, fines, and penalties and other sources, are recorded when probable that a liability has been incurred and the amount of the assessment and/or remediation can be reasonably estimated. Legal costs incurred in connection with loss contingencies are expensed as incurred. Recoveries of environmental remediation costs from third parties that are probable of realization are separately recorded as assets, and are not offset against the related environmental liability.

Accruals for estimated losses from environmental remediation obligations generally are recognized no later than completion of the remedial feasibility study. Such accruals are adjusted as further information develops or circumstances change. Costs of expected future expenditures for environmental remediation obligations are not discounted to their present value.

J. Asset Retirement Obligation

Obligations for dismantlement, restoration and removal of facilities and tangible equipment at the end of oil and gas property's useful life are recorded based on the estimate of the fair value of the liabilities in the period in which the obligation is incurred. This requires the use of management's estimates with respect to future abandonment costs, inflation, market risk premiums, useful life and cost of capital. The estimate of asset retirement obligations does not give consideration to the value the related assets could have to other parties, although it does take into account estimated residual salvage values. The obligation is recorded if sufficient information about the timing and (or) method of settlement is available to reasonably estimate fair value. (See note 8B)

K. Net Loss per Share Data

Basic and diluted net loss per share of common stock, par value $0.01 per share is presented in conformity with ASC 260-10 "Earnings Per Share". Diluted net loss per share is the same as basic net loss per share as the inclusion of 3,190,225 and 2,392,000 common stock equivalents in 2013 and 2012 respectively, would be anti-dilutive.

Due to the new shares of common stock issued in connection with the first rights offering in June 2009, the weighted average shares outstanding was adjusted by a factor of 1.089 which, in turn, adjusted the earnings per share calculations for the bonus element associated with the shares issued as part of such rights offering, as prescribed by ASC 260-10, "Earnings Per Share".

Due to the new shares of common stock issued in connection with the second rights offering in December 2009, the weighted average shares outstanding was further adjusted by a factor of 1.037 which, in turn, adjusted the earnings per share calculations for the bonus element associated with the second rights offering shares, as prescribed by ASC 260-10, "Earnings Per Share".

Due to the new shares of common stock issued in connection with the fourth rights offering in December 2010, the weighted average shares outstanding was further adjusted by a factor of 1.071 which, in turn, adjusted the earnings per share calculations for the bonus element associated with the fourth rights offering shares, as prescribed by ASC

260-10, “Earnings Per Share”.

L. Stock Based Compensation

The Company follows ASC 718-20-55, "Compensation – Stock Compensation" ("ASC 718-20-55"), which requires measurement of compensation cost for all stock-based awards based upon the fair value on date of grant and recognition of compensation over the service period for awards expected to vest. Under this method, the Company has recognized compensation cost for awards granted beginning January 1, 2006, based on the Black-Scholes option-pricing method.

The Company accounts for equity instruments issued to non-employees in accordance with the provisions of ASC 505, "Equity", using a fair-value approach.

As noted, the value of stock option grants is recognized as a compensation expense, on a graded-vesting basis, over the requisite service period of the entire award, net of estimated forfeitures unless vested.

M. Fair Value Measurements

The Company's financial instruments include mainly cash and cash equivalents, other receivables, prepaid expenses, assets held for severance benefits, and accounts payable. The carrying amounts of these financial instruments approximate their fair value.

N. Recently Adopted Accounting Pronouncements

We do not believe that the adoption of recently issued accounting pronouncements in 2013 will have a significant impact on our financial position, results of operations, or cash flow.

Note 3 – Provision for Severance Pay

Israeli law generally requires payment of severance pay upon dismissal of an employee or upon termination of employment in certain other circumstances. The following plans relate to the employees in Israel:

A. The liability in respect of certain of the Company's employees is discharged in part by participating in a defined contribution pension plan and making regular deposits with recognized pension funds.

   The deposits are based on certain components of the salaries of the said employees. The custody and management of the amounts so deposited are independent of the Company's control and accordingly such amounts funded (included in expenses on an accrual basis) and related liabilities are not reflected in the balance sheet.

B. The Company's liability for severance pay for its Israeli employees is calculated pursuant to Israeli severance pay law based on the most recent salary of the employee multiplied by the number of years of employment, as of the balance sheet date. Employees are entitled to one month's salary for each year of employment, or a portion thereof. Certain senior executives are entitled to receive additional severance pay. The Company's liability for all of its Israeli employees is partly provided for by monthly deposits in insurance policies and the remainder by an accrual in the financial statements. The value of these policies is recorded as an asset in the Company's balance sheet.

The deposited funds include profits/loss accumulated up to the balance sheet date. The value of the deposited funds is based on current redemption value of these policies.

C. Withdrawals from the funds may be made only upon termination of employment.

D. As of December 31, 2013 and 2012, the Company has a provision for severance pay of $177,000 and $199,000, respectively, of which all was long-term. As of December 31, 2013 and 2012, the Company has $144,000 and $114,000, respectively, deposited in funds managed by major Israeli financial institutions which are earmarked to cover severance pay liability. Such deposits are not considered to be "plan assets" and are therefore included in other assets.

Note 4 - Unproved Oil and Gas Properties, Full Cost Method

Unproved oil and gas properties, under the full cost method, are comprised as follows:

	December 31, 2013 US$ thousands	December 31, 2012 US$ thousands
Excluded from amortization base:		
Inventory ,and other operational related costs	929	1,175
Capitalized salary costs	602	781
Legal costs, license fees and other preparation costs	910	2,739
Other costs	5	5
	2,446	4,700

Impairment of unproved oil and gas properties comprised as follows:

	Year ended December 31, 2013	Year ended December 31, 2012	Period from April 6, 2000 (inception) to

			December 31, 2013
	US$ thousands	US$ thousands	US$ thousands
Drilling operations, completion costs and other related costs	480	1,319	66,111
Capitalized salary costs	488	182	4,473
Legal costs, license fees and other preparation costs	2,320	410	3,266
Other costs	1	54	5,408
	3,289	1,965	79,258

Note 5 – Accrued Liabilities

Accrued liabilities are comprised as follows:

	December 31, 2013 US$ thousands	December 31, 2012 US$ thousands
Employees related	102	103
Institutions & vendors	993	1,013
Other	379	242
	1,474	1,358

Note 6 - Stockholders' Equity

A. Authorized Shares of Common Stock

In June 2011, the Company's shareholders voted to increase the authorized shares of Common Stock from 50 million to 100 million. The increase became effective on June 27, 2011.

B. Dividend Reinvestment and Direct Stock Purchase Plan

On March 27, 2013, the Company filed with the Securities and Exchange Commission (the "SEC") the prospectus supplement dated as of March 27, 2013 and accompanying base prospectus (collectively, the "Prospectus") relating to the Company's Dividend Reinvestment and Direct Stock Purchase Plan (the "DSPP"). The Prospectus forms a part of the Company's Registration Statement on Form S-3 (File No. 333-174266) which was declared effective by the SEC on May 26, 2011.

Under the previously announced offering, the Company is offering (a) shares of common stock and (b) through February 28, 2014, units of the Company's securities with each unit comprised of (i) one share of common stock and (ii) a warrant to purchase an additional share of the Company's common stock at an exercise price of $2.00 per share for five years. The securities are being offered by the Company in accordance with the terms of the DSPP as described in the Prospectus.

On August 26, 2013, the Company extended the expiration date for the Unit program under its DSPP to November 29, 2013.

On November 25, 2013, the Company extended the expiration date for the Unit program under its DSPP to February 28, 2014.

The extensions were made, in part, to allow interested investors to utilize a new and more convenient electronic enrollment procedure with the TeleCheck Internet Check Acceptance service as a payment method.

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As of December 31, 2013, the Company and its registered agent, Registrar and Transfer Company ("RTC"), had collected approximately $2,478,000 from the DSPP. As a result, the Company issued a total of 1,099,486 shares of its common stock, comprised of 790,975 units (unit comprised of (i) one share of common stock and (ii) a warrant) and 308,511 shares.

C. Warrants Terms' Change

On June 6, 2012 and October 22, 2012, the Company implemented temporary reductions in the exercise price of all of its then publicly traded warrants, under which these warrants could be exercised, through August 15, 2012 and through their scheduled expiration date of December 31, 2012, respectively, at the reduced warrant exercise price of $1.75. The temporary reduction in exercise prices impacted only the warrants issued to investors in connection with the Company's equity offerings; consequently no expense was recorded.

Under the reduced warrant exercise price programs noted above, warrants for a total of 2,255,931 shares were exercised, resulting in cash proceeds to the Company of approximately $3,948,000. As a result of these warrant exercises, the Company issued a total of 2,255,931 shares of its common stock.

D. 2005 Stock Option Plan

In 2005, a stock option plan (the "2005 Plan") was adopted by the Company, pursuant to which 1,000,000 shares of common stock are reserved for issuance to officers, directors, employees and consultants. The Plan is administered by the Board of Directors or one or more committees appointed by the board (the "2005 Plan Administrator").

The Plan contemplates the issuance of stock options by the Company both as a private company and as a publicly traded company and is available to residents of the United States, the State of Israel and other jurisdictions as determined by the 2005 Plan Administrator. Awards of stock options under the Plan are made pursuant to an agreement between the Company and each grantee. The agreement will, among other provisions, specify the number of shares subject to the option, intended tax qualifications, the exercise price, any vesting provisions and the term of the stock option grant, all of which are determined on behalf of the Company by the 2005 Plan Administrator. The Plan remains in effect for a term of ten years unless terminated or extended according to its provisions.

During the year ended December 31, 2013, the Company granted the following options under the 2005 Stock Option Plan to purchase:

i. 45,000 shares of common stock to executive officers, other staff members and service providers at an exercise price of $0.01. The options vested upon grant and are exercisable through June 28, 2023. The fair value of the options at the date of grant amounted to $100,425.

ii. 197,500 shares of common stock to executive officers, other staff members and service providers at an exercise price of $0.01. The options vested upon grant and are exercisable through November 11, 2023. The fair value of the options at the date of grant amounted to $304,430.

During the year ended December 31, 2012, the Company did not grant options under the 2005 Plan.

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E. 2011 Equity Incentive Plan and 2011 Non-Employee Directors Stock Option Plan

In June 2011, the Company's shareholders authorized the adoption of the Zion Oil & Gas, Inc. 2011 Equity Incentive Plan for employees and consultants (the "2011 Plan"), initially reserving for issuance thereunder 2,000,000 shares of common stock and for non-employee directors initially reserving for issuance thereunder 1,000,000 shares of common stock.

The 2011 Plan provides for the grant of incentive stock options, nonqualified stock options, stock appreciation rights, restricted stock, bonus stock, awards in lieu of cash obligations, other stock-based awards and performance units. The plan also permits cash payments under certain conditions.

The compensation committee of the Board of Directors is responsible for determining the type of award, when and to whom awards are granted, the number of shares and the terms of the awards and exercise prices. The options are exercisable for a period not to exceed ten years from the date of grant.

During the year ended December 31, 2013, the Company granted the following options from the 2011 Plan:

25,000 shares of common stock were granted to one senior officer at an exercise price of $0.01. The options, granted pursuant to the terms of the officer' respective employment agreement, vested upon grant and are exercisable through December 31, 2023. The fair value of the options on their respective dates of grant amounted to $35,024.

During the year ended December 31, 2012, the Company granted the following options from the 2011 Plan:

i. 95,000 shares of common stock were granted to certain senior officers at an exercise price of $0.01. The options, granted pursuant to the terms of the officers' respective employment agreements, vest in four equal quarterly installments from their respective grant dates. Options for 40,000 shares were exercisable through December 3, 2017, of which options for 10,000 shares were forfeited upon one of the senior officer's departure from the Company; options for 20,000 shares are exercisable through January 31, 2020; options for 25,000 shares are exercisable through December 21, 2022; and options for 10,000 shares are exercisable through December 4, 2021. The fair value of the options on their respective dates of grant amounted to $185,196.

ii. 394,500 shares of common stock to two senior officers, non-management employees and consultants at an exercise price of $1.70. The options vest in equal quarterly installments over eight consecutive quarters, beginning with the quarter ended December 31, 2012. The fair value of the options on their respective dates of grant amounted to $460,700.

In June 2011, the Company's shareholders authorized the adoption of the Zion Oil & Gas, Inc. 2011 Non-Employee Directors Stock Option Plan for non-employee directors (the "2011 Directors' Plan"), initially reserving for issuance thereunder 1,000,000 share of common stock. Under the 2011 Directors' Plan, only non-qualified options may be issued, and they will be exercisable for a period of six years from the date of grant.

The Compensation Committee of the Board of Directors is responsible for determining the type of award, when to grant awards, to whom to grant awards, the number of shares and the terms of the awards and exercise prices. The options are exercisable for a period not to exceed six years from the date of grant.

During the year ended December 31, 2013, the Company granted the following options from the 2011 Directors' Plan, to purchase:

i. 25,000 shares of common stock to one non-employee director at an exercise price of $1.73. The options vested upon grant and are exercisable through January 9, 2019. The fair value of the options at the date of grant amounted to $19,099.

ii. 25,000 shares of common stock to one non-employee director at an exercise price of $2.28. The options vested upon grant and are exercisable through July 10, 2019. The fair value of the options at the date of grant amounted to $27,808.

iii. 25,000 shares of common stock to one non-employee director at an exercise price of $1.96. The options vested upon grant and are exercisable through September 3, 2019. The fair value of the options at the date of grant amounted to $24,196.

During the year ended December 31, 2012, the Company granted the following options from the 2011 Directors' Plan:

i. 50,000 shares of common stock to two non-employee directors were granted, of which options for 25,000 shares were at an exercise price of $1.82 and options for the remaining 25,000 shares were at $1.86. The options were vested upon grant and are exercisable through June 13, 2017 and December 3, 2018. The fair value of the options at their respective dates of grant amounted to $39,649.

ii. 160,000 shares of common stock were granted to eight non-employee directors at an exercise price of $1.70. The options vest in equal quarterly installments over eight consecutive quarters, beginning with the quarter ended December 31, 2012. The fair value of the options at their respective dates of grant amounted to $136,607.

F. Warrants and Options

The Company has reserved 3,190,225 shares of common stock as of December 31, 2013 for the exercise of warrants and options to employees and non-employees, of which 2,208,189 are exercisable. These warrants and options could potentially dilute basic earnings per share in future years. The warrants and options exercise prices and expiration dates are as follows:

	Exercise Price US$	Number of Shares	Expiration Date	Warrants or Options
To non-employees				
	1.70	130,000	December 20, 2022	Options
	2.50	25,000	December 31, 2014	Options
	2.61	77,000	December 04, 2021	Options
	0.01	20,000	November 11, 2023	Options
To employees and directors				
	1.70	239,500	December 20, 2022	Options
	0.01	25,000	December 31, 2023	Options
	1.70	145,000	December 21, 2018	Options
	7.15	12,000	December 31, 2014	Options
	2.61	256,250	December 04, 2017	Options
	2.61	939,500	December 04, 2021	Options
	0.01	30,000	January 31, 2020	Options
	0.01	5,000	June 28, 2023	Options
	4.45	25,000	January 26, 2016	Options
	4.55	15,000	January 31, 2016	Options
	1.73	25,000		Options

				January 09, 2019	
	2.50		245,000	December 31, 2014	Options
	2.28		25,000	July 10, 2019	Options
	1.86		25,000	December 3, 2018	Options
	1.82		25,000	June 13, 2017	Options
	1.96		25,000	September 3, 2019	Options
	0.01		85,000	November 11, 2023	Options
To investors					
	2.00		790,975	March 31, 2019	Warrants
	2.18	*	3,190,225		

*Weighted Average

The warrant and option transactions since April 6, 2000 (inception) are shown in the table below:

	Number of shares	Weighted Average exercise price US$
Outstanding, December 31, 2011	15,814,021	3.63
Changes during 2012 to:		
Employees, officers, directors and others	699,500	1.48
Expired/Cancelled/Forfeited	(11,785,571)	1.82
Exercised	(2,335,950)	1.70
Outstanding, December 31, 2012	2,392,000	2.41
Changes during 2013 to:		
Investors in DSPP (Units) (*)	790,975	2.00
Employees, officers, directors and others	342,500	0.44
Expired/Cancelled/Forfeited	(197,750)	2.71
Exercised	(137,500)	0.01
Outstanding, December 31, 2013	3,190,225	2.18
Exercisable, December 31, 2013	2,208,189	2.29

(*) See Note 6B

The aggregate intrinsic value of options exercised during 2013 and 2012 was approximately $224,000 and $360,000 respectively.

The aggregate intrinsic value of the outstanding options and warrants as of December 31, 2013 totaling 3,190,225 was approximately $231,000.

The following table summarizes information about stock warrants and options outstanding as of December 31, 2013:

Shares underlying outstanding warrants and options (non-vested/non-exercisable)				Shares underlying outstanding warrants and options (all fully vested/exercisable)			
Range of exercise price US$	Number outstanding	Weighted average remaining contractual life (years)	Weighted Average Exercise price US$	Range of exercise price US$	Number Outstanding	Weighted average remaining contractual Life (years)	Weighted Average exercise price US$
1.70	52,500	4.98	1.70	1.70	92,500	4.98	1.70
1.70	138,561	8.98	1.70	1.70	230,939	8.98	1.70
2.00	790,975	5.25	2.00	0.01	5,000	9.50	0.01
-	-	-	-	2.61	1,016,500	7.93	2.61
-	-	-	-	2.61	256,250	3.93	2.61
-	-	-	-	4.55	15,000	2.08	4.55
-	-	-	-	1.86	25,000	4.93	1.86
-	-	-	-	7.15	12,000	1.00	7.15
-	-	-	-	4.45	25,000	2.07	4.45
-	-	-	-	2.50	270,000	1.00	2.50
-	-	-	-	0.01	30,000	6.09	0.01
-	-	-	-	2.28	25,000	5.53	2.28
-	-	-	-	1.73	25,000	5.03	1.73
-	-	-	-	1.96	25,000	5.68	1.96
-	-	-	-	0.01	25,000	10.00	0.01
-	-	-	-	0.01	105,000	9.87	0.01
-	-	-	-	1.82	25,000	3.45	1.82
1.70-2.00	982,036		1.94	0.01-7.15	2,208,189		2.29

Granted to employees

The following table sets forth information about the weighted-average fair value of options granted to employees and directors during the year, using the Black Scholes option-pricing model and the weighted-average assumptions used for such grants:

	For the Year ended December 31, 2013	For the Year ended December 31, 2012	Period from April 6, 2000 (inception) to December 31, 2013
Weighted-average fair value of underlying stock at grant date	$ 1.78	$ 1.79	$ 1.78 - $8.23
Dividend yields	-	-	-
Expected volatility	67%-82 %	67%-87 %	28.2% - 87%
Risk-free interest rates	0.37% - 1.75 %	0.34% - 1.92 %	0.34% - 5.15 %
Expected lives (in years)	3.00 - 5.00	3.00 - 6.00	1.50 – 6.00
Weighted-average grant date fair value	$ 1.43	$ 1.14	$ 0.76 - $5.11

Granted to non-employees

The following table sets forth information about the weighted-average fair value of options granted to non-employees during the year, using the Black Scholes option-pricing model and the weighted-average assumptions used for such grants:

	For the Year ended December 31, 2013	For the Year ended December 31, 2012	Period from April 6, 2000 (inception) to December 31, 2013
Weighted-average fair value of underlying stock at grant date	$ 1.73	$ 1.77	$ 1.00 - $8.75
Dividend yields	-	-	-
Expected volatility	75%-76 %	74.13 %	32.20% - 99.80 %
Risk-free interest rates	2.52%-2.77%	1.77 %	1.60% - 5.50 %

Expected lives (in years)		10.00		10.00		0.56 – 10.00
Weighted-average grant date fair value	$	1.73	$	1.39	$	0.68 - $3.91

During the year ended December 31 2012, the expiration dates for 60,000 and 200,000 options previously granted to one senior officer were extended from January 18, 2013 to December 31, 2014 and December 4, 2021 respectively. In connection with the departure of a senior officer, options for 210,000 shares previously granted to such officer and not vested were forfeited. An expense of $279,000 was recorded as an adjustment to the original expense recognized.

The risk-free interest rate is based on the U.S. Treasury yield curve in effect at the time of grant for periods corresponding with the expected life of the options.

The expected life represents the weighted average period of time that options granted are expected to be outstanding. The expected life of the options granted to employees and directors is calculated based on the Simplified Method as allowed under Staff Accounting Bulletin No. 110 ("SAB 110"), giving consideration to the contractual term of the options and their vesting schedules, as the Company does not have sufficient historical exercise data at this time. The expected life of the option granted to non-employees equals their contractual term. In the case of an extension of the option life, the calculation was made on the basis of the extended life.

Prior to 2008, due to the lack of sufficient history of the Company's stock volatility, the Company estimated its own expected stock volatility based on the historic volatility for other oil exploration companies. Beginning in 2008 and continuing through December 31, 2013, the Company's stock volatility is based on actual trading of the Company's stock.

G. Compensation Cost for Warrant and Option Issuances

The following table sets forth information about the compensation cost of warrant and option issuances recognized for employees and directors:

For the Year ended December 31		Period from April 6, 2000 (inception) to December 31
2013	2012	2013
US$	US$	US$
773,000	1,955,000	7,121,000

The following table sets forth information about the compensation cost of warrant and option issuances recognized for non-employees:

For the Year ended December 31		Period from April 6, 2000 (inception) to December 31
2013	2012	2013
US$	US$	US$
246,000	119,000	706,000

As of December 31, 2013, there was $53,000 of unrecognized compensation cost, related to non-vested stock options granted under the Company's various stock option plans. That cost is expected to be recognized during 2014.

H. Warrant Descriptions

The price and the expiration dates for the four (4) series of warrants to investors are as follows:

	Period of Grant	US$	Expiration Date
ZNWOW Warrants	March 2013 – December 2013	2.00	March 31, 2019

ZNWAW Warrants	October 2008 – December 2008	7.00	December 31, 2012*
ZNWAZ Rights Offering Warrants	December 2010	4.00	December 31, 2012
ZNWAL Rights Offering Warrants	August 2011	3.50	August 15, 2012

* These warrants were originally scheduled to expire on January 31, 2012 and were extended to December 31, 2012.

Note 7 – Income Taxes

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities at December 31, 2013 and 2012 are presented below:

	December 31, 2013 US$ thousands	December 31, 2012 US$ thousands
Deferred tax assets:		
Net operating loss carry forwards	41,230	39,128
Other	1,577	1,379
Total gross deferred tax assets	42,807	40,507
Less – valuation allowance	(41,967)	(38,891)
Net deferred tax assets	840	1,616
Deferred tax liabilities :		
Property and equipment	(8)	(18)
Unproved oil and gas properties	(832)	(1,598)
Total gross deferred tax liabilities	(840)	(1,616)
Net deferred tax asset	-	-

In assessing the likelihood of the realization of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets, including net operating losses, is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible and tax carry forwards are utilizable.

Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income, and tax planning strategies in making this assessment. In order to fully realize the deferred tax asset, the Company will need to generate future taxable income of approximately $121,266,000 prior to the expiration of some of the net operating loss carry forwards between 2022 and 2033. Based upon the level of historical taxable losses since the Company's inception, management believes that the Company will not likely realize the benefits of these deductible differences and tax carry forwards and thus, full valuation allowances have been recorded at December 31, 2013 and 2012.

At December 31, 2013, the Company has available federal net operating loss carry forwards of approximately $121,266,000 to reduce future U.S. taxable income. These amounts expire from 2022 to 2033.

Income earned from activities in Israel is subject to regular Israeli tax rates. For Israeli tax purposes, exploration costs on unproved properties are expensed. Tax losses can be carried forward indefinitely. At December 31, 2013, the Company has available net operating loss carry forwards of approximately $89,900,000 to reduce future Israeli taxable income.

Reconciliation between the theoretical tax benefit on pre-tax reported (loss) and the actual income tax expense:

	Year ended December 31, 2013 US$ thousands	Year ended December 31, 2012 US$ thousands
Pre-tax loss as reported	(9,077)	(10,294)
U.S. statutory tax rate	34%	34%
Theoretical tax expense	(3,086)	(3,500)
Increase in income tax expense resulting from:		
Permanent differences	9	9
Other differences	1	691
Change in valuation allowance	3,076	2,800
Income tax expense	-	-

The Company has no material unrecognized tax benefit which would favorably affect the effective income tax rate in future periods and do not believe there will be any significant increases or decreases within the next twelve months. No interest or penalties have been accrued.

The Company has not received final tax assessments since incorporation. In accordance with the US tax regulations, the U.S. federal income tax returns remain subject to examination for the years beginning in 2010.

The Israeli branch has not received final tax assessments since incorporation. In accordance with the Israeli tax regulations, tax returns submitted up to and including the 2009 tax year can be regarded as final.

Note 8 - Commitments and Contingencies

A. Litigation

From time to time, the Company may be subject to routine litigation, claims, or disputes in the ordinary course of business. The Company defends itself vigorously in all such matters. In the opinion of management, no pending or known threatened claims, actions or proceedings against the Company are expected to have a material adverse effect on its financial position, results of operations or cash flows. However, the Company cannot predict with certainty the outcome or effect of any such litigation or investigatory matters or any other pending litigation or claims. There can be no assurance as to the ultimate outcome of any such lawsuits and investigations.

Zion Oil & Gas, Inc.

(A Development Stage Company)

Notes to Financial Statements

B. Asset Retirement

The Company currently estimates that the costs of plugging and decommissioning of the exploratory wells drilled to date in the Asher-Menashe and Joseph License areas to be approximately $483,000 based on current cost rather than Net Present Value. Liabilities for expenditures are recorded when environmental assessment and/or remediation is probable and the timing and costs can be reasonably estimated.

Changes in Asset Retirement Obligations were as follows:

	Year ended December 31, 2013 US$ thousands	Year ended December 31, 2012 US$ thousands
Asset Retirement Obligations, Beginning Balance	870	870
Liabilities Settled	(276)	-
Revision of Estimate	(111)	-
Asset Retirement Obligations, Ending Balance	483	870

Liabilities of $276,000 were settled related to the Joseph License area.

Revisions were primarily due to changes in estimated costs for future Plug & Abandonment activities related to the Asher-Menashe and Joseph License areas.

C. Environmental Matters

The Company is engaged in oil and gas exploration and production and may become subject to certain liabilities as they relate to environmental cleanup of well sites or other environmental restoration procedures and other obligations as they relate to the drilling of oil and gas wells or the operation thereof.

In March 2011, the Ministry of Environmental Protection (Environmental Ministry) issued initial guidelines relating to oil and gas drilling. This is the first time that the Ministry published specific environmental guidelines for oil and gas drilling operations, relating to onshore and offshore Israel. The guidelines are detailed and provide environmental guidance for all aspects of drilling operations, commencing from when an application for a license is filed, and continuing through license award, drilling exploration, production lease, petroleum production and abandonment of the well. The guidelines address details that must be submitted regarding the drill site, surrounding area, the actual drilling operations, the storage and removal of waste and the closing or abandoning of a well. Following meetings between the Ministry and industry representatives in 2011, the Ministry indicated that certain of their initial published guidelines would be revised.

In January 2012, the Ministry of Energy and Water Resources submitted for review a proposed code titled "Onshore Oil and Gas Exploration and Production-Environment (Health) and Safety Code – Draft". The purpose of the proposed draft code is to regulate and codify onshore environmental and safety matters relating to oil and gas exploration and production in Israel. Under the proposed draft of the code, as a condition to receiving a license for oil and gas exploration, an applicant will have to submit, in writing, an environmental assessment as well as a safety plan that will have to be periodically updated during and after operations. In addition, as a condition to receiving production rights (in the case of a discovery), an applicant will have to submit an environmental impact report as well as a production safety plan.

In April 2012, the "Environmental Protection Law (Emissions and Transfers to the Environment) Reporting Requirements and Register 2012" became effective. This statute imposes reporting obligations on entities engaged in oil and gas exploration activities in Israel relating to quantities of pollutants emitted into the air, water, land and sea (on an annual basis) and the off-site transfer of waste generated in the facility for treatment. The annual report that is to be furnished does not apply to the Company's operations until we establish oil and/or gas production.

In April 2012, the proposed draft regulations relating to petroleum exploratory drilling were adopted in large measure. The new regulations are entitled "Petroleum Regulations (Permission to deviate from the provisions of the Planning and Building Law) 2012" and detail a new permitting process. Among other things, the new regulations require the submission, to the local regulatory and permitting authorities, of a detailed environmental report relating to the proposed drilling site and surroundings. The report is to address, in detail, the environmental implications of the drilling, including hydrological analysis, surface water management, risk assessment, environmental impact, and abandonment and remediation of the drill site, among others. The drilling application must be published and there are specified time frames (approximately 100 days) for any person (including environmental and other interested bodies) to comment on the drilling application.

In June 2012, the Ministry of Energy and Water Resources (the "Energy Ministry) issued initial guidelines relating to onshore exploratory licensing. Under the guidelines, which have since been adopted, an application will have to meet certain specified conditions and provide detailed information with respect to the requested license area. The applicant must engage, at a minimum, an exploration manager, geologist, geophysicist and engineer with certain minimum years of experience in oil and gas exploration, and at least one of these persons must be a resident of Israel.

The applicant must also demonstrate the financial resources to support the estimated costs of non-drilling exploratory activities, and at least 50% of the estimated drilling costs, but in any event not less than $5 million. A condition to the issuance of any license is the submission by the licensee of a performance bank guarantee in an amount equal to 10% of the cost of the proposed work program. The performance bank guarantee is required at or prior to the award of the exploration rights.

In October 2012, the Energy Ministry published proposed guidelines relating to the submission of performance guarantees for new and existing onshore and offshore exploration licenses. Under the proposed guidelines, an applicant for a new onshore exploration license must submit a performance bank guarantee for 10% of the cost of the proposed work program upon the award by the Petroleum Commissioner (the "Commissioner") of the requested license. An existing onshore exploration license owner will be required to submit a performance bank guarantee equal to 10% of the cost of the balance of the planned work program by the earlier of (a) the application for a license extension, (b) the application for transfer of license rights, or (c) the application for changes to the work program. The face amount of the performance bank guarantee for existing licenses will be based on an estimated budget for the balance of the planned work program that an existing license owner is to submit to the Commissioner, which budget is subject to approval by the Commissioner. In the event that the licensee violates (whether intentionally or not) any of the license terms, then the Commissioner is entitled to demand payment of the bank guarantee, after giving the licensee notice and an opportunity to cure.

In December 2012, the Energy Ministry published proposed guidelines relating to the submission of bank guarantees for potential drilling-related environmental damages. The guidelines will apply to all petroleum exploration licenses to be granted on or after June 30, 2013 (and possibly extensions of existing licenses). Under the proposed guidelines, prior to receiving the approval of the Commissioner for a proposed drilling program, the licensee must submit a bank guarantee in the amount of $100,000 with respect to a drilling depth of up to (and including) 1,000 meters, which increases to $250,000 if the drilling depth is more than 1,000 meters. The Commissioner is entitled to demand a bank guarantee in excess of $250,000 if the Commissioner determines that there is a substantial risk of environmental damage. If the licensee causes environmental damage, the Commissioner is entitled to demand payment of the bank guarantee, after giving the licensee notice and an opportunity to respond to the allegation of damages.

In July 2013, the Environmental Ministry published: “Environmental Guidelines for the preparation of an environmental document supplementary to a license for searching – experimental drilling and land extraction tests.” This document extensively details the requirements for a supplemental environmental document to an oil and gas exploration plan.

On December 3, 2013, the State of Israel’s Petroleum Commissioner awarded the Company the Megiddo-Jezreel Petroleum Exploration License No. 401. Subsequently, the Company secured a US $930,000 bank guarantee in accordance with the performance guarantee guidelines. With these two actions, Zion believes it has met the requirements of the June 2012 onshore exploratory licensing guidelines and the October 2012 performance guarantee guidelines.

The Company believes that these new regulations will significantly increase the expenditures associated with obtaining new exploration rights and considerably increase the time needed to obtain all of the necessary authorizations and approvals prior to drilling.

D. Royalty and Levy Commitments

The Company is obligated, according to the Petroleum Law, to pay royalties to the Government of Israel on the gross production of oil and gas from the oil and gas properties of the Company located in Israel (excluding those reserves used to operate the wells and related equipment and facilities). The present 12.5% royalty on oil revenues remains unchanged. At December 31, 2013 and 2012, the Company did not have any outstanding obligation with respect to royalty payments, since it is at the “development stage” and, to this date, no proved reserves have been found.

In March 2011, the Israeli parliament enacted the Petroleum Profits Taxation Law, 2011, which imposes a new levy on oil and gas production. Under the new tax regime, the Israeli Government repealed the percentage depletion deduction and imposed a levy at an initial rate of 20% will be imposed on profits from oil and gas and will gradually rise to 44.56%, depending on the levy coefficient (the R-Factor). The R-Factor refers to the percentage of the amount invested in the exploration, the development and the establishment of the project, so that the 20% rate will be imposed only after a recovery of 150% of the amount invested (R-Factor of 1.5) and will range linearly up to 44.56 % after a recovery of 230% of the amount invested (R-Factor of 2.3). For purposes of the levy rate calculation, the minimal gas sale price, which will be accepted by the State, is the bi-annual average local price. The present 12.5% royalty imposed on oil revenues remains unchanged.

E. Charitable Foundations

Two charitable foundations were established, one in Israel and one in Switzerland, for the purpose of supporting charitable projects and other charities in Israel, the United States and internationally. A 3% royalty or equivalent interest in any Israeli oil and gas interests as may now be held or, in the future be acquired, by the Company shall be assigned to each charitable organization (6% interest in the aggregate). At December 31, 2013 or 2012, the Company did not have any outstanding obligation in respect of the charitable foundations, since it is at the “development stage” and, to this date, no proved reserves have been found.

F. Surface Rights of Drilling Operations.

The surface rights to the drill site from which the Company drilled the Ma’anit-Rehoboth #2 wells and Ma’anit-Joseph #3 well, are held under long-term lease by Kibbutz Ma’anit (the “Kibbutz”) with the Israel Lands Authority.

The necessary permission to use the drill site for the Ma’anit-Joseph #3 well to conduct petroleum exploration operations was granted to the Company by the Kibbutz in consideration for a fee of approximately $50,000 for the period up to October 10, 2010 and $5,000 for each year thereafter.

The Israel Lands Authority granted formal consent for the use of the surface with regard to the Ma'anit-Rehoboth #2 well; the expiration date of the consent is March 28, 2013. The Israel Lands Authority granted formal consent for the use of the surface with regard to the Ma'anit-Joseph #3 well; the expiration date of the consent was August 3, 2012; the Company has submitted a request to extend the expiration date

The Company has now completed the plugging obligations of all wells within the Joseph License and acknowledges its obligation to complete the abandonment of the wells in accordance with guidance from the Environmental Ministry even though the Joseph License period has technically expired.

The surface rights to the drill site from which the Company drilled the Elijah #3 well are held under long-term lease by Kibbutz Ein Carmel with the Israel Lands Authority. The necessary permission to enter and use the drill site to conduct petroleum operations on the Elijah #3 well was granted to the Company by Kibbutz Ein Carmel through July 20, 2015 in consideration for a one-time fee of approximately $145,000.

The Israel Lands Authority has granted formal consent for the use of the surface with regard to the Elijah #3 well; the expiration date of the consent was June 21, 2012 and the Company has submitted a request to extend the expiration date.

Once a specific site or sites have been designated from which we will drill our next deep exploration well(s), the Company will seek the appropriate authority/permission from the local landowner and from the Israel Lands Authority to conduct drilling-related operations.

G. Office and Vehicle Leases

(i) The Company has a lease for 3,600 square feet of corporate office space in Dallas, Texas, which expired on October 31, 2011. On October 11, 2011, the Company and the landlord entered into an amended lease for its current office premises in Dallas, Texas as well as the addition of adjacent space in the building. Pursuant to the lease amendment, the lease term on the existing office space as well as the additional premises was extended to October 31, 2015.

Rent is paid on a monthly basis and was $6,996 per month for each month from November 1, 2011 through October 31, 2012; thereafter, $7,534 for each month through October 31, 2013; $7,534 for each month through October 31, 2014 and $8,072 for each month through October 31, 2015. Notwithstanding the foregoing, the parties agreed that so long as there was no event of default under the lease amendment, monthly payments of $1,434 through October 31, 2012 and $1,544 thereafter through October 31, 2013 were to be abated.

(ii) The Company's field office in Caesarea Israel consists of 5,565 square feet. The sublease term continues through March 31, 2014. Rent is paid on a monthly basis in the base amount of approximately NIS 28,400 per month (approximately $8,100 per month at the exchange rate in effect on the date of this report). The Company is also obligated to pay all cost of living adjustments, as well as its pro-rated portion of all taxes, utilities, and insurance and maintenance payments during the sublease term.

With the sublease for the company's field office in Caesarea, Israel expiring in March 2014, on December 19, 2013 the Company signed a new lease agreement with Caesarea Asset Management and Development companies for new premises containing 6,566 square feet. The lease term is five years from February 1, 2014 to January 31, 2019. Rent is to be paid on a monthly basis in the base amount of approximately NIS 37,800 per month (approximately $10,800 per month at the exchange rate in effect on the date of this report and is linked to an increase (but not a decrease) in the CPI. The Company is also obligated to pay all related taxes, utilities, insurance and maintenance payments during the lease term. Pursuant to the lease, twenty-four months from the commencement of the lease term, the Company may terminate the agreement upon three months' notice provided the Company secures a replacement lessee approved by the lessor at its discretion.

The Company has an option to renew the lease for another five years, provided it is not in breach of the agreement, where it is required as well to furnish a notice of intent to exercise the option six months prior to termination of lease and furnishes a bank guarantee and insurance confirmation prior to commencement of option period. Under the lease agreement, the Company is authorized to further sublease part of the leased premises to a third party that is pre-approved by the sub-lessor. Rent and its related taxes, utilities, insurance and maintenance expenses for 2013 and 2012 were $256,000 and $238,000, respectively.

The future minimum lease payments as of December 31, 2013 are as follows:

	US$ thousands
2014	335
2015	304
2016	174

2017	171
2018	171
2019	14
	1,169

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H. Drilling Contract with AME/GYP

On September 12, 2008, the Company entered into a drilling contract with Aladdin Middle East Ltd. (“AME”) pursuant to which AME shipped into Israel its 2,000 horsepower rig for use in the drilling contemplated by the Company’s business plan. The rig arrived in Israel and cleared customs in April 2009 and was used to drill the Ma’anit-Rehoboth #2 well, the Elijah #3 and the Ma’anit-Joseph #3 well. Drilling operations on the Ma’anit-Joseph #3 well were concluded in July 2011, whereupon the Company released the rig.

As previously disclosed, AME is part of a group of privately owned affiliated entities. The Company also disclosed that Guyney Yildizi Petrol UretimSondajmut, vc Tic A.S. (“GYP”), an affiliated entity of AME, advised the Company in April 2011 that GYP was the owner of the rig and, following further investigation by the Company, the Company agreed to remit the payments payable under the drilling contract between it and AME directly to GYP. The Company obtained an indemnity from GYP with respect to any damages and costs resulting from such payments to GYP.

In the context of finalizing amounts owed to GYP under the drilling contract, in April, 2012 GYP advised the Company in writing that approximately $1.5 million remain outstanding under the drilling contract, which amount purportedly included $550,000 in rig demobilization fees.

In May, 2012, the Company and GYP agreed that the Company would pay GYP $627,000 in full and final settlement of past bills, and such amount was paid on May 15, 2012. However, the matter related to GYP’s demand for $550,000 for rig demobilization was excluded from the settlement. The drilling contract between the Company and AME, which was assumed by GYP, provides that all disputes are to be settled by arbitration in London, United Kingdom.

On February 25, 2013, GYP advised the Company in writing of GYP's intention to seek arbitration under the drilling contract; however, GYP also indicated its desire to find an amicable solution in lieu of initiating arbitration proceedings and offered a deep discount to resolve the matter. The Company, which denies it owes anything, offered a nuisance amount to resolve the matter. The Company's offer has not been accepted by GYP to date and periodic communications continue between it and the Company.

On October 13, 2013, the Company received a new letter from GYP requesting payment of the $550,000 with no reference to arbitration. By written response on October 29, 2013, the Company respectfully denied any liability on GYP's claim. On October 31, 2013, the Company received an email from GYP disagreeing with the Company's analysis and threatening arbitration if no satisfactory solution can be found. By written response on November 6, 2013, the Company, citing relevant provisions of the drilling contract, again respectfully denied any liability on GYP's claim.

See Note 10 on GYP's request for arbitration.

I. Bank Guarantees

As of December 31, 2013, the Company provided bank guarantees to various governmental bodies (approximately $1,143,000) and others (approximately $109,000) in respect of its drilling operation in an aggregate amount of approximately $1,252,000. The funds backing these guarantees and additional amounts added to support currency fluctuations as required by the bank, are held in interest-bearing accounts and are reported on the company's balance sheet as “restricted cash.

Note 9 – Risks and Uncertainties

We are directly influenced by the political, economic and military conditions affecting Israel.

We cannot predict the effect, if any, on our business of renewed hostilities between Israel and its neighbors or any other changes in the political climate in the area. Deterioration of political, economic and security conditions in Israel may adversely affect our operations.

We are subject to increasing Israeli governmental regulations and environmental requirements that may cause us to incur substantial incremental costs and/or delays in our drilling program.

Newly enacted onshore licensing and environmental and safety related regulations promulgated by the various energy related ministries in Israel during 2012-2013 have rendered obtaining new explorations licenses more time-consuming and expensive.

The Company believes that these new environmental regulations will also significantly increase the time, effort, and expenditures associated with obtaining all of the necessary authorizations and approvals prior to drilling any subsequent well.

Economic risks may adversely affect our operations and/or inhibit our ability to raise additional capital.

Economically, our operations in Israel may be subject to:

- exchange rate fluctuations between the Israeli shekel versus the US Dollar;
- royalty and tax increases and other risks arising out of Israeli State sovereignty over the mineral rights in Israel and its taxing authority; and
- changes in Israel's economy that could lead to legislation establishing oil and gas price controls.

Consequently, our operations may be substantially affected by local economic factors beyond our control, any of which could negatively affect our financial performance and prospects.

Legal risks could negatively affect our market value.

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Legally, our operations in Israel may be subject to:

- changes in the Petroleum Law resulting in modification of license and permit rights;
- adoption of new legislation relating to the terms and conditions pursuant to which operations in the energy sector may be conducted;
- changes in laws and policies affecting operations of foreign-based companies in Israel; and
- changes in governmental energy and environmental policies or the personnel administering them.

Our dependence on the limited contractors, equipment and professional services available in Israel may result in increased costs and possibly material delays in our work schedule.

The unavailability or high cost of drilling rigs, equipment, supplies, other oil field services and personnel could adversely affect our ability to execute our exploration and development plans on a timely basis and within our budget.

Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual outcomes may vary materially from those indicated.

Note 10 - Subsequent Events

On January 5, 2014, the Company initiated Elijah #3 re-entry operations and on January 30, 2014, the Lapidoth rig was released. Although we had hoped to encounter producible hydrocarbons, we did not (other than minimal amounts of gas), and we will now work to finalize all remaining plugging and abandonment procedures for that well.

On February 6, 2014, the Ministry of Energy and Water Resources issued guidelines for bank guarantees and insurance requirements with respect to oil rights. Under these guidelines, applicants for and existing holders of exploration rights will be required to submit certain bank guarantees and insurance policies that were not previously required. The Company's management is studying the new guidelines and evaluating the additional negative impact on the Company.

As it relates to existing onshore license holders like Zion, the Company must obtain a base guarantee in the New Israeli Shekel equivalent of $500,000, the earlier of:

- The date of approval of the application for extension of the license;
- The date of submission of an application for transfer of rights;
- The date of submission of an application for approval of drilling; or
- 45 days after the date of publication of the guidelines (late March 2014).

The Petroleum Commissioner, under exceptional circumstances, may demand a lower or higher guarantee sum.

Also, as it relates to existing onshore license holders, prior to the start of drilling, an additional bank guarantee in the New Israeli Shekel equivalent of $250,000 will be required.

Existing onshore license holders must have an insurance policy in place at least 30 days prior to the planned drilling date of a well. The insurance policy must include that which is usually taken out by international oil or gas exploration or production companies, in accordance with specific requirements set out in the guidelines.

The Company believes that these and other new regulations will significantly increase the expenditures associated with and serve as a disincentive for operators to engage in oil and gas exploration in Israel. On February 24, 2014, the Company received a request seeking that the Company arrange for three bank guarantees totaling $1.5 Million. The Company disputes that it is obligated to obtain the three bank guarantees even under the new regulations. The Company awaits word on the Israel Oil & Gas Association petition where the association is contemplating a legal challenge in Israel's Supreme Court and does not plan on providing any of the bank guarantees until the matter is resolved.

On February 21, 2014, the Company extended the expiration date for the Unit program under its DSPP to June 30, 2014. The extension is made, in part, to allow interested investors to utilize a new and more convenient electronic enrollment procedure with the TeleCheck Internet Check Acceptance service as a payment method.

On March 4, 2014, the Company received from GYP a request for arbitration. The Company continues to deny GYP's claim and intends to vigorously defend itself.