

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

FORM 10-Q

MARK ONE

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

for the Quarterly Period ended March 31, 2020; or

Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

for the transition period from _____ to _____

ZION OIL & GAS, INC.

(Exact name of registrant as specified in its charter)

| | |
|---|---|
| Delaware | 20-0065053 |
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification No.) |
| 12655 N Central Expressway, Suite 1000, Dallas, TX | 75243 |
| (Address of principal executive offices) | Zip Code |

(214) 221-4610

(Registrant's telephone number, including area code)

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

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

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

| | | |
|--|---|--|
| Large accelerated filer <input type="checkbox"/> | Accelerated filer <input type="checkbox"/> | |
| Non-accelerated filer <input type="checkbox"/> | Smaller reporting company <input checked="" type="checkbox"/> | |
| | Emerging growth company <input type="checkbox"/> | |

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

Securities registered pursuant to Section 12(b) of the Act:

| Title of each class | Trading Symbol(s) | Name of each exchange on which registered |
|---------------------|-------------------|---|
| ZN common shares | ZN | Nasdaq Capital Market |

As of May 7, 2020, Zion Oil & Gas, Inc. had outstanding 173,367,104 shares of common stock, par value \$0.01 per share.

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Zion Oil & Gas, Inc.

Consolidated Condensed Balance Sheets as of

| | March 31, 2020 | December 31, 2019 |
|--|---------------------------|------------------------------|
| | US\$ | US\$ |
| | thousands | thousands |
| | (Unaudited) | |
| Current assets | | |
| Cash and cash equivalents | 6,454 | 4,845 |
| Fixed short term bank and escrow deposits – restricted | 2,090 | 1,090 |
| Prepaid expenses and other | 674 | 511 |
| Other deposits | - | 197 |
| Governmental receivables | 10 | 34 |
| Other receivables | 421 | 222 |
| Total current assets | 9,649 | 6,899 |
| Unproved oil and gas properties, full cost method (see Note 4) | 10,860 | 10,637 |
| Property and equipment at cost | | |
| Net of accumulated depreciation of \$520 and \$505 | 103 | 115 |
| Right of Use Lease Assets (see Note 7) | 582 | 634 |
| Other assets | | |
| Drilling rig and related inventory (see note 2J) | 4,609 | - |
| Assets held for severance benefits | 373 | 371 |
| Total other assets | 4,982 | 371 |
| Total assets | 26,176 | 18,656 |
| Liabilities and Stockholders' Equity | | |
| Current liabilities | | |
| Accounts payable | 211 | 108 |
| Obligation under capital lease | 26 | - |
| Lease obligation – current (see Note 7) | 240 | 239 |
| Asset retirement obligation | 571 | 585 |
| Derivative liability (see Note 6) | 113 | 129 |
| Accrued liabilities | 656 | 826 |
| Total current liabilities | 1,817 | 1,887 |
| Long-term liabilities | | |
| 10% Senior convertible bonds, net of unamortized deferred financing cost of \$30 and \$36 and unamortized debt discount of \$523 and \$639 at March 31, 2020 and December 31, 2019 respectively (see Note 5) | 2,693 | 2,574 |
| Lease obligation – non-current (see Note 7) | 377 | 450 |
| Obligation under capital lease | - | 19 |
| Provision for severance pay | 404 | 402 |
| Total long-term liabilities | 3,474 | 3,445 |
| Total liabilities | 5,291 | 5,332 |
| Commitments and contingencies (see Note 8) | | |
| Stockholders' equity | | |
| Common stock, par value \$.01; Authorized: 200,000,000 shares at March 31, 2020; Issued and outstanding: 164,691,068 and 123,973,084 shares at March 31, 2020 and December 31, 2019 respectively | 1,647 | 1,240 |
| Additional paid-in capital | 226,654 | 217,892 |
| Accumulated deficit | (207,416) | (205,808) |
| Total stockholders' equity | 20,885 | 13,324 |
| Total liabilities and stockholders' equity | 26,176 | 18,656 |

The accompanying notes are an integral part of the unaudited interim consolidated condensed financial statements.

Zion Oil & Gas, Inc.

Consolidated Condensed Statements of Operations (Unaudited)

| | For the three months ended March 31, | |
|---|---|---------------------------|
| | 2020 | 2019 |
| | US\$ thousands | US\$ thousands |
| General and administrative | 975 | 926 |
| Impairment of unproved oil and gas properties | - | 163 |
| Other | 468 | 555 |
| Loss from operations | <u>(1,443)</u> | <u>(1,644)</u> |
| Other income (expense), net | | |
| Gain (Loss) on derivative liability | 16 | (378) |
| Foreign exchange gain | 11 | 6 |
| Financial (expenses), net | <u>(192)</u> | <u>(154)</u> |
| Loss before income taxes | (1,608) | (2,170) |
| Income taxes | <u>—</u> | <u>—</u> |
| Net loss | <u>(1,608)</u> | <u>(2,170)</u> |
| Net loss per share of common stock - basic and diluted (in US\$) | <u>(0.01)</u> | <u>(0.03)</u> |
| Weighted-average shares outstanding—basic and diluted (in thousands) | <u>138,813</u> | <u>69,987</u> |

The accompanying notes are an integral part of the unaudited interim consolidated condensed financial statements.

Zion Oil & Gas, Inc.

Consolidated Condensed Statement of Changes in Stockholders' Equity (Unaudited)

For the period ended March 31, 2020

| | Common Stock | | Additional | Accumulated | Total |
|--|----------------|--------------|----------------|------------------|---------------|
| | Shares | Amounts | paid-in | deficit | |
| | US\$ | US\$ | Capital | US\$ | |
| | thousands | thousands | thousands | thousands | thousands |
| Balances as of December 31, 2019 | 123,973 | 1,240 | 217,892 | (205,808) | 13,324 |
| Funds received from sale of DSPP units and shares | 40,328 | 403 | 8,706 | — | 9,109 |
| Value of bonds converted to shares | 2 | * | — | — | — |
| Funds received from option exercises | 388 | 4 | — | — | 4 |
| Value of options granted to employees, directors and others as non-cash compensation | — | — | 56 | — | 56 |
| Net loss | — | — | — | (1,608) | (1,608) |
| Balances as of March 31, 2020 | <u>164,691</u> | <u>1,647</u> | <u>226,654</u> | <u>(207,416)</u> | <u>20,885</u> |

For the period ended March 31, 2019

| | Common Stock | | Additional | Accumulated | Total |
|--|---------------|------------|----------------|------------------|--------------|
| | Shares | Amounts | paid-in | deficit | |
| | US\$ | US\$ | Capital | US\$ | |
| | thousands | thousands | thousands | thousands | thousands |
| Balances as of December 31, 2018 | 66,405 | 664 | 203,580 | (199,115) | 5,129 |
| Funds received from sale of DSPP units and shares | 4,608 | 46 | 2,482 | — | 2,528 |
| Value of bonds converted to shares | * | * | * | — | * |
| Funds received from option exercises | 53 | 1 | — | — | 1 |
| Value of options granted to employees, directors and others as non-cash compensation | — | — | 15 | — | 15 |
| Net loss | — | — | — | (2,170) | (2,170) |
| Balances as of March 31, 2019 | <u>71,066</u> | <u>711</u> | <u>206,077</u> | <u>(201,285)</u> | <u>5,503</u> |

* Less than one thousand.

The accompanying notes are an integral part of the unaudited interim consolidated condensed financial statements.

Zion Oil & Gas, Inc.

Consolidated Condensed Statements of Cash Flows (Unaudited)

| | For the three months ended | |
|--|-----------------------------------|------------------|
| | March 31, | |
| | 2020 | 2019 |
| | US\$ | US\$ |
| | thousands | thousands |
| Cash flows from operating activities | | |
| Net loss | (1,608) | (2,170) |
| Adjustments required to reconcile net loss to net cash used in operating activities: | | |
| Depreciation | 15 | 12 |
| Cost of options issued to employees, directors and others as non-cash compensation | 56 | 15 |
| Amortization of debt discount related to convertible bonds | 180 | 169 |
| Change in derivative liability | (16) | 378 |
| Impairment of unproved oil and gas properties | - | 163 |
| Change in assets and liabilities, net: | | |
| Other deposits | 197 | 130 |
| Prepaid expenses and other | (163) | 41 |
| Governmental receivables | 24 | 355 |
| Lease obligation – current | 1 | 210 |
| Lease obligation – non current | (73) | 564 |
| Right of Use Lease Assets | 52 | (730) |
| Other receivables | (199) | 14 |
| Severance pay | - | (3) |
| Accounts payable | 110 | (28) |
| Asset retirement obligation | (14) | (24) |
| Accrued liabilities | (288) | (162) |
| Net cash used in operating activities | <u>(1,726)</u> | <u>(1,066)</u> |
| Cash flows from investing activities | | |
| Acquisition of property and equipment | (3) | (2) |
| Acquisition of drilling rig and related equipment | (4,609) | - |
| Investment in unproved oil and gas properties | (162) | (2,448) |
| Net cash used in investing activities | <u>(4,774)</u> | <u>(2,450)</u> |
| Cash flows from financing activities | | |
| Payments related to capital lease | (4) | (3) |
| Proceeds from exercise of stock options | 4 | 1 |
| Deferred offering costs | - | - |
| Proceeds from issuance of stock and exercise of warrants | 9,109 | 2,528 |
| Net cash provided by financing activities | <u>9,109</u> | <u>2,526</u> |
| Net increase/(decrease) in cash, cash equivalents and restricted cash | 2,609 | (990) |
| Cash, cash equivalents and restricted cash – beginning of period | 5,935 | 4,125 |
| Cash, cash equivalents and restricted cash – end of period | <u>8,544</u> | <u>3,135</u> |
| Supplemental schedule of cash flow information | | |
| Cash paid for interest | \$ 1 | 1 |
| Non-cash investing and financing activities: | | |
| Cost of options capitalized to oil & gas properties | - | - |
| Unpaid investments in oil & gas properties | 57 | 587 |
| 10% Senior Convertible Bonds converted to shares | * | * |
| Capitalized convertible bond interest attributed to oil and gas properties | 20 | 10 |

* Less than one thousand

The accompanying notes are an integral part of the unaudited interim consolidated condensed financial statements.

Cash, cash equivalents and restricted cash, are comprised as follows:

| | March 31, 2020 | December 31, 2019 |
|--|-------------------------------|------------------------------|
| | US\$ | US\$ |
| | thousands | thousands |
| Cash and cash equivalents | 6,454 | 4,845 |
| Restricted cash included in fixed short-term bank deposits | 2,090 | 1,090 |
| | 8,544 | 5,935 |

Zion Oil & Gas, Inc.

Consolidated Condensed Notes to Financial Statements (Unaudited)

Note 1 - Nature of Operations, Basis of Presentation and Going Concern

A. Nature of Operations

Zion Oil & Gas, Inc., a Delaware corporation (“we,” “our,” “Zion” or the “Company”) is an oil and gas exploration company with a history of 20 years of oil & gas exploration in Israel. As of March 31, 2020, the Company has no revenues from its oil and gas operations.

Zion maintains its corporate headquarters in Dallas, Texas. The Company also have branch offices in Caesarea, Israel and Geneva, Switzerland. The purpose of the Israel branch is to support the Company’s operations in Israel, and the purpose of the Switzerland branch is to operate a foreign treasury center for the Company.

On January 24, 2020, Zion incorporated a wholly owned subsidiary, Zion Drilling, Inc., a Delaware corporation, for the purpose of owning the rig and related equipment and excess inventory, and on January 31, 2020, Zion incorporated another wholly owned subsidiary, Zion Drilling Services, Inc., a Delaware corporation, to act as the contractor providing such drilling services. When Zion is not using the rig for its own exploration activities, Zion Drilling Services may contract with other operators in Israel to provide drilling services at market rates then in effect.

Zion has the trademark “ZION DRILLING” filed with the United States Patent and Trademark Office. Zion has the trademark filed with the World Intellectual Property Organization in Geneva, Switzerland, pursuant to the Madrid Agreement and Protocol. In addition, Zion has the trademark filed with the Israeli Trademark Office in Israel.

Exploration Rights/Exploration Activities

The Company currently holds one active petroleum exploration license onshore Israel, the Megiddo-Jezreel License, comprising approximately 99,000 acres, which is scheduled to terminate on December 2, 2020.

The Megiddo Jezreel #1 (“MJ #1”) exploratory well was spud on June 5, 2017 and drilled to a total depth (“TD”) of 5,060 meters (approximately 16,600 feet). Thereafter, the Company successfully cased and cemented the well while awaiting the approval of the testing protocol. The Ministry of Energy approved the well testing protocol on April 29, 2018.

During the fourth quarter of 2018, the Company testing protocol was concluded at the MJ#1 well. The test results confirmed that the MJ #1 well did not contain hydrocarbons in commercial quantities in the zones tested. As a result, in the year ended December 31, 2018, the Company recorded a non-cash impairment charge to its unproved oil and gas properties of \$30,906,000. During the three months ended March 31, 2020, and 2019, the Company recorded a post-impairment charge of approximately \$0 and \$163,000, respectively.

The MJ#1 well provided Zion with information Zion believes is important for potential future exploration efforts within its license area. As with many frontier wildcat wells, the MJ#1 also left several questions unanswered.

While not meant to be an exhaustive list, a summary of what Zion believes to be key information learned in the MJ#1 well is as follows:

1. The MJ#1 encountered much higher subsurface temperatures at a depth shallower than expected before drilling the well. In our opinion, this is significant because reaching a minimum temperature threshold is necessary for the generation of hydrocarbons from an organic-rich source rock.
2. The known organic rich (potentially hydrocarbon bearing) Senonian age source rocks that are typically present in this part of Israel were not encountered as expected. Zion expected these source rocks to be encountered at approximately 1,000 meters in the MJ#1 well.
3. MJ#1 had natural fractures, permeability (the ability of fluid to move through the rock) and porosity (pore space in rock) that allowed the sustained flow of formation fluid in the shallower Jurassic and lower Cretaceous age formations between approximately 1,200 and 1,800 meters. While no hydrocarbons were encountered, Zion believes this fact is nonetheless significant because it provides important information about possible reservoir pressures and the ability of fluids to move within the formation and to the surface.
4. MJ#1 encountered oil in the Triassic Mohilla formation which Zion believes suggests an active deep petroleum system is in Zion’s license area. There was no natural permeability or porosity in the Triassic Mohilla formation to allow formation fluid to reach the surface naturally during testing and thus the MJ#1 was not producible or commercial.
5. The depths and thickness of the formations we encountered varied greatly from pre-drill estimates. This required the MJ#1 to be drilled to a much greater depth than previously expected. Zion has tied these revised formation depths to seismic data which will allow for more accurate interpretation and mapping in the future.

Zion Oil & Gas, Inc.

Consolidated Condensed Notes to Financial Statements (Unaudited)

Note 1 - Nature of Operations, Basis of Presentation and Going Concern (cont'd)

A summary of what Zion believes to be some key questions left to be answered are:

1. Is the missing shallow Senonian age source rock a result of regional erosion, or is it missing because of a fault that cut the well-bore and could be reasonably expected to be encountered in the vicinity of the MJ#1 drill site? Zion believes this is an important question to answer because if the Senonian source rocks do exist in this area, the high temperatures encountered are sufficient to mature these source rocks and generate oil.
2. Do the unusually high shallow subsurface temperatures extend regionally beyond the MJ#1 well, which could allow for the generation of hydrocarbons in the Senonian age source rock within our license area?
3. As a consequence of seismic remapping, where does the MJ#1 well lie relative to the potential traps at the Jurassic and Triassic levels and was the well location too low on the structures and deeper than the potential hydrocarbons within those traps?

Zion completed all of the land compensation for the 3-D survey in November 2019. All land parcels and the kibbutz approved the completion of the geophysical survey. Subsequently, the Contractor demobilized the equipment from Israel to Europe. All field data from acquisition was delivered to Dallas, Texas and the Ministry of Energy in Israel. Additionally, the final acquisition reports from the Contractor and Zion were delivered to the Ministry of Energy in December per the guidelines enacted in July 2019.

Zion and Agile Seismic Processing Services (“ASPS”) are continuing to process and interpret the data set with state-of-the-art technologies allowing for comprehensive imaging at depth. Zion’s previous 2-D data sets have been added into the 3-D volume allowing for further verification. Our estimated completion date for the final volume is mid-May 2020 due to circumstances brought on by the coronavirus pandemic which are beyond the control of both Zion and ASPS. While both parties are continuing to review and finalize the data, the timeframes are lengthened due to the current work environment. Our questions from the MJ#1 well are being correlated with the 3-D data set to provide potential solutions on a go forward basis.

Megiddo-Jezreel Petroleum License, No. 401 (“MJL”)

The Megiddo-Jezreel 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 current scheduled date of termination is December 2, 2020. The Megiddo-Jezreel License lies onshore, south and west of the Sea of Galilee and we continue our exploration focus here as it appears to possess the key geologic ingredients of an active petroleum system with significant exploration potential.

On January 31, 2019, Zion submitted its Application for Extension of Continued Work Program Due Date on the Megiddo-Jezreel License No. 401. The additional time was necessary to finalize the work program. On February 3, 2019 Israel’s Petroleum Commissioner granted Zion’s work program report extension to February 28, 2019, as shown below:

| Number | Activity Description | Execution by: |
|---------------|---|----------------------|
| 1 | Submit program for continuation of work under license | 28 February 2019 |

On February 24, 2019 and thereafter on February 26, 2019 Zion submitted its proposed 2019 Work Program on the Megiddo-Jezreel License No. 401.

On February 28, 2019 Israel’s Petroleum Commissioner officially approved the revised and updated Work Program on the Megiddo-Jezreel License No. 401 as shown below:

| Number | Activity description | Execution by: |
|---------------|--|----------------------|
| 1 | Submission of seismic survey plan to the Commissioner and execution of an agreement with a contractor to perform | 30 April 2019 |
| 2 | Commence 3D seismic survey in an area of approximately 50 square kilometers | 1 August 2019 |
| 3 | Transfer of field material configuration and processed material to the Ministry pursuant to Ministry guidelines | 15 December 2019 |
| 4 | Submit interpretation report | 20 February 2020 |

On April 30, 2019 Zion submitted its Application for Extension of Continued Work Program Due Date on the Megiddo-Jezreel License No. 401. The additional time was necessary for Zion to conduct a 3D survey in an area of approximately 72 square kilometers. This required, among others, extensive permitting activities with relevant local landowners, the ILA, certain authorities and others, and the seismic survey area may not conclude prior to the beginning of the rainy season in Israel. This in turn would result in additional delay, as rain and mud are not conducive to the performance of a seismic survey which includes extensive use of vibrators.

Zion Oil & Gas, Inc.

Consolidated Condensed Notes to Financial Statements (Unaudited)

Note 1 - Nature of Operations, Basis of Presentation and Going Concern (cont'd)

Zion's proposed new timelines and activity descriptions are shown below:

| Number | Activity description | Execution by: |
|---------------|--|----------------------|
| 1 | Submission of seismic survey plan to the Commissioner and execution of an agreement with a contractor to perform | 30 November 2019 |
| 2 | Commence 3D seismic survey in an area of approximately 72 square kilometers | 1 April 2020 |
| 3 | Transfer of field material configuration and processed material to the Ministry pursuant to Ministry guidelines | 15 August 2020 |
| 4 | Submit interpretation report | 15 November, 2020 |

On May 1, 2019, Israel's Petroleum Commissioner granted Zion's work program report extension.

As previously disclosed, the Company required authorization from the ILA, the formal lessor of the land to Kibbutz Sde Eliyahu, on whose property the drilling pad is currently situated, to access and utilize the drill site ("surface use agreement"). The Company received this authorization on July 4, 2016. This was preceded by the Company's May 15, 2016 signed agreement with the kibbutz. On January 11, 2017, an agreement was signed by the Company and the ILA by which the surface usage agreement was extended through December 3, 2017. On December 31, 2017, an agreement was signed by the Company and the ILA by which the surface usage agreement was extended through December 3, 2019. On July 1, 2019, an agreement was signed by the Company and the ILA by which the surface usage agreement was extended through December 3, 2020.

B. Basis of Presentation

The accompanying unaudited interim consolidated condensed financial statements of Zion Oil & Gas, Inc. have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") for interim financial information and with Article 8-03 of Regulation S-X. Accordingly, they do not include all of the information and notes required by GAAP for complete financial statements. In the opinion of management, all adjustments, consisting only of normal recurring accruals necessary for a fair statement of financial position, results of operations and cash flows, have been included. The information included in this Quarterly Report on Form 10-Q should be read in conjunction with the financial statements and the accompanying notes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2019. The year-end balance sheet data presented for comparative purposes was derived from audited financial statements, but does not include all disclosures required by GAAP. The results of operations for the three months ended March 31, 2020 are not necessarily indicative of the operating results for the year ending December 31, 2020 or for any other subsequent interim period.

C. Going Concern

The Company incurs cash outflows from operations, and all exploration activities and overhead expenses to date have been financed by way of equity or debt financing. The recoverability of the costs incurred to date is uncertain and dependent upon achieving significant commercial production.

The Company's ability to continue as a going concern is dependent upon obtaining the necessary financing to undertake further exploration and development activities and ultimately generating profitable operations from its oil and natural gas interests in the future. The Company's current operations are dependent upon the adequacy of its current assets to meet its current expenditure requirements and the accuracy of management's estimates of those requirements. Should those estimates be materially incorrect, the Company's ability to continue as a going concern may be impaired. The financial statements have been prepared on a going concern basis, which contemplates realization of assets and liquidation of liabilities in the ordinary course of business. During the three months ended March 31, 2020, the Company incurred a net loss of approximately \$1.61 million and had an accumulated deficit of approximately \$207.4 million. These factors raise substantial doubt about the Company's ability to continue as a going concern.

To carry out planned operations, the Company must raise additional funds through additional equity and/or debt issuances or through profitable operations. There can be no assurance that this capital or positive operational income will be available to the Company, and if it is not, the Company may be forced to curtail or cease exploration and development activities. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

Zion Oil & Gas, Inc.

Consolidated Condensed Notes to Financial Statements (Unaudited)

Note 2 - Summary of Significant Accounting Policies

A. Net Gain (Loss) per Share Data

Basic and diluted net (loss) gain per share of common stock, par value \$0.01 per share (“Common Stock”), 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 10,593,488 and 9,800,750 Common Stock equivalents in the three-month period ended March 31, 2020 and 2019 respectively, would be anti-dilutive.

B. 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.

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 proved 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 fourth quarter of 2018, the Company testing protocol was concluded at the Megiddo Jezreel #1 (“MJ #1”) well. The test results confirmed that the MJ #1 well did not contain hydrocarbons in commercial quantities in the zones tested. As a result of the above determination, in the year ended December 31, 2018, the Company recorded a non-cash impairment charge to its unproved oil and gas properties of \$30,906,000. During the three months ended March 31, 2020, and 2019, the Company recorded a post-impairment charge of approximately \$0 and \$163,000, respectively (see Note 4).

Currently, the Company has no economically recoverable reserves and no amortization base. The Company’s unproved oil and gas properties consist of capitalized exploration costs of \$10,860,000 and \$10,637,000 as of March 31, 2020, and December 31, 2019, respectively.

Zion Oil & Gas, Inc.

Consolidated Condensed Notes to Financial Statements (Unaudited)

Note 2 - Summary of Significant Accounting Policies (cont'd)

D. Fair Value Measurements

The Company follows Accounting Standards Codification (ASC) 820, "Fair Value Measurements and Disclosures," as amended by Financial Accounting Standards Board (FASB) Financial Staff Position (FSP) No. 157 and related guidance. Those provisions relate to the Company's financial assets and liabilities carried at fair value and the fair value disclosures related to financial assets and liabilities. ASC 820 defines fair value, expands related disclosure requirements, and specifies a hierarchy of valuation techniques based on the nature of the inputs used to develop the fair value measures. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, assuming the transaction occurs in the principal or most advantageous market for that asset or liability.

The Company uses a three-tier fair value hierarchy to classify and disclose all assets and liabilities measured at fair value on a recurring basis, as well as assets and liabilities measured at fair value on a non-recurring basis, in periods subsequent to their initial measurement. The hierarchy requires the Company to use observable inputs when available, and to minimize the use of unobservable inputs, when determining fair value. The three tiers are defined as follows:

- Level 1—Observable inputs that reflect quoted market prices (unadjusted) for identical assets or liabilities in active markets;
- Level 2—Observable inputs other than quoted prices in active markets that are observable either directly or indirectly in the marketplace for identical or similar assets and liabilities; and
- Level 3—Unobservable inputs that are supported by little or no market data, which require the Company to develop its own assumptions.

The Company's financial instruments, including cash and cash equivalents, accounts payable and accrued liabilities, are carried at historical cost. At March 31, 2020, and December 31, 2019, the carrying amounts of these instruments approximated their fair values because of the short-term nature of these instruments. Derivative instruments are carried at fair value, generally estimated using the Binomial Model.

E. Derivative Liabilities

In accordance with ASC 815-40-25 and ASC 815-10-15 Derivatives and Hedging and ASC 480-10-25 Liabilities-Distinguishing Liabilities from Equity, the embedded derivatives associated with the Convertible Bonds are accounted for as a liability during the term of the related Convertible Bonds (see Note 6).

F. Stock-Based Compensation

ASC 718, "Compensation – Stock Compensation," prescribes accounting and reporting standards for all share-based payment transactions in which employee services are acquired. Transactions include incurring liabilities, or issuing or offering to issue shares, options, and other equity instruments such as employee stock ownership plans and stock appreciation rights. Share-based payments to employees, including grants of employee stock options, are recognized as compensation expense in the financial statements based on their fair values. That expense is recognized over the period during which an employee is required to provide services in exchange for the award, known as the requisite service period (usually the vesting period).

The Company accounts for stock-based compensation issued to non-employees and consultants in accordance with the provisions of ASC 505-50, "Equity – Based Payments to Non-Employees." Measurement of share-based payment transactions with non-employees is based on the fair value of whichever is more reliably measurable: (a) the goods or services received; or (b) the equity instruments issued. The fair value of the share-based payment transaction is determined at the earlier of performance commitment date or performance completion date.

G. Warrants

In connection with the Dividend Reinvestment and Stock Purchase Plan ("DSPP") financing arrangements, the Company has issued warrants to purchase shares of its common stock. The outstanding warrants are standalone instruments that are not puttable or mandatorily redeemable by the holder and are classified as equity awards. The Company measures the fair value of the awards using the Black-Scholes option pricing model as of the measurement date. Warrants issued in conjunction with the issuance of common stock are initially recorded and accounted as a part of the DSPP investment as additional paid-in capital of the common stock issued. All other warrants are recorded at fair value and expensed over the requisite service period or at the date of issuance, if there is not a service period. Warrants granted in connection with ongoing arrangements are more fully described in Note 3, *Stockholders' Equity*.

H. Related parties

Parties are considered to be related to the Company if the parties, directly or indirectly, through one or more intermediaries, control, are controlled by, or are under common control with the Company. Related parties also include principal owners of the Company, its management, members of the immediate families of principal owners of the Company and its management and other parties with which the Company may deal if one party controls or can significantly influence the management or operating policies of the other to an extent that one of the transacting parties might be prevented from fully pursuing its own separate interests. All transactions with related parties are recorded at

fair value of the goods or services exchanged. Zion did not have any related party transactions for the periods covered in this report, with the exception of recurring monthly consulting fees paid to certain management personnel.

Zion Oil & Gas, Inc.

Consolidated Condensed Notes to Financial Statements (Unaudited)

Note 2 - Summary of Significant Accounting Policies (cont'd)

I. Recently Adopted Accounting Pronouncements

ASU 2016-02 and ASU 2018-01 – Leases (Topic 842)

In February 2016, the Financial Accounting Standards Board (“FASB”) issued ASU 2016-02, Leases (Topic 842) (“ASU 2016-02”) in order to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet for those leases classified as operating leases under previous GAAP. ASU 2016-02 requires that a lessee should recognize a liability to make lease payments (the lease liability) and a right-of-use asset representing its right to use the underlying asset for the lease term on the balance sheet. ASU 2016-02 is effective for fiscal years beginning after December 15, 2018 (including interim periods within those periods) using a modified retrospective approach and early adoption is permitted. Zion adopted ASU 2016-02 in the first quarter of 2019. Presently, Zion has operating leases for office space in Dallas, Texas and in Caesarea, Israel plus various leases for motor vehicles. These leases have been accounted for under ASU 2016-02 in 2019 by establishing a right-of-use asset and a corresponding current lease liability and non-current lease liability. Zion is not subject to any loan covenants and therefore, the increase in assets and liabilities does not have a material impact on its business.

In January 2018, the FASB issued ASU 2018-01, “Land Easement Practical Expedient for Transition to Topic 842.”

The amendments in this Update provide an optional transition practical expedient to not evaluate under Topic 842 existing or expired land easements that were not previously accounted for as leases under Topic 840, Leases. An entity that elects this practical expedient should evaluate new or modified land easements under Topic 842 beginning at the date that the entity adopts Topic 842. An entity that does not elect this practical expedient should evaluate all existing or expired land easements in connection with the adoption of the new lease requirements in Topic 842 to assess whether they meet the definition of a lease. The Company does not have any land easements and believes that this ASU 2018-01 has no effect on the Company.

ASU 2018-07

In June 2018, the FASB issued ASU 2018-07, Compensation – Stock Compensation (Topic 718): Improvements to Nonemployee Share-Based Payment Accounting, which simplifies the accounting for share-based payments to nonemployees by aligning it with the accounting for share-based payments to employees, with certain exceptions. ASU 2018-07 is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early adoption is permitted. The adoption of ASU 2018-07 did not have any impact on the Company’s consolidated financial statements.

ASU 2016-15 and ASU 2016-08 – Statement of Cash Flows (Topic 230)

In August 2016, the FASB issued AS 2016-15, “Classification of Certain Cash Receipts and Cash Payments”, which clarifies how certain cash receipts and cash payments are presented and classified in the statement of cash flows. The effective date for ASU 2016-15 is for fiscal years beginning after December 15, 2018, and interim periods within fiscal years beginning after December 15, 2019. Early adoption is permitted. The Company is currently evaluating the impact of adopting ASU 2016-15 on our financial statements.

In November 2016, the FASB issued ASU 2016-18, Statement of Cash Flows (Topic 230) (“ASU 2016-18”), which requires that restricted cash and restricted cash equivalents be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total cash amounts shown on the statement of cash flows. The effective date for ASU 2016-18 is for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. Early adoption is permitted. We adopted ASU 2016-18 effective January 1, 2018. The adoption of ASU 2016-18 had no impact on our retained earnings, and no impact to our net income on an ongoing basis. Adoption of the new standard requires that a statement of cash flows explain the change during the period in the total of cash, cash equivalents and amounts generally described as restricted cash, or restricted cash equivalents. The amounts generally described as restricted cash and restricted cash equivalents should be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown on the statements of cash flows. The amendments have been applied using a retrospective transition method to each period presented, as required.

ASU 2018-05 – Income Taxes (Topic 740)

In March 2018, the FASB issued ASU 2018-05, “Amendments to SEC Paragraphs Pursuant to SEC Staff Accounting Bulletin No. 118”. This ASU expresses the view of the staff regarding application of Topic 740, Income Taxes, in the reporting period that includes December 22, 2017, the date on which the Tax Cuts and Jobs Act (H.R.1, An Act to Provide for Reconciliation Pursuant to Titles II and V of the Concurrent Resolution on the Budget for Fiscal Year 2018) was signed into law. The Company is currently evaluating the impact of adopting ASU 2018-05 on our financial statements.

The Company does not believe that the adoption of any recently issued accounting pronouncements in 2020 had a significant impact on our financial position, results of operations, or cash flow, except for ASC Update No. 2016-02—

Leases, which requires organizations to recognize lease assets and lease liabilities on the balance sheet for leases classified as operating leases under previous GAAP. ASU 2016-02 requires that a lessee should recognize a liability to make lease payments (the lease liability) and a right-of-use asset representing its right to use the underlying asset for the lease term on the balance sheet. ASU 2016-02 is effective for fiscal years beginning after December 15, 2018 (including interim periods within those periods) using a modified retrospective approach and early adoption is permitted. The Company adopted ASU 2016-02 in the first quarter of 2019. See Note 7 for more complete details on balances at March 31, 2020, and December 31, 2019.

Zion Oil & Gas, Inc.

Consolidated Condensed Notes to Financial Statements (Unaudited)

Note 2 - Summary of Significant Accounting Policies (cont'd)

J. Depreciation and Accounting for Drilling Rig and Inventory

On March 12, 2020, Zion entered into a Purchase and Sale Agreement with Central European Drilling kft, a Hungarian corporation, to purchase an onshore oil and gas drilling rig, drilling pipe, related equipment and excess inventory for a purchase price of \$5.6 million in cash, subject to acceptance testing and potential downward adjustment. We remitted to the Seller \$250,000 on February 6, 2020 as earnest money towards the purchase price. The Closing anticipated by the Agreement also took place on March 12, 2020 by the Seller's execution and delivery of a Bill of Sale to us. On March 13, 2020, the Seller retained the earnest money deposit, and the Company remitted \$4,350,000 to the seller towards the purchase price and \$1,000,000 (the "Holdback Amount") was deposited in escrow with American Stock Transfer and Trust Company LLC, as escrow agent, through July 10, 2020, or as extended by mutual agreement of the parties, pending a determination, if any, by us of any operating deficiency in the drilling rig. Should we determine in our sole opinion that the drilling rig is not in satisfactory operating condition, then upon notice to the Seller, we and the Seller shall jointly determine if the operating deficiencies identified by us existed prior to the closing of the transaction. If it is determined that these deficiencies existed prior to the closing, then the Seller will undertake to cure the deficiencies within a reasonable time period. If the Seller is unable or unwilling to cure the deficiencies within the time period agrees to between the parties, we may solicit third party bids to repair the deficiencies and the cost thereof shall be paid out of the Holdback Amount.

The Drilling Rig will be imported into Israel from Romania, where the Drilling Rig is currently stored. The State of Israel has imposed travel restrictions relating to the Coronavirus outbreak, including a requirement that any person arriving into Israel, including the operating crew for the Drilling Rig, will need to undergo a two week quarantine. In addition, the ports of entry into Israel through which the Drilling rig will need to enter, may be undergoing work disruptions on account of the virus outbreak. Accordingly, it is not possible at the present time to accurately estimate the time or resources that may be necessary to import the Drilling Rig onto the well site or any delay arising as a consequence of the outbreak.

Since the rig was purchased and closed during March 2020, it is sound accounting practice for this purchase to be recorded on Zion's books as a long term fixed asset. The full purchase price of the drilling rig was \$5.6 million, inclusive of approximately \$900,000 in spare parts inventory ("spare parts" or "inventory"). The value of the inventory is contained inside the drilling rig and inventory account on the balance sheet and not broken out separately. However, only \$4,600,000 of the purchase price is charged to the drilling rig and inventory account. The remaining \$1,000,000 represents funds held in escrow until the rig undergoes acceptance testing in Israel. This \$1,000,000 is presently on our books as a fixed short term escrow deposit.

In accordance with GAAP accounting rules, per the matching principle, monthly depreciation will be recorded beginning in the month that the asset is "placed in service." The expectation at this point in time is that this date would be sometime in **Q3 2020** (however, this is subject to change given the coronavirus pandemic and other logistical factors). Due to the high quality of the I-35 drilling rig (the rig Zion purchased), we believe that the useful life is 10 years. Furthermore, we believe that straight-line depreciation is the best GAAP accounting method that most appropriately reflects the matching principle.

As mentioned previously, there is approximately \$900,000 worth of consumable inventory included in the rig purchase. When the drilling rig and inventory items arrive at the Israeli port or perhaps later at the well site, it is expected that there will be a verification/count of the inventory. Any such physical documentation of such count(s) will be obtained and saved in our files. Zion will also plan to obtain a physical count of the inventory at the end of each quarter, or as close to such date as practical, in accordance with our normal inventory procedures.

Zion will use the First In First Out ("FIFO") method of accounting for the inventory, meaning that the earliest items purchased will be the first item charged to the well in which the inventory gets consumed.

Zion expects the useful life of the rig to be 10 years. The depreciation method used will be straight line. It is also noteworthy that various components and systems on the rig will be subject to certifications by the manufacturer to ensure that the rig is maintained at optimal levels. Per standard practice in upstream oil and gas, each certification performed on our drilling rig increases the useful life of the rig by five years. The costs of each certification will be added to the drilling rig account and our straight-line amortization will be adjusted accordingly.

Note 3 - Stockholders' Equity

A. 2011 Equity Incentive Stock Option Plan

During the three months ended March 31, 2020, the Company granted the following options from the 2011 Equity Incentive Plan for employees, directors and consultants, to purchase as non-cash compensation (the exercise of penny stock options is taxable at full market value on the date of exercise):

- i. Options to purchase 110,000 shares of Common Stock to five senior officers at an exercise price of \$0.01 per share. The options vested upon grant and are exercisable through January 6, 2030. The fair value of the options at the date of grant amounted to approximately \$57,000.

During the three months ended March 31, 2019, the Company granted the following options from the 2011 Equity Incentive Plan for employees, directors and consultants, to purchase as non-cash compensation (the exercise of penny stock options are taxable on the date of exercise):

- i. Options to purchase 25,000 shares of Common Stock to one senior officer at an exercise price of \$0.01 per share. The options vested upon grant and are exercisable through January 6, 2029. The fair value of the options at the date of grant amounted to approximately \$10,000.

B. 2011 Non-Employee Directors Stock Option Plan

During the three months ended March 31, 2020, and 2019, the Company did not grant any qualified (market value) options from the 2011 Non-Employee Directors Stock Option Plan to its directors.

Zion Oil & Gas, Inc.

Consolidated Condensed Notes to Financial Statements (Unaudited)

Note 3 - Stockholders' Equity (cont'd)

C. Stock Options

The stock option transactions since January 1, 2020 are shown in the table below:

| | Number of shares | Weighted Average exercise price US\$ |
|--|---------------------|--|
| Outstanding, December 31, 2019 | 5,195,250 | 1.12 |
| Changes during 2020 to: | | |
| Granted to employees, officers, directors and others * | 110,000 | 0.01 |
| Expired/Cancelled/Forfeited | (25,000) | 0.01 |
| Exercised | (387,500) | 0.01 |
| Outstanding, March 31, 2020 | 4,892,750 | 1.19 |
| Exercisable, March 31, 2020 | 4,892,750 | 1.19 |

* The receipt of a stock option grant by the grantee recipient is a non-taxable event according to the Internal Revenue Service. The grantee who later chooses to exercise penny stock options must recognize the market value in income in the year of exercise.

The following table summarizes information about stock options outstanding as of March 31, 2020:

| Shares underlying outstanding options (non-vested) | | | | Shares underlying outstanding options (fully vested) | | | |
|--|-----------------------|---|--|--|-----------------------|---|--|
| 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\$ |
| — | — | — | — | 0.01 | 10,000 | 3.62 | 0.01 |
| — | — | — | — | 0.01 | 5,000 | 4.20 | 0.01 |
| — | — | — | — | 0.01 | 20,000 | 6.17 | 0.01 |
| — | — | — | — | 0.01 | 130,000 | 6.75 | 0.01 |
| — | — | — | — | 0.01 | 60,000 | 7.04 | 0.01 |
| — | — | — | — | 0.01 | 40,000 | 7.50 | 0.01 |
| — | — | — | — | 0.01 | 97,500 | 7.75 | 0.01 |
| — | — | — | — | 0.01 | 25,000 | 7.76 | 0.01 |
| — | — | — | — | 0.01 | 30,000 | 7.91 | 0.01 |
| — | — | — | — | 0.01 | 6,000 | 8.01 | 0.01 |
| — | — | — | — | 0.01 | 25,000 | 8.77 | 0.01 |
| — | — | — | — | 0.01 | 50,000 | 9.08 | 0.01 |
| — | — | — | — | 0.01 | 95,000 | 9.25 | 0.01 |
| — | — | — | — | 0.01 | 10,000 | 9.42 | 0.01 |
| — | — | — | — | 0.01 | 205,000 | 9.46 | 0.01 |
| — | — | — | — | 0.01 | 435,000 | 9.63 | 0.01 |
| — | — | — | — | 0.01 | 85,000 | 9.76 | 0.01 |
| — | — | — | — | 0.16 | 340,000 | 5.69 | 0.16 |
| — | — | — | — | 0.16 | 150,000 | 9.69 | 0.16 |
| — | — | — | — | 0.18 | 25,000 | 5.67 | 0.18 |
| — | — | — | — | 0.28 | 25,000 | 5.42 | 0.28 |
| — | — | — | — | 0.28 | 25,000 | 9.42 | 0.28 |
| — | — | — | — | 1.33 | 25,000 | 3.07 | 1.33 |
| — | — | — | — | 1.38 | 108,000 | 0.76 | 1.38 |
| — | — | — | — | 1.38 | 105,307 | 4.76 | 1.38 |
| — | — | — | — | 1.55 | 400,000 | 2.18 | 1.55 |
| — | — | — | — | 1.67 | 340,000 | 0.50 | 1.67 |
| — | — | — | — | 1.67 | 405,943 | 4.51 | 1.67 |
| — | — | — | — | 1.70 | 218,500 | 2.72 | 1.70 |
| — | — | — | — | 1.75 | 400,000 | 3.27 | 1.75 |
| — | — | — | — | 1.78 | 25,000 | 4.43 | 1.78 |
| — | — | — | — | 1.87 | 25,000 | 1.84 | 1.87 |
| — | — | — | — | 1.95 | 25,000 | 0.01 | 1.95 |
| — | — | — | — | 2.03 | 25,000 | 1.08 | 2.03 |
| — | — | — | — | 2.31 | 400,000 | 3.76 | 2.31 |
| — | — | — | — | 2.61 | 471,500 | 1.68 | 2.61 |
| — | — | — | — | 4.15 | 25,000 | 4.26 | 4.15 |
| | | | | 0.01-4.15 | 4,892,750 | | 1.19 |

Zion Oil & Gas, Inc.

Consolidated Condensed Notes to Financial Statements (Unaudited)

Note 3 - Stockholders' Equity (cont'd)

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 three months ended March 31, | |
|---|---|-------------|
| | 2020 | 2019 |
| Weighted-average fair value of underlying stock at grant date | \$ 0.52 | \$ 0.42 |
| Dividend yields | — | — |
| Expected volatility | 103% | 87% |
| Risk-free interest rates | 1.61% | 2.53% |
| Expected lives (in years) | 5.00 | 5.00 |
| Weighted-average grant date fair value | \$ 0.51 | \$ 0.41 |

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 three months ended March 31 , | |
|---|--|-------------|
| | 2020 | 2019 |
| Weighted-average fair value of underlying stock at grant date | \$ — | \$ — |
| Dividend yields | — | — |
| Expected volatility | — | — |
| Risk-free interest rates | — | — |
| Expected lives (in years) | — | — |
| Weighted-average grant date fair value | \$ — | \$ — |

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.

D. 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 three months ended March 31, | |
|---|-----------------------|
| 2020 | 2019 |
| US\$ thousands | US\$ thousands |
| 56 | 15 |

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

| For the three months ended March 31, | |
|---|-----------------------|
| 2020 | 2019 |
| US\$ thousands | US\$ thousands |
| — | — |

Zion Oil & Gas, Inc.

Consolidated Condensed Notes to Financial Statements (Unaudited)

Note 3 - Stockholders' Equity (cont'd)

The following table sets forth information about the compensation cost of option issuances recognized for employees and non-employees and capitalized to Unproved Oil & Gas properties:

| For the three months ended March 31, | |
|---|-----------------------|
| 2020 | 2019 |
| US\$ thousands | US\$ thousands |
| — | — |

E. Dividend Reinvestment and Stock Purchase Plan ("DSPP")

On March 27, 2014, we launched our Dividend Reinvestment and Stock Purchase Plan (the "DSPP") pursuant to which stockholders and interested investors can purchase shares of the Company's Common Stock as well as units of the Company's securities directly from the Company. The terms of the DSPP are described in the Prospectus Supplement originally filed on March 31, 2014 (the "Original Prospectus Supplement") with the Securities and Exchange Commission ("SEC") under the Company's effective registration Statement on Form S-3, as thereafter amended.

On January 13, 2015, the Company amended the Original Prospectus Supplement ("Amendment No. 3") to provide for a unit option (the "Unit Option") under the DSPP comprised of one share of Common Stock and three Common Stock purchase warrants with each unit priced at \$4.00. Each warrant afforded the participant the opportunity to purchase the Company's Common Stock at a warrant exercise price of \$1.00. Each of the three warrants series has different expiration dates that have been extended.

The ZNWAB warrants first became exercisable on May 2, 2016 and, in the case of ZNWAC on May 2, 2017 and in the case of ZNWAD on May 2, 2018, at a per share exercise price of \$1.00.

As of May 2, 2017, any outstanding ZNWAB warrants expired.

As of May 2, 2018, any outstanding ZNWAC warrants expired.

On May 29, 2019, the Company extended the termination date of the ZNWAD Warrant by one (1) year from the expiration date of May 2, 2020 to May 2, 2021. Zion considers this warrant as permanent equity per ASC 815-40-35-2. As such, there is no value assigned to this extension.

On November 1, 2016, the Company launched a unit offering (the "Unit Program") under the Company's DSPP pursuant to which participants could purchase units comprised of seven shares of Common Stock and seven Common Stock purchase warrants, at a per unit purchase price of \$10. The warrant is referred to as "ZNWAE."

The ZNWAE warrants became exercisable on May 1, 2017 and continue to be exercisable through May 1, 2020 at a per share exercise price of \$1.00.

On May 29, 2019, the Company extended the termination date of the ZNWAE Warrant by one (1) year from the expiration date of May 1, 2020 to May 1, 2021. Zion considers this warrant as permanent equity per ASC 815-40-35-2. As such, there is no value assigned to this extension.

The warrant terms provide that if the Company's Common Stock trades above \$5.00 per share at the closing price for 15 consecutive trading days at any time prior to the expiration date of the warrant, the Company may, in its sole discretion, accelerate the termination of the warrant upon providing 60 days advanced notice to the warrant holders.

On February 23, 2017, the Company filed a Form S-3 with the SEC (Registration No. 333-216191) as a replacement for the Form S-3 (Registration No. 333-193336), for which the three year period ended March 31, 2017, along with the base Prospectus and Supplemental Prospectus. The Form S-3, as amended, and the new base Prospectus became effective on March 10, 2017, along with the Prospectus Supplement that was filed and became effective on March 10, 2017. The Prospectus Supplement under Registration No. 333-216191 describes the terms of the DSPP and replaces the prior Prospectus Supplement, as amended, under the prior Registration No. 333-193336.

On May 22, 2017, the Company launched a new unit offering (the "New Unit Program"). The New Unit Program consisted of a new combination of common stock and warrants, a new time period in which to purchase under the program, and a new unit price, but otherwise the same unit program features, conditions and terms in the Prospectus Supplement applied. The New Unit Program terminated on July 12, 2017. This New Unit Program enabled participants to purchase Units of the Company's securities where each Unit (priced at \$250.00 each) was comprised of (i) the number of shares of Common Stock determined by dividing \$250.00 (the price of one Unit) by the average of the high and low sale prices of the Company's Common Stock as reported on the NASDAQ on the unit purchase date and (ii) Common Stock purchase warrants to purchase an additional 25 shares of Common Stock at a warrant exercise price of \$1.00 per share. The warrant is referred to as "ZNWAF."

Zion Oil & Gas, Inc.

Consolidated Condensed Notes to Financial Statements (Unaudited)

Note 3 - Stockholders' Equity (cont'd)

All ZNWAF warrants became exercisable on August 14, 2017 and continue to be exercisable through August 14, 2020 at a per share exercise price of \$1.00.

On May 29, 2019, the Company extended the termination date of the ZNWAF Warrant by one (1) year from the expiration date of August 14, 2020 to August 14, 2021. Zion considers this warrant as permanent equity per ASC 815-40-35-2. As such, there is no value assigned to this extension.

The warrant terms provide that if the Company's Common Stock trades above \$5.00 per share as the closing price for 15 consecutive trading days at any time prior to the expiration date of the warrant, the Company has the sole discretion to accelerate the termination date of the warrant upon providing 60 days advanced notice to the warrant holders.

An Amendment No. 2 to the Prospectus Supplement (as described below) was filed on October 12, 2017.

Under Amendment No. 2, the Company initiated another Unit Option Program which terminated on December 6, 2017. This Unit Option Program enabled participants to purchase Units of the Company's securities where each Unit (priced at \$250.00 each) was comprised of (i) a certain number of shares of Common Stock determined by dividing \$250.00 (the price of one Unit) by the average of the high and low sale prices of the Company's Common Stock as reported on the NASDAQ on the unit purchase date and (ii) Common Stock purchase warrants to purchase an additional 15 shares of Common Stock at a warrant exercise price of \$1.00 per share. The warrant is referred to as "ZNWAG."

The warrants became exercisable on January 8, 2018 and continue to be exercisable through January 8, 2021 at a per share exercise price of \$1.00. The warrant terms provide that if the Company's Common Stock trades above \$5.00 per share as the closing price for 15 consecutive trading days at any time prior to the expiration date of the warrant, the Company has the sole discretion to accelerate the termination date of the warrant upon providing 60 days advanced notice to the warrant holders.

On February 1, 2018, the Company launched another Unit Option Program which terminated on February 28, 2018. The Unit Option consisted of Units of our securities where each Unit (priced at \$250.00 each) was comprised of (i) 50 shares of Common Stock and (ii) Common Stock purchase warrants to purchase an additional 50 shares of Common Stock. The investor's Plan account was credited with the number of shares of the Company's Common Stock acquired under the Units purchased. Each warrant affords the investor the opportunity to purchase one share of Company Common Stock at a warrant exercise price of \$5.00. The warrant is referred to as "ZNWAH."

The warrants became exercisable on April 2, 2018 and continue to be exercisable through April 2, 2020 at a per share exercise price of \$5.00, after the Company, on December 4, 2018, extended the termination date of the Warrant by one (1) year from the expiration date of April 2, 2019 to April 2, 2020.

On May 29, 2019, the Company extended the termination date of the ZNWAH Warrant by one (1) year from the expiration date of April 2, 2020 to April 2, 2021. Zion considers this warrant as permanent equity per ASC 815-40-35-2. As such, there is no value assigned to this extension.

On August 21, 2018, the Company initiated another Unit Option Program, and it terminated on September 26, 2018. The Unit Option Program consisted of Units of the Company's securities where each Unit (priced at \$250.00 each) was comprised of (i) a certain number of shares of Common Stock determined by dividing \$250.00 (the price of one Unit) by the average of the high and low sale prices of the Company's publicly traded common stock as reported on the NASDAQ on the Unit Purchase Date and (ii) Common Stock purchase warrants to purchase an additional twenty-five (25) shares of Common Stock. The investor's Plan account was credited with the number of shares of the Company's Common Stock acquired under the Units purchased. Each warrant affords the investor the opportunity to purchase one share of Company Common Stock at a warrant exercise price of \$1.00. The warrant is referred to as "ZNWAJ."

The warrants became exercisable on October 29, 2018 and continue to be exercisable through October 29, 2020 at a per share exercise price of \$1.00, after the Company, on December 4, 2018, extended the termination date of the Warrant by one (1) year from the expiration date of October 29, 2019 to October 29, 2020.

Zion Oil & Gas, Inc.

Consolidated Condensed Notes to Financial Statements (Unaudited)

Note 3 - Stockholders' Equity (cont'd)

On May 29, 2019, the Company extended the termination date of the ZNWAJ Warrant by one (1) year from the expiration date of October 29, 2020 to October 29, 2021. Zion considers this warrant as permanent equity per ASC 815-40-35-2. As such, there is no value assigned to this extension.

On December 10, 2018, the Company initiated another Unit Option Program, and it terminated on January 23, 2019. The Unit Option Program consisted of Units of the Company's securities where each Unit (priced at \$250.00 each) is comprised of (i) two hundred and fifty (250) shares of Common Stock and (ii) Common Stock purchase warrants to purchase an additional two hundred and fifty (250) shares of Common Stock at a per share exercise price of \$0.01. The investor's Plan account was credited with the number of shares of the Company's Common Stock and Warrants that are acquired under the Units purchased. Each warrant affords the participant the opportunity to purchase one share of our Common Stock at a warrant exercise price of \$0.01. The warrant is referred to as "ZNWAK."

The warrants became exercisable on February 25, 2019 and continue to be exercisable through February 25, 2020 at a per share exercise price of \$0.01.

On May 29, 2019, the Company extended the termination date of the ZNWAK Warrant by one (1) year from the expiration date of February 25, 2020 to February 25, 2021. Zion considers this warrant as permanent equity per ASC 815-40-35-2. As such, there is no value assigned to this extension.

On April 24, 2019, the Company's most recent Unit Option Program began and it terminated on June 26, 2019, after the Company, on June 5, 2019, extended the termination date of the Unit Option Program.

The Unit Option Program consisted of Units of the Company's securities where each Unit (priced at \$250.00 each) was comprised of (i) two hundred and fifty (250) shares of Common Stock and (ii) Common Stock purchase warrants to purchase an additional fifty (50) shares of Common Stock at a per share exercise price of \$2.00. The investor's Plan account was credited with the number of shares of the Company's Common Stock and Warrants acquired under the Units purchased. For Plan participants who enrolled into the Unit Program with the purchase of at least one Unit and also enrolled in the separate Automatic Monthly Investments ("AMI") program at a minimum of \$50.00 per month or more, received an additional twenty-five (25) warrants at an exercise price of \$2.00 during this Unit Option Program. The twenty-five (25) additional warrants were for enrolling into the AMI program. Existing subscribers to the AMI were entitled to the additional twenty-five (25) warrants once, if they purchased at least one (1) unit during the Unit program. Each warrant affords the participant the opportunity to purchase one share of our Common Stock at a warrant exercise price of \$2.00. The warrant is referred to as "ZNWAL."

The warrants became exercisable on August 26, 2019 and continue to be exercisable through August 26, 2021 at a per share exercise price of \$2.00.

On December 9, 2019 Zion filed an Amendment No. 1 to the Registration Statement on Form S-1 (File No. 333-235299) solely for the purpose of re-filing a revised Exhibit 5.1 to the Registration Statement. This Amendment No. 1 does not modify any provision of the prospectus that forms a part of the Registration Statement and accordingly, such prospectus has not been included herein.

For the three months ended March 31, 2020, and 2019, approximately \$9,109,000, and \$2,528,000 was raised under the DSPP program, respectively.

The company raised approximately \$1,404,000 from the period April 1, 2020 through May 6, 2020, under the DSPP program.

The warrants represented by the ticker ZNWAA are tradable on the Nasdaq market. However, all of the other warrants characterized above, in the table below, and throughout this Form 10-K, are not tradeable and are used internally for classification and accounting purposes only.

F. Subscription Rights Offering

On April 2, 2018 the Company announced an offering ("2018 Subscription Rights Offering") through American Stock Transfer & Trust Company, LLC (the "Subscription Agent"), at no cost to the shareholders, of non-transferable Subscription Rights (each "Right" and collectively, the "Rights") to purchase its securities to persons who owned shares of our Common Stock on April 13, 2018 ("the Record Date"). Pursuant to the 2018 Subscription Rights Offering, each holder of shares of common stock on the Record Date received non-transferable Subscription Rights, with each Right comprised of one share of the Company Common Stock, par value \$0.01 per share (the "Common Stock") and one Common Stock Purchase Warrant to purchase an additional one share of Common Stock. Each Right could be exercised or subscribed at a per Right subscription price of \$5.00. Each Warrant affords the investor the opportunity to purchase one share of the Company Common Stock at a warrant exercise price of \$3.00. The warrant is referred to as "ZNWAI."

The warrants became exercisable on June 29, 2018 and continue to be exercisable through June 29, 2020 at a per share exercise price of \$3.00, after the Company, on December 4, 2018, extended the termination date of the Warrant by one (1) year from the expiration date of June 29, 2019 to June 29, 2020.

On May 29, 2019, the Company extended the termination date of the ZNWAI Warrant by one (1) year from the expiration date of June 29, 2020 to June 29, 2021.

Each shareholder received .10 (one tenth) of a Subscription Right (i.e. one Subscription Right for each 10 shares owned) for each share of the Company's Common Stock owned on the Record Date.

Zion Oil & Gas, Inc.

Consolidated Condensed Notes to Financial Statements (Unaudited)

Note 3 - Stockholders' Equity (cont'd)

The 2018 Subscription Rights Offering terminated on May 31, 2018. The Company raised net proceeds of approximately \$3,038,000, from the subscription of Rights, after deducting fees and expenses of \$243,000 incurred in connection with the rights offering.

G. Warrants Extended

On December 4, 2018, the Company executed an Amendment to certain Warrant Agent Agreements (the "Agreements") between the Company and American Stock Transfer & Trust Company ("AST"). The Company has implemented Agreements with AST as the Company's Warrant Agent (the "Warrant Agent"), under a Warrant Agent Agreement dated February 2, 2015 for the Warrant ZNWAD, under a Warrant Agent Agreement dated February 1, 2018 for the Warrant ZNWAH, under a Warrant Agent Agreement dated April 2, 2018 for the Warrant ZNWAI and under a Warrant Agent Agreement dated August 21, 2018 for the Warrant ZNWAJ.

The Warrant ZNWAD had an expiration date of May 2, 2019, the Warrant ZNWAH had an expiration date of April 19, 2019, the Warrant ZNWAI had an expiration date of June 29, 2019 and the Warrant ZNWAJ had an expiration date of October 29, 2019.

Pursuant to Section 3.2 of the Warrant Agent Agreements, the Company in its sole discretion extended the termination date of the above Warrants by delaying the Expiration Dates and such extension shall be identical in duration among all of the Warrants. The Company extended the duration of the Warrant ZNWAD by one (1) year from the expiration date of May 2, 2019 to May 2, 2020. The Company extended the duration of the Warrant ZNWAH by one (1) year from the expiration date of April 19, 2019 to April 19, 2020. The Company extended the duration of the Warrant ZNWAI by one (1) year from the expiration date of June 29, 2019 to June 29, 2020. The Company extended the duration of the Warrant ZNWAJ by one (1) year from the expiration date of October 29, 2019 to October 29, 2020.

On May 29, 2019, the Company executed an Amendment to certain Warrant Agent Agreements (the "Agreements") between the Company and American Stock Transfer & Trust Company, ("AST"). The Company has implemented Agreements with AST as the Company's Warrant Agent (the "Warrant Agent"), under a Warrant Agent Agreement dated August 1, 2014 for the Warrant ZNWAA, under a Warrant Agent Agreement dated November 1, 2016 for the Warrant ZNWAE, under a Warrant Agent Agreement dated May 22, 2017 for the Warrant ZNWAF, and under the Warrant Agent Agreement dated December 7, 2018 for the warrant ZNWAK.

The Warrant ZNWAA has an expiration date of January 31, 2020, Warrant ZNWAD has an has an expiration date of May 2, 2020, Warrant ZNWAE has an expiration date of May 1, 2020, Warrant ZNWAF has an expiration date of August 14, 2020, Warrant ZNWAH has an expiration date of April 19, 2020, Warrant ZNWAI has an expiration date of June 29, 2020, Warrant ZNWAJ has an expiration date of October 29, 2020 and the Warrant ZNWAK has an expiration date of February 25, 2020.

Pursuant to Section 3.2 of the Warrant Agent Agreements, on May 29, 2019, the Company in its sole discretion extended the duration of the above Warrants by delaying the Expiration Dates and such extension shall be identical in duration among all of the Warrants. The Company extended the duration of the Warrant ZNWAA by one (1) year from the expiration date of January 31, 2020 to January 31, 2021. The Company extended the duration of the Warrant ZNWAD by one (1) year from the expiration date of May 2, 2020 to May 2, 2021. The Company extended the duration of the Warrant ZNWAE by one (1) year from the expiration date of May 1, 2020 to May 1, 2021. The Company extended the duration of the Warrant ZNWAF by one (1) year from the expiration date of August 14, 2020 to August 14, 2021. The Company extended the duration of the Warrant ZNWAH by one (1) year from the expiration date of April 19, 2020 to April 19, 2021. The Company extended the duration of the Warrant ZNWAI by one (1) year from the expiration date of June 29, 2020 to June 29, 2021. The Company extended the duration of the Warrant ZNWAJ by one (1) year from the expiration date of October 29, 2020 to October 29, 2021. The Company extended the duration of the Warrant ZNWAK by one (1) year from the expiration date of February 25, 2020 to February 25, 2021.

H. Warrant Table

The warrants balances at December 31, 2019 and transactions since January 1, 2020 are shown in the table below:

| Warrants | Exercise Price | Warrant Termination Date | Outstanding Balance, 12/31/2019 | Warrants Issued | Warrants Exercised | Warrants Expired | Outstanding Balance, 03/31/2020 |
|----------|----------------|--------------------------|---------------------------------|-----------------|--------------------|------------------|---------------------------------|
| ZNWAA | \$ 2.00 | 01/31/2021 | 1,498,804 | - | - | - | 1,498,804 |
| ZNWAD | \$ 1.00 | 05/02/2021 | 243,853 | - | - | - | 243,853 |
| ZNWAE | \$ 1.00 | 05/02/2021 | 2,144,470 | - | (196) | - | 2,144,274 |
| ZNWAF | \$ 1.00 | 08/14/2021 | 359,585 | - | - | - | 359,585 |
| ZNWAG | \$ 1.00 | 01/08/2021 | 240,578 | - | - | - | 240,578 |
| ZNWAH | \$ 5.00 | 04/19/2021 | 372,400 | - | - | - | 372,400 |
| ZNWAI | \$ 3.00 | 06/29/2021 | 640,730 | - | - | - | 640,730 |
| ZNWAJ | \$ 1.00 | 10/29/2021 | 546,000 | - | - | - | 546,000 |

| | | | | | | | | |
|----------------------|----|------|------------|------------------|----------|----------------|----------|------------------|
| ZNWAK | \$ | 0.01 | 02/25/2021 | 457,725 | - | (6,250) | - | 451,475 |
| ZNWAL | \$ | 2.00 | 08/26/2021 | 517,925 | - | - | - | 517,925 |
| Outstanding warrants | | | | <u>7,022,070</u> | <u>-</u> | <u>(6,446)</u> | <u>-</u> | <u>7,015,624</u> |

Zion Oil & Gas, Inc.

Consolidated Condensed Notes to Financial Statements (Unaudited)

Note 3 - Stockholders' Equity (cont'd)

I. Warrant Descriptions

The price and the expiration dates for the series of warrants to investors are as follows * :

| | | <u>Period of Grant</u> | <u>US\$</u> | <u>Expiration Date</u> |
|----------------|-----|------------------------------|-------------|------------------------|
| ZNWAA Warrants | B | March 2013 – December 2014 | 2.00 | January 31, 2021 |
| ZNWAD Warrants | A,B | January 2015 – March 2016 | 1.00 | May 02, 2021 |
| ZNWAE Warrants | B | November 2016 – March 2017 | 1.00 | May 01, 2021 |
| ZNWF Warrants | A,B | May 2017 – July 2017 | 1.00 | August 14, 2021 |
| ZNWAG Warrants | | October 2017 – December 2017 | 1.00 | January 08, 2021 |
| ZNWAH Warrants | A,B | February 2018 | 5.00 | April 2, 2021 |
| ZNWAJ Warrants | A,B | April 2018 – May 2018 | 3.00 | June 29, 2021 |
| ZNWAJ Warrants | B | August 2018 – September 2018 | 1.00 | October 29, 2021 |
| ZNWAK Warrants | B | December 2018 – January 2019 | 0.01 | February 25, 2021 |
| ZNWAL Warrants | | July 2019 – August 2019 | 2.00 | August 26, 2021 |

* Zion's ZNWAB Warrants expired on May 2, 2017, and the ZNWAC Warrants expired on May 2, 2018

A On December 4, 2018, the Company extended the termination date of the Warrants by one (1) year.

B On May 29, 2019, the Company extended the termination date of the Warrants by one (1) year.

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

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

| | <u>March 31,</u> <u>2020</u> | <u>December 31,</u> <u>2019</u> |
|---|---------------------------------|------------------------------------|
| | <u>US\$</u> | <u>US\$</u> |
| | <u>thousands</u> | <u>thousands</u> |
| Excluded from amortization base: | | |
| Drilling costs, and other operational related costs | 1,227 | 1,227 |
| Capitalized salary costs | 1,805 | 1,759 |
| Capitalized interest costs | 1,010 | 990 |
| Legal and seismic costs, license fees and other preparation costs | 6,786 | 6,636 |
| Other costs | 32 | 25 |
| | <u>10,860</u> | <u>10,637</u> |

Impairment of unproved oil and gas properties comprised as follows:

| | <u>March 31,</u> <u>2020</u> | <u>March 31,</u> <u>2019</u> |
|---|---------------------------------|---------------------------------|
| | <u>US\$</u> | <u>US\$</u> |
| | <u>thousands</u> | <u>thousands</u> |
| Excluded from amortization base: | | |
| Drilling costs, and other operational related costs | - | 142 |
| Other costs | - | 21 |
| | <u>-</u> | <u>163</u> |

Changes in Unproved oil and gas properties during the three months ended March 31, 2020 and 2019 are as follows:

| | <u>March 31,</u> <u>2020</u> | <u>March 31,</u> <u>2019</u> |
|---|---------------------------------|---------------------------------|
| | <u>US\$</u> | <u>US\$</u> |
| | <u>thousands</u> | <u>thousands</u> |
| Excluded from amortization base: | | |
| Drilling costs, and other operational related costs | - | - |
| Capitalized salary costs | 46 | 46 |
| Capitalized interest costs | 20 | 10 |
| Legal costs, license fees and other preparation costs | 150 | 128 |
| Other costs | 7 | 2 |
| | <u>*223</u> | <u>*186</u> |

* Inclusive of non-cash amounts of approximately \$77,000, and \$597,000 during the three months ended March 31, 2020, and 2019, respectively

Zion Oil & Gas, Inc.

Consolidated Condensed Notes to Financial Statements (Unaudited)

Note 5 - Senior Convertible Bonds

Rights Offering -10% Senior Convertible Notes due May 2, 2021

On October 21, 2015, the Company filed with the SEC a prospectus supplement for a rights offering. Under the rights offering, the Company distributed at no cost, 360,000 non-transferable subscription rights to subscribe for, on a per right basis, two 10% Convertible Senior Bonds par \$100 due May 2, 2021 (the "Notes"), to shareholders of the Company's Common Stock on October 15, 2015, the record date for the offering. Each whole subscription right entitled the participant to purchase two convertible bonds at a purchase price of \$100 per bond. Effective October 21, 2015, the Company executed a Supplemental Indenture, as issuer, with the American Stock Transfer & Trust Company, LLC, a New York limited liability trust company ("AST"), as trustee for the Notes (the "Indenture").

On March 31, 2016, the rights offering terminated.

On May 2, 2016, the Company issued approximately \$3,470,000 aggregate principal amount of convertible bonds or "Notes" in connection with the rights offering. The Company received net proceeds of approximately \$3,334,000, from the issuance of the Notes, after deducting fees and expenses of \$136,000 incurred in connection with the offering. These costs have been discounted as deferred offering costs.

The Notes contain a convertible option that gives rise to a derivative liability, which is accounted for separately from the Notes (see below and Note 6). Accordingly, the Notes were initially recognized at fair value of approximately \$1,844,000, which represents the principal amount of \$3,470,000 from which a debt discount of approximately \$1,626,000 (which is equal to the fair value of the convertible option) was deducted.

During the three months ended March 31, 2020 and 2019, the Company recorded approximately \$6,000 and \$6,000, respectively, in amortization expense related to the deferred financing costs, approximately \$116,000 and \$93,000, respectively, in debt discount amortization net, and approximately \$4,000 and \$1,000, respectively, related to financing gains associated with Notes converted to shares. The Notes are governed by the terms of the Indenture. The Notes are senior unsecured obligations of the Company and bear interest at a rate of 10% per year, payable annually in arrears on May 2 of each year, commencing May 2, 2017. The Notes will mature on May 2, 2021, unless earlier redeemed by the Company or converted by the holder.

Interest and principal may be paid, at the Company's option, in cash or in shares of the Company's Common Stock. The number of shares for the payment of interest in shares of Common Stock, in lieu of the cash amount, will be based on the average of the closing prices of the Company's Common Stock as reported by Bloomberg L.P. for the 30 trading days preceding the record date for the payment of interest; such record date has been designated and will always be the 10th business day prior to the interest payment date on May 2 of each year. The number of shares for the payment of principal, in lieu of the cash amount, shall be based upon the average of the closing price of the Company's Common Stock as reported by Bloomberg L.P. for the 30 trading days preceding the principal repayment date; such record date has been designated as the trading day immediately prior to the 30-day period preceding the maturity date of May 2, 2021. Fractional shares were not issued, and the final number of shares were rounded up to the next whole share.

On May 4, 2020, the Company paid its annual 10% interest to its bondholders of record on April 20, 2020. The interest was paid-in-kind ("PIK") in the form of Common Stock. An average of the Company stock price of \$0.182 was determined based on the 30 trading days prior to the record date of April 20, 2020. This figure was used to divide into 10% of the par value of the bonds held by the holders. The Company issued 1,781,504 shares to the accounts of its bondholders.

At any time prior to the close of business on the business day immediately preceding April 2, 2021, holders may convert their notes into Common Stock at the conversion rate of 44 shares per \$100 bond (which is equivalent to a conversion rate of approximately \$2.27 per share). The conversion rate is subject to adjustment from time to time upon the occurrence of certain events, including, but not limited to, the issuance of stock dividends and payment of cash dividends.

Beginning May 3, 2018, the Company was entitled to redeem for cash the outstanding Notes at an amount equal to the principal and accrued and unpaid interest, plus a 10% premium. No "sinking fund" is provided for the Notes due May 2, 2021, which means that the Company is not required to periodically redeem or retire the Notes due May 2, 2021.

Zion Oil & Gas, Inc.

Consolidated Condensed Notes to Financial Statements (Unaudited)

Note 5 - Senior Convertible Bonds (cont'd)

Through the three months ended March 31, 2020 and 2019, approximately 39 and 10 convertible bonds of \$100 each, respectively, have been converted at a conversion rate of approximately \$2.27 per share. As a result, the Company issued approximately 1,700 and 440 shares of its Common Stock during the same period, respectively, and recorded approximately \$4,000 and \$1,000 in financial income during the same period.

| | March 31, 2020 | December 31, 2019 |
|--|---------------------------|------------------------------|
| | US\$ | US\$ |
| | thousands | thousands |
| 10% Senior Convertible Bonds, on the day of issuance | \$ 3,470 | \$ 3,470 |
| Unamortized Debt discount, net | \$ (523) | \$ (639) |
| Bonds converted to shares | \$ (224) | \$ (221) |
| Offering cost, net | \$ (30) | \$ (36) |
| 10% senior Convertible bonds – Long Term Liability | \$ 2,693 | \$ 2,574 |

Capitalized interest for the three months ended March 31, 2020 and 2019, was \$20,000 and \$10,000, respectively.

Interest expenses for the three months ended March 31, 2020 and 2019, was \$61,000 and \$71,000, respectively.

Note 6 - Derivative Liability

The Notes issued by the Company and discussed in Note 5 contain a convertible option that gives rise to a derivative liability.

The debt instrument the Company issued includes a make-whole provision, which provides that in the event of conversion by the investor under certain circumstances, the issuer is required to deliver to the holder additional consideration beyond the settlement of the conversion obligation.

Because time value make-whole provisions are not clearly and closely related to the debt host and would meet the definition of a derivative if considered freestanding, they are evaluated under the indexation guidance to determine whether they would be afforded the scope exception pursuant to ASC 815-10-15-74(a). This evaluation is generally performed in conjunction with the analysis of the embedded conversion feature.

The Company has measured its derivative liability at fair value and recognized the derivative value as a current liability and recorded the derivative value on its balance sheet. Changes in the fair value recorded are recorded as a gain or loss in the accompanying statement of operations.

The valuation of the Notes was done by using the Binomial Model, a well-accepted option-pricing model, and based on the Notes' terms and other parameters the Company identified as relevant for the valuation of the Notes' Fair Value.

The Binomial Model used the forecast of the Company share price during the Note's contractual term.

As of March 31, 2020, the Company's liabilities that are measured at fair value are as follows:

| | March 31, 2020 | | December 31, 2019 | |
|------------------------------------|---------------------------|------------------|------------------------------|------------------|
| | Level 3 | Total | Level 3 | Total |
| | US\$ | US\$ | US\$ | US\$ |
| | thousands | thousands | thousands | thousands |
| Fair value of derivative liability | 113 | 113 | 129 | 129 |

Zion Oil & Gas, Inc.

Consolidated Condensed Notes to Financial Statements (Unaudited)

Note 6 - Derivative Liability (cont'd)

Change in value of the derivative liability during 2020 is as follows:

| | <u>US\$ thousands</u> |
|--|---------------------------|
| Derivative liability fair value at December 31, 2019 | 129 |
| Gain on derivative liability | (16) |
| Derivative liability fair value at March 31, 2020 | <u>113</u> |

The following table presents the assumptions that were used for the model as of March 31, 2020:

| | <u>March 31, 2020</u> | <u>December 31, 2019</u> |
|--|---------------------------|------------------------------|
| Convertible Option Fair Value of approximately | \$ 113,000 | \$ 129,000 |
| Annual Risk-free Rate | 0.17% | 1.59% |
| Volatility | 115.23% | 121.68% |
| Expected Term (years) | 1.09 | 1.34 |
| Convertible Notes Face Value | \$3,245,600 | \$ 3,249,500 |
| Expected annual yield on Regular Notes | 28.77% | 28.77% |
| Price of the Underlying Stock | \$ 0.17 | \$ 0.17 |

During the three months ended March 31, 2020, and 2019, the Company recorded unrealized gains (losses) of approximately \$16,000, net, and (\$378,000), net, respectively, within the Statements of Operations on derivative liability. A slight change in an unobservable input like volatility could have a significant impact on the fair value measurement of the derivative liability.

Note 7 – Right of use leases assets and leases obligations

The Company is a lessee in several non-cancelable operating leases, primarily for transportation and office spaces.

The table below presents the operating lease assets and liabilities recognized on the balance sheets as of March 31, 2020:

| | <u>March 31, 2020</u> | <u>December 31, 2019</u> |
|---|---------------------------|------------------------------|
| | <u>US\$ thousands</u> | <u>US\$ thousands</u> |
| Operating lease assets | \$ 582 | \$ 634 |
| Operating lease liabilities: | | |
| Current operating lease liabilities | \$ 240 | \$ 239 |
| Non-current operating lease liabilities | \$ 377 | \$ 450 |
| Total operating lease liabilities | <u>\$ 617</u> | <u>\$ 689</u> |

Zion Oil & Gas, Inc.

Consolidated Condensed Notes to Financial Statements (Unaudited)

Note 7 – Right of use leases assets and leases obligations (cont'd)

The depreciable lives of operating lease assets and leasehold improvements are limited by the expected lease term.

The Company's leases generally do not provide an implicit rate, and therefore the Company uses its incremental borrowing rate as the discount rate when measuring operating lease liabilities. The incremental borrowing rate represents an estimate of the interest rate the Company would incur at lease commencement to borrow an amount equal to the lease payments on a collateralized basis over the term of a lease within a particular currency environment. The Company used incremental borrowing rates as of January 1, 2019 for operating leases that commenced prior to that date.

The Company's weighted average remaining lease term and weighted average discount rate for operating leases as of March 31, 2020 are:

| | March 31, 2020 |
|---|---------------------------|
| Weighted average remaining lease term (years) | 3.1 |
| Weighted average discount rate | 6.0% |

The table below reconciles the undiscounted future minimum lease payments (displayed by year and in the aggregate) under non-cancelable operating leases with terms of more than one year to the total operating lease liabilities recognized on the consolidated condensed balance sheets as of March 31, 2020:

| | US\$ thousands |
|--|---------------------------|
| April 1, 2020 through December 31, 2020 | 267 |
| 2021 | 158 |
| 2022 | 137 |
| 2023 | 114 |
| 2024 | - |
| Thereafter | - |
| Total undiscounted future minimum lease payments | 676 |
| Less: portion representing imputed interest | (49) |
| Total undiscounted future minimum lease payments | 617 |

Operating lease costs were \$61,000 and \$68,000 for the three months ended March 31, 2020, and 2019, respectively. Operating lease costs are included within general and administrative expenses on the statements of income.

Cash paid for amounts included in the measurement of operating lease liabilities was \$67,000 and \$71,000 for the three months ended March 31, 2020, and 2019, respectively, and this amount is included in operating activities in the statements of cash flows. Right-of-use assets obtained in exchange for new operating lease liabilities were \$0 and \$824,000 for the three months ended March 31, 2020 and 2019, respectively.

Zion Oil & Gas, Inc.

Consolidated Condensed Notes to Financial Statements (Unaudited)

Note 8 - Commitments and Contingencies

A. Securities and Exchange Commission (“SEC”) Investigation

As previously disclosed by the Company, on June 21, 2018, Zion received a subpoena to produce documents from the Fort Worth office of the SEC informing the Company of the existence of a non-public, fact-finding inquiry into the Company. Prior to the receipt of the subpoena on June 21, 2018, Zion had no previous communication with the SEC on this issue and was unaware of this investigation. The SEC stated that “the investigation and the subpoena do not mean that we have concluded that Zion or anyone else has violated the law.” To date, Zion has furnished all required documents to the SEC and will continue to fully cooperate with the investigation.

The Company cannot predict when this matter will be resolved or what further action, if any, the SEC may take in connection with it.

B. Litigation

Following the commencement of the SEC investigation, on August 9, 2018, a putative class action (the “class action”) Complaint was filed against Zion, Victor G. Carrillo, the Company’s Chief Executive Officer at such time, and Michael B. Croswell Jr., the Company’s Chief Financial Officer (collectively, the “Defendants”) in the U.S. District Court for the Northern District of Texas. On November 16, 2018, the Court entered an Order in the class action appointing lead plaintiffs and approving lead counsel and on January 22, 2019, an Amended Complaint was filed. On February 1, 2019, a Corrected Amended Class Action Complaint was filed. The suit alleges violations of Section 10(b) of the Securities Exchange Act of 1934 (the “Exchange Act”) and Rule 10b-5 promulgated thereunder by the SEC and Section 11 of the Securities Act of 1933 (the “Securities Act”) against all defendants and alleges violations of Section 20(a) of the Exchange Act and Section 15 of the Securities Act against the individual defendants. The alleged class period is from February 13, 2018 through November 20, 2018. On March 13, 2019, a Motion to Dismiss Plaintiffs’ Corrected Amended Complaint was filed on behalf of Zion, Victor Carrillo and Michael B. Croswell, Jr., pleading numerous grounds in support of their Motion to Dismiss. On April 29, 2019 Plaintiffs filed a Response to Defendants’ Motion to Dismiss, and on May 29, 2019 Defendants filed a Reply to Plaintiffs’ Response. On March 4, 2020, the Court granted Defendants’ Motion and dismissed all claims granting Plaintiffs leave to amend. On March 30, 2020, the Lead Plaintiffs voluntarily dismissed the Class Action with prejudice as to the Company and all other defendants.

The Company disputed the above claims and made an advance deposit of \$500,000 in 2018 to defense counsel for the cost of defending the litigation. The Company carries insurance that is applicable to these claims. As of March 31, 2020, the Company is owed \$140,000 from its defense counsel pertaining to the above legal claims.

On October 29, 2018, Zion received a shareholder request to inspect books and records pursuant to Section 220 of the Delaware General Corporation Law for the purpose of investigating potential corporate mismanagement and alleged breaches of fiduciary duty in connection with public statements made by the Company from March 12, 2018 to May 30, 2018. The Company responded to this request.

On August 10, 2019, Zion received two (2) additional shareholder requests from the same law firm to inspect books and records pursuant to section 220 of the Delaware General Corporation Law for the purpose of investigating potential corporate mismanagement and alleged breaches of fiduciary duty in connection with public statements made by the Company from February 1, 2018 to present. Following discussion with counsel to the shareholder, the Company’s counsel produced materials responsive to the shareholders’ request in January 2020.

On February 12, 2020, by letter to Zion’s Board of Directors, one of the shareholders making the August 10, 2019 request demanded that the Board investigate, address, remedy, and commence proceedings against certain of the Company’s current and former officers and directors for alleged breaches of fiduciary duties, violations of section 10(b) and 20(a) of the Exchange Act, waste of corporate assets, unjust enrichment, and violations of all other applicable laws. The shareholder alleges wrongdoing in connection with public statements made by the Company from February 1, 2018 regarding the Company’s oil and gas exploration activities, the Company’s accounting and disclosure of expenses, and the Board’s oversight of operations. The Board has hired an outside firm to investigate the claims made against certain of the Company’s current and former officers and directors.

From time to time, the Company may also be subject to routine litigation, claims or disputes in the ordinary course of business. The Company defends itself vigorously in all such matters. However, we cannot predict the outcome or effect of any of the litigation or any other pending litigation or claims.

C. Recent Market Conditions – Coronavirus Pandemic

During March 2020, a global pandemic was declared by the World Health Organization related to the rapidly growing outbreak of a novel strain of coronavirus (“COVID-19”). The pandemic has significantly impacted the economic conditions in the United States, with accelerated effects in February and March, as federal, state and local governments react to the public health crisis, creating significant uncertainties in the United States and world economies. In the interest of public health and safety, jurisdictions (international, national, state and local) where we have operations, required workforces to work from home. As of the date of this report, our employees are working from home.

However, while there are various uncertainties to navigate, the Company's business activities are continuing. The situation is rapidly changing and additional impacts to the business may arise that we are not aware of currently. We cannot predict whether, when or the manner in which the conditions surrounding COVID-19 will change including the timing of lifting any restrictions or work from home arrangements.

Zion Oil & Gas, Inc.

Consolidated Condensed Notes to Financial Statements (Unaudited)

Note 8 - Commitments and Contingencies (cont'd)

The full extent of COVID-19's impact on our operations and financial performance depends on future developments that are uncertain and unpredictable, including the duration and spread of the pandemic, its impact on capital and financial markets and any new information that may emerge concerning the severity of the virus, its spread to other regions as well as the actions taken to contain it, among others.

C. Environmental and Onshore Licensing Regulatory Matters

The Company is engaged in oil and gas exploration and production and may become subject to certain liabilities as they relate to environmental clean-up 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. Various guidelines have been published in Israel by the State of Israel's Petroleum Commissioner and Energy and Environmental Ministries as it pertains to oil and gas activities. Mention of these older guidelines was included in previous Zion filings.

On April 8, 2019 the Energy Ministry issued new procedural guidelines regarding a uniform reporting manner by which the rights holder in a license must submit a quarterly report regarding a summary of license history, the nature, scope, location and results of the exploration work, specification of the amounts expended for the exploration work, and the results and interpretation of the exploration work and basic data on which these results and interpretation are based. The guidelines will be binding as from the date of submission of the report for the third quarter 2019.

On July 18, 2019, the Energy Ministry issued a guidance document entitled "Instructions for Submitting Guarantees with respect to Oil Rights granted pursuant to the Petroleum Law" which states that onshore license applicants are required to deposit a base bank guarantee of \$500,000. Furthermore, prior to drilling, an onshore license holder is required to deposit an additional bank guarantee in the amount as determined by the Petroleum Commissioner in accordance with the characteristics of the drilling and the drilling plan but no less than \$250,000. The guarantee, as determined by the Commissioner, shall be deposited with the Commissioner Office for each well separately drilled. The Petroleum Commissioner has discretion to raise or lower those amounts or may also forfeit a Company's existing guarantee and/or cancel a petroleum right under certain circumstances.

In addition, new and extended insurance policy guidelines were added. The Petroleum Commissioner may also view non-compliance with the new insurance provisions as breaching the work plan and the rights granted and act accordingly.

The Company believes that these new regulations are likely to result in an increase in the expenditures associated with obtaining new exploration rights and drilling new wells. The Company expects that an additional financial burden could occur as a result of requiring cash reserves that could otherwise be used for operational purposes. In addition, these new regulations are likely to continue to increase the time needed to obtain all of the necessary authorizations and approvals to drill and production test exploration wells.

D. Bank Guarantees

As of March 31, 2020, the Company provided Israeli-required bank guarantees to various governmental bodies (approximately \$1,009,000) and others (approximately \$84,000) with respect to its drilling operation in an aggregate amount of approximately \$1,093,000. The Company also paid \$1,000,000 to its escrow agent with respect to the purchase of a drilling rig in March 2020. The (cash) funds backing these guarantees are held in restricted interest-bearing accounts and are reported on the Company's balance sheets as fixed short-term bank deposits – restricted.

E. Risks

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. During the period January 1, 2020 through March 31, 2020, the USD has fluctuated by approximately 3.2% against the NIS (the USD has strengthened relative to the NIS). By contrast, during the period January 1, 2019 through December 31, 2019, the USD fluctuated by approximately 7.8% against the NIS (the USD weakened relative to the NIS). Continued strengthening of the US dollar against the NIS will result in lower 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 March 31, 2020, we had cash, cash equivalents and short-term bank deposits of approximately \$7,544,000. The weighted average annual interest rate related to our cash and cash equivalents for the three months ended March 31, 2020, exclusive of funds at US banks that earn no interest, was approximately .52%.

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.

Note 9 - Subsequent Events

(i) Approximately \$1,404,000 was collected through the Company's DSPP program during the period April 1 through May 6, 2020.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

THE FOLLOWING DISCUSSION SHOULD BE READ IN CONJUNCTION WITH OUR UNAUDITED INTERIM FINANCIAL STATEMENTS AND THE RELATED NOTES TO THOSE STATEMENTS INCLUDED IN THIS FORM 10-Q. SOME OF OUR DISCUSSION IS FORWARD-LOOKING AND INVOLVES RISKS AND UNCERTAINTIES. FOR INFORMATION REGARDING RISK FACTORS THAT COULD HAVE A MATERIAL ADVERSE EFFECT ON OUR BUSINESS, REFER TO THE DISCUSSION OF RISK FACTORS IN THE "DESCRIPTION OF BUSINESS" SECTION OF OUR ANNUAL REPORT ON FORM 10-K FOR THE YEAR ENDED DECEMBER 31, 2019, FILED WITH THE SECURITIES AND EXCHANGE COMMISSION.

Forward-Looking Statements

Certain statements made in this discussion are "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. These statements may materially differ from actual results.

Forward-looking statements can be identified by terminology such as "may", "should", "expects", "intends", "anticipates", "believes", "estimates", "predicts", or "continue" or the negative of these terms or other comparable terminology and include, without limitation, statements regarding:

- The going concern qualification in our financial statements;
- our liquidity and our ability to raise capital to finance our overall exploration and development activities within our license area;
- our ability to meet the requisite listing requirements by Nasdaq to regain compliance and remain listed on the Nasdaq Capital Market;
- the outcome of the current SEC investigation;
- our ability to obtain new license areas to continue our petroleum exploration program;
- interruptions and other adverse impacts of the coronavirus pandemic on our planned operations and our capital raising efforts, including those related to the importation into Israel of our newly acquired drilling rig and the operating crew necessary to operate the rig;
- our ability to explore for and develop natural gas and oil resources successfully and economically within our license areas;
- our ability to maintain or obtain new exploration license rights to continue our petroleum exploration program;
- the availability of equipment, such as seismic equipment, drilling rigs, and production equipment;
- the impact of governmental regulations, permitting and other legal requirements in Israel relating to onshore exploratory drilling;
- our estimates of the time frame within which future exploratory activities will be undertaken;
- changes in our exploration 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 capital expenditure program;
- future market conditions in the oil and gas industry
- the demand for oil and natural gas, both locally in Israel and globally; and
- The impact of falling oil and gas prices on our exploration efforts.

Overview

Zion Oil and Gas, Inc., a Delaware corporation, is an oil and gas exploration company with a history of 20 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, par value \$0.01 per share (the “Common Stock”) currently trades on the Nasdaq Capital Market under the symbol “ZN” and our Common Stock warrant under the symbol “ZNWAA.”

The Company currently holds one active petroleum exploration license onshore Israel, the Megiddo-Jezreel License, comprising approximately 99,000 acres. The Megiddo Jezreel #1 (“MJ #1”) site was completed in early March 2017, after which the drilling rig and associated equipment were mobilized to the site. Performance and endurance tests were completed, and the MJ #1 exploratory well was spud on June 5, 2017 and drilled to a total depth (“TD”) of 5,060 meters (approximately 16,600 feet). Thereafter, the Company obtained three open-hole wireline log suites (including a formation image log), and the well was successfully cased and cemented. The Ministry of Energy approved the well testing protocol on April 29, 2018. The Megiddo-Jezreel License is scheduled to expire on December 2, 2020.

During the fourth quarter of 2018, the Company testing protocol was concluded at the MJL well. The test results confirmed that the MJ #1 well did not contain hydrocarbons in commercial quantities in the zones tested. As a result, in the year ended December 31, 2018, the Company recorded a non-cash impairment charge to its unproved oil and gas properties of \$30,906,000. During the three months ended March 31, 2020, and 2019, the Company recorded a post-impairment charge of approximately \$0 and \$163,000, respectively.

While the well was not commercially viable, Zion learned a great deal from the drilling and testing of this well. We believe that the drilling and testing of this well carried out the testing objectives which may support further evaluation and potential further exploration efforts within our License area.

As a result of the information gained drilling the MJ#1 well, Zion believed it was prudent and consistent with good industry practice to try and answer some of the questions raised by the drilling with a focused 3D seismic imaging shoot of approximately 72 square kilometers surrounding the MJ#1 well. See the discussion under Summary of Current and Former Company License Areas.

At present, we have no revenues or operating income. 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 12655 North Central Expressway, Suite 1000, Dallas, Texas 75243, and our telephone number is (214) 221-4610. Our branch office’s address in Israel is 9 Halamish Street, North Industrial Park, Caesarea 3088900, and the telephone number is +972-4-623-8500. Our website address is: www.zionoil.com.

Current Exploration and Operation Efforts

Megiddo-Jezreel Petroleum License

The Company currently holds one active petroleum exploration license onshore Israel, the Megiddo-Jezreel License, comprising approximately 99,000 acres, which is scheduled to terminate on December 2, 2020.

The Megiddo Jezreel #1 (“MJ #1”) exploratory well was spud on June 5, 2017 and drilled to a total depth (“TD”) of 5,060 meters (approximately 16,600 feet). Thereafter, the Company successfully cased and cemented the well while awaiting the approval of the testing protocol. The Ministry of Energy approved the well testing protocol on April 29, 2018.

During the fourth quarter of 2018, the Company testing protocol was concluded at the MJL well. The test results confirmed that the MJ #1 well did not contain hydrocarbons in commercial quantities in the zones tested. As a result, in the year ended December 31, 2018, the Company recorded a non-cash impairment charge to its unproved oil and gas properties of \$30,906,000. During the three months ended March 31, 2020, and 2019, the Company recorded a post-impairment charge of approximately \$0 and \$163,000, respectively.

The MJ#1 well provided Zion with information Zion believes is important for potential future exploration efforts within its license area. As with many frontier wildcat wells, the MJ#1 also left several questions unanswered.

While not meant to be an exhaustive list, a summary of what Zion believes to be key information learned in the MJ#1 well is as follows:

1. The MJ#1 encountered much higher subsurface temperatures at a depth shallower than expected before drilling the well. In our opinion, this is significant because reaching a minimum temperature threshold is necessary for the generation of hydrocarbons from an organic-rich source rock.
2. The known organic rich (potentially hydrocarbon bearing) Senonian age source rocks that are typically present in this part of Israel were not encountered as expected. Zion expected these source rocks to be encountered at approximately 1,000 meters in the MJ#1 well.
3. MJ#1 had natural fractures, permeability (the ability of fluid to move through the rock) and porosity (pore space in rock) that allowed the sustained flow of formation fluid in the shallower Jurassic and lower Cretaceous age formations between approximately 1,200 and 1,800 meters. While no hydrocarbons were encountered, Zion believes this fact is nonetheless significant because it provides important information about possible reservoir pressures and the ability of fluids to move within the formation and to the surface.
4. MJ#1 encountered oil in the Triassic Mohilla formation which Zion believes suggests an active deep petroleum system is in Zion’s license area. There was no natural permeability or porosity in the Triassic Mohilla formation to allow formation fluid to reach the surface naturally during testing and thus the MJ#1 was not producible or commercial.
5. The depths and thickness of the formations we encountered varied greatly from pre-drill estimates. This required the MJ#1 to be drilled to a much greater depth than previously expected. Zion has tied these revised formation depths to seismic data which will allow for more accurate interpretation and mapping in the future.

A summary of what Zion believes to be some key questions left to be answered are:

1. Is the missing shallow Senonian age source rock a result of regional erosion, or is it missing because of a fault that cut the well-bore and could be reasonably expected to be encountered in the vicinity of the MJ#1 drill site? Zion believes this is an important question to answer because if the Senonian source rocks do exist in this area, the high temperatures encountered are sufficient to mature these source rocks and generate oil.
2. Do the unusually high shallow subsurface temperatures extend regionally beyond the MJ#1 well, which could allow for the generation of hydrocarbons in the Senonian age source rock within our license area?
3. As a consequence of seismic remapping, where does the MJ#1 well lie relative to the potential traps at the Jurassic and Triassic levels and was the well location too low on the structures and deeper than the potential hydrocarbons within those traps?

Zion completed all of the land compensation for the 3-D survey in November 2019. All land parcels and the kibbutz have approved the completion of the geophysical survey. Subsequently, the Contractor demobilized the equipment from Israel to Europe. All field data from acquisition was delivered to Dallas, Texas and the Ministry of Energy in Israel. Additionally, the final acquisition reports from the Contractor and Zion were delivered to the Ministry of Energy in December 2019 per the guidelines enacted in July 2019.

Zion and Agile Seismic Processing Services (“ASPS”) are continuing to process and interpret the data set with state-of-the-art technologies allowing for comprehensive imaging at depth. Zion’s previous 2-D data sets have been added into the 3-D volume allowing for further verification. Our estimated completion date for the final volume is mid-May 2020 due to circumstances brought on by the coronavirus pandemic which are beyond the control of both Zion and ASPs. While both parties are continuing to review and finalize the data, the timeframes are lengthened due to the current work environment. Our questions from the MJ#1 well are being correlated with the 3-D data set to provide potential solutions on a go forward basis.

On March 12, 2020, Zion entered into a Purchase and Sale Agreement with Central European Drilling kft, a Hungarian corporation, to purchase an onshore oil and gas drilling rig, drilling pipe, related equipment and excess inventory for a purchase price of \$5.6 million in cash, subject to acceptance testing and potential downward adjustment. We remitted to the Seller \$250,000 on February 6, 2020 as earnest money towards the purchase price. The Closing also took place on March 12, 2020 by the execution and delivery of a Bill of Sale to us. On March 13, 2020, the Seller retained the earnest money deposit, and the Company remitted \$4,350,000 to the seller towards the purchase price and \$1,000,000 (the “Holdback Amount”) was deposited in escrow with American Stock Transfer and Trust Company LLC, as escrow agent, through July 10, 2020, or as extended by mutual agreement of the parties, pending a determination, if any, by us of any operating deficiency in the drilling rig. Should we determine in our sole opinion that the drilling rig is not in satisfactory operating condition, then upon notice to the Seller, we and the Seller shall jointly determine if the operating deficiencies identified by us existed prior to the closing of the transaction. If it is determined that these deficiencies existed prior to the closing, then the Seller will undertake to cure the deficiencies within a reasonable time period. If the Seller is unable or unwilling to cure the deficiencies within the time period agreed to between the parties, we may solicit third party bids to repair the deficiencies and the cost thereof shall be paid out of the Holdback Amount.

Zion's ability to fully undertake all of these aforementioned activities is subject to its raising the needed capital from its continuing offerings, of which no assurance can be provided.



Map 1. Zion's Megiddo-Jezreel Petroleum Exploration License as of March 31, 2020.

The Megiddo-Jezreel 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 lies onshore, south and west of the Sea of Galilee, and we continue our exploration focus here as it appears to possess the key geologic ingredients of an active petroleum system with significant exploration potential. In November 2016, the State of Israel's Petroleum Commission officially approved Zion's drilling date and license extension request to December 2, 2017. The current scheduled termination date is December 2, 2020.

On January 31, 2019, Zion submitted its Application for Extension of Continued Work Program Due Date on the Megiddo-Jezreel License No. 401. The additional time was necessary to finalize the work program. On February 3, 2019 Israel's Petroleum Commissioner granted Zion's work program report extension to February 28, 2019, as shown below:

| Number | Activity Description | Execution by: |
|---------------|---|----------------------|
| 1 | Submit program for continuation of work under license | 28 February 2019 |

On February 24, 2019 and thereafter on February 26, 2019 Zion submitted its proposed 2019 Work Program on the Megiddo-Jezreel License No. 401.

On February 28, 2019 Israel's Petroleum Commissioner officially approved the revised and updated Work Program on the Megiddo-Jezreel License No. 401 as shown below:

| Number | Activity description | Execution by: |
|---------------|--|----------------------|
| 1 | Submission of seismic survey plan to the Commissioner and execution of an agreement with a contractor to perform | 30 April 2019 |
| 2 | Commence 3D seismic survey in an area of approximately 50 square kilometers | 1 August 2019 |
| 3 | Transfer of field material configuration and processed material to the Ministry pursuant to Ministry guidelines | 15 December 2019 |
| 4 | Submit interpretation report | 20 February 2020 |

On April 30, 2019 Zion submitted its Application for Extension of Continued Work Program Due Date on the Megiddo-Jezreel License No. 401. The additional time was necessary for Zion to conduct a 3-D survey in an area of approximately 72 square kilometers. This required, among others, extensive permitting activities with relevant local landowners, the ILA, certain authorities and others, and the seismic survey area may not conclude prior to the beginning of the rainy season in Israel. This in turn would result in additional delay, as rain and mud are not conducive to the performance of a seismic survey which includes extensive use of vibrators.

Zion's proposed new timelines and activity descriptions are shown below:

| Number | Activity description | Execution by: |
|---------------|--|----------------------|
| 1 | Submission of seismic survey plan to the Commissioner and execution of an agreement with a contractor to perform | 30 November 2019 |
| 2 | Commence 3D seismic survey in an area of approximately 72 square kilometers | 1 April 2020 |
| 3 | Transfer of field material configuration and processed material to the Ministry pursuant to Ministry guidelines | 15 August 2020 |
| 4 | Submit interpretation report | 15 November, 2020 |

On May 1, 2019, Israel's Petroleum Commissioner granted Zion's work program report extension.

As previously disclosed, the Company required authorization from the ILA, the formal lessor of the land to Kibbutz Sde Eliyahu, on whose property the drilling pad is currently situated, to access and utilize the drill site ("surface use agreement"). The Company received this authorization on July 4, 2016. This was preceded by the Company's May 15, 2016 signed agreement with the kibbutz. On January 11, 2017, an agreement was signed by the Company and the ILA by which the surface usage agreement was extended through December 3, 2017. On December 31, 2017, an agreement was signed by the Company and the ILA by which the surface usage agreement was extended through December 3, 2019. On July 1, 2019, an agreement was signed by the Company and the ILA by which the surface usage agreement was extended through December 3, 2020.

Zion's Former Joseph License

Zion has plugged all of its exploratory wells on its former Joseph License area, and the reserve pits have been evacuated, but acknowledges its obligation to complete the abandonment of these well sites in accordance with guidance from the Energy Ministry, Environmental Ministry and local officials.

Onshore Licensing, Oil and Gas Exploration and Environmental Guidelines

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. Various guidelines have been published in Israel by the State of Israel’s Petroleum Commissioner, the Energy Ministry, and the Environmental Ministry in recent years as it pertains to oil and gas activities. Mention of these guidelines was included in previous Zion Oil & Gas filings.

We acknowledge that these new regulations are likely to increase the expenditures associated with obtaining new exploration rights and drilling new wells. The Company expects that additional financial burdens could occur as a result of the Ministry requiring cash reserves that could otherwise be used for operational purposes.

Capital Resources Highlights

We need to raise significant funds to finance the continued exploration efforts and maintain orderly operations. To date, we have funded our operations through the issuance of our securities and convertible debt. We will need to continue to raise funds through the issuance of equity and/or debt securities (or securities convertible into or exchangeable for equity securities). No assurance can be provided that we will be successful in raising the needed capital on terms favorable to us (or at all).

The Dividend Reinvestment and Stock Purchase Plan

On March 13, 2014 Zion filed a registration statement on Form S-3 that is part of a replacement registration statement that was filed with the SEC using a “shelf” registration process. The registration statement was declared effective by the SEC on March 31, 2014. On February 23, 2017, the Company filed a Form S-3 with the SEC (Registration No. 333-216191) as a replacement for the Form S-3 (Registration No. 333-193336), for which the three year period ended March 31, 2017, along with the base Prospectus and Supplemental Prospectus. The Form S-3, as amended, and the new base Prospectus became effective on March 10, 2017, along with the Prospectus Supplement that was filed and became effective on March 10, 2017. The Prospectus Supplement under Registration No. 333-216191 describes the terms of the DSPP and replaces the prior Prospectus Supplement, as amended, under the prior Registration No. 333-193336.

On March 27, 2014, we launched our Dividend Reinvestment and Stock Purchase Plan (the “DSPP”) pursuant to which stockholders and interested investors can purchase shares of the Company’s Common Stock as well as units of the Company’s securities directly from the Company. The terms of the DSPP are described in the Prospectus Supplement originally filed on March 31, 2014 (the “Original Prospectus Supplement”) with the Securities and Exchange Commission (“SEC”) under the Company’s effective registration Statement on Form S-3, as thereafter amended.

Please see Footnote 3E (“Dividend Reinvestment and Stock Purchase Plan (“DSPP”)), which is a part of this Form 10-Q filing, for details about specific unit programs, dates, and filings during the years 2015 through 2020.

For the three months ended March 31, 2020, approximately \$9,109,000 was raised under the DSPP program.

The Warrants balances at December 31, 2019 and transactions since January 1, 2020 are shown in the table below:

| Warrants | Exercise Price | Warrant Termination Date | Outstanding Balance, 12/31/2019 | Warrants Issued | Warrants Exercised | Warrants Expired | Outstanding Balance, 03/31/2020 |
|----------------------|----------------|--------------------------|---------------------------------|-----------------|--------------------|------------------|---------------------------------|
| ZNWAA | \$ 2.00 | 01/31/2021 | 1,498,804 | - | - | - | 1,498,804 |
| ZNWAD | \$ 1.00 | 05/02/2021 | 243,853 | - | - | - | 243,853 |
| ZNWAE | \$ 1.00 | 05/02/2021 | 2,144,470 | - | (196) | - | 2,144,274 |
| ZNWF | \$ 1.00 | 08/14/2021 | 359,585 | - | - | - | 359,585 |
| ZNWAG | \$ 1.00 | 01/08/2021 | 240,578 | - | - | - | 240,578 |
| ZNWAH | \$ 5.00 | 04/19/2021 | 372,400 | - | - | - | 372,400 |
| ZNWAI | \$ 3.00 | 06/29/2021 | 640,730 | - | - | - | 640,730 |
| ZNWAJ | \$ 1.00 | 10/29/2021 | 546,000 | - | - | - | 546,000 |
| ZNWAK | \$ 0.01 | 02/25/2021 | 457,725 | - | (6,250) | - | 451,475 |
| ZNWAL | \$ 2.00 | 08/26/2021 | 517,925 | - | - | - | 517,925 |
| Outstanding warrants | | | 7,022,070 | - | (6,446) | - | 7,015,624 |

According to the warrant table, the Company could potentially raise up to approximately \$11,356,000 if all outstanding warrants were exercised by its holders.

10% Senior Convertible Notes due May 2, 2021

Please see Footnote 5 (“Senior Convertible Bonds”), which is a part of this Form 10-Q filing, for a description and details about the Bonds.

2018 Subscription Rights Offering

Please see Footnote 3F (“Subscription Rights Offering”), which is a part of this Form 10-Q filing, for a description of and details about the Subscription Rights Offering.

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 is included in general and administrative expenses. General and administrative expenses also include 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 represents a principal component of our cost structure. 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.

Going Concern Basis

Since we have limited capital resources, no revenue to date and a loss from operations, our financial statements have been prepared on a going concern basis, which contemplates realization of assets and liquidation of liabilities in the ordinary course of business. The appropriateness of using the going concern basis is dependent upon our ability to obtain additional financing or equity capital and, ultimately, to achieve profitable operations. Therefore, there is substantial doubt about our ability to continue as a going concern. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

Critical Accounting Policies

Management’s discussion and analysis of financial condition and results of operations is based upon our 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.

During the fourth quarter of 2018, the Company's testing protocol was concluded at the MJ #1 well. The test results confirmed that the MJ #1 well did not contain hydrocarbons in commercial quantities in the zones tested. As a result of the above determination, in the year ended December 31, 2018, the Company recorded a non-cash impairment charge to its unproved oil and gas properties of \$30,906,000 (see Note 4). During the three months ended March 31, 2020, and 2019, the Company recorded a post-impairment charge of approximately \$0 and \$163,000, respectively.

The total net book value of our unproved oil and gas properties under the full cost method was \$10,860,000 at March 31, 2020.

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.

Fair Value Considerations

We follow ASC 820, "Fair Value Measurements and Disclosures," as amended by Financial Accounting Standards Board (FASB) Financial Staff Position (FSP) No. 157 and related guidance. Those provisions relate to the Company's financial assets and liabilities carried at fair value and the fair value disclosures related to financial assets and liabilities. ASC 820 defines fair value, expands related disclosure requirements, and specifies a hierarchy of valuation techniques based on the nature of the inputs used to develop the fair value measures. Fair value is defined as the price that would be received from the sale of an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, assuming the transaction occurs in the principal or most advantageous market for that asset or liability.

There are three levels of inputs to fair value measurements - Level 1, meaning the use of quoted prices for identical instruments in active markets; Level 2, meaning the use of quoted prices for similar instruments in active markets or quoted prices for identical or similar instruments in markets that are not active or are directly or indirectly observable; and Level 3, meaning the use of unobservable inputs. We use Level 1 inputs for fair value measurements whenever there is an active market, with actual quotes, market prices, and observable inputs on the measurement date. We use Level 2 inputs for fair value measurements whenever there are quoted prices for similar securities in an active market or quoted prices for identical securities in an inactive market. We use observable market data whenever available. We use Level 3 inputs in the Binomial Model used for the valuation of the derivative liability.

Derivative Liabilities

In accordance with ASC 815-40-25 and ASC 815-10-15 Derivatives and Hedging and ASC 480-10-25 Liabilities-Distinguishing Liabilities from Equity, the embedded derivatives associated with the Convertible Bonds are accounted for as liabilities during the term of the related Convertible Bonds.

RESULTS OF OPERATIONS

| | For the three months ended March 31, | |
|---|---|---------------------|
| | 2020 | 2019 |
| | (US \$ in thousands) | |
| Operating costs and expenses: | | |
| General and administrative expenses | 975 | 926 |
| Impairment of unproved oil and gas properties | - | 163 |
| Other | 468 | 555 |
| Subtotal Operating costs and expenses | <u>1,443</u> | <u>1,644</u> |
| (Gain) loss on derivative liability | (16) | 378 |
| Other expense, net | <u>181</u> | <u>148</u> |
| Net loss | <u><u>1,608</u></u> | <u><u>2,170</u></u> |

Revenue. We currently have no revenue generating operations.

Operating costs and expenses. Operating costs and expenses for the three months ended March 31, 2020 were \$1,443,000 compared to \$1,644,000 for the three months ended March 31, 2019. The decrease in operating costs and expenses during the three months ended March 31, 2020 compared to the corresponding period in 2019 is primarily attributable to a decrease in other expenses and a recognition of an impairment charge of \$163,000 during Q1 2019, offset by an increase in general and administrative expenses during the three months ended March 31, 2020 compared to the corresponding period in 2019.

General and administrative expenses. General and administrative expenses for the three months ended March 31, 2020 were \$975,000, compared to \$926,000 for the three months ended March 31, 2019. The increase in General and administrative expenses during the three months ended March 31, 2020 is primarily attributable to higher salary expenses compared to the corresponding period in 2019. These expenses were partially offset by a refund of legal fees due Zion from its defense counsel.

Other expense. Other expense during the three months ended March 31, 2020 was \$468,000, compared to \$555,000 for the three months ended March 31, 2019. Other general and administrative expenses are comprised of non-compensation and non-professional expenses incurred. The decrease in other expenses during the three months ended March 31, 2020 compared to the corresponding period in 2019 is primarily attributable to decreased marketing expenses associated with investor relations activities.

(Gain)loss on derivative liability. (Gain) loss on derivative liability during the three months ended March 31, 2020 was (\$16,000), compared to a loss of \$378,000 for the three months ended March 31, 2019. An embedded derivative is contained within the valuation of Zion's \$100 convertible bond offering which closed in March 2016. The gain on derivative liability during the three months ended March 31, 2020 compared to the loss on derivative liability during the three months ended March 31, 2019 is primarily due to the decrease in the share price of our common stock that occurred during the three months ended March 31, 2020.

Other expense, net. Other expense, net for the three months ended March 31, 2020 was \$181,000, compared to \$148,000 for the three months ended March 31, 2019. The increase in other expense, net during the three months ended March 31, 2020 compared to the corresponding period in 2019 is primarily attributable to exchange rate differences associated with the fluctuating exchange rates of the New Israeli Shekels (“NIS”) with the U.S. Dollar (“USD”) and to financial expenses related to the Company’s convertible bonds.

Net Loss. Net loss for the three months ended March 31, 2020 was \$1,608,000 compared to \$2,170,000 for the three months ended March 31, 2019.

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 as well as proceeds from the exercise of warrants and options to purchase common shares.

Our ability to continue as a going concern is dependent upon obtaining the necessary financing to complete further exploration and development activities and generate profitable operations from our oil and natural gas interests in the future. Our current operations are dependent upon the adequacy of our current assets to meet our current expenditure requirements and the accuracy of management’s estimates of those requirements. Should those estimates be materially incorrect, our ability to continue as a going concern will be impaired. Our financial statements for the three months ended March 31, 2020 have been prepared on a going concern basis, which contemplates the realization of assets and the settlement of liabilities and commitments in the normal course of business. We have incurred a history of operating losses and negative cash flows from operations. Therefore, there is substantial doubt about our ability to continue as a going concern.

At March 31, 2020, we had approximately \$6,454,000 in cash and cash equivalents compared to \$4,845,000 at December 31, 2019, which does not include any restricted funds. Our working capital (current assets minus current liabilities) was \$7,832,000 at March 31, 2020 and \$5,012,000 at December 31, 2019.

As of March 31, 2020, we provided bank guarantees to various governmental bodies (approximately \$1,009,000) and others (approximately \$84,000) in respect of our drilling operation in the aggregate amount of approximately \$1,093,000. The Company also paid \$1,000,000 to its escrow agent with respect to the purchase of a drilling rig in March 2020. The (cash) funds backing these guarantees are held in restricted interest-bearing accounts and are reported on the Company’s balance sheets as fixed short-term bank deposits restricted, and fixed long-term bank deposits restricted.

During the three months ended March 31, 2020, cash used in operating activities totaled \$1,726,000. Cash provided by financing activities during the three months ended March 31, 2020 was \$9,109,000 and is primarily attributable to proceeds received from the Dividend Reinvestment and Stock Purchase Plan (the “DSPP” or “Plan”). Net cash used in investing activities was \$4,774,000 for the three months ended March 31, 2020. This was primarily the result of the purchase of the drilling rig, equipment and inventory totaling \$4,600,000.

We expect to incur additional significant expenditures to further our exploration and development programs. While we raised approximately \$1,000,000 during the period April 1, 2020 through May 4, 2020, we will need to raise additional funds in order to continue our exploration and development activities in our license area. Additionally, we estimate that, when we are not actively drilling a well, our expenditures are approximately \$500,000 per month excluding exploratory operational activities. However, when we are actively drilling a well, we estimate an additional minimum expenditure of approximately \$2,500,000 per month. The above estimates are subject to change. Subject to the qualifications specified below, management believes that our existing cash balance, coupled with anticipated proceeds under the DSPP, will be sufficient to finance our plan of operations through December 2020.

The recent outbreak of the coronavirus has to date significantly disrupted business operations and resulted in significantly increased unemployment in the general economy. The extent to which the coronavirus impacts our operations, specifically our capital raising efforts, as well as our ability to continue our exploratory efforts, will depend on future developments, which are highly uncertain and cannot be predicted with confidence, including the duration of the outbreak, new information which may emerge concerning the severity of the coronavirus and the actions to contain the coronavirus or treat its impact, among others.

No assurance can be provided that we will be able to raise the needed operating capital required to continue our exploratory efforts or maintain orderly operations.

Even if we raise the needed funds, there are factors that can nevertheless adversely impact our ability to fund our operating needs, including (without limitation), unexpected or unforeseen cost overruns in planned non-drilling exploratory work (e.g., seismic acquisition costs, permitting and surface damages and importation of equipment into Israel, etc.) in existing license areas, the costs associated with extended delays in undertaking the required exploratory work, and plugging and abandonment activities which is typical of what we have experienced in the past.

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

The Company does not believe that the adoption of any recently issued accounting pronouncements in 2020 had a significant impact on our financial position, results of operations, or cash flow.

ITEM 3. 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. During the period January 1, 2020 through March 31, 2020, the USD has fluctuated by approximately 3.2% against the NIS (the USD has strengthened relative to the NIS). By contrast, during the period January 1, 2019 through December 31, 2019, the USD fluctuated by approximately 7.8% against the NIS (the USD weakened relative to the NIS). Continued strengthening of the US dollar against the NIS will result in lower 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 March 31, 2020, we had cash, cash equivalents and short-term bank deposits of approximately \$7,544,000. The weighted average annual interest rate related to our cash and cash equivalents for the three months ended March 31, 2020, exclusive of funds at US banks that earn no interest, was approximately .52%.

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 4. CONTROLS AND PROCEDURES

We maintain disclosure controls and procedures designed to ensure that information required to be disclosed in the reports that we file or submit under the Securities Exchange Act of 1934, is recorded, processed, summarized and reported within the time period specified in the SEC’s rules and forms. As of March 31, 2020, our chief executive officer and our chief financial officer conducted an evaluation of the effectiveness of our disclosure controls and procedures. Based on this evaluation, our chief executive officer and our chief financial officer concluded that our disclosure controls and procedures were effective as of March 31, 2020.

Changes in Internal Control over Financial Reporting

There were no changes in internal controls over financial reporting that occurred during the first quarter of 2020 that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

PART II—OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

Securities and Exchange Commission (“SEC”) Investigation

As previously disclosed by the Company, on June 21, 2018, Zion received a subpoena to produce documents from the Fort Worth office of the SEC informing the Company of the existence of a non-public, fact-finding inquiry into the Company. Prior to the receipt of the subpoena on June 21, 2018, Zion had no previous communication with the SEC on this issue and was unaware of this investigation. The SEC stated that “the investigation and the subpoena do not mean that we have concluded that [Zion] or anyone else has violated the law.” To date, Zion has furnished all required documents to the SEC and will continue to fully cooperate with the investigation.

The Company cannot predict when this matter will be resolved or what further action, if any, the SEC may take in connection with it.

Litigation

Following the commencement of the SEC investigation, on August 9, 2018, a putative class action (the “class action”) Complaint was filed against Zion, Victor G. Carrillo, the Company’s Chief Executive Officer at such time, and Michael B. Croswell Jr., the Company’s Chief Financial Officer (collectively, the “Defendants”) in the U.S. District Court for the Northern District of Texas. On November 16, 2018, the Court entered an Order in the class action appointing lead plaintiffs and approving lead counsel and on January 22, 2019, an Amended Complaint was filed. On February 1, 2019, a Corrected Amended Class Action Complaint was filed. The suit alleges violations of Section 10(b) of the Securities Exchange Act of 1934 (the “Exchange Act”) and Rule 10b-5 promulgated thereunder by the SEC and Section 11 of the Securities Act of 1933 (the “Securities Act”) against all defendants and alleges violations of Section 20(a) of the Exchange Act and Section 15 of the Securities Act against the individual defendants. The alleged class period is from February 13, 2018 through November 20, 2018. On March 13, 2019, a Motion to Dismiss Plaintiffs’ Corrected Amended Complaint was filed on behalf of Zion, Victor Carrillo and Michael B. Croswell, Jr., pleading numerous grounds in support of their Motion to Dismiss. On April 29, 2019 Plaintiffs filed a Response to Defendants’ Motion to Dismiss, and on May 29, 2019 Defendants filed a Reply to Plaintiffs’ Response. On March 4, 2020, the Court granted Defendants’ Motion and dismissed all claims granting Plaintiffs leave to amend. On March 30, 2020, the Lead Plaintiffs voluntarily dismissed the Class Action with prejudice as to the Company and all other defendants.

The Company disputed the above claims and made an advance deposit of \$500,000 in 2018 to defense counsel for the cost of defending the litigation. The Company carries insurance that is applicable to these claims. As of March 31, 2020, the Company is owed \$140,000 from its defense counsel pertaining to the above legal claims.

On October 29, 2018, Zion received a shareholder request to inspect books and records pursuant to Section 220 of the Delaware General Corporation Law for the purpose of investigating potential corporate mismanagement and alleged breaches of fiduciary duty in connection with public statements made by the Company from March 12, 2018 to May 30, 2018. The Company responded to this request.

On August 10, 2019, Zion received two (2) additional shareholder requests from the same law firm to inspect books and records pursuant to section 220 of the Delaware General Corporation Law for the purpose of investigating potential corporate mismanagement and alleged breaches of fiduciary duty in connection with public statements made by the Company from February 1, 2018 to present. Following discussion with counsel to the shareholder, the Company’s counsel produced materials responsive to the shareholders’ requests in January 2020.

On February 12, 2020, by letter to Zion’s Board of Directors, one of the shareholders making the August 10, 2019 request demanded that the Board investigate, address, remedy, and commence proceedings against certain of the Company’s current and former officers and directors for alleged breaches of fiduciary duties, violations of section 10(b) and 20(a) of the Exchange Act, waste of corporate assets, unjust enrichment, and violations of all other applicable laws. The shareholder alleges wrongdoing in connection with public statements made by the Company from February 1, 2018 regarding the Company’s oil and gas exploration activities, the Company’s accounting and disclosure of expenses, and the Board’s oversight of operations. The Board has hired an outside firm to investigate the claims made against certain of the Company’s current and former officers and directors.

From time to time, the Company may also be subject to routine litigation, claims or disputes in the ordinary course of business. The Company defends itself vigorously in all such matters. However, we cannot predict the outcome or effect of any of the litigation or any other pending litigation or claims.

ITEM 1A. RISK FACTORS

During the quarter ended March 31, 2020, there were no material changes to the risk factors previously reported in our Annual Report on Form 10-K for the year ended December 31, 2019.

ITEM 2. UNREGISTERED SALES OF SECURITIES AND USE OF PROCEEDS

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. MINE SAFETY DISCLOSURES

None.

ITEM 5. OTHER INFORMATION:

None.

ITEM 6. EXHIBITS

Exhibit Index:

| | |
|---------|---|
| 10.1 | Purchase and Sale Agreement between Zion Oil & Gas Inc. and Central European Drilling kft (seller), dated March 12, 2020 of an onshore drilling rig, drill pipe and related equipment (incorporated by reference to Exhibit 10.7 to the Company annual report on Form 10-K filed on March 27, 2020) |
| 10.2 | Bill of Sale between Zion Oil & Gas, Inc. (buyer) and Central European Drilling kft (seller) dated March 12, 2020 of an onshore drilling rig, drill pipe and related equipment (incorporated by reference to Exhibit 10.8 to the Company annual report on Form 10-K filed on March 27, 2020) |
| 10.3 | Escrow agreement between Zion Oil & Gas, Inc. (buyer), Central European Drilling kft (seller) and American Stock Transfer & Trust LLC (escrow agent) dated March 12, 2020 (incorporated by reference to Exhibit 10.9 to the Company annual report on Form 10-K filed on March 27, 2020) |
| 31.1 | Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 under the Exchange Act |
| 31.2 | Certification of the Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 under the Exchange Act |
| 32.1 | Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (furnished only) |
| 32.2 | Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (furnished only) |
| 101.INS | XBRL Instance Document |
| 101.SCH | XBRL Taxonomy Extension Schema |
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase |
| 101.DEF | XBRL Taxonomy Extension Definition Linkbase |
| 101.LAB | XBRL Taxonomy Extension Label Linkbase |
| 101.PRE | XBRL Taxonomy Extension Presentation Linkbase |

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

ZION OIL & GAS, INC.
(Registrant)

By: /s/ John M. Brown
John M. Brown
Chief Executive Officer
(Principal Executive Officer)

By: /s/ Michael B. Croswell Jr.
Michael B. Croswell Jr.
Chief Financial Officer
(Principal Financial and Accounting
Officer)

Date: May 11 2020

Date: May 11, 2020